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The 411 on 404

On November 16, 2009, the Board of Governors of the Federal Reserve (the “Board”) released an interim final rule (the “Interim Rule”) to implement Section 404 of the Helping Families Save Their Homes Act of 2009 (“Section 404”). Section 404 requires any assignee of a residential mortgage loan to provide a written disclosure to the borrower not later than thirty days after the date on which the loan is sold or otherwise transferred or assigned. Because Section 404 was enacted without substantial (or indeed any) industry input, there are a number of significant ambiguities in the statute that have led to uncertainty for institutions implementing the disclosure requirement. The Interim Rule attempts to clarify the scope of the disclosure requirement and addresses many, but not all, of the industry’s concerns.

Statutory Requirements

Section 404 added a new subsection (g) to Section 131 of the Truth in Lending Act (“TILA”). The new subsection requires any “creditor that is the new owner or assignee of the debt” to notify the borrower in writing of the following information, not later than 30 days after the date on which a “mortgage loan”¹ is sold or otherwise transferred or assigned to the creditor:

1. The identity, address, and telephone number of the new creditor;
2. The date of transfer;
3. How to reach an agent or party having authority to act on behalf of the new creditor;
4. The location of the place where transfer of ownership of the debt is recorded; and
5. Any other relevant information regarding the new creditor.

Interim Final Rule Clarifications

Section 404 did not require implementing regulations and became effective immediately on May 20, 2009. Section 404 does not expressly authorize the Board to issue regulations interpreting its scope, but the Board nevertheless decided to issue the Interim Rule under its general TILA rulemaking authority. The Interim Rule clarifies the scope of the disclosure requirement in several significant respects, although ambiguities still remain:²

- Section 404 imposes the notice obligation on “creditors.” The term “creditor” is defined in TILA to mean only the person to which a debt obligation is originally payable; TILA does not define the term to include assignees generally. According to the Board, the use of the term “creditor” in Section 404 to refer to an assignee appears to be a drafting error. The Interim Rule confirms that Section 404 is intended to have a broader scope and applies the disclosure obligation to any assignee or transferee of a mortgage loan, not just an assignee that extends credit or to which an obligation was initially payable. To avoid confusion with the defined term “creditor” used elsewhere in TILA and

- Regulation Z, the Interim Rule uses the term “covered person” in place of the term “creditor.” The Interim Rule also clarifies that the term “covered person” is limited to persons who acquire more than one loan in any 12-month period.
- The Section 404 disclosure requirement only applies to a person who acquires legal title to the debt obligation, whether by purchase or any other transfer or assignment (including through a merger, acquisition, or reorganization). No notice obligation arises if a person obtains only a beneficial interest in the obligation or assumes only the credit risk without acquiring legal title to the obligation, such as through the purchase of a mortgage-backed security, pass-through certificate, participation interest, or interest in a real estate mortgage investment conduit. Similarly, no notice requirement arises when an entity holds only a security interest in a loan, at least until the person acquires the loan.
 - A person servicing a mortgage loan is not treated as the owner of the obligation, even if the servicer has legal title, if the obligation was assigned to the servicer solely for the administrative convenience of the servicer in servicing the obligation.
 - The notice requirement does not apply to a person that acquires loans pursuant to a repurchase agreement, provided that the transfer is not recognized as a sale on the books and records maintained by the originating institution for accounting purposes. However, if the assignee does not resell the loan to the originating institution, the notice obligation arises at the time the transfer is recognized as a sale in the books and records of the originating institution.
 - If there is more than one covered person, the Interim Rule provides that only one disclosure can be given. The covered persons must determine among themselves which one of them will provide the disclosure. However, the required information must be provided for each covered person in that single notice. If there is more than one consumer, a covered person may mail or deliver the disclosures to any consumer who is primarily liable on the obligation.
 - The notice must be mailed or delivered to the consumer on or before the 30th calendar day following the date that the covered person acquired the loan, as reflected in the books and records of the covered person.
 - The disclosure requirement applies when ownership of a mortgage loan is transferred from one affiliate to another, *i.e.*, when the acquiring party is a separate legal entity from the transferor, even if the parties are affiliated entities.
 - If a covered person acquires a mortgage loan and subsequently transfers the loan to another entity, the regulation permits the two entities to combine their disclosures on a single document. For example, if a loan is acquired by Company A on August 1 and it knows that it will transfer the loan to Company B on October 15, only one notice that identifies both Company A and Company B may be provided, indicating when the subsequent transfer will occur.
 - There is no obligation to provide the notice if a covered person transfers ownership of the loan within 30 days of the date of acquisition. The acquisition date is defined as the date the acquisition of the loan is recognized in the books and records of the covered person. This exclusion is meant to reduce confusion that could result if the consumer receives outdated contact information for parties that no longer own his or her loan.
 - If the covered person has multiple agents authorized to receive legal notices or resolve payment issues, all the agents must be identified in the notice. If multiple agents are listed, the disclosure must state the extent to which the authority of each agent differs, for example, by indicating if only one of the agents is authorized to receive legal notices or only one is authorized to resolve issues concerning payments.
 - The notice need only provide a telephone number, and not an address, for an agent,

provided that by dialing that number, the borrower can obtain the agent's address.

- Section 404 requires that the disclosure state the location of the place where the transfer of ownership of the debt is recorded. This has proven to be a difficult compliance issue in different settings. For example, some transfers of ownership may be noted only in the registry maintained by MERS. The Interim Rule provides that the disclosure may refer to the location where the transfer of ownership "is or may be recorded," in order to accommodate situations where the transfer has not been formally recorded. The Interim Rule also permits a very general description of the location where the transfer is or may be recorded. For example, the Interim Rule provides that it would be sufficient in all cases to disclose that the transaction "is or may be 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."

The Interim Rule does not mention MERS registration. However, because the Interim Rule only requires the statement to describe the location where the transfer is or may be recorded in the most general terms, it does not appear that it would be necessary for the notice to mention MERS registration.

The Interim Rule is effective upon its publication in the *Federal Register*, although compliance will be optional for 60 days from that date. The Board is soliciting comments regarding the Interim Rule during that 60-day period and will promulgate a revised final rule once it considers comments from interested parties.

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If you have any questions about the Interim Rule, are interested in submitting comments to the Board, or have questions about any other issues under the Truth in Lending Act, please contact Jon Jaffe, Steve Kaplan, Kris Kully, David Tallman, or any other member of K&L Gates' Mortgage Banking and Consumer Financial Products Group.

¹ Section 404 defines the term "mortgage loan" to mean any consumer credit transaction that is secured by the principal dwelling of a consumer. 15 U.S.C. § 1641(g). "Consumer credit" is defined by Regulation Z to mean credit offered or extended to a consumer primarily for personal, family, or household purposes. Thus, it includes both closed-end and open-end lines of credit.

² This Client Alert only addresses the clarifications to Section 404 contained in the Interim Rule. It does not address the requirements under Section 404 more generally.

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