

Wall Street Reform and Consumer Financial Protection Act of 2010

Residential Mortgage Loan Origination Provisions

**February 4, 2011
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Financial Reform Legislation

- Dodd-Frank Wall Street Reform and Consumer Protection Act
- Timeline
 - President's White Paper – May 2009
 - Passed by the House – December 11, 2009
 - Passed by the Senate – May 20, 2010
 - Conference Report – June 29, 2010
 - Passed by the House – June 30, 2010
 - Passed by the Senate – July 15, 2010
 - Signed by the President – July 21, 2010
- Public Law No. 111-203
- 16 Titles, 2,300 pages

Introduction

- **Title XIV of the Dodd-Frank Act – Mortgage Reform and Anti-Predatory Lending Act**
 - 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

Introduction (Cont'd)

- **Selected Provisions from Title X (Bureau of Consumer Financial Protection)**
 - Section 1032(f) – Combined Mortgage Loan Disclosure
 - Section 1076 – Reverse Mortgage Study and Regulations
 - Section 1083 – Amendments to the Alternative Mortgage Transaction Parity Act of 1982
 - Section 1094 – Amendments to the Home Mortgage Disclosure Act of 1975
 - Section 1098 – Amendments to the Real Estate Settlement Procedures Act of 1974
 - Section 1100A – Amendments to the Truth in Lending Act

Overview

- This legislation is a “game changer” for the mortgage origination business
- Anti-steering prohibitions will irrevocably change how mortgage originators are compensated
- Ability-to-repay standard will change the way that loans are underwritten
- Pressure to make “qualified mortgages”
- Increased liability provisions
- New disclosures and limitations on long-standing lender practices
- More stringent regulation of high-cost mortgages
- Enhancements to appraisal independence and regulation of appraisal management companies (“AMCs”)
- Effective Dates – see slide 76

Important Definitions

- Mortgage Originator
 - 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; (iii) offers or negotiates terms of a residential mortgage loan; or (iv) any person who represents to the public that he/she can or will perform any of those services
 - Different than S.A.F.E. Act definition
 - Includes third-party brokers and mortgage loan officers who work for lenders
 - Exclusions for creditors, certain seller-financing, and certain loan modifications

Important Definitions (Cont'd)

- Residential Mortgage Loan
 - 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
 - Exclusions for open-end plans and certain time shares

Duty of Care

- **Duty of Care Imposed on Mortgage Originators**
 - Licensing and registration requirements
 - Mortgage loan originator required to be “qualified”
 - Unique mortgage originator identifier placed on all “loan documents”
 - Regulations to require reasonably designed procedures to assure and monitor compliance with the duty-of-care requirements

Prohibition on Steering Incentives

- **Prohibition on Certain Steering Incentives**
 - Mortgage Originator Compensation: Mortgage originators may not receive compensation that varies based on the terms of a residential mortgage loan, other than the principal amount of the loan. Prohibits yield spread premiums
 - Restructuring origination fee: If a mortgage originator receives compensation directly from the consumer, he/she may not also receive any compensation from the lender or any other person (however, payment of bona fide third-party charges permissible)
 - Exception: Mortgage originator may receive compensation from creditor if he/she does not receive any compensation directly from the consumer and the consumer does not make any upfront payment of discount points, origination points or fees (except for bona fide third-party charges not retained by creditor, mortgage originator, or their affiliates)

Steering Incentives (Cont'd)

- Regulations to be issued to prohibit certain steering practices by mortgage originators
 - To loan without an ability to repay, or with predatory characteristics
 - From qualified mortgage that he/she can qualify for to a non-qualified mortgage
 - Abusive/unfair practices that promote discrimination
 - Mischaracterizations re: credit history, available loans, or appraised value
 - Discouragement of borrower seeking a better loan elsewhere

Steering Incentives (Cont'd)

- Rules of construction provide some flexibility to creditors and mortgage originators
 - No limit on compensation from creditor's sale of closed loan
 - Ability to capitalize permitted origination fees and costs
 - Ability to pay mortgage originators extra fees based on number of loans originated in a particular period of time
- The Federal Reserve Board ("Board") has issued a regulation, effective 4/1/2011, that implements some, but not all, of these provisions. A summary is at <http://www.mofo.com//files//Uploads/Images/100831FinalRule.pdf>.
Some highlights:
 - Rule prohibits compensation based on factors that are proxies for loan terms, such as debt-to-income ratio, credit score, or credit history

Steering Incentives (Cont'd)

- Loan originator compensation may be based on a fixed percentage of the loan amount, and creditors may establish a floor and ceiling for the compensation
- Loan originator compensation also may be based on long term performance of loans originated, an hourly rate, a fixed fee for each loan originated, the percentage of loan applications that result in consummated transactions, or the quality of the loans
- Compensation arrangements also must comply with §8 of RESPA
- Once compensation is established, it cannot change based on a subsequent change in loan terms
- Higher compensation cannot be paid for CRA loans
- Affiliated entities are treated as the same person

Steering Incentives (Cont'd)

- Loan originator may not steer consumer into a credit transaction on the basis that he/she/it will receive more compensation than would be received from other transactions that the originator offered or could offer to the consumer, unless the consummated transaction is in the consumer's interest
 - This prohibition is focused on third party mortgage brokers
 - If the originator complies with a “safe harbor” provided by the regulation, the originator will be protected from liability. The safe harbor requires the originator to present the consumer with loan options for each type of transaction in which the consumer expresses an interest, and these options must be obtained from a significant number of creditors with which the originator regularly does business
- There will be additional rulemaking in the future

Liability and Abusive Practices

- Truth in Lending Act (“TILA”) civil liability for mortgage originators
 - Extends TILA civil liability provisions to mortgage originators
 - 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

Liability and Abusive Practices (Cont'd)

- Issuance of regulations
 - Prohibit practices found to be abusive, unfair, deceptive or predatory
 - Ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with anti-steering and ability-to-repay rules
 - Authority to establish full or partial exemptions
 - Certain time shares excluded

Ability to Repay

- Creditors must 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 at the time the loan is consummated
- Determination must be based on verified and documented information
- Ability-to-repay standard must be applied with respect to the combined total of multiple loans on the same property
- Basis for determination:
 - Credit history, current and expected income and obligations, debt-to-income or residual income, employment status, and financial resources other than the property
 - Need to verify income with W-2s, payroll receipts, etc.

Ability to Repay (Cont'd)

- Limited special rule for streamlined refinances of certain government loans
- Ability-to-repay standard does not apply to reverse mortgages or to temporary or bridge loans with terms of 12 months or less
- Non-Standard Loans
 - Variable rate loans that defer repayment of any principal or interest – use fully amortizing payment schedule
 - Interest-only loans – use amortizing payment schedule through final maturity
 - Negative Amortization – must take negative amortization into consideration
 - Assume disbursement on consummation, equal monthly amortizing payments (with special treatment of balloons), and application of fully-indexed rate for life of loan

Ability to Repay (Cont'd)

- Flexibility when considering a refinance of a hybrid loan with current lender
- Ability-to-Repay “Safe Harbor”
 - The safe harbor that is not a true safe harbor
 - Creditor and its assignees may “presume” that a loan meets the ability-to-repay standard if the loan is a “qualified mortgage”
 - Presumption is rebuttable
- A “qualified mortgage” is a residential mortgage loan that meets the following criteria. There is no “net tangible benefits” test
 - No negative amortization
 - Consumer cannot defer repayment of principal
 - No balloon payment (with a very narrow exception)
 - Income and financial resources must be verified and documented

Ability to Repay (Cont'd)

- If fixed rate, must be underwritten on the basis of a fully amortizing loan that takes all applicable taxes, insurance and assessments into consideration
- If adjustable rate, must be underwritten on the basis of the maximum rate that is permitted under the loan during the first five years and a repayment schedule that fully amortizes the loan over the scheduled term. Must take all applicable taxes, insurance and assessments into consideration
- Comply with any Board regulations on debt-to-income ratios or residual income
- Total points and fees may not exceed 3% of the total loan amount
- Scheduled loan term may not exceed 30 years
- Board regulations may revise, add to, or subtract from, the definition

Loan Standards

- Prepayment penalties
 - Non-qualified mortgage – prepayment penalties prohibited
 - Qualified mortgage that is a fixed rate and meets additional rate and other restrictions – limited prepayment penalties are permissible for 3 years (3% – 2% – 1% of outstanding balance). Creditor also must offer a loan without a prepayment penalty
- Single premium credit insurance
 - Creditors may not finance credit insurance product premiums or any payment for debt cancellation or suspension contracts
 - This rule applies to residential mortgage loans and to open-end loans secured by principal dwellings

Loan Standards (Cont'd)

- Arbitration
 - Arbitration and similar clauses impermissible for residential mortgage loan or open-end loan secured by principal dwelling
 - Parties may agree to arbitrate after dispute arises
 - Loan provision in residential mortgage loan or open-end loan secured by principal dwelling may not bar consumer from bringing civil action under TILA or other action for damages for violation of arbitration provision, other TILA provisions, or any other federal law

Loan Standards (Cont'd)

- Negative Amortization Loans
 - New disclosure required: (i) the transaction may or will result in negative amortization; (ii) describe 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
 - Homeownership counseling required for first-time borrower on residential mortgage loan that is not a qualified mortgage

Loan Standards (Cont'd)

- Protection against loss of anti-deficiency protections
 - For loans that contain anti-deficiency protections, a notice at the time of consummation describing the anti-deficiency protection and its importance
 - Notice before refinancing that would cause loss of anti-deficiency protection
- Acceptance of Partial Payments
 - Need to disclose policy re acceptance of partial payments
 - Need to disclose how partial payments will be applied and whether they will be escrowed
 - Same disclosure obligation applies on a “person becoming a creditor” with respect to an existing loan

TILA Liability

Increased TILA civil liability and statute of limitations

- Individual action – minimum statutory damages for consumer leases increased from \$100 to \$200 and maximum increased from \$1,000 to \$2,000
- Class action – maximum statutory damages increased from \$500,000 to \$1,000,000 (or 1% of the creditor's net worth, if less)
- Statute of limitations for violations of §129 (high-cost mortgages); §129B(c)(1) and (2) (prohibition on steering incentives) and §129C(a) (ability to repay requirement) of TILA have been increased from one year to three years. Special liability provisions for high-cost mortgages under §129 of TILA now also apply to violations of §129B(c)(1) and (2) and §129C(a) of TILA
- Ability to sue for recoupment under Sections 129B(c)(1) and (2) (prohibition on steering incentives) and Section 129C(a) (ability-to-repay requirement) once a foreclosure proceeding has commenced

Reset of Hybrid ARMs

- Notice Required Before Reset of Hybrid ARMs
 - Advance notice required during the one-month period that ends six months before a hybrid ARM's initial interest rate is first adjusted
 - A hybrid ARM 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

Reset of Hybrid ARMs (Cont'd)

- Notice Required Before Reset of Hybrid ARMs (Cont'd)
 - Contents of Notice: (i) any index or formula used to make the rate adjustment, together with a source of information; (ii) explanation of how the new rate and payment will be determined; (iii) good faith estimate of the new monthly payment, and the related assumptions; (iv) alternatives that the consumer may pursue before the adjustment date, and a description of required actions; (v) contact information of counseling agencies or programs that are reasonably available to the consumer; and (vi) contact information of state housing finance authority for the state in which the consumer resides

Closed-End Credit Disclosures

- ARMs with escrows
 - Initial monthly P&I payment, both with and without escrows
 - Fully-indexed monthly P&I payment, both with and without escrows
 - Compare: Other Dodd-Frank Act provisions require disclosure of payment schedule including escrows
 - Note: Two interim rules issued by the Board require the use of a rate and payment summary table in the standard closed-end Truth-in-Lending disclosure statement. The table replaces the detailed payment schedule that previously was required. Compliance with the original interim rule became mandatory on 1/30/2011. The subsequent interim rule, which clarifies the original rule, also became effective on 1/30/2011, but compliance

Closed-End Credit Disclosures (Cont'd)

is not mandatory until 10/1/2011. Summaries of the two interim rules are at <http://www.mofo.com/files/Uploads/Images/100820InterimRule.pdf> and <http://www.mofo.com/files/Uploads/Images/101229-Mortgage-Disclosure.pdf>

- Settlement charges
 - All settlement charges
 - Disclosure of those charges financed and those paid by consumer at settlement
 - Wholesale rate of funds
 - Total fees or required payments in connection with the loan
- Mortgage originator fees
 - Total fees paid to originator, fees paid by consumer, fees paid by creditor
- Total interest paid over life of loan as a percentage of principal

Monthly Statement Requirement

- A creditor, assignee or servicer of a residential mortgage loan must provide statements for each billing cycle
- Periodic statement must include the amount of the principal obligation; current interest rate; date on which the interest rate may next adjust; amount of any prepayment fee; description of any late payment fee; phone number and e-mail address to obtain information about the loan; contact information for approved counseling agencies; other information required by regulation
- Board to develop standard form
- No periodic statement is required for fixed-rate loan where the consumer is provided with a coupon book that provides substantially the same information as required for the periodic statements

High-Cost Mortgages

- Amended definition of “high-cost mortgage”
 - A consumer credit transaction that is secured by the consumer’s principal dwelling and that meets certain characteristics
 - Revised definition excludes reverse mortgages, but deletes previous exclusions for residential mortgage transactions (*i.e.*, purchase loans and loans for initial construction of dwelling) and open-end credit (HELOCs)
- To be a high-cost mortgage, one of the following must occur:
 - First lien loan – 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 (“APOR”) for a comparable transaction

High-Cost Mortgages (Cont'd)

- Subordinate lien loan – APR at consummation exceeds by more than 8.5% the APOR for a comparable transaction
- Total points and fees (excluding third-party charges not retained by mortgage originator, creditor, or an affiliate of either) exceed (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. Board has authority to adjust dollar amount
- Prepayment Fees – Loan documents allow a prepayment fee for more than 36 months after closing, or if fees exceed 2% of amount prepaid

High-Cost Mortgages (Cont'd)

- Special rules for calculation of interest component of APR
 - Fixed-rate loan – based on interest rate in effect at consummation
 - Variable-rate loan where rate is adjusted solely based on index movements – index value at consummation plus maximum margin value
 - Other loans – highest interest rate that can be charged
- Special rules for mortgage insurance
 - Mortgage insurance provided by federal or state government agency – exclude from points and fees
 - Private mortgage insurance meeting certain government standards – exclude from points and fees

High-Cost Mortgages (Cont'd)

- Mortgage insurance paid by consumer after loan closing – exclude from points and fees
- New “points and fees” definition will increase the potential group of loans that will be treated as high-cost mortgages
 - 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
 - Includes premiums or other charges paid at or before closing for credit insurance products, as well as any payments for debt cancellation or suspension contracts
 - Includes the maximum prepayment fees and penalties that may be charged and collected under the terms of the loan

High-Cost Mortgages (Cont'd)

- Includes 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
- These are in addition to amounts currently included in the points and fees
- Bona fide discount points paid by consumer may be excluded from points and fees
 - Up to 2 discount points if interest rate does not exceed APOR by more than 1%
 - Up to 1 discount point if interest rate does not exceed APOR by more than 2%
 - Only one of these may be excluded

High-Cost Mortgages (Cont'd)

- Discount points must be knowingly paid
- Interest rate reduction must be reasonably consistent with industry norms and practices for the secondary market
- Special rule for loans secured by personal property
- Calculation of 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

High-Cost Mortgages (Cont'd)

- Prepayment penalty provisions
 - Section 129(c)(2) of TILA, which previously provided a limited exception to the general prohibition on prepayment penalties, has been repealed
 - No prepayment penalty fees may be imposed on high-cost mortgages under any circumstances
- Balloon payments
 - Balloon payments prohibited for full term of a high-cost mortgage
 - Previously, balloon payments were allowed once the loan reached the five-year mark
- Prohibition on recommending or encouraging a default on the loan that will be refinanced by a high-cost mortgage

High-Cost Mortgages (Cont'd)

- Late fee restrictions
 - Maximum late fee of 4% of amount of payment past due
 - Loan contract must authorize late fee
 - Only one late fee per late payment
 - 15-day grace period
 - Anti-pyramiding restrictions have been imposed
 - Special rules for application of payments for purposes of determining when a late fee may be imposed
- Loan accelerations limited to the following circumstances
 - Default in payment
 - Exercise of due-on-sale clause
 - Material violation of loan documents other than payment schedule

High-Cost Mortgages (Cont'd)

- The following fees may not be financed by a high-cost mortgage
 - Prepayment fees, if creditor or affiliate holds note being refinanced
 - Any points and fees
- Prohibition on evasions
- Prohibition on modification, deferral, or similar fees
- Payoff statements
 - Basic rule – No charge for payoff statements
 - Multiple requests – Reasonable fee can be imposed for 5th and subsequent requests for payoff statements in same calendar year
 - Processing fees – Can be charged for fax or courier service, but not more than charge for a non-high-cost mortgage. Requires advance fee disclosure

High-Cost Mortgages (Cont'd)

- Prompt delivery – Within 5 business days. Compare: For other home loans, Dodd-Frank Act allows delivery within a reasonable time, but not more than 7 business days
- Pre-loan counseling by approved counselor required
- Special 30- and 60-day rights to cure violations, but at a potentially high cost

Office of Housing Counseling

- Subtitle D establishes an infrastructure for the U.S. Department of Housing and Urban Development's ("HUD") new Office of Housing Counseling
 - The Director of the Office will have primary responsibility within HUD for all activities and matters relating to homeownership and rental housing counseling
- Counseling Procedures
 - Secretary of HUD to establish standards, including materials and forms that will be used by organizations providing counseling and that receive grants for that activity
- HUD-certified counselors
 - Homeownership or rental housing counseling required by a HUD program must be provided only by organizations or counselors certified by HUD as competent

Housing Counseling (Cont'd)

- Updating of the HUD “special information booklet”
 - Prepared by Director of the Bureau of Consumer Financial Protection (“Bureau”) and revised every 5 years
 - In addition to settlement costs and escrows, the updated booklet will address most other aspects of the home loan process
 - To be prepared in “various languages and cultural styles”
 - Creditors required to provide version of booklet that is most appropriate for recipient
 - Creditors required to provide a reasonably complete or updated list of certified homeownership counselors “located in the area of the lender”

Housing Counseling (Cont'd)

- Home inspection counseling
 - Secretary of HUD to take actions to inform potential homebuyers of the availability and importance of obtaining an independent home inspection
- Warning to homeowners of foreclosure rescue scams
 - Funds to be allocated to the Neighborhood Reinvestment Corporation to provide a notice to delinquent consumers that will make them aware of the dangers of foreclosure rescue scams

Appraisals – Higher-Risk Mortgages

- “Super appraisal” requirement for “higher-risk” mortgages
- Higher-risk mortgage defined as a residential mortgage loan that is secured by a principal dwelling and has the following characteristics
 - Not a “qualified mortgage” – see definition 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 APOR for a comparable transaction 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 APOR for a comparable transaction as of the date the interest rate is set by 2.5% or more

Higher-Risk Mortgages (Cont'd)

- If the loan is a subordinate lien loan, the APR of the loan exceeds the APOR for a comparable transaction 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”
- In general, a creditor is not permitted to make a higher-risk mortgage without first obtaining a written appraisal that meets certain requirements
 - Physical property visit, including of the interior of the property
 - Second appraisal requirement under circumstances suggesting flipping, at no cost to applicant

Higher-Risk Mortgages (Cont'd)

- All appraisals performed by certified or licensed appraiser in accordance with the Uniform Standards of Professional Appraisal Practice (“USPAP”) and the Financial Institutions Reform, Recovery and Enforcement Act (“FIRREA”)
- Free copy of the first appraisal for the consumer. This does not preclude the creditor from requiring the consumer to pay for the cost of the first appraisal
- Consumer notification at the time of the initial loan application 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
- Penalty for willful failure to obtain required appraisal on higher-risk mortgage – \$2,000

Appraiser Independence

Appraiser and Valuation Independence

- The standards regarding appraisal and valuation independence apply to a consumer credit transaction secured by the consumer's principal dwelling
 - Other existing laws and regulations, as well as USPAP, still require appraisal independence for other types of loans
 - The revised Interagency Appraisal and Evaluation Guidelines ("Guidelines") issued on 12/2/2010 by five federal banking agencies require regulated banking institutions to maintain independence between the institution's appraisal/valuation program and its loan production staff; maintain independence in the institution's reporting lines for its appraisal/valuation program; require appraisers to be independent of the loan production and collection processes; and

Appraiser Independence (Cont'd)

prohibit appraisers from having any direct, indirect or prospective interest in the property being appraised or the transaction in question. The Guidelines apply to all real estate-related financial transactions – consumer, commercial, and industrial alike. The federal banking agencies have acknowledged that further revisions to the Guidelines may be necessary once the Dodd-Frank Act appraisal regulations are issued. A summary of the Guidelines is at <http://www.mofo.com/files/Uploads/Images/101216-Final-Interagency.pdf>

- The standards apply to any estimate of value prepared by a natural person (e.g., formal appraisals and broker price opinions). Automated valuation models are not covered
- Board issued an interim final rule on 10/18/2010
 - Rule became effective on 12/27/2010
 - Compliance with rule is optional until 3/31/2011
 - Compliance with rule is mandatory starting on 4/1/2011

Appraiser Independence (Cont'd)

- A summary of the rule is at <http://www.mofo.com/files/Uploads/Images/101101-Interim-Final-Rule-on-Real-Estate-Appraisals.pdf>
- It is unlawful to engage in any act or practice that violates appraiser or valuation independence. This includes:
 - Where a person with an interest in the transaction coerces, extorts, induces, bribes, intimidates, compensates, or colludes with a person who performs an appraisal, an AMC, or other person to cause the value of the property not to reflect the person's independent judgment
 - Materially misrepresenting the value of the property
 - Falsifying or materially altering the value of the property
 - Inducing a person to mischaracterize the value of the property

Appraiser Independence (Cont'd)

- Exceptions – It is permissible to:
 - Ask a person who performs an appraisal or other valuation to consider other property information, including comparable properties
 - Ask a person who performs an appraisal or other valuation to provide further detail, substantiation, or explanation for the value conclusion
 - Ask a person who performs an appraisal or other valuation to correct errors in the valuation report
 - Obtain multiple appraisals or other valuations in order to select the most reliable valuation
 - Take action permitted or required by applicable law

Appraiser Independence (Cont'd)

- The Guidelines state that a banking institution's policies and procedures should specify methods for communication between the collateral evaluation staff and the person performing the appraisal or evaluation, to ensure independence in the collateral valuation function
- Conflicts of Interest – A person who performs an appraisal or valuation, or performs valuation management functions, may not have direct or indirect financial or other interests in the property or transaction involving the valuation
 - There are regulatory “safe harbors” that may apply to a person who performs an appraisal or other valuation for his/her own employer, and to providers of multiple settlement services

Appraiser Independence (Cont'd)

- There are two types of safe harbors, one for employees and affiliates of creditors with assets of more than \$250 million as of 12/31 for both of the past two calendar years, and one for employees and affiliates of creditors with assets of \$250 million or less as of 12/31 for either of the past two calendar years
- Mandatory Reporting by Covered Persons – Covered person must report to state appraiser agency if it/he/she has reasonable belief that appraiser has failed to comply with USPAP or ethical or professional requirements for appraisers codified under federal or state laws, where the failure to comply was material
- There is only a duty to report for non-compliance by licensed or certified appraisers. The duty does not extend to persons who perform valuations but who are not appraisers

Appraiser Independence (Cont'd)

- A person that makes a report is not legally protected from defamation or other claims
- A person cannot threaten to make a report in an effort to undermine independence in the appraisal process

Appraisal Activities

- Prohibition on Making Tainted Loans – Creditor cannot make a loan if it knows of a violation of the appraisal or valuation independence or conflict-of-interest provisions at or before the consummation of the loan, unless creditor documents that it has acted with reasonable diligence to determine that the appraisal or other valuation does not materially misstate or misrepresent value of the dwelling – this means that the misstatement or misrepresentation did not affect the credit decision or the loan terms
 - Creditor can make the loan if it shows that it has relied on a different – and clean – appraisal or other valuation
- Board, Bureau, FHFA, OCC, FDIC and NCUA may issue rules and interpretive guidelines
- Appraisal report portability – Board, Bureau, FHFA, OCC, FDIC and NCUA may issue joint rules to ensure portability between lenders for 1-4 unit principal dwelling loans, or mortgage brokers for those loans

Appraisal Activities (Cont'd)

- Compensation for Fee Appraisers – Creditors and their agents must pay customary and reasonable compensation to fee appraisers
 - This is one of the most controversial of the Dodd-Frank Act appraisal provisions
 - The duty applies to both creditors and their agents. “Agents” include AMCs, whether or not they are required to register under the new Dodd-Frank Act provisions which regulate that industry
 - The duty is limited to payments to a “fee appraiser,” which includes both (i) a licensed or certified appraiser who is not employed by the person engaging the appraiser, and (ii) an organization that employs appraisers, but is not an AMC that must be registered under the new Dodd-Frank Act provisions
 - Payments by a creditor to its own in-house appraiser are not covered

Appraisal Activities (Cont'd)

- Payments by appraisal firm that is not an AMC to its own employee are not covered
- Board guidance:
 - Compensation may be withheld if fee appraiser fails to meet contractual obligations, such as delivery of the appraisal
 - A contract's characterization of the fee paid as "customary and reasonable" will not be legally determinative
 - The new rule does not prohibit volume-based compensation. However, other laws, such as §8 of RESPA, may not allow volume-based compensation
 - The duty to pay a customary and reasonable fee is based on the geographic market of the property being appraised

Appraisal Activities (Cont'd)

- What constitutes the “geographic market” is a fact-based determination
- There are two legal “presumptions of compliance” that are available. If either presumption is complied with, it is presumed that there has been compliance with the customary and reasonable compensation requirement. Either presumption may be rebutted
- First Presumption of Compliance – A three step process
 - Creditor or its agent must determine the amount of the fee that is reasonably related to recent rates paid for comparable appraisals performed in the geographic market of the property being appraised. In making this determination, the Board’s interim final rule does not prohibit the inclusion of compensation paid to fee appraisers by AMCs

Appraisal Activities (Cont'd)

- The amount so determined must be adjusted based on certain factors, such as type of property, appraiser qualifications and experience, work quality, etc.
- Creditor and its agent may not engage in any anticompetitive acts in violation of federal or state law
- Second Presumption of Compliance – A creditor and agent must rely on rate information that meets all of the following requirements:
 - The information must be based on objective third-party information, such as fee schedules, studies and surveys prepared by independent third parties
 - The information must be based on recent rates paid to a representative sample of providers of appraisal services in the geographic market of the property being appraised, or the fee schedules of those providers

Appraisal Activities (Cont'd)

- The information must exclude compensation paid to fee appraisers for appraisals ordered by AMCs. For this purpose, an AMC includes those that do not have to register under the new Dodd-Frank provisions which regulate that industry
- Home Valuation Code of Conduct (“HVCC”) – Dodd-Frank Act provides that HVCC sunsets when the Board’s interim final rule (discussed above) is promulgated
- Penalties
 - Violation of new appraiser independence rules subject violator to “enforcement provisions” in §130 of TILA
 - In addition, civil penalties of up to \$10,000 per day for first violation
 - Civil penalties increase to up to \$20,000 per day for subsequent violations

Appraisal Subcommittee

- Bureau to determine if current \$250,000 threshold for mandatory appraisal by licensed or certified appraiser provides reasonable protection for consumers who buy 1-4 unit residences
- Appraisal Subcommittee of the FFIEC to issue annual report to Congress of its activities
- Appraisal Subcommittee authorized to issue regulations re temporary practice, national registry, information sharing, and enforcement
- Federal banking agency rules to require that appraisals be subject to review for compliance with USPAP
- Appraisal Subcommittee to –
 - Monitor state requirements for registration and supervision of AMCs
 - Establish national registry for AMCs

Appraisal Subcommittee (Cont'd)

- Appraisal Subcommittee to monitor state appraiser regulatory agencies to determine if policies, etc. are consistent with maintenance of appraiser independence
- Appraisal Subcommittee to encourage states to accept courses offered by The Appraisal Foundation's Appraisal Qualifications Board Course Approval Program
- Complaint Hotline – Appraisal Subcommittee to establish hotline to receive complaints re non-compliance with appraisal independence standards and USPAP. To be established within 6 months if no other national hotline exists
- Bureau has been given a seat on the Appraisal Subcommittee
- At least one member of Appraisal Subcommittee must have demonstrated knowledge and competence through licensure, certification or professional designation within the appraisal profession

Appraisal Management Cos.

- Minimum requirements for AMCs to be established by federal regulation and applied by the states
 - 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 AMCs comply with USPAP
 - Require that appraisals are conducted independently and otherwise adhere to the independence standards required by the Dodd-Frank Act
- States may impose additional requirements

Appraisal Mgt Cos. (Cont'd)

- Subsidiaries of federally regulated financial institutions subject to new regulatory requirements but not registration with state appraiser regulatory agencies
- AMC cannot be registered by state or included in national registry if owned by person whose appraiser license or certification has been denied, cancelled, etc. by any state
- Person owning more than 10% of AMC must be of good moral character and submit to state appraiser regulatory agency background check
- Board, Bureau, FHFA, OCC, FDIC and NCUA to issue regulations by 1/21/2013 for reporting of AMC activities to Appraisal Subcommittee

Appraisal Mgt Cos. (Cont'd)

- Effective date
 - Once federal regulations are issued, AMCs have 36 months to register with states or be subject to oversight by a federal financial institutions regulatory agency
 - Appraisal Subcommittee, with FFIEC approval, can extend deadline by 12 months for a state that has made substantial progress in establishing a compliant regulatory regime
- “Appraisal Management Company” definition
 - Third party authorized by creditor in consumer credit transaction secured by principal dwelling, or by underwriter or principal in secondary market transaction
 - Third party must oversee a network or panel of 16 or more certified or licensed appraisers in one state, or 25 or more nationwide, in a given year

Appraisal Mgt Cos. (Cont'd)

- Third party must recruit, select and retain appraisers; contract with appraisers to perform appraisals; manage process of having appraisals performed; or review and verify work of appraisers
- Duties of state appraiser regulatory agencies have been increased to cover activities of AMCs
- RESPA has been amended to authorize a change to the HUD-1 and HUD-1A to include a clear disclosure of
 - Fee paid directly to the appraiser
 - Administrative fee charged by the AMC

Appraisal Activities

- National registry fees
 - Maximum fee for appraisers increased from \$25 to \$40, but can increase to as much as \$80 under certain circumstances
 - \$25-\$50 per appraiser in network of AMC, plus additional fees for AMC in existence one year or less; possible minimum fee
- Minimum qualification requirements for appraisers
 - State-licensed appraisers must meet or exceed minimum criteria of Appraisal Qualifications Board of The Appraisal Foundation
 - Appraisal Subcommittee may establish qualification and experience requirements
 - Requirements for trainee appraisers and supervisory appraisers must meet or exceed criteria set by Appraisal Qualifications Board of The Appraisal Foundation

Appraisal Activities (Cont'd)

- Appraisal Subcommittee powers to review and crack down on state appraiser regulatory agencies that are not performing, and to remove appraisers and AMCs from national registry for up to 90 days
- Reciprocity – State A is required to grant a reciprocal license or certification to appraisers licensed or certified in State B so long as:
 - The licensing or certification program in State B is compliant with the amended FIRREA provisions relating to appraisals; and
 - State B’s licensing or certification requirements meet or exceed the standards of State A
- Professional appraisal designations – Federal agencies’ appraiser criteria may consider membership, but lack of membership may not be the sole bar against consideration for an appraisal assignment

Automated Valuation Models

- Automated valuation models (“AVM”) must adhere to quality control standards to:
 - Ensure a high level of confidence in the estimates produced by AVMs
 - Protect against the manipulation of data
 - Seek to avoid conflicts of interest
 - Require random sample testing and reviews
 - Account for other factors set forth in regulations
- Definition of AVM – 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
- Board, OCC, FDIC, NUCA, FHFA and Bureau to adopt regulations, after consultation with Appraisal Subcommittee and Appraisal Standards Board

Automated Valuation Models (Cont'd)

- The Guidelines, which apply only to banking institutions, provide extensive guidance on the use of an AVM as a permissible “evaluation” tool. (Note: Banking agency regulations generally require formal appraisals, but there are some instances – for example, transactions of \$250,000 or less – in which qualifying evaluations may be used in lieu of appraisals) Although the Guidelines were issued as recently as 12/2/2010, the federal banking agencies have acknowledged that further revisions to the Guidelines may be necessary once the Dodd-Frank Act appraisal regulations are issued. As a result, the Guidelines’ guidance on AVMs is subject to additional changes

Automated Valuation Models (Cont'd)

- Some highlights of the Guidelines' provisions relating to AVMs:
 - Policies and Procedures. An institution must have policies and procedures that govern its use of AVMs and other evaluation methods or tools that it employs. An institution also needs to have internal controls to verify that the policies and procedures are being followed. An institution's policies and procedures must address the monitoring of the AVM and the ongoing validation processes for the AVM
 - Safety and Soundness. An institution bears the responsibility for demonstrating that use of an AVM is consistent with safety and soundness and the Guidelines

Automated Valuation Models (Cont'd)

- Actual Physical Condition. An AVM will qualify as a permissible evaluation only if it addresses the property's actual physical condition. An AVM that simply assumes that the property is in average condition will not qualify. This suggests that, as a practical matter, AVMs may need to be combined with some kind of inspection in order to be "bankable" as evaluations
- Other: The Guidelines provide standards for the selection of an AVM, determining the use of an AVM, and validating AVM results
- Neither the Dodd-Frank Act nor the Guidelines explicitly require that AVMs be tested against appraisals performed by licensed or certified appraisers. However, it is possible that the banking agency regulations to implement Dodd-Frank Act will require that AVMs be so tested

Automated Valuation Models (Cont'd)

- Enforcement responsibilities for new regulations
 - Regulated financial institution or subsidiary – primary federal regulator
 - Others – FTC, Bureau and state attorneys general

Broker Price Opinions

- Broker price opinions (“BPO”) 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
- Definition of BPO – 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
 - A BPO is prepared by a real estate broker, agent or salesperson
 - A BPO does not include an AVM
- The Guidelines state that a BPO (defined similarly) may not be used by a banking institution as an evaluation. The Guidelines state that a BPO could be used for monitoring the collateral value of an existing loan

Copies of Appraisals

Enhanced duty of creditors to provide copies of all written appraisals and valuations to loan applicant

- Requirement applies to all applications for a loan to be secured by a first lien loan on a dwelling regardless of whether the loan is granted or denied, the application is incomplete, or the application is withdrawn
- The requirement applies to both consumer and business purpose loans, so long as they are or would be secured by first liens on dwellings
- Copy must be furnished upon completion, but no later than three days before closing
- Applicant may waive 3-day requirement before loan closing except where not permitted by applicable law

Copies of Appraisals (Cont'd)

- Applicant may be required to pay a reasonable fee to cover cost of appraisal, unless applicable law provides otherwise
- Copy of appraisal must be provided at “no additional cost”
- Creditor is required, at the time of application, to notify applicant in writing of right to receive a copy of each written appraisal or valuation
- Definition of “valuation” – Any estimate of value of dwelling developed in connection with a creditor’s decision to provide credit, including:
 - A valuation developed “pursuant to a policy of a government sponsored enterprise”

Copies of Appraisals (Cont'd)

- An AVM
- A BPO – however, see discussion above regarding the Guidelines' prohibition on the use of BPOs as evaluations
- Any other methodology or mechanism

Effective Dates

- Provisions of Title XIV to take effect on dates stated in final regulations
- Except as otherwise provided in Dodd-Frank Act, required regulations under Title XIV to be issued in final form no later than 1/21/2013, and to take effect within 12 months of issuance in final form. Some regulations to be issued sooner
- If, for any reason, regulations for any section of Title XIV are not issued by 1/21/2013, the section itself will become effective on 1/21/2013
- The Board's interim final appraisal rule became effective on 12/27/2010, but compliance is not mandatory until 4/1/2011
- The Guidelines became effective when they were published in the Federal Register on 12/10/2010. On a case-by-case basis, the applicable federal banking agency can provide some flexibility regarding the compliance date

Combined Disclosures

- Combined mortgage loan disclosure
 - Dodd-Frank Act directs the Bureau to propose a single integrated model disclosure that combines certain disclosures required by TILA and certain disclosures required by RESPA. The Bureau is to do so by 1/21/2012 unless the Bureau determines that the Board and HUD have already done so
 - Other amendments to TILA and RESPA also require Bureau to produce a combined disclosure
 - Bureau also to revise the existing HUD “special information booklet” to jointly address compliance with RESPA and TILA

Parity Act

- Alternative Mortgage Transaction Parity Act of 1982 (“AMTPA”)
 - The AMTPA is now limited to loans in which the interest rate or payments may be adjusted or renegotiated
 - AMTPA preemption
 - State laws that prohibit the ARMs allowed by the designated federal regulations are preempted
 - State laws that regulate mortgage transactions generally are not preempted
 - Effective on 7/21/2011
 - On or before that date, use existing AMTPA regulations
 - After that date, use regulations of the Bureau
 - Bureau to review regulations of OCC and NCUA

Additional HMDA Data Elements

Amendments to the Home Mortgage Disclosure Act of 1975 (“HMDA”)

- Amends HMDA to greatly increase the types of information that must be reported by banks and other financial institutions
- The number and dollar amounts of mortgage loans, grouped according to measurements of the following
 - Total points and fees payable at origination
 - Difference between the APR of the loan and a benchmark rate or rates for all loans
 - Term in months of any prepayment penalty or similar fee
 - Other information required by the Bureau

HMDA Data Elements (Cont'd)

- The number and dollar amounts of mortgage loans and completed applications, grouped according to measurements of the following
 - Value of the real property collateral
 - 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
 - Channel through which the application was made
 - Unique identifier of the loan originator under the S.A.F.E Mortgage Licensing Act of 2008, if required by the Bureau
 - Universal loan identifier, if required by the Bureau
 - Security property's parcel number, if required by the Bureau

HMDA Data Elements (Cont'd)

- Each borrower's credit score, in the form required by the Bureau
- Other information required by the Bureau
- Bureau to issue regulations after consultation with other federal agencies
 - Prescribe format of disclosure and other procedural issues
 - Require collection of same data for loans sold
 - Require disclosure of classification of loan purchaser
 - Permit reporting of additional data
 - Provide for modification of itemized information to protect privacy of applicant or borrower
- Timing for submission of new data (other than age) – no earlier than first January 1 that occurs after the end of 9-month period following issuance of final regulations

HMDA Data Elements (Cont'd)

- Bureau, with assistance of other agencies, to develop or improve methods of matching addresses and census tracts to facilitate compliance on economical basis

Additional Information

- See Residential Mortgage User Guide at <http://www.mofo.com/files/Uploads/Images/ResidentialMortgage.pdf>
- See Consumer Financial Protection User Guide at <http://www.mofo.com/files/Uploads/Images/101111-Dodd-Frank-Consumer-Financial-Protection.pdf>
- See other Dodd-Frank Act and regulatory reform materials at <http://www.mofo.com/resources/regulatory-reform/>

Use of this Presentation

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