American Bankers Association

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December 23, 2010

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th and Constitution Avenue, NW
Washington, DC 20551
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Re: Docket No. R-1390
Proposed Rule Amending Regulation Z: *Comprehensive review of TILA's rules for home-secured credit* (75 FR 58539-788)

Dear Ms. Johnson:

The American Bankers Association appreciates this opportunity to comment on the Federal Reserve Board's Proposed Rule amending Regulation Z. The proposal is complex and our members would be strongly affected by its provisions. ABA will address those portions of the proposal regarding reverse mortgages in a joint comment letter being filed separately.

ABA respectfully requests that the Board postpone finalizing these proposed regulations until they can be better coordinated with, and incorporated into, the broader mortgage reform initiatives that are mandated by Congress. The mortgage sector has experienced unprecedented regulatory scrutiny in the past 24 months, resulting in expensive, disparate and piecemeal regulatory changes that yield complex, and even conflicting, requirements. Going forward, ABA believes that the Board must better coordinate with all regulators and the stand-up efforts for the new Bureau of Consumer Financial Protection (Bureau) to develop a comprehensive plan for regulatory reform that includes an agenda and timetable to propose finalize and implement all mortgage disclosure revisions by all agencies with a stake in mortgage lending.

In light of all the financial reform activities currently pending, ABA believes that the only reasonable approach to proper reform is to establish the broader RESPA-TILA integration process mandated under the Dodd-Frank Act as a first priority, as that effort will best improve disclosures and help consumers understand their mortgage loans. All other changes and regulatory improvements to the disclosure process, including the rules being proposed here, should be deferred to ensure that further modifications complement the RESPA-TILA integration effort and do not merely add undue burden and confusion.

Introduction

The Board's proposal represents a very comprehensive and significant overhaul of the TILA rules affecting home mortgages. Among many other detailed and structural changes, the proposal revises the rules for the consumer's right to rescind certain open-end and closed-end loans secured by the consumer's principal dwelling, revises rules for determining when a modification of an existing closed-end mortgage loan is a new transaction requiring new disclosures, and establishes new indices determining whether a closed-end loan secured by the consumer's principal dwelling is a ''higher-priced'' mortgage loan subject to the TILA's enhanced protections.

ABA has long supported improvements to the mortgage disclosure system. We have advocated deep reforms for two fundamental reasons. First, ABA believes that clear information on mortgage terms, including rate and payment information and information regarding consumer rights, is crucial to allowing the consumer to properly decide on a loan. Second, ABA believes that current TILA regulations are enormously complex and often opaque, posing constant legal risks to lenders. Although bankers support TILA's overall objective, the proposed regulations generate enormous compliance burdens and legal risk for all entities involved in mortgage lending, particularly when these rules are subject to constant revisions and change.

Over the years, ABA has been a steadfast participant in all government and industry efforts to improve the system. Notwithstanding the good intentions of all stakeholders, this two-decade process to achieve more clarity has yielded higher volumes of documents at the settlement table, but has not resulted in improvements to consumer understanding, or better rules for efficient compliance by banks.

New Regulation and Legislation

The past several months have seen regulatory activity that has exacerbated the complexity and bulk of regulations. In response to the recent mortgage market difficulties, regulators and policymakers have been exceptionally active with regulatory issuances. Mortgage-related rules constitute the heaviest burden in terms of length and scope of change. In early 2008, HUD proposed its overhaul of the Real Estate Settlement Procedures Act (RESPA), which amends the Good Faith Estimate and HUD-1 Settlement Statement, and imposes stricter rules and cost guarantees. Those regulations became effective January 1 of this year, and clarifying changes and interpretations have been issued on a continuing basis. These new regulations establish substantive and procedural requirements that sometimes vary from, and sometimes complement, those being proposed by the Board.

In the summer of 2009, after issuing rules to protect consumers from unfair, abusive, or deceptive lending and servicing practices, as well as accompanying changes to the Home Mortgage Disclosure Act (Regulation C), the Board separately proposed a complete overhaul of many of its TILA disclosures for closed-end and open-end transactions and required comments by December 24, 2009. Certain provisions of the Board's proposal concerning loan officer compensation have been finalized through interim final rule. In addition, the Board is currently finalizing disclosure rules to implement disclosure requirements mandated by the Mortgage Disclosure Improvement Act (MDIA).

In the midst of all this activity, Congress passed a massive overhaul of all rules affecting banking and financial services generally. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) was signed by the President on July 21, 2010. This legislation represents an unprecedented rewrite of the legal regime covering mortgage finance issues. The new law will comprehensively alter mortgage disclosures, redefine the permissibility of mortgage products and loan terms, and increase all legal liabilities connected with real estate finance. Most importantly, the Dodd-Frank Act contains Section 1032(f), which directs the new Bureau, within one year after the designated transfer date, to propose a single integrated model disclosure that combines the disclosures required by TILA with RESPA's good faith estimate, the HUD special information booklet, and the settlement statements required by Sections 4 and 5 of RESPA..

ABA believes that the Congressional directive to integrate RESPA and TILA is central to the considerations surrounding this proposed rulemaking.

Statutory and Administrative Considerations

The legislative directive to integrate RESPA and TILA requires that policymakers begin immediate consideration of disclosure reform possibilities. This forward planning is beginning to occur. On August 2, 2010, the Treasury Secretary announced that combining and streamlining RESPA and TILA disclosures is a priority. On September 21, 2010, Treasury Secretary Geithner and Assistant to the President and Special Adviser to the Treasury Secretary Elizabeth Warren convened a Mortgage Disclosure Forum for this purpose.

ABA understands that the Board has been engaged in activities surrounding the current review of Regulation Z since December 2004. We believe, however, that the enactment of the Dodd-Frank Act has dramatically altered the TILA statute and, indeed, the regulatory landscape. This legislation is intended to usher in a new era of stronger, coordinated regulation in which streamlined and simplified rules ensure transparency and promote fair competition. To achieve this objective, ABA believes that federal banking agencies must work with those organizing the Bureau to develop a comprehensive plan for disclosure reform that includes an agenda and timetable to propose, finalize and implement <u>all</u> mortgage disclosure revisions by the Board or the Bureau and other agencies in an orderly manner. ABA believes the Board should consider this rulemaking effort in light of that broader mortgage reform effort, and minimize the addition of repetitive forms and rulemakings in favor of a more comprehensive approach.

Under a proper consideration of circumstances, each and every proposal set forth in this proposed rule should be analyzed and evaluated in terms of legislation that has now altered the entire field on which the Board regulates. In the proposal's preamble, the Board provides careful descriptions on what "commenters" have described in response to previous Board solicitations for comment, detailing what such "commenters" opposed, what they agreed to, what their complaints were, and whether they belonged to "creditor" or to "consumer" interests. ABA points out that such considerations may no longer be valid or as consequential, and that the statements or opinions made by the commenting stakeholders no longer reflect an existing reality—the new proposals set forth here must now be considered in relation to the world as amended by the Dodd-Frank Act, and not, as the preamble does, on a regulatory order that has been razed. The Board's construction of these new rules is inapplicable to the reality of the "new" mortgage transaction—the mortgage delivery system is intended to be reformed and reshaped by the recent legislation.

The same considerations confront those responding to the current proposal. Since the Dodd-Frank Act provisions are yet to be implemented, or even proposed, it is simply impossible to adequately assess the impact of piecemeal regulatory proposals drafted primarily in the context of the current structure. The difficulty of considering these proposals when they likely would take effect in a new regulatory regime, rather than the one from which they are being proposed, reduces what should be analytical comments to mere guesses about potential effects or complications that may result from these rules.

In this sense, the Board should more directly join the governmental processes already underway. An essential component of regulatory reform is the consolidation of federal consumer protection responsibilities into the new Bureau that was given extensive rulemaking powers over mortgage protection laws. A primary reason for the consolidation of rulemaking authority within a single agency was to ensure the streamlining and simplification of consumer financial regulation. As explained by the August 2, 2010 speech of Secretary of the Treasury Timothy Geithner at New York University's Stern School of Business:

> [W]e will not simply layer new rules on top of old, outdated ones. Everyone that is part of the financial system—the regulated and regulators—knows that we have accumulated layers of rules that can be overwhelming, and these failures of regulation were in some ways as appalling as the failures produced where regulation was absent. So alongside our efforts to strengthen and improve protections for the economy, we will eliminate rules that did not work. Wherever possible, we will streamline and simplify.

Elizabeth Warren, Assistant to President Obama and Special Advisor to Secretary Geithner, charged with standing up the Bureau, echoed this goal when she spoke on September 29, 2010 about achieving regulatory simplification through "principles-based" regulation:

> To build the consumer agency, we will be drawing on the proven experience and competence of the staff at many federal agencies. But if all we do is bring together those staffs to continue writing "thou shalt not" regulations and layering on more disclosures, then we will have missed a real opportunity. And if all those resources are used just to force an entire industry, begrudgingly or worse, to accept marginal changes in a few forms, we will have missed a real opportunity. On the other hand, if we use this moment to rethink our approach to regulating financial services, then we can seize the opportunity to do something unexpected—and exceptional.

ABA believes that these aspirations, premised on the recent legislative reforms, require coordination and careful synchronization. The current Board proposals deal with elements that may or may not survive in the restructuring ordered by Congress and, as such, are incompatible with the longer view of reform adopted by the legislature.

Regulatory Environment

Even if the Board believes that the broad legislative reforms do not mandate a reconsideration of advancing with these proposals, ABA continues to express concern about the heavy regulatory burden imposed by regulators in the mortgage finance sector. Even in the absence of any legislative change, there is an urgent need for a far more orderly and coordinated approach to the ongoing rulemaking applicable to the mortgage lending industry. The disparate and piecemeal regulatory changes so far have yielded complex, confusing, and even conflicting requirements, and very considerable costs that threaten the availability of sound housing finance options going forward.

During the past two years, lenders have been subject to 50 new regulations, and Dodd-Frank mandates the issuance of at least 263 more regulations over the next several years, many within a year or two. These initiatives have stretched compliance capabilities thin, and greatly increase compliance and operating costs. Community bankers tell us that the regulatory compliance burden is reaching the point where many are seriously questioning the viability of the community bank business model, and all banks report that they are analyzing the continued feasibility of particular products and services, particularly in mortgage lending. The many initiatives also are straining the abilities of stakeholders to appropriately review and respond to proposals.

The vast majority of banks in our country are community banks—small businesses in their own right. In fact, more than 3,000 banks (41 percent) have fewer than 30 employees. For the first time, we are hearing community bankers question their ability to maintain their independence in the face of exploding regulatory cost and strain. These are leaders of healthy banks, and yet there is an increasing pressure to abandon or curtail mortgage lending, and in many instances, to explore sale or merger of the institution itself. The result could be that the number of community banks will shrink dramatically over the next few years. We certainly foresee a decrease in institutions that offer mortgage finance options. In addition to the near-term impact on the ability of community banks to support economic recovery, policy-makers should be very concerned about the ramifications for local economies and communities of industry consolidation driven not by economics, but by government regulatory policies.

As we reported to the Board in our comments on the recent interim final rule under the Mortgage Disclosure Improvement Act, banks of all sizes are having immense difficulty integrating recent changes to regulatory requirements under TILA, RESPA, Fair Lending, and mortgage-related state laws. The volume of changes over the past 18 months has been overwhelming, and banks' compliance activities and adjustments are still ongoing. Even when regulators deem a rulemaking "chapter" to have concluded, banks must deal with a wide range of unintended consequences, legal repercussions, and technical concerns. Moreover, we are advised that loan origination technology systems cannot be modified as quickly as the rule's timeframes for implementation would impose. The technology systems that ensure proper compliance with regulations and that generate the disclosures are integrated rather than isolated; one change, regardless of how limited, affects other processes and results, and if not properly instituted produces considerable difficulties across many product lines.

Impact

The very urgent need for coordination is well illustrated by dissecting the process and impact of only one of the multiple requirements proposed under this rulemaking—the redrawing of the higher priced mortgage loan (HPML) triggers. Under the current proposal, the Board seeks to replace the APR as the index that a creditor compares to the average prime offer rate (APOR) to determine whether the transaction triggers TILA's higher priced mortgage loan ("HPML") rules. The proposed change would provide that a creditor determines whether a transaction is an HPML by using a brand new metric, dubbed the "transaction coverage rate," rather than the current annual percentage rate, and compare that to the APOR. The proposed "transaction coverage rate" would be a modified version of the transaction's annual percentage rate, and would be more comparable to the APOR. Specifically, under proposed § 226.35(a)(2)(i), the transaction coverage rate would be calculated in the same manner as the APR, except that it would be based on a modified prepaid finance charge that would include only finance charges retained by the creditor, its affiliate, or a mortgage broker. This new figure would not be disclosed to consumers—it would serve only to determine whether a loan qualifies as an HPML loan.

The Board's stated reason for advancing this complex proposal is that it is attempting to resolve an "over-inclusiveness" problem caused by a previous final rule that created the HPML category. As described by the Board, the regulatory creation of the HPML segment was an imperfect attempt to increase protections for non-prime loans (where consumers tend to be more vulnerable), while generally excluding the prime market from its coverage (to avoid unneeded costs and legal risks). Given the limitations of the indices chosen to define the HPML coverage, however, the Board's final HPML triggers ensnared a much broader segment of loans than the Board intended. Subsequent to the issuance of the HPML rule, the Board then issued a different and unconnected proposal—the Board's August 2009 Closed-End Proposal—to reform TILA by, among other things, redefining APR with a more inclusive definition of "finance charge." As stated in that proposal's preamble, however, this re-definition would "widen the disparity between the APR and the average prime offer rate" and therefore cause many more prime loans to be incorrectly classified as higher-priced mortgage loans under § 226.35. In short, the Board's subsequent 2009 proposal to redefine "finance charge" exacerbates the initial "over-inclusive" problem under TILA's 2008 HPML rules.

ABA appreciates the Board's effort to improve the precision of these regulations, and also values the efforts made to craft these amendments. We are aware of the high stakes involved in achieving accurate coverage of the HPML rules, which are plagued by imprecision that can have very negative impacts to credit availability for many communities. We believe, however, that this regulatory endeavor was undertaken in a manner that will produce unnecessary burden, and failed to avoid predictable and very high expenses to banks. Although the industry urged, through comment letters in 2008, that there be a reconsideration of the HPML triggers, and that there be further adjustments to the benchmark for particular segments of the market, the Board nonetheless finalized these triggers "knowing that it would result in some degree of coverage beyond the subprime market." The industry had no choice but to comply at immeasurable compliance costs. The 2009 TILA proposal aggravates the over-coverage problem, and the current proposal now returns to confront this "over-inclusiveness" through additional formulas and calculations that do not serve to inform consumers, but only to achieve compliance ends. We must urge that the Board pause and take notice—previous experience makes very clear that there must be no haste to enact regulatory changes without fully analyzing effects.

In the preamble to the current proposal, the Board states that it recognizes that any new metric to determine HPML coverage would impose some costs, including training staff and modifying software and other systems; the Board believes, however, "that these costs should be relatively small because the proposal would necessitate only a one-time modification to creditors' systems." ABA thinks that this statement significantly underestimates the effects and burdens of the changes. Analyzing only the changes to HPML triggers, banks will be required to make very broad system adjustments at many levels. As we have expressed before, the technology systems that ensure proper compliance with regulations and that generate the proper disclosures for individualized transactions are integrated rather than isolated. A change to the HPML triggers will force a change in compliance software. These changes must be identified, incorporated into existing systems, and tested to ensure that they respond adequately to all product lines. As the Board recognizes in the preamble, this must be accompanied by training and educational costs. The proposed amendment will impose new guidelines with investors and lending partners, which will require an additional set of implementation resources. Since the HPML triggers define the market segments that banks are able to serve, this change redefines the scope of our product offerings—the proposed change will require a reconsideration of most product lines and their pricing. Fair lending and CRA considerations also would have to be reanalyzed and adjusted.

In short, what the Board defines as a mere "cost" or a "one time modification" is, in reality, only the initial shock that initiates ripples of change and implementation requirements. A more appropriate description is that this proposed change will begin a long process of separate but successive changes and adaptations. These will take months to complete, are very expensive, and significant in terms of impact to products and business models. These are also changes that many bankers fully expect to be undone by further changes that are mandated by Dodd-Frank.

This example quite clearly demonstrates why the Board should not advance into significant reforms of the HPML and HOEPA laws without a very real analysis into the new Dodd-Frank requirements, namely, the new market segments that have been delineated by the Dodd-Frank Act. For instance, Section 1412 of the Dodd-Frank Act sets forth a "qualified mortgage" segment that is triggered by various price and other classifying elements. The computation for this segment has points and fees tests, bona fide point subtractions, and "small loan" provisions that are similar to, but different than, the HPML triggers being proposed here. Likewise, Section 1431 of the Dodd-Frank Act redefines the thresholds applicable to the "high cost mortgage" categories under HOEPA. The thresholds in that segment are therefore being altered under different calculations. The Act then creates a further unique category, called "higher risk" mortgages, with its own unique requirement for certain specifically defined loans. Finally, all of these segments must be coordinated with a new "qualified residential mortgage" category under Section 941 of the Dodd-Frank Act, which will define risk-retention responsibilities for all mortgage lenders. This last category is central to the Dodd-Frank scheme, and is intended to promote sound underwriting through risk retention requirements and specifically defined criteria.

Each of these new lending segments—qualified mortgages, high cost mortgages, higher risk mortgages, and qualified residential mortgages—has new and detailed requirements, and different standards and restrictions that apply in differing ways and in varying permutations. Each of those segments would, in the new Dodd-Frank world, exist in tandem with the Board's HPML category of loans. We cannot fully predict nor unravel the technical difficulties that these intertwined mortgage segmentations will create. When placed together, all these triggers will combine to create countless categorizations of mortgage product segments, each defined by a different collection of restrictions, disclosures and thresholds.

Finally, we observe that the current proposal's preamble does not demonstrate that there has been a careful consideration of how the new HPML trigger will function with, or affect, the new market classifications that are created in the Dodd-Frank reform legislation. We are distressed that the Board is overlooking the complete legal reorganization and categorizations that are imminent under Dodd-Frank. The proposal has virtually no discussion of the Dodd-Frank Act and its deep effects on the regulatory regime affecting mortgage finance. The Board mentions the legislative reforms only once, and through a footnote. The Board's statement in footnote 101 points to only one of the new thresholds established by the Act, and then mentions that the "Dodd-Frank Act makes numerous other changes to HOEPA, including changes to the definition of points and fees and to the points and fees test itself." The Board then states, without discussion, that it "expects to propose for comment additional revisions to Regulation Z in a future rulemaking to implement the amendments to HOEPA under the Dodd-Frank Act."

This example of only one provision in this proposal delineates the need for further consideration of the cumulative burdens raised by these rules and a lack of common sense coordination. A mere statement that the Board will engage in further rule writing at a later date means that lenders will have to comply with an overhaul of the rules now, for a temporary period, to immediately return to reform their systems within a very short time span. ABA insists that the sum of the changes proposed under this rulemaking is colossal. The Board appears to understand this, as it refers these amendments as "significant changes to Regulation Z" and a "comprehensive review and update of the mortgage lending rules." Without doubt, the changes will require significant resources to implement. And without doubt, banks will have to completely replace these systems within 18-24 months, as they implement the changes under the Dodd-Frank legislation. ABA asks that the Board appreciate the counterproductive effects of the current piecemeal approach to regulation, and that it better calibrate and coordinate these continual regulatory hits to the banking industry.

Conclusion

Before advancing to finalize this proposal, ABA believes it is absolutely critical to pause and examine the current environment, the coming changes and their impact on financing availability, the health of banking institutions generally, and community banks in particular. The realities of the existing legislative and regulatory setting demand a much greater level of coordination among all agencies and under all laws that focus on mortgage lending. ABA urges that the Board postpone the current regulatory proposals until the Board, the Bureau and other agencies are able to properly coordinate meaningful and comprehensive reforms, as contemplated by the Dodd-Frank Act. Going forward, ABA stresses that the only reasonable approach to proper reform is to establish the broader RESPA-TILA integration process mandated under the Dodd-Frank Act as a first priority because that effort will best improve disclosures and help consumers understand their mortgage loans. All other changes and regulatory improvements, including to the disclosure process, should be deferred to ensure that further modifications complement the RESPA-TILA integration effort and do not merely add undue burden and confusion.

Sincerely,

Robert R. Davis

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