



## Summary of Federal Reserve's Final Home Ownership and Equity Protection Act (HOEPA) Rule Amending Regulation Z (Truth in Lending)

**Background:** On July 14, 2008, the Board of Governors of the Federal Reserve (Board) adopted its final "HOEPA Rule,"<sup>1</sup> amending its Truth in Lending Rules, Regulation Z. The rule prohibits specific acts and practices in mortgage lending under the Truth in Lending Act (TILA) and the Home Ownership and Equity Protection Act (HOEPA).

HOEPA defines a category of the highest priced mortgages (HOEPA-covered loans) in the marketplace and makes them subject to special disclosures and other requirements. HOEPA also empowers the Board to (1) prohibit acts or practices in connection with mortgage loans the Board finds unfair, deceptive or designed to evade HOEPA, and (2) refinancings of mortgage loans the Board finds to be associated with abusive lending practices or are otherwise not in the best interest of the borrower.

Using its HOEPA authority, the Board has defined a new class of higher-priced mortgages (higher-priced loans) under this rule and made them subject to new requirements, summarized below. This category is intended to cover nonprime loans, that are lower-priced than HOEPA-covered loans but higher-priced than prime loans. Also, using its authority, the Board has made all closed-end mortgage transactions subject to new requirements, also summarized. In developing this rule, the Board applied standards under the Federal Trade Commission Act's prohibitions against unfair or deceptive acts or practices.

In this rulemaking, the Board also announced it will comprehensively review its TILA disclosures. The Board indicates that some of the issues not resolved in this rule, including mortgage broker fee disclosures and servicing fees, may be considered as part of that review.

### Overview:

- Higher-Priced and HOEPA-Covered Loans - Prohibits certain acts or practices for new category of higher-priced loans as well as certain acts or practices for the highest priced HOEPA-covered loans. Prohibits: (a) extending credit without determining borrower's ability to repay; (b) relying on income and/or assets and failing to verify them using reasonably reliable third party documentation; (c) requiring prepayment penalties except in accordance with certain requirements; and (d) failing to establish an escrow account for taxes and insurance for at least one year.
- All Closed-End Mortgage Transactions – Prohibits certain acts or practices for all closed-end credit transactions secured by a consumer's principal dwelling, no matter what the pricing of the mortgage. Prohibits: (a) creditors, mortgage brokers and their affiliates from coercing, pressuring or otherwise encouraging appraisers to misstate or misrepresent a dwelling's value; and (b) certain practices by servicers involving the

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<sup>1</sup> Final Amendments to Regulation Z (Truth in Lending) to be published at 12 CFR Part 226, July 10, 2008 draft distributed to public.

crediting of payments, charging of late fees and providing payoff statements to consumers.

- Advertising - Revises disclosure requirements in advertisements for credit secured by a consumer's dwelling and prohibits several practices in mortgage advertising; and
- Early Disclosures - Requires earlier disclosures to consumers for closed-end mortgages secured by a principal dwelling.

**Definition of Higher-Priced Mortgages** – New category of "higher-priced mortgage loans" defined as consumer credit transactions secured by consumers' principal dwellings<sup>2</sup> that for first lien loans are 1.5 percentage points above the average prime offer rate issued by Freddie Mac, and for second- lien loans are 3.5 percentage points over the same index. For the foreseeable future, the Board will obtain or, as applicable, derive average prime offer rates for a wide variety of types of transactions from the Primary Mortgage Market Survey® (PMMS) conducted by Freddie Mac, and publish these rates on at least a weekly basis. The Board will adjust these rates to include points. Board dropped original proposal to define "higher-priced mortgages" using indices over comparable Treasury securities. Board invites comments by August 29, 2008 on new definition in conjunction with its proposal to also apply definition to higher- priced mortgage reporting under Home Mortgage Disclosure Act (HMDA). MBA is analyzing the new definition and will comment.

**Definition of HOEPA-Covered Loans** – Includes mortgage loans which exceed APR or points and fees thresholds. For loans consummated after October 1, 2002, for a loan to be HOEPA-covered, the APR must exceed the yield on a Treasury security having a comparable maturity by 8 percentage points, or the total points and fees must exceed 8 percent of the total loan amount. For loans consummated prior to October 1, 2002, APR trigger was higher, 10 percentage points.

**Definition of All Closed-End Mortgage Transactions** – Includes all mortgage loans which are secured by a consumer's principal dwelling not limited to the nonprime market. Open-end home equity plans are excluded.

#### **Requirements for Higher-priced loans:**

- **Ability to Repay** – Prohibits creditors from extending a higher-priced mortgage or a HOEPA-covered loan without considering borrowers' ability to repay the loan based on the consumer's income or assets. Notably, drops proposed rule requirement that pattern or practice must be shown for violation and therefore prohibits creditor from extending any HOEPA-covered loan or higher-priced loan based on collateral without regard to repayment ability.
  - **Presumption of Compliance** – Establishes a presumption of compliance with requirement where a creditor satisfies three requirements: (1) verifies and documents repayment ability of borrower; (2) determines repayment ability using

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<sup>2</sup> The final rule's requirements for "higher-priced loans" extend to home purchase and home improvement loans and refinancings as proposed.

the fully indexed rate and fully amortizing payment, except in certain circumstances, and considering other mortgage-related obligations such as property taxes and homeowners insurance; and (3) assesses the consumer's repayment ability using either ratio of the consumer's total debt obligation to income (DTI) or income the consumer will have after paying debt obligations. Does not prescribe particular thresholds for the DTI or the residual income ratio.

- **Variable Rate Loans** - Presumption of compliance generally requires creditors underwrite to fully indexed rate (the sum of the index value and margin) as of consummation or the initial rate, if greater. Creditor may use discounted initial rate, if rate is fixed for at least seven years. Also, while presumption of compliance generally requires use of fully amortizing payment, requirement does not pertain under interest-only loans where initial payment is fixed for at least seven years and for balloon loans with a term of at least seven years.
- **Note** – While presumption of compliance is more reasonable than presumption of noncompliance originally proposed, presumption of compliance is not conclusive and can be rebutted. Borrower may rebut presumption with evidence creditor disregarded repayment ability despite following requirements.
- **Documentation** – Prohibits creditor from relying on amounts of income (except for expected income) or assets to assess repayment ability for higher-priced loan or HOEPA-covered loan secured by consumer's principal dwelling unless the creditor verifies the amounts. Authorizes creditor to rely on W-2 forms, tax returns, payroll receipts, financial records or any other document providing reasonably reliable evidence, except statement only from the consumer. Final rule provides a defense where creditor can show amounts of consumer's income or assets the creditor relied on were not materially greater than what the creditor could have documented at closing.
- **Prepayment Penalties** – Prohibits prepayment penalties for any higher-priced loan or HOEPA-covered loan where payments can change during the four year period following loan consummation. For other higher-priced loans, where payments do not change for four years, prohibits prepayment penalties exceeding two years from loan consummation or applicable to refinancing by creditor or its affiliate. Provides tighter restrictions on prepayment penalties than proposed rule which would have permitted prepayment penalties up to five years. Excludes proposed requirement that prepayment penalties expire 60 days before first scheduled reset, as unnecessary. Also, drops restriction prohibiting prepayment penalties on higher-priced loans where consumer's verified DTI exceeds 50 percent; the restriction remains on HOEPA-covered loans because required by law.
- **Escrows** – Requires creditor to establish escrow account for property taxes and homeowners insurance on higher-priced loans secured by first lien on consumer's principal dwelling with exceptions for loans secured by cooperative apartments and certain condominium loans. Permits, but does not require, creditors to offer borrowers option to cancel escrow account no sooner than 12 months after loan consummation. Provides extended compliance periods for establishing escrows, with longer period for manufactured housing, to give creditors and servicers time to develop infrastructure (see below).

## Requirements for Closed-End Mortgage Loans:

- **Appraisals** – Prohibits creditors, mortgage brokers and their affiliates from coercing, pressuring or otherwise encouraging appraisers to misstate or misrepresent dwelling's value, for all closed-end residential loans. Further, prohibits creditor from extending credit if creditor knew of violation, i.e., that appraiser has been encouraged by creditor, mortgage broker or affiliate of either (including any of their employees) to misstate or misrepresent principal dwelling's value, unless the creditor acts with reasonable diligence to determine that the appraisal was accurate or extends credit based on a separate appraisal untainted by coercion. While final rule removes explicit provision for liability where lender has "reason to know" of violation, the preamble makes clear that creditors may not extend credit in willful disregard of facts that evidence a violation of rule.
- **Servicers/Loan Administration** – Prohibits certain practices by servicers of closed-end consumer credit transactions secured by consumer's principal dwelling including: (1) failing to credit a consumer's periodic payment as of the date received, but creditors are not required to credit partial payments, and whether a payment is a full or partial payment is governed by the loan agreement or promissory note; (2) imposing a late fee or delinquency charge where the only basis is consumer's failure to include in a current payment delinquency charge imposed on earlier payments; and (3) failing to provide accurate payoff statement within reasonable time after request. The Rule notes while prohibition under (2) is already prohibited under other rules, by issuing the rule under HOEPA, State Attorney Generals can enforce rule against servicers. Final rule lacks proposed rule's requirement that would have required current schedule of servicing fees and charges be given to consumer within a reasonable time upon request. However, as indicated, Board may consider servicing fees as part of Regulation Z mortgage disclosure review.
- **Yield Spread Premiums** – Drops proposed requirement that would have prohibited creditor from paying mortgage broker more than agreed by consumer in written agreement with the broker. Concludes proposed agreement would confuse consumers and undermine their decision-making rather than improving it. Also, indicates the matter is still under review and will likely be considered as part of Regulation Z review.

## Advertising Requirements:

- Amends advertising rules for both open-end home equity plans and closed-end mortgages including applying "clear and conspicuous" standard. Requires whenever rate or payment is included in advertisement for closed-end or open-end credit secured by dwelling, all rates or payments that will apply over term of loan must be disclosed with equal prominence and in close proximity to advertised rate or payment.
- For closed-end mortgages, no longer allows advertisement of any interest rate lower than rate at which interest is accruing on annual basis. Also, for closed-end mortgage loans, prohibits: (a) advertising fixed-rate or payments when rate or payments are fixed only for limited period of time rather than full loan term; (b) comparing an actual or hypothetical consumer's current rate or payment to advertised loan unless the advertisement states rate or payments over the full term of the advertised loan; (c) advertising loan products as "government" or "government sponsored" or otherwise

government endorsed loans programs when they are not; (d) prominently displaying the name of a consumer's current lender unless the advertisement also discloses that advertising lender is not affiliated with current lender; (e) advertising claims of debt elimination if product advertised merely replaces one debt obligation with another; (f) advertising that creates false impression that mortgage broker or lender has fiduciary relationship with consumer; and (g) foreign language advertisements in which certain information such as teaser rate is provided in foreign language and other disclosures only in English.

#### **Timing of disclosures:**

- Expands requirement that creditor provide "early" good faith estimate disclosure under TILA to consumer to mortgage refinancings, closed-end home equity loans and reverse mortgages. (Currently, early disclosure only required in connection with loan to purchase consumer's primary dwelling.) For these transactions, creditor must make good faith estimate of disclosure before consummation or deliver or place it in mail not later than three business days after consumer's written application, whichever is earlier. Required disclosure includes total payments, finance charge, amount financed and annual percentage rate (APR). Also, prohibits creditor or any other person from imposing fee on consumer in connection with consumer's application for a closed-end transaction until after consumer receives disclosure, except for a reasonable and *bona fide* fee for obtaining the consumer's credit history. Disclosure is deemed received three days after mailing.

#### **Effective Dates for Compliance:**

- Becomes effective, except for escrow requirements, October 1, 2009. Escrow requirements become effective April 1, 2010, except for requirements for manufactured homes, effective October 1, 2010.

#### **Questions:**

- If you have any questions, regarding this rulemaking, please contact Ken Markison, MBA Associate Vice President and Regulatory Counsel at (202) 557-2930 or [kmarkison@mortgagebankers.org](mailto:kmarkison@mortgagebankers.org)

July 18, 2008