



Financial Services Regulatory Practice

Regulatory Practice Letter

ADVISORY

RPL Number 09-30

Proposed Amendments to Regulation Z, Truth-in-Lending: Closed-End Mortgages and Home Equity Lines of Credit

Executive Summary

The Federal Reserve Board ("Fed") approved proposed rules on July 23 to amend its Regulation Z, which implements the *Truth-in-Lending Act* ("TILA") and the accompanying staff commentary. The revisions would affect disclosures related to closed-end mortgage loans (except for rescission and reverse mortgages) and open-end home-secured loans, or home equity lines of credit ("HELOCs"). They are intended to improve the effectiveness of the disclosures provided to consumers at the time of the application and throughout the term of the loan. In addition to disclosure changes, the proposed rules would, among other things, modify the calculation of the annual percentage rate ("APR"), limit loan originator compensation, and limit the ability of a creditor to terminate a HELOC for payment-related reasons. Comments are due to the Fed within 120 days of publication in the *Federal Register*.

In a separate action on July 15, the Fed approved an interim final rule to

implement provisions of the *Credit Card Accountability, Responsibility and Disclosure Act of 2009* (the "Credit CARD Act"), which amended Regulation Z with respect to open-end consumer credit that is not home-secured. The interim final rule becomes effective August 20, 2009 but comments on the rule are requested through September 21, 2009.

Background

The Fed announced in December 2004 that it was undertaking a comprehensive review of Regulation Z. The review was to be conducted in stages, the first of which focused on open-end credit accounts that are not secured by a home, which included primarily credit cards. The Fed adopted a final rule to change the format, timing, and content requirements for the open-end credit disclosures covered by Regulation Z in December 2008 that was generally scheduled to become effective in July 2010 (please refer to RPL 09-02). Many of these provisions were subsequently incorporated into the Credit CARD Act, which was signed

Subject:

Proposed amendments to Regulation Z, Truth-in-Lending, to revise disclosures related to Closed-End Mortgage Loans and Home Equity Lines of Credit

As Issued By:

Federal Reserve Board

Date:

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into law on May 22, and are now subject to a more accelerated implementation timeframe (refer to RPL 09-21).

In 2007, the Fed began working with an outside consultant to evaluate and conduct consumer testing of its closed-end mortgage loan disclosures. The resulting proposed rules and associated proposed and sample disclosure forms released on July 23, 2009 have been heavily influenced by this consumer testing, which included consideration of:

- How consumers shop for mortgages;
- What information consumers use in making mortgage decisions;
- What perceptions consumers have of TILA disclosures;
- What information consumers look at in TILA disclosures; and
- What mortgage-related words and phrases consumers generally understand.

Description

The Fed's disclosures under the proposed rules are intended to help consumers better understand the cost of credit and the terms of the loans available to them, as well as to help consumers compare loan products.

Closed-End Mortgages

The Fed is proposing changes to the format, timing, and content of disclosures for the four main types of closed-end credit information governed by Regulation Z: (1) disclosures at application; (2) disclosures within three days after application; (3) disclosures three days before consummation; and (4) disclosures after consummation. A sampling of these changes follows.

- At application, lenders would be required to provide consumers with two new one-page publications prepared by the Fed – “*Key Questions to Ask About Your Mortgage*,” which would address potentially risky loan features such as adjustable rates, negative amortization, and prepayment penalties, and “*Fixed vs. Adjustable Rate Mortgages*,” which would explain the basic differences between the two types of loans and would replace the currently required *Consumer Handbook on Adjustable-Rate Mortgages* (or CHARM booklet),
- Within three days of application, lenders would be required to provide consumers with newly formatted TILA disclosures (the “early TILA disclosures”) that are transaction-specific and have been designed to answer the “*Key Questions to Ask About Your Mortgage*,” document. Additional changes within the disclosure documents would include:
 - A revised APR that includes most fees and settlement costs paid by the consumer;
 - A graph comparing the loan's APR to the average APR offered to borrowers with “excellent credit” and borrowers with “impaired credit” (based on the *Home Ownerships and Equity Protection Act* (“HOEPA”) average prime offer rate for borrowers with excellent credit and the HOEPA threshold for higher-priced loans); and
 - Disclosures of how payments might change, including the highest monthly amount the consumer might pay.
- At least three days before consummation, lenders would be required to provide consumers with “final” TILA disclosures even if nothing has changed since the early TILA disclosures. If any loan terms or settlement charges change during the three day waiting period, two alternatives are proposed:
 - The lender would provide a revised “final” TILA disclosures and wait another three days for consummation; or
 - The lender would provide the revised “final” TILA disclosures but would not be required to wait an additional three days for consummation unless the APR exceeded a designated tolerance or the lender added an adjustable-rate feature.
- Following consummation of the loan, lenders would be required to provide borrowers with:
 - Monthly statements for payment option loans that explain the negative amortization feature;
 - A 60-day (rather than the current 25-day) advance notice of payment changes to adjustable rate mortgages (“ARMs”); and
 - A 45-day advance notice of the cost and coverage of creditor-placed property insurance.

Additional protections regarding origination practices and broker compensation are included in the proposal. These protections would:

- Prohibit payments to a mortgage broker or loan officer based on a loan's terms or conditions (but

- permit them based on the loan's principal balance); and
- Prohibit a mortgage broker or loan officer from "steering" consumers to a lender offering less favorable terms in order to increase the broker's or loan officer's compensation.

Home Equity Lines of Credit

The Fed is proposing changes to the timing, content, and format of HELOC disclosures provided to consumers at application and throughout the term of the loan. These modifications would require:

- A new one-page disclosure form prepared by the Fed summarizing basic information and potential risks about HELOCs to be distributed to consumers at application, replacing the longer current version.
- Disclosures specifically tailored to the actual credit terms for which the consumer qualifies to be distributed within three days after receiving the consumer's application. These disclosures would provide information about costs and potential risk features in a tabular format.
- Final disclosures in the same format as those provided at application to be distributed at account opening.
- Throughout the loan term:
 - Periodic statements to disclose the total amount of interest and fees charged for 1) the statement period and 2) year to date;
 - A 45-day advance notice of any change in the HELOC terms;
 - A prohibition on terminating an account for delinquency until the payment is more than 30 days late; and

- In cases where the consumer's credit line has been suspended or reduced, creditors would be required to provide additional information about the reasons for the action and consumers' right to request reinstatement. The rules also would require lenders to investigate and respond within 30 days of receiving a consumers' request to have their HELOC reinstated.

The Fed notes that the proposed requirements for periodic statements and change in terms notices are intended to generally conform to provisions in its final rule on credit cards. (please refer to RPL 09-02)

Interim Final Rule – Regulation Z Credit Card Disclosures

In a separate but related action on July 15, the Fed approved an interim final rule to implement provisions of the Credit CARD Act that go into effect on August 20, 2009. These provisions require creditors to:

- Provide a 45-day written notice to consumers in advance of any increases to an APR on a credit card account or any significant changes to the terms of a credit card account.
- Inform consumers of their right to cancel the credit card account before the increase or change goes into effect. If a consumer cancels the card, the creditor is generally prohibited from applying the increase or change to the account.
- Mail or deliver periodic statements for credit cards and other open-end consumer credit accounts at least 21 days before payment is due.

The Fed is requesting comments on the interim final rule by September 21, 2009.

KPMG Commentary

Some observers see the Fed's recent release of the proposed rules on closed-end mortgage loans and HELOCs as an opportunity to "flex its consumer protection muscles" and show the heightened importance the Fed is giving to consumer protection. This is a time when regulatory reform and a separate Consumer Protection Financial Agency ("CPFA") are under review (please refer to RPLs 09-23 and 09-24). By including prohibitions on loan originators' compensation, as well as modifying the calculations of "finance charges" and APRs, the proposal is clearly responsive to consumer protection criticisms identified in the mortgage markets.

The proposed rules are extensive and very detailed, comprising more than 650 pages, plus a total of 32 proposed sample forms and disclosures. The impact to the financial industry and market overall from these potential changes (or even a subset of the potential changes) is dramatic in terms of operational impact – consumer disclosures, system changes, compensation plans, policy changes and training, to name but a few.

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