Client Alert.

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Proposed Rule to Enhance Consumer Protections and Disclosures for Home Mortgage Transactions

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Background

On August 16, 2010, the Federal Reserve Board ("Board") issued two proposed rules and three final rules governing federal Truth-in-Lending Act ("TILA") requirements for residential mortgage loans. This client alert summarizes the Board's proposed rule to enhance consumer protections and disclosures for home mortgage transactions.

Previous client alerts addressed the Board's other four issuances.

History and Scope

- This is the most recent of a series of proposed and final rules that are designed to require more effective disclosures, and establish comprehensive protections, for consumers who obtain home mortgages.
- In particular, the Board issued massive proposals to upgrade its regulation of closed-end and open-end mortgage transactions in August of 2009. The Board stated that it plans to issue final rules that combine the elements of the 2009 and 2010 proposals.
- This proposal covers a wide array of topics—among others, reverse mortgages, the right of rescission, disclosures for loan modifications, refunding fees for withdrawn applications, information requests submitted to loan servicers, the definition of higher-priced mortgage loans, advertising for home equity lines of credit ("HELOCs"), and disclosures for credit insurance and similar products. Many of these items reflect longstanding concerns of consumer advocates.
- As in the case of other recent Board issuances, this proposal was issued following extensive consumer testing. The model forms proposed by the Board embrace a philosophy of conveying a simple message, rather than forms that provide more detailed information but risk information overload.
- This massive proposal—at roughly 1,000 pages, longer than the telephone books of many cities—devotes considerable space to reverse mortgages. Because only a limited number of our readers offer reverse mortgage products, this client alert focuses on the other elements of the Board's proposal.
- As authority for the issuance of its proposal, the Board cites its general power to issue regulations under Section 105 of TILA. The Board also cites Section 129(1)(2)(A) of TILA, which authorizes the Board to prohibit acts or practices relating to mortgage loans that it finds to be unfair, deceptive, or designed to evade provisions of the Home Ownership and Equity Protection Act ("HOEPA"). In developing its proposal in reliance on Section 129(l)(2)(A), the Board noted that it has considered the standards currently applied to the Federal Trade Commission Act's prohibition against unfair or deceptive acts or practices, as well as the standards applied by similar state statutes. In addition, the Board cites Section 129(l)(2)(B) of TILA, which authorizes the Board to prohibit acts or practices relating to

refinancings that the Board finds to be associated with abusive lending practices or that otherwise are not in the interests of a borrower.

- The comment period runs for 90 days from the publication of the Board's proposal in the Federal Register.

Highlights of Proposed Rule and Analysis

- *Voluntary Credit Insurance and Debt Cancellation/Suspension Coverage (Section 226.4(d), Sections 226.6(a)(5), (b)(5), and Section 226.38(h) of Regulation Z)*

  - Currently, the premiums or charges for voluntary credit insurance, debt cancellation coverage, and debt suspension coverage are excluded from the finance charge if the creditor provides certain disclosures and the consumer initials or signs a separate affirmative written request for the insurance or debt cancellation/suspension product. In its August 2009 proposal, the Board proposed to treat all premiums and charges for credit insurance or debt cancellation/suspension coverage as finance charges in the case of a closed-end consumer credit transaction secured by real property or a dwelling, even if the purchase is voluntary. For other transactions, the premiums and charges may continue to be excluded from the finance charge if the purchase is voluntary and the creditor complies with the disclosure and signature requirements.

  - The Board proposes that creditors use a new disclosure that highlights essential information in a short, blunt, question-and-answer format: Do I need this product? How much does it cost? What is the maximum benefit amount? Can I receive benefits? How long does the coverage last?

  - This disclosure will be required whether the credit insurance or debt cancellation/suspension coverage is voluntary or involuntary. A creditor must fulfill the conditions of the regulation before the consumer enrolls in the insurance or coverage "written in connection with the credit transaction." A creditor must use a disclosure that is substantially similar in headings, content, and format to one of two sets of model forms proposed by the Board.

  - The creditor has an affirmative obligation to determine, at or prior to the time of enrollment, that the consumer meets any age or employment eligibility criteria. If the consumer does not meet those criteria at that time, the product is not considered voluntary and the premium or charge will be a finance charge. (As noted above, the Board would treat all such premiums and charges as finance charges in the case of a closed-end consumer credit transaction secured by real property or a dwelling.)

  - For debt suspension coverage, the creditor also must disclose that the obligation to pay principal and interest is only suspended, that interest will continue to accrue during the suspension period, and that the balance will increase during the suspension period.

  - Comment: Consumer groups have never liked voluntary credit insurance, debt cancellation coverage, and debt suspension coverage, believing these to be overpriced products that most consumers will never have the opportunity to use. These groups also believe that some consumers have been victims of "insurance packing." The Board's proposal responds to these concerns. Creditors will be required to provide an "in your face" disclosure that is intended to cause the consumer to think carefully about whether the product is really in his/her best interest. Further, the proposal responds to reports that some creditors have sold coverage—particularly unemployment coverage— that some consumers were not eligible to receive in the first instance.

- *Consumer Credit Provided to Revocable Living Trusts (Paragraph 226.3(a)-8 of the Regulation Z Commentary)*

  - Regulation Z generally does not apply to credit extended to organizations, including entities such as corporations and limited liability companies. There has long been an exception to this rule for consumer credit extended to certain land trusts that are established to serve a function similar to that of a mortgage.

- The Board proposes to treat credit extended to revocable living trusts as a form of consumer credit. These transactions would require the full array of consumer credit disclosures, including notices of right to cancel.

- With this proposal, the Board formally recognizes that revocable living trusts are commonly established by individuals as estate planning tools. Accordingly, the Board is proposing to ignore the fact that trusts are legal entities and, instead, to look to the substance of these transactions. On this basis, loans to these trusts will receive the same disclosures that individuals receive.

- Comment: While the Board proposes to bring loans to revocable living trusts within Regulation Z, the fact is that most banks will not make a mortgage loan to a revocable living trust. In the vast majority of cases, title to the family home is held by the trust, the bank makes the loan to the individuals who are the trustors of the trust, and the trust executes a mortgage instrument to secure the loan. These transactions already are subject to Regulation Z because the individuals are receiving consumer credit. The individuals receive TILA disclosures and notices of the right to cancel, where applicable. The Board's proposal will require banks to consider also providing TILA disclosures and notices of the right to cancel to the trust itself. In fact, some banks already follow this approach.

- *Right of Rescission (Section 226.15 and Section 226.23 of Regulation Z)*

  - The Board proposes to clarify, strengthen, and modernize the forms, procedures and "rules of the road" for the right of rescission. While most of the changes are designed to benefit consumers, some will better protect creditors. The proposal affects both HELOCs and closed-end loans.

  - Consumers will be entitled to rescind a transaction only in writing. Creditors may, but need not, accept other methods of rescission, such as faxes and emails.

  - For the three-business-day period following the rescindable transaction, the consumer will be able to send the rescission notice to the creditor or the creditor's agent for receiving notice, as designated in the notice of right to cancel. If there is no designation in the notice, the rescission notice may be sent to the servicer of the loan. After the three-business-day period following the rescindable transaction, the consumer will be able to send the rescission notice to the current owner of the loan or the servicer of the loan. Receipt by any such proper recipient will be treated as receipt by the creditor or owner of the loan. This means that servicers will need to develop procedures to respond quickly to the receipt of rescission notices.

  - As at present, an open right of rescission will be cut off by the first to occur of: three years after the transaction, transfer of all of the consumer's interest in the property, or a sale of the property. (Under TILA, the rescission period can be extended in connection with certain administrative proceedings.) The proposal clarifies that each of the following will cut off an open right of rescission: a refinancing with a creditor other than the current holder, paying off the loan, a foreclosure sale, a sale of the property in the form of an installment sale or in which the consumer takes back financing, a transfer of the property by operation of law following the consumer's death, or a gift of the property. A bankruptcy filing by the consumer generally will not terminate the right of rescission if the consumer retains an interest in the property after the bankruptcy estate is created.

  - An error in a "material disclosure" leaves open the right of rescission. There has been an expansion and clarification of the items that constitute a "material disclosure," with different rules applying to HELOCs and closed-end transactions. For several of the numerical disclosures, there are new tolerances that apply. In general, where the misdisclosures would not tend to mislead a consumer to his/her detriment, the tolerance is unlimited. For example, the tolerance for understating the total of all one-time fees to open a HELOC is $100, but the tolerance for overstating those fees is unlimited.

  - If the creditor provides incorrect or incomplete material disclosures, the three-business-day period will not begin to run, leaving an open right of rescission. To fix this problem and get the three-business-day period started, the creditor will have to provide a complete and correct set of material disclosures together with a complete, correct, and updated notice of right to cancel.

- In contrast, if the material disclosures were correct and complete, but the notice of right to cancel was incorrect or incomplete, the creditor will get the three-business-day period started by delivering a complete, correct, and updated notice of right to cancel to the consumer.

- The proposal will require creditors to provide only one copy of the notice of right to cancel to each consumer entitled to rescind, in contrast with the requirement of two copies under the current rule. There are detailed rules for the mandatory and optional contents of the notice of right to cancel. A creditor will be deemed to satisfy these rules if it uses one of the appropriate model forms published by the Board or a substantially equivalent notice. In practice, creditors are likely to routinely use the model forms. The contents of the model forms are less legalistic and more consumer-friendly than the current model forms, but also less informative.

- The notice of right to cancel must identify the last date to rescind. If the creditor cannot provide an accurate date (*e.g.*, as will happen when the loan documents are sent to the consumer's home and the creditor will not necessarily know when the consumer will sign and return them), the creditor may provide the date that it reasonably and in good faith believes the rescission period will end. If the date turns out to be short of the requisite three-business-day rescission period, the creditor can comply with the regulation by notifying the consumer that the deadline in the first rescission notice has changed and by providing a new rescission notice that provides a rescission period which expires three business days from the date the consumer receives the second notice. The creditor will be able to give the consumer a longer period to rescind so long as the creditor honors rescissions made through the end of that date.

- The notice of right to cancel must include a "tear-off" form at the bottom which allows the consumer to exercise his/her right of rescission. The creditor may, at its option, populate this form with the consumer's name, property address and loan number. The creditor may not require the consumer to complete a blank with the loan number. The consumer can rescind by sending in the form at the bottom of the notice of right to cancel, or by sending in any other written notice.

- The proposed regulation provides more precise rules for the creditor's actions following its receipt of a rescission notice from the consumer. The first set of rules applies when the creditor receives the rescission notice before it has disbursed funds. The second set of rules applies when the creditor receives the rescission notice after it has disbursed funds but where the parties are not in a court proceeding. The third set of rules applies when the creditor receives the rescission notice after it has disbursed funds but where the parties are in a court proceeding. Collectively, these rules are designed to provide a more equitable process based upon the circumstances at the time of the rescission. Nevertheless, where the creditor believes that the consumer does not have the legal right to rescind a funded loan, the creditor's only means of fully protecting its rights will be to go to court, as is the case at present. A proposed amendment to the Regulation Z Commentary ("Commentary") states that when a creditor contests a rescission, the court normally will first determine if the right to rescind has expired. If it has not, the court will next determine the amounts owned by the consumer and creditor, and then the procedures for the consumer to tender any money or property.

- The courts continue to have the right to modify the rescission procedures. The Commentary states that this includes a modification of the loan when the consumer is in bankruptcy or "when the equities dictate." The Commentary also states that a court may modify the form or manner of the consumer's tender, such as by ordering payment in installments or by approving the parties' agreement to an alternative form of tender.

- The proposed rule changes the procedures that apply when the consumer wishes to waive or modify the right to rescind. The creditor must provide the notice of right to cancel and the required Regulation Z disclosures before the consumer can waive or modify the right. (This is the same approach used for waivers or modifications relating to high-cost mortgage disclosures under Section 226.31(c)(1)(iii) of Regulation Z, and for waivers or modifications relating to Regulation Z disclosures for closed-end dwelling secured loans under

Section 226.19(a)(3) of Regulation Z.) As at present, a waiver or modification of the right to rescind is only valid if the consumer determines that funds are needed to meet a bona fide personal financial emergency. A proposed amendment to the Commentary clarifies that a bona fide personal financial emergency typically, but not always, will involve imminent loss of or harm to a dwelling or harm to the health or safety of a natural person. A proposed amendment to the Commentary identifies three examples of circumstances in which there is a bona fide personal financial emergency: (i) imminent sale of the property at foreclosure, where the loan is needed to stop the foreclosure during the rescission period; (ii) a need for immediate repairs to ensure that the dwelling is habitable during the rescission period; and (iii) imminent need for healthcare services, where the loan is needed to obtain those services during the rescission period. In contrast, the Commentary states that there is no bona fide personal financial emergency when: (i) the consumer wishes to buy goods or services but not on an emergency basis, or (ii) the consumer wishes to invest immediately in a financial product. The existence of a bona fide personal financial emergency is a question of fact, and the creditor cannot ignore facts that are in its possession. Each consumer entitled to rescind must sign a dated written statement (but not a printed form) that describes the emergency, specifically modifies or waives the rescission right, and bears each consumer's signature. The consumers can sign one form, or they can each sign their own forms.

- There is a proposed change in the exemption from the right of rescission for a refinancing or consolidation of a closed-end credit transaction by the same creditor. At present, this exemption applies when the refinancing or consolidation is done by the creditor to whom the loan was initially payable. For example, this would include an original creditor that makes a loan, sells it, continues to service it, and later refinances it. The proposal narrows this exemption (which now relates only to modifications that qualify as new transactions under Section 226.20(a), discussed below), allowing it to be used only by an original creditor that is also the current holder of the debt obligation. However, this exemption does not apply to the extent of any new advance of money.

- As at present, there are two model rescission forms for closed-end credit transactions. The H-8 is the general form and the H-9 is the refinancing form. The Commentary clarifies that the H-9 is to be used only where the transaction involves a new advance of money by the original creditor that is also the current holder of the debt obligation. In all other situations, the H-8 form is to be used.

- Comment: Some creditors offer HELOCs that are used in connection with the purchase of a consumer's principal dwelling. The first advance from such a HELOC is used to pay part of the purchase price of the dwelling, and is exempt from the right of rescission because it is a "residential mortgage transaction." Subsequent advances may be used for any purpose, do not qualify as "residential mortgage transactions," and are subject to the right of rescission. The current set of model rescission forms in Appendix G of Regulation Z is not adequate for these situations, and it therefore is necessary to prepare and utilize a customized rescission form. The Board's proposal also does not include a model rescission form for these situations. If the final rule does not contain a model rescission form for these situations, it will continue to be necessary to prepare and utilize a customized rescission form.

- Comment: While the proposal provides more detailed rescission rules, those rules still leave many open issues. For example, while the Commentary states that a court may modify the form or manner of the consumer's tender, such as by ordering payment in installments, the Commentary does not address whether the creditor's security interest may remain in place while those installments are being made or whether the creditor is entitled to receive interest on the amount due (and, if so, at what rate). It also does not address what will happen if the borrower fails to make the payments or if the borrower files for bankruptcy. Some courts have held that rescission is an equitable process, leaving considerable opportunity for the exercise of judicial discretion and creativity. As at present, a creditor will be well advised to contact a consumer immediately after he/she rescinds and, if the rescission is lawful, to enter into an agreement with the consumer that addresses the rescission amounts and procedures.

- The Board has also proposed a revision to the Commentary to clarify that a guarantor will have the right to rescind where: (i) the borrower has the right to rescind because he/she is a natural person to whom consumer credit is offered or extended and in whose principal dwelling a security interest is or will be retained or acquired, and (ii) the guarantor pledges his/her own principal dwelling as additional security for the consumer credit transaction, and personally guarantees the borrower's repayment of the consumer credit transaction.

- *Advertising (Section 226.16 of Regulation Z)*
  - In 2008, the Board significantly revised the advertising rules that apply to closed-end credit transactions secured by a dwelling. See Section 226.24(i) of Regulation Z and the related Commentary provisions.
  - The Board proposes to revise the advertising rules for HELOCs in a somewhat comparable manner.

- *Prepayment Penalties on Closed-End Loans (Paragraph 226.18(k)(1)-1 of the Regulation Z Commentary)*
  - The Board proposes to amend the Commentary to clarify that prepayment penalties include charges determined by treating the loan balance as outstanding for a period after prepayment in full and applying the interest rate to such "balance," even if the charge results from the interest accrual amortization method used for the transaction. For example, if a FHA loan is prepaid on April 15th, and the creditor charges interest on the principal balance for the full month of April, the interest that is charged in excess of that earned through the date of payoff will be treated as a prepayment penalty. This is the case notwithstanding that the FHA does not regard this amount as a penalty.

- *Early Disclosures for Closed-End Loans (Section 226.19(a) of Regulation Z)*
  - The Board has proposed to modify its rules governing early disclosures for consumer credit transactions secured by real property or a dwelling. Currently, these rules generally require the creditor to deliver or mail the good faith estimates of the Regulation Z disclosures not later than the third business day after receipt of the consumer's written application. If the disclosures are mailed, they are deemed to have been received three business days after they are mailed. Fees (other than bona fide and reasonable credit report fees) cannot be imposed until the consumer has received the disclosures. The early disclosures must be delivered or mailed not later than the seventh business day before consummation of the credit transaction. If the disclosed APR becomes inaccurate, the creditor must provide corrected disclosures at least three business days before consummation.
  - The current rule applies to loans that are subject to RESPA. The proposed rule applies to all closed-end consumer credit transactions secured by real property or a dwelling, whether or not RESPA applies. However, creditors will be able to rely on the RESPA and HUD Regulation X rules in determining when a "written application" has been received.
  - Under the proposal, neither the creditor nor any other person will be able to impose a nonrefundable fee for three business days after the consumer receives the early disclosures. Any fee paid during this three-day period must be refunded to the consumer if the consumer requests a refund during that period and he/she decides not to enter into the credit transaction. If the creditor or other person relies on the allowed presumption of receipt of disclosures that are mailed or delivered other than in person, a nonrefundable fee may not be imposed until after the sixth business day following the date that the disclosures are so mailed or delivered. A notice of the right to receive the refund is contained in the Board's "Key Questions to Ask About Your Mortgage" document, which must be provided at the time the consumer is provided with an application form or before the consumer pays a non-refundable fee, whichever is earlier. If housing or credit counseling is required by applicable law, a bona fide and reasonable counseling fee is not subject to the prohibition on

pre-disclosure fees and is not refundable. A bona fide and reasonable credit report fee also need not be refundable.

- A final Regulation Z disclosure will need to be provided at least three-business-days before consummation. The final Regulation Z disclosure must be provided for all transactions, even if none of the items contained in the early disclosure have changed. Only certain of the disclosed items may be estimated.

- An additional three-business-day waiting period is required if the creditor must send a corrected final disclosure. The Board is seeking comment on two alternative approaches relating to the creditor's duty to send a corrected disclosure.

- For purposes of the seven- and three-business-day disclosure periods and the nonrefundable fee rules, a "business day" is defined to mean any calendar day except Sundays and the legal public holidays referenced in Section 226.2(a)(6) of Regulation Z.

- Waivers and modifications of the seven- and three-business-day disclosure periods remain permitted in the event of a bona fide personal financial emergency. The waiver and modification procedures are similar to those that apply to the right of rescission. The proposed Commentary references the examples of a bona fide personal financial emergency in the proposed Commentary provisions relating to rescissions.

- *Disclosures for Modifications of Residential Mortgages (Section 226.20 of Regulation Z)*

  - Currently, the modification of a closed-end loan is not treated as a new transaction and does not require new Regulation Z disclosures unless the transaction qualifies as a "refinancing." A "refinancing" occurs when an existing credit transaction is satisfied and replaced by a new transaction by the same consumer. There is an exception to the modification rule: if the interest rate is increased in accordance with a variable rate feature not previously disclosed, or if a new variable rate feature is added to the loan, the Commentary states that this will require new Regulation Z disclosures.

  - The current rule has led to considerable uncertainty and inconsistent treatment. The Board proposes to treat certain modifications as new transactions requiring new Regulation Z disclosures. The new rule will apply to the modification of an existing consumer credit transaction secured by real property or a dwelling, where the modification is done by the same creditor and the same consumer. For this purpose, the "same creditor" means the current holder or servicer of the loan. For example, if a bank makes a mortgage loan, sells the loan on a servicing retained basis, and the bank and consumer subsequently modify the loan, the modification will be subject to the new rule.

  - For a loan subject to the new rule, any of the following modifications will trigger new Regulation Z disclosures: increasing the loan amount; imposition of any fee (regardless of how denominated or paid); changing the loan term; changing the interest rate; increasing the periodic payment; adding an adjustable rate feature, prepayment penalty, interest-only payments, negative amortization, a balloon payment, a demand feature, a no or low doc feature, or a shared equity or shared appreciation feature; or adding new collateral that is real property or a dwelling.

  - However, certain modifications are exempt from the new disclosure requirement: those that are part of a court proceeding; those in connection with the consumer's default or delinquency (unless there is an increase in the loan amount or interest rate, or a fee is imposed on the consumer); or those due to a decrease in the interest rate only (except that a decrease in the periodic payment, an extension of the loan term, or both, are allowed), and provided that no fee is imposed on the consumer. As proposed, the exemption for modifications of loans in default or delinquency would not include loans that are in imminent default or delinquency.

- Under the proposed rule, a typical modification, extension, consolidation agreement (MECA) will require a new set of disclosures.

- In contrast, the exemptions provided by the proposed rule are sufficiently broad to cover many loan workouts that creditors commonly provide to delinquent or defaulted borrowers. In addition, most informal payment arrangements—for example, informal payment deferral arrangements—will not require new Regulation Z disclosures. However, the imposition of any fees on the consumer in connection with these modifications will trigger new Regulation Z disclosures.

- For purposes of the new modification rule, an increase in the loan amount includes any costs of the transaction (*e.g.*, points, appraisal fees, or title insurance fees) that are paid out of the proceeds of the new loan amount. However, loan proceeds that are used to fund an existing or newly-established escrow account are not treated as an increase in the loan amount.

- Where the modification does trigger new Regulation Z disclosures, all *applicable* rules under the regulation will apply: for example, the three- and seven-business-day rules discussed above, the right of rescission, the rules for higher-priced mortgage loans, etc.

- The prior rule for refinancings generally will continue to apply to closed-end loans that are not secured by real property or a dwelling.

* *Notice of Rate Adjustments (Section 226.20(c) of Regulation Z)*

  - Currently, at least once each year in which interest rate adjustments are implemented without accompanying payment changes, and 25-120 days before each payment adjustment, a prescribed adjustment notice must be provided to the consumer. This rule applies to a variable-rate mortgage subject to Section 226.19(b) of Regulation Z (*i.e.*, where the APR may increase after consummation in a transaction secured by the consumer's principal dwelling with a term greater than one year).

  - The Board proposes to require at least 60, but not more than 120, days' notice before a payment change that is associated with an interest rate change. If issued in final form, this regulation will make it impossible to offer ARMs with zero-day "look backs" and monthly rate and payment changes. The proposal will continue to require an annual notice where interest rate changes are not accompanied by payment changes.

  - The proposed rule will apply to ARMs subject to Section 226.19(b) of Regulation Z, where the adjustment is made under the terms of the existing legal obligation between the parties. If an adjustment is not based on the legal obligation between the parties, this will not trigger a notice under Section 226.20(c), but it may trigger a new set of Regulation Z disclosures under the modification rules summarized above.

  - The conversion of an ARM to a fixed-rate mortgage in accordance with the conversion provisions of the existing ARM (including the applicable index and margin or formula to determine the rate upon conversion) will trigger an adjustment notice under Section 226.20(c). However, new Regulation Z disclosures may be required if the existing loan does not provide for conversion, the existing loan provides for conversion but does not state a specific index and margin or formula (or if the loan does so state, but the parties agree to a change), a conversion fee is charged, or other loan terms are modified.

  - The required content of the notices has been increased considerably, with different notices required (i) where the payment is changing, and (ii) for annual interest rate changes.

  - Additional disclosures are required with respect to prepayment penalties, a telephone number to call for information about the loan, and a telephone number and website address for housing counseling resources maintained by HUD.

- Comment: Note that the ARM adjustment notices are in addition to information that the servicer will be required to provide on a timely basis in accordance with the Dodd-Frank Act, such as periodic statements, information in response to qualified written requests, information in response to certain allegations of errors in servicing, and contact information regarding the owner of the loan.

- The information required in the notices must be provided in the form of a table with the headings, content, and format substantially similar to Form H-4(G) (where the interest rate change is accompanied by a payment change) or Form H-4(K) (annual notice of interest rate adjustments without accompanying payment adjustments). These are consumer-friendly forms that are designed to be comprehensible to unsophisticated consumers.

- *High-Cost Mortgages (Section 226.32 of Regulation Z)*

  - In its proposed amendments to Regulation Z issued in August 2009, the Board proposed to eliminate virtually all of the exclusions from the finance charge for a closed-end consumer credit transaction secured by a dwelling or real property. Thus, items such as title insurance premiums, credit report fees, and appraisal fees will be treated as finance charges for residential mortgage loans. This will have the effect of increasing both the finance charge and APR for these transactions, potentially by significant amounts.

  - In its August 2010 proposal, the Board proposes to amend the Commentary relating to the calculation of the high-cost mortgage "points and fees" test by allowing creditors to continue to exclude from the finance charge those items that were previously excludable (*e.g.*, such as title insurance premiums, credit report fees, and appraisal fees). Similarly, the "total loan amount" will be calculated for purposes of the high-cost mortgage points and fees test by allowing creditors to continue to exclude from the finance charge those same items. This will avoid the large increases in the points and fees and APR that otherwise would occur. As a result, many loans that otherwise would be treated as high-cost mortgages will avoid that characterization.

  - Comment: The Dodd-Frank Act contains several provisions that are triggered by a "points and fees" test. For example, to be treated as a "qualified mortgage" for purposes of the presumption of compliance with the new ability to repay requirement, a residential mortgage loan may not have total points and fees that exceed 3% of the total loan amount. See Section 1412 of the Dodd-Frank Act. If the "points and fees" and "total loan amount" for purpose of the "qualified mortgage" test will be defined as the Board now proposes for its high-cost mortgage rule, it will be easier for more loans to meet the "qualified mortgage" test.

  - Section 226.34(a)(4)(iii) of Regulation Z provides a presumption of compliance with the repayment ability requirements for high-cost mortgage loans and higher-priced mortgage loans. The presumption of compliance is available if the creditor follows certain procedures. The presumption of compliance is not available for certain loan products, such as balloon loans with terms of less than seven years ("short-term balloon loans"). A proposed amendment to the Commentary states that the exclusion of short-term balloon loans from the presumption of compliance does not prohibit creditors from actually making short-term balloon loans that are higher-priced mortgage loans. The proposed comment goes on to state that the creditor must use prudent underwriting standards and determine that the value of the collateral is not the basis for repaying the obligation, including the balloon payment. The creditor need not verify that the consumer has assets and/or income at the time of consummation that would be sufficient to pay the balloon payment when it comes due. In addition to verifying the consumer's ability to make regular monthly payments, the creditor should verify that the consumer would likely be able to satisfy the balloon payment obligation by refinancing the loan or through income or assets other than the collateral. The proposed Commentary provision is consistent with a letter issued by the Board's staff in 2009. See Short-Term Balloon Loans and Regulation Z Repayment Ability Requirement for Higher-Priced Mortgage Loans, CA 09-12 (Nov. 9, 2009).

- *Higher-Priced Mortgage Loan Definition (Section 226.35(a) of Regulation Z)*

    - Currently, a "higher-priced mortgage loan" is defined as a consumer credit transaction secured by the consumer's principal dwelling in which the APR exceeds the Average Prime Offer Rate by 1.5% or more, for a first lien loan, or 3.5% or more, for a subordinate lien loan.

    - The Board proposes to substitute a new "Transaction Coverage Rate" ("TCR") for the APR in applying the test for a "higher-priced mortgage loan." The remainder of the test remains unchanged.

    - The new TCR is the same as the APR, except that the prepaid finance charges that are used for the calculation are limited to those prepaid finance charges that will be retained by the creditor, its affiliates, or a mortgage broker. This will exclude prepaid finance charges such as mortgage insurance premiums and tax service fees from the TCR, assuming that these are paid to unaffiliated persons. As a result, more loans that are not truly subprime loans will avoid characterization as "higher-priced mortgage loans."

    - Comment: As proposed, yield spread premiums paid by the creditor to the broker would not be included in the TCR calculation. Note, however, that yield spread premiums will themselves become unlawful under a separate regulation issued by the Board on August 16, 2010 and effective on April 1, 2011. See discussion at http://www.mofo.com//files//Uploads/Images/100831FinalRule.pdf.

    - There is no obligation to disclose the TCR to the consumer.

    - Comment: This rule, if issued in final form, will give creditors an incentive to use unaffiliated service providers, because fees paid to them will not be included in calculating TCRs, thereby allowing more loans to avoid characterization as "higher-priced mortgage loans." Further, the rule will incentivize creditors to originate retail loans because fees paid to in-house loan officers will not be included in calculating TCRs whereas fees paid by consumers to mortgage brokers will be included in calculating TCRs.

    - While a loan to finance the initial construction of a dwelling is exempt from the definition of a "higher-priced mortgage loan," the permanent loan on that dwelling is not exempted. For construction-permanent loans, a creditor has long had the option of providing one Regulation Z disclosure for both the construction and permanent phases or separate disclosures for each phase. A proposed Commentary provision states that a single TCR is calculated for the entire transaction. This TCR is calculated using the appropriate charges from both phases, regardless of whether the creditor provides one or two disclosures. If the loan qualifies as a higher-priced mortgage loan, the higher-priced mortgage loan rules will apply only to the permanent phase.

- *Servicer's Response to Borrower's Request for Information (Section 226.41 of Regulation Z)*

    - Under the Board's proposed rule, when a consumer makes a written request for the identity or contact information for the current owner and/or master servicer of the loan, the servicer must provide the consumer with the name, address, and telephone number of that person within a "reasonable time" and "to the best of its knowledge." The proposed rule is designed to implement Section 131(f)(2) of TILA.

    - The proposed Commentary states that, under most circumstances, a "reasonable time" will be ten business days from receipt of the consumer's written request. For this purpose, a "business day" is defined to mean "a day on which the creditor's offices are open to the public for carrying on substantially all of its business functions."

    - Comment: Section 1463 of the Dodd-Frank Act amends Section 6(k) of HUD Regulation X to prohibit a servicer from failing "to respond within 10 business days to a request from a borrower to provide the identity, address, and other relevant contact information about the owner or assignee of the loan." Hopefully, HUD will coordinate its implementing regulation with the Board's proposal. If not, presumably the Bureau will do so after it takes over responsibilities for issuing regulations under TILA and RESPA.

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