FannieMae

3900 Wisconsin Avenue, NW
Washington, DC 20016-2892
202 752 7000

By Electronic Mail: reg.comments@federalreserve.gov

December 23, 2010

Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, NW
Washington DC 20551
Attn: Jennifer J. Johnson, Secretary

Re: Comments on Proposed Rule, Docket No. R-1390 (Regulation Z; Truth in Lending)

Ladies and Gentlemen:

Fannie Mae is pleased to submit these comments regarding the Board of Governors' proposed rule to amend Regulation Z, which implements the Truth in Lending Act ("TILA"). *See* 75 Fed. Reg. 58539 (Sept. 24, 2010) ("Proposed Rule"). Our comments address the Board's proposed changes to the following sections: §226.20(a), regarding the rules for determining when a mortgage loan modification is a new transaction requiring new disclosures; §226.23, regarding a consumer's extended right of rescission; and §226.35, regarding the classification of loans as "higher-priced mortgage loans."

I. Modifications – §226.20(a)

Under Regulation Z as currently in effect, a modification to the terms of an existing legal obligation between a consumer and the original creditor does not require new disclosures *unless* the note is "satisfied and replaced" by a new note. 12 C.F.R. §226.20(a). Whether satisfaction and replacement has occurred is a matter of state law. As a practical matter, most modifications of existing obligations do not involve a satisfaction and replacement and so do not trigger disclosure obligations under TILA.

The Board now proposes to abandon the satisfaction and replacement rule and require new disclosures if certain types of changes are made to an existing legal obligation secured by real property or a dwelling. The Proposed Rule provides an exception for modifications made "[i]n connection with the consumer's default or delinquency, unless there is an increase in the loan amount or interest rate, or a fee is imposed on the consumer in connection with the modification." Proposed Rule, §226.20(a)(1)(ii)(A).

Fannie Mae agrees that modifications of delinquent loans should not be impeded by additional disclosure requirements. However, the exception provided in the Proposed Rule requires clarification. Without additional specificity regarding increases in loan amount or an exception for certain fees and costs imposed on the consumer, new disclosures would apply to a significant number of modifications of delinquent mortgage loans, adding another layer of complexity and delay to an already cumbersome and lengthy process.

In addition, since most TILA disclosures are traditionally provided as an origination function, Fannie Mae believes that many servicers currently lack the infrastructure and expertise to provide them. For example, most modifications, including those under the Home Affordable Modification Program, involve step rate features which are widely considered among the most difficult features to accurately disclose under TILA. Absent the clarifications and an exception for fees and costs proposed below, Fannie Mae is very concerned that the combined lack of servicer expertise, together with difficult disclosures, may result in delayed modifications and possible errors. Fannie Mae therefore proposes the following changes to §226.20(a).

A. Fees Owing Under The Original Loan Documents Should Not Trigger New Disclosures

The Proposed Rule provides that modifications made in connection with a consumer's default or delinquency will not trigger new disclosures unless there is "an increase in the loan amount" or "a fee is imposed on the consumer in connection with the modification." Proposed Rule, §226.20(a)(1)(ii)(B). However, there are certain default-related fees and costs that a consumer is contractually required to pay to the servicer in connection with the consumer's default under the original loan documents. Such fees and costs include:

- Foreclosure attorney fees and expenses charged prior to modification;
- Servicing advances actually paid out-of-pocket for taxes, insurance (*e.g.*, hazard, flood, mortgage insurance), leasehold payments, home owner association/planned unit development fees and other expenses authorized by the mortgage documents that are incurred to protect the property and/or preserve the priority of the lien securing repayment of the note; and
- Fees for property inspections conducted in connection with delinquent loans.

In some cases, the servicer may condition a loan modification on the consumer's payment of some or all of these accrued fees and costs, or on the inclusion of some or all of these fees and costs in the new loan amount. Because the consumer is required to pay these accrued fees and costs under the original contract, irrespective of the modification, payment of such fees and costs should not be considered "in connection with the modification," and inclusion of some or all of such fees and costs into the new loan amount should not be considered "an increase in the loan amount."

In its current definition of a refinancing, the Board already treats similar fees in connection with a defaulted mortgage as part of the original debt. *See* §226.20(a)(4). Earned finance charges and insurance premiums may be capitalized as part of a loan modification or restructuring without causing the "new amount financed" to exceed "the unpaid balance [of the existing loan] plus earned finance charge..." Staff commentary states that a "workout agreement is not a refinancing unless the annual percentage rate is increased or additional credit is advanced beyond amounts already accrued..." Comment §226.20(a)(4)-1. It would be appropriate for the Board to apply a consistent standard to modifications governed by §226.20(a)(1)(ii)(B).

B. Certain Third-Party Costs And *De Minimis* Processing Fees Should Not Trigger New Disclosures

The Board requested comment on whether payment by the consumer of some third-party costs and *de minimis* processing fees should be allowed without triggering new disclosures. Currently, the Board excludes from the calculation of the finance charge certain real estate related fees, if bona fide and reasonable in amount. 12 C.F.R. §226.4(c)(7). Similarly, Fannie Mae believes that reasonable and bona fide third-party costs for modifications of delinquent loans should not trigger new disclosures as long as the servicer is only passing through costs and not marking up the charges or otherwise earning income from them. Such costs include:

- Credit reports;
- Fees related to property valuation (*e.g.*, broker price opinions and appraisals);
- Title costs in states where endorsement title policies are required to protect the lien of the modified loan;
- Overnight express mail/courier service costs;
- Notary fees; and
- Recordation costs, when recordation is necessary to preserve the priority of the lien being modified.

In addition to such third-party costs, servicers generally charge consumers a fee for processing their loan modification. Fannie Mae respectfully requests the Board to establish a *de minimis* servicer fee for processing the loan modification which would not trigger the requirement to provide new disclosures.

In light of the fragility of the housing market, Fannie Mae is currently paying both the third-party costs and the servicer processing fees associated with modifications of defaulted mortgage loans that it owns. However, these costs and fees were historically paid by the consumer, and they may be borne by the consumer again in the future. As the total amount of these costs and fees typically represent a very small fraction of the overall cost of the transaction, there would be no practical benefit to the consumer in delaying the modification in order to receive a new set of disclosures for these costs and fees.

Furthermore, delinquent consumers should have the option of financing these costs and fees without triggering the disclosure requirement. Otherwise, consumers could be required to pay such costs and fees in cash, creating yet another barrier to completion of a modification.

C. The Final Rule Should Preserve The Current Definition Of "Creditor" And Specify That Servicers Of Delinquent Loans Are Obligated To Provide Disclosures, If Required

The Proposed Rule adds new language stating that disclosures are required for a mortgage modification where the "same creditor" and the "same consumer" modify the mortgage and implement certain specific changes to the obligation. The Proposed Rule defines "same creditor" as the "current holder, or servicer acting on behalf of the current holder, of an existing legal obligation." Proposed Rule §226.20(a)(1)(iii). This change, however, would expand potential liability for current holders of loans and unnecessarily complicate the definition of "creditor."

Under TILA, the term "creditor" refers "only to a person who both (1) regularly extends...consumer credit...and (2) is the person to whom the debt arising from the consumer credit transaction is initially payable on the face of the evidence of the indebtedness..." 15 U.S.C. §1602(f). "Credit" under the statute is "the right granted by a creditor to a debtor to defer payment of debt or to incur debt and defer its payment." *Id.* §1602(e). If a holder of an obligation is not also the person to whom the debt was originally made payable, then the holder does not meet the statutory definition of creditor.

In the Proposed Rule, the Board states that "any person who makes significant changes to the terms of an existing legal obligation...engages in extending credit to the consumer by continuing the extension of debt on different terms and, therefore, is a 'creditor' under TILA." 75 Fed. Reg. at 58597. Even if making significant changes to the terms of the legal obligation is tantamount to extending credit, a holder who is not the person to whom the note was originally made payable cannot be a creditor under the statute because only one half of the definition is satisfied.

By introducing the idea that the "current holder" or "current owner" could come within the definition of a "creditor," the Board opens the door for litigation asserting that a "current holder" or "current owner" is a "creditor" for other purposes under TILA. This would significantly expand the potential for litigation and liability beyond the Board's apparent intent.

Fannie Mae believes that the Board could achieve its objectives without creating ambiguity as to who is a creditor by deleting the term "same creditor" from proposed §226.20(a) and instead referring simply to the "same parties," meaning the "current holder" or "current owner"[1] and servicer.

We further request that the Board clarify that the obligation to make disclosures under §226.20(a) rests with the servicer, not with the current holder of the loan. Under proposed §226.20(a), the term "same creditor" refers to both the current holder and the servicer acting on behalf of the current holder. This presumes that both entities will be obligated to provide required disclosures. The servicer, however, is typically acting with delegated authority from the current holder, and is in a better position to provide disclosures to consumers because of its ongoing relationship with the consumers. The current holder has little, if any, direct involvement in the transaction.

D. Clarification Of Exception For "Informal" Payment Arrangements

The proposed commentary to §226.20(a)(1) provides that "informal" arrangements to remedy a breach by the consumer of an existing obligation, typically a repayment plan or forbearance, are not deemed new transactions which would require new disclosures. 75 Fed. Reg. at 58761. Fannie Mae requires that certain informal repayment/forbearance arrangements that extend for more than six months be in writing, which provides greater clarity to consumers. These informal arrangements, which do not legally modify the underlying obligation, are temporary measures designed to help the consumer repay the loan as originally scheduled. Fannie Mae requests that the Board clarify that the exception for "informal" arrangements includes all temporary arrangements designed to aid borrower repayment of the existing obligation, regardless of the length or form (oral or written) of the arrangement.

E. Further Issues For Clarification

Treating a loan modification or restructuring as a new consumer credit transaction under §226.20(a), which requires new §226.18 disclosures, raises the question whether servicers would also be required to provide

[1] In proposed §226.20(a), the term "current holder" is used, but in proposed §226.23 the term "current owner" is used. These terms appear to have the same meaning and either, but not both, would provide the needed accuracy and clarity. Alternatively, the Board could use the term "covered person" as is used in proposed §226.39, which requires a holder to send a notice to a consumer upon the purchase of a loan.

pre-"closing" disclosures pursuant to §226.19 before the loan modification is consummated, and/or post-"closing" disclosures pursuant to §226.20(c). Fannie Mae believes that the Board should expressly exempt modifications of defaulted or delinquent loans from the parts of these provisions that require delays between when a borrower receives a notice and when the new transaction may be completed or the interest rate adjusted. For consumers in default or delinquency, time can be of the essence. In this circumstance, the potential harm from a delay in consummating the transaction would appear to outweigh the potential benefit the consumer might gain from having three or more days to review the disclosures.

II. Right of Rescission – §226.23

Fannie Mae supports the Board's goals in establishing the different processes for the 3-day right of rescission and the extended 3-year right, both in and out of a court proceeding. The Board's detailed procedures for a consumer's exercise of the rescission right, which recognize the complexities and challenges that each scenario presents, will provide much needed certainty to the process.

As a secondary market investor, Fannie Mae is impacted by any regulatory provisions that govern a consumer's right to rescind the debt. In that regard, Fannie Mae has identified several procedural aspects of the right of rescission in the Proposed Rule that would benefit from greater clarification.

As discussed in further detail below, Fannie Mae supports a process that will ensure that the appropriate party receives the consumer's notice of rescission in a timely manner. Fannie Mae believes that all such notices should be sent to servicers rather than current owners of loans. Fannie Mae also recommends that the Board adopt a longer timeline for processing the consumer's notice of rescission, and require that consumers state the basis upon which they are exercising the right. The Proposed Rule should also distinguish between the right of rescission applicable to the original debt and the right to rescind the modification. Finally, the Board should clarify the Notice of Right to Cancel to clearly set forth the consequences to the consumer of rescinding a modification.

A. Notices To Exercise The Extended Right Of Rescission Should Go To Servicers

The Proposed Rule at §226.23(a)(2)(ii)(B) provides that a consumer must mail the notice of his or her decision to exercise the extended right to rescind to the current owner of the debt obligation, with delivery to the servicer as an acceptable alternative. The servicer is the primary entity with which a consumer has regular contact regarding his or her mortgage. The servicer works directly with a consumer to, among other things, collect monthly payments, handle property tax and insurance escrows and implement loss mitigation solutions for delinquent consumers -- on behalf of the owner of the mortgage loan. Fannie Mae believes that delivery to the servicer should be made in every case.

Consumers are well aware of the identity of their servicers. Consumers may be less familiar with the identity of the current owner of their loan, especially if their loan was originated prior to enactment of the Helping Families Save Their Homes Act of 2009, which requires written notice to consumers when ownership of their loan is transferred, or if they misplaced the §226.39 notice identifying the owner of their loan. Unlike owners, servicers interact with consumers on a daily basis and have systems and processes in place to efficiently receive and process consumer inquiries and evaluate the information to determine whether the transaction is rescindable. Directing notices to the current owner adds needless steps to the process -- the owner would generally need to identify the loan to which the rescission notice relates and route it to the correct servicer to obtain the origination file and evaluate the claims. If the owner delays in reviewing the rescission notice, errs in identifying the loan, or misdirects the notice, the process will be inefficient, inconvenient, and costly for all parties.

Fannie Mae recommends that the Proposed Rule, commentary, and model forms be revised to require that notices exercising the right to rescind be sent to servicers rather than current owners of loans and that the references to the current owner be deleted from proposed §226.23(a)(2)(ii)(B), its accompanying commentary and form H-8. These changes will make it clear that the servicer is the person who must receive the notice.

B. The 20-Day Timeline In Proposed §226.23(d)(2)(i) Should Be Extended

In proposed §226.23(d)(2)(i), the Board attempts to clarify the process by which a consumer exercises the right of rescission. Fannie Mae believes that the Proposed Rule's distinctions between the procedure during the 3-day period and the procedure during the extended 3-year period (with variations relating to whether the parties are in litigation) are very helpful. That said, the Proposed Rule creates a 20-day timeline to receive, process, and respond to the consumer's notice of rescission during the extended period. For several reasons, this timeline is too short.

First, if the rule is adopted as proposed, some rescission notices will go to current owners who are not accustomed to receiving and processing consumer inquiries and are ill-equipped to respond. There is also a risk that notices will be delivered to previous owners, causing delay and frustration for consumers.

Second, the process for exercising the right to rescind does not currently require the consumer to allege why the extended right to rescind is applicable for the particular loan. Without such information in the rescission notice, it may be difficult and time consuming to determine the material defect forming the basis of the consumer's right to rescind.

Third, the recipient of the consumer's notice of rescission must determine whether to cancel the transaction, calculate a tender amount, and communicate to the consumer. This requires retrieval and analysis of the consumer's origination file, which may be stored off-site, to determine whether the borrower is entitled to rescind and to begin the process of calculating the tender amount. The 20-day period afforded by the Proposed Rule is insufficient to perform the steps required.

For these reasons, Fannie Mae recommends that the Board establish a period longer than 20 days in which the servicer may respond to the consumer's notice of rescission. To protect consumers, creditors and servicers could be prohibited from taking adverse action against consumers (*e.g.,* charging late fees or reporting missed payments to credit reporting agencies) while their rescission notices are under consideration. The Board may want to consider regulations implementing the Real Estate Settlement Procedures Act which give servicers 60 business days after receiving a "qualified written request" from a borrower in which to investigate the request and take any appropriate corrective action arising from that request. See 24 C.F.R. §3500.21(e)(3). While the servicer is investigating, servicers are prohibited from reporting adverse information concerning "any payment that is the subject of the qualified written request to any consumer reporting agency..." 12 C.F.R. §3500.21(e)(4).

C. Consumers Should Be Required To Identify The Basis For Seeking Rescission

Under both current law and the Proposed Rule, the extended 3-year right to rescind is triggered when the creditor fails to provide either (i) notice of the rescission right, or (ii) the specified material disclosures within the applicable tolerances for accuracy. As previously discussed, however, the process for exercising the right to rescind does not require the consumer to state a reason that the right is applicable for the particular loan. Fannie Mae proposes that the Board require such a statement in the notice of rescission. Requiring consumers to identify the basis for exercising their right to rescind would greatly facilitate the evaluation of their claims.

D. The Effects Of Rescinding A Modification Transaction Are Unclear

Under §226.23(f)(2) as currently in effect, a refinance transaction is rescindable only to the extent that the new amount financed exceeds the unpaid principal balance, any earned unpaid finance charge on the existing debt, and amounts attributed solely to the costs of the refinancing or consolidation. Under the Proposed Rule, the consumer's right of rescission will apply to most modifications that are deemed to be new transactions under §226.20(a)(1). However, if the current holder of the obligation is also the original creditor, the modification would be exempt from the right of rescission, except to the extent that the original creditor/current holder advanced new money.

It is generally accepted that the purpose of the right of rescission is to restore the status quo ante and put the consumer into the same position that existed immediately prior to the new transaction. In the case of a new transaction that modifies a delinquent loan, this should mean that a consumer who exercises his or her right to rescind returns to being obligated under the original note with the original security interest remaining in place. To put the original loan (which was properly disclosed) at risk of rescission by virtue of a defective disclosure on the loan modification would be a disincentive and barrier for current holders, who are not the original creditors, to modify loans.

Fannie Mae requests that the Board clarify that only the modified terms giving rise to the new transaction are rescindable, not the entire transaction. Specifically, Fannie Mae proposes that the Board expand the exemption proposed in §226.23(f)(2) to extend to modifications by current holders of delinquent or defaulted mortgage loans. This would provide certainty concerning the consumer's exercise of the extended right of rescission based on a defective disclosure and would promote modifications.

E. The Notice Of Right To Cancel Should Be Revised To Address Modifications

While the Proposed Rule demonstrates the Board's careful use of consumer testing to improve model disclosures, neither the current nor proposed rescission notices describes the effects of rescinding a modification transaction. The Board should consider creating a variant of the Notice of Right to Cancel for use in connection with modification transactions. Such notice would explain to the consumer that the consequence of rescinding a mortgage loan modification is that the pre-existing non-modified terms of the mortgage loan would be reinstated, retroactive to the date the modification was performed, as if the modification had never occurred.

III. Higher-Priced Mortgage Loans – §226.35

Proposed §226.35 adjusts the definition of "higher-priced mortgage loan" – a new category created by the July 2008 revisions to Regulation Z. Fannie Mae respectfully asks the Board to consider whether adjusting other aspects of the higher-priced mortgage loan rule would accomplish the Board's goals while maintaining the current rule's annual percentage rate ("APR")-based measure and the current definitional alignment between higher-priced mortgage loans and loans for which the APR spread is reportable under the Home Mortgage Disclosure Act ("HMDA").

A. The Higher-Priced Mortgage Loan Test Should Be APR-Based

The Proposed Rule replaces the current APR-based higher-priced mortgage loan coverage test with one based on the proposed transaction coverage rate. Creation of this new measure specifically for the purpose of the higher-priced mortgage loan test adds unnecessary cost and complexity to compliance efforts that lenders will likely pass on to consumers. If the Proposed Rule is adopted, each loan would have one APR for general disclosure purposes, a different APR for purposes of the Home Ownership and Equity Protection Act ("HOEPA"), and the APR-based transaction coverage rate for higher-priced mortgage loans.

Fannie Mae respectfully requests that the Board consider the operational burdens of the proposed creation of APR variants for the various purposes discussed in the Proposed Rule. Rather than making limited-purpose adjustments to established concepts such as APR, the Board should consider making adjustments to other aspects of the higher-priced mortgage loan rule (*e.g.*, the average prime offer rate index or the current margin amounts) to achieve the Board's coverage goals.

B. The Industry Benefits From The Alignment Between The Higher-Priced Mortgage Loan And HMDA Rate Spread Definitions

In October 2008, the Board published a final rule to amend Regulation C to revise the rules for reporting price information on higher-priced mortgage loans. *See* 73 Fed. Reg. 63329 (Oct. 24, 2008). The rules were amended to conform the HMDA rate spread reporting threshold to the definition of "higher-priced mortgage loan" adopted by the Board in July 2008. The Board's actions were in part designed to reduce compliance burdens, and aligning these provisions has proven beneficial to the mortgage industry. To the extent the Board feels that an adjustment to the higher-priced mortgage loan definition is necessary, the Board should make every effort to maintain the consistency between that definition and similar HMDA provisions.

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Fannie Mae very much appreciates the opportunity to provide the foregoing comments to the Board. If the Board would like further information regarding these comments, please feel free to contact the undersigned at (202) 752-3096 or sheila_teimourian@fanniemae.com.

Sincerely,

FANNIE MAE

Sheila Teimourian

Sheila Teimourian
Vice President &
Deputy General Counsel