

FS Regulatory Brief

Proposed Changes to Regulation Z (Truth in Lending)

On July 23, 2009, the Federal Reserve released proposed sweeping changes to Regulation Z (Truth in Lending) to improve the disclosures consumers receive in connection with closed-end mortgages and home equity lines of credit (HELOCs). These proposed changes come at a time when banks are already working diligently to comply with the recently issued Regulation Z disclosure requirements under the Mortgage Disclosure Improvement Act and the final rules related to higher priced mortgage loans, which become effective October 1, 2009.

The proposed rules reflect the results of consumer testing conducted by the Federal Reserve Board and are aimed at helping consumers shop for and understand the true cost of credit for mortgage related transactions by improving the timing, content and format of disclosures. Federal Reserve Chairman Ben Bernanke stated in the press release announcing the proposal that "Consumers need the proper tools to determine whether a particular mortgage loan is appropriate for their circumstances." As such, the Board is seeking to revise closed-end mortgage disclosures to highlight potentially risky features such as adjustable rates, prepayment penalties, and negative amortization.

The timing, content, and format of HELOC disclosures would also be revised to provide consumers with more

detailed and useful information at application and throughout the life of the account.

Legislators continue to scrutinize the Federal Reserve for not doing enough to protect consumers and as a result, the banking industry should expect that the Federal Reserve will act quickly to finalize comprehensive changes to existing mortgage loan disclosures and other requirements.

The following provides a summary of the key provisions of the proposal. The comment period on the proposed rules ends on November 27, 2009.

Closed End Mortgage Loans

- *Application Disclosure* - At application, lenders would provide consumers with a one page list of questions to ask about the loan. The new Truth in Lending Act (TILA) disclosures are designed to answer these questions.
- *Content of disclosures* - Disclosures received by the customer within three days of application would be streamlined to highlight risky features such as payment increases or prepayment penalties. A simple graph would show consumers how their loan's APR compares to the average rate offered by borrowers with excellent credit.
- *Uniform Disclosure* - The Federal Reserve will work with the Department of Housing and Urban Development to make disclosures required by TILA and the Real Estate Settlement Procedures Act (RESPA) complementary; potentially developing a single disclosure form to satisfy both laws.
- *Calculation of the APR* - The APR, which reflects the total cost of the loan, would include most fees and settlement costs.

- *Adjustable Rate Mortgages* - Lenders would have to show consumers applying for adjustable rate mortgages how their payments might change during the life of the loan and notify borrowers 60 days in advance of a change in their monthly payment. The current requirement is 25 days notice.
- *Final Disclosures* - In addition to the early cost disclosures provided at application, lenders would be required to provide final TILA disclosures that consumers must receive at least three days before loan closing.

Home Equity Lines of Credit

- *Application Disclosure* - At application, consumers would be provided with a one page disclosure summarizing the basic information and risks of HELOCs. This would replace the lengthy, generic disclosure currently in use.
- *Content of disclosures* - Within three days of application, lenders would provide disclosures tailored to the actual credit terms for which the consumer qualifies. At account opening, the final disclosures would be in the same format as the earlier disclosure to facilitate comparison.
- *Periodic Statements* - Lenders would have to provide enhanced statements showing the total amount of interest and fees charged for the statement period and year to date.
- *Changes to the Account* - Lenders would have to notify consumers 45 days prior to a change in terms and would be prohibited from terminating an account for delinquency until the payment is more than 30 days late.
- *Consumer Protections* - When a consumer's credit line has been suspended or reduced, the creditor would have to provide information as to the reason(s) for the action and the consumer's right to request reinstatement. The rules would also require prompt

investigation and response to consumer reinstatement requests.

All Mortgage Transactions

- *Compensation Practices* - The proposal would prohibit payments to a mortgage broker or the creditor's loan officer based on the loan's interest rate or other terms.
- *Steering Prohibition* - Prohibits 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.

Conclusion

Clarity and transparency for consumers involved in the mortgage process is a key focus of legislators and regulators and there does not appear to be a slow down in the number of new requirements being issued to ensure that this occurs. As such, banks should start now to assess what impact, if any, finalization of the above rules could have on its policies, procedures, and business practices. At a minimum, banks should assess their current disclosure practices, current compensation structures for loan officers and brokers, and potential systems, internal control, and compliance program enhancements needed to comply with the proposal requirements.

We will continue to monitor legislative and regulatory activity in this area and will communicate key developments to our clients.

Additional Information

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