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**MEMORANDUM FOR: CHIEF EXECUTIVE OFFICERS**

**FROM:**

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**SUBJECT:**

Revised TILA Examination Procedures

The Truth in Lending Act (TILA) requires creditors to provide consumers with information about the cost of credit that they can use to make choices in the marketplace. As a result of recent revisions to Regulation Z which implements the TILA, OTS has updated its examination procedures.<sup>1</sup>

Specifically, the Board of Governors of the Federal Reserve System (the Board) issued a final rule that revises Regulation Z to prohibit unfair, abusive or deceptive lending and servicing practices for residential mortgage loans. The rule, which was adopted under the Home Ownership and Equity Protection Act (HOEPA), applies to all mortgage lenders and is now in effect.

The relevant revisions to Regulation Z established new requirements for mortgage lending and servicing designed to protect consumers against unfairness, deception and abuse while preserving responsible lending and sustainable homeownership. Consequently, Regulation Z now includes a newly defined category of “higher-priced mortgage loans” secured by a consumer’s principal dwelling. “Higher-priced mortgage loans” are defined as loans with an annual percentage rate that exceeds the average prime offer rate by 1.5 percentage points for first lien loans, or by 3.5 or more percentage points for subordinate lien loans. These loans are subject to requirements concerning repayment ability, income verification and prepayment penalties, as well as escrows and evasion.<sup>2</sup>

In addition, Regulation Z now includes new protections for all closed-end mortgages secured by a consumer’s principal dwelling, including a prohibition on abusive servicing practices. As amended, the rule also sets additional advertising standards for all mortgage loans and prohibits deceptive or misleading advertising practices.

<sup>1</sup> TILA examination procedures are being revised in several phases to address recent statutory and regulatory changes. This is the third set of revisions to the TILA examination procedures and follows revisions to the mortgage disclosure requirements resulting from the Mortgage Disclosure Improvement Act of 2008 and revisions to the open-end credit disclosure requirements resulting from the Credit Card Accountability Responsibility and Disclosure Act of 2009. As regulatory requirements evolve, OTS will work to ensure that its compliance examination process remains current and relevant.

<sup>2</sup> Only higher priced loans secured by a first lien on a principal dwelling are subject to the escrow requirement.

This set of revisions to the TILA examination procedures incorporates these changes to Regulation Z. Under the revised procedures, examiners will be required to evaluate whether savings associations meet the following requirements.

## **1. Protections for “Higher-Priced” Mortgage Loans and HOEPA Loans**

- A savings association is prohibited from making a higher-priced mortgage loan or HOEPA loan without regard to a borrower's ability to repay the loan from income and assets other than the home's value. Prior to the relevant revisions to Regulation Z, a lender was prohibited from engaging in a “pattern or practice” of extending HOEPA loans without regard to the consumer's ability to repay. The “pattern or practice” qualification has been removed.
- A savings association is required to verify the income and assets that it relies upon and the consumer's current obligations to determine repayment ability for higher-priced mortgage loans and HOEPA loans. Prior to the relevant revisions to Regulation Z, there was a rebuttable presumption of a violation when a lender engaged in a “pattern or practice” of making HOEPA loans without verifying repayment ability. The “pattern or practice” requirement has been removed.
- For higher-priced mortgage loans and HOEPA loans in which the payment can change in the first four years of the loan, a savings association is prohibited from imposing a prepayment penalty. For higher-priced mortgage loans and HOEPA loans in which the payment may not change for four years after consummation, a prepayment penalty period cannot last for more than two years after consummation. Prepayment penalties for HOEPA loans are also prohibited if: 1) the borrower's debt-to-income ratio exceeds 50 percent; 2) there is a refinancing by the same creditor or affiliate; or 3) applicable law prohibits such a penalty. A higher-priced mortgage loan or HOEPA loan with a prepayment penalty that does not conform to these prepayment penalty limitations is generally subject to a three-year right of rescission.
- For higher-priced mortgage loans secured by a first lien on a principal dwelling, a savings association must establish an escrow account for the payment of property taxes and homeowner's insurance. A savings association is permitted to allow borrowers to cancel escrows 365 days after loan consummation. The escrow requirement is effective as of April 1, 2010 for site-built homes and October 1, 2010 for manufactured homes.
- Savings associations are prohibited from structuring closed-end loans as open-end lines of credit for the purpose of evading these requirements.

## **2. Prohibited Acts or Practices**

For all closed-end mortgages secured by a consumer's principal dwelling: a savings association is prohibited from: 1) failing to credit payment to a consumer's account as of the date the payment is received; 2) failing to provide a payoff statement within a reasonable period of time; and 3) pyramiding late fees. In addition, for all closed-end mortgages secured by a consumer's principal dwelling, a savings association is prohibited from coercing a real estate appraiser to misstate a home's value.

### 3. Advertising Practices

For both open-end and closed-end mortgage loans, advertising must contain additional information about rates, monthly payments and other loan features. In addition, the following seven deceptive or misleading practices are prohibited in advertisements for closed-end loans:

- Advertisements that state that a rate or payment is fixed when it can change.
- Advertisements that compare an actual or hypothetical rate or payment obligation to the rates or payments that could 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.
- Advertisements that characterize the products offered as “government loan programs” or “government sponsored loans” even though the programs are not government supported or sponsored loans.
- Advertisements 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.
- Advertisements that make claims of debt elimination if the product advertised would merely replace one debt obligation with another.
- Advertisements that create a false impression that the mortgage broker or lender is a “counselor” for the consumer.
- Foreign-language advertisements in which certain information is provided in a foreign language while required disclosures are provided only in English.

The revised examination procedures were developed on an interagency basis. They reflect a risk-focused approach to comprehensive examinations. The revised Examination Handbook Section 1305 is available through the link provided below.

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[Link to Handbook Section 1305](#)