Massachusetts Bankers Association

April 8, 2008

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

RE: Docket No. R-1305

Dear Ms. Johnson:

On behalf of our 200 commercial, savings, cooperative, and savings and loan members throughout Massachusetts and New England, the Massachusetts Bankers Association (MBA) appreciates the opportunity to comment on the Federal Reserve's proposed rule amending Regulation Z, which implements the Home Ownership and Equity Protection Act (HOEPA) and the Truth in Lending Act (TILA). The proposed rule makes a number of changes that are intended to address some of the problems that arose in the mortgage markets over the last several years.

Over the last ten years, lightly regulated non-bank lenders and mortgage brokers captured a significant share of the mortgage lending market in Massachusetts and throughout the nation. With the growth of these entities, traditional lenders, including many community banks, have been forced out of the marketplace as non-bank lenders capitalized on weaker underwriting standards and a lack of safety and soundness regulation.

MBA applauds the Federal Reserve proposing rules to rein-in some of the more egregious practices that have occurred in the marketplace in recent years. We are concerned however, that enforcement of any new regulations must be consistent on all mortgage market participants. Many of the abuses of recent years could have been avoided if there were more stringent oversight of non-bank lenders and mortgage brokers at both the state and federal levels.

While the vast majority of our member banks currently do not make subprime loans, we are providing comments on a number of aspects of the proposed rule, including those that impose new requirements on lenders making higher-priced loans as defined under HOEPA. Our comments are below.

Proposed Definition of "Higher-priced Mortgage Loan"

The proposed rule creates a new definition for higher-priced mortgage loans. Specifically, the Federal Reserve is proposing that residential first mortgage loans with annual percentage rates (APR) more than three (3) percent over comparable Treasury securities, or five (5) percent for subordinate lien loans, be considered higher-priced. These are the same rate triggers that are used for reporting high-cost loans under the Home Mortgage Disclosure Act (HMDA). The proposed rule would apply to all home purchase loans, refinancings, and closed-end home-equity loans, while home equity lines of credit, reverse mortgages, and construction and bridge loans would be exempt.

The Federal Reserve has requested comment on a number of issues related to the definition. Specifically, whether the threshold would capture the so-called alt-A market; whether a higher threshold

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(four and six percentage points) is more appropriate; and potential benefits and/or unintended consequences of the regulation reaching further into the prime marketplace.

As we noted above, the vast majority of MBA member banks are not active in the subprime market. We are concerned however, that the proposed definition for higher-priced mortgage loans is too broad and could encompass a portion of the prime market. Given the interest rate environments in recent years, including the inverted yield curve, we believe that some products offered by our members would be needlessly classified as high-cost loans and would be subject to a range of new regulatory requirements. In particular, some adjustable-rate loans, jumbo mortgages, and other products that have become the predominant product lines for many community banks that were priced out of the conforming market in recent years, would be affected.

As you know, the flat, and at times inverted, yield curve has placed significant pressure on all banks, but in particular community banks. Many institutions are relying on more expensive short-term funding to make mortgage loans, which could push rates above the proposed thresholds. Additionally, local market pressures, specifically highly competitive deposit rates offered by some Internet banks as well as local credit unions, can also increase funding costs. We would urge the Federal Reserve to carefully consider the impact of a "one-size-fits-all" regulatory threshold given the local market conditions throughout the country.

Our member institutions have strived to distance themselves from the excesses of the subprime and other non-depository lenders. If traditional, prime mortgage products are classified as higher-cost by the Federal Reserve, these distinctions no longer exist. Not only will this contribute to significant reputation risk for traditional lenders, it could reduce consumer confidence in the mortgage marketplace and drive borrowers away from safe, sound mortgage loans offered by federally-insured depository institutions. This is one more reason why the Federal Reserve should amend the definition of higher-priced mortgages to include only subprime loans.

We recommend that the Federal Reserve increase the spread over Treasury securities, possibly to four percentage points for first liens and six percentage points for loans secured by subordinate liens. Alternatively, we would encourage the Federal Reserve to use an index that better reflects mortgage market rates. For example, most of the subprime adjustable-rate mortgages (ARMs) that are causing many of the problems in the market have rate adjustments tied to LIBOR, not Treasury securities.

MBA does agree with the proposed rule in the methodology used to match the proper Treasury security to the mortgage rate. As we have seen with the explosion of subprime ARMs, particularly so-called 2/28 and 3/27 loans, short initial fixed-rate periods and low "teaser rates" have caused significant problems for borrowers. Loans with longer initial fixed-rates, such as traditional ARMs offered by our member banks should not be subject to the same rate test, since they tend to be more stable products with lower delinquencies. Perhaps an exemption could be created for products with per adjustment and lifetime rate caps.

Finally, the definition of higher-priced loan in the proposal is somewhat different than the definition used for reporting high-cost loans under HMDA. We believe that in order to minimize the regulatory burden for the industry as well as provide accurate reporting of high-cost loans, these standards should be aligned as much as possible. We encourage the Federal Reserve to consider these issues as you move forward with implementation of the rule.

Proposed Rules for Higher-Priced Mortgage Loans

Under the proposal, lenders would be prohibited from engaging in a pattern or practice of making higher-priced mortgage loans without regard to a consumer's repayment ability, including the borrower's income, debt, employment, and assets. Lenders would be required to verify the consumer's income and assets; consider the borrower's ability to make payments based on the interest rate; determine the borrower's ability to make fully-amortizing payments that include property taxes, homeowner's insurance, and any other fees for which the consumer is liable; and consider the borrower's total debt-to-income ratio. The proposal would provide a safe harbor to lenders that: verify ability to repay for seven years and can show that the amount of the income/assets relied on were not materially greater than the lender could have verified.

If the definition of higher-priced mortgage is sufficiently broadened to exclude prime loans, we strongly believe that in any final rule, underwriting terms and standards for higher-priced loans should be clarified and clearly defined. Specifically, terms such as income, debt, ordinary living expenses, and residual income can be interpreted differently by different lenders, borrowers, and the courts. MBA believes that it would be helpful to the industry as a whole – both prime and subprime lenders – to define these terms as well as specify what an institution must do in order to "consider" these factors: then all lenders can be held to the same standard, regardless of primary regulator.

Proposed Rules for All Mortgage Loans

The rule also proposes a number of new requirements for all mortgage loans, regardless of pricing structure. Many of the new requirements address lender relationships with third-party originators, such as mortgage brokers, and other service providers, such as appraisers and servicers.

- Mortgage Broker Provisions:

The proposed rule prohibits lenders from paying mortgage brokers more than the consumer had agreed in advance that the broker would receive as compensation. The proposal would include disclosures and other requirements that must be included in the broker agreement, which would be provided to the borrower. The agreement would disclose that a creditor's payment to a broker can influence the broker to offer the consumer loan terms or products that are not in the consumer's interest or are not the most favorable the consumer could obtain. In addition, broker compensation would be disclosed as an actual dollar amount, not a percentage of the loan. The restrictions on broker compensation would not apply to payments that lenders make to their own employees.

We strongly support increased disclosure and regulatory requirements for mortgage brokers. MBA believes there is considerable misinformation among consumers regarding the duties of brokers and who they represent in the mortgage transaction. Many mortgage brokers currently market themselves as advocates for borrowers – able to secure funding through a secondary market investor at the best interest rate and terms for the borrower. However, as you know most brokers are compensated based on factors other than obtaining the lowest cost for the borrower. In fact, many times the broker's compensation is higher when the borrower receives a loan with higher costs and interest rates.

We support the proposed rule regarding broker disclosures and fee agreements. Borrowers should receive accurate information about the specific role of the mortgage broker and his/her compensation. However, depository institutions will have no way of knowing whether a broker fee agreement was signed on a timely basis. Therefore, banks should be able to rely on the signed agreement on its face.

- Appraisal Provisions

The proposed rule also prohibits lenders and mortgage brokers from coercing appraisers to misrepresent the value of the property. As the new requirements are consistent with existing rules and regulatory guidelines that apply to federally insured depository institutions, MBA supports the proposed rule. An explicit prohibition on all market participants, including mortgage brokers, on improperly influencing appraisals is appropriate given the problems in the marketplace.

We are concerned, however, about the provision that would prohibit a lender from extending credit if it knows or "has reason to know" that a broker improperly influenced an appraiser. We believe the "reason to know" standard is too broad and should be replaced with a standard that prohibits a lender from making a loan only if the lender had actual knowledge that the appraisal was improperly influenced.

- Servicing Provisions

Several new requirements are also placed on loan servicers. These include prohibitions on practices such as failing to credit payments as of the day that they are received and charging late fees on a timely payment that fails to include a previously assessed late fee. The proposed rule also requires servicers to provide fee schedules and accurate payoff statements to borrowers at their request.

MBA generally supports new rules governing mortgage servicing practices. Most of our member banks meet or exceed these standards, which are consistent with the business practices of most depository institutions.

Advertising

The proposed rule includes a number of new restrictions and requirements on the advertising of both closed-end home mortgage loans and open-end home-equity loans. MBA and our member banks strongly support efforts by the federal banking regulatory agencies to crack-down on misleading and deceptive advertising that continue to occur in the marketplace. The Association hears regularly from bankers about some of the deceptive advertising that is being used to entice borrowers to take out risky mortgage loans. In particular, advertisements for loans with low, initial "teaser" rates, loans with negative amortization features, and stated-income subprime loans are still common even with the current problems in the market.

Recently, the Federal Trade Commission (FTC) issued more than 200 warning letters to mortgage brokers, mortgage companies, and media outlets across the nation about concerns with advertisements for home mortgage loans. According to the FTC, many of these mortgage ads are potentially deceptive or in violation of the Truth in Lending Act. Of particular concern were ads that claimed rates of 1 percent without disclosing that this low rate was not an interest rate but a payment rate that applied only during the loan's initial period.

The proposed amendments are intended to disclose all rates or payments that will apply over the term of the loan as well as the time periods for which those rates or payments will apply to the borrower. Mortgage advertisements would be prohibited from stating any rate other than an APR. Ads for ARMs with discounted initial rates must show the limited term to which the rate applies and the APR that will apply after the term of the initial rate expires. Additional requirements for advertisements that promote particular payment amounts would also apply under the proposal. The proposal also prohibits using the word "fixed" to refer to rates or payments when the rate or payment would be "fixed" only for a limited time.

MBA supports the proposed prohibited acts and practices in connection with mortgage advertisements. In particular, the prohibition on using the term "fixed" to refer to rates or payments when the rate or payment is actually adjustable as well as provisions to prohibit the use of the borrower's current lender in an advertisement unless the ad also prominently discloses that it is not associated with the consumer's current lender are especially important. In 2006, the Massachusetts legislature adopted restrictions on the use of a bank's name in third-party advertising documents. However, abuses continue, particularly among non-bank lenders and mortgage brokers. We believe the Federal Reserve's proposal is an important step in curtailing this misleading and deceptive advertising, and we encourage you to work with the other banking regulators as well as the Federal Trade Commission to develop effective methods of enforcing any new requirements on lenders.

We also support the proposed disclosure alternative that would permit TV and radio advertisements to provide a toll-free telephone number that consumers may call in order to receive more information about the product. Similar flexibility should be provided for Internet advertisements by specifying that lenders may use links in online advertisements in order to provide required mortgage disclosure information.

Mortgage Loan Disclosures

The proposal includes a number of new requirements related to mortgage disclosures. Lenders would be required to provide borrowers with a good faith estimate of the payment schedule, illustrating any increases in payments over time, total of payments, finance charge, amount financed, and APR that reflects the fully indexed rate in cases of hybrid and payment-option ARMs. This disclosure would be required to be provided within three days after the borrower makes an application and before he/she pays a fee, however lenders would be allowed to charge reasonable fees to review the borrower's credit history.

While we understand the Federal Reserve's desire to allow consumers to obtain disclosures prior to paying an application fee, we do believe that this requirement places a significant new burden on lenders, particularly small community banks. Lenders would not be able to recoup any fees related to processing the application, with the exception of the costs of reviewing the borrower's credit, with no assurance that the borrower will complete the transaction with that lender. While we support the ability of consumers shopping for the best mortgage product, there are real costs that are associated with processing the application.

Since subprime borrowers tend to have less cash on hand and fewer options for comparative shopping, we recommend that this new requirement could be extended to consumers applying for higher-priced loans as defined in the proposed rule. This would alleviate the cost associated with application fees for those "cash-strapped" borrowers as well as provide greater price transparency in the subprime market.

Alternatively, we would ask that the Federal Reserve allow banks to collect appraisal fees and rate-lock fees. Without appraisal information, banks could not reliably determine actual costs of the loan for the borrower. In addition, banks that lock the interest rate without a fee are exposed to interest rate risk from the time of application until the disclosures are provided. If the institution hedges the lock-in and interest rates drop, the borrower may be able to find another lender offering a lower rate. The initial institution, meanwhile, is left with no fee to offset the hedge cost. This cost is particularly difficult for community banks to absorb.

If the signed agreements would not be enforceable prior to the disclosure receipt date, institutions would need to either incur the cost for expenses associated with the processing of the loan or delay the

processing of the loan. We would encourage the Federal Reserve to work with lenders, particularly smaller community banks, to find ways to mitigate the impact of this provision if it is included in the final rule.

Civil Liability and Remedies

Lenders that violate the proposed regulations for higher-priced loans or the proposed prohibitions that would apply to all mortgage loans would be liable for:

1) Actual damages;
2) Statutory damages in an individual action of up to $2000 or, in a class action, total statutory damages for the class of up to $500,000 or one percent of the creditor's worth, whichever is less;
3) Special statutory damages equal to the sum of all finance charges and fees paid by the consumer; and
4) Court costs and attorney fees.

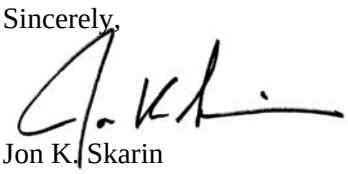
If the loan is a HOEPA loan that has been assigned to another entity, consumers may be able to obtain damages from the assignee, however under TILA, borrowers would not have a private right of action against a mortgage broker that participated in the transaction. We encourage the Federal Reserve to carefully consider the impact of extending the private right of action to mortgage brokers. As many of the abuses in the marketplace can be linked to the aggressive tactics of brokers, who are compensated only based on the transaction and not the sustainability of the loan, we believe that some liability should exist. In addition to helping borrowers recover some costs, placing liability, even if it is limited, on mortgage brokers could help to deter some of the more egregious practices that were so prevalent over the last several years.

Conclusion

Again, we appreciate the Federal Reserve's efforts to address the problems in the mortgage lending market through the promulgation of new regulations under TILA and HOEPA. MBA believes that this proposal is an important step in reining-in abuses that occurred while ensuring that banks and other traditional lenders, which largely did not engage in these practices, are not forced to bear a substantial regulatory burden because of the actions of non-bank lenders and mortgage brokers.

Thank you again for the opportunity to comment on the proposed rule. If you have any questions or need additional information, please contact me at (617) 523-7595 or via email at jskarin@massbankers.org.

Sincerely,



Jon K. Skarin
Director, Federal Regulatory & Legislative Policy