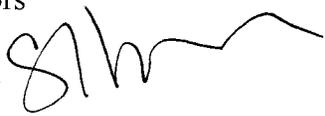


December 21, 2012

**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

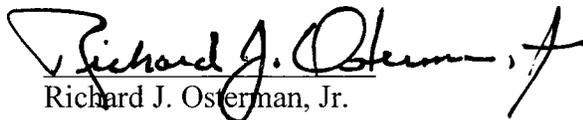
**SUBJECT:** Final Rule: Higher-Risk Mortgage Appraisal Requirements

**RECOMMENDATION:**

Staff recommends that the Board of Directors (Board) of the Federal Deposit Insurance Corporation (FDIC) approve, and authorize the Executive Secretary to publish in the *Federal Register*, a final rule implementing new appraisal requirements for certain residential mortgage transactions mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA). The final rule would be issued jointly with the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Federal Reserve Board), the National Credit Union Administration (NCUA), the Bureau of Consumer Financial Protection (CFPB), and the Federal Housing Finance Agency (FHFA) (collectively, the Agencies).

The Agencies published a notice of proposed rulemaking (NPR) on September 5, 2012 (77 FR 54722), which would modify Regulation Z to implement requirements in section 1471 of the DFA regarding appraisals for higher-risk mortgage (HRM) loans, as defined below. The Agencies received 220 comments on the NPR (114 with repeat comments excluded). Having carefully considered the comments, staff recommends that the final rule be issued as discussed below.

Concur:

  
Richard J. Osterman, Jr.  
Acting General Counsel

## **BACKGROUND:**

Section 1471 of the DFA added a new section 129H to the Truth in Lending Act (TILA), setting forth appraisal requirements applicable to HRM loans. A HRM loan is a residential mortgage loan that is not a qualified mortgage (QM),<sup>1</sup> is secured by a principal dwelling, and has an annual percentage rate (APR)<sup>2</sup> that exceeds the average prime offer rate (APOR)<sup>3</sup> for a comparable transaction as of the date the interest rate is set by one of the following thresholds :

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

Before extending credit for a HRM loan, 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;
- Obtain an additional written appraisal (at the creditor’s expense) 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 at a price that was lower than the current sale price of the property. The additional 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.

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<sup>1</sup> Section 1412 of the DFA separately amended TILA to require that a QM meet certain underwriting criteria in order to establish that a creditor has met the requirement to determine a borrower’s ability to repay the loan at consummation. The Federal Reserve Board 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.

<sup>2</sup> APR means the annual percentage rate of finance charge as determined in accordance with the Truth-in-Lending Act and Regulation Z.

<sup>3</sup> APOR is determined by reference to the average prime offer rates published by the CFPB. The average prime offer rates are a survey-based estimate of APRs currently offered on prime mortgage loans of a comparable type. The CFPB 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.

<sup>4</sup> 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.

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. If final regulations have been issued by that date, 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 additional appraisal requirement if the Agencies determine that the exemption is in the public interest and promotes the safety and soundness of creditors.

The NPR addressed the two statutory exemptions for QMs and open-end lines of credit, such as home equity lines of credit. The proposed regulations' preamble also requested comment on other possible exemptions. The comment period for the NPR closed on October 15, 2012. The Agencies received comments from banks, credit unions and other creditors, appraisers, appraisal management companies, industry trade associations, consumer groups, and others.

#### **COMMENT SUMMARY:**

As noted before, the Agencies received 220 comments, of which 114 were unique. In general, commenters supported harmonizing the term HRM loan with the term higher-priced mortgage loan (HPML)<sup>5</sup> to avoid confusion between the two terms, as their definitions are similar. Commenters also supported a proposed safe harbor and certain exemptions set forth in the proposed rule and/or discussed in the preamble. Some commenters expressed concern over compliance burden and the potential for reducing credit availability.

#### **SUMMARY OF FINAL RULE:**

- Harmonizes HRM Loan Definition with Higher-Priced Mortgage Loan (HPML) Definition

HPMLs are a legally-defined category of mortgage loan with special requirements including borrower's ability to repay; income/asset verification; prohibitions against prepayment penalties; and escrow requirements. The interest rate triggers for HPMLs are similar to those for a HRM, although not exactly alike. In response to commenters' concern over potential confusion, the final rule uses the term HPML rather than HRM to refer generally to the loans covered by the requirements of this final rule. Requirements for both loan categories will be implemented under section 1026.35 of Regulation Z.

- Excludes Transaction Coverage Rate Alternative to APR

The proposed regulations included a request for comments on an alternative method of determining coverage based on the "transaction coverage rate" (TCR) rather than the APR. Unlike the APR, the TCR would include all prepaid finance charges not retained by the creditor, a mortgage broker, or an affiliate of either.

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<sup>5</sup> The term HPML is used in other DFA mortgage requirements and in Regulation Z.

The TCR was intended to address a possible expansion of the definition of “finance charge” used to calculate the APR, which CFPB proposed in its rulemaking to integrate mortgage disclosures required by TILA and the Real Estate Settlement Procedures Act (RESPA) (2012 TILA-RESPA Proposal). The final rule, however, does not replace the APR with the TCR. The Agencies will instead determine subsequently whether it will be necessary to again address this issue, if and when the CFPB adopts the more inclusive definition of finance charge proposed in the 2012 TILA-RESPA Proposal.

- Retains the Safe Harbor in its entirety

The Agencies proposed a safe harbor that would establish affirmative steps for creditors to follow to satisfy statutory obligations under section 129H. This was done to address compliance uncertainties. Commenters generally supported such a safe harbor. Under the final rule, a creditor would be deemed to have obtained a written appraisal that meets general appraisal requirements if the creditor:

- Orders the appraiser to perform the appraisal in conformity with USPAP and FIRREA title XI, and any implementing regulations, in effect at the time the appraiser signs the appraiser’s certification;
- Verifies through the National Registry<sup>6</sup> that the appraiser who signed the appraiser’s certification holds a valid appraisal license or certification in the State in which the appraised property is located;
- Confirms that the elements set forth in appendix N to part 1026 are addressed in the written appraisal; and
- Has no actual knowledge to the contrary of facts or certifications contained in the written appraisal.

- Grants Exemptions from the Entire Rule

Under the final rule, an exemption would be provided from the rule’s entire scope for the following types of loans: (1) QMs (provided for by statute); (2) reverse mortgage loans that are not qualified mortgages; (3) initial construction loans; (4) bridge loans used to purchase a new dwelling; (5) loans secured by new manufactured housing; (6) transactions secured by mobile homes, boats or trailers.

- Grants Exemptions from the Additional Appraisal Requirement

Exemptions would be provided in the final rule from the additional appraisal requirement for subsequent sale transactions occurring within 180 days of the first purchase transaction for: (1) extensions of credit that finance the sale of property by a local, state, or federal government agency; (2) a residential dwelling acquired in connection with liquidating a mortgage through foreclosure; (3) transactions by a non-profit approved to purchase real estate owned as part of a government program; (4) transactions involving a

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<sup>6</sup> The National Registry is maintained by the Appraisal Subcommittee of the Federal Financial Institutions Examination Council and is available online at <https://www.asc.gov/National-Registry/NationalRegistry.aspx>.

seller who acquired property by inheritance, divorce, or dissolution of civil union/domestic partnership; (5) an employer or relocation agency in connection with employee relocation; and (6) a service member with permanent change of station orders. Exemptions also would be provided for property located in a federally-designated disaster area with an agency waiver and rural property located in non-metropolitan/non-micropolitan areas and micropolitan areas not adjacent to a metropolitan area.<sup>7</sup>

- Establishes a De Minimis Threshold

The Agencies also solicited comment on a potential “de minimis” exemption to the additional appraisal requirements for mortgage transactions within the 180-day period having a sale price that exceeds the seller’s purchase price by a relatively small amount. In particular, the Agencies asked 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.

Agencies’ staff reviewed public comments as well as other government standards and rules designed to curb harmful flipping in residential mortgage transactions. These included short sale reselling restrictions imposed by Fannie Mae, Freddie Mac and the Treasury Department, as well as HUD’s Anti-Flipping Rules, both HUD’s existing regulations and HUD rules currently in effect that temporarily “waive” existing regulations and replace them with other standards. Agencies’ staff believe that short sale reselling restrictions of the GSEs and Treasury are instructive. Like these rules, the final rule incorporates a tiered approach to addressing fraudulent flipping, based on the number of days between the seller’s purchase and the consumer’s purchase. The de minimis exception would be set at a two-stage 10/20 percent threshold. If a seller acquired a property 90 or fewer days prior to the date of the consumer’s agreement to acquire the property and the agreed upon price exceeds the seller’s acquisition price by no more than 10 percent, the loan would be exempted from the additional appraisal requirements. The loan would also be exempted from the additional appraisal requirement if a seller acquired a property 91 to 180 days prior to the date of the consumer’s agreement to acquire the property (the “second stage” of the exemption) and the agreed upon price exceeds the seller’s acquisition price by no more than 20 percent.

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<sup>7</sup> The final rule defines the term “rural” using Urban Influence Codes (UIC). Developed by the Economic Research Service (ERS), a component of the Dept. of Agriculture, UICs form a classification scheme that distinguishes metropolitan counties by size and nonmetropolitan counties by size of the largest city or town and proximity to metro and micro areas. The standard Office of Management and Budget (OMB) metro and non-metro categories have been subdivided into two metro and 10 non-metro categories, resulting in a 12-part county codification. The ERS, OMB, and the Census Bureau have collaborated together to help define rural areas. The exemption would cover approximately 10% of the population.

## **NEW PROPOSAL FOR STREAMLINED REFINANCINGS, SMALL DOLLAR LOANS, AND CERTAIN PROPERTY TYPES:**

The Agencies received comments in support of two additional exemptions from the rule's requirements for streamlined refinancings and small-dollar loans. Commenters contended that such exemptions would help to keep borrowers in their homes, reduce the number of delinquent loans, and encourage the rehabilitation and re-introduction to the marketplace of foreclosed or otherwise unavailable property, thus helping to rebuild communities that were adversely affected by the recent economic downturn. Due to concern that there is no informed basis upon which to define these exemptions, however, Agencies' staff recommend that a streamlined refinancing exemption and a small dollar loan exemption be proposed in a NPR as specific issues for comment after the final rule has been issued. Agencies' staff also recommend that the NPR seek clarification on whether it is appropriate to apply the appraisal rule for higher-risk mortgage loans to loans secured by certain property types such as cooperatives and non-purchase money loans for manufactured housing.

### **CONCLUSION:**

For the reasons explained above, staff recommends that the Board approve the attached final rule and authorize the Executive Secretary to publish it in the *Federal Register*.

Staff members knowledgeable about this case:

Mark Mellon, Legal Division (X83884)

Kim Stock, Legal Division (X83815)

Ben Gibbs, Legal Division (678-916-2458)

Glenn Gimble, DCP (X83718)

Sandra Barker, DCP (X83615)

Suzy Gardner, RMS (X83640)

Attachments