

REG Z CLOSED-END CREDIT RULE PROPOSED

The **Federal Reserve Board** (FRB) has issued a proposed rule amending *Truth in Lending* (Reg Z) as it pertains to closed-end mortgages. The proposal applies to disclosures for all closed-end credit transactions secured by real property or a dwelling, and would not be limited to credit secured by the consumer's principal dwelling except for the rules regarding rescission and reverse mortgages. The FRB anticipates reviewing these two provisions at a later date.

Some say that these changes really constitute a complete restructuring of the mortgage industry. The rule includes changes to the format, timing, and content of disclosures for the four main types of closed-end credit information governed by Reg Z as well as additional protections related to limits on loan originator compensation.

The proposed changes are based on the result of the FRB's consumer testing that was conducted as part of a comprehensive review of the rules for home-secured credit. The FRB's goal is to ensure that consumers receive the information they need, whether they are applying for a fixed-rate mortgage with level payments of 30 years, or an adjustable-rate mortgage with low initial payments that can increase sharply. The newly revised disclosures will highlight potentially risky features such as adjustable rates, prepayment penalties, and negative amortizations.

The proposal would also bar payments to a mortgage broker or loan officer based on the loan's interest rate or other terms and bar them from steering consumers to transactions that are not in their interest in order to increase the brokers or loan officer's compensation.

Summary of Changes

Disclosures at Application

Proposed changes include:

- Providing a new one-page FRB publication, entitled "*Key Questions to Ask About Your Mortgage*," which would explain the potentially risky features of a loan such as interest-only, negative amortization and prepayment penalties. This would be required for *all* closed-end loans secured by real property or a dwelling, not just variable rate loans. It must be provided before the consumer applies for a loan or pays a nonrefundable fee, whichever is earlier. It must be in plain-English question and answer format. The document would also include the ARM loan program disclosure and the final *Truth in Lending Act* (TILA) disclosures.
- Requiring creditors to provide a one-page FRB publication entitled, "*Fixed vs. Adjustable Rate Mortgages*," for all closed-end loans secured by real property or a dwelling, not just variable rate loans. This would include an explanation of the basic difference between fixed-rate mortgages and ARMs. It would replace the CHARM booklet. (The CHARM booklet would still be published to be used as an educational tool.)
- Providing a simplified ARM loan program disclosure to focus on the interest rate and payment and the potential risks associated with ARMs. Information on how to calculate payments, and the effect of rising interest rates on monthly payments would be moved to the early TILA disclosure provided *after* application. The new disclosure would be provided in a tabular question and answer format to enable consumers to easily locate the most important information.

Disclosures Within three Days After Application

TILA and Reg Z currently require creditors to provide an early TILA disclosure within three business days after application and at least seven business days before consummation, and before the consumer has paid a fee other than a fee for obtaining the consumer's credit history. The early disclosure rule that required the finance charge and the annual percentage rate (APR) to be disclosed more conspicuously than other information will no longer apply.

Calculation of Finance Charge

The proposal contains a number of revisions to the calculation of the finance charge and the disclosure of the finance charge and the APR to improve consumers' understanding of the cost of credit. The proposal will:

- Retain the definition of a "finance charge."
- Require the finance charge to include charges by third parties if the creditor requires the use of a third party as a condition of or incident to the extension of credit. (Charges that would be incurred in a comparable cash transaction, such as transfer taxes, would continue to be excluded from the finance charge.)

Disclosure of the Finance Charge and the APR

The proposal:

- Replaces the term "finance charge" with "interest and settlement charges" to make clear it is more than interest.
- Would no longer require the disclosure to be more conspicuous than the other required disclosures.
- Requires that the APR be disclosed in 16-point font in close proximity to a graph that compare the consumer's APR to the *Home Ownership Equity Protection Act* (HOEPA) average prime offer rate for borrowers with excellent credit and the HOEPA for threshold for higher priced loans. This disclosure would put the APR in context and help consumers understand if the loan being offered comports with their creditworthiness.

Interest Rate and Payment Summary

Under the proposal, creditors would be required to:

- Disclose in a tabular format the contract interest rate together with the corresponding monthly payment including escrows for taxes and property and/or mortgage insurance.
- Impose special disclosures for adjustable-rate or step-rate loans to show the interest rate and payment at consummation, the maximum interest rate and payment at first adjustment, and the highest possible maximum interest rate and payment.

Disclosure of Other Terms

Because consumers benefited from the disclosure of other key terms in a clear format during testing, the proposal would require:

- Providing information in a tabular format about the loan amount, loan term, loan type (such as fixed rate), the total settlement charges, and the maximum amount of any repayment penalty.
- Providing in tabular question and answer format the "*Key Questions about Risk.*" This would include information about the potentially risk loan features.

Disclosures Three Days Before Consummation

There are concerns about consumers facing different loan terms or increased settlement costs at closing. Therefore, the proposal would:

- Require the creditor to provide a final TILA disclosure that the consumer must receive at least three *business* days before consummation, even if no terms have changed since the early TILA disclosure was provided
- Provide two alternative approaches to address changes to loan terms and settlement charges during the three-business-day waiting period.
 - The first approach provides that if *any* of the terms change during that waiting period, the creditor would be required to provide another final TILA disclosure and wait an additional three business days before consummation could occur.
 - The second approach would require creditors to provide another final TILA disclosure but would have to wait an additional three business days before consummation *only* if the APR exceeds a designated tolerance or the creditor adds an adjustable-rate feature. Otherwise, the creditor would be permitted to provide the new final TILA disclosure at consummation.

Disclosures After Consummation

ARM Adjustment Notice

Currently, creditors are required to provide a notice of interest rate adjustment at least 25, but no more than 120, calendar days before a payment at a new level is due on variable-rate transactions. The proposal would require creditors to provide the ARM adjustment notice at least 60 days before a payment is due at a new level.

Payment Option Statement

Regulators are concerned about consumers receiving information about negatively amortizing loans which could lead to payment shock. Therefore, the proposal would require creditors to:

- Provide a periodic statement for payment option loans that have negative amortization.
- Put the information in a table with a comparison of the amount and impact on the loan balance and property equity of a fully-amortizing payment, interest-only payment, and minimum negatively-amortizing payment.
- Provide the disclosure no later than 15 days before a periodic payment is due.

Creditor-placed Property Insurance Notice

Currently, there are no requirements for creditors to provide notice before charging for creditor-placed property insurance. Industry reports indicate that the volume of creditor-placed property insurance has increased significantly. Therefore, under the proposal, creditors would be required to:

- Provide notice to consumers of the cost and coverage of creditor-placed property insurance at least 45 days before a charge is imposed for that insurance.
- Provide consumers with evidence of such insurance within 15 days of imposing a charge for the insurance.

The Proposal also includes prohibitions on payments to loan originators and steering. There are additional protections related to credit insurance or debt cancellation or debt suspension coverage eligibility.

The complete proposal can be reviewed at <http://edocket.access.gpo.gov/2009/pdf/E9-18119.pdf> and comments are due by December 24, 2009.