August 23, 2010

Final Rule for Disclosure Relating to the Acquisition of Legal Title to a Mortgage Loan

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BACKGROUND

On August 16, 2010, the Federal Reserve Board ("Board") issued two proposed rules and three final rules governing federal Truth-in-Lending Act ("TILA") requirements for residential mortgage loans. This Client Alert summarizes the Board's final rule that requires a disclosure relating to the acquisition of legal title to a mortgage loan.

Later Client Alerts will address the Board's remaining proposal and final rule.

HISTORY AND EFFECTIVE DATE OF FINAL RULE

- Section 131(g) of TILA was enacted on May 20, 2009 as Section 404(a) of the Helping Families Save Their Homes Act. Section 131(g) of TILA requires a creditor that is the new owner or assignee of a mortgage loan to provide a written notice to the consumer on the loan within 30 days of the sale, transfer or assignment of the loan. This statute was effective on May 20, 2009.
- On November 20, 2009, the Board issued Section 226.39 of Regulation Z as an interim rule to provide guidance relating to compliance with Section 131(g) of TILA.
- On August 16, 2010, the Board issued its final rule to implement Section 131(g) of TILA, which is set forth in Section 226.39 of Regulation Z. The final rule tweaks the interim rule and provides some clarifications. The final rule is effective 30 days following its publication in the Federal Register. The mandatory compliance date is January 1, 2011. It is permissible to continue to comply with the interim rule through December 31, 2010.

HIGHLIGHTS OF FINAL RULE

- Types of Loans Covered
  - Any consumer credit transaction secured by the consumer's principal dwelling.
  - The dwelling may, but need not, be secured by real property.
  - Both closed-end loans and open-end home equity lines of credit ("HELOCs") are covered.
- Who Provides the Disclosure
  - The disclosure required by Section 226.39 of Regulation Z must be provided by a person that is a "covered person."
  - Section 131(g) of TILA imposes the disclosure requirement on a "creditor that is the new owner or assignee." However, the term "creditor" is defined elsewhere in TILA and Regulation Z to mean the person to whom the

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credit obligation is initially payable, which is inconsistent with the concept of a person that is the new owner or assignee. To avoid confusion, Section 226.39 uses the term "covered person" to mean the person that must provide the Section 226.39 disclosure.

- A "covered person" is one that becomes the owner of an existing loan by acquiring legal title through a purchase, assignment or other transfer.
- A transferee of a loan is a "covered person" even if the transferor is an affiliate.
- A servicer of the loan is not a "covered person" if it holds legal title to the loan solely for administrative convenience. This is consistent with the treatment in §131(f) of TILA, relating to the exclusion of a servicer from assignee liability under TILA if it does not become the owner of the loan.
- A "covered person" excludes a person who acquires only one loan in any 12-month period.
- A "covered person" excludes a person that acquires only a beneficial interest or a security interest in the loan, or that assumes the credit risk of the loan without taking legal title. An investor that acquires a mortgage-backed security, pass-through certificate, or participation interest, but does not acquire legal title to the underlying loan itself, is not a covered person.
- In a merger, acquisition, or reorganization, it is necessary to determine if the legal title to the loan has been transferred to a different legal entity. If it has, the new owner is a covered person and must provide the Section 226.39 disclosure. If it has not, there is no need to provide the disclosure.

- Form of the Disclosure
  - The disclosure must be in writing.
  - Alternatively, the disclosure may be in electronic form and provided in accordance with the E-Signs Act, 15 U.S.C. §7001 *et seq.* If the disclosure is provided electronically, it will be necessary to comply with the consumer consent requirements contained in §101(c) of the E-Signs Act.
  - The disclosure is subject to the usual TILA clear and conspicuous standard.
- When the Disclosure Must be Delivered
  - The disclosure must be mailed or delivered to the consumer on or before the 30th calendar day following the "date of transfer" of the loan to the covered person.
  - The covered person has a choice regarding the "date of transfer" of the loan. At its option, the "date of transfer" will be the date of acquisition recognized in the books and records of the acquiring party or the books and records of the transferring party. Nothing in the regulation requires the use of a consistent approach for all of the loans acquired by the covered person.
- Who Receives the Disclosure
  - The disclosure must be provided to the consumer.
  - If there are two or more consumers, the disclosure must be provided to any consumer who is primarily liable on the loan. This would exclude a person who is only a surety or guarantor on the loan, or an authorized user under a HELOC. See Paragraph 226.5(d)-2 and Paragraph 226.17(d)-2 of the Federal Reserve Commentary to Regulation Z ("Commentary").

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- Transfers to Multiple Covered Persons in a Joint Acquisition
    - If two or more covered persons jointly acquire a loan, they must provide a single disclosure on behalf of all of them. It is not permissible for them to send separate disclosures.
        - There is a joint acquisition if they acquire partial interests in the loan under the same agreement, or they otherwise act in concert to acquire their interests in the loan.
        - There would not be a joint acquisition if legal title to the loan is transferred to a separate legal entity, and that legal entity transfers a beneficial interest to each of the investors. In that instance, only the legal entity will be a covered person and will be required to provide the disclosure.
    - If the covered persons make a joint acquisition but complete the acquisition on different dates, the disclosure must be provided on or before the 30th calendar day following the earliest acquisition date. This will be the case even if one of the covered persons has not completed its acquisition by that date.
    - Where one covered person sends the disclosure on behalf of one or more other covered persons, each covered person has a duty to make sure that the disclosure is accurate and timely.
- Transfers to Multiple Covered Persons Under Separate and Unrelated Agreements
    - Each covered person must provide its own disclosure.
    - The covered persons may, but need not, provide a single disclosure. If they do, the disclosure must meet the timing and content requirements for each of the covered persons.
    - Where one covered person sends the disclosure on behalf of one or more other covered persons, each covered person has a duty to make sure that the disclosure is accurate and timely.
- Multiple Transfers
    - If a loan is transferred to one covered person, and subsequently transferred to another covered person, the two covered persons can each send their own disclosure. Alternatively, a single disclosure can be sent on behalf of both covered persons if it satisfies the timing and content requirements for each.
    - If a single disclosure is sent, there is some flexibility if the date of the subsequent transfer is unknown at the time that the disclosure is sent. Information is "unknown" if it is not reasonably available when the disclosure is made. This requires the covered person to exercise due diligence, in good faith, in an effort to obtain the date. The Commentary states that the covered person "normally" may rely on the representations of other parties in obtaining information. The Commentary also states that an estimated date can be used, allowing a disclosure to the effect that the transfer to the second covered person will occur "on or about" a specified date. The problem with taking advantage of the flexibility allowed by the Commentary is the uncertainty associated with this approach. Whether the date is "unknown" will be a question of fact, and this creates risk – particularly since the Commentary makes clear that each of the covered persons in this situation have a duty to make sure that the disclosure is accurate and timely. Some covered persons may be inclined to send out separate disclosures, thereby avoiding this risk.
- Exceptions to the Disclosure Requirement
    - If a covered person sells, transfers or assigns legal title to the entire loan on or before the 30th day after it obtained the same loan, it is exempt from the disclosure requirement. For this purpose, it is necessary to look to the "date of transfer" (as described above) of the loan to the covered person so as to know when the 30 days begin to run. Note that the transferee of the covered person will itself be a covered person, and will be obligated to provide a Section 226.39 disclosure of its own. If the first covered person sells only a partial

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interest in the loan, then this exception will not apply, and both it and its subsequent transferee will be obligated to provide a disclosure (unless they qualify for and choose to provide a single disclosure, as described above).

This exception can be particularly useful for affiliated companies, which sometimes transfer loans among themselves several times in the days before the loan is ultimately transferred to a third party.

- If the loan is transferred to the covered person in connection with a repurchase agreement, and the transferor is legally obligated to repurchase the loan, the covered person is exempt from the disclosure requirement. The transferor is not required to continue to recognize the loan as an asset on its books and records as a condition to the use of the exception. The exception also applies if the covered person obtained the loan through an intermediary party – in that situation, both the covered person and the intermediary party are exempt from the disclosure requirement. If the transferor fails to repurchase the loan, the covered person will be obligated to send a Section 226.39 disclosure within 30 calendar days after its books and records recognize the acquisition of the loan.

  In any event, this exception will not apply if the transferor does not have a legal repurchase obligation for the specific loan in question.

- If the covered person acquires only a partial interest in the loan *and* the party that is authorized to receive rescission notices and resolve payment issues does not change as a result of the loan transfer, then the covered person is exempt from the disclosure requirement. If the party that is authorized to receive rescission notices and resolve payment issues *does* change as a result of the loan transfer, the exemption will not apply and the covered person must provide the disclosure.

- Contents of the Disclosure

  - Identification of the loan in question. The covered person has some flexibility here. The Commentary provides three examples of a suitable means of identifying the loan: (i) disclosing the address of the mortgage property, together with an account number or loan number that was previously provided to the consumer. The number can be provided in truncated form, although there is no guidance on how truncated the number can be; (ii) disclosing the account or other identifying number alone, so long as that number was previously provided to the consumer. Providing the number on a monthly statement is a satisfactory method of previously providing the number. For this second example, the Commentary is silent regarding the ability to truncate, but presumably that practice will also be permissible here; or (iii) disclosing the date on which the credit was extended and the original amount of the loan or HELOC.

  - Name, address and telephone number of each covered person that is the subject of the disclosure. This means the person(s) that have acquired legal title to the loan. However, if there is more than one covered person, one of them has been authorized to receive rescission notices and resolve payment issues, and this is reflected in the disclosure, the disclosure need not identify the other covered persons.

  - The date of transfer. See discussion above.

  - The name, address and telephone number of an agent or party, if any, that is authorized to receive rescission notices and resolve payment issues. Contact information for the agent need not be provided if the consumer can send rescission notices to and resolve payment issues with the covered person identified in the disclosure. Where there are two or more agents with different responsibilities, the disclosure must state which agent is authorized to receive rescission notices and which agent is authorized to resolve payment issues. If one agent is authorized both to receive rescission notices and to resolve payment issues, the disclosure can simply state that the consumer may contact the agent regarding any questions concerning the loan account, and need not make specific mention of rescission or payment issues.

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- Where the transfer of ownership is or may be recorded in the public records. Alternatively, the disclosure can state that transfer of ownership has not been recorded in the public records at the time that the disclosure is provided, if this is the case. Or, the disclosure may state where the transfer may later be recorded, if applicable. The description of the place of recording can be generic, such as a statement that the transfer of ownership is recorded in the office of public land records or the recorder of deeds office for the county or local jurisdiction where the property is located.

- Inclusion of the covered person's or agent's e-mail address or web site is permitted, but not required.

- The disclosure may contain other information that the covered person considers relevant or helpful to consumers. As an example, the Commentary states that the disclosure may tell consumers that the location to which they should send their payments has not changed.

ANALYSIS

- The obligation to send the Section 226.39 disclosure is in addition to the obligation to send a notice of transfer of servicing under the Real Estate Settlement Procedures Act, 12 U.S.C. §2605 ("RESPA") and 24 C.F.R. §3500.21(d), where applicable. The Commentary states that the Section 226.39 disclosure may be combined with the RESPA disclosure so long as the combined disclosure satisfies the timing and other requirements of Section 226.39. Note, however, that if HUD's standard form set forth in Appendix MS-2 of Regulation X is used, "[m]inor modifications to the sample language may be made to meet the particular circumstances of the servicer, but the substance of the sample language shall not be omitted or substantially altered." Thus, where the two disclosures are provided at the same time, their substantive provisions should not be combined. In addition, note that the timing requirements for the two disclosures may be different.

- The Section 226.39 disclosure also is in addition to other communications required by applicable law. For example, Section 1463 of the Wall Street Reform and Consumer Financial Protection Act of 2010 ("Dodd-Frank Act") adds a new §6(k)(1)(D) to RESPA which, when effective, will require a loan servicer to respond within 10 business days to a request from a borrower to provide the identity, address, and other relevant contact information about the owner or assignee of the loan.

- As discussed above, an investor that acquires a mortgage-backed security, pass-through certificate, or participation interest, but does not acquire legal title to the underlying loan itself, is not a covered person. However, if a transaction is structured such that the lender transfers legal title to the loan to a "depositor," and the depositor quickly transfers legal title to the loan to a trustee, a literal reading of the Regulation and Commentary would indicate that the trustee will become a covered person and must provide the Section 226.39 disclosure.

- In at least one jurisdiction, a lender will frequently purchase an existing mortgage loan that it has been asked to refinance, and the lender will then modify the loan rather than providing a refinance loan. This is done to avoid the payment of certain recording taxes. These transactions are frequently called Modification, Extension, Consolidation Agreements or MECAs. The Board was asked to exempt these purchases from the Section 226.39 disclosure requirement because these transactions are initiated by the consumers themselves. The Board declined to provide an exemption. Accordingly, these purchases do trigger the disclosure requirement. However, the Board's Supplementary Information states that the covered person has the option of providing the Section 226.39 disclosure at the time of the "refinancing" rather than 30 days later.

- As discussed above, the covered person is allowed to provide additional information in the disclosure. Two industry commenters asked the Board to clarify that a covered person is permitted to add a statement requiring the consumer to contact only the authorized agent and not the covered person. The Board declined to provide this clarification, stating that it would be inconsistent with the statute's goal. This makes clear that covered persons may not include such a statement in their disclosures.

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- As noted above, in a merger, acquisition, or reorganization, it is necessary to determine if the legal title to the loan has been transferred to a different legal entity. If it has, the new owner is a covered person and must provide the Section 226.39 disclosure. In some transactions, an acquiring bank holding company will purchase a new bank (“Target Bank”) and, at least initially, will maintain it as a separate legal entity. That acquisition will not trigger the disclosure because the acquisition itself does not cause legal title to loans held by the Target Bank to be transferred to a different legal entity. However, it is not uncommon for the Target Bank to be merged into another bank (“Flagship Bank”) controlled by the bank holding company at a later point in time – often, six months to one year later. If this merger occurs, it will trigger the disclosure requirement because legal title to the loans held by the Target Bank will now be transferred to the Flagship Bank, which is a different legal entity. If, instead, the merger of the two banks is structured so that the Flagship Bank is merged into the Target Bank, this will not trigger the disclosure requirement for the loans held by the Target Bank because legal title to those loans will continue to be held by the same legal entity. However, the merger of the Flagship Bank into the Target Bank will trigger the disclosure requirement for the loans held by the Flagship Bank because legal title to those loans will be transferred to the Target Bank, a different legal entity. This result will apply even if the Target Bank simultaneously changes its name to that of the Flagship Bank. The Board was asked by industry and industry trade group commenters to provide an exception for certain merger and acquisition transactions, but it declined to do so.
- A person need not be a “creditor” for purposes of Regulation Z for that person to be a “covered person” under Section 226.39. Similarly, the fact that a person is a “covered person” under Section 226.39 does not necessarily mean that the person is a “creditor” for purposes of Regulation Z.
- Violations of §131(g) of TILA, the statute implemented by Section 226.39 of Regulation Z, subject the violator to civil liability under §130 of TILA.

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