STATE OF COLORADO ATTORNEY GENERAL'S OFFICE CONSUMER PROTECTION SECTION In re: COLORADO EXECUTIVE MORTGAGE LLC Respondents: COLORADO EXECUTIVE MORTGAGE LLC, a Colorado limited liability company, and NATHAN SOROKA, as founder thereof and individually.	
JOHN W. SUTHERS, Attorney General JAN MICHAEL ZAVISLAN, Deputy Attorney General ANDREW P. McCALLIN, First Assistant Attorney General JENNIFER MINER DETHMERS, Assistant Attorney General 1525 Sherman Street, 7th Floor Denver, CO 80203 (303) 866-2296 Fax: (303) 866-4916 Email: jennifer.dethmers@state.co.us	

ASSURANCE OF VOLUNTARY COMPLIANCE AND DISCONTINUANCE WITH COLORADO EXECUTIVE MORTGAGE LLC AND NATHAN SOROKA

This Assurance of Voluntary Compliance and Discontinuance ("Assurance") is entered into between the State of Colorado, ex rel. John W. Suthers, Attorney General, and Respondents Colorado Executive Mortgage LLC and Nathan Soroka (collectively, "Respondents"). This Assurance is entered into pursuant to the Attorney General's powers under § 6-1-110(2), C.R.S. (2008), and is being agreed to by the parties in lieu of the Attorney General filing a complaint against Respondents for the conduct described below.

I. PARTIES

1. John W. Suthers is the duly elected Attorney General for the State of Colorado and has express jurisdiction to investigate and prosecute violations of the Colorado Consumer Protection Act ("CCPA"), §§ 6-1-101, *et seq.*, C.R.S. (2008).

2. Respondent Colorado Executive Mortgage LLC was a Colorado limited liability company with its principal place of business located at 12150 East Briarwood Ave., Suite 201, Centennial, Colorado 80112. Colorado Executive Mortgage voluntarily dissolved on October 15, 2008. Colorado Executive Mortgage was a mortgage brokerage firm or mortgage originator that advertised, marketed, and brokered mortgages for residential properties in Colorado. Colorado Executive Mortgage understands and agrees that this Assurance shall apply to Colorado Executive Mortgage, as well as any principals, officers, directors, agents, employees, representatives, loan officers, successors, affiliates, subsidiaries, assigns, contractors, and any person acting on behalf of Colorado Executive Mortgage.

3. Respondent Nathan Soroka, aka Natan Soroka, is a licensed mortgage broker with the State of Colorado (License No. LMB 100020537). Soroka was the founder and owner of Colorado Executive Mortgage. Soroka was the registered agent of Colorado Executive Mortgage from its formation on February 7, 2007, until his resignation as the registered agent on February 18, 2008.[1] This Assurance applies to Soroka personally, so long as he is

[1] Upon Soroka's resignation. Sean Cameron. an investor and/or owner of Colorado Executive Mortgage, became the registered agent.

affiliated with Colorado Executive Mortgage, is affiliated with any other mortgage brokerage firm in which he owns an interest or over which he has control, or acts as an independent contractor for any mortgage brokerage firm.

II. FACTUAL BACKGROUND

4. Pursuant to the CCPA, Colorado Attorney General John W. Suthers has conducted an investigation into the advertising and marketing activities of Respondents.

5. Colorado Executive Mortgage contracted with the Denver Newspaper Agency to publish newspaper and website advertisements promoting Colorado Executive Mortgage's loan products and services in the Mortgage Marketplace sections of the *Rocky Mountain News* and *The Denver Post*. Colorado Executive Mortgage incurred between $128,912.32 and $188,000 in newspaper advertising costs in 2007 and 2008.

6. Soroka was the sole person responsible for approving the content and design of the newspaper advertisements. Soroka also paid for the newspaper advertising; however, the Denver Newspaper Agency listed Sean Cameron as one of its contacts at Colorado Executive Mortgage and addressed some of Colorado Executive Mortgage's invoices to Cameron at the business address of his title company, LandMark Escrow & Title LLC.

7. Respondents advertised and marketed option adjustable rate mortgages ("option ARMs") and other loan products in Denver metropolitan newspapers. These option ARM loans allowed a borrower to choose from four payment options each month: (a) a minimum payment based on the "Start Rate"; (b) an interest-only payment based on the "Effective Rate"; (c) a 15-year amortizing payment of principal and interest based on the Effective

Rate; or (d) a 30-year amortizing payment of principal and interest based on the Effective Rate.

8. The "Start Rate" was a very low introductory or "teaser" rate while the "Effective Rate" was the fully indexed rate, comprised of the index rate plus a margin. Usually, the Start Rate only applied for one month; after this first month, the interest rate changed to the Effective Rate and the loan began accruing interest at the higher rate. Therefore, as the minimum payment was based on the Start Rate, the minimum payment would not be sufficient to pay the full amount of interest accruing on the loan at the Effective Rate, which became effective after the first month. Thus resulted in a phenomenon known as "negative amortization" or "deferred interest."

9. The State contends that, while the Respondents' newspaper advertisements promoted interest rates for traditional fixed rate mortgages, the advertisements featured payment amounts representing the minimum payments for option ARMs. For instance, in **Exhibit A**, which was published in the March 20, 2007, edition of the *Rocky Mountain News*, Respondents advertised "30 Year Fixed" loans with interest rates of 5.5% and 5.715% APR (Annual Percentage Rate) and "5 Year Fixed Payment" loans with interest rates of 1.75% and 3.65% APR.

10. In the same advertisement, Respondents advertised the monthly payments for various loan amounts in a payment chart: $579.67 per month for a $200,000 loan; $724.59 per month for a $250,000 loan; and $1,304.25 per month for a $450,000 loan. These payment amounts, however, did not correspond to a 30-year fixed rate loan at a rate of 5.5%

- 5.715% APR. Rather, these payment amounts reflect the principal and interest payment based on an option ARM amortized over 40 years with a start rate of 1.75%.

11. Respondents used this same payment chart for many advertisements, regardless of whether the interest rates in the advertisement changed. For example, in **Exhibit B**, which was published in the June 25, 2007, edition of *The Denver Post*, Respondents advertised the same payment amounts under a 5.7% interest rate heading, despite the fact that those payments correspond to the 1.75% Start Rate of an option ARM amortized over 40 years.

12. Nowhere in the advertisements did Respondents disclose that the payments in the chart did not include taxes or insurance or that the payments represented the minimum monthly payment for an option ARM instead of the monthly payment on a fixed interest rate mortgage. Moreover, Respondents' advertisements failed to disclose the monthly mortgage payments on the fixed rate loan products.

13. Exhibit B also promoted an interest rate of 5.75%-5.90% APR for a 30-year fixed loan product, an interest rate of 5.5%-5.71% APR for a 15-year fixed loan product, and an interest rate of 1.75%-3.65% APR for a 5-year fixed loan product. While the 30-year fixed and 15-year loan products had fixed interest rates, the 5-year loan product had a fixed *payment* – not a fixed interest rate as on the other two loan products advertised.

14. The State contends that Respondents used the term "fixed" to suggest that the consumer could expect to pay the advertised interest rates throughout the life of the loan even if that was not the case.

15. Additionally, the State contends that Respondents' newspaper advertisements did not disclose many of the key features of the advertised loans. Respondents' advertisements promoted option ARM loans but failed to disclose that (a) negative amortization will occur if the borrower only makes the minimum payment, (b) the loan may recast if negative amortization causes the original loan balance to increase over a certain percentage, (c) the borrower may experience payment shock if the loan recasts, (d) the low teaser rates applied for a limited time, and (e) applicable prepayment penalties may make it difficult or expensive to refinance the loan.

16. Respondents' advertisements also gave APRs with the advertised rates that may not have been representative of the fully indexed rate for the last three years, pursuant to federal regulations. Respondents' advertisements fail to state that the APR may increase after consummation of the loan and fail to provide the actual rate at which interest would accrue on the loan.

17. Additionally, Respondents advertised "6 mos. No Payments" in some of its advertisements. To take advantage of this promotion, the borrower would agree to have a prepayment penalty on his or her loan. In exchange for originating a loan with a prepayment penalty, the lender would pay money to the Respondents in the form of a yield spread premium. Respondents, then, would take the equivalent of six months of minimum mortgage payments out of its yield spread premium and give to the borrower in one lump sum. Respondents only offered this promotion in connection with its option ARM loan products.

Respondents did not disclose the terms of this six months of no payments promotion in its advertisements nor the possible consequences of having a prepayment penalty.

18. Respondents also advertised free appraisals. Customers had to pay for the appraisal at the time of the appraisal, and Respondents would credit the cost of the appraisal to the customer if the customer closed a loan with Colorado Executive Mortgage. If the prospective customer decided not to close a loan with Colorado Executive Mortgage, however, then Respondents would not refund the appraisal fee. The Respondents did not disclose the terms of this "free" appraisal promotion in its advertisements.

19. Respondents promoted "no cost loans" in its advertisements as well. What Respondents did not disclose in its advertisements was that these "no cost" loans resulted in higher interest rates.

20. Respondents admit that many of their newspaper advertisements did not contain a disclosure and, if the advertisement contained a disclosure, the disclosure was not readable. The State contends that any purported disclosure did not adequately disclose the material terms of the loan products or promotions advertised.

21. The State contends that, in part due to the extremely low interest rates promoted in its newspaper advertisements, Respondents received an average of five to seven telephone calls per day from prospective consumers in 2007 and 2008.

22. As such, the State contends that these misrepresentations and omissions of material facts may have caused significant financial harm to Colorado consumers and have the potential to continue despite Respondents' dissolution. Soroka has an active mortgage

broker license that does not expire until November 2, 2010. While Soroka has represented that he plans to stop working as a mortgage broker, he lives in Colorado.

23. The State contends that these advertising and sales practices violate the CCPA, including § 6-1-105(1), C.R.S. (2008) and § 38-40-105, C.R.S. (2008) as well as the Colorado Uniform Commercial Credit Code ("UCCC"), the federal Truth in Lending Act, and Regulation Z.

III. DEFINITIONS

24. "Advertising Material" shall mean all advertisements, marketing or promotional materials issued by Respondents, including but not limited to, newspaper and magazine advertisements, direct mail, flyers, brochures, emails, faxes, websites, telemarketing, billboards and banner or pop-up advertising that is disseminated electronically.

25. "CHARM Booklet" means the Consumer Handbook on Adjustable-Rate Mortgages published by the Federal Reserve Board.

26. "Clear and Conspicuous" or "Clearly and Conspicuously" as used herein shall mean that the information must be disclosed with Equal Prominence and in Close Proximity to the term or phrase that triggers the Clear and Conspicuous disclosure requirement.

27. "Close Proximity" shall mean that the information to be disclosed must be immediately adjacent or above the term or phrase that triggers the disclosure requirement.

28. "Credit score" means a numerical value that ranks a borrower's credit risk based upon a statistical evaluation of the borrower's credit history as determined by the Fair Isaac Corporation.

29. "Easily Readable Print" shall mean that the information to be disclosed shall be readable without the aid of magnification or the assistance of other devices. A disclosure shall not be deemed easily readable if it is located in a footnote, in small print, on the side or back of the Advertising Material, or in an unreadable font size or typeface.

30. "Equal Prominence" shall mean that the information to be disclosed must have the same contrast and be in the same font size and typeface as the term or phrase that triggers the disclosure requirement.

31. "Loan to Value ratio" means the relationship between the loan amount and the value of the property (the lower of the appraised value or sales price), expressed as a percentage of the property's value.

32. "Nontraditional Mortgage" means any residential mortgage loan product that allows the borrower to defer repayment of principal (in a manner different than an amortizing fixed rate mortgage) or interest. This includes all interest only products, payment option ARMs and negative amortization mortgages, with the exception of reverse mortgages and home equity lines of credit, other than a simultaneous second-lien loan.

33. A "Traditional 3/1, 5/1 or 7/1 ARM" shall mean a hybrid ARM, with a fixed rate for an initial period, but then changes at regular intervals after this initial period based on an index and margin. For example, a Traditional 5/1 ARM has a fixed rate for five years and then after the fifth year changes each year thereafter. The change in interest rate is based on changes in an index rate, such as the rate for Treasury securities, the London Interbank Offered Rate or the Cost of Funds Index plus a margin.

IV. UNDERTAKINGS

34. Respondents enter this Assurance as a compromise and settlement of the State's allegations herein. This Assurance shall not be considered an admission of violation for any purpose. Respondents assure the State that Soroka and any future loan officers employed by Colorado Executive Mortgage or Soroka, as well as any principals, officers, directors, agents, employees, representatives, successors, affiliates, subsidiaries, assigns, contractors, and any person acting on Respondents' behalf shall comply with the CCPA as now constituted or as may hereafter be amended in conducting business in the State of Colorado.

A. Disclosures Provided to Borrowers.

35. In discussing any loan product with a consumer, Respondents shall not represent that the introductory rate is the applicable interest rate for longer than the introductory period. Respondents shall affirmatively disclose the following:

a) The precise term of any introductory rate;

b) The interest rate the consumer will likely pay after the expiration of the introductory interest rate;

c) The consumer's estimated monthly payment for each payment option upon the expiration of that introductory rate; and

d) The maximum monthly payment the consumer may have to pay under the loan.

Additionally, Respondents shall not represent the introductory rate as the "interest rate" for purposes of the Good Faith Estimate.

36. Respondents shall not provide any consumer with a federal Truth in Lending Act, 15 U.S.C. §§ 1601, *et seq.* ("TILA"), disclosure based solely on the introductory rate without simultaneously providing the consumer with a TILA disclosure based upon the composite of the rate in effect during the introductory period and the rate that is the basis of the loan for the remainder of the term. Copies of all TILA disclosures provided to the consumer shall be part of the consumer's loan file.

37. At least twenty-four (24) hours before closing on any ARM product, Respondents must verify that the borrower has been provided a current copy of the CHARM booklet. If one has not been provided, Respondents shall give a copy of a current CHARM Booklet to the borrower twenty-four (24) hours before closing on any ARM loan product. A current copy of the CHARM Booklet is attached hereto as **Exhibit C.** Respondents shall go to www.FederalReserve.Gov to obtain the most current copy of the CHARM Booklet. The CHARM Booklet will be the borrower's to keep.

38. When Respondents have verified that the borrower has received the CHARM booklet and has kept it for at least twenty-four (24) hours, the borrower and Respondents shall sign and date a Confirmation of Receipt Form, attached hereto as **Exhibit D**.

39. Respondents shall adhere to the duty of good faith and fair dealing found at § 12-61-904.5, C.R.S. (2008); follow the reasonable inquiry standards set forth at § 12-61-904.5(1)(b), C.R.S. (2008); follow the reasonable, tangible net benefit standards set forth at § 12-61-904.5(1)(a), C.R.S. (2008); and comply with any rules adopted by the Division of Real Estate pertaining to these standards.

B. Advertising of Mortgage Loan Products.

40. The advertising standards set forth in this subsection IV(B) shall apply to all Advertising Material issued by Respondents.

1. **Requirements Regardless of Future Revisions to Regulation Z.**

41. When creating any Advertising Material for any mortgage loan products, Respondents shall follow the advertising standards set forth in Regulation Z, 12 C.F.R. § 226.24 and staff commentary, including any future revisions to either.

42. The following terms shall apply to Respondents' Advertising Material regardless of any revisions that may be made to Regulation Z:

a.) Respondents shall not advertise any Nontraditional Mortgages;

b.) Respondents shall not advertise an interest rate lower than the rate at which interest is accruing on the loan;

c.) Use of the term "fixed" may only refer to a traditional 15-year or 30-year fixed rate mortgage;

d.) Advertising Material for loans featuring no closing costs, no payments for a set time period, no document loans or reduced documentation or that income need not be verified shall also contain Clear and Conspicuous disclosures that such features will cause the borrower to finance a greater amount or pay a higher interest rate, if that is the case; and

e.) Any Advertising Material that Respondents run which offer free appraisals or no appraisal fees must Clearly and Conspicuously state the conditions for receiving the free appraisal. For example, if the borrower must pay for the appraisal at the time of appraisal and the Respondents reimburse or credit the appraisal fee to the borrower at a later time, and only if the loan closes, then the Advertising Material must state as such.

2. **Advertising Standards Pending Revisions to Regulation Z.**

43. The following terms shall govern Respondents' advertising of rates and payments. These terms shall take effect upon the execution of this Assurance. The Federal Reserve Board has proposed revisions to Regulation Z that would apply to the advertising of rates and payments. See 73 Fed. Reg. 1672, 1722 – 1724 (January 9, 2008) (proposed new rule found at 12 C.F.R. 226.24). On July 15, 2008, the Federal Reserve Board adopted the proposed revisions to Regulation Z, which will become effective on October 1, 2009. See 73 Fed. Reg. 44522, 44607-44610. Until these proposed revisions to Regulation Z become effective, Respondents must follow the standards as set forth below. Once the revisions to Regulation Z become effective on October 1, 2009, Respondents shall follow Regulation Z as revised and need not follow the standards set forth below.

44. When advertising the rate for a loan, Respondents may advertise a rate based either on: (1) a traditional 15-year or 30-year fixed rate mortgage; or (2) a Traditional 3/1, 5/1 or 7/1-year ARM.

45. When advertising the rate for a traditional 15-year or 30-year fixed rate mortgage, Respondents shall satisfy the following requirements:

a.) Respondents must have verifiable evidence that the rate advertised was actually available at the time of dissemination of the Advertising Material; and

b.) The Advertising Material must disclose in Close Proximity to the rate and in Easily Readable Print at least the following criteria, if applicable, that must be satisfied for a borrower to obtain the rate:

i.) Whether the mortgage is a 15-year or 30-year mortgage;

ii.) Whether or not the mortgage will come due with an unpaid balance that requires the borrower to pay the remaining principal balance at a date certain and, if so, the amount of the "balloon payment" and the date the balloon payment will be due;

iii.) The loan amount;

iv.) The Loan-to-Value ratio, using that term;

v.) The minimum Credit Score;

vi.) The buy down required; and

vii.) The amount of any prepayment penalty.

46. When advertising the rate for a Traditional 3/1, 5/1 or 7/1 ARM, Respondents shall satisfy the following requirements:

a.) Respondents must have verifiable evidence that the rate advertised was actually available at the time of dissemination of the Advertising Material;

b.) The Advertising Material must Clearly and Conspicuously disclose the APR for the loan and, if the Advertising Material also discloses an initial rate, then the Advertising Material must Clearly and Conspicuously state the term during which this initial rate will apply;

c.) If the rate will increase after the initial term, the Advertising Material must disclose in Close Proximity to the initial rate and in Easily Readable Print that the new rate will be based on an index plus a margin; and

d.) The Advertising Material must disclose in Close Proximity to the rate and in Easily Readable Print at least the following criteria, if applicable, that must be satisfied for a borrower to obtain the rate:

i.) The loan amount;

ii.) The Loan-to-Value ratio, using that term;

iii.) The minimum Credit Score;

iv.) The buy down required;

v.) Whether the loan includes a balloon payment and, if so, the amount and due date of the balloon payment; and

vi.) The amount of any prepayment penalty.

47. When advertising the amount of a payment on a loan, Respondents shall satisfy the following requirements:

a.) Respondents must have verifiable evidence that the payment amount advertised was actually available at the time of dissemination of the Advertising Material;

b.) The payment amount may be based only on a traditional 15-year or 30-year fixed rate mortgage;

c.) The Advertising Material must disclose in Close Proximity to the payment amount and in Easily Readable Print at least the following criteria, if applicable, that must be satisfied for a borrower to obtain the payment:

i.) The rate, including the APR, using that term;

ii.) Whether the mortgage is a 15-year or 30-year mortgage;

iii.) Whether the loan includes a balloon payment and, if so, the amount and due date of the balloon payment, and

iv.) The loan amount;

v.) The Loan-to-Value ratio, using that term;

vi.) The minimum Credit Score;

vii.) The buy down required; and

viii.) The amount of any prepayment penalty; and

d.) If the payment amount advertised does not include an escrow for taxes or insurance, a Clear and Conspicuous disclosure shall be made in Close Proximity to the to the payment amount that it does not include taxes and insurance.

C. Notification to the Attorney General's Office and State Regulatory Agencies.

48. Soroka must provide notice to the Attorney General and the Division of Real Estate if he intends to operate, incorporate, or form in Colorado any mortgage-related business, including but not limited to, loan origination, real estate, title services, underwriting mortgages, lending, or appraisals. Additionally, Soroka must notify the Attorney General if he intends to recommence operation of Colorado Executive Mortgage.

49. Soroka must provide notice to the Attorney General and the Division of Real Estate if he becomes affiliated with any mortgage-related business, in any capacity, including but not limited to, loan origination, real estate, title services, underwriting mortgages, lending, or appraisals. Soroka agrees to provide the name and business contact information of the mortgage-related business to the Attorney General and the Division of Real Estate.

50. Soroka agrees that, if he decides to apply for a mortgage broker license, real estate broker license, appraiser license, or any equivalent license in any other state, he will notify the licensing body of that state of the existence and terms of this Assurance. Additionally, Soroka agrees to notify the Attorney General if he intends to or applies for a mortgage broker license, real estate broker license, appraiser license, or any equivalent license in any state.

V. ENFORCEMENT

51. The obligations set forth in this Assurance are continuing and apply jointly to Colorado Executive Mortgage and Soroka, who is held personally liable under this Assurance.

52. Violation of any of the terms of this Assurance shall constitute a prima facie violation of the CCPA in accordance with § 6-1-110(2), C.R.S. (2008). Upon any violation of this Assurance by a Respondent, the Attorney General shall be entitled to file a civil action under the CCPA in any court of competent jurisdiction and to seek an injunction or other appropriate order from such court to enforce the provisions of this Assurance.

53. In addition to any remedies provided under the CCPA, the Attorney General will also be entitled to apply for and seek from a court of competent jurisdiction an order

converting this Assurance into a permanent injunction against a Respondent as if the parties had fully litigated all issues contained herein, upon a showing by the Attorney General's Office of a violation by a Respondent of this Assurance. In such event, Respondents agree to waive any and all defenses and counterclaims they may have had to such an action, except as to claims or defenses related to the alleged violation of this Assurance or as to the need for injunctive relief.

54. This Assurance shall not be construed to affect the rights of any private party to pursue remedies pursuant to § 6-1-113, C.R.S. (2008), or under any other statutes through claims or actions in common law.

55. Nothing in this Assurance shall be construed to release claims held by any other government authority.

56. Pursuant to § 6-1-110(2), C.R.S. (2008), this Assurance shall be a matter of public record.

57. The person who signs this Assurance in a representative capacity for Colorado Executive Mortgage warrants that he or she is duly authorized to do so. Respondents each acknowledge that they have had a full opportunity to review this Assurance and consult with legal counsel regarding same. Respondents agree and represent that they have read and understand this Assurance, that they accept the legal consequences involved in signing it and that there are no other representations, agreements or understandings between Respondents and the State that are not stated in writing herein.

58. Respondents and their principals, officers, directors, agents, employees, representatives, loan officers, successors, affiliates, subsidiaries, assigns, contractors, and any person acting on behalf of Respondents agree to cooperate with all investigations and other proceedings that the State may bring to enforce the terms of this Assurance or to enforce the CCPA against any other entity. Included within this cooperation agreement is the obligation to:

a) Appear for hearings, depositions or provide testimony in any form (including affidavits). All such testimony shall be truthful;

b) Produce documents, records, electronic records or any other tangible things in response to a subpoena or other written request issued by the State; or

c) Accept a subpoena from the State without the need for service of process.

59. Any notices, complaints or other documents required by this Assurance (including any request or subpoena) shall be sent to the following individuals at the address, email or fax set forth below:

To Respondent Colorado Executive Mortgage at:
12150 E Briarwood Ave, Ste. 201
Centennial, CO 80112

Phone:
Fax:
Email:

To Respondent Nathan Soroka at:
18712 E Prentice Dr.
Centennial, CO 80015

Phone: 720-394-4825
Fax:
Email:

To The State at:

Jennifer Miner Dethmers
Assistant Attorney General
Antitrust, Tobacco, and Consumer Protection Unit
Consumer Protection Section
1525 Sherman Street – 7th Floor
Denver, CO 80203
Email: jennifer.dethmers@state.co.us
Fax: (303) 866-2296
Phone: (303) 866-5079

Dated: 12-18-08

RESPONDENTS COLORADO EXECUTIVE MORTGAGE LLC and NATHAN SOROKA

By: ______________________
(Signature)

____
Nathan Soroka, individually and
as owner operator (title) of Colorado Executive Mortgage LLC

Dated: 12.29.08

JOHN W. SUTHERS
Attorney General

Jennifer Miner Dethmers
JENNIFER MINER DETHMERS
Assistant Attorney General
Consumer Protection Section

Rev. 11.7.2008

Jumpjet targets business flier without sky-high budget

By Chris Walsh
ROCKY MOUNTAIN NEWS

Private jets have long been the territory of high-profile executives and wealthy individuals — and nothing more than a daydream for the average traveler.

An upstart company hopes to change that.

Santa Fe-based Jumpjet is looking to bring private jets to travelers who can't afford to buy their own planes or charter aircraft. It's also targeting travelers who are just fed up with the hassles of commercial flights.

Starting May 29, the company will launch new service in Denver and more than a dozen other major cities that allows customers to fly on private jets for business and leisure trips in exchange for a fixed monthly fee.

Travelers can save time flying from smaller, less-crowded airports. Customers also can fly nonstop to smaller areas that have limited commercial service, and they sometimes can bring guests and pets along at no extra cost.

"Private jet travel has been out of reach for many people, and we want to bring it to a much greater audience," said Will Ashcroft, founder and chief executive officer of Jumpjet. "We think this will appeal to people who normally fly business class and first class or pay for full-fare tickets."

Ashcroft pegs the potential market at about 60 million passengers.

Jumpjet contracts with another company for aircraft and crews, which must meet some of the industry's highest safety standards, Ashcroft said. It has access to 16 types of jets ranging from an eight-seat Citation II to a swank Gulfstream V capable of carrying 16 passengers and loaded with amenities such as a microwave oven and a phone.

JUMPJET.COM

The Lear 35A, good for quick trips, is part of the Jumpjet fleet.

Membership plans range from $1,500 a month — good for up to two round-trip flights each month — to $4,000, which will get you four round-trip flights. The prices are lower than options such as fractional ownership, buying or chartering aircraft.

But observers say other factors will determine whether the company is successful.

"If people are going to spend extra money to fly, they do so primarily to save time," said Evergreen aviation consultant Mike Boyd. "It will depend on how convenient this is."

Members must make reservations several days in advance, which isn't ideal for business travelers who have to catch last-minute flights. Travelers also might have to share a plane with other passengers if more than one Jumpjet member wants to fly the same route on the same day.

Robert Olislagers, executive director of Centennial Airport, said he certainly sees a market for the service. But the size of that market remains to be seen.

"Obviously the difference between these guys and fractionals is that there's no ownership in aircraft, so there's no equity," Olislagers said. "But with a lower entry fee, they certainly might be able to attract a number of customers."

walshc@RockyMountainNews.com or 303-954-2744

Exhibit A

SPECTRUM: 1989 fire almost shut down paper

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"I won't even say it's not a difficult time now," Harris said. "Advertising dollars have gone down, but the bills are still there."

The Spectrum is in high demand in Five Points and surrounding neighborhoods, but a decline in frequent advertisers and the popularity of the Internet have been on Harris' mind lately.

The Spectrum has a monthly circulation of 25,000, with an estimated 60,000 readers per issue, according to Echo Media, an Atlanta-based print advertising company that tracks small newspapers nationwide.

According to Echo, 68 percent of the Spectrum's readers are black, while 20 percent are Hispanic. Women make up 58 percent of its readership.

Yet Harris said she's frustrated because major advertisers that once bought ads every month now save their ads for February and June — Black History Month and Juneteenth.

"We have to use the money we make in February to carry us for several months," she said.

The Spectrum's website and Denver Urban Connection, an online community events calendar for businesses, have attracted potential online advertisers, but Harris has been unable to build the infrastructure to support Internet ads because she hasn't been online long enough, she said.

But for now, the 50-something who's fond of eclectic jewelry and African masks is trying not to worry too much.

On a recent afternoon, Harris looked through boxes of back issues and smiled when she came across the March 1987 issue — the Spectrum's first. It was 11 pages long and featured an illustration of Oprah Winfrey on the cover. Last month's issue was 51 pages.

On a recent afternoon, Harris and Lawrence James, her son and Spectrum's general manager, skim through boxes of old pictures. They laugh at a picture of her with black, curly hair. Her hair is blonde and straight today.

Home for the Spectrum is an alabaster-white, two-story house at 2499 Washington St., two blocks south of the intersection that gives the Five Points neighborhood its name.

Day-to-day operations are run by Harris, James, a production assistant and an advertising consultant. The writers are all freelancers who meet once a month to discuss story ideas.

Al Bowen, a local business owner, drove to the Spectrum office from Park Hill Barbers while waiting for a haircut on a recent afternoon. The shop had run out of copies.

"We were looking for some information, and we thought of the Spectrum," he said.

On the same day, the Spectrum was holding orientation for its summer youth program. Fifteen metro-area students, ages 12 to 17, will put together their own newspaper, with lectures from Spectrum writers, local professors and the paper's interim editor, Tanya Ishikawa, occurring twice a week.

"They may not all go into journalism, but they learn skills that will carry them through life," Harris said.

The city of Denver partially funds the journalism program, which started during former mayor Wellington Webb's administration.

"The Spectrum and the youth program are needed now more than ever," Webb said in a phone interview, adding that local black media have taken a hit with the loss of TV and radio stations in the last four years.

A black-tie dinner at a downtown hotel and a free festival at Fuller Park are scheduled for mid-August to commemorate Spectrum's 20th year. The dinner will include planned appearances by actor Bill Cobbs and Denver Post editor Greg Moore.

Money raised from the events will be donated to the Spectrum's youth program.

Staff writer A.J. Miranda can be reached at 303-954-1381 or at amiranda@denverpost.com.

John Prieto | The Denver Post

Rosalind "Bee" Harris publishes the Denver Urban Spectrum, which remains popular in the Five Points area. These days, she's concerned about the Internet and an advertising decline.

- UNIVERSITY OF COLORADO AT BOULDER: Appointed **John Bennett**, the associate dean of engineering for education, the new director for the campus Alliance for Technology, Learning and Society, or ATLAS.
- THE COMMUNITY COLLEGE OF AURORA FOUNDATION: Elected **Debra Parcheta**, president of Blue Marble Enterprises Inc., to its board of directors.
- UAP HOLDING CORP.: Elected **David R. Birk** an independent director. Birk is senior vice president, general counsel and secretary for Avnet Inc.
- AFFORDABLE RESIDENTIAL COMMUNITIES INC.: Announced that **Lawrence E. Kreider** has resigned as executive vice president, chief financial officer and chief information officer, to accept a position with Cedar Shopping Centers Inc.
- PHOTO STENCIL: The Colorado Springs firm hired **James Petrain** as pallet product manager.
- PAYSIMPLE: Named **Eric Dunn** to its board of directors. Dunn is a general partner with Cardinal Venture Capital.
- VAIL RESORTS INC.: Promoted **Fiona Arnold** to senior vice president and general counsel.
- DALE CARNEGIE TRAINING OF COLORADO: Announced that Denver Mayor **John Hickenlooper** was the recipient of the 2007 Dale Carnegie Leadership Award.
- DESIGN WORKSHOP: Named **Bruce Ferguson** as a 2007 Faculty in Residence participant. Ferguson is a Franklin Professor of Landscape Architecture at the University of Georgia's School of Environmental Design.
- THE AMERICAN PHARMACISTS ASSOCIATION FOUNDATION: Selected **Dennis Helling** as the recipient of this year's Pinnacle Award. Helling is executive director of pharmacy operations and therapeutics for Kaiser Permanente Colorado. He was honored for his innovative approaches to improve pharmacy services in managed care and his long-standing commitment to patient care.
- FIRST NATIONAL BANK OF COLORADO: Hired **Steve Jensen** as vice president of corporate banking.
- COLORADO STATE UNIVERSITY: Announced that **Michael H. Thaut**, director of the Center for Biomedical Research in Music, was recently elected a member of the World Academy for Multidisciplinary Neurotraumatology.

John Bennett was named director for CU-Boulder's ATLAS program.

Debra Parcheta joins the Community College of Aurora Foundation board.

TO SUBMIT ITEMS

The Denver Post wants to include your company's hires, promotions and reassignments in PEOPLE ON THE MOVE. Please submit your news items and photos to: ON THE MOVE, The Denver Post, 100 W. Colfax Ave., Suite 600, Denver, CO 80202 or by **e-mail** to business@denverpost.com or by **fax** at 303-954-1334.

Working Washington in a Google-y way

Some critics call old-style lobbying a waste of the search giant's potential to innovate. Google says it's mixing old and new tools.

By Frank Davies
San Jose Mercury News

Washington — Slowly but surely, the government is getting Googled.

Two years ago, the Google staff in Washington was one person — Alan Davidson, an expert in technology law. Now the staff numbers a dozen, including lobbyists with close ties to both parties, and several other lawyers and lobbyists on retainer.

"I've never seen a tech company ramp up faster then they have in the last year or two — they're using all the tools in the lobbying tool kit," said Ralph Hellmann, a top lobbyist for a tech trade association.

Google's Washington office keeps growing to do old-fashioned lobbying along with projects that live up to the Google brand, such as pushing for greater access to government records.

Google lawyers and lobbyists try to protect the company's ever-expanding products and acquisitions from antitrust challenges. They defend the company's business dealings in China and other countries that censor the Internet.

And they recently succeeded in their complaint with the Justice Department that Microsoft's Vista operating system was anti-competitive. After first dismissing the complaint, Microsoft agreed to make changes in Vista to make it easier to use non-Microsoft search programs.

This fall, Google will move from Pennsylvania Avenue to more spacious quarters near the traditional K Street corridor of lobbying shops. Its brand is also becoming more visible.

On Capitol Hill, top Google operatives give "Google 101" cram courses to staffers on Web-based tools to help constituents and make their bosses look good. Senators returning from Iraq now use Google Earth and Google Maps to give multimedia presentations on their trips.

As presidential candidates make the high-visibility pilgrimage to the "Googleplex" in Mountain View, Calif., contributions from Google employees quietly help boost the campaigns of congressional candidates. Early donations are important to give "momentum" to candidates who support an open Internet, company lobbyist Jamie Brown explained.

Google's Washington team has also jumped into the hot-button debates on immigration, net neutrality and presidential politics, launching a new public-policy blog designed to raise Google's profile and get more input from users.

The overall goal for Google "is to bridge the gap between the innovative things Google is doing and the policy-makers who are trying to keep up with all the new technology," said Adam Kovacevich, Google spokesman in Washington.

"We're trying to approach government in a 'Googley' way — some things we're doing are traditional and some aren't," he said.

This is not easy to do, said one Internet analyst, Micah Sifry, who closely follows online politics.

He sees a culture clash, with a constantly evolving company that has become a global symbol of innovation laboring in a political world that is hidebound and inefficient.

Much of Google's work in Washington is explaining what the company does, how government can use its tools, and reminding policy-makers that many small businesses rely on the search and advertising giant.

Some of Google's most recent hires will deal with specific issues and disputes.

Makan Delrahim, a former top antitrust attorney in the Bush administration, is on retainer to defend Google's proposed $3.1 billion acquisition of the digital ad firm DoubleClick, which will be reviewed by the Federal Trade Commission.

One new hire, Johanna Shelton, worked as a senior counsel for Rep. John Dingell, D-Mich. and chairman of the House Energy and Commerce Committee. That's the committee that handles almost every business issue that could affect Google.

Shelton has worked on copyright legislation, a huge issue with Google and its subsidiary YouTube in disputes with publishers and entertainment companies.

Exhibit B

The Federal Reserve Board

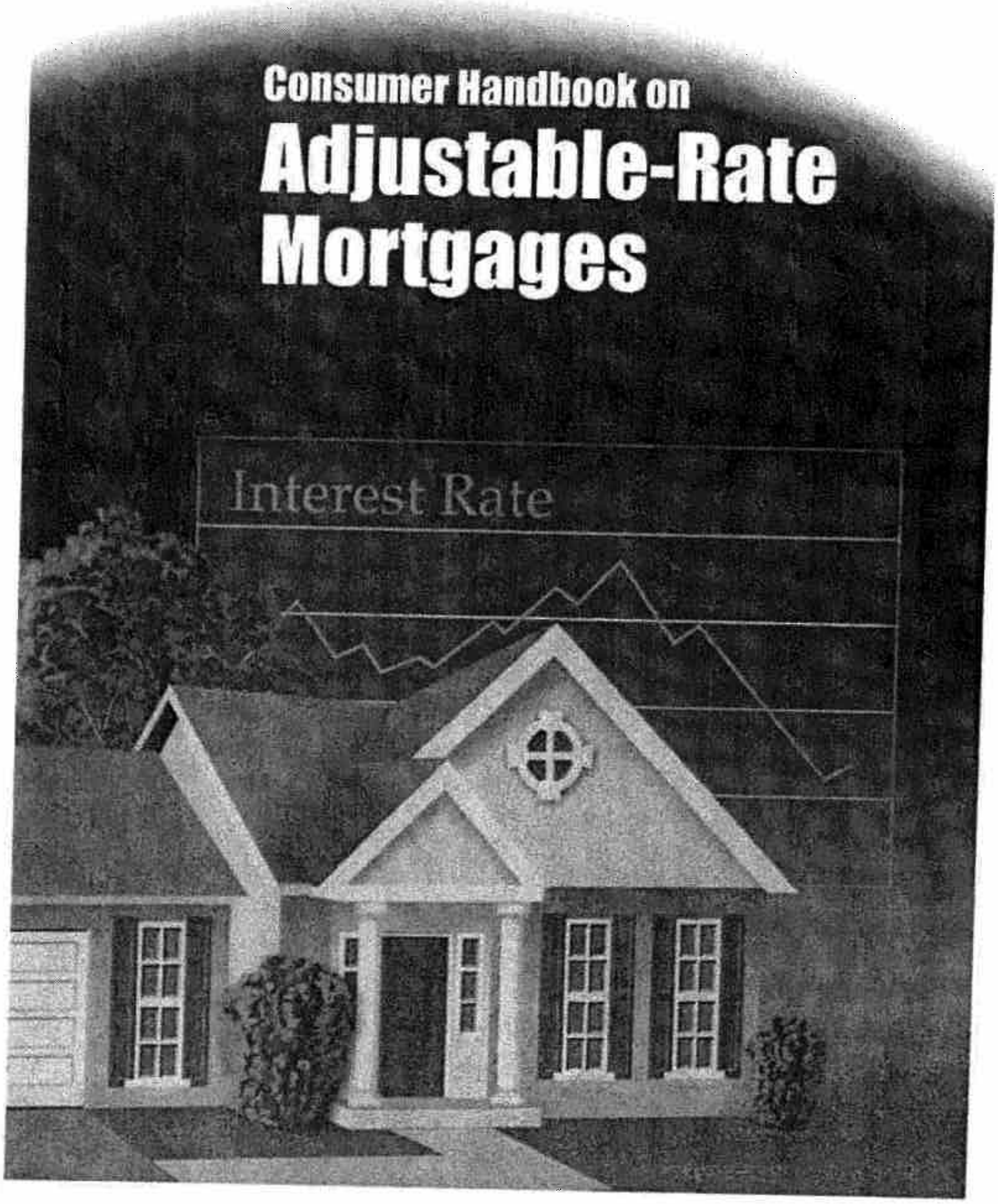


Exhibit C

Adjustable-rate mortgages (ARMs) are loans with interest rates that change. ARMs may start with lower monthly payments than fixed-rate mortgages, but keep the following in mind:

- Your monthly payments could change. They could go up—sometimes by a lot—even if interest rates don't go up. See page 20.
- Your payments may not go down much, or at all—even if interest rates go down. See page 11.
- You could end up owing more money than you borrowed—even if you make all your payments on time. See page 22.
- If you want to pay off your ARM early to avoid higher payments, you might have to pay a penalty. See page 24.

You need to compare features of ARMs to find the one that best fits your needs. See the Mortgage Shopping Worksheet on page 2.

This handbook explains how ARMs work and discusses some of the issues that borrowers may face. It includes ways to reduce the risks and gives some pointers about advertising and other ways you can get information from lenders and other trusted advisers. Important ARM terms are defined in a glossary. And the Mortgage Shopping Worksheet can help you ask the right questions and figure out whether an ARM is right for you. Ask lenders to help you fill out the worksheet so you can get the information you need to compare mortgages.

Mortgage Shopping Worksheet

Ask your lender or broker to help you fill out this worksheet.

Name of lender or broker and contact information
Mortgage amount
Loan term (e.g., 15 years, 30 years)
Loan description (e.g., fixed rate, 3/1 ARM, payment-option ARM, interest-only ARM)
Basic Features for Comparison
Fixed-rate mortgage interest rate and annual percentage rate (APR) (For graduated-payment or stepped-rate mortgages, use the ARM columns.)
ARM initial interest rate and APR
How long does the initial rate apply?
What will the interest rate be after the initial period?
ARM features
How often can the interest rate adjust?
What is the index and what is the current rate? (See chart on page 8.)
What is the margin for this loan?
Interest-rate caps
What is the periodic interest-rate cap?
What is the lifetime interest-rate cap? How high could the rate go?
How low could the interest rate go on this loan?
What is the payment cap?
Can this loan have negative amortization (that is, increase in size)?
What is the limit to how much the balance can grow before the loan will be recalculated?
Is there a prepayment penalty if I pay off this mortgage early?
How long does that penalty last? How much is it?
Is there a balloon payment on this mortgage? If so, what is the estimated amount and when would it be due?
What are the estimated origination fees and charges for this loan?
Monthly Payment Amounts
What will the monthly payments be for the first year of the loan?
Does this include taxes and insurance? Condo or homeowner's association fees? If not, what are the estimates for these amounts?
What will my monthly payment be after 12 months if the index rate... ...stays the same?
...goes up 2%?
...goes down 2%?
What is the **most** my minimum monthly payment could be after 1 year?
What is the **most** my minimum monthly payment could be after 3 years?
What is the **most** my minimum monthly payment could be after 5 years?

	Fixed-Rate Mortgage	ARM 1	ARM 2	ARM 3

What Is an ARM?

An adjustable-rate mortgage differs from a fixed-rate mortgage in many ways. With a fixed-rate mortgage, the interest rate stays the same during the life of the loan. With an ARM, the interest rate changes periodically, usually in relation to an index, and payments may go up or down accordingly.

Shopping for a mortgage is not as simple as it used to be. To compare two ARMs with each other or to compare an ARM with a fixed-rate mortgage, you need to know about indexes, margins, discounts, caps on rates and payments, negative amortization, payment options, and recasting (recalculating) your loan. You need to consider the maximum amount your monthly payment could increase. Most important, you need to know what might happen to your monthly mortgage payment in relation to your future ability to afford higher payments.

Lenders generally charge lower initial interest rates for ARMs than for fixed-rate mortgages. At first, this makes the ARM easier on your pocketbook than a fixed-rate mortgage for the same loan amount. Moreover, your ARM could be less expensive over a long period than a fixed-rate mortgage—for example, if interest rates remain steady or move lower.

Against these advantages, you have to weigh the risk that an increase in interest rates would lead to higher monthly payments in the future. It's a trade-off—you get a lower initial rate with an ARM in exchange for assuming more risk over the long run. Here are some questions you need to consider:

- Is my income enough—or likely to rise enough—to cover higher mortgage payments if interest rates go up?
- Will I be taking on other sizable debts, such as a loan for a car or school tuition, in the near future?
- How long do I plan to own this home? (If you plan to sell soon, rising interest rates may not pose the problem they do if you plan to own the house for a long time.)
- Do I plan to make any additional payments or pay the loan off early?

Lenders and Brokers

Mortgage loans are offered by many kinds of lenders—such as banks, mortgage companies, and credit unions. You can also get a loan through a mortgage broker. Brokers "arrange" loans; in other words, they find a lender for you. Brokers generally take your application and contact several lenders, but keep in mind that brokers are not required to find the best deal for you unless they have contracted with you to act as your agent.

How ARMs Work: The Basic Features

Initial rate and payment

The initial rate and payment amount on an ARM will remain in effect for a limited period of time—ranging from just 1 month to 5 years or more. For some ARMs, the initial rate and payment can vary greatly from the rates and payments later in the loan term. Even if interest rates are stable, your rates and payments could change a lot. If lenders or brokers quote the initial rate and payment on a loan, ask them for the annual percentage rate (APR). If the APR is significantly higher than the initial rate, then it is likely that your rate and payments will be a lot higher when the loan adjusts, even if general interest rates remain the same.

The adjustment period

With most ARMs, the interest rate and monthly payment change every month, quarter, year, 3 years, or 5 years. The period between rate changes is called the *adjustment period*. For example, a loan with an adjustment period of 1 year is called a 1-year ARM, and the interest rate and payment can change once every year; a loan with a 3-year adjustment period is called a 3-year ARM.

Loan Descriptions

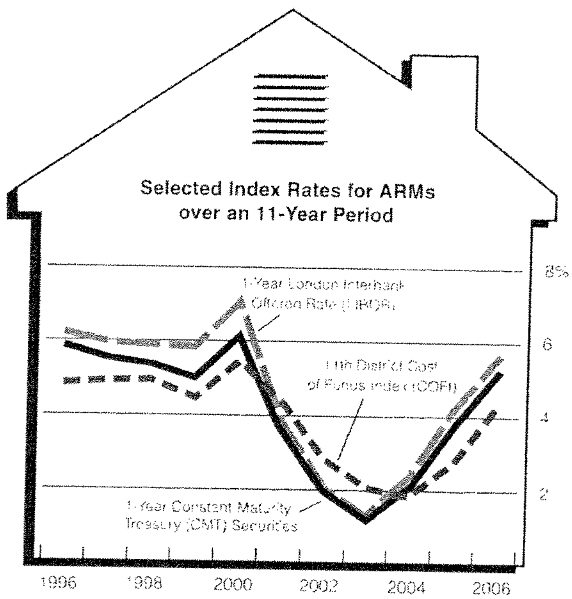
Lenders must give you written information on each type of ARM loan you are interested in. The information must include the terms and conditions for each loan, including information about the index and margin, how your rate will be calculated, how often your rate can change, limits on changes (or *caps*), an example of how high your monthly payment might go, and other ARM features such as negative amortization.

The index

The interest rate on an ARM is made up of two parts: the index and the margin. The index is a measure of interest rates generally, and the margin is an extra amount that the lender adds. Your payments will be affected by any caps, or limits, on how high or low your rate can go. If the index rate moves up, so does your interest rate in most circumstances, and you will probably have to make higher monthly payments. On the other hand, if the index rate goes down, your monthly payment could go down. Not all ARMs adjust downward, however—be sure to read the information for the loan you are considering.

Lenders base ARM rates on a variety of indexes. Among the most common indexes are the rates on 1-year constant-maturity Treasury (CMT) securities, the Cost of Funds Index (COFI), and the London Interbank Offered Rate (LIBOR). A few lenders use their own cost of funds as an index, rather than using other indexes. You should ask what index will be used, how it has fluctuated in the past, and where it is published—you can find a lot of this information in major newspapers and on the Internet.

To help you get an idea of how to compare different indexes, the following chart shows a few common indexes over an 11-year period (1996–2006). As you can see, some index rates tend to be higher than others, and some change more often. But if a lender bases interest-rate adjustments on the average value of an index over time, your interest rate would not change as dramatically.



The margin

To determine the interest rate on an ARM, lenders add a few percentage points to the index rate, called the *margin*. The amount of the margin may differ from one lender to another, but it is usually constant over the life of the loan. The *fully indexed rate* is equal to the margin plus the index. If the initial rate on the loan is less than the fully indexed rate, it is called a *discounted index rate*. For example, if the lender uses an index that currently is 4% and adds a 3% margin, the fully indexed rate would be

Index	4%
+ Margin	3%
Fully indexed rate	7%

If the index on this loan rose to 5%, the fully indexed rate would be 8% (5% + 3%). If the index fell to 2%, the fully indexed rate would be 5% (2% + 3%).

Some lenders base the amount of the margin on your credit record—the better your credit, the lower the margin they add—and the lower the interest you will have to pay on your mortgage. In comparing ARMs, look at both the index and margin for each program.

No-Doc/Low-Doc Loans

When you apply for a loan, lenders usually require documents to prove that your income is high enough to repay the loan. For example, a lender might ask to see copies of your most recent pay stubs, income tax filings, and bank account statements. In a no-doc or low-doc loan, the lender doesn't require you to bring proof of your income, but you will usually have to pay a higher interest rate or extra fees to get the loan. Lenders generally charge more for no-doc/low-doc loans.

Interest-rate caps

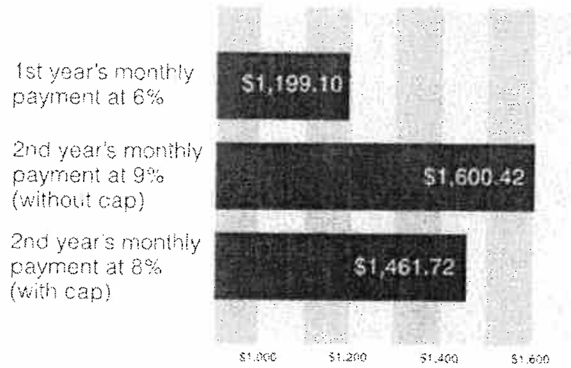
An interest-rate cap places a limit on the amount your interest rate can increase. Interest caps come in two versions:

- *periodic adjustment caps*, which limit the amount the interest rate can adjust up or down from one adjustment period to the next after the first adjustment, and
- *lifetime caps*, which limit the interest-rate increase over the life of the loan. By law, virtually all ARMs must have a lifetime cap.

Periodic adjustment caps

Let's suppose you have an ARM with a periodic adjustment interest-rate cap of 2%. However, at the first adjustment, the index rate has risen 3%. The following example shows what happens.

> **Examples in This Handbook**
>
> **All examples in this handbook are based on a $200,000 loan amount and a 30-year term. Payment amounts in the examples do not include taxes, insurance, condominium or home-owner association fees, or similar items. These amounts can be a significant part of your monthly payment.**



Difference in 2nd year between payment with cap and payment without = $138.70 per month

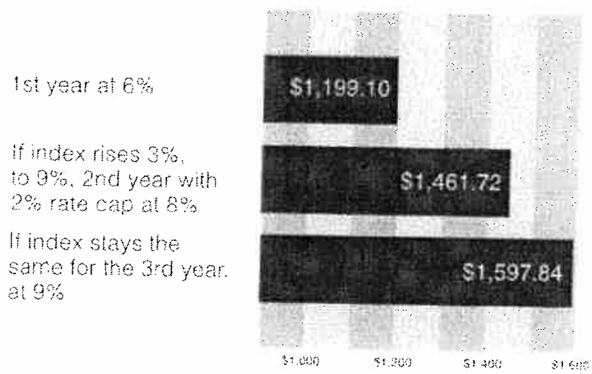
In this example, because of the cap on your loan, your monthly payment in year 2 is $138.70 per month lower than it would be without the cap, saving you $1,664.40 over the year.

Some ARMs allow a larger rate change at the first adjustment and then apply a periodic adjustment cap to all future adjustments.

A drop in interest rates does not always lead to a drop in your monthly payments. With some ARMs that have interest-rate caps, the cap may hold your rate and payment below what it would have been if the change in the index rate had been fully applied. The increase in the interest that was not imposed because of the rate cap might carry over to future rate adjustments. This is called *carryover*. So at the next adjustment date, your payment might increase even though the index rate has stayed the same or declined.

The following example shows how carryovers work. Suppose the index on your ARM increased 3% during the first year.

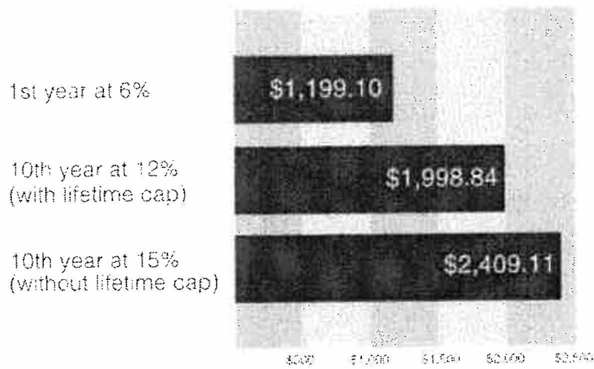
Because this ARM limits rate increases to 2% at any one time, the rate is adjusted by only 2%, to 8% for the second year. However, the remaining 1% increase in the index carries over to the next time the lender can adjust rates. So when the lender adjusts the interest rate for the third year, the rate increases by 1%, to 9%, even if there is no change in the index during the second year.



In general, the rate on your loan can go up at any scheduled adjustment date when the lender's standard ARM rate (the index plus the margin) is higher than the rate you are paying before that adjustment.

Lifetime caps

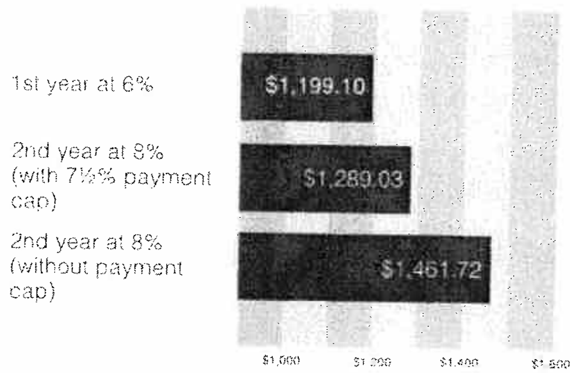
The next example shows how a lifetime rate cap would affect your loan. Let's say that your ARM starts out with a 6% rate and the loan has a 6% lifetime cap—that is, the rate can never exceed 12%. Suppose the index rate increases 1% in each of the next 9 years. With a 6% overall cap, your payment would never exceed $1,998.84—compared with the $2,409.11 that it would have reached in the tenth year without a cap.



Payment caps

In addition to interest-rate caps, many ARMs—including payment-option ARMs—limit, or cap, the amount your monthly payment may increase at the time of each adjustment. For example, if your loan has a payment cap of 7½%, your monthly payment won't increase more than 7½% over your previous payment, even if interest rates rise more. For example, if your monthly payment in year 1 of your mortgage was $1,000, it could only go up to $1,075 in year 2 (7½% of $1,000 is an additional $75). Any interest you don't pay because of the payment cap will be added to the balance of your loan. A payment cap can limit the increase to your monthly payments but also can add to the amount you owe on the loan. (This is called *negative amortization*, a term that is explained on page 22.)

Let's assume that your rate changes in the first year by 2 percentage points but your payments can increase no more than 7½% in any one year. The following graph shows what your monthly payments would look like.



Difference in monthly payment = $172.69

While your monthly payment will be only $1,289.03 for the second year, the difference of $172.69 each month will be added to the balance of your loan and will lead to negative amortization.

Some ARMs with payment caps do not have periodic interest-rate caps. In addition, as explained below, most payment-option ARMs have a built-in recalculation period, usually every 5 years. At that point, your payment will be recalculated (lenders use the term *recast*) based on the remaining term of the loan. If you have a 30-year loan and you are at the end of year 5, your payment will be recalculated for the remaining 25 years. The payment cap does not apply to this adjustment. If your loan balance has increased, or if interest rates have risen faster than your payments, your payments could go up a lot.

Types of ARMs

Hybrid ARMs

Hybrid ARMs often are advertised as 3/1 or 5/1 ARMs—you might also see ads for 7/1 or 10/1 ARMs. These loans are a mix—or a hybrid—of a fixed-rate period and an adjustable-rate period. The interest rate is fixed for the first few years of these loans—for example, for 5 years in a 5/1 ARM. After that, the rate may adjust annually (the 1 in the 5/1 example), until the loan is paid off. In the case of 3/1 or 5/1 ARMs

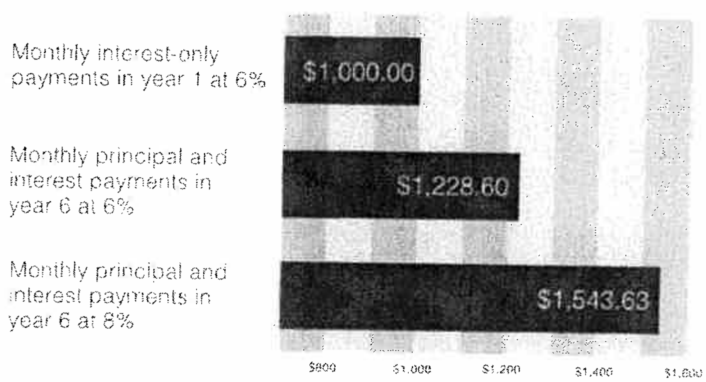
- the first number tells you how long the fixed interest-rate period will be and
- the second number tells you how often the rate will adjust after the initial period.

You may also see ads for 2/28 or 3/27 ARMs—the first number tells you how long the fixed interest-rate period will be, and the second number tells you the number of years the rates on the loan will be adjustable. Some 2/28 and 3/27 mortgages adjust every 6 months, not annually.

Interest-only ARMs

An interest-only (I-O) ARM payment plan allows you to pay only the interest for a specified number of years, typically between 3 and 10 years. This allows you to have smaller monthly payments for a period of time. After that, your monthly payment will increase—even if interest rates stay the same—because you must start paying back the principal as well as the interest each month. For some I-O loans, the interest rate adjusts during the I-O period as well.

For example, if you take out a 30-year mortgage loan with a 5-year I-O payment period, you can pay only interest for 5 years and then you must pay both the principal and interest over the next 25 years. Because you begin to pay back the principal, your payments increase after year 5, even if the rate stays the same. Keep in mind that the longer the I-O period, the higher your monthly payments will be after the I-O period ends.



Payment-option ARMs

A payment-option ARM is an adjustable-rate mortgage that allows you to choose among several payment options each month. The options typically include the following:

- *a traditional payment of principal and interest*, which reduces the amount you owe on your mortgage. These payments are based on a set loan term, such as a 15-, 30-, or 40-year payment schedule.

- *an interest-only payment*, which pays the interest but does not reduce the amount you owe on your mortgage as you make your payments.
- *a minimum (or limited) payment* that may be less than the amount of interest due that month and may not reduce the amount you owe on your mortgage. If you choose this option, the amount of any interest you do not pay will be added to the principal of the loan, **increasing the amount you owe and your future monthly payments**, and increasing the amount of interest you will pay over the life of the loan. In addition, if you pay only the minimum payment in the last few years of the loan, you may owe a larger payment at the end of the loan term, called a *balloon payment*.

The interest rate on a payment-option ARM is typically very low for the first few months (for example, 2% for the first 1 to 3 months). After that, the interest rate usually rises to a rate closer to that of other mortgage loans. Your payments during the first year are based on the initial low rate, meaning that if you only make the minimum payment each month, it will not reduce the amount you owe and it may not cover the interest due. The unpaid interest is added to the amount you owe on the mortgage, and your loan balance increases. This is called *negative amortization*. This means that even after making many payments, you could owe more than you did at the beginning of the loan. Also, as interest rates go up, your payments are likely to go up.

Payment-option ARMs have a built-in recalculation period, usually every 5 years. At this point, your payment will be recalculated (lenders use the term *recast*) based on the remaining term of the loan. If you have a 30-year loan and you are at the end of year 5, your payment will be recalculated for the remaining 25 years. If your loan balance has increased because you have made only minimum payments, or if interest rates have risen faster than your payments, your payments will increase each time your loan is recast. At each recast, your new minimum payment will be a fully amortizing payment and any payment cap will not apply. This means that your monthly payment can increase a lot at each recast.

Lenders may recalculate your loan payments before the recast period if the amount of principal you owe grows beyond a set limit, say 110% or 125% of your original mortgage amount. For example, suppose you made only minimum payments on your $200,000 mortgage and had any unpaid interest added to your balance. If the balance grew to $250,000 (125% of $200,000), your lender would recalculate your payments so that you would pay off the loan over the remaining term. It is likely that your payments would go up substantially.

More information on interest-only and payment-option ARMs is available in the Federal Reserve Board's brochure titled *Interest-Only Mortgage Payments and Payment-Option ARMs—Are They for You?*

Consumer Cautions

Discounted interest rates

Many lenders offer more than one type of ARM. Some lenders offer an ARM with an initial rate that is lower than their fully indexed ARM rate (that is, lower than the sum of the index plus the margin). Such rates—called discounted rates, start rates, or teaser rates—are often combined with large initial loan fees, sometimes called *points*, and with higher rates after the initial discounted rate expires.

Your lender or broker may offer you a choice of loans that may include "discount points" or a "discount fee." You may choose to pay these points or fees in return for a lower interest rate. But keep in mind that the lower interest rate may only last until the first adjustment.

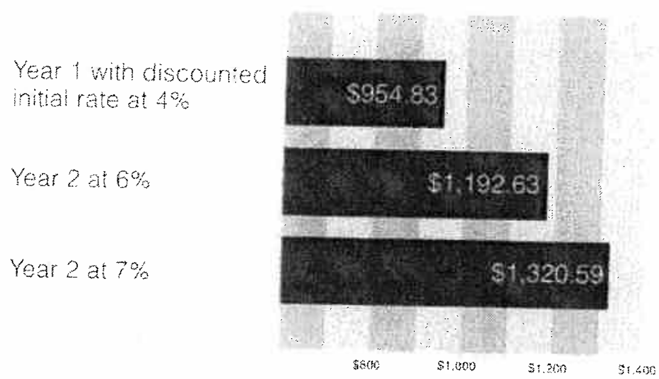
If a lender offers you a loan with a discount rate, don't assume that means that the loan is a good one for you. You should carefully consider whether you will be able to afford higher payments in later years when the discount expires and the rate is adjusted.

Here is an example of how a discounted initial rate might work. Let's assume that the lender's fully indexed one-year ARM rate (index rate plus margin) is currently 6%; the monthly payment for the first year would be $1,199.10. But your lender is offering an ARM with a discounted initial rate of 4% for the first year. With the 4% rate, your first-year's monthly payment would be $954.83.

With a discounted ARM, your initial payment will probably remain at $954.83 for only a limited time—and any savings during the discount period may be offset by higher payments over the remaining life of the mortgage. If you are considering a discount ARM, be sure to compare future payments with those for a fully indexed ARM. In fact, if you buy a home or refinance using a deeply discounted initial rate, you run the risk of payment shock, negative amortization, or prepayment penalties or conversion fees.

Payment shock

Payment shock may occur if your mortgage payment rises sharply at a rate adjustment. Let's see what would happen in the second year if the rate on your discounted 4% ARM were to rise to the 6% fully indexed rate.



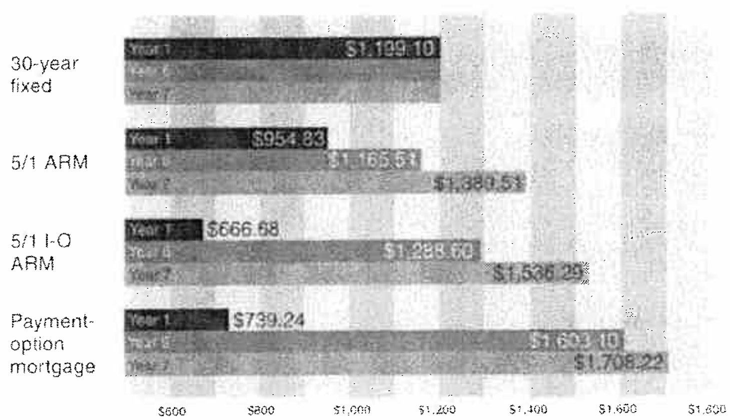
As the example shows, even if the index rate were to stay the same, your monthly payment would go up from $954.83 to $1,192.63 in the second year.

Suppose that the index rate increases 1% in one year and the ARM rate rises to 7%. Your payment in the second year would be $1,320.59.

That's an increase of $365.76 in your monthly payment. You can see what might happen if you choose an ARM because of a low initial rate without considering whether you will be able to afford future payments.

If you have an interest-only ARM, payment shock can also occur when the interest-only period ends. Or, if you have a payment-option ARM, payment shock can happen when the loan is recast.

The following example compares several different loans over the first 7 years of their terms; the payments shown are for years 1, 6, and 7 of the mortgage, assuming you make interest-only payments or minimum payments. The main point is that, depending on the terms and conditions of your mortgage and changes in interest rates, ARM payments can change quite a bit over the life of the loan—so while you could save money in the first few years of an ARM, you could also face much higher payments in the future.



Negative amortization—When you owe more money than you borrowed

Negative amortization means that the amount you owe increases even when you make all your required payments on time. It occurs whenever your monthly mortgage payments are not large enough to pay all of the interest due on your mortgage—the unpaid interest is added to the principal on your mortgage, and you will owe more than you originally borrowed. This can happen because you are making only minimum payments on a payment-option mortgage or because your loan has a payment cap.

For example, suppose you have a $200,000, 30-year payment-option ARM with a 2% rate for the first 3 months and a 6% rate for the remaining 9 months of the year. Your minimum payment for the year is $739.24, as shown in the previous graph. However, once the 6% rate is applied to your loan balance, you are no longer covering the interest costs. If you continue to make minimum payments on this loan, your loan balance at the end of the first year of your mortgage would be $201,118—or $1,118 more than you originally borrowed.

Because payment caps limit only the amount of payment increases, and not interest-rate increases, payments sometimes do not cover all the interest due on your loan. This means that the unpaid interest is automatically added to your debt, and interest may be charged on that amount. You might owe the lender more later in the loan term than you did at the beginning.

A payment cap limits the increase in your monthly payment by deferring some of the interest. Eventually, you would have to repay the higher remaining loan balance at the interest rate then in effect. When this happens, there may be a substantial increase in your monthly payment.

Some mortgages include a cap on negative amortization. The cap typically limits the total amount you can owe to 110% to 125% of the original loan amount. When you reach that point, the lender will set the monthly payment amounts to fully repay the loan over the remaining term. Your payment cap will not apply, and your payments could be substantially higher. You may limit negative amortization by voluntarily increasing your monthly payment.

Be sure you know whether the ARM you are considering can have negative amortization.

Home Prices, Home Equity, and ARMs

Sometimes home prices rise rapidly, allowing people to quickly build equity in their homes. This can make some people think that even if the rate and payments on their ARM get too high, they can avoid those higher payments by refinancing their loan or, in the worst case, selling their home. It's important to remember that home prices do not always go up quickly—they may increase a little or remain the same, and sometimes they fall. If housing prices fall, your home may not be worth as much as you owe on the mortgage. Also, you may find it difficult to refinance your loan to get a lower monthly payment or rate. Even if home prices stay the same, if your loan lets you make minimum payments (see *payment-option ARMs* on page 33), you may owe your lender more on your mortgage than you could get from selling your home.

Prepayment penalties and conversion

If you get an ARM, you may decide later that you don't want to risk any increases in the interest rate and payment amount. When you are considering an ARM, ask for information about any extra fees you would have to pay if you pay off the loan early by refinancing or selling your home, and whether you would be able to convert your ARM to a fixed-rate mortgage.

Prepayment penalties

Some ARMs, including interest-only and payment-option ARMs, may require you to pay special fees or penalties if you refinance or pay off the ARM early (usually within the first 3 to 5 years of the loan). Some loans have *hard prepayment penalties*, meaning that you will pay an extra fee or penalty if you pay off the loan during the penalty period for any reason (because you refinance or sell your home, for example). Other loans have *soft prepayment penalties*, meaning that you will pay an extra fee or penalty only if you refinance the loan, but you will not pay a penalty if you sell your home. Also, some loans may have prepayment penalties even if you make only a partial prepayment.

Prepayment penalties can be several thousand dollars. For example, suppose you have a 3/1 ARM with an initial rate of 6%. At the end of year 2 you decide to refinance and pay off your original loan. At the time of refinancing, your balance is $194,936. If your loan has a prepayment penalty of 6 months' interest on the remaining balance, you would owe about $5,850.

Sometimes there is a trade-off between having a prepayment penalty and having lower origination fees or lower interest rates.

The lender may be willing to reduce or eliminate a prepayment penalty based on the amount you pay in loan fees or on the interest rate in the loan contract.

If you have a hybrid ARM—such as a 2/28 or 3/27 ARM—be sure to compare the prepayment penalty period with the ARM's first adjustment period. For example, if you have a 2/28 ARM that has a rate and payment adjustment after the second year, but the prepayment penalty is in effect for the first 5 years of the loan, it may be costly to refinance when the first adjustment is made.

Most mortgages let you make additional principal payments with your monthly payment. In most cases, this is *not* considered prepayment, and there usually is no penalty for these extra amounts. Check with your lender to make sure there is no penalty if you think you might want to make this type of additional principal prepayment.

Conversion fees

Your agreement with the lender may include a clause that lets you convert the ARM to a fixed-rate mortgage at designated times. When you convert, the new rate is generally set using a formula given in your loan documents.

The interest rate or up-front fees may be somewhat higher for a convertible ARM. Also, a convertible ARM may require a fee at the time of conversion.

Graduated-payment or stepped-rate loans

Some fixed-rate loans start with one rate for one or two years and then change to another rate for the remaining term of the loan. While these are not ARMs, your payment will go up according to the terms of your contract. Talk with your lender or broker and read the information provided to you to make sure you understand when and by how much the payment will change.

Where to Get Information

Disclosures from lenders

You should receive information in writing about each ARM program you are interested in before you have paid a nonrefundable fee. It is important that you read this information and ask the lender or broker about anything you don't understand—index rates, margins, caps, and other ARM features such as negative amortization. After you have applied for a loan, you will get more information from the lender about your loan, including the APR, a payment schedule, and whether the loan has a prepayment penalty.

The APR is the cost of your credit as a yearly rate. It takes into account interest, points paid on the loan, any fees paid to the lender for making the loan, and any mortgage insurance premiums you may have to pay. You can compare APRs on similar ARMs (for example, compare APRs on a 5/1 and a 3/1 ARM) to determine which loan will cost you less in the long term, but you should keep in mind that because the interest rate for an ARM can change, APRs on ARMs cannot be compared directly to APRs for fixed-rate mortgages.

You may want to talk with financial advisers, housing counselors, and other trusted advisers. Contact a local housing counseling agency, call the U.S. Department of Housing and Urban Development toll-free at 800-569-4287, or visit www.hud.gov/offices/hsg/sfh/hcc/hccprof14.cfm to find a center near you.

Newspapers and the Internet

When buying a home or refinancing your existing mortgage, remember to shop around. Compare costs and terms, and negotiate for the best deal. Your local newspaper and the Internet are good places to start shopping for a loan. You can usually find information on interest rates and points for several lenders. Since rates and points can change daily, you'll want to check information sources often when shopping for a home loan.

The Mortgage Shopping Worksheet may also help you. Take it with you when you speak to each lender or broker and write down the information you obtain. Don't be afraid to make lenders and brokers compete with each other for your business by letting them know that you are shopping for the best deal.

Advertisements

Any initial information you receive about mortgages probably will come from advertisements or mail solicitations from builders, real estate brokers, mortgage brokers, and lenders. Although this information can be helpful, keep in mind that these are marketing materials—the ads and mailings are designed to make the mortgage look as attractive as possible. These ads may play up low initial interest rates and monthly payments, without emphasizing that those rates and payments could increase substantially later. So, get all the facts.

Any ad for an ARM that shows an initial interest rate should also show how long the rate is in effect and the APR on the loan. If the APR is much higher than the initial rate, your payments may increase a lot after the introductory period, even if interest rates stay the same.

Choosing a mortgage may be the most important financial decision you will make. You are entitled to have all the information you need to make the right decision. Don't hesitate to ask questions about ARM features when you talk to lenders, mortgage brokers, real estate agents, sellers, and your attorney, and keep asking until you get clear and complete answers.

Glossary

Adjustable-rate mortgage (ARM)

A mortgage that does not have a fixed interest rate. The rate changes during the life of the loan based on movements in an index rate, such as the rate for Treasury securities or the Cost of Funds Index.

Annual percentage rate (APR)

A measure of the cost of credit, expressed as a yearly rate. It includes interest as well as points, broker fees, and certain other credit charges that you are required to pay. Because all lenders follow the same rules when calculating the APR, it provides you with a good basis for comparing the cost of loans, including mortgages, over the term of the loan.

Balloon payment

A lump-sum payment that may be required when a mortgage loan ends. This can happen when the lender allows you to make smaller payments until the very end of the loan. A balloon payment will be a much larger payment compared with the other monthly payments you made.

Buydown

With a buydown, the seller pays an amount to the lender so that the lender can give you a lower rate and lower payments, usually for an initial period in an ARM. The seller may increase the sales price to cover the cost of the buydown. Buydowns can occur in all types of mortgages, not just ARMs.

Cap, interest rate

A limit on the amount your interest rate can increase. Interest caps come in two versions:

- *periodic adjustment caps*, which limit the interest-rate increase from one adjustment period to the next, and
- *lifetime caps*, which limit the interest-rate increase over the life of the loan. By law, virtually all ARMs must have an overall cap.

Cap, payment

A limit on how much the monthly payment may change, either each time the payment changes or during the life of the mortgage. Payment caps may lead to negative amortization because they do not limit the amount of interest the lender is earning.

Conversion clause

A provision in some ARMs that allows you to change the ARM to a fixed-rate loan at some point during the term. Conversion is usually allowed at the end of the first adjustment period. At the time of the conversion, the new fixed rate is generally set at one of the rates then prevailing for fixed-rate mortgages. The conversion feature may be available at extra cost.

Discounted initial rate (also known as a start rate or teaser rate)

In an ARM with a discounted initial rate, the lender offers you a lower rate and lower payments for part of the mortgage term (usually for 1, 3, or 5 years). After the discount period, the ARM rate will probably go up depending on the index rate. Discounts can occur in all types of mortgages, not just ARMs.

Equity

The difference between the fair market value of the home and the outstanding balance on your mortgage plus any outstanding home equity loans.

Hybrid ARM

These ARMs are a mix—or a hybrid—of a fixed-rate period and an adjustable-rate period. The interest rate is fixed for the first several years of the loan; after that, the rate could adjust annually. For example, hybrid ARMs can be advertised as 3/1 or 5/1—the first number tells you how long the fixed interest-rate period will be and the second number tells you how often the rate will adjust after the initial period.

Index

The economic indicator used to calculate interest-rate adjustments for adjustable-rate mortgages. No one can be sure when an index rate will go up or down. See the chart in the text for examples of how some common indexes have changed in the past.

Interest

The price paid for borrowing money, usually given in percentages and as an annual rate.

Interest-only payment ARM

An I-O payment ARM plan allows you to pay only the interest for a specified number of years. After that, you must repay both the principal and the interest over the remaining term of the loan.

Margin

The number of percentage points the lender adds to the index rate to calculate the ARM interest rate at each adjustment.

Negative amortization

Occurs when the monthly payments do not cover all the interest owed. The interest that is not paid in the monthly payment is added to the loan balance. This means that even after making many payments, you could owe more than you did at the beginning of the loan. Negative amortization can occur when an ARM has a payment cap that results in monthly payments that are not high enough to cover the interest due or when the minimum payments are set at an amount lower than the amount you owe in interest.

Payment-option ARM

An ARM that allows you to choose among several payment options each month. The options typically include (1) a traditional amortizing payment of principal and interest, (2) an interest-only payment, or (3) a minimum (or limited) payment that may be less than the amount of interest due that month. If you choose the minimum-payment option, the amount of any interest you do not pay will be added to the principal of your loan (see *negative amortization*).

Points (may be called discount points)

One point is equal to 1 percent of the principal amount of your mortgage. For example, if the mortgage is for $200,000, one point equals $2,000. Lenders frequently charge points in both fixed-rate and adjustable-rate mortgages in order to cover loan origination costs or to provide additional compensation to the lender or broker. These points usually are collected at closing and may be paid by the borrower or the home seller, or may be split between them. Discount points (sometimes called *discount fees*) are points that you voluntarily choose to pay in return for a lower interest rate.

Prepayment penalty

Extra fees that may be due if you pay off the loan early by refinancing your loan or selling your home, usually limited to the first 3 to 5 years of the loan's term. If your loan includes a prepayment penalty, be aware of the penalty you would have to pay. Compare the length of the prepayment penalty period with the first adjustment period of the ARM to see if refinancing is cost-effective before the loan first adjusts. Some loans may have prepayment penalties even if you make only a partial prepayment.

Principal

The amount of money borrowed or the amount still owed on a loan.

For More Information

Looking for the Best Mortgage—Shop, Compare, Negotiate
(at www.federalreserve.gov/pubs/mortgage/mortb_1.htm)

Interest-Only Mortgage Payments and Payment-Option ARMs—Are They for You?
(at www.federalreserve.gov/pubs/mortgage_interestonly/)

A Consumer's Guide to Mortgage Lock-Ins
(at www.federalreserve.gov/pubs/lockins/default.htm)

A Consumer's Guide to Mortgage Settlement Costs
(at www.federalreserve.gov/pubs/settlement/default.htm)

Know Before You Go . . .To Get a Mortgage: A Guide to Mortgage Products and a Glossary of Lending Terms
(at www.bos.frb.org/consumer/knowbeforeyougo/mortgage/mortgage.pdf)

Partners Online Mortgage Calculator
(at www.frbatlanta.org/partnerssoftwareonline/dsp_main.cfm)

This information was prepared by the Board of Governors of the Federal Reserve System and the Office of Thrift Supervision in consultation with the following organizations:

AARP
American Association of Residential Mortgage Regulators
America's Community Bankers
Center for Responsible Lending
Conference of State Bank Supervisors
Consumer Federation of America
Consumer Mortgage Coalition
Consumers Union
Credit Union National Association
Federal Deposit Insurance Corporation
Federal Reserve Board's Consumer Advisory Council
Federal Trade Commission
Financial Services Roundtable
Independent Community Bankers Association
Mortgage Bankers Association
Mortgage Insurance Companies of America
National Association of Federal Credit Unions
National Association of Home Builders
National Association of Mortgage Brokers
National Association of Realtors
National Community Reinvestment Coalition
National Consumer Law Center
National Credit Union Administration

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EXHIBIT D

CERTIFICATION OF PROVIDING CHARM BOOKLET

To be completed by Borrower:

I have received the CHARM Booklet, which I may keep, and have had it for at least 24 hours before closing on an adjustable rate mortgage ("ARM"). I have read the CHARM Booklet and understand it.

Dated: ____________________

______________________________ ______________________________

Borrower's signature Borrower name (please print)

To be completed by Colorado Executive Mortgage or Nathan Soroka

I hereby certify that I provided the CHARM Booklet to the borrower at the time and on the date indicated below:

Delivered to borrower on:

______________________________ (date)

at ______________________________ (time)

Signed

____

____

Print Name, Title, and Organization

Date: ______________________________

Federal Register

Wednesday,
July 30, 2008

Part III

Federal Reserve System

12 CFR Part 226
Truth in Lending; Final Rule

section, neither a creditor nor any other person may impose a fee on the consumer in connection with the consumer's application for a mortgage transaction subject to paragraph (a)(1)(i) of this section before the consumer has received the disclosures required by paragraph (a)(1)(i) of this section. If the disclosures are mailed to the consumer, the consumer is considered to have received them three business days after they are mailed.

(iii) *Exception to fee restriction.* A creditor or other person may impose a fee for obtaining the consumer's credit history before the consumer has received the disclosures required by paragraph (a)(1)(i) of this section, provided the fee is *bona fide* and reasonable in amount.

* * * * *

■ 7. Section 226.23 is amended by revising footnote 48 to paragraph (a)(3) to read "The term 'material disclosures' means the required disclosures of the annual percentage rate, the finance charge, the amount financed, the total of payments, the payment schedule, and the disclosures and limitations referred to in §§ 226.32(c) and (d) and 226.35(b)(2)."

■ 8. Section 226.24 is amended by redesignating paragraphs (b) through (d) as paragraphs (c) through (e), respectively, adding new paragraph (b), revising newly designated paragraphs (c) through (e), removing and reserving footnote 49, and adding new paragraphs (f) through (i), to read as follows:

§ 226.24 Advertising.

* * * * *

(b) *Clear and conspicuous standard.* Disclosures required by this section shall be made clearly and conspicuously.

(c) *Advertisement of rate of finance charge.* If an advertisement states a rate of finance charge, it shall state the rate as an "annual percentage rate," using that term. If the annual percentage rate may be increased after consummation, the advertisement shall state that fact. If an advertisement is for credit not secured by a dwelling, the advertisement shall not state any other rate, except that a simple annual rate or periodic rate that is applied to an unpaid balance may be stated in conjunction with, but not more conspicuously than, the annual percentage rate. If an advertisement is for credit secured by a dwelling, the advertisement shall not state any other rate, except that a simple annual rate that is applied to an unpaid balance may be stated in conjunction with, but not more conspicuously than, the annual percentage rate.

(d) *Advertisement of terms that require additional disclosures*—(1) *Triggering terms.* If any of the following terms is set forth in an advertisement, the advertisement shall meet the requirements of paragraph (d)(2) of this section:

(i) The amount or percentage of any downpayment.

(ii) The number of payments or period of repayment.

(iii) The amount of any payment.

(iv) The amount of any finance charge.

(2) *Additional terms.* An advertisement stating any of the terms in paragraph (d)(1) of this section shall state the following terms,[49] as applicable (an example of one or more typical extensions of credit with a statement of all the terms applicable to each may be used):

(i) The amount or percentage of the downpayment.

(ii) The terms of repayment, which reflect the repayment obligations over the full term of the loan, including any balloon payment.

(iii) The "annual percentage rate," using that term, and, if the rate may be increased after consummation, that fact.

(e) *Catalogs or other multiple-page advertisements; electronic advertisements*—(1) If a catalog or other multiple-page advertisement, or an electronic advertisement (such as an advertisement appearing on an Internet Web site), gives information in a table or schedule in sufficient detail to permit determination of the disclosures required by paragraph (d)(2) of this section, it shall be considered a single advertisement if—

(i) The table or schedule is clearly and conspicuously set forth; and

(ii) Any statement of the credit terms in paragraph (d)(1) of this section appearing anywhere else in the catalog or advertisement clearly refers to the page or location where the table or schedule begins.

(2) A catalog or other multiple-page advertisement or an electronic advertisement (such as an advertisement appearing on an Internet Web site) complies with paragraph (d)(2) of this section if the table or schedule of terms includes all appropriate disclosures for a representative scale of amounts up to the level of the more commonly sold higher-priced property or services offered.

(f) *Disclosure of Rates and Payments in Advertisements for Credit Secured by a Dwelling.*

(1) *Scope.* The requirements of this paragraph apply to any advertisement for credit secured by a dwelling, other than television or radio advertisements, including promotional materials accompanying applications.

(2) *Disclosure of rates*—(i) *In general.* If an advertisement for credit secured by a dwelling states a simple annual rate of interest and more than one simple annual rate of interest will apply over the term of the advertised loan, the advertisement shall disclose in a clear and conspicuous manner:

(A) Each simple annual rate of interest that will apply. In variable-rate transactions, a rate determined by adding an index and margin shall be disclosed based on a reasonably current index and margin;

(B) The period of time during which each simple annual rate of interest will apply; and

(C) The annual percentage rate for the loan. If such rate is variable, the annual percentage rate shall comply with the accuracy standards in §§ 226.17(c) and 226.22.

(ii) *Clear and conspicuous requirement.* For purposes of paragraph (f)(2)(i) of this section, clearly and conspicuously disclosed means that the required information in paragraphs (f)(2)(i)(A) through (C) shall be disclosed with equal prominence and in close proximity to any advertised rate that triggered the required disclosures. The required information in paragraph (f)(2)(i)(C) may be disclosed with greater prominence than the other information.

(3) *Disclosure of payments*—(i) *In general.* In addition to the requirements of paragraph (c) of this section, if an advertisement for credit secured by a dwelling states the amount of any payment, the advertisement shall disclose in a clear and conspicuous manner:

(A) The amount of each payment that will apply over the term of the loan, including any balloon payment. In variable-rate transactions, payments that will be determined based on the application of the sum of an index and margin shall be disclosed based on a reasonably current index and margin;

(B) The period of time during which each payment will apply; and

(C) In an advertisement for credit secured by a first lien on a dwelling, the fact that the payments do not include amounts for taxes and insurance premiums, if applicable, and that the actual payment obligation will be greater.

(ii) *Clear and conspicuous requirement.* For purposes of paragraph (f)(3)(i) of this section, a clear and conspicuous disclosure means that the

[49] [Reserved.]

required information in paragraphs (f)(3)(i)(A) and (B) shall be disclosed with equal prominence and in close proximity to any advertised payment that triggered the required disclosures, and that the required information in paragraph (f)(3)(i)(C) shall be disclosed with prominence and in close proximity to the advertised payments.

(4) *Envelope excluded.* The requirements in paragraphs (f)(2) and (f)(3) of this section do not apply to an envelope in which an application or solicitation is mailed, or to a banner advertisement or pop-up advertisement linked to an application or solicitation provided electronically.

(g) *Alternative disclosures—television or radio advertisements.* An advertisement made through television or radio stating any of the terms requiring additional disclosures under paragraph (d)(2) of this section may comply with paragraph (d)(2) of this section either by:

(1) Stating clearly and conspicuously each of the additional disclosures required under paragraph (d)(2) of this section; or

(2) Stating clearly and conspicuously the information required by paragraph (d)(2)(iii) of this section and listing a toll-free telephone number, or any telephone number that allows a consumer to reverse the phone charges when calling for information, along with a reference that such number may be used by consumers to obtain additional cost information.

(h) *Tax implications.* If an advertisement distributed in paper form or through the Internet (rather than by radio or television) is for a loan secured by the consumer's principal dwelling, and the advertisement states that the advertised extension of credit may exceed the fair market value of the dwelling, the advertisement shall clearly and conspicuously state that:

(1) The interest on the portion of the credit extension that is greater than the fair market value of the dwelling is not tax deductible for Federal income tax purposes; and

(2) The consumer should consult a tax adviser for further information regarding the deductibility of interest and charges.

(i) *Prohibited acts or practices in advertisements for credit secured by a dwelling.* The following acts or practices are prohibited in advertisements for credit secured by a dwelling:

(1) *Misleading advertising of "fixed" rates and payments.* Using the word "fixed" to refer to rates, payments, or the credit transaction in an advertisement for variable-rate transactions or other transactions where the payment will increase, unless:

(i) In the case of an advertisement solely for one or more variable-rate transactions,

(A) The phrase "Adjustable-Rate Mortgage," "Variable-Rate Mortgage," or "ARM" appears in the advertisement before the first use of the word "fixed" and is at least as conspicuous as any use of the word "fixed" in the advertisement; and

(B) Each use of the word "fixed" to refer to a rate or payment is accompanied by an equally prominent and closely proximate statement of the time period for which the rate or payment is fixed, and the fact that the rate may vary or the payment may increase after that period;

(ii) In the case of an advertisement solely for non-variable-rate transactions where the payment will increase (*e.g.*, a stepped-rate mortgage transaction with an initial lower payment), each use of the word "fixed" to refer to the payment is accompanied by an equally prominent and closely proximate statement of the time period for which the payment is fixed, and the fact that the payment will increase after that period; or

(iii) In the case of an advertisement for both variable-rate transactions and non-variable-rate transactions,

(A) The phrase "Adjustable-Rate Mortgage," "Variable-Rate Mortgage," or "ARM" appears in the advertisement with equal prominence as any use of the term "fixed," "Fixed-Rate Mortgage," or similar terms; and

(B) Each use of the word "fixed" to refer to a rate, payment, or the credit transaction either refers solely to the transactions for which rates are fixed and complies with paragraph (i)(1)(ii) of this section, if applicable, or, if it refers to the variable-rate transactions, is accompanied by an equally prominent and closely proximate statement of the time period for which the rate or payment is fixed, and the fact that the rate may vary or the payment may increase after that period.

(2) *Misleading comparisons in advertisements.* Making any comparison in an advertisement between actual or hypothetical credit payments or rates and any payment or simple annual rate that will be available under the advertised product for a period less than the full term of the loan, unless:

(i) *In general.* The advertisement includes a clear and conspicuous comparison to the information required to be disclosed under sections 226.24(f)(2) and (3); and

(ii) *Application to variable-rate transactions.* If the advertisement is for a variable-rate transaction, and the advertised payment or simple annual rate is based on the index and margin that will be used to make subsequent rate or payment adjustments over the term of the loan, the advertisement includes an equally prominent statement in close proximity to the payment or rate that the payment or rate is subject to adjustment and the time period when the first adjustment will occur.

(3) *Misrepresentations about government endorsement.* Making any statement in an advertisement that the product offered is a "government loan program", "government-supported loan", or is otherwise endorsed or sponsored by any federal, state, or local government entity, unless the advertisement is for an FHA loan, VA loan, or similar loan program that is, in fact, endorsed or sponsored by a federal, state, or local government entity.

(4) *Misleading use of the current lender's name.* Using the name of the consumer's current lender in an advertisement that is not sent by or on behalf of the consumer's current lender, unless the advertisement:

(i) Discloses with equal prominence the name of the person or creditor making the advertisement; and

(ii) Includes a clear and conspicuous statement that the person making the advertisement is not associated with, or acting on behalf of, the consumer's current lender.

(5) *Misleading claims of debt elimination.* Making any misleading claim in an advertisement that the mortgage product offered will eliminate debt or result in a waiver or forgiveness of a consumer's existing loan terms with, or obligations to, another creditor.

(6) *Misleading use of the term "counselor".* Using the term "counselor" in an advertisement to refer to a for-profit mortgage broker or mortgage creditor, its employees, or persons working for the broker or creditor that are involved in offering, originating or selling mortgages.

(7) *Misleading foreign-language advertisements.* Providing information about some trigger terms or required disclosures, such as an initial rate or payment, only in a foreign language in an advertisement, but providing information about other trigger terms or required disclosures, such as information about the fully-indexed rate or fully amortizing payment, only in English in the same advertisement.

Subpart E—Special Rules for Certain Home Mortgage Transactions

■ 9. Section 226.32 is amended by revising paragraphs (d)(6) and (d)(7) to read as follows:

§ 226.32 Requirements for certain closed-end home mortgages.

* * * * *

(d) * * *

(6) *Prepayment penalties.* Except as allowed under paragraph (d)(7) of this section, a penalty for paying all or part of the principal before the date on which the principal is due. A prepayment penalty includes computing a refund of unearned interest by a method that is less favorable to the consumer than the actuarial method, as defined by section 933(d) of the Housing and Community Development Act of 1992, 15 U.S.C. 1615(d).

(7) *Prepayment penalty exception.* A mortgage transaction subject to this section may provide for a prepayment penalty (including a refund calculated according to the rule of 78s) otherwise permitted by law if, under the terms of the loan:

(i) The penalty will not apply after the two-year period following consummation;

(ii) The penalty will not apply if the source of the prepayment funds is a refinancing by the creditor or an affiliate of the creditor;

(iii) At consummation, the consumer's total monthly debt payments (including amounts owed under the mortgage) do not exceed 50 percent of the consumer's monthly gross income, as verified in accordance with § 226.34(a)(4)(ii); and

(iv) The amount of the periodic payment of principal or interest or both may not change during the four-year period following consummation.

* * * * *

■ 10. Section 226.34 is amended by revising the heading and paragraph (a)(4) to read as follows:

§ 226.34 Prohibited acts or practices in connection with credit subject to § 226.32.

(a) * * *

(4) *Repayment ability.* Extend credit subject to § 226.32 to a consumer based on the value of the consumer's collateral without regard to the consumer's repayment ability as of consummation, including the consumer's current and reasonably expected income, employment, assets other than the collateral, current obligations, and mortgage-related obligations.

(i) *Mortgage-related obligations.* For purposes of this paragraph (a)(4), mortgage-related obligations are expected property taxes, premiums for mortgage-related insurance required by the creditor as set forth in § 226.35(b)(3)(i), and similar expenses.

(ii) *Verification of repayment ability.* Under this paragraph (a)(4) a creditor must verify the consumer's repayment ability as follows:

(A) A creditor must verify amounts of income or assets that it relies on to determine repayment ability, including expected income or assets, by the consumer's Internal Revenue Service Form 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.

(B) Notwithstanding paragraph (a)(4)(ii)(A), a creditor has not violated paragraph (a)(4)(ii) if the amounts of income and assets that the creditor relied upon in determining repayment ability are not materially greater than the amounts of the consumer's income or assets that the creditor could have verified pursuant to paragraph (a)(4)(ii)(A) at the time the loan was consummated.

(C) A creditor must verify the consumer's current obligations.

(iii) *Presumption of compliance.* A creditor is presumed to have complied with this paragraph (a)(4) with respect to a transaction if the creditor:

(A) Verifies the consumer's repayment ability as provided in paragraph (a)(4)(ii);

(B) Determines the consumer's repayment ability using the largest payment of principal and interest scheduled in the first seven years following consummation and taking into account current obligations and mortgage-related obligations as defined in paragraph (a)(4)(i); and

(C) Assesses the consumer's repayment ability taking into account at least one of the following: The ratio of total debt obligations to income, or the income the consumer will have after paying debt obligations.

(iv) *Exclusions from presumption of compliance.* Notwithstanding the previous paragraph, no presumption of compliance is available for a transaction for which:

(A) The regular periodic payments for the first seven years would cause the principal balance to increase; or

(B) The term of the loan is less than seven years and the regular periodic payments when aggregated do not fully amortize the outstanding principal balance.

(v) *Exemption.* This paragraph (a)(4) does not apply to temporary or "bridge" loans with terms of twelve months or less, such as a loan to purchase a new dwelling where the consumer plans to sell a current dwelling within twelve months.

* * * * *

■ 11. New § 226.35 is added to read as follows:

§ 226.35 Prohibited acts or practices in connection with higher-priced mortgage loans.

(a) *Higher-priced mortgage loans*—(1) For purposes of this section, a higher-priced mortgage loan is a consumer credit transaction 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 is set by 1.5 or more percentage points for loans secured by a first lien on a dwelling, or by 3.5 or more percentage points for loans secured by a subordinate lien on a dwelling.

(2) "Average prime offer rate" means an annual percentage rate that is derived from average interest rates, points, and other loan pricing terms currently offered to consumers by a representative sample of creditors for mortgage transactions that have low-risk pricing characteristics. The Board publishes average prime offer rates for a broad range of types of transactions in a table updated at least weekly as well as the methodology the Board uses to derive these rates.

(3) Notwithstanding paragraph (a)(1) of this section, the term "higher-priced mortgage loan" does not include a transaction to finance the initial construction of a dwelling, a temporary or "bridge" loan with a term of twelve months or less, such as a loan to purchase a new dwelling where the consumer plans to sell a current dwelling within twelve months, a reverse-mortgage transaction subject to § 226.33, or a home equity line of credit subject to § 226.5b.

(b) *Rules for higher-priced mortgage loans.* Higher-priced mortgage loans are subject to the following restrictions:

(1) *Repayment ability.* A creditor shall not extend credit based on the value of the consumer's collateral without regard to the consumer's repayment ability as of consummation as provided in § 226.34(a)(4).

(2) *Prepayment penalties.* A loan may not include a penalty described by § 226.32(d)(6) unless:

(i) The penalty is otherwise permitted by law, including § 226.32(d)(7) if the loan is a mortgage transaction described in § 226.32(a); and

(ii) Under the terms of the loan—

(A) The penalty will not apply after the two-year period following consummation;

(B) The penalty will not apply if the source of the prepayment funds is a refinancing by the creditor or an affiliate of the creditor; and

(C) The amount of the periodic payment of principal or interest or both may not change during the four-year period following consummation.

(3) *Escrows*—(i) *Failure to escrow for property taxes and insurance.* Except as provided in paragraph (b)(3)(ii) of this section, a creditor may not extend a loan secured by a first lien on a principal dwelling unless an escrow account is established before consummation for payment of property taxes and premiums for mortgage-related insurance required by the creditor, such as insurance against loss of or damage to property, or against liability arising out of the ownership or use of the property, or insurance protecting the creditor against the consumer's default or other credit loss.

(ii) *Exemptions for loans secured by shares in a cooperative and for certain condominium units*—(A) Escrow accounts need not be established for loans secured by shares in a cooperative; and

(B) Insurance premiums described in paragraph (b)(3)(i) of this section need not be included in escrow accounts for loans secured by condominium units, where the condominium association has an obligation to the condominium unit owners to maintain a master policy insuring condominium units.

(iii) *Cancellation.* A creditor or servicer may permit a consumer to cancel the escrow account required in paragraph (b)(3)(i) of this section only in response to a consumer's dated written request to cancel the escrow account that is received no earlier than 365 days after consummation.

(iv) *Definition of escrow account.* For purposes of this section, "escrow account" shall have the same meaning as in 24 CFR 3500.17(b) as amended.

(4) *Evasion; open-end credit.* In connection with credit secured by a consumer's principal dwelling that does not meet the definition of open-end credit in § 226.2(a)(20), a creditor shall not structure a home-secured loan as an open-end plan to evade the requirements of this section.

■ 12. New § 226.36 is added to read as follows:

§ 226.36 Prohibited acts or practices in connection with credit secured by a consumer's principal dwelling.

(a) *Mortgage broker defined.* For purposes of this section, the term "mortgage broker" means a person, other than an employee of a creditor, who for compensation or other monetary gain, or in expectation of compensation or other monetary gain, arranges, negotiates, or otherwise obtains an extension of consumer credit for another person. The term includes a person meeting this definition, even if the consumer credit obligation is initially payable to such person, unless the person provides the funds for the transaction at consummation out of the person's own resources, out of deposits held by the person, or by drawing on a bona fide warehouse line of credit.

(b) *Misrepresentation of value of consumer's dwelling*—(1) *Coercion of appraiser.* In connection with a consumer credit transaction secured by a consumer's principal dwelling, no creditor or mortgage broker, and no affiliate of a creditor or mortgage broker shall directly or indirectly coerce, influence, or otherwise encourage an appraiser to misstate or misrepresent the value of such dwelling.

(i) Examples of actions that violate this paragraph (b)(1) include:

(A) Implying to an appraiser that current or future retention of the appraiser depends on the amount at which the appraiser values a consumer's principal dwelling;

(B) Excluding an appraiser from consideration for future engagement because the appraiser reports a value of a consumer's principal dwelling that does not meet or exceed a minimum threshold;

(C) Telling an appraiser a minimum reported value of a consumer's principal dwelling that is needed to approve the loan;

(D) Failing to compensate an appraiser because the appraiser does not value a consumer's principal dwelling at or above a certain amount; and

(E) Conditioning an appraiser's compensation on loan consummation.

(ii) Examples of actions that do not violate this paragraph (b)(1) include:

(A) Asking an appraiser to consider additional information about a consumer's principal dwelling or about comparable properties;

(B) Requesting that an appraiser provide additional information about the basis for a valuation;

(C) Requesting that an appraiser correct factual errors in a valuation;

(D) Obtaining multiple appraisals of a consumer's principal dwelling, so long as the creditor adheres to a policy of selecting the most reliable appraisal, rather than the appraisal that states the highest value;

(E) Withholding compensation from an appraiser for breach of contract or substandard performance of services as provided by contract; and

(F) Taking action permitted or required by applicable federal or state statute, regulation, or agency guidance.

(2) *When extension of credit prohibited.* In connection with a consumer credit transaction secured by a consumer's principal dwelling, a creditor who knows, at or before loan consummation, of a violation of paragraph (b)(1) of this section in connection with an appraisal shall not extend credit based on such appraisal unless the creditor documents that it has acted with reasonable diligence to determine that the appraisal does not materially misstate or misrepresent the value of such dwelling.

(3) *Appraiser defined.* As used in this paragraph (b), an appraiser is a person who engages in the business of providing assessments of the value of dwellings. The term "appraiser" includes persons that employ, refer, or manage appraisers and affiliates of such persons.

(c) *Servicing practices.* (1) In connection with a consumer credit transaction secured by a consumer's principal dwelling, no servicer shall—

(i) Fail to credit a payment to the consumer's loan account as of the date of receipt, except when a delay in crediting does not result in any charge to the consumer or in the reporting of negative information to a consumer reporting agency, or except as provided in paragraph (c)(2) of this section;

(ii) Impose on the consumer any late fee or delinquency charge in connection with 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 applicable period and is paid on its due date or within any applicable grace period; or

(iii) Fail to provide, within a reasonable time after receiving a request from the consumer or any person acting on behalf of the consumer, an accurate statement of the total outstanding balance that would be required to satisfy the consumer's obligation in full as of a specified date.

(2) If a servicer specifies in writing requirements for the consumer to follow in making payments, but accepts a payment that does not conform to the requirements, the servicer shall credit the payment as of 5 days after receipt.

(3) For purposes of this paragraph (c), the terms "servicer" and "servicing" have the same meanings as provided in 24 CFR 3500.2(b), as amended.

(d) This section does not apply to a home equity line of credit subject to § 226.5b.

Supplement I to Part 226—Official Staff Interpretations

Subpart A—General

■ 13. In Supplement I to Part 226, under *Section 226.1—Authority, Purpose, Coverage, Organization, Enforcement* *and Liability*, new headings *1(d) Organization* and *Paragraph 1(d)(5)*, and new paragraph 1(d)(5)–1 are added to read as follows:

Section 226.1—Authority, Purpose, Coverage, Organization, Enforcement and Liability

* * * * *

1(d) Organization.

Paragraph 1(d)(5).

1. *Effective dates.* The Board's revisions to Regulation Z published on July 30, 2008 (the "final rules"), apply to covered loans (including refinance loans and assumptions considered new transactions under 226.20), for which the creditor receives an application on or after October 1, 2009, except for the final rules on advertising, escrows, and loan servicing. The final rules on escrows in § 226.35(b)(3) are effective for covered loans, (including refinancings and assumptions in 226.20) for which the creditor receives an application on or after April 1, 2010; but for such loans secured by manufactured housing on or after October 1, 2010. The final rules applicable to servicers in § 226.36(c) apply to all covered loans serviced on or after October 1, 2009. The final rules on advertising apply to advertisements occurring on or after October 1, 2009. For example, a radio ad occurs on the date it is first broadcast; a solicitation occurs on the date it is mailed to the consumer. The following examples illustrate the application of the effective dates for the final rules.

i. *General.* A refinancing or assumption as defined in 226.20(a) or (b) is a new transaction and is covered by a provision of the final rule if the creditor receives an application for the transaction on or after that provision's effective date. For example, if a creditor receives an application for a refinance loan covered by 226.35(a) on or after October 1, 2009, and the refinance loan is consummated on October 15, 2009, the provision restricting prepayment penalties in § 226.35(b)(2) applies. However, If the transaction were a modification of an existing obligation's terms that does not constitute a refinance loan under § 226.20(a), the final rules, including for example the restriction on prepayment penalties would not apply.

ii. *Escrows.* Assume a consumer applies for a refinance loan to be secured by a dwelling (that is not a manufactured home) on March 15, 2010, and the loan is consummated on April 2, 2010, the escrow rule in 226.35(b)(3) does not apply.

iii. *Servicing.* Assume that a consumer applies for a new loan on August 1, 2009. The loan is consummated on September 1, 2009. The servicing rules in 226.36(c) apply to the servicing of that loan as of October 1, 2009.

■ 14. In Supplement I to Part 226, under Section *226.2—Definitions and Rules of Construction, 2(a) Definitions, 2(a)(6) Business day,* paragraph 2(a)(6)–2 is revised, and under *2(a)(24) Residential mortgage transaction,* paragraphs 2(a)(24)–1 and 2(a)(24)–5.ii are revised, to read as follows:

Section 226.2—Definitions and Rules of Construction

2(a) Definitions.

* * * * *

2(a)(6) Business day.

* * * * *

2. *Recission rule.* A more precise rule for what is a business day (all calendar days except Sundays and the federal legal holidays listed in 5 U.S.C. 6103(a)) applies when the right of rescission, the receipt of disclosures for certain mortgage transactions under section 226.19(a)(1)(ii), or mortgages subject to section 226.32 are involved. (See also comment 31(c)(1)–1.) Four federal legal holidays are identified in 5 U.S.C. 6103(a) by a specific date: New Year's Day, January 1; Independence Day, July 4; Veterans Day, November 11; and Christmas Day, December 25. When one of these holidays (July 4, for example) falls on a Saturday, federal offices and other entities might observe the holiday on the preceding Friday (July 3). The observed holiday (in the example, July 3) is a business day for purposes of rescission, the receipt of disclosures for certain mortgage transactions under section 226.19(a)(1)(ii), or the delivery of disclosures for certain high-cost mortgages covered by section 226.32.

* * * * *

2(a)(24) Residential mortgage transaction.

1. *Relation to other sections.* This term is important in five provisions in the regulation:

i. § 226.4(c)(7)—exclusions from the finance charge.

ii. § 226.15(f)—exemption from the right of rescission.

iii. § 226.18(q)—whether or not the obligation is assumable.

iv. § 226.20(b)—disclosure requirements for assumptions.

v. § 226.23(f)—exemption from the right of rescission.

* * * * *

5. *Acquisition.* * * *

* * * * *

ii. Examples of new transactions involving a previously acquired dwelling include the financing of a balloon payment due under a land sale contract and an extension of credit made to a joint owner of property to buy out the other joint owner's interest. In these instances, disclosures are not required under § 226.18(q) (assumability policies). However, the rescission rules of §§ 226.15 and 226.23 do apply to these new transactions.

* * * * *

Subpart B—Open-End Credit

■ 15. In Supplement I to Part 226, under *Section 226.16—Advertising,* paragraph 16–1 is revised, paragraph 16–2 is redesignated as paragraph 16–6, and new paragraphs 16–2 through 16–5 and 16–7 are added; under *16(d) Additional requirements for home-equity plans,* paragraph 16(d)–3 is revised, paragraphs 16(d)–5, 16(d)–6, and 16(d)–7 are redesignated as paragraphs 16(d)–7, 16(d)–8, and 16(d)–9, respectively, new paragraphs 16(d)–5 and 16(d)–6 are added, and newly designated paragraphs 16(d)–7 and 16(d)–9 are revised; and new heading *16(e) Alternative disclosures—television or radio advertisements* is added, and new paragraphs 16(e)–1 and 16(e)–2 are added, to read as follows:

Section 226.16—Advertising

1. *Clear and conspicuous standard—general.* Section 226.16 is subject to the general "clear and conspicuous" standard for subpart B (*see* § 226.5(a)(1)) but prescribes no specific rules for the format of the necessary disclosures, aside from the format requirements related to the disclosure of a promotional rate under § 226.16(d)(6). Aside from the terms described in § 226.16(d)(6), the credit terms need not be printed in a certain type size nor need they appear in any particular place in the advertisement.

2. *Clear and conspicuous standard—promotional rates or payments for home-equity plans.* For purposes of § 226.16(d)(6), a clear and conspicuous disclosure means that the required information in § 226.16(d)(6)(ii)(A)–(C) is disclosed with equal prominence and in close proximity to the promotional rate or payment to which it applies. If the information in § 226.16(d)(6)(ii)(A)–(C) is the same type size and is located immediately next to or directly above or below the promotional rate or payment to which it applies, without any intervening text or graphical displays, the disclosures would be deemed to be equally prominent and in close proximity. Notwithstanding the above, for electronic advertisements that disclose promotional rates or payments, compliance with the requirements of § 226.16(c) is deemed to satisfy the clear and conspicuous standard.

3. *Clear and conspicuous standard—Internet advertisements for home-equity plans.* For purposes of this section, a clear and conspicuous disclosure for visual text advertisements on the Internet for home-equity plans subject to the requirements of § 226.5b means that the required disclosures are not obscured by techniques such as graphical displays, shading, coloration, or other devices and comply with all other requirements for clear and conspicuous disclosures under § 226.16(d). *See also* comment 16(c)(1)–2.

4. *Clear and conspicuous standard—televised advertisements for home-equity plans.* For purposes of this section, including alternative disclosures as provided for by § 226.16(e), a clear and conspicuous disclosure in the context of visual text advertisements on television for home-equity plans subject to the requirements of § 226.5b means that the required disclosures are not obscured by techniques such as graphical displays, shading, coloration, or other devices, are displayed in a manner that allows for a consumer to read the information required to be disclosed, and comply with all other requirements for clear and conspicuous disclosures under § 226.16(d). For example, very fine print in a television advertisement would not meet the clear and conspicuous standard if consumers cannot see and read the information required to be disclosed.

5. *Clear and conspicuous standard—oral advertisements for home-equity plans.* For purposes of this section, including alternative disclosures as provided for by § 226.16(e), a clear and conspicuous disclosure in the context of an oral advertisement for home-equity plans subject to the requirements of § 226.5b, whether by radio, television, the Internet, or other medium, means that the required disclosures are given at a speed and volume sufficient for a consumer to hear and comprehend them. For example, information stated very rapidly at a low volume in a radio or television advertisement would not meet the clear and conspicuous standard if consumers cannot hear and comprehend the information required to be disclosed.

6. *Expressing the annual percentage rate in abbreviated form.* * * *

7. *Effective date.* For guidance on the applicability of the Board's revisions to § 226.16 published on July 30, 2008, see comment 1(d)(5)–1.

* * * * *

16(d) Additional requirements for home-equity plans.

* * * * *

3. *Statements of tax deductibility.* An advertisement that refers to deductibility for tax purposes is not misleading if it includes a statement such as "consult a tax advisor regarding the deductibility of interest." An advertisement distributed in paper form or through the Internet (rather than by radio or television) that states that the advertised extension of credit may exceed the fair market value of the consumer's dwelling is not misleading if it clearly and conspicuously states the required information in §§ 226.16(d)(4)(i) and (ii).

* * * * *

5. *Promotional rates and payments in advertisements for home-equity plans.* Section 226.16(d)(6) requires additional disclosures for promotional rates or payments.

i. *Variable-rate plans.* In advertisements for variable-rate plans, if the advertised annual percentage rate is based on (or the advertised payment is derived from) the index and margin that will be used to make rate (or payment) adjustments over the term of the loan, then there is no promotional rate or promotional payment. If, however, the advertised annual percentage rate is not based on (or the advertised payment is not derived from) the index and margin that will be used to make rate (or payment) adjustments, and a reasonably current application of the index and margin would result in a higher annual percentage rate (or, given an assumed balance, a higher payment) then there is a promotional rate or promotional payment.

ii. *Equal prominence, close proximity.* Information required to be disclosed in § 226.16(d)(6)(ii) that is immediately next to or directly above or below the promotional rate or payment (but not in a footnote) is deemed to be closely proximate to the listing. Information required to be disclosed in § 226.16(d)(6)(ii) that is in the same type size as the promotional rate or payment is deemed to be equally prominent.

iii. *Amounts and time periods of payments.* Section 226.16(d)(6)(ii)(C) requires disclosure of the amount and time periods of any payments that will apply under the plan. This section may require disclosure of several payment amounts, including any balloon payment. For example, if an advertisement for a home-equity plan offers a $100,000 five-year line of credit and assumes that the entire line is drawn resulting in a minimum payment of $800 per month for the first six months, increasing to $1,000 per month after month six, followed by a $50,000 balloon payment after five years, the advertisement must disclose the amount and time period of each of the two monthly payment streams, as well as the amount and timing of the balloon payment, with equal prominence and in close proximity to the promotional payment. However, if the final payment could not be more than twice the amount of other minimum payments, the final payment need not be disclosed.

iv. *Plans other than variable-rate plans.* For a plan other than a variable-rate plan, if an advertised payment is calculated in the same way as other payments based on an assumed balance, the fact that the minimum payment could increase solely if the consumer made an additional draw does not make the payment a promotional payment. For example, if a payment of $500 results from an assumed $10,000 draw, and the payment would increase to $1,000 if the consumer made an additional $10,000 draw, the payment is not a promotional payment.

v. *Conversion option.* Some home-equity plans permit the consumer to repay all or part of the balance during the draw period at a fixed rate (rather than a variable rate) and over a specified time period. The fixed-rate conversion option does not, by itself, make the rate or payment that would apply if the consumer exercised the fixed-rate conversion option a promotional rate or payment.

vi. *Preferred-rate provisions.* Some home-equity plans contain a preferred-rate provision, where the rate will increase upon the occurrence of some event, such as the consumer-employee leaving the creditor's employ, the consumer closing an existing deposit account with the creditor, or the consumer revoking an election to make automated payments. A preferred-rate provision does not, by itself, make the rate or payment under the preferred-rate provision a promotional rate or payment.

6. *Reasonably current index and margin.* For the purposes of this section, an index and margin is considered reasonably current if:

i. For direct mail advertisements, it was in effect within 60 days before mailing;

ii. For advertisements in electronic form it was in effect within 30 days before the advertisement is sent to a consumer's e-mail address, or in the case of an advertisement made on an Internet Web site, when viewed by the public; or

iii. For printed advertisements made available to the general public, including ones contained in a catalog, magazine, or other generally available publication, it was in effect within 30 days before printing.

7. *Relation to other sections.* Advertisements for home-equity plans must comply with all provisions in § 226.16 not solely the rules in § 226.16(d). If an advertisement contains information (such as the payment terms) that triggers the duty under § 226.16(d) to state the annual percentage rate, the additional disclosures in § 226.16(b) must be provided in the advertisement. While § 226.16(d) does not require a statement of fees to use or maintain the plan (such as membership fees and transaction charges), such fees must be disclosed under § 226.16(b)(1) and (3).

* * * * *

9. *Balloon payment.* See comment 5b(d)(5)(ii)–3 for information not required to be stated in advertisements, and on situations in which the balloon payment requirement does not apply.

16(e) Alternative disclosures—television or radio advertisements.

1. *Multi-purpose telephone number.* When an advertised telephone number provides a recording, disclosures should be provided early in the sequence to ensure that the consumer receives the required disclosures. For example, in providing several options—such as providing directions to the advertiser's place of business—the option allowing the consumer to request disclosures should be provided early in the telephone message to ensure that the option to request disclosures is not obscured by other information.

2. *Statement accompanying telephone number.* Language must accompany a telephone number indicating that disclosures are available by calling the telephone number, such as "call 1–800–000–0000 for details about credit costs and terms."

Subpart C—Closed-End Credit

■ 16. In Supplement I to Part 226, under *Section 226.17—General Disclosure Requirements, 17(c) Basis of disclosures and use of estimates, Paragraph 17(c)(1),* paragraph 17(c)(1)–8 is revised, and under *17(f) Early disclosures,* paragraph 17(f)–4 is revised, to read as follows:

Section 226.17—General Disclosure Requirements

* * * * *

17(c) Basis of disclosures and use of estimates.

* * * * *

Paragraph 17(c)(1).

* * * * *

8. *Basis of disclosures in variable-rate transactions.* The disclosures for a variable-rate transaction must be given for the full term of the transaction and must be based on the terms in effect at the time of consummation. Creditors should base the disclosures only on the initial rate and should not assume that this rate will increase. For example, in a loan with an initial rate of 10 percent and a 5 percentage points rate cap, creditors should base the disclosures on the initial rate and should not assume that this rate will increase 5 percentage points. However, in a variable-rate transaction with a seller buydown that is reflected in the credit contract, a consumer

buydown, or a discounted or premium rate, disclosures should not be based solely on the initial terms. In those transactions, the disclosed annual percentage rate should be a composite rate based on the rate in effect during the initial period and the rate that is the basis of the variable-rate feature for the remainder of the term. (See the commentary to § 226.17(c) for a discussion of buydown, discounted, and premium transactions and the commentary to § 226.19(a)(2) for a discussion of the redisclosure in certain mortgage transactions with a variable-rate feature.)

* * * * *

17(f) Early disclosures.

* * * * *

4. *Special rules.* In mortgage transactions subject to § 226.19, the creditor must redisclose if, between the delivery of the required early disclosures and consummation, the annual percentage rate changes by more than a stated tolerance. When subsequent events occur after consummation, new disclosures are required only if there is a refinancing or an assumption within the meaning of § 226.20.

* * * * *

■ 17. In Supplement I to Part 226, under *Section 226.19—Certain Residential Mortgage and Variable-Rate Transactions,* the heading is revised, heading *19(a)(1) Time of disclosure* is redesignated as heading *19(a)(1)(i) Time of disclosure,* paragraphs 19(a)(1)(i)–1 and 19(a)(1)(i)–5 are revised, new heading *19(a)(1)(ii) Imposition of fees* and new paragraphs 19(a)(1)(ii)–1 through 19(a)(1)(ii)–3 are added , and new heading *19(a)(1)(iii) Exception to fee restriction* and new paragraph 19(a)(1)(iii)–1 are added, to read as follows:

Section 226.19—Certain Mortgage and Variable-Rate Transactions

19(a)(1)(i) Time of disclosure.

1. *Coverage.* This section requires early disclosure of credit terms in mortgage transactions that are secured by a consumer's principal dwelling and also subject to the Real Estate Settlement Procedures Act (RESPA) and its implementing Regulation X, administered by the Department of Housing and Urban Development (HUD). To be covered by § 226.19, a transaction must be a federally related mortgage loan under RESPA. "Federally related mortgage loan" is defined under RESPA (12 U.S.C. 2602) and Regulation X (24 CFR 3500.2), and is subject to any interpretations by HUD. RESPA coverage includes such transactions as loans to purchase dwellings, refinancings of loans secured by dwellings, and subordinate-lien home-equity loans, among others. Although RESPA coverage relates to any dwelling, § 226.19(a) applies to such transactions only if they are secured by a consumer's principal dwelling. Also, home equity lines of credit subject to § 226.5b are not covered by § 226.19(a). For guidance on the applicability of the Board's revisions to § 226.19(a) published on July 30, 2008, see comment 1(d)(5)–1

* * * * *

5. *Itemization of amount financed.* In many mortgage transactions, the itemization of the amount financed required by § 226.18(c) will contain items, such as origination fees or points, that also must be disclosed as part of the good faith estimates of settlement costs required under RESPA. Creditors furnishing the RESPA good faith estimates need not give consumers any itemization of the amount financed, either with the disclosures provided within three days after application or with the disclosures given at consummation or settlement.

19(a)(1)(ii) Imposition of fees.

1. *Timing of fees.* The consumer must receive the disclosures required by this section before paying or incurring any fee imposed by a creditor or other person in connection with the consumer's application for a mortgage transaction that is subject to § 226.19(a)(1)(i), except as provided in § 226.19(a)(1)(iii). If the creditor delivers the disclosures to the consumer in person, a fee may be imposed anytime after delivery. If the creditor places the disclosures in the mail, the creditor may impose a fee after the consumer receives the disclosures or, in all cases, after midnight on the third business day following mailing of the disclosures. For purposes of § 226.19(a)(1)(ii), the term "business day" means all calendar days except Sundays and legal public holidays referred to in § 226.2(a)(6). *See* Comment 2(a)(6)–2. For example, assuming that there are no intervening legal public holidays, a creditor that receives the consumer's written application on Monday and mails the early mortgage loan disclosure on Tuesday may impose a fee on the consumer after midnight on Friday.

2. *Fees restricted.* A creditor or other person may not impose any fee, such as for an appraisal, underwriting, or broker services, until the consumer has received the disclosures required by § 226.19(a)(1)(i). The only exception to the fee restriction allows the creditor or other person to impose a *bona fide* and reasonable fee for obtaining a consumer's credit history, such as for a credit report(s).

3. *Collection of fees.* A creditor complies with § 226.19(a)(1)(ii) if—

i. The creditor receives a consumer's written application directly from the consumer and does not collect any fee, other than a fee for obtaining a consumer's credit history, until the consumer receives the early mortgage loan disclosure.

ii. A third party submits a consumer's written application to a creditor and both the creditor and third party do not collect any fee, other than a fee for obtaining a consumer's credit history, until the consumer receives the early mortgage loan disclosure from the creditor.

iii. A third party submits a consumer's written application to a second creditor following a prior creditor's denial of an application made by the same consumer (or following the consumer's withdrawal), and, if a fee already has been assessed, the new creditor or third party does not collect or impose any additional fee until the consumer receives an early mortgage loan disclosure from the new creditor.

19(a)(1)(iii) Exception to fee restriction.

1. *Requirements.* A creditor or other person may impose a fee before the consumer receives the required disclosures if it is for obtaining the consumer's credit history, such as by purchasing a credit report(s) on the consumer. The fee also must be *bona fide* and reasonable in amount. For example, a creditor may collect a fee for obtaining a credit report(s) if it is in the creditor's ordinary course of business to obtain a credit report(s). If the criteria in § 226.19(a)(1)(iii) are met, the creditor may describe or refer to this fee, for example, as an "application fee."

* * * * *

■ 18. In Supplement I to Part 226, under *Section 226.24—Advertising,* paragraph 24–1 is revised; heading *24(d) Catalogs or other multiple-page advertisements; electronic advertisements* and paragraphs 24(d)–1 through 24(d)–4 are redesignated as heading *24(e) Catalogs or other multiple-page advertisements; electronic advertisements* and paragraphs 24(e)–1 through 24(e)–4, respectively; headings *24(c) Advertisements of terms that require additional disclosures, Paragraph 24(c)(1),* and *Paragraph 24(c)(2)* and paragraphs 24(c)–1, 24(c)(1)–1 through 24(c)(1)–4, and 24(c)(2)–1 through 24(c)(2)–4 are redesignated as headings 24(d) *Advertisements of terms that require additional disclosures, Paragraph 24(d)(1),* and *Paragraph 24(d)(2)* and paragraphs 24(d)–1, 24(d)(1)–1 through 24(d)(1)–4, and 24(d)(2)–1 through 24(d)(2)–4, respectively; heading *24(b) Advertisement of rate of finance charge* and paragraphs 24(b)–1 through 24(b)–5 are redesignated as heading *24(c) Advertisement of rate of finance charge* and paragraphs 24(c)–1 through 24(c)–5, respectively; new heading *24(b) Clear and conspicuous standard* and new paragraphs 24(b)–1 through 24(b)–5 are added; newly designated paragraphs 24(c)–2 and 24(c)–3 are revised, newly designated paragraph 24(c)–4 is removed, and newly designated paragraph 24(c)–5 is further redesignated as 24(c)–4 and revised; newly designated paragraphs 24(d)–1, 24(d)(1)–3, and 24(d)(2)–2 are revised, newly designated paragraphs 24(d)(2)–3 and 24(d)(2)–4 are further redesignated as 24(d)(2)–4 and 24(d)(2)–5, respectively, new paragraph 24(d)(2)–3 is added, and newly designated paragraph 24(d)(2)–5 is revised; newly designated paragraph 24(e)–1, 24(e)–2, and 24(e)–4 are revised; and new headings *24(f) Disclosure of rates and payments in advertisements for credit secured by a dwelling, 24(f)(3) Disclosure of payments, 24(g) Alternative disclosures—television or* *radio advertisements*, and *24(i) Prohibited acts or practices in advertisements for credit secured by a dwelling* and new paragraphs 24(f)–1 through 24(f)–6, 24(f)(3)–1, 24(f)(3)–2, 24(g)–1, 24(g)–2, and 24(i)–1 through 24(i)–3 are added, to read as follows:

Section 226.24—Advertising

1. *Effective date.* For guidance on the applicability of the Board's changes to § 226.24 published on July 30, 2008, see comment 1(d)(5)–1.

* * * * *

24(b) Clear and conspicuous standard.

1. *Clear and conspicuous standard—general.* This section is subject to the general "clear and conspicuous" standard for this subpart, *see* § 226.17(a)(1), but prescribes no specific rules for the format of the necessary disclosures, other than the format requirements related to the advertisement of rates and payments as described in comment 24(b)–2 below. The credit terms need not be printed in a certain type size nor need they appear in any particular place in the advertisement. For example, a merchandise tag that is an advertisement under the regulation complies with this section if the necessary credit terms are on both sides of the tag, so long as each side is accessible.

2. *Clear and conspicuous standard—rates and payments in advertisements for credit secured by a dwelling.* For purposes of § 226.24(f), a clear and conspicuous disclosure means that the required information in §§ 226.24(f)(2)(i) and 226.24(f)(3)(i)(A) and (B) is disclosed with equal prominence and in close proximity to the advertised rates or payments triggering the required disclosures, and that the required information in § 226.24(f)(3)(i)(C) is disclosed prominently and in close proximity to the advertised rates or payments triggering the required disclosures. If the required information in §§ 226.24(f)(2)(i) and 226.24(f)(3)(i)(A) and (B) is the same type size as the advertised rates or payments triggering the required disclosures, the disclosures are deemed to be equally prominent. The information in § 226.24(f)(3)(i)(C) must be disclosed prominently, but need not be disclosed with equal prominence or be the same type size as the payments triggering the required disclosures. If the required information in §§ 226.24(f)(2)(i) and 226.24(f)(3)(i) is located immediately next to or directly above or below the advertised rates or payments triggering the required disclosures, without any intervening text or graphical displays, the disclosures are deemed to be in close proximity. Notwithstanding the above, for electronic advertisements that disclose rates or payments, compliance with the requirements of § 226.24(e) is deemed to satisfy the clear and conspicuous standard.

3. *Clear and conspicuous standard—Internet advertisements for credit secured by a dwelling.* For purposes of this section, a clear and conspicuous disclosure for visual text advertisements on the Internet for credit secured by a dwelling means that the required disclosures are not obscured by techniques such as graphical displays, shading, coloration, or other devices and comply with all other requirements for clear and conspicuous disclosures under § 226.24. *See also* comment 24(e)–4.

4. *Clear and conspicuous standard—televised advertisements for credit secured by a dwelling.* For purposes of this section, including alternative disclosures as provided for by § 226.24(g), a clear and conspicuous disclosure in the context of visual text advertisements on television for credit secured by a dwelling means that the required disclosures are not obscured by techniques such as graphical displays, shading, coloration, or other devices, are displayed in a manner that allows a consumer to read the information required to be disclosed, and comply with all other requirements for clear and conspicuous disclosures under § 226.24. For example, very fine print in a television advertisement would not meet the clear and conspicuous standard if consumers cannot see and read the information required to be disclosed.

5. *Clear and conspicuous standard—oral advertisements for credit secured by a dwelling.* For purposes of this section, including alternative disclosures as provided for by § 226.24(g), a clear and conspicuous disclosure in the context of an oral advertisement for credit secured by a dwelling, whether by radio, television, or other medium, means that the required disclosures are given at a speed and volume sufficient for a consumer to hear and comprehend them. For example, information stated very rapidly at a low volume in a radio or television advertisement would not meet the clear and conspicuous standard if consumers cannot hear and comprehend the information required to be disclosed.

24(c) Advertisement of rate of finance charge.

* * * * *

2. *Simple or periodic rates.* The advertisement may not simultaneously state any other rate, except that a simple annual rate or periodic rate applicable to an unpaid balance may appear along with (but not more conspicuously than) the annual percentage rate. An advertisement for credit secured by a dwelling may not state a periodic rate, other than a simple annual rate, that is applied to an unpaid balance. For example, in an advertisement for credit secured by a dwelling, a simple annual interest rate may be shown in the same type size as the annual percentage rate for the advertised credit, subject to the requirements of section 226.24(f). A simple annual rate or periodic rate that is applied to an unpaid balance is the rate at which interest is accruing; those terms do not include a rate lower than the rate at which interest is accruing, such as an effective rate, payment rate, or qualifying rate.

3. *Buydowns.* When a third party (such as a seller) or a creditor wishes to promote the availability of reduced interest rates (consumer or seller buydowns), the advertised annual percentage rate must be determined in accordance with the commentary to § 226.17(c) regarding the basis of transactional disclosures for buydowns. The seller or creditor may advertise the reduced simple interest rate, provided the advertisement shows the limited term to which the reduced rate applies and states the simple interest rate applicable to the balance of the term. The advertisement may also show the effect of the buydown agreement on the payment schedule for the buydown period, but this will trigger the additional disclosures under § 226.24(d)(2).

4. *Discounted variable-rate transactions.* The advertised annual percentage rate for discounted variable-rate transactions must be determined in accordance with comment 17(c)(1)–10 regarding the basis of transactional disclosures for such financing.

i. A creditor or seller may promote the availability of the initial rate reduction in such transactions by advertising the reduced simple annual rate, provided the advertisement shows with equal prominence and in close proximity the limited term to which the reduced rate applies and the annual percentage rate that will apply after the term of the initial rate reduction expires. *See* § 226.24(f).

ii. Limits or caps on periodic rate or payment adjustments need not be stated. To illustrate using the second example in comment 17(c)(1)–10, the fact that the rate is presumed to be 11 percent in the second year and 12 percent for the remaining 28 years need not be included in the advertisement.

iii. The advertisement may also show the effect of the discount on the payment schedule for the discount period, but this will trigger the additional disclosures under § 226.24(d).

24(d) Advertisement of terms that require additional disclosures.

1. *General rule.* Under § 226.24(d)(1), whenever certain triggering terms appear in credit advertisements, the additional credit terms enumerated in § 226.24(d)(2) must also appear. These provisions apply even if the triggering term is not stated explicitly but may be readily determined from the advertisement. For example, an advertisement may state "80 percent financing available," which is in fact indicating that a 20 percent downpayment is required.

Paragraph 24(d)(1).

* * * * *

3. *Payment amount.* The dollar amount of any payment includes statements such as:

- "Payable in installments of $103".
- "$25 weekly".
- "$500,000 loan for just $1,650 per month".
- "$1,200 balance payable in 10 equal installments".

In the last example, the amount of each payment is readily determinable, even though not explicitly stated. But statements such as "monthly payments to suit your needs" or "regular *monthly* payments" are not deemed to be statements of the amount of any payment.

* * * * *

Paragraph 24(d)(2).

* * * * *

2. *Disclosure of repayment terms.* The phrase "terms of repayment" generally has the same meaning as the "payment schedule" required to be disclosed under § 226.18(g). Section 226.24(d)(2)(ii) provides flexibility to

creditors in making this disclosure for advertising purposes. Repayment terms may be expressed in a variety of ways in addition to an exact repayment schedule; this is particularly true for advertisements that do not contemplate a single specific transaction. Repayment terms, however, must reflect the consumer's repayment obligations over the full term of the loan, including any balloon payment, *see* comment 24(d)(2)–3, not just the repayment terms that will apply for a limited period of time. For example:

i. A creditor may use a unit-cost approach in making the required disclosure, such as "48 monthly payments of $27.83 per $1,000 borrowed."

ii. In an advertisement for credit secured by a dwelling, when any series of payments varies because of the inclusion of mortgage insurance premiums, a creditor may state the number and timing of payments, the fact that payments do not include amounts for mortgage insurance premiums, and that the actual payment obligation will be higher.

iii. In an advertisement for credit secured by a dwelling, when one series of monthly payments will apply for a limited period of time followed by a series of higher monthly payments for the remaining term of the loan, the advertisement must state the number and time period of each series of payments, and the amounts of each of those payments. For this purpose, the creditor must assume that the consumer makes the lower series of payments for the maximum allowable period of time.

3. *Balloon payment; disclosure of repayment terms.* In some transactions, a balloon payment will occur when the consumer only makes the minimum payments specified in an advertisement. A balloon payment results if paying the minimum payments does not fully amortize the outstanding balance by a specified date or time, usually the end of the term of the loan, and the consumer must repay the entire outstanding balance at such time. If a balloon payment will occur when the consumer only makes the minimum payments specified in an advertisement, the advertisement must state with equal prominence and in close proximity to the minimum payment statement the amount and timing of the balloon payment that will result if the consumer makes only the minimum payments for the maximum period of time that the consumer is permitted to make such payments.

4. *Annual percentage rate.* * * *

5. *Use of examples.* A creditor may use illustrative credit transactions to make the necessary disclosures under § 226.24(d)(2). That is, where a range of possible combinations of credit terms is offered, the advertisement may use examples of typical transactions, so long as each example contains all of the applicable terms required by § 226.24(d). The examples must be labeled as such and must reflect representative credit terms made available by the creditor to present and prospective customers.

24(e) Catalogs or other multiple-page advertisements; electronic advertisements.

1. *Definition.* The multiple-page advertisements to which this section refers are advertisements consisting of a series of sequentially numbered pages—for example, a supplement to a newspaper. A mailing consisting of several separate flyers or pieces of promotional material in a single envelope does not constitute a single multiple-page advertisement for purposes of § 226.24(e).

2. *General.* Section 226.24(e) permits creditors to put credit information together in one place in a catalog or other multiple-page advertisement or in an electronic advertisement (such as an advertisement appearing on an Internet Web site). The rule applies only if the advertisement contains one or more of the triggering terms from § 226.24(d)(1). A list of different annual percentage rates applicable to different balances, for example, does not trigger further disclosures under § 226.24(d)(2) and so is not covered by § 226.24(e).

* * * * *

4. *Electronic advertisement.* If an electronic advertisement (such as an advertisement appearing on an Internet Web site) contains the table or schedule permitted under § 226.24(e)(1), any statement of terms set forth in § 226.24(d)(1) appearing anywhere else in the advertisement must clearly direct the consumer to the location where the table or schedule begins. For example, a term triggering additional disclosures may be accompanied by a link that directly takes the consumer to the additional information.

24(f) Disclosure of rates and payments in advertisements for credit secured by a dwelling.

1. *Applicability.* The requirements of § 226.24(f)(2) apply to advertisements for loans where more than one simple annual rate of interest will apply. The requirements of § 226.24(f)(3)(i)(A) require a clear and conspicuous disclosure of each payment that will apply over the term of the loan. In determining whether a payment will apply when the consumer may choose to make a series of lower monthly payments that will apply for a limited period of time, the creditor must assume that the consumer makes the series of lower payments for the maximum allowable period of time. *See* comment 24(d)(2)–2.iii. However, for purposes of § 226.24(f), the creditor may, but need not, assume that specific events which trigger changes to the simple annual rate of interest or to the applicable payments will occur. For example:

i. *Fixed-rate conversion loans.* If a loan program permits consumers to convert their variable-rate loans to fixed rate loans, the creditor need not assume that the fixed-rate conversion option, by itself, means that more than one simple annual rate of interest will apply to the loan under § 226.24(f)(2) and need not disclose as a separate payment under § 226.24(f)(3)(i)(A) the payment that would apply if the consumer exercised the fixed-rate conversion option.

ii. *Preferred-rate loans.* Some loans contain a preferred-rate provision, where the rate will increase upon the occurrence of some event, such as the consumer-employee leaving the creditor's employ or the consumer closing an existing deposit account with the creditor or the consumer revoking an election to make automated payments. A creditor need not assume that the preferred-rate provision, by itself, means that more than one simple annual rate of interest will apply to the loan under § 226.24(f)(2) and the payments that would apply upon occurrence of the event that triggers the rate increase need not be disclosed as a separate payments under § 226.24(f)(3)(i)(A).

iii. *Rate reductions.* Some loans contain a provision where the rate will decrease upon the occurrence of some event, such as if the consumer makes a series of payments on time. A creditor need not assume that the rate reduction provision, by itself, means that more than one simple annual rate of interest will apply to the loan under § 226.24(f)(2) and need not disclose the payments that would apply upon occurrence of the event that triggers the rate reduction as a separate payments under § 226.24(f)(3)(i)(A).

2. *Equal prominence, close proximity.* Information required to be disclosed under §§ 226.24(f)(2)(i) and 226.24(f)(3)(i) that is immediately next to or directly above or below the simple annual rate or payment amount (but not in a footnote) is deemed to be closely proximate to the listing. Information required to be disclosed under §§ 226.24(f)(2)(i) and 226.24(f)(3)(i)(A) and (B) that is in the same type size as the simple annual rate or payment amount is deemed to be equally prominent.

3. *Clear and conspicuous standard.* For more information about the applicable clear and conspicuous standard, see comment 24(b)–2.

4. *Comparisons in advertisements.* When making any comparison in an advertisement between actual or hypothetical credit payments or rates and the payments or rates available under the advertised product, the advertisement must state all applicable payments or rates for the advertised product and the time periods for which those payments or rates will apply, as required by this section.

5. *Application to variable-rate transactions—disclosure of rates.* In advertisements for variable-rate transactions, if a simple annual rate that applies at consummation is not based on the index and margin that will be used to make subsequent rate adjustments over the term of the loan, the requirements of § 226.24(f)(2)(i) apply.

6. *Reasonably current index and margin.* For the purposes of this section, an index and margin is considered reasonably current if:

i. For direct mail advertisements, it was in effect within 60 days before mailing;

ii. For advertisements in electronic form it was in effect within 30 days before the advertisement is sent to a consumer's e-mail address, or in the case of an advertisement made on an Internet Web site, when viewed by the public; or

iii. For printed advertisements made available to the general public, including ones contained in a catalog, magazine, or other generally available publication, it was in effect within 30 days before printing.

24(f)(3) Disclosure of payments.

1. *Amounts and time periods of payments.* Section 226.24(f)(3)(i) requires disclosure of the amounts and time periods of all payments that will apply over the term of the loan. This section may require disclosure of several payment amounts, including any balloon payment. For example, if an

advertisement for credit secured by a dwelling offers $300,000 of credit with a 30-year loan term for a payment of $600 per month for the first six months, increasing to $1,500 per month after month six, followed by a balloon payment of $30,000 at the end of the loan term, the advertisement must disclose the amount and time periods of each of the two monthly payment streams, as well as the amount and timing of the balloon payment, with equal prominence and in close proximity to each other. However, if the final scheduled payment of a fully amortizing loan is not greater than two times the amount of any other regularly scheduled payment, the final payment need not be disclosed.

2. *Application to variable-rate transactions—disclosure of payments.* In advertisements for variable-rate transactions, if the payment that applies at consummation is not based on the index and margin that will be used to make subsequent payment adjustments over the term of the loan, the requirements of § 226.24(f)(3)(i) apply.

24(g) Alternative disclosures—television or radio advertisements.

1. *Multi-purpose telephone number.* When an advertised telephone number provides a recording, disclosures should be provided early in the sequence to ensure that the consumer receives the required disclosures. For example, in providing several options—such as providing directions to the advertiser's place of business—the option allowing the consumer to request disclosures should be provided early in the telephone message to ensure that the option to request disclosures is not obscured by other information.

2. *Statement accompanying telephone number.* Language must accompany a telephone number indicating that disclosures are available by calling the telephone number, such as "call 1–800–000–0000 for details about credit costs and terms."

24(i) Prohibited acts or practices in advertisements for credit secured by a dwelling.

1. *Comparisons in advertisements.* The requirements of § 226.24(i)(2) apply to all advertisements for credit secured by a dwelling, including radio and television advertisements. A comparison includes a claim about the amount a consumer may save under the advertised product. For example, a statement such as "save $300 per month on a $300,000 loan" constitutes an implied comparison between the advertised product's payment and a consumer's current payment.

2. *Misrepresentations about government endorsement.* A statement that the federal Community Reinvestment Act entitles the consumer to refinance his or her mortgage at the low rate offered in the advertisement is prohibited because it conveys a misleading impression that the advertised product is endorsed or sponsored by the federal government.

3. *Misleading claims of debt elimination.* The prohibition against misleading claims of debt elimination or waiver or forgiveness does not apply to legitimate statements that the advertised product may reduce debt payments, consolidate debts, or shorten the term of the debt. Examples of misleading claims of debt elimination or waiver or forgiveness of loan terms with, or obligations to, another creditor of debt include: "Wipe-Out Personal Debts!", "New DEBT-FREE Payment", "Set yourself free; get out of debt today", "Refinance today and wipe your debt clean!", "Get yourself out of debt * * * Forever!", and "Pre-payment Penalty Waiver."

Subpart E—Special Rules for Certain Home Mortgage Transactions

■ 19. In Supplement I to Part 226, under *Section 226.32–Requirements for Certain Closed-End Home Mortgages, 32(a) Coverage,* new heading *Paragraph 32(a)(2)* and new paragraph 32(a)(2)–1 are added, under *32(d) Limitations,* new paragraphs 32(d)–1 and 32(d)–2 are added, and under *32(d)(7) Prepayment penalty exception, Paragraph 32(d)(7)(iii),* paragraphs 32(d)(7)(iii)–1 and 32(d)(7)(iii)–2 are removed and new paragraphs 32(d)(7)(iii)–1 through 32(d)(7)(iii)–3 are added, and new heading *Paragraph 32(d)(7)(iv)* and new paragraphs 32(d)(7)(iv)–1 and 32(d)(7)(iv)–2 are added, to read as follows:

Section 226.32—Requirements for Certain Closed-End Home Mortgages 32(a) Coverage.

* * * * *

Paragraph 32(a)(2).

1. *Exemption limited.* Section 226.32(a)(2) lists certain transactions exempt from the provisions of § 226.32. Nevertheless, those transactions may be subject to the provisions of § 226.35, including any provisions of § 226.32 to which § 226.35 refers. *See* 12 CFR 226.35(a).

* * * * *

32(d) Limitations.

1. *Additional prohibitions applicable under other sections.* Section 226.34 sets forth certain prohibitions in connection with mortgage credit subject to § 226.32, in addition to the limitations in § 226.32(d). Further, § 226.35(b) prohibits certain practices in connection with transactions that meet the coverage test in § 226.35(a). Because the coverage test in § 226.35(a) is generally broader than the coverage test in § 226.32(a), most § 226.32 mortgage loans are also subject to the prohibitions set forth in § 226.35(b) (such as escrows), in addition to the limitations in § 226.32(d).

2. *Effective date.* For guidance on the application of the Board's revisions published on July 30, 2008 to § 226.32, see comment 1(d)(5)–1.

* * * * *

32(d)(7) Prepayment penalty exception.

Paragraph 32(d)(7)(iii).

1. *Calculating debt-to-income ratio.* "Debt" does not include amounts paid by the borrower in cash at closing or amounts from the loan proceeds that directly repay an existing debt. Creditors may consider combined debt-to-income ratios for transactions involving joint applicants. For more information about obligations and inflows that may constitute "debt" or "income" for purposes of § 226.32(d)(7)(iii), see comment 34(a)(4)–6 and comment 34(a)(4)(iii)(C)–1.

2. *Verification.* Creditors shall verify income in the manner described in § 226.34(a)(4)(ii) and the related comments. Creditors may verify debt with a credit report. However, a credit report may not reflect certain obligations undertaken just before or at consummation of the transaction and secured by the same dwelling that secures the transaction. Section 226.34(a)(4) may require creditors to consider such obligations; see comment 34(a)(4)–3 and comment 34(a)(4)(ii)(C)–1.

3. *Interaction with Regulation B.* Section 226.32(d)(7)(iii) does not require or permit the creditor to make inquiries or verifications that would be prohibited by Regulation B, 12 CFR part 202.

Paragraph 32(d)(7)(iv).

1. *Payment change.* Section 226.32(d)(7) sets forth the conditions under which a mortgage transaction subject to this section may have a prepayment penalty. Section 226.32(d)(7)(iv) lists as a condition that the amount of the periodic payment of principal or interest or both may not change during the four-year period following consummation. The following examples show whether prepayment penalties are permitted or prohibited under § 226.32(d)(7)(iv) in particular circumstances.

i. Initial payments for a variable-rate transaction consummated on January 1, 2010 are $1,000 per month. Under the loan agreement, the first possible date that a payment in a different amount may be due is January 1, 2014. A prepayment penalty is permitted with this mortgage transaction provided that the other § 226.32(d)(7) conditions are met, that is: provided that the prepayment penalty is permitted by other applicable law, the penalty expires on or before Dec. 31, 2011, the penalty will not apply if the source of the prepayment funds is a refinancing by the creditor or its affiliate, and at consummation the consumer's total monthly debts do not exceed 50 percent of the consumer's monthly gross income, as verified.

ii. Initial payments for a variable-rate transaction consummated on January 1, 2010 are $1,000 per month. Under the loan agreement, the first possible date that a payment in a different amount may be due is December 31, 2013. A prepayment penalty is prohibited with this mortgage transaction because the payment may change within the four-year period following consummation.

iii. Initial payments for a graduated-payment transaction consummated on January 1, 2010 are $1,000 per month. Under the loan agreement, the first possible date that a payment in a different amount may be due is January 1, 2014. A prepayment penalty is permitted with this mortgage transaction provided that the other § 226.32(d)(7) conditions are met, that is: provided that the prepayment penalty is permitted by other applicable law, the penalty expires on or before December 31, 2011, the penalty will not apply if the source of the prepayment funds is a refinancing by the creditor or its affiliate, and at consummation the consumer's total monthly debts do not exceed 50 percent of the consumer's monthly gross income, as verified.

iv. Initial payments for a step-rate transaction consummated on January 1, 2010 are $1,000 per month. Under the loan agreement, the first possible date that a payment in a different amount may be due is December 31, 2013. A prepayment penalty is prohibited with this mortgage transaction because the payment may change within the four-year period following consummation.

2. *Payment changes excluded.* Payment changes due to the following circumstances are not considered payment changes for purposes of this section:

i. A change in the amount of a periodic payment that is allocated to principal or interest that does not change the total amount of the periodic payment.

ii. The borrower's actual unanticipated late payment, delinquency, or default; and

iii. The borrower's voluntary payment of additional amounts (for example when a consumer chooses to make a payment of interest and principal on a loan that only requires the consumer to pay interest).

* * * * *

■ 20. In Supplement I to Part 226, under *Section 226.34—Prohibited Acts or Practices in Connection with Credit Secured by a Consumer's Dwelling; Open-end Credit,* the heading is revised, and under *34(a) Prohibited acts or practices for loans subject to § 226.32, 34(a)(4) Repayment ability,* paragraphs 34(a)(4)–1 through 34(a)(4)–4 are removed, and new paragraphs 34(a)(4)–1 through 34(a)(4)–7, new heading *34(a)(4)(i) Mortgage-related obligations* and new paragraph 34(a)(4)(i)–1, new heading *34(a)(4)(ii) Verification of repayment ability* and new paragraphs 34(a)(4)(ii)–1 through 34(a)(4)(ii)–3, new heading *Paragraph 34(a)(4)(ii)(A)* and new paragraphs 34(a)(4)(ii)(A)–1 through 34(a)(4)(ii)(A)–5, new heading *Paragraph 34(a)(4)(ii)(B)* and new paragraphs 34(a)(4)(ii)(B)–1 and 34(a)(4)(ii)(B)–2, new heading *Paragraph 34(a)(4)(ii)(C)* and new paragraph 34(a)(4)(ii)(C)–1, new heading *34(a)(4)(iii) Presumption of compliance* and new paragraph 34(a)(4)(iii)–1, new heading *Paragraph 34(a)(4)(iii)(B)* and new paragraph 34(a)(4)(iii)(B)–1, new heading Paragraph *34(a)(4)(iii)(C)* and new paragraph 34(a)(4)(iii)(C)–1, and new heading *34(a)(4)(iv) Exclusions from the presumption of compliance* and new paragraphs 34(a)(4)(iv)–1 and 34(a)(4)(iv)–2, are added to read as follows:

Section 226.34—Prohibited Acts or Practices in Connection with Credit Subject to § 226.32

34(a) Prohibited acts or practices for loans subject to § 226.32.

* * * * *

34(a)(4) Repayment ability.

1. *Application of repayment ability rule.* The § 226.34(a)(4) prohibition against making loans without regard to consumers' repayment ability applies to mortgage loans described in § 226.32(a). In addition, the § 226.34(a)(4) prohibition applies to higher-priced mortgage loans described in § 226.35(a). *See* 12 CFR 226.35(b)(1). For guidance on the application of the Board's revisions to § 226.34(a)(4) published on July 30, 2008, see comment 1(d)(5)–1.

2. *General prohibition.* Section 226.34(a)(4) prohibits a creditor from extending credit subject to § 226.32 to a consumer based on the value of the consumer's collateral without regard to the consumer's repayment ability as of consummation, including the consumer's current and reasonably expected income, employment, assets other than the collateral, current obligations, and property tax and insurance obligations. A creditor may base its determination of repayment ability on current or reasonably expected income from employment or other sources, on assets other than the collateral, or both.

3. *Other dwelling-secured obligations.* For purposes of § 226.34(a)(4), current obligations include another credit obligation of which the creditor has knowledge undertaken prior to or at consummation of the transaction and secured by the same dwelling that secures the transaction subject to § 226.32 or § 226.35. For example, where a transaction subject to § 226.35 is a first-lien transaction for the purchase of a home, a creditor must consider a "piggyback" second-lien transaction of which it has knowledge that is used to finance part of the down payment on the house.

4. *Discounted introductory rates and non-amortizing or negatively-amortizing payments.* A credit agreement may determine a consumer's initial payments using a temporarily discounted interest rate or permit the consumer to make initial payments that are non-amortizing or negatively amortizing. (Negative amortization is permissible for loans covered by § 226.35(a), but not § 226.32). In such cases the creditor may determine repayment ability using the assumptions provided in § 226.34(a)(4)(iv).

5. *Repayment ability as of consummation.* Section 226.34(a)(4) prohibits a creditor from disregarding repayment ability based on the facts and circumstances known to the creditor as of consummation. In general, a creditor does not violate this provision if a consumer defaults because of a significant reduction in income (for example, a job loss) or a significant obligation (for example, an obligation arising from a major medical expense) that occurs after consummation. However, if a creditor has knowledge as of consummation of reductions in income, for example, if a consumer's written application states that the consumer plans to retire within twelve months without obtaining new employment, or states that the consumer will transition from full-time to part-time employment, the creditor must consider that information.

6. *Income, assets, and employment.* Any current or reasonably expected assets or income may be considered by the creditor, except the collateral itself. For example, a creditor may use information about current or expected salary, wages, bonus pay, tips, and commissions. Employment may be full-time, part-time, seasonal, irregular, military, or self-employment. Other sources of income could include interest or dividends; retirement benefits; public assistance; and alimony, child support, or separate maintenance payments. A creditor may also take into account assets such as savings accounts or investments that the consumer can or will be able to use.

7. *Interaction with Regulation B.* Section 226.34(a)(4) does not require or permit the creditor to make inquiries or verifications that would be prohibited by Regulation B, 12 CFR part 202.

34(a)(4)(i) Mortgage-related obligations.

1. *Mortgage-related obligations.* A creditor must include in its repayment ability analysis the expected property taxes and premiums for mortgage-related insurance required by the creditor as set forth in § 226.35(b)(3)(i), as well as similar mortgage-related expenses. Similar mortgage-related expenses include homeowners' association dues and condominium or cooperative fees.

34(a)(4)(ii) Verification of repayment ability.

1. *Income and assets relied on.* A creditor must verify the income and assets the creditor relies on to evaluate the consumer's repayment ability. For example, if a consumer earns a salary and also states that he or she is paid an annual bonus, but the creditor only relies on the applicant's salary to evaluate repayment ability, the creditor need only verify the salary.

2. *Income and assets—co-applicant.* If two persons jointly apply for credit and both list income or assets on the application, the creditor must verify repayment ability with respect to both applicants unless the creditor relies only on the income or assets of one of the applicants in determining repayment ability.

3. *Expected income.* If a creditor relies on expected income, the expectation must be reasonable and it must be verified with third-party documents that provide reasonably reliable evidence of the consumer's expected income. For example, if the creditor relies on an expectation that a consumer will receive an annual bonus, the creditor may verify the basis for that expectation with documents that show the consumer's past annual bonuses and the expected bonus must bear a reasonable relationship to past bonuses. Similarly, if the creditor relies on a consumer's expected salary following the consumer's receipt of an educational degree, the creditor may verify that expectation with a written statement from an employer indicating that the consumer will be employed upon graduation at a specified salary.

Paragraph 34(a)(4)(ii)(A).

1. *Internal Revenue Service (IRS) Form W–2.* A creditor may verify a consumer's income using a consumer's IRS Form W–2 (or any subsequent revisions or similar IRS Forms used for reporting wages and tax withholding). The creditor may also use an electronic retrieval service for obtaining the consumer's W–2 information.

2. *Tax returns.* A creditor may verify a consumer's income or assets using the consumer's tax return. A creditor may also use IRS Form 4506 "Request for Copy of Tax Return," Form 4506–T "Request for Transcript of Tax Return," or Form 8821

"Tax Information Authorization" (or any subsequent revisions or similar IRS Forms appropriate for obtaining tax return information directly from the IRS) to verify the consumer's income or assets. The creditor may also use an electronic retrieval service for obtaining tax return information.

3. *Other third-party documents that provide reasonably reliable evidence of consumer's income or assets.* Creditors may verify income and assets using documents produced by third parties. Creditors may not rely on information provided orally by third parties, but may rely on correspondence from the third party, such as by letter or e-mail. The creditor may rely on any third-party document that provides reasonably reliable evidence of the consumer's income or assets. For example, creditors may verify the consumer's income using receipts from a check-cashing or remittance service, or by obtaining a written statement from the consumer's employer that states the consumer's income.

4. *Information specific to the consumer.* Creditors must verify a consumer's income or assets using information that is specific to the individual consumer. Creditors may use third-party databases that contain individual-specific data about a consumer's income or assets, such as a third-party database service used by the consumer's employer for the purpose of centralizing income verification requests, so long as the information is reasonably current and accurate. Information about average incomes for the consumer's occupation in the consumer's geographic location or information about average incomes paid by the consumer's employer, however, would not be specific to the individual consumer.

5. *Duplicative collection of documentation.* A creditor that has made a loan to a consumer and is refinancing or extending new credit to the same consumer need not collect from the consumer a document the creditor previously obtained if the creditor has no information that would reasonably lead the creditor to believe that document has changed since it was initially collected. For example, if the creditor has obtained the consumer's 2006 tax return to make a home purchase loan in May 2007, the creditor may rely on the 2006 tax return if the creditor makes a home equity loan to the same consumer in August 2007. Similarly, if the creditor has obtained the consumer's bank statement for May 2007 in making the first loan, the creditor may rely on that bank statement for that month in making the subsequent loan in August 2007.

Paragraph 34(a)(4)(ii)(B).

1. *No violation if income or assets relied on not materially greater than verifiable amounts.* A creditor that does not verify income or assets used to determine repayment ability with reasonably reliable third-party documents does not violate § 226.34(a)(4)(ii) if the creditor demonstrates that the income or assets it relied upon were not materially greater than the amounts that the creditor would have been able to verify pursuant to § 226.34(a)(4)(ii). For example, if a creditor determines a consumer's repayment ability by relying on the consumer's annual income of $40,000 but fails to obtain documentation of that amount before extending the credit, the creditor will not have violated this section if the creditor later obtains evidence that would satisfy § 226.34(a)(4)(ii)(A), such as tax return information, showing that the creditor could have documented, at the time the loan was consummated, that the consumer had an annual income not materially less than $40,000.

2. *Materially greater than.* Amounts of income or assets relied on are not materially greater than amounts that could have been verified at consummation if relying on the verifiable amounts would not have altered a reasonable creditor's decision to extend credit or the terms of the credit.

Paragraph 34(a)(4)(ii)(C).

1. *In general.* A credit report may be used to verify current obligations. A credit report, however, might not reflect an obligation that a consumer has listed on an application. The creditor is responsible for considering such an obligation, but the creditor is not required to independently verify the obligation. Similarly, a creditor is responsible for considering certain obligations undertaken just before or at consummation of the transaction and secured by the same dwelling that secures the transaction (for example, a "piggy back" loan), of which the creditor knows, even if not reflected on a credit report. *See* comment 34(a)(4)–3.

34(a)(4)(iii) Presumption of compliance.

1. *In general.* A creditor is presumed to have complied with § 226.34(a)(4) if the creditor follows the three underwriting procedures specified in paragraph 34(a)(4)(iii) for verifying repayment ability, determining the payment obligation, and measuring the relationship of obligations to income. The procedures for verifying repayment ability are required under paragraph 34(a)(4)(ii); the other procedures are not required but, if followed along with the required procedures, create a presumption that the creditor has complied with § 226.34(a)(4). The consumer may rebut the presumption with evidence that the creditor nonetheless disregarded repayment ability despite following these procedures. For example, evidence of a very high debt-to-income ratio and a very limited residual income could be sufficient to rebut the presumption, depending on all of the facts and circumstances. If a creditor fails to follow one of the non-required procedures set forth in paragraph 34(a)(4)(iii), then the creditor's compliance is determined based on all of the facts and circumstances without there being a presumption of either compliance or violation.

Paragraph 34(a)(4)(iii)(B).

1. *Determination of payment schedule.* To retain a presumption of compliance under § 226.34(a)(4)(iii), a creditor must determine the consumer's ability to pay the principal and interest obligation based on the maximum scheduled payment in the first seven years following consummation. In general, a creditor should determine a payment schedule for purposes of § 226.34(a)(4)(iii)(B) based on the guidance in the staff commentary to § 226.17(c)(1). Examples of how to determine the maximum scheduled payment in the first seven years are provided as follows (all payment amounts are rounded):

i. *Balloon-payment loan; fixed interest rate.* A loan in an amount of $100,000 with a fixed interest rate of 8.0 percent (no points) has a 7-year term but is amortized over 30 years. The monthly payment scheduled for 7 years is $733 with a balloon payment of remaining principal due at the end of 7 years. The creditor will retain the presumption of compliance if it assesses repayment ability based on the payment of $733.

ii. *Fixed-rate loan with interest-only payment for five years.* A loan in an amount of $100,000 with a fixed interest rate of 8.0 percent (no points) has a 30-year term. The monthly payment of $667 scheduled for the first 5 years would cover only the interest due. After the fifth year, the scheduled payment would increase to $772, an amount that fully amortizes the principal balance over the remaining 25 years. The creditor will retain the presumption of compliance if it assesses repayment ability based on the payment of $772.

iii. *Fixed-rate loan with interest-only payment for seven years.* A loan in an amount of $100,000 with a fixed interest rate of 8.0 percent (no points) has a 30-year term. The monthly payment of $667 scheduled for the first 7 years would cover only the interest due. After the seventh year, the scheduled payment would increase to $793, an amount that fully amortizes the principal balance over the remaining 23 years. The creditor will retain the presumption of compliance if it assesses repayment ability based on the interest-only payment of $667.

iv. *Variable-rate loan with discount for five years.* A loan in an amount of $100,000 has a 30-year term. The loan agreement provides for a fixed interest rate of 7.0 percent for an initial period of 5 years. Accordingly, the payment scheduled for the first 5 years is $665. The agreement provides that, after 5 years, the interest rate will adjust each year based on a specified index and margin. As of consummation, the sum of the index value and margin (the fully-indexed rate) is 8.0 percent. Accordingly, the payment scheduled for the remaining 25 years is $727. The creditor will retain the presumption of compliance if it assesses repayment ability based on the payment of $727.

v. *Variable-rate loan with discount for seven years.* A loan in an amount of $100,000 has a 30-year term. The loan agreement provides for a fixed interest rate of 7.125 percent for an initial period of 7 years. Accordingly, the payment scheduled for the first 7 years is $674. After 7 years, the agreement provides that the interest rate will adjust each year based on a specified index and margin. As of consummation, the sum of the index value and margin (the fully-indexed rate) is 8.0 percent. Accordingly, the payment scheduled for the remaining years is $725. The creditor will retain the presumption of compliance if it assesses repayment ability based on the payment of $674.

vi. *Step-rate loan.* A loan in an amount of $100,000 has a 30-year term. The agreement provides that the interest rate will be 5 percent for two years, 6 percent for three years, and 7 percent thereafter. Accordingly, the payment amounts are $537 for two years, $597 for three years, and $654 thereafter. To retain the presumption of compliance, the creditor must assess repayment ability based on the payment of $654.

Paragraph 34(a)(4)(iii)(C).

1. *"Income" and "debt".* To determine whether to classify particular inflows or obligations as "income" or "debt," creditors may look to widely accepted governmental and non-governmental underwriting standards, including, for example, those set forth in the Federal Housing Administration's handbook on Mortgage Credit Analysis for Mortgage Insurance on One- to Four-Unit Mortgage Loans.

34(a)(4)(iv) Exclusions from the presumption of compliance.

1. *In general.* The exclusions from the presumption of compliance should be interpreted consistent with staff comments 32(d)(1)(i)–1 and 32(d)(2)–1.

2. *Renewable balloon loan.* If a creditor is unconditionally obligated to renew a balloon-payment loan at the consumer's option (or is obligated to renew subject to conditions within the consumer's control), the full term resulting from such renewal is the relevant term for purposes of the exclusion of certain balloon-payment loans. See comment 17(c)(1)–11 for a discussion of conditions within a consumer's control in connection with renewable balloon-payment loans.

* * * * *

■ 21. In Supplement I to Part 226, a new *Section 226.35—Prohibited Acts or Practices in Connection with Higher-priced Mortgage Loans* is added to read as follows:

Section 226.35—Prohibited Acts or Practices in Connection With Higher-priced Mortgage Loans

35(a) *Higher-priced mortgage loans.*

Paragraph 35(a)(2).

1. *Average prime offer rate.* Average prime offer rates are annual percentage rates derived from average interest rates, points, and other loan pricing terms currently offered to consumers by a representative sample of creditors for mortgage transactions that have low-risk pricing characteristics. Other pricing terms include commonly used indices, margins, and initial fixed-rate periods for variable-rate transactions. Relevant pricing characteristics include a consumer's credit history and transaction characteristics such as the loan-to-value ratio, owner-occupant status, and purpose of the transaction. To obtain average prime offer rates, the Board uses a survey of creditors that both meets the criteria of § 226.35(a)(2) and provides pricing terms for at least two types of variable-rate transactions and at least two types of non-variable-rate transactions. An example of such a survey is the Freddie Mac Primary Mortgage Market Survey®.

2. *Comparable transaction.* A higher-priced mortgage loan is a consumer credit transaction 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 is set by the specified margin. The table of average prime offer rates published by the Board indicates how to identify the comparable transaction.

3. *Rate set.* A transaction's annual percentage rate is compared to the average prime offer rate as of the date the transaction's interest rate is set (or "locked") before consummation. Sometimes a creditor sets the interest rate initially and then re-sets it at a different level before consummation. The creditor should use the last date the interest rate is set before consummation.

4. *Board table.* The Board publishes on the Internet, in table form, average prime offer rates for a wide variety of transaction types. The Board calculates an annual percentage rate, consistent with Regulation Z (see § 226.22 and appendix J), for each transaction type for which pricing terms are available from a survey. The Board estimates annual percentage rates for other types of transactions for which direct survey data are not available based on the loan pricing terms available in the survey and other information. The Board publishes on the Internet the methodology it uses to arrive at these estimates.

35(b) Rules for higher-priced mortgage loans.

1. *Effective date.* For guidance on the applicability of the rules in § 226.35(b), see comment 1(d)(5)–1.

Paragraph 35(b)(2)(ii)(C).

1. *Payment change.* Section 226.35(b)(2) provides that a loan subject to this section may not have a penalty described by § 226.32(d)(6) unless certain conditions are met. Section 226.35(b)(2)(ii)(C) lists as a condition that the amount of the periodic payment of principal or interest or both may not change during the four-year period following consummation. For examples showing whether a prepayment penalty is permitted or prohibited in connection with particular payment changes, see comment 32(d)(7)(iv)–1. Those examples, however, include a condition that § 226.35(b)(2) does not include: the condition that, at consummation, the consumer's total monthly debt payments may not exceed 50 percent of the consumer's monthly gross income. For guidance about circumstances in which payment changes are not considered payment changes for purposes of this section, see comment 32(d)(7)(iv)–2.

2. *Negative amortization.* Section 226.32(d)(2) provides that a loan described in § 226.32(a) may not have a payment schedule with regular periodic payments that cause the principal balance to increase. Therefore, the commentary to § 226.32(d)(7)(iv) does not include examples of payment changes in connection with negative amortization. The following examples show whether, under § 226.35(b)(2), prepayment penalties are permitted or prohibited in connection with particular payment changes, when a loan agreement permits negative amortization:

i. Initial payments for a variable-rate transaction consummated on January 1, 2010 are $1,000 per month and the loan agreement permits negative amortization to occur. Under the loan agreement, the first date that a scheduled payment in a different amount may be due is January 1, 2014 and the creditor does not have the right to change scheduled payments prior to that date even if negative amortization occurs. A prepayment penalty is permitted with this mortgage transaction provided that the other § 226.35(b)(2) conditions are met, that is: provided that the prepayment penalty is permitted by other applicable law, the penalty expires on or before December 31, 2011, and the penalty will not apply if the source of the prepayment funds is a refinancing by the creditor or its affiliate.

ii. Initial payments for a variable-rate transaction consummated on January 1, 2010 are $1,000 per month and the loan agreement permits negative amortization to occur. Under the loan agreement, the first date that a scheduled payment in a different amount may be due is January 1, 2014, but the creditor has the right to change scheduled payments prior to that date if negative amortization occurs. A prepayment penalty is prohibited with this mortgage transaction because the payment may change within the four-year period following consummation.

35(b)(3) Escrows.

Paragraph 35(b)(3)(i).

1. Section 226.35(b)(3) applies to principal dwellings, including structures that are classified as personal property under state law. For example, an escrow account must be established on a higher-priced mortgage loan secured by a first-lien on a mobile home, boat or a trailer used as the consumer's principal dwelling. *See* the commentary under §§ 226.2(a)(19), 226.2(a)(24), 226.15 and 226.23. Section 226.35(b)(3) also applies to higher-priced mortgage loans secured by a first lien on a condominium or a cooperative unit if it is in fact used as principal residence.

2. *Administration of escrow accounts.* Section 226.35(b)(3) requires creditors to establish before the consummation of a loan secured by a first lien on a principal dwelling an escrow account for payment of property taxes and premiums for mortgage-related insurance required by creditor. Section 6 of RESPA, 12 U.S.C. 2605, and Regulation X address how escrow accounts must be administered.

3. *Optional insurance items.* Section 226.35(b)(3) does not require that escrow accounts be established for premiums for mortgage-related insurance that the creditor does not require in connection with the credit transaction, such as an earthquake insurance or debt-protection insurance.

Paragraph 35(b)(3)(ii)(B).

1. *Limited exception.* A creditor is required to escrow for payment of property taxes for all first lien loans secured by condominium units regardless of whether the creditors escrows insurance premiums for condominium unit.

■ 22. In Supplement I to Part 226, a new *Section 226.36—Prohibited Acts or Practices in Connection with Credit Secured by a Consumer's Principal Dwelling* is added to read as follows:

Section 226.36—Prohibited Acts or Practices in Connection With Credit Secured by a Consumer's Principal Dwelling

1. *Effective date.* For guidance on the applicability of the rules in § 226.36, see comment 1(d)(5)–1.

36(a) Mortgage broker defined.

1. *Meaning of mortgage broker.* Section 226.36(a) provides that a mortgage broker is any person who for compensation or other monetary gain arranges, negotiates, or otherwise obtains an extension of consumer credit for another person, but is not an employee of a creditor. In addition, this definition expressly includes any person that satisfies this definition but makes use of "table funding." Table funding occurs when a transaction is consummated with the debt obligation initially payable by its terms to one person, but another person provides the funds for the transaction at consummation and receives an immediate assignment of the note, loan contract, or other evidence of the debt obligation. Although § 226.2(a)(17)(1)(B) provides that a person to whom a debt obligation is initially payable on its face generally is a creditor, § 226.36(a) provides that, solely for the purposes of § 226.36, such a person is considered a mortgage broker. In addition, although consumers themselves often arrange, negotiate, or otherwise obtain extensions of consumer credit on their own behalf, they do not do so for compensation or other monetary gain or for another person and, therefore, are not mortgage brokers under this section.

36(b) Misrepresentation of value of consumer's principal dwelling.

36(b)(2) When extension of credit prohibited.

1. *Reasonable diligence.* A creditor will be deemed to have acted with reasonable diligence under § 226.36(b)(2) if the creditor extends credit based on an appraisal other than the one subject to the restriction in § 226.36(b)(2).

2. *Material misstatement or misrepresentation.* Section 226.36(b)(2) prohibits a creditor who knows of a violation of § 226.36(b)(1) in connection with an appraisal from extending credit based on such appraisal, unless the creditor documents that it has acted with reasonable diligence to determine that the appraisal does not materially misstate or misrepresent the value of such dwelling. A misstatement or misrepresentation of such dwelling's value is not material if it does not affect the credit decision or the terms on which credit is extended.

36(c) Servicing practices.

Paragraph 36(c)(1)(i).

1. *Crediting of payments.* Under § 226.36(c)(1)(i), a mortgage servicer must credit a payment to a consumer's loan account as of the date of receipt. This does not require that a mortgage servicer post the payment to the consumer's loan account on a particular date; the servicer is only required to credit the payment *as of* the date of receipt. Accordingly, a servicer that receives a payment on or before its due date (or within any grace period), and does not enter the payment on its books or in its system until after the payment's due date (or expiration of any grace period), does not violate this rule as long as the entry does not result in the imposition of a late charge, additional interest, or similar penalty to the consumer, or in the reporting of negative information to a consumer reporting agency.

2. *Payments to be credited.* Payments should be credited based on the legal obligation between the creditor and consumer. The legal obligation is determined by applicable state or other law.

3. *Date of receipt.* The "date of receipt" is the date that the payment instrument or other means of payment reaches the mortgage servicer. For example, payment by check is received when the mortgage servicer receives it, not when the funds are collected. If the consumer elects to have payment made by a third-party payor such as a financial institution, through a preauthorized payment or telephone bill-payment arrangement, payment is received when the mortgage servicer receives the third-party payor's check or other transfer medium, such as an electronic fund transfer.

Paragraph 36(c)(1)(ii).

1. *Pyramiding of late fees.* The prohibition on pyramiding of late fees in this subsection should be construed consistently with the "credit practices rule" of Regulation AA, 12 CFR 227.15.

Paragraph 36(c)(1)(iii).

1. *Reasonable time.* The payoff statement must be provided to the consumer, or person acting on behalf of the consumer, within a reasonable time after the request. For example, it would be reasonable under most circumstances to provide the statement within five business days of receipt of a consumer's request. This time frame might be longer, for example, when the servicer is experiencing an unusually high volume of refinancing requests.

2. *Person acting on behalf of the consumer.* For purposes of § 226.36(c)(1)(iii), a person acting on behalf of the consumer may include the consumer's representative, such as an attorney representing the individual, a non-profit consumer counseling or similar organization, or a creditor with which the consumer is refinancing and which requires the payoff statement to complete the refinancing. A servicer may take reasonable measures to verify the identity of any person acting on behalf of the consumer and to obtain the consumer's authorization to release information to any such person before the "reasonable time" period begins to run.

3. *Payment requirements.* The servicer may specify reasonable requirements for making payoff requests, such as requiring requests to be in writing and directed to a mailing address, e-mail address or fax number specified by the servicer or orally to a telephone number specified by the servicer, or any other reasonable requirement or method. If the consumer does not follow these requirements, a longer time frame for responding to the request would be reasonable.

4. *Accuracy of payoff statements.* Payoff statements must be accurate when issued.

Paragraph 36(c)(2).

1. *Payment requirements.* The servicer may specify reasonable requirements for making payments in writing, such as requiring that payments be accompanied by the account number or payment coupon; setting a cut-off hour for payment to be received, or setting different hours for payment by mail and payments made in person; specifying that only checks or money orders should be sent by mail; specifying that payment is to be made in U.S. dollars; or specifying one particular address for receiving payments, such as a post office box. The servicer may be prohibited, however, from requiring payment solely by preauthorized electronic fund transfer. (*See* section 913 of the Electronic Fund Transfer Act, 15 U.S.C. 1693k.)

2. *Payment requirements—limitations.* Requirements for making payments must be reasonable; it should not be difficult for most consumers to make conforming payments. For example, it would be reasonable to require a cut-off time of 5 p.m. for receipt of a mailed check at the location specified by the servicer for receipt of such check.

3. *Implied guidelines for payments.* In the absence of specified requirements for making payments, payments may be made at any location where the servicer conducts business; any time during the servicer's normal business hours; and by cash, money order, draft, or other similar instrument in properly negotiable form, or by electronic fund transfer if the servicer and consumer have so agreed.

By order of the Board of Governors of the Federal Reserve System, July 15, 2008.

Jennifer J. Johnson,

Secretary of the Board.

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