Mortgage Credit - Appraisals CFPB Proposed Rule

Executive Summary

The Bureau of Consumer Financial Protection ("CFBP" or "Bureau") recently released two separate proposed rules that would implement provisions of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (the "Dodd-Frank Act") that impact appraisals for certain mortgage home loans. In particular, the CFPB released:

- A proposed rule that would require creditors to provide copies of appraisal reports and valuations in connection with an application for a loan secured by a first lien on a dwelling. The proposed rule would amend Regulation B, which implements the *Equal Credit Opportunity Act* ("ECOA") as amended by Section 1474 of the Dodd-Frank Act.
- A proposed rule, issued jointly with five other Federal financial regulatory agencies ("Agencies"), that would establish new appraisal requirements for "higher-risk mortgages," including a requirement for appraisal reports to be based on a physical inspection (the "Higher Risk Proposal"). The proposed rule would amend Regulation Z, which implements the *Truth-in-Lending Act* ("TILA") as amended by Section 1471 of the Dodd-Frank Act.

Comments are requested on each of the proposals no later than October 15, 2012.

Background

Sections 1471 through 1476 of the Dodd-Frank Act address Appraisal Activities, broadly including appraisals for higher-risk mortgages, appraisal independence, regulation of Appraisal Management Companies, consumer access to appraisals, appraisal fees, and a General Accountability Office study of appraisal and valuation methodologies and models. A number of these provisions directly impact the TILA and the ECOA as well as the *Financial Institutions Reform Recovery and Enforcement Act* ("FIRREA"). The Federal Reserve Board ("Fed') released interim final rules in October 2010 to implement the appraisal independence provisions under TILA (which were transferred to the CFPB's authority in July 2011). And the Fed, along with the other Federal bank, thrift and credit union regulatory agencies released updated *Interagency Appraisal and Evaluation Guidelines* in December 2010 noting consideration of the Dodd-Frank Act provisions and referencing the standards set out in the *Uniform Standards of Professional Appraisal Practice* ("USPAP").

Section 1474 of the Dodd-Frank Act amended an existing provision in the ECOA and the CFPB's proposed rule (covered in this Regulatory Practice Letter) would amend an existing provision in Regulation B that governs consumer access to appraisal and valuation reports.

“Higher-risk mortgages” are a new category of loans established under TILA by Section 1471 of the Dodd-Frank Act. They are separate from “high cost mortgages,” which are covered by the *Home Ownership and Equity Protection Act* (“HOEPA”). (Please refer to Regulatory Practice Letter 12-15 for an overview of the Dodd-Frank Act revisions to high cost mortgages.) Higher-risk mortgages are generally defined as residential mortgage loans (though the Agencies’ proposed rule uses the language “a closed-end consumer loan secured by a principal dwelling”) with an annual percentage rate (“APR”) that exceeds the average prime offer rate (“APOR”) for a comparable transaction by:

- 1.5 percent for first-lien loans;
- 2.5 percent for first-lien jumbo loans; or
- 3.5 percent for subordinate-liens.

The CFPB’s second proposal, the Higher Risk Proposal, would amend Regulation Z to implement the changes to TILA brought about by Section 1471. Further, while the statutory definition of a higher-risk mortgage excludes qualified mortgages as defined in TILA, including but not limited to reverse mortgage loans, the Agencies would extend this exclusion to all reverse mortgage loans and loans secured solely by residential structures such as manufactured homes. A final rule to define “qualified mortgages,” however, is still forthcoming from the CFPB.

The “higher-risk mortgages” trigger rate thresholds are substantially similar to the rate triggers for “higher priced mortgages” under TILA. However, “higher priced mortgages,” which were defined to address UDAP (unfair or deceptive acts or practices) concerns associated with subprime mortgages, are subject to certain restrictions related to repayment ability, prepayment penalties and escrows. In addition, “higher priced mortgages” do not exclude “qualified mortgages” or loans secured by manufactured homes, which would be excluded from the definition of “higher-risk mortgages.”

Also as part of the Higher Risk Proposal, the Agencies are proposing to use a “transaction coverage ratio” (“TCR”) as an alternative to the APR for determining when a closed end loan is subject to the higher-risk mortgage loan rules. The CFPB previously proposed the use of a TCR in its mortgage disclosure integration proposal (see Regulatory Practice Letter 12-14) and its HOEPA proposal (see Regulatory Practice Letter 12-15) along with a new definition of “finance charge.” The Agencies state that if the TCR alternative were adopted for the Higher Risk Proposal, a creditor would calculate the TCR to determine coverage, but the new APR (based on the new finance charge definition) would be used for consumer disclosures. Further explanation provides that the TCR would be calculated in a manner similar to how the APR is calculated, except that the prepaid finance charge used for the TCR calculation would include only charges retained by the creditor, a mortgage broker, or an affiliate of either. The TCR would not reflect other closing costs that would be included in the broader finance charge for purposes of calculating the APR that would be disclosed to consumers.

Description

Each of the two proposed rules to modify appraisals activities are described below. Comments on each of the rules are due no later than October 15, 2012.

ECOA – Regulation B

The Bureau's proposed rule would make changes to Regulation B required by Section 1474 of the Dodd-Frank Act, which amended the ECOA to require creditors to provide copies of appraisal reports and valuations in connection with certain mortgage loans. In particular, the proposed rule would:

- Cover applications for credit secured by a first lien on a dwelling.
- Require creditors to notify applicants within three business days of receiving an application of their right to receive a copy of written appraisals and valuations developed.
  - A creditor may routinely provide an appraisal or valuation (whether credit is granted or denied); or
  - A creditor may provide notification to applicants that they may receive a copy of the appraisal or valuation upon written request.
- Require creditors to provide applicants a copy of all written appraisals and valuations promptly after receiving an appraisal or valuation, but in no case later than three business days prior to consummation of the mortgage.
  - "Promptly" would be interpreted to mean generally within 30 days of receipt by the creditor.
  - "Consummation" would be defined as the time that a consumer becomes contractually obligated on a credit transaction. The CFPB states this definition mirrors the definition in TILA.
- Permit applicants to waive the timing requirement to receive copies three days prior to consummation. However, applicants who waive the timing requirement must still be given a copy of all written appraisals and valuations at, or prior to, closing.
- Prohibit creditors from charging additional fees for providing a copy of written appraisals and valuations, but permit creditors to charge applicants a reasonable fee to reimburse the creditor for the cost of the appraisal or valuation unless otherwise required by law.
  - A creditor would not be permitted to charge an applicant for providing an appraisal, including costs such as photocopying, postage or similar charges.
  - A creditor may not impose fees for reimbursement of the costs of an appraisal where otherwise provided by law. For example, TILA prohibits a creditor from charging a consumer a fee for the performance of a second appraisal if the second appraisal is required under TILA section 129H(b)(2), which governs higher-risk mortgages.

TILA – Regulation Z – Higher-Risk Mortgage Appraisals

The Bureau, along with five other Federal financial regulatory agencies (the Fed, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency and the National Credit Union Administration– together the "Agencies") released a joint proposed rule that would establish new appraisal requirements for "higher-risk mortgages." The proposed rule would amend Regulation Z to implement the requirements of Section 1471of the Dodd-Frank Act, which amended TILA.

As proposed, a creditor would be permitted to make a higher-risk mortgage loan only if the following conditions are met:

- The creditor obtains a written appraisal;

- The appraisal is performed by a certified or licensed appraiser;
  - A "certified or licensed appraiser" would be a person who is (1) certified or licensed by the State in which the property to be appraised is located, and (2) performs each appraisal in conformity with USPAP (*Uniform Standards of Professional Appraisal Practice*) and the requirements applicable to appraisers in FIRREA Title XI and applicable regulations in effect on the date of the appraisal.
- The appraiser conducts a physical property visit of the interior of the property;
- At application, the applicant is provided with a statement regarding the purpose of the appraisal, that the creditor will provide the applicant a copy of any written appraisal, and that the applicant may choose to have a separate appraisal conducted at the expense of the applicant; and
- The creditor provides the consumer with a free copy of any written appraisals obtained for the transaction at least three business days before closing.

A safe harbor feature would provide that a creditor would be deemed to have met the requirements for a written appraisal if the creditor:
- Orders the appraiser to perform the appraisal in conformity with the USPAP, Title XI of FIRREA, and any implementing regulations in effect at the time the appraiser signs the appraiser's certification;
- Verifies through the National Registry that the appraiser who signed the appraiser's certification was a certified or licensed appraiser in the State in which the appraised property is located as of the date the appraiser signed the appraiser's certification;
- Confirms that required elements are included in the appraisal (detail of required elements are included in an Appendix to the regulation); and
- Has no actual knowledge to the contrary of facts or certifications contained in the written appraisal.

The creditor would also be required to provide an additional appraisal at no cost to the applicant when:
- The higher-risk mortgage loan would finance the acquisition of the consumer's principal dwelling;
- The seller acquired the home within 180 days prior to the consumer's purchase agreement (measured from the date of the consumer's purchase agreement); and
- The consumer is acquiring the home for a higher price than the seller paid. (Comment is requested on whether to include a threshold price increase.)

Such additional appraisal must be a written appraisal, from a different licensed or certified appraiser, and generally must include the following information:
- An analysis of the difference in sale prices (i.e., the sale price paid by the seller and the acquisition price of the property as set forth in the consumer's purchase agreement);
- Changes in market conditions, and
- Any improvements made to the property between the date of the previous sale and the current sale.

Commentary

The two proposed appraisal rules are a fundamental part of the CFPB's efforts to revise the regulations surrounding mortgage credit and implement the related Dodd-Frank Act changes, which include among other things, efforts to combine the TILA and RESPA (*Real Estate Settlement Procedures Act)* disclosures at mortgage originations and closings, establish mortgage servicing standards, and expand the type and number of mortgages covered by HOEPA protections. The appraisal rules, in particular, are intended to enhance consumer protections surrounding appraisals for mortgage loan applications by ensuring that all borrowers receive a copy of all written appraisals and valuations developed in connection with their application for a first-lien mortgage loan and that they pay a "reasonable fee" for the report (limited to an amount that reimburses the creditor for the cost of obtaining the report but not for providing it to the applicant). In addition, borrowers obtaining a higher-risk mortgage loan would be afforded greater protections such as, the requirements for the appraisal to include an interior inspection of the property and to be completed by a licensed appraiser. (Provisions impacting appraisal standards have or will be addressed through separate guidance, such as the Interagency Guidelines or other rulemakings.)

All creditors, including those that do not engage in higher-risk lending, will need to reassess and update their appraisal and valuations policies and procedures, systems requirements, monitoring and testing and training programs, to incorporate the new requirements (disclosures and triggers) and definitions (such as the TCR or new APR, if adopted, as well as the distinctions between "higher-risk mortgages," "higher priced mortgages" and "high cost mortgages") once they are finalized. Creditors should consider UDAAP (unfair, deceptive and abusive acts or practices) implications and the potential for consumer harm when developing the updates as well as when assessing potential revenue impacts resulting from the proposed fee limitations. Oversight of third party vendors is a critical concern for the CFPB and creditors should also review the processes of their vendors engaged in appraisal and valuations services to ensure they have enhanced policies and procedures that account for the new requirements and protect consumers.

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