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CHANGES, CHANGES AND MORE TRUTH-IN-LENDING CHANGES

On July 14, 2008, the Federal Reserve Board issued final rules making significant changes to Regulation Z on Truth in Lending. The revised regulation creates special rules for "higher priced mortgage loans," adds additional consumer protections for all loans secured by a consumer's principal dwelling and imposes new requirements for advertising dwelling secured credit. One major change to Reg. Z would require early Truth in Lending disclosures to be given to a consumer within 3 business days after receiving an application for any consumer loan to be secured by the consumer's principal dwelling. The ink was barely dry on the Fed's 484 page issuance when Congress acted later in July to approve the Housing and Economic Recovery Act of 2008 which included amendments to the Truth in Lending Act. Congress further amended Truth in Lending in October. As a result of those statutory changes, the Fed issued a new proposal revising its new rules even before they became effective. In this article, we will review the major changes to Truth in Lending including the most recent proposed revisions.

The final rules provide consumer protections for a new category of loans called "higher priced mortgage loans" secured by a consumer's principal dwelling; add new protections for all mortgage loans secured by a consumer's principal dwelling; require advertisements for dwelling secured credit to provide accurate and balanced information, in a clear and conspicuous manner, about rates, monthly payments, and other loan features; ban a laundry list of deceptive or misleading advertising practices; and, finally, require creditors to provide consumers with transaction specific loan disclosures within 3 business days after application and before they pay any fee, except a reasonable fee for reviewing credit history. This early disclosure requirement is the subject of the Fed's latest changes.

Higher Priced Mortgage Loans. Currently, Reg. Z places restrictions on HOEPA "high cost loans" secured by a consumer's principal dwelling with high cost being defined by reference to the interest rate and/or fees charged on the loan. Existing Reg. Z requirements for HOEPA high cost loans remain in effect. The new regulations create an entirely new category of mortgage loans called "higher priced mortgage loans" which is defined by reference to a new interest rate index to be published by the Federal Reserve.

A higher priced mortgage loan is a consumer loan secured by the consumer's principal dwelling with an annual percentage rate that exceeds the "average prime offer rate" for a comparable transaction as of the date the interest rate on the loan is set by 1.5% or more, if secured by a first lien, or by 3.5% or more, if

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secured by a subordinate lien. The Fed will determine the "average prime offer rate" based on a survey currently published by Freddie Mac and will publish the average prime offer rates for a variety of transaction types and maturities in a table updated weekly. The rates will be announced each Friday effective the following Monday. Exempt from the definition of higher priced mortgage loan are transactions to finance initial construction of a dwelling, a temporary or bridge loan with a term of 12 months or less, a reverse mortgage transaction, or a home equity line of credit.

Consumer Protections for Higher Priced Loans. The rules add new protections for consumers in connection with higher priced mortgage loans. First, the lender is prohibited from making a higher priced mortgage loan based on collateral value without regard to the borrower's ability to repay the loan from income and assets other than the home's value. A lender will be required to verify the consumer's repayment ability including the consumer's current and reasonably expected income, employment, assets other than the collateral, current obligations, and mortgage-related obligations such as expected property taxes, insurance premiums, PMI and similar housing related expenses. Verification of income and assets may be by W-2, tax returns, payroll receipts, financial institution records or other third party documents that provide reasonably reliable evidence of the consumer's income or assets. Reliance upon the borrower's application or financial statements without verification is not sufficient.

A safe harbor is provided in the rules for satisfying the verification requirements. A lender is presumed to comply if it verifies the consumer's income and assets to be relied upon and determines the borrower has the ability to repay the largest payment of principal and interest expected in the first 7 years of the loan, taking into account current debt obligations as well as mortgage related obligations, and the lender uses either debt to income or residual income (remaining income after paying debt and mortgage obligations) to assess repayment ability. No presumption of compliance is available if the loan includes the possibility of negative amortization or has a balloon payment within the first 7 years.

The existing HOEPA/Regulation Z requirements already prohibit making a high cost loan based on collateral value without regard to the consumer's ability to pay, but require a borrower to demonstrate a pattern or practice of lending based on collateral value in order to prove a violation. Under the new rules, the pattern or practice requirement will be eliminated for both HOEPA high cost and higher priced mortgage loans, so a single incident may result in a violation.

Prepayment penalties are restricted on higher priced mortgage loans. Prepayment penalties are prohibited if the loan payment amount can change at any time during the first 4 years. If the payment amount cannot change during the first four years, prepayment penalties are permitted but may not last for more than 2 years and may not be imposed when the source of the prepayment is a refinancing by the same lender or an affiliate of the lender.

The third and, perhaps, the most costly new consumer protection is the requirement that lenders escrow for payment of property taxes and insurance on first lien higher priced mortgage loans. The lender or servicer has the option of permitting a consumer to cancel the escrow account upon the consumer's written request after 1 year. Insurance premiums for condominium units where the condominium association has an obligation to maintain a master policy need not be included. The rules also prohibit a creditor from structuring a home secured loan as an open-end credit plan in order to evade the escrow requirements.

New Protections for all Principal Dwelling Secured Mortgages. The new rules prohibit certain mortgage loan servicing practices deemed unfair by the Fed. Prohibited practices include failing to credit a payment to a consumer's loan account as of the date of receipt (except where a delay in crediting does not result in any late fee or other charge to the consumer or in the reporting of negative information to a credit bureau). A servicer may

impose specific requirements in writing for a consumer to follow in making payments, such as by requiring payments be mailed to a particular address. Any payments that do not conform to the specified requirements must be credited within 5 days after receipt.

Servicers are prohibited from pyramiding late charges. No late fee or delinquency charge may be imposed with respect to a payment when the only delinquency is attributable to late fees or delinquency charges assessed on an earlier payment, and the payment is otherwise a full payment for the particular payment period and is made on time or within any applicable grace period.

In addition, servicers are required to provide a pay-off statement within a reasonable period of time after receiving a request from the consumer or any person acting on behalf of the consumer. Five calendar days is deemed to be a reasonable time under the rules. The statement must include the total outstanding balance that would be required to satisfy the consumer's obligation in full as of a specified date.

Under the new rules, a creditor or mortgage broker or any affiliate is prohibited from directly or indirectly coercing, influencing or otherwise encouraging an appraiser to misstate or misrepresent the value of a dwelling. Examples of prohibited actions include implying that present or future use of the appraiser may depend on the value the appraiser gives the dwelling, excluding an appraiser from future work because the value of the dwelling does not meet a minimum level, or telling an appraiser that a certain minimum value is needed in order to approve the consumer's loan. It would not be a violation, however, to ask the appraiser to consider additional information about the dwelling or additional comparable properties, to request the appraiser to provide additional information about the basis for the valuation, or to request the appraiser to correct factual errors in a valuation. Obtaining multiple appraisals is not a violation as long as the creditor follows a policy of using the most reliable appraisal rather than the appraisal with the highest value. A creditor who knows of a violation is prohibited from extending credit based on the appraisal unless the creditor also documents that it has acted with reasonable diligence to determine that the appraisal does not materially misstate or misrepresent the dwelling's value.

Early Disclosures. Currently under Reg. Z, lenders are required to provide early Truth in Lending disclosures (i.e. a good faith estimate of loan costs, including a schedule of payments) within 3 days after receiving an application for a loan in connection with a residential mortgage transaction to finance acquisition or initial construction of a dwelling. The Fed's initial set of revised regulations would extend this requirement to all consumer loans subject to RESPA secured by the consumer's principal dwelling other than home equity lines of credit. However, in the Housing and Economic Recovery Act of 2008, Congress amended the Truth in Lending Act to extend this early disclosure requirement to all consumer loans secured by any dwelling, not just the consumer's principal dwelling. As a result, the early disclosure requirements will cover all closed-end, dwelling secured loans that are subject to RESPA and Regulation Z, including first and second lien home improvement, home equity and refinance loans.

The Fed issued proposed revisions to Reg. Z on December 10, 2008 to implement the statutory changes concerning early disclosures. The comment period expires February 9, 2009. While the rules on early disclosure are not yet final, the Fed has virtually no flexibility and must implement the statutory changes including an accelerated effective date of July 30, 2009. We expect the final rules to be substantively the same as the proposal.

In the Act, Congress was very specific in its requirement that lenders deliver the early disclosures well in advance of loan closing. The early disclosures must be given no later than 3 business days after receiving the consumer's application and at least 7 business days prior to loan closing. If the loan APR changes by more than 1/8 of 1% between the time the early disclosures are given and the time the interest rate on the loan is fixed, either through a rate

lock or loan closing, then new, revised early disclosures must be given, and the loan may not be consummated until at least 3 business days later. This means a potential 10 business day delay between the time of application and the time of closing for many consumer home secured loans. If the loan is also subject to the right to rescind, then an additional 3 business day delay in funding following loan consummation will also apply.

Business day is defined in the regulation for purposes of this requirement as any calendar day other than a Sunday or federal holiday, so Saturdays will count. Still, this will in many cases result in a significant delay in loan closing. At least banks are not singled out. All creditors subject to Truth in Lending will have to play by the same rules.

A consumer may waive either or both the initial 7 business day delay or the 3 business day delay on re-disclosure in the case of a bona fide personal financial emergency. All consumers on the loan must sign a written waiver describing the emergency, and preprinted forms are prohibited. This rule is similar to the consumer's ability to waive the 3 day right to rescind period, meaning waivers should rarely occur.

<u>Advertising Requirements</u>. The final regulations require enhanced disclosures for advertising both open-end and closed-end dwelling secured loans. Advertisements must provide accurate and balanced information in a clear and conspicuous manner about rates, monthly payments and other loan features. New requirements will apply to advertisements of home equity plans concerning discounted or promotional rates and payment terms and balloon payments. A number of additional disclosures will be required for advertising of closed-end dwelling secured loans with respect to discounted and promotional rates, variable rates and payment amounts.

Generally, any advertisement of an initial discounted rate, a promotional rate or payment amount or a variable rate must disclose the loan terms that will apply over the full term of the loan. Required disclosures in advertisements will generally have to satisfy the clear and conspicuous standard, and information about post promotional rates and repayment terms must be disclosed in close proximity and with equal prominence to the promotional information.

The new rules also prohibit seven specific advertising practices with respect to closed-end mortgage loans that the Fed deemed to be deceptive or misleading. These include:

- Advertising "fixed" rates or payment amounts where rates or payments can vary without adequately disclosing that the interest rate or payment amount is fixed only for a limited period of time;

- Comparing an actual or hypothetical rate or payment amount with any rate or payment amount that will be available under the advertised loan for less than the full term of the loan unless the advertisement also discloses the rates or payments that will apply over the full term;

- Advertisements characterizing a product as a "government loan program," "government-supported loan" or otherwise endorsed or sponsored by a governmental entity unless the ad is for an FHA, VA or other loan that is actually endorsed or sponsored by a government entity;

- Advertisements, including solicitation letters, that use the name of the consumer's current mortgage lender unless it also prominently discloses the name of the person making the solicitation and states clearly and conspicuously that the person making the advertisement is not affiliated with the current lender;

- Any misleading claim about debt elimination (for example, advertising claims of debt elimination if the loan product would merely replace one loan with another);

- Using the term "counselor" in connection with a for-profit mortgage broker;

- Providing some information, such as a low introductory "teaser" rate or payment amount, in a foreign language while required disclosures are provided only in English.

Effective Dates. By statute, the date for compliance with the new early disclosure requirements will be July 30, 2009. Compliance with the new rules concerning loan servicing practices and advertising will be mandatory on October 1, 2009. Compliance with the requirements for underwriting higher priced mortgage loans is mandatory for all applications received on or after October 1, 2009. Escrow requirements are phased in over a longer period of time with an effective date of April 1, 2010 for site built homes and October 1, 2010 for manufactured homes.

Liability. Like the existing Reg. Z/HOEPA regulations covering high cost loans, these new requirements will carry a significant risk of liability for non-compliance. The Fed is relying on Section 129(l) of the Truth-in-Lending Act, added by HOEPA, as its authority for issuing the new regulations. Under the civil liability provisions of TILA, a violation of Section 129 gives rise to liability for an amount equal to all finance charges and fees paid by the consumer in addition to actual damages, the statutory penalty amount and attorney's fees. In amending the Truth in Lending Act, Congress also doubled the statutory penalty for a Truth in Lending violation from $200 to $2000 to $400 to $4000.

These new rules will require major changes for many lenders. While many banks made an effort to avoid making HOEPA loans under the existing rules, it seems unlikely that any bank will be able to totally avoid making higher priced mortgage loans meaning they will be forced to put systems, procedures and staff in place to handle escrow accounts for at least first lien higher priced mortgage loans. Some may find it easier to cover most or all first lien loans rather than trying to segregate higher priced mortgage loans and risk overlooking one. Underwriting and documentation requirements will also need to be looked at and, possibly, overhauled with respect to income and asset verification. New early disclosures will need to be developed. Prepayment penalties will need to be revisited. And, it will be more important than ever for home loan advertising to be reviewed and approved in advance by the compliance officer.

<Cliff Harrison>

FEDERAL RESERVE BOARD REVISES CREDIT CARD RULES

For several years the Federal Reserve Board (the "Board") has been engaged in a comprehensive review of regulations which pertain to all aspects of credit card and certain other forms of open-end credit. On December 18, 2008, the Board released a set of final rules that will:

- protect consumers from unexpected interest charges;
- forbid banks from imposing interest charges using the "two-cycle" billing method;
- require reasonable amounts of time for making credit card payments;
- prohibit certain payment allocation methods that would unfairly maximize interest charges; and
- limit the charging of fees in connection with so-called "subprime" credit cards where those fees would reduce the amount of available credit.

Each of these changes will be discussed in more detail below.

The final rule prohibiting the credit card practices described above was adopted under the Federal Trade Commission Act and Regulation AA which addresses unfair and deceptive acts and practices. In addition to the rules adopted under Regulation AA, the Board also adopted final rules to revise certain disclosures that consumers receive in connection with opening credit card accounts and other revolving credit plans to make sure that information is provided

in a timely manner and in an understandable format. These rules amend the open-end credit provisions of Regulation Z (Truth-in-Lending) and are the culmination of a several-year effort to review those rules. The final rules under Regulation Z require changes to the format, timing, and content requirements for credit card applications and solicitations and for the disclosures that consumers receive throughout the life of an open-end account. The modifications to Regulation Z are addressed in a separate article of the *Quarterly Report* (see related article).

As explained above, the final rule amends Regulation AA to prohibit unfair or deceptive acts or practices by banks in connection with credit card accounts. Listed below are summaries of each of the five areas of increased protection mentioned above.

Protection from Unexpected Interest Charges

The final rule requires banks to disclose all interest rates that will apply to the account at the time of account opening and prohibits a bank from increasing those rates, except in certain instances. For instance, if an introductory or "teaser" interest rate applies at account opening, but expires after a specified period of time, a bank may apply a later increased interest rate, provided that rate was also disclosed at account opening. Banks can also increase interest rates if the rate increase occurs as a result of an increase in a disclosed index, such as would be the case with a variable rate product. Furthermore, banks may increase interest rates for new transactions after the first year provided they comply with a 45-day advance notice requirement contained in Regulation Z. And the final rule would allow banks to increase a rate if the minimum payment on an account is received more than 30 days after the due date.

Prohibition of "Two-Cycle" Billing Method

The final rule prohibits banks from calculating interest using the so-called "two-cycle" billing method. This method was used by some banks to increase interest earnings in those situations where a customer would pay the entire account balance one month, but not do so in the following month. Banks using this two-cycle method would then calculate interest for the second month using the account balance for days in the previous billing cycle as well as the current cycle. That practice will be prohibited effective July 1, 2010.

Reasonable Amount of Time for Crediting of Payments

The final rule requires a bank to provide a reasonable amount of time for the consumer to make a payment before the bank can treat a payment as late for any purpose. A safe harbor is created under the final rule for banks that send periodic statements at least 21 days prior to the payment due date.

Restrictions on Payment Allocation Methods

When a bank applies different APRs to different balances on a credit card account (e.g., purchases, cash advances, etc.), the final rule now requires that any portion of a payment which exceeds the minimum payment must be applied to the balance with the highest interest rate first or, in the alternative, pro rata among all of the outstanding balances.

Subprime Credit Cards

The final rule addresses concerns regarding so-called "subprime" credit cards which carry high fees and low credit limits. Some of these credit card products are offered to customers who are trying to establish or re-establish their credit standing. Such accounts typically feature a security deposit which would secure a significant portion of the credit limit available under the card. Banks would be prohibited from financing those security deposits and any fees for credit availability such as account-opening fees or membership fees if the charges assessed during the first 12 months of the life of the card would exceed 50% of the initial credit limit. The security deposits and fees charged at account opening cannot exceed 25% of the initial credit limit and any additional amounts, up to 50%, are required to be spread evenly over at least the next five billing cycles.

The labeling of these practices as "unfair and deceptive" not only triggers regulatory enforcement actions for banks that violate these rules, but also raises the risks of litigation under State Unfair And Deceptive Practices Acts. The effective date for the amendments to Regulation AA is July 1, 2010.

<Ed Wilmesherr>

HUD FINALIZES RESPA REWRITE

In March, HUD announced a sweeping proposal to re-write RESPA regulations and make dramatic changes to GFE and HUD-1/1A disclosures. On behalf of compliance group members, Butler Snow prepared a draft comment letter which many of you used to prepare and send your own comments to HUD. Final rules were issued on November 17, 2008, and industry comments such as yours were partly successful in convincing HUD to drop some of the more controversial provisions from the final rules such as the concept of a GFE application (basically a pre-qualification that would trigger delivery of the GFE) and the proposed mandatory closing script to be read out loud at closing comparing the final loan terms and settlement costs with those disclosed in the GFE. The mandatory form of GFE was shortened from four to three pages but continues to include a summary of loan terms which is largely duplicative of soon-to-be required early Truth in Lending disclosures. Tolerances for accuracy of the amounts disclosed in the GFE also remain in the final rules, and the GFE terms generally must be available for at least 10 days. The revised HUD1/1A forms are designed so that borrowers can easily compare fees on this form with amounts disclosed in the GFE and determine whether or not the tolerance for accuracy was exceeded.

HUD expressed several objectives in the new rules. One is to allow consumers to obtain multiple GFEs with more detail on loan terms and closing costs in order to shop for the best terms. Another objective is to provide more accurate disclosures. Both are admirable goals, but the resulting regulations create some difficulties for lenders along with a greater risk of liability if accuracy tolerances are exceeded. Let's look at some specifics.

Good Faith Estimate. The new rules replace the current one page form used by lenders with a mandatory three page form which must be given to the applicant within three days after the lender receives an application. Page one of the new GFE starts with a listing of important dates including: the date to which interest rate quoted remains available; the date to which the estimates for settlement costs remains available (which must be at least 10 business days later); the expiration of rate lock period, if one; and the number of days prior to closing that the rate must be locked.

Page one of the GFE also provides a summary of the loan terms including loan amount, term, initial interest rate, monthly payment amount, whether the rate, balance or payment amount may increase, whether there is a balloon payment or prepayment penalty, and whether the loan includes escrows for taxes and insurance. Page one ends with a summary of the total settlement charges including "Your Adjusted Origination Charges" and "Your Charges for All Other Settlement Services" which when added together equal the "Total Estimated Settlement Charges."

Actual settlement costs are disclosed on page 2 and grouped into two basic categories: the lender's charges and charges for other settlement services. The category for lender's charges is called "Your Adjusted Origination Charges" and includes the lender's or broker's direct charges for processing and underwriting, such as an origination charge or underwriting or processing fee, called "Our Service Charge", and any credit or charge for the interest rate chosen. Points would be a "charge" that increases up front origination charges. A yield spread premium paid by the lender to a broker would be shown as a "credit" which would reduce total origination charges. The lender's direct charges do not have to be itemized or broken down. Only the total is shown.

Settlement costs paid to others would be disclosed under the heading "Your Charges for All Other Settlement Services" in categories for: (a) required services selected by the lender other than title, such as appraisal and credit report, with an estimated amount for each service and a total for all; (b) title services and lender's title insurance; (c) optional owner's title insurance; (d) required services the borrower can shop for (e.g. closing attorney, pest inspection or survey) with an estimated amount for each service and a total for all; (e) recording and transfer charges; (f) transfer taxes, such as indebtedness or mortgage taxes; (g) initial escrow deposits for taxes and insurance; (h) per-diem interest and number of days to closing; and (i) homeowners insurance. Those items are followed by a total for "Your Charges for All Other Settlement Services" and a grand total for "Total Estimated Settlement Charges."

Page three outlines what charges disclosed in the GFE can and cannot change at closing. Charges with zero tolerance (i.e., cannot increase) include the lender's direct origination charges, any charge or credit for the specific interest rate chosen (e.g., points), the total of "Your adjusted origination charges" (after the rate is locked), and transfer taxes. Charges that are subject to a 10% tolerance in the aggregate include those under the heading "Required services that we select" such as appraisal and credit report, title services and lender's title insurance, any charges under the heading "Required services that you can select" if the borrower uses providers identified by the lender, optional owner's title insurance if the borrower uses a provider identified by the lender, and government recording fees. Charges that can change with no specified tolerance include charges under the heading "Services the borrower is free to shop for" if the applicant is free to choose any provider and does not have to use a provider identified by lender, title services and lender's title insurance if the applicant does not use a provider identified by lender, owner's title insurance if the applicant does not use a provider identified by lender, the initial escrow deposit, daily interest charges, and any homeowners insurance premium paid at closing.

Subject to the tolerances for accuracy, the lender is bound by the terms of the GFE for at least 10 business days. Amounts disclosed in the GFE can change by more than the permitted tolerance if the change is due to "changed circumstances" and the lender provides a revised GFE within 3 business days of the change. Changed circumstances occur when information relied on in preparing the GFE changes or is found inaccurate, such as when a change results from an act of God, disaster or emergency; the credit quality of borrower, amount of the loan, or the estimated value of the property is no longer accurate; or the need arises for flood insurance or clearing of an environmental or title problem. A change in market prices of settlement services is not a changed circumstance. The reason for the revised GFE must be documented, and the documentation must be retained for 3 years.

Page three of the new GFE continues with a tradeoff table. The lender must complete the left hand column with information about the loan terms and, then, at its option, may provide additional rate options – one higher and one lower – and show for each option the changes in the amount of the monthly payment on the loan that would result, the effect on settlement costs to be paid at closing, and the estimated total settlement costs. For ARM loans, the comparisons are based on the initial rate. Under HUD's original proposal, completion of the tradeoff table would have been mandatory. Page three ends with a blank chart consumers may use to write in loan terms from different lenders in order to comparison shop.

While the lender is required to keep the settlement costs disclosed in the GFE available for ten business days in order to allow the borrower time to shop the terms, the loan interest rate may change at any time until the rate is locked, meaning those terms tied to the rate such as points and per diem interest may change as well. If the interest rate on the loan is locked after the initial GFE has been delivered, the lender must deliver a new GFE at that time showing the revised interest rate dependent terms, but all other charges disclosed on the initial GFE must remain the same unless there is also a changed circumstance. Also, if the

borrower chooses a different loan product or a higher or lower initial interest rate, the lender would be required to provide a completely new GFE.

Yield Spread Premiums. Currently, yield spread premiums (YSPs) are required to be disclosed on the HUD-1 as fees paid to a broker outside of closing. The new proposal would require any YSP to be disclosed as a "Credit for the Specific Interest Rate Chosen" without using the term "yield spread premium."

HUD-1/1A. The final rules revise the HUD-1 forms to organize the information by category similar to the GFE. The lender or broker's direct fees would be grouped together and shown as "Our Service Charge" rather than separately itemized. Line items would also indicate the section of the GFE matching the HUD-1 disclosures. In addition, the HUD-1 requires the amount of the premium for any title insurance, including optional owner's title insurance, to broken down to show the portion paid to the attorney or agent and the portion paid to the insurance company. The last page of the revised HUD-1/1A includes a chart comparing the loan terms and costs on the GFE with the final figures on the HUD-1 and explains whether costs are within applicable tolerances. To avoid liability for a RESPA violation, the lender would have to refund any amounts that exceed the tolerance. The final page also includes a summary of the final loan terms.

Other Changes. The servicing transfer disclosure has also been revised and greatly simplified. Other changes to the regulation would permit average cost pricing for some settlement services, allow for discounts or incentives for using a specific service provider including an affiliated company and permit electronic disclosures in compliance with E-Sign.

Effective Dates. The GFE and HUD-1 changes become effective January 1, 2010. The remaining changes to the regulation became effective on January 16, 2009.

<Cliff Harrison>

NEW RISK ASSESSMENT GUIDANCE FOR REMOTE DEPOSIT CAPTURE

Remote deposit capture has been a very popular service offering for banks, particularly over the past 2 or 3 years. The Federal Financial Institutions Examination Council (FFIEC) has very recently published guidance for financial institutions offering the remote deposit capture service that is focused on proper risk management practices.

The guidance emphasizes that while deposit taking is an essential, long standing bank activity, remote deposit capture is a new delivery system that calls for thorough risk assessment prior to implementation, and periodically thereafter. Since so many institutions have already implemented remote deposit capture prior to development of this guidance, risk assessment should be undertaken now, based on the remote deposit capture system in place. The guidance states that senior management should identify the legal, compliance, reputation, and operational risks associated with remote deposit capture (RDC) and ensure RDC is compatible with the institution's business strategies and management's ability to manage the risks inherent in RDC. The guidance suggests that existing risk assessment practices, such as those used for IT and Bank Secrecy Act risk assessments, be incorporated into the risk assessment process for RDC.

The risk assessment generally should address (a) legal and compliance risks, (b) operational risks, (c) methods to mitigate and control identified risks, (d) an assessment of the suitability of RDC for particular customers, (e) proper due diligence and management of third party vendors that provide RDC services, (f) proper systems for training customers that use RDC systems and equipment at their business or home locations, (g) development of legally sound customer contracts and agreements for use with RDC, and (f) business continuity procedures in the event of system disruption.

To further explain certain of the risk assessment issues detailed in the guidance, the legal and compliance risk assessment should include evaluation of the legal risk exposure potential to the bank such as:

- risk of money laundering activity and the bank's ability to comply with anti-money laundering laws and suspicious activity monitoring;
- the legal risk exposures to a bank that accepts a deposit of check images from customers through RDC that may be related to controls over the process used for image capture or image exchange and the institution's arrangements for clearing and settling checks;
- risks associated with sending RDC deposited items to another institution for collection or presentment pursuant to Check 21, Reg. CC, Reg. J, state laws (such as the UCC), or clearinghouse rules; and
- the legal and regulatory requirements related to funds availability and handling returned items, and methods for resolving disputes.

The operational risk assessment should be conducted by appropriate management and officers within the operations and IT departments of the bank. Once the legal and operational risk exposures have been property identified through the risk assessment, the issue of whether risks can be mitigated, measured and monitored must be addressed. Risk management policies to mitigate and monitor risk should include actions such as establishing customer selection processes that may limit the availability of RDC only to appropriate, qualified customers. Information obtained in the process of BSA customer due diligence procedures may be used to support an assessment of customer suitability for RDC. Other factors to consider as part of the suitability review are the customer's business activities, risk management processes, geographic location, and customer base. Possibly an on-site visit by bank staff may be necessary in certain situations.

In addition to general assessment of suitability of the RDC product to certain customers, training the RDC customers on an ongoing basis in necessary to clarify to the customer their role in managing risks, monitoring for processing errors and for unauthorized activity. Either the institution or the third party vendor, under the supervision of the institution, should conduct this training. Finally, the customer agreement drafting and implementation should address all risks identified in the risk assessment process and detail the duties, responsibilities and obligations of the customer and the institution relative to the RDC services.

The RDC risk assessment process required pursuant to this guidance will require coordination and cooperation among management, operations, IT, legal and compliance areas of the bank. Because these RDC services have already been implemented by so many banks, it is important to immediately begin to address the risk assessment process, and particularly work to mitigate any risks for customers or vendors that may already be involved with the RDC services and products.

<Virginia Wilson>

FEDERAL RESERVE BOARD AMENDS REGULATION Z OPEN-END CREDIT RULES

After several years of study and comment, the Federal Reserve Board (the "Board") announced a final rule which amends Regulation Z (Truth-in-Lending) to improve the effectiveness of disclosures given to consumers in connection with credit card accounts and other revolving (non-home secured) credit plans.

Since almost every member of the Bank Group uses a third-party vendor to supply its customers' credit card needs, this article will not go into great detail regarding the 1,053 page version of the final rule. Instead, we will provide a summary of the types of actions and changes made to the open-end credit portions of Regulation Z. Of course, those members of the group that still offer an open-end, revolving

credit product such an overdraft line of credit, etc., should still pay close attention to these changes.

To simplify consideration of these changes, we will divide the summary into three parts: (1) changes related to open-end credit applications and account-opening disclosures, (2) changes to periodic disclosure statements, and (3) changes to interest rate and other account terms.

Applications and Solicitations. Changes are made to the credit card application and solicitation disclosures to make those disclosures more meaningful and easier for consumers to use. The final rule gives these disclosures in the form of a table that summarizes the key account terms. The new format requirements for this summary table include rules regarding type size, the use of bold-face type for certain key terms, and the placement of information. Creditors must also disclose the duration that penalty rates may be in effect, as well as simplify disclosures about various rates and revise disclosures regarding when a grace period is offered on purchases, or when no grace period is offered.

Account-Opening Disclosures. The final rule enhances the cost disclosures which must be provided at account opening to make the information more conspicuous and easier to read. Certain key terms must be disclosed in a summary table at account opening, which is similar to the table required for credit and charge card applications and solicitations.

Periodic Statement Disclosures. The final rule revises Regulation Z in an attempt to make disclosures on periodic statements more understandable. The Board attempts to accomplish this by making changes to the format requirements, such as by grouping fees and interest charges together. These changes include:

- *Interest Charges and Fees*. Interest charges and fees must be grouped separately, with a total for each. Interest charges must be itemized according to the type of transaction (such as interest charged on purchases, and interest charged on cash advances). Separate year-to-date totals for fees and interest charges are also required.

- *Effective APR*. The Board elected to eliminate a proposed disclosure of an "effective annual percentage rate". The Board determined in the course of its inquiry that consumers failed to understand that term.

- *Minimum Payment Disclosure*. The effect of making only the minimum payment required on the length of time it takes to repay balances also must be disclosed. (As you will recall, this was a requirement under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.)

Changes in Interest Rate and Account Terms. The number of instances under which consumers must receive written notice of changes to account terms is expanded under the final rule, and the length of time these notices must be sent before changes become effective is increased. The changes include:

- *Increase in Advance Notice for Changes in Terms*. The amount of advance notice required before a change in terms can be imposed is increased from 15 to 45 days in order to allow consumers the opportunity to arrange for alternative financing or change their account usage.

- *Prior Notice Requirement for Penalty Rate Increases*. Creditors must provide a 45 day prior notice to the consumer before imposing an interest rate increase based upon the consumer's delinquency or default or as a penalty.

- *Summary Table*. If a change-in-terms or penalty-rate notice is sent with a periodic statement, the creditor must provide a tabular disclosure on the face of the periodic statement showing the key-terms being changed.

Additional Consumer Protections. The final rule includes the following additional protections for consumers:

- *"Fixed" Rates.* A creditor is only allowed to use the term "fixed" when referring to an interest rate if the time period is specified for which the rate is fixed and the rate will not increase for any reason during that time, or if a time period is not specified, if the rate will not increase for any reason while the plan is open.

- *Cut-off Times and Due Dates for Mailed Payments*. Creditors must establish reasonable cut-off hours for mailed payments to be considered timely when received on the due date. The final rule deems 5:00 p.m. to be a reasonable time. When mailed payments are not accepted on the due date, such as on weekends or holidays, creditors must treat a payment received on the next business day as timely. While many banks will be able to rely on third party vendors to make these changes to forms and billing statements, every bank should inventory its products to see if it offers other open-end credit products that are not secured by residential real estate which might require modification of the application or billing statement forms and procedures.

The effective date for these changes to Regulation Z is July 1, 2010.

<*Ed Wilmesherr*>

OVERDRAFT SERVICES: REGULATION DD AMENDMENTS AND REGULATION E PROPOSED RULES

December 18, 2008 was a busy day at the Federal Reserve Board (the "Board"). Along with major amendments to Regulations AA and Z dealing with credit card practices and disclosures, the Board also amended Regulation DD (Truth-in-Savings) and proposed amendments to Regulation E (Electronic Fund Transfers) aimed at the practice of providing overdraft services and charging overdraft fees.

Regulation DD Amendments

- *Disclosure of Aggregate Overdraft Fees*. At the present time only banks that promote or advertise the payment of overdraft transactions must disclose the aggregate amount of those transactions. However, the new final rule requires all institutions to disclose on periodic statements the aggregate dollar amount of overdraft fees and returned item fees charged, both for the statement period itself and for the year-to-date.

- *Disclosure of Balance Information*. The other amendment to Regulation DD requires banks that provide account balance information through any automated means to provide a balance that does not include additional funds that may be available to cover overdrafts.

Proposed Changes to Regulation E

Previously, the Board had proposed amendments under Regulations AA and DD on the subject of overdraft services. Those proposed changes have now been replaced with a proposal to amend Regulation E to provide consumers certain protections related to the assessment of overdraft fees. The proposed rule asks for comment on two approaches to providing consumers a choice regarding the payment of ATM and one-time debit card overdrafts. Under one approach, a bank would be prohibited from imposing an overdraft fee unless the consumer is given an initial notice and a reasonable opportunity to opt-out of the bank's overdraft service, and the consumer does not opt-out. Under the second approach, a bank would be prohibited from imposing an overdraft fee for paying overdrafts in these instances unless the consumer affirmatively consents or opts in to the bank's overdraft service. Regardless of which approach is selected, the proposed changes would represent a major modification to present practices and, in certain instances, an operational problem.

A second proposed amendment to Regulation E would prohibit banks from imposing an overdraft fee when an account is overdrawn because of a hold placed on funds which proves in excess of the actual transaction amount. This prohibition would only apply to debit card transactions in those instances where the actual amount of the transaction can usually be determined within a short period of time after the transaction is authorized, e.g., transactions at gas stations and restaurants.

<Ed Wilmesherr>

HMDA RATE SPREAD REPORTING REQUIREMENTS CHANGED

While we are on the subject of higher priced mortgage loans, remember that the Fed in October approved amendments to Regulation C revising the rules for reporting loan pricing/rate spread information on the HMDA LAR to conform to the new definition of a "higher priced mortgage loan" under the new Truth in Lending rules. Currently, HMDA reporters must collect and report the spread between the APR on a dwelling secured loan and the yield on a Treasury security of comparable maturity if the spread is 3.0% or greater for a first lien loan or 5.0% or greater for a subordinate lien loan.

Under the revisions, HMDA reporters must report the spread between the loan's APR and the "average prime offer rate", as announced by the Fed, if the spread is 1.5% or more for a first lien loan or 3.5% or more for a subordinate-lien loan. The Fed will publish the average prime offer rates weekly in two tables, one for variable rate products and one for fixed rate loans. The rates will be published Friday each week effective the following Monday. The spread will be determined based on the most recent average prime offer rate for the particular loan type and maturity in effect at the time the interest rate on the loan is set for the final time before closing.

The final rule is effective October 1, 2009. Lenders will use the new rate spread reporting test on loans for which applications are taken on or after October 1, 2009 and for all loans consummated on or after January 1, 2010 (regardless of the application date). Lenders will continue to use the existing rate spread reporting test using Treasury security yields for loans for which applications were taken before October 1, 2009 that close in 2009. As a result, the 2009 HMDA data reported by banks will include some rate spread loans of both types.

<Cliff Harrison>

MSRCG FEBRUARY MEETING TO BE HELD ON FEBRUARY 24, 2009

The MSRCG will hold its Quarterly Meeting on February 24, 2009, at the Racquet Club of Memphis in the Large Ballroom located at 5111 Sanderlin Avenue, Memphis, Tennessee. Registration will begin at 9:30 a.m. with the Quarterly Meeting to begin promptly at 10:00 a.m.

During the February Quarterly Meeting, we will focus on recent changes to the HOEPA (high-priced mortgages), rules, revisions to RESPA, changes to credit card and open-end credit disclosure rules and practices, as well as new overdraft protection rules and amendments to Regulation AA and Z. The lunch hour will provide the usual summary of recent regulatory developments.

As always, the dress code for this occasion is casual, and lunch will be provided. We ask that you fax or e-mail your registration form enclosed with this copy of the *Quarterly Report* to Liz Crabtree no later than **February 19, 2009** so that arrangements for lunch can be finalized. We look forward to seeing you there.

<Ed Wilmesherr>

MSRCG COMPLIANCE CALENDAR

1/31/05 - Revised FACT Act Notices Effective	**1/1/08** – FACT Act Affiliate Marketing Rule Effective
3/29/05 - Effective Date for Interagency Guidance on Response Programs for Unauthorized Access to Customer Information	**10/1/08** – FACT Act Affiliate Marketing Rule Mandatory Compliance Deadline
4/8/05 - Effective date for OCC Guidelines Establishing Standards for Residential Mortgage Lending Practices	**10/1/08** – Electronic Disclosure Regulation effective
4/26/05 - Joint Guidance on Banking Services to MSB's Issued	**11/1/08** – Red Flag Guidelines compliance mandatory
7/1/05 - Final Rule on Disposal of Consumer Information (FACT Act) effective	**11/13/08** – Deadline to opt-out of unlimited FDIC insurance for non-interest transaction accounts
7/1/05 - Effective Date for Joint Guidelines for Disposal of Consumer Information	**11/14/08** – Deadline for application for Treasury Department Capital Purchase Plan
8/1/05 -Disclosures re: Opt Out Rights for Credit Or Insurance (FACT Act) Final	**2/24/09** – MSRCG February Quarterly Meeting
9/01/05 - CRA Final Rule Becomes Effective	**4/28/09** – MSRCG Steering Committee Meeting
2/13/06 - OFAC Guidelines Effective	**5/19/09** – MSRCG May Quarterly Meeting
4/1/06 - Deposit insurance limits on retirement accounts increased to $250,000	**7/21/09** – MSRCG Steering Committee Meeting
4/1/06 - Effective date for FACT Act regulations on use of medical information in determining credit eligibility	**8/25/09** – MSRCG August Quarterly Meeting
6/30/06 - Effective Date for use of new SFHD forms	**9/22/09** – MSRCG Steering Committee Meeting
7/1/06 - Reg. DD Amendments on Overdraft Privilege Plans Effective	**10/1/09** – HOEPA Regulations changes generally effective
7/1/06 - Effective date for Reg. CC amendments on remotely created checks	**11/17/09** – MSRCG November Annual Meeting
11/1/06 - EPA All Appropriate Inquiries Rule Effective	**4/1/10** – Escrow requirements effective for site-built homes
1/1/07 - Mandatory compliance date for Reg. E changes on electronic check conversions, payroll card accounts and ATM surcharge disclosures	**7/1/10** - Amendments to Regulation AA become effective
7/1/07 - Reg. E payroll card account provisions effective	**10/1/10** – Escrow requirements effective for mobile homes
10/01/07 - National Defense Authorization Act Usury Provisions Effective	