CUNA REGULATORY ADVOCACY

CUNA REGULATORY COMMENT CALL

September 10, 2012

Joint Proposal on Appraisals for "Higher-Risk Mortgages"

EXECUTIVE SUMMARY

- The Consumer Financial Protection Bureau (CFPB), the National Credit Union Administration (NCUA), and the other federal financial regulators[1] (collectively, the Agencies) have jointly issued a proposal to amend Regulation Z, which implements the Truth in Lending Act (TILA). This proposal implements the appraisal requirements for extensions of credit for "higher-risk mortgage loans" required by the Dodd-Frank Act.
- The proposal was developed jointly by the Agencies and will apply to federally insured credit unions. As proposed, NCUA would amend § 722.3 of its regulations to cross reference the CFPB's updated Reg Z, which is referred to in this Comment Call as § 1026.XX.
- The Dodd-Frank Act generally defines a "higher-risk mortgage" as a closed-end consumer credit transaction secured by a principal dwelling with an annual percentage rate (APR) exceeding certain statutory thresholds. These rate thresholds are substantially similar to rate triggers currently in Reg Z for "higher-priced mortgage loans," a category of loans to which special consumer protections apply. In general, loans are "higher-risk mortgage loans" under this proposed rule if the APR exceeds the average prime offer rate (APOR) by 1.5% for first-lien loans, 2.5% for first-lien jumbo loans, and 3.5% for subordinate-lien loans.
- Consistent with the statute, the proposal would exclude "qualified mortgages" from the definition of higher-risk mortgage loan. The CFPB will define "qualified mortgage" when it finalizes its ability-to-repay proposal. In addition, the Agencies propose to exempt the following additional classes of loans: (1) reverse mortgage loans; and (2) loans secured solely by residential structures, such as manufactured homes.
- The proposal would allow a creditor to make a higher-risk mortgage loan only if certain conditions are met, such as the creditor has obtained a written appraisal by a certified or licensed appraiser.
- In addition, as required by the Act, the proposal would require a higher-risk mortgage loan creditor to obtain an additional written appraisal under certain circumstances.
- The Dodd-Frank Act requires the final rule on appraisals for higher-risk mortgages to be issued by January 21, 2013. However, the Act does not specify an effective date for the rule.
- The CFPB is accepting public comments until October 15, 2012. **Please send your comments to CUNA by October 5.**

Please send comments to Senior Vice President and Deputy General Counsel Mary Dunn and Assistant General Counsel Luke Martone. Click here for the proposed rule.

DESCRIPTION OF PROPOSAL

Proposed Definitions (§ 1026.XX(a))

"Certified or Licensed Appraiser": The proposal would define this term as a person who is certified or licensed by the state agency in the state in which the property that secures the transaction is located, and who performs the appraisal in conformity with the Uniform Standards of Professional Appraisal Practice (USPAP) and the requirements applicable to appraisers in title XI of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA).

[1] These are: the Federal Deposit Insurance Corporation, Federal Housing Finance Agency, and Office of the Comptroller of the Currency.

"National Registry": As proposed, this term would mean the database of information about state certified and licensed appraisers maintained by the Appraisal Subcommittee of the Federal Financial Institutions Examination Council (FFIEC).

"State Agency": As proposed, this term would be defined as a "state appraiser certifying and licensing agency" recognized in accordance with § 1118(b) of FIRREA.

"Higher-Risk Mortgage Loans":

Proposed § 1026.XX(a)(2)(i) provides that a "higher-risk mortgage loan" is a closed-end consumer credit transaction secured by the consumer's principal dwelling with an annual percentage rate (APR) that exceeds the average prime offer rate (APOR) for a comparable transaction as of the date the interest rate is set by a specified percentage depending on the type of transaction. The proposed rule uses the phrase "a closed-end consumer credit transaction secured by the consumer's principal dwelling" in place of the statutory term "residential mortgage loan" throughout § 1026.XX(a)(2). The Agencies have elected to incorporate the substantive elements of the statutory definition of "residential mortgage loan" into the proposed definition of "higher-risk mortgage loan" rather than using the term itself to avoid inadvertent confusion of the term "residential mortgage loan" with the term "residential mortgage transaction," which is an established term used throughout Reg Z.

In the CFPB's 2012 TILA–RESPA Proposal, the CFPB is proposing to adopt a simpler and more inclusive finance charge calculation for closed-end credit secured by real property or a dwelling. In light of the uncertainty regarding whether the CFPB will adopt such a finance charge and the potential impact of that change, the Agencies have proposed two alternative versions of § 1026.XX(a)(2)(i).[2] *Alternative 1* would define the threshold for higher-risk mortgages based on APR. *Alternative 2* would use a transaction coverage rate.[3] *Alternative 2* would allow creditors to exclude some fees from the "rate" used to determine if a loan is a "higher-risk mortgage loan"; by excluding these fees, it is possible fewer loans would be covered by the rule.

As proposed, a higher-risk mortgage loan generally would be:

- A closed-end consumer credit transaction secured by the consumer's principal dwelling with an APR (*Alternative 1*) / TCR (*Alternative 2*) that exceeds the APOR[4] for a comparable transaction as of the date the interest rate is set:
  - By 1.5% or more, for a loan secured by a first lien with a principal obligation at consummation that does not exceed the limit in effect as of the date the transaction's interest rate is set for the maximum principal obligation eligible for purchase by Freddie Mac;
  - By 2.5% or more, for a loan secured by a first lien with a principal obligation at consummation that exceeds the limit in effect as of the date the transaction's interest rate is set for the maximum principal obligation eligible for purchase by Freddie Mac; and
  - By 3.5% or more, for a loan secured by a subordinate lien.

Under the proposal, the following would be excluded from the definition of "higher-risk mortgage loan":

- Any loan that is a "qualified mortgage" loan as defined in § 1026.43(e).[5]
- A reverse-mortgage transaction as defined in § 1026.33(a).
- A loan secured solely by a residential structure.

[2] These alternative versions are similar to those in the CFPB's 2012 HOEPA Proposal.
[3] The Agencies would not adopt *Alternative 2* if the CFPB does not change the definition of finance charge.
[4] APORs (average prime offer rate) are APRs derived from average interest rates, points and other loan pricing terms currently offered to consumers by a representative sample of creditors for mortgage transactions that have low-risk pricing characteristics.
[5] As of the date of this proposal, the CFPB has not yet finalized its ability-to-repay rule defining "qualified mortgage."

Appraisals Required for Higher-Risk Mortgage Loans (§ 1026.XX(b))

In general, the proposal would prohibit a creditor from making a higher-risk mortgage loan unless prior to consummation, the consumer obtains a written appraisal from a certified or licensed appraiser who conducts a physical visit of the interior of the property.

The proposal would establish a safe harbor for creditors when the appraiser certifies compliance with USPAP and applicable FIRREA title XI requirements. Specifically, under the safe harbor, a creditor would be deemed to have obtained a written appraisal that meets the requirements of this section if the creditor:

- Orders that the appraiser perform the appraisal in conformity with the USPAP and title XI of FIRREA;
- Verifies through the National Registry that the appraiser who signed the appraiser's certification was certified or licensed in the state in which the appraised property is located as of the date it was signed;
- Confirms that the elements set forth in appendix N are addressed in the written appraisal; and
- Has no actual knowledge to the contrary of facts or certifications contained in the written appraisal.

Proposed appendix N to part 1026 provides that, to qualify for the safe harbor, a creditor must check to confirm that the written appraisal:

- (1) Identifies the creditor who ordered the appraisal and the property and the interest being appraised.
- (2) Indicates whether the contract price was analyzed.
- (3) Addresses conditions in the property's neighborhood.
- (4) Addresses the condition of the property and any improvements to the property.
- (5) Indicates which valuation approaches were used, and includes a reconciliation if multiple approaches were used.
- (6) Provides an opinion of the property's market value and an effective date for the opinion.
- (7) Indicates that a physical property visit of the interior of the property was performed.
- (8) Includes a certification signed by the appraiser that the appraisal was prepared in accordance with USPAP.
- (9) Includes a certification signed by the appraiser that the appraisal was prepared in accordance with FIRREA title XI.

Additional Appraisal for Certain Higher-Risk Mortgage Loans (§ 1026.XX(b)(3))

Under the proposal, a creditor would generally be required to obtain an additional[6] appraisal for a higher-risk mortgage loan if the property is being resold for a higher price within a 180-day period. The Agencies recognize that a property may be resold at a higher price within a short timeframe for legitimate reasons, such as when a seller makes valuable improvements to the property or market prices increase. Thus, to ensure the appropriateness of an increased sales price, the proposal would require an additional appraisal by a different appraiser analyzing the property's resale price before a creditor extends a higher-risk mortgage loan to finance the consumer's acquisition of the property.

To implement this proposed provision, the rule would require that the creditor compare (1) the date on which the consumer entered into the agreement to acquire the property from the seller, and (2) the date on which the seller acquired the property. The proposed commentary provides an illustration in which the creditor determines the seller acquired the property on April 17, 2012, and the consumer's acquisition agreement is dated October 15, 2012; an additional appraisal would not be required because 181 days would have elapsed between the two dates.

The proposal does not specify which of the two required appraisals a creditor must rely on in extending a higher-risk mortgage loan if the appraisals provide different valuations. However, the proposed commentary does specify that an appraisal previously obtained in connection with the seller's acquisition or the financing of the seller's acquisition of the property cannot be used as one of the two appraisals required under this section. The proposal also notes that, if the creditor is required to obtain two appraisals, it may charge the consumer for only one of the appraisals.

[6] Note that the Agencies have replaced the term "second appraisal" with "additional appraisal" throughout the proposal.

The proposed commentary explains that the price at which the seller acquired the property does not include the cost of financing the property. The proposed commentary also explains that the price at which the consumer is obligated to pay to acquire the property from the seller does not include the cost of financing the property to clarify that a creditor should only consider the sale price of the property as reflected in the consumer's acquisition agreement.

The Agencies are proposing an exemption to the additional appraisal requirement for relatively small increases in the price. The proposal contains a placeholder for the amount by which the price at which the seller acquired the property was lower than the resale price: "The seller acquired the property 180 or fewer days prior to the date of the consumer's agreement to acquire the property from the seller; and [t]he price at which the seller acquired the property was lower than the price that the consumer is obligated to pay to acquire the property, as specified in the consumer's agreement to acquire the property from the seller, by an amount equal to or greater than [**XX**]." The Agencies are seeking comment on whether to include a particular price threshold in the final rule.

The additional appraisal would need to include an analysis of: (1) the difference between the price at which the seller acquired the property and the price that the consumer is obligated to pay to acquire the property, as specified in the consumer's agreement to acquire the property from the seller; (2) changes in market conditions between the date the seller acquired the property and the date of the consumer's agreement to acquire the property; and (3) any improvements made to the property between the date the seller acquired the property and the date of the consumer's agreement to acquire the property.

Required Disclosure (§ 1026.XX(c))

Under the proposal, a creditor would be required to provide a consumer who applies for a higher-risk mortgage with the following written statement: "We may order an appraisal to determine the property's value and charge you for this appraisal. We will promptly give you a copy of any appraisal, even if your loan does not close. You can pay for an additional appraisal for your own use at your own cost."

This disclosure would need to be "mailed or delivered not later than the third business day after the credit receives the consumer's application." As proposed, if the disclosure is not provided to the consumer in person, the consumer is presumed to have received the disclosures three business days after they are mailed or delivered.

Copy of Appraisals (§ 1026.XX(d))

Under the proposal, the creditor would be required to provide a free copy of a written appraisal performed in connection with a higher-risk mortgage loan to the applicant. The copy must be provided to the consumer no later than three business days prior to consummation, and may be provided electronically, subject to compliance with the consumer consent and other applicable provisions of the E-Sign Act.

Effective Date

The Dodd-Frank Act requires the final rule on appraisals for higher-risk mortgages to be issued by January 21, 2013. However, the Act does not specify an effective date for the rule.

QUESTIONS TO CONSIDER REGARDING THE PROPOSAL

1) *"Certified or licensed appraiser":* Neither TILA section 129H nor the proposed rule defines the individual terms "certified appraiser" and "licensed appraiser," or specifies when a certified appraiser or a licensed appraiser must be used. Instead, the proposed rule, consistent with TILA section 129H, would require that creditors obtain an appraisal performed by "a certified or licensed appraiser." Certified and licensed appraisers generally differ based on the examination, education, and experience requirements necessary to obtain each credential. Existing state and federal law and regulations require the use of a certified appraiser rather than a licensed appraiser for certain types of transactions. For example, the federal banking agencies' FIRREA appraisal regulations define "state certified appraiser" and "state licensed appraiser," and specify the use of a certified appraiser based on the complexity of the residential property and the dollar amount of the transaction. Several state agencies do not issue licensed appraiser credentials and issue different certified appraiser credentials based on the type of property.

   The Agencies request comment on whether the rule should address the issue of when a creditor must use a certified appraiser rather than a licensed appraiser.

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   Further, the proposed rule does not specify competency standards. In selecting an appraiser for a particular appraisal assignment, creditors typically consider an appraiser's experience, knowledge, and educational background to determine the individual's competency to appraise a particular property and in a particular market. The Competency Rule in USPAP requires appraisers to determine, prior to accepting an assignment, that they can perform the assignment competently. The federal banking agencies' FIRREA appraisal regulations provide that a state certified or licensed appraiser may not be considered competent solely by virtue of being certified or licensed.

   The Agencies request comment on whether the rule should address the issue of appraiser competency.

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2) *"Higher-Risk Mortgage Loan" vs. "Higher-Priced Mortgage Loan":* TILA section 129H(f) defines the term "higher-risk mortgage" in a similar manner to the existing Reg Z definition of "higher-priced mortgage loan." However, the statutory definition of higher-risk mortgage differs from the existing regulatory definition of higher-priced mortgage loan in several important respects. First, the statutory definition of higher-risk mortgage expressly excludes loans that meet the definition of a "qualified mortgage" under TILA section 129C. In addition, the statutory definition of higher-risk mortgage includes an additional 2.5% threshold for first-lien jumbo mortgage loans, while the definition of higher-priced mortgage loan contains this threshold only for purposes of applying the requirement to establish escrow accounts for higher-priced mortgage loans. The Agencies have concerns that the use of two such similar terms within the same regulation may cause confusion to both consumers and industry. However, given that the definitions of the two terms differ in significant ways, the Agencies are proposing, consistent with the statute, to define and use the term "higher-risk mortgage loan" when establishing the scope of proposed § 1026.XX.

   The Agencies request comment on whether the concurrent use of the terms "higher-risk mortgage loan" and "higher-priced mortgage loan" in different portions of Reg Z may confuse industry or consumers and, if so, what alternative approach the Agencies could take to implementing the statutory definition of "higher-risk mortgage loan" consistent with the requirements of TILA section 129H.

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3) *More Inclusive Finance Charge:* In the CFPB's 2012 TILA–RESPA Proposal, the CFPB is proposing to adopt a simpler and more inclusive finance charge calculation for closed-end credit secured by real property or a dwelling. A more inclusive finance charge, however, would increase the APR for most mortgage loans. Accordingly, this proposal seeks comment on whether and how to account for the implications of a more inclusive finance charge on the scope of higher-risk mortgage coverage.

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The Agencies also seek comment on the impacts the proposed more inclusive finance charge would have on application of the higher-risk mortgage loan requirements, and whether it would be in the public interest and promote the safety and soundness of creditors to modify the triggers for higher-risk mortgage loans to approximate more closely the coverage levels under the finance charge and APR as currently calculated.

If potential modifications are warranted, the Agencies also seek comment on what methods may be appropriate, including use of the TCR in lieu of APR, or other methods commenters may suggest. The appraisal provisions of the Dodd-Frank Act are intended to protect lenders, consumers, and investors against fraudulent and inaccurate appraisals. With this in mind, commenters are invited to address the relative costs and benefits of any modification in the context of the higher-risk mortgage loan appraisal proposal, including any potential impact on the market.

4) *Loans Secured Solely by a Residential Structure:* The Agencies request comment on whether this proposed exclusion is appropriate, and if not, reasonable methods by which creditors could comply with the requirements of this proposed rule when providing loans secured solely by a residential structure. In particular, the Agencies request comment on whether, rather than an appraisal performed by a certified or licensed appraiser, some alternative standards for valuing residential structures securing higher-risk mortgage loans might be feasible and appropriate to include as part of the final rule.

5) *Other Exclusions from the Definition of Higher-Risk Mortgage Loan:* In construction loan transactions, an interior visit of the property securing the loan is generally not feasible because construction loans provide financing for homes that are proposed to be built or are in the process of being built. At the same time, the Agencies recognize that construction loans that meet the pricing thresholds for higher-risk mortgage loans may pose many of the same risks to consumers as other types of loans meeting those thresholds. The Agencies request comment on whether to exclude construction loans from the definition of higher-risk mortgage loan. If not, the Agencies seek comment on whether any additional compliance guidance is needed for applying TILA section 129H's appraisal rules to construction loans. Alternatively, the Agencies request comment on whether construction loans should be exempt only from the requirement to conduct an interior visit of the property, and be subject to all other appraisal requirements under the proposed rule.

The Agencies also request comment on whether other classes of loans should be excluded from the definition of higher-risk mortgage loan.

6) The Agencies request comment on the appropriateness of the safe harbor, the list of requirements a creditor must satisfy to receive the safe harbor under § 1026.XX(b)(2) and appendix N, and whether the proposed safe harbor should be included in the rule.

In addition, the Agencies request comment on whether particular types of transactions exist for which certain information in proposed appendix N would be especially difficult for an appraiser to include in the written appraisal. If so, in these cases, the Agencies seek comment on what alternative information, if any, might be appropriate to require creditors to confirm is included in the appraisal.

7) *Potential Exemptions From the Additional Appraisal Requirement:* TILA section 129H(b)(4)(B) permits the Agencies to jointly exempt a class of loans from the additional appraisal requirement if the Agencies determine the exemption "is in the public interest and promotes the safety and soundness of creditors."

   The Agencies invite commenters to submit data and other information supporting whether exempting any classes of higher-risk mortgage loans from the additional appraisal requirement would be in the public interest and promote the safety and soundness of creditors. Exemptions to be considered may include higher-risk mortgage loans made in rural areas where finding two independent appraisers may be difficult, as well as the types of transactions that are currently exempted from the restrictions on FHA insurance applicable to property resales in the FHA Anti-Flipping Rule, including, among others, sales by government agencies of certain properties, sales of properties acquired by inheritance, and sales by state- and federally-chartered financial institutions.

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8) Regarding a potential exemption from the additional appraisal requirement for higher-risk mortgage loans in "rural" areas, a number of industry representatives asserted during outreach with the Agencies that creditors making higher-risk mortgage loans in rural areas might have particular difficulty finding two competent appraisers in order to comply with the additional appraisal requirements of TILA section 129H. Accordingly, the Agencies request comment on whether, in the final rule, the Agencies should rely on the exemption authority in TILA section 129H(b)(4)(B) to exempt higher-risk mortgage loans made in "rural" areas from the additional appraisal requirement.

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9) The Agencies request that commenters who support applying the rule to higher-risk mortgage transactions where the seller acquired the property without purchasing it explain how doing so would be consistent with the statutory goal of addressing flipping scams. Moreover, if the final rule covers sales of properties acquired by the seller through non-purchase acquisitions, the Agencies request comment on how a creditor should calculate the seller's "acquisition price." For example, in a case where the seller acquired the property by inheritance, the "sale price" could be "zero," which could make a subsequent sale offered at any price within 180 days subject to the additional appraisal requirement.

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10) The Agencies invite comment on whether any non-purchase acquisitions by the consumer may implicate the additional appraisal requirement. If the rule covers non-purchase acquisitions by the consumer, the Agencies invite comment on how a creditor should calculate the consumer's "sale price."

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11) The Agencies are interested in receiving comment on how a creditor would calculate the price paid by a seller to acquire a property as part of a bulk sale that is later resold to a higher-risk mortgage consumer. The Agencies understand that, in bulk sales, a sales price might be assigned to individual properties for tax or accounting reasons, but the Agencies request comment on whether guidance may be needed for determining the sales price of such property. The Agencies request comment on any operational challenges that might arise for creditors in determining purchase prices for homes purchased as part of a bulk sale transaction. The Agencies also invite commenters' views on whether any challenges presented could impede neighborhood revitalization in any way, and, if so, whether the Agencies should consider an exemption from the additional appraisal requirement for these types of transactions altogether.

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12) In light of the diverging views on an appropriate exception, the Agencies have elected to seek public comment on what an appropriate threshold would be rather than provide a particular amount or formula in the proposal. In particular, the Agencies seek comment on whether a fixed dollar amount, a fixed percentage, or some alternate approach should be used to determine an exempt price increase, and what specific price threshold would be appropriate.

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13) The Agencies seek comment on whether the rule should include additional conditions on how the creditor must obtain the additional appraisal under § 1026.XX(b)(3)(i). For example, should the rule prohibit the creditor from obtaining the two appraisals from appraisers employed by the same appraisal firm, or from two appraisers who receive the assignments for the two required appraisals from the same appraisal management company?

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14) The Agencies request comment on whether the enhanced protections for consumers afforded by requiring an additional appraisal whenever the seller's acquisition date or price cannot be determined merit the potential restraint on the availability of higher-risk mortgage loans.

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15) Other comments or questions.

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