

Board of Governors of the Federal Reserve System

Highlights of Final Rule Amending Home Mortgage Provisions of Regulation Z (Truth in Lending)

The rule establishes a new category of "higher-priced mortgages" that includes virtually all closed-end subprime loans secured by a consumer's principal dwelling. Which loans qualify as "higher-priced" will be determined by a new index that will be published by the Federal Reserve Board.¹

The rule, **for these higher-priced loans:**

- Prohibits 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."
- Prohibits a lender from relying on income or assets that it does not verify to determine repayment ability.
- Bans any prepayment penalty if the payment can change during the initial four years. For other higher-priced loans, a prepayment penalty period cannot last for more than two years.
- Requires that the lender establish an escrow account for the payment of property taxes and homeowners' insurance for first-lien loans. The lender may offer the borrower the opportunity to cancel the escrow account after one year.

The rule, **for all closed-end mortgages secured by a consumer's principal dwelling:**

- Prohibits certain servicing practices: failing to credit a payment to a consumer's account as of the date the payment is received, failing to provide a payoff statement within a reasonable period of time, and "pyramiding" late fees.
- Prohibits a creditor or broker from coercing or encouraging an appraiser to misrepresent the value of a home.
- 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.

The rule, **for all mortgages:**

- Requires advertising to contain additional information about rates, monthly payments, and other loan features. The rule also bans seven deceptive or misleading advertising practices, including

representing that a rate or payment is "fixed" when it can change.

Based on compelling evidence from consumer testing, the Board is withdrawing the proposed rule regarding yield-spread premiums. The Board, however, intends to analyze alternative approaches to this issue as part of its ongoing review of the rules for closed-end loan rules under Regulation Z.

Compliance with the new rules, other than the escrow requirement, is mandatory for all applications received on or after October 1, 2009. The escrow requirement has an effective date of April 1, 2010 for site-built homes, and October 1, 2010 for manufactured homes.

Footnotes

1. 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. [Return to text](#)