

# LENDERS COMPLIANCE GROUP

*"Converting Risk to Opportunity"*

## ADVISORY BULLETIN

July 28, 2008

### FRB Finalizes Revision to Regulation Z (Truth in Lending)

On July 14, 2008, the Federal Reserve Board approved a final rule, which amends Regulation Z (Truth in Lending) and was adopted under the Home Ownership and Equity Protection Act (HOEPA).<sup>1</sup> The new rule addresses and defines "higher-priced" mortgage loans, while also providing additional protection to consumers.<sup>2</sup>

#### Survey-Based Index

The rule establishes a **category of "higher-priced mortgage loans"** secured by a consumer's principal dwelling, defined as a first-lien mortgage that has an annual percentage rate (APR) that is 1.5 percentage points or more above the "average prime offer rate," or, if the loan is a subordinate-lien loan, 3.5 percentage points above this survey-based index.

The average prime offer rate index is based on a survey currently published by Freddie Mac, and can be found at the following webpage:

<http://www.freddiemac.com/dlink/html/PMMS/display/PMMSOutputYr.jsp>.

The rule's definition of "higher-priced mortgage loans" will capture virtually all loans in the subprime market, but generally excludes loans in the prime market. To provide an index, the Federal Reserve Board will publish the "average prime offer rate," based on the above-mentioned survey currently published by Freddie Mac.

#### Four Key Protections for "higher-priced mortgage loans"

- **Borrower Ability.** Lenders must take a borrower's ability to repay the loan from income and assets other than the home's value into account when making the loan. A lender complies, in part, by assessing repayment ability based on the highest scheduled payment in the first seven years of the loan. A borrower does not need to demonstrate a "pattern or practice," in order to show that a lender violated this prohibition.

<sup>1</sup> FRB Press Release: July 14, 2008.

<sup>2</sup> Compliance with the new rules, other than the escrow requirement, is mandatory for all applications received on or after October 1, 2009. The escrow requirement has an effective date of April 1, 2010 for site-built homes, and October 1, 2010 for manufactured homes

- **Verification of Income/Assets.** Lenders must verify the income and assets they rely upon to determine repayment ability.
- **Prepayment Penalty.** Prepayment penalties are prohibited if the mortgage payments can change in the first four years; and, for other higher-priced loans a prepayment penalty period cannot last for more than two years.
- **Escrow Accounts.** Lenders must establish escrow accounts for property taxes and homeowner's insurance for all first-lien mortgage loans.

**Salient features affecting prime and subprime loans include:**

- **Advertising.** New disclosure rules in advertising prohibit seven deceptive or misleading advertising practices, including representing that a rate or payment is "fixed" when it actually can change; and, ads must provide additional information about rates, monthly payments, and other features.
- **Anti-Coercion.** Lenders and mortgage brokers are prohibited from coercing a real estate appraiser to misstate a home's value.
- **Servicing Restrictions.** Servicers are prohibited from engaging in certain practices, such as pyramiding late fees. Additionally, they are required to credit consumers' loan payments as of the date of receipt and provide a payoff statement within a reasonable time of request.
- **Good Faith Estimate.** A good faith estimate of the loan costs must be provided, along with a schedule of payments, within three (3) days after a consumer applies for any mortgage loan secured by a consumer's principal dwelling, that is, not only a purchase money mortgages but also a home improvement loans or a loan to refinance an existing loan. (Currently, early cost estimates are only required for home-purchase loans.)
- **Early Disclosures and Fees.** Consumers cannot be charged any fee until after they receive the early disclosures, except a reasonable fee for obtaining the consumer's credit history.

**IMPORTANT NOTE – REGULATION C**

Due to the above revisions to Regulation Z regarding the definition of a "higher-priced mortgage loan," the FRB is proposing to revise Regulation C, which implements the Home Mortgage Disclosure Act (HMDA). Specifically, the Board would revise the rules for reporting price information of "higher-priced mortgage loans" by conforming relevant HMDA data collection information to the new definition. To conform to the new rule, the Board proposes that lenders must report the spread between the loan's APR and the survey-based estimate of rates offered on prime mortgage loans of comparable type if the spread meets or exceeds 1.5 percentage points for a first-lien (or 3.5 percentage points for a subordinate-lien loan). Comments must be received by August 29, 2008.