Press Release

December 18, 2007

Request for comment on changes to Regulation Z to protect consumers from unfair or deceptive home mortgage lending and advertising practices

For immediate release

The Federal Reserve Board on Tuesday proposed and asked for public comment on changes to Regulation Z (Truth in Lending) to protect consumers from unfair or deceptive home mortgage lending and advertising practices. The rule, which would be adopted under the Home Ownership and Equity Protection Act (HOEPA), would restrict certain practices and would also require certain mortgage disclosures to be provided earlier in the transaction.

The Home Ownership and Equity Protection Act amended the Truth in Lending Act (TILA). Under HOEPA, the Board has the responsibility to prohibit acts and practices in connection with mortgage loans that it finds to be unfair or deceptive.

"Our goal is to promote responsible mortgage lending, for the benefit of individual consumers and the economy," said Federal Reserve Chairman Ben S. Bernanke. "We want consumers to make decisions about home mortgage options confidently, with assurance that unscrupulous home mortgage practices will not be tolerated."

The proposal includes four key protections for "higher-priced mortgage loans" secured by a consumer's principal dwelling:

Creditors would be prohibited from engaging in a pattern or practice of extending credit without considering borrowers' ability to repay the loan.
- Creditors would be required to verify the income and assets they rely upon in making a loan.
- Prepayment penalties would only be permitted if certain conditions are met, including the condition that no penalty will apply for at least sixty days before any possible payment increase.
- Creditors would have to establish escrow accounts for taxes and insurance.

The rule would define "higher-priced mortgage loan" to capture loans in the subprime market but generally exclude loans in the prime market. A loan would be covered if it is a first-lien mortgage and has an annual percentage rate (APR) that is three percentage points or more above the yield on comparable Treasury notes, or if it is a subordinate-lien mortgage with an APR exceeding the comparable Treasury rate by five points or more.

"Unfair and deceptive practices have harmed consumers and the integrity of the home mortgage market," said Federal Reserve Board Governor Randall S. Kroszner. "We have listened closely and developed a response to abuses that we believe will facilitate responsible lending."

The following protections would apply to all loans secured by a consumer's principal dwelling, regardless of the loan's APR:

- Lenders would be prohibited from compensating mortgage brokers by making payments known as "yield-spread premiums" unless the broker previously entered into a written agreement with the consumer disclosing the broker's total compensation and other facts. A yield spread premium is the fee paid by a lender to a broker for higher-rate loans. The consumer's written agreement with the broker must occur before the consumer applies for the loan or pays any fees.
- Creditors and mortgage brokers would be prohibited from coercing a real estate appraiser to misstate a home's value.
- Companies that service mortgage loans would be prohibited from engaging in certain practices. For example, servicers would be required to credit consumers' loan payments as of the date of receipt and would have to provide a schedule of fees to a consumer upon request.

The proposed revisions to TILA's advertising rules require additional information about rates, monthly payments, and other loan features. The amendments also would ban seven deceptive or misleading advertising practices, including representing that a rate or payment is "fixed" when it can change.

Under the proposal, creditors would have to provide a good faith estimate of the loan costs, including a schedule of payments, within three days after a consumer applies for any mortgage loan secured by a consumer's principal dwelling, such as a home improvement loan or a loan to refinance an existing loan. Currently, early cost estimates are only required for home-purchase loans. In addition, consumers could not be charged any fee until after they receive the early disclosures, except a reasonable fee for obtaining the consumer's credit history.

The Federal Reserve has engaged in extensive outreach efforts with consumer groups, the financial services industry, lawmakers, and others to ensure that the proposed rules are likely to achieve the goal of protecting consumers from unfair practices without shutting off access to responsible credit. The proposal takes into consideration testimony given at four public hearings the Board held in the summer of 2006, and a hearing held in June 2007, as well as public comment letters received in connection with those hearings. The Board also consulted with other federal and state agencies and its own Consumer Advisory Council.

The *Federal Register* notice is attached. The comment period ends ninety days after publication of the proposal in the *Federal Register*, which is expected shortly.

Highlights of Proposed Rule to Amend Home Mortgage Provisions of Regulation Z

Statement by Chairman Ben S. Bernanke

Statement by Governor Randall S. Kroszner

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Board meeting materials

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