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August 4, 2006

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

Re: Docket No. OP - 1253
Comments on disclosures for nontraditional mortgage products

Dear Ms. Johnson:

Countrywide Financial Corporation, on behalf of its subsidiaries Countrywide Home Loans, Inc. and Countrywide Bank, N.A. ("Countrywide") is pleased to offer written comments to the Board of Governors of the Federal Reserve System ("Board") in connection with the public hearings held by the Board on the home equity lending market.[1] Our comments are limited to the issues addressed in Topic 2 of the Notice pertaining to disclosures, specifically those posed regarding interest-only and payment-option adjustable rate mortgages.[2] As we stated in our comments to the proposed Interagency Guidance on Nontraditional Mortgage Products, if the Board believes that additional disclosures are warranted for these products, then we believe that all creditors, as defined by Regulation Z, should be subject to the same clear and precise disclosure requirements.[3] The existing Regulation Z disclosure framework relating to adjustable rate mortgages ("ARMs") provides the ideal mechanism through which additional disclosures can be fashioned to address the concerns underlying the related Topic 2 questions, as well as those expressed by the federal banking agencies in the Guidance. Our comments today provide more detailed and substantive recommendations for addressing these concerns.

I. Amending Regulation Z will standardize coverage, consistency and timing of disclosures and thereby benefit consumers.

Countrywide agrees that additional information specific to the product features of interest-only and payment-option adjustable rate mortgages would be helpful to consumers. We believe, and urge the Board to conclude, that what Regulation Z and the Official Staff Commentary already

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[1] 71 Fed. Reg. 26513 (May 5, 2006) ("Notice").
[2] Id. at 26514.
[3] 70 Fed. Reg. 77249 (December 29, 2005) ("Guidance"). 12 C.F.R. Part 226 ("Regulation Z" or "Regulation").

provide can be effectively amended to ensure meaningful information is given to consumers during both the shopping phase, as well as during the life of the loan.

Such an approach is consistent with prior Board actions concerning adjustable rate mortgages ("ARMs"). When amendments to Regulation Z related to ARM disclosures were first proposed over 20 years ago, the Board expressed its concern that the existing regulatory structure

> with Regulation Z mandating brief variable rate information and several other regulations calling for more extensive disclosure, may not be fully responding to the needs of . . . consumers . . .. ARMs have become more prevalent and the variety of ARM products must [sic] more extensive. This, combined with the potential of ARMs for significant unexpected payment changes, *raises questions about the ability of consumers to understand and make informed decisions about ARMs before entering into those transactions.*[4]

The Board responded by enacting amendments to Regulation Z that require creditors to provide better information about the features of closed-end ARMs. In connection with the 2006 HOEPA hearings and proposed Guidance, the Board has expressed precisely the same concerns about the evolution of mortgage products and the increased complexity of loan programs. Now, as then, the best approach to address those concerns is to amend Regulation Z.

First, amending Regulation Z affords the broadest possible coverage and ensures that all creditors are required to provide consumers useful information even if a lender is not regulated by a federal banking agency. Changes made through agency guidance, on the other hand, will not impose obligations on some creditors and the information deemed important by the Board in connection with these transactions will not be provided to all consumers. This also means an inequitable compliance burden for those lenders subject to the guidance versus those not subject.

Second, amending Regulation Z would establish clear and consistent disclosure requirements for all creditors. The Board noted in 1987 that a "regulatory structure . . . which requires different disclosures by different lenders delivered at different times, is causing problems for both consumers and mortgage lenders."[5] At that time, the individual federal banking agencies had adopted their own regulations to address concerns about the proper disclosure of information relating to ARMs. Because of the confusing array of different disclosures and product limitations, the Board, upon the recommendation of the Federal Financial Institutions Examination Council, implemented revisions to Regulation Z that standardized the timing and format of disclosures given in connection with these products. The concerns expressed by the

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[4] 50 Fed. Reg. 20221, 20222 (May 15, 1985)(emphasis added).

[5] 52 Fed. Reg. 48665 (December 24, 1987)(emphasis added). See also Memorandum "Disclosures for Adjustable Rate Mortgages Under Regulation Z", from Division of Consumer and Community Affairs to Board of Governors, dated December 16, 1987, at p. 7 ("consumers receive different information about ARMs at different times depending on the type of lender they approach. . . . nonuniformity in federal disclosure requirements inhibits the ability of consumers to compare various ARM products.)

Board in 1987 seem equally applicable now if the different banking agencies use the final guidance as a first step in implementation of requirements for their regulated institutions.[6] Amending Regulation Z would eliminate these perils and would ensure a level playing field in which all creditors would be subject to the same clear, precise disclosure requirements and the same types of risks for failure to comply.

Finally, we agree with the Board that the timing of providing disclosures is vital to their usefulness to consumers and we believe the existing timing requirements contained in Regulation Z are a useful paradigm. While the Notice identifies that the timing of disclosures may be important to aiding consumers' understanding of key credit terms and costs, neither the Notice, nor the testimony at the Home Equity hearings surfaced a clear direction as to when and how such disclosures should be made. Similarly, the proposed Guidance states:

> Institutions should provide consumers with information at a time that will help consumers make product selection and payment decisions. For example, institutions should offer full and fair product descriptions when a consumer is shopping for a mortgage, not just upon the submission of an application or at consummation.[7]

This level of generality, while perhaps understandable in concept, is not helpful in practice. Instead, we would encourage the Board to leave unchanged the existing timing requirements for ARM disclosures under section 226.19(b) which take a clearer, more specific approach requiring delivery of the program disclosures "*at the time an application form is provided* or before the consumer pays a nonrefundable fee, whichever is earlier."[8]

The timing embodied in Regulation Z also appropriately takes into account certain realities that general statements cannot. The Regulation and Commentary address situations where applications are received through intermediary agents or brokers, by telephone or electronically. The regulatory framework already exists to insure additional information about these products is received by consumers as early as possible. As delivering disclosures to specific consumers any

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[6] While Board guidance appears to offer consistency as to federally regulated institutions, the inapplicability of such guidance to state-regulated institutions leaves the same problems in place. Likewise, the prospect ofhaving federal guidance and a patchwork of different guidance from different states for stateregulated institutions offers no solution. See the June 7, 2006 proposal of the Conference of State Banking Supervisors and the American Association of Residential Mortgage Regulators to issue modified guidance based on the proposed federal Guidance that states may choose to adopt, presumably in whole or in part, and will choose to interpret and enforce as each deems appropriate.

[7] 70 Fed. Reg. 77249, 77256.

[8] 12 C.F.R. § 226.19(b) (emphasis added). We do note, however, that technology has significantly streamlined the loan process making it possible for borrowers to apply for loans electronically, including paying a fee for services related to that application before they have an opportunity to review all possible loan options. Borrowers today choose from a myriad of ARM products making immediate meaningful disclosure difficult. We would encourage the Board to consider that so long as useful information is provided early in the process, it should be sufficient to alert the consumer at time of application to carefully review the terms of the ARM disclosure for the particular products they are considering.

earlier than is now required does not seem practicable, the Board should preserve the existing timing rules in Regulation Z.

II. Amending Regulation Z reduces the likely multiplicity of lawsuits that would ensue from the issuance of general guidance.

In weighing the merits of various approaches, the Board should consider the likely effects of pursuing a course that does not involve the rigors of rulemaking. The proposed Guidance, as one such approach, sets forth standards that, while commendable, are vague and subject to varying interpretations and implementation. For example, it recommends that institutions "highlight key information so that it will be noticed" or "provide clear and comparably prominent information [relating to lower initial payments]."[9] It is highly likely that institutions subject to such direction will find themselves defending against myriad lawsuits brought under the various mini-FTC acts at the state level to litigate questions such as what constitutes adequate "highlighting" of information or what constitutes "clear and comparably prominent information."[10] These lawsuits would be based on allegations that a lender failed to meet the standards set forth in the Guidance, and, therefore, has committed an unfair and deceptive act or practice under state law.

We urge the Board to develop, in consultation with the other federal banking agencies, specific disclosure requirements pursuant to its authority under section 105 of the Truth in Lending Act. Implementation of clear and certain disclosure requirements will insure that institutions are not subjected to a multiplicity of lawsuits that would most certainly ensue if vague or uncertain requirements are merely suggested through guidance. While the federal banking agencies guidance may not have the force of law, it will certainly set a standard by which institutions will be judged and held accountable. We would certainly expect that the federal banking agencies "will seek to consistently implement the guidance."[11] There is no guarantee, however that the enforcement by private litigants or state regulators will be similarly consistent.

III. Summary of Suggested Regulation Z and Commentary Changes.

Our proposed revisions to Regulation Z and the Official Staff Commentary are straightforward and uncomplicated. As you will see in Exhibit A to this letter, they address the questions raised in Topic 2 of the Notice regarding interest-only and pay option ARMs and, in our estimation, the majority of the concerns previously expressed in the proposed Guidance. For ease, we have summarized the recommended amendments as follows:

Suggested Regulation Z Amendments. Countrywide agrees with the suggestion that monthly statements given to consumers on payment option loans should provide information that enables consumers to make responsible payment choices, including information about the consequences

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[9] 70 Fed. Reg. 77249, 77256 (Dec. 29, 2005)

[10] The situation is reminiscent of when there was an effort to define the standard for "clear and conspicuous disclosures" for various federal regulations. There, the Board ultimately withdrew the proposed revision partly in response to industry concerns about litigation risks as a result of "vague standards subject to differing interpretations."69 Fed. Reg. 35541, 35542 (2004).

[11] 70 Fed. Reg. at 77251.

of selecting various payment options on the principal balance. Section 226.20(c) currently requires creditors to notify the consumer of interest rate and payment changes. Most, if not all, mortgage lenders currently provide monthly statements to consumers. We have proposed language for a new subsection (d) to Section 226.20 that would require the inclusion of the additional information recommended in the Guidance on monthly billing statements.

Further, we believe it is in the best interests of both the consumer and the lender to notify consumers when their recurring payment option election result in negative amortization and the unpaid principal balance exceeds the original unpaid balance by a certain amount. When a Countrywide customer's election of the minimum payment results in the amount of negative amortization reaching 102% of the original unpaid balance of their loan, we provide a notice to the customer. The notice states that based on their current payment trends and potential future interest rate changes, the monthly payment that the consumer will be required to pay in the future may increase significantly and the increase in the unpaid balance may result in a decrease in the equity in their home. We have suggested a new subsection (e) to Section 226.20 to address such a disclosure.

Suggested Commentary Revisions. More clarity is needed with respect to the basis on which Truth in Lending ("TIL") disclosures are prepared pursuant to Section 226.17. Section 226.17(c)(1) states that the disclosures shall reflect the terms of the legal obligation between the parties. The Commentary to 226.17(c) provides guidance with respect to particular assumptions the lender should make in preparing the disclosures under certain circumstances and in connection with certain loan programs. Under the terms of a payment option loan, the borrower is legally obligated to make a minimum payment that may result in negative amortization; other payment options also are given to the borrower, but are not required. We recommend that the Commentary to 226.17(c) include guidance instructing lenders to prepare TIL disclosures for payment option loans based on the contractually required payment, as in this case the minimum payment.

Section 226.19(b)(2)(vii) requires the disclosure of an explanation of negative amortization. The Commentary on that section provides an example of a disclosure on the effect negative amortization has on the loan amount. *See* Comment (2)(vii)-2. Consistent with a prior proposal in the Guidance, Countrywide recommends an amendment to this Comment requiring creditors to alert consumers to the potential consequences of negative amortization.

Advertisements containing certain trigger terms also must contain the disclosures in Section 226.24(c)(2), including the repayment terms, and the Commentary provides creditors with flexibility in making this disclosure for advertising purposes. Existing regulatory guidance, however, does not clearly address payment option loan advertising disclosure requirements. When disclosing the repayment terms of a payment option loan, creditors should be directed to take into consideration the terms of the legal obligation and to make certain assumptions. To parallel the recommendation regarding Section 226.17(c)(1) above, disclosure of the payment amount should be based on an assumption that the borrower makes only the contractually required payments, which may result in negative amortization. To illustrate the potential

payment shock and negative amortization, creditors should disclose the amounts of the largest and smallest payments, and if negative amortization may occur, that fact should also be stated.

IV. Conclusion

The best vehicle for providing consumers with additional information regarding interest-only and pay option adjustable rate mortgages already exists in Regulation Z. Amending the Regulation to better describe the features of these products is the preferable course of action to ensure the proper coverage, consistency and timing of disclosures by all creditors. Moreover, Countrywide is convinced that the resulting specificity and level playing field for different types of creditors will more fully respond to the needs of consumers and enhance their ability to understand and make informed borrowing decisions. For these reasons, we urge the Board to adopt amendments to Regulation Z in lieu of adopting the proposed Guidance related to "Communications with Consumers."

Sincerely,

Mary Jane M. Seebach

Mary Jane M. Seebach
Managing Director, Public Affairs
Countrywide Financial Corporation

Enclosures

EXHIBIT A

SUGGESTED REGULATION Z REVISIONS

SECTION 226.19 --- Certain residential mortgage and variable-rate transactions

. . .

(b) *Certain variable-rate transactions.*
(1) . . .
(2) . . .

(xi) The ***timing of delivery and*** type of information that will be provided in ***monthly billing statements and*** notices of adjustments.

SECTION 226.20 --- Subsequent Disclosure Requirements

. . . .

(d) Monthly Billing Statement. In transactions where the required minimum payment may result in negative amortization, the creditor must provide the borrower with a monthly billing statement not less than 15 days before the next payment due date that discloses the following items to the extent applicable:

(1) The current loan balance;
(2) How the consumer's previous payment was allocated to principal and to interest;
(3) If the previous loan balance increased as a result of negative amortization, the amount of the increase;
(4) Each payment option available under the terms of the loan and an explanation of the terms each option; and
(5) The effect that selection of each payment option may have on the principal balance owed.

(e) Notice of Negative Amortization.

(1) If the principal amount of a loan increases due to negative amortization to an amount in excess of 102% of the original principal amount of the loan, the creditor must provide the borrower with a notice that contains the following information:

(i) the amount of the principal balance at the time of the notice;
(ii) the current interest rate;
(iii) the remaining term of the loan;
(iv) the current minimum monthly payment;
(v) the amount of the Full Payment;

(vi) the difference between the current minimum monthly payment and the amount of the Full Payment;

(vii) the fact that, based on current payment trends and possible future interest rate changes, the monthly payment that the consumer may be required to pay may increase significantly; and,

(viii) the fact that an increase in the unpaid balance my result in a decrease in the consumer's equity in the home.

(2) For the purposes of this section "Full Payment" means, the amount of the monthly payment that would be sufficient to repay the unpaid principal on the maturity date in substantially equal installments at the interest rate established in the note.

SECTION 226.24 -- Advertising

(c) *Advertisement of terms that require additional disclosures.*

. . . .

(iv) If negative amortization can occur under the terms of the loan, that fact.

SUGGESTED COMMENTARY REVISIONS

2(a)(2) Advertisement

1. Coverage.

. . .

ii. The term does *not* include:

. . .

E. Market research or educational materials, ***including booklets, pamphlets or brochures required under this regulation or provided by the creditor on a voluntary basis to explain, describe or compare features of loan products.***

Paragraph 17(c)(1)

[new] 19. Payment option loans. If the terms of the loan provide the borrower with payment options, the disclosures shall be prepared based on the assumption that the borrower makes only the required payment. In making the disclosures, the creditor shall consider all other loan terms, including periodic payment caps, interest rate caps, maximum negative amortization amount, and required recasting (reamortization) of

the loan. (See the commentary to section 226.17(c) for a discussion of variable rate, discount and premium transactions and the commentary to section 226.19(a)(2) for a discussion of rediscloSure in certain residential mortgage transactions with a variable-rate feature.)

Paragraph 19(b)(1)

. . . .

[new] 3. Educational Booklets, Pamphlets, Brochures. Creditors have the flexibility of providing consumers with educational booklets, pamphlets or brochures about the costs, terms, features, benefits and risks of mortgage products. Such materials should include information relating to, for example, payment shock, negative amortization, prepayment penalties, costs of reduced documentation loans. (See comment 2(a)(2)-1.ii regarding the exception from the definition of "advertising" for such materials.)

Paragraph 19(b)(2)(vii)

. . . .

2. *Negative amortization and interest rate carryover.* A creditor must disclose, where applicable, the possibility of negative amortization ***under the terms of the loan and the potential consequences of increasing principal balances and decreasing home equity.*** For example, the disclosure might state, "If any of your payments is not sufficient to cover the interest due, the difference will be added to your loan amount. ***Negative amortization increases your loan balance, reduces the amount of equity you have in your home, and increases the amount of the monthly payment that will be needed to pay off your loan.***" Loans that provide for more than one way to trigger negative amortization are separate variable-rate programs requiring separate disclosures. (See the commentary to §226.19(b)(2) for a discussion on the definition of a variable-rate loan program and the format for disclosure.) If a consumer is given the option to cap monthly payments that may result in negative amortization, the creditor must fully disclose the rules relating to the option, including the effects of exercising the option (such as negative amortization will occur, the principal loan balance will increase, ***monthly payments may increase upon recasting of the loan and the consumer's equity in the home may decrease***); however, the disclosure in §226.19(b)(2)(viii) need not be provided.

Paragraph 19(b)(2)(viii)(B)

. . . .

1. *Initial and maximum interest rates and payments.* The disclosure form must state the initial and maximum interest rates and payments for a $10,000 loan originated at an initial interest rate (index value plus margin adjusted by the amount of any discount or premium) in effect as of an identified month and year for the loan program disclosure. (See comment 19(b)(2)–5 on revisions to the loan program disclosure.) In calculating the maximum payment under this paragraph, a creditor should assume that the interest rate increases as rapidly as possible under the loan program, and the maximum payment

disclosed should reflect the amortization, ***or potential negative amortization,*** of the loan during this period. Thus, in a loan with 2 percentage point annual (and 5 percentage point overall) interest rate limitations or "caps," the maximum interest rate would be 5 percentage points higher than the initial interest rate disclosed. Moreover, the loan would not reach the maximum interest rate until the fourth year because of the 2 percentage point annual rate limitations, and the maximum payment disclosed would reflect the amortization of the loan during this period. If the loan program includes a discounted or premium initial interest rate, the initial interest rate should be adjusted by the amount of the discount or premium. ***If the loan program is a payment option ARM and provides for a required minimum payment, the creditor should assume that only the required payment is made. Other features of the payment option ARM program also should be reflected in the disclosure, such as payment caps or periodic recasting of the loan.***

Paragraph 20(c)(5)

1. Fully-amortizing payment. This paragraph requires a disclosure only when negative amortization occurs ***either*** as a result of the adjustment ***or because the required payment amount is insufficient to pay the amount of accrued interest.*** A disclosure is not required simply because a loan calls for non-amortizing or partially amortizing payments. For example, in a transaction with a five-year term and payments based on a longer amortization schedule, and where the final payment will equal the periodic payment plus the remaining unpaid balance, the creditor would not have to disclose the payment necessary to fully amortize the loan in the remainder of the five-year term. A disclosure is required, however, if the payment disclosed under §226.20(c)(4) is not sufficient to prevent negative amortization in the loan. The adjustment notice must state the payment required to prevent negative amortization. (This paragraph does not apply if the payment disclosed in §226.20(c)(4) is sufficient to prevent negative amortization in the loan but the final payment will be a different amount due to rounding.) ***If the loan is a payment option loan, the creditor shall substitute the disclosures required by this paragraph with the disclosures required by paragraph (d) of this section.***

[new]Paragraph 20(d)

1. Timing of monthly billing statement. Where the required monthly payment amount may result in negative amortization, the creditor (or a subsequent holder) must provide a monthly billing statement that contains the disclosures set forth in this section, as applicable.

2. Allocation of previous payment. The requirements under this paragraph are satisfied by disclosing the amount of the previous payment received by the creditor, the amount of the payment allocated to interest, and any amount applied to reduce the principal amount owed.

3. Amount by which principal balance increased. If the loan balance increased as a result of negative amortization, the creditor must disclose the amount by which the loan balance increased.

4. Each payment option available. If payment options are available under the terms of the loan program, this section requires disclosure of each payment option available and an explanation of the terms of each option.

Paragraph 24(c)(2)-2

. . . .

- *In an advertisement for a payment option ARM, a creditor must assume that the borrower makes only the required minimum payment and disclose the largest and smallest payments, taking into account all loan terms, including periodic payment caps, interest rate caps, maximum negative amortization amount, and required recasting (reamortization) of the loan.*