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CREDIT UNION EXECUTIVE NEWS

March 20, 2008

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FASTEN YOUR SEAT BELT — RESPA CHANGES COMING

The Department of Housing and Urban Development ("HUD") has been toying with RESPA changes in various forms since the late 1990s. It issued a proposal in 2002, withdrew the proposal in 2004, conducted workshops and solicited public input, and no doubt spent countless hours in endless meetings discussing the issues - in other words, everyday federal government business. Prompted by the recent mortgage market troubles, especially in the subprime lending area, on March 14, 2008, HUD published a new proposal that would substantially overhaul the mortgage origination process. Public comments on the proposal are due to HUD by May 13, 2008.

The proposal is designed to:

- Standardize and simplify the good faith estimate ("GFE") form so that consumers can more easily shop among various service providers before making a commitment.
- Add a summary of key loan terms to the GFE of settlement costs.
- Hold mortgage originators more strictly to the cost estimates included in the GFE.
- Provide clearer upfront disclosure of yield spread premiums.
- Provide a standard "closing script" to go with the HUD-1 or HUD-1A so that final loan and settlement terms are uniformly disclosed.
- The proposal seeks to achieve these goals by imposing several new requirements and restrictions on the loan application process.

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GFE Application

Currently, lenders or brokers must provide borrowers a GFE within three business days after receiving an application. The proposal would require a GFE when the loan originator (i.e., broker or lender) receives six basic pieces of information.

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FASTEN YOUR SEAT BELTS — RESPA CHANGES COMING (CONT.)

The proposal calls this information a "GFE Application," which is a "written or oral submission to a loan originator by a prospective borrower to obtain a GFE for a specific loan product."

The originator may require only the following information in a GFE application:

- Name;
- Social security number;
- Property address;
- Borrower's monthly income;
- Borrower's estimate of property value; and
- Mortgage loan amount sought.

If the GFE is submitted orally, the originator must convert it to a written or electronic record. The GFE requirement is triggered when the originator receives a GFE application or information sufficient to complete a GFE application. Thus, if an applicant provides the information listed above, the originator must provide a GFE even if the applicant does not provide the information in support of a specific application.

Presumably (though it is not clear from the regulation), the borrower must also identify a specific loan product in order to trigger the GFE requirement. The credit union may not require payment of any fees for underwriting or loan costs as a condition of providing the GFE, except the cost of providing the GFE, including the cost of an initial credit report. This limitation is imposed in order to allow borrowers to shop among originators without having to commit money to each originator.

Originators are excused from providing the GFE if within three business days after receiving the GFE application, the originator denies the GFE application or the full mortgage application, or the applicant withdraws the GFE application.

The GFE terms (other than interest rate if the rate was not locked in) must be available to the borrower until ten business days after the delivery of the GFE. If a full loan application is delivered to the originator within the ten business days, the GFE terms must remain available until closing.

Content of GFE

Currently, the GFE is essentially a slimmed-down version of the HUD-1. The proposal would dramatically alter the GFE form. The revised GFE would include:

- Key dates: expiration of interest rate offered; date that estimate for settlement charges expires; and expiration of loan terms offered
- Summary of loan terms: initial balance; loan term; initial interest rate; initial payment for principal, interest, and mortgage insurance; rate lock period; whether interest rate, loan balance, and monthly payment amount (principal, interest, and mortgage insurance) can rise; prepayment penalty; balloon payment; and whether an escrow is available
- Summary of settlement charges:
  - origination charges (paid to lender and broker)
  - third party charges
- Itemization of settlement charges
- Brief comparison of two alternative loans (if available from originator); one at a lower rate (presumably with higher settlement charges) and one with lower settlement charges (presumably at a higher rate). The comparison includes following information in table format for all three loans:
  - the loan amount
  - initial interest rate
  - monthly payment
  - difference between the monthly payment and GFE payment
  - difference between the settlement charges and GFE settlement charges
  - total settlement charges
- Disclosure of estimated additional charges often associated with mortgages: property taxes, homeowner's insurance, homeowner's association fees, and any other anticipated charges, expenses, or assessments

There is also lots of "boilerplate" explanatory information on the form written by HUD.

Cont. p 3

The credit union may not require payment of any fees for underwriting or loan costs as a condition of providing the GFE, except the cost of providing the GFE, including the cost of an initial credit report.

FASTEN YOUR SEAT BELTS — RESPA CHANGES COMING (CONT.)

Limited Variance Between GFE Costs and Final Settlement Costs

The proposal would impose substantial limitations on the permissible variance between costs shown in the GFE and final costs imposed at settlement. Barring unforeseen circumstances, the final charge for the following items may not exceed the charge shown on the GFE:

- Origination fee
- Points paid or credit received by borrower based on rate
- Government recording and transfer charges

In addition, the aggregate amount charged to the borrower for the following services may not exceed the GFE amount by more than 10%:

- Lender-required settlement services where the lender chooses the provider
- Lender required services and optional owner's title insurance if the borrower uses a provider identified by the originator

One result of these changes is that borrowers would be able to see the total compensation paid to the originator, and to determine whether any interest rate-based credit (i.e., yield spread premium) would go to the originator or would be go to the borrower. If the transaction is a new home purchase and settlement is anticipated to be more than 60 days after the GFE application is submitted, the originator may include a clear and conspicuous statement that a revised GFE may be issued at any time up until 60 days prior to closing.

HUD believes that these limitations will substantially reduce the potential for "bait and switch" tactics by loan originators. In addition, while "markups" of third party fees are not prohibited, all compensation paid to the originator must be disclosed on the GFE and the HUD-1 as part of the service charge payable to the lender. The amounts disclosed as third party fees may only include amounts actually paid to third parties, and may not include any originator markup.

Availability of Loan on Specified Terms

If a borrower receives a GFE and decides to pursue an application with the originator, the originator may require a full mortgage application containing additional information not included in the GFE application. However, if information in the GFE is sufficient to deny the loan application, the lender must deny it before accepting a full mortgage application.

Once the lender accepts the full mortgage application, the loan may not be denied based on information that was supplied in the GFE application unless there has been a change in that information (i.e., reduction in the borrower's monthly income) or unless unforeseeable circumstances or other final underwriting issues (i.e., property value is not supported by appraisal) form a basis for denying the loan. Absent such changes or unforeseen circumstances, the lender must make the loan available on the terms specified in the GFE.

HUD-1 and Closing Script

The proposal includes several changes to the HUD-1 settlement statement, primarily in the 800 and 900 sections regarding items payable in advance or at closing in connection with the loan. However, the most significant change is the requirement to include a "closing script" with the settlement statement. The closing script includes basic descriptions of the loan details (interest rate, payment, late fees, negative amortization, prepayment penalty, balloon, and closing costs).

The closing cost information includes a direct comparison of the GFE estimates and the final HUD-1 charges. The closing script requires the lender to select from among a list of alternative descriptions of these items; for the most part, the lender may not vary the language used.

The closing agent must read the script to the borrower at closing, and provided to the borrower in written format with the HUD-1. If the borrower requests, the lender must make the HUD-1 and closing script available 24 hours before the closing.

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RESPA CHANGES (CONT.)

Impact on Credit Unions

This reform proposal would significantly alter the way credit unions and other settlement service providers do business. Credit unions will have to be confident enough in preliminary underwriting to make a binding approval, subject only final underwriting on matters not included in the GFE. Credit unions will also have to arrange with settlement service providers (such as title companies) for more firm estimates of settlement fees and charges. There will be significant compliance training and changes in procedures required. The only good news we can share is that home equity lines of credit, which are not subject to existing GFE and HUD-1 requirements, will not be impacted by this proposal.

Hal Scoggins

UNINSURED SHARES BECOME INSURED? NEW NCUA EXAMINATION FOCUS

In recent weeks, NCUA Region V examiners have added a new focus to their examinations: the balance of uninsured shares reported on credit union call reports. Although the call reports (NCUA 5300) do not determine the actual amount of a credit union's insured shares (that is determined by NCUA in the event of a liquidation), a credit union's NCUSIF deposits are calculated based on the amount of insured shares on its call report. In recent months, NCUA examiners have requested credit unions to provide documentary support for their uninsured shares calculation.

If credit unions are unable to provide adequate support for their calculation, examiners have threatened to require an immediate increase in the amount of the credit union's NCUSIF deposit. This deposit is an asset, but is not counted toward capital for PCA purposes. Thus, an increase in the deposit can negatively impact a credit union's net worth.

UNINSURED SHARES (CONT.)

Calculation Issues

The problem is that credit unions have traditionally calculated uninsured shares on a "best estimate" basis, due to data processing constraints and a lack of all the information that would be needed to calculate the amount of uninsured shares accurately. For example, many DP systems are unable to match joint owners across various accounts and accurately assess the impact of a person's joint ownership interests in multiple accounts.

In addition, most credit unions do not have the information available to determine if beneficiaries on a POD account or an account for a living trust are within the special class (spouse, child, grandchild, parent, or sibling) that is separately insured. In fact, as to living trusts, the NCUA Regulations (Section 745.5 (e)) specify that the credit union's records do not need to indicate the names of the beneficiaries or their relationships to the grantor/trustor in order to qualify for the separate coverage.

Most credit unions look at account balances over $100,000, cull out the amounts that they can readily determine are insured, and report the rest as uninsured. Everyone has always recognized that this probably results in over reporting of uninsured shares, but no one has ever paid much attention to it. In the event of an actual credit union failure or liquidation, the insurance and payout determinations would be made by NCUA based on the credit union's records (not the 5300 reports) and on records and documents provided by members to back up their claims.

Potential Impact

The total uninsured shares reported for Region V as of 12/31/07 was about $29 billion. A 50% reduction in reported uninsured shares would require Region V credit unions to collectively deposit almost $73 million to the fund (an average of about $64,000 for each credit union that reports any uninsured shares).

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UNINSURED SHARES (CONT.)

NCUA's approach to this issue raises several concerns.

- NCUA needs to provide uniform treatment of this issue across all regions; it is not fair to have the NCUSIF deposit calculated one way for credit unions in some regions and a different way in others.
- Even with improvements, credit unions may never achieve anything close to true accurate reporting of uninsured shares because of the lack of information needed to make determinations about some accounts.
- Some data processors are simply unable to provide the support necessary to make the calculations that Region V examiners are asking for. It is difficult for credit unions to pressure data processors to make changes when only one NCUA region is raising this issue.
- If NCUA insurance regulations expressly provide that credit unions do not need to maintain records about beneficiaries in order to obtain enhanced insurance, how can NCUA require credit unions to make insurance calculations based on that same beneficiary information?

Hal Scoggins

REGULATION Z TO IMPOSE NEW RESTRICTIONS AND DISCLOSURE REQUIREMENTS ON MORTGAGE LOANS

On December 20, 2007, the Federal Reserve Board (FRB) issued a sweeping proposal that would amend Regulation Z to impose new restrictions and disclosure requirements on mortgage loans.

Public comments on the proposal are due to the FRB by April 8, 2008. A final rule is expected in late spring or early summer.

There are several different categories of proposed changes, with each category applying to a different class of mortgage loans. Here is a brief overview of the proposed changes.

REGULATION Z (CONT.)

1. **Good Faith Estimate of TIL Disclosures.** Regulation Z § 226.19 currently requires lenders to provide good faith estimates of the "Fed Box" Truth-in-Lending (TIL) disclosures within three days after receiving an application for any purchase money mortgage transactions. The proposal would expand this requirement to apply to any mortgage transaction that is subject to RESPA and secured by the consumer's principal dwelling. Home equity lines of credit would be excluded.

2. **Restrictions on All Dwelling Secured Loans.** A new Section 226.36 would impose a series of prohibitive practices and substantive restrictions on any loan secured by a consumer's principal dwelling (including real property or non-real property loans). All of these requirements would apply to any loan secured by the consumer's principal dwelling, irrespective of the interest rate or fees and points charged for the loan.

   a. **Contract/Disclosure Required for Broker Payments**. Section 226.36(a) would prohibit payments to mortgage brokers in excess of the amount stated in a written agreement (with mandatory warnings) between the borrower and the mortgage broker. The contract must disclose both "front end" payments (i.e. payments made at closing and charged directly to the borrower) and "back end" payments (i.e. yield spread premiums). This provision is intended to alert borrowers to the existence of a yield spread premium well before closing.

   b. **Appraiser Coercion Prohibited.** Section 226.36(b) would prohibit lenders and mortgage brokers from coercing or influencing appraisers to misrepresent the value of the borrower's dwelling.

   c. **Loan Servicing Requirements.** Section 226.36(d) would impose a number of servicing requirements:

      i. Servicers must credit payments as of the date received;

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Who stands behind your Credit Union compliance?

REGULATION Z TO IMPOSE NEW RESTRICTIONS (CONT.)

ii. Servicers are prohibited from "pyramiding" late fees by charging new late fees when the only delinquency on the account is attributable to prior late fees;

iii. Servicers must provide borrowers with a list of all fees and charges that could be imposed on the borrower in connection with servicing the loan; and

iv. Servicers must provide a payoff statement within a reasonable time after receiving a request from the borrower or the borrower's agent.

3. **Advertising Requirements For Dwelling Secured Loans.** Advertisements for loans secured by the borrower's principal dwelling would be subject to several new requirements:

   a. **Balloon Payments.** For a balloon payment loan, if the advertisement discloses sample repayment terms, the sample must include a balloon payment;

   b. **Simple Rates.** If an advertisement discloses a simple rate in addition to the APR, all anticipated simple rates that would apply over the life of the loan must be included. For example, if the loan is a variable rate loan with a discounted initial rate, and the advertisement states a simple interest rate, it must state both the discounted initial rate and the fully indexed rate expected to apply at the end of the initial rate period. In addition, the time periods for which each disclosed rate will apply must be stated;

   c. **Payments.** If payments are disclosed in the advertisement, the advertisement must disclose all anticipated payment streams for the loan. For example, if payments based on an initial discounted rate are disclosed, the advertisement must also state the anticipated payments after the discount period ends; and

   d. **Misleading Ads.** A number of specific practices deemed "misleading" are prohibited, most importantly including the use of the word "fixed" to refer to rates or payments for a variable rate transaction.

4. **Restrictions on "Higher Priced" Mortgage Loans.** The proposal would add a new Section 226.35 imposing several restrictions on "higher priced mortgage loans." A higher priced mortgage loan is one that is secured by the consumer's principal dwelling, and in which the APR exceeds the yield on "comparable" U.S. Treasury securities by three or more percentage points for first lien transactions, and five or more percentage points for second lien transactions. "Comparable" Treasury security yield for a particular loan is not simply securities of the same term, but is determined by a scale.

   For February 15, 2008, the applicable Treasury constant maturity yields were 2.02% (for 1 year securities) and 3.76% (for 10 year securities). Thus, for the second half of February 2008, a fixed rate first lien transaction of 20 years or more would be a "higher-priced" loan if its APR exceeded 6.76%. A second lien fixed rate transaction of 20 years or more would be a "higher-priced" loan if its APR exceeded 8.76%. A first lien variable rate transaction with a one year adjustment would be a "higher-priced" loan if the APR exceeds 5.02%. In other words, the restrictions imposed under Section 226.35 will likely apply to all but the lowest priced loans.

   These loans would be subject to the following restrictions:

   a. **Evaluation of Borrower Repayment Ability.** Credit unions would be prohibited from engaging in a "pattern or practice" of extending credit without regard to the borrower's repayment ability. Evaluation of repayment ability must include review and verification of income, obligations, employment, and assets other than the collateral for the loan.

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REGULATION Z (CONT.)

The credit union must also consider the effect of interest rate increases in a variable rate or step rate loan. The credit union must also consider the borrower's ability to cover anticipated property taxes, homeowner's association dues, insurance, and other related expenses in addition to the loan payment. The credit union must consider the borrower's debt-to-income ratio or the income available after paying debt obligations.

b. **Prepayment Penalties Limited.** Prepayment penalties cannot be imposed if the loan remains outstanding for five years or more, cannot be imposed if the prepayment is from a refinancing by the same creditor or an affiliate, and are prohibited in any loan where at the time of consummation, the borrower's total monthly debt obligation exceeds 50% of the borrower's monthly gross income, as verified by a signed financial statement, credit report, and employment income records.

c. **Escrow Accounts Required.** Credit unions would be required to establish escrow accounts for property taxes and insurance for all higher priced loans secured by a first lien. The borrower may cancel the escrow account after one year.

Brian Witt
Hal Scoggins

MORTGAGE CRISIS RAISES ATTENTION ON EXTENDED RESCISSION RIGHTS

The Truth-in-Lending Act creates a three business day right of rescission for most principal dwelling loans other than purchase money loans. Lenders usually get past the right of rescission at closing and then forget about it. In the current mortgage crunch, however, consumer advocates and debtor attorneys are increasing awareness of extended rescission rights as a defense to foreclosures.

MORTGAGE CRISIS (CONT.)

Credit unions should also be aware of this issue and take appropriate protective measures.

When Rescission Rights Are Extended

The borrower's right to rescind a loan transaction normally runs until midnight of the third business day after the latest of: (a) the date the "material disclosures" are provided; (b) the date the appropriate notice of right to cancel is provided, or (c) the date the loan is consummated. However, the rescission period can be extended for up to three years from the date of the transaction if the "material disclosures" were not accurate, or if the notice of right to cancel was not provided. Some experts also argue that disbursing loan proceeds before the end of the rescission period automatically extends it for three years. If a lender commences foreclosure, the borrower's rescission right may also be extended for up to three years if a mortgage broker fee was not properly included in the finance charge and annual percentage rate, or if the rescission notice was not in the proper format required by Regulation Z. As you can see, even minor defects can extend the right of rescission.

Borrowers who may have an extended right of rescission are often unaware of that fact. However, faced with a foreclosure demand or notice, borrowers may consult a consumer attorney or bankruptcy attorney to evaluate options for avoiding foreclosure. Unfortunately, awareness of extended rescission rights is growing among these attorneys as the level of delinquencies and foreclosures increases. In fact, consumer groups are providing seminars and training sessions for debtor attorneys to educate them on how and when extended rescission rights may be used to avoid foreclosure. The Truth-in-Lending disclosure requirements (especially for closed-end loans) can be very complex. This makes it easy for lenders (and debtor attorneys) to make errors.

Be Prepared

The best way to minimize potential fallout from a debtor's assertion of extended rescission rights is for the credit union to be aware of its position before the debtor is.

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MORTGAGE CRISIS (CONT.)

Credit unions will be well-served to add a "rescission check" to their collection and foreclosure procedures in order to avoid trouble spots, or at least know about them before triggering them. Standard form late notices and reminders probably will not generate much scrutiny from a debtor. However, before sending a demand letter, the credit union should evaluate potential rescission related issues in the loan file. If the loan is more than three years old, no further review is needed. If the loan is less than three years old, a rescission review may be worthwhile.

If the loan file indicates potential rescission problems, the credit union will need to determine the best course of action. If the loan is close to three years old, the credit union may choose to simply wait until the loan reaches three years before commencing its collection action. If that is not feasible, the credit union should more fully analyze the scope of the potential rescission problem, the likelihood that the borrower is aware or will become aware of the problem, and the impact of rescission.

If a borrower rescinds a loan, even after a couple of years, all payments previously made by the borrower must be credited to principal. The credit union is not entitled to retain any interest for any period of the loan, and must also refund to the borrower any other amounts paid in connection with origination of the loan (such as appraisal fees, etc.). The borrower is obligated to pay the credit union only the principal balance, with credit for all prior payments. Also, the credit union will be unable to foreclose its security interest, because the borrower has rescinded the transaction that created the security interest.

An ounce of prevention is worth is a pound of cure. If the credit union is aware of these issues before the borrower is, the credit union may consider alternative payment arrangements or take other preventive measures. Contact us (Hal or Brian) if you would like further information about how to "rescission check" your file.

Hal Scoggins

NEWS & UPCOMING EVENTS . . .

Firm Changes – You probably noticed that our firm name is once again Farleigh Wada Witt. Mark Wada has rejoined the firm and the firm name changed back to Farleigh Wada Witt effective March 1, 2008. Our website and email addresses have also changed, as set forth below, to reflect the name change.

CUAO Legal Update & Website/Advertising Compliance Seminar – Brian Witt and Hal Scoggins will present a legal update and website/advertising compliance seminar for the Credit Union Association of Oregon on April 23, 2008, at the Embassy Suites, Tigard. For more information, please visit CUAO's website: http://www.cuao.org/Education/CalendarOfEvents/index.cfm?id=496

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