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OVERVIEW

Franklin American Mortgage Company (FAMC) purchases loans that are in compliance with the requirements of Regulation Z/Truth in Lending Act (TILA). FAMC will purchase higher-priced mortgage loans (HPMLs), provided they are in compliance with all applicable federal, state, agency and investor requirements. FAMC will not purchase any high-cost home loans (HCHLs). This is applicable to loans secured by a borrower's principal dwelling with applications dated on and after October 1, 2009 (escrow requirements were effective for loans closed on and after April 1, 2010).

On July 14, 2008, the Board of Governors of the Federal Reserve System issued amendments to Regulation Z/TILA which provided additional requirements for mortgage loans. Regulation Z now provides three categories for loans secured by a consumer's principal residence. Each category, outlined below, has specific limitations and requirements:

- Standard rate loans;
- HCHL/Section 32 mortgages (very high annual percentage rate (APR) and fees); and
- HPML/Section 35 mortgages (moderately high APR).

Several changes were made to HCHL/Section 32 mortgages, including but not limited to:

- Revised prepayment penalty restrictions;
- Calculating debt-to-income ratio;
- Income verification;
- Payment change restrictions; and
- Repayment ability

Requirements for HPML/Section 35 mortgages were established, including but not limited to:

- Prohibiting extending credit to a borrower based on the value of the dwelling without regard to the borrower's repayment ability;
- Restricting prepayment penalties;
- Requiring the establishment of an escrow account for taxes and insurance (effective for loans closed on and after April 1, 2010.)

HPML DETERMINATION

HPML/Section 35 Loan Definition

Regulation Z defines an HPML as a mortgage secured by a borrower's principal dwelling with an APR that is at least 1.5% higher (for a first lien) or at least 3.5% higher (for a second lien) than the average prime offer rate (APOR) for a comparable transaction as of the rate lock date.

Jumbo Loans

The APR threshold for determining whether a jumbo loan is subject to mandatory escrow is 2.5 percentage points in excess of the APOR for a comparable transaction as of the date the interest rate is set.

All other requirements for HPML (verification of ability to pay, limitation on prepayment penalties, etc.) must be met.

The jumbo loan escrow requirement is effective for applications dated on and after April 1, 2011.

NOTE: FAMC does not purchase Jumbo loans that are HPML's.

Rate Lock Date

The rate lock date is the date the rate is locked with the borrower. For loans in which the lock was extended, the rate lock date remains the same. If the rate lock expires and the loan is re-locked, then the HPML test must be performed using the most recent date the rate was locked.

HPML REQUIREMENTS

Overview

Regulation Z has established specific requirements for HPML/Section 35 mortgages. These requirements include the following:

- Verification of repayment ability;
- Verification of income and assets;
- Limited prepayment penalties;
- Establishment of an escrow account for taxes and insurance (for loans closed on or after April 1, 2010); and
- Submission of the rate spread (difference) as part of HMDA reporting.

Prohibited Practices

Prohibited practices have been established for HPML/Section 35 mortgages. These prohibited practices result in some loan products that cannot be HPML/Section 35 mortgages, such as:

- Conventional Jumbo; and
- ARM loans with a payment adjustment prior to the seventh year (7/1 ARMs are acceptable).

NOTE: FHA Streamline credit qualifying and non-credit qualifying loans and VA IRRRLs can be HPMLs.

Repayment Ability and Verification of Income and Assets

The borrower's ability to pay must be assessed, including the borrower's current and reasonably expected income, employment, assets (other than the property being used as collateral), current obligations, and mortgage-related obligations, which include property taxes, homeowners insurance, and similar mortgage-related expenses (such as homeowners association dues or cooperatives fees).

Income or assets must be verified to determine the ability to repay by reviewing W-2s, tax returns, payroll information, financial institution records, or other third-party documents that provide reasonably reliable evidence of income. Additionally, all current obligations must be verified. Assets from which income can be derived that the borrower can or will be able to use to qualify for the loan must be verified.

FAMC has established procedures to validate income and/or assets that are in compliance with Regulation Z for HPML/Section 35 mortgages. Any loan programs that do not require verification of income cannot exceed the HPML APR threshold.

Prepayment Penalties

A prepayment penalty is permitted only if the penalty is otherwise permitted by law and under the terms of the loan and:

- The prepayment penalty period does not exceed two years from the date the loan closes;
- The penalty will not be imposed if refinanced by the same lender or affiliate; and
- The payment of principal and/or interest may not change during the first four years of the loan.

FAMC does not currently purchase loans with prepayment penalties.

HMDA Reporting

All loans must be reviewed for HPML status and be reported under Regulation C as applicable.

Escrow Requirements

An escrow account for taxes and insurance must be established for every first lien loan that is classified as an HPML/Section 35 mortgage.

Exemptions

- An escrow account does not have to be established for loans secured by shares in a cooperative;
- Insurance premiums do not have to be included in the escrow account for loans secured by condominiums (or a similar property) where the association maintains a master policy insuring the units.

Cancellation of the Escrow Account

An escrow account may be canceled only upon the earlier of:

- No earlier than five years after closing and upon the borrower's request to close the account;
- Termination of the loan.

Even with a consumer's request to close the account, the following must be true:

- The unpaid principal balance is less than 80% of the original value of the property securing the loan; and
- The consumer is current and not delinquent or in default.