BROWN, FOWLER & ALSUP
A Professional Corporation
Attorneys at Law

J. Alton Alsup
Board Certified in Residential Real Estate Law
Texas Board of Legal Specialization

10333 Richmond, Suite 860
Houston, Texas 77042
www.LoanLawyers.com

Telephone 713/468-0400
Facsimile 713/468-5335
AlAlsup@BFAlegal.com

MEMORANDUM

TO: Clients and Friends of the Firm

FROM: J. Alton Alsup

DATE: March 5, 2009

SUBJECT: Update on Truth in Lending Act Regulations Effective October 1, 2009

The Federal Reserve Board of Governors ("FRB") adopted amendments to Regulation Z and the Official Staff Commentary by final rule published July 30, 2008 in the Federal Register (73 F.R. 44522 – 44614) that are intended to protect consumers from certain unfair, deceptive, and abusive practices of originators and servicers of home mortgage loans. The new regulations generally will apply to covered loans for which a creditor receives an application on or after October 1, 2009.

New advertising rules targeting deceptive and misleading practices apply to all consumer credit transactions secured by a dwelling. Advertisements occurring on or after October 1, 2009 that promote mortgage credit secured by a dwelling are regulated by extensive new advertising rules set out in amendments to Reg. Z, §226.16 (open-end credits) and §226.24 (closed-end credits). The new rules are intended to assure that advertisements for credit provide accurate and balanced information about rates, monthly payments, and other loan features in a clear and conspicuous manner and that several deceptive and misleading advertising practices are banned, including, for example, describing a loan as a "fixed rate" mortgage when in fact the rate by its terms can increase after closing. These new advertising regulations apply to any advertisement (including promotional materials accompanying applications) in any medium promoting a credit transaction secured by a dwelling (except radio and television advertisements to which new alternative regulations apply).

Four additional new consumer protections apply to certain high-rate, high-cost loans bearing interest rates or fees above a certain percentage or amount described in Reg. Z, 12 C.F.R. §226.32, (generally referred to as "Section 32 loans" or "HOEPA loans") and a new category of so-called "higher priced mortgage loans" (HPMLs) secured by the consumer's principal dwelling and defined in new Reg. Z, 12 C.F.R. §226.35." HPMLs are defined to mean consumer credit transactions secured by the consumer's principal dwelling that have an annual percentage rate exceeding the "average prime offer rate" for a comparable transaction as of the date the interest rate is set by 1.5, or more, percentage points for loans secured by a first lien on a principal dwelling or by 3.5, or more, percentage points for loans secured by a subordinate lien on a principal dwelling. This definition expressly excludes new home construction loans, bridge loans with a term of 12 months or less, reverse mortgage loans, and home equity lines of credit. The "average prime offer rate" for this purpose means an annual percentage rate that is derived from average interest rates, points, and other loan pricing terms currently offered to consumers by a representative sample of creditors for mortgage transactions that have low-risk pricing characteristics, which rate is compiled and published as a table by the FRB at least weekly. New consumer protections applicable to HOEPA and HPML loans include:

- *Prohibited Lending without Regard to Repayment Ability [Reg. Z 12 C.F.R. §§226.34(a)(4) and 226.35(b)(1)]*. Creditors are prohibited from extending credit for HOEPA loans or HPML loans to consumers based on the value of the consumer's collateral without regard to the consumers' ability as of the date of consummation to repay the loan from sources other than the collateral itself. Creditors are required to verify borrowers' income and assets relied upon in underwriting the loan, and are prohibited from relying on stated amounts of income, including expected income, or assets unless the creditor verifies such amounts by inspection of the consumer's Internal Revenue Service federal tax returns and Form W-2, payroll receipts, financial institution records, or other third-party documents that provide reasonably reliable evidence of the consumer's income and assets. Any creditor who verifies a consumer's repayment ability by inspecting such third-party documents is presumed to comply with these prohibitions if the creditor additionally (i) determines the consumer's repayment ability based on the largest payment of principal and interest scheduled in the first seven (7) years of the loan term and takes into account in that determination the consumer's current obligations and mortgage-related obligations; and (ii) assesses the consumer's repayment ability taking into account either or both of the consumer's debt-to-income ratio and the net income the consumer will have available after paying debt obligations.

- *Restrictions on Prepayment Penalties [Reg. Z, 12 C.F.R. §§226.32(d)(6) and 226226.35(b)(2)]*. HOEPA and HPML loans may provide for a prepayment penalty only if (i) the penalty is otherwise permitted by state or other applicable law; (ii) the source of prepayment funds is not a refinancing by the same creditor, or its affiliate; (iii) the prepayment penalty will not apply after the two-year period following loan consummation; and (iv) the amount of the periodic payment of principal or interest, or both, does not change during the four-year period following loan consummation. HOEPA loans have one additional condition not applicable to HPMLs, viz: the consumers's total monthly debt payments (including amounts owed under the mortgage loan) may not exceed 50% of the consumers' gross monthly income as of the date of loan consummation and as verified under the new procedures requiring review of federal tax returns, Form W-2s, payroll receipts, bank records, or other third-party documents that provide reasonably reliable evidence of the borrower's income.

- *Mandatory Escrow Accounts [Reg. Z, 12 C.F.R. §226.35(b)(3)]*. Before consummating a first-lien HPML loan, creditors must establish, and thereafter maintain, an escrow account to collect reserves from consumers for the payment of property taxes and premiums for mortgage-related insurance required by the creditor. The creditor or loan servicer may permit a consumer to cancel the mandatory escrow account if the consumer requests cancellation in a dated written request received by the creditor no earlier than 365 days after loan consummation. Mandatory escrow account regulations apply to covered loans for which applications are received on or after April 1, 2010, or, if such loans are secured by manufactured housing, October 1, 2010.

Other new consumer protections apply to all closed-end loans secured by the consumer's principal dwelling:

- *Prohibited Coercion of Appraisers.[Reg. Z, 12 C.F.R. §226.36(b)]* Creditors and mortgage brokers, and their affiliates, are prohibited from directly, or indirectly, coercing, influencing, or otherwise encouraging an appraiser to misstate or misrepresent the value of a consumer's principal dwelling securing a covered loan. Any creditor who knows at or before a loan closing of a violation of these anti-coercion regulations is prohibited from extending credit based upon such an appraisal unless the creditor documents that it has acted with reasonable diligence to determine that the appraisal does not materially misstate or misrepresent the value of the appraised property.

- *Prohibited Servicing Practices.[Reg. Z, 12 C.F.R. §226.36(c)]* Mortgage servicers are prohibited from (i) failing to timely credit payments as of the date of receipt, with certain exceptions; (ii) imposing a late charge on a consumer in connection with the receipt of a payment when the only delinquency is attributable to a late fee or delinquency charge assessed on an earlier payment, (and the current payment is otherwise a full payment made on or before its due date or within an applicable grace period); and (iii) failing to timely provide accurate payoff statements within a reasonable time after receiving a request for it by a consumer (or a person acting on behalf of a consumer).

- *Required Early Consumer Disclosures [Reg. Z, 12 C.F.R. §226.19(a)(1)(i)]*. Early consumer disclosures of the annual percentage rate (APR), finance charge, and other material disclosures of the cost of credit set out in §226.18 (formerly required only for residential mortgage transactions to finance the purchase or initial construction of a principal residence) must now be made by a creditor in connection with all closed-end loans secured by the consumer's principal dwelling, including home loan refinancings. These early consumer disclosures must be delivered to the consumer at the time of loan application or placed in the mail within three business days after application. No creditor or other person may impose a fee (other than a bona fide and reasonable fee to cover the cost of a credit report) on the consumer in connection with the consumer's mortgage loan application before the consumer's receipt of the early consumer disclosures (although, if mailed, the consumer is presumed to have received the disclosure statement three business days after it is mailed).

Congress also enacted the Mortgage Disclosure Improvement Act of 2008 (MDIA) on July 30, 2008, (Title V, §§2501 –2503 of the Housing & Economic Recovery Act of 2008, Public Law No. 110289, 122 Stat. 2654) that further regulates the form and timing requirements of consumer disclosures required under Reg. Z, §226.19(a) and (b).These new disclosure requirements when implemented by further FRB rulemaking will be effective July 30, 2009, and will apply to any extension of credit that is secured by the dwelling of a consumer and subject to the Real Estate Settlement Procedures Act. On December 10, 2008 the FRB published its Proposed Rule to implement the MDIA (73 FR 74989) prior to its July 30, 2009 effective date.

As amended, §226.19(a) will require such early disclosures (referred to in that section as "good faith estimates of the disclosures required under [§226.18]") comply with the following additional rules:

- ***Timeliness of Disclosures*.** Early disclosures must be delivered or placed in the mail not later than three business days after the creditor receives the consumer's written application, *which shall be at least 7 business days before consummation of the transaction*, and final disclosures must be provided at the time of consummation of the transaction. In any case in which the early disclosure statement contains an annual percentage rate of interest that is no longer accurate the creditor must furnish an additional, corrected statement to the borrower *not later than 3 business days before the date of consummation* of the transaction. No creditor or other person may impose a fee (other than a bona fide and reasonable fee to cover the cost of a credit report) on the consumer in connection with the consumer's mortgage loan application before the consumer's receipt of the early consumer disclosures (although, if mailed, the consumer is presumed to have received the disclosure statement three business days after it is mailed).

- *Waiver of Timeliness of Disclosures.* To expedite consummation of a transaction, if the consumer determines that the extension of credit is needed to meet a "bona fide personal financial emergency" (as that term may be defined by the FRB in implementing rulemaking), the consumer may waive or modify the timing requirements for disclosures if (i) the consumer provides the creditor a dated, written statement describing the emergency and specifically waiving or modifying those timing requirements, and (ii) the creditor provides to the consumer final disclosures required by §226.19(a) at or before the time of such waiver or modification.

- ***Promulgated Notice*. Early disclosures, corrected disclosures, and final disclosures at consummation must** state in conspicuous type size and format, the following:

"YOU ARE NOT REQUIRED TO COMPLETE THIS AGREEMENT MERELY BECAUSE YOU HAVE RECEIVED THESE DISCLOSURES OR SIGNED A LOAN APPLICATION.";

- ***Variable Rate Disclosures*. Credit transactions in which the annual rate of interest is variable (or under which the regular payments may otherwise be variable) must additionally disclose the following:**

  (i) The payment schedule must be labeled as follows:
  "Payment Schedule: Payments Will Vary Based on Interest Rate Changes."

  (ii) Examples of adjustments to the regular required payments based on the change in the interest rates specified by the credit contract must be stated in conspicuous type size and format. Among the required examples, an example must be included that reflects the maximum payment amount of the regular required payments based on the maximum interest rate allowed under the contract. (Prior to issuing rules implementing this rule, the FRB must conduct consumer testing to determine the appropriate format for providing the disclosures to consumers so that they can be easily understood, including the fact that the initial regular payments are for a specific time period that will end on a certain date, that payments will adjust afterwards potentially to a higher amount, and that there is no guarantee that the borrower will be able to refinance to a lower amount.)