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March 7, 2008

To: Clients and Friends

From: David F. Dulock

Subject: Proposed amendments to Regulation Z (Federal Register, Vol. 73, No. 6).

On January 9, 2008, the Board of Governors of the Federal Reserve System ("Board") proposed significant amendments to Regulation Z, which are discussed in this memorandum. We believe these proposed amendments will have a dramatic impact on the way mortgage lending is conducted if the Board adopts them, as proposed.

TEXT OF PROPOSED AMENDMENTS:

The text of the proposed amendments and their proposed Official Staff Interpretations can be printed from the Federal Register website at:

http://www.gpoaccess.gov/nara/index.html. You may also obtain a copy by clicking on http://www.federalreserve.gov/newsevents/press/bcreg/20071218a.htm.

PUBLIC COMMENT PERIOD:

We urge you to send comments on the proposed amendments. **The Board must receive your comments on the proposed amendments no later than April 8, 2008.** You may submit comments, identified by Docket No. R-1305, by any of the following methods:

1. Agency Web site: http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.

2. Federal eRulemaking Portal: http://www.regulations.gov.

3. E-mail: regs.comments@ federalreserve.gov. Place docket number in message subject line.

4. Fax: (202) 452-3819 or (202) 452-3102.

5. Mail: Address to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551.

OVERVIEW OF PROPOSED AMENDMENTS:

(*This overview of the proposed amendments is taken from the Board's December 18, 2007 press release posted on its website and the Board's* SUMMARY *starting on page 1672 of the above referenced issue of the Federal Register.*)

The stated purpose of the proposed amendments is to protect consumers from unfair or deceptive home mortgage lending and advertising practices. They would restrict certain practices and would also require certain mortgage disclosures to be provided earlier in the transaction.

1. HOEPA Loans: The proposed amendments include amendments to HOEPA-covered loans contained in Sections 226.32 and 226.34.

2. Higher-Priced Mortgage Loans: The proposed amendments include four protections for a newly defined category of closed-end loans called a "higher-priced mortgage loan" secured by a consumer's principal dwelling:

(1) Creditors would be prohibited from engaging in a pattern or practice of extending credit without considering consumers' ability to repay the credit from income or from other sources besides the collateral.

(2) Creditors would be required to verify the income and assets they rely upon in making a loan.

(3) Prepayment penalties would only be permitted if certain conditions are met, including the condition that no penalty will apply for at least sixty days before any possible payment increase.

(4) Creditors would have to establish escrow accounts for taxes and insurance.

The rule would define "higher-priced mortgage loan" to cover subprime loans but generally exclude loans in the prime market. A loan would be covered if it is a first lien mortgage and has an APR that is three percentage points or more above the yield on comparable Treasury notes, or if it is a subordinate lien mortgage with an APR exceeding the comparable Treasury rate by five points or more.

3. Primary Dwelling Loans: The proposed amendments include three new protections to all closed-end loans secured by a consumer's principal dwelling, regardless of the loan's APR:

(1) Creditors would be prohibited from compensating mortgage brokers unless the broker previously entered into a written agreement with the consumer disclosing the broker's total compensation and other facts. The consumer's written agreement with the broker must occur before the consumer applies for the loan or pays any fees.

(2) Creditors and mortgage brokers would be prohibited from coercing a real estate appraiser to misstate a home's value.

(3) Mortgage loan servicers would be prohibited from engaging in certain practices. For example, servicers would be required to credit consumers' loan payments as of the date of receipt and would have to provide a schedule of fees to a consumer upon request.

4. Advertising: The proposed amendments to advertising rules would require additional information about rates, monthly payments, and other loan features. They also would ban certain deceptive or misleading advertising practices, including representing that a rate or payment is "fixed" when it can change.

5. Early Disclosures: Under the proposed amendments, creditors would have to provide a good faith estimate of the loan costs, including a schedule of payments, within three days after a consumer applies for any closed-end 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. In addition, consumers could not be charged any fee until after they receive the early disclosures, except a reasonable fee for obtaining the consumer's credit history.

SUMMARY OF PROPOSED AMENDMENTS:

(*This summary of the proposed amendments is taken from the* SUPPLEMENTARY INFORMATION *on pages 1672-1716 of the above referenced issue of the Federal Register.*)

1. HOEPA Loan Proposed Amendments – Sections 226.32 and 226.34

A. Prepayment Penalties – Proposed Amended Section 226.32(d)(7):

Section 226.32(d) prohibits a prepayment penalty in connection with a closed-end mortgage loan secured by the consumer's principal dwelling subject to Section 226.32 (a HOEPA loan) except as allowed under subsection 32(d)(7). The Board proposes to amend paragraph (d)(7)(iii) to change the verification of the consumer's monthly debt-to-income ratio at consummation from verification "by the consumer's signed financial statement, a credit report, and payment records for employment income" to verification "in accordance with Section 226.35(b)(2)(i)." The Board also proposes to amend subsection 32(d)(7) to add a new paragraph (d)(7)(iv) to state, "The penalty period ends at least sixty days prior to the first date, if any, on which the principal or interest payment amount may increase under the terms of the loan."

The proposed amendments to subsection 32(d)(7) make the creditor's verification of the consumer's debt-to-income ratio more stringent and lessen the five-year prepayment penalty period permitted by paragraph (d)(7)(i). For a detailed discussion of the effect of these proposed amendments (which also will apply to higher-priced mortgage loans subject to proposed Section 226.35), see section 2.G. of this memorandum.

B. Consumer's Ability to Repay - Proposed Amended Section 226.34(a)(4):

Section 226.34(a) prohibits certain acts or practices in connection with a HOEPA loan. The proposed amendments to paragraph (a)(4) delete existing paragraph (a)(4) and insert in its place a new and more detailed paragraph (a)(4), as follows:

> (4) Repayment ability. Engage in a pattern or practice of extending credit subject to Section 226.32 to consumers based on the value of consumers' collateral without regard to consumers' repayment ability as of consummation, including consumers' current and reasonably expected income, current and reasonably expected obligations, employment, and assets other than the collateral.
>
> (i) There is a presumption that a creditor has violated this paragraph (a)(4) if the creditor engages in a pattern or practice of failing to--

(A) Verify and document consumers' repayment ability in accordance with Section 226.35(b)(2)(i);

(B) Consider consumers' ability to make loan payments based on the interest rate, determined as follows in the case of a loan in which the interest rate may increase after consummation--

(1) For a variable rate loan, the interest rate as determined by adding the margin and the index value as of consummation, or the initial rate if that rate is greater than the sum of the index value and margin as of consummation; and

(2) For a step-rate loan, the highest interest rate possible within the first seven years of the loan's term;

(C) Consider consumers' ability to make loan payments based on a fully-amortizing payment that includes, as applicable: expected property taxes; homeowners' association dues; premiums for insurance against loss of or damage to property, or against liability arising out of the ownership or use of the property; premiums for any guarantee or insurance protecting the creditor against consumers' default or other credit loss; and premiums for other mortgage related insurance;

(D) Consider the ratio of consumers' total debt obligations to consumers' income; or

(E) Consider the income consumers will have after paying debt obligations.

(ii) A creditor does not violate this paragraph (a)(4) if it has a reasonable basis to believe consumers will be able to make loan payments for at least seven years after consummation of the transaction, considering the factors identified in paragraph (a)(4)(i) of this section and any other factors relevant to determining repayment ability.

(iii) This paragraph (a)(4) does not apply to temporary or "bridge" loans with terms of twelve months or less, such as a loan to purchase a new dwelling where the consumer plans to sell a current dwelling within twelve months.

For a detailed discussion of the effect of these proposed amendments (which also will apply to higher-priced mortgage loans subject to proposed Section 226.35), see section 2.E. of this memorandum.

2. <u>Higher-Priced Mortgage Loans — Proposed Section 226.35</u>

A. Overview:

The Board is proposing four protections for consumers receiving higher-priced mortgage loans, which would be defined as closed-end loans secured by a consumer's principal dwelling and having an annual percentage rate (APR) that exceeds the comparable Treasury security by three or more percentage points for first lien loans, or five or more percentage points for subordinate lien loans. The Board proposes to: (1) Prohibit creditors from engaging in a pattern or practice of extending credit under a higher-priced mortgage loan without regard to borrowers' ability to repay from sources other than the collateral itself; (2) Require creditors to verify income and assets they rely upon in making higher-priced mortgage loans; (3) Prohibit prepayment penalties unless certain conditions are met; and (4) Require creditors to establish escrow accounts for taxes and insurance, but permit creditors to allow borrowers to opt out of escrows 12 months after loan consummation. In addition, Proposed Section 226.35 would prohibit creditors from structuring higher-priced mortgage loans as open-end lines of credit for the purpose of evading these rules.

B. Types of Loans Covered:

Higher-priced mortgage loans would be defined as consumer credit transactions secured by the consumer's principal dwelling for which the APR on the loan exceeds the yield on comparable Treasury securities by at least three percentage points for first lien loans, or five percentage points for subordinate lien loans. The proposed definition would include home purchase loans, refinance loans, and home equity loans. The definition would exclude HELOCs, reverse mortgages, construction only loans, and bridge loans. The proposed definition would not cover loans that do not have primarily a consumer purpose, such as loans for real estate investment. The definition would appear in proposed Section 226.35(a) and such loans would be subject to the restrictions and requirements in Section 226.35(b) concerning repayment ability, income verification, prepayment penalties, escrows, and evasion, except that subordinate lien higher-priced mortgage loans would not be subject to the escrow requirement.

C. Rationale for Proposed APR Trigger:

The Board seeks to set the trigger at a level that would capture the subprime market but generally exclude the prime market. The Board believes that it may be appropriate to err on the side of covering somewhat more than the subprime market. Based on this approach, the Board proposes a threshold of three percentage points above the comparable Treasury security for first-lien loans, or five percentage points for subordinate-lien loans. Based on available data, it appears that this threshold would capture at least the higher-priced end of the alt-A market.

D. Mechanics of the APR Trigger:

Although the Board proposes to use the same numerical thresholds as Regulation C issued pursuant to the Home Mortgage Disclosure Act (12 U.S.C. 2801 *et seq.)*, the Board proposes to use somewhat different rules for matching mortgage loans to Treasury securities.

The Board proposes to prescribe rules based on three features: whether the loan is adjustable-rate or fixed-rate; the term of the loan; and the length of any initial fixed-rate period, if the loan is adjustable-rate. Proposed Section 226.35(a) would match closed-end loans to Treasury securities as follows: (1) First, variable rate transactions with an initial fixed-rate period of more than one year would be matched to Treasuries having maturity closest to the length of the fixed-rate period (unless the fixed-rate period exceeds seven years, in which case the creditor would use the rules applied to non-variable rate loans). For example, a 30-year ARM having an initial fixed-rate period of five years would be matched to a 5-year Treasury security. (2) Second, variable-rate transactions with an initial fixed-rate period of one year or less would be matched to Treasury security having a maturity of one year. (3) Third, fixed-rate loans would be matched on the basis of loan term in the following way: (i) a fixed-rate loan with a term of 20 years or more would be matched to a 10-year Treasury security; (ii) a fixed-rate loan with a term of more than 7 years but less than twenty years would be matched to a 7-year Treasury security; and (iii) a fixed-rate loan with a term of seven years or less would be matched to the Treasury security with a maturity closest to the term.

The proposed rule also would differ from Regulation C as to timing. The Treasury security yield that would be used is the yield (i) as of the 15th of the month preceding the month in which

the application is received, if received between the 1st and the 14th, or (ii) as of the 15th of the current month for all applications received on or after the 15th.

E. Consumer's Ability to Repay - Sections 226.34(a)(4) and 226.35(b)(1):

A creditor would be prohibited from engaging in a pattern or practice of making higher-priced mortgage loans based on the collateral without regard to repayment ability. A creditor would also be prohibited from making an individual higher-priced mortgage loan without verifying the income and assets the creditor relied upon to make the loan. The Board is proposing to extend the HOEPA prohibition against a pattern or practice of lending based on consumers' collateral without regard to their repayment ability to higher-priced mortgage loans as defined in Section 226.35(a). First, the prohibition in Section 226.34(a)(4), which applies to HOEPA loans, would be revised and strengthened (*see Section 1.B. of this memorandum*) and this revised prohibition would be incorporated as proposed Section 226.35(b)(1) as one of the restrictions that apply to higher-priced mortgage loans, so that HOEPA loans and higher-priced mortgage loans would have similar prohibitions (HOEPA loans under revised Section 226.34(a)(4) and higher-priced mortgage loans under Section 226.35(b)(1)).

Proposed Section 226.35(b)(1) would prohibit a lender from engaging in a pattern or practice of making higher-priced mortgage loans as provided in Section 226.34(a)(4) – *i.e.*, based on the value of consumers' collateral without regard to consumers' repayment ability as of consummation, including consumers' current and reasonably expected income, current and reasonably expected obligations, employment, and assets other than the collateral – as follows:

(1) “Pattern or practice” - The Board is not proposing to prohibit making an individual loan without regard to repayment ability, either for HOEPA loans or for higher-priced mortgage loans. Instead, the Board is proposing to retain the pattern or practice element in the prohibition, and to include that element in the proposed new prohibition for higher-priced mortgage loans. Whether a creditor had engaged in the prohibited pattern or practice would depend on the totality of the circumstances in the particular case, as explained in an existing official staff comment [*comment 34(a)(4)-2*] to Section 226.34(a)(4). The comment further indicates that while a pattern or practice is not established by isolated, random, or accidental acts, it can be established without the use of a statistical process. It also notes that a creditor might act under a lending policy (whether written or unwritten) and that action alone could establish a pattern or practice of making loans in violation of the prohibition. The Board is not proposing to adopt a quantitative standard for determining the existence of a pattern or practice nor for the Board to give examples, as the inquiry depends on the totality of the circumstances.

(2) “Current and expected income” - Existing Section 226.34(a)(4) prohibits a creditor from disregarding a consumer's repayment ability, including current and expected income. The Board proposes to retain the references to expected and current income, and to clarify that expectations of income must be reasonable. For example, a consumer seeking a professional degree or certificate may reasonably anticipate an increase in income after obtaining the degree or certificate. Under the proposal, a creditor could consider such an increase. For consumers who do not have a current income and cannot demonstrate a reasonable expectation of income, creditors may consider assets other than the collateral.

(3) "As of consummation" - The phrase "as of consummation" would be added to make clear that the prohibition is based on the facts and circumstances that existed as of consummation. Under proposed official staff comment 34(a)(4)-2, events after consummation, such as an unusually high default rate, may be relevant to determining whether a creditor has violated Section 226.34(a)(4), but events after consummation do not, by themselves, establish a violation.

(4) "Employment" - The reference to employment as a factor in determining repayment ability would indicate that in some circumstances it may be appropriate or necessary to take into account expected changes in employment.

(5) "Expected obligations" - Section 226.34(a)(4) would be amended to also refer to expected obligations. This would make the reference to obligations parallel to the references to current and expected income. Proposed comment 34(a)(4)(i)(A)-2 would clarify that, where two different creditors are extending loans simultaneously to the same consumer, one a first-lien loan and the other a subordinate-lien loan, each creditor would generally be expected to verify the obligation the consumer is undertaking with the other creditor. A pattern or practice of failing to do so would create a presumption of a violation.

(6) "Assets other than the collateral" - Proposed amended Section 226.34(a)(4) would make clear that creditors may rely on assets other than the collateral to determine repayment ability; for example, a creditor may take into account a savings account or investments that can be used by the consumer. Creditors may consider non-collateral assets such as these in determining repayment ability, and consumers are free to substitute assets for income in meeting their obligations.

(7) Minor revisions - would be made to Section 226.34(a)(4) solely for clarity. The term "consumer" would be put in the plural, "consumers," to reflect that the prohibition concerns a pattern or practice. The phrase "based on consumers' collateral" would be revised to read, "based on the value of consumers' collateral." No change in meaning is intended.

Current Section 226.34(a)(4) contains a rebuttable presumption that a creditor violates Section 226.34(a)(4) – *which prohibits a pattern or practice of extending credit based on the collateral's value without regard to repayment ability* - by engaging in a pattern or practice of failing to verify and document repayment ability. Proposed amended Section 226.34(a)(4) would retain this presumption, but it would be placed, along with other proposed new presumptions, in proposed subsections 34(a)(4)(i)(A)-(E). Subsection 34(a)(4)(i)(A) would incorporate by reference the repayment ability verification requirements stated in proposed Section 226.35(b)(2)(i), pursuant to which a lender would be required to verify amounts the lender relies on by the consumer's Internal Revenue Service Form W-2, tax returns, payroll receipts, financial institution records, or other third-party documents that provide reasonably reliable evidence of the consumer's income and assets. These proposed new, rebuttable presumptions in subsections 34(a)(4)(i)(A)-(E) also are incorporated by reference in proposed Section 226.35(b)(1). In addition to the above presumption of a violation described in proposed Section 226.35(b)(2)(i) and incorporated by reference in proposed subsection 34(a)(4)(i)(A), there would be presumptions of a violation for engaging in a pattern or practice of failing to consider: consumers' ability to pay the loan based on the interest rate specified in proposed subsection 34(a)(4)(i)(B); consumers' ability to make fully amortizing loan payments that include expected property taxes

and homeowners insurance as specified in proposed subsection 34(a)(4)(i)(C); the ratio of borrowers' total debt obligations to income as of consummation as specified in proposed subsection 34(a)(4)(i)(D); and borrowers' residual income as specified in proposed subsection 34(a)(4)(i)(E). These presumptions are not exhaustive. That is, a creditor may violate Section 226.34(a)(4) or Section 226.35(b)(1) by patterns or practices other than those specified in subsections 34(a)(4)(i)(A)-(E). The proposed presumptions in subsections 34(a)(4)(i)(B)-(E) are discussed below:

(1) Section 226.34(a)(4)(i)(B): Fully-indexed or highest interest rate - On a variable rate loan, proposed Section 226.34(a)(4)(i)(B) would provide that a pattern or practice of failing to consider a borrower's repayment ability at the fully-indexed rate creates a presumption of a violation of Section 226.34(a)(4) or Section 226.35(b)(1), as applicable. Proposed Section 226.34(a)(4)(i)(B) also addresses the case of a step-rate loan, a loan in which specific interest rate changes are agreed to in advance. Proposed Section 226.34(a)(4)(i)(B) would provide that, for a step-rate loan, a failure to consider the borrower's repayment ability at the highest interest rate possible within the first seven years of the loan's term creates a presumption of a violation.

(2) Section 226.34(a)(4)(i)(C): Fully amortizing payment/ Property taxes and insurance– Proposed Section 226.34(a)(4)(i)(C) creates a presumption of a violation of Section 226.34(a)(4) or Section 226.35(b)(1) for a pattern or practice of failing to consider the borrower's repayment ability based on a fully amortizing payment that includes expected property taxes, homeowners insurance, and other specified housing expenses. For example, this would prohibit creditors from determining a borrower's ability to repay a nontraditional loan that offered an option to defer principal or interest for several years on the basis of a payment that was non-amortizing (interest only) or negatively amortizing (less than interest), or on a variable rate loan with payment caps that creates negative amortization. Proposed Section 226.34(a)(4)(i)(C) would require lenders to consider the fully amortizing payment. The fully amortizing payment would be based on the term of the loan. For example, the amortizing payment for a 2-28 ARM would be calculated based on a 30-year amortization schedule.

(3) Sections 226.34(a)(4)(i)(D) and 226.34(a)(4)(i)(E): Borrower debt-to-income ratio and residual income - The proposed presumptions of a violation for failure to consider the debt-to-income ratio (Section 226.34(a)(4)(i)(D)) does not propose a specific debt-to-income ratio that would create a presumption of a violation; nor does it propose a specific ratio that would be a safe harbor. Similarly, Section 226.34(a)(4)(i)(E) does not require a specific level of residual income. These are but two of many factors that determine repayment ability. For example, depending on the circumstances, the repayment risk implied by a high debt-to-income ratio could be offset by other factors that reduce the risk, such as a high credit score and a substantial down payment.

Proposed Section 226.34(a)(4)(ii) provides a safe harbor for verifying and documenting repayment ability. Proposed Section 226.34(a)(4)(ii) provides that a creditor does not violate Section 226.34(a)(4) if the creditor has a reasonable basis to believe that consumers will be able to make loan payments for at least seven years, considering the factors identified in subsections 226.34(a)(4)(i)(A)-(E) and any other factors relevant to determining repayment ability. Proposed Section 226.34(a)(4)(ii), however, is not intended to preclude creditors from offering loans with substantial payment increases before seven years. If such loans fell outside of the safe harbor, they could nonetheless be justified in appropriate circumstances; for example, a consumer with a

documented intent to sell the home within three years may reasonably choose a loan with a substantial payment increase in the third year. In addition, proposed Section 226.34(a)(4)(iii) provides that Section 226.34(a)(4) does not apply to loans with terms of twelve months or less.

F. Verification of Income/Assets - Section 226.35(b)(2):

Proposed Section 226.35(b)(2) would prohibit creditors in a higher-priced mortgage loan transaction from relying on amounts of assets or income, including expected income, in extending credit unless the creditor verifies such amounts. Creditors who fail to verify income or assets before extending credit are given a safe harbor if they can show that the amounts of the consumer's income or assets relied on were not materially greater than what the creditor could have documented at consummation. Proposed Section 226.35(b)(2)(i) require creditors to verify the income and assets they rely on with third-party documents that provide reasonably reliable evidence such as W-2 forms, tax returns, payroll receipts, or financial institution records.

Five elements of Proposed Section 226.35(b)(2) are intended to reduce the costs that income verification may entail:

(1) Proposed Section 226.35(b)(2) requires that only the income or assets the creditor relies upon in approving the extension of credit be verified. For example, if a creditor does not rely on a part of the consumer's income, such as an annual bonus, in approving the extension of credit, the creditor would not need to verify the consumer's bonus. Creditors would, however, still be prohibited from engaging in a pattern or practice of extending higher-priced mortgage loans to consumers based on the collateral without regard to repayment ability. Consequently, creditors would not be able to evade the proposed income verification rule by consistently declining to consider income or assets.

(2) Proposed Section 226.35(b)(2) specifically authorizes a creditor to rely on W-2 forms, tax returns, payroll receipts, and financial institution records.

(3) Creditors may use any other third-party documents that provide reasonably reliable evidence of the borrower's income and assets. Examples of other third-party documents that provide reasonably reliable evidence of the borrower's income include check-cashing receipts or a written statement from the consumer's employer. These are examples, and a creditor may rely on third-party documents of any kind so long as they are reasonably reliable. The one kind of document that is categorically excluded is a statement only from the consumer.

(4) Proposed Section 226.35(b)(2) is not intended to limit creditors' ability to adjust their underwriting standards for consumers who for legitimate reasons have difficulty documenting income, such as self-employed borrowers, or employed borrowers with irregular income.

(5) Creditors who have extended credit to a consumer and wish to extend new credit to the same consumer need not re-collect documents that the creditor previously collected from the consumer if the documents would not have changed since they were initially verified. For example, if the creditor has collected the consumer's 2006 tax return for a loan in May 2007, and the creditor makes another loan to that consumer in August 2007, the creditor may rely on the 2006 tax return.

Proposed Section 226.35(b)(2)(ii) would contain a safe harbor for creditors who fail to verify income before extending credit if the amounts of income or assets relied on were not materially greater than the creditor could have verified when the extension of credit was consummated. The safe harbor would cover cases where the creditor's failure to verify income would not have altered the decision to extend credit to the consumer or the terms of the credit.

Proposed Section 226.35(b)(2) requires creditors to verify, for each higher-priced mortgage loan they originate, the income and assets relied on, without consideration of the extent to which the risks of inflating income or assets may vary from case to case.

Proposed Section 226.35(b)(2) covers both first-lien and subordinate-lien loans.

G. Prepayment Penalties – Sections 226.32(d)(7) and 226.35(b)(3):

Proposed Section 226.35(b)(3) applies the following HOEPA-covered loan prepayment penalty restrictions contained in proposed amended Section 226.32(d)(7) to higher-priced mortgage loans. A higher-priced mortgage loan may not provide for a prepayment penalty unless: (i) the borrower's debt-to-income (DTI) ratio at consummation does not exceed 50 percent (and debt and income are verified); (ii) prepayment is not made using funds from a refinancing by the same creditor or its affiliate; (iii) the penalty term does not exceed five years from loan consummation; (iv) notwithstanding the five-year period in (iii) above, the period during which a creditor may impose a prepayment penalty must expire at least sixty days before the first date, if any, on which the periodic payment amount may increase under the terms of the loan; and, (v) the penalty is not prohibited under other applicable law.

As for the DTI requirement in (i) above, proposed staff comments give examples of funds and obligations that creditors commonly classify as debt or income. Further, the proposed staff comments specify that creditors may, but need not, look to widely accepted governmental and non-governmental underwriting standards to determine how to classify particular funds or obligations as debt or income. The Board does not propose to require creditors to use any particular standard for calculating debt or income. A creditor would not violate the prepayment penalty rule if its particular calculation method deviated from those in widely used underwriting handbooks or manuals, so long as the creditor's method was reasonable.

The 60-day prepayment penalty expiration in (iv) above would depend on when the periodic payment may increase under the loan agreement, and not on when the periodic payment actually does increase. Periodic payments may increase for a variety of reasons, including (i) a scheduled shift from a discounted interest rate to a fully indexed rate, (ii) a change in index value on a non-discounted ARM, (iii) mandatory amortization of principal when deferred principal or interest exceeds a certain threshold, or (iv) if a payment-option ARM allows minimum monthly payments for a specific period and the first adjustment to the monthly payment is scheduled after that period. Furthermore, if periodic payments may change before the first scheduled payment adjustment, a prepayment penalty term would have to end at least sixty days before the first date on which such an unscheduled payment change could occur. For instance, the first adjustment on a loan may be scheduled for three years after loan origination, but the creditor may have the right to make an unscheduled payment change if negative amortization causes the loan's principal amount to exceed a certain threshold. In this case, a prepayment penalty could not be charged

fewer than sixty days before the first date on which negative amortization possibly could lead to an increase in the borrower's monthly payments. The mandatory expiration of the prepayment penalty would apply only when required payments may increase, not when consumers may opt to pay more than their agreement requires. Moreover, it would not apply to a payment increase due to a borrower's late payment, default, or delinquency.

Under footnote 48 to current Section 226.23(a)(3), a HOEPA loan having a prepayment penalty that does not conform to the requirements of Section 226.32(d)(7) is subject to the three-year right of the consumer to rescind (however, the right of rescission in Section 226.23 does not extend to home purchase loans, construction loans, or certain refinancing loans with the same creditor). Proposed Section 226.35(b)(3) would apply the restrictions on prepayment penalties in Section 226.32(d)(6) and (7) to higher-priced mortgage loans. Accordingly, the Board is proposing to revise footnote 48 to clarify that a higher-priced mortgage loan (whether or not it is a HOEPA loan) having a prepayment penalty that does not conform to the requirements of Section 226.32(d)(7), as incorporated in Section 226.35(b)(3), is also subject to the three-year right of rescission in Section 226.23.

H. Escrow Requirement - Section 226.35(b)(4):

Proposed Section 226.35(b)(4) would prohibit a creditor from making higher-priced mortgage loans secured by a first lien without establishing an escrow account for property taxes and homeowners insurance. Under proposed Section 226.35(b)(4), creditors may allow a borrower to "opt out" of the escrow, but no earlier than twelve months after consummation. Proposed Section 226.35(b)(4) defines "escrow account" by reference to the definition of "escrow account" in Regulation X (see §3500.17).

The Board recognizes that some state laws limit creditors' ability to require escrows. In addition, certain state laws permit consumers to cancel an escrow sooner than twelve months after closing. The Board's proposal would not be consistent with such laws and, if adopted, would preempt them to the extent of the inconsistency.

I. Evasion of Rule - Section 226.35(b)(5):

Proposed Section 226.35(b)(5) would prohibit a creditor from structuring a closed-end mortgage loan as an open-end line of credit for the purpose of evading the restrictions on higher-priced mortgage loans (which do not apply to open-end lines of credit).

3. <u>Primary Dwelling Mortgage Loans — Proposed Section 226.36</u>

A. Overview:

In connection with all closed-end loans secured by a consumer's principal dwelling, the Board is proposing to: (1) prohibit creditors from paying a mortgage broker more than the consumer had agreed in advance that the broker would receive; (2) prohibit any creditor or mortgage broker from coercing, influencing, or otherwise encouraging an appraiser to provide a misstated appraisal in connection with a mortgage loan; and (3) prohibit mortgage servicers from "pyramiding" late fees, failing to credit payments as of the date of receipt, failing to provide loan

payoff statements upon request within a reasonable time, or failing to deliver a fee schedule to a consumer upon request. Proposed Section 226.36 would apply to the prime market as well as the subprime market; however, it does not apply to HELOCs.

B. Mortgage Broker Payments - Sections 226.36(a) and (c):

Proposed Section 226.36(a) would prohibit a creditor from paying a mortgage broker in connection with a mortgage loan secured by a consumer's principal dwelling unless the payment does not exceed an amount the broker has, by written agreement, agreed in advance with the consumer will be the broker's total compensation. Proposed Section 226.36(a) requires the agreement to disclose the broker compensation as a flat dollar amount and prohibits disclosing it as a range of fees or as a percentage figure. The agreement must also disclose that the consumer will pay the entire compensation even if all or part is paid directly by the creditor, and that a creditor's payment to a broker can influence the broker to offer the consumer loan terms or products that are not in the consumer's interest or are not the most favorable the consumer could obtain. The broker and consumer must enter into the agreement before the consumer pays a fee to any person or submits a written application to the broker, whichever occurs earlier. Proposed Section 226.36(a) would restrict only amounts the broker retains, not amounts the broker pays to other settlement service providers.

A creditor could demonstrate compliance with proposed Section 226.36(a) by obtaining a copy of the broker’s agreement with the consumer and ensuring the creditor’s payment to the broker does not exceed the amount stated in the agreement. Proposed Section 226.36(a) would also provide a creditor two alternative means to comply: (i) where the creditor complies with a state law that provides consumers equivalent protection, or (ii) where a creditor can demonstrate that its payments to a mortgage broker are not determined by reference to the loan's interest rate (*i.e.*, not an above par loan or if above par, no yield spread premium). Proposed Section 226.36(a) is limited to creditor payments to brokers. It does not restrict creditor payments to their own employees.

Proposed Section 226.36(c) defines a broker as a person, other than a creditor's employee, who for monetary gain arranges, negotiates, or otherwise obtains an extension of credit for a consumer. A person who met this definition would be considered a mortgage broker even if the credit obligation were initially payable to the person, unless the person funded the transaction from its own resources, from deposits, or from a bona fide warehouse line of credit.

C. Compliance Alternatives - Section 226.36(a)(2):

Proposed Section 226.36(a)(2) would provide creditors two alternative ways to comply, one where the creditor complies with a state law that provides consumers equivalent protection, a second where a creditor can demonstrate that its payments to a mortgage broker are not determined by reference to the transaction's interest rate:

(1) The first safe harbor is for a creditor payment to a broker for a transaction in connection with a state statute or regulation that (a) expressly prohibits the broker from being compensated in a manner that would influence a broker to offer loan products or terms not in the consumer's interest or not the most favorable the consumer could obtain; and (b) requires that a

mortgage broker provide consumers with a written agreement that includes a description of the mortgage broker's role in the transaction and the broker's relationship to the consumer, as defined by such statute or regulation. An example would be a state statute or regulation that imposed a fiduciary obligation on a mortgage broker not to puts its own interests ahead of the consumer's and required the broker to disclose this obligation in an agreement with the consumer.

(2) The second alternative is for a creditor that can demonstrate that the compensation it pays to a mortgage broker in connection with a transaction is not determined, in whole or in part, by reference to the transaction's interest rate. For instance, if a creditor can show that it pays brokers the same flat fee for all transactions regardless of the interest rate, the creditor would not be subject to the restriction on payments to brokers under Section 226.36(a)(1).

D. Appraiser Coercion – Section 226.36(b):

Proposed Section 226.36(b) would prohibit creditors and mortgage brokers and their affiliates from coercing an appraiser to misrepresent a dwelling's value for all closed-end mortgage loans secured by a consumer's principal dwelling. It defines the term “appraiser” as a person who engages in the business of providing, or offering to provide, assessments of the value of dwellings. Further, it prohibits a creditor from extending credit if the creditor knew or had reason to know, at or before loan consummation, that an appraiser had been coerced to misstate a dwelling's value, unless the creditor acted with reasonable diligence to determine that the appraisal was accurate. It gives the following examples of acts that would violate proposed Section 226.36(b): (i) implying to an appraiser that retention of the appraiser depends on the amount at which the appraiser values a consumer's principal dwelling; (ii) failing to compensate an appraiser or to retain the appraiser in the future because the appraiser does not value a consumer's principal dwelling at or above a certain amount; and, (iii) conditioning an appraiser's compensation on loan consummation.

E. Servicing Abuses – Section 226.36(d):

Proposed Section 226.36(d) would prohibit servicers of closed-end mortgage loans secured by a consumer's principal dwelling from: (1) failing to credit a consumer's periodic payment as of the date received; (2) imposing a late fee or delinquency charge where the late fee or delinquency charge is due to a consumer's failure to include in a current payment a delinquency charge imposed on earlier payments; (3) failing to provide a current schedule of servicing fees and charges within a reasonable time of request, including the dollar amount and an explanation of each fee and the circumstances under which it will be imposed; or (4) failing to provide an accurate payoff statement within a reasonable time of request. Under proposed Section 226.36(d)(3), the term “servicer” and “servicing” are given the same meanings as provided in Regulation X (see §3500.2).

(1) Proposed Section 226.36(d)(1)(i) would require a servicer 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 a finance or other charge or in the reporting of negative information to a consumer reporting agency, or except as provided in Section 226.36(d)(2). The proposal would not require that a servicer physically enter the payment on the date received, but would require only that it be credited as of the date received. Thus, a servicer that receives a payment on or before its due date

and does not enter the payment on its books until after the due date does not violate the requirement as long as the entry does not result in the imposition of a late charge, interest, or other charge to the consumer. Proposed Section 226.36(d)(2) would require a servicer that specifies payment requirements in writing (*i.e.*, reasonable requirements for making payments, such as setting a cut-off hour for payment to be received), but that accepts a non-conforming payment, to credit the non-conforming payment within five days of receipt.

(2) Proposed Section 226.36(d)(1)(ii) would prohibit servicers from imposing any late fee or delinquency charge on the consumer 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 an applicable grace period.

(3) Proposed Section 226.36(d)(1)(iii) would require a servicer to provide to a consumer upon request a schedule of all specific fees and charges that may be imposed in connection with the servicing of the consumer's account, including a dollar amount and an explanation of each and the circumstances under which it may be imposed. It would require the servicer to provide, upon request, a fee schedule that is specific both as to the amount and reason for each charge, to prevent servicers from disguising fees by lumping them together or giving them generic names. A dollar amount may be expressed as a flat fee or, if a flat fee is not feasible, as an hourly rate or percentage. “Fees imposed” by the servicer include third party fees or charges passed on by the servicer to the consumer. A servicer who receives a request for the schedule of fees may either mail the schedule to the consumer or direct the consumer to a specific Web site where the schedule is located. Any such Web site address reference must be specific enough to inform the consumer where the schedule is located, rather than solely referring to the servicer's home page.

(4) Proposed Section 226.36(d)(1)(iv) would prohibit a servicer from failing 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 full amount required to pay the obligation in full as of a specified date. Under normal market conditions, three business days would be a reasonable time to provide the payoff statement. The servicer would be required to respond to the request of a person acting on behalf of the consumer; this is to ensure that the creditor with whom the consumer is refinancing receives the payoff statement in a timely manner.

4. Advertising

A. Overview:

The Board proposes to require that advertisements for both open-end and closed-end credit provide accurate and balanced information, in a clear and conspicuous manner, about rates, monthly payments, and other loan features. The Board proposes to amend the advertising rules for open-end home equity plans under Section 226.16, and for closed-end mortgage loans under Section 226.24 to address advertisements for home secured loans. For open-end home equity plan advertisements, the most significant changes relate to the clear and conspicuous standard and the advertisement of introductory terms. For advertisements for closed-end credit secured by a dwelling, the most significant changes relate to strengthening the clear and conspicuous standard

for advertising disclosures, regulating the disclosure of rates and payments in advertisements to ensure that low introductory or “teaser” rates or payments are not given undue emphasis, and prohibiting certain acts or practices in advertisements.

B. Advertising Rules for HELOC Plans—Proposed Amendments to Section 226.16:

First, the Board is proposing to revise the clear and conspicuous standard for home-equity plan advertisements, consistent with the approach taken in the advertising rules for consumer leases under Regulation M (see 12 CFR 213.7(b)). Second, the Board is proposing to amend the regulation and commentary to ensure that advertisements adequately disclose not only introductory plan terms, but also the rates and payments that will apply over the term of the loan. Third, the Board is proposing changes to implement TILA Section 147(b), amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which requires certain disclosures of the tax implications of those home equity plans that exceed the fair market value of the home in advertisements that are disseminated in paper form or through the Internet.

Section 226.16(d) governs advertisements of open-end home equity plans secured by the consumer's principal dwelling. Section 226.16(d)(2) provides that if an advertisement for a variable rate home equity plan states an initial annual percentage rate that is not based on the index and margin used to make later rate adjustments, the advertisement must also state the period of time the initial rate will be in effect, and a reasonably current annual percentage rate that would have been in effect using the index and margin. The Board proposes to revise Section 226.16(d)(2) to require that these triggered disclosures in Section 226.16(d)(2) be stated with equal prominence and in close proximity to the statement of the initial APR. The time period during which an index and margin would be considered *reasonably current* depends on the medium in which the advertisement is distributed: (1) Direct Mail - if in effect within 60 days before mailing; (3) Electronic form - if in effect within 30 days before it was sent to a consumer's e-mail address; (4) Internet Web site: when viewed by the public; and (5) Printed advertisements available to the general public: if in effect within 30 days before printing.

Section 226.16(d)(3) provides that if an advertisement for a home-equity plan contains a statement about any minimum periodic payment, the advertisement must also state, if applicable, that a balloon payment may result. The Board proposes to revise Section 226.16(d)(3): (1) to clarify that only statements about the amount of any minimum periodic payment trigger this required balloon payment disclosure, and to require that the disclosure of a balloon payment be equally prominent and in close proximity to the statement of a minimum periodic payment; (2) to clarify that the disclosure is triggered when an advertisement contains a statement of any minimum periodic payment and a balloon payment may result if only minimum periodic payments are made, even if a balloon payment is uncertain or unlikely; (3) to clarify that a balloon payment results if paying the minimum periodic payments would not fully amortize the outstanding balance by a specified date or time, and the consumer must repay the entire outstanding balance at such time; and, (4) if a balloon payment will occur when only the minimum payments are made, an advertisement which contains any statement of any minimum periodic payment also state with equal prominence and in close proximity to the minimum periodic payment statement: (i) that a balloon payment will result; and (ii) the amount and timing of the balloon payment that will result if the consumer makes only the minimum payments for the maximum period of time that the consumer is permitted to make such payments.

Section 226.16(d)(4) would require that for advertisements disseminated in paper form or through the Internet for a home-equity plan that may, by its terms, exceed the fair market value of the home, such advertisements must include clear and conspicuous statements that (i) the interest on the portion of the credit extension that is greater than the fair market value of the principal dwelling is not tax deductible for Federal income tax purposes and (ii) the consumer should consult a tax adviser for information on interest deductibility.

Proposed Section 226.16(d)(6) address the advertisement of introductory rates and payments in advertisements for home-equity plans.

(1) Proposed Section 226.16(d)(6)(i) defines the terms "introductory rate," "introductory payment," and "introductory period." In a variable-rate plan, the term "introductory rate" means any annual percentage rate applicable to a home-equity plan that is not based on the index and margin that will be used to make rate adjustments under the plan, if that rate is less than a reasonably current annual percentage rate that would be in effect based on the index and margin that will be used to make rate adjustments under the plan. The term "introductory payment" means, in the case of a variable-rate plan, the amount of any payment applicable to a home-equity plan for an introductory period that is not derived from the index and margin that will be used to determine the amount of any other payments under the plan and, given an assumed balance, is less than any other payment that will be in effect under the plan based on a reasonably current application of the index and margin that will be used to determine the amount of such payments. For a non-variable-rate plan, the term "introductory payment" means the amount of any payment applicable to a home-equity plan for an introductory period if that payment is less than the amount of any other payments that will be in effect under the plan given an assumed balance. The term "introductory period" means a period of time, less than the full term of the loan, that the introductory rate or payment may be applicable.

(2) Proposed Section 226.16(d)(6)(ii) provides that if an advertisement for a home-equity plan states an introductory rate or payment, the advertisement must use the term "introductory" or "intro" in immediate proximity to each mention of the introductory rate or payment.

(3) Proposed Section 226.16(d)(6)(iii) provides that such advertisements must disclose the following information in a clear and conspicuous manner, with equal prominence and in close proximity, with each listing of the introductory rate or payment: (i) the period of time during which the introductory rate or introductory payment will apply; (ii) in the case of an introductory rate, any annual percentage rate that will apply under the plan; and, (iii) in the case of an introductory payment, the amount and time periods of any payments that will apply under the plan. In variable-rate transactions, payments that will be determined based on application of an index and margin to an assumed balance shall be disclosed based on a reasonably current index and margin. Although introductory rates are addressed, in part, by Section 226.16(d)(2), which deals with the advertisement of discounted and premium rates, proposed Section 226.16(d)(6) is broader because it is not limited to initial rates, but applies to any advertised rate that applies for a limited period of time.

(4) Proposed Section 226.16(d)(6)(iv) provides that the requirements of Section 226.16(d)(6)(iii) do not apply to envelopes, or to banner advertisements and pop-up advertisements that are linked to an electronic application or solicitation provided electronically.

Proposed Section 226.16(f), which addresses alternative disclosures for television and radio advertisements, allows for alternative disclosures of the information required for home-equity plans under Section 226.16(d)(1) by stating the information required by Section 226.16(d)(1)(ii) and listing a toll-free telephone number along with a reference that such number may be used by consumers to obtain additional cost information. *I.e.*, if a triggering term is stated in the advertisement, one option would be to state each of the disclosures required by current Section 226.16(d)(1) at a speed and volume sufficient for a consumer to hear and comprehend them. Another option would be for the advertisement to state orally the APR applicable to the home-equity plan, and the fact that the rate may be increased after consummation, and provide a toll-free telephone number that the consumer may call to receive more information.

C. Advertising Rules for Closed-end Credit—Proposed Amendments to Section 226.24:

The Board is proposing to amend the closed-end credit advertising rules in Section 226.24 for home secured loans. The most significant changes relate to strengthening the clear and conspicuous standard for advertising disclosures, regulating the disclosure of rates and payments in advertisements to ensure that low introductory or "teaser" rates or payments are not given undue emphasis, and prohibiting certain acts or practices in advertisements.

For closed-end mortgage loans, the Board is proposing to prohibit the following seven deceptive or misleading practices in advertisements: (1) advertising "fixed" rates or payments for loans whose rates or payments can vary without adequately disclosing that the interest rate or payment amounts are "fixed" only for a limited period of time, rather than for the full term of the loan; (2) comparing an actual or hypothetical consumer's current rate or payment obligations and the rates or payments that would apply if the consumer obtains the advertised product unless the advertisement states the rates or payments that will apply over the full term of the loan; (3) advertisements that characterize the products offered as "government loan programs," "government-supported loans," or otherwise endorsed or sponsored by a federal, state, or local government entity even though the advertised products are not government supported or sponsored loans; (4) advertisements, such as solicitation letters, that display the name of the consumer's current mortgage lender, unless the advertisement also prominently discloses that the advertisement is from a mortgage lender not affiliated with the consumer's current lender; (5) advertising claims of debt elimination if the product advertised would merely replace one debt obligation with another; (6) advertisements that create a false impression that the mortgage broker or lender has a fiduciary relationship with the consumer; and (7) foreign language advertisements in which certain information, such as a low introductory "teaser" rate, is provided in a foreign language, while required disclosures are provided only in English.

Proposed Section 226.24(b) would add a clear and conspicuous standard that would apply to all closed-end advertising. It would supplement, rather than replace, the clear and conspicuous standard that applies to all closed-end credit disclosures under Section 226.17(a)(1).

The Board proposes to revise existing Section 226.24(b) and renumber it as Section 226.24(c). The proposed revision would provide, in pertinent part, that advertisements for home secured loans shall not state any rate other than an APR, except that a simple annual rate that is applied to an unpaid balance may be stated in conjunction with, but not more conspicuously than, the APR. Advertisement of a periodic rate, other than the simple annual rate, or any other rates

would no longer be permitted in connection with home secured loans. For non-home secured loans, the existing text of former Section 226.24(b) [now (c)] would remain the same.

The Board proposes to revise existing Section 226.24(c) and renumber it as new Section 226.24(d). The proposed revision would clarify the meaning of the "terms of repayment" required to be disclosed. Specifically, the terms of repayment must reflect "the repayment obligations over the full term of the loan, including any balloon payment," not just the repayment terms that will apply for a limited period of time.

The Board proposes to renumber existing Section 226.24(d) as new Section 226.24(e) and make technical changes to reflect the renumbering of certain sections of the regulation and commentary.

Proposed Section 226.24(f) addresses the disclosure of rates and payments in advertisements for home secured loans. The primary purpose is to ensure that advertisements do not place undue emphasis on low introductory "teaser" rates or payments, but adequately disclose the rates and payments that will apply over the term of the loan. The specific provisions of proposed Section 226.24(f) are discussed below.

(1) Proposed Section 226.24(f)(1) provides that Section 226.24(f) applies to any advertisement for home secured loans, other than television or radio advertisements, including promotional materials accompanying applications.

(2) Proposed Section 226.24(f)(2) addresses the disclosure of rates. If an advertisement for a home secured loan states a simple annual rate of interest and more than one simple annual rate of interest will apply over the term of the loan, the advertisement must disclose the following information in a clear and conspicuous manner: (a) each simple annual rate of interest that will apply; (b) in variable-rate transactions, a rate determined by an index and margin must be disclosed based on a reasonably current index and margin; (c) the period of time during which each simple annual rate of interest will apply; (d) the annual percentage rate for the loan; and, (e) if the rate is variable, the annual percentage rate must comply with the accuracy standards in Sections 226.17(c) and 226.22. Proposed Section 226.24(f)(2) also establishes a clear and conspicuous standard for the disclosure of rates in advertisements for home secured loans. The information required to be disclosed by Section 226.24(f)(2) must be disclosed with equal prominence and in close proximity to any advertised rate that triggered the required disclosures, except that the annual percentage rate may be disclosed with greater prominence than the other information.

(3) Proposed Section 226.24(f)(3) addresses the disclosure of payments. Under proposed Section 226.24(f)(3), if an advertisement for a home secured loan states the amount of any payment, the advertisement must disclose the following information in a clear and conspicuous manner: (a) the amount of each payment that will apply over the term of the loan, including any balloon payment; (b) in variable-rate transactions, payments that will be determined based on application of an index and margin must be disclosed based on a reasonably current index and margin; (c) the period of time during which each payment will apply; and (d) in an advertisement for a home loan secured by a first lien, 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. These requirements are in addition to the disclosure requirements of current Section 226.24(c) [now Section 226.24(d)].

(4) Proposed Section 226.24(f)(3) establishes a clear and conspicuous standard for the disclosure of payments in advertisements for home secured loans. The information required to be disclosed under proposed Section 226.24(f)(3) regarding the amounts and time periods of payments must be disclosed with equal prominence and in close proximity to any advertised payment that triggered the required disclosures. The information required to be disclosed under proposed Section 226.24(f)(3) regarding the fact that taxes and insurance premiums are not included in the payment must be prominently disclosed and in close proximity to the advertised payments.

(5) Under proposed Section 226.24(f)(3), the time period during which an index and margin would be considered *reasonably current* depends on the medium in which the advertisement is distributed: (1) Direct Mail - if in effect within 60 days before mailing; (3) Electronic form - if in effect within 30 days before it was sent to a consumer's e-mail address; (4) Internet Web site: when viewed by the public; and (5) Printed advertisements available to the general public: if in effect within 30 days before printing.

(6) Proposed Section 226.24(f)(4) provides that the requirements of proposed Sections 226.24(f)(2) and (3) do not apply to envelopes, or to banner advertisements and pop-up advertisements that are linked to an electronic application or solicitation provided electronically.

Proposed Section 226.24(g) allows alternative disclosures to be provided in oral television and radio advertisements. One option would be to state each of the disclosures required by proposed amended Section 226.24(d)(2) [*i.e.*, (i) the downpayment amount/percentage; (ii) repayment terms over the full loan term, including any balloon payment; (iii) the APR and, if applicable, the fact it may increase] at a speed and volume sufficient for a consumer to hear and comprehend them if a triggering term is stated in the advertisement. Another option would be for the advertisement to state orally the APR applicable to the loan, and the fact that the rate may be increased after consummation, if applicable, at a speed and volume sufficient for a consumer to hear and comprehend them, and listing a toll-free telephone number that the consumer may call to receive more information.

Proposed Section 226.24(h) requires that an advertisement distributed in paper form or through the Internet for a loan secured by the consumer's principal dwelling which may, by its terms, exceed the fair market value of the dwelling, shall clearly and conspicuously state that: (1) the interest on the portion of the loan 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 of interest and charges.

Proposed Section 226.24(i) would prohibit the following seven acts or practices connected with advertisements of home secured loans.

(1) Proposed Section 226.24(i)(1) would prohibit the use of the term “fixed” in advertisements for home secured loans, unless certain conditions are satisfied. It would prohibit

the use of the term "fixed" in advertisements for variable-rate transactions, unless: (i) the phrase "Adjustable-Rate Mortgage" or "Variable-Rate Mortgage" appears in the advertisement before the first use of the word "fixed" and is at least as conspicuous as every use of the word "fixed"; (ii) each use of the word "fixed" 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. It would also prohibit the use of the term "fixed" to refer to the advertised payment in advertisements solely for loans other than variable-rate loans where the advertised payment may increase (*i.e.*, fixed-rate mortgage loan with an initial lower payment that will increase), unless each use of the word "fixed" referring to the advertised 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 may increase after that period. Finally, the proposal would prohibit the use of the term "fixed" in advertisements for both variable-rate loans and non-variable-rate loans, unless: (i) the phrase "Adjustable-Rate Mortgage," "Variable-Rate Mortgage," or "ARM" appears in the advertisement with equal prominence as any use of the word "fixed"; (ii) each use of the term "fixed" referring to a rate, payment, or to the loan, clearly refers solely to loans for which rates are fixed and, if used to refer to an advertised payment, is accompanied by an equally prominent and closely proximate statement of the time period for which the advertised payment is fixed and the fact that the payment will increase after that period; (iii) if the term "fixed" refers to the variable-rate loans, it is accompanied by an equally prominent and closely proximate statement of a 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) Proposed Section 226.24(i)(2) would prohibit any advertisement for home secured loans from making any comparison between an actual or hypothetical consumer's current payments or rates and the payment or simple annual rate that will be available under the advertised product for less than the term of the loan, unless: (i) the comparison includes with equal prominence and in close proximity to the "teaser" payment or rate, all applicable payments or rates for the advertised product that will apply over the term of the loan and the period of time for which each applicable payment or simple annual rate will apply; (ii) the advertisement includes a prominent statement in close proximity to the advertised payments that such payments do not include amounts for taxes and insurance premiums, if applicable. In the case of advertisements for variable-rate loans where 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 comparison must include: (i) an equally prominent statement in close proximity to the advertised payment or rate that the payment or rate is subject to adjustment and the time period when the first adjustment will occur; and (ii) a prominent statement in close proximity to the advertised payment that the payment does not include amounts for taxes and insurance premiums, if applicable.

(3) Proposed Section 226.24(i)(3) would prohibit statements in advertisements that a loan is a "government loan program," "government-supported loan," or otherwise endorsed or sponsored by a 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) Proposed Section 226.24(i)(4) would prohibit any advertisement for a home secured loan, such as a letter, that is not sent by or on behalf of the consumer's current lender from using the name of the consumer's current lender, unless the advertisement also discloses with equal prominence the name of the person or creditor making the advertisement and 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) Proposed Section 226.24(i)(5) would prohibit advertisements for home secured loans that offer to eliminate debt or result in the waiver or forgiveness of a consumer's existing loan or obligation to another creditor.

(6) Proposed Section 226.24(i)(6) would prohibit advertisements for home secured loans from using the terms “counselor” or “financial advisor” to refer to a for-profit mortgage broker or lender, its employees, or persons working for the broker or lender that are involved in offering, originating or selling mortgages.

(7) Proposed Section 226.24(i)(7) would prohibit advertisements for home secured loans from providing information about some trigger terms or required disclosures, such as an initial rate or payment, only in a foreign language, 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. Advertisements that provide all disclosures in both English and a foreign language or advertisements that are entirely in English or entirely in a foreign language would not be affected by this prohibition.

5. Early Mortgage Loan Disclosures—Proposed Section 226.19

A. Overview:

The Board proposes to require creditors to provide transaction specific mortgage loan disclosures such as the APR and payment schedule for all home secured, closed-end loans no later than three days after application, and before the consumer pays any fee except a reasonable fee for the originator's review of the consumer's credit history.

B. Early Mortgage Loan Disclosures:

Under current Section 226.19(a), creditors need not deliver mortgage loan disclosures on non-residential mortgage transactions until consummation. Proposed amended Section 226.19(a) will extend the early mortgage loan disclosure requirement for residential mortgage transactions to other types of closed-end mortgage transactions, including mortgage refinancings, home equity loans, and reverse mortgages. Consistent with the existing requirement for residential mortgage transactions, this requirement would be limited to transactions secured by a consumer's principal dwelling. Proposed amended Section 226.19(a) will require that the early mortgage loan disclosure be delivered before the consumer pays a fee to any person for these transactions, except the fee for obtaining information on the consumer's credit history. This proposed early disclosure obligation would be limited to fees paid in connection with an application for a mortgage transaction. This limitation is necessary because a fee paid to any person, not just to the creditor, triggers the obligation.

6. Official Staff Interpretations – Supplement I

Consistent with the proposed amendments summarized above, the Board also proposes to revise, renumber and/or add to, as appropriate, the Official Staff Interpretations to Regulation Z.

CONCLUSION

Please be advised that the proposed amendments discussed in this memorandum are not final, they are proposals subject to public comment and possible changes by the Board before they become effective. If they do become effective, as proposed or as subsequently amended, the earliest possible effective date is October 1, 2008.

This Memorandum is provided for the general information of the clients and friends of our firm only and is not intended as specific legal advice. You should not place reliance on this general information alone but should consult legal counsel regarding the application of the information discussed in this Memorandum to your specific case or circumstances.