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MEMORANDUM

TO: Clients and Friends of the Firm

FROM: Al Alsup

DATE: July 16, 2009

SUBJECT: Understanding the New Truth in Lending Act Disclosure Rules Effective July 30th

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The home mortgage industry is abuzz with concerns about new disclosure rules under the Truth in Lending Act that go into effect this month on July 30, 2009 (the "Final Rule"). Under the Final Rule, creditors will be required to deliver or mail early estimates of the Annual Percentage Rate (APR), Finance Charge, and other material disclosures of the cost of credit for virtually all closed-end, home mortgage loans within three business days after loan application is made and at least seven business days before loan closing. If the early estimates prove inaccurate within a permitted tolerance for any reason, corrective disclosures must again be delivered to loan applicants at least three business days before closing. A major concern is that accurate disclosures of the APR and other material disclosures given at the time of closing of a home loan under current rules will now have to be given at least three business days in advance of closing.

In practice, estimated fees and charges routinely disclosed at loan application often change at the closing table when actual invoices of settlement service providers are received for payment by the settlement agent from loan proceeds. Under the Final Rule, any change in fees or charges that increase the APR from that earlier disclosed by more than a small permitted tolerance for accuracy will require that new corrected disclosures be given the borrower and the closing then scheduled for a date at least three business days after the borrower's receipt of the corrected disclosures. Although this statutorily imposed delay may be waived by a borrower under the Final Rule in the event of a bona fide personal financial emergency, few personal circumstances will qualify as such an emergency permitting waiver. To avoid the costs and disruptive effect of frequent delays in loan closings, therefore, mortgage lenders, settlement agents, and other settlement service providers must now adopt new procedures and work cooperatively to ascertain and disclose accurate fees and charges to borrowers at an earlier stage in the loan process.

The Federal Reserve Board of Governors ("FRB") adopted the Final Rule[1] as an amendment to Regulation Z[2] and its Official Staff Interpretations[3] ("Reg. Z") to implement provisions of the federal Mortgage Disclosure Improvement Act of 2008 (MDIA)[4] calling for new form and timing requirements

[1] Final Rule published in the Federal Register on May 19, 2009 (74 F.R. 233289 – 23305). See also Final Rule published July 30, 2008 in the Federal Register (73 F.R. 44522 – 44614) implementing other provisions of the MDIA effective October 1, 2009 summarized in our Client Memorandum dated March 5, 2009 posted under the Legal Articles tab at www.LoanLawyers.com.
[2] 12 C.F.R. Part 226
[3] Supplement I to Part 226 (12 C.F.R. Part 226)
[4] Mortgage Disclosure Improvement Act of 2008 (MDIA) enacted by Congress on July 30, 2008, (Title V, §§2501 –2503 of the Housing & Economic Recovery Act of 2008, Public Law No. 110289, 122 Stat. 2654)

for consumer disclosures under Reg. Z, §226.19(a) and (b) for covered loans for which application is made on or after July 30, 2009. This memorandum summarizes the new disclosure rules (and where appropriate notes how new rules differ from current rules) to assist our clients in an better understanding of the principal changes in the timing and content of required Truth in Lending Act consumer disclosures.

1. ***Early Disclosures to Applicants Now Required for All Consumer Loans Subject to RESPA and Secured by a Dwelling.*** Under current rules, any creditor taking an application for a *residential mortgage transaction* subject to the Real Estate Settlement Procedures Act ("RESPA") must provide the applicant early estimates of the disclosures required by Reg. Z §226.18 (the "Early Disclosures"). The Early Disclosures (generally referred to in the industry as the "Initial TIL") must be delivered or placed in the U.S. Mail to the loan applicant within three business days after receiving the applicant's written loan application. Although mortgage lenders routinely provide these early disclosures for all loan applications as a matter of practice, Reg. Z actually requires them under current rules only for *residential mortgage transactions*, a defined term that means mortgage loans secured by a consumer's principal dwelling to finance the purchase or initial construction of the dwelling. A "business day" for this purpose, both under current rules and the new Final Rule, means any day on which the creditor's offices are open to the public for carrying on substantially all of its business functions. Creditors are not required to deliver or mail Early Disclosures, however, if within the three-business-day period the credit application is denied or withdrawn.

   Under the new Final Rule, creditors will be required to provide Early Disclosures to a broader range of loan applicants that includes applicants for *all* closed-end, home mortgage loans subject to RESPA that are secured by the applicant's dwelling (and not just mortgage loans to finance the purchase or initial construction of a principal dwelling). Early Disclosures must be provided for all such loans regardless of whether the loan is secured by a first- or subordinate-lien, whether the loan is made to finance the purchase or initial construction of a principal dwelling or for another purpose (including refinance, home equity, and all other types of home mortgage loans except for home equity line of credit and timeshare plan transactions), or whether the applicant occupies the dwelling as a principal residence or as a second home.

2. ***Imposition of Fees Before Early Disclosures are Received by Loan Applicants Now Prohibited (Except for Credit Report Fee).*** No creditor or other person may impose a fee on a loan applicant in connection with a mortgage loan application before the applicant has received the Early Disclosures. The one exception is that a creditor or other party may impose a fee for obtaining a consumer credit report before delivering Early Disclosures if the fee is *bona fide* and reasonable in amount. If the Early Disclosures are mailed to the loan applicant, as is the usual case under current industry practices, the loan applicant is considered to have received them three business days after the Early Disclosures are mailed. Thus, if Early Disclosures are mailed within three business days after loan application, a creditor will have to wait an additional three business days (when the Early Disclosures are deemed delivered) before imposing a loan application or any other fee (except a bona fide and reasonable credit report fee).

3. ***Seven Business Day Waiting Period After Mailing Early Disclosures Now Required Prior to Loan Closing.*** Early Disclosures must be delivered or placed in the U.S. Mail to loan applicants not later than the third (3rd) business day after receiving the applicant's written loan application and not later than the seventh (7th) business day before consummation (i.e., closing) of the mortgage loan. The meaning of "business day" for this purpose means any day other than Sunday or the statutory federal legal public holidays[5] (such as New Year's Day, Birthday of Martin Luther King, Jr., Washington's Birthday, Memorial Day,

[5] 5 U.S.C. 6103(a)

Independence Day, Labor Day, Columbus Day, Veterans Day, Thanksgiving Day, and Christmas Day). Assuming Early Disclosures are not mailed until the third business day after loan application, therefore, this required seven-business-day waiting period means that home mortgage loans cannot be closed before at least the tenth business day after loan application, or effectively two calendar weeks. This requirement for a seven-day waiting period should not significantly burden the home mortgage industry, however, because the loan application and approval process in practice is seldom completed so quickly.

4. ***Correction Disclosures Now Required to be Delivered at Least Three Business Days Prior to Loan Closing.*** If estimates of fees and charges disclosed in the Early Disclosures change prior to loan consummation, and, as a result, the annual percentage rate (APR) disclosure set forth in the Early Disclosures is no longer accurate within permitted tolerances, the creditor must furnish a corrected statement of all changed terms to the borrower (the "Correction Disclosures") *not later than three business days* before the date of consummation of the transaction. For purposes of this rule:

    - *Allowable Tolerance for Accuracy.* Correction Disclosures must be provided if the annual percentage rate (APR) disclosed in the Early Disclosures *understates* the actual APR by more than one-eighth of one percentage point (1/8 %) in a regular transaction (or by more than ¼% in an irregular transaction).[6] An *overstated* APR (i.e., when the disclosed APR is greater than required to be disclosed) generally is deemed in tolerance under applicable rules.[7]

    - *Business Day.* "Business day" means any day other than Sunday or the statutory federal legal public holidays. Note that this is same definition of 'business day' as is used to determine the three-business-day rescission period for loans subject to rescission and the seven-day waiting period described above in paragraph 3.[8]

    - *Presumed Delivery.* If the Correction Disclosures are mailed to the loan applicant or delivered to the applicant by means other than delivery in person (e.g., overnight courier), the loan applicant is deemed to have received them three business days after the Correction Disclosures are mailed or delivered.

    - *Possible Delay of Closing.* Even after giving a Correction Disclosure at least three business days before a scheduled closing, if the APR is again determined to be out of tolerance at the time of loan closing, another Correction Disclosure must be given at that time and the closing accordingly must be delayed and rescheduled for a date that is at least three-business-days later.

5. ***Final Disclosures of Changed Terms that Do Not Render the APR Inaccurate Must Still Be Given at Loan Closing.*** If estimates of fees and charges disclosed in the Early Disclosures change prior to loan consummation, but the annual percentage rate (APR) set forth in the Early Disclosures is still considered accurate within permitted tolerances, the creditor must still disclose any changed terms that do not affect the APR before consummation (i.e., at closing), such as any change in a variable rate feature, demand feature, or terms of

[6] See Reg. Z, §226.18(d)(1) An APR may also be deemed within tolerance if resulting from the disclosed finance charge that is understated by no more than $100.

[7] See Reg. Z, §§226.22(a) and 226.18(d)(1) Our firm has verified with FRB counsel that, as interpreted by the Final Rule, these tolerances set out in Reg. Z §226.22 are applicable notwithstanding an apparent ambiguity created by §§2502(a)(6)(D) of the Housing & Economic Recovery Act of 2008 that appears to establish the applicable tolerance for accuracy to be "as determined under section 107(c) [of the Truth in Lending Act]." If applied, that particular section of the Act would not authorize an over-disclosure of greater than 1/8th % as being within the permitted tolerance for accuracy.

[8] See Reg. Z, §226.2(6)

prepayment, late payment, security interest charges, or assumption.[9] This "at closing" disclosure (generally referred to in the industry as the "Final TIL"), although correcting changed terms, does not trigger an additional waiting period, and the loan transaction may be closed when scheduled if both the seven-business-day waiting period and any applicable three-business-day waiting period triggered by Correction Disclosures have run.

6. ***Waiver by the Borrower of the 7-Day or 3-Day Waiting Periods May Be Permitted in Narrow Circumstances to Meet a "Bona Fide Personal Financial Emergency."*** After receiving Early Disclosures, the new requirement for the seven-business-day waiting period may be waived or modified by the loan applicant in limited circumstances if the loan applicant determines that the extension of credit is needed to meet a "bona fide personal financial emergency." Similarly, after receiving Correction Disclosures, the three-business-day waiting period triggered by Correction Disclosures may be waived or modified by the loan applicant under the same conditions of a bona fide personal financial emergency. To modify or waive either of these waiting periods, the loan applicant must give the creditor a dated, written statement that bears the signatures of all consumers who are primarily liable on the loan obligation and both describes the emergency and specifically waives or modifies the waiting period. However, the three-business-day waiting period may not be waived in advance (i.e., prior to delivery of the Correction Disclosures giving rise to that waiting period). If after receiving Early Disclosures, the applicant has given a written waiver of the seven-day waiting period but is later given Correction Disclosures, the applicant, if desiring to waive the three-business-day waiting period, must then give the creditor a separate written waiver statement.

   To waive either of the waiting periods, the loan applicant must be able to demonstrate that the applicant has a "bona fide personal financial emergency" that must be met before the end of the waiting period. Creditors should be cautious to require the loan applicant himself or herself to prepare the written statement describing the financial emergency and specifically waiving or modifying the waiting period and should be aware that a creditor may not provide the loan applicant a printed form for this purpose. Moreover, the applicant's description of the emergency must be sufficient to explain his or her immediate need to obtain loan funds prior to the expiration of the required waiting period. The term "bona fide personal financial emergency" is not defined by the Final Rule, although it is the identical term upon which waiver of the right of rescission[10] by consumers for certain loans is conditioned and should be similarly narrowly construed. Whether such an emergency exists must be determined from the facts of each applicant's situation as set out in the applicant's written waiver statement. The imminent sale of the applicant's home at foreclosure during the waiting period is suggested in the Final Rule as one example of such a bona fide personal financial emergency. Presumably, obtaining funds to repair a storm-damaged dwelling in an area declared by the President to be in a major disaster area may be another example. However, mere personal inconvenience or economic loss occasioned by the enforced waiting period would not satisfy the test of such a personal financial emergency. Creditors should be cautious in making these determinations particularly because the mere existence of the loan applicant's written waiver statement will not in itself automatically insulate a creditor from liability for failing to comply with the waiting period requirements.

7. ***New Promulgated Consumer Notice Now Required on Form of Early Disclosures, Correction Disclosures, and Final Disclosures.*** The form of Early Disclosures, Corrected Disclosures, and final disclosures (i.e., the Final TIL) given at consummation must additionally state in conspicuous type size and format, the following:

[9] See Reg. Z, §226.17(f) as amended.
[10] See Reg. Z §226.23(e).

YOU ARE NOT REQUIRED TO COMPLETE THIS AGREEMENT MERELY BECAUSE YOU HAVE RECEIVED THESE DISCLOSURES OR SIGNED A LOAN APPLICATION.

The Final Rule does not dictate the precise location of this required statement within the form of disclosures, but merely requires that the conspicuous statement be grouped together with other required disclosures.[11] The form of Truth in Lending Act disclosures prepared in connection with home mortgage loans for which applications are taken on or after July 30, 2009 should therefore incorporate this promulgated notice within the graphic box of the form in a grouping with other disclosures required under Reg. Z §§226.18 and 226.19(a).

8. ***Future Rulemaking will Require that New Variable Rate Disclosures be Added to Form of Disclosures.*** The Mortgage Disclosure Improvement Act of 2008 (MDIA)[12] also provides for enhanced Truth in Lending Act disclosures for consumer loans secured by a dwelling when the annual interest rate is variable and can change after consummation. But these additional variable rate disclosures will not go into effect until the FRB implements them through future rulemaking. Before issuing rules implementing these variable rate rules, the FRB must conduct consumer testing to determine the appropriate format for providing the disclosures to consumers so that they can be easily understood.

   Credit transactions in which the annual rate of interest is variable (or under which the regular payments may otherwise be variable) will be required to additionally disclose the following:

   (i) The payment schedule must be labeled as follows:

   "Payment Schedule: Payments Will Vary Based on Interest Rate Changes."

   (ii) Examples of adjustments to the regular required payments based on the change in the interest rates specified by the credit contract and stated in conspicuous type size and format. One required example that must be included would reflect the maximum payment amount of the regular required payments based on the maximum interest rate allowed under the contract. Other examples will be required to illustrate the fact that the initial regular payments are for a specific time period that will end on a certain date, that payments will adjust afterwards potentially to a higher amount, and that there is no guarantee that the borrower will be able to refinance to a lower amount.

[11] See Reg. Z §226.18 Content of Disclosures

[12] Title V, §§2502(a)(6)(C) of the Housing & Economic Recovery Act of 2008, Public Law No. 110289, 122 Stat. 2654