AMERICAN FINANCIAL SERVICES ASSOCIATION
CONSUMER MORTGAGE COALITION
MORTGAGE BANKERS ASSOCIATION

October 15, 2012

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Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551
Docket No. R-1443, RIN 7100-AD90
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Re: Appraisals for Higher-Risk Mortgage Loans

Ladies and Gentlemen:

The undersigned trade associations appreciate this opportunity to submit comments on a joint rule proposed by six agencies (the "Agencies") to implement requirements for property appraisals in connection with "higher-risk mortgage" loans. These rules would implement amendments that the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") made to the Truth in Lending Act ("TILA"). These amendments are designed to prevent flipping, a type of abuse in which an unscrupulous person purchases a property, inflates its value, and quickly resells ("flips") the property to an unsuspecting consumer at a price in excess of the market value.

We strongly support the proposal to prevent flipping. At the same time, we are concerned that the rule would be excessively complicated in relation to its focused purpose. As we discuss below, the main complexity of the proposed rule relates to the fact that Congress defined higher-risk mortgage based on the spread of the annual percentage rate ("APR") over the average prime offer rate

("APOR"). The definition of APR is tied to the definition of finance charge. The definition of finance charge, in turn, is complicated in mortgage loans, and is in a state of flux. We do not support amending the APR definition because it would be harmful in many circumstances.

We appreciate the Agencies' efforts to make compliance with the rule less burdensome, such as by including a proposed safe harbor.

We understand the statute requires a disclosure at the time of application. We strongly urge this disclosure be designed as part of the Bureau of Consumer Financial Protection ("CFPB") integration of TILA and Real Estate Settlement Procedures Act ("RESPA") disclosures by the CFPB. We comment on how to define an additional appraisal at no "charge." Additionally, we support the proposal that requires an "additional" appraisal as opposed to a second appraisal so creditors can obtain both at the same time, and suggest a method to ensure the creditor uses the more reliable of the two.

The Agencies have authority to exempt classes of transactions from the rule. We suggest exempting several types of transactions for which flipping is not a risk, as we discuss below. For those transactions where flipping could be a risk, we suggest that the loan interest rate is not relevant. We, therefore, suggest consideration of an alternative approach similar to the approach the Federal Housing Administration ("FHA") has used for years in its anti-flipping rule.

The Proposed Rule

The proposal would define a new type of mortgage on a principal dwelling, called a higher-risk mortgage, for which the creditor must obtain an appraisal of the subject property, including an interior inspection. The definition of a higher-risk mortgage is based on the spread between the APR and the APOR for a comparable loan. The APOR measures market rates on mortgage loans.

Notably, flipping is a sales abuse, not a lending abuse. Thus, it is unnecessary to apply the anti-flipping rule to refinance loans.

Higher-risk mortgages would require a disclosure at loan application. If the property had sold 180 or fewer days before consummation of the higher-risk mortgage loan, at a price lower than the new purchaser's purchase price, by an amount or percentage not yet known or proposed, an additional appraisal would be required by a different appraiser. The creditor could not charge the consumer for the additional appraisal. The rule would require delivery of the appraisal reports to the prospective borrower. The rule would also have a safe harbor from liability based on the fact that property appraisals require the exercise of judgment.

Qualified mortgage ("QM") loans are exempt from the rule by statute,[1] and the Agencies have statutory authority to exempt additional classes of loans by regulation.[2] The marketplace is unlikely to provide funding to non-QM loans in all but the rarest of exceptions. This rule will therefore affect a small number of loans and will apply only to creditors willing to make non-QM loans.

[1] TILA § 129H(f)(1).
[2] TILA § 129H(b)(4)(B).

QM Exemption Should be Expanded

We are pleased that the proposed rule would contain the statutory exemption for QM loans. This will avoid some unnecessary regulatory complexity without harming consumers.

The statutory definition of a qualified residential mortgage ("QRM") loan may be "no broader" than the definition of QM loan,[3] and QM loans are exempt from the higher-risk mortgage definition by statute. By statutory definition, a QRM loan is a QM loan. We therefore suggest a regulatory clarification that QRM loans are *per se* exempt from the higher-risk mortgage definition.

Fannie Mae and Freddie Mac (the "GSEs") are agencies under federal government control, placing them at little risk of financing flipped properties. The GSEs use comprehensive file reviews, which interfere with flipping schemes. We therefore suggest that loans that qualify for GSE securitization be exempt from the higher-risk mortgage rule.

We note that the Department of Housing and Urban Development ("HUD") is required to define QM loans for FHA purposes, in consultation with the CFPB.[4] HUD has not yet proposed a QM definition. FHA loans permit a relatively low down payment, making FHA-financed purchases potentially more vulnerable to flipping abuses. Therefore, FHA loans have had an anti-flipping rule in place for years.[5] As a result of this redundancy, we suggest that FHA loans be exempt from the higher-risk mortgage rule. This would allow lenders to more easily guard against flipping, while ensuring consumers are protected by strong, clear regulations.

For practical compliance reasons, we suggest construction loans should be excluded from the definition of higher-risk mortgage loan. In addition to being "generally not feasible,"[6] it is impossible to conduct an interior visit of a home where construction has not begun. Moreover, a construction loan appraisal typically reflects the value of the home "at completion." Therefore, an interior inspection of a home that is in the process of being constructed will not necessarily be determinative of the value of the home "at completion," especially where there may be change orders, which is quite common.

Similarly, bridge loans should be excluded from the definition of higher-risk mortgage loan because these loans can come with higher rates despite the consumer's creditworthiness. In addition, loans secured by multi-use properties, such as properties zoned for live/work space or both residential and commercial use should also be excluded from the definition of higher-risk mortgage because the higher rates charged could derive from its commercial or non-residential aspects, especially where the property is unique.

[3] Dodd-Frank Act § 941(b).
[4] TILA § 129C(b)(3)(B)(ii)(I).
[5] 24 C.F.R. § 203.37a.
[6] 77 Fed. Reg. 54722, 54733 733 (September 5, 2012)

Recommendation

We recommend that –

- the higher-risk mortgage loan definition exclude QM and reverse loans, as proposed;
- the definition also clarify that QRM rules are exempt because they are a subset of QM loans;
- the rule exclude FHA-insured loans because they have another, slightly different but effective, anti-flipping protection;
- loans qualified for GSE securitizations and refinance loans be exempt because of the lack of flipping risks in those loans; and
- construction and bridge loans be exempt because of the unique nature of those loans.

We note that some creditors will find it easier to apply the anti-flipping rule to all nonexempt loans, especially if the APR and APOR definitions are complex or change frequently. We recommend that this be explicitly permissible.

Confusing and Overlapping Mortgage Classifications

We are concerned about the costs and confusion created by establishing yet another unique mortgage classification. Under the proposal, and in the context of several other rules, creditors would have to distinguish higher-risk mortgage loans, QM loans, QRM loans,[7] and high-cost mortgage loans.[8] There is currently also a higher-priced mortgage loan, although whether that term will survive the several mortgage rulemakings pending at the CFPB is unknown.[9] Each of these definitions is created and revised largely in isolation, resulting in overly complicated and overlapping definitions.

The time and cost required for creditors to evaluate each loan opportunity against these overlapping definitions do not necessarily translate to increased consumer protection, yet they impose higher costs on potential borrowers, potentially even reducing access to credit as creditors decide to exit portions of the market because of regulatory uncertainty and burdens.

The proposed definition of higher-risk mortgage depends on the definition of APR. APR is an expression of the "finance charge," the definition of which is subject to potential change. In 2009, the Federal Reserve proposed a more inclusive, or "all in" APR."[10] The intent was for more meaningful APR disclosures. However, the proposal would have unintentionally triggered state and federal high-cost loan limits that are tied to Regulation Z, thereby reducing credit availability to qualified borrowers. Rather than finalize the proposal, the Federal Reserve instead reproposed a rule

[7] Created by Dodd-Frank § 941(b), but not yet defined.

[8] Created by the Home Ownership and Equity Protection Act of 1994, Pub. L. No. 103-325, §§ 151–158, 108 Stat. 2160, 2190-2198 (1994) (codified as amended in scattered sections of TILA, 15 U.S.C. §§ 1601–1667f), and amended by Dodd-Frank. The Dodd-Frank amendments are the subject of a pending rulemaking.

[9] The Federal Reserve Board defined higher-priced mortgage loans in 2008. 75 Fed. Reg. 44522 (July 30, 2008.) It proposed to repeal that definition in 2011 because the Dodd-Frank Act had made the definition largely obsolete. 76 Fed. Reg. 27390 (May 11, 2011). In its HOEPA rulemaking, the CFPB proposed to refer in § 1026.32(a)(1)(i) Alternative 1 to a definition of APOR in § 1026.35, which is the higher-price mortgage loan rule, and in Alternative 2 to a definition of transaction coverage rate, also in § 1026.35. The CFPB explained that it would finalize a rule affecting higher-priced mortgage loans. 77 Fed. Reg. 49090, 49093 (August 15, 2012).

[10] 74 Fed. Reg. 43232 (August 26, 2009).

in 2010.[11] The reproposal contained a transaction coverage rate ("TCR"), in addition to the APR, to prevent inappropriately triggering high-cost loan thresholds. That proposed rule was never finalized. The CFPB recently proposed to amend the finance charge definition, again with a TCR.[12]

Extensive consumer testing found that consumers do not understand the concept of the APR, regardless of what it includes. The problem with the APR is not how it is calculated but that consumers confuse it with the note interest rate.[13] This reaffirms what the Federal Reserve Board had found earlier.[14] Therefore, we oppose devoting extensive resources into refining the precise definition of a disclosure that consumers do not, and will not, comprehend or use.

We attach and incorporate by reference some of our comment letters on the Federal Reserve Board's 2009 and 2010, and the CFPB's 2012, proposals to amend the definition of finance charge. This will demonstrate how complex the definition is, and how changing it would unintentionally trigger many lending restrictions, state and federal. The goal of preventing flipping is straightforward. The finance charge definition is overly complicated for an anti-flipping rule.

We oppose expanding the APR and finance charge, as we discussed in detail in our prior comment letters. If it is amended, the TCR approach would reduce some of the negative aspects of including more items in the definition. This complexity is especially a concern in an anti-flipping rule, where the interest rate seems irrelevant.

For the very few loans that need an anti-flipping protection and do not have one, we suggest considering a far simpler approach, styled on the FHA's approach. The FHA rule looks at whether

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[11] 75 Fed. Reg. 58539 (September 24, 2010).
[12] 77 Fed. Reg. 49090 (August 15, 2012).
[13] A "Key Finding" of the Know Before You Owe testing was that consumers found the APR "confusing and not useful." Kleimann Report, *Know Before You Owe: Evolution of the Integrated TILA-RESPA Disclosures,* p. xxvii, (July 9, 2012): "As other studies have documented, participants often do not grasp the basics of the APR. They often confused it with the loan's interest rate. Across the rounds, to clarify the basic concept of the APR, we worked with various descriptions. We found the most effective way to reduce confusion surrounding the APR was to clarify that it was not the interest rate by adding the simple statement: 'This is not your interest rate[.]' Obviously, consumers may still have difficulty understanding the concept of the APR, but this statement minimized the confusion with the interest rate." P. xxviii (footnote omitted).
"Most consumer participants were confused by the *APR* and could not explain the difference between the *APR* and interest rate." *Id*. p. 61. The report contains selected quotations from consumers that show they are indeed unacceptably confused:

- **"***This is a rate per year [APR] and the other is rate per month, monthly interest."*
- *"I am reading down here the comparisons. I am trying to figure out where this 5.59 [APR] comes from because I thought the interest rate was 2.5. I would probably ask the loan officer about that. I would say how come it is 2.5 up here and 5.9 down there."*
- *"I'm looking at annual percentage rate of 5.89%. Express interest of course over 30 years ... who's giving this different interest rate out? Is it just a comparison that they put to make the interest rate more attractive? The comparison ... I want to know where they got this comparison from, what company did this come from?" Id.* pp. 61-62.

[14] "Participants in consumer testing indicated that much of the information in the current TILA disclosure was of secondary importance to them when considering a loan. Participants consistently looked for the contract rate of interest, monthly payment, and in some cases, closing costs. Most participants assumed that the APR was the contract rate of interest, and that the finance charge was the total of all interest they would pay if they kept the loan to maturity. . . . When asked to compare two loan offers using redesigned model forms that contained these disclosures, few participants used the APR and finance charge to compare the loans." 74 Fed. Reg. 43232, 43236 (August 26, 2009).

the property to be financed was recently sold. If so, the FHA rule compares that recent sales price to the price the prospective borrower will pay. If the difference is more than 100 percent, another appraisal is required.

This approach is focused on identifying potential flipping, does not use overly complex loan terms, and has a reasonable compliance burden. Significantly, compliance with this type of anti-flipping rule would not have to be amended each time the federal or any state definition of APR, finance charge, APOR, or TCR is amended, in any of several rulemakings, or is construed or reconstrued in litigation.

We realize the proposed higher-risk mortgage definition is based on statutory language. However, the statute gives the Agencies clear authority to exempt entire classes of loans.[15]

Recommendation

We recognize that the statute and proposed rule use the APR–to-APOR comparison. Nevertheless, we suggest that the rule permit, but not require, creditors to require appraisals with interior inspections on all nonexempt loans regardless of their APR. We suggest that it permit creditors to obtain two appraisals on any loan if the property sold within 180 days before consummation, for which the earlier sales price is lower than the borrower's purchase price by the by the amount specified in proposed § 1026.XX(b)(3)(i)(B), again, regardless of the APR.

Additional Reasonable Exemptions

We suggest a number of additional exemptions for property increases that do not involve flipping. Loans should be exempt if they finance purchases of property:

- That is real estate owned ("REO"), sold by the party that acquired it through foreclosure or through a deed in lieu of foreclosure;
- That is sold by a federal or state agency, including Fannie Mae or Freddie Mac;
- Acquired by the seller through inheritance or in connection with a divorce; and
- Purchased by an employer or relocation agency in connection with the relocation of an employee.

Copy of the Appraisal Provided to the Consumer

When the rule requires delivery of an appraisal to the consumer, what must be delivered is not clear. We are concerned that it could reach internal appraisal reviews. Congress required delivery of appraisals only, not other communications or reviews.[16] We believe the creditor should be required to deliver only a complete and signed appraisal report.

Internal reviews of appraisals are trade secrets, and they are confidential, proprietary information. Some of the internal reviews are proprietary but are not the property of the creditor.

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[15] TILA § 129H(b)(4)(B).
[16] TILA § 129H(c).

Fannie Mae and Freddie Mac (the “GSEs”) perform automated reviews of certain valuation information and produce findings about the reasonableness of the information. As a practical matter, the GSE reviews are not in a form that consumers would understand. If the Agencies require disclosure of this GSE information, they will need to work with the GSEs to see whether the GSEs will agree to have their proprietary, confidential information made public and, if so, who would pay for the systems changes necessary. In addition, the Agencies will need to determine how the GSEs' information can be presented in a form that would be meaningful to consumers.

Requiring creditors to provide consumers with internal and external reviews of appraisals would greatly complicate determining what must be disclosed. E-mail communications about the substance of appraisals could potentially be covered depending on the particular language used in the communications (*e.g.*, whether a valuation is sufficient; when the sufficiency determination would be available, or the maximum loan amount based on the creditor's evaluation). Determining what to disclose would require a careful legal examination of all communications about a loan to exclude privileged, proprietary, and trade secret information. Then it would require further careful examination to determine what is a review of the valuation itself and what is not.

This review would need to cover all communications inside the creditor's company, as well as those communications with any outside appraiser or appraisal management company. It would also need to cover communications within the appraisal firm or the appraisal management company; between the creditor and a GSE or mortgage insurer; and inside a mortgage insurance company. We do not know how a creditor could obtain access to third parties' internal communications about a valuation.

This would require an expensive, time-consuming undertaking, much like a discovery request, for every loan application. Creditors would need full time staff dedicated to this one task.

Recommendation

We recommend that when an appraisal must be delivered, the creditor should be required to deliver a signed appraisal report, but no other appraisal materials.

Appraisals in Rural Areas

Ensuring the accurate valuation of mortgage collateral is critical to the home buying process, and we recognize that the proposal is in large part implementing rules required under Dodd-Frank. We are concerned, however, that the proposal does not address the difficulty faced by lenders in rural areas in having a property appraised, let alone by an additional appraiser. This issue also applies in distressed markets and to unique properties[17] due to the infrequency of purchases. The low volume of comparable sales make it more difficult to appraise the fair market value of these types of properties.

We request the Agencies use their exemption authority to expressly exclude rural areas from the proposal's requirement for a second appraisal. It should be noted that the CFPB's proposed ECOA disclosure rules allow for a creditor to rely on prior appraisals when deciding whether to renew the

[17] Additionally, many marginal borrowers look to unconventional housing, which by definition makes determining fair market value more difficult.

loan; this approach can be applied here without undermining consumer protections, and we recommend doing so. These changes will ease the compliance burden on creditors, particularly small and independent mortgage bankers and those who operate in thin markets. Moreover, these savings will manifest themselves in increasing consumer access to home financing, helping continue the fragile gains we have won thus far in the recovery.

Recommendation

We recommend that the final rule expressly exclude rural areas form the requirement to obtain an additional appraisal.

Alternatively, we request the Agencies utilize their exemptive authority to allow alternative mechanisms to satisfy appraisal requirements, such as a field review of original appraisal materials.

Requests for Clarification

No "Charge" for a Second Appraisal

When two appraisals are required, the proposed rule would permit creditors to charge for only one.[18] The proposed Comment states that this prohibits both charging a specific fee for one appraisal and "marking up the interest rate or any other fees payable by the consumer in connection with the higher-risk mortgage loan."[19] Creditors need to recoup their costs. Many have safety and soundness obligations as well as fiduciary duties to shareholders to be profitable.

While a specific charge may be impermissible, creditors still need to recoup their costs indirectly, which should be permissible.

We do not know how creditors would be able to exclude the indirect costs. How would the creditor be sure the cost is excluded from the interest rate, which would likely already have been set before the creditor delivers the appraisal report? The only way to truly exclude it would be to not make the loan, or to refund the cost.

If a creditor uses an appraisal management company, this comment would seem to prohibit the creditor from charging the consumer for the management company's fee. The Dodd-Frank Act prohibits this. Dodd-Frank amended the Real Estate Procedures Act ("RESPA") § 4 to permit, but not require, the settlement statement to break down the appraisal management company's fee from the fee to an appraiser. That is, creditor may charge such fees to consumers. This is important because loans on which the creditor pays an appraisal management company may never close.

Recommendation

We recommend that creditors be prohibited from charging a direct cost for the second appraisal but not an indirect cost.

[18] Proposed § 1026.XX(b)(3)(v) (citing the CFPB's proposal).
[19] Proposed Comment XX(b)(3)(v).

Origination Disclosure Timing and Content

The proposed rule would require a disclosure at loan application. We recommend this disclosure be integrated with the Know Before You Owe Loan Estimate (which will replace today's good faith estimate ("GFE"). Lenders may not charge for an appraisal until after delivery of the GFE and after the consumer has indicated and intent to proceed,[20] so there is no significant benefit to the consumer in providing the disclosure at application.

The origination disclosure should implemented with the other disclosures under the integrated RESPA and TILA origination disclosures. One of the reasons those disclosures need integration is that they were designed piecemeal over many years without regard to how they work with other disclosures. Adding one more piece of paper to the pile of disclosures is not helpful to consumers. If the disclosure is required separately from the integration rulemaking, lenders will need at least six months to implement it. They will need time to integrate it into other appraisal disclosures. Creditors should be permitted, for example, to include the disclosure with Regulation B appraisal disclosures. If a rule has model language, we recommend writing it once, not once now and again as part of the integration rulemaking.

<u>Recommendation</u>

We recommend that any new origination disclosures be implemented with the Know Before You Owe disclosures. Consumers will still get the same appraisal reports.

Safe Harbor

The proposal includes a safe harbor that would allow a creditor to be "deemed to have obtained a written appraisal that meets the [appraisal requirements]" provided certain conditions are satisfied.[21] However, the text is ambiguous with regard to certain critical issues. For instance, the proposal is unclear as to whether the safe harbor applies to the second appraisal; indeed, a literal reading may in fact proscribe such an interpretation,[22] thus calling into question the protection afforded to creditors. The safe harbor also lacks a standard of review by which an originator can rely on "the face of the written appraisal and the appraiser's certification[,]"[23] further clouding the evaluation of a creditor's liability and duties.

The proposed safe harbor is also unclear as to the scope of information required under the Appendix. We request clarification as to the type of information that should be included regarding "the property's neighborhood." Likewise, we requests clarification as to whether Item 5 of the Appendix is intended to add to current USPAP reconciliation practices.

Finally, a related question arises due to the incorporation of FIRREA and USPAP standards in the safe harbor. Many of the express conditions for fulfilling the safe harbor are already part of industry

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[20] 12 C.F.R. § 1024.7(a)(4).
[21] Proposed § 1026.XX(b)(2).
[22] For instance, a creditor may be precluded from asserting a lack of "actual knowledge to the contrary of facts or certifications contained in the written appraisal" if the second appraisal is markedly different than the first, even if the disparity is the result of good faith on the part of both appraisers.
[23] Proposed Comment XX(b)(2)(iii)-1.

practice under FIRREA and USPAP. We request clarification whether the safe harbor is meant to codify current practices under FIRREA and USPAP, or whether the Agencies intend for the safe harbor to be a higher threshold.

This question manifests itself in the lack of guidance surrounding multiple appraisals containing different valuations. It is currently industry practice to exercise reasonable discretion and use the more credible appraisal report where creditors obtain two appraisals for the same property, regardless of which reports the lower value. However, as stated above, the presence of materially different valuations may preclude the safe harbor from applying at all.

Recommendation

We recommend that the safe harbor be retained. We also recommend that it be clarified to apply to all appraisals required or obtained under this rule, even if the creditor complies with the rule when not required to avoid the APR and APOR difficulties. We suggest the safe harbor not require more than is required by other appraisal standards. It should apply even if two appraisal reports arrive at differing valuation estimates, even if the second criticizes the first.

Conclusion

We strongly support anti-flipping protections. We request that compliance with this rule be clarified and simplified as discussed, with appropriate exemptions and flexibility.

Sincerely,

American Financial Services Association
Consumer Mortgage Coalition
Mortgage Bankers Association

Attachments

CONSUMER MORTGAGE COALITION

December 24, 2009

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Truth in Lending Proposed Rule – Closed End Mortgage Loans
Docket No. R-1366

Dear Sir or Madam:

The Consumer Mortgage Coalition (CMC), a trade association of national consumer mortgage lenders, servicers, and service providers, appreciates the opportunity to submit these comments on the proposal by the Board of Governors of the Federal Reserve System (Board) to amend Regulation Z to improve the effectiveness of consumer mortgage disclosures, in connection with an application and throughout the life of a mortgage.

Overall, the Board's proposal would improve the clarity and effectiveness of disclosures in important areas. We strongly support the Board's efforts to improve these important disclosures and to help consumers make informed decisions. We appreciate that the Board "sought to ensure that the proposal would not reduce access to credit[,]"[1] which is especially important in the current environment when many consumers need to refinance their mortgagee loans. We further appreciate the Board's stated desire to ensure that disclosures under the Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act of 1974 (RESPA) "are compatible and complementary, including potentially developing a single disclosure form" under both TILA and RESPA.[2] This is especially timely because the disclosure requirements under both sets of regulations are changing, and only coordinated disclosures will be useful to consumers.

We respectfully note some areas where the proposal could lead to adverse consequences, and make recommendations on how the Board might prevent or mitigate them. We suggest a number of technical clarifications to the definition of finance charge and to the disclosures. We comment on the regulatory burden of the proposed rule, which we believe

[1] 74 Fed. Reg. 43232, 43238 (August 26, 2009).
[2] 74 Fed. Reg. 43232, 43233 (August 26, 2009).

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the Board underestimates, and we suggest changes in one area where the proposed disclosure would entail extraordinary regulatory burden that we do not believe is outweighed by a consumer benefit. We also comment on the loan originator compensation proposal. Finally, we suggest a number of areas where the TILA and RESPA disclosures can be more closely coordinated.

I. ALL-IN APR

Background

One of the most significant proposed changes would be to include more items in the annual percentage rate (APR), the "all-in APR." As the Board explained:

> The Board believes consumers would benefit from having a disclosure that includes fees or charges that better represent the full cost of credit undiluted by myriad exclusions, the basis for which consumers cannot be expected to understand. In addition, having a single benchmark figure—the APR—that is simple to use should allow consumers to evaluate competing mortgage products by reviewing one variable. . . . Thus, the Board would retain the APR as a benchmark for closed-end transactions secured by real property or a dwelling but is proposing certain revisions designed to make the APR more useful to consumers.[3]

To this end, the Board proposes to include in the definition of "finance charge" a number of mortgage fees that currently are excluded from that definition. Because the APR is in part based on the finance charge, the proposed amendments would indirectly amend the APR.

Curtailed Credit Availability

We certainly support the intent of disclosing the cost of credit. We do note, however, one unintended consequence of amending the definition of finance charge, unrelated to the quality or effectiveness of consumer disclosures. That definition is the basis of other rules, in both federal and state laws that are not related to consumer disclosures. To the extent that the Board amends the finance charge definition in Regulation Z, it would also effectively change a number of other laws that refer to that definition. Those laws are designed to restrict the types of loans consumers obtain, as opposed to the disclosures they get in connection with all mortgage loans.

We are particularly concerned that the proposed change would inadvertently reduce the availability of consumer mortgage credit, which is the not the Board's intent.

TILA and Regulation Z effectively restrict Home Ownership and Equity Protection Act (HOEPA) loans, which include loans with an APR that exceeds the rate on comparable-term Treasury securities by a margin, as well as loans on which "the total points and fees

[3] 74 Fed. Reg. 43232, 43243 (August 26, 2009).

payable by the consumer at or before closing will exceed the greater of 8 percent of the total loan amount or [$579]."[4]

Most relevant here is the latter loan category, those with points and fees above a threshold. For these purposes, the proposal would amend the definition of points and fees to include "all items included in the finance charge, pursuant to § 226.4, except interest or the time-price differential."[5] The Board explains:

> This change would reflect the language of TILA more closely and is not meant to effect any substantive change to HOEPA's coverage.[6]

In addition, the proposed amendment to the definition of finance charge will affect the loans that meet the threshold for higher-priced mortgage loans (HPML). The threshold is loans:

> with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction as of the date the interest rate is set by 1.5 or more percentage points for loans secured by a first lien on a dwelling, or by 3.5 or more percentage points for loans secured by a subordinate lien on a dwelling.[7]

Since the proposal would include new items in the finance charge, and because the APR is based on the finance charge, the proposal will increase the APR, making it more likely any loan will reach the HPML threshold.

The Board addressed the impact of its proposal on HOEPA loans and on HPML loans. It estimated the effect on APRs on first-lien loans using Home Mortgage Disclosure Act (HMDA) records and found that a relatively small number of loans would reach the HOEPA threshold if the proposal were in effect. It also estimated that, in the three states that use an APR threshold lower than the HOEPA APR threshold for first lien loans, the proposal would cause 2.5%, 4.0%, or 0% of the first-lien loans in those states to reach the state-law threshold.[8]

The Board also, using data from Lender Processing Services from 2006, estimated that about 3% of the first-lien loans in an amount from $175,000 to $225,000 that were below the higher-priced mortgage loan threshold would have exceeded it if the proposal had been effect at the time.[9]

HOEPA has two thresholds, one based on APR and the other based on points and fees. Reaching either threshold makes a loan a restricted high-cost loan. The Board concluded that the proposal would not have a large impact under the APR threshold. But it is also

[4] 12 C.F.R. § 226.32(a)(1)(ii). (The $579 limit will become effective January 1, 2010, after its annual adjustment.)
[5] Proposed § 226.32(b)(1).
[6] 74 Fed. Reg. 43232, 43278 (August 26, 2009).
[7] 12 C.F.R. § 226.35(a)(1).
[8] 74 Fed. Reg. 43232, 43244 (August 26, 2009).
[9] 74 Fed. Reg. 43232, 43244 (August 26, 2009).

important to consider the effect of the proposal on the HOEPA threshold, and similar state law thresholds, based on points and fees. The proposal does not address this issue. We do not believe the Board should implement an all-in APR without considering or addressing the effects of an all-in APR on the points and fees thresholds under the various state laws.

The proposal would cause more loans to reach the state points and fees threshold for high-cost lending restrictions in four ways.

First, many states – almost half of the states – have a points and fees threshold lower than the federal threshold. Adding new items to the definition of finance charge would make loans in these states more likely to reach the high-cost threshold even if the loan would not reach the federal HOEPA threshold.

Second, regardless of the threshold level, some states follow HOEPA rules, in whole or in part, for the method of calculating points and fees. In twelve states, all of the new items the Board proposes to include in the finance charge would be included in the state points and fees calculation. In an additional five states, treatment of new finance charge items is unclear. Because of the high litigation risk, in these five states creditors would need to assume the finance charge includes all the new items. This means that in seventeen states, every item the Board adds to the finance charge definition would count towards the state threshold for high-cost loans. In an additional three states, some costs would count towards the threshold while others would not.

This means that in twenty states, the all-in APR as proposed would make more loans reach the state points and fees threshold for restricted high-cost loans, regardless of whether the threshold is high or low.

Third, the finance charge as proposed would vary by state. Our research shows that the average finance charge would increase $2,500 per loan, nationwide. But we estimate that in New Jersey the increase would average almost $3,500, while in New York the increase would average over $4,500.

In New Jersey, the points and fees threshold is usually 4.5% of the loan amount. Assuming a loan principal of $200,000, the proposed definition of finance charge would bring the loan almost halfway to the points and fees threshold. ($3,500 is 1.75% of $200,000.)

In New York, the points and fees threshold is usually 5% of the loan amount. Assuming a loan principal of $200,000, the proposed definition of finance charge would, again, bring the loan almost halfway to the points and fees threshold. ($4,500 is 2.25% of $200,000.)

Many consumers prefer a loan with a number of points because in exchange they can get a reduced interest rate and a lower monthly payment. Yet in the two states illustrated, this option would be substantially curtailed.

Fourth, the proposed amendment to the definition of finance charge would reduce the total loan amount, which is the threshold level used in the HOEPA points and fees threshold. Reducing that threshold would make a loan more likely to reach the threshold. That threshold level is set as the amount financed determined under § 226.18(b) less certain financed costs.[10] Section 226.18(b) defines the amount financed to include the principal loan amount plus other amounts financed that are *not* part of the finance charge. The proposal to include many more items in the finance charge will therefore lower the HOEPA points and fees threshold.

Therefore, the proposal would cause many loans to reach state law points and fees thresholds. Since high-cost loans are widely regarded as predatory, extremely few lenders are willing to make them, whether under federal or state law. The proposal, then, would force creditors to restrict credit in many states. We believe this would be contrary to the intent of the proposal, would be harmful to consumers, and would directly counter the federal government's many efforts to increase credit in the mortgage market.

We do not believe curtailing credit availability is an appropriate manner in which to help consumers understand the terms of their credit.

Other Unintended Disadvantages

- ***Revised APOR Would Be Needed***

If the Board were to adopt an all-in APR, it would affect the HPML threshold as well as the HMDA rate-reporting threshold because both are based on the APR.[11]

Both the HPML threshold and the HMDA rate-reporting threshold are based on a comparison of the APR to the average prime offered rate (APOR). Including more costs in the APR without similarly amending the APOR would alter both thresholds. The intent of the all-in APR is to improve the effectiveness of the APR disclosure. We do not believe the Board intended to amend the APR-based thresholds.

Altering the HMDA rate-reporting threshold would make HMDA data less useful because comparisons of data before and after the all-in APR effective date would be distorted by inconsistent reporting requirements, for economically equivalent loans. We do not believe distorting the HMDA data is appropriate when the goal is to improve consumer disclosures.

To avoid having an all-in APR amend the HPML threshold and the HMDA rate-reporting threshold, neither of which were the Board's intent, revised APORs would be necessary. Even if the Board were somehow able to accurately measure and track fees and incorporate them into revised APORs, it would be faced with a new problem. Since mortgage fees vary substantially from state to state, the APORs would need to be either set nationally and therefore be inaccurate, or would need to vary geographically. Neither result should be the effect of an effort to improve APR disclosures.

[10] Comment 226.32(a)(1)(ii)-1.
[11] 12 C.F.R. § 226.35(a)(1); 12 C.F.R. § 204.3(a)(12)(i).

A combination of the difficulties in including fees in APORs, and the credit curtailment and distortion of HMDA data without revised APORs, together are another reason we believe the Board should not adopt the proposed all-in APR.

- ***Increased Mandatory Waiting Periods***

The all-in APR would also result in a number of redisclosures before loan consummation as the cost of expanded number of items included in the APR change. Each redisclosure would require a new three-day waiting period before a loan could close. Consumers will undoubtedly be annoyed, inconvenienced, and sometimes economically harmed from mandatory waiting periods.

Conclusion

For these reasons, we are unable to support the proposal to eliminate the current exclusions from the definition of finance charge, in proposed §§ 226.4(c)(7) and 225.4(g). We believe the Board should not implement the all-in APR, as proposed.

II. ALL-IN APR ALTERNATIVES TO MITIGATE LENDING CURTAILMENT

While we believe the Board should not implement its proposed changes to the definition of finance charge because they would reduce credit availability, we support the Board's underlying goal of improving consumer's ability to understand the cost of mortgage credit.

However, the proposal would not accomplish this goal, and would come at the cost of restricting the availability of consumer mortgage credit to creditworthy families, delaying closings, and distorting HMDA data. For these reasons, we cannot support the proposed all-in APR approach to making disclosures more accurate.

Should the Board decide to finalize an all-in APR despite its flaws, we recommend a number of changes that would support the intent of the all-in APR but would help reduce some of the disadvantages.

Include Settlement Costs in the APR but not in the Finance Charge

The Board's intent is to make the APR a more meaningful disclosure for consumers. The proposal amends the definition of finance charge rather than the definition of APR, but this would have a number of disadvantages, discussed above, unrelated to the APR disclosure, or the quality of any disclosures.

A better approach would be to amend only the APR. The costs that are currently excluded from the definition of finance charge that the Board proposes to include could be included for purposes of the APR calculation but continue to be excluded from the finance charge for other purposes. This would meet the Board's goal of an improved APR disclosure, while avoiding some of the unrelated problems caused by amending the definition of finance charge.

Include Settlement Costs In The Finance Charge, With A RESPA-Based Cap

Creditors identify in a RESPA good faith estimate (GFE) the estimated cost of third-party settlement services. The Board's proposal would include third party costs in the finance charge and APR. This would have the effect of subjecting creditors to liability for changes, beyond extremely small tolerances, for third-party costs.

The Board has requested comment on whether it should increase the finance charge tolerance in light of the proposal to include more third-party charges in the finance charge.[12] The Board suggested the possibility of increasing the finance charge tolerance to $200.[13]

The proposed definition of finance charge would create another area of interplay between the TILA and RESPA rules. That is, the proposed expanded Regulation Z definition of finance charge would now include a number of third-party charges, but RESPA § 8 does not permit lenders to guarantee those costs to consumers. That means creditors will be accountable, under TILA, for third-party charges that are governed by the RESPA § 8, which effectively prohibits guaranteeing those fees.

We believe the best approach for consumers would be to permit settlement service providers to guarantee to consumers the costs of closing their mortgage loans. This would enable packagers of settlement services to use their purchasing leverage to lower closing costs for consumers. It would also make certain that consumers learn with certainty the costs of their loan very early in the application process, a major goal of both RESPA and TILA rules. This would, however, require relief from RESPA § 8 liability, which RESPA rules do not currently provide. The unfortunate effect is that consumers' closing costs are higher than they need to be.[14]

Until packagers are permitted relief from RESPA § 8, lenders will need to estimate third party charges rather than guarantee them. To handle the inevitable incorrect estimates that lenders give consumers about the cost of third party charges, RESPA rules establish a 10% tolerance above the estimated costs, for lender-required settlement services when the lender selects the provider or when the consumer selects the provider from a lender's written list of providers.

Because of RESPA § 8, incorporating third party charges into the Regulation Z definition of finance charge would make the TILA-based tolerance inappropriate. A $200 tolerance

[12] 74 Fed. Reg. 43232, 43246 (August 26, 2009).
[13] 74 Fed. Reg. 43232, 43246 (August 26, 2009).
[14] According to a HUD analysis in 2002, if lenders were permitted to guarantee settlement costs to consumers, the result would be a $10.3 billion in total savings to consumers.[14] This is almost $1,000 per loan. Similarly, in a joint report to Congress by the Board and HUD in 1998, the two agencies found that guaranteed closing packages would result in savings to consumers. The Report is available here: http://www.federalreserve.gov/boarddocs/rptcongress/tila.pdf. *See* Appendix E.

simply would not cover even the most routine fluctuations in third-party charges that lenders can neither predict nor control, and that they are not permitted to guarantee to consumers.

Short of RESPA § 8 relief, if the Board does finalize an expanded definition of finance charge, we recommend that it cap the amount of third party charges that are included in the finance charge, based on the RESPA tolerances. This would include in the finance charge the costs of third-party settlement services listed in GFE Blocks 3, 4, 6, and 7, that would not be paid on a comparable cash transaction, as the lesser of either the actual charge (after taking into consideration any cure of an exceeded tolerance) or the charge as listed on the GFE plus a 10% tolerance as provided in 24 C.F.R. § 3500.7(e)(2).

This approach has several advantages.

- It would reflect the true cost of credit. A cost would exceed the RESPA tolerance when the borrower shops for and selects a service provider that is more expensive than one the lender identified on the GFE, but this extra-expensive service is not an accurate cost of credit because the borrower could have selected a less expensive service provider. Presumably the borrower opted to pay a higher cost because it includes some unrelated extra service or benefit.

- It would reduce regulatory burden on lenders. Some charges are for service providers that a borrower selects, while the lender does not require the service, and does not select or identify the provider. In this case, the regulatory burden on the lender of knowing the actual charges would be extremely high, while the borrower is fully aware of the costs of services the borrower shops for and selects.

- It would enhance borrower's shopping ability and power. The proposal would put on creditors the burden of knowing the costs of third-party charges, within an extremely small tolerance. The only feasible way for creditors to know the charge would be to limit consumers to third parties whose costs the creditor can know in advance. It will be easier, and will greatly reduce litigation risk, for creditors to require consumers to use large national or regional service providers. Smaller or local service providers will be excluded even if they have better prices. Consumers would have fewer shopping options.

- It would reduce the number of loans inappropriately classified as high-cost loans or as HPML loans. If a consumer selects an expensive service provider, and if that extra cost were included in the finance charge, the loan would be more likely to reach the high-cost or HPML threshold. The consumer's selection of a settlement service would be irrelevant to the policy reasons behind the restrictions on high-cost or HPML loans. Rather, the consumer may select an expensive service provider for completely unrelated reasons – the service provider may be a friend, may have a convenient location, or may include in the charge unrelated services that are of value to the consumer. These extraneous matters should not affect whether a loan reaches the high-cost or HPML thresholds.

- It could decrease the number of additional waiting periods and delayed loan closings. Because the charges included in the finance charge would not exceed the amount disclosed in a GFE plus 10%, the borrower's decision to select a more expensive service provider would have a limited affect on the accuracy of the TILA disclosure, and would therefore be less likely to require a corrected disclosure and a new waiting period.

- It would help coordinate the TILA and RESPA rules, thereby increasing consumers' ability to understand and benefit from the disclosures, while reducing regulatory burden.

Exclude Points and Fees From § 226.32 Definition

Another approach to preventing an unintended curtailment of credit while improving the APR's accuracy would be to: (i) define points and fees in § 226.32(b)(1) to retain the current finance charge exclusions, for purposes of § 226.32, even though those amounts would still be finance charges, and (ii) retain the incorporation into the definition of the total loan amount under Comment 226.32(a)(1)(ii)-1 the finance charge exclusions currently stated in § 226.18(b).

This approach is consistent with TILA's approach to high-cost loans. TILA excludes, for high-cost loans, many real estate fees from the definition of points and fees. TILA defines points and fees, for purposes of high-cost loans, to exclude real estate-related fees, including government recording fees, when those fees are reasonable and are paid to a third party and not to the creditor or the creditor's affiliate.[15]

Excluding real estate-related fees from the § 226.32(b)(1) definition would permit the Board to adopt the all-in APR it proposes without unnecessarily curtailing credit, especially in those states that use a low points and fees threshold in restricting high-cost loans.

III. CLARIFICATIONS OF FINANCE CHARGE

Should the Board finalize its proposed amended definition of finance charge, we request clarification on a number of issues.

Special Rule for Closing Agent Charges

The proposal would exclude several items from the special rule for closing agent charges, § 226.4(a)(2). The result is that all fees a closing agent charges, or fees for another party the closing agent hires, would be included in the finance charge. Closing agents sometimes charge borrowers fees that are excessive, or that are both unrelated to the loan and were not requested by either the creditor or the consumer.

[15] 15 U.S.C. § 1602(aa)(4)(C).

To prevent surprise charges to consumers, and to avoid increasing creditors' liability for uncontrollable closing agent charges, we suggest the Board require closing agents to disclose to creditors all their charges, including those for third parties they hire, eight business days before consummation. This would provide sufficient time to accommodate the three-day waiting period after a final corrected disclosure before consummation.

Voluntary Credit Insurance Premiums, and Voluntary Debt Cancellation or Debt Suspension Fees

The proposal would include in the finance charge premiums for voluntary credit insurance, and premiums for voluntary debt cancellation coverage or debt suspension fees. As a practical matter, this would make it very difficult to continue to offer these products to consumers. It would be better to continue to exclude these charges from the finance charge, but instead:

- Prohibit charging the premium or fee as a single cost at or before closing.
- Require the fee to be charged with periodic loan payments.
- Permit the consumer to be able to cancel coverage at any time.
- Require that a consumer's cancellation must terminate all future obligations to pay premiums or fees.

We also recommend amendments to the proposed Model Clauses H-17(C) and H-17(D) for credit insurance and debt cancellation or suspension. These model clauses state that "If you have insurance already, this policy may not provide you with any additional benefits." This is not necessarily true, and could be misleading. It would be true only in the highly unusual case where a consumer has preexisting credit insurance, debt cancellation, or debt suspension protection coverage that would cover the loan to at least the coverage level, and in at least the same circumstances as, the new product.

Further, the statement may lead consumers to believe that if they have mortgage insurance or life insurance that the new product may not provide any benefits that the mortgage insurance or life insurance do not provide. This is not true, so we believe this is not an appropriate disclosure.

We also recommend removing the reference in the Model Clauses to employment status, as the creditor may be unable to verify the consumer's employment status at the time of providing the disclosure.

We also recommend removing the command "STOP" from the disclosure. The next sentence, "You do *not* have to buy this product to get this loan," makes the same point.

Hazard and Flood Insurance

We support the proposal's exclusion from the finance charge of premiums for hazard insurance. A homeowner would pay for hazard insurance in a comparable cash transaction. Additionally, the amount of hazard insurance coverage the homeowner selects will vary by borrower preferences regarding levels and types of insurance coverage, which is unrelated to a mortgage loan.

We recommend that, for the same reasons, flood insurance premiums be excluded from the finance charge in all cases, regardless of whether the borrower chooses the flood insurance provider. Otherwise, lenders would have an inappropriate incentive to discourage borrowers from obtaining flood insurance.

The proposal would require creditors to treat insurance available through the creditor's affiliate as available from or through the creditor, and thereby require disclosure of the premium and, if shorter than the loan term, the insurance term. We support this. However, we request clarification that the affiliate may deliver the required disclosures.

We also request clarification that proposed § 226.38(j)(4), which would require a disclosure that the consumer may obtain property insurance from any insurer acceptable to the creditor, also refer to the disclosures required to exclude property insurance available from or through the creditor from the finance charge.

Seller Points And Relocation Benefits

Points and fees that a seller pays should not be included in the finance charge because the seller would also pay them on a comparable cash transaction. Economically to the seller and buyer, they are part of the sales price of the property. If the seller did not pay them, the buyer would pay a lower price to purchase the house. In a comparable cash transaction, the seller would not pay the buyer's loan points or fees, but would instead receive a lower price, other things being equal.

We further recommend that the final regulation clarify that amounts an employer pays to relocate an employee are excluded from the finance charge because the consumer does not pay these costs. They are not part of the cost of consumer credit.

Charges for Lien Discharge or Resubordination

We recommend that the cost of discharging a lien or of resubordinating a lien be excluded from the definition of finance charge. On a refinance, the existing creditor may charge a fee to prepare and record a release of that creditor's lien or a resubordination of the lien.

The recording cost will vary by the length of the document, and will also vary by geographic area. We do not believe that including costs that vary for reasons unrelated to the new loan in the APR would serve the Board's intent of improving the usefulness of the APR disclosure to consumers.

Excluding these costs from the finance charge would not affect the consumer's ability to shop for loans because the consumer would need to pay the same costs regardless of which creditor the consumer selects.

Conversion or Modification Fees

Fees charged to convert a loan from an adjustable rate to a fixed rate, or to modify a loan, should be excluded from the definition of finance charge because at origination the creditor cannot know whether the consumer may convert or modify the loan. The disclosures should be made assuming the consumer pays the loan according to the legal obligation.

Required Property Completion or Repairs

If a property was or will be newly constructed, the creditor will need to ensure the building is fully and properly completed. Construction and repair costs may be needed. These costs should not be included in the definition of finance charge, for several reasons:

- The consumer would pay them on a comparable cash transaction.
- The costs would in many cases push the loan over the threshold for HOEPA or state law high-cost loans, preventing the loans from being made.
- The costs are difficult to predict, and would be unknown at the time of loan application.
- Including these costs in the finance charge would not improve the consumer's ability to shop for a loan, but would distract the consumer's attention from loan costs.
- Including these costs in the finance charge would encourage creditors avoid repairs that would benefit the homeowner, may protect the consumer's health and safety, and could prevent damage to the surrounding neighborhood.

Payoff of Existing Liens or Debts

The cost of payoff of an existing lien should not be included in the definition of a finance charge. The property may have, for example, a tax lien that the lender requires to be discharged. Or, the consumer may apply for a debt consolidation loan, or may be required to pay off other debts at the time the new loan is underwritten. These costs are unrelated to the mortgage loan. They should not be included in the definition of finance charge for the following reasons:

- Including these costs in the finance charge would not improve the consumer's ability to shop for a loan, but would distract the consumer's attention from loan costs.
- The costs would in many cases push the loan over the threshold for HOEPA or state law high-cost loans, preventing the loans from being made.
- Without the new mortgage loan, the consumer may be unable to pay off the debts or liens, possibly leading to an unnecessary and avoidable loss of the home.

Government Recording Fees

We recommend that the Board retain the exclusion of government recording fees from the definition of finance charge. Since these fees are set by governmental entities, the difference between these fees from one creditor's loan to another creditor's loan is trivial. Including such fees in the finance charge will not enhance the consumer's ability to shop.

Furthermore, the recording fees in some states are substantially higher than others. In higher cost states, including these fees may cause the loan to exceed HOEPA or state law high-cost loan APR thresholds, or points and fees thresholds, or both. This would not serve the Board's intent of improving the effectiveness of the APR disclosure.

Clarification About Fees Charged in Comparable Cash Transactions

Charges payable in a comparable cash transaction are excluded from the finance charge. Proposed comment 226.4(g)-3 clarifies that the cost of recording the deed that transfers title to the property from the seller to the buyer is excluded from the finance charge. We request that the following items be added to this comment and likewise excluded from the finance charge because they are paid in comparable cash transactions:

- Fees for preparing the deed and other documents related to the purchase of the property. (The Board's Section-By-Section analysis of the proposal describes these as included in the finance charge.[16])
- Real estate broker's fees.
- Fees of the borrower's attorney.
- Escrow agent charges.
- Fees for services required under the purchase and sale agreement with the seller.

It would be particularly helpful if the Board and the Department of Housing and Urban Development (HUD) would coordinate so that these charges were listed in a separate block on the GFE from the charges that are included in the finance charge.

Post-Closing Optional Services

Fees that are part of the original loan agreement are included in the definition of finance charge without regard to whether they are paid at closing or later, such as interest. Sometimes, though, after a loan closes, the loan servicer may provide services to the consumer that are outside the loan agreement. The cost of these optional services should be excluded from the finance charge. At origination, the creditor cannot know what they may be at some future time.

Voluntary and Optional Fees Incident to the Extension of Credit

Creditors may sell products or services to a consumer in addition to a mortgage loan. It is important that the costs of services that are only tangentially related to the loan, or that the creditor might not know about at all, not be included in the finance charge.

For example, a bank making a mortgage loan may cross-sell the borrower a checking account with a monthly fee. It is not clear whether the fact that the cross-sale opportunity arose out of the mortgage application makes the checking account charge a voluntary charge incident to the extension of credit

[16] 74 Fed. Reg. 43232, 43247 (August 26, 2009).

Or, a consumer, prior to closing on a new loan, may arrange with a bank, other than the creditor, for automated payments on the mortgage loan, but the lending bank may be unaware of this. It is not clear whether, if the non-lender bank charges a fee for that service, the fee is a finance charge.

Moreover, including the cost of optional products or services in the finance charge and APR would distort the usefulness of the finance charge and APR disclosures as shopping comparison or consumer education tools. It would cause the finance charge and APR to fluctuate based on matters unrelated to the loan, such as what non-loan services a creditor offers or a consumer selects.

If the Board does require additional disclosures or includes the cost of optional services in the finance charge, we recommend that the service be deemed "incident to" the loan, and therefore subject to the requirements, only if the creditor requires the consumer to purchase the service and if the consumer contracts for the service at or before consummation.

Payments into Escrow

Proposed § 226.4(g) excludes, with some exceptions, certain real estate-related charges from the definition of finance charge on closed-end transactions secured by real property or a dwelling. The Board's Section-By-Section Analysis of the proposed rule explains that the finance charge will exclude "amounts required to be paid into escrow or trustee accounts if the amounts would not otherwise be included in the finance charge."[17] This makes sense because property insurance premiums and property taxes are unrelated to mortgage credit, and are paid on comparable cash transactions. Also, including property taxes in the finance charge would cause APRs to vary geographically on identical loans. Moreover, including taxes in the finance charge could cause a loan to well exceed the HOEPA or HPML threshold, or a similar state threshold, depending on the wholly irrelevant fact of when a tax payment is next due.

If a loan closing is scheduled shortly before a property tax payment is due, the property tax payment to be made into the escrow account would bring the loan much closer to the HOEPA or HPML threshold, particularly in states with high property taxes. Property tax rates, and the timing of when taxes are due, should be entirely irrelevant to HOEPA and HPML thresholds. Property taxes are due regardless of whether the consumer has a mortgage.

Proposed § 226.4(g) does not include a reference to § 226.4(c)(7), escrowed items that are not otherwise included in the finance charge. We strongly urge including such a reference so that the timing and amount of property tax payments does not affect the HOEPA and HPML thresholds.

[17] 74 Fed. Reg. 43232, 43247 (August 26, 2009).

Premiums and Rebates

Proposed comment 226.28(e)(5)(iii)-2, regarding disclosure of the loan principal amount, states that when a creditor offers a premium or when a third party pays some of the cost of credit or offers a buy down, the disclosure of the premiums or buy downs must be reflected in accordance with the terms of the legal obligation between the creditor and consumer.

➢ ***Preclosing Credits***

Where the premium will be paid after the loan is consummated, it should be relatively clear whether the premium is part of the legal obligation. However, creditors often provide marketing credits to reduce closing costs that are not documented in the note or other documentation evidencing the loan because those credits are applied at or before consummation. We recommend a clarification that amounts paid by the creditor at or before consummation may be used to reduce the finance charge.

➢ ***Rate Reduction Mortgages***

Rate reduction mortgages provide that if the consumer makes a certain number of timely payments, the rate on the loan will decrease. These programs are generally offered to borrowers who have less than excellent credit as an incentive to make timely payments. We request a clarification on whether the disclosures should assume that timely payments will be made and reflect the decrease.

IV. DISCLOSURES AT OR BEFORE CONSUMMATION

Scope

We support the proposal to require disclosures for all closed-end consumer loans secured by real property or a dwelling, with the following exceptions.

➢ ***Vacant Land***

We believe it would be preferable to permit creditors the option of providing disclosures on loans secured by vacant land under either the general closed-end credit rules or the new rules applicable to closed-end loans secured by a dwelling. Because loans on vacant land are not secured by a dwelling, there does not seem to be a need to *require* all of the same protections that apply to loans secured by a dwelling. As a practical matter, creditors may find it easier to apply the same rules, whether the property is vacant or has a home on it. Therefore, we believe creditors should have a choice.

But if a loan is secured by vacant land, if a creditor were to make disclosures as for a loan secured by a consumer's dwelling, certain adjustments would be advisable.

- Proposed § 226.38(b)(5) exempts construction loans and temporary bridge loans from the requirements of § 226.38(b)(2) and (b)(3) to compare the loan's APR to the

APOR. That exemption should be extended to loans secured by vacant land, because the rates for loans on vacant land are substantially different that the rates for conforming, owner occupied loans. Comparing the APR and APOR would result in a misleading disclosure, and therefore should not be required.

- On a loan secured by vacant land, creditors should be permitted to revise the security interest disclosure required by § 226.38(f)(2) so that it does not refer to the possible loss of "the home" because there is no home on vacant land.

➢ ***Loans Secured By Personal Property That is a Dwelling***

The Board's proposal would require creditors to provide certain disclosures for all closed-end transactions secured by real property or a dwelling, not just principal dwellings. This would greatly increase creditor's litigation risk, and thereby the cost of consumer credit, while there is no reason to believe that such loans have been the subject of inappropriate lending practices. Extending Regulation Z to these loans could reduce the availability of credit, and we therefore recommend against it.

Preapplication Disclosures

The Board proposes Model Forms for preapplication disclosures, which we believe are useful and clear. We recommend some minor adjustments.

➢ ***Brokers Should Be Able To Provide Disclosures***

We recommend that brokers be permitted to provide the forms. This would help get the disclosures to consumers quickly.

➢ ***"Key Questions To Ask About Your Mortgage"***

The Board proposes a new form, Key Questions to Ask About Your Mortgage, listing seven questions and answers. We suggest the following revisions to this form.

Question 1. The answer to this question indicates that on ARMs the interest can go up or down "after a short period." However, that may not be accurate. The rate may be fixed for a period of years, perhaps five or ten years. We suggest this disclosure be revised to delete the language in ~~struck through~~ and add the language in **bold**.

> *If you have an adjustable rate mortgage (ARM), your interest rate can go up or down ~~after a short period~~. This means that your monthly payment could increase.* ***On some ARMs your initial rate and payment may be in effect for only a short period.***

Question 2. The answer to question 2 indicates that payment may increase because "your property taxes or insurance premiums increase." However, the consumer's property taxes or insurance premiums may increase regardless of what mortgage loan the consumer chooses or whether the consumer has a mortgage at all. To be most clear, we suggest separating the loan payment from the taxes and insurance, as follows:

> *This increase could be because you have a lower introductory interest rate~~, your property taxes or insurance premiums increase,~~ or because in the beginning your monthly payment only covers the interest on the loan, and not the principal amount.* ***Your payments for property taxes or insurance premiums could increase.***

Question 3. Generally, the questions listed in the *Key Questions To Ask About Your Mortgage* are asked and answered in the same format in subsequent disclosures. However, Question 3, "Will my monthly payments reduce my loan balance?" becomes "Will any of my monthly payments be interest-only?" in subsequent disclosures. We suggest that this question on the *Key Questions To Ask About Your Mortgage* form use the same language as used on subsequent disclosures.

Additionally, whether the loan requires payment of principal has an effect on the consumer's equity, but decreases in the market value of the home may have an even greater effect. We suggest adding the language in bold to the last sentence of the answer: "As a result, if you have this type of loan, you may not build any equity in your home **even if your home does not decrease in value.**

Making both changes, Question 3 would read,

> *Will any of my monthly payments be interest-only?*
>
> *Some loans let you pay only the interest on your loan each month. These payments do not pay down the amount you borrowed. As a result, if you have this type of loan, you may not build any equity in your home even if your home does not decrease in value.*

Question 4. For the same reason discussed above under Question 3, we suggest adding language to the last sentence of the answer:

> This could cause you to lose equity in your home over time **even if your home does not decrease in value**.

Question 5. This question covers prepayment penalties. It alerts consumers that "Some loans charge you a large fee if you pay off your loan, refinance it, or sell your home within the first few years of the loan. The penalty fee could be thousands of dollars."

While these are true statements, we suggest alerting consumers to an additional fact, that they have a decision to make. They need to decide whether to select a loan with a prepayment penalty and a lower loan cost, or a loan with no prepayment penalty and a higher cost. We believe consumers should be aware of the tradeoff so that they can ask appropriate questions and make the most informed decisions. We suggest revising the disclosure to state:

> *Some loans charge you a large fee if you pay off your loan, refinance it, or sell your home within the first few years of the loan. The penalty fee could be thousands of dollars.* ***These loans may have lower costs than loans with no prepayment penalty.***

<u>Question 7.</u> This question, "Will I have to document my employment, income and assets to get this loan?" in subsequent disclosures becomes "Will my loan have a higher rate or fees because I did not document my employment, income or other assets?" in subsequent disclosures. We suggest that this question on the Key Questions form use the same language as used on subsequent disclosures.

- ***"Fixed vs. Adjustable Rate Mortgages"***

The Board proposes a new form, *Fixed vs. Adjustable Rate Mortgages*. We suggest the following revisions to this form.

The column of the form describing ARMs contains the following sentence: "However, both the rate and payment can increase very quickly." This statement is not accurate for hybrid ARMs that have many years until the first adjustment. We recommend revising this sentence to add the bold language as follows:

> *However,* ***on some ARMs*** *both the rate and payment may increase very quickly.*

Subsequent disclosures distinguish between fixed rate loans and step rate loans and have additional requirements for fixed rate balloon loans, but this disclosure appears to tell the consumer that if the rate is fixed then payments will stay the same for the life of the loan. We suggest adding the bold language to the first sentence of the first paragraph of the disclosure:

> *A traditional fixed rate mortgage* ***with equal monthly payments throughout the life of the loan*** *is a safe choice for many borrowers*.

We further suggest that description in the Fixed Rate Mortgages column be revised to address this issue and the risks of a fixed rate mortgage:

> *With a fixed rate mortgage, the interest rate and monthly payment* ***usually*** *stay the same for the entire loan term.* ***However, the interest rate and monthly payment often are higher than the initial rate and payment on an ARM.***

- ***ARM Program Disclosures***

<u>ARMs Where the Initial Rate is Not Determined Using the Index or Formula That Applies to Rate Adjustments</u>

On ARM programs where the initial interest rate is not determined using the index or formula that applies to later rate adjustments, the creditor will often not know, when giving the program disclosure, whether the initial rate will be discounted from the fully indexed rate, will be the same as the fully indexed rate, or will be a premium over the fully indexed rate. This is precisely because the rate is not set using the formula that will apply to later rate adjustments.

Additionally, borrowers often have the choice of paying discount points and obtaining a lower initial interest rate, or taking a higher initial interest rate and receiving a credit towards closing costs. Whether a borrower chooses to pay discount points to get a lower initial rate or chooses to pay a higher initial rate to receive a credit, the fully indexed rate would not be affected. Because the disclosure precedes the loan application, the creditor does not know, when giving the program disclosure, what choice the borrower will make and whether the initial rate will be a discounted or premium rate. Further, changes in the index value after the disclosure and before consummation could change whether the initial rate was a discounted or premium rate. That is, it is too early in the loan application process to make an accurate, transaction-specific disclosure.

We recommend that the Board require a disclosure that better informs consumers about the nature of the transaction. We recommend that the Board revise the Introductory Period box to state:

> *The interest rate will stay the same for [length of time].*

A statement could be added either in the Introductory Period box or in the Index/Formula box to state that:

> *During the initial period the interest rate may be based on the index [shown below] plus a margin or could be a higher or lower amount. Ask us for more detail.*

This would be more informative to consumers, and would give them all the information then known.

<u>Other Loan Programs Presenting Risks</u>

We believe it would be beneficial to require pre-application loan program disclosures that describe the risks of the loan features identified in the *Key Questions To Ask About Your Mortgage* form. This would include loans other than fixed rate, fully amortizing loans,

The disclosures should describe the risks but, because the disclosure would precede the loan application, the disclosures could not be transaction-specific. In many cases, creditors and mortgage brokers are already required by the Nontraditional Mortgage Guidance adopted by both federal and state regulators to provide information about risks. These disclosures can help consumers identify the type of loan they want early in the process.

- ***Disclosure Timing Requirements For "Key Questions To Ask About Your Mortgage" and "Fixed vs. Adjustable Rate Mortgage"***

The proposal includes two model forms, *Key Questions To Ask About Your Mortgage* and *Fixed vs. Adjustable Rate Mortgage*, that describe information similar to that in the "Summary of your loan" section in the new GFEs. The Board proposes to require creditors to deliver these forms at application, although RESPA rules require delivery of the GFE within three days of receiving an application. All of these disclosures should be required within three days of application because this would coordinate the RESPA TILA rules.

We believe many or most creditors and brokers will provide the two model forms earlier, and will post them on their websites, as will real estate agents, housing counselors, and many others. However, we believe the disclosure timing rules under RESPA and TILA should be as consistent as possible to reduce the cost of complying with both sets of rules. We recommend that a creditor or broker be required to provide these two forms within three days of receipt of an application,

If the Board believes consumers need these disclosures sooner, the Board and HUD could post the model forms on their websites. This would make the forms very widely published and available, while reducing regulatory burden.

<u>TILA Timing and Redisclosure Requirements</u>

- ***Early TILA Disclosure***

<u>Definition of Application</u>

The Proposal's revised Comment 19(a)(1)(i)-2 provides that creditors may, in determining whether an application has been received, rely on RESPA and Regulation X even for a transaction not subject to RESPA. We recommend that this comment be further revised to state that for such transactions, the creditor may also determine whether an application has been received by relying on the Equal Credit Opportunity Act (ECOA) and Regulation B. This would have no material effect on consumers, yet would reduce regulatory burden.

<u>General or Precise Definition of "Business Day"</u>

Both the current regulation and the proposal require that early TILA disclosures be mailed or delivered within three "general" business days after application. "Precise" business days are all calendar days except Sundays and the legal holidays specified in 5 U.S.C. § 6103(a). "General" business days are defined as days that "the creditor's offices are open to the public for carrying on substantially all of its business functions." In most instances, creditors will have far fewer employees working on Sundays and legal holidays and would have difficulty preparing disclosures on those days. However, because the public may be able to contact the creditor on those days, or possibly close a loan on those days, the current rule creates unnecessary uncertainty as to whether the creditor is "open."

Comment 226.2(a)(6)-1 states that indicators of when a creditor is open for substantially all of its business include the availability of personnel to make loan disbursements, open new accounts, and handle credit transaction inquiries. This is a difficult standard to apply because creditors often have personnel available to handle inquiries and at all hours, and have website capability to handle many functions at all times.

In contrast, a creditor's staff that prepares the disclosure is normally only available during standard, weekday, non-holiday business hours.

For these reasons, we recommend that the creditor be deemed to have delivered the early TILA disclosure on a timely basis if the early TILA disclosure is mailed or delivered within three "general" business days. We further recommend that creditors should not be required to count Sundays and Federal holidays as business days, regardless of how "open" the creditors are on those days.

- ***Guidance on Whether Revised TILA Disclosure May Reflect Current Estimates of Charges or May Reflect Charges Shown on a GFE***

The final RESPA rule and HUD's implementing Frequently-Asked-Questions (FAQs) indicate that a revised GFE should not increase the estimates for settlement charges from the estimates for those charges in the initial GFE, unless justified by changed circumstance or a borrower-requested change. This is the case even if the creditor may have subsequently obtained information showing that the fee is higher than initially estimated.

For example, assume that fees subject to the 10% tolerance were initially estimated at $2,000 but are now estimated at $2,100, yet there has been no changed circumstances warranting a revised GFE with an increase in those estimated costs. Since the comparison of GFE fees to actual fees on page 3 of the HUD-1 settlement statement bases the tolerance calculation on the amounts disclosed on the GFE, the amount disclosed on the revised GFE should continue to be $2,000, so that borrower can see that the actual charge of $2,100 is within tolerance.

We request a clarification to Comment 226.17(c)(2)(i)-1 that the creditor may estimate the amounts of fees for TILA purposes using either:

- The amount of the fees based upon information reasonably available at the time the TILA disclosure is made (the $2,100 amount in this example); or

- Amounts shown on GFE plus 10% ($2,200 in this example) even though Regulation X may require any revised GFE to disclose a lower amount.

- ***Final TILA Disclosure***

<u>Use of Estimates</u>

The Proposal would limit the use of estimates in the final TILA disclosure to certain disclosures affected by escrowed taxes, insurance premiums, and mortgage insurance premiums.

- Limit on Consumer's Ability to Float Rate Until Closing

  Many creditors allow borrowers to choose to continue to float the interest rate up until closing rather than lock the rate earlier. The proposed limits on the use of estimates will effectively require borrowers to have their rates locked more than a week before consummation. We defer to the Board's judgment on whether it is in the consumer's interest to remove the ability to float the rate until closing in exchange for greater certainty in the final TILA disclosure.

- Per Diem Interest

  Since closing are sometimes postponed, we recommend a clarification to Comment 226.17(c)(2)(ii)-1. This comment states that disclosures affected by per diem interest are considered accurate if they are prepared on information known at the time the disclosure is prepared, even if they are not labeled as estimates. We recommend clarifying that this also applies to per diem interest disclosures in the final TILA disclosures, so that those disclosures are not deemed inaccurate simply because of a delayed closing.

- Disclosures Affected by Changes in Settlement Charges

  Required disclosures that are affected by changes in settlement charges but which may not be estimated under the Board's proposal include the Total Settlement Charges as required to be disclosed on the HUD-1, the Interest and Settlement Charges (Finance Charge) disclosure, the APR disclosure, and the Amount Financed disclosure.

  While the Board's proposal does not conflict with the tolerance and timing rules of Regulation X to the extent that it would be possible to comply with both the Regulation Z and Regulation X requirements, the Proposal is certainly inconsistent with and duplicative of Regulation X requirements. We recommend that estimates of settlement charges be permitted on the final TILA disclosure if they are consistent with Regulation X requirements.

  As the Board recognizes, requiring disclosures that are not estimates will require settlement costs to be finalized as much as a week before consummation.[18] Since the creditor cannot necessarily predict third-party closing costs, the creditor will need to have the closing agent provide the Total Settlement Charges and information sufficient to determine the Finance Charges included within the Interest and Settlement Charges at least eight business days prior to closing. The

[18] 74 Fed. Reg. 43232, 43260 (August 26, 2009).

Board also recognizes that most creditors provide either a GFE or HUD-1 according to Regulation X timing rules to satisfy the Itemization of Amount Financed requirement, but the Board's proposal would not permit using the HUD-1 to fulfill this requirement unless it is delivered with the final TILA disclosure.

If the Board intends to have closing agents finalize settlement costs and prepare the final HUD-1 so that a final TILA disclosure will not require any estimates, then the regulation should explicitly require the closing agent to do so.

- ***Corrected Final TILA Disclosure***

Alternative 2 With a Modification

The Board proposes two alternatives regarding the need to correct a final TILA disclosure due to changes after a final disclosure. Alternative 1 would require a corrected disclosure if the APR becomes inaccurate, while Alternative 2 would require a corrected disclosure only if the APR becomes inaccurate beyond the applicable tolerance, or if a fixed-rate transaction becomes an adjustable rate transaction. We recommend, as follows:

- We recommend that the Board adopt Alternative 2, with a modification, for several reasons. Alternative 1 could result in unnecessary and repeated delays in closing that could present inconveniences and other problems for consumers. Since a corrected disclosure requires a three-day waiting period, each correction would require a delay in closing. A change in the APR, within the applicable tolerance, is not a sufficient change in the loan to require such a significant consumer inconvenience.

- Also, Alternative 2, while the better alterative, would be improved by permitting flexibility to waive the three-day waiting period, as discussed next.

In summary, we recommend that the Board require a corrected final disclosure only if the disclosure understated the APR beyond the tolerance, and provide consumers the ability to waive the waiting period.

Consumers May Want to Waive a Waiting Period

There are many cases where a mandatory waiting period could cause unnecessary consumer harm. Some costs are third-party costs that creditors may be unable to accurately predict. Should they change and require a new waiting period, consumers could be in a bind.

A consumer may be purchasing a home under a contract that requires closing by a date certain. Failure to close by that date could cost the consumer a down payment as well as contractual damages. Either could be quite expensive to the consumer. Or, there may be multiple sales that are made dependent on each other, so that if one fails to close, another fails as well. Or, a consumer may have an interest rate lock that will expire during a period of rising rates. In each of these cases, the waiting period could do more harm than good.

Consumers will have a variety of reasons why they may wish to waive the waiting period. Creditors are not able to make a waiver decision for on a consumer's behalf nor do can the Board. Consumers should be permitted to affirmatively waive the waiting period when they wish to do so.

For these reasons, we recommend strongly that the Board permit consumers to request a waiver of the three-day waiting period, in writing, and creditors be permitted to honor those requests.

APR Reduction, Regardless of the Reason, Should Not Require a Corrected TILA Disclosure And a New Waiting Period

The Board discusses the possibility that in the same transaction both of the following occur after the consumer receives a TILA disclosure:

- The consumer selects a smaller principal amount, so that the earlier disclosed finance charge becomes overstated.
- The interest rate increases, so that the disclosed APR becomes understated.

The Board believes an APR is based on an overstated finance charge only where the APR is also overstated. Therefore, the Board would require a corrected disclosure in this case even though the APR was based on an overstated finance charge.[19] We agree that an APR based on an overstated finance charge is accurate only if the APR is overstated.

Under proposed § 226.19(a)(2)(iv), an APR also would be considered accurate if it decreases for specified reasons. We believe that if the interest rate used to calculate the final TILA disclosures is accurate when the final disclosure is mailed or delivered to the consumer, a reduction in the APR, regardless of the reason, is clearly beneficial to the consumer and should not require corrected TILA disclosures and a delay in closing. An APR decrease always benefits the consumer, but redisclosure may not because of the waiting period.

We believe that the applicable APR and RESPA tolerances adequately protect consumers against unanticipated increases in settlement costs at closing. While RESPA tolerance rules provide an incentive not to understate estimates, substantially overstating the disclosures would be such a significant competitive disadvantage that creditors have a very strong incentive to avoid doing so. Concerns that over-disclosures on earlier disclosures will undermine their integrity are misplaced because of the strong competitive pressures against overstating costs.

If an overstated APR will be deemed accurate when the overstatement is based on an overstated finance charge alone, the rule would be uncertain and difficult to apply. In the

[19] 74 Fed. Reg. 43232, 43261(August 26, 2009).

following circumstances, for example, it is unclear whether the overstated APR results from an overstated finance charge:

- A settlement charge included on the final TILA disclosure was included in the prepaid finance change when it should have been excluded.
- The estimated amount of a settlement charge included on the final TILA disclosure was properly treated as a prepaid finance charge but the actual charge is waived or reduced.
- A charge that was treated as a prepaid finance charge and was expected to be paid by the borrower when the final TILA disclosure was prepared is paid by the seller and excluded as seller's points.
- The finance charge included within the payment schedule of the final TILA disclosure is overstated because the borrower negotiated a lower rate and the actual fixed rate or initial interest rate on an ARM is lower than the rate used to prepare the final TILA disclosure.
- The prepaid finance charge, initial interest rate, and margin used to calculate the fully indexed rate on an ARM loan have not changed from the final TILA disclosure, but an updated lower index value results in a lower fully indexed rate and causes the finance charges included within the payment schedule of the final TILA disclosure to be overstated.

We recommend that the Board clarify that an overstated APR, regardless of the reason for the overstatement, is considered accurate and that no corrected disclosure, and no new waiting period, is required. Any reduction in an APR benefits the consumer, and a new waiting period is not necessary because consumers do not need protection from benefits.

<u>Proposed Exceptions for Discounts for Title Insurance Discounts or Automatic Debits</u>

- Title Insurance

  Proposed § 226.19(a)(2)(iv)(B) states that the APR will be considered accurate even if there is a decrease in the loan's APR due to a discount a title insurer gives the consumer on voluntary owners' title insurance. However, proposed Comment 226.4(g)-2 states that "premiums for owner's title insurance coverage are not finance charges because they are not imposed as an incident to the extension of credit." If such premiums are not finance charges, how could a reduction in the amount of those premiums result in an overstatement of the APR? Is this exception meant to cover a discount given to the consumer on the cost of the lender's coverage due to the purchase of voluntary owner's title insurance coverage?

- Automatic Debits

  If the final TILA disclosure is prepared before the borrower chooses to obtain a lower rate by arranging for automatic debits, it would appear that the actual APR would be overstated from the APR disclosed on the final TILA disclosure due to an overstatement of the finance charge (the higher finance charge included in the payment schedule). We believe this exception should be covered by the general rule that a disclosed APR is accurate if it results from a disclosed finance charge that is overstated.

Consummation Disclosure

We suggest revising proposed Comment 19(a)(2)(iii)-1 under the Board's Alternative 2 by adding the bold language and deleting the language ~~struck through~~:

> *(If a change occurs* ***that makes a disclosed term inaccurate but does not require receipt of a corrected disclosure three business days before consummation*** *~~that does not render the annual percentage rate on the early TILA disclosures inaccurate~~, the creditor must disclose the changed terms before consummation, consistent with Section 226.17(f).)*

For clarity, we further recommend that § 226.19(a)(iii) should also refer to the requirement to provide disclosures prior to consummation in these cases.

ARMs Where the Initial Rate is Not Determined Using the Index or Formula that Applies to Rate Adjustments

- The proposal retains existing Comment 26.17(c)(1)-10(i) (renumbered Comment 226.17(c)(1)(iii)-3(i)), which states that for an ARM where the initial rate is not calculated using the index or formula for later rate adjustments and the loan contract provides for a delay in the implementation of changes in an index value (a "look-back period"), the creditor may use any index value in effect during the look-back period before consummation in calculating the disclosures. We request that proposed Comment 17(c)(1)(iii)-3(i) clarify that, for disclosures prepared prior to consummation, the creditor may use any index value during the look-back period as of the date the disclosures are mailed or delivered, and that that the final APR to which the previously disclosed APR is compared for accuracy may be calculated with any index value in effect during the look-back period before consummation.

- The proposal retains existing Comment 17(c)(1)-10(iv) (renumbered Comment 17(c)(1)(iii)-3(iv)), which states that these transactions involve irregular payment amounts and are subject to the rate tolerance of ¼ of 1%. We request a further clarification to Comment 17(c)(1)(iii)-3(iv) that these transactions are considered irregular transactions notwithstanding the fact that an index value in effect during the look-back period before consummation may result in a fully indexed rate that happens to equal the initial interest rate and payments that happen to be equal.

V. CONTENT AND FORMAT OF DISCLOSURES

We are pleased that the proposed format requirements, including the requirement to tailor the disclosures to the specific features of the requested loan, are designed to improve consumers' ability consumers to read and understand the disclosures. We very strongly support disclosures that consumers can understand.

However, the format requirements are complex, increasing the risk that a consumer may not understand them or that a creditor may make an inadvertent error. We therefore make several recommendations.

Additional Examples

To help creditors deal with the complex formatting requirements, we recommend that additional disclosure examples be provided which cover, at a minimum, the structure of all of the standard mortgage programs of Fannie Mae, Freddie, Mac FHA, and VA.

The Proposed APR/APOR Graph Is Not Informative to Consumers And Is Overly Complex to Produce

The proposed APR to APOR comparison would be given to consumers early in the application process to illustrate where the consumer's APR falls in comparison to rates on other consumer loans in the same week the disclosure is given. While we certainly agree that consumers should be clearly informed about their interest rates, we do not believe this particular disclosure would be very helpful, as discussed below. At the same time, operationally, it would be extraordinarily difficult to produce because it would require technology the mortgage industry does not have in place. Further, the shading requirement would make the disclosures difficult to read and photocopy in most circumstances. We suggest below other disclosure methods that would provide more timely and useful disclosures with considerable less regulatory burden.

- ***The Proposed Disclosure Would Be Hypothetical***

The disclosure would disclose an APR on a graph that compares the range of rates, during the week the disclosure is produced, from the "average best" APR to the APRs in the "high-cost zone." The disclosure would compare the APR to APRs on "similar" conforming loans offered to applicants with "excellent" credit. It would also disclose the amount the consumer's payment would decrease by a 1% point APR reduction.

Because the disclosure would be provided early in the application process, it would be hypothetical because the APR will change before consummation, for a number of reasons.

- With an all-in APR, many, many factors would cause the APR to change after application before closing.
- Market interest rates are always fluctuating.
- The consumer may not yet have decided whether to select an adjustable or fixed rate.
- The consumer may not yet have decided whether to make a larger down payment in exchange for a lower rate, or to do the opposite.
- The loan-to-value (LTV) ratio would not yet be known, yet it can have a significant affect on the APR of a mortgage loan.

The disclosure would lead consumers to believe that their credit score determines their APR. It would compare the APR to applicants with excellent credit and to high-cost loans, "usually available to applicants with poor credit history."

While credit score is one factor that determines a loan's interest rate, it is by no means the only factor. Market interest rates certainly affect the loan rate very significantly. The LTV also can be very significant, yet the disclosure makes no mention of the effect of the LTV. Lien position affects the loan rate but not the APOR. (It does affect the margin added to the APOR to determine the HPML and HMDA reporting thresholds, because lien position is so significant to the loan rate.) Owner occupancy also affects the loan rate. We question whether emphasizing the credit score and ignoring other significant factors would be an appropriate form of disclosure.

At this stage of the loan application process, it may be too late for consumers to be able to improve their credit scores materially. Even if a consumer could do so, it is unlikely that the credit score would improve enough to cause a 1 percentage point decrease in the APR, as the disclosure would show.

- ***The Disclosure Would Require Adopting New Technology***

Loan origination systems are designed to make a number of consumer disclosures, but are not equipped to handle graphic displays such as the proposed graph. The technology in place today can put numbers and characters into particular boxes and locations, but is simply not capable of creating the proposed graph.

Should the Board go forward with the proposed graph, new mortgage origination software would need to be developed and programmed to produce the shaded disclosures. The new systems would then need to be integrated into all the loan origination systems nationwide. This process would need 18 to 24 months to complete, and would be hugely expensive.

- ***Shading May Make Disclosures Illegible***

Shaded text or background would be a particular problem in any mortgage disclosure, even if creditors did bear the expense of equipping themselves to produce disclosures with shading. Shaded disclosures are more difficult to read. This would be especially true where consumers and creditors may need to fax or make photocopies of the disclosures, which could render the text printed on a shaded background illegible. We are concerned about a disclosure that lenders would be unable to fax, and that would be illegible if photocopied.

Given that the disclosure uses a hypothetical or potential APR rather than the APR the loan will actually have, given that the disclosure will become obsolete right away and certainly in a week, and given that the disclosure focuses on credit history over market rates, LTV, lien position, owner occupancy, and other significant factors, we suggest that in this case the cost of the disclosure far outweighs the consumer benefit.

- ***Suggested Alternative Disclosure***

We suggest that a better alternative would be to combine the APOR comparison with a credit score disclosure. The APR to APOR comparison will only be useful if consumers understand how their creditworthiness compares to the creditworthiness of other consumers. We recommend that the Board adopt a disclosure that is generic rather than transaction-specific.

Alternatively or in addition, the Board could post a graph weekly that consumers could use, showing current market rates on a range of relevant loans.

- ***Suggestions if the Board Adopts the Proposed Graph***

If the Board does adopt the proposed graph, we have the following suggestions for improvements and requests for clarification.

- *Revised APOR Calculations to Reflect All-In APR.* Because the APR will now be an all-in APR, the calculation of the APOR should be revised to include the average amount of all of the fees now included in the calculation. Without this change, the comparison of the APR to the APOR will be misleading because the APOR will be understated from the actual average APRs offered to prime customers.

- *Date of APOR.* In proposed § 226.38, paragraph (b)(2) indicates that the disclosed APOR should be for the week in which the disclosure required under this section is "provided" while paragraph (b)(3) says that it should be the APOR as of the date the disclosure is "produced." Since there may be a delay between when a disclosure is produced and when it is provided to the consumer (for example, when a disclosure is produced but mailed the next business day) we request a clarification that the creditor may use the APOR in effect on the date the disclosure is either produced or provided. This would be very helpful because when the disclosure is produced, the creditor may or may not know exactly when it will be provided. Additionally both paragraphs (b)(2) and (b)(3) refer to the higher-priced mortgage loan threshold as defined in § 226.35(a)(1). That threshold is determined using the rate set date. We recommend that proposed Comment 38(b)(3) be revised to indicate that the APOR may be determined as of the date the disclosure is either produced or provided, and to delete the reference to Comment 35(a)(2)-3, because that Comment states that the APOR is determined by the rate set date.

- *Comparison for Loans Not Secured by Owner-Occupied Properties, Loans Above Conforming Loan Limits, and for Loans with LTVs above 80%.* The APOR is computed for owner occupied conforming loans with LTVs of 80% or less. As a result, the APOR substantially understates the average prime offer rate for loans that are not secured by owner-occupied properties, for loan amounts above the Fannie Mae / Freddie Mac conforming loan limit, and for loans with LTVs above 80%. That is, the APOR understates the rate for a significant proportion of loans. We offer two suggestions:

The Board should consider publishing separate APORs for these types of loans so that consumers will see an accurate comparison.

We recommend revising the language used to explain the comparison by adding the bold language and deleting the language ~~struck through~~:

> *How does this loan compare? For the week of (date) the average APR on similar {but **smaller**} conforming loans offered to applicants with excellent credit **and substantial equity in their homes** was ___%. Today an APR of ___% or above is considered high cost and is usually ~~available~~ charged to applicants with poor credit history **or whose loan amounts are very large or are more than 80% of their home's worth**.*

<u>Format Errors Should Not Give Rise to Statutory Damages</u>

We recommend that the Board clarify that failure to comply with format requirements should not give rise to statutory damages.

<u>Top of Form</u>

- ***Address***

The borrower's mailing address may be different than the address of the property securing the loan. We request clarification that both addresses may be shown.

- ***The Number of Loan Officer Unique Identifications***

Proposed Comment 38(g)(2)-1 would require that where there are multiple originators, the unique identification numbers of all originators be listed. However, many loans may have five or six individuals who are registered as loan originators touch the file indirectly. Tracking every originator who touches a loan file, however indirectly or superficially, would be a significant regulatory burden with little or no apparent consumer benefit.

We recommend that, for loans with no broker, no more than one loan originator be required to be disclosed. If there is a broker, we suggest requiring disclosure of one loan originator from the creditor and one from the broker. Additionally, we recommend permitting creditors to use any reasonable method of determining which loan originator to list. For example, the loan originator who takes the application, who the consumer will deal with directly, should be a reasonable and satisfactory disclosure.

- ***Loan Type – Rate Reduction Mortgages***

There are rate reduction mortgage products where the loan's rate will decrease by specified amounts at specified times if the loan is paid as agreed. We request a clarification that these loans should not be disclosed as step rate mortgages. Step rate mortgages are defined by proposed § 226.38(a)(3)(i)(B) as loans where the interest rate may "change" after consummation and the rates and periods in which they will apply are known. We recommend that the word "change" be revised to "increase." This would be consistent with § 226.38(a)(3)(ii)(A), which requires a step rate disclosure if rates will "gradually increase."

<u>Total Settlement Charges and Itemization of Amount Financed – Conforming TILA and RESPA Requirements</u>

- ***Disclosure of Total Settlement Charges on Final Disclosure***

Proposed Comment 226.38(a)(4) provides that for the final TILA disclosure, the creditor may disclose the sum of "Charges That Cannot Increase," "Charges That In Total Cannot Increase By More Than 10%," and "Charges That Can Change." It appears that the total that will be shown on Line 1400 of the HUD-1 or HUD-1A may not be used. Presumably this is because Line 1400 may include amounts such as real estate broker fees that were not disclosed on the GFE and are not a cost of the loan. If this is the intent, the Comment should state that the Line 1400 total may not be used.

The Comment further indicates that the creditor has the alternative for the final TILA disclosure of providing the consumer with the final HUD-1 or HUD-1A. In all of the model forms provided in the Proposal, however, the Total Settlement Charges disclosure appears in the Loan Summary section and is not bracketed. If the creditor provides the final HUD-1 or HUD-1A, the creditor should have the option of either making or not making the Total Settlement Charges disclosure on the final TILA disclosure. The Board should also include within the model forms a final TILA disclosure that does not include the Total Settlement Charges disclosure because the final HUD-1 or HUD-1A was provided.

- ***Requirement to Provide GFE with Early TILA Disclosure Should be Eliminated When Processing Broker Provides the Initial GFE***

The Board's proposal would permit the GFE to substitute for the Itemization of Amount Financed when provided with the early TILA disclosure. Where the creditor provides the initial GFE, this presents no problems.

However, where application is taken by a processing broker (rather than a table funded broker) the processing broker will usually send the initial GFE to the borrower within three business days after the broker receives the application, and the creditor will usually send the early TILA disclosure in a separate package within three business days after the creditor receives the application. We recommend that in these circumstances the broker's provision of the GFE in accordance with RESPA requirements be deemed to satisfy the Itemization of Amount Financed requirements.

➢ ***Requirement for No Estimates and HUD-1 with Final TILA Disclosure***

The Board states that "the Board believes that to permit substitution of the HUD-1 settlement statement for the itemization without requiring that it be delivered three business days before consummation would be inconsistent with the purposes of the MDIA amendments."[20] We respectfully disagree. First, nothing in the Mortgage Disclosure Improvement Act (MDIA) restricts the use of estimates on TILA disclosures given prior to consummation. Second, the MDIA only requires redisclosure and a new waiting period if the APR becomes inaccurate. Thus, MDIA recognizes that disclosures may reflect estimates and that the closing should not be delayed because the final disclosures may be somewhat different than the estimated disclosures.

As noted above, if the Board intends to have the total settlement charge disclosure on the final TILA disclosure not be an estimate and will not permit the HUD-1 given at settlement to substitute for the Itemization of Amount Financed, then the Board should require the closing agent to finalize all fees and provide the HUD-1 to the creditor at least eight business days prior to closing. Otherwise, the Board should permit estimates that are consistent with RESPA's tolerance requirements. The Board should also permit the HUD-1 itemization given at consummation to satisfy the requirement to itemize the amount financed.

➢ ***Revise Itemization of Amount Financed to Be Consistent With Other TILA Disclosures***

Under the Board's proposal, creditors would continue to have the option of providing an Itemization of Amount Financed, but the TILA disclosures will not refer to prepaid finance charges and will highlight the loan amount more prominently than the amount financed. We recommend that an additional model form for the Itemization be provided for use with closed-end mortgage loans. The new form should be an itemization of the disbursements from the loan amount, which would not contain a disclosure of the amount financed or prepaid finance charge.

➢ ***Prepayment Penalty Disclosures***

We address a number of factors that require clarification concerning prepayment penalty disclosures.

- Circumstances of Penalty on HOEPA and HPML loans. We recommend that model language be provided on how to disclose the limitations on the assessment of prepayment penalties under §§ 226.32 and 226.35.

- Two-Stage Penalty Calculation. We request that in situations where the use of the two-stage penalty calculation is permissible, creditors be given the option of disclosing the actual maximum prepayment penalty.

[20] 74 Fed. Reg. 43232, 43314 (August 26, 2009).

- Incorporate into Official Commentary That Prepayment on FHA Loans Mid-Month is Not a Penalty. Proposed Comment 226.18(k)(1)-1 lists as an example of a prepayment penalty "Charges determined by treating the loan balance as outstanding for a period after prepayment in full and applying the interest rate to such 'balance'." This Comment appears to be inconsistent with Comments 226.36(c)(1)(i)-1 and 2 and the explanation of these comments provided by the Board[21] on the required prompt crediting of payments. Those comments and the explanation noted that (i) many loans require calculation of interest based on an amortization schedule where payments are deemed credited as of the due date, whether the payment was actually received prior to the schedule due date or within any grace period, (ii) the rule requiring crediting of payments as of the date of receipt was not intended to prohibit or alter the use of the monthly accrual amortization method, and (ii) the crediting the payment as of the payment due date was not considered to be the imposition of additional interest.

  In a letter dated September 29, 2009, after publication of the Board's proposal, the Board clarified that lenders that use such an interest accrual method that accepts a prepayment mid-month but charging interest through the next scheduled due date is not an assessment of a prepayment penalty for any purpose under Regulation Z.

  We recommend that the clarification the Board provided in that letter be incorporated into Proposed Comment 18(k)(1)-1, that for FHA loans and other loans on the monthly accrual amortization method, crediting a prepayment as of the next installment due date is not considered to be additional interest after prepayment in full and is not a prepayment penalty. Should the Board decide that such situations should be considered prepayment penalties then we request that the Board also clearly note that this change is prospective only.

<u>How Much Could I Save By Lowering My APR?</u>

As the Board acknowledges, although this disclosure refers to a lowering of the applicant's APR by 1 percentage point, the actual calculation, as explained in proposed § 226.38(b)(4), would be based upon a reduction in the interest rate, rather than APR, by 1 percentage point. It is also unclear why the model form has a blank for the amount of the reduction in the APR if 1 percentage point should always be used.

We recommend that the disclosure be revised to state

> *How much could I save by lowering my interest rate? For this loan, a 1 ~~%~~ **percentage point** reduction in the ~~APR~~ **interest rate** could save you an average of $______each month.*

Alternatively, if the Board determines that to use the APR in the disclosure, in addition to the calculation method contained in the proposal the Board should also permit the savings to be calculated using the same methodology that is used to reduce payments to cure an APR violation.

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[21] 74 Fed. Reg. 43232, 44571 (August 26, 2009).

We also note that the examples only address fully amortizing loans with monthly payments. We request that the Board provide an example of how the disclosure was calculated for the balloon loan shown in form H-19(D). We further suggest the Board publish model language for loans that do not require monthly payments.

<u>Treatment of Escrow Payments</u>

- Under the Proposal, if the creditor requires the establishment of an escrow account, then the escrow payments must be included in the Interest Rate and Payment Summary. The rationale is that many consumers compare loans based on the monthly payment amount. However, while it makes sense for consumers to understand the amount that they will need to set aside for taxes and insurance each month, they will need to set aside the same amount, regardless of whether an escrow account is established. As the Board's HPML rules recognize, it is often in the consumer's benefit to have an escrow account. Requiring that the average monthly amount of taxes and insurance be disclosed only on loans where an escrow account will be required may be misleading. Also, it would facilitate an unscrupulous loan originator comparing its payments without escrow to the consumer's existing loan, or a competitor's new loan, that includes escrow.

  We recommend that for all first lien loans, the Interest Rate and Payment Summary should include the Estimated Tax and Insurance amounts whether or not an escrow account is required.

  For subordinate loans, the creditor should have the option of either estimating the taxes and insurance amounts, or of disclosing that the taxes and insurance are not included in the disclosures. Escrows on subordinate loans are rare, and the subordinate lender may not know what the consumer pays for escrowed items.

- Disclosure should accommodate the possibility that some but not all items are escrowed. When an escrow account is required, some items may be paid out of the escrow account while other items are paid directly by the consumer. However, the Escrow language for loans that require escrow accounts in the "More Information About Your Payments" section of the disclosure does not appear to take this possibility into consideration, although the GFE and HUD-1 do. We suggest revising the language by deleting the language ~~struck through~~ and adding the language that in bold as follows:

  > *An escrow account is required ~~for property taxes and insurance (such as homeowner's insurance)~~. Your escrow payment is an estimate and can change at any time. See your Good Faith Estimate or HUD-1 form for ~~more~~ details **on what property taxes, insurance (such as homeowner's insurance) and other items will be paid from the escrow account and which items you must pay on your own**.*

- Disclosure for Key Questions About Risk and payment increases. We request a clarification to the requirements of § 226.38(d)(1)(ii) that, on a loan with an escrow account, the possibility of an increase in the escrow payment will not trigger this disclosure. The consumer bears the risk of an increase in the cost of property taxes and insurance whether or not the consumer obtains a loan or has an escrow account.

<u>Introductory Rate Notice And Discounted Initial Rate</u>

When the initial interest rate on an ARM loan is not set by using the same formula that will be used for rate adjustments, the creditor will not know at the time that the early TILA disclosure is prepared whether the initial rate chosen by the borrower will be higher or lower than the fully indexed rate at the time of consummation. This is because the index value used to compute the fully indexed rate may increase or decrease between the time the early TILA disclosures are prepared and consummation.

For example, assume that at the time the early TILA disclosure is prepared the initial interest rate is 6.00% and, based upon an index value of 3.00% and the margin of 2.75%, the fully-indexed rate is 5.75%. At consummation, the initial interest rate is 6.00% and, based upon an updated index value of 3.375% and the margin of 2.75%, the fully-indexed rate is 6.125%.

We recommend a clarification to Comment 226.38(c)(2)(iii)-1 that the creditor should determine whether to provide the introductory rate notice on early TILA disclosures and any revised TILA disclosure given prior to the final TILA disclosure based upon an estimate of the fully-indexed rate, using an index value no older than the look-back period as of the date the disclosure is mailed or delivered to the consumer.

<u>Disclosures Required When Loan Assumed by "Subsequent Consumer" Should be Limited to Situations Where Subsequent Consumer Was Not Obligated on the Loan, Was Not an Owner of the Property, and is Purchasing an Interest in the Property</u>

The proposed revised Comment 226.2(a)(24)-1 on the definition of residential mortgage transaction removes the reference stating that the definition was relevant to the § 226.20(b) disclosure requirements for assumptions. Section 226.20(b) continues to indicate that an assumption requires new disclosure if the assumption is by a "subsequent consumer." The proposal would delete Comment 226.20(b)-2, which does clarify when assumption disclosures are required. This leaves no definition of subsequent consumer and no reference to a residential mortgage transaction, so it is not clear when new disclosures would be required.

We recommend that new disclosures only be required if a consumer who was not obligated on the original loan and was not already an owner of the property purchases an interest in the property. There are many situations when there has been a transfer of an interest in the property. Also, the Garn-St Germain Depository Institutions Act of 1982[22] prohibits acceleration of the loan under a due on sale provision. In these cases, one of the original

[22] 12 U.S.C. 1701j-3, implemented in 12 C.F.R. Part 591.

borrowers will ask to be released from personal liability on the loan and servicer will agree to such release if the other individual agrees to be personally liable and is creditworthy. However, the Garn-St Germain Act does not require servicers to provide such releases. If servicers are now required to provide assumption disclosures in these circumstances, then they may not decide not to entertain such requests.

Clarifications in Model Forms

➢ ***Percent or Percentage Point***

The APR disclosure, in the model forms, says "For this loan, a __% reduction in the APR could save you an average of $___ each month." The regulation, § 226.38(b)(4), requires disclosure of "a 1 percentage **point** reduction in the APR." The form needs to be revised to match the regulation, by adding the word "point." A one percentage point reduction in the APR, such as from 8% to 7%, is a 12.5% reduction in the APR, not 1%.

This change is needed in the Adjustable Rate Loan Program Model Form, Adjustment Notices, and in the APR disclosures on the model forms.

➢ ***Unless a Cap Applies***

The Adjustment Notices do not accommodate the possibility that a cap may limit a future rate increase, which is important information. We suggest the adding the following language in bold:

> We could have increased your interest rate another ___ % but did not because a rate cap applied. We can add this to your interest rate when the interest rate adjusts again on (date) **unless a cap applies**.

Separate Disclosures Required by Proposed § 226.38(j)

The Proposal notes that the rebate, late payment, property insurance, contract reference, and assumption disclosures were not of primary importance to consumers and were not always well understood. Even if these disclosures are provided in a separate form, they will still contribute to information overload. We therefore recommend that these disclosures be eliminated entirely. It is not the purpose of the TILA to require consumer disclosures that do not benefit consumers.

If the Board does retain them, we recommend:

- The Board should not expand the current assumption disclosure requirement to disclose whether a loan is assumable from purchase transactions to all mortgage loans. As Board noted, "very few participants understood the language indicating that the loan was assumable, and even fewer felt it was important information."[23]

[23] 74 Fed. Reg. 43232, 43313 (August 26, 2009).

- It should be sufficient to provide the disclosures once at any time prior to consummation.

<u>Disclosures In Languages Other Than English</u>

The Board solicits comment on issues concerning disclosures in languages other than English. CMC members do provide non-English disclosures. However, we do not believe creditors should be specifically required to provide disclosures in languages other than English. The costs and litigation risk would be extraordinarily high. Different translators may translate the same language in different ways, making each translation subject to risk.

We believe it is important that disclosures be as clear and as consistent as possible. If the Board were to require creditors to provide non-English disclosures, each creditor would provide a differently worded disclosure than each other creditor. We believe this would be rather confusing to consumers, especially if they are attempting to shop among lenders. We believe the far better approach would be for the Board to provide its model forms in each language needed. This would ensure consistency and clarity, and would ensure that the disclosures meet legal requirements. Further, the forms would be available on the Board's website for consumers to access.

VI. PROHIBITING LOAN ORIGINATOR COMPENSATION BASED ON LOAN TERMS AND CONDITIONS

We agree with the Board that loan originator compensation should not adversely affect the loans that consumers obtain. We support the proposed prohibition on loan originator compensation based on loan terms, subject to the clarifications listed below.

We note that the Board proposes § 226.36(d) under the Board's authority under TILA § 129(l)(2), which permits class actions and statutory damages for very minor and technical violations. This exposes lenders to the risk of hugely expensive litigation, sometimes frivolous litigation. We therefore urge the Board to make the rules as clear as possible.

<u>General Issues</u>

- ***Loan Originator Definition***

The definition of "loan originator" should exclude individuals who are managers and supervisors, whose compensation is not based upon loans that they directly originate, but on the production of the individuals they manage and supervise. Managers and supervisors have little actual impact on an individual loan, so their compensation arrangements do not raise the same concerns about incentives to encourage consumers to obtain inappropriate loans. We suggest the Board restrict the compensation arrangements only of those individuals who regularly deal with consumers directly and who have the ability to set, negotiate, or decide loan terms or loan amounts. The compensation restrictions should not apply to those who only process loan applications because they do not have the ability to set, negotiate, or decide loan terms.

- ***Loan Amount***

Compensation based on loan amount should be permitted. In addition to compensation based on a fixed percentage of the loan amount subject to a minimum or maximum that was discussed in the proposal, it should also be permissible to use percentages that decrease as the loan amounts increase. To address the Board's concern that larger loan sizes may increase LTVs, lower the consumer's equity, and increase risks, we recommend that the final rule permit lower compensation for higher LTVs.

We note that is particularly important that creditors be able to consider loan amount in the compensation they pay to brokers. While there are a number of ways that creditors and mortgage brokers may be able to compensate their own employees in a way that may be financially viable without directly considering loan amount, (such as considering the loan originator's overall volume) the inability to consider loan amounts could cause severe distortion in the mortgage broker market. Furthermore, HUD would likely view compensating a broker based upon the broker's overall volume as a violation of § 8 of RESPA.

- ***Loan Originator Volume***

We request clarification that the ability to consider the loan originator's "overall volume" includes not only the number of loans but the total dollar amount of loans. This amount is too attenuated from individual loans to affect loans individually.

- ***CRA Loans***

Additional compensation should be permitted for Community Reinvestment Act (CRA) loans, defined as loans to low- and moderate-income (LMI) consumers and loans secured by property in LMI census tracts. This is important because CRA loans can be much more difficult to originate than other loans,

- ***Certain Commonly Used Compensation Criteria Should Not Be Loan Terms or Conditions***

We request clarification that compensation may be based upon pull-through rates, file quality, customer satisfaction, and communication quality. Lenders need these common sense management tools.

- ***Amounts Not Retained Should Be Excluded From Definition of "Compensation"***

The definition of loan originator "compensation" should be clarified to exclude any amounts that are not retained by the loan originator, such as amounts that are used to pay closing costs.

- ***Concessions Should Be Permitted to Affect Compensation***

We recommend that an employer should be able to reduce the loan originator's compensation for granting a concession. This will permit reasonable flexibility in unusual circumstances.

- ***Broker's Receipt of Compensation from Both Creditor and Consumer Should Not Be restricted if Total Compensation is Reasonable***

In many transactions, both the wholesale creditor and the consumer will be making compensation payments. The proposal provides no guidance on how to determine in these situations whether broker compensation is being paid by the creditor, the consumer, or both.

It would be preferable to allocate payments in a manner consistent with the RESPA rule and eliminate the restriction on receipt of compensation from both the creditor and the consumer when the broker's total compensation is reasonable. This would allow creditors to compensate brokers in a manner similar to how they compensate retail loan originators they employ, without violating RESPA.

- ***Creditor Payments Should Be Allocated Consistently With RESPA***

Consistent with how creditor payments will be disclosed on the GFE and HUD-1 under the final RESPA rule, we recommend that payments by creditors (after netting with any payments made by the broker to the creditor) be first allocated to broker compensation and then to a credit to other closing costs. The consumer should not be considered to pay discount points in a transaction with creditor-paid broker compensation.

- ***If Total Broker Compensation Does Not Exceed Agreed Upon Amount and is Reasonable, Brokers Should Be Allowed to Receive Payments From Both Creditor and Consumer***

We recommend that if the creditor and the broker agree upon an amount of total broker compensation that is not based upon the transaction's rate or other terms and conditions and that does not exceed reasonable amounts of compensation, the broker may receive compensation from both the creditor and the consumer that does not exceed the agreed upon amount. We suggest that total broker compensation be deemed reasonable if it does not exceed 2% of the loan amount, subject to a minimum of $500.

> **Examples** - Assuming that the broker and wholesale creditor A agreed that the broker would receive compensation of 1% from the creditor for rates of 5.500% or higher, wholesale creditor A could also offer a rate of 5.375% and pay the broker .5 points and the broker could also receive .5 points from the consumer, because the 1% total broker compensation does not exceed reasonable charges.

On the other hand, if the broker and wholesale creditor B agreed that the broker would receive compensation of 3%, then because that amount exceeds what is reasonable, the broker could not receive compensation from both the creditor and the consumer. Because payments would be allocated in a manner consistent with RESPA, wholesale creditor B might offer a rate of 6.125% at which it would pay all of the broker's 3% compensation or the consumer could be offered wholesale creditor B's rates of par (5.250%, for example) or below with the consumer paying all of the broker's compensation at whatever amount the broker and consumer agree upon.

APR to APOR Comparison – If the concern is that consumers will not know that they are paying too high a price for a loan due to excessive broker compensation, that concern could be addressed by prohibiting a broker from receiving any compensation from a creditor unless at the time of the GFE the broker provides a disclosure comparing the transaction's APR to the APOR in the format required by § 226.38(b) (or arranges for the creditor to provide the early TILA disclosure within three business days of the broker's receipt of the application from the consumer).

Steering

We agree that prohibiting payments from creditors to brokers based on loan terms and conditions would be meaningless if brokers could significantly increase their compensation by steering the borrower to another creditor.

The proposed rule would define prohibited steering based on what is in the "consumer's interest." It would state that there is no steering if the consumer selects a loan from "three loan options for each type of transaction in which the consumer expressed an interest," and the loan originator meets several other requirements, including a requirement to supply a number of options for loan types in which the consumer "expresses an interest" and for which the loan originator has a good faith belief that the consumer "likely qualifies." However, compliance with the proposed rule would be extraordinarily burdensome. The proposed rule uses vague terms that are not readily susceptible to any definition, let alone actual implementation. It would also require burdensome tracking requirements. We suggest that the Board could address its concerns in a manner that would entail significantly less uncertainty and less regulatory burden.

We suggest that the anti-steering rule should not apply to transactions where the broker's total compensation (not just creditor-paid compensation) is reasonable. We suggest that total broker compensation be deemed reasonable if it does not exceed 2% of the loan amount, subject to a minimum of $500. By exempting transactions where total broker compensation is reasonable, it is unlikely that consumers will be inappropriately steered due to compensation considerations, and the risks and operational burdens of brokers will be greatly reduced.

- ***Focus on Total Broker Compensation, Not Creditor-Paid Compensation***

It is not clear why it should be permissible for a broker to steer a consumer to consummate a transaction in which the consumer will pay direct broker compensation that is greater than amounts that are reasonable, particularly if the loan amount is increased so that the consumer may pay the broker's compensation from loan proceeds. We believe the rule should focus on whether the broker is steering the consumer to consummate a transaction in order to receive greater total broker compensation than could have been received on other transactions the broker could have offered.

- ***Employees of Affiliates in Compliance With Anti-Steering Rules***

Proposed amendments to § 226.36(d)(1) would prohibit loan originators from receiving compensation based on a loan's terms or conditions, and it would treat affiliated entities as a single person.

Proposed § 226.36(e)(1) is similar. It prohibits loan originators from "steering" consumers to loans on which the loan originator would greater compensation, unless the loan is in the consumer's interest. While similar, proposed § 226.36(e)(1) does not state how it would treat affiliates.

Proposed Comment 226.36(e) states that a loan originator who is a creditor's employee and who complies with § 226.36(d)(1) also satisfies the requirements of § 226.36(e)(1). We recommend an analogous clarification for employees of a creditor's affiliate. Loan originators who comply with § 226.36(d)(1) should be deemed in compliance with § 226.36(e)(1) if they are employees of the creditor's affiliate.

VII. DISCLOSURES AFTER CONSUMMATION

Adjustment Notices

- ***Timing of Adjustment Notices***

We support changing the minimum period of time that an adjustment notice must be provided before a payment change from 25 days to 60 days. However, exceptions should be provided for existing loans with look-back periods shorter than 45 days, and construction and temporary loans, as below.

- ***Existing Loans With Short Look-Back Periods***

Consider an FHA loan that will have a rate adjustment on February 1 and a payment adjustment on March 1. Sixty days prior to March 1 is December 31. FHA loans have a 30-day look-back period, so that the index value used to determine the new rate is the index as of January 2. It is impossible to send a rate adjustment notice on December 31 reflecting a January 2 index value. In any case, servicers need time after the index value becomes available to perform quality control checks before mailing the notices.

- ***Recommended Exception for Existing Loans With Short Look-Back Periods***

For adjustable rate loans with application dates prior to the effective date of the revised regulation, and that have look-back periods shorter than 45 days, the adjustment notice should be provided within 15 days after the look-back date, but not less than 25 days prior to the payment change.

- ***Construction and Temporary Loans***

These products should continue to be exempt from the requirements to provide adjustment notices. The concern that borrowers have sufficient time to refinance before the payment increases is not relevant in these circumstances because it is highly unlikely that the consumer would be able to refinance a construction or bridge loan prior to completion of construction or the sale of the house. Construction loans and bridge loans often have adjustable rates with short or no look-back periods. Imposing the longer look-back period may cause creditors not to offer these products.

Content and Format of Adjustment Notices

- ***Combining With Other Required Notices***

We request a clarification that servicers may combine the adjustment notices with other disclosures, such as disclosures required by law, or disclosures that are required by Fannie Mae, Freddie Mac, the Federal Housing Administration, Veterans Administration, or Rural Housing Service, unless expressly prohibited by law.

- ***Prepayment Penalty Disclosure***

The proposed ARM adjustment forms require disclosure of the amount of a prepayment penalty. This disclosure is difficult to make accurately, which we believe is a problem. The amount of any prepayment penalty can vary for a number of reasons, all of which are difficult to incorporate into a short, clear disclosure form. For example, the amount of a penalty may vary based on whether the consumer sells the home or refinances the loan. Further, any calculation would necessarily be based on an assumed principal balance, which may or may not be inaccurate. We recommend that the disclosure state that:

> *If you pay off your loan, refinance or sell your home before (date) you could pay a penalty. Call us to find out the amount.*

- ***Description of Interest Rate***

The language provided in Model Form H-4(G) indicates that "Your rate will change due to an [increase] [decrease] in the (index)." This language does not appear to take into consideration the following situations:

- The current and new rates are the same;

- The old and new index values are the same; or
- The current rate is a premium or discount rate so that the change in rate if any, is not entirely due to a change in the index value (or may be directionally different if the amount of the premium or discount exceeds the amount of the change in the index).

Because it is possible for the rate to remain unchanged, or to change in part independently of the index, we believe it would be more accurate to discuss the change in the index rather than the change in the rate. We suggest the following disclosure:

> *The index on your mortgage [increased] [decreased] [stayed the same], which may affect the interest rate.*

- ***Allocation of Principal, Interest, and Escrow On Interest Only and Negative Amortization Loans***

Providing an allocation of the current and new payment between principal, interest, and escrow on interest only and negative amortization loans is a substantial compliance burden. Since the notice must also include a Disclosure of New Monthly Payment that includes the amortizing payment as shown in model clauses H-4(H), it is also unnecessary. Moreover, because escrow payments may also be in the process of adjustment according to RESPA requirements, providing correct escrow information may be difficult. Providing escrow information would also be confusing if the escrow changes will occur at a different time than the loan payment change, which is a very common occurrence.

Escrows and escrow disclosures are governed by RESPA. RESPA escrow rules provide thorough consumer protections. There does not seem to be a need for TILA disclosures to duplicate RESPA escrow disclosures, especially when doing so would likely confuse consumers.

- ***Conversion to Fixed Rate***

Where an adjustable rate loan is converted to a fixed rate loan under a written agreement, no adjustment notice should be required because the consumer will already have received disclosures about this event.

Statement Requirements for Negative Amortization Loans with Payment Options

The proposed negative amortization monthly disclosure model form is certain, or almost certain, to be inaccurate and misleading. It simply does not take into consideration all the permutations on these types of loans. For example, it would tell consumers that if they make their minimum payment, their principal balance will increase. This is not necessarily true. The minimum payment amount may be based on a different loan interest rate than applies to newly accruing interest. The outstanding principal could increase or decrease. Payment-option loans are not feasibly handled by a one-size form.

A better solution would be to require the proposed form to be used only on loans that are originated after the final rule becomes effective. The number of loans affected by that time would likely be extremely small. This would greatly reduce the number of inaccurate or misleading consumer disclosures. Existing loans continue to be covered by the interagency guidelines on nontraditional mortgage products.

Creditor Placed Insurance

We support the proposed requirements, but make the following suggestions.

- A Comment should be added clarifying that all references to the "creditor" in this section refer to the creditor or the servicer performing these functions for the creditor.

- The proposal would require a creditor to make a reasonable determination that the property insurance has lapsed before placing insurance. However, the rule needs to permit servicers to comply with pooling and servicing agreements, under which the servicer is contractually obligated to obtain insurance if the consumer has not documented that there is sufficient insurance coverage in place.

- Servicers may be contractually obligated to obtain insurance, even if the coverage has not lapsed, because the coverage is insufficient.

- Importantly, the proposal would permit a creditor to charge the consumer retroactively for insurance. This is important because consumers are contractually obligated to maintain adequate insurance coverage at their expense.

- The Proposal asks whether the notice should include a local or toll-free number to contact the creditor regarding creditor-placed insurance. We agree that the contact information included in the notice should include such a local or toll-free number.

VIII. SUGGESTIONS FOR CONFORMING RESPA AND TILA

Pre-Application Disclosures

Mortgage brokers should provide TILA's pre-application forms prior to application or collection of any fee. These disclosures include:

- "Key Questions to Ask About Your Mortgage"
- "Fixed vs. Adjustable Rate Mortgages"
- Adjustable Rate Loan Program Disclosures for programs in which consumer expresses an interest.

Conforming TILA Disclosures and GFEs

Consumers would greatly benefit from coordinated TILA disclosures and GFE "Summary of Loan" and "Escrow Account Information" sections.

One alternative would be to require all loan originators to provide TILA disclosures and replace the Summary of Loan" and "Escrow Account Information" sections of the GFE with a cross-reference to the TILA disclosure. This would help consumers understand the interplay between the two sets of disclosures.

Providing a TILA disclosure would be a new requirement for processing brokers, but they possess all of the information necessary to provide the TILA disclosure. It would be useful for consumers to have this information earlier in the process.

A second alternative would be for processing brokers to use a different form than creditors, and require processing brokers to have the creditor mail or deliver early TILA disclosures to the consumer within three business days after the broker receives an application from the consumer.

- ***Creditor Form***

The first form would be used by creditors under TILA (including table-funded brokers), which would be the same as the GFE under the first alternative discussed just above, cross-referencing the TILA disclosures provided by the creditor.

- ***Processing Brokers***

We recommend that processing brokers who are not creditors under TILA be required to provide, or that the creditor provide, the early Regulation Z disclosures and the GFE, within three days of receipt of an application.

Revise GFE Blocks and HUD-1 To Reflect TILA's Proposed All-In APR

If the Board does adopt an all-in APR, it will need to be coordinated with the GFE and HUD-1. The all-in APR includes in the calculation of the APR all charges the borrower incurs because of the loan. It excludes charges that the borrower would have incurred had the property been purchased for cash, such as the owner's title and the cost of preparing and recording the deed. The GFE and HUD-1 would need to similarly distinguish between charges incurred as part of the purchase transaction from charges incurred because of the loan. Making this distinction will make it much easier to reconcile the GFE and HUD-1 with the TILA disclosure.

Conform Treatment of Amounts Paid by Parties other than Borrower

The proposed new TILA disclosure requires the disclosure of "Total Settlement Charges" as shown on the HUD-1. However, RESPA rules are not clear about whether this amount will reflect the only the amounts that the borrower will pay. There are ambiguities in the RESPA treatment of amounts paid by the seller, a builder, an employer or the broker or creditor. We believe these should be clarified and coordinated.

Conform Timing Rules and Waiting Period Requirements

- ***HUD-1 Three Business Days Before Consummation***

Because a consumer must receive a final TILA disclosure at least three precise business days before consummation, the borrower should also receive the final HUD-1 at the same time. The closing agent should also be required to finalize all fees and charges at least eight business days prior to closing and provide that information to the creditor in order for the creditor to provide an accurate final TILA Disclosure. All of the fees for the closing agent and for the services of third parties arranged by the closing agent should be disclosed as the closing or settlement fee on Line 1102 of the HUD-1, other than amounts that are disclosed as part of the title insurance premiums.

- ***Redisclosure Requirements***

Loan terms and APR should be disclosed on TILA disclosures under TILA rules, rather than on RESPA disclosures under differing rules. TILA rules and not RESPA rules should govern redisclosures for increases in the APR, beyond tolerances. Other changes should not require TILA redisclosure, even if they require a revised GFE.

RESPA's requirements to provide a revised GFE should apply only to change in settlement costs beyond the applicable tolerance, not to a change in loan terms.

The timing of both TILA and RESPA redisclosures should be reasonably coordinated.

These improvements would reduce the number of disclosures that are duplicative in substance but differing in form, thereby improving the clarity and value of all the disclosures.

- ***Waiting Period***

RESPA may require that fees be reduced in order to stay within tolerance. Reductions in fees or in interest rates after the final TILA disclosure should not trigger requirements for an additional corrected TILA disclosure and should not require a new waiting period.

Settlement Cost Booklet

On December 16, 2009, HUD published a Settlement Cost Booklet that is designed to help consumers shop for a mortgage loan. It discusses the new RESPA forms in detail but does not discuss the TILA disclosures. We believe all disclosures about the same transaction should be complementary, and should be integrated into one set of forms. We urge HUD and the Board to design their disclosures and their disclosure requirements together.

IX. PAPERWORK REDUCTION ACT AND EFFECTIVE DATE

We note that the Board estimates:

> The Board estimates that 1,138 respondents regulated by the Federal Reserve would take, on average, 200 hours (five business weeks) to update their systems, internal procedure manuals, and provide training for relevant staff to comply with the proposed disclosure requirements in §§ 226.38 and 226.20(d), and revisions to existing disclosure requirements in §§ 226.19(b) and 226.20(c). . . . On a continuing basis the Board estimates that 1,138 respondents regulated by the Federal Reserve would take, on average, 40 hours a month to comply with the closed-end disclosure requirements[.][24]

We respectfully submit that this estimate is extremely low.

The notice of proposed rulemaking runs almost 200 *Federal Register* pages. Just reading the proposal, let alone understanding its implications, took days. Preparing this comment letter required assembling a team who then worked on this project for over four months. Once the final rule is published, the industry will then have to implement the rule, which will then reasonably take at least 24 months.

There are a number of different loan origination technology systems across the industry, as well as within individual companies. Implementing Regulation Z amendments will require each revision to be programmed, implemented, and then tested, separately in each of these origination systems. Changes to loan origination systems must be made in a coordinated fashion because each change can impact other changes that are being designed and made simultaneously. Coordination itself is a labor-intensive task.
For some perspective, we note that at one large lender, implementing the Regulation Z amendments that became effective October 1, 2009 required over 70,000 hours. Implementing the recent amendments to Regulation X took twice that amount of time, and those rules are still changing. Implementing the present rulemaking will likely require more resources than the October 2009 rulemaking but less than Regulation X.

If the Board does finalize the APR/APOR comparison with shaded text and a graph, the regulatory burden would increase greatly. That single item presents the largest technology challenge of any part of the proposed rule. We urge the Board to revise that disclosure, as discussed above.

We request the Board consider the implementation challenges the rulemaking will have on the industry, and recommend that the Board give the industry at least 24 months to implement the final rule.

[24] 74 Fed. Reg. 43232, 43318 (August 26, 2009).

X. CONCLUSION

The CMC appreciates the Board's proposed rule to improve the quality and effectiveness of consumer mortgage disclosures through out the loan application process and through the life of the loan. The proposed all-in APR is intended to make the APR disclosure more useful, but would create a number of issues. In particular, we are concerned that it would constrain credit in states where the laws are based on TILA and Regulation Z terms. We do not believe the Board meant to curtail credit, but that will be the unintended result of the proposal. If the Board does adopt an all-in APR, we suggest some ways to address the problems that will arise. An all-in APR would also require a number of clarifications about the revised definition of "finance charge."

We appreciate the clarity in the new model forms for TILA disclosures. We do suggest ways to make them even clearer. We also suggest more clarity concerning compensation restrictions.

Finally, we suggest some ways the TILA disclosures and RESPA disclosures can be more closely coordinated.

Thank you for your time and consideration of our views.

Sincerely,

Anne C. Canfield
Executive Director

Consumer Mortgage Coalition

December 23, 2010

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Truth in Lending Proposed Rule – Open-End and Closed-End Loans
Docket No. R-1390

Dear Ms. Johnson:

The Consumer Mortgage Coalition (CMC), a trade association of national mortgage lenders, servicers, and service providers, appreciates the opportunity to submit comments on this proposed rule. The Board of Governors of the Federal Reserve System (the Board) proposes to amend Regulation Z to improve the effectiveness of consumer mortgage disclosures, clarify rescission rights, redefine "material disclosures" and rescission tolerances, and to require disclosures in connection with certain types of modified loans, among other things.

With this proposal, the Board continues its process of systematically creating improved TILA disclosures. We remain in support of clear, concise, informative disclosures because well-crafted disclosures will enable consumers to better understand the terms of their mortgage loans.

Need for Coordinated Rulemakings

As the Board was drafting its proposal, Congress enacted the Dodd-Frank Act (the DFA).[1] The DFA made a number of major changes to rules governing the financial services and mortgage finance industries, as well as the Truth in Lending Act (TILA), which Regulation Z implements.

As a result of DFA, some portions of the Board's current proposal need to be revisited. One mandate in the DFA is that the Real Estate procedures Act (RESPA) and TILA disclosures be integrated. This proposed rule contains a number of new disclosures that

[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat 1376 (2010) (hereafter DFA).

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are not integrated with RESPA disclosures. Until that integration takes place, we believe the Board should not pursue changes to Regulation Z, and we urge that any Regulation Z changes be coordinated with the several upcoming DFA rulemakings. Furthermore, we strongly recommend that all disclosure revisions be done at one time, with appropriate testing and a rational implementation period. Making piecemeal, rather than coordinated changes to consumer disclosures would not provide any benefit to consumers, but it would impose a significant compliance and systems challenge to the industry.

Given that the Bureau of Consumer Financial Protection (the Bureau) has made the integration project an early priority, our recommendation seems prudent. In addition, we note that in one area the current proposal would create a new, and very serious, conflict with the RESPA rules that are now in force. The proposed rule would impose TILA liability for third party charges that RESPA rules do not permit creditors to control. We discuss the need to address and resolve this conflict below.

Finally, we recommend that federal policymakers working on the RESPA-TILA integration project begin by reviewing the enormous volume of work that has been already done in this area. More specifically, we would recommend that policymakers begin by using the TILA forms that the Board proposed in its 2009 rulemaking. While a few adjustments will need to be made to those forms, as we noted in our comment letter last year,[2] the forms are excellent. After making those adjustments, the information required by RESPA can be added to the Board's forms and the integration of the disclosures can be tested in a real-world environment and ultimately finalized.

Additional consumer information that describes the various types of mortgage products, settlement services, and the mortgage process itself should be prepared by a professional educational public relations firm that is experienced in using new media. In today's environment, many consumers simply do not read detailed handbooks. Instead, they "listen and watch." Recognizing this reality will help to ensure that consumers receive communications that enable them to understand and select the product choices that best meet their personal financial needs. The disclosure forms should not be used for general consumer education because that would crowd out the specific disclosures. Instead, the disclosure forms should be used to disclose to consumers the specific costs and terms of the mortgage options available to them and of the mortgage product they select.

Rescission Procedures

Notice of Right to Cancel

The Board proposes to revise the format and content of the notice of right to cancel. The content in the proposed notice is clearer because it presents information in a tabular format. We support this change.

[2] The Board's proposed TILA forms are excellent, but they will need to be expanded so they can be used smoothly in variable rate products. In addition, the industry does not have the capability to display the graphics that were proposed in the disclosure forms.

The Board also proposes to remove the antiquated requirement that creditors deliver two identical copies of the very same disclosure about the right to rescind. In the information age, this is a welcome improvement. It will help reduce information overload.

We recommend, however, that the Form H-8, Rescission Model Form (General) and H-9 Rescission Model Form (New Advance of Money With the Same Creditor) be combined into one. They differ only slightly, so they could be combined easily. The difference to consumers would be negligible because the key disclosure – the right to cancel and the deadline – would not differ. Yet operationally it would be substantially easier to comply because it would not require the creditor on the new loan to determine whether it is the original creditor.

We also recommend that the Board include a form for the notice of the right to cancel when an open-end loan finances the purchase of a home. The first advance would not be rescindable. However, future advances on the same line of credit would be. A form making this distinction clear to the consumer would improve consumer understanding.

Notice to Servicer

The Board proposes to permit a consumer to notify the loan's servicer of a rescission even if the servicer was not the original creditor. We support this change because the servicer is the entity with whom the consumer regularly communicates, not necessarily the original creditor. This intuitive process will make it easier for consumers to exercise their rights.

Important Clarity About Procedure for Rescission After Disbursement

We also support the Board's proposal concerning the procedure for rescissions after a creditor disburses loan funds. As currently written, Regulation Z could mislead consumers into believing that the mere execution and delivery of a rescission notice means the security interest becomes void, although this is not true. The Board's proposal would revise the regulation so that consumers would better be able to understand their right to rescind under Regulation Z.

Rescission is a remedy that restores the parties to their pre-contract position. That is, the creditor returns interest and other loan costs to the consumer, the consumer returns loan principal to the creditor, and the creditor records a release of its lien. In most cases, the net payment will be from the consumer to the creditor because the loan principal is a larger dollar amount than the interest and charges the consumer has paid on the loan.

Black's Law Dictionary defines the term "rescission" as follows:

> A party's unilateral unmaking of a contract for a legally sufficient reason, such as the other party's material breach, or a judgment rescinding the contract; Voidance. Rescission is generally available as a remedy or defense for a nondefaulting party and is accompanied by restitution of any partial performance, thus restoring the parties to their precontractual positions. Also termed avoidance.

TILA sets out the procedure for a rescission.

> When an obligor exercises his right to rescind under subsection (a) of this section, he is not liable for any finance or other charge, and any security interest given by the obligor, including any such interest arising by operation of law, becomes void upon such a rescission. Within 20 days after receipt of a notice of rescission, the creditor shall return to the obligor any money or property given as earnest money, downpayment, or otherwise, and shall take any action necessary or appropriate to reflect the termination of any security interest created under the transaction. If the creditor has delivered any property to the obligor, the obligor may retain possession of it. Upon the performance of the creditor's obligations under this section, the obligor shall tender the property to the creditor, except that if return of the property in kind would be impracticable or inequitable, the obligor shall tender its reasonable value.[3]

Many consumers do not understand the consequences of rescission and erroneously believe that delivery of an executed rescission notice immediately voids the lien without any need to return any principal. This is a serious misunderstanding.

TILA sets out the rights of the parties upon exercise of a "right" to rescind. Delivery of a rescission notice to a creditor may be an exercise of a "right" to rescind, but not necessarily. Not every loan is rescindable and not every executed rescission notice exercises a right to rescind. The Board's proposal merely provides time for a creditor to review the facts of the case and determine whether it believes there is a valid right to rescind. The proposal would make clear that TILA does not require any steps toward rescission based only on execution and delivery of a rescission notice. TILA requires those steps only after exercise of a *valid* right to rescind.

When there is a valid right to rescind, TILA provides that a rescinding obligor is not liable for any "finance or other charge[.]" At first glance, this may imply that the consumer has no further duty of any sort, but TILA also provides that a rescinding obligor "shall tender the property to the creditor" or tender "its reasonable value." That is, the language is seemingly contradictory, first stating that the rescinding obligor has no liability for charges, then requiring the consumer to repay the loan principal.

A closer reading clarifies the two phrases. Upon valid rescission, the obligor is no longer liable for "any finance or other charge" on the loan. A TILA "finance charge" includes interest and certain other, but not all, loan charges. The language that the obligor is not liable for any "finance or other charge" refers only to the interest and other loan charges. It does not cover the loan principal because, under TILA definitions, principal is not a "finance charge" or any type of "charge."

The phrase "the obligor shall tender the property" requires the obligor to return something, of course. It must refer to something the obligor could return. Loan principal

[3] TILA § 125(b), 15 U.S.C. § 1635(b).

is the only property the obligor would be able to return to a creditor because it is the only property the creditor has transferred to the obligor. Clearly, TILA requires rescinding borrowers to repay the loan principal.

The language making the creditor's security interest void upon a rescission does not require the creditor to release its lien immediately. Rather, within twenty days of receiving a valid notice of rescission, the creditor must take specified actions. Neither releasing its lien nor recording a release is among them. Within that period of time, the creditor must return earnest money and any downpayment. It must also take any action "necessary or appropriate" to reflect termination of its security interest. That is all the creditor is required to do.

It may not be "necessary or appropriate" for the creditor to release its lien immediately in all circumstances. Given that TILA requires a rescinding obligor to return the loan principal, it is only appropriate for creditor to release its lien when the obligor has met its obligation.

The Board's proposal is designed to clarify this statutory language and to implement the plain obligation of a rescinding obligor to repay the loan obligation.

Clarification Concerning Guarantors

The Board proposes helpful guidance about guarantors' rescission rights. The Board proposes a Comment that a right to rescind exists when guarantors both guarantee repayment and pledge their principal dwelling as security on a consumer credit transaction.[4] This is welcome clarity.

Clarification Concerning Estimated Dates

The Board proposes helpful guidance for circumstances in which creditors need to estimate the deadline for expiration of a right to cancel. The proposal permits estimates as necessary without affecting consumer's substantive rights. This is an appropriate clarification.

Rescission Waiver Requests

- *Investigation of Consumer's Personal Matters Should Not Be Required*

The Board proposes additional guidance about consumers' ability to waive the three-day rescission period so that a loan may fund upon consummation.

> The conditions for a waiver are not met where the consumer's waiver statement is inconsistent with facts known to the creditor.[5]

[4] Proposed Comment 2(a)(11)-1.i.
[5] Proposed Comment 23(e)2.iii.

It is unclear what is "inconsistent" with known facts. Is an implied possible difference inconsistent? How much inconsistency would be required? Creditors need either to permit or reject a waiver request, which requires a yes or no answer.

It is also unclear what a creditor "knows" because a creditor is a corporation. Upon receipt of a waiver request, does the Board intend the creditor to investigate the veracity of the request? If so, to what extent? How quickly? A reasonable inquiry could take much or all of the three days, and effectively eliminate all waivers.

If, for example, a consumer wishes a waiver to pay for emergency health care services, is the creditor to request and review medical information? Creditors are not medical experts, and will not be able to determine which medical services are needed immediately and which can wait. We also believe requiring consumers to provide detailed medical or other unneeded, but private information to creditors would be an unwarranted breach of privacy.

We do not believe creditors should be required to investigate the facts underlying waiver requests. Any investigation requirement would in effect eliminate all waivers.

- *Clarification About Consumer Facing Foreclosure*

We request clarification of one of the Board's examples of a *bona fide* personal emergency upon which a waiver is permissible. The Board proposes this example:

> The imminent sale of the consumer's home at foreclosure, where the foreclosure sale will proceed unless the loan proceeds are made available to the consumer during the rescission period.[6]

This could be read to imply that the consumer facing foreclosure must be the same consumer who is seeking a new loan and a waiver. One person may apply for a mortgage loan, on that person's home, to avoid foreclosure on a different consumer's home, such as to help a family member. We believe waiver should be permissible in this case.

Death of a Consumer

The Board proposes to incorporate into its regulation a clarification of a provision in TILA. This is the provision in TILA § 125(a) that a right to rescind a mortgage loan terminates upon transfer of all the consumer's interest in the property. The Board proposes to clarify that a consumer's death, which as a matter of law immediately transfers all the consumer's interest in all property, terminates that consumer's right to rescind. TILA mandates this outcome, and the clarification is helpful to consumers' understanding of their rights.

[6] Proposed Comment 23(e)2.i.A.

Material Disclosures

The Board proposes a number of additions to, and deletions from, the definition of material disclosure. This definition is significant because a creditor's failure to deliver a required "material disclosure" extends the period during which a consumer may rescind a loan.[7]

> The Board now proposes to revise the definition of material disclosures to include the information that is critical to consumers in evaluating loan offers, and to remove information that consumers do not find to be important. The proposal is intended to ensure that consumers have the information they need to decide whether to rescind a loan.[8]

Overview of Proposed Changes to Material Disclosure

The Board proposes to remove from the definition of material disclosures the amount financed, the number of payments, and total of payments. This is designed to make the material disclosures be as their name conveys – disclosures of information that is material to consumers as they decide whether to rescind. The Board proposes to remove these items from the definition of material disclosure because consumer testing demonstrated that consumers do not place importance on the disclosures.[9]

The Board also proposes to exclude from the definition of material disclosures for reverse mortgage loans the loan amount, loan term, and payment summary. With reverse mortgage loans, the loan amount may be unknown, the loan term is unknown, and there are no periodic payments.

For reverse mortgage loans, the Board also proposes to exclude the loan features in proposed § 226.38(a)(ii) – step payments, payment options, and interest-only payments. These items are not relevant to reverse mortgage loans. The Board also proposes to exclude negative amortization as a material disclosure because there are no periodic payments, but would include the interest costs.

The Board proposes to add several items to the definition of material disclosures. It also proposes to revise the definition of "finance charge" to include more charges, including third party charges.

The Specific Proposed Changes

The Board proposes to define "material disclosures" to include a number of items, including the following:

For open-end loans:

[7] Proposed § 226.15(a)(3)(ii) (open-end); § 226.23(a)(3)(ii) (closed-end).
[8] 75 Fed. Reg. 58539, 58613 (September 24, 2010).
[9] 75 Fed. Reg. 58539, 58619-20 (September 24, 2010).

- The annual percentage rate (the "APR").[10]
- The "total of all one-time fees imposed by the creditor and any third parties to open the plan disclosed under § 226.6(a)(2)(vii) or § 226.33(c)(7)(i)(A)[.]"[11]

For closed-end loans:

- The total settlement charges disclosed under § 226.38(a)(4) or the total fees under § 226.33(c)(7)(i)(A).[12] For this purpose, settlement charges are either of two amounts. One amount is settlement charges as disclosed under RESPA,[13] which includes third party settlement costs. (We discuss below a problem with using a RESPA reference for transactions not subject to RESPA.) The other amount is the total of all one-time fees, imposed by either a creditor or any third party, to consummate a reverse loan transaction, stated as a dollar amount.[14]
- The APR.[15]
- The interest and settlement charges disclosed under § 226.38(e)(5)(ii) or § 226.33(c)(14)(ii).[16]

The August 2009 closed-end proposal would add to the definition of finance charge certain third-party charges on closed-end loans, in § 226.4(g), and the Board has continued to include that § 226.4(g) with its current proposal.

As a result, the new definition of material disclosure, for both open-end and closed-end credit, would include third-party charges.

Modifications to Material Disclosure Should be Coordinated

The number of proposed changes to material disclosures alone increases the chances for inadvertent error, especially if there is not sufficient time to understand them and implement them properly.

We discuss below that the Board may not have fully considered the conflicts with RESPA. For this reason, we believe this rulemaking should be pursued only when it can be coordinated with the RESPA integration.

We also suggest that if the material disclosures were to be amended, revisiting the tolerances would be necessary.

Material Disclosures Should Not Include Third-Party Charges Without Addressing RESPA § 8

Including third-party charges in the definition of material disclosure creates a conflict

[10] Proposed 12 C.F.R. § 226.15(a)(5)(i)(A).
[11] Proposed 12 C.F.R. § 226.15(a)(5)(i)(B).
[12] Proposed 12 C.F.R. § 226.23(a)(5)(i)(E).
[13] Proposed 12 C.F.R. § 226.23(a)(5)(i)(E), referring to § 226.38(a)(4).
[14] Proposed 12 C.F.R. § 226.23(a)(5)(i)(E), referring to 226.33(c)(7)(i)(A).
[15] Proposed 12 C.F.R. § 226.23(a)(5)(i)(G).
[16] Proposed 12 C.F.R. § 226.23(a)(5)(i)(I).

between RESPA and TILA rules, and this conflict creates a problem that needs to be resolved. The issue concerns settlement charges that the creditor cannot control because they are third-party charges. The reason the creditor cannot control those costs is not related to TILA, but is based on RESPA § 8. RESPA § 8, as currently implemented in Regulation X, does not permit creditors to control third party settlement costs, such as the charges for title examination and title insurance.

Not only can creditors not control those costs, creditors must rely on closing agents to tell the creditor what some of the costs are. This process is hardly infallible. A closing agent may permit charges to be added without the creditor's knowledge or approval.

Defining as a material disclosure the third party charges that the creditor cannot control and is not always able to know may extend a consumer's right to rescind a loan if the disclosure inaccurately states those charges. That is, it would very severely penalize a creditor for not controlling third party costs, while RESPA rules prohibit the creditor from doing just that. This is inappropriate, as well as unfair.

We understand the desire for consumers to have accurate disclosures of third party settlement costs, and agree with that goal. It is possible to have accurate disclosures while not penalizing creditors under TILA with the harsh remedy of rescission for complying with RESPA.

Several solutions to this problem are available.

- Exclude all third party charges for purposes of determining rescission tolerances.
- Provide ten percent tolerances for third-party charges, as under RESPA rules.
- Require disclosures of third party charges under RESPA but not under TILA.
- Relax RESPA § 8 liability for the purpose of improving consumer disclosures of third party settlement costs.
- Provide creditors with time after making a TILA disclosure to amend it to correct errors, much as RESPA rules permit 30 days after a loan closes to revise a settlement statement.[17]

We recommend consideration of this issue as RESPA disclosures are integrated with TILA disclosures. Until this issue can be resolved, we must oppose inclusion of third party settlement charges in the Regulation Z definition of material disclosure. This is unfortunate, because we believe the intent behind the Board's proposal, to ensure consumers know their settlement charges regardless of who provides the services, is in the interest of consumers.

Interest Rate and Payment Summary Should Not Be a Material Disclosure

Defining the Interest Rate and Payment Summary as a material disclosure would be inappropriate because the requirements for that disclosure are not always clear. On December 22, 2010, the Board revised the interim final rule that requires this disclosure

[17] 24 C.F.R. § 3500.8(c).

to clarify some matters, but uncertainty remains, as we will detail in a subsequent comment letter.

It would be fundamentally unfair to define as material any disclosure that the creditor in good faith may be unable to prepare accurately.

Defining Material Disclosures to Include Settlement Disclosures Disclosed Under RESPA

The proposal would define material disclosures to include settlement charges as disclosed under RESPA on certain closed-end transactions. The Board also proposes to require Regulation Z disclosures on modifications that are not subject to RESPA. For transactions not subject to RESPA, this reference would need revision.

This presents yet another example of the need to coordinate TILA disclosures with RESPA disclosures rather than pursue them independently.

Refinance with the "Same Creditor"

TILA permits consumers to rescind loans in some, but not all, circumstances. It exempts from rescission:

> [A] transaction which constitutes a refinancing or consolidation (with no new advances) of the principal balance then due and any accrued and unpaid finance charges of an existing extension of credit by the same creditor secured by an interest in the same property[.][18]

When an existing loan is refinanced, it can be unclear whether the "same creditor" is making the change to the loan. The Board proposes that an extended right to rescind a loan terminates when the loan is refinanced, if the refinanced loan is made by a creditor other than the current holder.[19] It also proposes that rescission rights should not apply to a loan refinanced by the same creditor, and proposes to define "same creditor" to mean the original creditor, to whom the loan was initially payable, if that creditor is also the current holder of the loan.[20]

We believe that in a refinance the right of rescission for the new loan should apply only to new advances. Any redress regarding the prior loan should be pursued against the creditor that made the prior loan, not the creditor who makes the new loan.

A hypothetical example will illustrate why this distinction is appropriate. Creditor A makes a loan and fails to deliver a required material disclosure. Creditor A sells the loan to Creditor B within three years. Also within three years, the consumer refinances the loan that Creditor B owns with Creditor A, the creditor at fault. Creditor A has already

[18] TILA § 125(e)(2).
[19] Proposed § 226.23(a)(3)(ii).
[20] Proposed § 226.23(f)(2)(i).

been repaid for the original loan by selling the loan to Creditor B. Under the proposal, this refinance would terminate the consumer's right to rescind the original loan. This is contrary to the Board's stated intent of preventing "unscrupulous creditors [from] refinanc[ing] their own loans . . . to purposely terminate a consumer's right to rescind the previous loan[.]"[21]

The Board's proposal would effectively rewrite TILA. TILA plainly exempts refinanced loans from rescissions to the extent there are no new advances. Congress just passed a law that rewrote and revised much of TILA, yet Congress left alone the language quoted above.

We recommend that the Board limit the rescission of the refinanced loan to the extent of new advances, as Congress requires. This does not need to affect any rights the consumer may have as to the original creditor on the original loan. In the example above, even after refinancing, the consumer would remain able to seek redress from Creditor A, the creditor at fault on the earlier loan, for the failure to deliver material disclosures for that loan, but not from Creditor B, the creditor not at fault. This would be more equitable than penalizing Creditor B and not Creditor A for Creditor A's violation.

Rescission Tolerances

Having proposed to redefine material disclosures, the Board also proposes to revise the tolerances, for rescission purposes, to cover the newly defined material disclosures. The Board explains:

> The Board recognizes that increasing the number of material disclosures could increase the possibility of errors resulting in extended rescission rights. Although the creditor must re-disclose any changed terms before consummation, consistent with § 226.17(f), there may still be errors in the final TILA disclosure. To ensure that inconsequential disclosure errors do not result in extended rescission rights, the Board proposes to add tolerances for accuracy of disclosures of the loan amount, the total settlement charges, the prepayment penalty, and the payment summary. The proposal would retain the existing tolerances for the interest and settlement charges (currently referred to as the "finance charge").[22]

We understand the intent behind the proposal, but we explain why it cannot work as intended. First, we set out the proposed tolerances:

Tolerances for Rescission Purposes – Open-End

For open-end credit, the proposal would set a tolerance for rescission purposes for the total of all one-time fees to open the plan that are imposed by the creditor and by third parties, and other disclosures affected by the total. The disclosure would be considered accurate if it were understated by no more than $100, and overstatements would be

[21] 75 Fed. Reg. 58539, 58612 (September 24, 2010).
[22] 75 Fed. Reg. 58539, 58614 (September 24, 2010).

considered accurate.[23]

Tolerances for Rescission Purposes – Closed-End

For closed-end credit, the proposal would set tolerances, for rescission purposes, as follows.

- *Interest and Settlement Charges, and APR*

Disclosures of the interest and settlement charges and of the APR, with two exceptions, would be considered accurate if they were understated by no more than one half of one percent of the note amount, or $100, whichever is greater. In the case of a refinance with a new creditor without a new advance or loan consolidation, the disclosure would be considered accurate if it were understated by no more than 1% of the note amount or $100, whichever is greater. After foreclosure is initiated on a consumer's principal dwelling, the disclosure would be considered accurate if it were understated by no more than $35. In each case, an overstatement would be considered accurate.[24]

- *Loan Amount*

The disclosed loan amount would be considered accurate, with two exceptions, if it were understated by no more than as one half of one percent of the note amount or $100, whichever is greater. In the case of a refinance with a new creditor without a new advance or loan consolidation, the amount disclosed would be considered accurate if it were understated by no more than 1 percent of the note amount or $100, whichever is greater. In each case, an overstatement would be considered accurate.[25]

- *Total Settlement Charges, Prepayment Penalties, and Payment Summary*

A disclosure of total settlement charges, prepayment penalties, and payment summary would be considered accurate if each disclosure were understated by no more than $100, and overstatements would be considered accurate.[26]

- *Loan Term*

The Board does not propose, but requests comment on, whether it should include a tolerance for the loan term. We recommend that the tolerance be sufficient to accommodate the difficulty in defining the loan term precisely in disclosures prepared more than three days before consummation, so that creditors making disclosures in good faith will not exceed the tolerances.

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[23] Proposed 12 C.F.R. § 226.15(a)(5)(ii).
[24] Proposed 12 C.F.R. § 226.23(a)(5)(ii).
[25] Proposed 12 C.F.R. § 226.23(a)(5)(iii).
[26] Proposed 12 C.F.R. § 226.23(a)(5)(iv).

Tolerances for Rescission Purposes Should Bear a Relation to the Amount of Consumer Harm and to the Severity of the Rescission Penalty

The Board has proposed a number of new tolerances for rescission purposes. Many of them are quite low, often only $100, and one is only $35. The Board describes how it arrived at its proposed tolerances. "[T]his proposal would provide a tolerance for the loan amount modeled after the tolerances for the finance charge created by Congress in 1995."[27]

We question why this is appropriate in light of the significant changes the proposal would make to the finance charge, to be called the interest and settlement charge. In particular, this proposal would include third party charges in the definition of finance charge, and subject the creditor to a minor tolerance for charges the creditor cannot control.

At the time Congress created the tolerances, the finance charge excluded items that the Board would now include, including third party charges. It simply does not follow that the tolerances for material disclosures should remain at the same level while the definition of material disclosures is greatly expanded.

Especially where a tolerance can be as low as $35 – an amount that may not even increase with inflation – rescission would be an extraordinarily harsh penalty, wholly disproportional to any consumer harm, and wholly disproportional to the damage to creditors.

The Board states that the purpose of its proposal is "to ensure that consumers have the information they need to decide whether to rescind a loan."[28] We respectfully suggest that rescinding a loan over $100 or $35 is most unreasonable. If the problem were that a consumer was inappropriately charged a small amount of money, rescission would be an inappropriate remedy because it is disproportional to the amount of consumer harm.

The Board states that its intention is "[t]o ensure that inconsequential disclosure errors do not result in extended rescission rights,"[29] but the effect would be to ensure that inconsequential errors *do* extend rescission rights.

If creditors were subject to the harsh penalty of rescission under miniscule tolerances, a few inadvertent inaccuracies that the creditor cannot prevent due to RESPA § 8, that have only a negligible effect on consumers, could put creditors, especially small creditors, out of business. We strongly urge the Board to rethink the level of the rescission tolerances.

Tolerances and Inflation

The Board also asks whether it should adjust the loan amount tolerance figure of $100, which was set in 1995, or adjust it for inflation. We believe all tolerances that are set as a

[27] 75 Fed. Reg. 58539, 58615 (September 24, 2010).
[28] 75 Fed. Reg. 58539, 58613 (September 24, 2010).
[29] 75 Fed. Reg. 58539, 58614 (September 24, 2010).

fixed dollar amount should be adjusted for inflation because over time inflation can have a significant effect. We do not believe this should require a rulemaking for each adjustment because it would be a mere arithmetic calculation. Just as the Board annually adjusts its HOEPA points and fees threshold under § 226.32(a)(1)(ii) without a notice and comment rulemaking, it should do the same for this tolerance. Given that the $100 figure has not been adjusted for inflation since 1995, the first adjustment should account for inflation since that year.

The Board did not propose a different tolerance for the loan amount in connection with a foreclosure, due to compliance concerns. We share the Board's concern about compliance. TILA compliance is one of the most difficult areas of compliance in consumer mortgage lending, and it imposes tremendous costs on creditors. Consumers in the long run bear all those costs. To the extent that a reasonable tolerance can reduce the cost of housing credit, it would benefit consumers and the housing markets.

The Board also solicits comment on whether the loan amount tolerance should be revised to be similar to the HOEPA tolerance, under which a disclosure is considered accurate if it is overstated or understated by no more than $100. We believe this would be inappropriate. It is understandable that Congress put extra restrictions on HOEPA loans. HOEPA loans are a narrow and specific category of loans warranting specialized restrictions. It does not follow that the same restrictions should apply to all loans.

Additionally, creditors are under strong competitive pressure not to overstate the loan amount because that would risk overstating other amounts that are tied to the loan amount, and that could drive a promising customer to the creditor's competitor.

For these reasons, we believe the loan amount tolerance, and all tolerances expressed as a fixed dollar amount, should adjust for inflation.

Disclosures in Connection With Loan Modifications

The Board's proposal would require new disclosures in some but not all instances when the same creditor and consumer modify an existing loan obligation, which the Board would define as a new transaction.

A modification of an existing loan is not the origination of a new loan transaction. It merely revises one or a few terms of an existing loan. It does not require releasing a lien and replacing it with a new one because the same loan is in place before and after the modification. There is no new loan transaction. Despite the fact that there is no origination of a new loan, the Board is proposing to require a full set of TILA origination disclosures, with all of the inherent complexities, all of the TILA liability and litigation risk, a three-day waiting period, and a right to rescind. This would be very disproportionate to the modification, a relatively simple event with low risk to consumers. A clear, concise, complete disclosure for modifications could fit on one page. A modification disclosure should not be complicated, much like a rate reset notice.

Moreover, modifications can be beneficial to consumers. A common type of modification, other than one in connection with default or imminent default which we discuss below, is the conversion of an adjustable rate to a fixed rate when interest rates are rising. This is beneficial to the creditor who retains a customer considering refinancing with a different creditor. It benefits the consumer who can avoid a rate increase and avoid the cost of a refinance. There is no need for a full array of disclosures for such a minor and beneficial change. Another common type of modification is a loan assumption. In this case, no loan term changes. Any disclosure in connection with modifications should be tailored to just the information that is relevant to a modification.

Were the Board to require a full array of disclosures for modifications, it would not inform consumers about the terms of the modification. It would greatly reduce the possibility of modifications.

Default or Delinquency

The Board's proposal would not require new disclosures for a modification in connection with a default or delinquency, unless there is an increase in the loan amount, an increase in the interest rate, or unless the creditor imposes a fee for the modification. The Board solicits comment on whether, for modifications in the case of default or delinquency, to require a new, streamlined disclosure that highlights changed terms, or whether to keep the proposed exception from modification disclosures in cases of default or delinquency.

We believe it is important for consumers to understand their loan terms in all circumstances. We believe, though, applying TILA to modifications in the event of default or delinquency would be very harmful.

It is important for policy makers to understand that adding new TILA litigation risks onto loan modifications would increase the cost, and therefore reduce the availability of, loan modifications.

Done correctly, modifications in the event of default can provide a benefit to consumers and to the communities in which they live. The Treasury Department has made its Making Home Affordable programs, HAMP and HARP, a central part of its response to the housing crisis. FHA has adopted an analogous modification program for the same reasons. Loan servicers also have adopted similar modification programs. Imposing TILA liability on these modification programs could eliminate them overnight.

To the extent that the Board can identify a shortcoming in disclosures used in modifications in case of default, it could ask Treasury to incorporate new disclosures into its HAMP and HARP programs, and FHA into its program, rather then to require them under TILA.

This approach would not be limited to HAMP, HARP, and FHA programs. Rather, this approach would smoothly incorporate the same disclosures into modifications performed outside of the Treasury's programs because Congress enacted a "servicer safe harbor" against liability for servicers that use modification programs, such as the Treasury's programs.[30] In this way, the Board could cause creditors to use the disclosures it believes are best without causing the risk of TILA liability to disrupt a major platform of the country's foreclosure prevention efforts.

Imminent Default

The Board also solicits comment on whether consumers should be provided TILA disclosures when they are in imminent default or delinquency. The Treasury's HAMP and HARP programs are specifically designed to avoid foreclosure for borrowers who are in imminent default. This is a central platform of the Treasury's housing policies. We do not believe TILA litigation risk should be imposed because it would severely disrupt Treasury's policies and programs, as well as the housing markets.

We recommend that the Board include an exception to the proposed new disclosure requirement in proposed § 226.20(a)(1)(ii) for "Modifications, including trial period plans and refinances, consistent with the Home Affordable Modification Program and the Home Affordable Refinance Program established by the Department of the Treasury."

Clarification on the definition of imminent default would be advisable. The HAMP guidance provides:

> A borrower that is current or has only one payment due and unpaid by the end of the month in which it is due and who contacts the servicer to request HAMP consideration must be evaluated to determine if he or she is at risk of imminent default. Each servicer must have written standards for determining imminent

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[30] (a) IN GENERAL.—Notwithstanding any other provision of law, whenever a servicer of residential mortgages agrees to enter into a qualified loss mitigation plan with respect to 1 or more residential mortgages originated before the date of enactment of the Helping Families Save Their Homes Act of 2009, including mortgages held in a securitization or other investment vehicle—
(1) to the extent that the servicer owes a duty to investors or other parties to maximize the net present value of such mortgages, the duty shall be construed to apply to all such investors and parties, and not to any individual party or group of parties; and
(2) the servicer shall be deemed to have satisfied the duty set forth in paragraph (1) if, before December 31, 2012, the servicer implements a qualified loss mitigation plan that meets the following criteria:
(A) Default on the payment of such mortgage has occurred, is imminent, or is reasonably foreseeable, as such terms are defined by guidelines issued by the Secretary of the Treasury or his designee under the Emergency Economic Stabilization Act of 2008.
(B) The mortgagor occupies the property securing the mortgage as his or her principal residence.
(C) The servicer reasonably determined, consistent with the guidelines issued by the Secretary of the Treasury or his designee, that the application of such qualified loss mitigation plan to a mortgage or class of mortgages will likely provide an anticipated recovery on the outstanding principal mortgage debt that will exceed the anticipated recovery through foreclosures.
(b) NO LIABILITY.—A servicer that is deemed to be acting in the best interests of all investors or other parties under this section shall not be liable to any party who is owed a duty under subsection (a)(1), and shall not be subject to any injunction, stay, or other equitable relief to such party, based solely upon the implementation by the servicer of a qualified loss mitigation plan.
Preventing Mortgage Foreclosures And Enhancing Mortgage Credit, Pub. L. No. 111-22, § 201, 123 Stat. 1632, 1638-39 (2009).

default that are consistent with applicable contractual agreements and accounting standards and must apply the standards equally to all borrowers.[31]

Any TILA definition of imminent default should be consistent with the HAMP definition because this definition is in widespread use and is designed specifically to benefit consumers.

Clarification of Creditor Under HARP

We request one clarification concerning the identity of the creditor under the HARP program. Under this program, the government sponsored entities Fannie Mae and Freddie Mac (the GSEs) refinance loans for eligible borrowers. Each GSE may only refinance loans that it owns or has guaranteed through its mortgage-backed securities.

Fannie Mae and Freddie Mac are both prohibited by their charter acts from originating loans.[32] They both also are generally prohibited from acquiring loans with a loan-to-value ratio greater than 80 percent without credit protection, usually mortgage insurance.[33] Further, both are required to obtain regulatory approval before offering new products. Regulatory approval is not permitted before public notice and opportunity to comment.[34]

To effectuate HARP, the Federal Housing Finance Agency (FHFA) conditionally approved GSE participation as "akin to a loan modification for charter purposes" rather than as a loan without required mortgage insurance.[35] FHFA noted the "unusual and exigent market circumstances" and did not enforce the prohibition on GSE loan origination, and did not enforce the required public notice-and-comment procedure for new GSE products.[36]

The Board discusses the definition of creditor for purposes of proposed § 226.20(a)(1):

> The Board believes that any person who makes significant changes to the terms of an existing legal obligation, such as the interest rate or the loan amount, engages in extending credit to the consumer by continuing the extension of debt on different terms and, therefore, is a "creditor" under TILA.[37]

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[31] *Making Home Affordable Program Handbook for Servicers of Non-GSE Mortgages*, version 3.0, § 4.4, p. 58 (December 2, 2010), available here https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/mhahandbook_30.pdf
[32] Fannie Mae charter § 304(a)(2)(B), 12 U.S.C. § 1719(a)(2)(B); Freddie Mac charter § 305(a)(5)(B), 12 U.S.C. § 1454(a)(5)(b).
[33] Fannie Mae charter § 302(b)(2), 12 U.S.C. § 1717(b)(2); Freddie Mac charter § 305(a)(2)(C), 12 U.S.C. § 1454(a)(2)(C).
[34] Housing and Economic Recovery Act of 2008, § 1123, Pub. L. No. 110-289, 122 Stat 2654, 2689 (to be codified at 12 U.S.C. § 4541).
[35] Letter from James B. Lockhart III, Director, FHFA, to Suzanne Hutchison, Executive Vice President, Mortgage Insurance Companies of America (February 20, 2009), available at: http://www.fhfa.gov/webfiles/1256/HutchinsonGSERefi22009.pdf
[36] *Id*.
[37] 75 Fed. Reg. 58539, 58597 (September 24, 2010).

We request clarification of the definition of creditor when a GSE refinances a loan under HARP.

We also suggest that the difficulty of the many issues surrounding this question provides further reason not to apply proposed § 226.20(a)(1) to the Treasury Department's HAMP and HARP initiatives due to unintended consequences. Requiring TILA disclosures for HAMP and HARP would have a number of unforeseen and unintended consequences such as this one. Of course, crippling HAMP and HARP would be another consequence.

Clarification of Creditor Outside of HARP

It is not entirely clear in a modification who the creditor would be for disclosure purposes. Logically, it would seem to be the holder of the obligation, but identifying this holder in TILA disclosures would be quite confusing to consumers. Identification of the servicer would be more relevant, as the Board recognizes in its proposal to permit consumers send cancellation notices to servicers. We request clarification that the "creditor" for modification disclosures would be the servicer, even though the servicer is not the creditor for other TILA purposes.

Increase in Loan Amount

New disclosures would be required when a modification increases the loan amount. The Board asks whether it should establish a *de minimis* threshold for increased loan amounts below which disclosures should not be required. This would be appropriate because without a minimum threshold, creditors will not make minor changes due to TILA litigation risk. For example, a consumer with a HELOC may inadvertently go over the credit limit by a small amount. This should not require a disclosure under § 226.20.

Determining the loan amount on a modification is difficult because the loan amount can change daily as interest accrues and as a consumer makes payments. When preparing a disclosure, the creditor may not know the date the modification will become effective, and will not know the loan amount.

We recommend that the Board permit the creditor to prepare disclosures based on an assumption that the modification will be effective on a scheduled payment date, and that all payments will be made when and in the amounts scheduled.

Definition of Application

The Board proposes to require disclosures within three days after a consumer applies for a modification. It proposes to incorporate the RESPA definition of application.

> Creditors may rely on RESPA and Regulation X (including any interpretations issued by HUD) in deciding whether a "written application" has been received. In general, Regulation X defines an "application" to mean the submission of a

> borrower's financial information in anticipation of a credit decision relating to a federally-related mortgage loan, using the RESPA definition of application.[38]

The use of common definitions under RESPA and TILA rules would normally be a welcome integration of the two areas of rules. Nevertheless, in this matter, we believe the RESPA definition of application needs clarification. The RESPA definition is:

> *Application* means the submission of a borrower's financial information in anticipation of a credit decision relating to a federally related mortgage loan, which shall include the borrower's name, the borrower's monthly income, the borrower's social security number to obtain a credit report, the property address, an estimate of the value of the property, the mortgage loan amount sought, and any other information deemed necessary by the loan originator.[39]

- *Would a Submission Be Required?*

The Board proposes to permit creditors to rely on information they already have on file for modifications.

> The Board is aware that consumers may not always formally apply for a modification of the terms of an existing obligation. In many cases, the creditor may have in its possession the information in the definition of "application" under RESPA and Regulation X (*e.g.,* the consumer's name, monthly income, or property address). *See* 12 CFR 3500.2(b). Therefore, proposed comment 20(a)(1)(i)–4 also provides that an application is deemed received in those instances where the creditor has the information necessary to constitute an "application" as defined under RESPA and Regulation X, whether the creditor requests the information from the consumer anew or uses information on file.[40]

This seems to contradict the RESPA definition, which requires "the **submission** of a borrower's financial information." If the creditor were to use information already on file, it would not have the submission necessary for a RESPA-defined application.

We request clarification that the income information and property valuation on which a creditor relies must be current at the time of a modification. Income and property values can fluctuate in a short amount of time, so that the information collected during origination likely will be obsolete at the time of a modification.

- *What Information Would Be Required?*

The RESPA definition permits loan originators flexibility to decide what they require in loan applications. Could a creditor use one definition of application for RESPA purposes

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[38] Proposed Comment 19(a)(1)(i)-2.
[39] 24 C.F.R. § 3500.2(b).
[40] 75 Fed. Reg. 58539, 58598 (September 24, 2010).

and a different one for modification purposes? This is not clear because the RESPA definition is not designed to answer that question.

Moreover, the RESPA definition is designed for a full loan application, which may be much different from the Board's broad definition of modification. Must the creditor require "the borrower's social security number to obtain a credit report" for every modification? The Board seems to want creditors not to charge fees for modifications, but requiring credit histories would appear to counter that goal. Using the RESPA definition of application, creditors will be compelled to obtain credit histories for every modification.

By the same reasoning, creditors will feel compelled to obtain "an estimate of the value of the property" for every modification. In many instances, this would be an expense for no apparent purpose. Further, the DFA will require new regulations for automated valuation methods, which will increase their costs.[41] Valuations should be current when creditors rely on them, but it does not follow that creditors must use them for every modification broadly defined.

- *What Would Trigger a Disclosure?*

If the definition were clarified to permit creditors to use information on file, what would trigger the disclosure? One proposed comment would provide that the modification disclosure requirement would arise when the creditor "has" the information enumerated in the RESPA definition.

> Whether the creditor requests the information from the consumer anew or uses information on file, an application is deemed received where the creditor has the information set forth in the definition of "application" as defined under Regulation X.[42]

It is not clear what it means for a corporation to "have" information. Does the three-day period begin when the consumer calls and asks for a modification? Or is the creditor permitted time to determine whether it has sufficient information, that is recent enough, before the three-day period begins?

When the consumer first indicates a possible desire for a modification, it is in many cases not clear what type of transaction would be appropriate under the circumstances. This determination must precede the determination whether the creditor has sufficient information to consider the modification.

We are concerned that the definition of application would require disclosures, with attendant TILA litigation risk, within three days of a consumer phone call, from a consumer who may not be audible or who may not speak English, which might be construed as a request for some unspecified modification. Under a vague definition,

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[41] DFA § 1473(q), 24 Stat 1376, 2198 (2010).
[42] Proposed Comment 20(a)(1)(i)-4.

creditors would have only two choices. First, avoid modifications. Second, require formal, written applications specifying the type of modification requested, so creditors can be certain when the three day period begins to run, and can have some factual basis upon which to prepare a disclosure.

Lender-Placed Insurance

The Board proposes not to require disclosures when insurance coverage is extended.

> Charging an insurance premium for the continuation of coverage does not constitute a fee under § 226.20(a)(1)(i). That is, if a creditor does not impose on the consumer additional insurance premiums or new insurance requirements (for example, if the creditor does not increase the existing premium for hazard insurance or require increased property insurance amounts), but merely continues coverage, such costs are not fees imposed on the consumer in connection with the agreement under § 226.20(a)(1)(i).[43]

This language could be read to require a new disclosure when a servicer places hazard insurance after a consumer fails to purchase the required insurance, or the required amount of insurance, if the premium increases. There is already a series of rules for lender-placed insurance, and the Dodd-Frank Act rules may revise them.[44] To the extent those disclosures are insufficient, they should be revised.

We request clarification that proposed § 226.20 does not apply to lender-placed insurance because the need for a lender to place insurance only arises when a consumer fails to purchase insurance as required, and is therefore in default, under proposed § 226.20(a)(ii)(B). This need for a § 226.20 disclosure in connection with lender-placed insurance would need to be revisited if § 226.20(a)(1) were made applicable to instances of default to ensure it would not require a disclosure that it not consistent with the existing disclosures for lender-placed insurance.

Payment Decreases Do Not Need Disclosures

The Board asks whether disclosures should be required when a payment decreases.

> The Board solicits comment on whether consumers would benefit from having new TILA disclosures not only for increases in the periodic payment amount, but also for decreases in the payment amount obligation, when no other terms listed in § 226.20(a)(1)(i)(A)–(G) are modified.[45]

Consumers do not need protection from events that benefit them. Requiring TILA disclosures would harm consumers more that it would help them. Increasing TILA litigation risk in these cases would deter creditors from taking actions that would lower

[43] 75 Fed. Reg. 58539, 58762 (September 24, 2010).
[44] TILA § 129D(j)(2)(C), added by DFA § 1462, 24 Stat 1376, 2181-82 (2010).
[45] 75 Fed. Reg. 58539, 58600 (September 24, 2010).

payment obligations, which is contrary to the Board's goals. As the Board similarly reasons:

> The Board believes that where creditors provide these consumers [in default] with certain changes to terms, such as a decrease in rate and payment, and the consumer does not take on new debt or pay any fee, the modification is beneficial. In these instances, the benefit to consumers of a TILA disclosure appears outweighed by the risk that creditors would be discouraged from extending beneficial modifications (in lieu of foreclosure) due to the burden of giving new TILA disclosures and the potential exposure to TILA remedies for errors, including rescission.[46]

The Board's proposal would not require new disclosures when the only change to a loan is a rate decrease. We also recommend that no disclosure should be required when the payment amount is lowered. We request clarification that disclosure also would not be required where an adjustable rate mortgage loan (ARM) is modified to a fixed rate but there is no rate change.

Creditors should not be discouraged by TILA risks from lowering loan rates or payment amounts, or from converting ARMs to fixed-rate loans.

Term Extension and Reamortization to Lower a Payment Should Not Require Disclosure

Proposed § 226.20 exempts from the disclosure requirement a rate decrease with no other modifications except a decreased payment amount or term extension, or both, with no fee. This should be amended to permit the creditor to reamortize the loan over the extended term and increase the number of payments. We recommend that no modification disclosure be required in this case as long as there is no prepayment penalty.

ARM Converting to Fixed-Rate Loan Pursuant to Original Agreement

The Board solicits comment on whether, when an ARM is converted to a fixed-rate loan pursuant to its existing legal obligation, new TILA disclosures under § 226.20(a) should be provided instead of notice of an interest rate adjustment under § 226.20(c).[47]

The § 226.20(c) disclosures of rate adjustment would be required when a fixed rate loan converts, under its contract, to an ARM. The disclosure would be in the format of Form H-4(G) or (K). These form disclosures are designed to provide all the relevant information, in clear language, in a format that is easy to read. To the extent the Board believes there is a deficiency with these forms, the Board could revise them.

The Board asks whether liability risk, including rescission risk, of requiring disclosures under § 226.20(a), would discourage creditors from providing ARMs that convert to

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[46] 75 Fed. Reg. 58539, 58601 (September 24, 2010).
[47] 75 Fed. Reg. 58539, 58606 (September 24, 2010).

fixed-rate loans.[48] TILA liability can be so severe that it always discourages creditors from offering products subject to that risk.

Proposed Comment 20(c)-4 suggests that a disclosure would be required when an ARM converts to a fixed rate and there is a conversion fee, even if the existing obligation provides for the option by specifying the index and margin used to calculate the fixed rate and by specifying that there will be a fee. We do not believe disclosure should be required in this circumstance because, from the consumer's point of view, the conversion is easy to understand. From the creditor's point of view, the conversion entails significant costs, so that a fee is reasonable. Any new restriction on conversion fees should not apply to contracts existing before a new rule becomes effective.

Rate Determination on ARMs

The Board proposes a comment to clarify how to determine whether there is a rate change on an ARM.

> A change in rate occurs for purposes of § 226.20(a)(1)(i)(D) when the interest rate (the fully-indexed rate for an adjustable-rate mortgage) for the new obligation is different than the interest rate for the existing obligation that is in effect within a reasonable period of time of the modification. For example, 30 calendar days would be a reasonable period of time.[49]

We request additional clarity for certain situations.

The initial rate on the modification may be higher or lower than the fully-indexed rate. If the new fully-indexed rate is the same as the current rate on the existing obligation, are disclosures required? The initial rate on the modification may not be the same as the rate on the existing obligation in this instance.

The existing obligation may be an ARM. If so, in almost all cases, its current rate will not equal the fully-indexed rate computed using a recent index value, either because the initial rate was not set using the index or margin or because the index value has changed since the loan was made or last adjusted. Should creditors use the current rate or the fully-indexed rate? If the fully-indexed rate, what index value should be used?

We appreciate the proposed use of a reasonable time as a way to ease compliance. However, we do request clarity. If the rate on a current obligation is 4 % and will increase in less than 30 days to 5%, and the rate on the modification will be fixed at 5%, are disclosures required because one of the rates in effect during the 30 days differs from the rate on the new obligation?

If not, then the 30-day example will need to be coordinated with section 1418 of the DFA. This will require notices six months before a rate reset. This notice will be

[48] 75 Fed. Reg. 58539, 58606 (September 24, 2010).
[49] Proposed Comment 20(a)(1)(i)(D).

required to list alternatives the consumer may pursue, including a renegotiation of loan terms, that is, a modification. We suggest that if the rate on the existing obligation would increase within six months, modification to a rate less than or equal to the rate in the DFA reset notice should not be considered a rate increase. This would harmonize and streamline the disclosures and thereby improve consumer understanding.

Removal of Risky Features

The proposal would require disclosures if a modification would add new features such as an adjustable rate, prepayment penalty, interest-only payments, negative amortization, balloon payment, demand feature, no- or low-documentation, or shared equity or appreciation. By the same reasoning, we suggest that removal of any of those features should not by itself require a disclosure.

Modification Fees

We recommend that creditors be permitted to charge reasonable modification fees without requiring disclosures. Modifications do impose costs on creditors. When a consumer seeks a modification, creditors will weigh the modification against requiring a refinance. Without the ability to collect a modification fee, refinance will be required more frequently. Especially when market rates are rising or have risen, this can harm consumers. We believe that $500 would be a reasonable modification fee.

Accrued Interest

We request clarification about how to reflect accrued unpaid interest in calculating prepaid finance charges, the amount financed, total of payments, APR, and other disclosures. Should the disclosures include accrued interest and be calculated in the same manner as current Comment 226.20(b)-6? Including accrued interest in the disclosed loan amount would greatly complicate preparing disclosures because the amount of accrued interest makes the loan amount change on a daily basis. The difference to consumers would not be significant because the consumer is already aware that the loan accrues interest. We recommend that creditors be explicitly permitted to make modifications effective on a payment due date and to prepare final disclosures based upon the assumption that the loan will be current on that date.

Three-Day Refundable Fees

The Board proposes to permit consumers with a right to a refund of most fees imposed during the three business days following the consumer's receipt of early disclosures, for closed-end loans secured by real property or a dwelling.[50]

RESPA rules have no such requirement. Similar to Regulation Z, Regulation X requires a disclosure within three days of loan application, and prohibits charging a fee, other than

[50] Proposed § 226.5b(e) (open-end); proposed § 226.19(a)(1)(iv) (closed-end).

for a credit history or credit report, until after the applicant has received a GFE.[51] HUD has advised, in Frequently Asked Questions, that no fee is permissible until after the consumer has received a GFE and has "indicate[d] an intention to proceed with the loan[.]"[52] The RESPA FAQs did not go through notice-and-comment rulemaking, so they are not binding law.

We believe RESPA and TILA rules should be consistent about when a creditor or loan originator may charge a fee. This is one area where there is no statutory or other reason why the rules should differ. Having a uniform standard would provide uniform treatment to consumers, regulatory clarity, and would ease compliance costs.

We recommend that a creditor be permitted to charge the consumer at the earlier of either the consumer's expression of an intention to proceed or the end of three days. The early disclosure should make clear when a consumer will be charged and the amount. This way, consumers will be permitted to make informed choices about their loan's progress.

We request clarification about the refundability of counseling fees. Counselors may provide their services before a consumer decides to apply for a loan or selects a creditor. Counseling fees in advance of a loan application should not be refundable, regardless of whether the fee is required by law.

Portions of the Board's Proposal Will Not Survive the DFA

Clearly, the Board has put considerable effort into the current, very lengthy proposal. While the Board was working on this proposal, Congress passed the DFA. The DFA will change the laws governing consumer mortgage loans, as well as the TILA disclosures. We believe the timing of the Board's proposed rule and of the imminent DFA rulemakings warrants consideration.

The DFA rulemakings are already underway. Treasury has suggested that the new Bureau may propose new regulations before the designated transfer date. In this case, final Dodd-Frank rules could become final on or soon after the designated transfer date, which is only seven months away.

The DFA rules will revise many of the provisions in this proposed rule. We question whether it is appropriate to continue with the present rulemaking. A final rule resulting from the present proposal would have a very short life. The mortgage industry would need to incur the costs of complying with the new rule, and immediately thereafter, undo implementation of the new rule and begin implementing the DFA rules. We believe this would be counterproductive. We address the extent of the regulatory burden later in this letter. Here we question the need for it.

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[51] 24 C.F.R. § 3500.7(a), (b).
[52] *New RESPA Rule FAQs*, p. 7, no. 10 (April 2, 2010).

Rather than continue with the present rulemaking, we urge the Board to incorporate its changes into the DFA rulemakings, including the integration of RESPA disclosures into the TILA disclosures.

Transaction Coverage Rate

In its August 2009 closed-end proposal, the Board proposed an "all-in APR" to more accurately reflect the cost of mortgage credit. This would have amended the definition of "finance charge" to include certain third-party charges. In our comment letter in response to that proposal, we supported the concept behind the proposal. However, we noted that the proposal would result in one unintended consequence, causing prime loans to reach the thresholds for loans governed by the Home Ownership and Equity Protection Act of 1994 (HOEPA) loans and for higher-price mortgage loans (HPMLs) restricted under Regulation Z § 226.35.

The current proposal revises the August 2009 closed-end proposal to define HPMLs by a "transaction coverage rate" (TCR) to prevent prime loans from reaching the thresholds designed to protect subprime borrowers.

HPMLs are subject to specified restrictions. Creditors of HPMLs must assess the consumer's ability to repay the loans, the loans are subject to restrictions on prepayment penalties, and the loans require escrow accounts in many instances.

The DFA similarly requires that creditors verify consumers' ability to repay,[53] restricts prepayment penalties,[54] and mandates escrow accounts for many loans.[55] New rulemakings in these areas are imminent, which are very likely to replace § 226.35. There appears no purpose to revising the now-obsolete § 226.35 apart from the related DFA rulemakings.

The DFA also introduces APR-to-APOR comparisons for HMDA reporting,[56] ability-to-repay determinations,[57] *bona fide* discount point definition,[58] prepayment penalty restrictions,[59] HOEPA loan rate threshold,[60] appraisal requirements for higher-risk mortgages,[61] and mandatory escrow requirements.[62] We would support incorporating the TCR into these comparisons.

If the Board were to pursue its proposal to require a chart comparing the disclosed APR with the APR for loans in the "high cost zone," the chart should not be misleading. If the

[53] TILA § 129C(a), added by DFA § 1411(a)(2), 24 Stat 1376, 2142-45 (2010).
[54] TILA § 129C(c), added by DFA § 1414, 24 Stat 1376, 2149-50 (2010).
[55] TILA § 129D, added by DFA § 1461, 24 Stat 1376, 2178-81 (2010).
[56] Home Mortgage Disclosure Act § 304(b)(5), as amended by DFA § 1094(3)(iv), 24 Stat 1376, 2097 (2010).
[57] TILA § 129C(a)(6)(D)(ii), added by DFA § 1411, 24 Stat 1376, 2144 (2010).
[58] TILA § 103(dd)(1) and (2), added by DFA § 1431, 24 Stat 1376, 2160 (2010).
[59] TILA § 129C(c)(1)(B)(ii), added by DFA § 1414, 24 Stat 1376, 2149-50 (2010).
[60] TILA § 103(aa)(1)(A)(i), as amended by DFA § 1431, 24 Stat 1376, 2157 (2010).
[61] TILA § 129H(f)(2), added by DFA § 1471, 24 Stat 1376, 2187 (2010).
[62] TILA § 129D(b)(3), added by DFA § 1461, 24 Stat 1376, 2178-79 (2010).

chart were to use the disclosed APR, it would inadvertently tell consumers that the loan is a high-cost loan when it is not, or that it is closer to a high-cost loan than it actually is. This would be inappropriate.

A preferable solution to this problem would be to revise the APOR calculation to make the comparisons with the APR more accurate. The APOR currently includes some, but not all, prepaid finance charges. Including in the APOR everything required to be included in the prepaid finance charge would make for the best disclosures because it would make the comparison most meaningful.

Some of the charges vary geographically, but this is mainly due to government charges, which are known. We suggest three separate APOR calculations for high, medium, and low cost counties.

Revising the APOR would have several significant benefits. Most importantly, it would make the comparisons to the APR more accurate because the comparison would look at the same cost items. Including some costs in the APR but not in the APOR would mislead consumers. It would also defeat the purpose of making the comparison in the first place.

Using the same APOR calculation for all the new APR-to-APOR comparisons would greatly ease compliance burdens. It would also make HMDA data easier to understand.

Further, some states use the Regulation Z comparison of the APR to the APOR for defining whether a loan is a high cost loan under state law. For this reason, including costs in the APR but not in the APOR would inadvertently cause some prime loans to be treated as restricted subprime loans.

Points and Fees Definition

We strongly support the Board's proposal to preserve the current treatment of third-party charges under the HOEPA points and fees test. This is important because it would prevent prime loans from meeting the HOEPA threshold and similar thresholds under state law.

We note that the DFA amends the definition of points and fees in TILA section 103. We believe the reasoning behind the proposed exclusion from the points and fees calculation should carry forward under the DFA definition. We urge the Board to coordinate the proposed definition with the new DFA definition. The definitions should be made together in one rulemaking so that they will be coordinated.

FHA Prepayment Penalties

The DFA also makes obsolete one aspect of the present rulemaking affecting prepayment penalties on FHA loans.

FHA loans use a monthly interest accrual amortization method, under which payments are treated as made on the scheduled payment due date even if they occur on a different date. Under this method, if a consumer pays off an FHA loan after a scheduled payment due date and during the grace period for that due date, the consumer owes interest only until the scheduled payment due date. The consumer is charged no interest for a period of time while the loan is outstanding. If payoff occurs after the grace period but before the next scheduled payment date, the consumer owes interest through the following scheduled payment date. That is, the consumer owes interest for a few days although the loan is paid off. The Board proposes to treat any interest paid after loan payoff as a prepayment penalty.

We do not object to requiring disclosure of the FHA accounting method. However, we recommend coordinating the FHA prepayment penalty treatment with the DFA.

Under the Board's proposal, disclosures for FHA loans would need to alert consumers to the possibility of a prepayment penalty even if the creditor does not intend to charge the consumer for interest after payoff. HPML loans may not have a prepayment penalty more than two years after consummation. By treating the FHA accounting method as a prepayment penalty, the proposal would prohibit FHA loans from being HPML loans. That will have a significant unintended impact on FHA credit availability.

The DFA bans prepayment penalties on loans that are not a "qualified mortgage," a term that does not yet have a definition.[63] If an FHA loan were to have a prepayment penalty, if would need to be a qualified mortgage. Importantly, Congress directed FHA, not the Board, to define qualified mortgage for FHA purposes.[64] Defining qualified mortgage necessarily involves setting prepayment penalty restrictions because only qualified mortgages may have prepayment penalties. Were the Board to finalize its proposal, it would interfere with the FHA's authority to determine the appropriate prepayment penalty restrictions on FHA loans.

The DFA also created a "qualified residential mortgage." This term is not yet defined, but must be "no broader" than the definition of qualified mortgage.[65] Congress again specifically exempted FHA from the restrictions relating to qualified residential mortgages,[66] so that FHA, not the Board, will determine the appropriate prepayment penalty rules for FHA loans.

For these reasons, we do not believe there is any longer a reason for the Board to revise the Regulation Z prepayment penalty treatment of the FHA's monthly interest accrual amortization method.

Credit Protection Products

The Board proposes revised disclosures concerning credit protection products. We note that these products are highly regulated by the states. Credit protection products can be benefit to consumers by permitting them to retain their homes despite death, illness, or

[63] TILA § 129C(c)(1)(A), added by DFA § 1414, 24 Stat 1376, 2149 (2010).
[64] TILA § 129C(b)(3)(B)(ii)(I), added by DFA § 1412, 24 Stat 1376, 2148 (2010).
[65] DFA § 941, 124 Stat. 1376, 1895 (2010), to be codified at 15 U.S.C. § 78o-11(e)(4)(C).
[66] DFA § 941, 124 Stat 1376, 1894 (2010), to be codified at 15 U.S.C. § 78o-11(e)(3)(B).

loss of income by the family member whose income covers the mortgage loan payments. Many consumers lack sufficient life insurance to cover their mortgage credit. We believe it would be inappropriate for disclosures to lead consumers to believe that the products are harmful when they can be beneficial.

We also note that the DFA rulemakings may affect the treatment of credit protection products, such as by including their cost in new debt-to-income definitions.[67] We recommend that the Board amend the rules for credit protection only in a rulemaking that is coordinated with the DFA rulemakings.

Revocable Living Trusts

We appreciate the Board's proposal to clarify the applicability of Regulation Z to revocable living trusts. We request further clarification. It is not clear whether disclosures should be provided to the settlor, the trustee, or to the beneficiary. It is also not clear which of the parties would have the right to rescind the loan.

In the case of a rescission under an extended right to cancel, the trust would be obligated to return principal under TILA § 125. However, the trust terms may be not permit this. We recommend clarification that rescission in the case of a trust not be available if return of principal is restricted by the trust arrangement.

Alternative Approaches for Corrected Disclosures

The Board proposes two alternatives for requiring corrected disclosures and a new waiting period if an early disclosure becomes inaccurate. We urge the Board to consider this question in connection with the RESPA requirements. RESPA rules often require a number of revised disclosures, far too many on some loans. Deluging a consumer with multiple disclosures is not helpful.

We support revising disclosures only when it would be helpful to consumers. For this reason, we prefer the alternative of requiring a corrected disclosure only when an APR included in an early disclosure becomes inaccurate, or when a risky feature is added to a loan.

The proposal would not require a corrected disclosure when the APR decreases by more than the tolerance only if the decrease was due to a discount for making payments by automated debits or for a discount on voluntary owner's title insurance. These exceptions are far too narrow.

An APR should be considered accurate whenever an inaccuracy is due to an overstated finance charge because overstatements do not harm consumers as understatements do. A corrected disclosure should not be required when the rate is decreased and the APR is overstated because the disclosed finance charge and APR reflect overstated interest charges in the scheduled payments.

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[67] TILA § 129C(b)(2)(A)(vi), added by DFA § 1414, 24 Stat 1376, 2146 (2010).

A corrected disclosure should not be required when a closing cost included in the finance charge is lower than the amount estimated in the previous disclosure.

Closing agents, not creditors, control the amounts actually paid at closing. For this reason, limits on using estimating fees in disclosures are inappropriate unless the Board also requires closing agents to provide the creditor with the final amounts of all fees before consummation.

Irregular Transactions

It is not clear whether the proposal would affect current Comment 17(c)(1)-10(iv). This comment states that ARMs whose initial rates are not calculated using the index or formula used for later rate adjustments are irregular transactions. The proposal does not seem to amend this comment. Proposed § 226.22(a)(3) defines irregular transactions, but does not include those ARM loans. We are not sure whether the Board proposes to delete this Comment.

HMDA

The Board seeks comment on whether "refinancing" under Regulation C should include a "new transaction" under proposed § 226.20(a)(1). In part, this will depend on which transactions the new rule will cover.

The Home Mortgage Disclosure Act (HMDA) describes its purpose:

> The purpose of this title is to provide the citizens and public officials of the United States with sufficient information to enable them to determine whether depository institutions are filling their obligations to serve the housing needs of the communities and neighborhoods in which they are located and to assist public officials in their determination of the distribution of public sector investments in a manner designed to improve the private investment environment.[68]

If the Board were to apply this rule to transactions that bear directly on housing needs, then HMDA reporting may be appropriate. But if the new rule were to apply to minor transactions that do not have much bearing on housing, reporting those minor transactions may introduce "noise" into the HMDA data and devalue its usefulness.

We note that the DFA added new HMDA reporting requirements, and that there may soon be a new HMDA rulemaking to implement these changes.[69] We suggest that it would be preferable to consider all HMDA issues together, in that rulemaking rather than in the present rulemaking.

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[68] Home Mortgage Disclosure Act § 302(b), 12 U.S.C. § 2801(b).
[69] DFA § 1094, 124 Stat 1376, 2097-2101 (2010).

SAFE Act

The Board solicits comment on whether there would be operational difficulties in defining “loan originator” for SAFE Act purposes to exclude those who work on modifications of existing loans, although those modifications may be modifications. The operational problem would be subjecting modifications to Regulation Z and TILA. Modifications are straightforward transactions about which consumers can make a decision quickly because little changes. The operational burden of providing TILA disclosures would be disproportional to the substance of modifications.

Regulatory Burden

The Board estimates:

> The proposed rule would impose a one-time increase in the total annual burden under Regulation Z for all [1138] respondents regulated by the Federal Reserve by 190,168 hours, from 1,497,362 to 1,687,530 hours. In addition, the Board estimates that, on a continuing basis, the proposed revisions to the rules would increase the total annual burden by 610,464 hours from 1,497,362 to 2,107,826 hours.[70]

It then estimates that respondents would need 160 hours to implement proposed §§ 226.15 and 226.23, 8 hours to implement advertising requirements of proposed § 229.16, and 160 hours to implement proposed § 226.33.[71]

As just one example, one large lender expended over 70,000 hours to implement the Regulation Z amendments that became effective October 1, 2009, while implementing the recent amendments to Regulation X took twice that amount of time.

In its Initial Regulatory Flexibility Analysis, the Board states:

> The Board has not identified any Federal rules that conflict with the proposed revisions to Regulation Z.[72]

We have described in this letter a significant conflict the proposal would have with RESPA rules. Further, this proposed rule does not integrate RESPA and TILA disclosures. The proposal therefore conflicts with the integration that the DFA mandates.

We urge the Board to address these conflicts before pursuing this proposal. It would be counterproductive for the industry to come into compliance with this very major proposed rule, which will soon be replaced by new DFA rules.

[70] 75 Fed. Reg. 58539, 58684 (September 24, 2010).
[71] 75 Fed. Reg. 58539, 58684-85 (September 24, 2010).
[72] 75 Fed. Reg. 58539, 58687 (September 24, 2010).

The Regulatory Flexibility Act requires the Board's Initial Regulatory Flexibility Analysis to contain:

> [A] description of any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and which minimize any significant economic impact of the proposed rule on small entities.[73]

There is one alternative that would minimize the economic impact of the proposal on small entities and on consumers. That would be to pursue changes to Regulation Z only with RESPA integration and with other related DFA rules.

In this letter, we suggest alternatives to the proposal to include third party charges in determining rescission tolerances. Our recommendations would reduce the economic impact on small entities and on consumers,

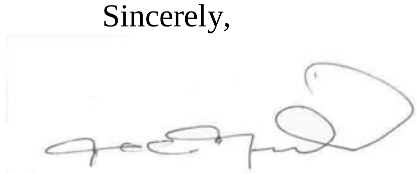
We note that we had difficulty following precisely what regulatory text is proposed in this rulemaking. The Board refers to its 2009 proposals in some places in the preamble to the present proposal, but does not include all of the regulatory text of the prior proposals in the regulatory text of this proposal. The Board republished in this proposal some portions of prior proposals, such as in § 226.20(c), but does not consistently republish other parts of its prior proposals that are still effective. We are unsure what meaning to read into this inconsistent treatment. We suggest that the Board could reduce regulatory burden by including all proposed changes in one *Federal Register* publication, or on its website, if that would be more practical.

Conclusion

We appreciate the Board's efforts to improve TILA disclosures for consumers.

As noted at the beginning of this letter, we urge the Board not to amend Regulation Z until its amendment can be integrated with RESPA and with the many changes that the DFA rulemakings will introduce. The best approach would be to make the amendments together at one time. This would prevent inadvertently making changes that conflict. It would also prevent making changes now, only to have to revise them again once the DFA is implemented.

Sincerely,



Anne C. Canfield
Executive Director

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[73] Regulatory Flexibility Act § 603(c), codified at 5 U.S.C. § 603(c).

Consumer Mortgage Coalition

September 7, 2012

Ms. Monica Jackson
Office of the Executive Secretary
Bureau of Consumer Financial Protection
1700 G Street N.W.
Washington, D.C. 20552

Re: Docket No. CFPB-2012-0028, RIN 3170-AA19 and
Docket No. CFPB-2012-0029, RIN 3170-AA12

Dear Ms. Jackson:

The Consumer Mortgage Coalition ("CMC"), a trade association of national mortgage lenders, servicers, and service providers, appreciates the opportunity to submit comments to the Consumer Financial Protection Bureau ("CFPB") on two related rulemakings:

- High-cost mortgages;
- Homeownership counseling amendments;
- Other aspects of the proposed rulemaking to integrate mortgage disclosures, for which comments are due September 7, 2012; and
- The proposal to redefine "finance charge."

We are pleased that the CFPB is integrating the KBYO rulemaking with what the CFPB terms as the "Affected Title XIV Disclosures." The KBYO rulemaking is required by Title X under a different deadline. Without the CFPB's coordination of the different deadlines, marketplace disruptions would likely result.

These are just two of the long list of mortgage rulemakings that are currently underway. Combined, these rulemakings will reshape the consumer mortgage industry for decades to come.

The CFPB has a historic opportunity to design mortgage disclosures that will enable consumers understand their mortgage loans. We believe the CFPB should coordinate its Title XIV rulemakings and its KBYO rulemakings, as proposed. We also believe the CFPB should coordinate all of the mortgage rulemakings in a manner that allows the

CFPB to make the best use of this important opportunity. The rules and disclosures can only be well-designed if they are designed together because they interact with each other. Rather than changing the rules to meet an arbitrary deadline, we strongly urge the CFPB design its rules in the way that would lead to the best rules, and streamlined and clear disclosures.

The attached Appendix contains our specific comments and recommendations.

Thank you for your consideration of our views and recommendations.

Sincerely,

Anne C. Canfield
Executive Director

Attachment

Consumer Mortgage Coalition

APPENDIX

September 7, 2012

Docket No. CFPB-2012-0028, RIN 3170-AA19
Docket No. CFPB-2012-0029, RIN 3170-AA12

Table of Contents

I. Timing of Rulemakings

These are among the earliest mortgage-related rulemakings under the Dodd Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank" or the "Dodd-Frank Act"), but many others are underway at the CFPB and other agencies. The several pending and upcoming mortgage rulemakings will revise the mortgage lending and servicing markets in profound ways. In addition, the CFPB's proposed mortgage regulations are technically complex and lengthy.

Unfortunately, the CFPB is under aggressive statutory deadlines. While we respect the CFPB's diligence in meeting its deadlines, we do not believe that Congress intended the CFPB to work so quickly that it throws the mortgage markets into turmoil.

All of the rules, existing and new, and their disclosures, need to be coordinated with each other to implement the overarching Congressional goal of improving the manner in which the mortgage markets function.

A. Revisions are Inevitable

Since the pending rulemakings are so far-reaching and so technically complex, revisions will be inevitable after the rules are finalized. With multiple comment letters being written simultaneously, some issues will not be identified and addressed during the comment periods and many will not be identified until after January 21, 2013. The Department of Housing and Urban Administration ("HUD") demonstrated with its 2008 amendments to Regulation X what happens when a rule is finalized without sufficient input on the unforeseen ramifications. The result was marketplace turmoil. That rulemaking was *considerably* narrower in scope than the sum of mortgage rules the CFPB is writing today. The CFPB's rules, if done without sufficient input, have the potential to cause significant marketplace disruptions.

B. Integrating the Rulemakings is Critical to Their Effectiveness

The CFPB proposes to postpone the Affected Title XIV Disclosures until its Know Before You Owe ("KBYO") rule can be implemented at the same time. The CFPB explains:

> Implementing the Affected Title XIV Disclosures as part of the broader integrated TILA–RESPA rulemaking, rather than issuing rules implementing each requirement individually or allowing those statutory provisions to take effect by operation of law, will improve the overall effectiveness of the integrated disclosure for consumers and reduce burden on industry.[1]

We *strongly agree* that the disclosures must be integrated to be effective. The disclosures will not work, as intended, if they do not take into account the still unknown substantive

[1] 77 Fed. Reg. 51116, 51133 (footnote omitted) (August 23, 2012).

rules. If the disclosures do not work, creditors may not use them. Under TILA § 105(b), use of the forms cannot be mandatory. Creating disclosures creditors are unwilling or unable to use would be very unfortunate, given the opportunity that is now present to streamline and simplify mortgage disclosures.

We agree that finalizing proposed § 1026.1(c) (in the KBYO proposal, implementing the Title XIV Affected Disclosures) would satisfy the CFPB's mandate under Dodd-Frank § 1400(c)(1)(B). The CFPB plans to remove this exemption when the KBYO rule takes effect, but solicits comment on whether the exemption should sunset on a specific date. The CFPB may be trying to avoid having to undertake a separate rulemaking just to remove § 1026.1(c)(5) at the appropriate time. We support avoiding unnecessary rulemakings. The exemption should expire on the compliance date for the KBYO rule rather than a date certain because that date certain may precede the KBYO rule's compliance date, and major disruptions could result. Tying the sunset to the KBYO implementation would –

- Avoid a major disruption;
- Avoid an unnecessary rulemaking;
- Enable the CFPB to postpone a decision on when to remove § 1026.1(c)(5) until the CFPB knows when that will be appropriate;
- Provide regulatory certainty; and
- Give creditors the option of complying earlier than the required compliance date.

C. All of the Rules Need to be Integrated

We would strongly support the CFPB going even further to avoid unintended harm by integrating *all* of its mortgage rulemakings. We urge the CFPB to take this historic opportunity to revise mortgage rules holistically and carefully so that it can create a comprehensive set of rules that work together, protect consumers, and provide the industry with a sound set of rules that will work for years to come. This cannot happen by January 21, 2013, but it is critically important.

The CFPB began immediately and quickly on designing its revisions, but it is not possible to finish on a rapid timetable. The problem is not lack of effort or diligence on the CFPB's part.

We suggest that the CFPB take comments on all its proposed rules, then repropose, in one rulemaking, all of the revisions.[2] More iterations should be considered. This suggested process would provide the CFPB with the input it needs to design and implement rules that work as intended. As the CFPB proposes its substantive rules, it should solicit comment on the disclosure amendments they will need. Once the rules are firm, the CFPB should solicit input on all of their disclosures. Again, more iterations would result in the best disclosures. Once the CFPB has well-designed disclosures, and

[2] Putting all the rules into one rulemaking would prevent some of the confusion the public is experiencing in trying to see how related but separate proposed rules would work together, as we discuss below.

there has been time to implement all of the changes, the new rules and disclosures can be made effective.

This should be the procedure even for loans that are not subject to the KBYO rules (reverse mortgages, HELOCs, and loans secured by personal property) because disclosures should be consistent for different loan types. Operationally, it is more efficient because the same systems support multiple loan types, and the systems may not have the capability to handle varying types of disclosures for the same loan information.

Only in this manner will the following result:

- Consumers would have well-designed, carefully drafted rules and disclosures for all aspects of the mortgage transaction.
- Implementation costs would be dramatically lower, thus assisting the CFPB in meeting its § 1022 cost-benefit analysis responsibilities.
- Credit constraints would be minimized. The Dodd-Frank Act limits both the maximum interest rate and the maximum points and fees on mortgage loans. In addition, all lender and servicer costs need to be passed through to consumers. Increasing implementation costs will bring loans closer to the price caps. Once the caps are breached, credit will be curtailed unnecessarily to the detriment of families and housing markets nationwide.

Overall, getting from where we are today to where we need to be – operating under one set of mortgage rules and disclosures that work – may be faster if the CFPB works in a sensible, planned fashion rather than under arbitrary statutory deadlines. Working in a systematic manner will prevent having to write one set of several rules and rewrite them repeatedly as issues become apparent and as markets reel from the regulatory confusion.

D. A Reasonable Implementation Period Is Needed

Implementing all the new rules and disclosures, if done all at once, would reasonably take 18-24 months.

Those creditors who are able to implement the new rules earlier should be permitted to do so.

The origination rule changes should apply to loans based on the application date. The origination rules should not change for a loan after application but before closing. This is necessary to prevent a myriad of unanticipated issues that the new rules are not designed to handle.

II. Opportunity for Public Comment

We appreciate that the CFPB is tasked in simultaneously writing rules that will revise the mortgage marketplace, and doing so in a short amount of time. Due to the compressed time frame, we are finding it difficult to understand exactly what is being proposed because the proposed rules cross-reference each other. It is difficult to follow the cross-references. We may be unknowingly commenting on potential provisions that the CFPB did not intend to propose. While there are a number of examples, one example concerns conflicting proposals on the future existence of higher-priced mortgage loans ("HPMLs"). In its 2011 proposed escrow rule, the Federal Reserve Board ("Board") indicated that it would eventually remove the HPML definition:

> The Dodd-Frank Act also establishes new TILA provisions concerning a consumer's ability to repay and prepayment penalties that apply to all closed-end mortgage loans (other than loans secured by a timeshare), not just higher-priced mortgage loans. *See* TILA Sections 129C(a) and 129C(c). For higher-priced mortgage loans, those two matters currently are addressed by § 226.35(b)(1) and (2). The provisions of the Dodd-Frank Act regarding repayment ability and prepayment penalties will be implemented through future rulemakings. To preserve those existing protections for higher-priced mortgage loans until such future rulemakings are completed, however, the Board is not proposing to remove § 226.35(b)(1) and (2) *at this time.*[3]

Shortly thereafter, the ability-to-repay ("ATR") proposal was published, and it would remove § 1026.35.[4] This makes sense because the Dodd-Frank Act largely made HPML restrictions obsolete. HPMLs require the creditor to establish the consumer's ability to repay the loan, usually require an escrow, and limit prepayment penalties to loans whose interest rate cannot adjust for four years, limit them to two years, and prohibit them on refinances by the same lender or its affiliate. The Dodd-Frank Act requires extensive documentation of ability to repay,[5] usually requires an escrow,[6] and limits prepayment penalties to fixed-rate, prime qualified mortgage ("QM") loans and caps them at three percent the first year, two percent the second year, one percent the third year, and prohibits them thereafter.[7] As the Board explained:

> The proposed changes to Regulation Z in the 2011 Escrow Proposal and this proposal would render all of current § 226.35 unnecessary. The 2011 Escrow Proposal would adopt in proposed § 226.45(a) the coverage test for higher-priced mortgage loans in 226.35(a); would revise and adopt in § 226.45(b) the escrow requirements in § 226.35(b)(3); and would adopt in proposed § 226.45(d) the prohibition of evasion of the higher-priced mortgage loan protections by structuring a transaction as open-end credit, now in § 226.35(b)(4). This proposal, as discussed below, would supersede in § 226.43(a)–(f) the ability to repay requirement in § 226.35(b)(1), and would supersede in § 226.43(g) the prepayment penalty rules in § 226.34(b)(2). Accordingly, the Board proposes to remove and reserve § 226.35 and its accompanying commentary.[8]

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[3] 76 Fed. Reg. 11598, 11608 (March 2, 2011) (emphasis added).
[4] 76 Fed. Reg. 27390, 27482 (May 11, 2011).
[5] TILA § 129C.
[6] TILA § 129D.
[7] TILA § 129C(c).
[8] 76 Fed. Reg. 27390, 27407 (May 11, 2011).

In the HOEPA rulemaking, the CFPB does not propose a § 1026.35, but does propose to refer in § 1026.32(a)(1)(i) Alternative 1 to a definition of average prime offer rate ("APOR") in § 1026.35(a)(2)(ii), and in Alternative 2 to a definition of transaction coverage rate ("TCR") in § 1026.35(a)(2)(i). The CFPB explains:

> The Bureau is in the process of finalizing a proposal issued by the Board to implement provisions of the Dodd-Frank Act requiring certain escrow account disclosures and exempting from the higher-priced mortgage loan escrow requirement loans made by certain small creditors, among other provisions, pursuant to TILA section 129D[.][9]

We gather, but are not sure, that the HPML rule will remain, although we do not know what it will contain or why it may be retained.

It is also unclear which comment letters the CFPB will rely on when it decides whether to retain, remove, or amend § 1026.35. We request that this appendix be considered, and be part of the administrative record, in whichever rulemaking or rulemakings that may be finalize § 1026.35.

If the HPML threshold remains, it would be yet one more loan threshold to have to measure and track. We support continuing to require escrow accounts on loans that were HPMLs and required an escrow account at origination. However, for compliance purposes on new loans, it would be far easier to have only one ability-to-repay standard, one standard for when escrow accounts are required, and prepayment penalty restrictions that are the same as those that are required for QM loans.

Recommendation and Requests

- We recommend removing the HPML regulation, other than to continue to require escrow accounts on HPML loans that required escrow accounts before a final rule, until the consumer requests its cancellation in writing at least a year after consummation, consistent with current § 1026.35(b)(3)(iii).
- We respectfully request that the CFPB publish a single version of Regulation Z as it would be amended by all of the pending mortgage rulemakings as soon as possible. This would improve our ability to provide input that CFPB will need, before the comment periods close.
- We request that each comment letter received in each rulemaking be considered in all of the rulemakings because they are all related.

[9] 77 Fed. Reg. 49090, 49093 (August 15, 2012).

III. Amended Finance Charge

The CFPB proposes to amend the finance charge to make the APR disclosure a more useful and accurate tool for comparing the cost of credit.[10]

A. Consumers Do Not Understand the APR Concept

The CFPB's testing showed that consumers do not understand the APR, even in the KBYO prototypes, and even after the CFPB tried to explain it. The best the CFPB could do was to explain that the APR is not the same as the interest rate, but that still leaves consumers confused about what it is, why it is disclosed, and how to use it.[11] This is presumably why the CFPB has relegated the APR disclosure to the last page of the Loan Estimate and Closing Disclosure, includes the finance charge on the last page of the Closing Disclosure, and omits it from the Loan Estimate. This reaffirms what the Board found in 2009:

> Participants in consumer testing indicated that much of the information in the current TILA disclosure was of secondary importance to them when considering a loan. Participants consistently looked for the contract rate of interest, monthly payment, and in some cases, closing costs. Most participants assumed that the APR was the contract rate of interest, and that the finance charge was the total of all interest they would pay if they kept the loan to maturity. . . . When asked to compare two loan offers using redesigned model forms that contained these disclosures, few participants used the APR and finance charge to compare the loans.[12]

The CFPB has not tested the all-in APR with consumers, so there is no basis to believe that they will understand a revised APR. The consumers have chronically had trouble

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[10] 77 Fed. Reg. 49090, 49100 (August 15, 2012).

[11] A "Key Finding" of the KBYO testing was that consumers found the APR "confusing and not useful." Kleimann Report, *Know Before You Owe: Evolution of the Integrated TILA-RESPA Disclosures,* p. xxvii, (July 9, 2012).

"As other studies have documented, participants often do not grasp the basics of the APR. They often confused it with the loan's interest rate. Across the rounds, to clarify the basic concept of the APR, we worked with various descriptions. We found the most effective way to reduce confusion surrounding the APR was to clarify that it was not the interest rate by adding the simple statement: 'This is not your interest rate[.]' Obviously, consumers may still have difficulty understanding the concept of the APR, but this statement minimized the confusion with the interest rate." P. xxviii (footnote omitted).

"Most consumer participants were confused by the *APR* and could not explain the difference between the *APR* and interest rate." *Id*. p. 61. The report contains selected quotations from consumers that show they are indeed unacceptably confused:

- **"***This is a rate per year [APR] and the other is rate per month, monthly interest."*
- *"I am reading down here the comparisons. I am trying to figure out where this 5.59 [APR] comes from because I thought the interest rate was 2.5. I would probably ask the loan officer about that. I would say how come it is 2.5 up here and 5.9 down there."*
- *"I'm looking at annual percentage rate of 5.89%. Express interest of course over 30 years … who's giving this different interest rate out? Is it just a comparison that they put to make the interest rate more attractive? The comparison … I want to know where they got this comparison from, what company did this come from?" Id.* pp. 61-62.

[12] 74 Fed. Reg. 43232, 43236 (August 26, 2009).

with the concept of what appears to be an alternative interest rate. Their lack of understanding is unrelated to which items are included in or omitted from the APR. Including more items in the APR will not address the reason consumers are confused by what appears to be an alternative interest rate.

Although consumer testing indicates that the APR should be removed, the CFPB explained in an August 15 industry call that it is reluctant to remove the APR disclosure because it is a "linchpin" of TILA. The age of a disclosure is not a sufficient reason to require a disclosure that consumers find "confusing and not useful." The fact that consumers do not understand it after all these years indicates that they have been receiving confusing disclosures for many years. The most significant purpose of TILA is to ensure that consumers get meaningful, useful, and understandable disclosures.

B. The CFPB Has RESPA Authority to Resolve the Problem In a Manner That was Unavailable to the Board

The Board was concerned that the creditors "have an incentive to unbundle the cost of credit and shift some of the costs from the interest rate into the ancillary fees that are excluded from the finance charge and not considered when calculating the APR."[13] This concern is no longer valid. At that time, HUD, but not the Board, had authority to require lenders to "conspicuously and clearly itemize all charges imposed upon the borrower and all charges imposed upon the seller in connection with the settlement" under RESPA § 4. TILA is limited to lending and leasing. Congress enacted TILA because "[t]he informed use of credit results from an awareness of the cost thereof by consumers."[14] Working with the limited authority it had, the Board proposed amending the finance charge to "disclose" additional closing costs in the APR because it could not require their itemization as RESPA authority allows. The CFPB describes its proposal as benefiting consumers "to the extent it discourages the proliferation of certain 'junk fees,' such as fees for preparing loan-related documents, which are currently excluded from the finance charge."[15] Consumers cannot see which fees are included in the finance charge, and they do not use it or the APR for shopping purposes.

The CFPB has both RESPA and TILA authority, so it is not constrained, as the Board was, to including real estate settlement charges as loan disclosures. The CFPB acknowledges that any consumer benefit from amending the finance charge is not established. In its cost-benefit analysis, it says:

> The proposed rule may benefit consumers by making the finance charge and corresponding APR more meaningful disclosures of the cost of credit for closed-end transactions secured by real property or a dwelling. Certain limitations on the usefulness of APR as a price comparison tool, however, such as the assumption in

[13] 74 Fed. Reg. 43232, 43243 (August 26, 2009).
[14] TILA § 102(a).
[15] 77 Fed. Reg. 51116, 51278 (August 23, 2012).

the calculation that the loan will be paid as according to the note to maturity and not pre-paid, may limit this benefit.[16]

Consumer testing shows the APR is not a useful comparison tool. The solution is to provide consumers with a tool they can use, not to revise one they cannot use. The CFPB's proposed Loan Estimates and Closing Disclosures make clear what the closing charges are, in a manner accessible and clear to consumers. The fact that the same agency can design the Loan Estimate and Closing Disclosures removes the need to depend on the APR and Finance Charge to "disclose" closing costs. The APR and finance charge have always been unclear, and now that one agency has both RESPA and TILA authority, those disclosures are now irrelevant and unnecessary for mortgage loans.

C. There Are Several Major Disadvantages to Amending the APR

Having established that there is no consumer benefit from disclosing an APR and finance charge and that the information consumers need is otherwise disclosed in the Loan Estimate and Closing Disclosure, we now turn to the significant disadvantages in amending the finance charge definition to include more items in the APR. The disadvantages of expanding the APR far outweigh any possible consumer benefit.

Including more items in the APR would put more loans over the several federal and state high-cost loan thresholds. These include the HOEPA threshold, the HPML threshold if it survives, and the several similar state thresholds that are based on the Regulation Z finance charge. It would also cause fewer loans to be QM loans and qualified residential mortgage ("QRM") loans.[17]

The CFPB describes its proposal as "consistent with the Board's 2009 Closed-End Proposal."[18] The Board also grappled with the high-cost threshold issue when it considered revising the APR. However, the problem is more severe now because the Dodd-Frank Act lowered the HOEPA thresholds, and established the QM and QRM definitions. Comment letters to the Board on this matter before the enactment of Dodd-Frank Act do not address the Dodd-Frank effects on these issues. In addition, comments in the 2010 rulemaking do not fully address the current issues because the impacts of the Dodd-Frank Act were not fully understood at the time.

Creditors are unwilling to make HOEPA loans and will make non-QM loans in only rare circumstances because of the litigation risk they entail. Forcing more loans to cross the several thresholds will constrain credit. *Constraining credit for the purpose of revising a disclosure consumers do not understand or use is ill-advised, in our view*.

[16] 77 Fed. Reg. 51116, 51278 (August 23, 2012).
[17] There is no final QRM definition. However, by statute the definition may be "no broader" than the QM definition. Dodd-Frank Act § 941(b), to be codified at 15 U.S.C. § 78o-11(e)(4)(C). If fewer loans will be QM loans, fewer will be QRM loans as well.
[18] 77 Fed. Reg. 51116, 51277 (August 23, 2012).

The CFPB acknowledges that its proposal would force more loans to cross the several high-cost thresholds, and that it would reduce the number of loans that are QM loans.[19] It does not mention, however, that it would also result in making fewer QRM loans. It states the proposal "would not impose substantial additional burden" on creditors because creditors could implement the amended finance charge when they implement other rules.[20] The CFPB does not address the diminished ability to make loans.

> With respect to the Ability to Repay rulemaking, creditors may incur costs associated with making fewer loans with prepayment penalties, or may incur costs from the additional underwriting requirements and/or liability associated with making more loans that are higher-priced balloon loans or that are not qualified mortgages. In addition, a small number of creditors may also lose a very small fraction of revenue if they are reluctant to make high-cost, higher-priced, or higher-risk mortgage loans and cannot offer alternatives that are as profitable as those loans.[21]

The inability to make certain types of loans entails loss of business, loss of revenue, and loss of profits. Shrinking the mortgage lending volume would not only impact lenders, but would harm consumers directly because their access to credit would be constrained.

Moreover, the amount of the finance charge would vary by state even for loans of the same size, so credit would be more constrained by high-cost, QM and QRM definitions in some states than others.

Including more third-party charges in the finance charge would force creditors to restrict consumer shopping to avoid liability. It would subject creditors to increased TILA liability for inaccurately estimating third-party charges, and for changes in those charges before closing, over which they have no control. Regulation X prohibits the creditors from controlling these charges. This is fundamentally unfair without relief from RESPA § 8.

Consumers do not rely on the finance charge and APR, so there would be no apparent consumer benefit from amending them. The new KBYO disclosures are a better avenue for disclosing closing and other costs. The CFPB's combined RESPA and TILA authorities make the APR and finance charge obsolete for mortgage loans.

<u>Recommendations</u>

- The APR and finance charge should not be required to be disclosed on mortgage loans, and they should not be defined as material disclosures.

- If the CFPB does retain the APR and finance charge, they should reflect the creditor's and the broker's charges, but not the costs of third-parties not affiliated with either.

[19] 77 Fed. Reg. 51116, 51277 (August 23, 2012).
[20] 77 Fed. Reg. 51116, 51279 (August 23, 2012).
[21] 77 Fed. Reg. 51116, 51279 (August 23, 2012).

Since Regulation X prohibits lenders from controlling third party costs, creditors should not be liable under TILA for third-party charges they cannot control under Regulation X.

D. The TCR Would be Preferable to the APR-APOR Comparison, if the APOR Will Not be Disclosed

If the CFPB does not require disclosure of the APOR, the TCR would be preferable to the APR-APOR comparisons. An all-in APR would not be comparable to APORs because APORs are based on different costs. The CFPB could revise the APOR definition to make it more comparable to the APR, but that would be unnecessarily complex. If recording fees and transfer taxes, which vary geographically, were included in the APOR, the CFPB may need to calculate separate APORs for areas where those taxes and fees are high.

With the Board's 2009 and 2010 proposals to amend the finance charge, we were concerned that the APR and APOR would measure different items, and we suggested revising the APOR to make the comparison more meaningful. However, it is possible that the CFPB will not require disclosure of the APOR or the HOEPA or HPML thresholds to consumers, which would alleviate that concern. Absent that concern, the TCR is easier to use and avoids several problems.

If the CFPB uses an all-in-APR for disclosure purposes, the TCR should be used for the high-cost threshold as well as for all federal rate tests, including the HMDA rate spreads. The purpose of the all-in-APR, to the extent there was one before the Dodd-Frank Act, was to improve disclosures of closing costs. It is not related to the purposes of the APR-APOR comparisons.

Recommendation

If the CFPB does not require disclosure of the APOR, the TCR should be used instead of the all of the APR-APOR comparisons.

E. Disclose TCR Instead of APR and Finance Charge

Disclosing the TCR instead of the APR and finance charge would have several advantages. This approach would not require using one method for calculating the APR for disclosures and another method for the high-cost and other thresholds. It would eliminate the "some in - some out" problem with the APR. It would also be much easier for lenders, investors, and regulators to verify.

Creditors first determine what the closing costs are, then categorize them as in or out of the finance charge for disclosure purposes. This categorization is a compliance burden, especially if some of the fees are in and some are out of the finance charge. Using the TCR instead of the APR and finance charge substantially eliminates this compliance burden.

The current exclusions from the finance charge for third-party closing costs should remain in place. Third-party closing costs that are currently finance charges would remain finance charges, and would be included in the Closing Disclosure. For liability purposes, the finance charge should be considered accurate if the sum of the third-party charges included in the Closing Disclosure plus the amount of the disclosed finance charge is not understated by $100. This dollar number should be adjusted annually for inflation.

Recommendation

We recommend disclosing the TCR instead of the APR and finance charge.

F. Determining the TCR and APR on ARM Loans Needs Clarity

The proposed rule would require determination of the TCR or APR for adjustable-rate mortgage ("ARM") loans, where the index is not under the creditor's control, using the maximum margin and the index value at consummation or account opening.[22]

We request clarification of what is an index that is "not under the creditor's control[.]" We recommend that the CFPB state explicitly who controls each index in use in any loan backed by the Federal Housing Administration ("FHA") or by Fannie Mae or Freddie Mac (the "GSEs").

The proposed rule would use "the value of the index rate in effect on the date of the consummation or opening of the transaction[.]"[23] The disclosures must be prepared several days before closing. Unnecessary waiting periods should not be required due to the creditor's inability to know and verify the index before the creditor must begin preparing disclosures. The index value is only known after it is set. Some are published only every 7 or 8 days. Index values need to be verified before creditors can use them in disclosures. Many are published in the *Wall Street Journal,* in which typographical errors, while rare, have occurred.

We suggest a practical approach would be to permit use of any value of the index during a period that is the same as the look-back period specified in the note, following similar treatment in Comment 17(c)(1)-10.i.

The proposed rule would use the maximum possible margin on the loan.[24] ARM loans often have an initial rate that is not set by the index and margin – the initial rate may be higher or lower than the rate using the maximum margin. We suggest that the final rule clarify that the initial rate should be used in the calculation if it is higher than the rate with the maximum margin.

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[22] Proposed § 1026.32(a)(2)(ii).
[23] Proposed § 1026.32(a)(2)(iii).
[24] Proposed § 1026.32(a)(2)(ii).

If the initial rate is discounted from the fully-indexed rate, it is not clear how the APR or TCR should be calculated for threshold purposes. Differences between the initial rate and fully-indexed rate could affect the amount of interim interest, how much principal will amortize before the first rate adjustment, and when mortgage insurance will terminate. It would be helpful to have examples illustrating how to calculate the APR or TCR for threshold purposes.

APORs for ARMs should be calculated using the maximum margin. If the APR or TCR calculated for threshold purposes reflects the higher of the initial interest rate or fully-indexed rate using the maximum margin, the APOR should be calculated in the same way so that there is an apples-to-apples comparison. For example, if the Freddie Mac PMMS Survey for a 5/1 ARM reflects a 2.75% margin and the current index value is 1% for a fully indexed rate of 3.75%, if the initial rate on the survey were less than 3.75% it would be ignored in the APOR calculation.

For open-end credit, the CFPB proposes to use APORs for closed-end loans. We suggest the CFPB work with the GSEs to find a better source of APORs for open-end credit. Closed-end loans have different risk characteristics, and therefore different pricing, than open-end credit. Closed-end APORs are not reasonable proxies for market rates on HELOCs.

The Commentary says § 1026.32(a)(1)(i) requires creditors, for open-end credit, to use the APOR by reference to the APOR for the most closely comparable closed-end loan, based on applicable loan characteristics and other loan pricing terms.[25] If a HELOC has multiple characteristics that make it comparable to multiple, different closed-end loans, the regulation would apparently permit the creditor to use any of the comparable closed-end loans, because it is not clear which would be more or less comparable. If the CFPB wishes another result, it will need to specify which HELOC characteristic is "comparable" to which closed-end loan characteristic. It will also need to rank characteristics in order of "comparability" so that when there are multiple characteristics, the creditor will know the relative importance of each one.

Recommendations

We recommend that the CFPB make the clarifications explained above.

IV. The Proposed Points and Fees Definition is Too Broad

The proposed HOEPA rule would define points and fees very broadly. We believe the rule should be amended to prevent excessive lending constraints. If points and fees on a loan reach three percent of the loan amount, the creditor will need to reject the application on that basis to avoid TILA liability under the ability-to-repay rule. It is doubtful that Congress understood that this would be a result of the Dodd-Frank Act, and it is clear Congress wanted to continue credit availability in appropriate circumstances. Where the statutory definition of points and fees would inappropriately constrain credit,

[25] Proposed Comment 32(a)(1)(i)-3.

the CFPB should not mimic the statute, but should make reasonable exceptions to enable the housing markets to recover.

The closer the points and fees get to a threshold, the less opportunity consumers would have to buy down the rate by paying discount points. Buying down the rate through discount points benefits consumers who want to lower their interest rate.

A. Section 4(c)(7) Fees

The proposed rule would include in points and fees 4(c)(7) real estate-related fees unless they are paid to a non-affiliated third party and are reasonable.[26] Congress set a *bona fide* standard, not a reasonableness standard.[27] This should be the applicable standard because creditors are prohibited from setting third-party charges and, therefore, should not be responsible for them.

When a creditor permits the consumer to shop for a required service and the consumer selects a provider that was not the Written List of Providers, the consumer, not the creditor, decides what services to obtain. The consumer negotiates and agrees to the fee for those services. For example, if the creditor's Written List of Providers gives the name of a settlement agent and lists a reasonable charge for that service, the consumer may choose a settlement agent not on the list and agree to pay a higher price for the closing service. The consumer may also agree to purchase from the agent additional services the creditor does not require, for additional fees. The amounts of these fees should be deemed reasonable and *bona fide* and excluded from points and fees because the creditor cannot control them.

TILA § 106(a) excludes from the finance charge fees for third-party closing agents when the creditor does not require the charge or the service, and does not retain the charge. Consistent with this intent, creditors should not bear liability for third-party charges they neither require nor retain. These charges should be deemed reasonable and *bona fide* and excluded from point and fees.

The proposed approach would require creditors to select the lowest cost third-party service or service provider above all other considerations, which is inappropriate.

Recommendation

Fees included in 4(c)(7) that are paid to a third party should be excluded from points and fees if they are *bona fide*. If the consumer selects either the service provider or the service, the fee should be deemed *bona fide* because creditors should not bear TILA liability for charges that Regulation X prohibits them from controlling.

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[26] Proposed § 1026.32(b)(1)(iii) (closed-end) and § 1026.32(b)(3)(ii) (open-end).
[27] TILA § 103(bb)(1)(A)(ii).

B. Employee Compensation Should be Excluded

The proposed rule would include employee compensation in points and fees for close-end loans. This would overly constrain credit and would vastly complicate compliance. It is also unnecessary in light other rules, including the Dodd-Frank rules that prohibit inappropriate steering, yield spread premiums, compensation based on loan terms, and dual compensation.

Including employee compensation introduces a number of compliance problems including the calculation of the amount of compensation and fact that the total amount of compensation may not be known at consummation.

Including compensation in points and fees also would subject compensation to discovery, making it public. This would be a breach of the financial privacy employees reasonably expect. Making employee compensation public would be inconsistent with the proposed RESPA servicing rule, which is clear that servicers may maintain the confidentiality of confidential or proprietary information even if a consumer requests such information.[28] Protected information would specifically include "Compensation, bonuses, or personnel actions relating to servicer personnel, including personnel responsible for servicing a consumer's mortgage loan account."[29] We support the proposed Regulation X protection of employee income information as an important employee protection. We urge the Regulation Z treatment be the same, and that employee compensation not be included within points and fees.

Recommendation

Employee compensation should be excluded from points and fees in all cases.

C. Fees Paid to Affiliates

The CFPB proposes to include within points and fees many fees paid to the creditor's affiliates.[30] Affiliated business arrangements are already regulated, and appropriate disclosures of affiliated arrangements are already required, so we do not believe this is necessary.

There is no indication that the CFPB has identified a problem with fees paid to affiliates, and in many instances the consumer is better served. Affiliated service providers provide the convenience of one-stop shopping, which many consumers prefer.

Recommendation

The final rule should not distinguish between fees paid to affiliates and fees paid to non-affiliates.

[28] Proposed Regulation X Comment 36(f)(1)(ii)-1.
[29] Proposed Regulation X Comment 36(f)(1)(ii)-1.iii.
[30] Proposed §§ 1023.32(b)(1)(iii); 1026.32(b)(3)(i).

D. Double Counting

The proposed points and fees definition would include "[a]ll compensation paid directly or indirectly by a consumer or creditor to a loan originator[.]"[31] If a consumer pays a creditor $100, and that creditor pays its originator employee $50, the rule would count $150 towards points and fees. The proposed commentary intends to exclude this double-counting, but is not effective in doing so. It says, "[l]oan originator fees already included in the points and fees calculation . . . *need not* be counted again[.]"[32] "Need not" can mean "may be." This language is not binding on courts.

Recommendation

If employee compensation is included in points and fees, the rule should definitively exclude double counting. "[N]eed not" should be changed to "must not[.]"

E. Hourly Pay

The proposed Commentary states that compensation includes items "such as a bonus, commission, yield spread premium, award of merchandise, services, trips, or similar prizes, *or hourly pay* for the actual number of hours worked on a particular transaction."[33] This language indicates that compensation includes all compensation including, but not limited to, hourly pay.

Including hourly pay would:

- Require loan originators to track how much time they spend on each loan. This would be unnecessarily costly.
- Require rejection of the loan at the point the hourly pay causes a loan to reach the points and fees cap, if it could be tracked and calculated.
- Not be known until after consummation, or until after final disclosures are prepared.
- Disincentivize loans designed to assist lower-income consumers or loans under the Community Reinvestment Act, which can involve more time to originate.

Recommendation

Hourly pay should be excluded from points and fees.

F. Base Salary

The proposed commentary would include hourly pay in points and fees. It is unclear as to whether it would include base salary. The commentary states, "Loan originator compensation includes amounts the loan originator retains and is not dependent on the

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[31] Proposed § 1026.32(b)(1)(ii).
[32] Proposed Comment 32(b)(1)(ii)-1 (emphasis added).
[33] Proposed Comment 32(b)(1)(ii)-2.i (emphasis added).

label or name of any fee imposed in connection with the transaction."[34] It also states that compensation "excludes compensation that cannot be attributed to a particular transaction at the time of origination, including, for example . . . [t]he base salary of a loan originator who is also the employee of the creditor[.]"[35]

The difference between hourly pay and base salary is a difference in how the compensation is labeled. If base salary is a flat salary of $X annually, $X / 2000 hours would be hourly pay.

Recommendation

The rule should clearly exclude base salary.

G. Definition of Loan Originator

The proposed regulation would includes in points and fees compensation to loan originators, referring to the definition of originator in § 1026.36(a)(1).[36] This appears to refer to the definition in the proposed loan originator compensation regulation. In that proposal, the definition includes anyone who, for compensation, "takes an application, arranges, offers, negotiates, or otherwise obtains an extension of consumer credit for another person[.]" While this clearly includes a broker and a loan officer who interact with the applicant directly during the loan process, it is not limited to them. It could include those who participate in any of the following:

- Underwriting;
- Appraising the property;
- Reviewing the file quality post-closing;
- Preparing for or conducting a settlement;
- Preparing loan disclosures;
- Helping the applicant select a lender, such as property sellers; and
- Real estate brokerage, if the creditor pays the real estate agent.

Compensation creditors pay to real estate agents when the creditor is selling a property it acquired through foreclosure ("REO") should be excluded. Creditors should have an incentive to sell REO by offering favorable financing. This benefits consumers.

The definition of loan originator would also include "producing" managers of any of the above.[37] That term is undefined. This appears to be different than a "manager" but the difference is not clear.

This definition of loan originator is too broad and unworkable. Creditors cannot determine how to calculate this compensation. It would require the creation of a

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[34] Proposed Comment 32(b)(1)(ii)-3.
[35] Proposed Comment 32(b)(1)(ii)-2.ii.C.
[36] Proposed § 1026.32(b)(1)(ii).
[37] Proposed Comment 36(a)-4 in the compensation rulemaking.

company-wide system of tracking how much time each person spends on a loan, which would be a massive undertaking for no apparent consumer benefit.

The commentary to § 1026.36(a)(1) (in the proposed compensation rule) does not narrow the definition. It reinforces the broad reach of the definition by stating that loan originator "includes employees of a creditor[.]"[38] It also states:

> For purposes of §1026.36, managers, administrative and clerical staff, and similar individuals who are employed by a creditor or loan originator but do not arrange, negotiate, or otherwise obtain an extension of credit for a consumer, **or** whose compensation is not based on whether any particular loan is originated, are not loan originators.[39]

The phrase "For purposes of § 1026.36" may make this comment inapplicable to the regulation that includes compensation in points and fees, which is § 1026.32(b)(1)(iii). We recommend clarifying that it applies, such as by adding a reference to § 1026.32(b)(1).

Under this comment, managers and clerical and administrative staff are included within the definition of loan originator if they either:

- "[A]rrange, negotiate, or otherwise obtain" loans for consumers; or
- Do not do so but are compensated based on whether particular loans are originated.

Any employee of a creditor whose compensation is tied to lending volume, lending profits, or even company profits, is a loan originator for purposes of defining loan originator compensation within the definition of points and fees under the proposed rule. This definition is too broad, and may actually harm consumers if their loan hits the cap on points and fees.

<u>Recommendation</u>

We recommend defining loan originator using the same definition as in 12 C.F.R. § 1007.102 and its appendix (under the SAFE Act), which includes those who take an application and offer or negotiate loan terms, and excludes those who perform purely administrative or clerical tasks for loan originators.

H. Points and Fees Unknown at Consummation Need to Be Excluded

Creditors need to know the amount of points and fees far enough in advance before the closing to make the origination disclosures. Closing Disclosures are required to include costs paid at or before consummation; therefore, those costs must be known at consummation.[40]

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[38] Proposed Comment 36(a)-1.i.B in the compensation rulemaking.
[39] Proposed Comment 36(a)(1)-4 in the compensation rulemaking (emphasis added).
[40] KBYO proposed Comment 34(g)(6)-1.

Creditors need to decide whether to go through with the loan. If points and fees increase above three percent, the creditor needs the ability to reject the loan application on that basis. Potential assignees need to use origination disclosures to determine TILA compliance, so the disclosures need to include all points and fees. Mortgage loan originators also need to use origination disclosures to determine points and fees so they can comply with the prohibition on steering a consumer who qualifies for a QM loan into another loan.[41]

The CFPB states that it includes points and fees payable "in connection with the transaction" because Congress removed the phrase "payable at or before closing" from TILA § 103(aa)(1)(B).[42] This statutory change was necessary was to prevent evasion of the cap on points and fees by making them payable one minute after closing. The CFPB similarly prevents evasion in open-end credit in § 1026.32(b)(4), which includes in points and fees amounts waived at closing and charged thereafter. There is no indication that Congress intended points and fees to include amounts unknown at closing. This would be especially disruptive to lending if it were to mean that creditors and investors could not determine whether a loan crosses one of the high-cost thresholds, or is a QM or QRM loan, until after closing.

The regulation includes compensation in points and fees without regard to when the amount becomes known. The commentary states:

> Compensation paid to a loan originator for a closed-end mortgage loan must be included in the 'points and fees' calculation for that loan whenever paid, whether before, at, or after closing, as long as that compensation amount can be determined at the time of closing.[43]

The commentary gives examples of compensation paid after closing, such as an annual bonus based on the number of loans closed. However, this does not address the common practice of paying annual bonuses only on the condition that the recipient remain an employee of the employer when bonuses are paid. Who will remain at the employer weeks or months into the future is unknown at closing. For that reason, bonuses contingent on the occurrence of an event unknown at closing should be excluded.

The commentary states that "compensation includes amounts the loan originator retains[.]"[44] This could mean that contingent bonuses that might not be paid are excluded from points and fees.

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[41] TILA § 129B(c)(3)(B).
[42] 77 Fed. Reg. 49090, 49104 (August 15, 2012).
[43] HOEPA proposed Comment 32(b)(1)(ii)-2.
[44] Proposed HOEPA Comment 32(b)(1)(ii)-3.

Recommendation

Any amounts unknown when closing disclosures are prepared should be excluded from points and fees to prevent unnecessary marketplace turmoil.

I. Discount Points Paid by Third Party

The proposed rule would in some circumstances exclude *bona fide* discount points "paid by the consumer" from points and fees.[45] It would define discount points as proposed in the ATR rule.[46] Sometimes a third party pays the discount points directly, such as a seller or an employer. In these instances, the consumer pays the discount points indirectly, through a higher purchase price or lower employment compensation.

Recommendation

Discount points should be excludable without regard to who pays them, for both the HOEPA and ATR rules.

V. Prepayment Penalties

A. FHA loans

The proposed rule would define as a prepayment penalty amounts paid on FHA loans as a result of the FHA's amortization method. While we agree that the FHA method is disadvantageous to consumers, the CFPB needs to resolve the matter with FHA and Ginnie Mae. The CFPB should define the FHA method as a prepayment penalty only to loans originated after FHA changes its method and notes; after Ginnie Mae revises its requirement that servicers pass through the interest even if servicers do not collect it; and after these changes are fully implemented. The CFPB's approach of making the change unilaterally would cause serious disruption that is disproportionate to the importance of the issue.

1. Inconsistent with other laws

If the CFPB were to treat FHA's interest accrual amortization method as a potential prepayment penalty, it would make all FHA loans HOEPA high-cost loans because high-cost loans include any loan with a prepayment penalty permitted after 36 months.[47] This would shut down FHA lending at a time when the market is dependent on it. It would also require all FHA loans to be QMs because only QM loans may have prepayment penalties.[48] Moreover, prepayment penalties are permitted on QM loans only during the

[45] Proposed §§ 1026.32(b)(5)(ii)(A) and 1026.32(b)(5)((ii)(B).
[46] Proposed § 1026.32(b)(5)(ii)(C) refers to proposed § 1026.43(e)(3)(iv).
[47] Proposed § 1026.32(a)(1)(iii).
[48] TILA § 129C(c)(1)(A).

first three years.[49] FHA loans may be paid off after three years, so all FHA loans would be non-QM loans.

Non-QM loans "may not *contain terms* under which a consumer must pay a prepayment penalty[.]"[50] That is, *even if a servicer did not charge the interest*, a non-QM FHA loan would violate TILA because of the language in the note permitting the charge. Defining each FHA loan as a TILA violation would create a major disruption based on federal policy.

By contract , servicers can permit FHA borrowers to pay off their loans after three years, on any day of the month the borrower chooses; servicers are required to pass through the interest to Ginnie Mae; and servicers have the right to collect the interest from borrowers. The proposed treatment would unconstitutionally interfere with existing, valid contracts.

Under existing § 1026.23(a)(3), the rescission period is extended if the creditor does not deliver material disclosures. Material disclosures include § 1026.35(b)(2) items, which are prepayment penalties.[51] The 2010 proposal would redefine material disclosure to include prepayment penalties required to be disclosed under § 1026.38(a)(5).[52] There is no § 1026.38(a)(5) today and the 2010 proposal does not contain one. However, the 2010 preamble says:

> The August 2009 Closed-End Proposal would require all mortgage loans to indicate the amount of the maximum prepayment penalty and the circumstances and period in which the creditor may impose the penalty. *See* proposed § 226.38(a)(5). Therefore, the Board proposes § 226.23(a)(5)(i)(F) to include the prepayment penalty disclosed under § 226.38(a)(5) in the definition of 'material disclosures.'[53]

The 2009 proposal in § 1026.38(a)(5) would require disclosure of a prepayment penalty:

> (5) *Prepayment penalty*. If the obligation includes a finance charge computed from time to time by application of a rate to the unpaid principal balance and permits the creditor to impose a penalty if the obligation is prepaid in full, a statement indicating the amount of the maximum penalty and the circumstances and period in which the creditor may impose the penalty.

If the final rule defines an FHA accounting method as a prepayment penalty, it should not apply retroactively to extend the rescission period on existing FHA loans on which creditors complied with Regulation Z.

Again, the impact of retroactively determining that all FHA loans are in violation of

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[49] TILA § 129C(c)(3)(D).
[50] TILA § 129C(c)(1)(A) (emphasis added).
[51] 12 C.F.R. § 1026.23(a)(3)(ii).
[52] 2010 Proposed § 23(a)(5)(i)(F).
[53] 75 Fed. Reg. 58539, 58617 (September 24, 2010).

TILA would be a major disruption at a time when FHA loans are the only loans available to many borrowers.

2. CFPB does not have authority to define FHA QM loans

HUD is required by statute to "prescribe rules defining the types of loans [FHA insures] that are qualified mortgages[.]"[54] HUD, not the CFPB, must define which FHA loans are QM loans. The CFPB does not have authority to define all FHA loans to be in violation of the QM rule.

The CFPB's preference would be for HUD to revise its accounting method, a major undertaking that would take time and resources. Alternatively, it would mean servicers would need to prohibit FHA payoffs at certain times, which could be a serious interference for consumers who are refinancing or selling their home. Servicers do not have authority to do this. The CFPB's rule would require servicers of FHA loans to violate Regulation Z when they comply with FHA standards.

The CFPB does not discuss the havoc this approach would wreak with FHA lending. It states that it intends to coordinate the § 32(b)(8)(i) definition of prepayment penalty with the definition in other CFPB rulemakings.[55] We suggest it is equally important to coordinate the definition with HUD's rules.

Recommendation

- At a minimum, any rule defining FHA's accounting method to constitute prepayment penalties should apply only to loans originated after HUD has implemented the changes to the FHA accounting method; has revised all the FHA notes; and after Ginnie Mae has ceased requiring servicers to pass through interest, regardless of whether it is collected.
- The CFPB and HUD should discuss any harm from the accounting method FHA has been using for years and how best to resolve the issue; and
- The CFPB should not define FHA's accounting method as resulting in prepayment penalties, in the HOEPA or other rulemakings.

B. Charges Waived at Closing

The proposed ATR definition of prepayment penalties excludes payoff-related fees.[56] The HOEPA Commentary includes in points and fees, on a closed-end loan, a closing or origination cost the creditor waives if the consumer does not prepay the loan.[57] The HOEPA Commentary would also include as a prepayment penalty on HELOCs a waived closing cost that is reimposed upon early termination[58] but, unlike closed-end loans,

[54] TILA § 129C(b)(3)(b)(ii).
[55] 77 Fed. Reg. 49090, 49116 (August 15, 2012).
[56] Proposed § 1026.43(b)(10)(ii) (ATR).
[57] Proposed HOEPA Comment 32(b)(8)-1.ii.
[58] Proposed HOEPA Comment 32(b)(8)-2.

would exclude a waived *bona fide* third-party charge that is imposed if an open-end credit plan is terminated within 36 months.[59]

This distinction between closed-end and open-end transactions should apply to closed-end subordinate loans, and treat them as HELOCs, because creditors commonly waive third-party fees on these loans. If the closed-end subordinate loan is prepaid within 36 months and the fee is owed, the fee should not be a prepayment penalty. Alternatively, a fee that would have been excluded from points and fees for high-cost purposes if the consumer pays it at closing should not be a prepayment penalty under the HOEPA rule because of the high-cost limit on prepayment penalties.

The proposed definition of high-cost loan includes loans on which prepayment penalties can exceed two percent of the amount prepaid or may be charged after 36 months.[60] In some states, mortgage taxes can exceed two percent. If the consumer pays the taxes at closing, that fact would not make the loan a high-cost loan. However, if the creditor paid the taxes at closing and recoups them if the loan is prepaid within 36 months, it would be. This will create an incentive for lenders not to waive taxes, and it will impose a cost that consumers may not be prepared to pay.

Recommendation

Prepayment penalties should exclude closing costs for which the lender is reimbursed by the borrower for early payoff within 36 months for both open-end credit and closed-end subordinate loans. Charges not included in points and fees, if the consumer pays them at closing, should not be treated as prepayment penalties, and thereby included in points and fees, if the creditor waives them at closing.

VI. Settlement Agents and Third-Party Service Providers

A. Settlement Agent Fees

The current special rule for settlement agent fees derives from TILA § 106(a), which states that "The finance charge shall not include fees and amounts imposed by third party closing agents (including settlement agents, attorneys, and escrow and title companies) if the creditor does not require the imposition of the charges or the services provided and does not retain the charges." This provision clearly recognizes that creditors do not control third party settlement agents, and should not be responsible for services that the creditor does not require and for which the creditor does not retain a portion of the charge.

[59] Proposed HOEPA Comment 32(b)(8)-2.
[60] Proposed HOEPA § 1026.32(a)(1)(iii)

Recommendation

If the final rule includes all settlement agent fees in the finance charge, the rule should also take appropriate steps to prevent the creditor from being exposed to additional liability for those charges, consistent with the intent of TILA.

B. Responsibility for Accuracy of Settlement Charges

RESPA makes settlement agents responsible for providing an accurate HUD-1.[61] The proposed rules would remove any responsibility under RESPA for settlement agents to coordinate the closing by gathering accurate financial information on the purchase and sale transaction or on title services or other services that the settlement agent arranges.

The proposal would add many more charges to the finance charge, including third-party charges, but would have a tolerance of only $100.[62] However, the proposal would not require any service provider, other than the creditor, to be responsible for the accuracy of the charges. If creditors are to be held responsible for the accuracy of the charges and if they are to disclose those charges accurately, they will need a mechanism to ensure that the service providers give the creditor accurate fee information so that the Closing Disclosure may be prepared both accurately and on a timely basis.

Recommendation

Settlement Agents, providers of optional services, and providers of required services where the consumer shops and selects a provider not on the lender's Written List of Providers should be required to provide to both the lender and the consumer:

- An identification of the services that will be provided; and
- A firm price for those services, which may change only if there is a changed circumstance or a borrower-requested change. If there is a changed circumstance or borrower-requested change, the settlement agent or other provider must notify the both the borrower and the creditor within three business days.
- The creditor should be permitted to rely upon the services identified and charges provided, and should never be liable for differences between the quoted amounts of the fees and the actual fees.

Even if the creditor is made responsible for the Closing Disclosure, if the creditor provides a draft Closing Disclosure to the settlement agent before the disclosure is provided to the consumer, the settlement agent should remain responsible for the accuracy of the fees for such services.

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[61] RESPA § 4(b).
[62] Proposed § 1026.19(f)(2)(ii) in the KBYO proposal.

VII. Ability to Correct Unintentional Violations Should be Available

The Dodd-Frank Act includes a provision governing corrections of unintentional violations.[63] The ability to cure errors benefits consumers because consumers would get any funds mistakenly charged to them refunded without the expense and inconvenience of unnecessary litigation. TILA compliance is complex, especially with unclear regulations, and unintentional violations do occur.

The CFPB solicits comment on the extent to which creditors or assignees are likely to invoke this provision and whether regulatory guidance would be useful. The likelihood that creditors or assignees would use this provision is low because it would in effect be punitive.

It would permit correction of unintentional violations within 30 or 60 days, but in either case only "prior to the institution of any action[.]" Putting a cure into place would require giving the consumer a choice of remedies. That is, the creditor or assignee would need to communicate with the consumer. The consumer could then institute an action, and the creditor or assignee would lose the protection of the ability to cure the violation.

Unfortunately, the cure must be put into place in as little as 30 days, but the consumer may, quite reasonably, request more than 30 days to make an informed decision.

Moreover, "the institution of any action" is not limited to actions by the consumer. If there were two similar unintentional violations and a consumer in one brought an action, the creditor may have lost the ability to cure the second loan. An action by the CFPB or a state attorney general may also eliminate the right to cure. The term action is not defined, and could include a subpoena, a civil investigative demand, an examination, or even filing a complaint with a regulator.

We support CFPB efforts to prevent evasions of the federal consumer financial laws, such as its proposed strengthening section 1026.34(v). As amended, it would prohibit

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[63] TILA § 129(v):
(v) CORRECTIONS AND UNINTENTIONAL VIOLATIONS.—A creditor or assignee in a high-cost mortgage who, when acting in good faith, fails to comply with any requirement under this section will not be deemed to have violated such requirement if the creditor or assignee establishes that either—

(1) within 30 days of the loan closing and prior to the institution of any action, the consumer is notified of or discovers the violation, appropriate restitution is made, and whatever adjustments are necessary are made to the loan to either, at the choice of the consumer—

(A) make the loan satisfy the requirements of this chapter; or

(B) in the case of a high-cost mortgage, change the terms of the loan in a manner beneficial to the consumer so that the loan will no longer be a high-cost mortgage; or

(2) within 60 days of the creditor's discovery or receipt of notification of an unintentional violation or bona fide error and prior to the institution of any action, the consumer is notified of the compliance failure, appropriate restitution is made, and whatever adjustments are necessary are made to the loan to either, at the choice of the consumer—

(A) make the loan satisfy the requirements of this chapter; or

(B) in the case of a high-cost mortgage, change the terms of the loan in a manner beneficial so that the loan will no longer be a high-cost mortgage.

structuring transactions that should be high-cost loans so as to evade the high-cost loan restrictions. This will prevent consumers from potential harm. For the same reason, the ability to cure errors should be available.

Recommendation

We recommend that the CFPB implement some definitions and timing procedures so that creditors and assignees will be able to cure unintentional violations:

- The 30-day and 60-day time limits should refer to the time in which the creditor or assignee must notify the consumer about the potential unintentional violation, or error, or the consumer notifies the creditor. It should not measure the time by which the cure must be in place.
- Creditors should have another 30 days to offer any cures to the consumer.
- Consumers should have 60 days from receiving the offer to make a decision.
- The term "any action" should be limited to judicial action by a consumer on the loan in question.
- The § 129(v) right to cure should be in addition to the rights in § 130(b).
- Once a loan is cured, subsequent assignees should be protected by the cure.

VIII. The Proposed Points and Fees Definition is Unclear

We note some areas where the proposed points and fees definition could be clarified to prevent unnecessary litigation, and to prevent different courts from deciding the same question in different ways.

Lack of clarity in Regulation Z will unnecessarily constrain credit in today's environment where credit is already far too constrained. Potential new credit constraints caused the CFPB to reopen the comment period in the ATR rulemaking to solicit additional input on the costs of litigation under that rule. Litigation risks and costs arise from the HOEPA rule as well. An unclear rule poses more litigation costs than a clear rule.

The HOEPA caps on rates and the QM cap on points and fees together limit creditors' ability to pass their costs through to consumers. When the costs meet the HOEPA and QM caps, lending will cease. Any lack of clarity in the rules, and particularly in TILA rules, will curtail credit in this manner. The proposed definition of points and fees needs substantial clarification to prevent unnecessary litigation risk.

A. Closed-End Loans

1. Interest

The definition contradicts itself on whether interest is included in points and fees.

- Interest is excluded.[64]
- Points and fees include "All compensation paid directly or indirectly by a consumer or creditor to a loan originator," which can include the lender.[65] Interest is compensation paid directly to the lender.

Recommendation

Interest should be explicitly excluded from points and fees.

2. Real Estate Agents' Fees

The definition contradicts itself on whether real estate agents' fees are included. Points and fees exclude charges payable in a comparable cash transaction. Existing § 1026.4(a) excludes these, and proposed § 1026.32(b)(1) incorporates 4(a) by reference. Real estate agents' fees are payable in a comparable cash transaction.

Points and fees include 4(b) items.[66] Section 4(b)(3) includes "finders' fees[.]" Real estate agents are a type of finder.

The proposed points and fees definition excludes compensation to a "person that only performs real estate brokerage activities[,]" but includes that compensation if the creditor pays it.[67] Excluding creditor-paid real estate agent fees would incentivize creditors to offer attractive financing when they sell properties acquired through foreclosure.

Recommendation

Real estate agent fees should be excluded from points and fees in all cases.

3. Hazard Insurance Premiums

The definition contradicts itself on whether hazard insurance premiums are included.

- Points and fees exclude charges payable in a comparable cash transaction.[68] Hazard insurance premiums are payable in a comparable cash transaction.
- Points and fees include "[p]remiums . . . payable at or before consummation for any . . . accident . . . insurance[.]"[69] Notably, the proposal would remove

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[64] Proposed § 1026.32(b)(1)(i)(A).
[65] Proposed § 1026.32(b)(1)(ii).
[66] Proposed § 1026.32(b)(1)(i).
[67] Proposed § 1026.32(b)(2)(ii).
[68] Existing § 1026.4(a) excludes charges payable in a comparable cash transaction, and proposed § 1026.32(b)(1) incorporates items in 4(a) by reference.

language that limits the definition to insurance "that provides for cancellation of all or part of the consumer's liability in the event of the loss of life, health, or income or in the case of accident[.]" Homeowners' insurance is accident insurance.

- Points and fees exclude items in 4(d).[70] Section 4(d)(1) excludes "[p]remiums for . . . accident . . insurance . . . if . . . [t]he insurance coverage is not required by the creditor[.]" Mortgage lenders do require hazard insurance.
- Section 4(d)(2) says, "[p]remiums for insurance against loss of or damage to property . . . may be excluded from the finance charge if" certain conditions are met (they commonly are). That means hazard insurance premiums "may be" excluded. If they may be excluded, a court may find that they may be included.

<u>Recommendation</u>

The regulation should be clear that hazard insurance premiums are excluded from points and fees in all cases because they are payable in a cash transaction.

4. Property Taxes

The definition is unclear about whether property taxes are included.

- Amounts held for future payment of taxes are excluded from points and fees.[71]
- Section 4(c)(7) items (real estate related fees) are excluded only if they are reasonable and paid to a third party.[72]
- Section 4(c)(7)(v) includes escrowed amounts not otherwise included in the finance charge. Property taxes are always excluded from the finance charge because they are payable in a comparable cash transaction.
- Must property taxes be reasonable under § 1026.32(b)(1)(iii) to be excluded?

<u>Recommendation</u>

Property taxes should be excluded from points and fees in all cases regardless of whether they are reasonable in amount.

5. Section 4(c)(7) Fees

The exclusion for 4(c)(7) fees is unclear in two respects.

First, the rule includes in points and fees the items listed in 4(c)(7). However, 4(c)(7) is a list of excluded items. It is not clear whether including the excluded items would result in the fees being included or excluded from the points and fees calculation.

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[69] Proposed § 1026.32(b)(1)(iv).
[70] Proposed § 1026.32(b)(1)(i).
[71] Proposed § 1026.32(b)(1)(iii).
[72] Proposed § 1026.32(b)(1)(iii).

Second, the exclusion for 4(c)(7) fees, if they are reasonable and paid to a third party, sometimes contradicts the blanket exclusion for "any charge of a type payable in a comparable cash transaction" in 4(a). Charges payable in a comparable cash transaction should be excluded in all cases. Some 4(c)(7) fees are payable in a comparable cash transaction:

- Title and survey fees in (c)(7)(i);
- Notary fees, relating to the purchase and sale of real estate, in (c)(7)(iii); and
- Pest infestation fees in (c)(7)(iii).

Recommendation

The regulation should be clear when 4(c)(7) fees are included or excluded. It should be clear that fees are excluded if they are payable in a comparable cash transaction.

6. Appraisal Fees

The exclusion for 4(c)(7) fees, including appraisal fees, if they are reasonable and paid to a third party should not contradict the rule requiring customary and reasonable appraisal fees, § 1026.42(f).

Recommendation

Any fee permissible under the customary and reasonable rule should be *per se* reasonable under § 1026.32(b)(1)(iii) and *per se bona fide* under § 1026.32(b)(5)(i).

7. Servicing Fees

The definition contradicts itself about whether servicing fees are included.

- Points and fees exclude compensation paid to a servicer or servicer employees, agents, and contractors.[73]
- Points and fees include 4(b) items.[74] These include "[s]ervice, transaction, activity, and carrying charges[.]"[75]
- They also include assumption fees.[76] Servicers may charge assumption fees, but not at consummation.

Servicing fees can only be guessed at closing. Consumers elect some servicing fees for convenience, such as the option to make a payment by telephone. Servicing fees depend on how long the loan is outstanding and whether the loan goes into default. Servicing fees are unrelated to loan origination.

Including, or even not clearly excluding, servicing fees would create a significant marketplace disruption.

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[73] Proposed § 1026.32(b)(2)(iii).
[74] Proposed § 1026.32(b)(1)(i).
[75] 12 C.F.R. § 1026.4(b)(2).
[76] 12 C.F.R. § 1026.4(b)(3).

Recommendation

The rule should clearly exclude all servicing fees from points and fees.

8. Mortgage Insurance Premiums

The definition would exclude certain mortgage insurance premiums if they are "[a]ssessed in connection with any Federal or State agency or program;" are "not in excess of" FHA premiums and are refundable *pro rata*; or are payable at or before consummation.[77]

The commentary explains that "not in excess of" means "only to the extent that the premium" is not in excess of FHA premiums.[78] The commentary cannot alter what the regulation means, it only can provide a defense to liability. Charging premiums in excess of FHA premiums is not illegal, so the commentary does not resolve the issue. As written, if a premium were one cent over the FHA cost, the entire premium would be included in points and fees.

Recommendation

Section 1026.32(b)(1)(i)(B) should be amended to remove the phrase "Not in excess of" and instead read "Only to the extent that the premium or charge of[.]" The regulation should also make clear whether Fannie Mae and Freddie Mac are federal agencies.

9. Other

The definition includes "[d]iscounts for the purpose of inducing payment by a means other than the use of credit."[79] This is inapplicable in a mortgage context.

Recommendation

This should not be incorporated by reference.

10. Plain English

We note that the points and fees definition in the proposed HOEPA rule is different than in the proposed ATR rule. In the ATR proposal, points and fees include "all items considered to be a finance charge under § 226.4(a) and 226.4(b) except" a list of items. In the HOEPA proposal, the term includes "all items included in the finance charge under § 1026.4(a) and (b), but excluding items described in § 1026.4(c) through (e), except to the extent otherwise included by this paragraph (b)(1)) and also excluding" a list of items. The ATR proposed language is clearer and easier to use.

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[77] Proposed § 1026.32(b)(1)(i)(B).
[78] Proposed Comment 32(b)(1)(i)-3.
[79] 12 C.F.R. § 1026.4(b)(8); proposed § 1026.32(b)(1)(i).

Recommendation

We recommend using plain English. Rather than a process of putting items in and removing them, there should simply be a list of what is included, what is excluded, and what is included conditionally.

B. Open-End Credit

1. Hazard Insurance Premiums

The definition contradicts itself on whether hazard insurance premiums are included.

- Points and fees exclude charges payable in a comparable cash transaction.[80] Hazard insurance premiums are payable in a comparable cash transaction.
- Points and fees include "[p]remiums . . . payable at or before account opening for any . . . accident . . . insurance[.]"[81] Again, as under the closed-end points and fees definition, there is no language limiting this to insurance that cancels all or part of the consumer's liability in the event of an accident.

Recommendation

The regulation should be clear that hazard insurance premiums are excluded from points and fees in all cases because they are payable in a cash transaction.

2. Loan Originator Compensation Should Be Excluded

The CFPB does not propose to include compensation to originators in points and fees for open-end credit. For the reasons discussed above, we strongly support this. We agree with the CFPB that Congress did not intend to include originator compensation.[82]

Recommendation

Employee compensation should be excluded from points and fees in all cases.

[80] Existing § 1026.4(a) excludes charges payable in a comparable cash transaction, and proposed § 1026.32(b)(3)(i) incorporates items in 4(a) by reference.
[81] Proposed § 1026.32(b)(3)(iii).
[82] 77 Fed. Reg. 49090, 49111 (August 15, 2012).

C. Both Closed- and Open-End Credit

1. Unrelated or Optional Fees

The proposal, existing § 4(a) and § 4(b), and the commentary are unclear about when fees for optional products are included in points and fees and the finance charge because they are "imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit" within § 4(a).

Some charges may be unknown to the creditor or unknown at closing, and some may be only tangentially related to the loan. Homeownership counseling is not sufficiently related to the loan because the consumer may obtain counseling but not a loan.

Recommendations

Charges should be excluded from § 4(a) if any of the following are true:

- The creditor may be unaware of the charge.
- The charge is for homeownership counseling, even if the consumer found the counselor by a list the creditor provided.
- Fees for a product the creditor cross-sells that is unrelated to the mortgage loan, such as a checking account or credit card with a periodic fee, because the consumer may have obtained those products without a mortgage loan.
- Services related to the loan, which are sold after consummation.
- Services not offered by or through the creditor. For example, the consumer may arrange with a bank that is unaffiliated with the creditor for automatic mortgage loan payments from a bank account, for a fee.

Voluntary or optional services should be included in § 4(a) only if all the following are true:

- The creditor offered the service or provided leads from the mortgage process to the third party that offers the service;
- The type of service directly relates to the loan, such as credit insurance on the loan or an automatic payment service from the creditor for the loan, rather than a service that the consumer could have used even if there had been no loan;
- The consumer contracts for the service at or before loan consummation; and
- The creditor was aware of the service and its cost before consummation.

2. Required to be Included

The points and fees definition excludes *bona fide* third-party charges not retained by the creditor, loan originator, or an affiliate of either unless the charge is "required to be included" in points and fees under proposed § 1026.32(b)(1)(i)(B).[83] Section (b)(1)(i)(B) is part of a definition and does not contain a requirement. It does not contain an inclusion, it excludes certain items only.

[83] Proposed § 1025.32(b)(5)(i).

Recommendation

We recommend revising the reference in § (b)(5)(i) to read, "except to the extent mortgage insurance premiums are included in points and fees by paragraph (b)(1)(i) of this section."

3. Bona Fide Discount Points

The proposed HOEPA rule incorporates by reference the ATR definition of *bona fide* discount point, § 1026.43(e)(3)(iv).[84] In proposing that definition, the Board explained that TILA § 129C(b)(2)(C)(iv) [as does TILA § 103(dd)(4)] mandates that "the amount of discount points paid by consumers for a particular interest rate reduction be tied to the capital markets."[85]

The policy goal is for discount points to reduce the rate on the loan. The difficulty is establishing when this occurs. To the extent creditors have difficulty understanding or applying the definition, they will not offer discount points as a way to buy down loan rates. This would harm consumers who prefer to lower their rates.

The definition would require the discount points to account for compensation the creditor can reasonably expect in the secondary market. This exceeds the Dodd-Frank Act. It is undefined and would result in litigation if a creditor were to allow discount points. Supply and demand (prices) in the secondary market are not necessarily correlated with supply and demand (prices) in the primary market.

The proposed ATR definition of *bona fide* discount point has relevant proposed commentary.[86] However, it is in proposed comment 43(e)(3)(ii)-3 and -4, rather than (e)(3)(iv), so it apparently would not apply because 43(e)(3)(ii) is not incorporated into the § 1026.32 commentary.

Recommendations

- The definition of discount points should not relate to what a creditor can reasonably expect in the secondary market.

[84] Proposed § 1026.32(b)(5)(ii)(C). The ATR definition is:
(iv) The term *bona fide discount point* means any percent of the loan amount of a covered transaction paid by the consumer that reduces the interest rate or time-price differential applicable to the covered transaction based on a calculation that—
(A) Is consistent with established industry practices for determining the amount of reduction in the interest rate or time-price differential appropriate for the amount of discount points paid by the consumer; and
(B) Accounts for the amount of compensation that the creditor can reasonably expect to receive from secondary market investors in return for the mortgage loan.

[85] 76 Fed. Reg. 27390, 27467 (May 11, 2011).

[86] 76 Fed. Reg. 27390, 27504 (May 11, 2011).

- For jumbo loans and loans on second homes, which have higher interest rates, there should be one percentage point added to the margin above APOR for excludable discount points.
- The language in Comments 43(e)(3)(ii)-3 and -4 should be repeated as Commentary to § 1026.32(b)(5)(ii).

4. Clarification of Specific Fees

We would very much appreciate clarification that the following fees would continue to be excluded from the finance charge:

- Charges related to the discharge or subordination of existing liens;
- Modification or conversion fees;
- Required property completion or repairs;
- Payoff of prior liens or debts;
- Amounts charged by a homeowners association or by a condominium or cooperative association;
- Fees of the consumer's attorney;
- Fees for services required under the purchase and sale agreement with the seller;
- Fees for recording the discharge when the loan is paid in full; and
- Fees paid after closing to evaluate collateral on a HELOC to determine whether to reinstate a suspended HELOC.

5. Credits Should Be Excluded

It is common for lenders to provide credits against specific fees, or a credit that applies against closing costs generally (such as a general marketing or promotional credit or a credit given to the consumer in exchange for a higher rate). While the proposed regulation indicates that seller-paid amounts will be excluded from the finance charge, it is not unusual for the consumer's employer to provide credits, or for a governmental agency or non-profit to provide a credit against closing costs.

Recommendation

Lender or third-party credits that reduce what the consumer pays should be excluded from points and fees.

IX. Total Loan Amount

A. Closed-End Loans

For closed-end loans, the total loan amount is not clear. The proposed rule describes it as "the amount of credit extended at consummation that the consumer is legally obligated to repay, as reflected in the loan contract, and deducting any cost that is both included in points and fees . . . and financed by the creditor."[87]

[87] Proposed § 1026.32(b)(6)(i).

One mortgage loan can involve more than one loan contract, such as note in addition to a buy-down contract between the borrower and a third party, but the regulation does not specify which contract it references.

Money is fungible, so it is not clear what costs the creditor finances. Suppose a promissory note is $100,000, the cost of the property is $125,000, the cost of the appraisal included in points and fees is $400, and the consumer brings $25,400 in cash to closing. Two scenarios that will appear the same to the consumer would result in different total loan amounts.

Loan proceeds disbursed to seller	100,000	99,600
Appraisal charge paid at closing	400	400
Buyer's payment to seller at closing outside of loan proceeds	25,000	25,400
Appraisal cost financed	0	400
Total loan amount	100,000	99,600

Recommendation

The total loan amount needs to be clarified. It should be the loan amount evidenced by the promissory note between the consumer and the creditor.

B. Optional Products

The proposed rule would include in the loan amount any charges for optional credit insurance or debt cancelation coverage if they are included in the note amount.[88] The commentary, but not the regulation, would restrict this inclusion to refinances.[89] In a purchase transaction, including charges for optional products introduces the problem that money is fungible.

The regulation would require disclosure of the optional charges "grouped together with the disclosure of the amount borrowed."[90] There are multiple disclosures of the amount borrowed, but this does not specify which it means. The meaning of "grouped together with" is unclear. The disclosure of the amount borrowed would be treated as accurate within a $100 tolerance.[91]

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88 Proposed § 1026.32(c)(5).
89 Proposed Comment 32(c)(5)-1.
90 Proposed § 1026.32(c)(5).
91 Proposed § 1026.32(c)(5).

Recommendations

- The regulation should make clear when charges for optional products are included in the loan amount.
- There should be more clarity about which disclosure of the loan amount § 1026.32(c)(5) references, and what grouped together with means.
- The $100 tolerance for the total loan amount should be adjusted annually for inflation.
- Existing § 1026.31(d)(1), which says the disclosures should reflect the terms of the legal obligation between the parties, should have added, "except as otherwise provided by this part" so it will not contradict the $100 tolerance.

X. High-Cost Mortgage Loans

A. Thresholds Calculations Should Be Similar for All Federal Purposes

As the CFPB notes, changes to threshold calculations will affect not only whether a loan is a high cost HOEPA loan, but also whether it is a non-QM loan, a "higher priced" loan subject to mandatory escrow, a "higher risk" loan subject to additional appraisal requirements, or a "higher priced" balloon loan subject to additional underwriting requirements. The rate spread reported under HMDA is also currently calculated by comparing the disclosed APR to the APOR. While the CFPB indicates that it would like to analyze the impact on a rule-by-rule basis, all of the rules are focused on what is the appropriate measurement of higher-cost loans. Requiring lenders to calculate higher costs in different ways for each different rule will cause significant operational burdens. The same basic metrics should be used for each of these rules.

Recommendation

If the CFPB adopts an all-in-APR, we agree that third party fees that would become finance charges should be excluded from points and fees, not only for the high-cost threshold, but for all federal requirements containing a points and fees test.

B. Construction Loans

We are concerned about the apparent expansion of HOEPA to cover construction financing. Neither the proposal nor the preamble is explicitly clear on whether the amended HOEPA provisions will cover construction financing, or construction-to-permanent financing. The existing rules provide an exception to the balloon payment prohibition for a bridge loan with a maturity of less than one year.[92] Under existing law, such bridge loans must be in connection with the acquisition or construction of a dwelling that is intended to become the consumer's principal dwelling. We note that in the proposal, the CFPB would delete this exemption, including that portion stating that "loans with maturities of less than one year, if the purpose of the loan is a 'bridge' loan

[92] 12 C.F.R. § 1026.32(d)(1)(ii).

connected with the acquisition or construction of a dwelling intended to become the consumer's principal dwelling."

We believe the current exemption is very beneficial to consumers and does not undercut consumer protection. In fact, we fear that subjecting construction-to-permanent financing to the new HOEPA provisions will disrupt creditors' ability to finance new home construction projects. In typical instances of home construction financing, the initial construction loan (that is later refinanced into a permanent 30-year loan) is structured as a balloon note, or a very short-term, but higher interest rate loan, because of the unique risks and costs of financing new construction. Either option would now be restricted. The higher interest rates needed for such temporary financing are high enough to trigger HOEPA thresholds, and do not have comparable APOR indices to allow for proper comparisons.

Construction lending was never a segment that was ripe with abuse. Removing the exemption would greatly disrupt the construction loan industry, while limiting consumers' ability to finance and build homes.

<u>Recommendation</u>

The CFPB should retain the exemption in § 1026.32(d)(1)(ii).

C. Personal Property

The CFPB seeks comment on the separate percentage point trigger for first-lien transactions that are secured by a dwelling that is personal property and for which the total loan amount is less than $50,000.[93] Application of the HOEPA rule to personal property that is not designed to be a dwelling would be unnecessary and disruptive because it could impact the financing of recreational vehicles and boats. Financing personal property is a separate line of business than mortgage lending, with different risks and, therefore, different pricing. Vendors that finance purchases of recreational vehicles and boats may not have the capacity to comply with HOEPA. HOEPA is designed to combat predatory mortgage lending, and should not cap rates and fees on boat and vehicle financing.

<u>Recommendation</u>

The CFPB should make clear that the HOEPA restrictions do not apply to personal property such as recreational vehicles or boats, even if they are principal dwellings.

D. The Proposal Would Interfere with Existing Contracts

Creditors have the constitutional right to enforce their contracts. A regulation cannot interfere with existing, valid contracts, yet this proposed rule would do so in several respects, as discussed below. *See, e.g.,* the GSEs' Uniform Security Instruments. These

[93] 77 Fed. Reg. 49090, 49100 (August 15, 2012).

instruments are in common usage nationwide, even on non-GSE loans, and set out the contractual rights in the event of payment default and nonpayment default. The GSEs developed the Uniform Security Instruments after a substantial effort to balance the needs of consumers with the safety and soundness needs of investors. The instruments have created more liquidity in the secondary market by providing investors with certainty about loan terms. The CFPB's regulations need to be entirely consistent with these instruments.

1. Acceleration of Debt

The CFPB proposes to implement the statutory limitations on accelerating high-cost loans. The Dodd-Frank Act permits acceleration in three circumstances:

- Payment default;
- Pursuant to a due-on-sale provision; and
- In case of material violation of the loan agreement unrelated to the payment schedule.[94]

The CFPB proposes to prohibit acceleration in the event of a payment default "in error[.]" This would permit consumers to mail a payment, or all payments, to the wrong location then prohibit the creditor from accelerating the loan. The CFPB gives the example of a consumer who sends a payment to "a branch rather than the main office of the creditor."[95] However, the comment is not limited to cases of legitimate error. It would enable a consumer to mail all payments to a party unrelated or unknown to the creditor, claim error, and prevent acceleration.

The Dodd-Frank Act gives creditors a statutory right to accelerate high-cost loans in the event of "default in payment[.]" A default in payment is defined by the loan agreement. When a consumer fails to make payments when and as required, that is a "default in payment" for which creditors are statutorily permitted to protect themselves, regardless of whether the consumer made an error. The loan agreement also gives creditors the right to treat a payment mailed to the wrong location, in error or otherwise, as a default.

<u>Recommendation</u>

Regulation Z should be consistent with the Uniform Security Instruments and other loan contracts, and with the Dodd-Frank Act. Creditors should be permitted to accelerate loans as provided by their contracts.

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[94] TILA § 129(l).

[95] Proposed Comment 32(d)(8)(i).

2. *Material Violation*

The CFPB proposes to permit acceleration if the consumer materially violates a loan term unrelated to the payment schedule.[96] The commentary gives examples, including failure to pay taxes or "permit[ting] the filing of" a senior lien.[97]

Recommendations

We suggest several ways to make this consistent with the Uniform Security Instrument, which requires the borrower to "promptly discharge" prior liens regardless of the borrower's intent or whether the borrower permits the lien.

- The examples should include failure to pay condominium or homeowner association dues or assessments, including special assessments, when and as due. This should be regardless of the filing of a lien because several states permit, and other states are pursuing legislation that would permit, such unpaid costs to result in a lien prior to a first mortgage lien, even if the mortgage predated the newer lien.
- The examples should include failure to pay utilities or other costs that can result in a lien prior to the creditor's lien.
- The failure to pay when and as required, not the filing of a lien, needs to be the operative event because by the time a prior lien is filed, the creditor has been materially harmed.
- The examples should include failure to maintain or repair the property as required by the loan agreement or security instrument. For example, if the property is damaged by fire, the Uniform Security Instrument generally requires the hazard insurance proceeds to be used to repair the property.
- The proposed language in comment 32(d)(8)(iii)-2.i.C allows acceleration if the consumer "permits" the filing of a senior lien. The word "permits" should be removed. It is the possibility of a lien that harms the creditor, not the consumer's intent or belief or other action.

3. *The Death of an Obligor Should Not Always Prevent Acceleration*

The CFPB proposes to delete Comment 32(d)(8)(iii)-2.i.E and an example in Comment 32(d)(8)(iii)-2.ii about permissible acceleration if the sole consumer obligated on the credit dies. It does not provide an explanation. Existing law prohibits enforcement of due-on-sale clauses in many events.[98] These include a transfer of the property to a relative resulting from the consumer's death. Therefore, the purpose of the proposal is not clear. To the extent not otherwise prohibited by law, creditors have a contractual right to accelerate loans in the event of default. If a consumer dies and the consumer's estate or family permit default, the creditor can accelerate. A servicer may be under a contractual obligation to do so.

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[96] Proposed § 1026.32(d)(8).
[97] Proposed Comment 32(d)(8)(iii)-2.i.
[98] 12 U.S.C. § 1701j-3(d).

Recommendation

We recommend retaining Comment 32(d)(8)(iii)-2.i.E and the example in Comment 32(d)(8)(iii)-2.ii the example of permissible acceleration if the sole consumer obligated on the credit dies.

4. Eminent Domain

The CFPB proposes to remove the example of a property taken by eminent domain.[99] This is inappropriate. In this event, the creditor may have a contractual right to some portion of the government payment for the property. Failure of the borrower to pay the proceeds owed is a default for which creditors may have a contractual right to take action. The Uniform Security Instrument provides "In the event of a total taking, destruction, or loss in value of the Property, the Miscellaneous Proceeds shall be applied to the sums secured by this Security Instrument, whether or not then due, with the excess, if any, paid to Borrower."

Recommendation

We recommend retaining Comment 32(d)(8)(iii)-2.i.F.

XI. Housing Counselors Disclosure

A. Content

The proposal would require disclosure of five housing counselors in the consumer's zip code, or in the "closest" zip code. Closest zip code is not defined. The proposed rule would not require disclosure of a counselor's name, address, and phone number in all cases, and the email address and website only if available from the CFPB or HUD.[100]

We strongly support the fact that the CFPB is expecting to maintain a database of counselors searchable by zip code that lenders could use.[101]

Recommendations

We suggest the CFPB go further:
- Make the database available to the public, not just lenders. This would let consumers readily receive the information at any time, not just when applying for a loan. It would also prevent creating a problem where certain counselors are identified to consumers frequently and others less often or not at all.
- The creditor should be able to comply by notifying the consumer of the website and a HUD toll-free number where the consumer can get the information.

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[99] Proposed Comment 32(d)(8)(iii)-2.i.F.
[100] Proposed § 1024.20(a)(3)(i).
[101] 77 Fed. Reg. 49090, 49098 (August 15, 2012).

- The proposal seems to assume that creditors' and brokers' systems can access the CFPB's website on a loan-by-loan basis. This is operationally difficult. The CFPB should make the information available in a table format that creditors and brokers can download so their systems can access the downloaded information, instead of the website. The information will not change extensively or frequently so that monthly updates to the downloaded information should be sufficient.
- When a person enters a zip code for which there are not 5 counselors, the database should select the "closest" zip codes.
- Disclosing what the CFPB database produces should be *per se* compliance with the required content of the disclosure.
- If a counselors' address or phone number is not available on the CFPB's or HUD's website, its disclosure should not be required.
- HUD's website shows Alaska only has three counselors, and the Virgin Islands only one. Counselors from a different state should not be required to be disclosed.

B. Timing

Lenders would need to deliver the "most current" information available on the CFPB's or HUD's website.[102] We appreciate that the proposal would permit the flexibility of delivering the list, on HELOCs, under either § 1024.20(b) or § 1026.40(b).[103]

***Recommendation*s**

- Most current should be any time during the month before the disclosure is prepared.
- Regardless of whether the CFPB requires the list at the same time as the Loan Estimate, a list of counselors should only need to be disclosed once per loan, even if a Loan Estimate is revised.[104]
- The CFPB should retain the proposal to permit the flexibility of delivering the list, on HELOCs, under either § 1024.20(b) or § 1026.40(b).

C. Other

The rule would both refer to the list of counseling information as a "written list"[105] and permit electronic delivery under the E-Sign Act.[106]

If a mortgage loan "involves" more than one lender, the proposed rule would require only one to provide the list of counseling information.[107] Operationally, it may be easier for more than one lender to deliver a list. One lender may not know there is another lender involved, or the two may not agree on who is responsible for sending the list.

[102] Proposed § 1024.20(a)(2).
[103] Proposed § 1024.20(b).
[104] 77 Fed. Reg. 49090, 49099 (August 15, 2012).
[105] Proposed § 1024(a)(1).
[106] Proposed § 1024.24(a)(6).
[107] Proposed § 1024.20(a)(8).

Recommendations

- It should be permissible for multiple lenders to provide a list.
- Section § 1024.20(a)(1) should not refer to the list as a "written" list so as not to interfere with § 1024.20(a)(6).