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## MEMORANDUM

**TO: MBA**

**FROM: Jenny Dozier**

**DATE: September 12, 2008**

**SUBJECT: Final Regulation Z Amendments Regarding Unfair and Deceptive Lending Practices**

The Federal Reserve Board recently issued its final rule effecting changes to Regulation Z regarding unfair or deceptive home mortgage lending and advertising practices. The final rule restricts certain practices relative to a new category of loans (higher-priced loans) and amends existing disclosure requirements. The final rule will take effect October 1, 2009, except for provisions related to escrows, which will be effective in 2010.

### Higher-Priced Mortgage Loans

The final rule establishes a new category of loans to which additional restrictions are applicable. “Higher-priced mortgage loan” means a consumer credit transaction secured by the consumer’s principal dwelling with an annual percentage rate that exceed the average prime offer rate for a comparable transaction as of the date the interest rate is set by 1.5 or more percentage points for loans secured by a first lien, or by 3.5 or more percentage points for loan secured by a subordinate lien on a dwelling.

“Average prime offer rate” means an annual percentage rate that is derived from average interest rates, points, and other loan pricing terms currently offered to consumers by a representative sample of creditors for mortgage transactions that have low-risk pricing characteristics. The Board publishes average prime offer rates.

“Higher-priced mortgage loan” does not include a transaction to finance the initial construction of a dwelling, a temporary or bridge loan with a term of 12 months or less, a reverse mortgage transaction, or a home equity line of credit.



The following restrictions are applicable to higher-priced mortgage loans:

- (1) A creditor must not extend credit based on the value of the consumer's collateral without regard to the consumer's repayment ability as of consummation. The consumer's current and reasonably expected income, employment, assets other than the collateral, current obligations, and mortgage-related obligations must be considered. A creditor must verify the consumer's repayment ability as follows:
  - a. Verify amounts of income or assets that it relies on to determine repayment ability, including expected income or assets, by the consumer's IRS W-2, tax returns, payroll receipts, financial institution records, or other third-party documents that provide reasonably reliable evidence of the consumer's income or assets.
  - b. Notwithstanding the above, a creditor is not in violation of the requirement to verify income if the amounts of income and assets that the creditor relied upon in determining repayment ability are not materially greater than the amounts of the consumer's income or assets that the creditor could have verified at the time the loan was consummated.
  - c. A creditor must verify the consumer's current obligations.
- (2) No prepayment penalties unless (a) the penalty is otherwise permitted by law; (b) under the terms of the loan the penalty will not apply after the two-year period following consummation, the penalty will not apply if the source of the prepayment funds is a refinancing by the creditor or an affiliate of the creditor, and the amount of the periodic payment of principal or interest or both may not change during the 4-year period following consummation.
- (3) A creditor must not extend a loan secured by a first lien on a principal dwelling unless an escrow account is established before consummation for payment of property taxes and premiums for mortgage-related insurance required by the creditor. A creditor or servicer may permit a consumer to cancel the escrow account only in response to a consumer's written request to cancel the escrow account that is received no earlier than 365 days after consummation. Escrow accounts are not required for loans secured by shares in a cooperative. Additionally, hazard or liability insurance is not required to be included in escrow amounts for loans secured by condominium units, where the condominium association has an obligation to the units owners to maintain a master policy insuring units.

### Prohibited Practices

The final rules also establish a new section relative to prohibited acts or practices. This section addresses appraisal and servicing issues. This section is not applicable to a home equity line of credit subject to § 226.5b. In connection with a consumer credit transaction secured by a



consumer's principal dwelling, a creditor, mortgage broker, or affiliate of either is prohibited from directly or indirectly coercing, influencing, or otherwise encouraging an appraiser to misstate or misrepresent the value of such dwelling. The following are examples of violations of this new restriction:

- 1) Implying to an appraiser that current or future retention of the appraiser depends on the amount at which the appraiser values a consumer's principal dwelling;
- 2) Excluding an appraiser from consideration for future engagement because the appraiser reports a value of a consumer's principal dwelling that does not meet or exceed a minimum threshold;
- 3) Telling an appraiser a minimum reported value of a consumer's principal dwelling that is needed to approve the loan;
- 4) Failing to compensate an appraiser because the appraiser does not value a consumer's principal dwelling at or above a certain amount; and
- 5) Conditioning an appraiser's compensation on loan consummation.

The following are examples of actions that do not violate this restriction:

- 1) Asking an appraiser to consider additional information about a consumer's principal dwelling or about comparable properties;
- 2) Requesting that an appraiser provide additional information about the basis for a valuation;
- 3) Requesting that an appraiser correct factual error in a valuation;
- 4) Obtaining multiple appraisals of a consumer's principal dwelling, so long as the creditor adheres to a policy of selecting the most reliable appraisal, rather than the appraisal that states the highest value;
- 5) Withholding compensation from an appraiser for breach of contract or substandard performance of services as provided by contract; and
- 6) Taking action permitted or required by applicable federal or state statute, regulation, or agency guidance.

A creditor who knows, at or before loan consummation, of a violation of the restrictions above in connection with an appraisal must not extend credit based upon such appraisal unless the creditor documents that it has acted with reasonable diligence to determine that the appraisal does not materially misstate or misrepresent the value of such dwelling.

“Appraiser” means a person who engages in the business of providing assessments of the value of dwellings. It includes persons that employ, refer, or manage appraisers and affiliates of such persons. “Mortgage broker” means a person, other than an employee of a creditor, who for compensation or other monetary gain, or in expectation of compensation or other monetary gain, arranges, negotiates, or otherwise obtains an extension of consumer credit for another person. The terms includes a person meeting this definition even if the consumer credit obligation is initially payable to such person, unless the person provides the funds for the transaction at



consummation out of the person's own resources, out of deposits held by the person, or by drawing on a bona fide warehouse line of credit.

This section also establishes new restrictions relative to servicing. Specifically, in connection with a consumer credit transaction secured by a consumer's principal dwelling, no servicer shall:

- 1) Fail to credit a payment to the consumer's loan account as of the date of receipt, except when a delay in crediting does not result in any charge to the consumer or in the reporting of negative information to a consumer reporting agency;
- 2) Impose on the consumer any late fee or delinquency charge in connection with a payment, when the only delinquency is attributable to late fees or delinquency charges assessed on an earlier payment, and the payment is otherwise a full payment for the applicable period and is paid on its due date or within any applicable grace period;
- 3) Fail to provide, within a reasonable time after receiving a request from the consumer or any person acting on behalf of the consumer, an accurate statement of the total outstanding balance that would be required to satisfy the consumer's obligation in full as of a specified date.

If a servicer specifies in writing requirements for a consumer to follow in making payments, but accepts a payment that does not conform to the requirements, the servicer must credit the payment as of 5 days after receipt. "Servicer" and "servicing" have the same meaning as in Regulation X.

### Disclosure Requirements

Under the existing provisions of Regulation Z, creditors are required to provide a good faith estimate of loan costs, including a schedule of payments, within three days after a consumer applies for a home purchase loan (early TIL). Under the new rules, the good faith estimate must be given within three days after a consumer applies for any closed-end mortgage loan secured by a consumer's principal dwelling, including a home improvement loan or loan to refinance an existing loan. Additionally, neither the creditor nor any other person may impose a fee on the consumer in connection with the consumer's application for a mortgage transaction before the consumer has received the good faith estimate of loan costs. A fee may be imposed for obtaining the consumer's credit history before the consumer has received the disclosure provided that the fee is bona fide and reasonable in amount.

### Advertising

The final rule establishes new prohibited practices relative to advertisements for credit secured by a dwelling. Specifically, the following acts or practices are prohibited:



- 1) Using the word “fixed” to refer to rates, payments, or the credit transaction in an advertisement for variable-rate transactions or other transactions where the payment will increase, unless:
  - a. In the case of an advertisement solely for one or more variable-rate transactions, the phrase “Adjustable-Rate Mortgage,” “Variable-Rate Mortgage,” or “ARM” appears in the advertisement before the first use of the word “fixed” and is at least as conspicuous as any use of the word “fixed” in the advertisement, and each use of the word “fixed” to refer to a rate or payment is accompanied by an equally prominent and closely proximate statement of the time period for which the rate or payment is fixed, and the fact that the rate may vary or the payment may increase after that period;
  - b. In the case of an advertisement solely for non-variable-rate transactions where the payment will increase, each use of the word “fixed” to refer to the payment is accompanied by an equally prominent and closely proximate statement of the time period for which the payment is fixed, and the fact that the payment will increase after that period; or
  - c. In the case of an advertisement for both variable-rate transactions and non-variable-rate transactions, the phrase “Adjustable-Rate Mortgage,” “Variable-Rate Mortgage,” or “ARM” appears in the advertisement with equal prominent as any use of the term “fixed,” “Fixed-Rate Mortgage,” or similar terms and each use of the word “fixed” to refer to a rate, payment, or the credit transaction either refers solely to the transactions for which rates are fixed and complies with the applicable requirements above, or, if it refers to the variable-rate transactions, is accompanied by an equally prominent and closely proximate statement of the time period for which the rate or payment is fixed, and the fact that the rate may vary or the payment may increase after that period.
- 2) Making any comparison in an advertisement between actual or hypothetical credit payments or rates and any payment or simple annual rate that will be available under the advertised product for a period less than the full term of the loan, unless:
  - a. The advertisement includes a clear and conspicuous comparison to the information required to be disclosed under § 226.24(f)(2) and (3); and
  - b. If the advertisement is for a variable-rate transaction, and the advertised payment or simple annual rate is based on the index and margin that will be used to make subsequent rate or payment adjustments over the term of the loan, the advertisement includes an equally prominent statement in close proximity to the payment or rate that the payment or rate is subject to adjustment and the time period when the first adjustment will occur.
- 3) Making any statement in an advertisement that the product offered is a “government loan program,” “government-supported loan,” or is otherwise endorsed or sponsored by any federal, state, or local government entity, unless the advertisement is for an FHA loan, VA loan, or similar loan program that is, in fact, endorsed or sponsored by a federal, state, or local government entity.



- 4) Using the name of the consumer's current lender in an advertisement that is not sent by or on behalf of the consumer's current lender, unless the advertisement discloses with equal prominence the name of the person or creditor making the advertisement and includes a clear and conspicuous statement that the person making the advertisement is not associated with, or acting on behalf of, the consumer's current lender.
- 5) Making any misleading claim in an advertisement that the mortgage product offered will eliminate debt or result in a waiver or forgiveness of a consumer's existing loan terms with, or obligations to, another creditor.
- 6) Using the term "counselor" in an advertisement to refer to a for-profit broker or mortgage creditor, its employees, or persons working for the creditor or broker that are involved in offering, originating or selling mortgages.
- 7) Providing information about some trigger terms or required disclosures, such as an initial rate or payment, only in a foreign language in an advertisement, but providing information about other trigger terms or required disclosures, such as information about the fully-indexed rate or fully amortizing payment, only in English in the same advertisement.

The final rules also require advertising to contain additional information about rates, monthly payments, and other loan features. If an advertisement for credit secured by a dwelling states a simple annual rate of interest and more than one simple annual rate of interest will apply over the term of the advertised loan, the advertisement must disclose in a clear and conspicuous manner each simple annual rate of interest that will apply, the period of time during which each simple annual rate of interest will apply, and the annual percentage rate for the loan.

Additionally, if an advertisement states the amount of any payment, the advertisement must disclose in a clear and conspicuous manner (1) the amount or each payment that will apply over the term of the loan, including any balloon payment; (2) the period of time during which each payment will apply; and (3) for first mortgage loan, the fact that the payments do not include amounts for taxes and insurance premiums, if applicable, and that the actual payment obligation will be greater.

If an advertisement distributed in paper form or through the Internet is for a loan secured by the consumer's principal dwelling, and the advertisement states that the advertised extension of credit may exceed the fair market value of the dwelling, the advertisement must clearly and conspicuously state that: (1) the interest on the portion of the credit extension that is greater than the fair market value of the dwelling is not tax deductible for Federal income tax purposes; and (2) the consumer should consult a tax adviser for further information regarding the deductibility to interest and charges.

Please feel free to contact me with any questions regarding these new rules. As always, thank you for allowing us to assist with legislative monitoring.