From the Examiner's Desk: Changes to Regulation Z Afford Increased Consumer Protections

This regular feature focuses on developments that affect the bank examination function. We welcome ideas for future columns. Readers are encouraged to e-mail suggestions to ***SupervisoryJournal@fdic.gov.***

The Home Ownership and Equity Protection Act of 1994 (HOEPA) targets certain deceptive and unfair mortgage lending practices by amending the Truth in Lending Act (TILA) to require special disclosures and impose prohibitions for mortgage loans with high rates or fees. However, the protections afforded consumers under the 1994 TILA amendments extended *only* to homeowners who already owned their homes (i.e., home equity mortgages). Furthermore, in promulgating implementing regulations under Regulation Z, the Board of Governors of the Federal Reserve System (Federal Reserve), exercising its discretion under TILA and HOEPA, further restricted the reach of these protections to home equity mortgages that met or exceeded specific cost parameters (i.e., "high-cost" mortgages).[1]

In 2008 and 2009, pursuant to its continuing authority under TILA and HOEPA, the Federal Reserve further amended Regulation Z.[2] The 2008/2009 Regulation Z amendments extend specific protections to consumers of a newly created category of mortgage loans called "higher-priced" home mortgages. In addition, the 2008/2009 Regulation Z amendments enhance existing protections for consumers of high-cost mortgages to match more closely many of the newly created protections for higher-priced mortgage loans.[3] The amendments also add protections for consumer mortgages other than higher-priced or high-cost mortgages and expand and enhance the early disclosure requirements of Regulation Z.

New and Enhanced Protections for Consumers of Higher-Priced and High-Cost Mortgage Loans

Although TILA and Regulation Z attempt to protect consumers primarily through requirements to provide sufficient information (i.e., disclosures) with which to make an informed credit decision, Congress, through its broad grant of authority to the Federal Reserve to explicitly prohibit unfair or deceptive mortgage lending practices, recognized that disclosures alone cannot always protect consumers from the significant harm (e.g., high costs and unsustainable loans) caused by certain mortgage terms and lending practices.

Many have attributed the rising number of home mortgage delinquencies, defaults, and foreclosures, as well as declining home values—and even, to some degree, the general decline of entire communities—to the relatively recent practice of "flipping" (i.e., repeated refinancing by the same lender) unsustainable home mortgage loans. With each flip, a homeowner's equity is

[1] Regulation Z requires disclosures of terms of closed-end and open-end consumer credit. It also contains several limitations and prohibitions pertaining to certain categories of mortgage loans. See 12 CFR 226.32, 226.34, and 226.35. http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&tpl=/ecfrbrowse/Title12/12cfr226_main_02.tpl.

[2] For the 2008 amendments, see http://www.fdic.gov/news/news/financial/2008/fil08134a.html. For the 2009 amendments, pursuant to the Mortgage Disclosure Improvement Act of 2008, see http://www.fdic.gov/news/news/financial/2009/fil09026.html.

[3] Unlike higher-priced mortgage loans, high-cost home mortgage loans are, by definition, limited to home equity mortgage loans and refinancings.

Advertising

In general, Regulation Z requires advertisements for mortgages (obtained for a personal, family, or household purpose, secured by a consumer's dwelling) to provide accurate and balanced information, in a clear and conspicuous manner, about rates, monthly payments, and other loan features. It prohibits advertisements that fail to do this.

Regulation Z, as amended, delineates several mortgage advertising practices and, effective October 1, 2009, specifically prohibits them as deceptive or misleading. The following two tables (one applicable to closed-end mortgages and the other to home-equity plans) set forth the practices and prohibitions addressed by the advertising provisions of amended Regulation Z.

Prohibited Advertisements for Closed-End Mortgages[41]

PRACTICE	PROHIBITED ADVERTISEMENT
Advertising "fixed" rates or payments.	Advertisements that state "fixed" rates or payments for loans whose rates or payments can vary without adequately disclosing that the interest rate or payment amounts are "fixed" only for a limited period of time, rather than for the full term of the loan.
Advertising an example of a rate or payment and comparing it to the consumer's rate or payment.	Advertisements that compare an actual or hypothetical rate or payment obligation to the rates or payments that would apply if the consumer obtains the advertised product unless the advertisement states the rates or payments that will apply over the full term of the loan.
Advertising a "government" association with the loan product.	Advertisements that characterize the products offered as "government-supported loans," or otherwise endorsed or sponsored by a federal or state government entity when, in fact, the advertised products are not government-supported or government-sponsored loans.
Advertising that includes the name of the consumer's current mortgage lender.	Advertisements, such as solicitation letters, that display the name of the consumer's current mortgage lender, unless the advertisement also prominently discloses that the advertisement is from a mortgage lender not affiliated with the consumer's current lender.
Advertising that makes claim of debt elimination.	Advertisements that make claims of debt elimination if the product advertised would merely replace one debt obligation with another.
Advertising that suggests the establishment of a "counselor" relationship.	Advertisements that create a false impression that the mortgage broker or lender is a "counselor" for the consumer.
Advertising selective attributes of a loan product in a foreign language.	Foreign-language advertisements in which certain information, such as a low introductory "teaser" rate, is provided in a foreign language, while required disclosures are provided only in English.

[41] See Section 226.24 http://www.fdic.gov/news/news/financial/2008/fil08134a.html.

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Prohibited Advertisements for Home-Equity Plans[42]

PRACTICE	PROHIBITED ADVERTISEMENT
Advertising discounted annual percentage rates (APR) for adjustable rate mortgage (ARM) loans.	An ARM advertisement that states an initial APR that is not based on the index and margin used to make later rate adjustments that does not also state, with equal prominence and in close proximity to the initial rate:
	■ The period of time such initial rate will be in effect; and
	■ A reasonably current annual percentage rate that would have been in effect using the index and margin.
Advertising a loan's minimum required payment.	An advertisement that contains a statement of a loan's minimum periodic payment if, by making only the minimum payment, a balloon payment may result, unless:
	■ The advertisement also states, with equal prominence and in close proximity to the minimum periodic payment statement that a balloon payment may result.
Advertising the tax deductibility of interest expense.	An advertisement that suggests that any interest expense incurred under the home-equity plan is or may be tax deductible when it is not.
	■ If an advertisement distributed in paper form or through the Internet (rather than by radio or television) is for a home-equity plan secured by the consumer's principal dwelling, and the advertisement states that the advertised extension of credit may exceed the fair market value of the dwelling, the advertisement shall clearly and conspicuously state that:
	1. The interest on the portion of the credit extension that is greater than the fair market value of the dwelling is not tax deductible for federal income tax purposes; and
	2. The consumer should consult a tax adviser for further information regarding the deductibility of interest and charges.
Advertising of promotional rate or promotional payment.	If any APR that may be applied to a plan is a promotional rate,[43] or if any payment applicable to a plan is a promotional payment,[44] advertisements (other than television or radio advertisements) that fail to disclose the following information, in a clear and conspicuous manner with equal prominence and in close proximity to each listing of the promotional rate or payment:
	■ The period of time during which the promotional rate or promotional payment will apply.[45]
	■ In the case of a promotional rate, any annual percentage rate that will apply under the plan. (If such rate is variable, the APR must be disclosed in accordance with Regulation Z's accuracy standards in §§226.5b, or 226.16(b)(1)(ii) as applicable).
	■ In the case of a promotional payment, the amounts and time periods of any payments that will apply under the plan. In ARM transactions, payments that will be determined based on application of an index and margin shall be disclosed based on a reasonably current index and margin.
	Envelope / Electronic Advertisements Excluded The requirement to state the promotional period and post-promotional rate or payments does not apply to an advertisement on an envelope in which an application or solicitation is mailed, or to a banner advertisement or pop-up advertisement linked to an application or solicitation provided electronically.
	Alternative Disclosures for Television or Radio Ads An advertisement for a home-equity plan made through television or radio stating any of the terms requiring additional disclosures may alternatively comply by stating the information required by these advertising provisions and listing a toll-free telephone number, or any telephone number that allows a consumer to reverse the phone charges when calling for information, along with a reference that such number may be used by consumers to obtain additional cost information.

[42] See Section 226.16 http://www.fdic.gov/news/news/financial/2008/fil08134a.html.

[43] Promotional rate. The term "promotional rate" means, in a variable-rate plan, any annual percentage rate that is not based on the index and margin that will be used to make rate adjustments under the plan, if that rate is less than a reasonably current annual percentage rate that would be in effect under the index and margin that will be used to make rate adjustments under the plan.

[44] Promotional payment. The term "promotional payment" means—

For a variable-rate plan, any minimum payment applicable for a promotional period that is:

Not derived by applying the index and margin to the outstanding balance when such index and margin will be used to determine other minimum payments under the plan; and

Less than other minimum payments under the plan derived by applying a reasonably current index and margin that will be used to determine the amount of such payments, given an assumed balance.

For a plan other than a variable-rate plan, any minimum payment applicable for a promotional period if that payment is less than other payments required under the plan given an assumed balance.

[45] Promotional period. A "promotional period" means a period of time, less than the full term of the loan, that the promotional rate or promotional payment may be applicable.

Effective Dates

Regulation Z's *early disclosure provisions* (now applicable to non-purchase-money mortgage transactions and to mortgage transactions secured by any consumer dwelling) become effective on July 30, 2009. The effective date for the early disclosure provisions was initially October 1, 2009. However, the Federal Reserve, pursuant to the Mortgage Disclosure Improvement Act of 2008, subsequently moved up the effective date to July 30, 2009.

Regulation Z's *escrow provisions* for higher-priced mortgage transactions become effective on April 1, 2010. Given the limited industry infrastructure for escrowing for mortgage loans secured by manufactured housing, the effective date for compliance with Regulation Z's escrow provisions for higher-priced mortgage loans secured by manufactured housing is October 1, 2010.

All other provisions of the Regulation Z amendments take effect on October 1, 2009.

Conclusion

In promulgating its final rule implementing these amendments to Regulation Z, the Federal Reserve noted that nothing in this rule should be construed or interpreted to be a determination that acts or practices restricted or prohibited under this rule are, or are not, unfair or deceptive before the effective dates of the rule's provisions. Accordingly, questionable mortgage lending practices, such as the ones addressed by this rule and discussed in this article, engaged in by FDIC-supervised institutions will continue to be scrutinized by the FDIC on a case-by-case basis under all applicable consumer protection laws, including section 5 of the FTC Act, through its examination-consultation process and, if warranted, through agency enforcement actions. For this reason, FDIC-supervised institutions should regularly monitor and update their compliance management programs and remain vigilant against engaging in unfair or deceptive mortgage lending practices that violate Regulation Z or any other consumer protection law or regulation.[46]

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[46] The FDIC, in concert with other federal and state bank regulatory agencies, is in the process of promulgating interagency examination procedures pertaining to these amendments to Regulation Z and anticipates their issuance shortly.