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April 8, 2008

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

Re: Truth in Lending; Docket No. R-1305

Dear Ms. Johnson,

The California Bankers Association (CBA) appreciates the opportunity to provide comments to the Federal Reserve Board's proposed amendments to Regulation Z related to mortgage lending (the "Proposal"). CBA is a non-profit organization established in 1891 that represents most of the FDIC-insured depository financial institutions doing business in California. CBA frequently provides comments in response to regulatory proposals that have a significant impact upon the California banking industry.

California has some of the highest real estate values in the nation and has borne the brunt of the mortgage crisis. Most of CBA's members do not offer subprime home loans, which comprise most of the problem loans, and those that do (almost exclusively through a non-bank affiliated company), do so responsibly. In responding to the problem, state and federal legislators have appropriately focused much of their attention upon state-supervised, non-bank creditors and brokers that are under-supervised. In providing our comments, CBA supports the Board's efforts that target those problems and practices that need attention while ensuring that home mortgage credit remains accessible and affordable.

Introduction

At the outset, we offer these general observations. As with all banking regulations, the Proposal must clearly state what is required in order to reduce the risk of liability. Several provisions in the Proposal create general obligations upon creditors that are broad, ambiguous, and difficult to comply with, and thus would expose them to enforcement actions and legal liability. The obligation, for example, for banks to ensure that mortgage brokers furnish borrowers with complying fee agreements could be construed as a general duty of supervision, exposing banks to liability for the actions of third parties.

The Proposal must be reasonable in how it seeks to accomplish its purposes without creating undue burdens for the creditor. The Proposal must be narrowly tailored to address known problems without creating new ones, particularly in the prime mortgage market, which most acknowledge is efficient and effective. The final regulation should not establish criteria that amount to regulatory underwriting standards, which should remain the province of creditors rather than regulators. Finally, the Proposal should seek to establish a uniform standard applicable to all mortgage creditors, including state-regulated non-bank creditors. FDIC-insured banks and savings associations generally maintain prudent mortgage underwriting standards, and are regularly examined by state and federal banking agencies, including the Board. In contrast, non-banks are subject to widely varying degrees of supervision. CBA shares the Board's goal to reduce this disparity.

Higher-Priced Loans

Rate threshold: The Proposal creates a new category of loans called "higher-priced mortgage loans," which would be subject to stricter regulation. These are defined as consumer mortgage loans with an APR greater than three percentage points over comparable Treasury securities, or five percentage points over Treasury securities for subordinate liens. Our concern here is that the threshold triggers are too broad, and would likely affect home loans that are currently considered "prime" or "alt A" mortgages. It does not serve consumers or creditors to institute broad rules that may make mortgage loans generally more expensive and risky.

The proposed definition of a higher-priced loan is based on Treasury securities; however, actual mortgage rates are not always closely tied to Treasury security indexes. For example, and as pointed out by the American Bankers Association in its comment letter to the Board, recent yields on Treasuries are reflective of volatility in the demand in the international marketplace. Current mortgage rates are typically reflective of broader market forces, such as the secondary market for securitized mortgages.

The tradeoff between fees and rates also creates a variety of mortgage rates to choose from, which is beneficial to borrowers. It is not unusual or unfair for a borrower to decide to pay higher points up front in order to secure a lower interest rate if the borrower intends to keep the loan for a long period of time. When factoring in all APR related fees, many prime loans may well fall within the proposed threshold.

The mortgage crisis itself has placed upward pressure on rates as creditors tighten credit. For example, the mortgage GSEs have been imposing a series of surcharges on mortgage loans, including a 25 basis point "adverse market surcharge," making mortgage loans more expensive and spurring creditors to raise rates as a consequence. Private mortgage insurance rates, a factor in the APR, are also rising because of rising defaults. Finally, the pricing of jumbo loans and small dollar first-lien mortgage loans are more likely to fall within the proposed thresholds. For all these reasons, CBA believes the proposed threshold is too low. If the Board insists upon using a threshold tied to Treasury securities, then we strongly encourage the Board to raise the threshold to five percent for first lien loans.

The Proposal also creates an increased regulatory burden in that it creates a new method for matching the comparable Treasury securities to particular loan terms. Although the Proposal appears to mimic HMDA's 3% and 5% triggers for rate spread reportable loans, the Proposal would match loans to Treasuries based on whether the loan is adjustable or fixed, its term, and the length of any initial fixed-rate period of an adjustable-rate mortgage. The timing of matching Treasury securities is also inconsistent with HMDA. If the Board's intention was to coordinate the requirements of Regulations C and Z, a new proposal is warranted so that these requirements are properly coordinated. To create inconsistent standards would substantially and unnecessarily increase the regulatory burden on all creditors, with no offsetting benefits to consumers.

<u>Ability to repay;</u> Creditors would be prohibited from engaging in a pattern or practice of making higher-priced mortgage loans based on the collateral without regard to a consumer's repayment ability. We agree with this in concept; however, much more clarity is needed. Banks need to know precisely what is encompassed by the need to "consider" income, debt, ordinary living expenses, and residual income. It is important to note that many higher priced loans are made to small business owners, investors, and others whose incomes are variable and who may have other assets to support repayment. For example, an otherwise successful plaintiff's attorney experiencing a lull between big cases may have very low current-year income, but sufficient savings and long-term prospects to support a mortgage. The Proposal should make allowance for creditor discretion, and stated income loans should not be categorically prohibited.

In addition, the Proposal should clearly define the factors that creditors are required to consider. But, here again, the regulation must also avoid setting rigid underwriting standards, as it would be impossible to address each situation that may arise. Also, what constitutes a "pattern or practice" should be more clearly defined. For example, many creditors rely on automated software, some supplied by the GSEs, to process loans. Would banks be exposed to regulatory criticism or legal liability for using automated software that, in hindsight, someone believes to insufficiently consider a borrower's ability to repay?

The Board asks whether there should be a rebuttable presumption that a loan is unaffordable if the borrower's debt-to-income ratio exceeds 50%. While this is an uncomfortably high ratio for an individual whose income is static and who has no other assets to support loan payments, the assumption often does not apply. High DTI loans may be attractive to persons who are starting promising careers and anticipate steady increases in income. Small business owners, real estate brokers and developers, investors, and anyone with variable but generally high income may desire to leverage a mortgage loan as a means of preserving liquidity for other investments or for capital. Therefore, we do not support such a presumption.

Creditors need clear compliance benchmarks, but standards must be balanced against regulatory micro-management of credit underwriting. Indeed, creditors are able to offer a wide variety of affordable loan programs partly because of a competitive market and because of innovation. We urge the Board to consider both the need for clarity and flexibility. A regulation should not dictate how creditors must underwrite each loan. Most importantly, the Board should always keep in mind whether a regulation exposes creditors to unwarranted risks of litigation. Wherever a restriction is imposed that substantially subjects the creditor to liability for noncompliance, there should also be made available clear guidelines that, if followed, create a safe harbor from liability.

Prepayment penalties: Prepayment penalties are not categorically detrimental to borrowers. Borrowers could benefit from lower interest rates or closing costs with respect to ARM loans, while creditors benefit from increased certainty regarding the duration of the loan. However, CBA recognizes that some creditors impose unfair and abusive prepayment penalties, and reasonable restrictions should be imposed, such as on duration and in those situations where a substantial increase in payment is likely to occur after the fixed period expires.

Escrow: We agree that a borrower should consider the obligation to pay taxes and insurance when obtaining a mortgage loan, and we acknowledge that not all borrowers fully appreciate this obligation. Banks and savings institutions already consider borrowers' ability to pay taxes and insurance when evaluating creditworthiness. But we object to any mandate for creditors to create escrows for taxes and insurance for higher priced loans. Such a requirement would be costly as many creditors do not currently have departments or programs to perform these functions on behalf of their borrowers. We would support, in the alternative, a requirement that all creditors consider taxes and insurance when reviewing the borrower's ability to repay, and that they must disclose these obligations to borrowers.

Provisions Applicable to All Mortgage Loans

Many of the proposed provisions related to all mortgage loans are standard practice for insured depository institutions. Some, however, require improved coordination with other laws and regulations. We discuss each in order.

Creditor payments to mortgage brokers: The Board proposes to prohibit a mortgage broker from being paid a yield spread premium unless the consumer agrees in advance to the compensation. Please note that the pending HUD RESPA proposal differs from this Proposal's disclosure and treatment of the same fees. The two proposals should be developed jointly to ensure consistency. It benefits no one if creditors are subject to different rules; consumers would be confused, and creditors would be burdened with ineffective and inconsistent regulations. We also understand that the Board is in the process of amending the closed-end credit disclosures that are required by Regulation Z. We strongly urge the Board to work with all relevant agencies to adopt streamlined, effective, and coordinated disclosures.

CBA and its members are also concerned by any rigorous obligation to monitor or supervise third parties, such as mortgage brokers, for compliance with the proposed fee disclosure. It would be very difficult for creditors that work with third parties to ensure that they execute advance fee agreements in each instance. Instead, we urge the Board to place a direct obligation on such third parties to execute a conforming agreement before accepting any fees or taking an application, while specifying that creditors may rely on the face of the agreement to meet their own compliance obligations. Creditors should not be made, in effect, to guarantee third parties' compliance, and thus be legally exposed for the actions or inaction of third parties.

Appraisals: CBA agrees that appraisals must be independent, and any coercion used to influence the outcome of an appraisal should be prohibited. The state of California last year enacted a law to prohibit inappropriate influence on appraisers, and the Proposal is consistent with existing regulations applicable to banks. Nevertheless, we are once again concerned that the Proposal would subject creditors to liability for the actions of mortgage brokers and other third parties in this regard. Under the Proposal, a creditor would be prohibited from extending credit if it knows or "has reason to know" that a broker improperly influenced an appraiser. This is a broad and ambiguous standard, and would subject creditors to second guessing by the borrower and, ultimately, to litigation. Given the severe sanctions available under Regulation Z, we believe a creditor should not be liable for third parties' actions unless a creditor has actual knowledge of coercion.

Servicing: CBA generally supports the purposes of the Proposal addressing servicing of mortgage loans. They are reasonable and largely consistent with current practices applicable to banks. Our concern is that adoption of these standards within the Truth in Lending Act would make any violation subject to Regulation Z penalties. These penalties are not commensurate to the harm that these violations would cause to the consumer. Therefore, we request that the Board specify that a violation of the servicing requirements is not "material" for purposes of the civil liability provisions of TILA.

We agree that consumers should receive a fee schedule within a reasonable time after a request is made. However, servicers cannot know the exact amount of all fees that may be assessed, particularly third party fees. Some servicers work with loans originated in different states in which different laws apply. As such, servicers should be given sufficient flexibility to provide information to the best of their ability, rather than requiring them to provide what amounts to a guarantee of accuracy, and thus exposing them to a strict liability standard.

Advertising Rules

We support addressing misleading and deceptive advertising practices. However, it is difficult to assess whether increased disclosures in advertising are effective. Particularly, there is a need for flexibility when providing disclosures in radio and television advertisements, which are time-limited. It is the nature of these media that make lengthy disclosures not only infeasible, but of questionable value. Therefore, we support any alternative that would permit advertisements to provide a toll-free telephone number for consumers to obtain more information about the advertised product. Similarly, flexibility is needed for web-based advertisements. The regulation should explicitly allow disclosures within links, which is a common practice in the online world.

Prohibition on certain acts or practices: The Proposal includes certain prohibitions applicable to closed-end credit deemed to be unfair or misleading, including the misleading use of the term "fixed," deceptive reference to a borrower's current creditor in an advertisement unless the ad also prominently discloses that it is not associated with the consumer's current creditor, and misleading claims that the advertised product will eliminate debt or result in a waiver or forgiveness of an existing loan. These practices are unfair and have been used primarily by non-bank creditors and brokers. CBA supports these restrictions.

Early mortgage disclosures

The Proposal would require creditors to provide consumers with transaction-specific mortgage loan disclosures before they pay any fee, except a reasonable fee for reviewing a consumer's credit history. Banks and savings institutions generally provide the disclosures within three days of application. However, we request that the Proposal be amended to permit creditors to collect appraisal fees and rate-lock fees, in addition to the fee to obtain a credit report; otherwise, creditors would need to incur the cost of these services or delay processing. Additionally, we encourage the Board to coordinate this Proposal with HUD's RESPA proposal, as the HUD proposal, if approved, would permit creditors to collect a fee for preparing a Good Faith Estimate, which may include the cost of an initial credit report.

Conclusion

CBA appreciates the Board's efforts to address identified problems. We support those efforts and we reiterate the need to issue consistent regulations applicable to all mortgage lenders. We thank the Board for considering our comments, and please do not hesitate to contact me if you have any questions.

Sincerely,

Leland Chan
General Counsel