Aerospace Federal Credit Union

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December 24, 2009
Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

regs.comments@federalreserve.gov

Re: Comments on Proposed Amendments to Regulation Z, Rules for Closed End Credit
Docket No. R–1366

Dear Ms. Johnson,

Aerospace Federal Credit Union appreciates the opportunity to provide comments in connection with the proposed rule issued by the Board of Governors of the Federal Reserve System (the Board), referenced above. The Proposal represents a major overhaul to Regulation Z for closed-end credit transactions secured by real property or a consumer's dwelling.

With respect to the new rules for Closed End loans secured by a dwelling unit, the following comments are offered.

From the proposed rules:
The Board anticipates working with the Department of Housing and Urban Development (HUD) to ensure that TILA and Real Estate Settlement Procedures Act of 1974 (RESPA) disclosures are compatible and complementary, including potentially developing a single disclosure form that creditors could use to combine the initial disclosures required under TILA and RESPA…The two statutes have different purposes but have considerable overlap**.** Harmonizing (these) would ensure that consumers receive consistent information…It may also help reduce information overload by eliminating some duplicative disclosures….the revised TILA disclosure would include the total settlement charges that appear on the GFE required under RESPA…The revised GFE form was developed through HUD's consumer testing. (The TILA) proposal … was developed through consumer testing.

Comment:
The value of providing consumers specific, simplified, and straight forward information is immeasurable. The Agencies (i.e., HUD and the Board) have reached the same conclusion: consumers want fewer, simpler, and easier to understand disclosures (i.e., to enhance understand and reduce confusion). While the Board expects to work with HUD (and vice versa certainly) to ensure that TILA and RESPA disclosures are compatible and complementary, little cooperation or action is expected since each Agency has its own purpose, turf, and authority—leaving consumers and Lenders to struggle with new forms and increased regulation.

From the proposed rules:
In the course of developing the proposal, the Board has considered the views of interested parties, its experience in implementing and enforcing Regulation Z, and the results obtained from testing various disclosure options in controlled consumer tests…The goal of the proposed revisions is to improve the

effectiveness of the Regulation Z disclosures…The proposed revisions…are intended to provide the most essential information to consumers when the information would be most useful to them, with content and formats that are clear and conspicuous. The proposed revisions are expected to improve consumers' ability to make informed credit decisions and enhance competition among creditors. Many of the changes are based on the consumer testing that was conducted in connection with the review of Regulation Z.

Comment:
The value of consumer testing comes when it is done using real life situations and conditions—asking consumers how new forms work or help in their understanding when such new forms are included with all other disclosures consumers receive when applying for a loan. Consumer testing done in vacuum (i.e., consumers comparing new forms to existing forms without consideration of all other forms provided at application), does not produce reliable results. The problem many consumers have is not with one form but there are so many forms to read application and closing. And, all of the forms are saying something different in order to inform and protect—unfortunately, the myriad of forms confuse and overwhelm (changing one form will not eliminate this problem). Thus, the validity of results from the Board's consumer testing must be considered questionable (perhaps, unreliable) at best.

From the proposed rules:
The Board proposes to use its exception and exemption authority to revise the finance charge calculation for closed-end mortgages, including HOEPA loans...This approach would cause more loans to be subject to the special protections of the Board's 2008 HOEPA Final Rule, special disclosures and restrictions for HOEPA loans, and certain State anti-predatory lending laws. However, the proposal could also reduce compliance burdens, regulatory uncertainty, and litigation risks for creditors.

Comment:
As later commentary in the proposal states, "the increase of loans subject to HOEPA and certain State anti-predatory lending laws is small." The issue with this change is not that the number of loans will increase but the fact that the Board concludes that while the number of loans will increase, this change "could also reduce compliance burdens, regulatory uncertainty, and litigation risks for creditors."

Compliance will have to increase to ensure loans, especially smaller balance loans, do not inadvertently fall into the HOEPA trap. This will result in more activity from the plaintiff's bar (both class action and individual law suits), increased regulatory scrutiny (as the number of loans reported under HEOPA goes up), and higher costs for Lenders (both from defending itself and instituting compliance systems and checks to ensure no HOEPA violations).

From the proposed rules:
Disclosure of the finance charge and the APR.
Currently, creditors are required to disclose the loan's ``finance charge'' and ``annual percentage rate,'' using those terms…Consumer testing indicated that consumers do not understand the term ``finance charge.'' Most consumers believe the term refers to the total of all interest they would pay … (they) do not realize that it includes the fees and costs associated with the loan. For these reasons, the proposal replaces the term ``finance charge'' with ``interest and settlement charges'' to make clear it is more than interest....

Comment:
Substituting terms will not eliminate "term" confusion; how many consumers know what the term settlement charges includes—the term is as inarticulate as "finance charge." Settlement is not a conventional or conversational term; it is term of art used in the closing of a loan (i.e., by Lenders, Title companies, and Closing agents). Notably, in California (the state with the most loan closings in the nation) the term "settlement" is seldom heard or used—escrow and Title charges are often used in place of settlement costs while escrow or closing often substitutes for settlement.

“Total Loan Costs or Fees, not including interest” could be an alternative to the settlement charges; this is certainly self explanatory and reduces confusion (plus it includes words used commonly today).

From the proposed rules:
…the disclosure of the APR would be enhanced to improve consumers' comprehension of the cost of credit. Under the proposal, creditors would be required to disclose the APR in 16-point font in close proximity to a graph that compares the consumer's APR to the HOEPA average prime offer rate for borrowers with excellent credit and the HOEPA threshold for higher-priced loans. This disclosure would put the APR in context and help consumers understand whether they are being offered a loan that comports with their creditworthiness.

Comment:
Despite how well intentioned this change is, consumer confusion will continue. While “(t)he APR is calculated based on the finance charge and is meant to be a single, unified number to help consumers understand the total cost of credit,” when APR is different from the interest rate, most consumers are confused. Coupled with the fact that most Lenders cannot explain *in simple terms* how the APR is calculated, what the APR represents, and how it differs from the borrower’s interest rate, “(the) consumers' comprehension of the cost of credit” will remain muddled.

Depending on how the chart is set up, one must consider the fact that the HOEPA prime offer rate is a trailing interest rate for market priced Lenders. The HOEPA prime offer rate is last week’s interest rate; if today’s rates are going up, the HOEPA prime offer rate will be lower and if today’s rates are going down, the HOEPA prime offer rate will be higher. This will produce greater confusion, more questions, and even a few disgruntled borrowers (particularly if a Lender rate exceeds the HOEPA prime offer rate—which it will when rates are rising).

Additionally, it is anticipated that by including the chart additional time will be required by Loan Officers who must try to explain to borrowers what the chart says, where rates come from, why the HOEPA prime offer rate is different from the Lender’s rate, and why the chart is included. This “disclosure” does not “put the APR in (any) context and (it dos not) help consumers understand whether they are being offered a loan that comports with their creditworthiness.” These changes will definitely slow the loan process down but not reduce borrower confusion.

From the proposed rules:
The proposal would require the creditor to provide a final TILA disclosure that the consumer must receive at least three business days before consummation, even if no terms have changed since the early TILA disclosure was provided. In addition, the Board is proposing two alternative approaches to address changes to loan terms and settlement charges during the three-business-day waiting period…Under the first approach, if any terms change during the three-business-day waiting period, the creditor would be required to provide another final TILA disclosure and wait an additional three business days before consummation could occur. Under the second approach, creditors would be required to provide another final TILA disclosure, but would have to wait an additional three business days before consummation only if the APR exceeds a designated tolerance or the creditor adds an adjustable-rate feature. Otherwise, the creditor would be permitted to provide the new final TILA disclosure at consummation.

Comment:
There are three principal issues, concerns, and problems with this change:

- **Purchase transactions closing dates missed in order to comply with the new time line and the penalties, including lawsuits, that result**
- **Buyers losing a property, and the lawsuits that result, as Lenders comply with the new time line**

- **Lock expiration dates and the borrower's loss of a rate as Lenders comply with the new time line—and the lawsuits that result.**

There should be an exception, such as the MDIA exception, that allows a borrower to waive the three day requirement if there is a personal financial emergency. Without this type of exception, Lenders will require:

- **Extension of closing dates (i.e., beyond contract closing dates—which may be impossible without the seller's cooperation and could result in a loss a property if a seller does not cooperate**
- **Longer closing periods, resulting in higher costs to borrower for the longer interest rate lock period and the possibility that a buyer will lose a property if the seller will not agree to a lock period the Lender needs to ensure compliance with this change.**

From the proposed rules:
To address the concerns related to loan originator compensation, the Board proposes to prohibit payments to loan originators that are based on the loan's terms and conditions. This prohibition would not apply to payments that consumers make directly to loan originators…If a consumer directly pays the loan originator, the proposal would prohibit the loan originator from also receiving compensation from any other party in connection with that transaction….Under the proposal, a ``loan originator'' would include both mortgage brokers and employees of creditors who perform loan origination functions…The Board also seeks comment on an optional proposal that would prohibit loan originators from directing or ``steering'' consumers to … products based on the fact that the loan originator will receive additional compensation even when that loan may not be in the consumer's best interest. The Board solicits comment on whether the proposed rule would be effective in achieving the stated purpose. In addition, the Board solicits comment on the feasibility and practicality of such a rule, its enforceability, and any unintended adverse effects the rule might have.

Comment:
There are two parts to this:

Part 1.
Allowing the Board to dictate employment pay practices is the first step in nationalizing wages for this group of employees and by extension all Lender wages (i.e., through regulatory creep). Regardless of how well intentioned this area of the proposal is, the Board should not "legislate" pay practices.

Part 2.
With the expectation that the Board will disregard the aforesaid commentary, one practical alternative is to allow Lenders to make payments by loan amount only. This would require that a Lender establish a set a dollar amount for each loan amount or a set percentage rate for each loan amount that would be paid regardless of loan type, including Fixed vs. ARM. No differentiation in the payment could be made by product type, including higher priced loans. No sharing of service release premiums should be allowed. No payments for or sharing in "adds" should be allowed. The only compensation the Loan Officer or Broker should receive is the set dollar payment or percentage payment for the loan amount.

Instituting such a pay practice will not eliminate the possibility of a Loan Officer or Broker increasing a borrower's loan amount to increase their own compensation. However, no incentive based compensation system will produce a sterile environment unless the Loan Officer or Broker is an employee of the Lender and is salaried only with no bonus structure allowed (thereby eliminating incentive compensation).

Notably, the vast majority of Loan Officers and Brokers are honest and ethical—they try to help borrowers obtain the best loan available; to establish or rewrite rules for a few bad apples is the same as "throwing the baby out with the bath water." This whole are of the proposed rules should eliminated.
From the proposed rules:

Section-by-Section Analysis
The Board has considered the purposes for which it may exercise its authority under TILA Section 105(a) carefully and, based on that review, believes that the proposed adjustments and exceptions are appropriate. The proposal has the potential to effectuate the statute's purpose by better informing consumers of the total cost of credit and to prevent circumvention or evasion of the statute through the unbundling or shifting of the cost of credit from finance charges to fees or charges that are currently excluded from the finance charge….The Board believes that Congress did not anticipate how such unbundling would undermine the purposes of TILA, when it enacted the exceptions…

Comment:
The change to include most charges in the borrower's settlement charges is a good first step in trying to eliminate the confusion of what is included and what gets to be excluded from the finance charge.

The Board is making the change through its exception and exemption authority. However, the Board's right to make this change is dubious. The Board justifies using this authority since "The Board believes that Congress did not anticipate how such unbundling would undermine the purposes of TILA, when it enacted the exceptions." This conclusion is debatable given the Board's own statement that "In the 1998 Joint Report, the Board and HUD recommended that Congress adopt a more comprehensive definition for the finance charge."

Notably, Congress did not act; had Congress concluded that Lenders were doing wrong or improper things, it could have amended the rules—it did nothing. And, Congress has not acted on this matter since (i.e., the past eleven years). Congress may have determined that the competitive market is a better way to regulate than by statute—but we do not know what Congress intended since the Board did not ask nor consult with Congress before proposing the change. Allowing this change will let the Board broaden its own powers (and will diminish Congressional supervision).

From the proposed rules:
The Board seeks comment on whether the rules for determining the finance charge treatment of taxes imposed by State and local governments should be simplified and, if so, how.

Comment:
If State and local government taxes are the same for cash transactions and loan transactions, then State and local taxes should be exempted from finance charges, which is consistent with the Board's proposal (i.e., "Charges that would be incurred in a comparable cash transaction, such as transfer taxes, would continue to be excluded from the finance charge.").

From the proposed rules:
Board believes that fees charged by closing agents…and those of other third parties they hire to perform… services, should be treated uniformly as finance charges… Requiring third-party charges to be included in the finance charge creates some risk that a creditor may understate the finance charge if the creditor does not know that a particular charge was imposed by a third party. This risk is mitigated to some extent by TILA Section 106(f), which provides that a disclosed finance charge is treated as accurate if it does not vary from the actual finance charge by more than $100 or is greater than the amount required to be disclosed.

Comment:
As previously stated, the change proposed, to include most charges in the borrower's settlement charges, is a good first step in eliminating confusion about what is included and what gets excluded from the finance charge. The inclusion of all third party costs creates a level playing field, may help to produce competitive pricing, and eliminates the race to drive the APR down by fee exclusion.

RESPA's new requirement to reissue a GFE charges (i.e., the Lender did not know there would be an additional cost when the original GFE was issued) when there a "changed circumstance" may solve the problem of Lenders understating finance charges.

If there is a change to the tolerance, it should be a sunset change, not an inflation adjusted change. Using a sunset provision would require that the Board revisit the tolerance change every two or three years. A real cost review is more appropriate since costs can accelerate much faster than any inflation adjustment can resolve.

From the proposed rules:
Credit insurance and debt cancellation or debt suspension products

Comment:
The best proposal the Board could make for these products is to decouple them entirely from the mortgage process. If Lenders want to offer such programs, they should offer them only after the mortgage is closed—not as part of the mortgage process. The fees and costs should not be part of the mortgage transaction (whether or not the products are voluntary).

These programs are income centers for Lenders and provide nominal borrower benefit. Allowing these programs to be part of the mortgage process "lends" credence to their usefulness and need; no amount of "plain-language disclosures" can or will overcome this. Also, as stated previously, consumer testing in a vacuum does not render a reliable result to borrowers who have a myriad of forms to sign and return when taking out a loan.

From the proposed rules:
Property Insurance Premiums

Comment:
It is agreed that property insurance premiums should be excluded from any computation involving finance or settlement charges.

Final Comment:
Recognizing that the Board's proposed changes will in fact become approved, thereby requiring Lenders to abide by new regulations and to use new disclosures, it is hoped that the Board fully appreciates and understands the cost burden and time requirements the proposed changes will have on Lending institutions.

These changes require programming, testing, training, and implementation—and, the timely cooperation of third party providers. The changes proposed are not easy or simple to implement. They will require a significant cost outlay and time investment. And, if Lenders do not get the changes right, the plaintiff bar and regulators or examiners will be quick to react. Thus, it is requested that Lenders be given adequate time to make the adjustments and changes. Requiring such changes to be implements in just a few months will guarantee chaos, mistakes, and lawsuits.

Thank you for your time and review of these comments.

Sincerely,

Ed Casanova
Vice President
Aerospace Federal Credit Union