



4900 Woodway Drive, Suite 650

Houston, TX 77056

Phone: 713-871-0005

Fax: 713-871-1358

Thomas E. Black, Jr., P. C.*

Calvin C. Mann, Jr., P. C.

Gregory S. Graham, P. C.

David F. Dulock

Diane M. Gleason

Benjamin R. Idziak **

Shawn P. Black **

Thomas L. Kapioltas

Margaret A. Noles

Robert J. Brewer

Marc E. Sanders ***

* Also Licensed in Iowa, New York,
Washington and West Virginia

** Also Licensed in New York

*** Licensed in New Mexico

July 14, 2008

TO: Clients and Friends

FROM: David F. Dulock

SUBJECT: FRB Announces Final Rule Amending Regulation Z

The Board of Governors of the Federal Reserve System (FRB) announced today that it has approved its final rule amending Regulation Z. Please see our memo of March 7, 2008, discussing the proposed rule (published in the January 9, 2008 issue of the *Federal Register*) which formed the basis of today's final rule. Fortunately, lenders will have a long lead-time to prepare for the new requirements in the final rule, as it does not become **effective until October 1, 2009**.

We will issue a more detailed memorandum discussing the final rule after it is published in the *Federal Register*. In the mean time, below is a brief summary of the final rule's more important changes, taken from the FRB announcements published on its website:

The final rule defines a new category of "higher-priced mortgage loans" that the FRB believes will cover virtually all subprime closed-end loans secured by a consumer's principal dwelling, but generally will exclude prime market closed-end loans secured by a consumer's principal dwelling. A loan is "higher-priced" if it is a first-lien mortgage that has an annual percentage rate 1.5 percentage points or more above the "average prime offer rate," or if it is a subordinate lien mortgage that has an annual percentage rate 3.5 percentage points or more above the "average prime offer rate." The "average prime offer rate" will be published weekly by the FRB in an index that is based on the Primary Mortgage Market Survey® currently published by Freddie Mac.

The final rule adds the following four key protections for higher-priced mortgage loans:

- Prohibits a lender from making a loan without regard to a borrower's 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."
- Requires a lender to verify the income or assets it relies on to determine repayment ability and prohibits a lender from relying on income or assets that it does not verify.
- Bans any prepayment penalty if the payment can change during the initial four years. For other higher-priced mortgage loans, a prepayment penalty cannot apply after two years from consummation.
- Requires the lender to establish an escrow account for the payment of property taxes and insurance for first lien loans. The lender may permit the borrower to cancel the escrow account after one year from consummation.

In addition to the requirements governing higher-priced mortgage loans, the final rule adopts the following protections for all mortgage loans secured by a consumer's principal dwelling:

- Prohibits companies that service mortgage loans from engaging in certain practices, such as pyramiding late fees, failing to credit a payment to a consumer's loan account as of the date the payment is received, and failing to provide an accurate payoff statement within a reasonable time of request.
- Requires a lender to 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*). A consumer cannot be charged any fee until after the consumer receives the early disclosures, except a reasonable fee for obtaining the consumer's credit history.

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

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.

Note: In a major victory for the mortgage broker industry, the FRB has withdrawn, and the final rule does not contain, the proposed rule's provision prohibiting a lender from paying a mortgage broker unless the broker has entered into a written compensation agreement with the consumer before the consumer has paid a fee or submitted a written application in connection with the loan, whichever is earlier (proposed §226.36(a), *Federal Register*, Jan. 9, 2008, page 1725).

This Memorandum is provided for the general information of the clients and friends of our firm only and is not intended as specific legal advice. You should not place reliance on this general information alone but should consult counsel regarding the application of information in this Memorandum to your specific case or circumstances.