

## Federal Reserve amends the Home Mortgage Provisions of Regulation Z (Truth in Lending)

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On July 14, 2008 The Federal Reserve Board approved a final rule for home mortgage loans to curb abusive lending practices and provide increased protection of consumers.

The rule, which amends Regulation Z (Truth in Lending) and was adopted under the Home Ownership and Equity Protection Act (HOEPA), prohibits unfair, abusive or deceptive home mortgage lending practices and restricts certain other problematic mortgage practices. The rule also establishes advertising standards and requires that certain mortgage disclosures be provided to consumers earlier in the transaction.

Federal Reserve Chairman Ben S. Bernanke stated: "The proposed final rules are intended to protect consumers from unfair or deceptive acts and practices in mortgage lending, while keeping credit available to qualified borrowers and supporting sustainable homeownership. Importantly, the new rules will apply to all mortgage lenders, not just those supervised and examined by the Federal Reserve. Besides offering broader protection for consumers, a uniform set of rules will level the playing field for lenders and increase competition in the mortgage market, to the ultimate benefit of borrowers."

The rule adds four key protections for a newly defined category of "higher-priced mortgage loans" secured by a consumer's principal dwelling. For loans in this category, these protections will:

- Prohibit a lender from making a loan without regard to the borrowers' ability to repay the loan from income and assets other than the home's value. A lender complies, in part, by assessing repayment ability based on the highest scheduled payment in the first seven years of the loan. To show that a lender violated this prohibition, a borrower does not need to demonstrate that it is part of a "pattern or practice."
- Require creditors to verify the income and assets they rely upon to determine repayment ability.
- Ban any prepayment penalty if the payment can change in the initial four years. For other higher-priced loans, a prepayment penalty period cannot last for more than two years. This rule is substantially more restrictive than originally proposed.
- Require creditors to establish escrow accounts for property taxes and homeowner's insurance for all first-lien mortgage loans.

"These changes have made for better rules that will go far in protecting consumers from unfair practices and restoring confidence in our mortgage system," said Governor Randall S. Kroszner. "Listening carefully to the commenters, collecting and analyzing data, and undertaking consumer testing, has led to more effective and improved final rules," said Governor Kroszner (who serves as a member of NeighborWorks America's board of Directors).

In addition to the rules governing higher-priced loans, the rules adopt the following protections for loans secured by a consumer's principal dwelling, regardless of whether the loan is higher-priced:

- Creditors and mortgage brokers are prohibited from coercing a real estate appraiser to misstate a home's value.
- Companies that service mortgage loans are prohibited from engaging in certain practices, such as pyramiding late fees. In addition, servicers are required to credit consumers' loan payments as of the date of receipt and provide a payoff statement within a reasonable time of request.
- Creditors must provide a good faith estimate of the loan costs, including a schedule of payments, within three days after a consumer applies for any mortgage loan secured by a consumer's principal dwelling, such as a home improvement loan or a loan to refinance an existing loan. Currently, early cost estimates are only required for home-purchase loans. Consumers cannot be charged any fee until after they receive the early disclosures, except a reasonable fee for obtaining the consumer's credit history.

For all mortgages, the rule also sets additional advertising standards:

- Advertising rules will require additional information about rates, monthly payments, and other loan features.
- The final rule bans seven deceptive or misleading advertising practices, including representing that a rate or payment is "fixed" when it can change.

The rule's definition of "higher-priced mortgage loans" will capture virtually all loans in the subprime market, but generally exclude loans in the prime market. A loan is higher-priced if it is a first-lien mortgage and has an annual percentage rate that is 1.5 percentage points or more above this index, or 3.5 percentage points if it is a subordinate-lien mortgage.

The new rules take effect on October 1, 2009. The single exception is the escrow requirement, which will be phased in during 2010 to allow lenders to establish new systems as needed.