

LENDERS UPDATE™

A MONTHLY SERVICE TO THE MORTGAGE LENDING INDUSTRY

AN ALT & ASSOCIATES NEWSLETTER

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ADVERTISING

Recently we asked for suggestions as to issues that we might discuss during this quiet period on the regulatory front. We received a number of very good suggestions but the subject raised most frequently concerned advertising.

Advertising mortgage loans is highly regulated and can be a dangerous activity. The regulations encompass the Federal Truth in Lending Act and other federal regulations such as those that govern “pre-screened”, “pre-approved” offers of credit.

In addition, each state has its own regulatory scheme and they can be quite detailed. The state regulatory requirements obviously vary on a state by state basis.

As a consequence, we will break this discussion into two categories:

1. Regulations under the Federal Truth and Lending Act, and
2. State regulations.

We will discuss the Reg. Z issues in this issue and later this month we address state regulatory issues. The subject is a large one and an entire volume would be necessary to do it justice. We will attempt in this article to set forth the general applicable principles. For Reg. Z, this means concentrating on closed end consumer credit secured by a dwelling. We will leave open end credit, adjustable rate programs and other more esoteric features such as buy downs, graduated payment loans, etc. to a different venue. Also, the principles we discuss below may change if the advertising will use TV, radio or in another format. We will concentrate on written advertising.


RESTRICTIONS ON ADVERTISING REQUIRED BY THE FEDERAL TRUTH IN LENDING ACT AND REGULATION Z

What is an advertisement?


The staff commentary to Reg. Z describes an advertisement as commercial messages that promote consumer credit transactions requiring disclosures. These include messages inviting, offering or otherwise announcing to prospective customers the availability of credit. These can include messages in the print media, oral conversations or other visual media.

The term does not include communications about existing credit accounts or promoting additional services related to these accounts or to notices required by federal or state law, to the extent that the notices only include required information. Material distributed to business entities containing information concerning loan terms such as interest rate and also contacts directed to individual consumers that relate to a negotiation of a transaction, are excluded.

General concepts and requirements applicable to closed end credit

-  **Available terms.** When an advertisement mentions specific credit terms it may only state those terms that the creditor is actually prepared to offer. For example, a creditor may not advertise a very low Annual Percentage Rate (APR) that will not in fact be available at any time. The commentary states that the

restriction is not intended to inhibit the promotion of new credit programs but only the advertising of terms that are not and will not, be available. Terms may be advertised if they are to be available only for a limited period of time or will become available at a future date, if so disclosed.


 **Advertising of rate of finance charge.** Where an advertisement states a rate of finance charge it must state the rate as an APR. If the advertisement is secured by a dwelling, it may also show a simple annual rate that is applied to an unpaid balance which may be stated in conjunction with, but not more conspicuously than the APR.

The terms “not more conspicuously” or as we will later use “clear and conspicuous” have somewhat complicated meanings. Generally, the terms mean that the required information must be disclosed with equal prominence (but not greater prominence) and in close proximity to any advertised term that triggered the required disclosures. Footnotes are usually insufficient.

The advertisement must state that the APR is subject to increase after consummation if that is the case but the advertisement need not describe the rate increase, its limits or how it would affect the payment schedule.

As to disclosures of simple annual interest rates, as said, these may be shown but must be in the same type size as the APR. The simple annual rate or periodic rate that is applied to an unpaid balance is the rate at which interest is accruing. It is not a rate lower than the rate at which the interest is accruing, such as effective rate, payment rate or qualifying rate.

Special rules apply to buy downs, discounted variable rate transactions, initial rate reductions, caps on periodic rates, payment adjustments, fixed rate conversion loans, and preferred rate loans. These issues should be addressed aggressively where the advertised loans involves these types of features.

 **Triggering terms.** Where any of the following terms are set forth in an advertisement there are further requirements which must be met as detailed below. The terms are as follows:

- The amount or percentage of any down payment,
- The number of payments or period of repayment,

- The amount of any payment, or
- The amount of any finance charge.

Where any of these referenced terms are used, the following information must be provided:

- The amount or percentage of the down payment
- the terms of repayment which reflect the repayment obligations over the full term of the loan including a balloon payment, or
- the annual percentage rate using that term and if the rate may be increased after consummation

If an advertisement for credit secured by a dwelling uses 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 following should be disclosed in a clear and conspicuous manner:

- Each simple annual rate of interest that will apply,
- In a variable rate transaction, the rate determined by adding an index and margin shall be disclosed based on a reasonably current index and margin,
- The period of time in which each simple annual rate of interest will apply, and
- The Annual Percentage Rate for the loan.

Again, remember that these disclosures must be made in a clear and conspicuous manner, meaning that they shall be disclosed with equal prominence and in close proximity to any advertised rate which triggered the required disclosures.

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:

- The amount of each payment that will apply over the term of the loan,
- The period of time during which each payment will apply, and
- Where the lien securing the loan is the first lien on the dwelling, the fact that the payments do not include amounts for taxes and insurance premiums if applicable.
- A few practice pointers:

- Terms of repayment may be expressed in a variety of ways. In addition to the precise repayment schedule, for example, advertisers may use a unit-cost approach in making the required disclosures, such as “48 monthly payments of \$27.83 per \$1000 borrowed.
- An advertiser may use credit transactions which illustrate the necessary triggered disclosures. Where a range of possible combinations of credit terms is offered, the advertisement may use examples of typical transactions.
- Certain phrases are not trigger terms, such as “monthly payments to suit your needs”, “regular monthly payments”, “pay weekly”, “take years to repay” or “monthly terms arranged”.

Again, remember that specific requirements or restrictions may apply to features, such as fixed rate conversion loans, preferred rate loans, and rate reductions. Also, the method and nature of disclosure may vary depending upon the type of medium used such as newspapers, TV, radio, catalogue etc.

Prohibited acts and practices in advertisements for credit secured by a dwelling

The following acts or practices are prohibited:

- ✚ **Misleading advertising of fixed rates.** The use of the term “fixed” is prohibited to refer to rates, payments or the general loan transaction in an advertisement for variable rate transactions, except in limited situations such as loans in which the rate may fixed for a period time or stepped rate mortgage transactions with an initial lower payment. In situations such as these, the terms “fixed rate” or “fixed” must be followed by an equally prominent and closely proximate statement of the time period for which the payment is fixed, and the fact that it will increase.
- ✚ **Misleading Comparisons in Advertisements.** Comparisons in an advertisement between actual or hypothetical credit terms.
- ✚ **Misrepresentation about Government Endorsement.** Statements in an advertisement that the loan is a government loan program, government supported loan, or is endorsed by a governmental entity are prohibited. This does not apply to FHA loans, VA loans or similar programs that are in fact sponsored by federal, state or local government entities. (Please be aware that the individual agencies

may also have specific rules concerning these issues and the use of their names in advertisements.)

- ✚ **Misuse of the Current Lender's Name.** The use 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 discloses with equal prominence, the name of the entity making the advertisement in a clear and conspicuous statement and that the entity is not associated with the current lender.
- ✚ **Misleading Claims of Debt Elimination.**
- ✚ **Misleading Use of the Term Counseling.**
- ✚ **Misleading Foreign Language Advertisements.** The use of "trigger terms" in a foreign language where further required disclosures are provided only in English.

We hope this general summary has been of help. Advertising can be serious business and can impose sanctions not only the company but upon its owners, directors or officers.

Our Lenders Update is published via e-mail as a complimentary service to our friends and clients in the financial industry throughout California and the United States. Only those persons who have requested this newsletter are on our mailing list. Should you have colleagues who wish to receive this complimentary service, please have them e-mail us at

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ALT & ASSOCIATES provides regulatory, compliance, operational advice and transactional assistance, as well as litigation representation, to the financial services industry. Over the past two decades, members of the firm have represented Institutional Lenders and Mortgage Bankers and Brokers in all aspects of their operations. If you have any questions please contact:

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