

### A. *Current and Proposed Interest Rate Adjustment Disclosures*

To implement DFA section 1418, the Bureau is proposing to revise § 1026.20(d) to require that creditors, assignees, or servicers provide notices to consumers six to seven months prior to the first time the interest rate of their adjustable-rate mortgages adjusts. In contrast to this one-time disclosure, Regulation Z currently requires notice to consumers regarding each adjustment of their adjustable-rate mortgages.

Under current rule § 1026.20(c), creditors must provide consumers with a notice of interest rate adjustment for variable-rate transactions subject to § 1026.19(b) at least 25, but no more than 120, calendar days before a payment at a new level is due. For the reasons discussed below, the Bureau is proposing in § 1026.20(c), among other things, to change the minimum time for providing advance notice to consumers from 25 days to 60 days before payment at a new level is due. The maximum time for advance notice would remain the same: 120 days prior to the due date of the first payment at a new level.

Current § 1026.20(c) also requires creditors to provide consumers with an adjustment notice at least once each year during which an interest rate adjustment is implemented without resulting in a corresponding payment change. The Bureau is proposing to eliminate this provision. As explained in more detail below in the section-by-section analysis, the Bureau believes that certain Dodd-Frank Act amendments to TILA and the Bureau's proposed amendments that would implement those provisions provide consumers with much of the information contained in the annual notice, thereby greatly minimizing its value for consumers.

In the interest of harmonizing the two proposed ARM disclosures, the coverage, content, and format of proposed § 1026.20(c) and (d) closely track one another and incorporate most of the content currently required by § 1026.20(c).

*Historic context of § 1026.20(c) rate adjustment disclosures.* The Board adopted the rule that is current § 1026.20(c) in 1987, as part of a larger revision of Regulation Z.<sup>44</sup> In 2009, the Board proposed to revise regulations governing ARM disclosures as part of a larger revision of closed-end provisions in Regulation Z (2009 Closed-End Proposal). In that proposal, the Board said that, in 1987, it set the minimum time for providing notice of a rate adjustment at 25 days before payment at new level is due in order to track the rules of the Office of the Comptroller of the Currency (OCC) and to provide creditors with flexibility in giving adjustment notices for a variety of ARMs.<sup>45</sup> It also noted that, as of 2009, neither the OCC nor any other Federal financial institution supervisory agency had any comprehensive disclosure requirements for ARMs.<sup>46</sup>

Since 1987, the popularity of ARMs has increased, especially during the period from 2002 to 2007.<sup>47</sup> Beginning in 2007, ARM growth began to slow as consumers experienced difficulty repaying such loans and concerns grew about the risk of payment shock that ARMs pose.<sup>48</sup> According to Freddie Mac, “[i]n June 2004, ARMs hit a peak share of 40% of the home-purchase market but by early 2009, that share had fallen to just 3%, according to the Federal

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<sup>44</sup> 52 FR 48665 (Dec. 24, 1987).

<sup>45</sup> 74 FR 43232, 43269 (Aug. 26, 2009) (citing 52 FR 48665, 48668 (Dec. 24, 1987)).

<sup>46</sup> *Id.* at 43272.

<sup>47</sup> *Id.* at 43269.

<sup>48</sup> *Id.*

Housing Finance Agency.”<sup>49</sup> Generally, ARMs are financing just over 10% of new home-purchase loans but are expected to rise to a 14% share of that market in 2012.<sup>50</sup>

For many consumers, the current era of declining interest rates has reduced the incidence of the significant payment increases that can accompany ARM interest rate adjustments. Anecdotal evidence from mortgage servicers with which the Bureau has conducted outreach supports this conclusion. To the extent interest rates rise in the future, ARM interest rate adjustments may result in significant payment increases for many consumers. The popularity of adjustable-rate mortgages, which provide the opportunity for reduced interest rates, also may increase along with the advent of higher interest rates.

Regardless of current market conditions, ARMs can pose a risk of payment shock. Therefore, it is critical that consumers receive advance notice of ARM payment changes so that, if their rates increase, they can prepare to make higher mortgage payments or pursue alternative plans, such as seeking to refinance their loans.

*Timing of current and proposed ARM regulations.* DFA section 1418 requires that interest rate adjustment disclosures be provided to consumers six to seven months before the interest rate adjusts for the first time (which is equivalent to 210 to 240 days before payment at a new level is due). Generally, this much advance notice will require disclosure of an estimated new interest rate and payment instead of exact amounts. This is because ARM contracts generally require an index value published closer to the adjustment date to calculate the adjusted interest rate and new payment. Nevertheless, the consumer would be put on notice of upcoming changes and would have ample time to refinance or pursue other alternatives if the estimate indicates a potential increase in payments that the consumer cannot afford.

Current § 1026.20(c) requires notice of rate adjustments resulting in a corresponding payment change at least 25 days prior to when payment at a new level is due. This notice, unlike the one required under DFA section 1418, provides the actual, not estimated, new interest rate and payment. Twenty-five days likely does not provide sufficient time for consumers to refinance, pursue other alternatives, or adjust their finances to make higher payments. Research conducted for the years 2004 through 2007 also suggested that a requirement to provide ARM adjustment disclosures 60, rather than 25, days before payment at a new level is due more closely reflects the time needed for consumers to refinance a loan.<sup>51</sup> In the current market, the nation’s biggest mortgage lenders take an average of more than 70 days to complete a refinance.<sup>52</sup>

For these reasons, proposed § 1026.20(c) revises the time frame for providing the ARM adjustment notice from the current 25 to 120 days to 60 to 120 days before payment at a new level is due. Under the proposed rule, consumers will know the actual amount of their new interest rate and payment at least 60 days before the new payment is due. Most existing ARMs will be able to comply with this proposed timing. The Bureau proposes grandfathering existing

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<sup>49</sup> Press Release, Freddie Mac, *Freddie Mac Releases 28<sup>th</sup> Annual ARM Survey Results* (January 18, 2012), available at: <http://freddiemac.mediaroom.com/index.php?s=12329&item=109996>.

<sup>50</sup> *Id.*

<sup>51</sup> Robert B. Avery, Kenneth P. Brevoort, & Glenn B. Canner, *The 2007 HMDA Data*, 94 Fed. Reserve Bull. A107 (Dec. 23, 2008).

<sup>52</sup> Nick Timiraos & Ruth Simon, *Borrowers Face Big Delays in Refinancing Mortgages*, Wall St. J., May 9, 2012, at A1, available at: <http://online.wsj.com/article/SB10001424052702303459004577364102737025584.html>.

ARMs that contractually will not be able to comply with the new timing, *i.e.*, those with look-back periods of less than 45 days. *See* section-by-section analysis for proposed § 1026.20(c) for a full discussion of timing and look-back periods.

*Content of current and proposed ARM regulations.* The Bureau is generally proposing to retain the content required by current § 1026.20(c). Proposed § 1026.20(c) would require additional information such as a statement that the consumer's interest rate is scheduled to adjust, the adjustment may change the mortgage payment, the time period the current interest rate has been in effect, and the dates of the future rate adjustments; the date when the new payment is due after the adjustment; any interest rate or payment limits; any unapplied carryover interest and the earliest date it could be applied; additional amortization information for negatively-amortizing and interest-only loans; and the amount and expiration date of any prepayment penalty. Much of this additional content was proposed by the Board's 2009 Closed-End Proposal to amend Regulation Z's payment change interest rate adjustment disclosures.<sup>53</sup>

The initial interest rate adjustment notices proposed by § 1026.20(d) include much of the same information listed above for proposed § 1026.20(c). The content of the two proposed notices in § 1026.20(c) and (d) closely track one another in order to promote consistency and simplify compliance. However, proposed § 1026.20(c), which applies to the ongoing disclosures at each interest rate adjustment that results in a corresponding payment change, would not require some of the disclosures mandated for the initial interest rate adjustment notices by DFA section 1418. These disclosures include a list of alternatives consumers may pursue, including refinancing, renegotiation of loan terms, payment forbearance, and pre-foreclosure sales; contact information for the appropriate State housing finance agency; and information on how to access a list of government-certified counseling agencies and programs. The Bureau believes it is not necessary to provide this information in § 1026.20(c) notices because much of it will be provided to consumers through other mortgage servicing measures implemented by the Dodd-Frank Act. For example, new TILA section 128(f), which would be implemented by proposed rule § 1026.41 for periodic statements, each billing cycle would provide information on how to contact the appropriate State housing finance authority and how to access a list of government-certified counseling agencies and programs. Also, the early intervention provisions of the 2012 RESPA Servicing Proposal would require this same information as well as examples of alternatives consumers may want to consider. Finally, consumers will have received this information pursuant to § 1026.20(d) the first time their adjustable-rate mortgages adjust.

The model forms proposed for § 1026.20(c) and (d) closely track one another and disclose virtually the same information, except for the additional information proposed for § 1026.20(d), as discussed above, and the reference to estimates in the proposed § 1026.20(d) notices. The Bureau believes that harmonizing the two proposed rules regarding ARM interest rate adjustment disclosures would ease the burden of compliance for creditors, assignees, and servicers while providing consumers with consistent information in similar notices.

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<sup>53</sup> 74 FR 43232, 43269-73 (Aug. 26, 2009).

The Bureau is proposing model and sample forms<sup>54</sup> for both § 1026.20(c) and (d). The Bureau worked with Macro to design and test the forms for § 1026.20(d), but did not specifically test § 1026.20(c) notices. *See* Part II.B above. Because of the similarity in the model forms for both proposed rules, the results of the testing of § 1026.20(d) forms is relevant for proposed § 1026.20(c) as well. Thus, throughout the section-by-section analysis for § 1026.20(c), the Bureau refers to the testing results for § 1026.20(d) where the information and concepts tested are identical in the model forms for both proposed § 1026.20(c) and (d).

~~*B. Proposed Rule Regarding Prompt Crediting of Mortgage Payments and Response to Requests for Payoff Amounts*~~

~~DFA section 1464(a) codifies the existing Regulation Z requirements in § 1026.36(e)(1)(i) on prompt crediting of payments. The proposed modifications to § 1026.36(e) would clarify the handling of partial payments. The proposal would limit application of the current prompt crediting provision, existing § 1026.36(e)(1)(i), to full contractual payments (as opposed to all payments), and add a new provision, § 1026.36(e)(1)(ii), to address the handling of partial payments (anything less than a full contractual payment).~~

~~DFA section 1464(b) generally codifies the existing Regulation Z requirement in § 1026.36(e)(3) to provide payoff statements, with modifications relating to the scope and timing of the requirement, and the need for the request to be written. Proposed modifications to § 1026.36(e) reflect these changes.~~

~~As part of implementing these changes, the Bureau is proposing a reorganization of the requirements in § 1026.36(e).~~

~~*C. Proposed Rule Regarding Periodic Statements*~~

~~DFA section 1420 establishes new TILA section 128(f), requiring periodic statements for residential mortgage loans to be provided each billing cycle. The statute requires that a creditor, assignee, or servicer disclose certain information in the periodic statement, along with “such other information as the Bureau may prescribe in regulations.”<sup>55</sup> The statute requires the Bureau to develop and prescribe a standard form for this disclosure, taking into account that the required statements may be transmitted in writing or electronically.<sup>56</sup> The statute also provides an exemption to the periodic statement requirement for fixed rate loans where the creditor, assignee, or servicer provides the obligor with a coupon book which provides substantially the same information as the periodic statement.<sup>57</sup>~~

~~Proposed § 1026.41 contains the periodic statement requirement. Paragraph (a) establishes the general requirement for creditors, assignees, or servicers to provide a periodic statement. Paragraphs (b)–(d) establish requirements for the timing, form, content, and layout of the statement. Paragraph (e) sets forth exemptions from the periodic statement requirement.~~

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<sup>54</sup> The Bureau proposes four model forms for the ARM adjustment notices: two forms for the § 1026.20(c) ARM payment change notices, one labeled a model form and the other a sample form and two forms for the § 1026.20(d) ARM initial interest rate adjustment notices, one labeled a model form and the other a sample form. *See* Appendix H-4(D)(1)-(4).

<sup>55</sup> TILA section 128(f)(1)(H).

<sup>56</sup> TILA section 128(f)(2).

<sup>57</sup> TILA section 128(f)(3).