

of interest!

A timely digest of regulatory changes, specialized reports and important information for the consumer finance industry.

SPRING 2003



Vol. 18, Issue 1

Carleton Partners with AFS

Carleton has enjoyed tremendous growth over the past 30 years and partnerships have been a key factor in that growth. Now joining our list of partners is Automated Financial Systems (AFS), the country's leading provider of integrated lending software to major U.S. banks.

Headquartered in Exton, Pa., AFS provides asset and liability products and services as an Application Service Provider (ASP) through its fully integrated e-business model AFSCommerce. AFS' loan origination system will incorporate Carleton's SmartCALCS calculation and compliance capabilities.

AFS began in 1970 with a fledgling staff of 13 programmers. Today, the suburban Philadelphia company employs over 300 professionals. With assets of more than \$50 million, the privately held company is led by Jim Greenwood, chairman and CEO, and John Shain, president.

For three decades, AFS has delivered what they term "success through execution" to over 75 percent of the largest banks in the United States.

"We chose Carleton as a critical component of our delivery process," Shain said, "because of their superior reputation in the industry of keeping on top of individual state regulatory man-

dates as they pertain to consumer rate calculations, payments, dealer reserves and insurance rates. This strategic alliance facilitates the regulatory compliance of our customers, accessing the most accurate and reliable source available."

By providing a seamless integration for users, the AFSXpress product offering calls upon Carleton's software, which supports interest and payment calculations, insurance rates, dealer-reserve and state regulatory compliance requirements.

Patrick J. Ruskowski, president and CEO of Carleton, believes the alliance with AFS is an absolute win-win situation for both companies. "Compliance is certainly critical to the success of any financial service provider," he noted, "and we're proud of our reputation for having superior compliant and accurate software. Carleton is pleased to be working with the leader in providing lending infrastructure to top-tier U.S. banks."

Already in use with Carleton SmartCALCS, the AFSXpress Consumer Loan Origination product automates the front-end application, credit approval, document preparation, booking and funds disbursement processes associated with issuing consumer credit.



PUBLISHER'S NOTEBOOK

New Look For *of interest!*

Carleton is pleased to announce a new and improved format for our newsletter, *of interest!*, now in its 18th year of publication. Each quarter we'll be bringing you information that we hope will make your job a little easier.

Our research staff will provide you with up-to-date information on our industry's ever-changing federal regulations and our compliance updates will advise you of the most recent state changes in credit lending computations.

Our "quotes & calcs" column will tell you a little about Carleton's partner organizations, and we'll also provide you with information about our latest products and on-going developments.

Some of you may find it easier to receive *of interest!* via e-mail. If so, just send us your e-mail address and we'll put you on the list to receive the digital version of our newsletter. You can send your requests to ofinterest@carletoninc.com. And we'll take it from there.

Thanks for your interest. We look forward to seeing you again soon.

INSIDE

EVALUATING THE MOB RUSH 2
Reviewing the Reg. Z HOEPA Amendments

COMPLIANCE SUBSCRIPTION SERVICE 2
Lending Rules and Rates for All 50 States

INSURANCE INDUSTRY CAN NOW ACCESS CLIENTS ONLINE 3

COMPLIANCE UPDATE 3
Changes in the State of Arizona



Serving consumer lending and credit insurance providers with full-service, one-stop solutions.

Evaluating the “MOB Rush”

from our research dept. ...

HOEPA has caused its share of confusion and misunderstanding, switching many lenders from single premium to MOB insurance products. At Carleton, we do not necessarily share the often-presented view that single premium products have one foot in the grave.

With the Reg. Z HOEPA amendments now in place, many creditors and insurance carriers are scrambling to make the necessary changes in administrative, system and compliance areas to accommodate outstanding balance, or what many people call MOB (Monthly Outstanding Balance) insurance coverage. MOB insurance is credit life, A&H, IUI, and/or property coverage that is remitted by the consumer as a part of each payment and not financed as part of the loan principal. Historically, it has been a common form of coverage in the credit union industry.

Now that the initial “HOEPA rush hour” has come and gone, we thought it might be helpful to review some points about the HOEPA amendments and MOB calculations in general.

Point 1 – The HOEPA amendments do not prohibit single-premium computations. The key element is that single-premium credit insurance is now included in the points and fees trigger amount.

Unlike many state predatory lending statutes that expressly prohibit single-premium credit insurance computations, HOEPA allows single-premium computations. However, the new amendment that requires they be placed in the fee “trigger amount” may make it impractical for them to be employed on certain transactions secured by real estate (also, first mortgages are not subject to HOEPA).

The combination of single-premium amounts, in conjunction with fees that contribute to the fee trigger amount, may consistently exceed the allowed eight-percent trigger value. The “trigger” cannot exceed eight percent of the “total loan amount” as

defined in HOEPA. (The Federal Reserve Board Official Staff Commentary associated with Sec. 226.18 of Reg. Z provides extensive details in determining the proper amount to use.)

Point 2 – It is generally presumed that MOB coverage will always produce a substantially lower premium and total interest amount than a transaction that incorporates single-premium credit insurance. That is not necessarily so.

Our studies have shown that MOB coverage does not always produce substantially lower premium amounts. In fact, in some states, due to the underlying rate structure, the MOB premiums exceeded single premiums when using comparable rates. (See the examples on our web site presentation titled “Closed-end MOB Premium Calculations & Considerations” or call your Carleton representative for a printed copy of the white paper report by the same name.)

Given the fact that only transactions secured by real estate are subject to the HOEPA amendments, and that those transactions tend to be longer term, credit insurance coverage is almost certain to be truncated term coverage. There have been cases where 60 months of traditional MOB credit insurance coverage on a 240-month transaction actually produces negative amortization! Many of the state predatory lending statutes have two key clauses prohibiting single-premium and negative amortization. However, by prescribing MOB calculations they can potentially create the situation they have prohibited!

(cont. page 4)

Compliance Subscription Service

Lending Rules and Rates for All 50 States



Carleton has provided a subscription compliance service to the consumer credit industry for the past 30 years. *The Cost of Personal Borrowing* is a consolidated reference source that contains the most current lending information. This single volume contains state consumer lending regulation summaries: state maximum interest rates, loan amounts, terms, fees, and late charges. Also included are the published prima facie credit insurance rates and methods of computations.

From an educational standpoint, this publication provides an overview of the Federal Truth-in-Lending disclosure requirements, as well as mortgage lending requirements. In addition, you will find an explanation of the various methods for calculating interest and a description of the different types of consumer credit insurance premiums and rebates.

As part of this service, you will receive the Consumer Finance Newsletter that will alert you to pending changes in legislation before it becomes law. And, anytime

(cont. page 4)

Insurance Industry Can Now Access Clients Online

Carleton and StoneEagle Group have developed a shared application which allows credit insurance companies to provide their customers with a state-of-the-art turnkey solution for quoting loans with payment protection premiums, printing insurance certificates and providing all reporting and administration functions.

"This new Internet solution leverages the unique strengths of our SmartNet loan quoting and document printing product," explains Patrick J. Ruskowski, president and CEO of Carleton. "Combined with the strengths of StoneEagle's credit insurance administrative product, we're able to provide a fully integrated online solution to credit insurance companies."

StoneEagle has developed a highly secure ASP that can send and receive data from the insurance company's StoneEagle administrative system. With this integration in place, Carleton's SmartNet applications can share the same database as the insurance company enabling premium computations based on online data. In addition, policy data and certificates can be transmitted back to the insurance company.

According to Bobby Allen, president of StoneEagle.com, the company has long been intrigued with the idea of marrying the loan origination and document processing aspect of the financial industry to the insurance product administration process.

"Our relationship with Carleton allows us to actually create the link between the two applications and industries," Allen said. "With real time rates and underwriting being supplied by the insurance administrator, all calculations are correct and all underwriting is performed at the point of loan origination."

(cont. page 4)

Effective State Changes

In each issue of our newsletter, we're **compliance** update pleased to bring you "Compliance Update" and "From Our Research Department," the latest information on federal and state regulation changes.

Carleton maintains comprehensive familiarity with over 300 state consumer finance and real estate lending laws in the U.S., as well as the consumer credit insurance regulations in all 50 states, plus the Provincial laws and acts of Canada.

Our "compliance smart" support includes regulatory change notification and compliance white papers designed to keep you aware of regulatory changes that would affect your software.

Our research staff can also provide professional consulting support to make sure your origination and processing systems are in compliance.

If you have any questions regarding the information provided in this issue, you can e-mail Jeff Buysse, director of research, at jbuysse@carletoninc.com.

Arizona

The Order of the Director adopting new prima facie credit life and A&H rates was filed on December 24, 2002, and was effective April 1, 2003.

Highlights of the Order are:

PRIMA FACIE CREDIT LIFE RATES

Single Premium

Single Decreasing Life	\$.47/\$1000/mo (currently \$.44/\$100/yr)
Joint Decreasing Life	\$.78/\$1000/mo 165% of single (currently \$.66/\$100/yr)
Single Level Life	\$.83/\$1000/mo (currently \$.82/\$100/yr)
Joint Level Life	\$1.37/\$1000/mo 165% of single (currently \$1.23/\$100/yr)

If single premium, the above rates are to be discounted for interest and mortality at 4.4% annually and the monthly discount factor in the formula is equal to .0036.

Outstanding Balance

Single Life	\$.83/\$1000/mo
Joint Life	\$1.37/\$1000/mo

PRIMA FACIE CREDIT LIFE RATES

Prima Facie credit A&H rates are published by class of business. There are five classes listed:

- Class 1** – Credit unions
- Class 2** – Banks, savings and loan institutions, mortgage companies
- Class 3** – Finance companies, small loan companies, A.R.S. 6-601(5) consumer lenders
- Class 4** – Dealers (auto, boat, retail) and all others selling financed goods
- Class 5** – All others selling credit insurance not already classified

Refund formulas must be at least as favorable to the consumer as the Rule of Anticipation for both credit life and A&H.



Carleton maintains comprehensive familiarity with over 300 state consumer finance and real estate lending laws in the U.S., as well as the consumer credit insurance regulations in all 50 states, plus the Provincial laws and acts of Canada.

“MOB Rush” (cont. from page 2)

Point 3 – It is probably a good idea to review some basic features of traditional MOB coverage:

- The declining insurance base is the outstanding principal balance.
- Insurance premiums are neither amount financed nor finance charge.
- The premium is not financed.
- The premium is not insured.
- The interest is not insured.
- The allocation of each monthly payment is first applied to accrued insurance premiums, second to accrued interest, and third to principal.
- The interest charge will be higher than for a comparable no-insurance transaction with the same principal. (The “level monthly premium” approach recently introduced is an exception.)

Point 4 – Federal Truth-in-Lending APR calculations may no longer be simple.

Regulation Z gives creditors the option of whether or not to disclose a periodic payment that includes the outstanding balance premium. The Official Staff Commentary associated with Section 226.18(g)(1) states, “For example, the disclosed payments may, at the creditor’s option, reflect certain insurance premiums where the premiums are not part of either the amount financed or the finance charge. . . .”

Traditionally, creditors have disclosed the complete “total payment,” including the insurance premium the consumer will make each period.

In the traditional model, the payment disclosed to the consumer is a level amount. In order to compute a proper Truth-in-Lending Act (TILA) annual percentage rate, the P&I payment must be extracted each period since the insurance portion of the payment is neither amount financed nor finance charge.

In the past, many systems disregarded an actual calculation of the APR and simply disclosed the computational interest rate as the Fedbox value. Since pre-paid finance charges were rarely included on such transactions, the accurately computed APR

was always well within the .125 percent tolerance of the disclosed value (interest rate) as allowed by Regulation Z.

Since HOEPA is directed at loans secured by real estate, pre-paid finance charges become an important factor. Simply disclosing the prevailing interest rate will not produce an acceptable APR value for the purpose of Truth in Lending disclosure.

For example, let’s assume a simple 12-month transaction with an original amount requested of \$5,000. The interest rate is eight percent and the MOB credit life rate is \$1 per month per \$1,000 of coverage. Employing the traditional approach where the consumer will pay a level payment amount each month and the payment includes a variable credit life portion each month, the following are potential TILA federal box annual percentage rate disclosure values once a \$50 pre-paid finance charge has been included in the transaction.

9.891%	8.000%
9.869%	10.025%

Which of these represents an accurate APR disclosure?

What would your system produce for this transaction?

We will look at each of these values in Part II of this article in our next issue of this newsletter.

Intense activity in the credit insurance industry has caused its share of confusion and misunderstanding. At Carleton, we do not necessarily share the often-presented view that single premium products have one foot in the grave. MOB-type coverage products are sound and appropriate for a number of situations but they are not the across-the-board panacea that many believe them to be.

Time will tell and, if nothing else, it should be interesting to watch.

Insurance Industry Can Now Access Clients Online

(cont. from page 3)

Online access allows for collecting the non-insured loan data and enables the insurance companies to measure insurance penetration and production output at the lender, branch or loan officer level.

The StoneEagle Group provides aftermarket financial services such as charge-back indemnity administration, finance, insurance and lender penetration reporting, services contract validation, quoting and claim submission via the Web. The Dallas, Texas company has worked with banks, credit unions, insurance companies, automobile dealers and other financial institutions nationwide since 1967.

“This is another significant partnership for Carleton,” Ruzskowski notes. “We understand how important the full solution is to the insurance industry and we’re constantly looking to develop the best products to meet those needs.”

Compliance Subscription Service

(cont. from page 2)

regulatory changes take place, Carleton will also send revised information so the most current regulatory information is always at your fingertips.

The cost of our Compliance Subscription Service is \$249 for *The Cost of Personal Borrowing* and the first year’s update service. Annual renewal of the update service is only \$150. Call us today to take advantage of this proven and highly relied upon compliance service.



3975 William Richardson Dr.
South Bend, IN 46628
800-433-0900
Fax 574-243-6060

www.carletoninc.com