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NEW REGULATION Z PROPOSAL BANS YIELD SPREAD PREMIUMS, REVAMPS DISCLOSURE REQUIREMENTS

The Federal Reserve Board on July 23 proposed significant changes to Regulation Z, the Truth in Lending Act regulation, including new consumer protections for receiving home mortgages and home equity lines of credit. These changes include a prohibition of payments to a mortgage broker or loan officer that are based on the loan's interest rate or other terms (often referred to as "yield spread premiums" or "overages"), and a prohibition of a mortgage broker or loan officer "steering" consumers to transactions that are not in the consumer's best interest in order to increase the mortgage broker's or loan officer's compensation. The Board maintains that consumers rely on the professional expertise of brokers and other loan originators and expect they will act fairly. These expectations, however, are not met when the consumer is steered into a more expensive loan. As a result, the Board's proposal went beyond disclosure revisions and suggested these substantive protections. However, the proposal stopped short of imposing on the originator a fiduciary duty to the customer. Such a responsibility would require that the originator find the "best" loan to meet a consumer's requirements. The proposal only prohibits the originator from steering a customer to a more expensive or risky loan to increase the originator's own fees, but does not require the extra step of requiring the originator to seek out the best available loan product.

These proposals do not make any distinction between payments by a creditor to third parties (such as brokers), and payments by the creditor to its employees (e.g., loan officers). In addition, the proposal would prohibit the broker from receiving additional compensation from the creditor (or any other third party) if the broker is paid directly by the consumer, which could affect the consumer's ability to finance his or her payments to the broker. Finally, the Board is seeking comment on whether it should be permissible for creditors to compensate brokers or loan officers based on loan amount.

The Board's proposal includes numerous changes to the current Regulation Z disclosure requirements, including the following for closed end mortgage loans:

Disclosures at Application

Providing a new one-page Board publication which would explain the potentially risky features of a mortgage loan;

Providing a new one-page Board publication which would explain the basic differences between fixed and adjustable rate mortgage loans and would replace the Consumer Handbook on Adjustable-Rate Mortgages;

Revising the format and content of current adjustable rate mortgage loan program disclosure, including a requirement that the disclosure be in a tabular question and answer format, a streamlined plain language disclosure of interest rate and payment information, and a new disclosure of potentially risky features, such as prepayment penalties.

Disclosures within Three Business Days after Application

Revising the calculation of the finance charge and the annual percentage rate (APR) so that they better capture most fees and costs paid by consumers in connection with the credit transaction;

Providing a graph that would show consumers how their APR compares to the APRs for borrowers with excellent credit and for borrowers with impaired credit;

Requiring disclosure of potential changes to the interest rate and monthly payment;

Disclosing total settlement charges, as is currently required for the Good Faith Estimate under the Real Estate Procedures Settlement Act (RESPA) and Regulation X;

Summarizing key loan features, including the loan term, amount and type;

Adopting new format requirements, including rules regarding type size, use of bold face for certain terms, placement of information, and highlighting certain information in a tabular format.

Disclosures Three Business Days before Consummation

Requiring creditors to provide a final TILA disclosure that the consumer must receive at least three business days before consummation. In addition, the Board has asked for comments on two proposed alternatives:

1. If any terms change after the final TILA disclosure is provided, then another final TILA disclosure would need to be provided that the consumer must receive at least three business days before consummation; or
2. If the APR exceeds a certain tolerance or an adjustable rate feature is added after the final TILA disclosure is provided, then another TILA disclosure would be provided that the consumer must receive at least three business days before consummation. All other changes could be disclosed at consummation.

Disclosures after Consummation

Increasing the advance notice of a payment change for an adjustable rate mortgage loan from 25 to 60 days, and revising the form and content of interest rate adjustment notices;

For loans with negative amortization, requiring a monthly statement to provide information about payment options that include the costs and effects of negatively amortizing payments;

For creditor-placed property insurance, requiring notice of the cost and coverage of such insurance at least 45 days before imposing a charge for the insurance.

For home equity lines of credit (HELOCs), the Board's proposals include the following:

Disclosures at Application

Eliminating the requirement to provide a multiple-page disclosure of generic rates and terms of the creditor's HELOC products, as well as the requirement to provide a Board-published lengthy brochure explaining HELOC products and risks;

Requiring the creditor to provide a new one page Board publication summarizing basic information and risks regarding HELOCS.

Disclosures within Three Business Days after Application

Providing information about rates and fees, payments, and risks in a tabular format;

Highlighting whether the consumer will be responsible for a balloon payment;

Presenting payment examples based on both the current rate available and the maximum possible rate for the HELOC.

Disclosures at Account Opening

The proposal would retain the existing requirement to provide consumers with transaction-specific information about rates, terms, payments, and risks at the time of account opening. To facilitate comparison, the proposal would prescribe formatting for this information similar to that of the proposed disclosure provided within three business days after application.

Periodic Statements

Eliminating the disclosure of the effective APR;

Grouping interest charges and fees separately and requiring disclosure of separate totals of interest and fees for both the period and the year to date.

Change-in-Terms Notices

Increasing advance notice of a change in a HELOC term from 15 to 45 days in advance of the effective date of the change.

Account Terminations

Prohibiting creditors from terminating an account for payment-related reasons until the consumer has failed to make a required minimum periodic payment for more than 30 days after the due date for that payment.

Suspensions and Credit Limit Reductions

Establishing a new safe harbor for suspending or reducing a line of credit based on a "significant" decline in property value. For HELOCs with a combined loan-to-value ratio at origination of 90% or higher, a 5% decline in the property value would be "significant;"

Providing additional guidance regarding the information on which a creditor may rely to take action based on a material change in the consumer's financial circumstances, such as the type of credit report information that would be appropriate to consider.

Reinstatement of Accounts

Requiring additional information in notices of suspension or reduction about consumers' ongoing right to request reinstatement and creditors' obligation to investigate the request;

Requiring creditors to complete an investigation of a request within 30 days of receiving a request for reinstatement and to give a notice of the investigation results to consumers whose lines will not be reinstated.

The public will have 120 days after publication of these proposals in the Federal Register, which is expected shortly, to provide comments on these proposals.

The Board also announced that it will work with HUD to make the disclosures mandated by TILA and HUD's disclosures required by RESPA complementary, potentially developing a single disclosure form that creditors could use to satisfy both laws.

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