



## **Key Points in the Federal Reserve's Proposed Amendments to its Truth in Lending Act (TILA) Regulations**

**Background** – On December 18, 2007, the Board of Governors of the Federal Reserve proposed changes to its rules under the Truth in Lending Act, Regulation Z. The rule seeks to protect consumers from unfair and deceptive acts and practices. Under the proposal, some protections would be directed only to higher-priced mortgages (essentially subprime loans), some protections would be directed to all loans and some protections to high-cost Home Ownership and Equity Protection Act (HOEPA) loans.

**Higher-Priced Mortgages** – The rule would provide protections for loans in addition to current protections already provided under HOEPA through the establishment of a new category of "higher-priced mortgage loans" defined as closed-end consumer credit transactions secured by the consumer's principal dwelling where the APR on the loan exceeds the rate on a Treasury security with a comparable maturity by 3%. This would include purchase loans, refinancings of such loans, and home equity loans, but would exclude loans for vacation properties, open-end home-equity plans, reverse mortgages, or construction-only loans. The Board seeks comment on whether other prohibitions for high-cost HOEPA loans (below) should also apply to higher-priced loans.

**For Higher Priced Mortgages-** The rule would:

- **Ability to Repay** – Prohibit creditors from engaging in a pattern or practice of extending credit without considering a borrower's ability to repay the loan. This provision also applies to high-cost HOEPA loans.
  - **Rebuttable Presumption** – Establish a rebuttable presumption of a violation of the rule where a lender engages in a pattern or practice of failing to verify and document consumers': repayment ability including considering the margin and index at consummation for variable rate loans; ability to make fully amortizing payment including expected taxes and insurance; the ratio of the consumer's total debt obligation to income; and residual income after paying obligations.
  - **Safe Harbor** – Provide a safe harbor where creditor has a reasonable basis to believe that consumers will be able to make loan payments for at least seven years, considering all of the factors of the ability to repay requirements.
- **Documentation** – Require creditors to verify the income and assets they rely upon with third-party documents that provide reasonably reliable evidence such as W-2 forms, tax returns, payroll receipts, or financial records.

- **Prepayment Penalties** – Extend the prohibitions that are currently associated with high-cost loans to HOEPA loans. The regulation would prohibit prepayment penalties unless: (1) the consumer’s DTI at closing does not exceed 50% of the consumers verified monthly gross income (2) the source of the prepayment funds is not a refinancing by the creditor or its affiliate; (3) the penalty term does not exceed five years; and (4) the penalty is not otherwise prohibited by law. In addition, prepayment penalties must expire at least sixty days prior to the first date, if any, on which the periodic payment amount may increase under the terms of the loan.
- **Escrows** – Require establishment of escrow accounts for taxes and insurance for at least the first year of a first lien higher-priced mortgage. The proposal also permits, but does not require, creditors to offer borrowers an option to opt out of the escrow once the first year has passed.

**For All Loans-** The rule would:

- **Yield Spread Premiums** – Prohibit YSPs unless the broker enters into a written agreement with the consumer before the consumer applies or pays any fee to the broker that clearly and conspicuously states (1) the total dollar amount of compensation the broker will receive and retain from all sources; (2) the consumer will pay the entire compensation the broker will receive, even if all or part is paid directly by the creditor; and (3) that a creditor’s payment to a broker can influence the broker to offer loan terms or products that are not in the consumer’s interest or are not the most favorable the consumer otherwise could obtain.
- **Appraisers** – Prohibit creditors and mortgage brokers and their affiliates from coercing, influencing, or encouraging an appraiser to misrepresent a dwelling’s value, for all closed-end residential loans. Further, creditors are prohibited from extending credit if the creditor knew or had reason to know that a broker had coerced, influenced or encouraged an appraiser to misstate a dwelling’s value, unless the creditor acted with reasonable diligence to determine that the appraisal was accurate.
- **Loan Administration** – Prohibit certain practices by servicers including: (1) failing to credit a consumer’s periodic payment as of the date received; (2) “pyramiding” of late fees, i.e., prohibiting a service from imposing a late fee on a consumer for an otherwise timely payment that would be the full amount currently due except for its failure to include a previously assessed late fee; (3) failing to provide a current schedule of all specific servicing fees and charges within a reasonable time after a request; or (4) failing to provide an accurate payoff statement within a reasonable time after a request.
- **Advertising** – Prohibit additional deceptive advertising practices, including, for example, misleading use of the word “fixed” in describing payments for variable

rate loans, and advertising loans as government loans such as FHA or VA loans when they are not.

- **Early disclosures** – Require early TILA along with RESPA disclosures for all closed-end mortgage transactions, and prohibit originators from taking any application fee (except a fee for a credit report) until disclosures are received.
- **Liability** – Consumers who bring action against creditors for violations may seek: (1) actual damages; (2) statutory damages in an individual action of up to \$2,000 or, in a class action, total statutory damages for the class of up to \$500,000 or one percent of the creditor’s net worth, whichever is less; (3) special statutory damages equal to the sum of all finance charges and fees paid by the consumer; and (4) court costs and attorney fees. Refinance mortgages are also subject to the right of rescission.

*In addition to these key points above, the proposed rule itself contains extensive commentary on the specific proposals, and in many cases, but not all, a justification for the proposal recommended by the Federal Reserve Board that may be useful to anyone interested or concerned about a specific provision.*