OTS Mortgage Regulations

RESCINDED

Program

EXAMINATION OBJECTIVES

Replaced by Comptroller's Handbook, "Truth in Lending Act"

To determine whether the initial loan disclosures contain all of the required elements, as applicable, and are being provided to consumers within the time frame set forth in the regulation.

To determine whether adjustment notices are complete and are being issued within the required time frame.

To determine the adequacy of policies, procedures and internal controls for ensuring accurate rate-change adjustments on variable-rate loans.

To determine that the association's employees are operating consistent with established guidelines.

To determine whether the loan servicing system is tested periodically for accuracy by internal or external auditors or other staff.

To determine that the institution's rate change adjustments are accurate and made when required.

To determine whether the association has included in its loan contracts the maximum interest rate that may be imposed during the term of the obligation in its loan contracts.

EXAMINATION PROCEDURES

Initial and Program Disclosures

1. Review the Matters Requiring Board Attention and Corrective Actions from the three or four previous ROEs to ensure that the board and management have taken appropriate corrective action where necessary and persistent problems have not recurred.

2. Determine if the association utilizes the booklet entitled: *Consumer Handbook on Adjustable Rate Mortgages*, or a suitable substitute.

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3. Review the association's disclosure policies, procedures, and practices to determine if the booklet entitled: *Consumer Handbook on Adjustable Rate Mortgages* and all appropriate loan program disclosures are provided when an application is provided or prior to the payment of a nonrefundable fee, whichever is earlier.

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4. Determine through a review of the association's loan program disclosures if they include all of the following required disclosures, as applicable:

- The fact that the interest rate, payment, or term may change;
- The index or formula used in making adjustments, and a source of information about the index or formula;
- An explanation of how the interest rate and payment will be determined, including how the index is adjusted;
- A statement indicating the consumer should inquire about the current margin value and interest rate;
- The fact that the interest rate will be discounted and a statement that the consumer should inquire as to the amount of the discount;
- The frequency of interest rate and payment changes;
- Rules relating to changes in the index, interest rate, payment amount, and the outstanding loan balance;
- A historical example, based on a sample $10,000 loan amount.
- An explanation of how the consumer may calculate the payments for the loan amount to be borrowed based on the most recent payment shown in the historical example;
- The maximum interest rate and payment for a sample $10,000 loan originated at the most recent interest rate shown in the historical example assuming the maximum periodic increases in rates and payments;
- The fact that the loan contains a demand feature;

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- The type of information that will be provided in notices of adjustments and the timing of such notices; and
- A statement that disclosure forms are available for the creditor's other variable-rate loan programs.

ADJUSTMENT PROCEDURES AND NOTICES

The following procedures can be performed in connection with the review of compliance with the Federal Reserve's Regulation Z and the OTS' Mortgage Loan Disclosure Regulations. It may be possible to use the same sample(s) of document files drawn to review compliance with other provisions relating to open- and closed-end credit. Consequently, it may not be necessary to draw additional samples of adjusted loans for analysis.

To validate the findings of the analysis performed by management, we recommend an initial sample of recent adjustments for two loans of each variable-rate type in which an association or its subsidiaries holds an ownership interest, only to the extent necessary to reach a supportable conclusion with respect to compliance. If, for example, an association has 30 different loan products and it has reviewed its adjustment procedures for each type and found no exceptions, the examiner should use judgment in determining how many of those products should be reviewed to validate the association's own analysis. In situations where an association has not conducted any internal review, the examiner will have to conduct a more detailed analysis. However, that analysis should be limited to the number and variety of samples necessary to assure the examiner that no problems exist or, if there are problems, the nature and extent of them.

In choosing loan programs for sampling purposes, minor variations in variable-rate loan documents should be ignored. For example, an institution may separate loan programs by minor differences in loan features such as the initial discounted rate or assumability. In identifying loan types, consideration should be given to significant features such as the frequency and timing of adjustments and the index to which the interest rate is tied. A lender may refer to "three-year ARMs" as those loans that are adjusted annually after an initial three-year period as well as loans that adjust every three years. In this case, both represent significantly different loan types and both would be reviewed.

For the purposes of compliance examinations, the review should be limited to transactions covered by Regulation Z and the OTS' Mortgage Loan Disclosure Regulations. The review for each adjustment should focus on compliance with the notification provisions, such as timing and content, and whether the adjustment calculations conform to the underlying obligation. The examiner's judgment should be used to determine appropriate expansion of initial samples, and to identify the extent and underlying causes of any problems noted.

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The type of review outlined above involves recently originated loans which have adjusted. For loans which have had interest rate changes, but not payment adjustments, such as loans with negative amortization features, the interest rate adjustments should be reviewed. Examiners should also review a sample of loan conversions, from variable to fixed rate, since the same types of errors may occur in this process, as in calculating periodic adjustments for variable-rate loans. For recently originated loans which have not yet adjusted the existence and adequacy of adjustment procedures should be evaluated.

5. Determine through a review of the association's policies, procedures, and practices if adjustment notices are provided (delivered or placed in the mail):

   - At least once each year when an interest rate adjustment is implemented without an accompanying payment change; and
   - At least 25, but not more than 120, calendar days prior to the due date of a payment at a new level.

6. Review a sample of the association's adjustment notices to determine if they contain the following required provisions, as applicable:

   - The current and prior interest rates;
   - The index values upon which the current and prior interest rates are based;
   - The extent to which the creditor has foregone any increase in the interest rate;
   - The contractual effects of the adjustment, including the payment due after the adjustment is made, and a statement of the loan balance; and
   - The amount of the payment required to fully amortize the loan at the new interest rate over the remainder of the loan term if that amount is different from the payment resulting from the adjustment.

7. Review the adequacy of the computer system's or servicer's ability to handle the institution's variable rate products. Determine if operating procedures and internal controls are adequate.

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8. Verify whether internal or external auditors or other staff periodically test the accuracy of the association's variable interest rate adjustment system.

9. Determine the extent and adequacy of the instruction and training received by those individuals who implement rate changes.

10. Determine whether the association has retained records of index values (e.g. copies of the Federal Reserve Statistical Release).

11. Verify that when the account was opened or loan was consummated that loan data was recorded correctly into the association's calculation systems (e.g., its computer). Determine the input accuracy of the:

- Index value.
- Method for calculating rate changes.
- Rounding method.
- Adjustment caps (periodic and lifetime).

12. Using a sample of periodic disclosures for open-end variable rate accounts (e.g., home equity accounts) and closed-end rate change notices for adjustable rate mortgage loans (ARMs):

- Compare the rate change date on the credit obligation to the actual rate change date and to any rate change notice.
- Determine that the index is determined based on the terms of the contract (e.g. the weekly average of 1-year Treasury constant maturities, taken 45 days prior to the change date).

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(Note: Rate changes must be made consistent with contractual terms. However, in some cases "readily available" or "currently available" index values at the time the notice was sent, subsequently used with the rate change, need not necessarily agree with the index value when that value was printed.)

- Determine that the new interest rate is correctly computed by adding the correct index value with the margin stated in the note, plus or minus any contractual fractional adjustment.
- Determine that the new payment was based on an interest rate and loan balance in effect at least 25 days before the payment change date (consistent with the contract).

EXAMINER'S SUMMARY, RECOMMENDATIONS, AND COMMENTS

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