



JONES DAY
COMMENTARY

FEDERAL RESERVE BOARD REVISES MORTGAGE DISCLOSURE REQUIREMENTS UNDER THE MORTGAGE DISCLOSURE IMPROVEMENT ACT OF 2008

The Federal Reserve Board recently approved a new interim rule revising its September 2010 interim rule that implemented certain provisions of the Mortgage Disclosure Improvement Act of 2008 (“MDIA”). The September 2010 interim rule introduced rate and payment disclosure tables for variable-rate loans secured by real property or a dwelling. This December 2010 interim rule clarifies the Regulation Z requirements affecting “5/1” adjustable-rate mortgages, interest-only loans, and negative amortization loans. Like the September 2010 interim rule, the December 2010 interim rule will be effective on January 30, 2011, although compliance is optional for credit applications received before October 1, 2011. This highlights the Board’s clarifications and does not describe the full text of the rule. Companies should carefully consider the full text of the December 2010 interim rule and submit comments by February 28, 2011.

OVERVIEW OF SEPTEMBER 2010 INTERIM RULE

The MDIA amended the Truth in Lending Act of 1968 (“TILA”) to require variable-rate residential mortgage disclosures to include examples of possible adjustments based on the maximum allowable rate, a “no-guarantee-of-refinance” statement, and an explanation that the initial regular payments are for a limited period. Congress further directed the Federal Reserve Board to implement these changes and develop a readily understandable disclosure format.

The September 2010 interim rule unveiled that new format. Creditors are now required to disclose information in a “tabular form,” specifying the maximum interest rate and corresponding monthly payment. Disclosure then increases by loan type. For example, “plain vanilla” adjustable-rate mortgage disclosures

must state the interest rate at consummation and identify the period of time until the first adjustment. “Negative amortization loans” require additional disclosures such as the interest rate for both the first and second scheduled payment increases and the rate upon conversion to fully amortizing payments. The variation and extent of these requirements prompted significant comments to the Board. Although the September 2010 interim rule remains in effect, the Board issued its December clarification to address some of these lingering ambiguities.

“5/1” ADJUSTABLE-RATE MORTGAGES

The September 2010 interim rule originally required creditors to disclose the maximum possible rate applicable to an adjustable or step-rate mortgage during the first five years after consummation. Yet, as commentators noticed, that wording presented unique problems for “5/1” adjustable-rate mortgages (“5/1 ARMs”). These agreements typically involve regular periodic payments at a set rate for the first 60 months after consummation and first adjust during the 61st month. Counting from the date of consummation, at least for 5/1 ARMs, would exclude from the disclosure the first significant rate adjustments.

The Board addressed this issue by requiring the disclosure period for 5/1 ARMs after the first regular periodic payment date. The summary table column labeled “maximum during first five years” must include the first major rate adjustment—even if that takes place more than five years after consummation.

INTEREST-ONLY LOANS

Under the September 2010 interim rule, where a loan allowed for payment increases resulting from something other than an interest rate adjustment, the summary table was required to identify both the earliest date that a change could apply and the earliest date payment would be due. Commentators worried that this requirement would cause confusion in cases of interest-only home loans because that interest is

usually paid in arrears. In other words, the two dates could be presented as more than a month apart even though the consumer would be responsible for the accrued interest. The Board eliminated the confusion in the December 2010 interim rule by requiring creditors to disclose only the date the interim rate may become effective.

NEGATIVE AMORTIZATION LOANS

The September 2010 interim rule defined negative amortization loans simply as those allowing for negative amortization, with reverse mortgages being the sole exclusion. Under this definition, if a loan included repayment terms that could result in negative amortization, it was a “negative amortization loan” under Regulation Z. The rule applied even if the loan did not allow multiple payment options. Keeping this definition would have extended heightened disclosure requirements to loans not typically considered “negative amortization loans,” such as certain option ARMs. As a result, several commentators asked whether the Board meant to capture loans that did not make negative amortization a requirement.

The Board intended these disclosures to show consumers the effects of making minimum payments as opposed to regularly paying in full. However, the Board recognized that these effects only occur if the loan allows for multiple payment options. Accordingly, a revised definition now limits this category to loans that permit consumers to make minimum payments that result in amortization.

MULTIPLE-ADVANCE CONSTRUCTION LOANS

After the September 2010 interim rule, confusion arose over its application to multiple-advance construction loans. Many such loans are secured by residential property or a dwelling and thus seem to fall under the September 2010 interim rule’s requirements. The lingering question was whether disclosure should be made through a “repayment schedule” (under Regulation Z, Appendix D) or the new interest rate and summary table (under the September 2010 interim rule).

The Board adopted a new comment under Appendix D to clarify what provision applies. If the creditor elects to disclose the construction and permanent phases as separate (*i.e.*, multiple) transactions, the construction phase must be disclosed in tabular form pursuant to Regulation Z. If, however, the creditor chooses to disclose the construction and permanent phases as a single loan, the construction phase should be disclosed under an Appendix D analysis, which requires a “repayment schedule.” Interest payment disclosures and timing of those payments should not be in the Regulation Z tabular form. In other words, the September 2010 interim rule requirements apply only to permanent phases.

LAWYER CONTACTS

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our “Contact Us” form, which can be found at www.jonesday.com.

Lee Ann Russo

Chicago

+1.312.269.4283

larusso@jonesday.com

Jayant W. Tambe

New York

+1.212.326.3604

jtambe@jonesday.com

Albert J. Rota

Dallas

+1.214.969.3698

ajrota@jonesday.com

Jones Day publications should not be construed as legal advice on any specific facts or circumstances. The contents are intended for general information purposes only and may not be quoted or referred to in any other publication or proceeding without the prior written consent of the Firm, to be given or withheld at our discretion. To request reprint permission for any of our publications, please use our “Contact Us” form, which can be found on our web site at www.jonesday.com. The mailing of this publication is not intended to create, and receipt of it does not constitute, an attorney-client relationship. The views set forth herein are the personal views of the authors and do not necessarily reflect those of the Firm.