From: Advocates for Basic Legal Equality, Stanley Hirtle

Subject: Reg Z - Truth in Lending

Comments:

Closed End Comments - Docket No. R-1366

December 22, 2009

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

Re: Truth in Lending - Proposed Rule: Regulation Z Part 226; Docket No. R-1366

Dear Members of the Federal Reserve Board:

Advocates for Basic Legal Equality is a not for profit law firm that provides free legal services in civil matters to the low income and elderly who can not afford to pay for a lawyer. We serve 32 counties in Northwestern Ohio, roughly from Dayton to Toledo to Mansfield, from offices in Dayton and Toledo. We work closely with Legal Aid of Western Ohio which serves the same area. We provide assistance in matters of family, housing, consumer, civil rights and economic opportunity. ABLE is a participant in Ohio's "Save the Dream" program, where we provide legal assistance in order to save the homes of borrowers in foreclosure. We have received over 400 calls for assistance with foreclosure problems in the most recent quarter. We and our predecessor legal services programs have years of experience helping clients who received predatory mortgage loans.

Ohio's Foreclosure Crisis Shows the Need for Regulation of Lending Practices

Ohio has been in a foreclosure crisis for years. Since 1995, the number of foreclosure filings has at least quadrupled in all but a few of Ohio's counties and has quintupled statewide.[1] In 2008, there were 85,773 foreclosures filed in Ohio. Of these 5,194 foreclosures were filed in Montgomery County, 4,359 in Lucas County, 1,124 in Clark County, 996 in Allen County, 862 in Richland County.[2] As of November 23, 2009 there have been 4207 foreclosures filed in Montgomery County. This would be a slight decline in filings compared to previous years. However nationally, mortgage loan default rates remain high. While we hope that some of this slight decline in filings reflects a willingness of loanholders to modify mortgages through the federal government's HAMP and other programs, results have so far been disappointing. People are losing their homes in large numbers.

Loss of homes is a tragedy to a family that has staked its dreams on homeownership. But it is also a tragedy to the surrounding community. It has been estimated that each foreclosure costs a municipality as much as $10,000.[3] Furthermore, the municipalities are left dealing with the vacant and abandoned homes after a foreclosure. A recent study of eight Ohio cities identified nearly $64 million in costs to local jurisdictions related to vacant and abandoned properties.[4] This included nearly $15 million in city service costs such as code enforcement, boarding, demolition, maintenance, and police and fire services, and over $49 million in lost tax revenues from demolitions and tax delinquencies.[5] School districts are facing the greatest impact of tax loss since school districts receive about two-thirds of real property tax revenue.[6]

The foreclosure crisis has wreaked havoc on neighborhoods. Dayton's Santa Clara neighborhood is the 9th most vacant in the country at 40.5% vacancies, as reported by the Associated Press[7]. This blight has spread through the surrounding Five River Oaks area. Ohio contains three other neighborhoods that were even more abandoned, one in Franklin County and two in Hamilton County.[8]

We support the Board's significant changes in the disclosure rules, as well as the expansion of substantive rules. In this brief letter, we highlight only the most important of the Board's proposed changes, as well as encourage the Board to use its authority to ban unfair mortgage practices more aggressively. There are many other issues which merit comment. In particular, we refer the Board to the comprehensive comments provided by the National Consumer Law Center.

A Good Start on Substantive Regulations, but More is Needed.

Yield spread premiums. We applaud the Board's ban on yield spread premiums. One cause of the irresponsible lending boom that led to the subprime mortgage meltdown has been the payment of "yield spread premiums" to loan originators - both lender employees and independent brokers - for giving borrowers loans with higher interest rates or disadvantageous terms such as prepayment penalties, adjustable rates with initial low teaser rates, and payment option ARMS..

We have seen many cases where a borrower has been charged a yield spread premium. In virtually all these cases the borrower was also charged a large direct broker's fee. The borrower was never told that the broker could have obtained a less expensive or otherwise more favorable loan. No borrower would have agreed to pay a more expensive loan in order to pay an additional "yield spread premium" fee to a broker. The yield spread premium is concealed with cryptic initials such as "POC" that no borrower understands.

Yield spread premiums reflect the fact that many lenders chose to operate without the overhead of having offices to find customers and to instead rely on mortgage brokers to bring them business. Lenders were competing for the business of brokers, not the business of customers, and were paying kickbacks to brokers as a result. These perverse incentives resulted in more bad expensive loans that were more likely to go into foreclosure. They also resulted in excessive compensation for mortgage brokers, which helped to fuel the mortgage meltdown and economic crisis.

We support the Board's proposed ban on all yield spread premiums that are based on loan terms or conditions, including the loan amount. We do not support, however, any weaker versions of this prohibition. No justification for yield spread premiums have ever stood up to scrutiny. The Board should adopt the full ban on yield spread premiums. Consumers should not have to deal with loan originators who are going behind their backs to give them worse loans than those for which they qualify.

We also strongly support the Board's proposed ban on loan originators being paid from two sources - both the lender and the consumer. Limiting payment from one or the other will eliminate conflicts of interest and reduce the incentives originators now have to increase the price of the loans.

The Board Needs to Prohibit More Unfair Practices.

However good these substantive proposals are, they are not nearly enough. Even in the face of the current disaster in the mortgage market, it appears that the Board continues to rely on the discredited notion that better disclosures will prevent dangerous, predatory mortgage lending. Our recent experience shows that consumers are no match for mortgage professionals who are much more sophisticated about how the mortgage market works. Psychological research into consumer behavior shows that people process large amount of information by selecting only a few key issues, that they are often overly optimistic about future risks, and that they often rely on personal trust rather than studying difficult legal texts. [9] Sophisticated sellers have studied these consumer biases and shortcuts and learned how to take advantage of them.

In this sweeping rewrite of TILA rules - much of which is driven by recognition of the extent to which predatory lending has played in causing the current economic crisis - the Board still fails to use its authority to prohibit blatant and far-reaching unfair practices. With the important exception of yield spread premiums, the Board continues to allow creditors to write abusive, predatory loans, and is merely reworking the requirements for disclosing the abusive terms.

Instead, the Board should obey the mandate of Congress to stop unfair practices in the mortgage market, and should -

- Ban Payment Option ARM terms for all loans secured by the borrower's principal residence.
- Extend the requirements currently applicable only to higher cost loans regarding the determination of the borrower's ability to repay, to all mortgage loans secured by a borrower's principal residence.
- Require underwriting for all adjustable rate loans to determine the borrower's ability to repay the highest possible payments that may be required under the loan terms (counting both alternative amortization terms and the highest permissible interest rates).
- Prohibit the initiation of a foreclosure unless the HAMP loan modification analysis and procedure have been completed.

Similarly it is necessary not just to prohibit specific practices that have been abusive in the past, but to have some general indicia of unfairness to respond to new abuses that are likely to be invented in the future.

Much Improved Disclosures are also valuable.

We do not believe that disclosures will adequately protect homeowners from most abusive mortgages. However, the disclosure rules are still very important so that consumers will be able to determine the real costs and risks of the loans they are evaluating. The new disclosures proposed by the Board are substantial enhancements over the very weak disclosures that mortgage borrowers have received in the past. Some of the highlights of the Board's proposed improvements include:

Much more meaningful definition of the APR. As the annual percentage rate or "APR" is the single number that captures all loan costs, including not just interest but also hidden fees, it is important for it to be meaningful and accurate. The existing rules regarding which fees and charges must be included are full of holes. This Swiss cheese approach makes the APR a poor indicator of the true cost of a loan. We support the Board's proposal to adopt a sweeping all-in rule that will make the APR much more useful. Under the new proposal, the finance charge will always include credit insurance premiums, fees for recording and releasing the security interest, almost all closing costs, and all settlement agent charges. These are very good changes.

Innovative, targeted disclosure of the particular APR offered to the consumer. We also support the Board's proposal to require creditors to disclose a mini-chart that shows exactly how the APR offered to a particular consumer compares to the average rate for prime loans and to current rates for higher priced loans. This innovative requirement will help alert consumers whenever they are offered a bad deal - something that loan originators in the past have been able to obscure.

Final disclosures 3 days before closing. Until a recent change in the law by Congress, creditors were not required to provide any TILA disclosures before closing on refinance loans. Consumers often arrived at closing only to find significant changes to important loan terms. Closing is far too late to back out of the loan even if the consumer is able to detect the change amid the piles of papers presented. Many consumers are emotionally committed to signing the loan once they are at closing and may respond to any dissonance that they discover by "getting it over with" and signing, rather than demanding changes or walking out. Now, the Board is proposing two alternatives to address this problem. One would require re-disclosure and a three-day waiting period if any loan term changes. The other would require this only if the APR changed or an adjustable rate feature was added. The first of these proposals is far better and the Board should adopt it. In addition, the Board should tighten up its current rule, which allows consumers to waive these protections.

Major improvements in format and understandability of mortgage disclosures. The Board has conducted extensive consumer testing and has dramatically redesigned all its disclosure forms. It has replaced obscure prose with tables and plain language. It has jettisoned some disclosures that consumers do not find useful, such as the incomprehensible and deceptive Consumer Handbook on Adjustable Rate Mortgages. The Board has failed, however, to be sufficiently strict. In many instances, it has carefully crafted the easiest language for consumers to understand, yet inexplicably does not require creditors to use that language.

Much better disclosure of risky loan features. The Board is requiring creditors to make special disclosures regarding certain risky loan terms:

Prepayment penalties
Interest-only payments
Negative amortization
Balloon payment
Demand feature
No-documentation or low-documentation loans
Shared equity or shared-appreciation

Up until now, the Board's rules required only weak, obscure disclosures of some of these features, or even no disclosure at all. This will be a significant improvement.

Conclusion

We very much appreciate how far the Board has come in its recognition of the harm that unfair practices can have on homeowners, neighborhoods, and the economy. We appreciate the many significant improvements that the Board is proposing to disclosure rules. We now urge the Board to use the authority Congress gave it to move more aggressively and affirmatively to stop the continuing unfair practices in mortgages. For more information and specifics on all of these suggestions, please see the comments of the National Consumer Law Center.

Truly yours,

Stanley A. Hirtle
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Advocates for Basic Legal Equality

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[4] Community Research Partners and Rebuild Ohio, $60 Million and Counting: The Cost of Vacant and Abandoned Properties to Eight Ohio Cities, at http://greaterohio.org/rebuildohio/FullReport_Nonembargoed.pdf.
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[9] White, Behavior and Contract, 27 Minn. J.L. Inequality 135 (Winter 2009); White, Risk Based Mortgage Pricing, Present And Future Research, Fannie Mae Found. Hous. Policy Debate Vol. 15 Issue 3, at 503, 509-511 (2004), http://www.fanniemaefoundation.org/programs/hpd/pdf/hpd_1503_White.pdf