

CB101.65 Marketing Nontraditional Mortgage Loans [Section 11-102-106, C.R.S.]

A. Applicability

This rule applies only to nontraditional mortgage loans, as defined in Section C.2 below, made to individual borrowers for the purchase or refinancing of residential property.

B. Purpose

The Colorado State Banking Board finds that when promoting or describing nontraditional mortgage products, banks should provide consumers with information that is designed to help them make informed decisions when selecting and using these products.

C. Definitions

For the purpose of this Rule:

1. “Interest Only Mortgage Loan” means a nontraditional mortgage on which, for a specified number of years the borrower is required to pay only the interest due on the loan, during which time, the rate may fluctuate or may be fixed. After the interest-only period, the rate may be fixed or fluctuate, based on the prescribed index, and payments include both principal and interest.
2. “Nontraditional Mortgage” means any residential mortgage loan product that allows the borrower to defer repayment of principal and/or interest. This includes, without limitation, all interest-only residential mortgage products, payment option adjustable rate mortgages, and negative amortization mortgages, with the exception of a reverse mortgage and home equity line of credit, other than a simultaneous second-lien loan. Nontraditional mortgages do not include temporary loans or construction loans.
3. “Simultaneous Second-Lien Loan” means a lending arrangement where either a closed-end second-lien or a home equity line of credit is originated simultaneously with the first lien mortgage loan, typically in lieu of a higher down payment.
4. “Payment Option ARM” means a nontraditional adjustable rate mortgage that allows the borrower to choose from a number of different payment options. For example, Payment Option ARMs include, without limitation, loans whereby, each month, the borrower may choose a minimum payment option based on a “start” or introductory interest rate, an interest-only payment option based on the fully indexed interest rate, or a fully amortizing principal and interest payment option based on a 15-year or 30-year loan term, plus any required escrow payments. The minimum payment option can be less than the interest accruing on the loan, resulting in negative amortization. The interest-only option avoids negative amortization but does not provide for principal amortization. After a specified number of years, or if the loan reaches a certain negative amortization cap, the required monthly payment amount is recast to require payments that will fully amortize the outstanding balance over the remaining loan term.
5. “Reduced Documentation” means a loan feature that is commonly referred to as “low doc/no doc,” “no income/no asset,” “stated income,” or “stated assets.” For mortgage loans with this feature, however designated, an institution sets reduced or minimal documentation standards to substantiate the borrower’s income and assets.

D. Communications with Consumers

1. Promotional materials and other product descriptions must include information about the costs, terms, features, and risks of nontraditional mortgages that can assist consumers in their product selection decisions, including, as applicable, information on the following:
 - a. Payment Shock - Banks should apprise consumers of potential increases in payment obligations for these products, including circumstances in which interest rates or negative amortization reach a contractual limit. For example, product descriptions shall, when appropriate, state the maximum monthly payment a consumer would be required to pay under a hypothetical loan example, after amortizing payments are required and the interest rate and negative amortization caps have been reached. Such information also should describe when structural payment changes will occur, and what the new payment amount would be, or how it would be calculated. If applicable, such descriptions shall indicate that a higher payment may be required at other points in time due to factors such as negative amortization or increases in the interest rate index.
 - b. Negative Amortization - When negative amortization is possible under the terms of a nontraditional mortgage product, consumers shall be informed of the potential for increasing principal balances and decreasing home equity, as well as other potential adverse consequences of negative amortization. For example, product descriptions shall disclose the effect of negative amortization on loan balances and home equity, and describe the potential consequences to the consumer of making minimum payments that cause the loan to negatively amortize. (One possible consequence is that it could be more difficult to refinance the loan or to obtain cash upon sale of the home).
 - c. Prepayment Penalties - If the loan documents allow a bank to impose a penalty in the event that the consumer prepays the mortgage, consumers shall be informed to this fact and that they may ask the lender about the amount of any such penalty.
 - d. Cost of Reduced Documentation Loans - If a bank offers both reduced and full documentation loan programs, and there is a pricing premium attached to the reduced documentation program, consumers should be advised of the cost differential.
2. Promotional materials and other product descriptions outlined under Paragraph (C)(1) of this Rule shall be designed to reasonably:
 - a. Focus on information important to consumer decision making;
 - b. Highlight key information so that it will be noticed;
 - c. Employ a user-friendly and readily navigable format for presenting the information;
 - d. Use plain language, with concrete and realistic examples.

3. Banks shall provide consumers with information at a time and in a manner that will help consumers select products and choose among payment options. For example, institutions should offer clear and balanced product descriptions when a consumer is shopping for a mortgage – such as when the consumer makes an inquiry to the institution about a mortgage product and receives information about nontraditional mortgage products, or when marketing relating to nontraditional mortgage products is provided by the institution to the consumer – not just upon the submission of an application or at consummation.
4. When advertising nontraditional mortgages through certain forms of media, such as radio, television, or billboards, banks shall provide clear and balanced information about the risks of these products, to the extent reasonably practical.

E. Monthly Statements on Payment Option ARMs

Monthly statements that are provided to consumers on payment option ARMs shall provide sufficient information to allow consumers to make informed payment choices, including an explanation of each payment option available and the impact of that choice on loan balances. For example, the monthly payment statement shall contain an explanation, as applicable, next to the minimum payment amount, that making this payment would result in an increase to the consumer's outstanding loan balance. Payment statements also shall provide the consumer's current loan balance, what portion of the consumer's previous payment was allocated to principal and to interest, and, if applicable, the amount by which the principal balance increased.

F. Practices to Avoid

1. Banks shall not present information regarding nontraditional loans in a manner that obscures significant risks to the consumer. For example, if a bank advertises or promotes a nontraditional mortgage by emphasizing the comparatively lower initial payments permitted for these loans, the institution must also provide clear and equally prominent information alerting the consumer to the risks. Such information should explain, as relevant, that these payment amounts will increase, that a balloon payment may be due, and that the loan balance will not decrease and may even increase due to the deferral of interest and/or principal payments.
2. Banks shall not advertise payment patterns that are structurally unlikely under the terms of a loan and shall avoid such practices as: giving consumers unwarranted assurances or predictions about the future direction of interest rates (and, consequently, the borrower's future obligations); making representations about the cash savings or expanded buying power to be realized from nontraditional mortgage products without stating the risks associated with nontraditional mortgages; suggesting that initial minimum payments in a payment option ARM will cover accrued interest (or principal and interest) charges; and making misleading claims that interest rates or payment obligations for these products are "fixed."
3. Banks shall not recommend that ARM borrowers select a nonamortizing or negatively-amortizing payment (for example, through the format or content of monthly statements).

G. Control Systems

1. Banks offering nontraditional mortgage products shall develop and use control systems reasonably designed to monitor whether actual practices are consistent with applicable policies and procedures. Such control systems shall address compliance and consumer information concerns as well as safety and soundness considerations. Lending personnel shall be trained so that they are able to convey information to consumers about product terms and risks in a timely, accurate, and balanced manner. As products evolve and new products are introduced, lending personnel shall receive additional training, as necessary, to continue to be able to convey information to consumers in this manner. Lending personnel shall be monitored to determine whether they are following these policies and procedures. Banks shall review consumer complaints to identify potential compliance, reputation, and other risks. Banks shall obtain legal review of nontraditional loan procedures as necessary. Banks shall not use compensation programs that compensate lending personnel for directing consumers to nontraditional mortgages.
2. If a bank utilizes a third party, such as a mortgage broker, correspondent, or other intermediary, to originate, purchase, or service nontraditional mortgage loans, or if a bank serves as an agent for a third party mortgage lender, the bank shall implement appropriate measures to mitigate risks relating to compliance with this regulation, and all other applicable state and federal laws and regulations. Such measures shall include, but are not limited to:
 - a. Conducting due diligence procedures for reviewing the knowledge and trustworthiness of the third party, and establishing criteria for entering into and maintaining relationships with such third parties;
 - b. Establishing criteria for third-party compensation, which may not include origination incentives that are inconsistent with this Rule;
 - c. Setting the terms for agreements with such third parties,
 - d. Establishing procedures and systems to monitor compliance with applicable agreements, bank policies, and laws, and
 - e. Implementing appropriate corrective actions in the event that the third party fails to comply with applicable agreements, bank policies, or laws.

H. Illustrations

In complying with the provisions of this Rule, banks may utilize the sample illustrations included in the "Illustrations of Consumer Information for Nontraditional Mortgage Products" issued by the Office of the Controller of the Currency, Treasury; Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; Office of Thrift Supervision, Treasury; and National Credit Union Administration on June 8, 2007, as such publication may be amended. Banks may provide information included in the sample illustrations, and expand, abbreviate, or otherwise tailor the material to the specific products offered by the bank, or provide the information required by this Rule in a format developed by the bank, or utilize other disclosures developed or published by the federal banking agencies for consumer use that contains similar information.

I. References

1. "Interagency Guidance on Nontraditional Mortgage Products Risks" refers to guidance issued by the Office of the Comptroller of the Currency, Treasury; Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; Office of Thrift Supervision, Treasury; and National Credit Union Administration. The interagency guidance was published in the Federal Register on October 4, 2006.
2. "Illustrations of Consumer Information for Nontraditional Mortgage Products" refers to guidance illustrations issued by the above referenced agencies. The guidance illustrations were published in the Federal Register on June 8, 2007.
3. Copies of the above referenced interagency guidance and illustrations may be examined at any State Publications Depository.
4. For more detailed information pertaining to these provisions, please contact the Secretary to the Colorado State Banking Board at banking@dora.state.co.us or (303) 894-7584.

Promulgated Effective December 30, 2007

Promulgated to address requirements stipulated in SB 07-216 concerning the marketing of nontraditional products as outlined in the provisions of The Interagency Guidance on Nontraditional Mortgage Products Risks.