



# Off the Press - September 2008

PENNSYLVANIA ASSOCIATION OF COMMUNITY BANKERS

THE VOICE FOR COMMUNITY BANKING IN PENNSYLVANIA SINCE 1876

## Compliance Issues in Today's Mortgage Lending Environment

By Tim Schofer, CFSA,  
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New lending regulations in response to the mortgage crisis will affect community bankers as much as they will other lenders. Here are some potential pitfalls and regulatory changes that you should be aware of.

### REDUCING HOME EQUITY LINES OF CREDIT (HELOCs)

As real estate values decline, many prudent bankers are looking at limiting their exposure by reducing borrowers' credit lines. Institutions must comply with several laws and regulations when HELOCs are reduced or suspended. For example, Regulation Z expressly permits lenders to restrict additional extensions of credit or reduce the credit limit when the value of the dwelling declines significantly below its appraised value. To use this exception, lenders must determine that a "significant decline" occurred. You need not obtain a full appraisal, but you should have a sound method on which to base your decision, such as an automated valuation model or local tax assessments.

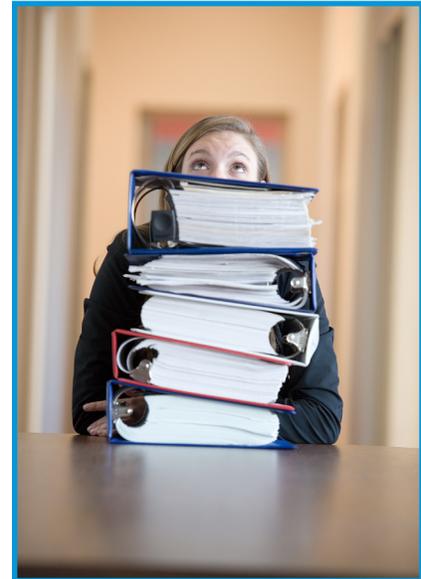
Regulation Z also permits such actions if the creditor reasonably believes that the consumer will be unable to fulfill

the repayment obligations under the plan because of a material change in the consumer's financial circumstances. Again, you should be able to substantiate your reasonable belief in the event of litigation.

If you decide to reduce the credit line, you must provide written notice to each affected consumer. The notice must be provided no later than three business days after the action is taken and must contain specific reasons for the action. More detail can be found in FDIC FIL-58-2008.

### OTHER REAL ESTATE (ORE)

Many of you will experience an increase in ORE acquired through foreclosure or a deed in lieu of foreclosure. The FDIC recently reminded bankers that, after foreclosure, each foreclosed real estate asset must be carried at the lower of (1) the fair value of the asset minus the estimated costs to sell the asset or (2) the "cost" of the asset. This determination must be made on an asset-by-asset basis. If the fair value of a foreclosed real estate asset minus the estimated costs to sell it is less than the asset's cost, the deficiency must be recognized as a valuation allowance against the asset which



is created through a charge to expense. The valuation allowance should thereafter be increased or decreased (but not below zero) through charges or credits to expense for changes in the asset's fair value or estimated selling costs. More details can be found in FDIC FIL-62-2008.

### TRUTH-IN-LENDING ACCURACY AND RESCISSION

Although these regulations haven't changed much recently, there are two reasons to review:

1. If you have not reviewed or audited your disclosures or processes lately, there may be some issues of which you are not aware or software upgrades might have automatically instituted changes.
2. A savvy borrower (or his/her attorney) in default or foreclosure will look for a way out. Dozens of lawsuits are filed over items such as nondisclosure, unclear



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disclosure, untimely disclosure, and inaccurate disclosure. Most of us realize that a simple finance charge error of \$101 on a refinanced mortgage could result in a rescindable transaction.

## FLOOD INSURANCE

Bankers everywhere have seen increased examiner scrutiny of insurance requirements. Examiners have stepped up their diligence to ensure that losses to consumers caused by flood damage are minimized and covered by insurance when required.

Compliance can be relatively simple:

- Make sure that all new loans in a flood hazard area have an adequate amount of flood insurance when you make the loan. This applies equally to commercial loans.
- Make sure that all existing loans maintain an adequate amount of flood insurance. You'll need to monitor for

renewal, cancellation, and changes to the insurance policies on covered loans. To simplify things, why not just escrow for the premium?

## TRUTH-IN-LENDING CHANGES

In July the Federal Reserve approved a final rule for home mortgage loans to better protect consumers and facilitate responsible lending. For a newly defined category of "higher priced mortgage loans," lenders are:

- Prohibited from making a loan without regard to the borrower's ability to repay the loan from income and assets.
- Required to verify repayment ability from income and assets.
- Required to limit prepayment penalties.
- Required to escrow taxes and insurance.

For ALL specified mortgage loans, lenders are:

- Prohibited from coercing appraisers to misstate property values and also pyramiding of

late charges.

- Required to provide a good faith estimate of settlement costs and schedule of payments within 3 days of application. Currently, these estimates are only required for purchase transactions.

Additional advertising standards are imposed to avoid deceptive or misleading practices.

## RESPA REFORMS PROPOSED BY HUD

HUD is moving aggressively to tighten up disclosure requirements on real estate loans. HUD's stated purpose for proposing the extensive revisions to RESPA is to reduce "unnecessarily high settlement costs."

Changes include a revised Good Faith Estimate, substantial changes to the HUD-1 Settlement Statement, a comparison chart, and a closing script to be used at settlement.

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### About the Author:

*Tim Schofer is a Principal at S.R. Snodgrass, A.C. Tim's areas of expertise include internal audit and regulatory compliance where he helps financial institutions ensure – and improve – their compliance with regulatory agencies. Snodgrass is best known for our expertise in the financial services industry, where we currently serve over 175 financial institutions on a national scale. Accordingly, we have extensive industry business experience and sound working relationships with all of the regulatory agencies. Examples of that experience are displayed on our Web site's Knowledge Bank at [www.srsnodgrass.com](http://www.srsnodgrass.com), where you can view several articles and video presentations on banking-related topics, including a training webcast on The Bank Secrecy Act.*