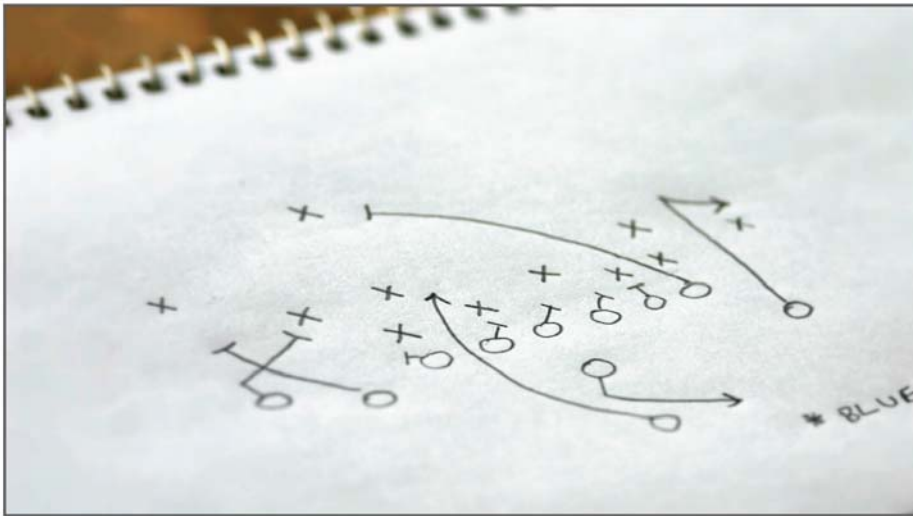


# Dodd-Frank Wall Street Reform and Consumer Protection Act Residential Mortgage User Guide



This is the second of a series of user guides that will be published by Morrison & Foerster. The user guides provide an in depth discussion on specific topics raised by the Dodd-Frank Act. For our Dodd-Frank overview and brief alerts, please see our dedicated website at:

<http://www.mofo.com/resources/regulatory-reform/>.

## Introduction

This is a user guide for the residential mortgage loan origination-related provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 ("Dodd-Frank Act"). More specifically, it covers the following provisions of Title XIV of the Dodd-Frank Act, all of which are part of the "Mortgage Reform and Anti-Predatory Lending Act," as well as the following sections from Title X that affect mortgage originations:

- Subtitle A – Residential Mortgage Loan Origination Standards
- Subtitle B – Minimum Standards for Mortgages
- Subtitle C – High-Cost Mortgages
- Subtitle D – Office of Housing Counseling
- Subtitle F – Appraisal Activities
- Sections 1032(f), 1076, 1083, 1094, 1098, and 1100A

The remainder of Title XIV of the Dodd-Frank Act – Subtitle E (Mortgage Servicing), Subtitle G (Mortgage Resolution and Modification), and Subtitle H (Miscellaneous Provisions) – will be covered by a separate user guide to be issued at a later time.

## Use of this Guide

This guide is designed for use by executives and managers who are responsible for the mortgage loan origination activities of banks, thrifts, and mortgage companies. It is intended to be a pragmatic reference piece relating to the implementation of the mortgage origination provisions of the Dodd-Frank Act. When regulations are issued for the mortgage origination provisions of the Dodd-Frank Act, the guidance provided by this guide will need to be refined accordingly. This guide does not provide legal advice and should not be relied upon as such.

## Organization of this Guide

For ease of reference, this guide will be organized by the various subtitles and sections of Titles X and XIV of the Dodd-Frank Act. With each provision, we summarize the critical issues under the new law, discuss linkages to existing law, and analyze some of the more important ramifications for residential mortgage lenders.

Note that certain federal agencies' consumer protection authorities under the "Enumerated Consumer Laws" will eventually be transferred to the new Bureau of Consumer Financial Protection ("Bureau"). These transfers of authority are not reflected in this guide. The "Enumerated Consumer Laws" are listed in Section 1002(12) of the Dodd-Frank Act.

## Section 1032(f). Combined Mortgage Loan Disclosure

(f) Combined Mortgage Loan Disclosure—Not later than 1 year after the designated transfer date, the Bureau shall propose for public comment rules and model disclosures that combine the disclosures required under the Truth in Lending Act and sections 4 and 5 of the Real Estate Settlement Procedures Act of 1974, into a single, integrated disclosure for mortgage loan transactions covered by those laws, unless the Bureau determines that any proposal issued by the Board of Governors and the Secretary of Housing and Urban Development carries out the same purpose.

**Analysis.** Section 1032(f) directs the new Bureau to propose a single integrated model disclosure that combines the disclosures required by the federal Truth-in-Lending Act ("TILA") with the good faith estimate, the Department of Housing and Urban Development ("HUD") special information booklet, and the HUD-1 or HUD-1A settlement statement required by Sections 4 and 5 of the federal Real Estate Settlement Procedures Act of 1974 ("RESPA"). The Bureau is to do this within one year after the designated transfer date, unless the Bureau determines that any proposal issued by the Board of Governors of the Federal Reserve System ("Board") and HUD carries out the same purpose.

The "designated transfer date" will be established by the Treasury Secretary, following consultation with other federal officials, within 60 days following enactment of the Dodd-Frank Act. The designated transfer date will be no earlier than 180 days, and no later than 12 months, following enactment. The Treasury Secretary can establish a designated transfer date beyond the 12-month period by following certain procedures, but the designated transfer date may not be more than 18 months following enactment. See Section 1062. These rather lengthy timeframes reflect Congress's recognition that it will take considerable time to organize the Bureau, which will be responsible for issuing a large number of regulations.

This is not the first time that Congress has encouraged the integration of TILA and RESPA disclosures. The last time, representatives from the Board and HUD concluded that it was not possible to do so under the existing statutory regimes. Many of the same challenges remain in place. Further, note that the two statutes require the giving of certain disclosures at different times. Whether a single integrated disclosure is produced by the Bureau, or by the Board and HUD, the result will be another massive overhaul of pre-closing disclosures for mortgage loans.

It remains to be seen whether the Bureau will restrict its disclosure integration efforts to closed-end loans, or whether it also will attempt to establish an integrated disclosure for open-end loans. The latter will require an even more ambitious effort.

The requirement of an integrated disclosure has also been written into TILA and RESPA. See Sections 1098 and 1100A, discussed below.

## Section 1076. Reverse Mortgage Study and Regulations

(a) Study—Not later than 1 year after the designated transfer date, the Bureau shall conduct a study on reverse mortgage transactions.

(b) Regulations—

(1) IN GENERAL—If the Bureau determines through the study required under subsection (a) that conditions or limitations on reverse mortgage transactions are necessary or appropriate for accomplishing the purposes and objectives of this title, including protecting borrowers with respect to the obtaining of reverse mortgage loans for the purpose of funding investments, annuities, and other investment products and the suitability of a borrower in obtaining a reverse mortgage for such purpose.

(2) IDENTIFIED PRACTICES AND INTEGRATED DISCLOSURES—The regulations prescribed under paragraph (1) may, as the Bureau may so determine—

(A) identify any practice as unfair, deceptive, or abusive in connection with a reverse mortgage transaction; and

(B) provide for an integrated disclosure standard and model disclosures for reverse mortgage transactions, consistent with section 4302(d), that combines the relevant disclosures required under the Truth in Lending Act (15 U.S.C. 1601 et seq.) and the Real Estate Settlement Procedures Act, with the disclosures required to be provided to consumers for Home Equity Conversion Mortgages under section 255 of the National Housing Act.

(c) Rule of Construction—This section shall not be construed as limiting the authority of the Bureau to issue regulations, orders, or guidance that apply to reverse mortgages prior to the completion of the study required under subsection (a).

**Analysis.** The Bureau is to undertake a study of reverse mortgages and determine if additional regulations are necessary to protect consumers. The regulations are to identify unfair and deceptive acts and practices, and to provide for an integrated disclosure that combines the disclosures required by TILA, RESPA, and the HUD regulations for home equity conversion mortgages (“HECMs”). The Bureau may issue other regulations as it sees fit. The study is to be completed within one year following the designated transfer date. For a discussion of the “designated transfer date,” see Section 1032(f), above.

The integration of HECM disclosures into those required by TILA and RESPA will be even more challenging than the integration of TILA and RESPA disclosures required for mortgages that are not reverse mortgages. See discussion at Section 1032(f), above.

## Section 1083. Amendments to the Alternative Mortgage Transaction Parity Act of 1982

(a) In General—The Alternative Mortgage Transaction Parity Act of 1982 (12 U.S.C. 3801 et seq.) is amended—

(1) in section 803 (12 U.S.C. 3802(1)), by striking ‘1974’ and all that follows through ‘described and defined’ and inserting the following: ‘1974), in which the interest rate or finance charge may be adjusted or renegotiated, described and defined’; and

(2) in section 804 (12 U.S.C. 3803)—

(A) in subsection (a)—

(i) in each of paragraphs (1), (2), and (3), by inserting after ‘transactions made’ each place that term appears ‘on or before the designated transfer date, as determined under section 1062 of the Consumer Financial Protection Act of 2010.’;

(ii) in paragraph (2), by striking ‘and’ at the end;

(iii) in paragraph (3), by striking the period at the end and inserting ‘; and’; and

(iv) by adding at the end the following new paragraph:

‘(4) with respect to transactions made after the designated transfer date, only in accordance with regulations governing alternative mortgage transactions, as issued by the Bureau of Consumer Financial Protection for federally chartered housing creditors, in accordance with the rulemaking authority granted to the Bureau of Consumer Financial Protection with regard to federally chartered housing creditors under provisions of law other than this section.’;

(B) by striking subsection (c) and inserting the following:

‘(c) Preemption of State Law—An alternative mortgage transaction may be made by a housing creditor in accordance with this section, notwithstanding any State constitution, law, or regulation that prohibits an alternative mortgage transaction. For purposes of this subsection, a State constitution, law, or regulation that prohibits an alternative mortgage transaction does not include any State constitution, law, or regulation that regulates mortgage transactions generally, including any restriction on prepayment penalties or late charges.’; and

(C) by adding at the end the following:

(d) Bureau Actions—The Bureau of Consumer Financial Protection shall—

(1) review the regulations identified by the Comptroller of the Currency and the National Credit Union Administration, (as those rules exist on the designated transfer date), as applicable under paragraphs (1) through (3) of subsection (a);

(2) determine whether such regulations are fair and not deceptive and otherwise meet the objectives of the Consumer Financial Protection Act of 2010; and

(3) promulgate regulations under subsection (a)(4) after the designated transfer date.

(e) Designated Transfer Date—As used in this section, the term ‘designated transfer date’ means the date determined under section 1062 of the Consumer Financial Protection Act of 2010.’

(b) Effective Date—This section and the amendments made by this section shall become effective on the designated transfer date.

(c) Rule of Construction—The amendments made by subsection (a) shall not affect any transaction covered by the Alternative Mortgage Transaction Parity Act of 1982 (12 U.S.C. 3801 et seq.) and entered into on or before the designated transfer date.

**Analysis.** Significant changes have been made to the Alternative Mortgage Transaction Parity Act of 1982 (“AMTPA”). In general, the AMTPA allows state housing creditors to originate adjustable rate mortgages (“ARMs”) and other alternative mortgage transactions under the same regulations to which their federal counterparts are subject. For example, the AMTPA allows a state commercial bank to make ARMs using the national bank ARM regulations designated by the Office of the Comptroller of the Currency (“OCC”). To the extent that state laws would otherwise prohibit the state bank from making these ARMs, those state laws are preempted. The states have the right to opt out from the AMTPA, and a small number of states have done so. The AMTPA does not apply to national banks, federal savings banks, or federal credit unions, but does apply to their subsidiaries and affiliates.

- **In General.** The AMTPA is now limited to loans in which the interest rate or payments may be adjusted or renegotiated. This would appear to exclude reverse mortgages, balloon payment loans, shared appreciation mortgages, and other nontraditional mortgages whose interest rates or payments are not adjusted or renegotiated. For state lenders, these loans are now permissible only if allowed by state law.
- **Bureau Regulations.** On or before the designated transfer date, state housing creditors will use the regulations designated by the applicable federal banking agency to make ARMs and other alternative mortgages. Following the designated transfer date, state housing creditors will use the regulations designated by the Bureau to make ARMs.
- **Preemption of State Law.** The preemption afforded by the AMTPA has been cut back. Previously, any state law that was inconsistent with the designated federal regulations was preempted. With this amendment, only state laws that prohibit the ARM allowed by the designated federal regulations are preempted. State laws regulating mortgage transactions generally, such as laws governing prepayment penalties and late charges, are not preempted by the AMTPA. For example, the existing OCC regulation at 12 C.F.R. § 34.24 allows state commercial banks to make alternative mortgage loans in accordance with “the provisions of this subpart,” which means that when those loans are made by those state banks, any state laws that restrict or prohibit prepayment penalties are preempted (see 12 C.F.R. § 34.23). This will no longer be the case. (Historical Note: A former Office of Thrift Supervision (“OTS”) regulation under the AMTPA gave state savings associations, mortgage companies and finance companies the benefit of federal preemption of state prepayment penalty and late charge laws. The validity of this regulation was upheld in *National Home Equity Mortgage Association v. Face*, 239 F.3d 633 (4th Cir. 2001). The OTS subsequently repealed this part of its AMTPA regulation.)
- **Bureau Actions – OCC and NCUA.** The Bureau is directed to review the regulations identified by the OCC and the National Credit Union Administration (“NCUA”) under the AMTPA as of the designated transfer date, and to determine if those regulations are fair, not deceptive, and meet the objectives of the Dodd-Frank Act. Appropriate regulations will be issued as necessary.
- **Designated Transfer Date/Effective Date/Rule of Construction.** The amendment to the AMTPA will be effective on the designated transfer date. This indicates that alternative mortgage transactions of all kinds made on or

prior to the designated transfer date in accordance with the applicable federal agency AMTPA regulations should continue to receive the preemption benefits of the AMTPA. This is confirmed by the rule of construction set forth in Section 1083(c) of the Dodd-Frank Act.

For a discussion of the “designated transfer date,” see Section 1032(f), above.

## Section 1094. Amendments to the Home Mortgage Disclosure Act of 1975

The Home Mortgage Disclosure Act of 1975 (12 U.S.C. 2801 et seq.) is amended—

(1) by striking ‘Board’ each place that term appears, other than in sections 303, 304(h), 305(b) (as amended by this section), and 307(a) (as amended by this section) and inserting ‘Bureau’.

(2) in section 303 (12 U.S.C. 2802)—

(A) by redesignating paragraphs (1) through (6) as paragraphs (2) through (7), respectively; and

(B) by inserting before paragraph (2) the following:

‘(1) the term ‘Bureau’ means the Bureau of Consumer Financial Protection;’;

(3) in section 304 (12 U.S.C. 2803)—

(A) in subsection (b)—

(i) in paragraph (4), by inserting ‘age,’ before ‘and gender’;

(ii) in paragraph (3), by striking ‘and’ at the end;

(iii) in paragraph (4), by striking the period at the end and inserting a semicolon; and

(iv) by adding at the end the following:

‘(5) the number and dollar amount of mortgage loans grouped according to measurements of—

‘(A) the total points and fees payable at origination in connection with the mortgage as determined by the Bureau, taking into account 15 U.S.C. 1602(aa)(4);

‘(B) the difference between the annual percentage rate associated with the loan and a benchmark rate or rates for all loans;

‘(C) the term in months of any prepayment penalty or other fee or charge payable on repayment of some portion of principal or the entire principal in advance of scheduled payments; and

‘(D) such other information as the Bureau may require; and

‘(6) the number and dollar amount of mortgage loans and completed applications grouped according to measurements of—

‘(A) the value of the real property pledged or proposed to be pledged as collateral;

‘(B) the actual or proposed term in months of any introductory period after which the rate of interest may change;

‘(C) the presence of contractual terms or proposed contractual terms that would allow the mortgagor or applicant to make payments other than fully amortizing payments during any portion of the loan term;

‘(D) the actual or proposed term in months of the mortgage loan;

‘(E) the channel through which application was made, including retail, broker, and other relevant categories;

‘(F) as the Bureau may determine to be appropriate, a unique identifier that identifies the loan originator as set forth in section 1503 of the S.A.F.E. Mortgage Licensing Act of 2008;

‘(G) as the Bureau may determine to be appropriate, a universal loan identifier;

‘(H) as the Bureau may determine to be appropriate, the parcel number that corresponds to the real property pledged or proposed to be pledged as collateral;

‘(I) the credit score of mortgage applicants and mortgagors, in such form as the Bureau may prescribe; and

‘(J) such other information as the Bureau may require.’;

(B) by striking subsection (h) and inserting the following:

‘(h) Submission to Agencies—

‘(1) IN GENERAL—The data required to be disclosed under subsection (b) shall be submitted to the Bureau or to the appropriate agency for the institution reporting under this title, in accordance with rules prescribed by the Bureau. Notwithstanding the requirement of

subsection (a)(2)(A) for disclosure by census tract, the Bureau, in consultation with other appropriate agencies described in paragraph (2) and, after notice and comment, shall develop regulations that—

- `(A) prescribe the format for such disclosures, the method for submission of the data to the appropriate agency, and the procedures for disclosing the information to the public;
- `(B) require the collection of data required to be disclosed under subsection (b) with respect to loans sold by each institution reporting under this title;
- `(C) require disclosure of the class of the purchaser of such loans;
- `(D) permit any reporting institution to submit in writing to the Bureau or to the appropriate agency such additional data or explanations as it deems relevant to the decision to originate or purchase mortgage loans; and
- `(E) modify or require modification of itemized information, for the purpose of protecting the privacy interests of the mortgage applicants or mortgagors, that is or will be available to the public.

`(2) OTHER APPROPRIATE AGENCIES—The appropriate agencies described in this paragraph are—

- `(A) the appropriate Federal banking agencies, as defined in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)), with respect to the entities that are subject to the jurisdiction of each such agency, respectively;
- `(B) the Federal Deposit Insurance Corporation for banks insured by the Federal Deposit Insurance Corporation (other than members of the Federal Reserve System), mutual savings banks, insured State branches of foreign banks, and any other depository institution described in section 303(2)(A) which is not otherwise referred to in this paragraph;
- `(C) the National Credit Union Administration Board with respect to credit unions; and
- `(D) the Secretary of Housing and Urban Development with respect to other lending institutions not regulated by the agencies referred to in subparagraph (A) or (B).

`(3) RULES FOR MODIFICATIONS UNDER PARAGRAPH (1)—

`(A) APPLICATION—A modification under paragraph (1)(E) shall apply to information concerning—

- `(i) credit score data described in subsection (b)(6)(I), in a manner that is consistent with the purpose described in paragraph (1)(E); and
- `(ii) age or any other category of data described in paragraph (5) or (6) of subsection (b), as the Bureau determines to be necessary to satisfy the purpose described in paragraph (1)(E), and in a manner consistent with that purpose.

`(B) STANDARDS—The Bureau shall prescribe standards for any modification under paragraph (1)(E) to effectuate the purposes of this title, in light of the privacy interests of mortgage applicants or mortgagors. Where necessary to protect the privacy interests of mortgage applicants or mortgagors, the Bureau shall provide for the disclosure of information described in subparagraph (A) in aggregate or other reasonably modified form, in order to effectuate the purposes of this title.;

(C) in subsection (i), by striking `subsection (b)(4)' and inserting `subsections (b)(4), (b)(5), and (b)(6)';

(D) in subsection (j)—

- (i) by striking paragraph (3) and inserting the following:

`(3) CHANGE OF FORM NOT REQUIRED—A depository institution meets the disclosure requirement of paragraph (1) if the institution provides the information required under such paragraph in such formats as the Bureau may require'; and

- (ii) in paragraph (2)(A), by striking `in the format in which such information is maintained by the institution' and inserting `in such formats as the Bureau may require';

(E) in subsection (m), by striking paragraph (2) and inserting the following:

`(2) FORM OF INFORMATION—In complying with paragraph (1), a depository institution shall provide the person requesting the information with a copy of the information requested in such formats as the Bureau may require.;

(F) by adding at the end the following:

`(n) Timing of Certain Disclosures—The data required to be disclosed under subsection (b) shall be submitted to the Bureau or to the appropriate agency for any institution reporting under this title, in accordance with regulations prescribed by the Bureau. Institutions shall not be required to report new data under paragraph (5) or (6) of subsection (b) before the first January 1 that occurs after the end of the 9-month period beginning on the date on which regulations are issued by the Bureau in final form with respect to such disclosures.;

(4) in section 305 (12 U.S.C. 2804) —

(A) by striking subsection (b) and inserting the following:

`(b) Powers of Certain Other Agencies—

`(1) IN GENERAL—Subject to subtitle B of the Consumer Financial Protection Act of 2010, compliance with the requirements of this title shall be enforced—

(A) under section 8 of the Federal Deposit Insurance Act, the appropriate Federal banking agency, as defined in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)), with respect to—

- (i) any national bank or Federal savings association, and any Federal branch or Federal agency of a foreign bank;
- (ii) any member bank of the Federal Reserve System (other than a national bank), branch or agency of a foreign bank (other than a Federal branch, Federal agency, and insured State branch of a foreign bank), commercial lending company owned or controlled by a foreign bank, and any organization operating under section 25 or 25A of the Federal Reserve Act; and
- (iii) any bank or State savings association insured by the Federal Deposit Insurance Corporation (other than a member of the Federal Reserve System), any mutual savings bank as, defined in section 3(f) of the Federal Deposit Insurance Act (12 U.S.C. 1813(f)), any insured State branch of a foreign bank, and any other depository institution not referred to in this paragraph or subparagraph (B) or (C);

(B) under subtitle E of the Consumer Financial Protection Act of 2010, by the Bureau, with respect to any person subject to this subtitle;

(C) under the Federal Credit Union Act, by the Administrator of the National Credit Union Administration with respect to any insured credit union; and

(D) with respect to other lending institutions, by the Secretary of Housing and Urban Development.

(2) INCORPORATED DEFINITIONS—The terms used in paragraph (1) that are not defined in this title or otherwise defined in section 3(s) of the Federal Deposit Insurance Act (12 U.S.C. 1813(s)) shall have the same meanings as in section 1(b) of the International Banking Act of 1978 (12 U.S.C. 3101); and

(B) by adding at the end the following:

(d) Overall Enforcement Authority of the Bureau of Consumer Financial Protection—Subject to subtitle B of the Consumer Financial Protection Act of 2010, enforcement of the requirements imposed under this title is committed to each of the agencies under subsection (b). To facilitate research, examinations, and enforcement, all data collected pursuant to section 304 shall be available to the entities listed under subsection (b). The Bureau may exercise its authorities under the Consumer Financial Protection Act of 2010 to exercise principal authority to examine and enforce compliance by any person with the requirements of this title.;

(5) in section 306 (12 U.S.C. 2805(b)), by striking subsection (b) and inserting the following:

(b) Exemption Authority—The Bureau may, by regulation, exempt from the requirements of this title any State-chartered depository institution within any State or subdivision thereof, if the agency determines that, under the law of such State or subdivision, that institution is subject to requirements that are substantially similar to those imposed under this title, and that such law contains adequate provisions for enforcement. Notwithstanding any other provision of this subsection, compliance with the requirements imposed under this subsection shall be enforced by the Office of the Comptroller of the Currency under section 8 of the Federal Deposit Insurance Act, in the case of national banks and Federal savings associations, the deposits of which are insured by the Federal Deposit Insurance Corporation.;

(6) by striking section 307 (12 U.S.C. 2806) and inserting the following:

SEC. 307. COMPLIANCE IMPROVEMENT METHODS.

(a) In General—

(1) CONSULTATION REQUIRED—The Director of the Bureau of Consumer Financial Protection, with the assistance of the Secretary, the Director of the Bureau of the Census, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and such other persons as the Bureau deems appropriate, shall develop or assist in the improvement of, methods of matching addresses and census tracts to facilitate compliance by depository institutions in as economical a manner as possible with the requirements of this title.

(2) AUTHORIZATION OF APPROPRIATIONS—There are authorized to be appropriated, such sums as may be necessary to carry out this subsection.

(3) CONTRACTING AUTHORITY—The Director of the Bureau of Consumer Financial Protection is authorized to utilize, contract with, act through, or compensate any person or agency in order to carry out this subsection.

(b) Recommendations to Congress—The Director of the Bureau of Consumer Financial Protection shall recommend to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives, such additional legislation as the Director of the Bureau of Consumer Financial Protection deems appropriate to carry out the purpose of this title.;

**Analysis.** Section 1094 of the Dodd-Frank Act amends the Home Mortgage Disclosure Act (“HMDA”) to greatly increase the types of information that must be reported by banks and other financial institutions. Because HMDA information is made available to the public, this will allow the Bureau, other federal regulators, consumer groups, and the plaintiff’s bar to access, analyze and potentially challenge a far wider set of lending behaviors. This is a classic “sleeper” statute—although the amendments to HMDA did not receive particular attention while the Dodd-Frank Act was being negotiated by the Senate/House Conference Committee, these amendments have the potential to create considerable mischief.

- Collection of Additional Information. The number and dollar amounts of mortgage loans, grouped according to measurements of the following, must be reported:
  - The total points and fees payable at origination.
  - The difference between the annual percentage rate (“APR”) of the loan and a benchmark rate or rates for all loans.
  - The term in months of any prepayment penalty or similar fee.
  - Other information required by the Bureau.

In addition, the number and dollar amounts of mortgage loans and completed applications, grouped according to measurements of the following, must be reported:

- The value of the real property collateral.
- The duration of any introductory interest rate period.
- Loan terms that would allow the borrower to pay less than a fully amortizing payment.
- Term of the loan in months.
- The channel through which the application was made – retail, broker, or certain others.
- The unique identifier of the loan originator under the S.A.F.E. Mortgage Licensing Act of 2008 (“SAFE Act”), if the Bureau so requires.
- A universal loan identifier, if the Bureau so requires.
- The security property’s parcel number, if the Bureau so requires.
- Each borrower’s credit score, in the form required by the Bureau.
- Other information required by the Bureau.

Although the language of the statute is unclear, the implementing regulations will likely require the submission of all of the foregoing information to the government on a loan-by-loan basis.

- Submission to Agencies. Currently, HMDA data is submitted to the financial institution’s federal supervisory agency. Under the amended statute, HMDA data will be submitted either to that agency or the Bureau, as the Bureau determines. The Bureau is directed to issue regulations, in consultation with certain designated federal agencies, to do the following:
  - Prescribe the format of disclosure and related “housekeeping” issues.
  - For loans that are sold, to require the collection of the same data that is collected in connection with the loan origination process.
  - Require disclosure of the classification of the loan purchaser.

- Permit the financial institution to report additional data relating to the loan origination or purchase decision.
- Provide for the modification of itemized information to protect the privacy of the mortgage applicant or borrower with respect to the public. This will include credit scores and certain other information.
- Timing of Certain Disclosures. Financial institutions will not be required to begin submitting the new HMDA data until the first January 1 that occurs after the end of the nine-month period following the issuance of the Bureau's final regulations.
- Compliance Improvement Methods. The Bureau, with the assistance of certain other federal agencies and other persons selected by the Bureau, is to develop or improve the methods of matching addresses and census tracts to facilitate compliance by financial institutions on an economical basis.

### Section 1098. Amendments to the Real Estate Settlement Procedures Act of 1974

The Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2601 et seq.) is amended—

(1) in section 3 (12 U.S.C. 2602)—

(A) in paragraph (7), by striking `and' at the end;

(B) in paragraph (8), by striking the period at the end and inserting `; and'; and

(C) by adding at the end the following:

`(9) the term `Bureau' means the Bureau of Consumer Financial Protection.';

(2) in section 4 (12 U.S.C. 2603)—

(A) in subsection (a), by striking the first sentence and inserting the following: `The Bureau shall publish a single, integrated disclosure for mortgage loan transactions (including real estate settlement cost statements) which includes the disclosure requirements of this section and section 5, in conjunction with the disclosure requirements of the Truth in Lending Act that, taken together, may apply to a transaction that is subject to both or either provisions of law. The purpose of such model disclosure shall be to facilitate compliance with the disclosure requirements of this title and the Truth in Lending Act, and to aid the borrower or lessee in understanding the transaction by utilizing readily understandable language to simplify the technical nature of the disclosures.';

(B) by striking `Secretary' each place that term appears and inserting `Bureau'; and

(C) by striking `form' each place that term appears and inserting `forms';

(3) in section 5 (12 U.S.C. 2604)—

(A) by striking `Secretary' each place that term appears and inserting `Bureau'; and

(B) in subsection (a), by striking the first sentence and inserting the following: `The Bureau shall prepare and distribute booklets jointly addressing compliance with the requirements of the Truth in Lending Act and the provisions of this title, in order to help persons borrowing money to finance the purchase of residential real estate better to understand the nature and costs of real estate settlement services.';

(4) in section 6(j)(3) (12 U.S.C. 2605(j)(3))—

(A) by striking `Secretary' and inserting `Bureau'; and

(B) by striking `, by regulations that shall take effect not later than April 20, 1991,';

(5) in section 7(b) (12 U.S.C. 2606(b)) by striking `Secretary' and inserting `Bureau';

(6) in section 8(c)(5) (12 U.S.C. 2607(c)(5)), by striking `Secretary' and inserting `Bureau';

(7) in section 8(d) (12 U.S.C. 2607(d))—

(A) in the subsection heading, by inserting `Bureau and' before `SECRETARY'; and

(B) by striking paragraph (4), and inserting the following:

`(4) The Bureau, the Secretary, or the attorney general or the insurance commissioner of any State may bring an action to enjoin violations of this section. Except, to the extent that a person is subject to the jurisdiction of the Bureau, the Secretary, or the attorney general or the insurance commissioner of any State, the Bureau shall have primary authority to enforce or administer this section, subject to subtitle B of the Consumer Financial Protection Act of 2010.';

- (8) in section 10(c) (12 U.S.C. 2609(c) and (d)), by striking `Secretary' and inserting `Bureau';
- (9) in section 16 (12 U.S.C. 2614), by inserting `the Bureau,' before `the Secretary';
- (10) in section 18 (12 U.S.C. 2616), by striking `Secretary' each place that term appears and inserting `Bureau'; and
- (11) in section 19 (12 U.S.C. 2617)—
- (A) in the section heading by striking `SECRETARY' and inserting `BUREAU';
  - (B) in subsection (a), by striking `Secretary' each place that term appears and inserting `Bureau'; and
  - (C) in subsections (b) and (c), by striking `the Secretary' each place that term appears and inserting `the Bureau'.

**Analysis.** Section 1032(f) of the Dodd-Frank Act, discussed above, requires the Bureau to propose a model disclosure that combines the disclosures required by TILA with certain disclosures required by RESPA. Section 1098 amends RESPA to require the Bureau to do the same thing.

The Bureau also is to revise the existing HUD special information booklet to jointly address compliance with RESPA and TILA. This is interesting because Section 1450 of the Dodd-Frank Act, discussed below, also directs the Bureau to revise the HUD special information booklet, using completely different language. Presumably, the Bureau will find a way to accommodate both sets of directions.

Note that HUD most recently revised its special information booklet effective July 15, 2010. It is currently entitled "Shopping for Your Home Loan – HUD's Settlement Cost Booklet."

## Section 1100A. Amendments to the Truth In Lending Act

The Truth in Lending Act (15 U.S.C. 1601 et seq.) is amended—

- (1) in section 103 (15 U.S.C. 1602)—
- (A) by redesignating subsections (b) through (bb) as subsections (c) through (cc), respectively; and
  - (B) by inserting after subsection (a) the following:
- “(b) Bureau—The term `Bureau' means the Bureau of Consumer Financial Protection.”;
- (2) by striking `Board' each place that term appears, other than in section 140(d) and sections 105(i) and 108(a), as amended by this section, and inserting `Bureau';
- (3) by striking `Federal Trade Commission' each place that term appears, other than in section 108(c) and section 129(m), as amended by this Act, and other than in the context of a reference to the Federal Trade Commission Act, and inserting `Bureau';
- (4) in section 105(a) (15 U.S.C. 1604(a)), in the second sentence—
- (A) by striking `Except in the case of a mortgage referred to in section 103(aa), these regulations may contain such' and inserting `Except with respect to the provisions of section 129 that apply to a mortgage referred to in section 103(aa), such regulations may contain such additional requirements,'; and
  - (B) by inserting `all or' after `exceptions for';
- (5) in section 105(b) (15 U.S.C. 1604(b)), by striking the first sentence and inserting the following: `The Bureau shall publish a single, integrated disclosure for mortgage loan transactions (including real estate settlement cost statements) which includes the disclosure requirements of this title in conjunction with the disclosure requirements of the Real Estate Settlement Procedures Act of 1974 that, taken together, may apply to a transaction that is subject to both or either provisions of law. The purpose of such model disclosure shall be to facilitate compliance with the disclosure requirements of this title and the Real Estate Settlement Procedures Act of 1974, and to aid the borrower or lessee in understanding the transaction by utilizing readily understandable language to simplify the technical nature of the disclosures.';
- (6) in section 105(f)(1) (15 U.S.C. 1604(f)(1)), by inserting `all or' after `from all or part of this title';
- (7) in section 105 (15 U.S.C. 1604), by adding at the end the following:
- “(i) **AUTHORITY OF THE BOARD TO PRESCRIBE RULES**—Notwithstanding subsection (a), the Board shall have authority to prescribe rules under this title with respect to a person described in section 1029(a) of the Consumer Financial Protection Act of 2010. Regulations prescribed under this subsection may contain such classifications, differentiations, or other provisions, as in the judgment of the Board are necessary or proper to effectuate the purposes of this title, to prevent circumvention or evasion thereof, or to facilitate compliance therewith.”;

(8) in section 108 (15 U.S.C. 1604), by adding at the end the following:

(A) by striking subsection (a) and inserting the following:

`(a) Enforcing Agencies—Subject to subtitle B of the Consumer Financial Protection Act of 2010, compliance with the requirements imposed under this title shall be enforced under—

`(1) section 8 of the Federal Deposit Insurance Act, by the appropriate Federal banking agency, as defined in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)), with respect to—

`(A) national banks, Federal savings associations, and Federal branches and Federal agencies of foreign banks;

`(B) member banks of the Federal Reserve System (other than national banks), branches and agencies of foreign banks (other than Federal branches, Federal agencies, and insured State branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act; and

`(C) banks and State savings associations insured by the Federal Deposit Insurance Corporation (other than members of the Federal Reserve System), and insured State branches of foreign banks;

`(2) the Federal Credit Union Act, by the Director of the National Credit Union Administration, with respect to any Federal credit union;

`(3) the Federal Aviation Act of 1958, by the Secretary of Transportation, with respect to any air carrier or foreign air carrier subject to that Act;

`(4) the Packers and Stockyards Act, 1921 (except as provided in section 406 of that Act), by the Secretary of Agriculture, with respect to any activities subject to that Act;

`(5) the Farm Credit Act of 1971, by the Farm Credit Administration with respect to any Federal land bank, Federal land bank association, Federal intermediate credit bank, or production credit association; and

`(6) subtitle E of the Consumer Financial Protection Act of 2010, by the Bureau, with respect to any person subject to this title.'; and

(B) by striking subsection (c) and inserting the following:

`(c) Overall Enforcement Authority of the Federal Trade Commission—Except to the extent that enforcement of the requirements imposed under this title is specifically committed to some other Government agency under any of paragraphs (1) through (5) of subsection (a), and subject to subtitle B of the Consumer Financial Protection Act of 2010, the Federal Trade Commission shall be authorized to enforce such requirements. For the purpose of the exercise by the Federal Trade Commission of its functions and powers under the Federal Trade Commission Act, a violation of any requirement imposed under this title shall be deemed a violation of a requirement imposed under that Act. All of the functions and powers of the Federal Trade Commission under the Federal Trade Commission Act are available to the Federal Trade Commission to enforce compliance by any person with the requirements under this title, irrespective of whether that person is engaged in commerce or meets any other jurisdictional tests under the Federal Trade Commission Act.'; and

(9) in section 129 (15 U.S.C. 1639), by striking subsection (m) and inserting the following:

`(m) Civil Penalties in Federal Trade Commission Enforcement Actions—For purposes of enforcement by the Federal Trade Commission, any violation of a regulation issued by the Bureau pursuant to subsection (l)(2) shall be treated as a violation of a rule promulgated under section 18 of the Federal Trade Commission Act (15 U.S.C. 57a) regarding unfair or deceptive acts or practices.'; and

(10) in chapter 5 (15 U.S.C. 1667 et seq.)—

(A) by striking 'the Board' each place that term appears and inserting 'the Bureau'; and

(B) by striking 'The Board' each place that term appears and inserting 'The Bureau'.

**Analysis.** Section 1032(f) of the Dodd-Frank Act, discussed above, requires the Bureau to propose a model disclosure that combines the disclosures required by TILA with certain disclosures required by RESPA. Section 1100A amends TILA to require the Bureau to do the same thing.

## Section 1400. Short Title; Designation As Enumerated Consumer Law

(a) Short Title—This title may be cited as the 'Mortgage Reform and Anti-Predatory Lending Act'.

(b) Designation as Enumerated Consumer Law Under the Purview of the Bureau of Consumer Financial Protection—Subtitles A, B, C, and E and sections 1471, 1472, 1475, and 1476, and the amendments made by such subtitles and sections, shall be enumerated consumer laws, as defined in section 1002, and come under the purview of the Bureau of Consumer Financial Protection for purposes of title X, including the transfer of functions and personnel under subtitle F of title X and the savings provisions of such subtitle.

(c) Regulations; Effective Date—

(1) REGULATIONS—The regulations required to be prescribed under this title or the amendments made by this title shall—

(A) be prescribed in final form before the end of the 18-month period beginning on the designated transfer date; and

(B) take effect not later than 12 months after the date of issuance of the regulations in final form.

(2) **EFFECTIVE DATE ESTABLISHED BY RULE**—Except as provided in paragraph (3), a section, or provision thereof, of this title shall take effect on the date on which the final regulations implementing such section, or provision, take effect.

(3) **EFFECTIVE DATE**—A section of this title for which regulations have not been issued on the date that is 18 months after the designated transfer date shall take effect on such date.

**Analysis.** Section 1400 is a “housekeeping” section that does the following:

- **Designation of Enumerated Consumer Law Under the Purview of the Bureau.** Subtitles A (Residential Mortgage Loan Origination Standards), B (Minimum Standards for Mortgages), C (High-Cost Mortgages), and E (Mortgage Servicing), and Sections 1471 (property appraisal requirements), 1472 (appraiser independence requirements), 1475 (RESPA provisions relating to appraisal fees), and 1476 (Government Accountability Office (“GAO”) study regarding effectiveness of various appraisal methods) are designated as enumerated consumer laws that come under the jurisdiction of the new Bureau. This means that the Bureau will issue the implementing regulations for these provisions and will have enforcement authority with respect to these provisions for depository institutions with more than \$10 billion in assets, mortgage-related businesses, and certain larger participants in financial services.
- **Regulations.** Regulations to implement Title XIV must be issued in final form within 18 months following the designated transfer date. The regulations must take effect within 12 months after they are issued.

For a discussion of the “designated transfer date,” see Section 1032(f), above.

- **Regulations; Effective Date.** The provisions of Title XIV will take effect on the dates stated in the final implementing regulations. However, if final regulations have not been issued within 18 months following the designated transfer date, the corresponding statutory provisions will become effective at that time. Given the lack of details in many of the statutory provisions, this would result in havoc. As a result, the Bureau and other federal banking agencies should be well motivated to issue the implementing regulations prior to the 18-month deadline.

## **Subtitle A – Residential Mortgage Loan Origination Standards**

### **Section 1401. Definitions**

Section 103 of the Truth in Lending Act (15 U.S.C. 1602) is amended by adding at the end the following new subsection:

(cc) **Definitions Relating to Mortgage Origination and Residential Mortgage Loans**—

(1) **COMMISSION**—Unless otherwise specified, the term ‘Commission’ means the Federal Trade Commission.

(2) **MORTGAGE ORIGINATOR**—The term ‘mortgage originator’—

(A) means any person who, for direct or indirect compensation or gain, or in the expectation of direct or indirect compensation or gain—

(i) takes a residential mortgage loan application;

(ii) assists a consumer in obtaining or applying to obtain a residential mortgage loan; or

(iii) offers or negotiates terms of a residential mortgage loan;

(B) includes any person who represents to the public, through advertising or other means of communicating or providing information (including the use of business cards, stationery, brochures, signs, rate lists, or other promotional items), that such person can or will provide any of the services or perform any of the activities described in subparagraph (A);

(C) does not include any person who is (i) not otherwise described in subparagraph (A) or (B) and who performs purely administrative or clerical tasks on behalf of a person who is described in any such subparagraph, or (ii) an employee of a retailer of manufactured homes who is not described in clause (i) or (iii) of subparagraph (A) and who does not advise a consumer on loan terms (including rates, fees, and other costs);

(D) does not include a person or entity that only performs real estate brokerage activities and is licensed or registered in accordance with applicable State law, unless such person or entity is compensated by a lender, a mortgage broker, or other mortgage originator or by any agent of such lender, mortgage broker, or other mortgage originator;

(E) does not include, with respect to a residential mortgage loan, a person, estate, or trust that provides mortgage financing for the sale of 3 properties in any 12-month period to purchasers of such properties, each of which is owned by such person, estate, or trust and serves as security for the loan, provided that such loan—

(i) is not made by a person, estate, or trust that has constructed, or acted as a contractor for the construction of, a residence on the property in the ordinary course of business of such person, estate, or trust;

(ii) is fully amortizing;

(iii) is with respect to a sale for which the seller determines in good faith and documents that the buyer has a reasonable ability to repay the loan;

(iv) has a fixed rate or an adjustable rate that is adjustable after 5 or more years, subject to reasonable annual and lifetime limitations on interest rate increases; and

(v) meets any other criteria the Board may prescribe;

(F) does not include the creditor (except the creditor in a table-funded transaction) under paragraph (1), (2), or (4) of section 129B(c); and

(G) does not include a servicer or servicer employees, agents and contractors, including but not limited to those who offer or negotiate terms of a residential mortgage loan for purposes of renegotiating, modifying, replacing and subordinating principal of existing mortgages where borrowers are behind in their payments, in default or have a reasonable likelihood of being in default or falling behind.

(3) **NATIONWIDE MORTGAGE LICENSING SYSTEM AND REGISTRY**—The term ‘Nationwide Mortgage Licensing System and Registry’ has the same meaning as in the Secure and Fair Enforcement for Mortgage Licensing Act of 2008.

(4) **OTHER DEFINITIONS RELATING TO MORTGAGE ORIGINATOR**—For purposes of this subsection, a person ‘assists a consumer in obtaining or applying to obtain a residential mortgage loan’ by, among other things, advising on residential mortgage loan terms (including rates, fees, and other costs), preparing residential mortgage loan packages, or collecting information on behalf of the consumer with regard to a residential mortgage loan.

(5) **RESIDENTIAL MORTGAGE LOAN**—The term ‘residential mortgage loan’ means any consumer credit transaction that is secured by a mortgage, deed of trust, or other equivalent consensual security interest on a dwelling or on residential real property that includes a dwelling, other than a consumer credit transaction under an open end credit plan or, for purposes of sections 129B and 129C and section 128(a) (16), (17), (18), and (19), and sections 128(f) and 130(k), and any regulations promulgated thereunder, an extension of credit relating to a plan described in section 101(53D) of title 11, United States Code.

(6) **SECRETARY**—The term ‘Secretary’, when used in connection with any transaction or person involved with a residential mortgage loan, means the Secretary of Housing and Urban Development.

(7) **SERVICER**—The term ‘servicer’ has the same meaning as in section 6(i)(2) of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2605(i)(2)).

**Analysis.** Section 1401 of the Dodd-Frank Act adds new definitions to TILA relating to residential mortgage loan originations. Two of the more critical definitions are discussed below.

- **Mortgage Originator.**

- **Basic Definition.** A “mortgage originator” is any person who, for (or in the expectation of) direct or indirect compensation or gain: (i) takes a residential mortgage loan application; (ii) assists a consumer in obtaining or applying to obtain a residential mortgage loan (e.g., advising on loan terms, preparing loan packages, or collecting information on behalf of the consumer with regard to a residential mortgage loan); (iii) offers or negotiates terms of a residential mortgage loan; or (iv) represents to the public that he/she can or will perform any of such services.
- **Relation to the SAFE Act.** The definition of “mortgage originator” – which includes people such as mortgage brokers and mortgage loan officers at banks and mortgage banking companies – expands upon the definition of a “loan originator” in the SAFE Act. The SAFE Act definition is limited to persons who perform the services described in (i) and (iii) above. Most of the state laws that implement the SAFE Act define the term to include persons who perform the services described in (i) or (iii) above. In any event, a “mortgage originator” under Title XIV, Subtitle A of the Dodd-Frank Act will cover more individuals than are covered by the SAFE Act. This means that there will be some individuals who will be subject to the new TILA restrictions relating to mortgage originators (discussed below) but who will not be required to be licensed or registered in accordance with the SAFE Act.

- Basic Exclusions. The definition of “mortgage originator” excludes (i) a person who performs purely administrative or clerical tasks for a mortgage originator, or an employee of a retailer of manufactured homes, so long as he/she does not advise a consumer on loan terms and (ii) a person who performs only real estate brokerage activities and is licensed/registered under state law to do so, so long as he/she is not compensated by a lender, mortgage broker, mortgage originator, or their agents. These exclusions are similar to those contained in the SAFE Act.
- Exclusion of Creditors. The term “mortgage originator” also generally excludes the creditor itself, other than a creditor in a table-funded transaction. This means that a table-funding lender will be treated as a mortgage originator for purposes of the new TILA restrictions on mortgage originators, even though that lender will be treated as the “creditor” that is responsible for providing TILA disclosures. The same lender will be treated as a mortgage broker for purposes of RESPA and Regulation X and will be treated as a creditor for purposes of the federal Equal Credit Opportunity Act (“ECOA”) and Regulation B.
- Exclusion of Seller-Financings. There is also an exclusion from the definition of “mortgage originator” for seller-financings of three properties in any 12-month period. Presumably, this will be interpreted to mean *up to* three properties in any 12-month period. This exclusion is limited to financing provided by a person, estate or trust that is not the builder or contractor for the property. To qualify for the exclusion, the loan must be fully amortizing, the lender must determine in good faith that the buyer has a reasonable ability to repay the loan, which determination must be documented, the loan must carry a fixed rate or an adjustable rate that is not adjustable for at least five years (and must be subject to “reasonable” annual and lifetime rate caps), and meet any other criteria prescribed by the Board. There is no equivalent exclusion from the definition of a “loan originator” in the SAFE Act, although many of the implementing state laws do provide a less rigorous exclusion for seller-financed mortgage originators. That being the case, it is possible that some individuals who effect credit sales of their own homes will not be loan originators under state laws implementing the SAFE Act, but will be “mortgage originators” for purposes of the new TILA provisions.

Many of the details on this exclusion must await the issuance of regulations by the Board. For example, the Board may impose the same “ability to repay” standards here that it will impose under new § 129C of TILA, but it is equally possible that a lesser standard will be imposed.

- Exclusion of Loan Modifications. Finally, there is an exclusion for loan servicers and their employees and agents. This exclusion is directed to those who offer or negotiate terms in connection with renegotiating, modifying, replacing and subordinating principal of existing loans for borrowers who are delinquent, in default, or have a reasonable likelihood of defaulting. For example, the exclusion should cover loan servicing personnel who negotiate loan modifications under the U.S. Treasury Department’s Home Affordable Modification Program (“HAMP”). Many of the state laws implementing the SAFE Act also contain exclusions for those who renegotiate the terms of existing loans.
- Residential Mortgage Loan
    - Basic Definition. A “residential mortgage loan” is a consumer credit transaction that is secured by a mortgage, deed of trust or equivalent consensual security interest on a dwelling or on residential real property that includes a dwelling. Under Regulation Z, a “dwelling” means a residential structure that contains 1-4 units, whether or not the structure is attached to real property. Examples include condominium units, cooperative units, mobile homes, and trailers or boats used as residences. Loans secured by any of these are “residential mortgage loans” that are subject to the new TILA rules. Note that the residence is covered whether or not it is the borrower’s principal residence.
    - Exclusion of Open-End Plans. An open-end credit plan is excluded from the definition of “residential mortgage loan,” which means that home equity lines of credit and other open-end credit plans are not subject to any of the new TILA provisions governing “residential mortgage loans.” However, open-end

credit plans are subject to other provisions of Title XIV.

- Exclusion of Certain Timeshares. Loans to finance certain timeshares are excluded from coverage by some of the most important of the new TILA provisions, including those relating to loan originations (TILA § 129B), minimum standards (TILA § 129C), new disclosures (TILA §§ 128(a)(16)-(19)), periodic statements (TILA § 128(f)), and defense to foreclosure (TILA § 130(k)). Extensions of credit secured by such timeshares are also excluded from the definition of “loan originator” under the SAFE Act.

## Section 1402. Residential Mortgage Loan Origination

(a) In General—Chapter 2 of the Truth in Lending Act (15 U.S.C. 1631 et seq.) is amended—

(1) by redesignating the 2nd of the 2 sections designated as section 129 (15 U.S.C. 1639a) (relating to duty of servicers of residential mortgages) as section 129A; and

(2) by inserting after section 129A (as so redesignated) the following new section:

“Sec. 129B. Residential mortgage loan origination

(a) Finding and Purpose—

(1) **FINDING**—The Congress finds that economic stabilization would be enhanced by the protection, limitation, and regulation of the terms of residential mortgage credit and the practices related to such credit, while ensuring that responsible, affordable mortgage credit remains available to consumers.

(2) **PURPOSE**—It is the purpose of this section and section 129C to assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deceptive or abusive.

(b) Duty of Care—

(1) **STANDARD**—Subject to regulations prescribed under this subsection, each mortgage originator shall, in addition to the duties imposed by otherwise applicable provisions of State or Federal law—

(A) be qualified and, when required, registered and licensed as a mortgage originator in accordance with applicable State or Federal law, including the Secure and Fair Enforcement for Mortgage Licensing Act of 2008; and

(B) include on all loan documents any unique identifier of the mortgage originator provided by the Nationwide Mortgage Licensing System and Registry.

(2) **COMPLIANCE PROCEDURES REQUIRED**—The Board shall prescribe regulations requiring depository institutions to establish and maintain procedures reasonably designed to assure and monitor the compliance of such depository institutions, the subsidiaries of such institutions, and the employees of such institutions or subsidiaries with the requirements of this section and the registration procedures established under section 1507 of the Secure and Fair Enforcement for Mortgage Licensing Act of 2008.’

(b) Clerical Amendment—The table of sections for chapter 2 of the Truth in Lending Act is amended by inserting after the item relating to section 129 the following new items:

“129A. Fiduciary duty of servicers of pooled residential mortgages.

“129B. Residential mortgage loan origination.’

**Analysis.** Section 1402 of the Dodd-Frank Act adds a new § 129B to TILA, which is the first of several sections that regulate the substantive terms of residential mortgage loan transactions. Historically, TILA was a disclosure statute and did not regulate the substantive terms of loans. While this concept has eroded over the years, the Dodd-Frank Act will bring about a “sea change” in how TILA regulates the residential mortgage loan business.

- Finding and Purpose. This reflects the conventional wisdom that the collapse of the residential mortgage market triggered the most severe recession since the Great Depression of the 1930s. Congress has responded by imposing “ability to repay” standards on mortgage lenders, prohibiting mortgage loans that are unfair, deceptive or abusive, and enhancing disclosure requirements.
- Duty of Care. A new duty of care is imposed on all mortgage originators (see discussion of mortgage originator definition in Section 1401, above). This duty is in addition to any duty imposed by other applicable federal and state laws. A mortgage originator is required to be licensed or registered, as applicable, when otherwise required to do so under the state and federal laws that implement the SAFE Act. That provision merely reiterates existing law. A mortgage loan originator is also required to be “qualified,” but an explanation of that

term will need to await implementing regulations. Presumably, this means that the loan originator must meet some basic standards of competence and integrity. For depository institutions, it may be possible to demonstrate that a reasonable belief that a mortgage originator is “qualified” by undertaking appropriate due diligence on the mortgage originator (or by engaging a third party to do so on behalf of the institution).

Mortgage originators are required to include on all “loan documents” any unique identifier of the mortgage originator that is provided by the Nationwide Mortgage Licensing System and Registry (“Nationwide Registry”). Since the Nationwide Registry will only issue unique identifiers to those individuals who are loan originators under the SAFE Act, only those individuals should be subject to this requirement. There is no explanation of which loan documents are subject to this requirement. In theory, this could mean the application, mortgage, note, loan disclosures, and the like, which could include dozens of documents. A more reasonable approach would be to limit the requirement to the note and mortgage. Presumably, this issue will be resolved in the final regulations, and compliance undoubtedly will present operational challenges.

- **Compliance Procedures Required.** All depository institutions will be subject to new Board regulations requiring them to establish and maintain procedures that are reasonably designed to assure and monitor compliance by those institutions, their subsidiaries, and their respective employees with the duty of care requirements and the SAFE Act’s licensing/registration procedures. In practice, these requirements are most likely declarative of an obligation to which depository institutions are already subject.

### Section 1403. Prohibition on Steering Incentives

Section 129B of the Truth in Lending Act (as added by section 1402(a)) is amended by inserting after subsection (b) the following new subsection:

“(c) Prohibition on Steering Incentives—

“(1) IN GENERAL—For any residential mortgage loan, no mortgage originator shall receive from any person and no person shall pay to a mortgage originator, directly or indirectly, compensation that varies based on the terms of the loan (other than the amount of the principal).

“(2) RESTRUCTURING OF FINANCING ORIGATION FEE—

“(A) IN GENERAL—For any mortgage loan, a mortgage originator may not receive from any person other than the consumer and no person, other than the consumer, who knows or has reason to know that a consumer has directly compensated or will directly compensate a mortgage originator may pay a mortgage originator any origination fee or charge except bona fide third party charges not retained by the creditor, mortgage originator, or an affiliate of the creditor or mortgage originator.

“(B) EXCEPTION—Notwithstanding subparagraph (A), a mortgage originator may receive from a person other than the consumer an origination fee or charge, and a person other than the consumer may pay a mortgage originator an origination fee or charge, if—

“(i) the mortgage originator does not receive any compensation directly from the consumer; and

“(ii) the consumer does not make an upfront payment of discount points, origination points, or fees, however denominated (other than bona fide third party charges not retained by the mortgage originator, creditor, or an affiliate of the creditor or originator), except that the Board may, by rule, waive or provide exemptions to this clause if the Board determines that such waiver or exemption is in the interest of consumers and in the public interest.

“(3) REGULATIONS—The Board shall prescribe regulations to prohibit—

“(A) mortgage originators from steering any consumer to a residential mortgage loan that—

“(i) the consumer lacks a reasonable ability to repay (in accordance with regulations prescribed under section 129C(a)); or

“(ii) has predatory characteristics or effects (such as equity stripping, excessive fees, or abusive terms);

“(B) mortgage originators from steering any consumer from a residential mortgage loan for which the consumer is qualified that is a qualified mortgage (as defined in section 129C(b)(2)) to a residential mortgage loan that is not a qualified mortgage;

“(C) abusive or unfair lending practices that promote disparities among consumers of equal credit worthiness but of different race, ethnicity, gender, or age; and

“(D) mortgage originators from—

“(i) mischaracterizing the credit history of a consumer or the residential mortgage loans available to a consumer;

(ii) mischaracterizing or suborning the mischaracterization of the appraised value of the property securing the extension of credit; or

(iii) if unable to suggest, offer, or recommend to a consumer a loan that is not more expensive than a loan for which the consumer qualifies, discouraging a consumer from seeking a residential mortgage loan secured by a consumer's principal dwelling from another mortgage originator.

(4) RULES OF CONSTRUCTION—No provision of this subsection shall be construed as—

(A) permitting any yield spread premium or other similar compensation that would, for any residential mortgage loan, permit the total amount of direct and indirect compensation from all sources permitted to a mortgage originator to vary based on the terms of the loan (other than the amount of the principal);

(B) limiting or affecting the amount of compensation received by a creditor upon the sale of a consummated loan to a subsequent purchaser;

(C) 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 this subsection, or the mortgage originator's right to receive such fees or costs (including compensation) from any person, subject to paragraph (2)(B), so long as such fees or costs do not vary based on the terms of the loan (other than the amount of the principal) or the consumer's decision about whether to finance such fees or costs; or

(D) prohibiting incentive payments to a mortgage originator based on the number of residential mortgage loans originated within a specified period of time.'

**Analysis.** Section 1403 of the Dodd-Frank Act, which adds a new § 129B(c) to TILA, is designed to prohibit the payment of yield spread premiums ("YSPs") and other steering incentives.

- Prohibition on Steering Incentives.

- In General. Mortgage originators may not receive, and no person may pay, any compensation that varies based on the terms of a residential mortgage loan, other than the principal amount of the loan. This is designed to prohibit YSPs and other payments that are tied to the interest rate, points, or other fees relating to the loan. Consumer groups have long been opposed to YSPs, and YSPs have been the source of RESPA, TILA and other types of litigation. After many years of fighting over this issue, the consumer groups have won. This is not a surprise given that the Board itself proposed an amendment to Regulation Z on August 26, 2009 that would ban YSPs.
- Scope of Prohibition. Given the broad definition of "mortgage originator" (see Section 1401, above), the prohibition on steering incentives applies, among others, to all mortgage brokers and mortgage loan officers at banks and mortgage banking companies. The prohibition is limited to closed-end residential mortgage loans.
- Impact. The prohibition on the payment of YSPs will bring about substantial changes. Historically, YSPs have represented a major component of compensation for mortgage brokers and loan officers. A new, compliant compensation structure will be required.

- Restructuring of Financing Origination Fee.

- In General. If a mortgage originator is receiving any compensation directly from the consumer/borrower, he/she may not also receive any compensation from the lender or any other person. Similarly, neither the lender nor any other person may pay any compensation to the mortgage originator if it knows or has reason to know that the mortgage originator is receiving fees directly from the consumer. However, it is permissible to pay bona fide third party charges, so long as they are not retained by the creditor, mortgage originator, or any of their respective affiliates.
- Exception. There is an exception to the new rule, which allows the mortgage originator to receive compensation from the creditor or other person if (i) the mortgage originator is not receiving any compensation directly from the consumer, and (ii) the consumer does not make any "upfront" payment of discount points, origination points, or fees (although bona fide third party charges are permissible so

long as they are not retained by the creditor, mortgage originator, or any of their respective affiliates). The Board has the authority to waive or provide exemptions from item (ii).

Under prior practice, mortgage brokers customarily received fees from both the consumer and the lender. Under the new rule, the mortgage originator must be paid by the consumer, or the creditor, but not both. If the creditor pays, the consumer cannot be required to pay origination or similar fees to the creditor at the inception of the transaction. Given the strict limitations on points and fees that may be imposed if a loan is to be treated as a “qualified mortgage” (see Section 1412, below), it may well be the case that the industry will migrate toward a practice of having mortgage originators (or, at least, those who are mortgage brokers) being compensated solely by the consumers.

- Regulations. The Board is directed to issue regulations that prohibit: (i) mortgage originators from steering a consumer to a loan that he/she does not have a reasonable ability to repay (see Section 1411, below) or that has predatory characteristics (*e.g.*, equity stripping, excessive fees, or abusive terms); (ii) mortgage originators from steering a consumer from a loan he/she is qualified for and that is a “qualified mortgage” to a loan that is not a qualified mortgage; (iii) abusive/unfair lending practices that promote discrimination on the basis of race, ethnicity, gender or age; (iv) mortgage originators from mischaracterizing a consumer’s credit history, the loans available to the consumer, or the appraised value of the property (or encouraging a misappraised value); or (v) mortgage originators from discouraging a consumer from seeking a loan from another mortgage originator if the first mortgage originator is unable to suggest, offer, or recommend a loan that is not more expensive than a loan for which the consumer qualifies.

This provision is designed to protect against the most egregious practices that the mortgage brokerage industry has been accused of during the years leading up to the recent residential mortgage crises. Creditors will need to adopt appropriate policies and procedures to implement these provisions, and to monitor against violations. The Board’s proposal from August 2009 to prohibit certain steering practices indicates that the agency is well capable of promulgating effective regulations in this area. The regulations are likely to paraphrase the statutory provisions and then provide examples of prohibited conduct.

- Rules of Construction. There are a few clarifications that will provide some relief to mortgage lenders.
  - First, § 129B(c) does not limit or affect the amount of compensation that a creditor can receive upon the sale of a consummated loan. This is somewhat analogous to the bona fide secondary market exception to RESPA (see 24 C.F.R. § 3500.5(b)(7)). The clarification should give a bona fide loan correspondent some flexibility when it sets its own pricing, although it will remain subject to the § 129B(c) restrictions relating to the compensation of its own mortgage originators. It is highly unlikely that this clarification will apply to the original creditors in table-funding transactions.
  - Second, at the option of the consumer, creditors may capitalize into the loan any origination fees or costs that are otherwise permitted. This includes the creditor’s ability to pay the fees so capitalized to the mortgage originator, subject to the prohibitions discussed above, provided that the fees and costs do not vary based on the loan terms (other than the principal amount of the loan). Alternatively, the creditor can cover those fees or costs by increasing the interest rate of the loan. However, capitalizing origination fees and costs may be prohibited by some state laws, particularly state laws governing high rate or high fee loans. In addition, there are strict limitations on points and fees that may be imposed if a loan is to be treated as a “qualified mortgage.” Further, increasing the interest rate could move some loans into the high-cost mortgage or higher-priced mortgage loan categories, which would impose other restrictions on the loans.
  - Third, the prohibition on paying steering incentive payments to a mortgage originator does not prohibit paying a mortgage originator extra fees based on the number of mortgage loans originated within a particular period of time. At first glance, it would appear that, going forward, this clarification is likely to serve as a significant element in the design of compensation programs for mortgage brokers and loan

officers. However, note that volume-based compensation programs for mortgage brokers may raise significant issues under Section 8 of RESPA. See, e.g., HUD Statement of Policy 1996-1, 64 Fed. Reg. 10,080 (Mar. 1, 1999). In this regard, Section 1415 makes clear that the fact that such compensation is permissible under TILA does not mean that it is permissible under Section 8 of RESPA. Note that a similar RESPA Section 8 concern would *not* arise with respect to the payment of compensation based on the number of loans originated where the mortgage originator is a bona fide employee of the creditor, so long as the compensation falls within RESPA's employer-employee exemption. See 24 C.F.R. § 3500.14(g)(1)(vii).

## Section 1404. Liability

Section 129B of the Truth in Lending Act is amended by inserting after subsection (c) (as added by section 1403) the following new subsection:

### (d) Liability for Violations—

(1) **IN GENERAL**—For purposes of providing a cause of action for any failure by a mortgage originator, other than a creditor, to comply with any requirement imposed under this section and any regulation prescribed under this section, section 130 shall be applied with respect to any such failure by substituting 'mortgage originator' for 'creditor' each place such term appears in each such subsection.

(2) **MAXIMUM**—The maximum amount of any liability of a mortgage originator under paragraph (1) to a consumer for any violation of this section shall not exceed the greater of actual damages or an amount equal to 3 times the total amount of direct and indirect compensation or gain accruing to the mortgage originator in connection with the residential mortgage loan involved in the violation, plus the costs to the consumer of the action, including a reasonable attorney's fee.

**Analysis.** Section 1404 of the Dodd-Frank Act adds a new § 129B(d) to TILA, to extend the civil liability provisions of TILA to mortgage originators.

- **In General.** New § 129B(d) of TILA applies the civil liability provisions of TILA to mortgage originators by substituting the term "mortgage originator" for "creditor" wherever the latter term appears in § 130 of TILA.

As amended by the Dodd-Frank Act, § 130 of TILA imposes civil liability for actual damages, statutory damages equal to twice the finance charge (with a minimum of \$400 and a maximum of \$4,000 in an individual action for a credit transaction not under an open-end credit plan that is secured by real property or a dwelling, and a maximum of the lesser of \$1,000,000 or 1% of the creditor's net worth in a class action), costs and reasonable attorneys' fees. For a violation of the high-cost loan, prohibition on steering incentives, or ability to repay rules, there is liability equal to all finance charges and fees paid by the consumer, unless the creditor demonstrates that the failure to comply was not material.

- **Maximum.** The maximum liability under this provision is the greater of actual damages or an amount equal to three times the total amount of direct and indirect compensation or gain accruing to the mortgage originator in the loan transaction in question, plus costs and reasonable attorneys' fees.

The technique of substituting the term "mortgage originator" for "creditor" has facilitated the drafting of this section at the expense of clarity. Several provisions of § 130 focus on the providing of Regulation Z disclosures by creditors, a concept that generally should be inapplicable to mortgage originators. In addition, most courts have held that actual damages under § 130 are limited to those incurred by the consumer solely by relying upon the disclosures of the creditor. Again, this concept may be difficult to apply to mortgage originators. Will the cure defense, bona fide error defense, defense by good faith reliance upon Board rule or commentary, other defenses, statute of limitations, and other provisions of § 130 apply to mortgage originators? Presumably, they should, but the determination of these issues will likely need to play out in the courts.

What liability will a creditor have should it violate the new rules relating to steering and the like? Since these will be violations of TILA, the creditor will presumably have civil liability under § 130. Again, it may be more difficult to apply § 130 to the new rules given that § 130 was written in contemplation of a statute that is disclosure oriented.

## Section 1405. Regulations

(a) Discretionary Regulatory Authority—Section 129B of the Truth in Lending Act is amended by inserting after subsection (d) (as added by section 1404) the following new subsection:

(e) Discretionary Regulatory Authority—

(1) IN GENERAL—The Board shall, by regulations, prohibit or condition terms, acts or practices relating to residential mortgage loans that the Board finds to be abusive, unfair, deceptive, predatory, necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of this section and section 129C, necessary or proper to effectuate the purposes of this section and section 129C, to prevent circumvention or evasion thereof, or to facilitate compliance with such sections, or are not in the interest of the borrower.

(2) APPLICATION—The regulations prescribed under paragraph (1) shall be applicable to all residential mortgage loans and shall be applied in the same manner as regulations prescribed under section 105.

(f) Section 129B and any regulations promulgated thereunder do not apply to an extension of credit relating to a plan described in section 101(53D) of title 11, United States Code.

(b) Disclosures—Notwithstanding any other provision of this title, in order to improve consumer awareness and understanding of transactions involving residential mortgage loans through the use of disclosures, the Board may, by rule, exempt from or modify disclosure requirements, in whole or in part, for any class of residential mortgage loans if the Board determines that such exemption or modification is in the interest of consumers and in the public interest.

**Analysis.** Section 1405 of the Dodd-Frank Act adds a new § 129B(e) to TILA.

**In General.** Section 1405 directs the Board to issue additional regulations to prohibit mortgage practices that it finds to be abusive, unfair, deceptive, or predatory. The Board regulations also are required to ensure that “responsible, affordable mortgage credit remains available to consumers in a manner consistent with [§ 129B and § 129C of TILA].”

As in the case of the regulations to implement the steering prohibitions in § 129B(c) of TILA, this section will probably lead to a sample list of prohibited practices from the Board. Creditors will need to adopt appropriate policies and procedures to implement these provisions, and to monitor against violations.

Section 129B(e) represents a second effort by Congress to get the Board to issue regulations that prohibit predatory practices. Existing § 129(l)(2) of TILA directs the Board to issue regulations or orders that prohibit acts and practices with respect to mortgage loans that the Board finds to be unfair, deceptive, or designed to evade § 129, as well as acts and practices relating to the refinancing of mortgage loans that the Board finds to be associated with abusive lending practices or that otherwise are not in the interests of the borrower. Until recently, the Board did not issue regulations to implement § 129. With the enactment of § 129B(e) and in the current political environment, the Board will almost certainly issue regulations this time.

- **Application.** The new Board regulations will apply to all residential mortgage loans, whether or not the security property is owner-occupied.
- **Timeshares.** Once again, the timeshare industry has received a free pass – under § 129B(f), neither these regulations nor § 129B itself are applicable to certain loans to finance timeshare units.
- **Disclosures.** Under Section 1405(b), the Board is authorized to provide full or partial exemptions from disclosure requirements for any class of residential mortgage loans if it finds that this is in the interests of consumers and the public interest. The Board currently holds a somewhat similar exemptive authority under § 129(l)(1) of TILA, which it has not used. In the current political environment, it is not anticipated that the Board will exercise its new exemptive authority any time soon.

## Section 1406. Study of Shared Appreciation Mortgages

(a) Study—The Secretary of Housing and Urban Development, in consultation with the Secretary of the Treasury and other relevant agencies, shall conduct a comprehensive study to determine prudent statutory and regulatory requirements sufficient to provide for the widespread use of shared appreciation mortgages to strengthen local housing markets, provide new opportunities for affordable homeownership, and enable homeowners at risk of foreclosure to refinance or modify their mortgages.

(b) Report—Not later than the expiration of the 6-month period beginning on the date of the enactment of this Act, the Secretary of Housing and Urban Development shall submit a report to the Congress on the results of the study, which shall include recommendations for the regulatory and legislative requirements referred to in subsection (a).

**Analysis.** HUD, in consultation with the Treasury, is to conduct a study to determine prudent statutory requirements for the widespread use of shared appreciation mortgages. The thinking appears to be that such mortgages could provide stability to housing markets, new opportunities, and relief for troubled homeowners. The report is due within six months of enactment of the Dodd-Frank Act.

## *Subtitle B – Minimum Standards For Mortgages*

### Section 1411. Ability to Repay

(a) In General—

(1) RULE OF CONSTRUCTION—No regulation, order, or guidance issued by the Bureau under this title shall be construed as requiring a depository institution to apply mortgage underwriting standards that do not meet the minimum underwriting standards required by the appropriate prudential regulator of the depository institution.

(2) AMENDMENT TO TRUTH IN LENDING ACT—Chapter 2 of the Truth in Lending Act (15 U.S.C. 1631 et seq.) is amended by inserting after section 129B (as added by section 1402(a)) the following new section:

Sec. 129C. Minimum standards for residential mortgage loans

(a) Ability To Repay—

(1) IN GENERAL—In accordance with regulations prescribed by the Board, no creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance (including mortgage guarantee insurance), and assessments.

(2) MULTIPLE LOANS—If the creditor knows, or has reason to know, that 1 or more residential mortgage loans secured by the same dwelling will be made to the same consumer, the creditor shall make a reasonable and good faith determination, based on verified and documented information, that the consumer has a reasonable ability to repay the combined payments of all loans on the same dwelling according to the terms of those loans and all applicable taxes, insurance (including mortgage guarantee insurance), and assessments.

(3) BASIS FOR DETERMINATION—A determination under this subsection of a consumer's ability to repay a residential mortgage loan shall include consideration of the consumer's credit history, current income, expected income the consumer is reasonably assured of receiving, current obligations, debt-to-income ratio or the residual income the consumer will have after paying non-mortgage debt and mortgage-related obligations, employment status, and other financial resources other than the consumer's equity in the dwelling or real property that secures repayment of the loan. A creditor shall determine the ability of the consumer to repay using a payment schedule that fully amortizes the loan over the term of the loan.

(4) INCOME VERIFICATION—A creditor making a residential mortgage loan shall verify amounts of income or assets that such creditor relies on to determine repayment ability, including expected income or assets, by reviewing the consumer's Internal Revenue Service Form W-2, tax returns, payroll receipts, financial institution records, or other third-party documents that provide reasonably reliable evidence of the consumer's income or assets. In order to safeguard against fraudulent reporting, any consideration of a consumer's income history in making a determination under this subsection shall include the verification of such income by the use of—

(A) Internal Revenue Service transcripts of tax returns; or

(B) a method that quickly and effectively verifies income documentation by a third party subject to rules prescribed by the Board.

(5) EXEMPTION—With respect to loans made, guaranteed, or insured by Federal departments or agencies identified in subsection (b)(3)(B)(ii), such departments or agencies may exempt refinancings under a streamlined refinancing from this income verification requirement as long as the following conditions are met:

(A) The consumer is not 30 days or more past due on the prior existing residential mortgage loan.

(B) The refinancing does not increase the principal balance outstanding on the prior existing residential mortgage loan, except to the extent of fees and charges allowed by the department or agency making, guaranteeing, or insuring the refinancing.

(C) Total points and fees (as defined in section 103(aa)(4), other than bona fide third party charges not retained by the mortgage originator, creditor, or an affiliate of the creditor or mortgage originator) payable in connection with the refinancing do not exceed 3 percent of the total new loan amount.

(D) The interest rate on the refinanced loan is lower than the interest rate of the original loan, unless the borrower is refinancing from an adjustable rate to a fixed-rate loan, under guidelines that the department or agency shall establish for loans they make, guarantee, or issue.

(E) The refinancing is subject to a payment schedule that will fully amortize the refinancing in accordance with the regulations prescribed by the department or agency making, guaranteeing, or insuring the refinancing.

(F) The terms of the refinancing do not result in a balloon payment, as defined in subsection (b)(2)(A)(ii).

(G) Both the residential mortgage loan being refinanced and the refinancing satisfy all requirements of the department or agency making, guaranteeing, or insuring the refinancing.

(6) NONSTANDARD LOANS—

(A) VARIABLE RATE LOANS THAT DEFER REPAYMENT OF ANY PRINCIPAL OR INTEREST—For purposes of determining, under this subsection, a consumer's ability to repay a variable rate residential mortgage loan that allows or requires the consumer to defer the repayment of any principal or interest, the creditor shall use a fully amortizing repayment schedule.

(B) INTEREST-ONLY LOANS—For purposes of determining, under this subsection, a consumer's ability to repay a residential mortgage loan that permits or requires the payment of interest only, the creditor shall use the payment amount required to amortize the loan by its final maturity.

(C) CALCULATION FOR NEGATIVE AMORTIZATION—In making any determination under this subsection, a creditor shall also take into consideration any balance increase that may accrue from any negative amortization provision.

(D) CALCULATION PROCESS—For purposes of making any determination under this subsection, a creditor shall calculate the monthly payment amount for principal and interest on any residential mortgage loan by assuming—

(i) the loan proceeds are fully disbursed on the date of the consummation of the loan;

(ii) the loan is to be repaid in substantially equal monthly amortizing payments for principal and interest over the entire term of the loan with no balloon payment, unless the loan contract requires more rapid repayment (including balloon payment), in which case the calculation shall be made (I) in accordance with regulations prescribed by the Board, with respect to any loan which has an annual percentage rate that does not exceed the average prime offer rate for a comparable transaction, as of the date the interest rate is set, by 1.5 or more percentage points for a first lien residential mortgage loan; and by 3.5 or more percentage points for a subordinate lien residential mortgage loan; or (II) using the contract's repayment schedule, with respect to a loan which has an annual percentage rate, as of the date the interest rate is set, that is at least 1.5 percentage points above the average prime offer rate for a first lien residential mortgage loan; and 3.5 percentage points above the average prime offer rate for a subordinate lien residential mortgage loan; and

(iii) the interest rate over the entire term of the loan is a fixed rate equal to the fully indexed rate at the time of the loan closing, without considering the introductory rate.

(E) REFINANCE OF HYBRID LOANS WITH CURRENT LENDER—In considering any application for refinancing an existing hybrid loan by the creditor into a standard loan to be made by the same creditor in any case in which there would be a reduction in monthly payment and the mortgagor has not been delinquent on any payment on the existing hybrid loan, the creditor may—

(i) consider the mortgagor's good standing on the existing mortgage;

(ii) consider if the extension of new credit would prevent a likely default should the original mortgage reset and give such concerns a higher priority as an acceptable underwriting practice; and

(iii) offer rate discounts and other favorable terms to such mortgagor that would be available to new customers with high credit ratings based on such underwriting practice.

(7) FULLY-INDEXED RATE DEFINED—For purposes of this subsection, the term 'fully indexed rate' means the index rate prevailing on a residential mortgage loan at the time the loan is made plus the margin that will apply after the expiration of any introductory interest rates.

(8) REVERSE MORTGAGES AND BRIDGE LOANS—This subsection shall not apply with respect to any reverse mortgage or temporary or bridge loan with a term of 12 months or less, including to any loan to purchase a new dwelling where the consumer plans to sell a different dwelling within 12 months.

(9) SEASONAL INCOME—If documented income, including income from a small business, is a repayment source for a residential mortgage loan, a creditor may consider the seasonality and irregularity of such income in the underwriting of and scheduling of payments for such credit.

(b) Clerical Amendment—The table of sections for chapter 2 of the Truth in Lending Act is amended by inserting after the item relating to section 129B (as added by section 1402(b)) the following new item:

129C. Minimum standards for residential mortgage loans.

**Analysis.** Section 1411 of the Dodd-Frank Act adds a new § 129C to TILA to establish a new “ability to repay” standard for residential mortgage loans.

- **Rule of Construction.** Section 1411(a)(1) clarifies that the new ability to repay standard should not be construed to require a depository institution to apply underwriting standards that do not also meet the minimum standards required by an institution’s prudential regulator. As a practical matter, compliance with the Board’s ability to repay regulations should satisfy any safety and soundness standards that any of the banking agencies might adopt.

**In General.** This new section requires creditors to make a reasonable and good faith determination that a consumer has a reasonable ability to repay a residential mortgage loan in accordance with its terms, including principal, interest, taxes, insurance, mortgage guaranty insurance, and assessments at the time the loan is consummated. The creditor’s determination must be based on verified and documented information. A so-called “safe harbor” for compliance with Section 1411 is provided by Section 1412, discussed below.

Regulation Z currently imposes ability to repay standards for high-cost loans (see 12 C.F.R. § 226.34(a)(4)) and higher-priced mortgage loans (see 12 C.F.R. § 226.35(b)(1)). In contrast, the Board’s new rules under § 129C will apply to all residential mortgage loans, without regard to the pricing of those loans. The new rules will apply to both owner-occupied and non-owner-occupied property loans. The rule protects a working class person buying his/her first home in the same way that it protects a sophisticated and wealthy private bank customer. It is expected that the Board will use its existing ability to repay regulations and related commentary provisions as the basis of the new regulations under § 129C, and will make any changes necessitated by the new statute. The new rules will prohibit “stated income,” “no doc,” and similar loans.

- **Multiple Loans.** Where the creditor knows or has reason to know that the consumer will receive more than one loan on the same property, it must apply the ability to repay standard with respect to the combined total of all such loans, including principal, interest, taxes, insurance, mortgage guaranty insurance, and assessments. This obligation will apply whether or not the creditor itself is making all of the loans. The existing Regulation Z ability to repay standards for high-cost loans and higher-priced mortgage loans also require the creditor to take such loans into consideration. See Paragraph 226.34(a)(4)-3 of the Regulation Z Commentary.

The statute does not explain when a creditor will be charged with knowledge of the additional loans. This may be explained in the implementing regulations. If not, the creditor should assume that it will be charged with knowledge of any additional loans that are referenced in any documentation relating to the loan, such as instructions to the closing agent. Moreover, it is likely that the creditor will be expected to deduce the existence of additional loans based on the circumstances surrounding its loan. For example, in a purchase loan transaction, if the amount of the creditor’s loan plus any down payment is less than the purchase price of the property, the creditor is likely to be charged with knowledge of the existence of additional loans. Note that the multiple loan rule is limited to loans secured by the same dwelling. This means that any unsecured loans – for example, unsecured loans that the consumer obtains from an employer, parent or other relative – technically will not be subject to this rule. However, the safety and soundness standards imposed by the creditor’s regulator, or standards imposed by the secondary market, may nonetheless require the creditor to take unsecured loan obligations into consideration when underwriting the loan.

- **Basis for Determination.** The consumer’s ability to repay is to be based upon a consideration of his/her credit history, current income, reasonably expected income, current obligations, debt-to-income ratio or residual income, employment status, and financial resources other than the security property. The creditor must measure the ability to repay using a payment schedule that fully amortizes the loan over its scheduled term (see below for more details).

While the statute identifies the factors that are relevant to an ability to repay determination, it does not identify specific standards. For example, it states that the creditor must consider the consumer’s debt-to-income ratio or residual income, but does not mandate a specified debt-to-income ratio or a minimal amount of residual income.

This is consistent with the approach of the Board's existing ability to repay regulations and related Regulation Z Commentary provisions. See 12 C.F.R. §§ 226.34(a)(4)(iii) and (iv) and Paragraphs 226.34(a)(4)(iii)(A), (B), (C) of the Regulation Z Commentary.

- Income Verification. The income or assets (including expected income or assets) relied upon by the creditor must be verified by an IRS W-2, tax returns (presumably, using an IRS Form 4506, 4506-T, or 8821), payroll receipts, financial institution records, or other third-party documents. This is similar to the Board's existing rule at 12 C.F.R. § 226.34(a)(4)(ii). The existing Regulation Z Commentary provides some flexibility in this regard, allowing creditors to rely on a letter or e-mail (but not oral information) from a third party. The creditor may rely on any third party document that provides reasonable evidence of the consumer's income or assets, such as receipts from a check-cashing service or a written statement of income from the consumer's employer. Creditors also may rely on third-party databases that provide consumer-specific information relating to income or assets. See Paragraphs 226.34(a)(4)(ii)(A)-3, 4 of the Regulation Z Commentary. Thus, the existing rule even provides a way to verify income for consumers who live in a cash-based economy. It is likely that the new rules will follow a similar approach.
- Exemption. This exemption is limited to loans made, guaranteed, or insured under certain HUD, Department of Veterans Affairs ("VA"), Department of Agriculture, and Rural Housing Service programs. The statute allows these agencies to exempt streamlined refinancings from the income verification requirement discussed above if: (i) the consumer is not 30 days or more past due on the existing loan; (ii) the refinancing will not increase the principal balance of the existing loan other than for fees and charges allowed by the agency; (iii) total points and fees (using the high-cost mortgage definition), other than bona fide third party charges not retained by the creditor, mortgage originator or their affiliates, do not exceed 3% of the total new loan amount; (iv) the new interest rate is lower than the interest rate of the existing loan unless the borrower is refinancing an ARM to a fixed rate loan under agency guidelines; (v) the new loan will be fully amortized in accordance with agency regulations; (vi) there is no balloon payment; and (vii) both the new loan and the existing loan meet agency requirements. Unfortunately, there is no equivalent streamlined refinance program for non-agency loans. Non-agency loans must meet the income verification standards described above.
- Nonstandard Loans. New TILA Section 129C apparently considers a "standard loan" to mean a traditional fixed-rate, fixed payment fully amortizing loan. Section 129C outlines how certain nonstandard loans are to be treated for purposes of applying the new ability to repay test.
  - Variable Rate Loans that Defer Repayment of any Principal or Interest. The creditor must use a fully amortizing payment schedule. See further comments below.
  - Interest-Only Loans. The creditor must use an amortizing payment through the final maturity date of the loan. See further comments below.
  - Calculation for Negative Amortization. The creditor must take into consideration any negative amortization that may occur.
  - Calculation Process. The creditor must make the following assumptions:
    - That the loan proceeds are fully disbursed on the date of the consummation of the loan. For example, this means that the creditor may ignore any "repair holds" or similar hold-backs of loan proceeds. Use of the consummation date may be problematic, since this ordinarily means the date that the consumer signs loan documents, even if the loan does not close until some days later. This may be something that the Board addresses in its implementing regulations.
    - That the loan will be paid in substantially equal monthly amortizing payments of principal and interest. However, if the loan requires a balloon payment or otherwise requires more rapid repayment (e.g., as in the case of some stepped payment loans), the calculation is to be made

under the Board's regulations, if the APR does not exceed the Average Prime Offer Rate, as of the date the interest rate is set, by 1.5 or more points for a first lien, or by 3.5 or more points for a junior lien. If the loan requires a balloon payment or requires more rapid repayment and has an APR in excess of these thresholds, then the loan's actual repayment schedule must be used.

The "Average Prime Offer Rate" is not defined under this subsection, but presumably the definition of that term used in § 129C(b)(2)(B) will be used here as well. The Board's existing regulation for higher-priced mortgage loans defines this term in more detail at 12 C.F.R. § 226.35(a)(2) and Paragraph 226.35(a)(2) of the Regulation Z Commentary. (There is a similar definition in Regulation C at 12 C.F.R. § 203.4(a)(12)(ii) and Paragraph 203.4(a)(12) of the Regulation C Commentary.)

There is also no explanation of how a creditor determines when the interest rate is "set." There are analogous concepts detailed in Paragraph 226.35(a)(2)-3 of the Regulation Z Commentary and Regulation C, Appendix A, at I.G.2, and these generally refer to the last date that the interest rate is locked or set before consummation. The Board may employ the same principles here. Because the interest rate is often not set until shortly before loan funding, it may not be possible until then to determine if the consumer has an ability to repay such loans. Creditors should make this clear in their communications to the consumer.

- That the interest rate for the entire loan term is the fully-indexed rate (defined below) at the time of loan closing. Any introductory rate is to be ignored.
- Refinance of Hybrid Loans with Current Lender. When a hybrid loan is refinanced into a standard loan by the same creditor, there will be a reduction of the monthly payment and if the consumer has not been delinquent on any payment, the creditor may: (i) consider the consumer's good standing on the existing loan; (ii) consider whether the new loan will prevent a likely default if the existing loan will reset, and to give this concern a higher priority in underwriting; and (iii) offer rate discounts and other favorable terms that would be available to new borrowers with high credit ratings.

While these factors may be considered in determining the consumer's ability to repay, they do not obviate the creditor's duty to consider other factors, verify income and assets, apply the multiple loan rule, and otherwise comply with TILA Section 129C(a). It would be advisable for the Board to create a "safe harbor" approach for applying the ability to repay rules when a hybrid loan is refinanced into a standard loan.

This provision contains several ambiguities. The terms "hybrid loan," "standard loan," "delinquent," and "same creditor" are not defined.

- A "hybrid loan" is generally considered to be one that starts at a low initial payment and a fixed introductory rate, where the rate expires after a short period and becomes adjustable for the remaining loan term. (Although the term "hybrid" is not used as such, this concept is described in the federal banking agencies' Statement on Subprime Mortgage Lending, 72 Fed. Reg. 37,569 (July 10, 2007).) The term "hybrid adjustable rate mortgage" is defined in new TILA Section 128A(a) (discussed in Section 1418, below) as "a consumer credit transaction secured by the consumer's principal residence with a fixed interest rate for an introductory period that adjusts or resets to a variable interest rate after such period." The use of different terms in § 129C and § 128A suggest that the terms are not the same. For example, there is no reason to believe that the benefits of § 129C discussed above are to be limited to loans secured by principal residences.
- In the context of § 129C(a), a "standard loan" appears to be a traditional fixed-rate, fixed payment fully amortizing loan.

Technically, a loan that is even a single day late could be considered “delinquent,” but this seems absurd in an industry that generally employs a 30-day standard of delinquency. This is an issue that the Board may clear up in its regulations. The statute also states that the loan may not have been delinquent “on any payment,” which could be read to mean that the special hybrid loan rule cannot apply unless the consumer has been current on the loan from its inception. A more rationale approach would be to require no 30-day delinquencies during the prior 12 months and no 60-day delinquencies during the prior 24 months, but this will need to await the Board’s rulemaking.

- The “same creditor” is an easy concept to apply in the case of a portfolio lender that refinances its own loan, but what about a creditor that sells a loan but then continues to service that loan? An analogous situation arises under 12 C.F.R. § 226.23(f)(2), which exempts a loan from the right of rescission if it consists of a refinancing by the “same creditor.” In that context, the same creditor means “the creditor to whom the [loan] was initially made payable.” This would cover a creditor that sells a loan but continues to service that loan. The same creditor is also construed to include any successor to the original creditor by merger, consolidation or acquisition. See Paragraph 226.23(f)-4 of the Regulation Z Commentary.
- Fully-Indexed Rate Defined. A “fully-indexed rate” is the index rate prevailing at the time the loan is made plus the margin that will apply after any introductory interest rates. If this is defined to mean the date the loan is funded, then this will be problematic because it will not be possible to determine the index value – and, therefore, the consumer’s ability to repay – until the same day that loan is actually funded. Hopefully, the Board will recognize this dilemma, and will define “the time the loan is made” to mean an earlier date, such as the date the interest rate is set (see discussion above) or, better yet, some earlier date.

Only the fully-indexed rate, as described above, may be used to determine the ability to repay. Historically, most loans have initial rates that reflect market conditions, and these introductory rates typically are not equal to the fully-indexed rates. The statute makes clear, however, that creditors must ignore such introductory rates when applying the ability to repay test. This appears to be inconsistent with other regulatory requirements. For example, in a Regulation Z disclosure statement, the repayment schedule and other disclosures governed by existing 12 C.F.R. § 226.18 require creditors to take initial rate discounts and premiums into consideration. See Paragraph 226.17(c)(1)-10 of the Regulation Z Commentary. Similarly, in an ARM program disclosure, the historical example governed by 12 C.F.R. § 226.19(b)(2)(viii)(A) and the maximum interest rate and payment example governed by 12 C.F.R. § 226.19(b)(2)(viii)(B) both require an initial rate discount or premium to be taken into consideration.

- Reverse Mortgages and Bridge Loans. The ability to repay rules do not apply to reverse mortgages or to temporary or bridge loans with terms of 12 months or less. By their very nature, these loans are made without regard to the borrower’s ability to repay. Short-term bridge loans are also exempt from RESPA and Regulation X. See 24 C.F.R. § 3500.5(b)(3).
- Seasonal Income. If income is documented, a creditor can consider the seasonality and irregularity of the income in underwriting the loan and scheduling payments.

## Section 1412. Safe Harbor and Rebuttable Presumption for the Ability to Repay Requirement

Section 129C of the Truth in Lending Act is amended by inserting after subsection (a) (as added by section 1411) the following new subsection:

“(b) Presumption of Ability To Repay—

(1) IN GENERAL—Any creditor with respect to any residential mortgage loan, and any assignee of such loan subject to liability under this title, may presume that the loan has met the requirements of subsection (a), if the loan is a qualified mortgage.

(2) DEFINITIONS—For purposes of this subsection, the following definitions shall apply:

(A) QUALIFIED MORTGAGE—The term 'qualified mortgage' means any residential mortgage loan—

(i) for which the regular periodic payments for the loan may not—

(I) result in an increase of the principal balance; or

(II) except as provided in subparagraph (E), allow the consumer to defer repayment of principal;

(ii) except as provided in subparagraph (E), the terms of which do not result in a balloon payment, where a 'balloon payment' is a scheduled payment that is more than twice as large as the average of earlier scheduled payments;

(iii) for which the income and financial resources relied upon to qualify the obligors on the loan are verified and documented;

(iv) in the case of a fixed rate loan, for which the underwriting process is based on a payment schedule that fully amortizes the loan over the loan term and takes into account all applicable taxes, insurance, and assessments;

(v) in the case of an adjustable rate loan, for which the underwriting is based on the maximum rate permitted under the loan during the first 5 years, and a payment schedule that fully amortizes the loan over the loan term and takes into account all applicable taxes, insurance, and assessments;

(vi) that complies with any guidelines or regulations established by the Board relating to ratios of total monthly debt to monthly income or alternative measures of ability to pay regular expenses after payment of total monthly debt, taking into account the income levels of the borrower and such other factors as the Board may determine relevant and consistent with the purposes described in paragraph (3)(B)(i);

(vii) for which the total points and fees (as defined in subparagraph (C)) payable in connection with the loan do not exceed 3 percent of the total loan amount;

(viii) for which the term of the loan does not exceed 30 years, except as such term may be extended under paragraph (3), such as in high-cost areas; and

(ix) in the case of a reverse mortgage (except for the purposes of subsection (a) of section 129C, to the extent that such mortgages are exempt altogether from those requirements), a reverse mortgage which meets the standards for a qualified mortgage, as set by the Board in rules that are consistent with the purposes of this subsection.

(B) AVERAGE PRIME OFFER RATE—The term 'average prime offer rate' means the average prime offer rate for a comparable transaction as of the date on which the interest rate for the transaction is set, as published by the Board.

(C) POINTS AND FEES—

(i) IN GENERAL—For purposes of subparagraph (A), the term 'points and fees' means points and fees as defined by section 103(aa)(4) (other than bona fide third party charges not retained by the mortgage originator, creditor, or an affiliate of the creditor or mortgage originator).

(ii) COMPUTATION—For purposes of computing the total points and fees under this subparagraph, the total points and fees shall exclude either of the amounts described in the following subclauses, but not both:

(I) Up to and including 2 bona fide discount points payable by the consumer in connection with the mortgage, but only if the interest rate from which the mortgage's interest rate will be discounted does not exceed by more than 1 percentage point the average prime offer rate.

(II) Unless 2 bona fide discount points have been excluded under subclause (I), up to and including 1 bona fide discount point payable by the consumer in connection with the mortgage, but only if the interest rate from which the mortgage's interest rate will be discounted does not exceed by more than 2 percentage points the average prime offer rate.

(iii) BONA FIDE DISCOUNT POINTS DEFINED—For purposes of clause (ii), the term 'bona fide discount points' means loan discount points which are knowingly paid by the consumer for the purpose of reducing, and which in fact result in a bona fide reduction of, the interest rate or time-price differential applicable to the mortgage.

(iv) INTEREST RATE REDUCTION—Subclauses (I) and (II) of clause (ii) shall not apply to discount points used to purchase an interest rate reduction unless the amount of the interest rate reduction purchased is reasonably consistent with established industry norms and practices for secondary mortgage market transactions.

(D) SMALLER LOANS—The Board shall prescribe rules adjusting the criteria under subparagraph (A)(vii) in order to permit lenders that extend smaller loans to meet the requirements of the presumption of compliance under paragraph (1). In prescribing such rules, the Board shall consider the potential impact of such rules on rural areas and other areas where home values are lower.

- (E) BALLOON LOANS—The Board may, by regulation, provide that the term “qualified mortgage” includes a balloon loan—
- (i) that meets all of the criteria for a qualified mortgage under subparagraph (A) (except clauses (i)(II), (ii), (iv), and (v) of such subparagraph);
  - (ii) for which the creditor makes a determination that the consumer is able to make all scheduled payments, except the balloon payment, out of income or assets other than the collateral;
  - (iii) for which the underwriting is based on a payment schedule that fully amortizes the loan over a period of not more than 30 years and takes into account all applicable taxes, insurance, and assessments; and
  - (iv) that is extended by a creditor that—
    - (I) operates predominantly in rural or underserved areas;
    - (II) together with all affiliates, has total annual residential mortgage loan originations that do not exceed a limit set by the Board;
    - (III) retains the balloon loans in portfolio; and
    - (IV) meets any asset size threshold and any other criteria as the Board may establish, consistent with the purposes of this subtitle.

(3) REGULATIONS—

(A) IN GENERAL—The Board shall prescribe regulations to carry out the purposes of this subsection.

(B) REVISION OF SAFE HARBOR CRITERIA—

- (i) IN GENERAL—The Board may prescribe regulations that revise, add to, or subtract from the criteria that define a qualified mortgage upon a finding that such regulations are necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of this section, necessary and appropriate to effectuate the purposes of this section and section 129B, to prevent circumvention or evasion thereof, or to facilitate compliance with such sections.
- (ii) LOAN DEFINITION—The following agencies shall, in consultation with the Board, prescribe rules defining the types of loans they insure, guarantee, or administer, as the case may be, that are qualified mortgages for purposes of paragraph (2)(A), and such rules may revise, add to, or subtract from the criteria used to define a qualified mortgage under paragraph (2)(A), upon a finding that such rules are consistent with the purposes of this section and section 129B, to prevent circumvention or evasion thereof, or to facilitate compliance with such sections:
  - (I) The Department of Housing and Urban Development, with regard to mortgages insured under the National Housing Act (12 U.S.C. 1707 et seq.).
  - (II) The Department of Veterans Affairs, with regard to a loan made or guaranteed by the Secretary of Veterans Affairs.
  - (III) The Department of Agriculture, with regard to loans guaranteed by the Secretary of Agriculture pursuant to 42 U.S.C. 1472(h).
  - (IV) The Rural Housing Service, with regard to loans insured by the Rural Housing Service.

**Analysis.** Section 1412 of the Dodd-Frank Act adds a new § 129C(b) to TILA.

- Presumption of Ability to Repay. Section 1412 establishes a “safe harbor” for compliance with the ability to repay requirements of § 129C(a). A creditor and its assignees may “presume” that a loan meets the ability to repay requirements if the loan is a “qualified mortgage,” discussed below. There is an ambiguity in Section 1412’s heading, which refers to both a “safe harbor” (suggesting that qualified mortgages will always meet the ability to repay requirement) and a “rebuttable presumption” (suggesting that it is possible to demonstrate that qualified mortgages still fail to meet the ability to repay requirement). The Board’s existing ability to repay rule that is applicable to high-cost mortgages and higher-priced mortgage loans establishes a presumption of compliance standard, but the Regulation Z Commentary states that the consumer may rebut the presumption with “evidence that the creditor nonetheless disregarded repayment ability despite following these procedures.” (See Paragraph 226.34(a)(4)(iii)-1 of the Regulation Z Commentary.) Notwithstanding the reference to a “safe harbor” in the heading to Section 1412, it is likely that the Board will follow a similar approach here.

Nevertheless, compliance with the “qualified mortgage” rules should provide a high level of comfort that the ability to repay requirement has been met. It remains to be seen whether the industry will generally refuse to

make any loans that are not qualified mortgages, much as the industry has generally refused to make Home Ownership and Equity Protection Act (“HOEPA”) loans (a/k/a high-cost mortgages). Presumably, the answer to this question will be driven by the demands of the secondary market. To the extent that non-qualified mortgages continue to be made, the added risks will likely be reflected in the pricing of those loans.

- Qualified Mortgage. A “qualified mortgage” is a residential mortgage loan (see discussion at Section 1401, above) that meets all of the following criteria:
  - There is no negative amortization.
  - Repayment of principal cannot be deferred by the consumer (except for the limited balloon payment rule discussed below).
  - There is no balloon payment (except for the limited balloon payment rule discussed below). For this purpose, a “balloon payment” is one where a scheduled payment is more than twice as large as the average of earlier scheduled payments. This contrasts with existing regulations which, if they define a balloon payment at all, generally reference a payment that is twice the amount of any previously scheduled payment. See, e.g., Paragraphs 226.32(d)(1)-1, 226.5b(d)(5)(ii)-3, and 226.24(f)(3)-1 of the Regulation Z Commentary.
  - The income and financial resources relied upon to qualify the consumer are verified and documented. Essentially, this is the same standard that is set forth in the ability to repay rule itself.
  - If the loan has a fixed rate, the loan must be underwritten on the basis of a fully amortizing loan that takes all applicable taxes, insurance, and assessments into consideration. Essentially, this is the same standard that is set forth in the ability to repay rule itself. Presumably, this standard will also be applied to a loan with a series of stepped fixed rates, but this is not clear from the wording of the statute.
  - If the loan has an adjustable rate, the loan must be underwritten on the basis of the maximum rate that is permitted under the loan during the first five years and a payment schedule that fully amortizes the loan over the scheduled term, taking into consideration all applicable taxes, insurance, and assessments. This is starkly different than the approach set forth in the ability to repay rule, which requires underwriting on the basis of the fully-indexed rate. This may cause the market to favor ARMs with longer fixed rate periods (e.g., 7/1 ARMs), which will allow the loan to be underwritten on the basis of the initial rate. Alternatively, the market may favor ARMs whose rate increases are capped substantially during the first five years.
  - The loan must comply with any Board regulations or guidelines relating to debt-to-income ratios or residual income. The ability to repay rule itself contains a requirement that a debt-to-income ratio or residual income be taken into consideration. Based on the Board’s approach in its existing ability to repay regulations and related Commentary provisions, it is unlikely that the Board will identify specific maximum debt-to-income ratios or specific minimum residual income standards. See 12 C.F.R. §§ 226.34(a)(4)(iii) and (iv) and Paragraphs 226.34(a)(4)(iii)(A), (B), (C) of the Regulation Z Commentary. In contrast with the rules for qualified mortgages, Congress did impose a specific maximum debt-to-income ratio standard (i.e., 50%) with respect to the exception to its prohibition on prepayment penalties for high-cost mortgages. See § 129(c)(2)(A)(i) of TILA.
  - The total points and fees for the loan may not exceed 3% of the total loan amount. For many creditors, this limitation will impose a significant challenge with respect to their efforts to bring their loans into the qualified mortgage definition, particularly for brokered loans. With regard to the application of the points and fees test, note the following:

- “Points and fees” are generally defined by reference to the definition for high-cost mortgages used in TILA § 103(aa)(4) (but excluding bona fide third party charges not retained by the mortgage originator, creditor, or an affiliate of either).
- Certain bona fide discount points paid by the consumer may be excluded in computing the points and fees, as follows: (i) up to and including 2 bona fide discount points may be excluded if the interest rate to be discounted does not exceed by more than 1% the Average Prime Offer Rate; (ii) up to and including 1 bona fide discount point may be excluded if the interest rate to be discounted does not exceed by more than 2% the Average Prime Offer Rate; (iii) the amount in item (ii) can only be excluded if the amount in item (i) is not being excluded; (iv) the bona fide discount points must be “knowingly” paid by the consumer for the purpose of obtaining the interest rate reduction (suggesting the advisability of obtaining a written acknowledgment of that fact from the consumer), and must actually result in a bona fide reduction of the interest rate; and (v) the interest rate reduction must be “reasonably consistent with established industry norms and practices for secondary market transactions” (there is no guidance on what this means). This is similar to the treatment of discount points in the high-cost mortgage points and fees test (see discussion of Section 1431, below), but this rule does not contain the high-cost mortgage points and fees test’s special provisions for discount points on loans secured by personal property.

The “Average Prime Offer Rate” is defined to mean the average prime offer rate for a comparable transaction as of the date on which the interest rate is set, as published by the Board. The Board’s existing regulation for higher-priced mortgage loans defines “Average Prime Offer Rate” in more detail at 12 C.F.R. § 226.35(a)(2) and Paragraph 226.35(a)(2) of the Regulation Z Commentary. (There is a similar definition in Regulation C at 12 C.F.R. § 203.4(a)(12)(ii) and Comment 203.4(a)(12) of the Regulation C Commentary.)

- Among others, the “points and fees” will include regular points, origination fees, amounts paid by a consumer or creditor to a mortgage originator from any source (including a mortgage originator who is also the creditor in a table-funded transaction), settlement agent charges (*e.g.*, where the creditor requires the settlement agent’s services, requires the imposition of the charge, or retains a portion of the charge – see 12 C.F.R. § 226.4(a)(2)), and required credit insurance or debt cancellation coverage premiums. See 12 C.F.R. § 226.32(b)(1).
- The “total loan amount” is not defined. This term is defined in Paragraph 226.32(a)(1)(ii)-1 of the Regulation Z Commentary, relating to high-cost mortgages, to mean the amount financed (as calculated under 12 C.F.R. § 226.18(b)) minus the amounts listed in 12 C.F.R. §§ 226.32(b)(1)(iii) and (iv) that are included as points and fees and financed by the creditor. It is likely that the Board will employ the same definition for purposes of § 129C(b), but the final regulations will need to be reviewed to determine if this is correct.
  - The scheduled loan term may not exceed 30 years, subject to any exception that the Board may create, such as for high-cost areas.
  - A reverse mortgage that is subject to the ability to repay requirement must meet standards that will be established by the Board’s rules. This is a curious requirement, given the fact that reverse mortgages are excluded from the ability to repay rule. See discussion of Section 1411, above.

The qualified mortgage definition does not contain a net tangible benefit test.

Note that the “qualified mortgage” definition used with respect to the ability to repay requirement may be different than the “qualified residential mortgage” definition used with respect to the exclusion of certain mortgages from the credit risk retention requirements of Section 941 of the Dodd-Frank Act.

- **Smaller Loans.** The statute directs the Board to adjust the points and fees test to permit lenders that make smaller loans to take advantage of the presumption of compliance. The statute references rural areas and other areas where home values are lower.
- **Balloon Loans.** The Board is authorized, but not directed, to establish a very narrow exception that will allow certain balloon loans to be treated as qualified mortgages, as follows:
  - The creditor must determine that the consumer is able to make all of the scheduled payments (other than the balloon payment) out of income or assets, other than the security property. Presumably, the standards set forth in the ability to repay rule will be used.
  - The loan must be underwritten on the basis of a fully amortizing repayment schedule over not more than 30 years. This must taken into consideration all applicable taxes, insurance and assessments.
  - The creditor must operate predominantly in rural or underserved areas, the total annual residential mortgage loan originations by the creditor and its affiliates must not exceed a threshold that will be set by the Board, all of the balloon loans must be retained in the creditor's own portfolio, and the creditor must meet any asset size threshold and other criteria that the Board establishes.

This exception is so narrow that it was likely designed to fit a particular creditor or small group of creditors.
- **Regulations.** The Board is directed to issue implementing regulations for Section 1412. The Board is authorized, but not directed, to revise, add to, or subtract from the criteria used to define a qualified mortgage. Regulations that modify the qualified mortgage standard must be consistent with the purposes of § 129B and § 129C of TILA.
- **Loan Definition.** For loans made, guaranteed, or insured under certain HUD, VA, Department of Agriculture, and Rural Housing Service programs, those agencies are to prescribe their own rules for "qualified mortgages." They must first consult with the Board, and any rules that modify the qualified mortgage standard must be consistent with the purposes of § 129B and § 129C of TILA.

### Section 1413. Defense to Foreclosure

Section 130 of the Truth in Lending Act (15 U.S.C. 1640) is amended by adding at the end the following new subsection:

“(k) Defense to Foreclosure—

“(1) IN GENERAL—Notwithstanding any other provision of law, when a creditor, assignee, or other holder of a residential mortgage loan or anyone acting on behalf of such creditor, assignee, or holder, initiates a judicial or nonjudicial foreclosure of the residential mortgage loan, or any other action to collect the debt in connection with such loan, a consumer may assert a violation by a creditor of paragraph (1) or (2) of section 129B(c), or of section 129C(a), as a matter of defense by recoupment or set off without regard for the time limit on a private action for damages under subsection (e).

“(2) AMOUNT OF RECOUPMENT OR SETOFF—

“(A) IN GENERAL—The amount of recoupment or set-off under paragraph (1) shall equal the amount to which the consumer would be entitled under subsection (a) for damages for a valid claim brought in an original action against the creditor, plus the costs to the consumer of the action, including a reasonable attorney's fee.

“(B) SPECIAL RULE—Where such judgment is rendered after the expiration of the applicable time limit on a private action for damages under subsection (e), the amount of recoupment or set-off under paragraph (1) derived from damages under subsection (a)(4) shall not exceed the amount to which the consumer would have been entitled under subsection (a)(4) for damages computed up to the day preceding the expiration of the applicable time limit.’.

**Analysis.** Section 1413 of the Dodd-Frank Act amends the civil liability provisions in § 130 of TILA.

- In General. Section 1413 adds a new subsection (k) to allow a consumer, following the initiation of any judicial or nonjudicial foreclosure proceeding, to assert a violation of § 129B(c)(1) or (2) (prohibition on payment and receipt of steering incentives) or a violation of § 129C(a) (ability to repay requirement), as a matter of defense by recoupment or set off, and without regard to the normal statute of limitations applicable to TILA actions for damages.
- Amount of Recoupment or Set Off. While § 130(k) is titled “defense to foreclosure,” the section does not, in fact, provide a defense to a foreclosure proceeding. Instead, the new subsection allows the consumer to sue for recoupment or set off, thereby exacerbating the losses that the creditor or assignee is already likely to sustain with respect to the loan. The amount of the recoupment or set off is equal to the civil damages to which the consumer would be entitled under § 130(a) of TILA. For a summary of those civil damages, see below.
- Special Rule. If the normal statute of limitations has run, the recoupment or set off for a violation of the high-cost mortgage rules is limited to the amount to which the consumer would have been entitled up to the date before the expiration of the statute of limitations. Note that there is no similar limitation imposed for an action under other subsections of § 130(a).
- Actual Damages. Most courts have held that actual damages under § 130(a) are limited to those incurred by the consumer by solely relying upon the disclosures of the creditor. This concept may be difficult to apply in this context, and the courts may apply a much broader concept of actual damages here.
- Impact on Creditors and Assignees. Section 130(k) of TILA has the potential to be exceedingly costly for creditors and their assignees. Virtually any consumer who defaults for non-payment will be tempted to sue for recoupment in connection with the resulting foreclosure on the ground that the creditor violated the ability to repay requirement. The potential for this liability will create a particularly strong incentive for the market to move the industry toward the origination of qualified mortgages.

## Section 1414. Additional Standards and Requirements

(a) In General—Section 129C of the Truth in Lending Act is amended by inserting after subsection (b) (as added by this title) the following new subsections:

(c) Prohibition on Certain Prepayment Penalties—

(1) PROHIBITED ON CERTAIN LOANS—

(A) IN GENERAL—A residential mortgage loan that is not a ‘qualified mortgage’, as defined under subsection (b)(2), may not contain terms under which a consumer must pay a prepayment penalty for paying all or part of the principal after the loan is consummated.

(B) EXCLUSIONS—For purposes of this subsection, a ‘qualified mortgage’ may not include a residential mortgage loan that—

(i) has an adjustable rate; or

(ii) has an annual percentage rate that exceeds the average prime offer rate for a comparable transaction, as of the date the interest rate is set—

(I) by 1.5 or more percentage points, in the case of a first lien residential mortgage loan having an original principal obligation amount that is equal to or less than the amount of the maximum limitation on the original principal obligation of mortgage in effect for a residence of the applicable size, as of the date of such interest rate set, pursuant to the 6th sentence of section 305(a)(2) of the Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1454(a)(2));

(II) by 2.5 or more percentage points, in the case of a first lien residential mortgage loan having an original principal obligation amount that is more than the amount of the maximum limitation on the original principal obligation of mortgage in effect for a residence of the applicable size, as of the date of such interest rate set, pursuant to the 6th sentence of section 305(a)(2) the Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1454(a)(2)); and

(III) by 3.5 or more percentage points, in the case of a subordinate lien residential mortgage loan.

(2) PUBLICATION OF AVERAGE PRIME OFFER RATE AND APR THRESHOLDS—The Board—

(A) shall publish, and update at least weekly, average prime offer rates;

(B) may publish multiple rates based on varying types of mortgage transactions; and

(C) shall adjust the thresholds established under subclause (I), (II), and (III) of paragraph (1)(B)(ii) as necessary to reflect significant changes in market conditions and to effectuate the purposes of the Mortgage Reform and Anti-Predatory Lending Act.

(3) PHASED-OUT PENALTIES ON QUALIFIED MORTGAGES—A qualified mortgage (as defined in subsection (b)(2)) may not contain terms under which a consumer must pay a prepayment penalty for paying all or part of the principal after the loan is consummated in excess of the following limitations:

(A) During the 1-year period beginning on the date the loan is consummated, the prepayment penalty shall not exceed an amount equal to 3 percent of the outstanding balance on the loan.

(B) During the 1-year period beginning after the period described in subparagraph (A), the prepayment penalty shall not exceed an amount equal to 2 percent of the outstanding balance on the loan.

(C) During the 1-year period beginning after the 1-year period described in subparagraph (B), the prepayment penalty shall not exceed an amount equal to 1 percent of the outstanding balance on the loan.

(D) After the end of the 3-year period beginning on the date the loan is consummated, no prepayment penalty may be imposed on a qualified mortgage.

(4) OPTION FOR NO PREPAYMENT PENALTY REQUIRED—A creditor may not offer a consumer a residential mortgage loan product that has a prepayment penalty for paying all or part of the principal after the loan is consummated as a term of the loan without offering the consumer a residential mortgage loan product that does not have a prepayment penalty as a term of the loan.

(d) Single Premium Credit Insurance Prohibited—No creditor may finance, directly or indirectly, in connection with any residential mortgage loan or with any extension of credit under an open end consumer credit plan secured by the principal dwelling of the consumer, any credit life, credit disability, credit unemployment, or credit property insurance, or any other accident, loss-of-income, life, or health insurance, or any payments directly or indirectly for any debt cancellation or suspension agreement or contract, except that—

(1) insurance premiums or debt cancellation or suspension fees calculated and paid in full on a monthly basis shall not be considered financed by the creditor; and

(2) this subsection shall not apply to credit unemployment insurance for which the unemployment insurance premiums are reasonable, the creditor receives no direct or indirect compensation in connection with the unemployment insurance premiums, and the unemployment insurance premiums are paid pursuant to another insurance contract and not paid to an affiliate of the creditor.

(e) Arbitration—

(1) IN GENERAL—No residential mortgage loan and no extension of credit under an open end consumer credit plan secured by the principal dwelling of the consumer may include terms which require arbitration or any other nonjudicial procedure as the method for resolving any controversy or settling any claims arising out of the transaction.

(2) POST-CONTROVERSY AGREEMENTS—Subject to paragraph (3), paragraph (1) shall not be construed as limiting the right of the consumer and the creditor or any assignee to agree to arbitration or any other nonjudicial procedure as the method for resolving any controversy at any time after a dispute or claim under the transaction arises.

(3) NO WAIVER OF STATUTORY CAUSE OF ACTION—No provision of any residential mortgage loan or of any extension of credit under an open end consumer credit plan secured by the principal dwelling of the consumer, and no other agreement between the consumer and the creditor relating to the residential mortgage loan or extension of credit referred to in paragraph (1), shall be applied or interpreted so as to bar a consumer from bringing an action in an appropriate district court of the United States, or any other court of competent jurisdiction, pursuant to section 130 or any other provision of law, for damages or other relief in connection with any alleged violation of this section, any other provision of this title, or any other Federal law.

(f) Mortgages With Negative Amortization—No creditor may extend credit to a borrower in connection with a consumer credit transaction under an open or closed end consumer credit plan secured by a dwelling or residential real property that includes a dwelling, other than a reverse mortgage, that provides or permits a payment plan that may, at any time over the term of the extension of credit, result in negative amortization unless, before such transaction is consummated—

(1) the creditor provides the consumer with a statement that—

(A) the pending transaction will or may, as the case may be, result in negative amortization;

(B) describes negative amortization in such manner as the Board shall prescribe;

(C) negative amortization increases the outstanding principal balance of the account; and

(D) negative amortization reduces the consumer's equity in the dwelling or real property; and

(2) in the case of a first-time borrower with respect to a residential mortgage loan that is not a qualified mortgage, the first-time borrower provides the creditor with sufficient documentation to demonstrate that the consumer received homeownership counseling from organizations or counselors certified by the Secretary of Housing and Urban Development as competent to provide such counseling.'

(b) Conforming Amendment Relating to Enforcement—Section 108(a) of the Truth in Lending Act (15 U.S.C. 1607(a)) is amended by inserting after paragraph (6) the following new paragraph:

(7) sections 21B and 21C of the Securities Exchange Act of 1934, in the case of a broker or dealer, other than a depository institution, by the Securities and Exchange Commission.'

(c) Protection Against Loss of Anti-deficiency Protection—Section 129C of the Truth in Lending Act is amended by inserting after subsection (f) (as added by subsection (a)) the following new subsection:

(g) Protection Against Loss of Anti-deficiency Protection—

(1) DEFINITION—For purposes of this subsection, the term ‘anti-deficiency law’ means the law of any State which provides that, in the event of foreclosure on the residential property of a consumer securing a mortgage, the consumer is not liable, in accordance with the terms and limitations of such State law, for any deficiency between the sale price obtained on such property through foreclosure and the outstanding balance of the mortgage.

(2) NOTICE AT TIME OF CONSUMMATION—In the case of any residential mortgage loan that is, or upon consummation will be, subject to protection under an anti-deficiency law, the creditor or mortgage originator shall provide a written notice to the consumer describing the protection provided by the anti-deficiency law and the significance for the consumer of the loss of such protection before such loan is consummated.

(3) NOTICE BEFORE REFINANCING THAT WOULD CAUSE LOSS OF PROTECTION—In the case of any residential mortgage loan that is subject to protection under an anti-deficiency law, if a creditor or mortgage originator provides an application to a consumer, or receives an application from a consumer, for any type of refinancing for such loan that would cause the loan to lose the protection of such anti-deficiency law, the creditor or mortgage originator shall provide a written notice to the consumer describing the protection provided by the anti-deficiency law and the significance for the consumer of the loss of such protection before any agreement for any such refinancing is consummated.’

(d) Policy Regarding Acceptance of Partial Payment—Section 129C of the Truth in Lending Act is amended by inserting after subsection (g) (as added by subsection (c)) the following new subsection:

(h) Policy Regarding Acceptance of Partial Payment—In the case of any residential mortgage loan, a creditor shall disclose prior to settlement or, in the case of a person becoming a creditor with respect to an existing residential mortgage loan, at the time such person becomes a creditor—

(1) the creditor’s policy regarding the acceptance of partial payments; and

(2) if partial payments are accepted, how such payments will be applied to such mortgage and if such payments will be placed in escrow.

(i) Timeshare Plans—This section and any regulations promulgated under this section do not apply to an extension of credit relating to a plan described in section 101(53D) of title 11, United States Code.’

**Analysis.** Section 1414 of the Dodd-Frank Act adds new §§ 129C(c)-(i) to TILA to further regulate the mortgage loan industry. These provisions are directed at the perceived abuses that led to the recent mortgage loan crisis. Once again, certain timeshare plan loans are exempt.

- Prohibition on Certain Prepayment Penalties.

- Non-Qualified Mortgages. New § 129C(c) flat out prohibits prepayment penalties for residential mortgage loans that are not “qualified mortgages” as described above. This will further incentivize the market to move the industry toward the origination of qualified mortgages.

- Qualified Mortgages. New § 129C(c) allows limited prepayment penalties for a subset of qualified mortgages as follows:

- The loan must not have an adjustable rate. This means that the loan must have a fixed rate, and presumably means that the loan may have a predetermined schedule of stepped fixed rates.
- The APR may not exceed the Average Prime Offer Rate for a comparable transaction as of the date the interest rate is set by 1.5% or more, for a first lien loan that is equal to or less than the applicable Freddie Mac conforming loan limit.

See discussion of Section 1411, above, regarding the date that the interest rate is set.

- The APR may not exceed the Average Prime Offer Rate for a comparable transaction as of the date the interest rate is set by 2.5% or more, for a first lien loan that exceeds the applicable Freddie Mac conforming loan limit.

- The APR may not exceed the Average Prime Offer Rate for a comparable transaction as of the date the interest rate is set by 3.5% or more, for a junior lien loan.
- The prepayment penalty is limited to 3% of the outstanding balance during the first year following the consummation of the loan, 2% of the outstanding balance during the second year following the consummation of the loan, and 1% of the outstanding balance during the third year following the consummation of the loan. After the third year, no prepayment penalty may be imposed.

The Board is authorized to adjust the foregoing prepayment penalty thresholds for qualified mortgages to reflect market conditions.

The statute is silent regarding the imposition of prepayment penalties for a series of partial prepayments, but presumably the aggregate prepayment penalties may not exceed these thresholds in each of the first, second, and third years.

The prepayment penalty provisions for qualified mortgages would appear to be out of synch with the revisions to the definition of a “high-cost mortgage” under § 103(aa)(1) of TILA. A high-cost mortgage includes one in which the prepayment fees and penalties exceed 2% of the amount prepaid. Thus, a loan with a permissible 3% prepayment penalty in the first year could be both a qualified mortgage and a high-cost mortgage, which makes little sense.

- The creditor must also offer the consumer a residential mortgage loan product that contains no prepayment penalty. The statute does not require the creditor to offer the same loan product without a prepayment penalty, but rather only “a” residential mortgage loan product that contains no prepayment penalty. This would indicate, for example, that the creditor could offer the consumer a fixed rate loan with a prepayment penalty together with an ARM that contains no prepayment penalty. In addition, the statute does not require the creditor to offer the same pricing (e.g., interest rates or origination fees) for the two loans. This would indicate, for example, that the creditor could offer the consumer a fixed rate loan with a prepayment penalty together with a fixed rate loan that contains no prepayment penalty but is at a higher interest rate.
- Publication of Average Prime Offer Rate. The Board is directed to publish, and update weekly, the Average Prime Offer Rates, and is authorized to publish different rates for different types of transactions. The Board already makes this data available in accordance with its regulations for higher-priced mortgage loans. See 12 C.F.R. § 226.35(a)(2).
- Single Premium Credit Insurance Prohibited. Creditors may not finance, directly or indirectly, credit insurance product premiums or any payments for debt cancellation or suspension contracts.
  - The prohibition applies to both residential mortgage transactions and open-end consumer credit that is secured by the principal dwelling of the consumer. Therefore, this prohibition applies to principal and nonprincipal dwellings for closed-end loans, but only principal dwellings for open-end loans. A “principal dwelling” is defined in Paragraphs 226.2(a)(24)-3, 226.15(a)(1)-5, 6 and 226.23(a)(1)-3, 4 of the Regulation Z Commentary. The basic rule is that a person can have only one principal dwelling at a time, thereby excluding vacation or second homes. If a consumer buys or builds a new dwelling that will become his/her principal dwelling within one year or upon the completion of construction, the new dwelling is considered the “principal dwelling” for purposes of applying the definition to a particular transaction. However, notwithstanding the general rule that a consumer can have only one principal dwelling at time, if the consumer acquires or constructs a new principal dwelling, any loan secured by the current principal dwelling is subject to the TILA/Regulation Z right of rescission.

- The prohibition does not apply to premiums or payments that are calculated and paid in full on a monthly basis.
- There is a limited exception for credit unemployment insurance where the premiums are reasonable, the creditor does not receive any direct or indirect compensation in connection with the premiums, the premiums are paid under “another insurance contract” (*i.e.*, presumably, an insurance contract sold outside the loan transaction), and the premiums are not paid to an affiliate of the creditor.
- Arbitration. It is impermissible to include an arbitration or other nonjudicial procedure clause in a residential mortgage loan or an open-end consumer credit that is secured by the principal dwelling of the consumer.
  - The prohibition applies to both residential mortgage transactions and open-end consumer credit that is secured by the principal dwelling of the consumer. Therefore, this prohibition applies to principal and nonprincipal dwellings for closed-end loans, but only principal dwellings for open-end loans. See discussion above regarding “principal dwellings.”
  - The prohibition does not preclude the consumer and creditor from agreeing to use arbitration or other nonjudicial procedure, after a dispute arises, to resolve the dispute.
  - Another provision states that no provision of a residential mortgage loan or an open-end consumer credit transaction that is secured by the principal dwelling shall be applied or interpreted to bar a consumer from bringing a legal action under § 130 of TILA or other provision of law for damages or other relief in connection with a violation of the arbitration provisions, any other provision of TILA, or any other federal law. While the intent of this provision is understandable, the statute also applies this prohibition to any “other agreement between the consumer and the creditor” relating to the loan. This would literally apply this prohibition to a settlement agreement under which the consumer agrees not to pursue a TILA or other federal claim in return for the payment of money. It is inconceivable that the provision was intended to be read in this manner, but it will be up to the courts to resolve the issue. Until that time, settlement agreements should be carefully drafted around this issue.
- Mortgages with Negative Amortization. While the statute does not outlaw negative amortization entirely, it will now be extremely burdensome to offer loans with a negative amortization feature.
  - The new restrictions apply to both closed-end and open-end loans that are secured by a dwelling or residential real property that includes a dwelling. This means that both principal dwellings and nonprincipal dwellings are covered. Reverse mortgages are exempt.
  - Before the transaction is consummated, the creditor must provide the consumer with a statement that: (i) the transaction may or will result in negative amortization; (ii) describes negative amortization in the manner required by the Board; (iii) negative amortization increases the outstanding principal balance of the loan; and (iv) negative amortization reduces the consumer’s equity in the security property.

This statement will be in addition to existing disclosures that must address negative amortization, including the ARM program disclosure and the Consumer Handbook on Adjustable-Rate Mortgages (“CHARM”) booklet required by 12 C.F.R. § 226.19(b) for closed-end loans and the program disclosure and Board’s home equity brochure required by 12 C.F.R. §§ 226.5b(d), (e) for open-end loans. It is possible, but by no means certain, that the Board regulations will allow the new statement to be combined with these other disclosures.
  - In the case of a first-time borrower with respect to a residential mortgage loan that is not a qualified mortgage (see discussion of Section 1411, above), the borrower must provide the creditor with documentation to demonstrate that he/she received homeownership counseling from an organization or counselor certified by HUD.

The reference to a loan that is not a qualified mortgage is unnecessary, since a qualified mortgage cannot, by definition, contain a negative amortization feature.

The term “first-time borrower” is not defined. While the term undoubtedly will include a consumer who has never had a mortgage loan before, it may also include a consumer who has not been a borrower on such a loan within a prescribed period of time (e.g., two years). It will be necessary for the Board to define this term in its implementing regulations.

Some state laws further limit or prohibit the making of loans with negative amortization features.

- Protection Against Loss of Anti-Deficiency Protections. This new subsection is designed to protect consumers who have residential mortgage loans that are subject to anti-deficiency protections. It contains two separate provisions:
  - Notice at the Time of Consummation. Before a residential mortgage loan that contains anti-deficiency protections is consummated, the creditor or mortgage originator must provide a written notice to the consumer that describes the protection provided by the anti-deficiency law and the significance of the loss of that protection.

This may be more difficult than it appears. In some instances, the availability of anti-deficiency protections will be fact-dependent (e.g., whether the property will be occupied by the consumer), and the creditor may not know with certainty whether the relevant facts will provide the consumer with anti-deficiency protections. In those instances, the prudent approach may be to err in favor of providing the notice.

In some states, a creditor never has the right to pursue a deficiency if it forecloses nonjudicially. The creditor may have a right to a deficiency if it forecloses judicially. Absent clarification to the contrary, the prudent approach would be to provide the notice in those states (even in states where the customary practice is to foreclose nonjudicially and lose the right to a deficiency).

The notice may be provided by either the creditor or mortgage originator. Presumably, the creditor will not wish to rely upon a third party mortgage originator (e.g., a mortgage broker) to provide the notice.

Because this provision applies to residential mortgage loans, and a residential mortgage loan can include a loan on a dwelling that is not real property (e.g., certain manufactured homes), it is necessary to consider the applicable state anti-deficiency laws that apply to both real property and nonreal property transactions.

Note that this provision does not apply to open-end credit transactions.

- Notice Before Refinancing that Would Cause Loss of Protection. If a creditor provides (or receives) an application to refinance a residential mortgage loan that is subject to protection under an anti-deficiency law, and this would cause the loan to lose that protection, the creditor or mortgage originator must provide a written notice to the consumer that describes the protection provided by the anti-deficiency law and the significance of the loss of that protection. The notice must be provided before the refinancing is consummated.

Once again, compliance may be problematic. Because the availability of anti-deficiency protections to the existing loan may be fact-dependent, the new creditor may not know whether the relevant facts provide the existing loan with anti-deficiency protections. In these instances, the prudent approach may be to err in favor of providing the notice.

As noted above, in some states a creditor never has the right to pursue a deficiency if it forecloses nonjudicially. If the new creditor would have the right to pursue a deficiency if it forecloses judicially, but would not have the right to pursue a deficiency if it forecloses nonjudicially, the prudent approach will be to provide the notice. This is so even if the new creditor's practice is to foreclose nonjudicially and lose the right to a deficiency, since the new creditor cannot predict how it or a subsequent servicer will conduct itself in the future.

Because this provision applies to residential mortgage loans, and a residential mortgage loan can include a loan on a dwelling that is not real property (e.g., certain manufactured homes), it is necessary to consider the applicable state anti-deficiency laws that apply to both real property and non-real property transactions.

Note that this provision does not apply where the existing loan is an open-end credit transaction.

- Policy Regarding the Acceptance of Partial Payment. New § 129C(h) of TILA requires a creditor to disclose prior to settlement (i) its policy regarding the acceptance of partial payments and (ii) if partial payments are accepted, how the payments will be applied to the mortgage and whether the payments will be escrowed. This same obligation is imposed on a "person becoming a creditor" with respect to an existing loan at the time the person becomes a creditor.

Compliance with this requirement should not be difficult for the original creditor, as it is simply one more disclosure to provide to the consumer. Given the possibility that the loan servicing will be transferred at some point during the lifetime of the loan, it would be advisable for the disclosure to note that possibility and the fact that any successor servicer may have a different policy regarding the handling of partial payments.

On its face, § 129C(h)'s imposition of this requirement on a "person becoming a creditor" with respect to an existing loan does not make sense. Technically, a "creditor" under TILA is the person to whom the residential mortgage loan is initially payable, which means that an assignee cannot become a creditor with respect to the existing loan. See § 103(f) of TILA and 12 C.F.R. § 226.2(a)(17)(i). However, it is acknowledged that Congress followed a similar approach in 2009 when § 131(g) was added to TILA to require the "new creditor" holding a mortgage loan to provide a notice to the consumer. The Board recognized the inappropriateness of using the term "creditor" and decided to construe "new creditor" to mean "the owner of the debt following the sale, transfer or assignment, without regard to whether that party would be a "creditor" for other purposes under TILA or Regulation Z." See 74 Fed. Reg. 60,145 (Nov. 20, 2009). The interim rule that implements § 131(g) refers to such person as a "covered person." See 12 C.F.R. § 226.39(a)(1). Presumably, the Board will similarly ignore Congress's misuse of the term "creditor" in § 129C(h). Logically, the Board should construe that term to mean a successor servicer rather than a successor owner of the loan since the servicer's policies should dictate how partial payments are applied. Assuming this is the case, the challenge for the successor servicer will be the timing of the new notice. Section 129C(h) states that the notice must be provided "at the time" that the successor becomes the new creditor. In contrast, the Notice of Assignment, Sale, or Transfer of Servicing Rights mandated for mortgage servicing loans under RESPA and Regulation X must be provided within 15 days after the effective date of the transfer of the servicing or, if a combined notice is provided with the transfer of the servicing (which frequently happens), at least 15 days before the effective date of the transfer of the servicing. See 24 C.F.R. § 3500.21(d)(2). Most likely, the successor servicer under § 129C(h) will also wish to provide the new notice at the same time it provides the RESPA notice, assuming that the RESPA notice is provided at least 15 days before the effective date of the transfer of the servicing. Presumably, providing the § 129C(h) notice earlier than required will be compliant, although this will have to await the Board's implementing regulations. If the § 129C(h) notice is provided with the RESPA notice, note that the standard RESPA form in Appendix MS-2 to Regulation X may not be substantially altered. See 24 C.F.R. § 3500.21(d)(4). This suggests that the § 129C(h) notice may be provided in the same envelope as the RESPA notice, but may not be added to the RESPA notice itself. Finally, note that the RESPA notice is limited to "mortgage servicing loans," a term that is not co-extensive with TILA's "residential mortgage loans." For example, a mortgage servicing loan is limited to

first lien loans while a residential mortgage loan includes subordinate lien loans. Accordingly, in some instances it will be necessary to provide the new § 129C(h) notice even where the RESPA notice is not required.

Section 129F of TILA, which is added by Section 1464 of the Dodd-Frank Act, generally states that a payment on a consumer credit transaction secured by the consumer's principal dwelling must be credited as of the date of receipt, except when the delay in crediting does not result in any charge to the consumer or in a negative report to a consumer reporting agency. When partial payments are made, they must be credited in accordance with § 129F. Section 129F will be discussed in more detail in our mortgage servicing user guide.

## Section 1415. Rule of Construction

Except as otherwise expressly provided in section 129B or 129C of the Truth in Lending Act (as added by this title), no provision of such section 129B or 129C shall be construed as superseding, repealing, or affecting any duty, right, obligation, privilege, or remedy of any person under any other provision of the Truth in Lending Act or any other provision of Federal or State law.

**Analysis.** Section 1415 of the Dodd-Frank Act states the obvious: The enactment of new §§ 129B and 129C of TILA do not supersede any existing provisions of TILA or other federal or state law, except as otherwise expressly provided.

## Section 1416. Amendments to Civil Liability Provisions

(a) Increase in Amount of Civil Money Penalties for Certain Violations—Section 130(a) of the Truth in Lending Act (15 U.S.C. 1640(a)) is amended—

(1) in paragraph (2)(A)(ii)—

(A) by striking '\$100' and inserting '\$200'; and

(B) by striking '\$1,000' and inserting '\$2,000';

(2) in paragraph (2)(B), by striking '\$500,000' and inserting '\$1,000,000'; and

(3) in paragraph (4), by inserting ', paragraph (1) or (2) of section 129B(c), or section 129C(a)' after 'section 129'.

(b) Statute of Limitations Extended for Section 129 Violations—Section 130(e) of the Truth in Lending Act (15 U.S.C. 1640(e)) is amended—

(1) in the first sentence, by striking 'Any action' and inserting 'Except as provided in the subsequent sentence, any action'; and

(2) by inserting after the first sentence the following new sentence: 'Any action under this section with respect to any violation of section 129, 129B, or 129C may be brought in any United States district court, or in any other court of competent jurisdiction, before the end of the 3-year period beginning on the date of the occurrence of the violation.'

**Analysis.** Section 1416 of the Dodd-Frank Act significantly increases the exposure for civil liability under TILA.

- In an individual action with respect to a consumer lease, the minimum recovery for statutory damages is increased from \$100 to \$200, and the maximum recovery is increased from \$1,000 to \$2,000.
- In a class action, the maximum recovery for statutory damages is increased from \$500,000 to \$1,000,000 (or 1% of the creditor's net worth, whichever is less).
- The special liability provisions for a violation of § 129 of TILA (high-cost loans) now also apply to violations of § 129B(c)(1) and (2) (prohibition on steering incentives) and § 129C(a) (ability to repay requirement). Liability for any of these violations creates civil liability equal to all finance charges and fees paid by the consumer, unless the creditor demonstrates that the failure to comply was not material.
- The statute of limitations for violations of § 129 (high-cost loans), § 129B(c)(1) and (2) (prohibition on steering incentives) and § 129C(a) (ability to repay requirement) of TILA has been increased from one year to three years.

The hefty liability for a violation of § 129C(a) (ability to repay requirement) provides further incentive for the market to require creditors to originate qualified mortgages in accordance with § 129C(b).

### Section 1417. Lender Rights in the Context of Borrower Deception

Section 130 of the Truth in Lending Act (15 U.S.C. 1640) is amended by adding after subsection (k) (as added by this title) the following new subsection:

“(l) Exemption From Liability and Rescission in Case of Borrower Fraud or Deception—In addition to any other remedy available by law or contract, no creditor or assignee shall be liable to an obligor under this section, if such obligor, or co-obligor has been convicted of obtaining by actual fraud such residential mortgage loan.”

**Analysis.** Section 1417 of the Dodd-Frank Act adds a new § 130(l) to TILA that provides a legal defense to civil and rescission liability where the obligor or co-obligor has been convicted of obtaining a residential mortgage loan by actual fraud. The defense may be used by the creditor or an assignee.

- In practice, it will be very difficult to use new § 130(l) as a defense. Very few consumers are convicted of actual fraud in their obtaining of residential mortgage loans. If the borrower’s mortgage broker or other person is convicted of actual fraud, but the consumer him/herself has not been so convicted, the creditor will not be able to use this defense.
- To use the new § 130(l) defense, the actual fraud must relate to the consumer’s obtaining of the loan itself, not to other types of fraud.
- If the new § 130(l) defense can successfully be used against the proposed class representative in a TILA class action, this should provide a sufficient basis to disqualify that person from serving as the class representative. However, this will not preclude the lawyer bringing the action from finding a new class representative. In practice, it is unlikely that new § 130(l) will discourage the bringing of many TILA actions.
- Note that the new § 130(l) defense is limited to residential mortgage loans. It does not apply to open-end loans.

### Section 1418. Six-Month Notice Required Before Reset of Hybrid Adjustable Rate Mortgages

(a) In General—Chapter 2 of the Truth in Lending Act (15 U.S.C. 1631 et seq.) is amended by inserting after section 128 the following new section:

“Sec. 128A. Reset of hybrid adjustable rate mortgages

“(a) Hybrid Adjustable Rate Mortgages Defined—For purposes of this section, the term ‘hybrid adjustable rate mortgage’ means a consumer credit transaction secured by the consumer’s principal residence with a fixed interest rate for an introductory period that adjusts or resets to a variable interest rate after such period.

“(b) Notice of Reset and Alternatives—During the 1-month period that ends 6 months before the date on which the interest rate in effect during the introductory period of a hybrid adjustable rate mortgage adjusts or resets to a variable interest rate or, in the case of such an adjustment or resetting that occurs within the first 6 months after consummation of such loan, at consummation, the creditor or servicer of such loan shall provide a written notice, separate and distinct from all other correspondence to the consumer, that includes the following:

- “(1) Any index or formula used in making adjustments to or resetting the interest rate and a source of information about the index or formula.
- “(2) An explanation of how the new interest rate and payment would be determined, including an explanation of how the index was adjusted, such as by the addition of a margin.
- “(3) A good faith estimate, based on accepted industry standards, of the creditor or servicer of the amount of the monthly payment that will apply after the date of the adjustment or reset, and the assumptions on which this estimate is based.
- “(4) A list of alternatives consumers may pursue before the date of adjustment or reset, and descriptions of the actions consumers must take to pursue these alternatives, including—
  - “(A) refinancing;
  - “(B) renegotiation of loan terms;
  - “(C) payment forbearances; and

(D) pre-foreclosure sales.

(5) The names, addresses, telephone numbers, and Internet addresses of counseling agencies or programs reasonably available to the consumer that have been certified or approved and made publicly available by the Secretary of Housing and Urban Development or a State housing finance authority (as defined in section 1301 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989).

(6) The address, telephone number, and Internet address for the State housing finance authority (as so defined) for the State in which the consumer resides.

(c) Savings Clause—The Board may require the notice in paragraph (b) or other notice consistent with this Act for adjustable rate mortgage loans that are not hybrid adjustable rate mortgage loans.

(b) Clerical Amendment—The table of sections for chapter 2 of the Truth in Lending Act is amended by inserting after the item relating to section 128 the following new item:

128A. Reset of hybrid adjustable rate mortgages.

**Analysis.** Section 1418 of the Dodd-Frank Act adds a new § 128A to TILA to require an advance notice before a hybrid adjustable rate mortgage's initial interest rate is first adjusted. This is Congress's response to the perceived problems associated with the "payment shock" experienced by some borrowers when the interest rates of their 2/28 or 3/27 ARMs adjusted for the first time.

- Hybrid Adjustable Rate Mortgages Defined. For purposes of § 128A, a "hybrid adjustable rate mortgage" means a consumer credit transaction secured by the consumer's principal residence, which contains a fixed interest rate for an introductory period that adjusts or resets to a variable interest rate after the conclusion of that period.

The term "hybrid adjustable rate mortgage" is limited to loans secured by the consumer's "principal residence," a term that is not defined. The Board will likely interpret the term "residence" to mean a "dwelling," which is defined at 12 C.F.R. § 226.2(a)(19) to mean a residential structure that contains 1-4 units, whether or not the structure is attached to real property. Examples include condominium units, cooperative units, mobile homes, and trailers or boats used as residences. The Board is likely to apply its existing Regulation Z Commentary provisions regarding when a dwelling is a "principal" dwelling in this context as well. See discussion under Section 1414, above.

Although the conventional use of the term "hybrid ARM" would be limited to closed-end loans, the term "hybrid adjustable rate mortgage" is defined broadly enough in § 128A that it would apply to both closed-end credit and open-end credit. Absent a clarification in the final regulations, it will be necessary to provide the new notice to any open-end credit secured by the consumer's principal dwelling that involves a fixed interest rate for an introductory period followed by an adjustable rate.

The term "hybrid adjustable rate mortgage" is also broad enough to cover many ordinary ARMs that ordinarily would not be thought of as hybrid ARMs. Many ordinary ARMs have a fixed interest rate for an introductory period, after which the interest rate adjusts periodically. The initial fixed interest rate is set based on market conditions at the time, and typically is not equal to the fully-indexed rate. These loans would technically fall within the definition of a "hybrid adjustable rate mortgage" and, once again, it will be necessary to provide the new notice absent clarification in the final regulations to the contrary.

- Notice of Reset and Alternatives.
  - Timing of the Notice. The creditor or servicer must provide the notice during the one-month period that ends six months before the date on which the introductory interest rate first adjusts.

If the first adjustment date falls within the first six months after the consummation of the loan, the creditor or servicer must provide the notice at consummation. For most creditors, "consummation" occurs when the note and mortgage documents are signed (see 12 C.F.R. § 226.2(a)(13)), which means that, for these loans, the § 128A notice would have to be provided at that time.

- Content of the Notice. The new notice must include the following:
  - Any index or formula used to make the rate adjustment, together with a source of information about the index or formula.
  - An explanation of how the new rate and payment will be determined, including an explanation of how the index will be adjusted (*e.g.*, by adding a margin, subject to any rounding and rate caps).
  - A good faith estimate of the creditor or servicer of the amount of the monthly payment that will apply after the adjustment, and the assumptions on which the estimate is based. The estimate is to be provided based on “accepted industry standards.” For example, this will include an assumption that the consumer will make all payments in full when due. More problematic will be the estimate of the new interest rate. When adjusting interest rates, most adjustable rate mortgages use an index value that is 0, 30 or 45 days prior to the interest rate adjustment date, and this will be well after the six-month notice that must be provided under § 128A. Most likely, “accepted industry standards” will justify using the index value in effect at the time of the giving of the § 128A notice, although this should be fully explained in the notice.
  - A list of alternatives that the consumer may pursue before the adjustment date, and a description of the actions the consumer must take to pursue those alternatives. The alternatives listed in the statute include refinancing, renegotiation of loan terms, payment forbearances, and pre-foreclosure sales.

Note that nothing in § 128A requires the creditor or servicer to actually offer any of these alternatives to the consumer. The § 128A notice should clearly state which alternatives are being offered and which are not.

- The names, addresses, phone numbers, and Internet addresses of counseling agencies or programs that are reasonably available to the consumer. The counseling agencies must be certified or approved and made publicly available by HUD or a qualifying state housing finance agency.
  - The address, phone number and Internet address for such state housing finance authority for the state in which the consumer resides.
- Other Issues. Please note:
    - The provision of the § 128A notice does not obviate the need to send a timely ARM adjustment notice under 12 C.F.R. § 226.20(c), monthly statement under new § 128(f) of TILA (added by Section 1420, discussed below), or the periodic statement required by 12 C.F.R. § 226.7.
    - The Board is authorized, but not required, to require the same or other notice for ARMs that do not qualify as “hybrid adjustable rate mortgages.”

## Section 1419. Required Disclosures

Section 128(a) of Truth in Lending Act (15 U.S.C. 1638(a)) is amended by adding at the end the following new paragraphs:

<sup>(16)</sup> In the case of a variable rate residential mortgage loan for which an escrow or impound account will be established for the payment of all applicable taxes, insurance, and assessments—

<sup>(A)</sup> the amount of initial monthly payment due under the loan for the payment of principal and interest, and the amount of such initial monthly payment including the monthly payment deposited in the account for the payment of all applicable taxes, insurance, and assessments; and

(B) the amount of the fully indexed monthly payment due under the loan for the payment of principal and interest, and the amount of such fully indexed monthly payment including the monthly payment deposited in the account for the payment of all applicable taxes, insurance, and assessments.

(17) In the case of a residential mortgage loan, the aggregate amount of settlement charges for all settlement services provided in connection with the loan, the amount of charges that are included in the loan and the amount of such charges the borrower must pay at closing, the approximate amount of the wholesale rate of funds in connection with the loan, and the aggregate amount of other fees or required payments in connection with the loan.

(18) In the case of a residential mortgage loan, the aggregate amount of fees paid to the mortgage originator in connection with the loan, the amount of such fees paid directly by the consumer, and any additional amount received by the originator from the creditor.

(19) In the case of a residential mortgage loan, the total amount of interest that the consumer will pay over the life of the loan as a percentage of the principal of the loan. Such amount shall be computed assuming the consumer makes each monthly payment in full and on-time, and does not make any over-payments.'

**Analysis.** Section 1419 of the Dodd-Frank Act amends § 128(a) of TILA to add a multitude of new disclosures for closed-end residential mortgage loans, as follows:

- **ARMs with Escrows.** If a residential mortgage loan has a variable rate and an escrow account will be established for all taxes, insurance and assessments, then the Regulation Z disclosure statement must disclose: (i) the initial monthly payment of principal and interest only; (ii) the initial monthly payment of principal, interest, and all taxes, insurance and assessments; (iii) the fully-indexed monthly payment of principal and interest only; and (iv) the fully-indexed monthly payment of principal, interest, and all taxes, insurance and assessments.
  - The term “fully-indexed monthly payment” is not defined, but presumably means the monthly payment at the fully-indexed interest rate.
  - This new disclosure is a marked change from the current rule, which gives creditors the right, but not the obligation, to provide a loan repayment schedule that includes escrow amounts. See Paragraph 226.18(g)-1 of the Regulation Z Commentary. Moreover, the new disclosure is also different in that it requires a payment that includes “interest” while the current rule requires a payment schedule that “reflects all components of the finance charge.” *Id.* Thus, the new disclosure would not include mortgage insurance premiums in the principal and interest payment while the current rule mandates the inclusion of mortgage insurance premiums. Absent a clarification in the Board’s implementing regulations, this is likely to be highly confusing for the consumer.
  - The creditor continues to be obligated to provide the more detailed escrow account disclosures required by RESPA and Regulation X. See 24 C.F.R. § 3500.17.
  - The requirements of § 128(a) as added by § 1419 appear to be inconsistent with the requirements of § 128(b)(4), which is added by Section 1465 of the Dodd-Frank Act. Section 128(b)(4) as added by § 1465 states that when disclosing the payment schedule required by § 128(a) for any consumer credit transaction secured by a first lien on a principal dwelling (excluding open-end credit plans and reverse mortgages) for which an escrow account is required, that payment schedule shall take into account the amount of the periodic escrow payments for the loan. In contrast, § 128(a) as added by § 1419, which applies to ARMs with escrow accounts, requires the disclosure of both initial and fully-indexed payment schedules with, and without, the escrows. Further, § 128(b)(4) as added by § 1465 provides more details regarding the escrow payments, stating that the escrow payments are to be calculated in accordance with § 10(a)(2) of RESPA. The escrow payments are to be based on the taxable assessed value of the security real property, including the value of any improvements on the property or to be constructed (and whether or not the improvements are to be financed by the loan in question) and the replacement costs of the property for hazard insurance in the initial year after the transaction. The Board will need to sort out the differences between § 1419 and § 1465 when issuing its regulations.

- Settlement Charges. The Regulation Z disclosure statement must disclose the aggregate amount of “settlement charges for all settlement services” provided in connection with the loan, the amount of charges that are included in the loan, the amount of charges that the consumer must pay at closing, the approximate amount of the “wholesale rate of funds” in connection with the loan, and the aggregate amount of other fees or required payments in connection with the loan.
  - This ambiguous new disclosure will need to be sorted out by the Board in its implementing regulations. It is likely that “settlement charges” and “settlement services” will be defined by reference to the way those terms are used in RESPA and Regulation X. If this approach is followed, the settlement charges should be equal to the sum listed in Line 1400 of the HUD-1 or HUD-1A settlement statement, although any amounts paid outside of closing (“P.O.C.”) presumably will need to be added to that sum. It is unclear whether this new disclosure includes all settlement charges paid by either the seller or the buyer (in a purchase transaction), but it is likely that only those charges paid by the buyer/consumer are covered.
  - There will be a further challenge in meeting the timing requirements of Regulation Z. While the “early” Regulation Z disclosure need only include a “good faith estimate” of the relevant items, the final Regulation Z disclosure is expected to be accurate. This disclosure must be provided to the consumer before the consummation of the loan, which typically occurs when the note and mortgage documents are signed. This may predate the loan closing by several days, yet it is not until closing occurs that the settlement statement is typically delivered and all settlement costs are known. (For loans closing in California and other states where the borrower or his/her agent do not attend the closing or where the settlement agent does not conduct a meeting of the parties to effect the closing, the settlement statement need only be mailed or delivered “as soon as practicable after settlement.” See 24 C.F.R. § 3500.10(d).) Presumably, the creditor will need to prepare the final Regulation Z disclosure on the basis of the best information available, using the Regulation Z estimates rule at 12 C.F.R. § 226.17(c).
  - The disclosure of the “wholesale rate of funds” is a new and uncertain concept. It is unclear whether that creditor must include its own cost of funds or the cost of funds experienced by the broader industry (e.g., by reference to a national rate such as one of those listed in Federal Reserve Statistical Release H.15). The Board will need to clarify this in its implementing regulations.
  - There is also uncertainty regarding the new disclosure of “the aggregate amount of other fees or required payments in connection with the loan.” The Board may or may not conclude that the current disclosure of the “total of payments” (see 12 C.F.R. § 226.18(h)) will be sufficient.
- Mortgage Originator Fees. The Regulation Z disclosure must include the aggregate amount of fees paid to the mortgage originator, the amount of fees paid to the mortgage originator by the consumer, and the amount of fees paid by the creditor to the mortgage originator.
  - It will be challenging to comply with this requirement because the creditor will not have independent knowledge of the amount of fees paid directly by the consumer to the mortgage originator. It will be necessary to get this information from the consumer and/or mortgage originator, and it would be advisable to have the person confirm that information in writing.
  - In general, it will not be difficult to comply with this requirement in the case of a creditor’s payments to a mortgage originator who is a mortgage broker because a discrete amount is typically paid to the mortgage broker for each loan, which amount is disclosed in the HUD-1 or HUD-1A. It will be much more difficult to comply with this requirement in the case of a creditor’s payments to a mortgage originator who is a loan officer of the creditor. What should be included in this disclosure – the loan officer’s payment for the loan in question? A portion of his/her base salary? A portion of the value of other benefits he/she receives? Something else? The most workable approach would look solely to the

amount paid to the loan officer for the loan in question, but the resolution of this issue will depend upon the Board's implementing regulations.

- Some creditors may pay loan originators additional amounts based upon the number of loans they close in a particular period of time. See discussion at Section 1403, above. Should these amounts be included in the disclosure of the amounts paid by the creditor? Since these amounts are not directly tied to a particular loan, and the amounts cannot be determined with any specificity until the end of the relevant measurement period, the most workable approach would be to ignore these payments for purposes of the new statute. Again, the resolution of this issue will depend upon the Board's implementing regulations.
- Interest Paid as a Percentage of Principal. The Regulation Z disclosure must disclose the total amount of interest that the consumer will pay over the scheduled life of the loan as a percentage of the principal of the loan. This calculation will assume all of the scheduled payments are made in the exact amount due and on time.

This calculation will be more easily accomplished in the case of a fixed rate loan. In the case of an ARM, the logical approach would be to make the calculation on the basis of the payment schedule contained in the Regulation Z disclosure, although the Board regulations will need to confirm this.

There is a further ambiguity regarding what will be treated as "interest" for purposes of this disclosure. While regular periodic interest will clearly be included, it is uncertain whether the calculation should include origination fees, discount points, and other items that may be "interest" for other purposes. It was because of this very uncertainty that TILA and Regulation Z developed the concept of a "finance charge" (which generally includes all amounts directly or indirectly paid by the consumer as an incident to or a condition of credit), but Congress has now required a new disclosure that will require the Board to provide clarification.

The new disclosure will ordinarily be lower than the APR shown on the Regulation Z disclosure, and this is likely to be confusing to the consumer.

## Section 1420. Disclosures Required in Monthly Statements for Residential Mortgage Loans

Section 128 of the Truth in Lending Act (15 U.S.C. 1638) is amended by adding at the end the following new subsection:

(f) Periodic Statements for Residential Mortgage Loans—

(1) IN GENERAL—The creditor, assignee, or servicer with respect to any residential mortgage loan shall transmit to the obligor, for each billing cycle, a statement setting forth each of the following items, to the extent applicable, in a conspicuous and prominent manner:

(A) The amount of the principal obligation under the mortgage.

(B) The current interest rate in effect for the loan.

(C) The date on which the interest rate may next reset or adjust.

(D) The amount of any prepayment fee to be charged, if any.

(E) A description of any late payment fees.

(F) A telephone number and electronic mail address that may be used by the obligor to obtain information regarding the mortgage.

(G) The names, addresses, telephone numbers, and Internet addresses of counseling agencies or programs reasonably available to the consumer that have been certified or approved and made publicly available by the Secretary of Housing and Urban Development or a State housing finance authority (as defined in section 1301 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989).

(H) Such other information as the Board may prescribe in regulations.

(2) DEVELOPMENT AND USE OF STANDARD FORM—The Board shall develop and prescribe a standard form for the disclosure required under this subsection, taking into account that the statements required may be transmitted in writing or electronically.

(3) EXCEPTION—Paragraph (1) shall not apply to any fixed rate residential mortgage loan where the creditor, assignee, or servicer provides the obligor with a coupon book that provides the obligor with substantially the same information as required in paragraph (1).

**Analysis.** Section 1420 of the Dodd-Frank Act adds a new § 128(f) to TILA to require the creditor, assignee, or servicer of a residential mortgage loan to provide statements for each billing cycle. This is a new requirement. Historical Note: Regulation Z, as it existed prior to the Truth in Lending Simplification Act, did regulate the content of periodic statements for closed-end loans if the creditor chose to provide them. See old 12 C.F.R. § 226.8(n).

- In General. The information must be disclosed in a “conspicuous and prominent” manner. This will probably require more than the “clear and conspicuous” standard required generally for closed-end disclosures (see 12 C.F.R. § 226.17(a)(1) and Paragraph 226.17(a)(1)-1 of the Regulation Z Commentary).
- Content of the Periodic Statements. The periodic statements must include the following information, to the extent applicable.
  - The amount of the principal obligation under the loan.
  - The current interest rate.
  - The date on which the interest rate may next adjust.
  - The amount of any prepayment fee.
  - A description of any late payment fee.
  - A phone number and e-mail address that the consumer may use to obtain information about the loan.
  - The names, addresses, phone numbers, and Internet addresses of counseling agencies or programs reasonably available that have been certified or approved and made publicly available by HUD or certain qualified state housing finance authorities.
  - Other information required by the Board’s regulations. This might include information such as the amount of the monthly payment due, the amount of any escrows due, and the duration of any grace period for the imposition of a late fee.

The new disclosure will be in addition to the variable rate adjustment notice that is required by 12 C.F.R. § 226.20(c) and Paragraph 226.20(c) of the Regulation Z Commentary for ARMs.

- Development and Use of Standard Form. The statute directs the Board to develop and prescribe a standard form for the new disclosure, taking into consideration that the disclosure may be sent in writing or electronically. The statute does not state that use of the standard form will be mandatory, but it is likely that use of the standard form will provide a “safe harbor” for compliance with the statute and implementing regulation.
- Exception. No periodic statement is required if the loan is a fixed rate loan where the consumer is provided with a coupon book that provides substantially the same information as required for the periodic statements. Presumably, the coupon book will be permitted to provide principal balance and other information based on the assumption that the loan payments will be paid in the exact amount due and when due. If not, it would be difficult to see how a coupon book approach could work.

## Section 1421. Report by the GAO

(a) Report Required—The Comptroller General of the United States shall conduct a study to determine the effects the enactment of this Act will have on the availability and affordability of credit for consumers, small businesses, homebuyers, and mortgage lending, including the effect—

- (1) on the mortgage market for mortgages that are not within the safe harbor provided in the amendments made by this subtitle;
- (2) on the ability of prospective homebuyers to obtain financing;

- (3) on the ability of homeowners facing resets or adjustments to refinance—for example, do they have fewer refinancing options due to the unavailability of certain loan products that were available before the enactment of this Act;
- (4) on minorities' ability to access affordable credit compared with other prospective borrowers;
- (5) on home sales and construction;
- (6) of extending the rescission right, if any, on adjustable rate loans and its impact on litigation;
- (7) of State foreclosure laws and, if any, an investor's ability to transfer a property after foreclosure;
- (8) of expanding the existing provisions of the Home Ownership and Equity Protection Act of 1994;
- (9) of prohibiting prepayment penalties on high-cost mortgages; and
- (10) of establishing counseling services under the Department of Housing and Urban Development and offered through the Office of Housing Counseling.

(b) Report—Before the end of the 1-year period beginning on the date of the enactment of this Act, the Comptroller General shall submit a report to the Congress containing the findings and conclusions of the Comptroller General with respect to the study conducted pursuant to subsection (a).

(c) Examination Related to Certain Credit Risk Retention Provisions—The report required by subsection (b) shall also include an analysis by the Comptroller General of the effect on the capital reserves and funding of lenders of credit risk retention provisions for non-qualified mortgages, including an analysis of the exceptions and adjustments authorized in section 129C(b)(3) of the Truth in Lending Act and a recommendation on whether a uniform standard is needed.

(d) Analysis of Credit Risk Retention Provisions—The report required by subsection (b) shall also include—

- (1) an analysis by the Comptroller General of whether the credit risk retention provisions have significantly reduced risks to the larger credit market of the repackaging and selling of securitized loans on a secondary market; and
- (2) recommendations to the Congress on adjustments that should be made, or additional measures that should be undertaken.

**Analysis.** The GAO is directed to conduct a study of the effect of Title XIV of the Dodd-Frank Act on the availability and affordability of credit for consumers, small businesses, homebuyers, and mortgage lending. Among other things, the GAO is to analyze the effect on capital and reserves of the credit risk retention provisions of non-qualified mortgages, an issue that is addressed by Section 941 of the Dodd-Frank Act. The GAO also is to study whether the risk retention provisions have significantly reduced risks to the larger credit market of the repackaging and selling of securitized loans on the secondary market and any related recommendations. The GAO's report is to be submitted to Congress before the one-year anniversary date of enactment of the Dodd-Frank Act.

## Section 1422. State Attorney General Enforcement Authority

Section 130(e) of the Truth in Lending Act (15 U.S.C. 1640(e)) is amended by striking 'section 129 may also' and inserting 'section 129, 129B, 129C, 129D, 129E, 129F, 129G, or 129H of this Act may also'.

**Analysis.** Section 130(e) of TILA currently authorizes the state attorneys general to bring actions under § 129 (high-cost mortgages) within three years of the date of the violation. Section 1422 of the Dodd-Frank Act amends § 130(e) to allow the state attorneys general to also bring actions within the three-year period under § 129B (steering prohibitions), § 129C (ability to repay requirements), § 129D (minimum standards for residential mortgage loans), § 129E (appraisal independence requirements), § 129F (requirements for prompt crediting of home loan payments), § 129G (requests for payoff amounts of home loan), and § 129H (property appraisal requirements) of TILA.

## Subtitle C – High-Cost Mortgages

### Section 1431. Definitions Relating to High-Cost Mortgages

(a) High-cost Mortgage Defined—Section 103(aa) of the Truth in Lending Act (15 U.S.C. 1602(aa)) is amended by striking all that precedes paragraph (2) and inserting the following:

(aa) High-cost Mortgage—

(1) DEFINITION—

(A) IN GENERAL—The term 'high-cost mortgage', and a mortgage referred to in this subsection, means a consumer credit transaction that is secured by the consumer's principal dwelling, other than a reverse mortgage transaction, if—

“(i) in the case of a credit transaction secured—

“(I) by a first mortgage on the consumer’s principal dwelling, the annual percentage rate at consummation of the transaction will exceed by more than 6.5 percentage points (8.5 percentage points, if the dwelling is personal property and the transaction is for less than \$50,000) the average prime offer rate, as defined in section 129C(b)(2)(B), for a comparable transaction; or

“(II) by a subordinate or junior mortgage on the consumer’s principal dwelling, the annual percentage rate at consummation of the transaction will exceed by more than 8.5 percentage points the average prime offer rate, as defined in section 129C(b)(2)(B), for a comparable transaction;

“(ii) the total points and fees payable in connection with the transaction, other than bona fide third party charges not retained by the mortgage originator, creditor, or an affiliate of the creditor or mortgage originator, exceed—

“(I) in the case of a transaction for \$20,000 or more, 5 percent of the total transaction amount; or

“(II) in the case of a transaction for less than \$20,000, the lesser of 8 percent of the total transaction amount or \$1,000 (or such other dollar amount as the Board shall prescribe by regulation); or

“(iii) the credit transaction documents permit the creditor to charge or collect prepayment fees or penalties more than 36 months after the transaction closing or such fees or penalties exceed, in the aggregate, more than 2 percent of the amount prepaid.

“(B) INTRODUCTORY RATES TAKEN INTO ACCOUNT—For purposes of subparagraph (A)(i), the annual percentage rate of interest shall be determined based on the following interest rate:

“(i) In the case of a fixed-rate transaction in which the annual percentage rate will not vary during the term of the loan, the interest rate in effect on the date of consummation of the transaction.

“(ii) In the case of a transaction in which the rate of interest varies solely in accordance with an index, the interest rate determined by adding the index rate in effect on the date of consummation of the transaction to the maximum margin permitted at any time during the loan agreement.

“(iii) In the case of any other transaction in which the rate may vary at any time during the term of the loan for any reason, the interest charged on the transaction at the maximum rate that may be charged during the term of the loan.

“(C) MORTGAGE INSURANCE—For the purposes of computing the total points and fees under paragraph (4), the total points and fees shall exclude—

“(i) any premium provided by an agency of the Federal Government or an agency of a State;

“(ii) any amount that is not in excess of the amount payable under policies in effect at the time of origination under section 203(c)(2)(A) of the National Housing Act (12 U.S.C. 1709(c)(2)(A)), provided that the premium, charge, or fee is required to be refundable on a pro-rated basis and the refund is automatically issued upon notification of the satisfaction of the underlying mortgage loan; and

“(iii) any premium paid by the consumer after closing.’.

(b) Adjustment of Percentage Points—Section 103(aa)(2) of the Truth in Lending Act (15 U.S.C. 1602(aa)(2)) is amended by striking subparagraph (B) and inserting the following new subparagraph:

“(B) An increase or decrease under subparagraph (A)—

“(i) may not result in the number of percentage points referred to in paragraph (1)(A)(i)(I) being less than 6 percentage points or greater than 10 percentage points; and

“(ii) may not result in the number of percentage points referred to in paragraph (1)(A)(i)(II) being less than 8 percentage points or greater than 12 percentage points.’.

(c) Points and Fees Defined—

(1) IN GENERAL—Section 103(aa)(4) of the Truth in Lending Act (15 U.S.C. 1602(aa)(4)) is amended—

(A) by striking subparagraph (B) and inserting the following:

“(B) all compensation paid directly or indirectly by a consumer or creditor to a mortgage originator from any source, including a mortgage originator that is also the creditor in a table-funded transaction;”;

(B) by redesignating subparagraph (D) as subparagraph (G); and

(C) by inserting after subparagraph (C) the following new subparagraphs:

“(D) premiums or other charges payable at or before closing for any credit life, credit disability, credit unemployment, or credit property insurance, or any other accident, loss-of-income, life or health insurance, or any payments directly or indirectly for any

debt cancellation or suspension agreement or contract, except that insurance premiums or debt cancellation or suspension fees calculated and paid in full on a monthly basis shall not be considered financed by the creditor;

(E) the maximum prepayment fees and penalties which may be charged or collected under the terms of the credit transaction;

(F) all prepayment fees or penalties that are incurred by the consumer if the loan refinances a previous loan made or currently held by the same creditor or an affiliate of the creditor; and

(2) CALCULATION OF POINTS AND FEES FOR OPEN-END CONSUMER CREDIT PLANS—Section 103(aa) of the Truth in Lending Act (15 U.S.C. 1602(aa)) is amended—

(A) by redesignating paragraph (5) as paragraph (6); and

(B) by inserting after paragraph (4) the following new paragraph:

(5) CALCULATION OF POINTS AND FEES FOR OPEN-END CONSUMER CREDIT PLANS—In the case of open-end consumer credit plans, points and fees shall be calculated, for purposes of this section and section 129, by adding the total points and fees known at or before closing, including the maximum prepayment penalties which may be charged or collected under the terms of the credit transaction, plus the minimum additional fees the consumer would be required to pay to draw down an amount equal to the total credit line.

(d) Bona Fide Discount Loan Discount Points—Section 103 of the Truth in Lending Act (15 U.S.C. 1602) is amended by inserting after subsection (cc) (as added by section 1401) the following new subsection:

(dd) Bona Fide Discount Points and Prepayment Penalties—For the purposes of determining the amount of points and fees for purposes of subsection (aa), either the amounts described in paragraph (1) or (2) of the following paragraphs, but not both, shall be excluded:

(1) Up to and including 2 bona fide discount points payable by the consumer in connection with the mortgage, but only if the interest rate from which the mortgage's interest rate will be discounted does not exceed by more than 1 percentage point—

(A) the average prime offer rate, as defined in section 129C; or

(B) if secured by a personal property loan, the average rate on a loan in connection with which insurance is provided under title I of the National Housing Act (12 U.S.C. 1702 et seq.).

(2) Unless 2 bona fide discount points have been excluded under paragraph (1), up to and including 1 bona fide discount point payable by the consumer in connection with the mortgage, but only if the interest rate from which the mortgage's interest rate will be discounted does not exceed by more than 2 percentage points—

(A) the average prime offer rate, as defined in section 129C; or

(B) if secured by a personal property loan, the average rate on a loan in connection with which insurance is provided under title I of the National Housing Act (12 U.S.C. 1702 et seq.).

(3) For purposes of paragraph (1), the term "bona fide discount points" means loan discount points which are knowingly paid by the consumer for the purpose of reducing, and which in fact result in a bona fide reduction of, the interest rate or time-price differential applicable to the mortgage.

(4) Paragraphs (1) and (2) shall not apply to discount points used to purchase an interest rate reduction unless the amount of the interest rate reduction purchased is reasonably consistent with established industry norms and practices for secondary mortgage market transactions.

**Analysis.** High-cost loans (also known as "high-cost, high-fee," "HOEPA" or "Section 32" loans) became part of the TILA landscape in 1994. Subtitle C makes significant changes to the high-cost mortgage provisions of TILA, many of which will now be similar to those found in the various state high-cost loan laws. With these amendments, the secondary market will be even more reluctant to purchase high-cost mortgages and creditors will be even more reluctant to make those loans.

- **High-Cost Mortgage Defined.** The term "high-cost mortgage" is defined to mean a consumer credit transaction that is secured by the consumer's principal dwelling and that meets certain characteristics. The term "high-cost mortgage" continues to exclude reverse mortgages. Prior to this amendment, the term also excluded residential mortgage transactions (*i.e.*, loans secured by a principal dwelling to finance the acquisition or initial construction of the dwelling) and open-end credit. These exemptions have been deleted. Thus, this amendment greatly expands the scope of transactions that may be covered by the definition. This will require a revision of the regulations governing high-cost mortgages, particularly the disclosure required by 12 C.F.R. § 226.32(c), which contemplates a closed-end credit obligation. See sample disclosure at 12 C.F.R. Part 226, App. H-16.

To be a "high-cost mortgage" under the amended definition, at least one of the following must occur:

- First Lien Loan. If the loan is a first lien, the APR at consummation exceeds by more than 6.5% (8.5% if the dwelling is personal property and for less than \$50,000) the Average Prime Offer Rate (see discussion of Average Prime Offer Rate at Section 1411) for a comparable transaction.

This definition is in contrast to the existing regulation, under which a first lien loan is covered if the APR exceeds by more than 8% the yield on Treasury securities having a comparable period of maturity to the loan maturity as of the 15th day of the month immediately preceding the month in which the loan application was received by the creditor. See 12 C.F.R. § 226.32(a)(1)(i). The current rule does not provide a special rule for small loans on dwellings that are personal property. As discussed below, the APR for purposes of the new test is calculated in a unique manner. The new rule will increase the scope of loans that are covered by the high-cost mortgage definition.

- Subordinate Lien Loan. If the loan is a subordinate lien and the APR at consummation exceeds by more than 8.5% the Average Prime Offer Rate for a comparable transaction.

This definition is in contrast to the existing regulation, under which a subordinate lien loan is covered if the APR exceeds by more than 10% the yield on Treasury securities having a comparable period of maturity to the loan maturity as of the 15th day of the month immediately preceding the month in which the loan application was received by the creditor. See 12 C.F.R. § 226.32(a)(1)(i). As discussed below, the APR for purposes of the new test is calculated in a unique manner. The new rule will further increase the scope of loans that are covered by the high-cost mortgage definition.

- Points and Fees. The total points and fees (other than third party charges not retained by the mortgage originator, creditor, or an affiliate of either) exceeds (i) for a transaction of \$20,000 or more, 5% of the total transaction amount or (ii) for a transaction of less than \$20,000, the lesser of 8% of the total transaction amount or \$1,000 (which dollar amount is subject to revision by Board regulation).

The new points and fees test is substantially different than the current test, which is triggered when the total points and fees exceed the greater of 8% of the total loan amount or a small dollar amount that is subject to annual adjustment. See 12 C.F.R. § 226.32(a)(1)(ii). The new rule will further increase the scope of loans that are covered by the high-cost mortgage definition.

The new points and fees test is also different in that it covers all points and fees paid “in connection with the transaction,” whereas the existing test covers only points and fees payable by the consumer at or before closing.” This means that the new test includes points and fees payable at any time during the loan term. Also, the new test literally includes points and fees paid by a person other than the consumer him/herself. However, note the special treatment of certain mortgage insurance premiums in the points and fees test, discussed below.

- Prepayment Fees. The loan documents allow the creditor to charge or collect any prepayment fees or penalties more than 36 months after the transaction closing, or if these fees and penalties have an aggregate amount of more than 2% of the amount prepaid.

This trigger for high-cost mortgage treatment is new. There is no equivalent provision in the existing high-cost mortgage rule.

There is no definition of prepayment fees or penalties. The term will certainly include ordinary charges to prepay a loan, in whole or in part. However, it is likely that the term will also include “breakage fees” that are imposed when a hedge rate associated with the loan is lower on the prepayment date than it was at the time the loan was made. The term may also include charges that are imposed when a home equity line of credit is cancelled within a specified period of time after its establishment.

See discussion at Section 1414, above, regarding why this provision is out of sync with the definition of a “qualified mortgage.”

- Introductory Rates Taken Into Account. In calculating the “annual percentage rate of interest” for purposes of the first lien and subordinate lien tests discussed above, three unique rules are applied. While the first lien and subordinate lien tests refer only to the “annual percentage rate,” it appears that Congress intended that the three rules be used solely to determine the *interest* component of the APR. It would follow that *other* finance charges should be included in the calculation of the APR in the normal manner.
  - Fixed Rate Transactions. In a fixed rate transaction in which the APR will not vary during the full term of the loan, the interest rate in effect on the day of consummation will be used. This would exclude a step rate loan that contains a series of fixed rates.
  - Variable Rate Transactions. In a variable rate transaction in which the rate of interest varies solely in accordance with an index, the interest rate is determined by adding the index value on the day of consummation to the maximum margin value during the term of the loan. Although this subsection refers to an interest rate that may vary solely in accordance with an index, it implicitly also applies to a variable rate loan with a series of margins.
  - Other Transactions. For any other transaction, the highest interest rate that may be charged during the loan term will be used. For example, if the loan is a step rate loan that contains a series of fixed rates, the highest fixed rate will be used. If the loan is a step rate loan that contains a series of fixed rates but also contains a variable rate feature, the highest rate that can be charged – whether it is one of the fixed rates or the maximum interest rate cap for the variable rate feature – must be used.
- Mortgage Insurance. In applying the points and fees test discussed above, there is a special rule for the treatment of certain mortgage insurance premiums.
  - First, any mortgage insurance premium provided by an agency of the federal or state governments may be excluded from the points and fees.
  - Second, any mortgage insurance premium that does not exceed the premium payable at the time of loan origination under a Mutual Mortgage Insurance Fund policy, as set forth in 12 U.S.C. § 1709(c)(2)(A), may be excluded from the points and fees. This is conditioned on the premium being refundable on a prorated basis upon loan payoff, and the refund being automatically issued at that time. This exclusion from points and fees should apply to any private mortgage insurance premium that meets these standards.
  - Third, any mortgage insurance premium paid by the consumer after loan closing is excluded from the points and fees.
- Adjustment of Points and Fees. The Board’s authority to adjust the points and fees test percentages has been revised. Under the previous rule, the Board has the authority to establish a points and fees percentage between 8% and 12%. Under the new rule, the Board has the authority to establish a percentage between 6% and 10% for first lien loans and between 8% and 12% for subordinate lien loans.
- Points and Fees Defined. Section 103(aa)(4) of TILA, which defines “points and fees,” has been substantially revised. The amended statute greatly increases the amounts that are included in the points and fees, thereby increasing the potential group of loans that will be treated as high-cost mortgages.
  - First, the new test includes all compensation directly or indirectly paid by a consumer or creditor to a mortgage originator, including a mortgage originator who is a creditor in a table-funded transaction. This includes fees paid to a mortgage broker as well as amounts paid to a loan officer of the creditor. The

Board's existing regulation is limited to amounts paid by the consumer to a mortgage broker. See 12 C.F.R. § 226.32(b)(1)(ii). As discussed more fully at the discussion of Section 1419, above, there is considerable uncertainty regarding the determination of what amounts paid to a loan officer will be included for this purpose. Similarly, there is uncertainty regarding the treatment of fees paid to a loan originator based on the number of loans closed within a particular time period.

- Second, premiums or other charges paid at or before closing for credit insurance products, and any payments for debt cancellation or suspension contracts, are included in the points and fees. However, premiums or payments that are calculated and paid in full on a monthly basis are excluded. This is somewhat similar to the Board's existing rule, which includes credit insurance premiums and payments for debt cancellation or suspension contracts that are paid at or before loan closing. See 12 C.F.R. § 226.32(b)(1)(iv).
- Third, the maximum prepayment fees and penalties that may be charged and collected under the terms of the loan are included in the points and fees. There is a similar requirement in the high-cost loan laws in a number of states. See discussion above regarding what constitutes a prepayment fee or penalty.
- Fourth, all prepayment fees or penalties that the consumer incurs if the new loan refinances a previous loan made or currently held by the same creditor or an affiliate of the creditor. Again, there is a similar requirement in the high-cost loan laws in a number of states.

These items are in addition to items that are currently part of the points and fees.

- Calculation of Points and Fees for Open-End Consumer Credit Plans. There is now a special rule for calculating points and fees for open-end credit plans. The points and fees are equal to the total points and fees known at or before closing, plus the maximum prepayment penalties that may be charged or collected under the transaction, plus the minimum additional fees that the consumer will pay to draw down the total credit line. For this purpose, the points and fees will include any of the items that would be part of the points and fees in a closed-end transaction. For example, any prepayment fees and penalties that the consumer incurs if the open-end credit plan refinances a previous loan made or held by the same creditor or its affiliate will be included. The special rule for open-end credit is interesting in that it refers to the "maximum prepayment penalties" that may be charged or collected, whereas the basic points and fees definition refers to the "maximum prepayment fees and penalties" that may be charged and collected. In all likelihood, the different language was not intended to bring about a different result, but this is an issue that the Board's implementing regulations may clarify. See discussion above regarding what constitutes a prepayment fee or penalty.
- Bona Fide Discount Points and Prepayment Penalties. Certain bona fide discount points paid by the consumer may be excluded in computing the points and fees, as follows: (i) up to and including 2 bona fide discount points may be excluded if the interest rate to be discounted does not exceed by more than 1% the Average Prime Offer Rate (or, if the loan is secured by personal property, the average rate on an insured loan under 12 U.S.C. § 1702 *et seq.*); (ii) up to and including 1 bona fide discount point may be excluded if the interest rate to be discounted does not exceed by more than 2% the Average Prime Offer Rate (or, if the loan is secured by personal property, the average rate on an insured loan under 12 U.S.C. § 1702 *et seq.*); (iii) the amount in item (ii) can only be excluded if the amount in item (i) is not being excluded; (iv) the bona fide discount points must be "knowingly" paid by the consumer for the purpose of obtaining the interest rate reduction (suggesting the advisability of obtaining a written acknowledgment of that fact from the consumer), and must actually result in a bona fide reduction of the interest rate; and (v) the interest rate reduction must be "reasonably consistent with established industry norms and practices for secondary market transactions" (there is no guidance on what this means).

## Section 1432. Amendments to Existing Requirements for Certain Mortgages

(a) Prepayment Penalty Provisions—Section 129(c)(2) of the Truth in Lending Act (15 U.S.C. 1639(c)(2)) is hereby repealed.

(b) No Balloon Payments—Section 129(e) of the Truth in Lending Act (15 U.S.C. 1639(e)) is amended to read as follows:

(e) No Balloon Payments—No high-cost mortgage may contain a scheduled payment that is more than twice as large as the average of earlier scheduled payments. This subsection shall not apply when the payment schedule is adjusted to the seasonal or irregular income of the consumer.

**Analysis.** Section 1432 of the Dodd-Frank Act amends § 129 of TILA to make two changes to the prohibitions imposed with respect to high-cost mortgage loans.

- **Prepayment Penalty Provisions.** Section 129(c)(2) of TILA, which previously provided a limited exception to the general prohibition on prepayment penalties for high-cost mortgages, has been repealed. As a result, no prepayment penalties may be imposed on a high-cost mortgage under any circumstances. This is conceptually inconsistent with the new definition of a high-cost mortgage implemented by Section 1431 of the Dodd-Frank Act. Section 1431 treats a loan as a high-cost mortgage if it could impose prepayment penalties or fees more than 36 months after closing or if the prepayment penalties or fees would exceed 2% of the amount prepaid. However, once such a loan is classified as a high-cost mortgage, then Section 1432 states that the loan may not contain a prepayment penalty provision in the first instance. If the prepayment penalty is then taken out of the loan documents, then the loan should not be a high-cost mortgage at all (assuming that nothing else triggers coverage). The Board will need to sort this out in the implementing regulations. In practice, creditors will need to make sure that their prepayment penalties do not trigger coverage by the high-cost mortgage statute in the first instance.
- **No Balloon Payments.** Section 129(e) of TILA is amended to prohibit balloon payments throughout the term of a high-cost mortgage. Previously, the statute allowed balloon payments once the loan reached the five-year mark.
  - The new statute defines a “balloon payment” as one that is twice as large as the average of earlier scheduled payments. See discussion at Section 1412, above, regarding the contrast with existing provisions defining a balloon payment.
  - The statute adds a limited exception to the prohibition on balloon payments. The exception is for a payment schedule that is adjusted to the seasonal or irregular income of the consumer.
  - The Board’s existing rules provide an exception to the balloon payment prohibition for a bridge loan with a maturity of less than one year. See 12 C.F.R. § 226.32(d)(1)(ii). The bridge loan must be in connection with the acquisition or construction of a dwelling that is intended to become the consumer’s principal dwelling. Because this exception is beneficial to consumers and does not undercut the purpose of the balloon payment prohibition, it is likely to remain in place.

## Section 1433. Additional Requirements for Certain Mortgages

(a) Additional Requirements for Certain Mortgages—Section 129 of the Truth in Lending Act (15 U.S.C. 1639) is amended—

(1) by redesignating subsections (j), (k), (l) and (m) as subsections (n), (o), (p), and (q) respectively; and

(2) by inserting after subsection (i) the following new subsections:

(j) Recommended Default—No creditor shall recommend or encourage default on an existing loan or other debt prior to and in connection with the closing or planned closing of a high-cost mortgage that refinances all or any portion of such existing loan or debt.

(k) Late Fees—

(1) IN GENERAL—No creditor may impose a late payment charge or fee in connection with a high-cost mortgage—

(A) in an amount in excess of 4 percent of the amount of the payment past due;

(B) unless the loan documents specifically authorize the charge or fee;

(C) before the end of the 15-day period beginning on the date the payment is due, or in the case of a loan on which interest on each installment is paid in advance, before the end of the 30-day period beginning on the date the payment is due; or

(D) more than once with respect to a single late payment.

(2) COORDINATION WITH SUBSEQUENT LATE FEES—If a payment is otherwise a full payment for the applicable period and is paid on its due date or within an applicable grace period, and the only delinquency or insufficiency of payment is attributable to any late fee or delinquency charge assessed on any earlier payment, no late fee or delinquency charge may be imposed on such payment.

(3) FAILURE TO MAKE INSTALLMENT PAYMENT—If, in the case of a loan agreement the terms of which provide that any payment shall first be applied to any past due principal balance, the consumer fails to make an installment payment and the consumer subsequently resumes making installment payments but has not paid all past due installments, the creditor may impose a separate late payment charge or fee for any principal due (without deduction due to late fees or related fees) until the default is cured.

(l) Acceleration of Debt—No high-cost mortgage may contain a provision which permits the creditor to accelerate the indebtedness, except when repayment of the loan has been accelerated by default in payment, or pursuant to a due-on-sale provision, or pursuant to a material violation of some other provision of the loan document unrelated to payment schedule.

(m) Restriction on Financing Points and Fees—No creditor may directly or indirectly finance, in connection with any high-cost mortgage, any of the following:

(1) Any prepayment fee or penalty payable by the consumer in a refinancing transaction if the creditor or an affiliate of the creditor is the noteholder of the note being refinanced.

(2) Any points or fees.

(b) Prohibitions on Evasions—Section 129 of the Truth in Lending Act (15 U.S.C. 1639) is amended by inserting after subsection (q) (as so redesignated by subsection (a)(1)) the following new subsection:

(r) Prohibitions on Evasions, Structuring of Transactions, and Reciprocal Arrangements—A creditor may not take any action in connection with a high-cost mortgage—

(1) to structure a loan transaction as an open-end credit plan or another form of loan for the purpose and with the intent of evading the provisions of this title; or

(2) to divide any loan transaction into separate parts for the purpose and with the intent of evading provisions of this title.

(c) Modification or Deferral Fees—Section 129 of the Truth in Lending Act (15 U.S.C. 1639) is amended by inserting after subsection (r) (as added by subsection (b) of this section) the following new subsection:

(s) Modification and Deferral Fees Prohibited—A creditor, successor in interest, assignee, or any agent of any of the above, may not charge a consumer any fee to modify, renew, extend, or amend a high-cost mortgage, or to defer any payment due under the terms of such mortgage.

(d) Payoff Statement—Section 129 of the Truth in Lending Act (15 U.S.C. 1639) is amended by inserting after subsection (s) (as added by subsection (c) of this section) the following new subsection:

(t) Payoff Statement—

(1) FEES—

(A) IN GENERAL—Except as provided in subparagraph (B), no creditor or servicer may charge a fee for informing or transmitting to any person the balance due to pay off the outstanding balance on a high-cost mortgage.

(B) TRANSACTION FEE—When payoff information referred to in subparagraph (A) is provided by facsimile transmission or by a courier service, a creditor or servicer may charge a processing fee to cover the cost of such transmission or service in an amount not to exceed an amount that is comparable to fees imposed for similar services provided in connection with consumer credit transactions that are secured by the consumer's principal dwelling and are not high-cost mortgages.

(C) FEE DISCLOSURE—Prior to charging a transaction fee as provided in subparagraph (B), a creditor or servicer shall disclose that payoff balances are available for free pursuant to subparagraph (A).

(D) MULTIPLE REQUESTS—If a creditor or servicer has provided payoff information referred to in subparagraph (A) without charge, other than the transaction fee allowed by subparagraph (B), on 4 occasions during a calendar year, the creditor or servicer may thereafter charge a reasonable fee for providing such information during the remainder of the calendar year.

(2) PROMPT DELIVERY—Payoff balances shall be provided within 5 business days after receiving a request by a consumer or a person authorized by the consumer to obtain such information.

(e) Pre-Loan Counseling Required—Section 129 of the Truth in Lending Act (15 U.S.C. 1639) is amended by inserting after subsection (t) (as added by subsection (d) of this section) the following new subsection:

(u) Pre-Loan Counseling—

(1) IN GENERAL—A creditor may not extend credit to a consumer under a high-cost mortgage without first receiving certification from a counselor that is approved by the Secretary of Housing and Urban Development, or at the discretion of the Secretary, a State housing finance authority, that the consumer has received counseling on the advisability of the mortgage. Such counselor shall not be employed by the creditor or an affiliate of the creditor or be affiliated with the creditor.

(2) DISCLOSURES REQUIRED PRIOR TO COUNSELING—No counselor may certify that a consumer has received counseling on the advisability of the high-cost mortgage unless the counselor can verify that the consumer has received each statement required (in connection with such loan) by this section or the Real Estate Settlement Procedures Act of 1974 with respect to the transaction.

“(3) REGULATIONS—The Board may prescribe such regulations as the Board determines to be appropriate to carry out the requirements of paragraph (1).”

(f) Corrections and Unintentional Violations—Section 129 of the Truth in Lending Act (15 U.S.C. 1639) is amended by inserting after subsection (u) (as added by subsection (e)) the following new subsection:

“(v) Corrections and Unintentional Violations—A creditor or assignee in a high-cost mortgage who, when acting in good faith, fails to comply with any requirement under this section will not be deemed to have violated such requirement if the creditor or assignee establishes that either—

“(1) within 30 days of the loan closing and prior to the institution of any action, the consumer is notified of or discovers the violation, appropriate restitution is made, and whatever adjustments are necessary are made to the loan to either, at the choice of the consumer—

“(A) make the loan satisfy the requirements of this chapter; or

“(B) in the case of a high-cost mortgage, change the terms of the loan in a manner beneficial to the consumer so that the loan will no longer be a high-cost mortgage; or

“(2) within 60 days of the creditor's discovery or receipt of notification of an unintentional violation or bona fide error and prior to the institution of any action, the consumer is notified of the compliance failure, appropriate restitution is made, and whatever adjustments are necessary are made to the loan to either, at the choice of the consumer—

“(A) make the loan satisfy the requirements of this chapter; or

“(B) in the case of a high-cost mortgage, change the terms of the loan in a manner beneficial so that the loan will no longer be a high-cost mortgage.”

**Analysis.** Section 1433 of the Dodd-Frank Act amends § 129 of TILA to add additional substantive restrictions and responsibilities with respect to high-cost mortgages. These will have the effect of making high-cost mortgages even more risky for creditors.

- **Recommended Default.** The creditor is prohibited from recommending or encouraging a default on an existing mortgage or other loan that will be refinanced, in whole or in part, by the new high-cost mortgage. This addresses a practice that consumer groups find objectionable. On its face, the prohibition is limited to the creditor, and therefore would not apply directly to a mortgage originator. However, if the mortgage originator – whether he/she is a mortgage broker or the creditor's own loan officer – is deemed to be acting on behalf of the creditor, the mortgage originator's recommendation of default may be attributed to the creditor, thereby putting the creditor in violation of this new provision. Given this risk, the prudent course would be for the creditor to advise all mortgage originators not to recommend a default on the existing mortgage or other loan.
- **Late Fees.** The new statute imposes restrictions on late fees, some of which reflect customary industry practice. While these restrictions apply to the creditor, they undoubtedly also apply to subsequent holders of the mortgage and any servicer of the mortgage.
  - **In General.** The late fee or charge may not exceed 4% of the “amount of the payment past due.” This is lower than the 5% or 6% late fees that are allowed by many states, and will have the effect of reducing servicing income. It is unclear from this language whether the 4% is applied to the principal and interest components of the late payment or to the entire payment of principal, interest, mortgage insurance and escrows. Fannie Mae requires the calculation of a late charge on only the principal and interest components of the late payment, and the Board regulations are likely to follow this approach.

A late charge may not be imposed unless the loan documents specifically authorize the charge. This is standard industry practice.

There is a mandatory 15-day grace period before the late charge may be imposed. This is consistent with Fannie Mae requirements and industry practice. If the loan installments are imposed in advance, the late charge may not be imposed before the end of the 30-day period beginning on the date the payment is due.

Only one late charge may be imposed with respect to a single late payment. This is customary industry practice.

- Coordination with Subsequent Late Charges. This anti-pyramiding provision is similar to the one found in the Regulation Z rules that apply to the servicing of a consumer credit transaction that is secured by the consumer's principal dwelling. See 12 C.F.R. § 226.36(c)(1)(ii) which, in accordance with Paragraph 226.36(c)(1)(ii)-1 of the Regulation Z Commentary, is to be construed in accordance with the Board's credit practices rule at 12 C.F.R. § 227.15. It prohibits the imposition of a late charge when a full payment is made on time (or within the applicable grace period) and where the only delinquency is the failure to include in the payment the amount of a previously imposed late charge. The Board's implementing regulation is likely to follow the same approach as its existing regulation.
- Failure to Make Installment Payment. This provision clarifies the late charge imposition rules when the note provides that payments are first applied to any past due principal balances. If the consumer fails to make a payment, and then subsequently resumes making payments, but has not paid all past due installments, the creditor may impose a separate late payment charge for any principal due (without deduction due to late fees or related fees) until the default is cured. In essence, this provision allows the application of payments, for purposes of imposing late charges, in accordance with the provisions of the note. This approach is consistent with Paragraph 226.36(c)(1)(i)-2 of the Regulation Z Commentary, which allows the payments to be credited based on the legal obligation of the parties which, in turn, is determined by applicable state or other law. Note, however, that some state laws require the application of payments to the most recent installment due, which would preclude the imposition of separate late charges for each past due payment in this situation. See, e.g., California Civil Code § 2954.4(b).
- Acceleration of Debt. This provision prohibits acceleration clauses in a high-cost mortgage unless it is one of the following types: (i) acceleration by reason of a default in payment; (ii) acceleration by reason of a due-on-sale clause provision; or (iii) acceleration by reason of a material violation of a provision of the loan documents other than the payment schedule.

Accelerations by reason of a due-on-sale clause provision are subject to 12 C.F.R. § 591.5(b), which limits such accelerations in the case of loans secured by homes that are occupied or will be occupied by the borrower. In addition, the due-on-sale clause contained in the mortgage documents needs to be reviewed in each case to determine when it can be exercised. For example, certain ARM products often lack full scope due-on-sale clauses.

This provision allows accelerations under circumstances that are somewhat narrower than the Board's existing regulation for high-cost mortgages. See 12 C.F.R. § 226.32(d)(8) and Paragraphs 226.32(d)(8)(ii) and (iii) of the Regulation Z Commentary. The existing rule also allows an acceleration where there has been fraud or material misrepresentation by the consumer in connection with the loan, and this would not appear to provide a basis for acceleration under the new law (unless this constituted a material violation of a provision of the loan documents). The existing regulation also allows an acceleration if an action or inaction by the consumer affects the creditor's security for the loan or any right of the creditor in the security. Paragraph 226.32(d)(8)(iii)-2 of the Regulation Z Commentary (which was modeled after the rule for open-end credit lines secured by dwellings at Paragraph 226.5b(f)(2)(iii) of the Regulation Z Commentary) provides a list of examples of such actions or inactions, but the new restriction on the grounds of acceleration to "material violations" may preclude acceleration in some of these circumstances. For example, acceleration on the basis of the fact that the sole consumer has died may no longer be material (for example, where the consumer's estate has the wherewithal to continue to make payments).

- Restriction on Financing Points and Fees. This new provision imposes a severe limitation on high-cost mortgages. A high-cost mortgage may not directly or indirectly finance (i) any prepayment fee or penalty payable by a consumer in a refinance transaction if the creditor or its affiliate is the note holder of the note being refinanced or (ii) any points and fees. This same type of provision is found in some of the state high-cost mortgage laws.

The effect of this provision is to require the consumer to pay such amounts out-of-pocket, which may make the loan unaffordable for some consumers. It also may have the effect of inducing creditors to restrain the amount of points and fees they impose, and instead to increase the interest rates of their loans.

Note that this prohibition applies to both direct and indirect actions by the creditor. Examples of an indirect action would include providing a subordinate lien loan to finance the points and fees, or a subordinate loan by an affiliate to finance the points and fees.

- Prohibitions on Evasions. This new provision prohibits the creditor from taking actions to structure a loan as an open-end credit plan or other form of loan for the purpose and with the intent of evading the provisions of TILA, or to divide the loan into separate parts for the purpose and with the intent of evading the provisions of TILA.

The prohibition on structuring the loan as an open-end credit plan is based on the Board's existing regulation at 12 C.F.R. § 226.34(b). It would seem that this is no longer necessary given the fact that open-end credits are no longer exempt from the definition of "high-cost mortgages."

- Modification or Deferral Fees. This new provision prohibits the creditor, any assignee, or any of their agents (e.g., servicers) from charging any fee to modify, renew, extend or amend a high-cost mortgage or to defer any payment.

While the prohibition on modification or deferral fees is understandable in the current financial environment, the prohibition on fees for renewing a high-cost mortgage is unduly broad. Conceivably, this could prohibit the imposition of fees in connection with a refinancing of the high-cost mortgage, potentially even the refinancing of the high-cost mortgage into a nonhigh-cost mortgage. This is not what Congress likely intended, and the Board's implementing regulations should clarify this.

- Payoff Statement. This new provision imposes some very burdensome requirements relating to payoff information ("payoff statements") for high-cost mortgages.
  - In General. Except as noted below, the creditor and servicer may not charge any fees for informing or transmitting to any person the balance due to pay off the high-cost mortgage.

The prohibition on fees for payoff statements will reduce servicing income, thereby increasing the cost of servicing high-cost mortgages.

In some states, there are two different types of statements that may be requested by the consumer or his/her agent – a demand statement (which states how much must be paid to pay off the loan), and a statement of obligation (which simply provides a status report on how much is owed under the loan). Technically, a case can be made that only the former statement is subject to this new prohibition, although the Board regulations may conclude otherwise.

The prohibition on payoff statement fees is not applicable to nonhigh-cost mortgages.

- Transaction Fee. If the payoff statement is provided by fax or a courier service, the creditor or servicer may charge a processing fee to cover the cost of the transmission or service. The fee may not exceed an amount that is comparable to that imposed with respect to similar services for nonhigh-cost mortgages.

This exception to the general prohibition on the imposition of fees for payoff statements is, by its terms, limited to faxes and courier services. It does not also apply to telephonic or electronic deliveries of payoff statements.

It is not clear what can go into the processing fee. The use of that term, and the ability to charge fees

comparable to those imposed for nonhigh-cost loan transactions, suggests that the fee need not be limited to the actual cost of the fax or courier service, and that a reasonable amount for expenses in arranging the fax or courier service may also be included in the fee. Creditors and servicers should document that the fees are reasonable and are comparable to those imposed for nonhigh-cost mortgages.

- Fee Disclosure. Before charging the transaction fee, the creditor or servicer must disclose that the payoff balances are available for free if transmitted by a method other than by fax or courier.

There is nothing in this provision stating that the disclosure must be in writing, suggesting that oral disclosures are permissible. Ideally, however, this disclosure will be included in documents relating to payoffs.

There is nothing in this provision that states who must receive this disclosure. Nothing states that the disclosure must be made to the consumer, suggesting that the disclosure may be made to the person who requests the transmittal of the payoff statement.

- Multiple Requests. If the creditor or servicer has provided four payoff statements without charge (other than permissible transaction fees described above) during a calendar year, it may thereafter charge a reasonable fee for each additional payoff statement that it provides for the remainder of the calendar year.

There is no guidance regarding the calculation of a reasonable fee. In any event, the fee should not exceed the fee imposed for payoff statements for nonhigh-cost mortgages, and should comply with any fee limitations imposed by the loan documents and applicable state or other law.

- Prompt Delivery. The payoff statement must be provided within five business days after receiving a request from the consumer or a person authorized by the consumer to obtain this information. The five-business-day delivery requirement could be burdensome, particularly in times of high activity. The Board's existing regulation for the servicing of consumer credit transactions secured by principal dwellings states that the payoff statement must be provided within a "reasonable time." See 12 C.F.R. § 226.36(c)(1)(iii). The Regulation Z Commentary provides a more flexible approach than the new statute, stating that a reasonable time under most circumstances would be five business days, but that a longer time frame may be reasonable when, for example, the servicer is experiencing an unusually high volume of refinancing requests. See Paragraph 226.36(c)(1)(iii)-1 of the Regulation Z Commentary. Hopefully, the Board will find a way to employ a similarly flexible standard in its implementing regulations notwithstanding the wording of the new statute.

The existing Regulation Z Commentary gives examples of a person who is authorized by the consumer to obtain the payoff statement, such as an attorney representing the consumer, a non-profit counseling center, or a creditor that is refinancing the consumer's loan. The Commentary also states that the servicer may take reasonable measures to verify the requestor's identity and to obtain the consumer's authorization before the "reasonable time" period begins to run. See Paragraph 226.36(c)(1)(iii)-2 of the Regulation Z Commentary. The Commentary also allows the servicer to specify reasonable requirements for making payoff requests. See Paragraph 226.36(c)(1)(iii)-3 of the Regulation Z Commentary. It is expected that the Board will continue to follow this approach with the new statute.

The five-day delivery requirement for high-cost mortgages is in contrast with the maximum seven-day delivery requirement for other home loans. See § 129G of TILA, which is added by Section 1464 of the Dodd-Frank Act. Section 129G will be discussed in more detail in our mortgage servicing user guide.

- Pre-Loan Counseling. The creditor may not make a high-cost mortgage unless it first receives a certification from a HUD-approved counselor that the consumer has received counseling on the advisability of the mortgage.

HUD has the discretion to approve the performance of the counseling by a state housing financing authority. In any event, the counselor may not be employed by the creditor or its affiliate and may not otherwise be affiliated with the creditor. The counselor is not to provide the certification unless the counselor can verify that the consumer has received each statement required by § 129 of TILA or RESPA with respect to the transaction. The Board may issue implementing regulations.

The problem with this requirement is that the high-cost mortgage disclosures required by § 129 of TILA need not be provided to the consumer until three business days before the consummation of the loan, which may be long after the counseling process has been completed. See 12 C.F.R. § 226.31(c)(1). Similarly, the good faith estimate of settlement costs, the HUD special information booklet, and the servicing disclosure statement must be provided within three business days following receipt of an application, and in some instances this will follow the counseling process. Other RESPA disclosures, including the HUD-1 or HUD-1A and initial escrow account statement may not be provided until later yet in the process. The Board regulations implementing this provision will need to address these timing issues. The best solution would be to allow the counselor to provide the certification a few days prior to loan closing, and to limit the certification requirement to pre-closing disclosures.

- Corrections and Unintentional Violations. This adds a new § 129(v) to TILA to provide two limited rights to cure violations of the high-cost mortgage provisions of § 129. The creditor or assignee wishing to cure must be acting in good faith. The literal wording of this provision might be read to allow an assignee only to cure its own violations, and not the violations of the creditor, but this would be bad policy and the courts hopefully will allow an assignee to cure both its own violations and the violations of the creditor.
  - 30-Day Right to Cure. The first right to cure is limited to 30 days following the loan closing and prior to the institution of any action. The creditor or assignee must establish that the consumer is notified of or discovers the violations, appropriate restitution is made, and whatever adjustments are necessary are made to the loan to achieve one of the following results, at the choice of the consumer (i) cause the loan to satisfy the requirements of “this chapter” (presumably, this should be read to mean § 129, since that is what is being cured in the first instance), or (ii) change the terms of the high-cost mortgage so that it is no longer a high-cost mortgage.

There is nothing in this provision that limits the use of the right to cure to violations that are unintentional or the result of a bona fide error. In addition, while the general right to cure TILA violations set forth in § 130(b) of TILA cannot be exercised once the consumer has provided written notice of the error, no such restriction applies to this right to cure.

- 60-Day Right to Cure. The second right to cure is limited to 60 days following the creditor’s discovery or receipt of notification of an unintended violation or bona fide error and prior to the institution of any action. The reference to the “creditor” presumably should be read to include the assignee given that the prefatory paragraph refers to cures by both the creditor and the assignee. The creditor or assignee must establish that the consumer is notified of the violation, appropriate restitution is made, and whatever adjustments are necessary are made to the loan to achieve one of the following results, at the choice of the consumer (i) cause the loan to satisfy the requirements of “this chapter” (again, presumably this should be read to mean § 129, since that is what is being cured in the first instance), or (ii) change the terms of the high-cost mortgage so that it is no longer a high-cost mortgage.

This contrasts with the general defense for bona fide TILA violations set forth in § 130(c) of TILA, which is a defense to a civil or rescission action rather than a right to cure. Further, unlike the general TILA bona fide error defense, the 60-day right to cure in § 129(v) does not require the creditor or assignee to prove its entitlement to the right by a preponderance of the evidence. In addition, unlike the general TILA bona fide error defense, this right to cure does not require the creditor or assignee to prove that it had procedures in place that were reasonably adapted to avoid the error. Finally, the general TILA bona fide error defense excludes errors or legal judgment regarding compliance with TILA, and there is no such exclusion here. Note, however, that a recent Supreme Court decision read such an exclusion into

a similar provision in the federal Fair Debt Collection Practices Act. See *Jerman v. Carlisle, et al.*, 130 S. Ct. 1604 (2010).

Both of the new rights to cure are fraught with risk. The consumer is given the choice of which approach – make the loan comply, or change the loan terms so that it is no longer a high-cost mortgage – will be used to effect the cure, and the creditor or assignee could face dramatically different costs depending on which approach is selected. Further, some violations, such as disclosures that are not provided on a timely basis, may not be subject to correction under any circumstances. As a result, many creditors and assignees may be highly reluctant to cure.

One question remains: Can the general TILA right to cure and the general bona fide error defense, set forth at § 130(b) and (c) of TILA, continue to be used for high-cost mortgage violations? A literal reading would suggest yes. The general TILA right to cure states that a creditor can use that provision to cure “any failure to comply with any requirement [of TILA],” while the general bona fide error defense states that the defense can be used with respect to “any action brought under this section or section 125” (emphasis added). At best, however, the continued use of the general TILA right to cure and the general bona fide error defense for high-cost mortgage violations is uncertain given the more specific rights to cure that are set forth in § 129 itself. The risk of continuing to rely on the general TILA right to cure and the general bona fide error defense for high-cost mortgage violations is that there could be a subsequent determination that these actions were legally ineffective. Further, if the general TILA right to cure is attempted, the creditor or assignee will be signaling to the consumer that a violation has in fact occurred. The Board is unlikely to clarify whether the general TILA right to cure and the general bona fide error defense may continue to be used for high-cost mortgage violations. Absent clarification from the courts, the working assumption going forward should be that the new provisions in § 129(v) of TILA provide the sole avenue for curing violations of the high-cost mortgage rules.

## **Subtitle D – Office of Housing Counseling**

### **Section 1441. Short Title**

This subtitle may be cited as the ‘Expand and Preserve Home Ownership Through Counseling Act’.

**Analysis.** Subtitle D of the Dodd-Frank Act establishes an infrastructure for HUD’s new Office of Housing Counseling. Apparently, Congress’s thinking is that consumers have not been adequately protected by disclosures, so now the most vulnerable of consumers will be provided with financial counseling to help them make wise choices relating to their mortgages. Only those portions of Subtitle D that are likely to directly impact the mortgage industry will be discussed in depth below.

### **Section 1442. Establishment of Office of Housing Counseling**

Section 4 of the Department of Housing and Urban Development Act (42 U.S.C. 3533) is amended by adding at the end the following new subsection:

“(g) Office of Housing Counseling—

“(1) ESTABLISHMENT—There is established, in the Department, the Office of Housing Counseling.

“(2) DIRECTOR—There is established the position of Director of Housing Counseling. The Director shall be the head of the Office of Housing Counseling and shall be appointed by, and shall report to, the Secretary. Such position shall be a career-reserved position in the Senior Executive Service.

“(3) FUNCTIONS—

“(A) IN GENERAL—The Director shall have primary responsibility within the Department for all activities and matters relating to homeownership counseling and rental housing counseling, including—

“(i) research, grant administration, public outreach, and policy development relating to such counseling; and

(ii) establishment, coordination, and administration of all regulations, requirements, standards, and performance measures under programs and laws administered by the Department that relate to housing counseling, homeownership counseling (including maintenance of homes), mortgage-related counseling (including home equity conversion mortgages and credit protection options to avoid foreclosure), and rental housing counseling, including the requirements, standards, and performance measures relating to housing counseling.

(B) SPECIFIC FUNCTIONS—The Director shall carry out the functions assigned to the Director and the Office under this section and any other provisions of law. Such functions shall include establishing rules necessary for—

(i) the counseling procedures under section 106(g)(1) of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x(h)(1));

(ii) carrying out all other functions of the Secretary under section 106(g) of the Housing and Urban Development Act of 1968, including the establishment, operation, and publication of the availability of the toll-free telephone number under paragraph (2) of such section;

(iii) contributing to the distribution of home buying information booklets pursuant to section 5 of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2604);

(iv) carrying out the certification program under section 106(e) of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x(e));

(v) carrying out the assistance program under section 106(a)(4) of the Housing and Urban Development Act of 1968, including criteria for selection of applications to receive assistance;

(vi) carrying out any functions regarding abusive, deceptive, or unscrupulous lending practices relating to residential mortgage loans that the Secretary considers appropriate, which shall include conducting the study under section 6 of the Expand and Preserve Home Ownership Through Counseling Act;

(vii) providing for operation of the advisory committee established under paragraph (4) of this subsection;

(viii) collaborating with community-based organizations with expertise in the field of housing counseling; and

(ix) providing for the building of capacity to provide housing counseling services in areas that lack sufficient services, including underdeveloped areas that lack basic water and sewer systems, electricity services, and safe, sanitary housing.

(4) ADVISORY COMMITTEE—

(A) IN GENERAL—The Secretary shall appoint an advisory committee to provide advice regarding the carrying out of the functions of the Director.

(B) MEMBERS—Such advisory committee shall consist of not more than 12 individuals, and the membership of the committee shall equally represent the mortgage and real estate industry, including consumers and housing counseling agencies certified by the Secretary.

(C) TERMS—Except as provided in subparagraph (D), each member of the advisory committee shall be appointed for a term of 3 years. Members may be reappointed at the discretion of the Secretary.

(D) TERMS OF INITIAL APPOINTEES—As designated by the Secretary at the time of appointment, of the members first appointed to the advisory committee, 4 shall be appointed for a term of 1 year and 4 shall be appointed for a term of 2 years.

(E) PROHIBITION OF PAY; TRAVEL EXPENSES—Members of the advisory committee shall serve without pay, but shall receive travel expenses, including per diem in lieu of subsistence, in accordance with applicable provisions under subchapter I of chapter 57 of title 5, United States Code.

(F) ADVISORY ROLE ONLY—The advisory committee shall have no role in reviewing or awarding housing counseling grants.

(5) SCOPE OF HOMEOWNERSHIP COUNSELING—In carrying out the responsibilities of the Director, the Director shall ensure that homeownership counseling provided by, in connection with, or pursuant to any function, activity, or program of the Department addresses the entire process of homeownership, including the decision to purchase a home, the selection and purchase of a home, issues arising during or affecting the period of ownership of a home (including refinancing, default and foreclosure, and other financial decisions), and the sale or other disposition of a home.'

**Analysis.** An Office of Housing Counseling is established in HUD. The Director of the Office, who is appointed by and reports to the Secretary of HUD, has primary responsibility within HUD for all activities and matters relating to homeownership and rental housing counseling. The Director will be advised by an Advisory Committee appointed by the Secretary of HUD, which will be composed of representatives of the mortgage and real estate industries, consumers, and housing agencies.

## Section 1443. Counseling Procedures

(a) In General—Section 106 of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x) is amended by adding at the end the following new subsection:

(g) Procedures and Activities—

(1) COUNSELING PROCEDURES—

(A) IN GENERAL—The Secretary shall establish, coordinate, and monitor the administration by the Department of Housing and Urban Development of the counseling procedures for homeownership counseling and rental housing counseling provided in connection with any program of the Department, including all requirements, standards, and performance measures that relate to homeownership and rental housing counseling.

(B) HOMEOWNERSHIP COUNSELING—For purposes of this subsection and as used in the provisions referred to in this subparagraph, the term 'homeownership counseling' means counseling related to homeownership and residential mortgage loans. Such term includes counseling related to homeownership and residential mortgage loans that is provided pursuant to—

- (i) section 105(a)(20) of the Housing and Community Development Act of 1974 (42 U.S.C. 5305(a)(20));
- (ii) in the United States Housing Act of 1937—
  - (I) section 9(e) (42 U.S.C. 1437g(e));
  - (II) section 8(y)(1)(D) (42 U.S.C. 1437f(y)(1)(D));
  - (III) section 18(a)(4)(D) (42 U.S.C. 1437p(a)(4)(D));
  - (IV) section 23(c)(4) (42 U.S.C. 1437u(c)(4));
  - (V) section 32(e)(4) (42 U.S.C. 1437z-4(e)(4));
  - (VI) section 33(d)(2)(B) (42 U.S.C. 1437z-5(d)(2)(B));
  - (VII) sections 302(b)(6) and 303(b)(7) (42 U.S.C. 1437aaa-1(b)(6), 1437aaa-2(b)(7)); and
  - (VIII) section 304(c)(4) (42 U.S.C. 1437aaa-3(c)(4));
- (iii) section 302(a)(4) of the American Homeownership and Economic Opportunity Act of 2000 (42 U.S.C. 1437f note);
- (iv) sections 233(b)(2) and 258(b) of the Cranston-Gonzalez National Affordable Housing Act (42 U.S.C. 12773(b)(2), 12808(b));
- (v) this section and section 101(e) of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x, 1701w(e));
- (vi) section 220(d)(2)(G) of the Low-Income Housing Preservation and Resident Homeownership Act of 1990 (12 U.S.C. 4110(d)(2)(G));
- (vii) sections 422(b)(6), 423(b)(7), 424(c)(4), 442(b)(6), and 443(b)(6) of the Cranston-Gonzalez National Affordable Housing Act (42 U.S.C. 12872(b)(6), 12873(b)(7), 12874(c)(4), 12892(b)(6), and 12893(b)(6));
- (viii) section 491(b)(1)(F)(iii) of the McKinney-Vento Homeless Assistance Act (42 U.S.C. 11408(b)(1)(F)(iii));
- (ix) sections 202(3) and 810(b)(2)(A) of the Native American Housing and Self-Determination Act of 1996 (25 U.S.C. 4132(3), 4229(b)(2)(A));
- (x) in the National Housing Act—
  - (I) in section 203 (12 U.S.C. 1709), the penultimate undesignated paragraph of paragraph (2) of subsection (b), subsection (c)(2)(A), and subsection (r)(4);
  - (II) subsections (a) and (c)(3) of section 237 (12 U.S.C. 1715z-2); and
  - (III) subsections (d)(2)(B) and (m)(1) of section 255 (12 U.S.C. 1715z-20);
- (xi) section 502(h)(4)(B) of the Housing Act of 1949 (42 U.S.C. 1472(h)(4)(B));
- (xii) section 508 of the Housing and Urban Development Act of 1970 (12 U.S.C. 1701z-7); and
- (xiii) section 106 of the Energy Policy Act of 1992 (42 U.S.C. 12712 note).

(C) RENTAL HOUSING COUNSELING—For purposes of this subsection, the term 'rental housing counseling' means counseling related to rental of residential property, which may include counseling regarding future homeownership opportunities and providing

referrals for renters and prospective renters to entities providing counseling and shall include counseling related to such topics that is provided pursuant to—

- `(i) section 105(a)(20) of the Housing and Community Development Act of 1974 (42 U.S.C. 5305(a)(20));
- `(ii) in the United States Housing Act of 1937—
  - `(I) section 9(e) (42 U.S.C. 1437g(e));
  - `(II) section 18(a)(4)(D) (42 U.S.C. 1437p(a)(4)(D));
  - `(III) section 23(c)(4) (42 U.S.C. 1437u(c)(4));
  - `(IV) section 32(e)(4) (42 U.S.C. 1437z-4(e)(4));
  - `(V) section 33(d)(2)(B) (42 U.S.C. 1437z-5(d)(2)(B)); and
  - `(VI) section 302(b)(6) (42 U.S.C. 1437aaa-1(b)(6));
- `(iii) section 233(b)(2) of the Cranston-Gonzalez National Affordable Housing Act (42 U.S.C. 12773(b)(2));
- `(iv) section 106 of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x);
- `(v) section 422(b)(6) of the Cranston-Gonzalez National Affordable Housing Act (42 U.S.C. 12872(b)(6));
- `(vi) section 491(b)(1)(F)(iii) of the McKinney-Vento Homeless Assistance Act (42 U.S.C. 11408(b)(1)(F)(iii));
- `(vii) sections 202(3) and 810(b)(2)(A) of the Native American Housing and Self-Determination Act of 1996 (25 U.S.C. 4132(3), 4229(b)(2)(A)); and
- `(viii) the rental assistance program under section 8 of the United States Housing Act of 1937 (42 U.S.C. 1437f).

`(2) **STANDARDS FOR MATERIALS**—The Secretary, in consultation with the advisory committee established under subsection (g)(4) of the Department of Housing and Urban Development Act, shall establish standards for materials and forms to be used, as appropriate, by organizations providing homeownership counseling services, including any recipients of assistance pursuant to subsection (a)(4).

`(3) **MORTGAGE SOFTWARE SYSTEMS**—

`(A) **CERTIFICATION**—The Secretary shall provide for the certification of various computer software programs for consumers to use in evaluating different residential mortgage loan proposals. The Secretary shall require, for such certification, that the mortgage software systems take into account—

- `(i) the consumer's financial situation and the cost of maintaining a home, including insurance, taxes, and utilities;
- `(ii) the amount of time the consumer expects to remain in the home or expected time to maturity of the loan; and
- `(iii) such other factors as the Secretary considers appropriate to assist the consumer in evaluating whether to pay points, to lock in an interest rate, to select an adjustable or fixed rate loan, to select a conventional or government-insured or guaranteed loan and to make other choices during the loan application process.

If the Secretary determines that available existing software is inadequate to assist consumers during the residential mortgage loan application process, the Secretary shall arrange for the development by private sector software companies of new mortgage software systems that meet the Secretary's specifications.

`(B) **USE AND INITIAL AVAILABILITY**—Such certified computer software programs shall be used to supplement, not replace, housing counseling. The Secretary shall provide that such programs are initially used only in connection with the assistance of housing counselors certified pursuant to subsection (e).

`(C) **AVAILABILITY**—After a period of initial availability under subparagraph (B) as the Secretary considers appropriate, the Secretary shall take reasonable steps to make mortgage software systems certified pursuant to this paragraph widely available through the Internet and at public locations, including public libraries, senior-citizen centers, public housing sites, offices of public housing agencies that administer rental housing assistance vouchers, and housing counseling centers.

`(D) **BUDGET COMPLIANCE**—This paragraph shall be effective only to the extent that amounts to carry out this paragraph are made available in advance in appropriations Acts.

`(4) **NATIONAL PUBLIC SERVICE MULTIMEDIA CAMPAIGNS TO PROMOTE HOUSING COUNSELING**—

`(A) **IN GENERAL**—The Director of Housing Counseling shall develop, implement, and conduct national public service multimedia campaigns designed to make persons facing mortgage foreclosure, persons considering a subprime mortgage loan to purchase a home, elderly persons, persons who face language barriers, low-income persons, minorities, and other potentially vulnerable consumers aware that it is advisable, before seeking or maintaining a residential mortgage loan, to obtain homeownership counseling from an unbiased and reliable sources and that such homeownership counseling is available, including through programs sponsored by the Secretary of Housing and Urban Development.

(B) CONTACT INFORMATION—Each segment of the multimedia campaign under subparagraph (A) shall publicize the toll-free telephone number and website of the Department of Housing and Urban Development through which persons seeking housing counseling can locate a housing counseling agency in their State that is certified by the Secretary of Housing and Urban Development and can provide advice on buying a home, renting, defaults, foreclosures, credit issues, and reverse mortgages.

(C) AUTHORIZATION OF APPROPRIATIONS—There are authorized to be appropriated to the Secretary, not to exceed \$3,000,000 for fiscal years 2009, 2010, and 2011, for the development, implementation, and conduct of national public service multimedia campaigns under this paragraph.

(D) FORECLOSURE RESCUE EDUCATION PROGRAMS—

(i) IN GENERAL—Ten percent of any funds appropriated pursuant to the authorization under subparagraph (C) shall be used by the Director of Housing Counseling to conduct an education program in areas that have a high density of foreclosure. Such program shall involve direct mailings to persons living in such areas describing

(I) tips on avoiding foreclosure rescue scams;

(II) tips on avoiding predatory lending mortgage agreements;

(III) tips on avoiding for-profit foreclosure counseling services; and

(IV) local counseling resources that are approved by the Department of Housing and Urban Development.

(ii) PROGRAM EMPHASIS—In conducting the education program described under clause (i), the Director of Housing Counseling shall also place an emphasis on serving communities that have a high percentage of retirement communities or a high percentage of low-income minority communities.

(iii) TERMS DEFINED—For purposes of this subparagraph:

(I) HIGH DENSITY OF FORECLOSURES—An area has a 'high density of foreclosures' if such area is one of the metropolitan statistical areas (as that term is defined by the Director of the Office of Management and Budget) with the highest home foreclosure rates.

(II) HIGH PERCENTAGE OF RETIREMENT COMMUNITIES—An area has a 'high percentage of retirement communities' if such area is one of the metropolitan statistical areas (as that term is defined by the Director of the Office of Management and Budget) with the highest percentage of residents aged 65 or older.

(III) HIGH PERCENTAGE OF LOW-INCOME MINORITY COMMUNITIES—An area has a 'high percentage of low-income minority communities' if such area contains a higher-than-normal percentage of residents who are both minorities and low-income, as defined by the Director of Housing Counseling.

(5) EDUCATION PROGRAMS—The Secretary shall provide advice and technical assistance to States, units of general local government, and nonprofit organizations regarding the establishment and operation of, including assistance with the development of content and materials for, educational programs to inform and educate consumers, particularly those most vulnerable with respect to residential mortgage loans (such as elderly persons, persons facing language barriers, low-income persons, minorities, and other potentially vulnerable consumers), regarding home mortgages, mortgage refinancing, home equity loans, home repair loans, and where appropriate by region, any requirements and costs associated with obtaining flood or other disaster-specific insurance coverage.'

(b) Conforming Amendments to Grant Program for Homeownership Counseling Organizations—Section 106(c)(5)(A)(ii) of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x(c)(5)(A)(ii)) is amended—

(1) in subclause (III), by striking 'and' at the end;

(2) in subclause (IV) by striking the period at the end and inserting '; and'; and

(3) by inserting after subclause (IV) the following new subclause:

(V) notify the housing or mortgage applicant of the availability of mortgage software systems provided pursuant to subsection (g)(3).'

**Analysis.** A variety of federal laws require homeownership and rental housing counseling. The Secretary of HUD is to establish standards for materials and forms that are used by organizations that provide counseling and receive grants for that activity. The Secretary will provide for certifications of software programs used by consumers to evaluate residential mortgage loans. The Secretary is also to develop, implement and conduct national public service multimedia campaigns to assist certain groups on mortgage-related matters. The Secretary is also to provide advice and technical assistance on educational programs relating to mortgage financing.

#### Section 1444. Grants for Housing Counseling Assistance

Section 106(a) of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x(a)) is amended by adding at the end the following new paragraph:

(4) Homeownership and Rental Counseling Assistance—

(A) IN GENERAL—The Secretary shall make financial assistance available under this paragraph to HUD-approved housing counseling agencies and State housing finance agencies.

(B) QUALIFIED ENTITIES—The Secretary shall establish standards and guidelines for eligibility of organizations (including governmental and nonprofit organizations) to receive assistance under this paragraph, in accordance with subparagraph (D).

(C) DISTRIBUTION—Assistance made available under this paragraph shall be distributed in a manner that encourages efficient and successful counseling programs and that ensures adequate distribution of amounts for rural areas having traditionally low levels of access to such counseling services, including areas with insufficient access to the Internet. In distributing such assistance, the Secretary may give priority consideration to entities serving areas with the highest home foreclosure rates.

(D) LIMITATION ON DISTRIBUTION OF ASSISTANCE—

(i) IN GENERAL—None of the amounts made available under this paragraph shall be distributed to—

- (I) any organization which has been convicted for a violation under Federal law relating to an election for Federal office; or
- (II) any organization which employs applicable individuals.

(ii) DEFINITION OF APPLICABLE INDIVIDUALS—In this subparagraph, the term 'applicable individual' means an individual who—

(I) is—

- (aa) employed by the organization in a permanent or temporary capacity;
- (bb) contracted or retained by the organization; or
- (cc) acting on behalf of, or with the express or apparent authority of, the organization; and

(II) has been convicted for a violation under Federal law relating to an election for Federal office.

(E) GRANTMAKING PROCESS—In making assistance available under this paragraph, the Secretary shall consider appropriate ways of streamlining and improving the processes for grant application, review, approval, and award.

(F) AUTHORIZATION OF APPROPRIATIONS—There are authorized to be appropriated \$45,000,000 for each of fiscal years 2009 through 2012 for—

- (i) the operations of the Office of Housing Counseling of the Department of Housing and Urban Development;
- (ii) the responsibilities of the Director of Housing Counseling under paragraphs (2) through (5) of subsection (g); and
- (iii) assistance pursuant to this paragraph for entities providing homeownership and rental counseling.<sup>1</sup>

**Analysis.** The Secretary of HUD is to make grants to HUD-approved housing counseling agencies and state housing finance agencies.

## Section 1445. Requirements to Use HUD-Certified Counselors Under HUD Programs

Section 106(e) of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x(e)) is amended—

(1) by striking paragraph (1) and inserting the following new paragraph:

(1) REQUIREMENT FOR ASSISTANCE—An organization may not receive assistance for counseling activities under subsection (a)(1)(iii), (a)(2), (a)(4), (c), or (d) of this section, or under section 101(e), unless the organization, or the individuals through which the organization provides such counseling, has been certified by the Secretary under this subsection as competent to provide such counseling.<sup>1</sup>

(2) in paragraph (2)—

(A) by inserting 'and for certifying organizations' before the period at the end of the first sentence; and

(B) in the second sentence by striking 'for certification' and inserting ', for certification of an organization, that each individual through which the organization provides counseling shall demonstrate, and, for certification of an individual,';

(3) in paragraph (3), by inserting 'organizations and' before 'individuals';

(4) by redesignating paragraph (3) as paragraph (5); and

(5) by inserting after paragraph (2) the following new paragraphs:

(3) REQUIREMENT UNDER HUD PROGRAMS—Any homeownership counseling or rental housing counseling (as such terms are defined in subsection (g)(1)) required under, or provided in connection with, any program administered by the Department of Housing and Urban Development shall be provided only by organizations or counselors certified by the Secretary under this subsection as competent to provide such counseling.

(4) **OUTREACH**—The Secretary shall take such actions as the Secretary considers appropriate to ensure that individuals and organizations providing homeownership or rental housing counseling are aware of the certification requirements and standards of this subsection and of the training and certification programs under subsection (f).<sup>1</sup>

**Analysis.** Any homeownership or rental housing counseling required by a HUD program must be provided only by organizations or counselors certified by HUD as competent. HUD is directed to reach out to counseling organizations and counselors so that they are aware of this requirement.

### Section 1446. Study of Defaults and Foreclosures

The Secretary of Housing and Urban Development shall conduct an extensive study of the root causes of default and foreclosure of home loans, using as much empirical data as are available. The study shall also examine the role of escrow accounts in helping prime and nonprime borrowers to avoid defaults and foreclosures, and the role of computer registries of mortgages, including those used for trading mortgage loans. Not later than 12 months after the date of the enactment of this Act, the Secretary shall submit to the Congress a preliminary report regarding the study. Not later than 24 months after such date of enactment, the Secretary shall submit a final report regarding the results of the study, which shall include any recommended legislation relating to the study, and recommendations for best practices and for a process to identify populations that need counseling the most.

**Analysis.** HUD is to study the root causes of defaults and foreclosures, and report back to Congress within 12 months of enactment of the Dodd-Frank Act with a preliminary report. A final report is due within 24 months of enactment. The reports are to include recommendations for legislation and best practices and a process to identify populations that are in the greatest need of counseling.

### Section 1447. Default and Foreclosure Database

(a) **Establishment**—The Secretary of Housing and Urban Development and the Director of the Bureau, in consultation with the Federal agencies responsible for regulation of banking and financial institutions involved in residential mortgage lending and servicing, shall establish and maintain a database of information on foreclosures and defaults on mortgage loans for one- to four-unit residential properties and shall make such information publicly available, subject to subsection (e).

(b) **Census Tract Data**—Information in the database may be collected, aggregated, and made available on a census tract basis.

(c) **Requirements**—Information collected and made available through the database shall include—

- (1) the number and percentage of such mortgage loans that are delinquent by more than 30 days;
- (2) the number and percentage of such mortgage loans that are delinquent by more than 90 days;
- (3) the number and percentage of such properties that are real estate-owned;
- (4) number and percentage of such mortgage loans that are in the foreclosure process;
- (5) the number and percentage of such mortgage loans that have an outstanding principal obligation amount that is greater than the value of the property for which the loan was made; and
- (6) such other information as the Secretary of Housing and Urban Development and the Director of the Bureau consider appropriate.

(d) **Rule of Construction**—Nothing in this section shall be construed to encourage discriminatory or unsound allocation of credit or lending policies or practices.

(e) **Privacy and Confidentiality**—In establishing and maintaining the database described in subsection (a), the Secretary of Housing and Urban Development and the Director of the Bureau shall—

- (1) be subject to the standards applicable to Federal agencies for the protection of the confidentiality of personally identifiable information and for data security and integrity;
- (2) implement the necessary measures to conform to the standards for data integrity and security described in paragraph (1); and
- (3) collect and make available information under this section, in accordance with paragraphs (5) and (6) of section 1022(c) and the rules prescribed under such paragraphs, in order to protect privacy and confidentiality.

**Analysis.** The Secretary of HUD and the Director of the Bureau, in consultation with other federal agencies, are to establish and maintain a database of information on defaults and foreclosures and make this information publicly available. Information in the database will be kept by census tract, which means that it can easily be cross-referenced to data that is reported under HMDA and Regulation C. Consumer groups, regulators and others are likely to do so, and the results of those analyses are likely to inform their actions.

## Section 1448. Definitions for Counseling-Related Programs

Section 106 of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x), as amended by the preceding provisions of this subtitle, is amended by adding at the end the following new subsection:

“(h) Definitions—For purposes of this section:

“(1) **NONPROFIT ORGANIZATION**—The term ‘nonprofit organization’ has the meaning given such term in section 104(5) of the Cranston-Gonzalez National Affordable Housing Act (42 U.S.C. 12704(5)), except that subparagraph (D) of such section shall not apply for purposes of this section.

“(2) **STATE**—The term ‘State’ means each of the several States, the Commonwealth of Puerto Rico, the District of Columbia, the Commonwealth of the Northern Mariana Islands, Guam, the Virgin Islands, American Samoa, the Trust Territories of the Pacific, or any other possession of the United States.

“(3) **UNIT OF GENERAL LOCAL GOVERNMENT**—The term ‘unit of general local government’ means any city, county, parish, town, township, borough, village, or other general purpose political subdivision of a State.

“(4) **HUD-APPROVED COUNSELING AGENCY**—The term ‘HUD-approved counseling agency’ means a private or public nonprofit organization that is—

“(A) exempt from taxation under section 501(c) of the Internal Revenue Code of 1986; and

“(B) certified by the Secretary to provide housing counseling services.

“(5) **STATE HOUSING FINANCE AGENCY**—The term ‘State housing finance agency’ means any public body, agency, or instrumentality specifically created under State statute that is authorized to finance activities designed to provide housing and related facilities throughout an entire State through land acquisition, construction, or rehabilitation.’

**Analysis.** No comments necessary.

## Section 1449. Defaults and Foreclosure Database

Section 106 of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x), as amended by the preceding provisions of this subtitle, is amended by adding at the end the following:

“(i) **Accountability for Recipients of Covered Assistance**—

“(1) **TRACKING OF FUNDS**—The Secretary shall—

“(A) develop and maintain a system to ensure that any organization or entity that receives any covered assistance uses all amounts of covered assistance in accordance with this section, the regulations issued under this section, and any requirements or conditions under which such amounts were provided; and

“(B) require any organization or entity, as a condition of receipt of any covered assistance, to agree to comply with such requirements regarding covered assistance as the Secretary shall establish, which shall include—

“(i) appropriate periodic financial and grant activity reporting, record retention, and audit requirements for the duration of the covered assistance to the organization or entity to ensure compliance with the limitations and requirements of this section, the regulations under this section, and any requirements or conditions under which such amounts were provided; and

“(ii) any other requirements that the Secretary determines are necessary to ensure appropriate administration and compliance.

“(2) **MISUSE OF FUNDS**—If any organization or entity that receives any covered assistance is determined by the Secretary to have used any covered assistance in a manner that is materially in violation of this section, the regulations issued under this section, or any requirements or conditions under which such assistance was provided—

“(A) the Secretary shall require that, within 12 months after the determination of such misuse, the organization or entity shall reimburse the Secretary for such misused amounts and return to the Secretary any such amounts that remain unused or uncommitted for use; and

“(B) such organization or entity shall be ineligible, at any time after such determination, to apply for or receive any further covered assistance.

The remedies under this paragraph are in addition to any other remedies that may be available under law.

“(3) **COVERED ASSISTANCE**—For purposes of this subsection, the term ‘covered assistance’ means any grant or other financial assistance provided under this section.’

**Analysis.** No comments necessary.

## Section 1450. Updating and Simplification of Mortgage Information Booklet

Section 5 of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2604) is amended—

(1) in the section heading, by striking 'SPECIAL' and inserting 'HOME BUYING';

(2) by striking subsections (a) and (b) and inserting the following new subsections:

(a) Preparation and Distribution—The Director of the Bureau of Consumer Financial Protection (hereafter in this section referred to as the 'Director') shall prepare, at least once every 5 years, a booklet to help consumers applying for federally related mortgage loans to understand the nature and costs of real estate settlement services. The Director shall prepare the booklet in various languages and cultural styles, as the Director determines to be appropriate, so that the booklet is understandable and accessible to homebuyers of different ethnic and cultural backgrounds. The Director shall distribute such booklets to all lenders that make federally related mortgage loans. The Director shall also distribute to such lenders lists, organized by location, of homeownership counselors certified under section 106(e) of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x(e)) for use in complying with the requirement under subsection (c) of this section.

(b) Contents—Each booklet shall be in such form and detail as the Director shall prescribe and, in addition to such other information as the Director may provide, shall include in plain and understandable language the following information:

(1) A description and explanation of the nature and purpose of the costs incident to a real estate settlement or a federally related mortgage loan. The description and explanation shall provide general information about the mortgage process as well as specific information concerning, at a minimum—

(A) balloon payments;

(B) prepayment penalties;

(C) the advantages of prepayment; and

(D) the trade-off between closing costs and the interest rate over the life of the loan.

(2) An explanation and sample of the uniform settlement statement required by section 4.

(3) A list and explanation of lending practices, including those prohibited by the Truth in Lending Act or other applicable Federal law, and of other unfair practices and unreasonable or unnecessary charges to be avoided by the prospective buyer with respect to a real estate settlement.

(4) A list and explanation of questions a consumer obtaining a federally related mortgage loan should ask regarding the loan, including whether the consumer will have the ability to repay the loan, whether the consumer sufficiently shopped for the loan, whether the loan terms include prepayment penalties or balloon payments, and whether the loan will benefit the borrower.

(5) An explanation of the right of rescission as to certain transactions provided by sections 125 and 129 of the Truth in Lending Act.

(6) A brief explanation of the nature of a variable rate mortgage and a reference to the booklet entitled 'Consumer Handbook on Adjustable Rate Mortgages', published by the Director, or to any suitable substitute of such booklet that the Director may subsequently adopt pursuant to such section.

(7) A brief explanation of the nature of a home equity line of credit and a reference to the pamphlet required to be provided under section 127A of the Truth in Lending Act.

(8) Information about homeownership counseling services made available pursuant to section 106(a)(4) of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x(a)(4)), a recommendation that the consumer use such services, and notification that a list of certified providers of homeownership counseling in the area, and their contact information, is available.

(9) An explanation of the nature and purpose of escrow accounts when used in connection with loans secured by residential real estate and the requirements under section 10 of this Act regarding such accounts.

(10) An explanation of the choices available to buyers of residential real estate in selecting persons to provide necessary services incidental to a real estate settlement.

(11) An explanation of a consumer's responsibilities, liabilities, and obligations in a mortgage transaction.

(12) An explanation of the nature and purpose of real estate appraisals, including the difference between an appraisal and a home inspection.

(13) Notice that the Office of Housing of the Department of Housing and Urban Development has made publicly available a brochure regarding loan fraud and a World Wide Web address and toll-free telephone number for obtaining the brochure.

The booklet prepared pursuant to this section shall take into consideration differences in real estate settlement procedures that may exist among the several States and territories of the United States and among separate political subdivisions within the same State and territory.;

(3) in subsection (c), by inserting at the end the following new sentence: 'Each lender shall also include with the booklet a reasonably complete or updated list of homeownership counselors who are certified pursuant to section 106(e) of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x(e)) and located in the area of the lender.:'; and

(4) in subsection (d), by inserting after the period at the end of the first sentence the following: 'The lender shall provide the booklet in the version that is most appropriate for the person receiving it.'.

**Analysis.** What has long been known as the HUD “special information booklet” will now be prepared by the Director of the Bureau and revised by the Director every five years. While the previous booklet focused on settlement services costs and escrows, the new booklet will address most other aspects of the home loan process, including such matters as certain terms of the loan, the trade-off between closing costs and interest rates, prohibited lending practices, the TILA right of rescission, explanations of other government-supplied booklets, an explanation of the nature of a home equity line of credit, information about home counseling services, the consumer’s responsibilities under the loan, and the nature and purpose of appraisals. Some information provided in the booklet will also be provided by other government-supplied booklets and government mandated disclosures. This may be confusing for some consumers.

The new booklet is to be prepared in “various languages and cultural styles,” but does not specify which. The issuance of the booklet in other languages is consistent with current industry trends. This may increase the pressure on creditors to produce loan documents and disclosures in other languages.

Creditors are required to provide a reasonably complete or updated list of certified homeownership counselors “located in the area of the lender.” This requirement reflects the new emphasis that Congress is placing on counseling as a protector of consumers. The implementing regulations may require that the counselors be located in the consumer’s area, not in the “area of the lender.”

Creditors are directed to provide the version of the booklet that is “most appropriate for the person receiving it.” While compliance with this requirement may not be difficult where the creditor’s representative is discussing the loan with the consumer in another language, compliance will be more difficult where the creditor’s representative is conversing with the consumer in English. Even where oral communications are in English, it is possible that another language or cultural style will be more appropriate for the written booklet. This should be sorted out in the implementing regulations. A common sense approach would allow the creditor to provide the booklet in the primary language used for oral communications with the consumer unless the consumer has expressly requested a booklet in another language. If the oral communications are in a language into which the booklet has not been translated, it should be permissible to provide the booklet in English. A bad approach would be to require the creditor or its representative to determine the most appropriate language or cultural style based on visual observation and the consumer’s surname (by analogy to Appendix B of Regulation C, which requires a determination of a loan applicant’s race, ethnicity, and gender by visual observation and surname where the applicant chooses not to provide it). If inadequate guidance is provided, or if the implementing regulations outline an extremely burdensome approach, it may be possible to comply by providing a copy of the booklet in *all* of the available languages and cultural styles.

HUD’s current regulations state that its existing special information booklet need not be provided for refinancings, subordinate lien closed-end loans, reverse mortgages, and any other loan that is not for the purchase of a 1-4 unit residential property. Given the broader nature of the new booklet, it is highly likely that the new booklet will need to be provided for almost all mortgage transactions secured by a 1-4 unit dwelling.

Section 1098 of the Dodd-Frank Act also requires the Bureau to revise the HUD booklet. See discussion above.

## **Section 1451. Home Inspection Counseling**

### **(a) Public Outreach—**

(1) IN GENERAL—The Secretary of Housing and Urban Development (in this section referred to as the ‘Secretary’) shall take such actions as may be necessary to inform potential homebuyers of the availability and importance of obtaining an independent home inspection. Such actions shall include—

(A) publication of the HUD/FHA form HUD 92564-CN entitled ‘For Your Protection: Get a Home Inspection’, in both English and Spanish languages;

(B) publication of the HUD/FHA booklet entitled ‘For Your Protection: Get a Home Inspection’, in both English and Spanish languages;

(C) development and publication of a HUD booklet entitled ‘For Your Protection—Get a Home Inspection’ that does not reference FHA-insured homes, in both English and Spanish languages; and

(D) publication of the HUD document entitled 'Ten Important Questions To Ask Your Home Inspector', in both English and Spanish languages.

(2) AVAILABILITY—The Secretary shall make the materials specified in paragraph (1) available for electronic access and, where appropriate, inform potential homebuyers of such availability through home purchase counseling public service announcements and toll-free telephone hotlines of the Department of Housing and Urban Development. The Secretary shall give special emphasis to reaching first-time and low-income homebuyers with these materials and efforts.

(3) UPDATING—The Secretary may periodically update and revise such materials, as the Secretary determines to be appropriate.

(b) Requirement for FHA-approved Lenders—Each mortgagee approved for participation in the mortgage insurance programs under title II of the National Housing Act shall provide prospective homebuyers, at first contact, whether upon pre-qualification, pre-approval, or initial application, the materials specified in subparagraphs (A), (B), and (D) of subsection (a)(1).

(c) Requirements for HUD-approved Counseling Agencies—Each counseling agency certified pursuant by the Secretary to provide housing counseling services shall provide each of their clients, as part of the home purchase counseling process, the materials specified in subparagraphs (C) and (D) of subsection (a)(1).

(d) Training—Training provided the Department of Housing and Urban Development for housing counseling agencies, whether such training is provided directly by the Department or otherwise, shall include—

(1) providing information on counseling potential homebuyers of the availability and importance of getting an independent home inspection;

(2) providing information about the home inspection process, including the reasons for specific inspections such as radon and lead-based paint testing;

(3) providing information about advising potential homebuyers on how to locate and select a qualified home inspector; and

(4) review of home inspection public outreach materials of the Department.

**Analysis.** The Secretary of HUD is to take actions to inform potential homebuyers of the availability and importance of obtaining an independent home inspection. This includes various HUD publications, which are to be made available electronically. FHA-approved lenders are to provide prospective homebuyers, “at first contact,” with certain of these materials. HUD-certified counseling agencies are also to provide certain of these materials to their clients, and HUD training for counselors is to include the providing of this information.

Creditors that provide nonFHA mortgage programs also may wish to provide certain of these materials to consumers.

## Section 1452. Warnings to Homeowners of Foreclosure Rescue Scams

(a) Assistance to NRC—Notwithstanding any other provision of law, of any amounts made available for any fiscal year pursuant to section 106(a)(4)(F) of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x(a)(4)(F)) (as added by section 1444), 10 percent shall be used only for assistance to the Neighborhood Reinvestment Corporation for activities, in consultation with servicers of residential mortgage loans, to provide notice to borrowers under such loans who are delinquent with respect to payments due under such loans that makes such borrowers aware of the dangers of fraudulent activities associated with foreclosure.

(b) Notice—The Neighborhood Reinvestment Corporation, in consultation with servicers of residential mortgage loans, shall use the amounts provided pursuant to subsection (a) to carry out activities to inform borrowers under residential mortgage loans—

(1) that the foreclosure process is complex and can be confusing;

(2) that the borrower may be approached during the foreclosure process by persons regarding saving their home and they should use caution in any such dealings;

(3) that there are Federal Government and nonprofit agencies that may provide information about the foreclosure process, including the Department of Housing and Urban Development;

(4) that they should contact their lender immediately, contact the Department of Housing and Urban Development to find a housing counseling agency certified by the Department to assist in avoiding foreclosure, or visit the Department’s website regarding tips for avoiding foreclosure; and

(5) of the telephone number of the loan servicer or successor, the telephone number of the Department of Housing and Urban Development housing counseling line, and the Uniform Resource Locators (URLs) for the Department of Housing and Urban Development Web sites for housing counseling and for tips for avoiding foreclosure.

**Analysis.** Certain funds are to be allocated to the Neighborhood Reinvestment Corporation (“NRC”) to provide a notice to delinquent consumers that will make them aware of the dangers of foreclosure rescue scams. The NRC is to do this in consultation with servicers of residential mortgage loans.

It is unclear whether the NRC will provide these notices directly to the affected consumers, or instead request that servicers provide these notices to their respective delinquent consumers. Given the fact that the notices must include the telephone number of the servicer or its successor, it is possible that servicers will be requested or required to provide the notice. The statute does not state when the notice will be provided, but a logical time would be at or shortly following the initiation of the foreclosure process.

### **Subtitle F – Appraisal Activities**

#### **Section 1471. Property Appraisal Requirements**

Chapter 2 of the Truth in Lending Act (15 U.S.C. 1631 et seq.) is amended by inserting after 129G (as added by section 1464(b)) the following new section:

Sec. 129H. Property appraisal requirements

(a) In General—A creditor may not extend credit in the form of a higher-risk mortgage to any consumer without first obtaining a written appraisal of the property to be mortgaged prepared in accordance with the requirements of this section.

(b) Appraisal Requirements—

(1) PHYSICAL PROPERTY VISIT—Subject to the rules prescribed under paragraph (4), an appraisal of property to be secured by a higher-risk mortgage does not meet the requirement of this section unless it is performed by a certified or licensed appraiser who conducts a physical property visit of the interior of the mortgaged property.

(2) SECOND APPRAISAL UNDER CERTAIN CIRCUMSTANCES—

(A) IN GENERAL—If the purpose of a higher-risk mortgage is to finance the purchase or acquisition of the mortgaged property from a person within 180 days of the purchase or acquisition of such property by that person at a price that was lower than the current sale price of the property, the creditor shall obtain a second appraisal from a different certified or licensed appraiser. The second appraisal shall include an analysis of the difference in sale prices, changes in market conditions, and any improvements made to the property between the date of the previous sale and the current sale.

(B) NO COST TO APPLICANT—The cost of any second appraisal required under subparagraph (A) may not be charged to the applicant.

(3) CERTIFIED OR LICENSED APPRAISER DEFINED—For purposes of this section, the term 'certified or licensed appraiser' means a person who—

(A) is, at a minimum, certified or licensed by the State in which the property to be appraised is located; and

(B) performs each appraisal in conformity with the Uniform Standards of Professional Appraisal Practice and title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, and the regulations prescribed under such title, as in effect on the date of the appraisal.

(4) REGULATIONS—

(A) IN GENERAL—The Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration Board, the Federal Housing Finance Agency, and the Bureau shall jointly prescribe regulations to implement this section.

(B) EXEMPTION—The agencies listed in subparagraph (A) may jointly exempt, by rule, a class of loans from the requirements of this subsection or subsection (a) if the agencies determine that the exemption is in the public interest and promotes the safety and soundness of creditors.

(c) Free Copy of Appraisal—A creditor shall provide 1 copy of each appraisal conducted in accordance with this section in connection with a higher-risk mortgage to the applicant without charge, and at least 3 days prior to the transaction closing date.

(d) Consumer Notification—At the time of the initial mortgage application, the applicant shall be provided with a statement by the creditor that any appraisal prepared for the mortgage is for the sole use of the creditor, and that the applicant may choose to have a separate appraisal conducted at the expense of the applicant.

(e) Violations—In addition to any other liability to any person under this title, a creditor found to have willfully failed to obtain an appraisal as required in this section shall be liable to the applicant or borrower for the sum of \$2,000.

(f) Higher-risk Mortgage Defined—For purposes of this section, the term 'higher-risk mortgage' means a residential mortgage loan, other than a reverse mortgage loan that is a qualified mortgage, as defined in section 129C, secured by a principal dwelling—

(1) that is not a qualified mortgage, as defined in section 129C; and

(2) with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction, as defined in section 129C, as of the date the interest rate is set—

(A) by 1.5 or more percentage points, in the case of a first lien residential mortgage loan having an original principal obligation amount that does not exceed the amount of the maximum limitation on the original principal obligation of mortgage in effect for a residence of the applicable size, as of the date of such interest rate set, pursuant to the sixth sentence of section 305(a)(2) the Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1454(a)(2));

(B) by 2.5 or more percentage points, in the case of a first lien residential mortgage loan having an original principal obligation amount that exceeds the amount of the maximum limitation on the original principal obligation of mortgage in effect for a residence of the applicable size, as of the date of such interest rate set, pursuant to the sixth sentence of section 305(a)(2) the Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1454(a)(2)); and

(C) by 3.5 or more percentage points for a subordinate lien residential mortgage loan.<sup>1</sup>

**Analysis.** Section 1471 of the Dodd-Frank Act adds a new § 129H to TILA to impose a “super appraisal” requirement for “higher-risk” mortgages.

- In General. A creditor is not permitted to make a higher-risk mortgage to a consumer without first obtaining a written appraisal that meets the requirements described below.

- Physical Property Visit. The appraisal must be performed by a certified or licensed appraiser. The appraiser must conduct a physical property visit of the interior of the property.

The requirement of an appraisal for all higher-risk mortgages represents a dramatic change from the existing rules of the federal banking agencies, which do not require an appraisal by a certified or licensed appraiser under a variety of circumstances. See, e.g., 12 C.F.R. § 34.43 (OCC appraisal regulations). For example, these regulations ordinarily do not require such an appraisal for loans of \$250,000 or less. For such loans, it is nonetheless necessary to obtain a less formal evaluation. The new statute will require formal appraisals for all higher-risk mortgages, which will increase the cost of originating these loans and will slow down the origination process. The additional time required to undertake a formal appraisal will be particularly challenging where a consumer requests a higher-risk mortgage to pay off an existing loan that is shortly scheduled for foreclosure.

This is yet another example of the evolution of TILA beyond its early function as a disclosure statute.

The requirement for a visit of the appraiser to the interior of the property may result in an increase in the cost of an appraisal.

- Second Appraisal Under Certain Circumstances. A second appraisal is required if the higher-risk mortgage is to finance the purchase or acquisition of the property within 180 days of the seller’s own purchase or acquisition of the same property, where the seller’s purchase or acquisition was at a lower price. The second appraisal must be performed by a different certified or licensed appraiser. The second appraisal must include an analysis of the difference in the sale prices, changes in market conditions, and any improvements made to the property in between the dates of the prior sale and the current sale.

The requirement of a second appraisal is unprecedented. In a rising market, virtually all resales within a six-month period will require a second appraisal if the new mortgage is a higher-risk mortgage. The necessity of a second appraisal will increase the cost of loan origination and will require additional time. Creditors that originate higher-risk mortgages may wish to determine early in the mortgage application process whether the second appraisal requirement will be triggered, so that they can arrange for the second appraisal without delay.

The second appraisal is required to analyze the basis for the difference in the two sales prices. This may be beyond the expertise of many appraisers, and the creditor will need to engage appraisers who are capable of making these determinations. The new statute does not state what actions, if any, must be taken by the creditor if the second appraisal does not provide a credible basis for the differences between the two prices. As a practical matter, if the creditor nonetheless provides the higher-risk

mortgage loan, this may subject the creditor to a variety of risks. Accordingly, creditors should develop policies and procedures to govern their actions in these situations. It would be expected that those policies and procedures would not allow the creditor to proceed with the transaction unless it is able to document a reasonable basis for the second sale price.

The second appraisal must be performed by a “different” certified or licensed appraiser. The prudent practice would be to choose the second appraiser from a different appraisal firm. Absent a contrary direction from the implementing regulations, there is no reason that the same appraisal management company could not be used to find and engage the second appraiser.

- No Cost to Applicant. The applicant may not be charged for the cost of the second appraisal.

This prohibition undoubtedly will increase the cost of originating higher-risk mortgages. The inability to charge the consumer for the second appraisal presumably precludes increasing the consumer’s loan origination fees, increasing the cost of the first appraisal, or imposing new fees to cover the cost of the second appraisal. On the other hand, it is likely that creditors which regularly originate higher-risk mortgages will find a way to build the additional cost and risk into their basic pricing model for these mortgages. This is a reasonable approach, but not without risk.

- Certified or Licensed Appraiser Defined. A certified or licensed appraiser is one who (i) has been certified or licensed in the state in which the property is located and (ii) performs each appraisal in accordance with the Uniform Standards for Professional Appraiser Practice (“USPAP”) and Title XI of the Financial Institutions Reform, Recovery and Enforcement Act (“FIRREA”) (governing appraisals) and its implementing regulations in effect on the date of the appraisal (e.g., 12 C.F.R. §§ 34.41, *et seq.*, in the case of the OCC).

As literally worded, this statute shifts regulatory risk to the creditor. That is, unless the appraiser is both licensed or certified and in compliance with USPAP and the FIRREA regulations, the appraiser will not qualify as a “licensed or certified appraiser” for purposes of the new statute, and the creditor could not lawfully make the higher-risk mortgage in reliance on an appraisal performed by such an appraiser (or in reliance on a second appraisal performed by such an appraiser, where applicable). This risk suggests the necessity of obtaining appropriate representations and warranties from the appraisers in question and, where applicable, from any appraisal management companies through which appraisers are engaged. Creditors also may wish to monitor the appraiser’s compliance with USPAP and the FIRREA regulations.

- Regulations. The Board, Bureau, Federal Housing Finance Agency (“FHFA”), OCC, Federal Deposit Insurance Corporation (“FDIC”), and NCUA are directed to jointly issue implementing regulations. The joint rules can exempt a class of loans from the foregoing requirements if there is a finding that the exemption is in the public interest and promotes the safety and soundness of creditors.
- Free Copy of Appraisal. The creditor is required to provide to the applicant, without charge, one copy of each appraisal that is conducted with respect to the higher-risk mortgage. This requirement applies to both the original appraisal and any second appraisal. The copies must be provided at least three days prior to closing.

The obligation to provide “one copy” of each appraisal report “without charge” raises an interpretive question. Does this mean that the creditor may not charge any fees for the cost of the appraisals, or does this simply mean that the creditor may not charge any additional fees for providing copies of the appraisals? As noted above, § 129H explicitly states that the creditor may not charge for the *second* appraisal when one is required. This suggests that it is permissible for the creditor to charge the consumer fees for the cost of the *first* appraisal. As a result, the better reading is that the creditor may charge fees for the cost of the first appraisal, may not charge fees for the cost of the second appraisal

when one is required, and may not charge any additional fees for providing copies of either appraisal. This reading is consistent with the reading of a somewhat similar issue in Section 1474 of the Dodd-Frank Act, discussed below.

- Consumer Notification. At the time of the initial loan application, the creditor is to provide the applicant with a statement to the effect that the appraisal is for the sole use of the creditor, and that the consumer may choose to obtain a separate appraisal at his/her own expense.

This notice is helpful because it will establish an early record regarding the purpose of the appraisal, but providing the notice will impose a new operational burden. Creditors may wish to elaborate somewhat on the statutorily required notice. For example, creditors could make clear that the appraisal is solely for the benefit of the creditor and may only be relied upon by the creditor. The notice also should advise that (a) free copy(ies) of the appraisal(s) will be provided at least three days prior to closing if the loan is a higher-risk mortgage as defined by law, as this will forestall complaints by consumers who might otherwise claim that they would not have purchased their own appraisals if they knew that they might be receiving the free copy(ies).

This provision presumably is limited to higher-risk mortgages. If a creditor is not sure whether a loan application will ultimately result in a higher-risk mortgage, the creditor may wish to take the safer approach by providing the notice to the consumer.

The statute states that the creditor must provide the notice at the time of application. This raises the question of how creditors may comply with this requirement when the application is taken by a mortgage broker and then forwarded to the creditor, or where the application is taken by telephone. An analogous issue arises under 12 C.F.R. § 226.19(b), which requires a creditor to provide certain information at the time an application form is provided for an ARM (or, if earlier, when the consumer pays a nonrefundable fee). Footnote 45b to Regulation Z states that the disclosure may be provided within three business days following the creditor's receipt of the application by telephone or through an intermediary agent or broker. See Paragraph 226.19(b)-3 of the Regulation Z Commentary regarding who is an "intermediary agent or broker." The implementing regulations for the new statute may follow a similar approach.

- Violations. A creditor that willfully fails to obtain an appraisal as set forth above (*i.e.*, either the original appraisal or a second appraisal, where applicable) is liable to the applicant or borrower in the amount of \$2,000.

The liability under this new provision is in addition to any other liability under TILA (*i.e.*, civil liability, administrative liability, and criminal liability). An applicant or borrower who brings an action under this new statute need not prove any damages. Note that the general TILA cure provision in § 130(b) and the general TILA bona fide error defense in § 130(c) do not apply to a creditor's liability under this new statute.

- Higher-Risk Mortgage Defined. A higher-risk mortgage is a residential mortgage loan (see discussion above) that is secured by a principal dwelling and has the following characteristics:
  - The loan is not a "qualified mortgage" under § 129C of TILA (see discussion at Section 1412, above).
  - If the loan is a first lien loan that is equal to or less than the applicable Freddie Mac conforming loan limit, the APR of the loan exceeds the Average Prime Offer Rate for a comparable transaction as defined in § 129C of TILA as of the date that the interest rate is set by 1.5% or more.

- If the loan is a first lien loan that exceeds the applicable Freddie Mac conforming loan limit, the APR of the loan exceeds the Average Prime Offer Rate for a comparable transaction as defined in § 129C of TILA as of the date that the interest rate is set by 2.5% or more.
- If the loan is a subordinate lien loan, the APR of the loan exceeds the Average Prime Offer Rate for a comparable transaction as defined in § 129C of TILA as of the date that the interest rate is set by 3.5% or more.
- The loan is not a reverse mortgage that is a qualified mortgage.

This definition identifies yet another set of costs and risks of originating mortgages that are not qualified mortgages.

See discussion regarding the date that the interest rate is set at Section 1411, above.

## Section 1472. Appraisal Independence Requirements

(a) In General—Chapter 2 of the Truth in Lending Act (15 U.S.C. 1631 et seq.) is amended by inserting after section 129D (as added by section 1461(a)) the following new section:

### Sec. 129E. Appraisal independence requirements

(a) In General—It shall be unlawful, in extending credit or in providing any services for a consumer credit transaction secured by the principal dwelling of the consumer, to engage in any act or practice that violates appraisal independence as described in or pursuant to regulations prescribed under this section.

(b) Appraisal Independence—For purposes of subsection (a), acts or practices that violate appraisal independence shall include—

(1) any appraisal of a property offered as security for repayment of the consumer credit transaction that is conducted in connection with such transaction in which a person with an interest in the underlying transaction compensates, coerces, extorts, colludes, instructs, induces, bribes, or intimidates a person, appraisal management company, firm, or other entity conducting or involved in an appraisal, or attempts, to compensate, coerce, extort, collude, instruct, induce, bribe, or intimidate such a person, for the purpose of causing the appraised value assigned, under the appraisal, to the property to be based on any factor other than the independent judgment of the appraiser;

(2) mischaracterizing, or suborning any mischaracterization of, the appraised value of the property securing the extension of the credit;

(3) seeking to influence an appraiser or otherwise to encourage a targeted value in order to facilitate the making or pricing of the transaction; and

(4) withholding or threatening to withhold timely payment for an appraisal report or for appraisal services rendered when the appraisal report or services are provided for in accordance with the contract between the parties.

(c) Exceptions—The requirements of subsection (b) shall not be construed as prohibiting a mortgage lender, mortgage broker, mortgage banker, real estate broker, appraisal management company, employee of an appraisal management company, consumer, or any other person with an interest in a real estate transaction from asking an appraiser to undertake 1 or more of the following:

(1) Consider additional, appropriate property information, including the consideration of additional comparable properties to make or support an appraisal.

(2) Provide further detail, substantiation, or explanation for the appraiser's value conclusion.

(3) Correct errors in the appraisal report.

(d) Prohibitions on Conflicts of Interest—No certified or licensed appraiser conducting, and no appraisal management company procuring or facilitating, an appraisal in connection with a consumer credit transaction secured by the principal dwelling of a consumer may have a direct or indirect interest, financial or otherwise, in the property or transaction involving the appraisal.

(e) Mandatory Reporting—Any mortgage lender, mortgage broker, mortgage banker, real estate broker, appraisal management company, employee of an appraisal management company, or any other person involved in a real estate transaction involving an appraisal in connection with a consumer credit transaction secured by the principal dwelling of a consumer who has a reasonable basis to believe an appraiser is failing to comply with the Uniform Standards of Professional Appraisal Practice, is violating applicable laws, or is otherwise engaging in unethical or unprofessional conduct, shall refer the matter to the applicable State appraiser certifying and licensing agency.

(f) No Extension of Credit—In connection with a consumer credit transaction secured by a consumer's principal dwelling, a creditor who knows, at or before loan consummation, of a violation of the appraisal independence standards established in subsections (b) or (d) shall not extend credit based on such appraisal unless the creditor documents that the creditor has acted with reasonable diligence to determine that the appraisal does not materially misstate or misrepresent the value of such dwelling.

“(g) Rules and Interpretive Guidelines—

“(1) IN GENERAL—Except as provided under paragraph (2), the Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration Board, the Federal Housing Finance Agency, and the Bureau may jointly issue rules, interpretive guidelines, and general statements of policy with respect to acts or practices that violate appraisal independence in the provision of mortgage lending services for a consumer credit transaction secured by the principal dwelling of the consumer and mortgage brokerage services for such a transaction, within the meaning of subsections (a), (b), (c), (d), (e), (f), (h), and (i).

“(2) INTERIM FINAL REGULATIONS—The Board shall, for purposes of this section, prescribe interim final regulations no later than 90 days after the date of enactment of this section defining with specificity acts or practices that violate appraisal independence in the provision of mortgage lending services for a consumer credit transaction secured by the principal dwelling of the consumer or mortgage brokerage services for such a transaction and defining any terms in this section or such regulations. Rules prescribed by the Board under this paragraph shall be deemed to be rules prescribed by the agencies jointly under paragraph (1).

“(h) Appraisal Report Portability—Consistent with the requirements of this section, the Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration Board, the Federal Housing Finance Agency, and the Bureau may jointly issue regulations that address the issue of appraisal report portability, including regulations that ensure the portability of the appraisal report between lenders for a consumer credit transaction secured by a 1-4 unit single family residence that is the principal dwelling of the consumer, or mortgage brokerage services for such a transaction.

“(i) Customary and Reasonable Fee—

“(1) IN GENERAL—Lenders and their agents shall compensate fee appraisers at a rate that is customary and reasonable for appraisal services performed in the market area of the property being appraised. Evidence for such fees may be established by objective third-party information, such as government agency fee schedules, academic studies, and independent private sector surveys. Fee studies shall exclude assignments ordered by known appraisal management companies.

“(2) FEE APPRAISER DEFINITION—For purposes of this section, the term ‘fee appraiser’ means a person who is not an employee of the mortgage loan originator or appraisal management company engaging the appraiser and is—

“(A) a State licensed or certified appraiser who receives a fee for performing an appraisal and certifies that the appraisal has been prepared in accordance with the Uniform Standards of Professional Appraisal Practice; or

“(B) a company not subject to the requirements of section 1124 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3331 et seq.) that utilizes the services of State licensed or certified appraisers and receives a fee for performing appraisals in accordance with the Uniform Standards of Professional Appraisal Practice.

“(3) EXCEPTION FOR COMPLEX ASSIGNMENTS—In the case of an appraisal involving a complex assignment, the customary and reasonable fee may reflect the increased time, difficulty, and scope of the work required for such an appraisal and include an amount over and above the customary and reasonable fee for non-complex assignments.

“(j) Sunset—Effective on the date the interim final regulations are promulgated pursuant to subsection (g), the Home Valuation Code of Conduct announced by the Federal Housing Finance Agency on December 23, 2008, shall have no force or effect.

“(k) Penalties—

“(1) FIRST VIOLATION—In addition to the enforcement provisions referred to in section 130, each person who violates this section shall forfeit and pay a civil penalty of not more than \$10,000 for each day any such violation continues.

“(2) SUBSEQUENT VIOLATIONS—In the case of any person on whom a civil penalty has been imposed under paragraph (1), paragraph (1) shall be applied by substituting ‘\$20,000’ for ‘\$10,000’ with respect to all subsequent violations.

“(3) ASSESSMENT—The agency referred to in subsection (a) or (c) of section 108 with respect to any person described in paragraph (1) shall assess any penalty under this subsection to which such person is subject.’.

(b) Clerical Amendment—The table of sections for chapter 2 of the Truth in Lending Act is amended by inserting after the item relating to section 129D (as added by section 1461(c)) the following new items:

“129E. Appraisal independence requirements.

“129F. Requirements for prompt crediting of home loan payments.

“129G. Requests for payoff amounts of home loan.

“129H. Property appraisal requirements.’.

(c) Deference—Section 105 of the Truth in Lending Act (15 U.S.C. 1604) is amended by adding at the end the following:

“(h) Deference—Notwithstanding any power granted to any Federal agency under this title, the deference that a court affords to the Bureau with respect to a determination made by the Bureau relating to the meaning or interpretation of any provision of this title, other than section 129E or 129H, shall be applied as if the Bureau were the only agency authorized to apply, enforce, interpret, or administer the provisions of this title.’.

(d) Conforming Amendments in Title X Not Applicable to Sections 129E and 129H—Notwithstanding section 1099A, the term ‘Board’ in sections 129E and 129H, as added by this subtitle, shall not be substituted by the term ‘Bureau’.

**Analysis.** Section 1472 of the Dodd-Frank Act adds a new § 129E to TILA to establish new appraisal independence requirements for certain dwelling-secured loans. This reflects Congress’s belief that a failure to

achieve independence in the appraisal process contributed significantly to the recent collapse of the residential mortgage market, many banking institutions and other mortgage lenders. A similar failure was cited in the banking crises and failures of the later 1980s, leading to FIRREA's establishment of a regulatory regime for appraisers and the appraisal process.

- In General. It is unlawful to engage in any act or practice that violates appraiser independence as described below or in the implementing regulations.
  - Scope. The new requirement applies to any consumer credit transaction secured by the principal dwelling of the consumer. See discussion at Section 1414, above, regarding principal dwellings. The persons covered by the new statute include, among others, buyers, sellers, borrowers, appraisers, appraisal management companies, creditors, mortgage originators, and their respective employees.
  - Other Independence Standards. Loans that fall outside the scope of this statute remain subject to appraiser independence standards imposed by other regulatory requirements, USPAP, and other applicable federal and state laws. See, e.g., 12 C.F.R. § 34.45, an OCC regulation that imposes appraiser independence standards for staff and fee appraisers. However, only a violation of the new statute's provisions can trigger the liabilities imposed by TILA.
- Appraisal Independence. The statute provides a non-exclusive list of the acts or practices that violate appraisal independence:
  - Where a person with an interest in the underlying transaction compensates, coerces, extorts, colludes, instructs, induces, bribes, or intimidates a person, appraisal management company, firm or other company conducting or involved in an appraisal, for the purpose of causing the appraised value to be based on any factor other than the appraiser's independent judgment. Similarly, an attempt to engage in these acts is a violation.

This provision is similar to the Board's existing anti-coercion regulation at 12 C.F.R. § 226.36(b)(1). The principal difference is that the existing regulation is limited to creditors, the original creditors in table-funded transactions, mortgage brokers, and their affiliates, whereas the new statute covers any person with an interest in the transaction. The examples of unlawful actions set forth in § 226.36(b)(1) are as follows:

- Implying to an appraiser that current or future retention of the appraiser depends on the amount at which the appraiser values a consumer's principal dwelling.
- Excluding an appraiser from consideration for future engagements because the appraiser reports a value of a consumer's principal dwelling that does not meet or exceed a minimum threshold.
- Telling an appraiser a minimum reported value of a consumer's principal dwelling that is needed to approve the loan.
- Failing to compensate an appraiser because the appraiser does not value a consumer's principal dwelling at or above a certain amount.
- Conditioning an appraiser's compensation on loan consummation.

Additional unlawful actions would include: (i) threatening to withhold additional appraisal assignments if the appraisal fails to come in at a particular value; (ii) agreeing to employ a relative or friend in return for having the appraisal come in at a particular value; and (iii) payments of money or other consideration in return for having the appraisal come in at a particular value.

- Mischaracterizing the appraised value of the security property. Similarly, persuading another to do so is a violation.

A simple example of this type of violation is an appraiser or appraisal management company that marks up the value of the appraised property.

In many cases, this type of violation occurs when a person responds affirmatively to the acts or practices described in the previous paragraph. For example, if a mortgage originator presents a bribe, this would violate the preceding paragraph. If the appraiser marks up the value of the appraised property, that would violate this paragraph. Note, however, that any mischaracterization of the value of the property is a violation of this paragraph regardless of whether a bribe or its equivalent is offered or received. Note also that mischaracterization of the appraised value is not legally justified by the coercive acts of another person or entity.

- Seeking to influence an appraiser or otherwise to encourage a targeted value in order to facilitate the making or pricing of the transaction.

This is similar to one of the examples of illegal actions set forth in the first set of prohibitions, above, but does not require that the person have an interest in the transaction.

- Withholding timely payment for an appraisal report or services, or threatening to do so.

This is similar to one of the examples of illegal actions set forth in 12 C.F.R. § 226.36(b)(1).

Taken together, these prohibition examples portray a broad proscription against any activities, direct or indirect, that attempt to influence the independence of the judgments made by the appraiser and the appraisal process. Companies should develop policies and procedures that are designed to protect against these violations, and should monitor compliance with those policies and procedures.

- Exceptions. The prohibitions relating to appraisal independence do not prohibit any person with an interest in the transaction from asking an appraiser to: (i) consider additional and appropriate property information, including other comparable properties; (ii) provide further detail, substantiation, or explanation for the appraiser's value conclusion; or (iii) correct errors in the appraisal report.

These exceptions are similar to several of the exceptions found at 12 C.F.R. § 226.36(b)(1). The exceptions must be exercised in good faith. Any effort to use an exception to improperly influence the appraised value of the property will not be protected. Creditors would be well advised to develop policies and procedures relating to the circumstances and manner in which these exceptions may be properly exercised. Compliance with such appropriate and well-defined policies and procedures will go a long way in demonstrating the credible use of these exceptions.

The Board's existing regulations set forth at 12 C.F.R. § 226.36(b)(1) contain three additional exceptions that were not included in the new statute: (i) obtaining multiple appraisals of a consumer's principal dwelling, so long as the creditor adheres to a policy of selecting the most reliable appraisal, rather than the appraisal that states the highest value, (ii) withholding compensation from an appraiser for breach of contract or substandard performance of services as provided by contract, and (iii) taking action permitted or required by applicable federal or state statute, regulation, or agency guidance. The fact that these exceptions were not included in the new statute should not be interpreted to mean that they necessarily are no longer valid. The Board will likely review the exceptions, determine their continued merit, and modify or delete them as appropriate.

- Prohibitions on Conflicts of Interest. Both certified and licensed appraisers, as well as appraisal management companies, are prohibited from having a direct or indirect financial or other interest in the property or the

transaction involving the appraisal. This prohibition applies to any consumer credit transaction secured by the principal dwelling of the consumer.

Loans that fall outside the scope of this statute remain subject to conflict of interest standards imposed by other regulatory requirements, USPAP, and other applicable federal and state laws. See, e.g., the OCC regulation at 12 C.F.R. § 34.45, which prohibits staff appraisers “from performing an appraisal in connection with federally related transactions in which the appraiser is otherwise involved” and which prohibits fee appraisers from holding any “direct or indirect interest, financial or otherwise, in the property or the transaction.” However, only a violation of the new statute’s provisions will trigger the liabilities imposed by TILA.

- **Mandatory Reporting.** Any person involved in a consumer credit transaction secured by a consumer’s principal dwelling who has a reasonable basis to believe that an appraiser has failed to comply with USPAP or applicable laws, or that the appraiser is engaged in unethical or unprofessional conduct, is required to refer the matter to the applicable state agency that certifies and licenses appraisers. This duty is imposed on creditors, mortgage originators, appraisal management companies and their employees, and any other person involved in the transaction. The precise scope of persons covered by this mandatory whistleblower law is uncertain. Clearly, however, Congress intended to cover a broad swath of persons, and it would be prudent to read the scope of persons covered by this statute expansively. Companies should develop policies and procedures to handle referrals and should advise their employees of their duty to report. When an employee of a company determines that there is a reasonable basis to make a report under this statute, the statute literally requires the employee to report directly to the applicable state agency. It is possible that the implementing regulations will allow employees to submit the relevant information to their employers which will, in turn, submit the report to the state agency.

This statute does not contain a “safe harbor” that protects those who make the required reports from liability. (This is in contrast to 31 U.S.C. § 5318(g)(3), which provides a “safe harbor” for financial institutions that file suspicious activity reports under certain circumstances.) Accordingly, it is possible that reporters could be faced with defamation or other lawsuits. This further emphasizes the necessity of developing detailed policies and procedures to govern reporting.

- **No Extension of Credit.** If the creditor knows of a violation of the appraiser independence or conflict of interest provisions described above, at or before the consummation of the loan, the creditor is not permitted to extend credit based on the appraisal unless the creditor documents that it has acted with reasonable diligence to determine that the appraisal does not materially misstate or misrepresent the value of the dwelling.

This provision applies to any consumer credit transaction secured by the principal dwelling of the consumer. It is modeled on the Board’s existing regulation at 12 C.F.R. § 226.36(b)(2). Paragraph 226.36(b)(2)-2 of the Regulation Z Commentary states that “[a] misstatement or misrepresentation of [a] dwelling’s value is not material if it does not affect the credit decision or the terms on which the credit is extended.” As a practical matter, once it is determined that the appraisal is tainted by reason of a violation of the appraiser independence or conflict of interest provisions described above, it would be difficult to conceive of a situation in which the creditor could safely conclude that a misstatement or misrepresentation of the dwelling’s value is not material. Instead, once the appraisal is identified as tainted, the prudent approach is to obtain a new, compliant appraisal from another source. Paragraph 226.36(b)(2)-1 of the Regulation Z Commentary states that a creditor will be deemed to have acted with reasonable diligence if it extends credit on the basis of a new and compliant appraisal.

- **Rules and Interpretive Guidelines.** The Board, Bureau, FHFA, OCC, FDIC, and NCUA are authorized, but not required, to issue joint regulations, interpretive guidelines and general statements of policy regarding acts and practices that violate the new appraisal rules. The Board is directed to issue interim final rules within 90 days following enactment of the Dodd-Frank Act.

- Appraisal Report Portability. The Board, Bureau, FHFA, OCC, FDIC, and NCUA are authorized, but not required, to issue joint regulations addressing the subject of appraisal report portability. The regulations are to “ensure the portability of the appraisal report between lenders for a consumer credit transaction secured by a 1-4 unit single [*sic*] family residence that is the principal dwelling of the consumer, or mortgage brokerage services for such a transaction.”

The purpose of this provision is to facilitate credit shopping by consumers by allowing them to take an appraisal commissioned by one creditor or mortgage broker to one or more other creditors or mortgage brokers. The underlying assumption is that these regulations will require the consumer to pay for only one appraisal. Current banking agency interpretive guidance allows for some portability of appraisals so long as they continue to reflect an accurate valuation of the property.

The practical problem with the portability of appraisals is that each creditor establishes its own criteria for its staff and fee appraisers and develops its own list of approved appraisers. An appraiser who appears on one creditor’s approved list will not necessarily appear (or even be qualified to appear) on another creditor’s approved list. It is unlikely that the final regulations will require a creditor to accept the appraisals produced by appraisers who are not on the creditor’s approved list.

- Customary and Reasonable Fee. Creditors and their agents are required to compensate fee appraisers at a rate that is “customary and reasonable for appraiser services performed in the market area” of the property being appraised.
  - The fees may be based on objective third-party schedules, academic studies, and independent private sector surveys. Any fee studies must exclude assignments ordered by known appraisal management companies. This may be because some appraisal management companies maintain a single (artificially low) national fee schedule for their networks of appraisers. Given the requirements of the new statute, it will be prudent for creditors that use fee appraisers to identify a credible third party’s data to support its appraiser fee schedules.
  - Note that the new statute requires that compensation be “customary and reasonable for appraiser services performed in the market area” of the property being appraised. This indicates that a single national fee schedule will not be permissible, assuming that a single schedule is not supported by third party data.
  - For purposes of the new statute, a “fee appraiser” is a person who is not an employee of the creditor or an appraisal management company engaging the appraiser, where the fee appraiser is state licensed or certified and certifies that the appraisal has been performed in accordance with USPAP. A “fee appraiser” is also a company that is not an appraisal management company that is subject to the new registration provisions discussed below.
  - If the appraiser performs a complex assignment, the customary and reasonable fee may be increased to reflect the increased time, difficulty and scope of the work. The statute does not define the term “complex assignment,” but a “complex 1-to-4 unit single [*sic*] family residential appraisal” is defined by amended 12 U.S.C. § 3342 to mean one in which “the property to be appraised, the form of ownership, the property characteristics, or the market conditions are atypical.” Institutions subject to the FIRREA appraisal regulations must already have policies and procedures to deal with situations in which they are given information that an appraisal is complex. (Note: Complex appraisals of 1-4 unit residential properties for transactions of \$250,000 or more must be performed by state-certified appraisers.) See, e.g., 12 C.F.R. § 34.43(d)(3) (OCC regulation).
- Sunset. When the interim final Board regulations referenced above are promulgated, the Home Valuation Code of Conduct (“HVCC”) announced by the FHFA on December 23, 2008 will have no force or effect. The HVCC remains applicable to actions and transactions prior to that date.

The HVCC was entered into by the New York Attorney General's Office with the FHFA and Fannie Mae and Freddie Mac to enhance the independence and accuracy of the appraisal process.

- **Penalties.** A violation of the appraiser independence rules in new § 129E of TILA subjects the violator to the "enforcement provisions" referred to in § 130 of TILA. In addition, violators are subject to a civil penalty of up to \$10,000 per day for the first violation, and up to \$20,000 per day for subsequent violations. The civil penalties are to be assessed by the federal agencies with administrative enforcement authority under TILA (e.g., for a national bank, the OCC).

For purposes of imposing civil penalties, it is likely that each violation (e.g., for each loan) will be considered a separate violation. While it is likely that the highest level of penalties will be reserved for the most egregious situations, the power to impose civil penalties of this magnitude is intended to communicate that Congress is serious about reining in creditors, appraisers, appraisal management companies and others who have compromised the independence of the appraisal process.

- **Deference.** This provision clarifies that the deference to be accorded to the Bureau relating to any provision of Title XIV of the Dodd-Frank Act shall be applied as if the Bureau were the only agency authorized to act under that title. The only exception is with respect to § 129H (property appraisal requirements) and § 129E (appraisal independence) of TILA, presumably because those sections dictate that the Bureau act jointly with other agencies.
- **Conforming Amendments in Title XIV Not Applicable to Sections 129E and 129H.** Although certain functions of the Board relating to consumer protection laws ultimately will be moved to the Bureau, the functions delegated to the Board by new § 129H (property appraisal requirements) and § 129E (appraisal independence) of TILA will not be so delegated.

### **Section 1473. Amendments Relating to Appraisal Subcommittee of FFIEC, Appraiser Independence Monitoring, Approved Appraiser Education, Appraisal Management Companies, Appraiser Complaint Hotline, Automated Valuation Models, and Broker Price Opinions**

(a) Threshold Levels—Section 1112(b) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3341(b)) is amended by inserting before the period the following: ", and receives concurrence from the Bureau of Consumer Financial Protection that such threshold level provides reasonable protection for consumers who purchase 1-4 unit single-family residences'.

(b) Annual Report of Appraisal Subcommittee—Section 1103(a) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3332(a)) is amended at the end by inserting the following new paragraph:

“(5) transmit an annual report to the Congress not later than June 15 of each year that describes the manner in which each function assigned to the Appraisal Subcommittee has been carried out during the preceding year. The report shall also detail the activities of the Appraisal Subcommittee, including the results of all audits of State appraiser regulatory agencies, and provide an accounting of disapproved actions and warnings taken in the previous year, including a description of the conditions causing the disapproval and actions taken to achieve compliance.’.

(c) Open Meetings—Section 1104(b) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3333(b)) is amended—

(1) by inserting “in public session after notice in the Federal Register, but may close certain portions of these meetings related to personnel and review of preliminary State audit reports,” after “shall meet”; and

(2) by adding after the final period the following: “The subject matter discussed in any closed or executive session shall be described in the Federal Register notice of the meeting.’.

(d) Regulations—Section 1106 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3335) is amended—

(1) by inserting “prescribe regulations in accordance with chapter 5 of title 5, United States Code (commonly referred to as the Administrative Procedures Act) after notice and opportunity for comment,” after “hold hearings”; and

(2) at the end by inserting “Any regulations prescribed by the Appraisal Subcommittee shall (unless otherwise provided in this title) be limited to the following functions: temporary practice, national registry, information sharing, and enforcement. For purposes of prescribing regulations, the Appraisal Subcommittee shall establish an advisory committee of industry participants, including appraisers, lenders, consumer advocates, real estate agents, and government agencies, and hold meetings as necessary to support the development of regulations.’.

## (e) Appraisal Reviews and Complex Appraisals—

(1) SECTION 1110—Section 1110 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3339) is amended—

(A) in paragraph (1), by striking `and';

(B) in paragraph (2), by striking the period at the end and inserting `; and'; and

(C) by inserting after paragraph (2) the following:

`(3) that such appraisals shall be subject to appropriate review for compliance with the Uniform Standards of Professional Appraisal Practice.'.

(2) SECTION 1113—Section 1113 of the Financial Institutions and Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3342) is amended by inserting before the period the following: `, where a complex 1- to 4-unit single family residential appraisal means an appraisal for which the property to be appraised, the form of ownership, the property characteristics, or the market conditions are atypical'.

## (f) Appraisal Management Services—

(1) SUPERVISION OF THIRD-PARTY PROVIDERS OF APPRAISAL MANAGEMENT SERVICES—Section 1103(a) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3332(a)) (as previously amended by this section) is amended—

(A) by amending paragraph (1) to read as follows:

`(1) monitor the requirements established by States—

`(A) for the certification and licensing of individuals who are qualified to perform appraisals in connection with federally related transactions, including a code of professional responsibility; and

`(B) for the registration and supervision of the operations and activities of an appraisal management company;'; and

(B) by adding at the end the following new paragraph:

`(6) maintain a national registry of appraisal management companies that either are registered with and subject to supervision of a State appraiser certifying and licensing agency or are operating subsidiaries of a Federally regulated financial institution.'.

(2) APPRAISAL MANAGEMENT COMPANY MINIMUM REQUIREMENTS—Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3331 et seq.) is amended by adding at the end the following new section (and amending the table of contents accordingly):

`SEC. 1124. APPRAISAL MANAGEMENT COMPANY MINIMUM REQUIREMENTS.

`(a) In General—The Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration Board, the Federal Housing Finance Agency, and the Bureau of Consumer Financial Protection shall jointly, by rule, establish minimum requirements to be applied by a State in the registration of appraisal management companies. Such requirements shall include a requirement that such companies—

`(1) register with and be subject to supervision by a State appraiser certifying and licensing agency in each State in which such company operates;

`(2) verify that only licensed or certified appraisers are used for federally related transactions;

`(3) require that appraisals coordinated by an appraisal management company comply with the Uniform Standards of Professional Appraisal Practice; and

`(4) require that appraisals are conducted independently and free from inappropriate influence and coercion pursuant to the appraisal independence standards established under section 129E of the Truth in Lending Act.

`(b) Relation to State Law—Nothing in this section shall be construed to prevent States from establishing requirements in addition to any rules promulgated under subsection (a).

`(c) Federally Regulated Financial Institutions—The requirements of subsection (a) shall apply to an appraisal management company that is a subsidiary owned and controlled by a financial institution and regulated by a Federal financial institution regulatory agency. An appraisal management company that is a subsidiary owned and controlled by a financial institution regulated by a Federal financial institution regulatory agency shall not be required to register with a State.

`(d) Registration Limitations—An appraisal management company shall not be registered by a State or included on the national registry if such company, in whole or in part, directly or indirectly, is owned by any person who has had an appraiser license or certificate refused, denied, cancelled, surrendered in lieu of revocation, or revoked in any State. Additionally, each person that owns more than 10 percent of an appraisal management company shall be of good moral character, as determined by the State appraiser certifying and licensing agency, and shall submit to a background investigation carried out by the State appraiser certifying and licensing agency.

`(e) Reporting—The Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration Board, the Federal Housing Finance Agency, and the Bureau of Consumer Financial Protection shall jointly promulgate regulations for the reporting of the activities of appraisal management companies to the Appraisal Subcommittee in determining the payment of the annual registry fee.

**(f) Effective Date—**

(1) **IN GENERAL**—No appraisal management company may perform services related to a federally related transaction in a State after the date that is 36 months after the date on which the regulations required to be prescribed under subsection (a) are prescribed in final form unless such company is registered with such State or subject to oversight by a Federal financial institutions regulatory agency.

(2) **EXTENSION OF EFFECTIVE DATE**—Subject to the approval of the Council, the Appraisal Subcommittee may extend by an additional 12 months the requirements for the registration and supervision of appraisal management companies if it makes a written finding that a State has made substantial progress in establishing a State appraisal management company registration and supervision system that appears to conform with the provisions of this title.

(3) **STATE APPRAISER CERTIFYING AND LICENSING AGENCY AUTHORITY**—Section 1117 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3346) is amended by adding at the end the following: 'The duties of such agency may additionally include the registration and supervision of appraisal management companies and the addition of information about the appraisal management company to the national registry.'

(4) **APPRAISAL MANAGEMENT COMPANY DEFINITION**—Section 1121 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3350) is amended by adding at the end the following:

(11) **APPRAISAL MANAGEMENT COMPANY**—The term 'appraisal management company' means, in connection with valuing properties collateralizing mortgage loans or mortgages incorporated into a securitization, any external third party authorized either by a creditor of a consumer credit transaction secured by a consumer's principal dwelling or by an underwriter of or other principal in the secondary mortgage markets, that oversees a network or panel of more than 15 certified or licensed appraisers in a State or 25 or more nationally within a given year—

(A) to recruit, select, and retain appraisers;

(B) to contract with licensed and certified appraisers to perform appraisal assignments;

(C) to manage the process of having an appraisal performed, including providing administrative duties such as receiving appraisal orders and appraisal reports, submitting completed appraisal reports to creditors and underwriters, collecting fees from creditors and underwriters for services provided, and reimbursing appraisers for services performed; or

(D) to review and verify the work of appraisers.'

**(g) State Agency Reporting Requirement**—Section 1109(a) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3338(a)) is amended—

(1) by striking 'and' after the semicolon in paragraph (1);

(2) by redesignating paragraph (2) as paragraph (4); and

(3) by inserting after paragraph (1) the following new paragraphs:

(2) transmit reports on the issuance and renewal of licenses and certifications, sanctions, disciplinary actions, license and certification revocations, and license and certification suspensions on a timely basis to the national registry of the Appraisal Subcommittee;

(3) transmit reports on a timely basis of supervisory activities involving appraisal management companies or other third-party providers of appraisals and appraisal management services, including investigations initiated and disciplinary actions taken; and'

**(h) Registry Fees Modified—**

(1) **IN GENERAL**—Section 1109(a) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3338(a)) is amended—

(A) by amending paragraph (4) (as modified by section 1473(g)) to read as follows:

(4) collect—

(A) from such individuals who perform or seek to perform appraisals in federally related transactions, an annual registry fee of not more than \$40, such fees to be transmitted by the State agencies to the Council on an annual basis; and

(B) from an appraisal management company that either has registered with a State appraiser certifying and licensing agency in accordance with this title or operates as a subsidiary of a federally regulated financial institution, an annual registry fee of—

(i) in the case of such a company that has been in existence for more than a year, \$25 multiplied by the number of appraisers working for or contracting with such company in such State during the previous year, but where such \$25 amount may be adjusted, up to a maximum of \$50, at the discretion of the Appraisal Subcommittee, if necessary to carry out the Subcommittee's functions under this title; and

(ii) in the case of such a company that has not been in existence for more than a year, \$25 multiplied by an appropriate number to be determined by the Appraisal Subcommittee, and where such number will be used for determining the fee of all such companies that were not in existence for more than a year, but where such \$25 amount may be adjusted, up to a maximum of \$50, at the discretion of the Appraisal Subcommittee, if necessary to carry out the Subcommittee's functions under this title.'; and

(B) by amending the matter following paragraph (4), as redesignated, to read as follows:

Subject to the approval of the Council, the Appraisal Subcommittee may adjust the dollar amount of registry fees under paragraph (4)(A), up to a maximum of \$80 per annum, as necessary to carry out its functions under this title. The Appraisal Subcommittee shall consider at least once every 5 years whether to adjust the dollar amount of the registry fees to account for inflation. In implementing any change in registry fees, the Appraisal Subcommittee shall provide flexibility to the States for multi-year certifications and licenses already in place, as well as a transition period to implement the changes in registry fees. In establishing the amount of the annual registry fee for an appraisal management company, the Appraisal Subcommittee shall have the discretion to impose a minimum annual registry fee for an appraisal management company to protect against the under reporting of the number of appraisers working for or contracted by the appraisal management company.

(2) INCREMENTAL REVENUES—Incremental revenues collected pursuant to the increases required by this subsection shall be placed in a separate account at the United States Treasury, entitled the 'Appraisal Subcommittee Account'.

(i) Grants and Reports—Section 1109(b) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3338(b)) is amended—

(1) by striking 'and' after the semicolon in paragraph (3);

(2) by striking the period at the end of paragraph (4) and inserting a semicolon;

(3) by adding at the end the following new paragraphs:

(5) to make grants to State appraiser certifying and licensing agencies, in accordance with policies to be developed by the Appraisal Subcommittee, to support the efforts of such agencies to comply with this title, including—

(A) the complaint process, complaint investigations, and appraiser enforcement activities of such agencies; and

(B) the submission of data on State licensed and certified appraisers and appraisal management companies to the National appraisal registry, including information affirming that the appraiser or appraisal management company meets the required qualification criteria and formal and informal disciplinary actions; and

(6) to report to all State appraiser certifying and licensing agencies when a license or certification is surrendered, revoked, or suspended.

Obligations authorized under this subsection may not exceed 75 percent of the fiscal year total of incremental increase in fees collected and deposited in the 'Appraisal Subcommittee Account' pursuant to subsection (h).

(j) Criteria—Section 1116 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3345) is amended—

(1) in subsection (c), by inserting 'whose criteria for the licensing of a real estate appraiser currently meet or exceed the minimum criteria issued by the Appraisal Qualifications Board of The Appraisal Foundation for the licensing of real estate appraisers' before the period at the end; and

(2) by striking subsection (e) and inserting the following new subsection:

(e) Minimum Qualification Requirements—Any requirements established for individuals in the position of 'Trainee Appraiser' and 'Supervisory Appraiser' shall meet or exceed the minimum qualification requirements of the Appraiser Qualifications Board of The Appraisal Foundation. The Appraisal Subcommittee shall have the authority to enforce these requirements.

(k) Monitoring of State Appraiser Certifying and Licensing Agencies—Section 1118 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3347) is amended—

(1) by amending subsection (a) to read as follows:

(a) In General—The Appraisal Subcommittee shall monitor each State appraiser certifying and licensing agency for the purposes of determining whether such agency—

(1) has policies, practices, funding, staffing, and procedures that are consistent with this title;

(2) processes complaints and completes investigations in a reasonable time period;

(3) appropriately disciplines sanctioned appraisers and appraisal management companies;

(4) maintains an effective regulatory program; and

(5) reports complaints and disciplinary actions on a timely basis to the national registries on appraisers and appraisal management companies maintained by the Appraisal Subcommittee.

The Appraisal Subcommittee shall have the authority to remove a State licensed or certified appraiser or a registered appraisal management company from a national registry on an interim basis, not to exceed 90 days, pending State agency action on licensing, certification, registration, and disciplinary proceedings. The Appraisal Subcommittee and all agencies, instrumentalities, and Federally recognized entities under this title shall not recognize appraiser certifications and licenses from States whose appraisal policies, practices, funding, staffing, or procedures are found to be inconsistent with this title. The Appraisal Subcommittee shall have the authority to impose sanctions, as described in this section, against a State agency that fails to have an effective appraiser regulatory program. In determining whether such a program is effective, the Appraisal Subcommittee shall include an analysis of the licensing and certification of appraisers, the registration of appraisal management companies, the issuance of temporary licenses and certifications for appraisers, the receiving and tracking of submitted complaints against appraisers and appraisal management companies, the investigation of complaints, and enforcement actions against appraisers and appraisal management companies. The Appraisal Subcommittee shall have the authority to impose interim actions and suspensions against a State agency as an alternative to, or in advance of, the derecognition of a State agency.

(2) in subsection (b)(2), by inserting after 'authority' the following: 'or sufficient funding'.

(l) Reciprocity—Subsection (b) of section 1122 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3351(b)) is amended to read as follows:

'(b) Reciprocity—Notwithstanding any other provisions of this title, a federally related transaction shall not be appraised by a certified or licensed appraiser unless the State appraiser certifying or licensing agency of the State certifying or licensing such appraiser has in place a policy of issuing a reciprocal certification or license for an individual from another State when—

'(1) the appraiser licensing and certification program of such other State is in compliance with the provisions of this title; and

'(2) the appraiser holds a valid certification from a State whose requirements for certification or licensing meet or exceed the licensure standards established by the State where an individual seeks appraisal licensure.'

(m) Consideration of Professional Appraisal Designations—Section 1122(d) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3351(d)) is amended by striking 'shall not exclude' and all that follows through the end of the subsection and inserting the following: 'may include education achieved, experience, sample appraisals, and references from prior clients. Membership in a nationally recognized professional appraisal organization may be a criteria considered, though lack of membership therein shall not be the sole bar against consideration for an assignment under these criteria.'

(n) Appraiser Independence—Section 1122 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3351) is amended by adding at the end the following new subsection:

'(g) Appraiser Independence Monitoring—The Appraisal Subcommittee shall monitor each State appraiser certifying and licensing agency for the purpose of determining whether such agency's policies, practices, and procedures are consistent with the purposes of maintaining appraiser independence and whether such State has adopted and maintains effective laws, regulations, and policies aimed at maintaining appraiser independence.'

(o) Appraiser Education—Section 1122 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3351) is amended by inserting after subsection (g) (as added by subsection (l) of this section) the following new subsection:

'(h) Approved Education—The Appraisal Subcommittee shall encourage the States to accept courses approved by the Appraiser Qualification Board's Course Approval Program.'

(p) Appraisal Complaint Hotline—Section 1122 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3351), as amended by this section, is amended by adding at the end the following new subsection:

'(i) Appraisal Complaint National Hotline—If, 6 months after the date of the enactment of this subsection, the Appraisal Subcommittee determines that no national hotline exists to receive complaints of non-compliance with appraisal independence standards and Uniform Standards of Professional Appraisal Practice, including complaints from appraisers, individuals, or other entities concerning the improper influencing or attempted improper influencing of appraisers or the appraisal process, the Appraisal Subcommittee shall establish and operate such a national hotline, which shall include a toll-free telephone number and an email address. If the Appraisal Subcommittee operates such a national hotline, the Appraisal Subcommittee shall refer complaints for further action to appropriate governmental bodies, including a State appraiser certifying and licensing agency, a financial institution regulator, or other appropriate legal authorities. For complaints referred to State appraiser certifying and licensing agencies or to Federal regulators, the Appraisal Subcommittee shall have the authority to follow up such complaint referrals in order to determine the status of the resolution of the complaint.'

(q) Automated Valuation Models—Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3331 et seq.), as amended by this section, is amended by adding at the end the following new section (and amending the table of contents accordingly):

'SEC. 1125. AUTOMATED VALUATION MODELS USED TO ESTIMATE COLLATERAL VALUE FOR MORTGAGE LENDING PURPOSES.

'(a) In General—Automated valuation models shall adhere to quality control standards designed to—

'(1) ensure a high level of confidence in the estimates produced by automated valuation models;

'(2) protect against the manipulation of data;

'(3) seek to avoid conflicts of interest;

'(4) require random sample testing and reviews; and

'(5) account for any other such factor that the agencies listed in subsection (b) determine to be appropriate.

'(b) Adoption of Regulations—The Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration Board, the Federal Housing Finance Agency, and the Bureau of Consumer Financial Protection, in consultation with the staff of the Appraisal Subcommittee and the Appraisal Standards Board of the Appraisal Foundation, shall promulgate regulations to implement the quality control standards required under this section.

'(c) Enforcement—Compliance with regulations issued under this subsection shall be enforced by—

'(1) with respect to a financial institution, or subsidiary owned and controlled by a financial institution and regulated by a Federal financial institution regulatory agency, the Federal financial institution regulatory agency that acts as the primary Federal supervisor of such financial institution or subsidiary; and

(2) with respect to other participants in the market for appraisals of 1-to-4 unit single family residential real estate, the Federal Trade Commission, the Bureau of Consumer Financial Protection, and a State attorney general.

(d) Automated Valuation Model Defined—For purposes of this section, the term “automated valuation model” means any computerized model used by mortgage originators and secondary market issuers to determine the collateral worth of a mortgage secured by a consumer’s principal dwelling.’

(r) Broker Price Opinions—Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3331 et seq.), as amended by this section, is amended by adding at the end the following new section (and amending the table of contents accordingly):

“SEC. 1126. BROKER PRICE OPINIONS.

(a) General Prohibition—In conjunction with the purchase of a consumer’s principal dwelling, broker price opinions may not be used as the primary basis to determine the value of a piece of property for the purpose of a loan origination of a residential mortgage loan secured by such piece of property.

(b) Broker Price Opinion Defined—For purposes of this section, the term “broker price opinion” means an estimate prepared by a real estate broker, agent, or sales person that details the probable selling price of a particular piece of real estate property and provides a varying level of detail about the property’s condition, market, and neighborhood, and information on comparable sales, but does not include an automated valuation model, as defined in section 1125(c).’

(s) Amendments to Appraisal Subcommittee—Section 1011 of the Federal Financial Institutions Examination Council Act of 1978 (12 U.S.C. 3310) is amended—

(1) in the first sentence, by adding before the period the following: “, the Bureau of Consumer Financial Protection, and the Federal Housing Finance Agency”; and

(2) by inserting at the end the following: “At all times at least one member of the Appraisal Subcommittee shall have demonstrated knowledge and competence through licensure, certification, or professional designation within the appraisal profession.”.

(t) Technical Corrections—

(1) Section 1119(a)(2) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3348(a)(2)) is amended by striking “council,” and inserting “Council,”.

(2) Section 1121(6) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3350(6)) is amended by striking “Corporations,” and inserting “Corporation,”.

(3) Section 1121(8) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3350(8)) is amended by striking “council” and inserting “Council”.

(4) Section 1122 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3351) is amended—

(A) in subsection (a)(1) by moving the left margin of subparagraphs (A), (B), and (C) 2 ems to the right; and

(B) in subsection (c)—

(i) by striking “Federal Financial Institutions Examination Council” and inserting “Financial Institutions Examination Council”; and

(ii) by striking “the council’s functions” and inserting “the Council’s functions”.

**Analysis.** Section 1473 of the Dodd-Frank Act is another provision that seeks to upgrade federal regulation of the appraisal process. Faulty appraisals received a considerable amount of the blame for the banking failures of the late 1980s, and FIRREA established federal regulatory standards for appraisers and the use of appraisers. Faulty appraisals are once again receiving considerable blame for the recent collapse of the residential mortgage business. As a result, Congress is tightening up on its regulation of appraisals and is regulating, for the first time, appraisal management companies.

- **Threshold Levels.** Previous law allowed the federal banking agencies to set a dollar threshold for federally related transactions that do not require an appraisal by a licensed or certified appraiser. At present, that threshold is \$250,000, although an evaluation will be required in accordance with safe and sound banking practices. See, e.g., 12 C.F.R. § 34.43(b) (OCC regulation). As amended, 12 U.S.C. § 3341(b) requires the Bureau to concur that the threshold “provides reasonable protection for consumers who purchase 1-4 unit single-family [sic] residences.” This amendment extends the power and reach of the Bureau. Any reduction of the threshold will increase the cost of originating a single family home loan. While the current threshold of \$250,000 has been in place for many years, and is well below the Fannie Mae/Freddie Mac conforming loan limit, it is conceivable that the Bureau will designate a lower threshold.

- Annual Report of Appraisal Subcommittee. Under amended 12 U.S.C. § 3332(a), the Appraisal Subcommittee of the FFIEC is now required to provide an annual report to Congress that describes its activities for the prior year. This will include results of all audits of state appraiser regulatory agencies and an accounting of disapproved actions and warnings taken in the prior year.

The Appraisal Subcommittee was created as a result of FIRREA. Previously, it was charged with monitoring state requirements relating to the certification and licensing of appraisers, monitoring the appraisal requirements of the federal banking agencies, and establishing a national registry of certified and licensed appraisers. The amended statute requiring an annual report to Congress is intended to increase the Appraisal Subcommittee's accountability.

- Open Meetings. While the Appraisal Subcommittee generally must conduct meetings in public session, 12 U.S.C. § 3333(b) is amended to allow it to meet in closed session where the meeting is to review preliminary state audit reports. This reflects the anticipated sensitive nature of the state audit reports conducted by the Appraisal Subcommittee.
- Regulations. 12 U.S.C. § 3335 is amended to authorize the Appraisal Subcommittee to issue regulations, although the regulations are limited to temporary practice, the national registry, information sharing, and enforcement. The Appraisal Subcommittee is to establish an advisory committee of industry participants, including consumer advocates.

The authority of the Appraisal Subcommittee to issue regulations, even in these limited areas, implicitly reflects Congress's belief that the state appraiser regulatory agencies have not performed adequately. This could represent the first step in shifting significant regulatory control over the appraisal industry from the states to the federal government.

The establishment of an advisory committee that includes consumer advocates reflects a concern that the Appraisal Subcommittee is too closely tied to the banking industry. This may foretell an approach that is more focused on consumer protection.

- Appraisal Reviews and Complex Appraisals. 12 U.S.C. § 3339 is amended to require the federal banking agencies' rules to include a mandate that appraisals be subject to appropriate review for compliance with USPAP. This is consistent with the current banking agency regulations, which generally require appraisals for federally related transactions to conform to USPAP, unless safe and sound banking principles require compliance with stricter standards. See, e.g., 12 C.F.R. § 34.44(a) (OCC regulation).

12 U.S.C. § 3342 is amended to define the term "complex 1-4 unit single family residential appraisal" to mean an appraisal for which the property to be appraised, the form of ownership, the property characteristics, or the market conditions are atypical. This expands the definition of that term used in the current federal banking agency appraisal regulations, which do not include a reference to the property's characteristics. See, e.g., 12 C.F.R. § 34.42(e) (OCC regulation). In practice, it is unlikely that this will result in a significant change in the way this term is used.

- Appraisal Management Services – Supervision of Third Party Providers of Appraisal Management Services.
  - 12 U.S.C. § 3332(a) is further amended by increasing the responsibilities of the Appraisal Subcommittee to include the monitoring of requirements imposed by the states for the registration and supervision of appraisal management companies.

Congress has recognized the important role that appraisal management companies play in the industry, and has concluded that the independence and integrity of the appraisal process is highly dependent upon the operations and activities of those companies. As a result, appraisal management companies are to be regulated by the state appraiser regulatory agencies and, as noted below, will be required to register with the Appraisal Subcommittee's new national registry.

- 12 U.S.C. § 3332(a) also is amended to require the Appraisal Subcommittee to establish a national registry of appraisal management companies that are either (i) registered with and subject to the supervision of the state appraiser regulatory agencies or (ii) operating subsidiaries of a federally regulated financial institution.
- Appraisal Management Company Minimum Requirements. A new Section 1124 is added to FIRREA to provide for the regulation of the operations and activities of appraisal management companies.
  - In General. The Board, OCC, FDIC, NCUA, FHFA, and Bureau are directed to issue regulations to establish minimum requirements to be applied by the states in the registration of appraisal management companies. These requirements include a requirement that these companies do the following:
    - Register with and be subject to supervision by the state appraiser regulatory agencies.
    - Verify that only licensed and certified appraisers are used for federally related transactions.
    - Require that the appraisals coordinated by the appraisal management companies comply with USPAP.
    - Require that appraisals are conducted independently and otherwise adhere to the standards set forth in § 129E of TILA (discussed at Section 1472, above).

While Congress obviously believes that the current state regulatory scheme for appraisers has not been effective, Congress apparently felt that it had no choice other than to assign the regulation of appraisal management companies to the same state appraiser regulatory agencies that have been responsible for the regulation of appraisers.

- Relation to State Law. The states are permitted to impose additional regulatory burdens on appraisal management companies.
- Federally Regulated Financial Institutions. Subsidiaries of federally regulated financial institutions are subject to the new regulatory requirements. However, they will not be required to register with the state appraiser regulatory agencies.

This treatment of bank subsidiaries appears to be inconsistent with Sections 1044, 1045 and 1046 of the Dodd-Frank Act, which generally strip operating subsidiaries of national banks and federal savings associations of their prior ability to use the federal preemption doctrine to avoid state licensing, registration, and regulation.

- Registration Limitations. An appraisal management company cannot be registered by a state appraiser regulatory agency or included in the national registry if it is owned by a person who has had his/her appraiser license or certification refused, denied, cancelled, surrendered in lieu of revocation, or revoked by any state. Any person who owns more than 10% of an appraisal management company must be of good moral character and submit to the state appraiser regulatory agency's background check.

These are minimal qualification requirements. The states may impose a higher standard.

- Reporting. The Board, OCC, FDIC, NCUA, FHFA, and Bureau are directed to issue regulations for the reporting of activities of appraisal management companies to the Appraisal Subcommittee. This apparently relates to the payment of the annual registry fee.

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o Effective Date.

- In General. Once the federal regulations establishing minimum requirements to be applied by the states in the registration of appraisal management companies are issued in final form, an appraisal management company will have 36 months to (i) register with each state appraiser regulatory agency that has jurisdiction in a state in which federally related transactions occur or (ii) be subject to oversight by a federal financial institutions regulatory agency. If it is not, the company may not arrange for appraisals in that state.

This 36-month period means that, for a considerable time to come, appraisal management companies will continue to be unregulated entities. The 36-month period contrasts with FIRREA, which gave the states roughly two years to establish their initial regulatory regimes for appraisers.

- Extension of Effective Date. The Appraisal Subcommittee, with the approval of the FFIEC, can extend the time period by 12 months in a particular state if it makes a written finding that a state has made substantial progress in establishing a compliant registration and supervision regime.
- State Appraiser Certifying and Licensing Agency Authority. The federal authority for the states to establish state appraiser regulatory agencies is amended to allow those agencies to also register and supervise appraisal management companies.
- Appraisal Management Company Definition. 12 U.S.C. § 3350 is amended to define an “appraisal management company” to mean a third party authorized by either a creditor in a consumer credit transaction secured by a consumer’s principal dwelling, or an underwriter or principal in a secondary market transaction, that oversees a network or panel of 16 or more certified or licensed appraisers in a single state, or 25 or more certified or licensed appraisers nationwide, in a given year, and which does the following: (i) recruits, selects, and retains appraisers; (ii) contracts with licensed and certified appraisers to perform appraisals; (iii) manages the process of having appraisals performed; or (iv) reviews and verifies the work of appraisers.

Note that appraisal management company is defined in a manner that limits it to consumer credit transactions secured by a consumer’s principal dwelling. The states may choose to regulate appraisal management companies that handle appraisers for other types of loans, but need not do so.

The reference to transactions authorized by an underwriter or principal in a secondary market transaction, which is part of the definition of an appraisal management company, does not similarly limit the loans to consumer credit transactions secured by a consumer’s principal dwelling, but presumably this will be read into the definition.

This definition is broad enough to include all of the major appraisal management companies used by the largest mortgage lenders.

- State Agency Reporting Requirement. 12 U.S.C. § 3338 is amended to increase the responsibilities of the state appraiser regulatory agencies. Those agencies are now also required to (i) transmit timely reports to the national registry established by the Appraisal Subcommittee on the issuance of licenses, certifications, sanctions, disciplinary actions, revocations, and suspensions, and (ii) transmit timely reports of supervisory activities involving appraisal management companies or other third party providers of appraisal management services, including investigations initiated and disciplinary actions taken.

This amendment reflects Congress's decisions to tighten the regulation of the appraiser industry and to require state regulation of appraisal management companies.

Although the statute is silent regarding the recipient of the reports on appraisal management companies, those reports undoubtedly must also be submitted to the national registry established by the Appraisal Subcommittee. The statute provides that the state appraiser regulatory agencies are also to send reports regarding "other third party providers of appraisal management services." This is a bit strange, since those providers will not, by definition, be registered with the state appraiser regulatory agencies. This may refer to enforcement actions taken against any providers of appraisal management services that should register as appraisal management companies but fail to do so.

- Registry Fees Modified. 12 U.S.C. § 3338(a) is amended to increase the maximum annual registry fee for appraisers from \$25 to \$40. That fee can increase to as much as \$80 under certain conditions, subject to the approval of the FFIEC. Maximum annual registry fees are also set for appraisal management companies, with those fees ranging from \$25 to \$50 for each appraiser in the company's network during the year, with an additional multiplier being used to calculate the fees of companies that have been in existence for one year or less. The Appraisal Subcommittee is permitted to impose a minimum fee on appraisal management companies to protect against the under reporting of the number of appraisers in their networks. The Appraisal Subcommittee is directed to consider an inflation adjustment to the fees at least once every five years.

Better funding for the registry will enable the Appraisal Subcommittee to take a more active role in the exercise of its new appraisal industry regulatory powers.

- Grants and Reports. 12 U.S.C. § 3338(b) is modified to authorize the Appraisal Subcommittee to provide grants to the state appraiser regulatory agencies. The grants are to be used to support the state appraiser regulatory agencies' enforcement efforts, their submission of data to the national registry, and the like. The amended statute also authorizes the Appraisal Subcommittee to use its funding to report back to all of the state appraiser regulatory agencies when a license or certification is surrendered, revoked, or suspended. Up to 75% of the increase in fees described above may be used for the foregoing.

Providing funding to the state appraiser regulatory agencies is the most effective way to induce them to take a more active approach in discharging their regulatory responsibilities.

- Criteria/Minimum Qualification Requirements. 12 U.S.C. § 3345 is modified to upgrade the qualifications of appraisers, as follows: (i) state licensed appraisers must meet or exceed the minimum criteria established by The Appraisal Foundation's Appraisal Qualifications Board; (ii) a provision that prohibited the Appraisal Subcommittee from establishing qualification and experience requirements for the licensing of appraisers (thereby leaving the setting of those requirements to the state appraiser regulatory agencies) has been deleted; and (iii) any requirements established for Trainee Appraisers and Supervisory Appraisers must meet or exceed the minimum criteria established by The Appraisal Foundation's Appraisal Qualifications Board, and the Appraisal Subcommittee has the power to enforce those requirements.

This is part of the larger plan to shift responsibility for appraiser regulation from the state appraiser regulatory agencies – a recognition that the prior regulatory regime was ineffective.

By way of background, The Appraisal Foundation is a non-profit organization dedicated to the advancement of the appraisal profession. Among other things, its mission statement requires it

to establish USPAP and to establish educational experience and examination qualification criteria for the licensing and certification of real property appraisers.

- Monitoring of State Appraiser Certifying and Licensing Agencies. 12 U.S.C. § 3347 is amended to give the Appraisal Subcommittee significant authority to review and crack down on state appraiser regulatory agencies that are not performing and to remove state-licensed or certified appraisers or appraisal management companies from the national registries. More specifically:
  - ❖ The Appraisal Subcommittee is to monitor each state appraiser regulatory agency to determine if the agency: (i) has adequate policies, practices, procedures, and funding; (ii) processes complaints and completes investigations in a timely manner; (iii) appropriately disciplines appraisers and appraisal management companies; (iv) maintains an effective regulatory program; and (v) makes timely reports of complaints and disciplinary actions to the national registries.
  - ❖ The Appraisal Subcommittee and all agencies, instrumentalities and federally recognized entities (*e.g.*, banks, thrifts, and credit unions) may not recognize appraiser certifications and licenses from any states whose state appraiser regulatory agencies are found lacking.
  - ❖ The Appraisal Subcommittee is authorized to impose sanctions (discussed below) against any state appraiser regulatory agency that fails to have an effective regulatory program. A wide variety of criteria are to be considered in determining whether a state appraiser regulatory agency has an effective regulatory program.
  - ❖ The Appraisal Subcommittee is authorized to take interim actions and impose interim sanctions against a state appraiser regulatory agency in lieu or in advance of derecognizing the agency.
  - ❖ The Appraisal Subcommittee is authorized, on its own initiative, to remove a licensed or certified appraiser, or an appraisal management company, from the national registry for up to 90 days pending an action by the state appraiser regulatory agency on licensing, certification, registration, or a disciplinary proceeding.
- Reciprocity. 12 U.S.C. § 3351(b), relating to reciprocity for appraisers, has been amended. Previously, the Appraisal Subcommittee was only required to encourage each state to allow a person to perform an appraisal if the person is a licensed or certified appraiser in good standing in another state. The amended statute effectively requires a state to grant another state's appraiser a reciprocal license or certification so long as (i) the appraiser licensing and certification program of the other state is compliant with the amended FIRREA provisions relating to appraisals, and (ii) the requirements for licensing and certification of the other state meet or exceed the standards of the state where he/she is seeking a reciprocal license or certification.

The amended statute requires the states to provide reciprocity when the requisite conditions are met, but does not explain how the states are to determine whether those conditions have been met. It would be impractical for each state appraiser regulatory agency to make an independent assessment of the programs of all of the other states. More likely, the Appraisal Subcommittee will provide a mechanism for making these determinations.

- Consideration of Professional Appraisal Designations. 12 U.S.C. § 3351(d) has been amended to address membership in a nationally recognized professional appraisal organization in different manner. The previous statute stated that the appraiser criteria established by the federal

banking agencies and other government agencies in addition to state requirements could not exclude a certified or licensed appraiser solely by virtue of membership or nonmembership in any particular appraisal organization (e.g., the Appraisal Institute). The banking agencies' implementing regulations contain similar provisions. See, e.g., 12 C.F.R. § 34.46(a) (OCC regulation). The amended statute states that the agencies' criteria may include education achieved, experience, sample appraisals, and references from prior clients. Membership in a nationally recognized appraisal organization may be considered, but lack of membership may not be the sole bar against consideration for an appraisal assignment.

The previous provision presumably was to protect those appraisers who did not wish to become members of a professional appraiser organization. The amended provision does not require membership, but does allow the agencies' rules to consider membership as one of several criteria. The agencies are likely to issue rules that paraphrase the amended statute, which ultimately may result in banks using more appraisers who are members of a professional appraiser organization.

- Appraiser Independence Monitoring. A new subsection (g) is added to 12 U.S.C. § 3351 to require the Appraisal Subcommittee to monitor the various state appraiser regulatory agencies to determine if their policies and the like are consistent with the maintenance of appraiser independence. The Appraisal Subcommittee is also to monitor the various states to determine if they have laws, regulations and policies that are aimed at maintaining appraiser independence.

This is yet another statute that places the Appraisal Subcommittee in the position of overseeing state performance in the regulation of appraisers. If the Appraisal Subcommittee determines that a state appraiser regulatory agency falls short, it will be able to impose the sanctions described above. If the Appraisal Subcommittee determines that a state's laws, regulations and policies fall short, its remedies are more uncertain.

- Appraiser Education. A new subsection (h) is added to 12 U.S.C. § 3351 to require the Appraisal Subcommittee to encourage the states to accept courses approved by The Appraisal Foundation's Appraisal Qualifications Board's Course Approval Program.
- Appraisal Complaint Hotline. A new subsection (i) is added to 12 U.S.C. § 3351 to require the Appraisal Subcommittee to establish a national hotline to receive complaints of non-compliance with the appraiser independence standards and USPAP. The Appraisal Subcommittee is to do so within six months of enactment of this subsection if the Appraisal Subcommittee determines that no such national hotline otherwise exists. The national hotline requires a toll-free telephone number and an e-mail address. Any person, including appraisers, individuals, and entities, may call the hotline.

If the Appraisal Subcommittee operates the hotline, it must refer complaints to the state appraiser regulatory agency, financial institution regulator, other appropriate governmental body, or other legal authority. If a complaint is referred to a state appraiser regulatory agency or a federal regulator, the Appraisal Subcommittee is authorized to follow up and determine the status of the resolution of the complaint.

If the Appraisal Subcommittee makes a referral to a state appraiser regulatory agency or a federal regulator (e.g., one of the federal banking agencies), follows up, and is dissatisfied with the resolution of the complaint, this may provide it with a basis for taking an interim action against the appraiser in question, as described above. In addition, if the Appraisal Subcommittee is dissatisfied with the state appraiser regulatory agency's performance, this may provide it with a basis for exercising a sanction against that agency.

- Automated Valuation Models Used to Estimate Collateral Value for Mortgage Lending Purposes. A new § 1125 is added to FIRREA to regulate automated valuation models (“AVMs”).

- ❖ In General. AVMs must adhere to quality control standards to: (i) ensure a high level of confidence in the estimates produced by AVMs; (ii) protect against the manipulation of data; (iii) seek to avoid conflicts of interest; (iv) require random sample testing and reviews; and (v) account for other factors set forth in the regulations described below.

This statute reflects Congress’s recognition that AVMs are extensively used by banks and other mortgage lenders where a valuation of a property is needed but a full appraisal is not necessary. For example, AVMs are often used in determining whether the value of a dwelling has declined significantly below its appraised value at the time a home equity credit line was entered into. See 12 C.F.R. § 226.5b(f)(3)(vi)(A) and Paragraph 226.5b(f)(3)(vi)-6 of the Regulation Z Commentary. This use of AVMs has been criticized by consumers, who believe that the AVMs understate current property values, and there has been litigation over the use of AVMs for this purpose. These concerns, as well as concerns by the federal banking agencies, undoubtedly contributed to Congress’s decision to regulate AVMs.

- ❖ Adoption of Regulations. The Board, OCC, FDIC, NCUA, FHFA, and Bureau are directed to issue regulations to implement the quality control standards described above. The agencies are to do so in consultation with the Appraisal Subcommittee and The Appraisal Foundation’s Appraisal Standards Board.

In some instances, the current federal banking agency appraisal regulations do not require an appraisal performed by a licensed or certified appraiser, but instead require an appropriate evaluation of value that is consistent with safe and sound banking practices. See, e.g., the OCC regulation at 12 C.F.R. §§ 34.43(a)(1) [transaction values of \$250,000 or less], (a)(5) [business loans with transaction values of \$1 million or less that are not dependent on the sale of, or rental income derived from, real estate as the primary source of repayment], and (a)(7) [transactions involving existing extensions of credit where there has been no obvious and material change in market conditions or physical aspects of the property that threatens the adequacy of the institution’s collateral protection after the transaction, even with the advancement of new monies; or where there is no advancement of new monies other than reasonable closing costs]. There is a question of whether an AVM provides a satisfactory evaluation of value for this purpose. In 2008, the federal banking agencies proposed a revision of their Interagency Appraisal and Evaluation Guidelines that would, among other things, allow an AVM to be used for an evaluation. The proposal would require an institution to obtain the prior approval of its primary regulator before doing so. In addition, the proposal imposed stringent requirements relating to the use of AVMs, including extensive due diligence and establishing “standards and procedures for model validation testing and monitoring.” See 73 Fed. Reg. 69,647, 69,659 (November 19, 2008). It is not unlikely that the banking agencies will impose similar restrictions on the use of AVMs in their regulations to implement this subsection.

The new statute does not explicitly require that the AVMs be tested against appraisals performed by licensed or certified appraisers. In fact, there are various accepted methods for validating computer-based financial models. See OCC Bulletin 2000-16, Risk Modeling – Model Validation (May 30, 2000). However, it is possible that, in practice, the banking agencies will require that AVMs be tested against appraisals performed by licensed or certified appraisers.

- ❖ Enforcement. In the case of a regulated financial institution (or its subsidiary), the new regulations discussed above will be enforced by the institution's primary federal regulator. For all "other participants in the market for appraisals of 1-to-4 unit single [*sic*] family residential real estate," the new regulations will be enforced by the FTC, the Bureau, and a state attorney general.

Banking institutions and their subsidiaries can expect to be examined by their federal regulators regarding compliance with the new regulations. Other institutions can expect to be subject to enforcement, but not regulatory examinations.

The "other participants" that are subject to enforcement include AVM companies, vendors, and testing companies.

- ❖ Automated Valuation Model Defined. An AVM is defined as "any computerized model used by mortgage originators and secondary market issuers to determine the collateral worth of a mortgage secured by a consumer's principal dwelling."

This definition is somewhat narrower than the definition used by the federal banking agencies in their proposed revision of their Interagency Appraisal and Evaluation Guidelines. That proposal defined an AVM as "[a] computer program that analyzes data to determine a property's market value." See 73 Fed. Reg. 69,647, 69,660 (Nov. 19, 2008). The new statutory definition is limited to loans secured by principal dwellings.

Note that the definition of an AVM depends on whether the computerized model is *used* by mortgage originators and secondary market issuers to determine the collateral value. Thus, if the model is actually used by those persons or entities, then it becomes an AVM that is subject to the new regulatory regime – literally, even if the creator of the model did not intend that it be so used.

- Broker Price Opinions. 12 U.S.C. § 3331 is amended to restrict the use of broker price opinions ("BPOs").
  - ❖ General Prohibition. BPOs may not be used as the "primary basis" for determining the value of the security property for a loan to finance the purchase of the consumer's principal dwelling.

The amended statute reflects Congress's belief that BPOs are insufficiently reliable for use as the primary basis for establishing the value of the security property in a purchase loan transaction. The restriction of this prohibition to the "primary basis" may suggest that a BPO can be used as a secondary basis to support a valuation in a purchase loan transaction. While this remains to be seen, there is every indication that the federal banking agencies will be inclined to allow the use of BPOs for some transactions. The current Interagency Appraisal and Evaluation Guidelines do not specifically mention BPOs as such, but instead discuss the qualifications of persons who perform evaluations. In providing examples of qualified persons, the Guidelines state "Examples include individuals with appraisal experience, *real estate* lenders, consultants or *sales persons*, agricultural extension agents, or foresters" (emphasis added). Similarly, the proposed revisions to the Guidelines issued in 2008 provide the following examples of qualified persons: "Examples include persons with appraisal experience, *real estate* lending or *sales professionals*, agricultural extension agents, or foresters" (emphasis added). See 73 Fed. Reg. 69,647, 69,659 (Nov. 19, 2008). Moreover, the revisions to § 701(e) of the Equal Credit Opportunity Act effected by Section 1474 of the Dodd-Frank

Act, discussed below, specifically reference the use of BPOs, strongly indicating that BPOs can continue to be used for some valuation purposes. Where a valuation of property is needed but the regulations do not require an evaluation (e.g., to determine whether there is a basis to reduce the credit limit of a home equity line of credit in accordance with 12 C.F.R. § 226.5b(f)(3)(vi)(A)), the case for using a qualified BPO is even stronger. Note that no BPO may be used unless it meets the independence and other qualifications described in the Guidelines.

- ❖ Broker Price Opinion Defined. A BPO is generally defined to mean an estimate of the probable selling price of a particular piece of real property and provides a varying level of detail about the property's condition, market and neighborhood, and information on comparable sales. The BPO must be prepared by a real estate broker, agent or sales person. A BPO does not include an AVM.
- Amendments to Appraisal Subcommittee. 12 U.S.C. § 3310 is amended to give the Bureau a designee on the Appraisal Subcommittee. In addition, the Appraisal Subcommittee must now have at least one member who has demonstrated knowledge and competence through licensure, certification, or professional designation within the appraisal profession.

Previously, the only qualification for membership on the Appraisal Subcommittee was that members were required to have "demonstrated knowledge and competence concerning the appraisal profession." The amended statute is probably broad enough to include a member who, either currently or *previously*, was licensed, certified, or held a professional designation.

## Section 1474. Equal Credit Opportunity Act Amendment

Subsection (e) of section 701 of the Equal Credit Opportunity Act (15 U.S.C. 1691) is amended to read as follows:

### (e) Copies Furnished to Applicants—

(1) IN GENERAL—Each creditor shall furnish to an applicant a copy of any and all written appraisals and valuations developed in connection with the applicant's application for a loan that is secured or would have been secured by a first lien on a dwelling promptly upon completion, but in no case later than 3 days prior to the closing of the loan, whether the creditor grants or denies the applicant's request for credit or the application is incomplete or withdrawn.

(2) WAIVER—The applicant may waive the 3 day requirement provided for in paragraph (1), except where otherwise required in law.

(3) REIMBURSEMENT—The applicant may be required to pay a reasonable fee to reimburse the creditor for the cost of the appraisal, except where otherwise required in law.

(4) FREE COPY—Notwithstanding paragraph (3), the creditor shall provide a copy of each written appraisal or valuation at no additional cost to the applicant.

(5) NOTIFICATION TO APPLICANTS—At the time of application, the creditor shall notify an applicant in writing of the right to receive a copy of each written appraisal and valuation under this subsection.

(6) VALUATION DEFINED—For purposes of this subsection, the term 'valuation' shall include any estimate of the value of a dwelling developed in connection with a creditor's decision to provide credit, including those values developed pursuant to a policy of a government sponsored enterprise or by an automated valuation model, a broker price opinion, or other methodology or mechanism.'

**Analysis.** Section 701(e) of the ECOA is amended to expand a creditor's obligation to provide copies of appraisals and valuations to a loan applicant.

- Copies Furnished to Applicants – In General. Each creditor is required to provide a copy of all written appraisals and valuations that are developed in connection with an application for a loan to be secured by a first lien on a dwelling. The copy is to be furnished upon completion, but in no event later than three days before loan closing. The obligation to provide the appraisal or valuation exists regardless of whether (i) the loan is granted or denied; (ii) the application is complete; or (iii) the application is withdrawn.

- Appraisals vs. Valuations. This substantially amends the previous statute and will require changes to the Board's current regulation at 12 C.F.R. § 202.14 and the related provisions of the Regulation B Commentary. As amended, § 701(e) applies to both appraisals and valuations, while the previous statute was limited to "appraisals." Note, however, that Regulation B defines an "appraisal" to mean "the document(s) relied upon by a creditor in evaluating the value of the dwelling." See 12 C.F.R. § 202.14(c). The existing definition is sufficiently broad that it probably already includes a valuation that a creditor relies upon in valuing a dwelling.
- Mandatory Delivery. The previous statute allowed the creditor, at its option, to routinely provide a copy of the appraisal or to provide a copy only upon request. If the creditor followed the latter approach, it was required to provide a notice of the applicant's right to request the appraisal. The new statute takes away that option, and requires the creditor to provide the appraisal or valuation to every applicant. In practice, many creditors were already providing appraisals routinely, so this should not be unduly burdensome.
- Multiple Creditors. The amended statute states that "[e]ach creditor" must provide the appraisal or valuation. Where there are multiple creditors in the transaction – which is not uncommon, since every person who participates in the credit decision, including setting the terms of credit, is a "creditor" for purposes of ECOA and Regulation B – this would literally mean that each of those creditors must separately provide a copy of the appraisal or valuation to the applicant. The existing statute also applies to "each creditor," and Regulation B has implemented this requirement by stating that only "[a] creditor" must provide the copy of the appraisal. See 12 C.F.R. § 202.14(a). Presumably, the amended regulation will continue to take this sensible approach.
- Multiple Applicants. The amended statute states that the appraisal or valuation must be provided to "an applicant," leaving some question regarding the creditor's responsibility when there are multiple applicants in the transaction. The existing Regulation B Commentary concludes that the notice regarding the appraisal need be provided to only one of the applicants, but that it must be given to the primary applicant where one is readily apparent. See Paragraph 202.14(a)(2)(i)-1 of the Regulation B Commentary. Presumably, the Board will take a similar approach with respect to the revised obligation to routinely provide the appraisal or valuation.
- First Lien on a Dwelling. The amended statute is limited to loans to be secured by a first lien on a dwelling. The previous statute applied to a loan secured by "a lien on residential property." Regulation B implemented the previous statute by restricting the creditor's obligation to any loan to be secured by any lien on a dwelling (*i.e.*, a 1-4 unit residential property, whether or not attached to real property. See 12 C.F.R. § 202.14(c)). In short, while both the previous and amended statute apply to dwellings, the amended statute is restricted to first liens, a narrowing of the scope of the previous statute. The Board is likely to amend § 202.14 of Regulation B to limit it to first lien loans. The existing regulation applies to both consumer and business purpose loans, and this is likely to remain the case. See Paragraph 202.14(a)-1 of the Regulation B Commentary.
- Written Appraisals and Valuations. Unlike the previous statute, the amended statute is restricted to "written" appraisals and valuations. Presumably, the word "written" will include electronically delivered appraisals and valuations inasmuch as these can easily be reduced to a written form. However, the term "written" may be construed even more broadly. For example, Section 202.4(c) of Regulation B, which generally requires creditors to take "written" applications for certain dwelling-related loans, has been construed to be complied with when (i) a creditor simply writes down the information that it considers in making a credit decision, (ii) a creditor takes a telephonic application and writes down the pertinent information, or (iii) information is entered into a computerized system. See Paragraph 202.4(c) of the Regulation B Commentary. In short, it is possible that any memorialized record of the appraisal or valuation will be sufficient to subject it to the amended statute.

- Application for a Loan. The obligation to provide the appraisal or valuation applies when there has been an “application.” The obligation will not apply in other circumstances, such as where the creditor undertakes an appraisal or valuation of the property after the loan is made for other purposes. However, other statutes or regulations may independently require the creditor to provide a copy of the appraisal or valuation. For example, in its 2009 proposal to revise the rules for open-end credit lines secured by dwellings, the Board proposed to add a new § 226.5b(g)(3) to Regulation Z, which would require a creditor that freezes credit advances or reduces a credit limit due to a significant decline in property value to “provide, upon the consumer’s request, a copy of the documentation supporting the property value on which the creditor based the action.” See 74 Fed. Reg. 43,428, 43,537 (Aug. 26, 2009).
- Prompt Furnishing of Appraisal or Valuation. The amended statute requires the creditor to furnish the appraisal or valuation promptly upon completion, but no later than three days before closing. Under the HVCC, “loan closing” means the date that the loan documents are signed. The timing requirement under the amended statute contrasts with the previous statute, which simply required that the appraisal be provided promptly following the applicant’s written request. The existing Board regulation provides much more flexibility, stating that the appraisal may generally be provided within 30 days after the creditor receives the report, receives the request for the report, or receives reimbursement for the cost of the report, whichever occurs last. See 12 C.F.R. § 202.14(a)(2)(ii). While the regulation will need to be revised, if the amended regulation follows an analogous approach, it will allow delivery within 30 days following receipt of the completed appraisal by the creditor or reimbursement for the cost of the appraisal or valuation (where legally permitted – see below), whichever is later. However, in any event the regulation will require the creditor to furnish the appraisal or valuation no later than three days before loan closing (subject to waiver – see below).
- Waiver. The applicant may waive the requirement that the appraisal or valuation be furnished not later than three days before loan closing, except where otherwise required by law.

This suggests that a creditor may provide the applicant with the choice of either waiving the three-day period or delaying the loan closing. If the applicant wishes to waive, it would be prudent to obtain the applicant’s waiver in writing or electronically. If this is not feasible, it would be prudent to record a telephonic waiver, where this is permitted by applicable law. If there are multiple applicants, it would be prudent to obtain such a waiver from each applicant.

- Reimbursement. The applicant may be required to pay a reasonable fee to reimburse the creditor for the cost of the appraisal, unless applicable law provides otherwise.

For example, Section 1471 of the Dodd-Frank Act adds a new § 129H to TILA, which prohibits a creditor from charging for a second appraisal that is performed in connection with a higher-risk mortgage. See discussion above.

- Free Copy. Notwithstanding the rules relating to reimbursement described above, the creditor is required to provide a copy of each written appraisal or valuation at “no additional cost to the applicant.”

There is some difficulty in reconciling the provisions regarding “reimbursement” (which allows the creditor to charge a reasonable fee to cover the cost of the appraisal or valuation) and “free copy” (which does not allow the creditor to charge additional costs to the applicant). The better reading is that the creditor may charge the applicant a reasonable fee for the cost of the appraisal or valuation itself, but may not charge the applicant any additional fees. This reading gives full meaning to both provisions of the amended statute. This reading also is consistent with the HVCC. Finally, this reading is consistent with the existing Regulation B Commentary, which states that if a consumer has already paid for the cost of an appraisal report, “the creditor may not require additional fees for the appraisal (other than photocopy and postage costs).” See Paragraph 202.14(a)(2)(ii)-1 of the Regulation B Commentary. However, it would be prudent not to charge the applicant for photocopy and postage costs unless the implementing regulations clarify that this is permissible.

- Notification to Applicants. The creditor is required to notify the applicant in writing of the right to receive a copy of each written appraisal or valuation. This notice must be provided at the time of application.

At first glance, this provision may appear to be inconsistent with the amended statute's general requirement that the creditor furnish a copy of any appraisal or valuation to the applicant. The two provisions are not inconsistent. This provision simply notifies the applicant of his/her right to *receive* a copy of each written appraisal or valuation. This contrasts with the previous statute, which required the creditor to notify the applicant of his/her right to make a written *request* for a copy of the appraisal.

It is possible that the standard Fannie Mae/Freddie Mac application form will be modified to include a notice of the right to receive copies of the appraisal or valuation. Alternatively, the notice may be provided at the same time as the application form. It is likely that the implementing regulations will provide some flexibility in providing the notice, particularly where the application is submitted by a mortgage broker or is submitted electronically.

- Valuation Defined. A "valuation" is defined to include any estimate of the value of a dwelling developed in connection with a creditor's decision to provide credit. This includes those values developed "pursuant to a policy of a government sponsored enterprise" or by an AVM, a BPO, or other methodology or mechanism.

This broadly defined term should cover virtually any written document (see discussion above) that relates to the valuation of the property and that is developed in connection with the creditor's underwriting process. The existing Regulation B Commentary states that an appraisal report includes: (i) a report prepared by an appraiser (whether or not licensed or certified), including written comments and other documents submitted to the creditor in support of the appraiser's estimate or opinion of the property's value; (ii) a valuation of the property prepared by the creditor's staff if a third party appraisal report has not been used; and (iii) an internal document reflecting that the creditor's valuation is different from the valuation of a third party's appraisal report (e.g., a review appraisal). All three of these undoubtedly would be treated as valuations (or, in some instances, as an appraisal) and would be subject to the amended statute. See Paragraph 202.14(c)-1 of the Regulation B Commentary.

In contrast, the existing Regulation B Commentary states that an appraisal report does not include: (i) internal documents, if a third party appraisal was used to establish the value of the property; (ii) government agency statements of appraised value; or (iii) valuation lists that are publicly available (such as published sales prices or mortgage amounts, tax assessments, and retail price ranges), and valuations such as manufacturers' invoices for mobile homes. See Paragraph 202.14(c)-2 of the Regulation B Commentary. Given the expansive definition of "valuation" in the amended statute, the second and third of these items would appear to be valuations. The first of these items could be a valuation if the internal documents were used in connection with the assessment of the value of the property.

Note: The fact that something qualifies as a "valuation" under § 701(e) of ECOA does not necessarily mean that it meets the regulatory requirements for an "evaluation" under the federal banking agency appraisal rules. For example, an AVM is a type of "valuation" under new § 701(e)(6) of ECOA, but see discussion at Section 1473, above, regarding the use of AVMs as "evaluations." Similarly, a BPO is a type of "valuation" under new § 701(e)(6) of ECOA, but 12 U.S.C. § 3331 states that BPOs may not be used as the "primary basis" for determining the value of the security property for a loan to finance the purchase of the consumer's principal dwelling. See discussion at Section 1473, above.

## Section 1475. Real Estate Settlement Procedures Act of 1974 Amendment Relating to Certain Appraisal Fees

Section 4 of the Real Estate Settlement Procedures Act of 1974 is amended by adding at the end the following new subsection:

“(c) The standard form described in subsection (a) may include, in the case of an appraisal coordinated by an appraisal management company (as such term is defined in section 1121(11) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3350(11))), a clear disclosure of—

- “(1) the fee paid directly to the appraiser by such company; and
- “(2) the administration fee charged by such company.”.

**Analysis.** Section 1475 of the Dodd-Frank Act amends § 4 of RESPA to authorize a change in the HUD-1 and HUD-1A settlement statements where the appraisal was coordinated by an appraisal management company. The change includes a clear disclosure of the fee paid directly to the appraiser and the administration fee charged by the appraisal management company.

It is likely that HUD will respond to this amendment by modifying its standard HUD-1 and HUD-1A settlement statements to include these additional disclosures.

## Section 1476. GAO Study of the Effectiveness and Impact of Various Appraisal Methods, Valuation Models and Distribution Channels, and on the Home Valuation Code of Conduct and the Appraisal Subcommittee

(a) In General—The Government Accountability Office shall conduct a study on—

(1) the effectiveness and impact of—

- (A) appraisal methods, including the cost approach, the comparative sales approach, the income approach, and others that may be available;
- (B) appraisal valuation models, including licensed and certified appraisals, broker-priced opinions, and automated valuation models; and
- (C) appraisal distribution channels, including appraisal management companies, independent appraisal operations within mortgage originators, and fee-for-service appraisers;

(2) the Home Valuation Code of Conduct; and

(3) the Appraisal Subcommittee's functions pursuant to title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989.

(b) Study—Not later than—

- (1) 12 months after the date of enactment of this Act, the Government Accountability Office shall submit a study to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives; and
- (2) 90 days after the date of enactment of this Act, the Government Accountability Office shall provide a report on the status of the study and any preliminary findings to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.

(c) Content of Study—The study required by this section shall include an examination of the following:

(1) APPRAISAL APPROACHES, VALUATION MODELS, AND DISTRIBUTION CHANNELS—

- (A) The prevalence, alone or in combination, of certain appraisal approaches, models, and channels in purchase-money and refinance mortgage transactions.
- (B) The accuracy of these approaches, models, and channels in assessing the property as collateral.
- (C) Whether and how these approaches, models, and channels contributed to price speculation during the previous cycle.
- (D) The costs to consumers of these approaches, models, and channels.
- (E) The disclosure of fees to consumers in the appraisal process.
- (F) To what extent the usage of these approaches, models, and channels may be influenced by a conflict of interest between the mortgage lender and the appraiser and the mechanism by which the lender selects and compensates the appraiser.
- (G) The suitability of these approaches, models, and channels in rural versus urban areas.

## (2) HOME VALUATION CODE OF CONDUCT (HVCC)—

- (A) How the HVCC affects mortgage lenders' selection of appraisers.
- (B) How the HVCC affects State regulation of appraisers and appraisal distribution channels.
- (C) How the HVCC affects the quality and cost of appraisals and the length of time to obtain an appraisal.
- (D) How the HVCC affects mortgage brokers, small businesses, and consumers.

## (d) Additional Study Required—

(1) IN GENERAL—Not later than 18 months after the date of enactment of this Act, the Government Accountability Office shall submit a study to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.

## (2) CONTENT OF ADDITIONAL STUDY—The study required under paragraph (1) shall include—

## (A) an examination of—

- (i) the Appraisal Subcommittee's ability to monitor and enforce State and Federal certification requirements and standards, including by providing a summary with a statistical breakdown of enforcement actions taken during the last 10 years;
- (ii) whether existing Federal financial institutions regulatory agency exemptions on appraisals for federally related transactions needs to be revised; and
- (iii) whether new means of data collection, such as the establishment of a national repository, would benefit the Appraisal Subcommittee's ability to perform its functions; and

## (B) recommendations from this examination for administrative and legislative action at the Federal and State level.

**Analysis.** The GAO is directed to conduct a study of (i) the effectiveness and impact of various appraisal methods, appraisal valuation models, and appraisal distribution channels; (ii) the HVCC; and (iii) the Appraisal Subcommittee's functions under FIRREA. (Recall that Section 1472 of the Dodd-Frank Act, discussed above, requires a termination of the HVCC at some point.) A preliminary report is due 90 days after enactment of the Dodd-Frank Act and a final report is due within 12 months after enactment.

An additional study, due 18 months after enactment, is to examine (x) the Appraisal Subcommittee's ability to monitor and enforce state and federal certification requirements and standards, (y) whether the existing appraisal exemptions require revision, and (z) whether new means of data collection would benefit the Appraisal Subcommittee's ability to perform its functions. In this latter study, the GAO also is to make appropriate recommendations for federal and state administrative and legislative action.

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