

Truth in Lending: A 20/20 view

FREEZ

Complying with the new early disclosure rule

By Kathlyn (Lyn) L. Farrell

On May 11, the Federal Reserve issued a major new Regulation Z rule that became effective for consumer real estate applications that are received after July 30. Now is a great time to make sure that your institution has appropriate procedures in place to comply with the new rule.

The Truth in Lending Act early disclosure rules were substantially changed by The Mortgage Disclosure Improvement Act enacted in July 2008. There are three major changes to the rule: the expanded coverage, the requirement to wait before closing a loan and the prohibition against charging fees before the consumer receives the disclosures.

Expanded coverage

Arguably, one of the biggest changes is the expanded coverage. Any consumer loan secured by a dwelling that is covered by RESPA is subject to the early disclosure rules. Previously, only loans to purchase principal dwellings had to have these early disclosures. Now all types of dwelling-secured loans are covered. That means that home improvement loans and home equity loans are included in all the new rules. HELOCs are not covered by RESPA, so early disclosures are not required. Here are a few examples of loans:

1. A loan to purchase a recreational lot and mobile home for the borrower's own use
Covered. Purchase loans for any type of residence, including condominiums and mobile homes, are covered—except for timeshares and HELOCs.
2. An interim construction loan for the borrower's residence
Not covered. Interim construction loans are not covered by RESPA, so this loan is not subject to the early disclosure rules. Note, however, that this loan is covered by Regulation Z and a disclosure must be provided to the borrower prior to consummation.
3. A loan to pay the borrower's taxes secured by a rental house owned by the borrower
Covered. This loan is for a consumer purpose—to pay the borrower's taxes—therefore, it's covered by Regulation Z. Since it's secured by a residence, it's subject to the early disclosure requirement.
4. A loan to purchase a rent house
Not covered. Loans for the purpose of purchasing or improving rental property are specifically excluded from the coverage of Regulation Z, so the rules do not apply.
5. A loan to construct the borrower's residence where the first advance is to purchase the lot upon which the house will be built
Covered. Since loans where a part of the proceeds are to finance the transfer of the title to the first user are covered by RESPA, this loan is covered by the early disclosure rules.
6. A home equity loan used to finance the borrower's new business, secured by the borrower's home
Not covered. Since this loan has a business purpose it is not covered by Regulation Z.

Required disclosure and waiting periods

For all covered loan applications received on or after July 30, 2009, the early TILA disclosures must be provided within three business days of the application date and at least seven business days prior to the loan closing. The bank begins counting the business days for closing the loan from the date the disclosures were mailed or delivered to the customer.

For purposes of determining when the disclosures have to be delivered, a business day is any day the bank is open for conducting substantially all of its business operations. So if the bank's back offices (i.e., the operations departments) are not fully functional on Saturday, then Saturday will not count. However, in contrast, with the rule for counting the seven days to close the loan, the bank counts all days except Sundays and federal holidays.

When an early TILA disclosure is mailed, the lender may presume that the consumer received the disclosures three business days after being placed in the mail. The definition of "business day" for determining the presumed date of receipt includes all calendar days except Sundays and legal holidays specified by law. Saturdays are always counted.

To illustrate the new rule, consider this example:

The lender receives an application on Friday, Oct. 2. The lender is not open on Saturday, except for the purpose of cashing checks and taking deposits; therefore, Saturday is not counted as a business day in determining the three-day deadline to get the TILA disclosures in the mail to the applicant. So, the disclosures must be mailed no later than the next Wednesday, Oct. 7.

Assume that the lender mailed the disclosures on Wednesday, Oct. 7. When can the lender assume that the consumer received them? For this purpose, the lender always counts Saturdays, even though the lender's offices are not open on that day to conduct substantially all of its business operations. So, the lender can consider that the consumer received the early disclosures on Saturday, Oct. 10. After this date, the lender can charge a loan-related fee.

When can the lender close this loan?

The disclosures must be mailed or delivered no later than the seventh business day prior to closing the loan. Since the disclosures were mailed on Wednesday, Oct. 7, the loan closing can occur on or after Friday, Oct. 16. For purpose of counting the seven business days, the lender counts all business days except Sunday and federal holidays. Since Monday, Oct. 12, is Columbus Day (a federal holiday), the bank should not count this day.

What if the APR changes?

If the APR becomes inaccurate (that is, if it changes more than 1/8 of 1 percent in a regular transaction and 1/4 of 1 percent in an irregular transaction), the bank must provide corrected disclosures that include all changed terms. The consumer must receive the corrected disclosure no later than three business days prior to the loan's consummation. So, when corrected disclosures are given, count from the date the consumer receives the disclosures—not the date they were mailed.

What is an irregular transaction?

An irregular transaction is one with at least one of the following characteristics:

- Multiple advances
- Irregular payment periods (except for an irregular first payment)
- Irregular payment amounts (except for the first or last payment)

Rule for the timing of fees

The bank may not charge anything except a fee for obtaining a credit report until the consumer has received the early disclosures. The commentary issued with the rule indicate that fees may not be either "imposed" or "collected," so it would not be advisable to obtain a check

and agree to hold it until the disclosures are received.

The lender should have procedures to determine when the consumer has received the disclosures. All disclosures that are mailed or delivered by overnight messenger or electronically are presumed to be received on the third business day after they are sent unless the bank has documentation of actual receipt. Again, the bank should count all days except Sunday and federal holidays in determining when disclosures are presumed to be received.

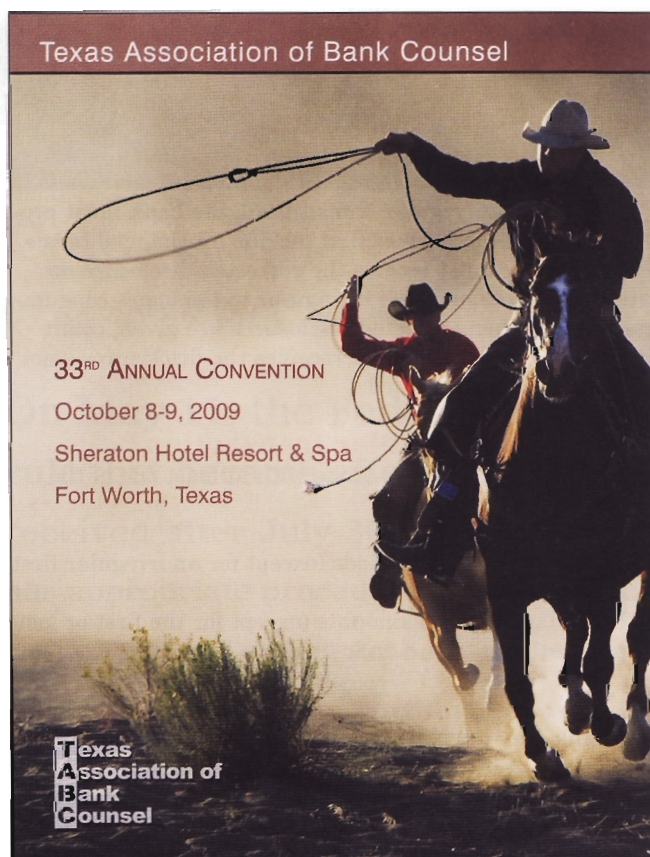
Can the early disclosure waiting period be waived?

Yes, but only in the case of a bona fide personal emergency. The borrower must provide a statement that is signed and dated, that waives his right to the waiting period and that is not pre-printed.

Policies and procedures

The best compliance defense is to have detailed policies and procedures that assist the bank's personnel in determining the correct coverage, providing disclosures in a timely manner and waiting the correct number of days to close the loan. To the right is a checklist to help you ensure compliance with the new rules. ♦

Kathlyn (Lyn) L. Farrell, CRCM, CAMS, AMLP has worked in the field of regulatory compliance for financial institutions for more than 30 years. She is a licensed attorney in the state of Texas and has been employed as in-house counsel and compliance officer to medium and large financial institutions. She currently is national director of risk management services for Sheshunoff Consulting + Solutions, an Austin-based financial services consulting company.



Texas Association of Bank Counsel

33RD ANNUAL CONVENTION
October 8-9, 2009
Sheraton Hotel Resort & Spa
Fort Worth, Texas

Texas Association of Bank Counsel

Checklist for Compliance with MDIA Residential Mortgage Rule

- ☑ Determine that all early TILA disclosures have the following language: "You are not required to complete this agreement merely because you have received these disclosures or signed a loan application."
- ☑ Develop procedures to determine when an application is received.
- ☑ Check your procedures to determine that early disclosures will be provided within three business days from receiving an application for all consumer-purpose loans to be secured by a dwelling (including purchase, home equity, home improvement, etc.) – don't count federal holidays, but count all other days that your offices are open to conduct substantially all business operations.
- ☑ Develop a system to document when the applicant(s) will be considered to have received disclosures that have been mailed (for this purpose count all calendar days except Sundays and federal holidays).
- ☑ Implement a control to ensure that no fees are charged (except for a bona fide credit report fee) until the consumer can be presumed to have received the disclosures.
- ☑ Implement a tracking system to ensure that mortgage loans will not close until seven business days after the early disclosures have been mailed or delivered. (Don't count Sundays or federal holidays for this purpose.)
- ☑ Establish a system to review all early TILA disclosures at least three business days prior to the loan's closing to determine that they remain correct. If the APR has changed outside the tolerance, re-disclose and make sure that there is a three-day waiting period before consummation. (For purposes of this requirement, don't count Sundays and federal holidays.)
- ☑ Develop procedures for handling waivers of the early disclosure waiting period, including the requirement to receive a written, signed and dated waiver that specifically describes the personal emergency.
- ☑ Train lenders, lending assistants, loan operations review personnel, etc. on the requirements.