

July 31, 2012

MEMORANDUM TO: The Board of Directors

FROM: Sandra L. Thompson
Director, Division of Risk Management Supervision

Mark E. Pearce
Director, Division of Depositor and Consumer Protection

SUBJECT: NPR: DFA Higher-Risk Mortgage Appraisal Requirements

Proposal: That the Board of Directors (Board) of the Federal Deposit Insurance Corporation (FDIC) approve the attached Notice of Proposed Rulemaking entitled *Appraisal Requirements for Higher-Risk Mortgages* (NPR) for publication in the *Federal Register* for a 60-day comment period. If it is approved, the NPR would be issued jointly by the FDIC, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the National Credit Union Administration, the Federal Housing Finance Administration, and the Bureau of Consumer Financial Protection (the Agencies). The NPR would implement the appraisal requirements for higher-risk mortgages (HRMs) in section 1471 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the DFA). The rule would supersede the FDIC's Rules and Regulation Part 323's exemption from the appraisal requirement for transactions of \$250,000 or less if the transaction is a HRM. The Agencies intend to individually promulgate the rule according to each Agency's preference.

Concur:

Richard J. Osterman, Jr.
Acting General Counsel

Recommendation: That the Board approve publication of the NPR for a 60-day comment period.

Discussion

Background

Section 1471 of the DFA added a new section 129H to the Truth in Lending Act (TILA) which sets forth appraisal requirements applicable to HRM loans. An HRM loan is a residential mortgage loan that is not a qualified mortgage (QM),¹ and is secured by a principal dwelling and has an annual percentage rate (APR)² that exceeds the average prime offer rate (APOR)³ for a comparable transaction as of the date the interest rate is set, depending upon the type of transaction as follows:

- 1.5% for non-jumbo mortgage loans;⁴
- 2.5% for loans over the jumbo limit; or
- 3.5% above “comparable rates” for junior liens.

Summary of the NPR

Before extending credit in the form of a mortgage loan that qualifies for HRM status, a creditor must:

- Obtain a written appraisal by a certified or licensed appraiser who has conducted a physical visit of the interior of the property;

¹ Section 1412 of the Dodd-Frank Act amended TILA to require that a QM meet certain underwriting criteria relative to borrowers' ability to repay. The Federal Reserve issued a proposal on how to implement this requirement in May 2011. The public comment period for that proposal closed just after the implementation authority transferred to the CFPB in July 2011. In May 2012, the CFPB reopened the comment period on the proposal based on new data and information it had received. That comment period closed on July 9, 2012.

² APR means the annual percentage rate of finance charge as determined in accordance with the Consumer Credit Protection Act and Regulation Z.

³ APOR is defined by reference to the average prime offer rates published by the Federal Reserve. The average prime offer rates are a survey-based estimate of APRs currently offered on prime mortgage loans of a comparable type. The Federal Reserve publishes two separate tables, one for fixed rate loans (the Average Prime Offer Rates – Fixed) and another for adjustable rate loans (the Average Prime Offer Rates – Adjustable). APORs are published weekly on Friday, effective as of the following Monday. See also the APOR definition set forth in section 129C(b) of the TILA as added by section 1412 of the DFA.

⁴ As of January 1, 2010, the limit on a non-jumbo mortgage loan is \$417,000 for most of the United States (the US), apart from Alaska, Hawaii, Guam, and the US Virgin Islands, where the limit is \$625,500.

- Obtain a second written appraisal from a different certified or licensed appraiser if the mortgaged collateral was previously purchased or acquired by the seller within 180 days of the current mortgage transaction. The second appraisal must analyze any difference in sales prices, changes in market conditions, and any improvements made to the property in the period between the two mortgage loan transactions;
- Provide the borrower with a statement at the time of initial mortgage application that informs the borrower that any appraisal prepared in connection with the mortgage is for the creditor's sole use, and that the borrower may choose to have a separate appraisal conducted at the applicant's expense; and
- Provide the borrower with one copy of each appraisal without charge in connection with a HRM at least three business days prior to the transaction closing date.

Section 129H of TILA, as added by Section 1471 of the DFA, will become effective on January 21, 2013 if implementing regulations have not been issued by that date. Otherwise, section 129H will take effect on the same date the final regulations take effect. The Agencies may jointly exempt by rule a class of loans from the requirement for an appraisal with an interior visit by a licensed or a certified appraiser and the second appraisal requirement if the Agencies determine that the exemption is in the public interest and promotes the safety and soundness of creditors.

Exemptions

The NPR addresses the two statutory exemptions for QMs and open-end lines of credit, such as home equity lines of credit. The NPR requests comment on other possible exemptions to both the appraisal requirement and the second appraisal requirements. The NPR requires a creditor to use reasonable diligence to determine whether a second appraisal must be performed.

Appraisal Review Safe Harbor

Because Section 129H of TILA, as added by section 1471 of the DFA, is unclear as to the extent of creditors' obligations to evaluate appraisers' compliance with the Uniform Standards of Professional Appraisal Practice and title XI of FIRREA⁵ in performing an interior visit of the property, the NPR proposes a safe harbor for lenders who check for certain minimum information in an appraisal report prepared in connection with an HRM. The NPR notes the inherent difficulty if a creditor should attempt to determine whether an appraiser complied with USPAP or whether an interior visit was performed. The NPR points out that there is a risk of significant liability and litigation under TILA, and expresses concern that requiring creditors to assume liability for appraisers' compliance would unduly increase cost and restrict HRM availability.

Alternative: Substitution of Transaction Coverage Rate for APR in Determining HRM Status

In various 2012 rulemakings,⁶ the CFPB proposes to adopt a more inclusive definition of the finance charge that could increase the APR for most mortgage loans. The higher APR could cause more loans to exceed the trigger for the HRM's definition threshold. Therefore, the Agencies are seeking comment on how to calculate and define the numeric threshold for the purposes of this rule.

RECOMMENDATION:

Staff recommends that the Board approve for publication in the *Federal Register* the attached NPR, which seeks comment on numerous aspects of the proposal.

⁵ 12 U.S.C. 3331 *et seq.*

⁶ The CFPB proposes to adopt a more inclusive definition of the finance charge in its 2012 TILA-RESPA (Real Estate Settlement Procedures Act) Integration and HOEPA NPRs, and other Dodd-Frank Act rulemakings.

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Attachments