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December 21, 2010

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

**Via e-mail (regs.comments@federalreserve.gov)**

RE: Docket No. R-1390
Regulation Z (Truth in Lending)

Dear Ms. Johnson:

This comment letter is submitted in response to recently published proposed revisions to Regulation Z (at 75 Fed. Reg. 58539 (September 24, 2010)). I submit these comments in my personal capacity only, and not on behalf of any client or colleague.

With regard to the proposed revisions to Section 226.20(a), please consider the following issues relating to modifications of existing loans already in default:

1. Please clarify in Section 226.20(a) that no new Truth in Lending disclosures would be required for a transaction that will become secured by a mortgage on real property or the consumer's dwelling for the first time (as a result of the modification), if the consumer is in default on the existing consumer credit transaction and the existing consumer credit transaction will not be extinguished, satisfied or replaced by a new set of consumer credit agreements. (The new mortgage may be subject to a rescission right if it is on the consumer's primary residence, but no new Truth in Lending disclosures should be required.)

(a) As proposed, Section 226.20(a) implicitly excludes from its scope all modifications of any consumer credit transaction that was originally outside the scope of Regulation Z, even if such transactions subsequently are modified through the addition of a mortgage on real property or on a consumer's dwelling. This should be made more clear in the final version of the regulation, for consistency with existing Comment 3 to 12 CFR Section 226.3(b).

Example: Suppose the original consumer credit transaction was not secured by any real property and also was not secured by any dwelling. Suppose further it was for an amount greater than $25,000 (such that no Truth in Lending disclosures were required at time of consummation). The collateral for the loan might have originally included such things as securities (stocks and bonds) and/or collectibles (art, antiques, etc.). Several years later, suppose the loan is now in default and the consumer and creditor are negotiating a possible restructuring of the past-due loan, to avoid or delay acceleration and related remedies. As a practical matter, the consumer will want reduced monthly payments and an extension of time in which to make required payments. Depending on the perceived likelihood of recovering the full accelerated amount due in the near future, the creditor might also prefer to enter into a loan restructuring. Practically speaking, for this type of "friendly" loan workout, the dollar amount of the currently required payments generally will not be increased (the consumer typically would be allowed to make smaller payments for a period of time, and may also be allowed an extension of the original scheduled maturity date of the loan). However, the creditor may require new and/or additional collateral for added protection in case of a new default under the restructured or modified loan (especially if the value of the pre-existing collateral is diminished and/or if the pre-existing collateral is no longer as readily saleable as when the loan was first originated), and may also require a loan modification fee or other consideration for the loan restructuring. In some cases, the consumer might agree to give the creditor a mortgage on the consumer's real property (which could be a primary or secondary residence or rental property), behind all then-existing mortgages and liens on that property. In general, no new principal would be lent in connection with such a negotiated restructuring of the defaulted loan (other than to cover past-due amounts already owed pursuant to the terms of the existing loan documents and modification-related fees), and the interest rate would not be increased in this hypothetical loan workout scenario.

Under this hypothetical scenario, it is possible the consumer might incur fees in connection with the loan workout (for example, fees for real property appraisal, title search, title insurance, and/or for the consumer's or creditor's outside counsel fees). The creditor might also impose a modification fee (similar to an origination fee) to help offset its costs relating to the negotiated restructuring of the defaulted loan. However, this type of loan workout should not be subject to new Truth in Lending disclosure requirements (apart from rescission requirements if the creditor takes a mortgage on the consumer's primary residence). Consumers who were presumed under the Truth in Lending Act and Regulation Z to have enough financial sophistication to be able to enter into a consumer-purpose loan up front without any required Regulation Z disclosures should not need to receive additional disclosures if their loans are modified post-default. Treating this type of transaction as a "new" consumer credit transaction requiring Section 226.18 disclosures becomes very problematic under Regulation Z, since (among other things) it becomes unclear whether (i) any pre-closing disclosures should be provided pursuant to Section 226.19, (ii) any post-closing disclosures should be provided pursuant to Section 229.20(c), and (iii) the creditor might be required to document that the workout is in the borrower's interest and that the borrower has the ability to repay the restructured loan. Clarifying this issue will be even more important in view of the pending scheduled increase(s) to the $25,000 threshold for consumer credit transactions exempt under the Truth in Lending Act, pursuant to the Dodd-Frank Act.

(b) As proposed, Section 226.20(a)(2) appears to exclude from its scope all modifications of any non-real property and non-dwelling secured consumer credit transaction that was originally subject to Regulation Z, provided that the modifications do not satisfy and replace the pre-existing consumer credit transaction, even if the creditor acquires a mortgage on real property or on a consumer's dwelling as a result of such a modification. (The new mortgage may be subject to a rescission right if it is on the consumer's primary residence, but no new Truth in Lending disclosures would be required in connection with the modification.) This should be made more clear in the final version of the regulation.

2. The concept of a fee that is imposed on the consumer "in connection with the modification" should also be clarified. In many instances, the terms of the pre-existing loan agreement may clearly require the consumer to pay for certain default-related expenses (such as costs of obtaining appraisals, credit reports, title searches, etc.) The terms of the pre-existing loan might also require the consumer to give the creditor updated financial statements from time to time, and/or might permit the creditor to consider the loan in default if there is a material adverse change to the consumer's financial condition. Expenses the creditor incurs in connection with the consumer's default under an existing loan are not expenses incurred in connection with a workout or modification of that loan – they are incurred pursuant to the default-related provisions of the pre-existing loan. In cases where the consumer's obligation to pay for some or all of these default-related expenses arises from the terms of the original consumer credit contract, the fact that the consumer and creditor might agree to condition a loan workout on the consumer's payment of some or all of these fees (or on the inclusion of some or all of these fees in the recalculated principal amount owed on the existing loan) should not, by itself, transform such fees into fees paid by the consumer "in connection with the modification".

Fees the consumer chooses to incur for such things as personal legal representation in connection with the negotiation and closing of a loan workout or modification also should not be considered fees imposed directly or indirectly by the creditor on the consumer in connection with the modification (even if the creditor advises the consumer that such personal legal representation may be advisable).

Fees exempt from the finance charge due to 12 CFR Section 226.4(c)(7), if imposed in connection with a loan modification or loan workout that will be secured by the consumer's real property or dwelling, also should not, by themselves, trigger the need to provide new Regulation Z disclosures for the loan modification or workout pursuant to 12 CFR Section 226.20(a).

In addition, any fees described in the preceding three paragraphs, to the extent included in the recalculated principal amount owed on the existing loan, should not be considered an increase to the "loan amount" for purposes of 12 CFR Section 226.20(a).

3. If the creditor is entitled to impose a certain default interest rate on the pre-existing loan as a matter of contract, any negotiated loan workout agreement for that pre-existing loan that includes an interest rate less than or equal to that default interest rate should not be regarded as an agreement to increase the consumer's interest rate, for purposes of 12 CFR Section 226.20(a).

4. Multiple advance closed-end loans that go into default may require special treatment under Section 226.20(a). For example: Suppose a multiple advance closed-end construction loan goes into default before construction is completed. In many instances, this will be because the construction project has gone over budget and has also taken longer to complete than originally agreed upon in the construction loan contract documents. The borrower will be in default, but the lender's mortgage is on a partially completed, unfinished structure that may not be habitable (may not be eligible for a certificate of occupancy). To resolve the default, the borrower and lender might agree to a loan modification that could include such things as (a) an additional construction loan advance (to facilitate completion of the property to a point where the property becomes eligible for a certificate of occupancy), (b) extension of the originally agreed-upon construction completion date, (c) modification of the originally agreed-upon construction plans and specifications (blueprints), and (d) the borrower's payment of site inspection and title search update fees, title insurance update fees, and related matters. If the additional construction loan advance will not cause the total principal amount advanced and unpaid to exceed the originally

agreed-upon maximum principal amount of the construction loan, the "loan amount" would not have increased (since the total outstanding, advanced principal would be less than or equal to the originally agreed-upon maximum principal amount for the construction loan).

As discussed in item 2. of this letter, above, fees payable by a borrower in connection with a modification of a defaulted construction loan also should not, by themselves, trigger the requirement for new disclosures under Section 226.20(a), to the extent the fees are (i) exempt from the finance charge under Section 226.4(c)(7), or (ii) fees the construction mortgage lender may lawfully impose on the borrower pursuant to the terms of the pre-existing construction mortgage loan, or (iii) fees the consumer voluntarily chooses to incur (such as fees for the consumer's own personal legal representation in connection with the negotiation and closing of the loan modification, architect or general contractor fees, etc.).

5. To put some of these loan workout issues into slightly better context, the Board may wish to note case law indicating that loan workout agreements may not have sufficient contract "consideration" to be enforceable unless both sides (the borrower and lender) make certain concessions to each other. A "one-way" loan workout that only involves lender concessions (such as the lender's agreement to accept reduced payment amounts for a period of time, to extend the maturity date of the loan, to reduce the interest rate, etc.) may not be enforceable. *See, e.g.*, Willamette Mgmt. Assocs. v. Palczynski, 2009 Conn. Super. LEXIS 2747 (Conn. Super. 2009), where the trial court refused to enforce a settlement agreement that provided an extended payment schedule and reduced the total amount owed, without eliminating or reducing the creditor's risk of collection and without conferring any benefit on the creditor; *compare* Mario DeVivo Realty v. 64 Magee Avenue Associates, 2009 Conn. Super. LEXIS 1818 (Conn. Super. 2009), where the Superior Court held that a mortgage modification agreement that extended the original loan term and reduced the interest rate on the loan was supported by sufficient consideration when the borrower agreed to a prepayment penalty as a condition of the loan extension and interest rate reduction. (The original loan did not include any prepayment penalty.)

I thank you very much for the opportunity to present these comments. Please do not hesitate to contact me at (203) 776-1911 during regular business hours (Eastern Time) if you have any questions about any of the matters discussed in this letter or would like any further information.

Sincerely,
/s/ *Elizabeth C. Yen*
Elizabeth C. Yen