# BANKING LEGISLATION & POLICY

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**HIGHLIGHTS**

This issue contains detailed descriptions of legislative and regulatory proposals related to the subprime mortgage market and financial liquidity, pending legislation that would affect the credit card industry, and a proposed rule that would alter the Department of Housing and Urban Development's implementation of the Real Estate Settlement Procedures Act.

In addition, it summarizes other notable legislative, regulatory, and judicial developments that occurred during the first quarter of 2008.

## MORTGAGE AND LIQUIDITY DEVELOPMENTS

Over the past several months, policymakers have introduced a number of proposals intended to dampen disturbances in mortgage markets and to prevent foreclosures. Among the most prominent developments during the first quarter of 2008 were a rule proposed by the Federal Reserve that would strengthen the regulation of higher-priced mortgages and the introduction of several bills in the U.S. House and Senate. Also notable is a new Federal Reserve website that directs at-risk homeowners to agencies and organizations that might be able to help them avoid foreclosure. The Federal Reserve also made a series of moves to increase liquidity in financial markets.

### Background

The primary focus in recent months has been on the direct and indirect effects of the deteriorating performance of subprime mortgages. These are housing loans issued to borrowers who are perceived to pose a relatively high risk of default. These loans often have nontraditional features, including low initial payments that reset to a higher level as the loan matures. The subprime market has grown rapidly in recent years. While only 5 percent of all mortgages originated in 1995 were subprime, about 20 percent were subprime by 2005.[1]

In February 2008, payments on 17 percent of securitized first-lien subprime adjustable-rate mortgages (ARMs) in the United States were 60 or more days delinquent. An additional 12 percent of first-lien subprime ARMs had already entered the foreclosure process.[2] The increase in subprime

[1] Testimony of Sandra F. Braunstein, Director, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, before the Subcommittee on Financial Institutions and Consumer Credit, Committee on Financial Services, U.S. House of Representatives, March 27, 2007.

[2] LoanPerformance ABS Loan Level Data Extract, with calculations by the Federal Reserve Bank of New York.

delinquencies and foreclosures has been blamed largely on slowing house-price appreciation and a loosening of underwriting standards. In many cases, lenders failed to verify borrowers' income, assets, and other factors that might affect their ability to repay their loans.

Policymakers are concerned about the increases in default and foreclosure rates on subprime mortgages for several reasons. First, losing a home through foreclosure can be financially and emotionally traumatic for a borrower, often reducing future access to credit and housing. It also creates significant losses for lenders and investors. In addition, foreclosures can have negative spillover effects on the prices of nearby houses.

The deteriorating performance of subprime mortgages also contributed to a sharp contraction in the liquidity of financial markets that began in early August 2007. Institutions and individuals around the world that had invested in securitized packages of subprime mortgages or commercial paper collateralized with subprime loans suddenly encountered unexpected losses.[3] Some lenders have remained reluctant to lend to leveraged investors and have increased the amount of collateral they require, causing investors to reduce their leverage and liquidate their security holdings. In addition, large financial institutions, including some commercial and investment banks, as well as the government-sponsored enterprises (GSEs), have suffered substantial credit losses. More recently, the shortage of liquidity has spread to other sectors, including the markets for auction rate municipal securities, student loans, and, to a lesser extent, mortgage-backed securities issued by government agencies. The growth of real economic indicators, such as employment, housing starts, and real disposable income, has also weakened in recent months.[4]

**Regulatory Developments**

***Fed HOEPA Proposed Rule***

On January 9, the Board of Governors of the Federal Reserve System issued proposed rules intended to improve the regulation of residential mortgage loans by amending portions of Regulation Z, which implements the Truth in Lending Act (TILA) and the Home Ownership and Equity Protection Act (HOEPA). Some provisions of the rule would apply only to higher-priced (subprime and alt-A) mortgages, while others would apply to nearly all owner-occupied residential mortgage loans. The proposed rule would also bring new parties, such as mortgage brokers and nonbank mortgage servicers, under Fed regulation. Comments on the proposed rule were due April 8.

*Higher-Priced Mortgages*

Several provisions of the proposed rule would apply only to higher-priced mortgage loans, which are defined as closed-end consumer loans that are secured by the consumer's principal dwelling and have an APR exceeding the yield on a comparable Treasury security by at least three percentage points for a first-lien loan or by five percentage points for a subordinate-lien loan. This definition is intended to capture the subprime market, and it covers more loans than the high-priced home equity loans currently regulated by HOEPA.[5]

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[3] For more detail on the recent liquidity issues, see *Banking Legislation and Policy*, Volume 26, No. 3.

[4] Testimony of Ben Bernanke, Chairman, Board of Governors of the Federal Reserve, before the Joint Economic Committee, April 2, 2008.

[5] High-priced loans covered by HOEPA are closed-end mortgages secured by a consumer's principal dwelling where either (a) the APR at consummation will exceed the yield on Treasury securities of a comparable maturity by more than eight percentage points for first-lien loans, or 10 percentage points for subordinate-lien loans; or (b) the total points and fees payable by the consumer at or before closing exceed the

First, the proposed rules would prohibit a mortgage lender from engaging in a pattern or practice of issuing higher-priced mortgages without regard for the potential borrowers' abilities to repay the loans. Lenders must have a reasonable basis on which to conclude that customers will be able to make their loan payments for at least seven years. This requirement already holds for high-priced mortgages under existing HOEPA provisions.

The proposed rules would also require creditors to verify a potential borrower's income and assets using third-party documents, such as W-2 forms, tax returns, and payroll receipts, before issuing higher-priced mortgages. This section includes a safe harbor provision for creditors who fail to verify income and assets as long as the borrowers' actual income and assets are later found to be close to what they reported on their mortgage applications.

Prepayment penalties are already regulated for some HOEPA-covered loans, and the proposed rules would do the same for some higher-priced mortgages. Specifically, charging a prepayment penalty would be prohibited unless the consumer's debt-to-income ratio was relatively low (below 50 percent after including the proposed mortgage), the consumer did not obtain the funds to make the prepayment by refinancing with the creditor or an affiliate, and the penalty term was less than five years. In addition, for both higher-priced and HOEPA-covered mortgages, the proposed rules would require that any prepayment penalty terms expire at least 60 days before an interest rate increase was permitted to occur.

Finally, lenders would be required to escrow payments for property taxes and homeowner's insurance premiums for first-lien, higher-priced mortgages to ensure there are funds available to cover those costs over the first few years of the mortgage. A year after the signing of a mortgage, the lender would be permitted, but not required, to allow the borrower to opt out of the escrow. The proposal requests comments from the public on whether this provision should preempt state escrow laws.

*All Mortgage Loans*

Additional provisions would apply to all closed-end, principal residence mortgage loans, regardless of their price. First, lenders would be prohibited from making any direct or indirect payments to brokers unless the borrower agreed to them in writing before paying any fees or submitting a written application to the broker for the transaction. Among other content, the written agreement must clearly disclose that the borrower's payments will ultimately cover the entire amount of the broker's compensation and that a creditor's payment to a broker may influence the broker to offer loan terms that are not in the consumer's best interest.

A creditor or mortgage broker would also be prohibited from "coercing, influencing, or encouraging" an appraiser to misrepresent the value of a potential borrower's home. Lenders would be prohibited from issuing loans based on appraisals that they knew were based on misrepresentation of home values that resulted from coercing, influencing, or encouraging an appraiser.

Finally, the rules would also impose several requirements on mortgage servicers. First, servicers would be required to credit borrowers' accounts with their payments as of the date of receipt. A servicer would also be forbidden to charge a late fee to a consumer who failed to pay a late fee from a previous period but otherwise made his or her payment in full. Additionally, servicers would be required to provide schedules of "all specific fees and charges that the servicer may impose on the consumer" and to provide accurate payoff statements upon request.

greater of 8 percent of the total loan amount or $561 for 2008 (adjusted annually).

The proposed rules would also extend the early disclosure obligations already required under Regulation Z for residential mortgage transactions to nonpurchase, closed-end mortgage transactions, including refinancings, home equity loans, and reverse mortgages secured by the consumer's principal residence. A lender would be required to make these disclosures, which include information about the loan's APR, before the consumer paid any fee for the transaction, excluding credit report fees.

*Advertising*

The proposed rules would also enhance requirements for mortgage advertising. Specifically, the rules would clarify the "clear and conspicuous" standard for home-equity plan advertisements, requiring that "certain disclosures about introductory rates or payments in advertisements for home-equity plans be prominent and in close proximity to the triggering terms." The same standard would apply to Internet, television, and oral advertisements of home-equity plans; in addition, visual displays on the Internet and television "must not be obscured by techniques such as graphical displays, shading, coloration or other devices," while oral advertisements must be loud and slow enough for consumers to hear and comprehend them. Furthermore, home-equity plan advertisers would be required to disclose both introductory plan terms and the rates and payments that would apply over the term of the loan.

The clear and conspicuous standard would also apply to advertisements for all closed-end loans. Advertisers would be required to adequately disclose all rates and payments that will apply over the term of the loan, without placing undue emphasis on low introductory "teaser" rates and payments. Advertisers are also forbidden to describe rates as fixed when the loan offers a fixed rate for only a short period of the total maturity. The proposed rules also address misleading comparisons in advertisements, misrepresentations of government endorsement, misleading use of the consumer's current mortgage lender's name, misleading claims of debt elimination, misleading claims suggesting a fiduciary or other relationship, and misleading foreign-language advertisements.

***SEC Guidance on Accounting for Loan Modifications***

The Security and Exchange Commission's chief accountant, Conrad Hewitt, issued a staff guidance letter on January 8 that addresses accounting issues for mortgages modified under the American Securitization Forum's (ASF) Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans.[6] The ASF framework makes certain adjustable-rate mortgage loans automatically eligible for interest-rate freezes, which generally last five years.

Industry members have expressed concerns that mortgage modification could violate the terms of Financial Accounting Standards Board (FASB) Statement No. 140, which allows entities to account for the transfer of assets to a securitization trust as a sale and record the assets off balance sheet only if the transferor relinquishes control, including decision-making ability, over those assets. A July 2007 letter by SEC Chairman Christopher Cox advised that mortgage modification was permissible and would not affect entities' status under Statement 140 if default was "reasonably foreseeable."[7] Applying this guidance, Hewitt expressed the belief that fast-track loan modification under the ASF framework would not affect entities' accounting status, even though the modifications occur automatically and "without a comprehensive loan-by-loan analysis…as to whether default is 'reasonably foreseeable'."

[6] The ASF framework is described in detail in *Banking Legislation and Policy*, Volume 26, Number 4.

[7] Chairman Cox's letter is summarized in *Banking Legislation and Policy*, Volume 26, Number 3.

Hewitt urged FASB to offer further guidance, emphasizing that his letter was meant to provide only interim guidance.

***GSE Regulation Changes***

On February 27, the Office of Federal Housing Enterprise Oversight (OFHEO) announced that it would begin to remove some regulatory restrictions it had imposed on housing GSEs Fannie Mae and Freddie Mac in recent years, stating that Fannie Mae's and Freddie Mac's success in filing timely, audited financial statements suggested that they had made significant progress toward remedying operational weaknesses of recent years.

The OFHEO removed growth caps from both companies' retained mortgage portfolios, effective March 1. Announcing that both companies had made good progress toward completing the remediation actions required by their consent orders, the regulator promised to lift the orders when the requirements were fulfilled, as long as the companies continued to file timely and audited financial statements. In addition, on March 19, the OFHEO decreased the GSEs' surplus capital requirements from 30 percent to 20 percent of the statutory minimum capital requirement.

On March 31, the OFHEO also released final guidance signaling that it would not change the conforming loan limit for Fannie Mae and Freddie Mac in the near future. The conforming loan limit, which is the maximum nominal value mortgage that the GSEs can purchase, has remained at $417,000 since 2006. Although housing prices have fallen recently, the OFHEO committed not to decrease the limit in the immediate future. One important exception to this limit is a provision of the enacted housing stimulus bill, described below, which will temporarily allow Fannie Mae and Freddie Mac to purchase higher-value mortgages in high-cost regions of the country.

***Appraisal Standards for Fannie and Freddie Lenders***

The OFHEO and New York Attorney General Andrew Cuomo announced on March 3 that Fannie Mae and Freddie Mac have agreed not to purchase mortgages from lenders that fail to abide by a new Home Valuation Code of Conduct, beginning on January 1, 2009. Under the code of conduct, lenders and their affiliates will be prohibited from influencing or trying to influence appraisers through "coercion, extortion, collusion, compensation, instruction, inducement, intimidation, [or] bribery," or by threatening to withhold payment or future business, among other acts. Lenders will be required to provide borrowers with prompt appraisal reports on their property at no charge and to establish telephone hotlines and e-mail addresses to receive complaints about improper conduct with regard to appraisals, among other requirements.

***OCC Lending Interim Rule***

On March 20, the Office of the Comptroller of the Currency (OCC) published an interim final rule that would allow the agency to approve temporary increases in the amount of money a national bank can lend to a single institution in emergency situations. The rule came partly in response to JPMorgan Chase's purchase of Bear Stearns. In addition to purchasing the company, JPMorgan agreed to lend enough money to keep it functioning.

In general, a national bank is permitted to lend up to 15 percent of its unimpaired capital and surplus to a single borrower, plus an additional 10 percent if the bank secures the additional loans with specific types of collateral. The rule, which took effect immediately, makes it possible for a national bank, with written OCC approval, to exceed this limit as long as the loan is of short duration and the OCC judges the loan to pose an acceptable level of risk. Banks were already permitted to make this type of emergency loan to commercial banks, savings banks, trust companies, savings associations, and credit unions. Comments on the rule were due on April 21.

### *FTC Advisory Opinion*

On March 19, the Federal Trade Commission released an advisory opinion stating that it is permissible for debt collectors to discuss settlement and foreclosure avoidance options with consumers under the Fair Debt Collection Practices Act (FDCPA). The letter, which addresses questions raised by the USFN, formerly known as the U.S. Foreclosure Network, expresses the FTC's judgment that as long as the debt collector does not violate FDCPA consumer protection provisions by deemphasizing or contradicting the consumer's right to dispute the debt within 30 days, this type of communication is permissible.

### *FHLB MBS Purchase Limit Increased*

On March 24, the Board of Directors of the Federal Housing Finance Board (FHFB) voted to allow the Federal Home Loan Banks to increase their purchases of agency mortgage-backed securities (MBS) during the next two years in order to increase market liquidity. Effective immediately, the limit on the banks' MBS purchasing authority rose from 300 percent of capital to 600 percent of capital. The resolution requires that any mortgages that back the additional security purchases must be in compliance with federal regulatory guidance on nontraditional and subprime mortgage lending. The banks are permitted to purchase CMOs or REMICs only if Freddie Mac or Fannie Mae has guaranteed all of the underlying mortgages or issued all of the underlying mortgage securities. According to the FHFB, the move could provide over $100 billion of additional liquidity to the MBS market.

## Legislative Developments

### *Enacted*

*Economic Stimulus Act of 2008 (H.R. 5140)*

President Bush signed the Economic Stimulus Act of 2008 (H.R. 5140) on February 13. In addition to providing rebates to many taxpayers, the enacted legislation also includes provisions that increase the maximum size of mortgage that Fannie Mae and Freddie Mac can purchase. For mortgages originated between July 1, 2007, and the end of 2008, the limit will be the higher of the 2008 limit or 125 percent of the area median home price, adjusted for home size. Additionally, the bill temporarily increases the size of mortgage that the Federal Housing Administration (FHA) can insure in specific high-cost areas. This provision applies to mortgages for which the borrower receives credit approval by the end of 2008. In areas where the FHA limit exceeds the standard GSE conforming loan limit, the GSE limit will be the same as the FHA limit.

### *New Legislation*

*Foreclosure Prevention Act of 2008 (S. 2636)*

On February 13, Senate Majority Leader Harry Reid (D-Nev.) introduced the Foreclosure Prevention Act of 2008 (S. 2636). Among other measures, this bill would allow a Chapter 13 bankruptcy judge to modify the terms of a mortgage if the debtor's income was insufficient to cure the default while continuing to make regular mortgage payments.[8] In addition, the bill would waive the pre-filing credit counseling requirement for bankruptcy filers whose homes were scheduled for foreclosure, allowing them to gain bankruptcy protection more quickly. The bill would also increase funding for pre-foreclosure counseling and allow housing finance agencies to use more of the proceeds from mortgage revenue bonds to

[8] Several bills introduced in late 2007 and currently pending would also allow judges to modify mortgages in bankruptcy. These bills are summarized in *Banking Legislation and Policy, Volume 26, Number 4*.

refinance subprime mortgages. The bill would also give the Department of Housing and Urban Development $4 billion to purchase and rehabilitate foreclosed homes. Finally, the bill would also amend TILA to increase some mortgage disclosure requirements and increase the penalty for TILA violations. The bill is currently pending in the Senate.

*Emergency Mortgage Loan Modification Act of 2008 (H.R. 5579)*

On March 11, Rep. Paul Kanjorski (D-Pa.) and Rep. Michael Castle (R-Del.) introduced the Emergency Mortgage Loan Modification Act of 2008 (H.R. 5579). This bill would shield loan servicers that modified securitized mortgages from liability, provided that their modifications were intended to maximize the aggregate proceeds to the investor pool by preventing foreclosure or default. The House removed a similar provision from the Mortgage Reform and Anti-Predatory Lending Act of 2007 (H.R. 3915) before passing the bill on November 15. The new bill was referred to the House Committee on Financial Services, where it awaits further action.

**Fed Liquidity Actions**

During the first quarter of 2008, the Federal Reserve took several actions to increase liquidity in interbank financial markets. Among these were changes to its regular discount window lending program, as well as the establishment of the term auction, term securities lending, and primary dealer credit facilities. More information about these developments can be found at http://www.newyorkfed.org/markets/Understanding_Fed_Lending.html and http://www.ny.frb.org/markets/Forms_of_Fed_Lending.pdf.

**Judicial Developments**

On March 5, the U.S. District Court for the District of Columbia blocked Department of Housing and Urban Development limits on down payment assistance, citing the agency's failure to include evidence supporting the decision in the proposed rule (*Penobscot Indian Nation v. United States Department of Housing and Urban Development*, D. D.C., No. 07-1282 (PLF), 3/5/08); (*AmeriDream Inc. v. Jackson*, D. D.C., No. 07-1752, (PLF), 3/5/08). The court issued a preliminary injunction before the rule went into effect.[9]

**PENDING LEGISLATION AFFECTING THE CREDIT CARD INDUSTRY**

On February 7, House Financial Institutions and Consumer Credit Subcommittee Chairwoman Carolyn Maloney (D-N.Y.) and co-sponsors introduced a bill, the Credit Cardholders' Bill of Rights Act of 2008 (H.R. 5244), that would prohibit a number of practices viewed by some as misleading or predatory. The bill also broadens the rights of consumers to opt out of changes in credit card contracts without incurring penalties. On March 12, Sen. Robert Menendez (D-N.J.) introduced a similar bill, the Credit Card Reform Act of 2008 (S. 2753). It includes additional provisions that apply specifically to young consumers and to the verification by issuers of a consumer's ability to pay.

**Credit Cardholders' Bill of Rights Act**

Rep. Maloney's bill (H.R. 5244) would prohibit universal default clauses in credit card contracts. In other words, an issuer could not use a consumer's delinquency or default on another debt as a rationale for raising the interest rate charged on his or her credit card account. Nor would an issuer be allowed to retroactively increase rates on an existing balance from a previous billing period.

The rights of consumers to opt out of credit card contracts prior to increases in interest rates are broadened by this bill. Under the bill, issuers would have to notify cardholders 45 days before

[9] The rule is summarized in more detail in *Banking Legislation and Policy*, Volume 26, Number 4.

any interest rate increases, and cardholders would be permitted to cancel their accounts and pay off the balance at their existing rate of interest.

Any amount of a balance that is repaid during a grace period would be exempt from interest charges under the bill, ending "double-cycle billing" – the practice of charging interest based on balances on days in billing cycles other than the most recent billing cycle.

Some credit card accounts charge two interest rates: one for balances on purchases and another for cash advances, for example. Some issuers allocate payments to any balances charged the lower interest rate before applying them to balances charged the higher rate. Under the bill, issuers would be required to allocate payments in proportion to the outstanding balances; they would also have the option of applying payment to high-interest rate balances first.

The bill would give consumers the right to set a fixed credit limit that cannot be exceeded and to "elect to prohibit the creditor…from completing any transaction…in excess of the amount of credit authorized." In that case, a consumer could not initiate a transaction that would cause his or her balance to exceed the credit limit and trigger an over-the-limit fee.

For accounts where it is possible to exceed the credit limit, card issuers would be permitted to charge an over-the-limit fee only once in a billing period. The issuer would be limited to charging an over-the-limit fee for a maximum of three consecutive billing periods. Issuers would be able to charge over-the-limit fees in subsequent billing periods only if the consumer increases his or her credit line or makes a payment sufficient to reduce the outstanding balance below the credit limit and then exceeds it again.

Other provisions of the bill would apply to subprime card accounts, defined as accounts that charge fixed fees upon account opening of 25 percent or more of the initial credit limit. The bill would require the consumer to pay these fees before the account is activated.

Issuers would also be prohibited from advertising terms such as "fixed rate" or "prime rate" in a misleading way.[10]

The bill codifies some aspects of billing practices for issuers. Billing statements would need to be mailed 25 days before the date on which payment is due rather than the current 14-day limit; any payment made by 5 p.m. EST on the due date will count as being on time. A consumer is presumed to have paid a credit card bill on time if he or she presents proof—a post office receipt, for example—that it was sent seven or more days before the due date. Finally, on every statement issuers would have to provide a phone number and web address where the cardholder can pay off balances.

The bill has been referred to the House Committee on Financial Services.

**Credit Card Reform Act of 2008**

Sen. Menendez's bill (S. 2753) contains many provisions similar to those contained in Rep. Maloney's bill. In addition, it would amend the Fair Credit Reporting Act to require that any "firm offer of credit or insurance" specify the annual percentage rate, any fees, and the credit limit. Issuers would be required to verify a consumer's ability to repay before extending a line of credit by considering employment status, current and expected income, and existing debt. In addition, consumer reporting agencies would be prohibited from furnishing any reports not initiated by the consumer that include the consumer's name and address if he or she is under 21. But consumers 18 or older would be able to authorize agencies to furnish these reports (which can lead to prescreened offers of credit or insurance).

[10] The Federal Reserve System has been considering an amendment to Regulation Z (Truth in Lending) that would clarify advertising and soliciting regulations for issuers. The amendment is currently open for public comment.

This bill has been referred to the Senate Committee on Banking, Housing, and Urban Affairs.

## PROPOSED REAL ESTATE SETTLEMENT PROCEDURES ACT RULE

On March 14, the Department of Housing and Urban Development issued a proposed rule that would amend its implementation of the Real Estate Settlement Procedures Act (RESPA) to simplify and improve disclosure requirements related to mortgage settlement costs and to help protect consumers from unnecessarily high settlement costs. Comments on the proposed rule are due on May 13.

### Background

RESPA was enacted in 1974 with the intention of improving disclosures to consumers regarding settlement costs, eliminating kickbacks and referral fees, and reducing escrow requirements, among other stated goals. RESPA's provisions apply to "federally related mortgage loans," which include virtually all purchase money and refinance mortgages. HUD enforces RESPA through Regulation X, which was first issued in 1976. The agency issued a proposed rule similar to the current one in July 2002 but withdrew it two years later in response to public and government criticism.

### Proposed Rule

The proposed rule would revise two forms: the good faith estimate (GFE) form, which originators are required to provide when initially offering a mortgage, and the HUD-1/1A uniform settlement statements, which originators present to borrowers just prior to the settlement of the mortgage. It would also affect rules that govern yield-spread premiums and certain pricing mechanisms. HUD proposes a 12-month transition period to begin after the final rule is issued, during which time originators will be able to choose whether to comply with the current requirements or the new requirements.

Under current RESPA rules, a loan originator is required to provide a potential customer with a GFE of the transaction's settlement costs within three days of a mortgage loan application. At closing, the originator must provide a HUD-1 or HUD-1A form that itemizes final settlement charges. Since originators are not required to provide GFEs until after potential borrowers have submitted final applications, consumers sometimes incur high costs before they receive their GFEs, making it difficult to "shop around" and compare different originators' offers. Moreover, GFEs are not currently required to include information about loan terms beyond settlement costs, and, according to HUD, the costs listed are often inaccurate or incomplete.

HUD proposes a number of revisions to the process of obtaining a GFE and to the form itself. First, a consumer would be required to submit only basic information — his or her name, Social Security number, property address, gross monthly income, information on the value of his or her house, and the amount of the mortgage loan sought — before receiving a GFE. The originator would be permitted to collect a reasonably small fee to cover the cost of providing the GFE, including the cost of acquiring an initial credit report.

The GFE would be required to disclose the initial loan amount, the loan term, the loan's initial interest rate, the initial monthly payment, the rate lock period, and the date until which these terms are available. The form would also include information about whether the interest rate, loan balance, or monthly payment could rise, as well as information about prepayment penalties, balloon payments, and escrow payments.

Originators would be required to group settlement fees and charges into major categories to make the GFE form more clear, and the rules would limit the amount by which they could adjust the final settlement charges and other costs, absent unforeseeable circumstances, which are defined in the rule. The amounts of some fees, including loan origination fees, points, recording, and transfer charges, would be prohibited from changing at settlement, barring unforeseen circumstances. Other fees, including title and closing services, appraisal and credit report charges, flood certification, and title insurance, could increase by no more than 10 percent in aggregate at settlement. The GFE would also include information on how to apply for the loan and how to obtain government-produced information on mortgages and settlement charges. After the consumer obtained GFEs and selected an originator, the chosen originator could request additional underwriting information from the consumer.

The proposed rule would modify the HUD-1/1A settlement statements to make it easier to compare final charges and loan terms with the estimates listed on the GFE form. HUD-1/1A forms would include more detailed information on the loan and settlement terms, and the settlement agent would be required to read this portion of the statement aloud to the borrower, also pointing out discrepancies between the GFE and actual settlement fees.

HUD emphasizes in the proposed rule that it does not object to the use of yield spread premiums (YSPs), which are lenders' payments to brokers in exchange for their services in originating mortgages. Under current RESPA regulations, originators are required to report YSPs on GFEs and HUD-1/1A forms, but borrowers often find them confusing. The proposed rule would require originators to disclose YSPs more clearly on both forms by including them in the category labeled "Our service charge."

The proposed rules would also allow for the use of some pricing mechanisms that simplify the GFE disclosure process for originators. Originators would be permitted to estimate charges for third-party services by stating the average cost in accordance with a HUD-approved method. Certain volume-based discounts would also be permitted, as long as borrowers were not charged more than the discounted price.

In addition, the proposal addresses the "required use" of services from a party affiliated with the originator. HUD hopes to prevent originators from disingenuously referring customers to individuals or businesses that will not provide them with the best service. The proposed rules also emphasize that as long as they comply with the Electronic Signatures in Global and National Commerce Act (ESIGN) and the consumer consents, all RESPA disclosures can be provided and retained in electronic form.

Finally, HUD expresses its desire to seek changes to RESPA that will give it stronger enforcement power, including the authority to impose monetary penalties on parties that violate RESPA. HUD also seeks the authority to require the delivery of the HUD-1 form to the borrower three days before closing, as well as a "uniform and expanded statute of limitations applicable to governmental and private actions under RESPA."

## Federal Legislation

*College Opportunity and Affordability Act of 2007*

On February 7, the House of Representatives passed the College Opportunity and Affordability Act of 2007 (H.R. 4137) by a 354-58 vote. The bill, which was introduced by Rep. George Miller (D-Ca.), would reauthorize the Higher Education Act. It would also penalize states that cut their contributions to higher education, increase protections for potential student loan borrowers, and expand funding options for lower-income and nontraditional students, among other measures. It now awaits further action in the Senate.

*Credit Card Fair Fee Act of 2008*
On March 6, 2008, House Judiciary Committee Chairman John Conyers (D-Mich.) and co-sponsors introduced the Credit Card Fair Fee Act of 2008 (H.R. 5546). The bill would create a panel of three judges to help merchants in negotiating with credit card network providers. Merchants are seeking to lower interchange fees charged by the networks. The bill has been referred to the House Committee on the Judiciary.

**State Legislation**
*Credit Freeze Laws*
Several states enacted legislation in recent months allowing consumers to place freezes on their credit reports, making it more difficult for identity thieves to open fraudulent accounts in their names. Among the states that have recently adopted credit-freeze legislation are Arkansas (H.B. 2215), Idaho (S.B. 1380), Maryland (S.B. 52), and Tennessee (H.B. 200).

**Federal Regulation**
***Board of Governors of the Federal Reserve System***
*Payments System Risk Modification*
The Federal Reserve published a proposed rule on March 7 that would modify its payments system risk (PSR) policy to provide intraday balances and credit to banks and encourage banks to collateralize their daylight overdrafts. Specifically, the Fed would provide intraday balances to banks mainly through zero-fee, explicitly collateralized daylight overdrafts. Under the proposed rule, the fee for uncollateralized daylight overdrafts would rise from 36 basis points to 50 basis points per year. The biweekly daylight overdraft fee waiver would also rise from $25 to $150. Comments are due on June 4.

***Federal Deposit Insurance Corporation***
*Assessment Dividend Calculation and Distribution*
On March 14, the Federal Deposit Insurance Corporation published a proposed rule that would implement the assessment dividend requirements set by the Federal Deposit Insurance Reform Act of 2005 and the Federal Deposit Insurance Reform Conforming Amendments Act of 2005. The proposed regulations, which are intended to replace a temporary rule that expires at the end of 2008, outline a methodology by which the FDIC can calculate and distribute dividends if the Deposit Insurance Fund reserve ratio exceeds 1.35 percent. Comments are due on May 23.

***Federal Trade Commission***
*Credit Freeze Effectiveness*
On January 11, the Federal Trade Commission requested public comment on the effectiveness of credit freezes as a tool in preventing identity theft. In enacting credit freezes, consumers ask credit reporting agencies to temporarily not release their credit reports, making it more difficult for identity thieves to open new accounts in their names. Most states guarantee all consumers the right to place freezes on their credit reports.

*Deceptive Internet Card Marketing Consent Judgment*
A consent judgment against several Internet payment card marketers was entered in the U.S. District Court for the Central District of California on January 17 (*FTC v. EDebitPay, LLC*, C.D. Cal., No.: CV-07-4880 ODW (AJWx), 1/17/08). The Federal Trade Commission alleged that the companies and individuals who marketed

Visa and MasterCard prepaid debit cards online to subprime customers had engaged in deceptive marketing practices and made unauthorized debits from consumers' bank accounts. Under the consent judgment, the defendants are required to pay $2,258,258 in consumer redress, amend their consumer disclosures, and respond to all consumer complaints and refund requests within 30 days.

*Deceptive Credit Service Consent Orders*
On January 31, the Federal Trade Commission filed proposed consent orders against two companies and three individuals that falsely promised to lower consumers' credit card interest rates and reduce their debt (*FTC v. Debt-Set, Inc.*, D. Colo., No.: 1:07-cv-00558-RPM, 1/31/08). The orders contain suspended monetary relief of $1 million, and the defendants are prohibited from engaging in the practices that the order addressed.

*Consent Orders Against Payday Lenders*
On February 27, the Federal Trade Commission published three proposed consent orders against Internet payday lenders (*In re American Cash Market, Inc.* FTC, FTC File No. 072-3210, 2/27/08; *In re Anderson Payday Loans*, FTC, FTC File No. 072-3212, 2/27/08; *In re CashPro*, FTC, FTC File No. 072-3203, 2/27/08). The FTC alleges that the companies failed to disclose their loans' APRs in Internet advertising, violating TILA and Regulation Z. After the orders are finalized, the companies will be required to amend their disclosures in future advertising.

*Consumer Information Security Consent Orders*
Consent orders that the Federal Trade Commission proposed on March 27 would require a discount retailer and two data brokers to implement comprehensive information security systems and obtain biannual, independent audits for 20 years (In re TJX Cos., Inc., FTC, File No. 072-3055, 3/27/08; *In re Reed Elsevier Inc. and Seisint, Inc.*, FTC, File No. 052-3094, 3/27/08). The companies agreed to settle on charges that they engaged in practices that failed to provide reasonable and appropriate security for sensitive consumer information.

***Financial Accounting Standards Board***
*Shortcut Hedge Accounting for Swaps*
The Financial Accounting Standards Board issued final guidance on January 10 that allows institutions to use a shortcut hedge accounting method for swaps with nonzero fair value at inception and for hedged items with settlement dates subsequent to their swap trade dates. This guidance clarifies the implementation of Statement 133, which focuses on hedging and derivatives, and is retroactively effective as of January 1.

***Office of the Comptroller of the Currency***
*Bank Assessment Fee Calculation Brackets*
On February 19, the Office of the Comptroller of the Currency published an interim final rule that revises the asset-size brackets that it uses to calculate national banks' semiannual assessment fees. The rule will add a new top bracket for banks with assets of more than $250 million. Comments were due on March 20.

## Judicial Rulings

### *Supreme Court Rulings*

*Debt Collection Harassment*

On February 19, the U.S. Supreme Court announced that it would not review a ruling by the U.S. Court of Appeals for the Sixth Circuit (*Javitch, Block & Rathbone LLP v. Gionis*, U.S., No. 07-805, *cert. denied*, 2/19/08). The plaintiff alleged that after she became delinquent in her payments to a credit card lender, the debt collector violated the Fair Debt Collection Practices Act's ban on the use of harassment and deceptive practices. The court ruled that although the collector did not have the immediate means to prove the existence of the debt, the collector did not violate the Fair Debt Collection Practices Act.

*TILA Violation Appeal*

On March 24, the Supreme Court declined to review a TILA decision by the U.S. Court of Appeals for the Seventh Circuit (*Ameriquest Mortgage Securities Inc. v. Hamm*, U.S., No. 07-941, cert. denied, 3/24/08). The lower court ruled that Ameriquest violated TILA by failing to include payment due dates explicitly in disclosure statements.

### *Circuit Court Rulings*

*RESPA Kickback Ruling*

On January 22, the U.S. Court of Appeals for the Eleventh Circuit rejected a class action suit that accused an arrangement between Countrywide Home Loans and a credit reporting agency of violating anti-kickback provisions of the Real Estate Settlement Procedures Act (*Krupa v. Landsafe Inc.*, 11th Cir., No. 07-10061, 1/22/08). The court ruled that since there was no promise of business referrals, the pricing deal was permissible.

*Federal Preemption of State Disclosure Requirements*

On January 23, the U.S. Court of Appeals for the Ninth Circuit ruled that the National Bank Act and rules promulgated by the OCC preempt California state consumer protection disclosure requirements for national banks that issue convenience checks (*Rose v. Chase Bank USA N.A.*, 9th Cir., No. 05-56850, 1/23/08).

*State Rescission Rights Preempted*

A January 30 ruling by the U.S. Court of Appeals for the Ninth Circuit blocked a class action suit against E*Trade Mortgage Corporation, finding that Home Owners Loan Act regulations promulgated by the Office of Thrift Supervision preempt the California state laws under which the plaintiffs sued (*Silvas v. E*Trade Mortgage Corporation*, 9th Cir., No. 06-55556, 1/30/08). The plaintiffs claimed that E*Trade had misrepresented their rescission rights under the Truth in Lending Act and failed to refund interest rate lock-in fees when they cancelled their mortgage transactions.

*Bankruptcy Debt Satisfaction*

On February 5, the U.S. Court of Appeals for the Eighth Circuit issued a ruling on two cases, stating that a lender can charge a bankrupt individual the remainder of the unpaid balance on an auto loan even after the individual has surrendered the vehicle (*Capital One Auto Finance v. Osborn*, 8th Cir., No. 07-1726, 2/5/08); (*AmeriCredit Financial Services Inc. v. Moore*, 8th Cir., No. 07-1315, 2/5/08). In previous cases, some courts have disagreed, ruling that the entire debt is satisfied after the vehicle is returned.

*Bank-to-Bank Transfers in Bankruptcy*
The U.S. Court of Appeals for the Sixth Circuit's Bankruptcy Appellate Panel ruled on February 11 that a debtor could not use convenience checks from one credit account to make payments on another account (*In re: Wells (Meoli v. MBNA America Bank, N.A.)*, 6th Cir. BAP, No. 07-8021, 2/11/08). The court sided with the bankruptcy trustee, who argued that the payments were preferential transfers and did not meet the criteria for permissible bank-to-bank transfers.

*Bankruptcy Trustee Debt Collection*
On February 22, the U.S. Court of Appeals for the Tenth Circuit ruled that a bankruptcy trustee could not collect more than the amount of a bank's secured interest in a bank loan (*In re: Christopher Lee Haberman Morris v. St. John National Bank)*, 10th Cir., No. 06-3324, 2/22/08). The trustee attempted to collect the full amount owed to St. John National Bank, which failed to perfect its security interest in a vehicle securing a loan, claiming that the trustee "becomes" the creditor when the lien is avoided. The court ruled that Congress intended that trustees be able to recover only in the amount of a bank's secured interest.

*HOEPA Coverage of Mortgage Brokers*
The U.S. Court of Appeals for the Fourth Circuit ruled on February 29 that a mortgage broker was not subject to the consumer protection responsibilities that HOEPA requires of high-cost mortgage lenders (*Cetto v. LaSalle Bank National Association*, 4th Cir., No. 06-1720, 2/29/08). The court ruled that although the broker had engaged in high-cost mortgage lending in the past, it could not be considered a "creditor" in later, nonlending transactions.

*Winstar Ruling*
On March 6, the U.S. Court of Appeals for the Federal Circuit released a decision upholding a lower court's grant of summary judgment to American Savings Bank, F.A. in a *Winstar*-related case (*American Savings Bank F.A. v. United States*, Fed. Cir., No. 2007-5067, 3/6/08). The plaintiff was promised reduced regulatory capital requirements when it acquired a failed thrift in the late 1980s. The company sued in 1989 when the government enacted a law that deprived it of the benefit. Although it upheld the grant of summary judgment, the court also overruled a lower court's award of partial restitution related to a warrant forbearance.

*Winstar Ruling*
The U.S. Court of Appeals for the Federal Circuit released a second *Winstar*-related decision on March 10, affirming a lower court's award of $76.5 million to Fifth Third Bank (*Fifth Third Bank v. United States*, Fed. Cir., No. 2006-5128, 3/10/08). The bank sued for breach of contract when the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 eliminated tax benefits that the bank had been promised in exchange for its purchase of failing thrifts during the savings and loan crisis of the 1980s.

*Firm Credit Offer Class Action Suit*
On March 19, the U.S. Court of Appeals for the First Circuit, in response to a class action suit, ruled that a lending company's unsolicited, prescreened mailing qualified as a "firm offer of credit" despite its omission of information on specific credit terms and, therefore, did not violate the Fair Credit Reporting Act (*Sullivan v. Greenwood Credit Union*, 1st Cir., No. 07-2354, 3/19/08). The Fair Credit Reporting Act limits circumstances under which the unconsented use of consumers' credit information is permissible.

*RESPA Protection Against Excessive Fees*
On March 20, the U.S. Court of Appeals for the Eleventh Circuit ruled that section 8(b) of RESPA could not be used to challenge an allegedly excessive escrow waiver fee where some service was performed and there was no fee splitting or markup (*Friedman v. Market Street Mortgage Corp.*, 11th Cir., No. 05-13820, 3/20/08).

***State Court Rulings***
*Unconscionable Arbitration Clause*
The North Carolina Supreme Court ruled on January 25 that an arbitration clause contained in at least 68,000 loan agreements issued by Commercial Credit Loans Inc., which is now CitiFinancial Services Inc., was unconscionable (*Tillman v. Commercial Credit Loans Inc.*, N.C., No. 360A06, 1/25/08). The court's ruling called the clause "one-sided" and argued that it "expose[d] claimants to prohibitively high costs."

Prepared by the Research Department. For further information, contact Robert O'Loughlin at 215-574-4335 or bob.o'loughlin@phil.frb.org. 