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Board issues final rule amending home mortgage provisions of Regulation Z (Truth in Lending)

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Press Release

July 14, 2008

Board issues final rule amending home mortgage provisions of Regulation Z (Truth in Lending)

For immediate release

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The Federal Reserve Board on Monday approved a final rule for home mortgage loans to better protect consumers and facilitate responsible lending. The rule prohibits unfair, abusive or deceptive home mortgage lending practices and restricts certain other mortgage practices. The final rule also establishes advertising standards and requires certain mortgage disclosures to be given to consumers earlier in the transaction.

The final rule, which amends Regulation Z (Truth in Lending) and was adopted under the Home Ownership and Equity Protection Act (HOEPA), largely follows a proposal released by the Board in December 2007, with enhancements that address ensuing public comments, consumer testing, and further analysis.

"The proposed final rules are intended to protect consumers from unfair or deceptive acts and practices in mortgage lending, while keeping credit available to qualified borrowers and supporting sustainable homeownership," said Federal Reserve Chairman Ben S. Bernanke. "Importantly, the new rules will apply to all mortgage lenders, not just those supervised and examined by the Federal Reserve. Besides offering broader protection for consumers, a uniform set of rules will level the playing field for lenders and increase competition in the mortgage market, to the ultimate benefit of borrowers," the Chairman said.

The final rule adds four key protections for a newly defined category of "higher-priced mortgage loans" secured by a consumer's principal dwelling. For loans in this category, these protections will:

- Prohibit a lender from making a loan without regard to borrowers' ability to repay the loan from income and assets other than the home's value. A lender complies, in part, by assessing repayment ability based on the highest scheduled payment in the first seven years of the loan. To show that a lender violated this prohibition, a borrower does not need to demonstrate that it is part of a "pattern or practice."
- Require creditors to verify the income and assets they rely upon to determine repayment ability.
- Ban any prepayment penalty if the payment can change in the initial four years. For other higher-priced loans, a prepayment penalty period cannot last for more than two years. This rule is substantially more restrictive than originally proposed.
- Require creditors to establish escrow accounts for property taxes and homeowner's insurance for all first-lien mortgage loans.

"These changes have made for better rules that will go far in protecting consumers from unfair practices and restoring confidence in our mortgage system," said Governor Randall S. Kroszner.

In addition to the rules governing higher-priced loans, the rules adopt the following protections for loans secured by a consumer's principal dwelling, regardless of whether the loan is higher-priced:

- Creditors and mortgage brokers are prohibited from coercing a real estate appraiser to misstate a home's value.
- Companies that service mortgage loans are prohibited from engaging in certain practices, such as pyramiding late fees. In addition, servicers are required to credit consumers' loan payments as of the

date of receipt and provide a payoff statement within a reasonable time of request.

- Creditors must 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. Consumers cannot be charged any fee until after they receive the early disclosures, except a reasonable fee for obtaining the consumer's credit history.

For all mortgages, the rule also sets additional advertising standards. Advertising rules now require additional information about rates, monthly payments, and other loan features. The final rule bans seven deceptive or misleading advertising practices, including representing that a rate or payment is "fixed" when it can change.

The rule's definition of "higher-priced mortgage loans" will capture virtually all loans in the subprime market, but generally exclude loans in the prime market. To provide an index, the Federal Reserve Board will publish the "average prime offer rate," based on a survey currently published by Freddie Mac. A loan is higher-priced if it is a first-lien mortgage and has an annual percentage rate that is 1.5 percentage points or more above this index, or 3.5 percentage points if it is a subordinate-lien mortgage. This definition overcomes certain technical problems with the original proposal, but the expected market coverage is similar.

One element of the original proposal has been withdrawn. The Federal Reserve Board had proposed for public comment certain requirements pertaining to so-called "yield-spread premiums." During the intervening period, the Board engaged in consumer testing that cast significant doubt on the effectiveness of the proposed rule. As part of its ongoing review of closed-end loan rules under Regulation Z, however, the Board will consider alternative approaches.

In finalizing the rule, the Board carefully considered information obtained from testimony, public hearings, consumer testing, and over 4,500 comment letters submitted during the comment period. "Listening carefully to the commenters, collecting and analyzing data, and undertaking consumer testing, has led to more effective and improved final rules," Governor Kroszner said.

The new rules take effect on October 1, 2009. The single exception is the escrow requirement, which will be phased in during 2010 to allow lenders to establish new systems as needed.

In a related move, the Board is publishing for public comment a proposal to revise the definition of "higher-priced mortgage loan" under Regulation C (Home Mortgage Disclosure), which requires lenders to report price information for such loans, to conform to the definition the Board is adopting under Regulation Z.

The *Federal Register* notices are attached.

Federal Register notice, Regulation Z: [565 KB PDF](#) | [HTML](#)

Federal Register notice, Regulation C: [93 KB PDF](#) | [HTML](#)

[Statement of Chairman Ben S. Bernanke](#)

[Statement of Governor Randall S. Kroszner](#)

[Highlights of Final Rule Amending Home Mortgage Provisions of Regulation Z \(Truth in Lending\)](#)

[Consumer Testing of Mortgage Broker Disclosures, Summary of Findings \(7.45 MB PDF\)](#)

[Open Board Meeting Materials](#)

Last Update: July 14, 2008