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.

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tapped to cover the cost of the refinancing. This constant churning of mortgages and repeated collection of fees has become known as "fee harvesting." This pattern of home mortgage lending typically disregards a consumer's repayment ability, which, in turn, leads to repeated refinancings and the imposition of often exorbitant prepayment penalties and other fees. As a result, a home's equity is often stripped and larger mortgage balances are created, which ultimately can result in foreclosure and loss of a consumer's home.

More recently, many of the harmful practices typically associated with home equity lending have been seen in the financing of home purchases as well, resulting in unsustainable homeownership and other harm to consumers.[4] To address this unwelcome trend in financing of home purchases, Regulation Z has been amended. TILA's prohibition against making certain home equity mortgage loans based on the underlying collateral without regard to the consumer's repayment ability has been extended under Regulation Z to certain purchase-money mortgages as well.

Overall, the amended provisions (which, with limited exception, become effective on October 1, 2009) do the following:

1. Establish consumer protections specific to a new category of mortgage loans called higher-priced mortgage loans,
2. Strengthen current consumer protections relating to prepayment penalty and repayment ability provisions for high-cost (section 32, HOEPA) mortgage loans,
3. Establish new consumer protections relating to prohibited behavior toward appraisers and prohibited practices by servicers, and
4. Expand and enhance the regulation's early disclosure requirements and impose new prohibitions against deceptive advertising.

This article examines and discusses each of these four significant amendments to Regulation Z and offers suggestions for FDIC examiners (and other compliance professionals) responsible for ensuring compliance with these critical regulatory changes.

New Protections for Consumers of Higher-Priced Mortgage Loans

Although TILA and Regulation Z seek to protect consumers primarily through disclosure, by enacting HOEPA Congress sought to protect consumers by specifically prohibiting certain unfair and harmful mortgage lending practices. And during 2008 and 2009, the Federal Reserve amended Regulation Z by establishing specific consumer protections for a new category of mortgage loans, i.e., higher-priced mortgage loans.[5] A higher-priced mortgage loan is any mortgage (purchase-money or

[4] While home ownership has been expanded through use of alternative financing products, such as "nontraditional" (i.e., interest-only and payment-option) and "subprime" (i.e., hybrid adjustable-rate mortgages [ARMS], ARMs with an initial fixed-rate period that later adjusts, often significantly) mortgage loans, such alternative loan products often contain terms and features that result in unsustainable homeownership and other harm to consumers. The offering of such alternative mortgage loan products by institutions should present red flags to FDIC examiners and others concerned with compliance with these latest amendments to Regulation Z. For further discussion relating to FDIC guidance on nontraditional mortgage loans and subprime mortgage lending, see "Impact of Regulation Z's Higher-Priced and High-Cost Mortgage Amendments on Nontraditional and Subprime Mortgage Guidance" below, at page 36.

[5] These higher-priced mortgage loan protections are similar to and complement those protections already established for high-cost mortgages under sections 32 and 34 of CFR Part 226, discussed below.

non-purchase-money) secured by a consumer's principal dwelling, extended for a consumer (i.e., personal, family, or household) purpose, with an annual percentage rate (APR) exceeding the "average prime offer rate" on prime loans (published by the Federal Reserve) by at least 1.50 percentage points for first-lien loans and 3.50 percentage points for subordinate-lien loans.[6] Mortgage lenders originating higher-priced mortgage loans are prohibited from engaging in specific practices deemed unfair under Regulation Z, including the following.[7]

Relying on the collateral securitizing the loan without regard to the consumer's ability to repay the loan

A mortgage lender is prohibited from originating a higher-priced mortgage loan based on the value of the collateral securing that loan without regard to the consumer's ability to repay the loan as of consummation.[8] In determining repayment ability, a mortgage lender may consider a consumer's current and reasonably expected income,[9] employment, assets other than the collateral, current obligations, and mortgage-related obligations. Mortgage-related obligations include obligations such as property taxes (relating to the property securing the mortgage), premiums for mortgage-related insurance required by the mortgage lender, homeowners association dues, and condominium fees, as well as secondary mortgages taken on the same property before or at consummation. For example, when underwriting a higher-priced mortgage as a first lien to purchase a home, the mortgage lender must consider any piggy-back second-lien transaction used to finance part of the down payment on the house.

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[6] The average prime offer rate used to establish a higher-priced mortgage loan is an annual percentage rate (APR) derived from average interest rates, points, and other loan pricing terms offered to consumers by a representative sample of creditors for mortgage transactions with low-risk pricing characteristics. To determine current average prime offer rates go to http://www.ffiec.gov/ratespread/newcalc.aspx. Higher-priced mortgage loans do not include mortgage loans to finance the initial construction of a dwelling, a temporary or bridge loan with a term of 12 months or less, a reverse mortgage, or a home equity line of credit. See section 226.35(a)(3). Note: Home Mortgage Disclosure Act (HMDA) Regulation C requires the reporting of rate spreads for higher-priced mortgage loans. However, currently under Regulation C, mortgage lenders collect and report the spread between the APR on a mortgage loan and the yield on a Treasury security of comparable maturity if the spread is greater than 3.0 percentage points for a first-lien loan or greater than 5.0 percentage points for a subordinate-lien loan. Under the revised HMDA rule, a mortgage lender will report the rate spread for higher-priced mortgage loans in conformance with these amendments to Regulation Z; that is, a mortgage lender will report the spread between a loan's APR and the survey-based estimate of APRs currently offered on prime mortgages of a comparable type (average prime offer rate) if the spread is equal to or greater than 1.5 percentage points for a first-lien loan or equal to or greater than 3.5 percentage points for a subordinate-lien loan. For further discussion on the implications of the Regulation Z amendments for HMDA reporting, see "Higher-Priced Mortgages and HMDA," below, at page 32.

[7] In addition to these practices, Regulation Z also prohibits as unfair the practice of structuring a home-secured loan as an open-end plan to evade the higher-priced mortgage provisions of Regulation Z. See section 226.35(b)(4).

[8] As previously noted by the FDIC and the other federal banking agencies, predatory lending practices often involve inducing a borrower to refinance a loan repeatedly to charge high points and fees each time the loan is refinanced (loan flipping). See FIL-9-2001 (http://www.fdic.gov/news/news/financial/2001/fil0109.html). The rule's prohibition against originating a higher-priced mortgage loan based on the value of the collateral securing that loan without regard to the consumer's ability to repay the loan is equally applicable to high-cost mortgages under sections 226.32 and 226.34.

[9] For instance, a medical resident's income can be expected to significantly increase on completion of his or her residency, and a mortgage lender may consider this information in determining repayment ability. However, if an applicant states an intention to retire within 12 months of consummation of the loan with no plans to obtain new employment, the mortgage lender also must consider this reduction in income in determining repayment ability.

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Relying on the consumer's income or assets without verifying such amounts through reasonably reliable third-party documents

When evaluating a consumer's ability to repay a higher-priced mortgage, a mortgage lender is prohibited from relying on the consumer's income, assets, or obligations without verifying such amounts through reasonably reliable third-party documentation.[10] For example, if a consumer earns a salary and states that he or she is paid an annual bonus, but the creditor relies only on the applicant's salary to evaluate repayment ability, the creditor need verify only the salary. However, if a future annual bonus is relied on to qualify the consumer at consummation, the expectation of the future bonus must be reasonable and verified with third-party documentation demonstrating past bonuses in amounts bearing a reasonable relationship to the amount of the expected bonus.[11] Although reliance on documentation specific to a consumer's individual income obtained from an employer's third-party database is permissible, information about average incomes for the consumer's occupation in the local geographic location or information about average incomes paid by the consumer's employer does not satisfy the verification-of-income requirement. With respect to obligations, a mortgage lender may rely on the information contained in a credit report to verify a consumer's obligations.[12]

A mortgage lender is presumed to have complied with Regulation Z's prohibition against granting higher-priced mortgage loans without regard to a consumer's ability to repay and without verifying income, assets, and obligations if the lender[13] (1) verifies the consumer's repayment ability per the requirements described above,[14] (2) determines the consumer's repayment ability using the

[10] Compliance practitioners should note that the Regulation Z amendments supersede previously issued Nontraditional Mortgage (NTM) Guidance relative to higher-priced mortgages that allowed stated income documentation. The superseded provision of the NTM Guidance provides, "Reduced Documentation—Institutions increasingly rely on reduced documentation, particularly unverified income, to qualify borrowers for nontraditional mortgage loans. Because these practices essentially substitute assumptions and unverified information for analysis of a borrower's repayment capacity and general creditworthiness, they should be used with caution. As the level of credit risk increases, the Agencies expect an institution to more diligently verify and document a borrower's income and debt reduction capacity. Clear policies should govern the use of reduced documentation. For example, stated income should be accepted only if there are mitigating factors that clearly minimize the need for direct verification of repayment capacity. For many borrowers, institutions generally should be able to readily document income using recent W-2 statements, pay stubs, or tax returns" http://www.fdic.gov/news/news/financial/2006/fil06089.html. Compliance practitioners should also note that Regulation Z's prohibition against relying on the consumer's income, assets, or obligations without verifying such amounts through reasonably reliable third-party documentation is equally applicable to high-cost mortgages under sections 226.32 and 226.34.

[11] Higher-priced mortgage lenders (as well as high-cost mortgage lenders, discussed below) may *not* rely on information provided orally by third parties, but may rely on various forms of correspondence from third parties, such as letters or e-mails. See Supplement I to section 226.34(a)(4)(ii)(A)(3).

[12] Where a consumer lists an obligation not reflected in a credit report, a higher-priced mortgage lender (as well as a high-cost mortgage lender, discussed below) must consider such obligation in determining a consumer's ability to repay the higher-priced mortgage, but it is not required to verify the obligation. See Supplement I to section 226.34(a)(4)(ii)(C)(1).

[13] No presumption of compliance is available for higher-priced mortgage loans where the loan provides for negative amortization (a feature prohibited for high-cost mortgages, discussed below) or where a balloon payment can occur within seven years of consummation. See section 226.34(a)(4)(iv).

[14] Verification of a consumer's ability to repay is a requirement under Regulation Z regardless of the presumption of compliance; in other words, forgoing this available presumption of compliance does not relieve a mortgage lender from its regulatory obligation to verify a consumer's repayment ability.

largest payment of principal and interest scheduled in the first seven years following consummation (and considering current and mortgage-related obligations in the manner described above),[15] and (3) assesses the consumer's repayment ability taking into account the ratio of total debt obligations to income or the income the consumer will have after paying all debt obligations.[16]

Compliance Practitioner Note:

Where a higher-priced mortgage loan has a fixed monthly payment for the first seven years concluding with a balloon payment, a mortgage lender may, for purposes of the presumption, determine the consumer's repayment ability by considering the amount of the consumer's fixed monthly payment. But where a balloon payment comes due before the end of seven years, the balloon payment must be considered in determining repayment ability, in effect, prohibiting higher-priced mortgage loans with balloon payments due in less than seven years in almost all cases.

This seemingly innocuous provision of the Regulation Z amendments has the potential to significantly impact real estate lending activity among banks, predominately smaller banks, which commonly originate and portfolio three- or five-year balloon mortgages. These mortgage loans are originated in this manner because they often do not qualify for sale into the secondary mortgage market. Banks offering these short-term, in-house mortgage loans tend to charge more in interest, but often less in fees, than loans conforming to and sold into the secondary mortgage market.

Typically, the interest rates charged for these mortgage loans qualify them as higher-priced mortgages and, therefore, subject them to the repayment ability standard of the Regulation Z amendments. Consumers seeking these three- or five-year balloon mortgage loans likely will not satisfy the repayment ability standard owing to the balloon payment. Banks continuing to offer these mortgage loans on or after October 1, 2009, likely will have to reduce the APR charged to prevent these loans from being higher-priced mortgages.

Many banks adopting this approach might consider compensating for the APR reduction by increasing loan fees. However, banks contemplating any such rate or fee restructuring must take into account whether the fees are finance charges under Regulation Z and therefore must be included in the APR calculation.

Further, where the purpose of the mortgage is other than purchase or construction of the borrower's home, banks choosing to restructure their pricing of these short-term balloon loans by adding loan fees must remain aware of and in compliance with Regulation Z's provisions relating to high-cost mortgages. As discussed elsewhere in this article, the Regulation Z provisions governing high-cost mortgages, unlike higher-priced mortgages, have thresholds both for fees and APR, and the fees included here are broader than just those that are considered finance charges under other Regulation Z provisions.

Of course, where the borrower has the right under the mortgage contract to renew the loan beyond seven years, there is no balloon payment that needs to be considered in determining repayment ability. While this right may be conditional, it is important to note that satisfying the conditions must be within the borrower's control.[17]

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[15] For examples of how to determine the maximum scheduled payment in the first seven years under several mortgage product types, see Supplement I to section 226.34(a)(4)(iii)(B)(1), applicable to higher-priced mortgage loans (and to high-cost mortgage loans, discussed below).

[16] Although the regulation does not set forth specific numerical standards for establishing repayment ability, it does note that the presumption of compliance with the prohibition against extending higher-priced mortgages without regard to repayment ability is rebuttable by a consumer showing that a mortgage lender that otherwise followed the regulation's delineated underwriting procedures disregarded the consumer's ability to repay the loan. As an example, the regulation states that evidence of a very high debt-to-income ratio or very limited residual income could be sufficient to rebut the presumption of compliance. However, the regulation clarifies that merely failing to follow one of the nonrequired underwriting procedures (#2 or #3) does not result in a presumption of violation of Regulation Z; rather, determination of a mortgage lender's compliance with the regulation in such cases must turn on the individual facts and circumstances.

[17] See comment 17(c)(1)-(7) for conditions within a consumer's control in connection with renewable balloon-payment loans. http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&rgn=div5&view=text&node=12:3.0.1.1.7&idno=12#12:3.0.1.1.7.5.8.7.33.

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Compliance Practitioner Note:

With respect to the requirement to verify or document income or assets, the Federal Reserve has created a safe harbor for a mortgage lender that does *not* verify or document income or assets used to determine repayment ability. Under the safe harbor, a mortgage lender does *not* violate Regulation Z if it demonstrates that the stated income or assets it relied upon were not materially greater than the amounts it could have verified. For example, if a mortgage lender determines a consumer's repayment ability by relying on the consumer's stated annual income of $100,000, but fails to obtain reliable third-party documentation verifying that amount before consummating a higher-priced mortgage loan, the mortgage lender will *not* have violated Regulation Z if it later obtains reliable evidence that would satisfy Regulation Z's verification requirement. Such evidence might be a W-2 or tax return information showing that the mortgage lender could have documented, at the time the higher-priced mortgage loan was consummated, that the consumer had an annual income not materially less than $100,000. However, FDIC-supervised institutions engaging in mortgage loan underwriting practices that base extensions of mortgage credit on consumers' stated income (without verification through reliable third-party documentation) will be carefully evaluated on a case-by-case basis to determine whether such practices raise (1) safety and soundness concerns, particularly if seen on a portfolio-wide basis; or (2) consumer protection concerns under section 5 of the Federal Trade Commission (FTC) Act (Unfair or Deceptive Acts or Practices) or other consumer protection laws or FDIC guidance.[18]

Imposing a prepayment penalty after two years or imposing a prepayment penalty at any time under certain circumstances[19]

A mortgage lender is prohibited from imposing a prepayment penalty on a higher-priced mortgage loan after the first two years. In addition, a mortgage lender is prohibited from imposing a prepayment penalty *at any time* during the term of a higher-priced mortgage loan if

- Other applicable law (e.g., state law) prohibits such penalty.[20]
- The consumer's mortgage payment (i.e., payment of principal or interest or both) can change during the first four years of the loan term. For example, the imposition of a prepayment penalty on a higher-priced adjustable-rate mortgage that resets every five years would be permissible. However, if the loan contract in this example permits negative amortization and the right of the mortgage lender to accelerate the payment reset date, for instance, when the loan balance reaches a contractually set threshold caused by the negative amortization within the first four years

[18] For example, see FDIC's Supervisory Policy Statement on Predatory Lending, http://www.fdic.gov/news/news/financial/2007/fil07006a.html. "Predatory lending involves … making unaffordable loans based on the assets of the borrower rather than on the borrower's ability to repay an obligation." In its comment letter to the Federal Reserve on the 2008 Regulation Z amendments, the FDIC expressed its belief that the Federal Reserve should eliminate the safe harbor and stand firm in requiring lenders to adequately verify borrowers' income and assets. Specifically, the FDIC wrote, "Verifying a borrower's income and assets is a fundamental principle of sound mortgage loan underwriting that protects borrowers, neighborhoods, investors, and the financial system as a whole.… Requiring borrowers to document their income will make it far less likely that consumers will receive loans that they cannot afford to pay. Documentation also will provide the markets with greater confidence in the quality of pools of higher-priced (and nontraditional) mortgage loans and their projected income streams. Thus, both consumers and the economy as a whole will benefit." See http://www.federalreserve.gov/SECRS/2008/April/20080409/R-1305/R-1305_1075_1.pdf.

[19] These prepayment penalty prohibitions are equally applicable to "high-cost mortgages" under sections 226.32 and 226.34. Note: Under Regulation Z, 12 CFR 226.23(a)(3), footnote 48, a high-cost mortgage loan having a prepayment penalty that does not conform to the requirements of section 226.32(d)(7) is subject to a three-year right of the consumer to rescind. The FRB is revising footnote 48 to clarify that a higher priced mortgage loan (whether or not it is a HOEPA loan) having a prepayment penalty that does not conform to the requirements of section 226.35(b)(2) also is subject to a three-year right of rescission.

[20] FDIC-supervised institutions may not impose prepayment penalties on *any* consumer mortgage, even if it is not higher-priced or high-cost under Regulation Z, if other applicable law prohibits such penalties.

of the loan term, the imposition of a prepayment penalty would be prohibited.[21]

- The source of the prepayment funds is a refinancing by the same mortgage lender or an affiliate of the mortgage lender. This prohibition is specifically designed to prevent equity stripping through repeated loan flipping by the same mortgage lender, a historically common practice among subprime mortgage lenders.[22]

Failing to escrow for property taxes and mortgage-related insurance when the mortgage loan is secured by a first lien

A mortgage lender is prohibited from originating a higher-priced mortgage loan *secured by a first lien* without establishing an escrow account for property taxes and premiums for mortgage-related insurance required by the mortgage lender. Mortgage-related insurance includes insurance against loss of or damage to the property securing the loan, against liability arising out of the ownership or use of the property, or protecting the mortgage lender against the consumer's default or other credit loss.[23] A mortgage lender is permitted to offer the borrower an opportunity to cancel the escrow account, but such cancellation can occur only in response to a written request from the consumer received by the mortgage lender no earlier than one year after consummation.[24]

Higher-Priced Mortgages and HMDA

Compliance practitioners should note the Home Mortgage Disclosure Act (HMDA) and Regulation C implications of Regulation Z's higher-priced mortgage amendments. Pursuant to the amendments to Regulation Z, the Federal Reserve has amended Regulation C, implementing HMDA. The amendments to Regulation C revise the rules for reporting price information on higher-priced mortgage loans. Regulation C currently requires mortgage lenders to collect and report the spread between the APR on a mortgage loan and the yield on a Treasury security of comparable maturity if the spread is greater than 3.0 percentage points for a first-lien loan or greater than 5.0 percentage points for a subordinate-lien loan. This difference is known as the rate spread. Under the revised rule, a mortgage lender will report the spread between the loan's APR and a survey-based estimate of APRs currently offered on prime mortgages of a comparable type (average prime offer rate) if the spread is equal to or greater than 1.5 percentage points for a first-lien loan or equal to or greater than 3.5 percentage points for a subordinate-lien loan.[25]

The changes are intended to improve the accuracy and usefulness of data reported under HMDA and conform the threshold for rate-spread reporting to the definition of higher-priced mortgage loans adopted under the Regulation Z amendments discussed above. By adopting this rate-spread-reporting threshold, the Federal Reserve expressed its intent to cover subprime mortgages and generally avoid covering prime mortgages. The Federal Reserve believes applying the new, market survey–based benchmarks in place of Treasury security yields will better achieve this purpose and ensure more consistent and more useful data. In addition, by implementing the same pricing threshold test under both regulations, the Federal Reserve aims to reduce the overall regulatory burden on mortgage lenders.

Regulation C's (HMDA) amended higher-priced mortgage loan reporting requirements take effect October 1, 2009. Thus, any subsequent HMDA analysis of higher-priced mortgage lending using 2009 loan data will be bifurcated between the loan data collected for the January through September period (using the former thresholds of APRs of 3.0 percentage points or 5.0 percentage points over Treasury yields) and the loan data collected for the October through December period (using the new benchmark of 1.5 percent points or 3.5 percent points over the average prime offer rate). Any year-over-year aberration noted in an institution's higher-priced mortgage lending involving 2009 loan data must be analyzed in the context of this bifurcation of collection thresholds.

[21] For examples demonstrating whether prepayment penalties are permitted or prohibited based on changes in mortgage payments due to negative amortization, see Supplement I to Part 226 under 226.35(b) (2) i-ii, applicable to both higher-price and high-cost mortgages. Exception: Negative amortization is prohibited for high-cost mortgage loans under section 226.32. Thus, the negative amortization examples contained in the rule are applicable only to higher-priced mortgage loans under section 226.35(b). For other examples demonstrating whether prepayment penalties are permitted or prohibited based on changes in mortgage payments during the first four years of a mortgage, see Supplement I to Part 226 under 226.32(d)(7)(iv). These examples also are applicable to higher-priced mortgages under 226.35 and high-cost mortgages under 226.32. Exception: The example relating to debt-to-income ratio is not applicable to higher-priced mortgages.

[22] As previously noted by the FDIC and the other federal banking agencies, predatory lending practices often involve inducing a borrower to refinance a loan repeatedly to charge high points and fees each time the loan is refinanced (loan flipping). See FIL-9-2001, http://www.fdic.gov/news/news/financial/2001/fil0109.html.

[23] Regulation Z provides two exemptions from this general prohibition. A mortgage lender is not required to (1) establish an escrow account for mortgage loans secured by a cooperative, or (2) escrow for mortgage-related insurance premiums for mortgage loans secured by a condominium where the condominium association has an obligation to the condominium unit owners to maintain a master policy insuring condominium units.

[24] Unlike the other amendments to Regulation Z discussed in this article that have an October 1, 2009, effective date, the provisions relating to escrowing for higher-priced mortgage loans have a delayed effective date of April 1, 2010. Thus, all mortgage loans for which written applications were received by April 1, 2010, must comply with Regulation Z's escrow provisions for higher-priced mortgage loans.

[25] The Federal Reserve intends to publish average prime offer rates based on the Primary Mortgage Market Survey® currently published by Freddie Mac. To determine current average prime offer rates go to http://www.ffiec.gov/ratespread/newcalc.aspx.

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Enhanced Protections for Consumers of High-Cost Mortgage Loans

Although higher-priced mortgage loans represent a new category of loans covered by Regulation Z, high-cost mortgage loans do not. A high-cost mortgage is any closed-end, home-equity mortgage (either in a first or a subordinate position), extended for a consumer (i.e., personal, family, or household) purpose, secured by a consumer's principal dwelling with either (1) an APR at consummation greater than 8.0 percentage points for first-lien loans or 10.0 percentage points for subordinate-lien loans above the yield on Treasury securities with comparable maturities, or (2) points and fees payable by the consumer at or before loan closing exceeding the greater of 8 percent of the total loan amount or $583.[26]

Because these mortgage loans are secured by "the roof under which one sleeps," consumers taking out high-cost mortgage loans have long been afforded special protections under Regulation Z.[27] In addition to receiving information (i.e., disclosures) specific to the high-cost mortgage loan (information beyond that which is provided to consumers in connection with a non-high-cost mortgage loan), homeowners obtaining high-cost mortgage loans receive several substantive protections as well.[28] However, pursuant to the same laws under which consumer protections for higher-priced mortgage loans have been promulgated, enhancements to some of the long-established consumer protections for high-cost mortgage loans also have been promulgated. To a significant degree, these enhancements parallel and conform to Regulation Z's higher-priced mortgage loan protections and relate to collateral-based lending without regard to repayment ability and prepayment penalties.

Collateral-based Lending without Regard to Repayment Ability

As with higher-priced mortgage lending, mortgage lenders extending high-cost mortgage loans are prohibited from extending such loans based on the collateral securing the loan without regard

[26] The $583 figure is as of 2009. This amount is adjusted annually by the Federal Reserve based on changes in the Consumer Price Index.

[27] Unlike higher-priced mortgage loans under section 226.35 of Regulation Z (which include both purchase-money and non-purchase-money mortgage loans secured by a consumer's principal dwelling), section 32 high-cost mortgage loans are limited to non-purchase-money home loans (i.e., mortgage loans on homes already owned, such as refinancings or home equity loans) secured by a consumer's principal dwelling. As with higher-priced mortgage loans, high-cost mortgage loans exclude home equity lines of credit and reverse mortgages.

[28] Sections 32 and 34 of Regulation Z prohibit a high-cost mortgage lender from (1) imposing, with limited exception, a balloon payment in connection with a high-cost mortgage loan with a term of less than five years; (2) imposing negative amortization; (3) collecting advance payments, i.e., the consolidation and collection of more than two periodic payments, paid in advance from the loan proceeds; (4) increasing an interest rate upon default; (5) including, with limited exception, a due-on-demand clause; (6) unfairly calculating interest to be rebated to a consumer in connection with loan acceleration resulting from default; (7) making, with limited exception, a direct payment of loan proceeds to a home improvement contractor, payable solely in the name of the home improvement contractor; (8) failing to furnish the required Regulation Z notice to an assignee of a high-cost mortgage loan (such notice informs the assignee that this is a mortgage subject to special protections under TILA and that the assignee could be liable for claims and defenses that the consumer could assert against the lender); (9) refinancing a high-cost mortgage loan that was made by the same mortgage lender into another high-cost mortgage loan to the same homeowner within one year of consummation, unless the refinancing is in the homeowner's interest (e.g., a lower interest rate); (10) extending a high-cost mortgage loan based on the value of the collateral securing the loan without regard to the homeowner's repayment ability; and (11) imposing prepayment penalties in certain circumstances. In addition to these practices, Regulation Z also prohibits as unfair the practice of structuring a home-secured loan as an open-end plan to evade the high-cost and higher-priced mortgage provisions of Regulation Z.

to the homeowner's ability to repay the loan. This is not a new prohibition under the high-cost mortgage loan provisions of Regulation Z. However, under the previous regulation, such practice was a violation of Regulation Z only when a "pattern or practice" of such behavior was demonstrated. Under amended Regulation Z, there is no longer a requirement to demonstrate a pattern or practice of engaging in this form of underwriting to establish a violation.

In addition, the previous regulation created a mere presumption of violation if a mortgage lender engaged in a pattern or practice of making high-cost mortgage loans without verifying and documenting a consumer's repayment ability. Under amended Regulation Z, this presumption has been eliminated. Instead, the new high-cost mortgage loan provisions (and the higher-priced mortgage loan provisions) *specifically prohibit* relying on a consumer's income or assets without verifying such amounts through reasonably reliable third-party documentation, such as W-2s, tax returns, payroll receipts, or financial institution records.[29]

Prepayment Penalties

Other changes to Regulation Z's high-cost mortgage loan provisions pertain to prepayment penalties and provide enhanced consumer protections. Prepayment penalties may be imposed on high-cost mortgage loans only if such penalties are permitted by other applicable law (e.g., state consumer protection laws) and, per the Regulation Z amendments, only if imposed within the first two years of the loans.

High-cost mortgage loans share most of the prepayment penalty prohibitions for higher-priced mortgage loans.[30] As with higher-priced mortgage loans, prepayment penalties on high-cost mortgage loans may not be imposed:

- At any time during the term of the loan if other applicable law (e.g., state law) prohibits such penalty. This represents no change from previous high-cost mortgage loan prohibitions.
- After the first two years of the loan term. This is a change from the previous regulation and enhances consumer protection by reducing the period after consummation from five to two years, after which no prepayment penalty may be imposed.
- At any time during the term of the loan if the consumer's mortgage payment (i.e., payment of principal or interest or both) can change during the first four years of the loan term. This is a completely new provision added to the prepayment penalty prohibitions for high-cost mortgage loans.[31]
- At any time during the term of the loan if the source of the prepayment funds is a refinancing by the same mortgage lender or an affiliate of the

[29] With respect to a consumer's obligations, a mortgage lender may verify such obligations via a credit report. With respect to obligations listed on an application but not appearing on a credit report, the mortgage lender has no further duty regarding such obligation other than to consider it in determining a consumer's repayment ability. For further information, see discussion on ability to repay and income/asset/obligation verification under higher-priced mortgage loans above.

[30] Some of the prepayment penalty prohibitions for high-cost mortgage loans represent changes from the previous regulation, while others do not.

[31] For examples demonstrating whether prepayment penalties are permitted or prohibited based on changes in mortgage payments during the first four years of a mortgage, see Supplement I to Part 226 under 226.32(d)(7)(iv). These examples are applicable to both higher-priced mortgages under 226.35, except for the example relating to debt-to-income ratio, which is not applicable to higher-priced mortgages, and high-cost mortgages under 226.32. Note: Negative amortization is prohibited for high-cost mortgage loans under section 226.32. Thus, the negative amortization examples provided are applicable only to higher-priced mortgage loans under section 226.35(b).

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mortgage lender. This represents no change from previous high-cost mortgage loan prohibitions.

However, unlike higher-priced mortgage loans, prepayment penalties on high-cost mortgage loans may not be imposed when, at consummation, the consumer's total monthly debt payments, including amounts owed under the mortgage, exceed 50 percent of the consumer's monthly gross income. This represents no change from previous high-cost mortgage loan prohibitions. This particular prepayment penalty restriction for high-cost mortgage loans under section 226.32 was the only restriction *not* incorporated into the prepayment penalty provisions for higher-priced mortgage loans under section 226.35.

To summarize key features and prohibitions of higher-priced and high-cost mortgages originated on or after October 1, 2009, and high-cost mortgages originated prior to October 1, 2009, a side-by-side comparison of these categories of mortgages appears below.

Comparison of Higher-Priced and High-Cost Mortgages

	Higher-Priced Mortgage Loans (Purchase-Money, Refinancings, and Home Equity Loans) **[10/1/09 and later originations]**	**High-Cost Mortgage Loans (Refinancings and Home Equity Loans Only)** **[10/1/09 and later originations]**	**High-Cost Mortgage Loans (Refinancings and Home Equity Loans Only)** **[pre-10/1/09 originations]**
Thresholds	Thresholds based on average prime offer rate: APR must exceed the average prime offer rate by at least 1.5 percentage points for first-lien loans and 3.5 percentage points for subordinate-lien loans.	Thresholds based on either Treasuries or fees: An APR greater than 8.0 percentage points for first-lien loans or 10.0 percentage points for subordinate-lien loans above the yield on Treasury securities with comparable maturities – OR – Points and fees exceeding the greater of 8 percent of the total loan amount or $583.	<Same
Prohibition	May not rely on the collateral securing the loan without regard to the consumer's ability to repay.	<Same	May not engage in a *pattern or practice* of asset-based lending.
Prohibition	May not rely on the consumer's income or assets without verifying such amounts through reasonably reliable third-party documents.	<Same	May not fail to use documented, independent sources when considering the consumer's repayment ability.
Prohibition	May not impose a prepayment penalty after two years.	<Same	May not impose a prepayment penalty after five years.
Prohibition	May not impose a prepayment penalty at any time if	May not impose a prepayment penalty at any time if	May not impose a prepayment penalty at any time if
	■ other applicable law prohibits such penalty;	<Same	<Same
	■ the consumer's mortgage payment can change during the first four years of the loan term; or	<Same	<None
	■ the source of the prepayment funds is a refinancing by the same mortgage lender or an affiliate.	<Same	<Same
	None>	■ The consumer's total monthly debt payments (at consummation), including amounts owed under the mortgage, exceed 50 percent of the consumer's monthly gross income.	<Same

Comparison of Higher-Priced and High-Cost Mortgages			
	Higher-Priced Mortgage Loans (Purchase-Money, Refinancings, and Home Equity Loans) **[10/1/09 and later originations]**	**High-Cost Mortgage Loans (Refinancings and Home Equity Loans Only)** **[10/1/09 and later originations]**	**High-Cost Mortgage Loans (Refinancings and Home Equity Loans Only)** **[pre-10/1/09 originations]**
Prohibition	May not fail to escrow for property taxes and mortgage-related insurance when the mortgage loan is secured by a first lien	<None	<None
Prohibition	May not structure a home-secured loan as an open-end plan to evade Regulation Z's *higher-priced* mortgage provisions.	May not structure a home-secured loan as an open-end plan to evade Regulation Z's *high-cost* mortgage provisions	<Same
Prohibition	None>	May not ■ impose, with limited exception, a balloon payment on loans with a term of less than five years; ■ impose negative amortization; ■ collect advance payments, i.e., the consolidation and collection of more than two periodic payments, paid in advance from the loan proceeds; ■ increase an interest rate upon default; ■ include, with limited exception, a due-on-demand clause; ■ unfairly calculate interest due to be rebated to a consumer in connection with loan acceleration resulting from default; ■ make, with limited exception, a direct payment of loan proceeds to a home improvement contractor, payable solely in the name of the contractor; ■ fail to furnish the required Regulation Z notice to an assignee of a high-cost mortgage (informs the assignee this mortgage is subject to special TILA protections and the assignee could be liable for claims and defenses the consumer could assert against the lender); ■ refinance a high-cost mortgage made by the same lender into another high-cost mortgage to the same homeowner within one year of consummation unless the refinancing is in the homeowner's interest, e.g., a lower interest rate.	May not <Same <Same <Same <Same <Same <Same <Same <Same <Same

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Impact of Regulation Z's Higher-Priced and High-Cost Mortgage Amendments on Nontraditional and Subprime Mortgage Guidance

Responsible creative financing, which often can help many borrowers obtain a prudent, affordable loan, sometimes gives way to irresponsible, costly, and (in certain cases) unsustainable and abusive financing. While Regulation Z has long provided protections against certain abusive mortgage lending practices, these protections applied primarily to a limited class of high-cost home equity mortgage loans (i.e., mortgage loans taken out by consumers who already owned their homes). Such protections did not extend to consumers first purchasing their homes (i.e., purchase-money home mortgage loans). Compounding the situation, home purchasers most vulnerable to these aggressive mortgage terms and lending practices are those who, by virtue of the fact they are often first-time or unsophisticated homebuyers, are least able to protect themselves against the onerous terms or practices often associated with these products.

To address and mitigate the risks associated with many of these mortgage loans and lending practices, whether relating to home purchase or refinancing, the FDIC and other bank regulators issued guidance to their respective supervised institutions advising them of supervisory expectations with respect to the origination of these mortgage products (often referred to as nontraditional or subprime home mortgage loans), including expectations with respect to consumer protection.[32] The Nontraditional Mortgage (NTM) and Subprime Mortgage Guidance documents reflect the FDIC's position on appropriate lending behavior with respect to mortgage loans subject to this guidance.

Many of the mortgage loan characteristics, and the risks they present, discussed in these guidance documents are the subject of the recent amendments to Regulation Z. Thus, with the promulgation of these Regulation Z amendments, much of the previously issued guidance relating to managing heightened risk levels has been superseded by Regulation Z's outright prohibitions against certain mortgage lending practices. What was guidance in the form of admonishment has essentially become law. As discussed in this article, many of the risk-layering practices of concern addressed in those documents—such as relying on reduced or no documentation, failing to verify a borrower's repayment ability, and the imposition of prepayment penalties without limit—are now prohibited by Regulation Z where the terms of a mortgage loan constitute a higher-priced or high-cost mortgage. As such, a comprehensive review for predatory or abusive mortgage lending practices should reference the amendments to Regulation Z along with the NTM and Subprime Mortgage Guidance documents. And, of course, any practices of concern not specifically addressed by Regulation Z or other consumer protections laws should be scrutinized under the unfair or deceptive prongs of section 5 of the Federal Trade Commission Act.

Appraisal and Servicing Protections for Consumers of Mortgage Loans Secured by the Consumer's Principal Dwelling

To prevent practices that the Federal Reserve describes as "unfair, deceptive, associated with abusive lending practices, or otherwise not in the interest of the borrower,"[33] Regulation Z has been amended to extend new protections to consumers of all mortgage loans (i.e., not limited to higher-priced or high-cost mortgage loans) secured by the consumer's principal dwelling, extended for a consumer (i.e., personal, family, or household) purpose. These protections are intended to ensure the accuracy and integrity of appraisals and the fair treatment of borrowers by servicers. The Federal Reserve believes these protections will also enhance a consumer's informed use of credit.

The amended regulation prohibits mortgage lenders and mortgage brokers from coercing, influencing, or encouraging an appraiser to misrepresent the value of the property. The rule also prohibits creditors from extending credit when a creditor knows that a person has coerced, influenced, or encouraged an appraiser, unless the creditor acts with reasonable diligence to determine that the appraisal does not materially misstate or misrepresent the value of the property.[34] Given the prevalence of these types of unfair appraisal practices among brokered mortgages loans, FDIC-supervised institutions should pay particular attention to and closely monitor for the existence of such practices when originating mortgage loans through third parties.[35]

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[32] See http://www.fdic.gov/news/news/financial/2006/fil06089.html and http://www.fdic.gov/news/news/financial/2007/fil07062.html.

[33] See page 44563 of the July 30, 2008 ***Federal Register*** notice at http://www.fdic.gov/news/news/financial/2008/fil08134a.html.

[34] Though Regulation Z limits the coverage of this prohibition to mortgage loans secured by a consumer's principal dwelling, the FDIC will examine and potentially cite such practices relative to all mortgage loans pursuant to section 5 the FTC Act, under the standards for unfair or deceptive active acts or practices. Furthermore, the FDIC has promulgated regulations and guidance that set forth standards for the policies and procedures FDIC-supervised institutions are expected to implement to ensure the independent judgment of appraisers when valuing property. See Appraisals at 12 CFR 323, http://www.fdic.gov/regulations/laws/rules/2000-4300.html, and Real Estate Lending Standards at 12 CFR 365, http://www.fdic.gov/regulations/laws/rules/2000-8700.html.

[35] Bill Garber, director of government affairs for The Appraisal Institute (Institute), notes that "there are a number of pressure points for appraisers, and that pressure can come from any number of parties in a given transaction (mortgage broker, loan officer, realty agent, etc.)." Garber goes on to say that, according to the Institute's members, "the most pervasive pressure comes from mortgage brokers or other parties that are 'volume' driven." See http://realtytimes.com/rtpages/20050208_appraisers.htm.

In addition, under the amendments to Regulation Z, servicers are prohibited from (1) failing to credit a payment to the consumer's account as of the date of its receipt,[36] (2) "pyramiding" late fees (i.e., levying or collecting a delinquency charge on a payment, when the only delinquency is attributable to late fees or delinquency charges assessed on earlier installments),[37] and (3) failing to provide a payoff statement within a reasonable amount of time after receiving a request from the consumer.[38]

Expanded and Enhanced Early Disclosure Requirements and New Prohibitions against Deceptive Advertising

Regulation Z also has been amended to provide new and enhanced protections to consumers of all home mortgage loans secured by "any" dwelling (i.e., not limited to a consumer's principal dwelling), extended for a consumer (i.e., personal, family, or household) purpose. These protections relate to Regulation Z's early disclosure requirements and prohibited advertising practices.

Early Disclosures

The amendments to Regulation Z extend the early disclosure requirements of section 226.19 in several important ways. First, the amendments extend these requirements, previously applicable only to purchase-money transactions, to refinancings and home equity loans. Second, the amendments extend the early disclosure requirements, previously applicable only to mortgage loans secured by a consumer's principal dwelling, to mortgage loans secured by *any* consumer dwelling. Third, the amendments require delivery or mailing of the early disclosures to occur at least seven business days before consummation. Fourth, if the annual percentage rate provided in the early disclosures changes (beyond the tolerances provided in section 226.22[39]), the amendments require redisclosure at least three business days before consummation.[40] Fifth, except to the extent that such a fee is for the purpose of obtaining a credit report, the amendments prohibit charging an application fee until after a consumer has received the early disclosures.

Compliance Practitioner Note:

The amendments to Regulation Z pertaining to early disclosures under Section 226.19, "Certain residential mortgage and variable-rate transactions," have occurred over the course of ten months and two separate rulemakings, the first in the summer of 2008 and the second in the spring of 2009. The 2008 amendments had an effective date of October 1, 2009, and therefore did not take effect before the superseding 2009 amendments. The 2009 amendments, prompted by Congress under the Mortgage Disclosure Improvement Act, take effect on July 30, 2009. Thus, all written applications received by mortgage lenders on or after July 30, 2009, must comply with the early disclosure requirements of Regulation Z as amended in 2009 and as described in this article.

[36] Section 226.36(c) provides limited exceptions to this prohibition, such as where the delay does not result in a charge to the consumer or negative reporting to a consumer reporting agency, or, where the consumer fails to follow the lender's written instructions for making payment, the servicer credits a payment received under such circumstances within five days of receipt.

[37] Note: Regulation AA, implementing section 5 of the FTC Act (UDAP) also prohibits the pyramiding of late fees in credit transactions, including transactions secured by real estate (other than for the purchase of real estate which are not covered by Regulation AA). However, unlike Regulation Z, Regulation AA applies only to institutions supervised by the federal banking agencies. By adding this explicit prohibition to Regulation Z, the Federal Reserve has extended this prohibition to all mortgage lenders, not just banks, thrifts, and credit unions.

[38] The Federal Reserve notes that while five days is reasonable, a longer period may be warranted under certain conditions.

[39] Section 226.22 provides a tolerance of one-eighth of 1 percent for regular transactions and one-quarter of 1 percent for irregular transactions.

[40] These timing restrictions notwithstanding, the rule allows consumers to expedite consummation to meet a bona fide personal financial emergency. See section 226.19(a)(3), http://www.fdic.gov/news/news/financial/2009/fil09026.html.

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A side-by-side comparison of the differences between the 2008 early disclosures amendments to Regulation Z (i.e., those that were to take effect October 1, 2009, but now will not) and the superseding 2009 early disclosure amendments (i.e., those that will take effect starting July 30, 2009) appears below.

Regulation Z Early Disclosure Requirements of Section 226.19
2008 Revisions (will not take effect) vs. 2009 Revisions (effective July 30, 2009)

Early TIL Disclosure	2008 Revisions (never took effect)	2009 Revisions (effective 7/30/09)
Applies to loan to:	Purchase or construct home, refinance home, and home equity loans	Same
Secured by:	Principal dwelling	Any consumer dwelling
Timing of delivery:	Within three business days of application	Within three business days of application and at least seven business days before consummation (Timing waiver for bona fide emergency)
Content:	Good faith estimate of 226.18 disclosures	Good faith estimate of 226.18 disclosures and the statement: "You are not required to complete this agreement merely because you have received these disclosures or signed a loan application."
Timing of re-disclosure (if APR outside 226.22 tolerance):	Must be given no later than consummation or settlement	Must be given at least three business days before consummation
Application fee:	No application fee allowed until after early disclosures provided, except for a credit report fee	Same

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.

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[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.