Proposed Consumer Safeguards
for
Alternative Mortgage Instruments

Introduction

The staff of the Federal Home Loan Bank Board has suggested significant strengthening of Consumer Safeguards in comparison with the 1975 proposal. Among areas changed are the following:

		1975 FHLBB Proposal	1978 Staff Proposal
a.	Frequency of payment change--not more often than	6 months	1 year
b.	VRM Rate Changes not more than--	1% per year	½% per year
c.	Date of Rate Change	Uncertain	Must be on Anniversary of the Loan
d.	Maximum Term to Maturity	30 years	40 years

The following are merely guidelines and are subject to change. Interested groups and individuals have been asked to evaluate them with the goal in mind of ensuring that the consumer has adequate information and Freedom of Choice.

Your thoughts are welcome.

General Consumer Safeguards

Would apply to all Alternative Mortgage Instruments.

1. Frequency of Payment Change--not more than once a year.

2. Balloon Payment Mortgages--not permitted.

3. Amount of Payment Increase--not more than 7½ percent per year (principle and interest).

4. Freedom of Choice--lenders must offer the standard fixed-payment mortgage to all applicants.

   Lenders must also present to the potential borrower a written statement of the terms of the standard fixed-payment mortgage side-by-side with the terms of the alternative mortgage instrument. The borrower would then be required to sign a statement indicating that a standard mortgage had been offered and that the terms of both the standard mortgage and the alternative offered were explained fully. We are terming this safeguard--"Documented Choice".

5. Full Disclosure--the lender would be required to provide a direct comparison of monthly payments between the alternative mortgage instrument and the standard fixed-payment mortgage offered.

   For the VRM the lender would be required to show borrowers the maximum payments they could face over the life of the mortgage (worst case possible).

VRM Consumer Safeguards

Would apply to the variable rate mortgage only.

1. VRM Index--the Bank Board would outline the following general criteria and monitor the selection of an index to insure that whatever index chosen:

   a. has a proven ability to fall as well as to rise in response to credit market conditions.

   b. is "beyond the influence" of the individual savings and loan using it.

   c. can be easily explained in simple terms to prospective borrowers, and

   d. is as free as possible from manipulation by peculiar economic factors.

2. Rate Changes--Not more than ½ percent per year.

   (This compares with a one percent per year change permitted under the FHLBB 1975 proposal). Not more than two and one-half percent over the life of the loan. The rate could only be increased on the anniversary date of the mortgage.

3. Advance Notice of Rate Increase--45 days in writing.

4. Mandatory Downward Decreases--on anniversary dates.

   Whenever the VRM Index changes in the downward direction a decrease in the rate would be mandatory.

5. Optional Loan Term Changes--upon notification of a rate increase the borrower would have the option of changing the maturity of the loan.

   The maximum term to maturity for outstanding variable rate mortgages would be allowed to increase from the current 30 years to 40 years. Borrowers could use this option to achieve a "fixed-payment VRM".

6. Minimum Rate Change--nuisance rate changes of less than .1% would not be allowed.

   The lender would also be required to make payment tables available to borrowers so that the borrowers could check the accuracy of the lender's calculations. For example, an increase in the rate of .14% probably would not be allowed because generally available payment tables are not calibrated in this manner.

7. No Prepayment Penalty--whenever the current rate is above the initial VRM rate.

GPM Consumer Safeguards

Would apply to the Graduated Payment Mortgage only.

1. Graduation Terms--five or ten years--follows HUD-FHA GPM Program.

2. Graduation Rate--ten year GPM's--3% per year; five year GPM's--7% per year. (Follows HUD-FHA guidelines).

3. Conversion to Standard Fixed-Payment Mortgage--whenever borrowers desire to convert from a GPM to a standard fixed-payment mortgage they will be allowed to do so without payment of fees or penalties.

   The rate would be the standard fixed-payment rate that was offered at iniation of the GPM. This would permit a family whose income increased at a rapid rate to save on their total life-time mortgage payments by converting to the standard fixed-payment mortgage early in the term of the mortgage.

Rollover Mortgage Consumer Safeguards

Would apply to the Rollover Mortgage only.

1. Same safeguards as applied to VRM's would apply to rollovers.

2. Guaranteed Refinancing--the lender must guarantee refinancing of at least the outstanding loan balance for at least the remaining term of the loan.