

Consumer Compliance “Hot Topics”

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Consumer Compliance
Division of Banking Supervision and Regulation
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Today's Agenda

- **Fair Lending Implications in this Economic Environment**
 - Laura L. Boughner, Senior Examiner
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- **Spousal Signature Rules**
 - Kenneth J. Benton, Consumer Regulations Specialist
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- **New Mortgage Lending Rules**
 - William V. Beall, Senior Examiner
Federal Reserve Bank of Richmond
 - Laura L. Boughner, Senior Examiner
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Fair Lending Implications in this Economic Environment



Fair Lending Implications

- Current Environment
 - Economic summary and outlook
 - More regulation
- Industry Challenges & Changes
- Elevated Fair Lending Risk
 - Current
 - Emerging
- Best Practices



Current Economic Outlook

Excerpts from FRS Beige Book April 2009:

- Many signs of continued contraction
- Housing market conditions remain anemic with home prices and construction falling in most areas
- Commercial real estate conditions continue to decline as well as demand for these loans
- Consumer spending remained relatively weak
- Labor market conditions were weak



Industry Changes & Challenges

- Risk management pressures
 - Protect capital and continue to lend
- Cost-cutting measures
 - Reduction in compliance staff
 - Greater reliance on audit or outsourcing
- Change in demand
 - Borrowers on the sidelines
- Composition of applicants
 - Changing due to tightening of lending standards



Elevated Fair Lending Risk

- Delinquencies, foreclosures and loan modifications continue to increase
 - OCC & OTS Mortgage Metrics First Quarter 2009 Report
 - Judgmental processes raise concerns of consistency across groups of borrowers
- “At-Risk” market policies
 - May lead to allegations of redlining
 - May result in disparate impact
- Tightening of underwriting standards
 - FRS April 2009 senior loan officer opinion survey on bank lending practices
 - Likely to impact low-to-moderate income applicants
 - Potential for inconsistent application of lending standards



Elevated Fair Lending Risk *(continued)*

- Line reductions / increased minimum monthly payments
 - HELOCs & credit cards
 - Need for consistency in application of changes
- Pricing
 - Discretion by lenders and third party originators
 - Potential for overages to offset declining profits
- Reduction in staff & outsourcing
 - Lack of adequate monitoring and independent testing



Emerging Risk – Reverse Mortgages

- More popular as the economy sours
- FHA loan limit increased to \$625,500 in 2009
- Risks to consumers
 - Product complexity underscores need for controls
 - Potential for steering
- GAO study findings (June 29, 2009)
 - Potentially misleading marketing claims
 - Instances of non-compliance with HECM counseling requirements
 - No internal controls to prevent “inappropriate cross-selling”
- Banking agencies working on developing guidance



Control & Monitor Fair Lending Risk By

- Fair Lending Risk Assessment
- Strong policies and procedures
 - Established by board and stating commitment to fair lending
- Processes
 - Procedures that are understood by staff
 - Contain controls to mitigate risk
- Control Systems
 - MIS
 - Compliance reviews
 - Audit



Regulation B – Spousal Signature Rules



Three Common Violations

1. Requiring spousal signature for an applicant who satisfies lender's credit standards
2. Failing to establish intent of spousal applicants to apply jointly at time of application
3. Specifying, for a loan requiring a guarantor, that the guarantor be a spouse



Applicant Meets Credit Standards

- Regulation B – §202.7(d) provides, with exceptions, that a creditor cannot require a spousal signature on a credit instrument of non-joint applicant if applicant qualifies for credit standards on his or her own
- ***Exception for secured credit:*** spousal signature on instrument necessary under state law to reach loan collateral in event of default
- ***Exception for unsecured credit:*** spousal signature on instrument necessary under state law to reach jointly held property creditor relied upon in extending credit
- ***Exception for unsecured credit in community property state:*** spousal signature on instrument necessary under state law to reach community held property in event of default



Establishing Joint Intent

- Official Staff Commentary §202.7(d)(1)-3: intent for joint application must be evidenced *at time of application*
- Spousal signatures or initials on a credit application for joint credit is acceptable evidence of intent
 - Signatures on promissory note or financial statement are *not* acceptable
 - Use of Regulation B model forms in Appendix B provides a safe harbor
- Method used to establish intent must be distinct from the means used by individuals to affirm the accuracy of information (e.g., signed financial statement)



Specifying Spouse as Guarantor

- Regulation B – §202.7(d)(5) states that if under the creditor's lending standards the personal liability of an additional party is necessary to support applicant's credit, the creditor may require a co-signer or guarantor *but cannot require that the spouse be the additional party*
- Official Staff Commentary §202.7(d)(6)-1: creditors may require personal guarantee of partners, directors, or officers of a business, and the shareholders of a closely held corporation, even if the business or corporation is creditworthy
 - Must be based on guarantor's relationship with business and not on a prohibited basis.



New Mortgage Lending Rules

Mortgage Disclosure Improvement Act
Regulation Z Amendments
RESPA Amendments



Mortgage Disclosure Improvement Act (MDIA)

New early truth in lending disclosure rules



New Early Disclosure Rules

- Regulation Z's early disclosure rules – Section 226.19
 - Amended as a result of the Mortgage Disclosure Improvement Act (MDIA)
 - Go into effect on July 30, 2009 (next week)
- Applies to the following types of *consumer mortgage transactions*
 - Closed-end
 - Secured by a dwelling (includes other than a principal dwelling)
 - Applications received on or after July 30, 2009
- Business Day – 226.2(a)(6) – has two definitions
 - Days when open to the public for substantially all business functions
 - All days except Sundays & legal public holidays (rescission count)



Early Disclosure – Timing Rules

- Mail or deliver early disclosures for applicable mortgage loans no later than **three business days** after the creditor receives a consumer's written application (226.19(a)(1)(i) – open for business days)
- If disclosures are mailed, the consumer is deemed to have received them three business days after they are mailed (226.19(a)(1)(ii) – rescission count)

This rule has significance when related to two requirements:

- 1) Imposition of Fees
- 2) Mailing Corrected Disclosures

- Creditor must deliver or place in the mail the early disclosures no later than **seven business days** before consummation (226.19(a)(1)(ii) – rescission count)



Early Disclosure – Timing Rules *(continued)*

- If the APR becomes “inaccurate,” creditor must provide corrected disclosures of at least all the changed terms, so that consumers receive them not later the ***third business day before consummation*** (226.19(a)(2)(ii) – rescission count)
 - Tolerance for APR Accuracy in Section 226.22(a)
- Creditor must provide disclosures before the creditor or any other person imposes any fee in connection with the application, other than a bona fide and reasonable fee for obtaining the consumer’s credit history
 - Requirement Includes Rate Lock Fees



"3-7-3" Timing Rules

Sunday	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
				May 28 Application Received	May 29 Business Day 1	May 30 Business Day 2 (open for business)
May 31	June 1 Business Day 3 Initial disclosures mailed	June 2 Business Day 1	June 3 Business Day 2	June 4 Business Day 3 Mailed initial disclosures considered received	June 5 Business Day 4 Fees can now be collected	June 6 Business Day 5
X	June 8 Business Day 6 Corrected disclosures mailed	June 9 Business Day 7 Consummation date if no corrected disclosures required	June 10	June 11 Mailed corrected disclosure s considered received	June 12	June 13
X	June 15 Consummation based upon corrected disclosure					



Other MDIA Early Disclosure Rules

- Consumer waiver of waiting periods – 226.19(a)(3)
 - Consumer can waive both the 3 & 7 day waiting periods
 - Bona fide personal financial emergency
- Disclosure notice rule – 226.19(a)(4)
 - The following statement must be contained within *both* early and corrected disclosures

“You are not required to complete this agreement merely because you have received these disclosures or signed a loan application.”

- Special rules for timeshare plans – 226.19(a)(5)



Regulation Z Amendments

*Protections from unfair, abusive or deceptive
lending practices*



Regulation Z Amendments

- Address concerns in subprime mortgage lending
 - Protect consumers from unfair or deceptive acts and practices in mortgage lending
 - Applies to loans secured by consumer's principal dwelling
- Effective date of October 1, 2009
 - Except for escrow accounts
 - April 1, 2010 for site-built homes & October 1, 2010 for manufactured homes
- Defines new "Higher-Priced Mortgage Loan"
 - 150 bps over average prime rate offer rate; 350 bps for subordinate lien loans
 - Few exceptions (e.g., HELOCs, reverse mortgages, temporary financing)
 - Basis for new restrictions



Higher-Priced Mortgage Loans *(continued)*

- Creates “Ability to Repay” and “Verification of Income” Standards
- Prohibits making loan without regard to borrower’s ability to repay from income and assets other than home value
 - Does not prescribe underwriting standards
 - Required for all loans; “pattern or practice” standard removed
- Required to verify income and assets relied upon to determine repayment ability
 - Third-party documentation
 - Must consider and verify current income and obligations
 - May rely on credit bureau report
- Presumption of Compliance
 - Verify income and assets relied upon and verify current obligations
 - Use highest scheduled payment for first seven years
 - Use *fully amortizing* payment (exception for certain interest only and balloon loans)
 - Consider debt-to-income ratio or residual income



Higher-Priced Mortgage Loans *(continued)*

- Escrow Accounts Required
 - Mandated on first-lien loans
 - Creditor decides whether to permit opt-out
 - Prohibited in first 12 months
- Prepayment Penalties Restricted
 - Not permitted on loans subject to payment changes during the first 4 years
 - Restricted for all other loans (fixed rate)
 - Cannot exceed first two years of loan term
 - Cannot be imposed by same creditor or affiliate
- Cannot structure as open-end to avoid these rules



Protections for all Mortgages

- Appraiser coercion
 - Cannot influence appraiser to misrepresent value of home
 - Lender prohibited from extending credit if “had reason to know” value influenced
- Loan servicing practices
 - Payment credited date received
 - Prohibits “pyramiding” of late fees
 - Requires prompt pay-off statement
- Prohibits seven misleading or deceptive advertising practices



RESPA Final Rule

Rule to simplify & improve the process of obtaining mortgages & reduce consumer settlement costs



RESPA Final Rule

- Final Rule published in November 17, 2008, Federal Register
- Effective date split into two parts:
 - Technical changes went into effect this past January 16, 2009
 - More significant GFE & HUD-1 changes effective January 1, 2010
- Implementation of the rule is open for discussion



RESPA – Recap of 2009 Changes

- Section 3500.21 revised to accommodate 1996 Congressional changes to Section 6 of RESPA Statute & Mortgage Servicing Transfer Disclosure
- Appendix MS-1 provides a *revised* model disclosure
- New sections 3500.22 (Severability) & 3500.23 (ESIGN applicability) added
- Use of average charges
- Technical change was made to Section 3500.17 & Appendix E regarding the arithmetic steps for Escrow Analysis
- “Required Use” definition revised to revoke a builder’s Section 8 exemption
 - Prohibits a builder from enticing consumers to use builder’s affiliates, such as title or mortgage companies, through the use of incentives or discounts
 - After litigation HUD withdrew proposed change in May 2009



RESPA – Recap of 2010 Changes

Application “defined”

- Means the submission of a borrower’s financial information in anticipation of a credit decision
- May either be in writing or electronically submitted, including a written record of an oral application
- Content – contains these six items:
 1. Borrower’s name
 2. SS # for credit report
 3. Monthly income
 4. Property address
 5. Estimated value of property
 6. Loan amount
- Originators may ask for additional information beyond these six items



RESPA – Recap of 2010 Changes

(continued)

- Significant changes to both the GFE and HUD-1 Settlement Statement
 - New 3-page disclosure forms for both
- **GFE** – encourages consumers to comparison shop
 - Page 1: Summary of Loan Terms, Settlement Charges
 - Page 2: Adjusted Origination Charges, Settlement Charges
 - Page 3: Instructions, Fee Tolerances, Tradeoff Tables, Shopping Chart
- Tolerances
 - ***Zero Percent***
Origination charges – credit or charge (points), adjusted origination charges, transfer taxes
 - ***Ten Percent***
Required services (e.g., title services, lender's & owner's title insurance), required services the consumer can shop for, government recording charges
 - ***None***
Required services the consumer can shop for (e.g., title services, lender's & owner's title insurance), initial deposit for escrow account, daily interest charges, homeowner's insurance



RESPA – Recap of 2010 Changes

(continued)

- GFE terms must be available for at least 10 business days from delivery, with exceptions
- Once borrower indicates “intent to move forward” within 10 day period, then GFE is binding, subject to tolerances and changed circumstances
- Like the TILA rules, no charge permitted, except for the cost of a credit report, may be collected *until after* the consumer has received the GFE so that consumer is not as committed to the transaction
- **HUD 1/1A Settlement Statement**
 - New 3 Page Format
 - Modified to allow comparison of charges on the GFE
 - Lines reference corresponding “Block” numbers on the GFE
 - New format and requirements for disclosing mortgage broker and other origination charges
 - Opportunity to “cure” an inadvertent or technical error within 30 calendar days after settlement
 - Some current requirements still apply



Best Practices

- Determine applicability and need for change
- Review policies and procedures for needed changes for the new rules
- Train staff
- Sample loans to ensure accuracy of systems
- Ensure adequate monitoring systems in place to identify errors
- Keep senior management and board of directors informed with periodic MIS



Questions?



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