December 22, 2009

Jennifer J. Johnson
Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Ave. NW
Washington, DC 20551
regs.comments@federalreserve.gov

Re: Proposed Amendments to Regulation Z, Rules for Closed-End Credit (Docket No. R-1366)

Dear Ms. Johnson:

The Mortgage Bankers Association[1] (MBA) appreciates the opportunity to comment on proposed amendments to Regulation Z and the Official Staff Commentary to Regulation Z (the "Commentary") issued for public comment by the Board of Governors of the Federal Reserve System (the Board).[2] The Proposal constitutes a major revision of Regulation Z, the implementing regulations for the Truth in Lending Act (TILA) that would significantly revise consumer disclosures and compensation practices for closed-end credit transactions secured by real property or a consumer's dwelling for generations to come. The Proposed Rule is part of a comprehensive review of TILA's rules for closed-end credit. The Proposal was published along with the Board's proposal regarding rules for disclosures of open-end credit secured by a consumer's dwelling for which MBA provides comments separately today.

MBA has long supported far greater transparency in the mortgage process and greatly appreciates the outstanding work the Board has done over the last several years to develop this important initiative. We believe that many of the disclosures that have been proposed represent major improvements over those that are currently required.

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

[2] The proposed amendments were published at 74 Fed. Reg. 43,232 (Aug. 26, 2009), and will be referred to in this letter as the "Proposal" or the "Proposed Rule."

We are concerned, nonetheless, that aspects of the Proposal would harm consumers and increase costs unnecessarily unless they are significantly revised. Accordingly, our comments address these matters and seek to improve the Proposed Rule, including the new disclosures to avoid unintended consequences.

MBA notes that the Proposal does not include provisions regarding rescission and reverse mortgages which the Board anticipates will be reviewed at a later date. Considering the importance of that review to certain provisions proposed in the closed-end rule, such as changes to the timing of "final" disclosures, we suggest that certain aspects of the Proposal be considered in conjunction with the proposed changes to the rescission requirements.[3] MBA looks forward to working with the Board on that effort.

Similarly, MBA urges the Board that if it eliminates the finance charge exclusions and establishes an all-in APR, as proposed, it make appropriate changes in the Average Prime Offer Rate (APOR) or other means used to establish the APR thresholds for higher-priced mortgage loans under Section 226.35 of Regulation Z and Home Mortgage Disclosure Act (HMDA) reportable rate spreads under Section 203.4(a)(12) of Regulation C. We further recommend that the Board revise the definitions of "points and fees" and "total loan amount" used to establish the threshold for loans subject to Section 226.32 of regulation Z ("HOEPA Loans") to continue to exclude the charges currently excluded from those definitions, notwithstanding the fact that some of these charges would now be finance charges. Failure to do so will result in over-reporting of higher priced lending under HMDA and unwarranted regulation under HOEPA. Rulemaking on this matter should also occur following an analysis of the elimination of the finance charge exclusions and the establishment of an all-in APR on state lending laws. Specifically, many state lending law requirements are triggered by points and fees and APR thresholds. Changes to the APR calculation may place a greater portion of mortgage loans in more highly regulated categories than was intended under state laws.

If the Board goes forward with the elimination of the finance charge exclusions, it should differentiate between third party fees and creditor fees in arriving at its tolerances as the U.S. Department of Housing and Urban Development (HUD) has done under its recent revisions to its rules under the Real Estate Settlement Procedures Act (RESPA), known as Regulation X. The implications of making such a significant change to the APR also must be fully analyzed under other laws, including the Depository Institutions Deregulation and Monetary Control Act (DIDMCA), to ensure that there are no unintended consequences.

[3] For example, because the closed-end rescission rules at footnote 47 of Section 226.23 of Regulation Z require the delivery of all "material disclosures" in order to avoid rescission, the numerous and complicated new transaction-specific disclosures and their relation to "materiality" for rescission purposes should be carefully considered as part of this rulemaking process. 12 C.F.R. § 226.23 n. 47.

MBA strongly opposes a broad restriction against loan officer compensation based on the rate and terms of loans. MBA believes a far better approach than restricting such compensation in the mortgage market would involve greatly improving disclosures so consumers could avoid any steering and understand and negotiate the best compensation to serve their lending needs.

If the Board determines to proceed with restrictions on compensation based on the terms of loans, protections in this area should be targeted carefully to protect vulnerable borrowers and guard against steering to risky products. We strongly urge that the Board explicitly except a variety of practices from any restriction. The restriction should not apply to payments to lender companies and compensation to managers and executive personnel. Practices outside of any restriction should also include: methods to enable consumers to reduce their upfront closing costs; additional compensation for special programs to provide sustainable credit for those who have been underserved; and compensation to personnel where additional or expedited services are provided. MBA also favors explicitly permitting compensation based on the loan amount.

MBA has profound concerns about the imposition of a subjective restriction against steering. Such a standard invites litigation, the costs of which will ultimately be borne by consumers. If a restriction against steering is established, MBA believes that bright line safe harbors empowering consumers and/or reasonable limits on compensation will be more effective consumer protection.

Our comments address these and numerous other matters.

General Background: The Proposal respecting closed-end mortgages would change the procedural format, timing and content of disclosures given to consumers for closed-end credit at the time of application, within three days after application, three days before consummation and during the life of the mortgage. It also includes proposed substantive restrictions against originator compensation based on the terms of loans and against steering of consumers by loan originators to products that are not in the best interest of consumers. Finally, the Proposal contains other miscellaneous provisions. Accordingly our comment discusses these topics in the following sections:

- **I. MBA's Major Comments**
- **II. Disclosures at Application**
- **III. Disclosures Within Three Days After Application**
- **IV. Disclosures Within Three Days Before Consummation**
- **V. Disclosures During the Life of the Mortgage**
- **VI. Originator Compensation**
- **VII. Other Concerns**

I. **MBA's Major Comments:** MBA has several major comments on the rule which are discussed further below:

A. **MBA Supports Many of the Changes the Board Proposes –** MBA strongly supports many of the changes proposed by the Board to improve disclosures to help make the mortgage market much more transparent to consumers. MBA and its members have long undertaken similar initiatives. Notably, MBA developed generic materials in 2007 entitled the "Simple Facts" (see http://www.homeloanlearningcenter.com/MortgageBasics/TheSimpleFacts.htm/) to help consumers prudently choose between fixed and adjustable mortgages. We support many of the generic disclosures proposed including "Key Questions to Ask About Your Mortgage" and "Fixed v. Adjustable Rate Mortgages" as well as the overhaul of the Truth in Lending (TIL) closed-end disclosure itself.[4] These sound materials promise to facilitate market competition and lower costs to consumers.

B. **MBA Has Questions About the Legality of Key Aspects of these Proposals –** While MBA is supportive of many of the Board's proposals, it has questions about the legality of key provisions of this Proposed Rule, including the provisions that would revise the calculation of the finance charge and the APR and that would broadly restrict compensation based on the terms of the loans. The Board cites its exemption authority and its unfair and deceptive acts or practices authorities as the bases for these provisions. MBA believes that the Board should reexamine its authorities carefully. Considering the costs of implementing this Proposal, litigation that successfully strikes down some or all of these provisions could waste these resources and increase consumer costs while destabilizing mortgage lending contrary to the Board's objectives.

C. **Considering the Unparalleled Length and Detail in this Proposal, the Board Should Utilize a Process to Obtain Further Input From Stakeholders –** While MBA appreciates the opportunity to comment, no stakeholder can adequately review a proposal of this size during the comment period provided considering the other rules and laws that have been proposed or become effective during this same period. Considering the length of the Proposed Rule, MBA urges the Board to consult more aggressively with stakeholders before the Proposal is finalized to assure that unwise provisions are not adopted precipitously.

D. **These Extensive Changes Will Require Considerable Implementation Time –** Changes proposed, including but not limited to the finance charge, APR, and those that require new, transaction-specific disclosures, will require

[4] 74 Fed. Reg. at 43,333 (to be codified at 12 C.F.R. §§ 226.37 and 226.38).

extensive changes in loan origination systems and numerous business processes. MBA would urge that considering the breadth and scope of the proposed changes, at minimum the implementation period for the numerous changes contained in the Proposal should be at least 24 months.

E. **The Drafting Paradigm Incorporating the Proposal into Regulation Z is Unnecessarily Difficult to Navigate –** The Board should establish separate regulations under TILA applicable to closed-end and open-end mortgage transactions rather than melding the modifications made by the Proposal into Regulation Z rules for other closed-end credit transactions. Submerging the changes made by the Proposal along with countless cross references in the Closed-end Credit section of the Regulation is confusing and far less effective in presenting requirements to consumers and practitioners. Effective compliance is greatly facilitated by clear and concise rules – the time has come for the creation of separate parts in Regulation Z that contain all rules governing open-end and closed-end mortgage lending.

F. **The Board and HUD Should Redouble their Efforts to Work Together –** MBA appreciates the Board's comment early in the preamble to the Proposal that the Board anticipates working with HUD to ensure that TILA and 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. MBA urges, however, that it is essential that the Board and HUD work together *now* to make key features of this Proposal and HUD's RESPA rules (Regulation X) consistent before this Proposal is finalized. This includes but is not limited to the format for loan terms and the operation of the tolerances as well as the timing of disclosures.[5]

G. **Better Generic Disclosures Are Welcome and Will Reduce Costs –** MBA greatly appreciates the Board's proposal to require new one-page generic – not transaction specific – disclosures such as "Key Questions to Ask About Your Mortgage" and "Fixed vs. Adjustable Rate Mortgages." The latter replaces the Board's much longer Consumer Handbook on Adjustable-Rate Mortgages (CHARM Booklet). MBA has dedicated considerable resources to similar efforts for consumers including the establishment of its Home Loan Learning Center Web site (http://www.homeloanlearningcenter.com) and the development of MBA's "Simple Facts."

MBA believes that sound generic disclosures such as these can provide the borrower necessary context to understand transaction-specific disclosures,

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[5] 74 Fed. Reg. at 43,333 (to be codified at 12 C.F.R. § 226.37).

which cost much more to produce. Generic disclosures should be made available earlier in the home buying and financing process, including from real estate agents and housing counselors, as well as on the Web sites of government agencies. Considering the multiplicity of languages other than English, MBA also would strongly support an effort by the Board to translate its generic disclosures into foreign languages and warn borrowers in each language that, if they have difficulty understanding spoken or written English, they should have an interpreter or attorney of their own assist throughout the mortgage process.

H. **An All-In APR Makes Sense But Other Changes Must Be Made and Considerations Addressed Before It Is Implemented –** MBA supports establishment of a more inclusive finance charge and "all-in" APR. MBA believes that the elimination of most finance charge exclusions and an all-in APR would result in a more realistic calculation of the cost of credit and a more useful shopping tool for consumers. At the same time, such a change would render unnecessary a complex regulatory morass of calculations that presents a significant regulatory burden but little value for consumers. It is for this reason that we welcome the Board's proposed modification.

   However, there are several factors which must be addressed before the change to an all-in approach can engender our support in the current regulatory environment. Specifically, MBA recommends adjustment of the HMDA rate-spread, higher priced mortgage loan, and HOEPA loan triggers and appropriate exclusion, or at least differentiation, of third-party fees for purposes of the tolerances permitted under TILA. Transition to the elimination of finance charge exclusions and an all-in APR should not occur until the Board has carefully considered the effects of such a change on all other Federal and state lending laws including DIDMCA.

   Finally, we strongly urge that the Board also adopt an express overstatement tolerance for the APR. If the Board has the authority to make the very significant changes to the APR which it proposes, surely it should be able to adopt an express overstatement tolerance to assist borrowers.

I. **Certain Demands of the New Disclosure Forms Are Unnecessarily Burdensome –** While it is important that the forms be updated to provide borrowers relevant information, MBA is concerned that some requirements will be unnecessarily costly – and potentially easily susceptible to errors and misunderstanding – such as the requirement for a graph of where the borrower's APR stands in comparison to those of other borrowers. The purpose of providing the borrower credit information is better accomplished through the credit score disclosure required under the Fair and Accurate

Credit Transactions Act (FACTA).[6] Also, the characterization of rates in the higher priced mortgage loan category as the "high cost zone" is not appropriate, and will lead to confusion regarding whether the loans are HOEPA loans.

J. Establishment of a New Requirement for Final Disclosures Three Days Prior to Consummation in All Cases Should Occur in Conjunction with Rescission Changes and Coordination of RESPA Disclosure Requirements – MBA supports efforts to ensure consumers receive clear disclosures and to ensure they have adequate time to consider disclosures before they are committed to a loan. However, under current law, there is already a requirement for redisclosure where tolerances are exceeded three days prior to consummation. Also, for refinance transactions, there currently is a three-day right of rescission following settlement. For these transactions, requiring a three-day period in all cases on top of the rescission period when the borrower also cannot receive funds is counterproductive and would unnecessarily slow the mortgage process. This change should be considered in conjunction with changes to the rescission requirements. At the same time, HUD's RESPA Rules (Regulation X) require redisclosures of the GFE to consumers when there are "changed circumstances" that affect estimated costs. Regulation X also does not require that disclosures be provided three days prior to consummation but instead provides a borrower a right to review the HUD-1, to the extent information is available, the day before settlement. MBA strongly recommends that the Board and HUD coordinate their timing requirements for disclosures so consumers are not confused.

K. Waivers of Waiting Periods Should Be a Viable Option for Consumers – Any new requirement for a new disclosure three days before settlement should include provisions that truly permit borrowers to waive the requirements based on exigent circumstances. The Board has provided little guidance on current waiver provisions including the provisions for waiver of the three-day right of rescission or the new seven-day and three-day prescribed periods under the Mortgage Disclosure Improvement Act (MDIA). Consequently, lenders tend to be fearful of granting waivers to avoid later litigation.

The Board should provide more examples of waiver circumstances that would support a finding of a bona fide financial emergency, so borrowers are not denied needed funds because of a paucity of relevant guidance. Such circumstances should include the expiration of a rate lock, the need to complete the purchase of the home or move into the home by a specific date, and the need to obtain funds by a specific date to meet contractual

[6] Pub. L. 108-159, 111 Stat. 1952

obligations or prevent the expiration of contractual rights. Moreover, lenders should be able to rely on borrower statements and claims of financial emergency when considering the merit of a request for waiver or modification of a waiting period. Lenders should not be required to look behind or otherwise police borrowers' certifications to determine the extent to which a borrower has a financial emergency.

L. **Whether or Not the Board Requires a Three-day Pre-Closing Disclosure, the Board Should Clarify its Requirements for Redisclosure under MDIA so Borrowers Are Not Harmed –** Currently, under the MDIA amendments to TILA, creditors must provide a borrower redisclosure of the TIL three days prior to closing when the APR changes beyond the prescribed tolerance, apparently whether or not the change represents a decrease or increase in the borrower's costs. Under this approach, decreased costs for a borrower will ironically lead to a three-day delay in closing and the concomitant unavailability of needed funds. Provisions to protect consumers should not become harmful "Catch 22's." The Board should modify this position and establish a bright-line test that only increased costs beyond the tolerances should result in redisclosure to avoid harm and unnecessary delay to borrowers. Such an approach would be consistent with HUD's position that under RESPA violations of the tolerances occur only where the tolerances are exceeded, not where charges come in under the initial estimates. Consistent with this approach, MBA believes the Board should adopt an express "overstatement tolerance" that would permit overstatements at the initial stage and ensure that regulatory attention focuses on underestimates.

M. **Any Restrictions on Compensation and Steering Should Be Targeted to Serve their Intended Purposes and Not Unduly Limit Competition or Harm the Consumers They Are Intended to Serve –** MBA strongly opposes broad restrictions against loan officer compensation based on the rate and terms of loans. Commission-based compensation occurs throughout the nation's economy and results in good service to consumers. Before the Board moves to dismantle such compensation in the mortgage markets, the Board should implement clear disclosures regarding originator compensation so consumers can help protect themselves against steering and understand and negotiate the best compensation to serve their lending needs. In this connection, the Board should carefully monitor HUD's efforts to improve compensation disclosures. If, nonetheless, the Board determines to proceed with restrictions on compensation based on loans' terms, MBA believes any restrictions should be narrowly tailored to protect vulnerable borrowers and against steering to loans with risky features to carry out the Board's stated purpose for this proposal. Prime mortgage lending markets are highly competitive with thin margins and there is little room for compensation to drive steering. Government programs offer sustainable mortgage products. For these reasons compensation restrictions on these loans are unnecessary.

Whether or not the Board takes a narrower, more targeted approach, MBA strongly urges that the Board explicitly except a variety of practices from any restriction. The restriction should not apply to payments to lender companies and compensation to managers and executive personnel. It also should except practices to enable consumers to reduce their upfront closing costs and to provide sustainable credit to those who have been underserved. MBA also favors permitting compensation based on the loan amount.

As indicated, MBA also has profound concerns about the imposition of a subjective restriction against mortgage brokers receiving additional compensation when the loan "may not be in the consumer's interest." Such a qualitative standard invites litigation, the costs of which will ultimately be borne by consumers. If a restriction against steering is established, MBA believes that bright line safe harbors capable of being measured quantitatively will be more effective.

Considering that this issue has engendered more concern from our industry than the rest of these significant proposals combined, raises a very complicated set of issues and has the potential to cause significant economic dislocations and adverse effects on small businesses, we would urge the Board to conduct a fact-finding hearing on this aspect of the rule.

II. Disclosures at Application

A. Background and Proposal

Currently, Regulation Z requires pre-application disclosures to consumers only for variable-rate loan transactions.[7] For these transactions, creditors are required to provide the Consumer Handbook on Adjustable-Rate Mortgages (CHARM booklet) and a loan program disclosure that provides twelve items of information at the time an application form is provided or before the consumer pays a nonrefundable fee, whichever is earlier. [8]

Under the Proposal, the Board would require creditors to provide to consumers two new one-page publications, commented on below, entitled (1) "Key Questions to Ask About Your Mortgage" (hereinafter "Key Questions") and (2) a new one-page publication, entitled "Fixed vs. Adjustable Rate

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[7] 12 C.F.R. § 226.19(b).

[8] 12 C.F.R. § 226.19(b).

Mortgages" in lieu of the CHARM booklet for all closed-end loans secured by real property or a dwelling, not just for variable rate loans.[9]

Creditors would be required to provide these documents before the consumer applies for a loan or pays a nonrefundable fee, whichever is earlier. Key Questions in a "Question and Answer" format explains the features of the loan with an emphasis on potentially risky features such as provisions for interest only and negative amortization. Also, to enable consumers to track the presence or absence of potentially risky features throughout the mortgage transaction process, the same questions in this one-page document would also be included in "Fixed vs. Adjustable Rate Mortgages."

The Board proposes to require creditors to provide the foregoing disclosures at the time an application is provided along with an ARM disclosure for each type of ARM in which the consumer expresses an interest.[10] The "Key Questions" disclosure would be subject to special formatting requirements, including a tabular question and answer format, as described under proposed § 226.19(b) (4).

B. General Comments on Proposed Disclosures at Application

MBA welcomes the Board's development and introduction of new generic disclosures to be provided to consumers "at application" and offers several suggestions to improve their value. MBA has long maintained that the development of simpler, uniform, and more readable information for consumers will improve the mortgage process by better empowering consumers to navigate through complicated but important financial choices while leveling the playing field for competitors to lower consumer costs. For this reason, as indicated, MBA created the Simple Facts, which it believes the Board considered in developing "Fixed v. Adjustable Rate Mortgages." The Board's "Fixed v. Adjustable" document is a positive development to replace the CHARM booklet which, while informative, is too long. MBA is confident that this shorter document will be read and understood by many more consumers.

Considering the content of the documents – questions to ask about mortgages and comparing fixed to adjustable loans – the requirements for

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[9] 74 Fed. Reg.at 43,329 (to be codified at 12 C.F.R. § 226.19(c)).

[10] The Board proposes to simplify the ARM loan program disclosure to focus on the interest rate and payment risks and the potential risks associated with ARMs. Information on how to calculate the payments would be moved to the early TILA disclosure provided after application. The Board believes that placing that information there will allow the creditor to customize the information to the consumer's potential loan making the information more useful to consumers.

providing the document are incongruous. The Proposal provides that the document is to be given at the time an application form is given to the consumer or before a fee is obtained from the consumer, whichever is earlier. However, the document would be far more valuable if it were used in the shopping process up to the time of application, not merely at application itself. Indeed, Key Questions starts with the entreaty "When you are shopping for a loan, ask each lender the questions below…" With some additions and improvements to the forms, both the Key Facts and Fixed v. Adjustable rate documents should be distributed widely by the government and required to be distributed by private entities and creditors to consumers before and during the home buying and mortgage shopping process to facilitate maximum understanding.

Specifically, consideration should be given to requiring that they be made available by mortgage brokers, real estate sales professionals, housing counselors and government agencies such as HUD, the Department of Veterans Affairs and the Department of Agriculture Rural Housing Service (RHS). MBA believes that too often consumers may make choices in the home buying process with urging by commissioned real estate sales personnel that they use adjustable rate mortgages to buy higher priced homes. Provision of the Board's generic forms by real estate sales persons and others who deal with or provide information to consumers earlier in the home buying process would aid consumer understanding of the risks and benefits of adjustable rate mortgages. These forms also should be made available through links to creditor, mortgage broker, housing counseling agency, governmental and real estate Web sites.

While MBA appreciates the Board's educational efforts and believes it should retain a key role in providing materials through links or otherwise to assist consumers, government agencies, trade associations, creditors and other settlement service providers, MBA strongly recommends that the Board also invest in improving its own Web site so the site is better organized and has better search capabilities for consumers.

Considering that the dissemination of these forms must occur prior to application[11] or payment of a fee whichever is earlier, as a general matter, the

[11] 24 C.F.R. § 3500.2 provides:

> Application means the submission of a borrower's financial information in anticipation of a credit decision relating to a federally related mortgage loan which shall include the borrower's name, the borrower's monthly income, the borrower's social security number to obtain a credit report, the property address, an estimate of the value of the property, the mortgage loan amount sought, and any other information deemed necessary by the loan originator. An application may either be in writing or electronically submitted, including a written record of an oral application.

Board should work with HUD to determine how HUD's definition of application under Regulation X should pertain.[12]

C. Specific Comments on *Key Questions to Ask About Your Mortgage*

Considering that we believe the forms should be provided prior to application, we believe that this document would be enhanced if in the introductory text it provided additional brief information to consumers about what they should do as they consider applying for a mortgage. Notably, the form should advise the borrower that their credit quality and the ratio of the loan to the home's value will be considered when they apply and that borrowers should carefully consider how large a monthly payment they can comfortably afford now and in the future. These items of information can help a borrower obtain affordable and sustainable home financing. Accordingly, the following should be inserted:

> You should prepare yourself before you shop for a mortgage. You should know your credit score and the amount of money you could comfortably borrow considering the payments required and the total amount of the loan. Your credit rating and the greater the amount of money you borrow compared to the value of your house will help determine your interest rate and loan costs.

The value of Key Questions also would be greatly enhanced for many borrowers if at the top of the form it also clearly advised that interpreter services should be obtained in instances where the borrower did not understand English.[13] The document should be revised to include a statement along these lines:

> It is necessary that you understand the many documents you will be provided before you enter into a mortgage. If you cannot read and understand English, you should arrange for an English speaking interpreter or lawyer to review the documents for you and explain them to you in your language.

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[12] MBA does not believe an application should be regarded as received when a mortgage broker has received it, as HUD has held.

[13] In response to the Board's request for comments discussed below regarding whether the Board should require that creditors translate disclosures into languages other than English, MBA urges that the Board arrange translation of key documents such as Key Questions and Fixed v. Adjustable Mortgages into several languages and make the translations widely available through the Board's Web site. Lenders do not have the current capability to translate documents into a wide range of languages. Therefore, high costs could be avoided if the Board took the initiative to translate its generic forms into a range of languages. Such translations could be made available to link to creditor, real estate broker, mortgage brokers and other Web sites.

Since some ARMs, for example 7-23s and 5-25s, adjust after a relatively long period, it is misleading to say in the first sentence of the answer to question 1 that if you have an adjustable rate mortgage, your interest rate can go up or down after a “short period.” The document would be more accurate if the word “short” were replaced by “specified.”

Question 1 “Can my interest rate increase?” and question 2 “Can my monthly payment increase?” might be combined into one point, although we recognize that products exist with a fixed rate and stepped payment. Rate and payments are generally strongly related concerns to consumers. Also, the monthly payment would be better explained as payment of principal and interest rather than a more expansive monthly payment, which may include taxes and insurance as well. In this connection, we suggest the matter of increases in taxes and insurance should be removed from the second sentence and the third sentence should be rewritten to address taxes and insurance.

Can my interest rate and monthly payment for principal and interest increase?

> If you have an adjustable rate mortgage (ARM), your interest rate and your monthly payment for principal and interest can go up or down after a specified period, often by hundreds of dollars. This increase could be because you have a lower introductory rate or because in the beginning your monthly payment only covers the interest on your loan and not the principal owed. Over the life of your mortgage, your property taxes and insurance premiums for the property also can be expected to increase, increasing your monthly payment for principal, interest, taxes and insurance.

An additional question after question 1 would be a valuable addition – “Will my taxes and insurance be ‘escrowed’ for my mortgage?” Consideration could be given to combining the last sentence of the response above under this question.

> Some loans require that your monthly payment include approximately 1/12 of your annual property taxes and insurance premiums for your property. Considering that taxes and insurance may be substantial annual sums, many borrowers prefer these arrangements.

The answer in point 3 should say “reduce your loan balance” instead of “build any equity in your home.” This substitution would be more appropriate considering the question asked, “Will my monthly payments reduce my loan balance?”

In question 5, the term “large fee” is undefined and unnecessary in context. Such a prepayment fee reduces the interest rate and monthly payment. The text should be rewritten:

> Some loans charge you a prepayment fee if you pay off your loan, refinance it, or sell your home within the first few years of the loan. The prepayment fee could be thousands of dollars.

In question 5, in the interest of clarity the question should be “Will I pay more if I don’t document my employment, income or assets?”

D. Specific Comments on *Fixed v. Adjustable Rate Mortgages*

Generally, the document should be revised to remove what appears as an unfair bias against ARM mortgage products. ARM products continue to prove to be an excellent choice for many borrowers. Indeed, many who took out ARMs in the late stages of the recent real estate boom have been able to better afford their homes because the period that followed has been a lower-interest rate environment lowering their financing costs. In this vein, consideration should be given to providing a more balanced and understandable title such as “Choosing Between Fixed and Adjustable Mortgages.” Also, in this vein and in the interest of precision since some loans have fixed rates but may not fully amortize, the answer to “What Type of Mortgage is Right for You?” should be revised to provide:

> A traditional fixed rate fully amortizing mortgage [or a traditional fixed rate mortgage with equal monthly payments for principal and interest over the life of the loan] is a safe choice for many borrowers but in some circumstances an adjustable rate mortgage could be a good choice for you.

In the first sentence under Fixed Rate Mortgage, to avoid misleading the consumer that taxes will stay the same for the entire loan term, the sentence should be revised to state:

> With a fixed rate mortgage the monthly payment of principal and interest stay the same for the entire loan term.

In the interest of providing additional relevant considerations to borrowers, the Board should consider providing information on refinancing under a fixed rate mortgage v. a decreased rate on an ARM in a lower interest rate environment, an additional set of bullets should be added to both columns.

In the fixed rate mortgage column:

> If interest rates decrease markedly, you are willing to refinance to receive a lower rate

In the ARMs column:

> You think interest rates may drop and you want your rate to drop as well without the need to refinance,

Considering that some borrowers may be able to refinance under their ARM loans, the final paragraph should be revised to provide:

> If you are considering an ARM, do not count on being able to refinance before your interest rate and monthly payments increase. You may not qualify for refinancing if the market value of your home goes down, or your financial situation changes due to job loss, illness or other debts.

E. Specific Comments on H-4 (B) the *Adjustable Rate Loan Program Model Form*

Below, we provide some specific comments relating to Form H-4(B). Our comments follow the format of the disclosure itself addressing: (i) Interest Rate and Payment; and (ii) Key Questions About Risk.

Interest Rate And Payment

The narrative associated with the "Introductory Period" requires disclosure if the “interest rate” “is discounted.”[14] MBA believes that consumers may be confused by the term "discount," as it is used here, which may distract the borrower’s attention from the central point of the disclosure, which is that the interest rate may change. We suggest that the Board delete the reference to a "discount" and provide the borrower with the remaining information on the length of the introductory period and any possible increase or decrease in the rate. Also, by requiring disclosure of an increase or decrease as a “%” rather than in the form of “percentage points” consumers may be confused about whether a creditor is describing an increase or decrease of a percentage of the initial rate or the addition of percentage points to the initial rate. To avoid

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[14] 42 Fed. Reg. at 43,340 (Sample Form H-4(B) Adjustable-Rate Loan Program Model Form).

these potential areas of confusion, MBA suggests that the Board revise the narrative to read as follows:

> [T]he initial interest rate will stay the same for [a] (*length of time*) [introductory period]. After this initial period, the interest rate could change, even if market rates do not change, this rate will [increase] [decrease] by ___ percentage points.

Additionally, we recommend that the narrative disclosure for "Limits on [Rate] [and Payment] Changes"[15] be revised to accommodate loans that may have two caps. We also recommend revising the disclosure to address rate decreases, as provided, below:

> "decreases of no more than ____ percentage points are also depicted."

Key Questions About Risk

With respect to this portion of the disclosure form, we have two generalized comments and one specific comment. Specifically, we suggest that the Board revise the question "Can my monthly payment increase?" to read (more accurately) "Can my monthly payment of principal and interest increase?" (Note that HUD uses the term "rise"). We make this recommendation because the narrative associated with this question does not contemplate increases in taxes or insurance, which could also trigger a payment increase. Our two general comments regarding this portion of the disclosure follow.

The disclosures required under "Key Questions About Risk"[16] would not require originators to make disclosures that are not applicable to the particular loan. For example, loans without balloon payments would not be required to provide information on balloon payments unless one was characteristic of the loan offered. Although this would shorten the information provided to consumers for some loans, it will necessitate tailored forms for each loan product, increase costs, and, most importantly, will make it considerably more difficult for consumers to compare loan products from originator to originator. The better approach would be for the form to include checkboxes with accompanying explanations. For example, before each narrative description, there would be a check box for the creditor to check if the loan contained that term. Some examples provided, below:

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[15] 42 Fed. Reg. at 43,340 (Sample Form H-4(B) Adjustable-Rate Loan Program Model Form).

[16] 42 Fed. Reg. at 43,340 (Sample Form H-4(B) Adjustable-Rate Loan Program Model Form).

☐ **YES**. You would owe a balloon payment due (period).

☐ **YES.** If you provide more documentation, you could decrease your interest rate or fees.

MBA also urges the Board to consider harmonizing this disclosure with HUD's Good Faith Estimate and HUD-1 and HUD-1A. We strongly believe that the narrative description of terms in this form should be identical to the "Summary of the Loan" provisions on HUD's new Good Faith Estimate form and the "Loan Terms" provision on HUD's new HUD-1 and HUD-1A. Consumers will be receiving the TILA and RESPA forms contemporaneously at key stages of the loan process. As such, we believe it is imperative that the forms use identical language to describe the loan's terms, otherwise, by describing the same loan terms differently in different disclosures, there is a risk that consumers may be confused about the actual loan terms.

For example, Form H-4(B) uses: "Can my interest rate increase," however, as indicated, the HUD-1/-1A uses different language to describe the same concept: "Can your interest rate rise?" Another example is that Form H-4(B) uses this language: "Will I owe a balloon payment?" and the HUD forms again use different language to describe the same comment: "Does your loan have a balloon payment?"

As indicated, MBA strongly supports efforts by the Board and HUD to simplify and improve the mortgage process by creating a single simple combined RESPA and TILA form that specifies the key terms of a borrower's loan. Pending that action, MBA urges the Board to describe loan terms using language identical to language found on the HUD forms in the interest of economy, consistency and efficiency.

F. Specific Comments on *H-4 (F) Adjustable-Rate Loan Program Sample (Payment Option ARM)*

Below we provide specific recommendations for revising the language associated with Model Form H-4(F), relating to payment option ARMs.

Key Questions about Risk

First, we recommend that the Board revise: "Will any of my monthly payments be interest-only?" to read: "Can my monthly payments be interest only?" The latter construction better expresses that the choice to make interest only payments is at the option of the consumer.

Second, we recommend that the Board revise the response to: "Even if I make my monthly payments could my loan balance increase?" to clarify the effect of making minimum payments as follows:

> YES. Your initial minimum payment may cover only part of the interest you owe each month and none of the principal. If you choose the minimum payment the unpaid interest will be added to your loan amount. Over time this will increase the total amount you are borrowing, cause the reduction of any equity you may have in your home, and result in much higher payments.

III. Disclosures Within Three Days After Application (the "early TILA disclosure")

A. Background and Proposal –

TILA and Regulation Z currently require creditors to provide an early TILA disclosure within three business days after application.[17] Since July 30 of this year, when the Board implemented its MDIA rules, such disclosure must be mailed or delivered at least seven business days before consummation, and must be received by the consumer before the consumer has paid a fee other than a fee for obtaining the consumer's credit history. Under these new rules, if the APR on the early TILA disclosure changes beyond a specified tolerance before consummation, the creditor must provide corrected disclosures that the consumer must receive at least three business days before consummation. If any term other than the APR becomes inaccurate, the creditor must give the corrected disclosure no later than at consummation.

The early TILA disclosure, and any corrected disclosure currently include the amount financed, the finance charge, the APR, the total of payments, and the amount and timing of payments.[18] The finance charge is the sum of all credit-related charges, but excludes a variety of fees and charges.[19] The APR is calculated based on the note rate and the finance charge and is meant to be a single, unified number to help consumers understand the total cost of credit.[20]

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[17] 15 U.S.C. § 1638; 12 C.F.R. § 226.19(a),

[18] 12 C.F.R. § 226.18.

[19] 12 C.F.R. § 226.4.

[20] 12 C.F.R. § 226.22.

Currently, TILA and Regulation Z permit creditors to exclude several fees or charges from the finance charge, including certain fees or charges imposed by third party closing agents; certain premiums for credit or property insurance or fees for debt cancellation or debt suspension coverage, if the creditor meets certain conditions; security interest charges; and real-estate related fees, such as title examination or document preparation fees.[21]

Under this rulemaking the Board proposes to:

1. Revise the finance charge calculation for closed-end mortgages, and the definition of "points and fees" for HOEPA loans, using its exception and exemption authority under TILA. The finance charge, which the Board proposes to rename the "interest and settlement charges" and the annual percentage rate (APR) calculations would be revised so that they capture most fees and costs paid by consumers in connection with the credit transaction. Third-party fees would be included if the creditor requires the use of a third party as a condition of or incident to the extension of credit (even if the consumer chooses the third party), or if the creditor retains a portion of the third-party charge (to the extent of the portion retained).

2. Overhaul the form of the disclosures given three business days after application including renaming the finance charge as "interest and settlement charges" and on the form:

    a. Provide a graph that would show consumers how their APR compares to the APRs for borrowers with excellent credit to the APR threshold for Higher-Priced Mortgage Loans;

    b. Summarize key loan features, such as the loan term, amount, and type, and disclose total settlement charges, as is currently required for the GFE under RESPA and Regulation X;

    c. Require disclosure of potential changes to the interest rate and monthly payment; adopting new format requirements, including rules regarding: type size and use of boldface for certain terms, placement of information, and highlighting certain information in a tabular format.

[21] 12 C.F.R. § 226.4(c)(7), (d) and (e).

B. Comments on Proposal

1. All-In Finance Charge and APR

MBA has, over the years since TILA was enacted in 1968, supported establishment of a more inclusive finance charge and all-in APR. MBA believes an all-in APR would be a more realistic calculation of the cost of credit and would provide a more useful shopping tool for consumers. A change to such an approach, if done properly, could render obsolete a far too complex regulatory structure where time is spent noting which items are inside and outside of the calculation rather than arriving at optimal transparency for consumers. It is for this reason that MBA welcomes the Board's proposal. Nevertheless, there are several factors which must be addressed under current rules before MBA can support such a conversion. These include adjustment of the Average Prime Offer Rate (APOR) used to determine the Home Mortgage Disclosure Act (HMDA)[22] and higher priced mortgage loan triggers, and definition of "points and fees" used to determine the HOEPA loan points and fees trigger, appropriate exclusion or at least differentiation of third party fees for purposes of the TILA tolerances as well as careful analysis of the ramifications of such a change on coverage of loans under state anti-predatory lending laws. Considering that MBA's rationale for supporting such a change has been to better serve consumers, precipitous change could, ironically, have the opposite effect.

Both first and second lien loans may be Higher-Priced Mortgage Loans or have HMDA-reportable rate spreads based on the amount their APRs exceed the APOR. Assuming an all-in APR and concomitant increases in APRs across the market, to avoid unnecessary application of the High-Priced Mortgage Loan restrictions and over reporting of higher priced lending on HMDA data, the Board should revise its calculation of the APOR. The Board currently calculates the APOR by converting the rates and fees reported in Freddie Mac's Primary Mortgage Market Survey ("PMMS") into APRs. However, the PMMS does not report as fees all of the fees that would now be included in the APR as a result of the elimination of finance charge exclusions. Accordingly, the Board should revise its APOR calculation to include all of the fees that would now be considered finance charges.

While the Board noted that there would indeed be increased HOEPA Loans as a result of this change, it indicated that the affects would be minimal. However, the Board's figures do not reflect the internal analyses

[22] 12 U.S.C. §§ 2801 *et seq.*

of lenders. MBA would be willing to assist the Board in reviewing this data to avoid misleading over reporting. The Board estimated that the share of first lien refinance and home improvement loans that were HOEPA loans would increase by about .06 percent (see 74 Fed. Reg 43244), it appears that the Board made this determination based solely upon the impact of its proposed changes on the APR calculation. It does not appear to have considered how the elimination of the finance charge exclusion and the changes to the definition of "points and fees" under Section 226.32(b)(1) could significantly increase the share of loans that are HOEPA loans due to reaching HOEPA's points and fees limit of eight percent of the "total loan amount" or $583 (for 2009). To avoid this result, we recommend that bona fide and reasonable fees that are currently excluded from the definition of points and fees should continue to be excluded. Furthermore, the definition of "total loan amount" should also be revised so that these fees are added to back to the Amount Financed, so that the eight percent limit is not computed on a substantially lower amount.

Even if the Board makes adjustments in the HOEPA, Higher-Priced Mortgage Loan and HMDA triggers, many states have laws that also have APR and points and fees triggers. Before the Board eliminates the finance charge exemptions and establishes an all-in APR, MBA strongly believes it should analyze the effect of these changes on state lending laws. While the Board noted that only three state high cost loan laws established APR thresholds lower than HOEPA's APR threshold, the Board failed to consider that 20 states have high cost loan laws with Points and Fees Threshold lower than HOEPA's Points and Fees Threshold. Many of these states directly incorporate TILA and Regulation Z definitions of APR, finance charge, points and fees, and total loan amount. If the changes to these definitions, the elimination of the finance charge exclusions and the establishment of an all-in APR results in over coverage under these laws, the resultant regulatory burden and restraints to competition will outweigh the benefits to the consumer of a more useful APR, because very few lenders are willing to make loans that are subject to state high cost loan laws.

If the Board determines to go forward with an all-in APR following the comment period, in addition to the recommendations made above, MBA also believes it should adjust its tolerances[23] and differentiate between third party charges and creditor fees for purposes of those tolerances. Currently, under MDIA, when the APR changes by 1/8 of a percentage

[23] Current "tolerances" for determining whether an APR disclosure is accurate for TILA purposes is 1/8 of one percent for regular transactions and 1/4 of one percent for irregular transactions. 12 C.F.R. § 226.22.

point for regular transactions or 1/4 of a percentage point for irregular transactions (from the time of early disclosure to the time of consummation), the TIL must be redisclosed at least three days prior to loan consummation.[24] Changes in an all-in APR are likely to exceed these triggers far more frequently necessitating this adjustment.

Creditors cannot be expected to meet the APR and Finance Charge tolerances with the same precision when fees of third parties, which they do not control, are introduced into the finance charge and APR calculation. Notably, under HUD's RESPA rules fees are subject to different "tolerances" depending on the extent to which the creditor can be reasonably expected to predict the amount of the charge. For example, fees charged by "loan originators" (defined to mean the creditor and the broker, if any) have zero tolerance following rate lock (meaning that they cannot change), third party fees where the consumer selected the provider from a list generated by the creditor are subject to a 10 percent tolerance, and third party fees where the consumer selected the provider without knowledge by the creditor may change by any amount at consummation.

MBA urges the Board to follow HUD's lead. Fees that are outside of HUD's tolerances should be outside of the Board's.

In sum, changes to the Board's rules to eliminate finance charge exclusions and establish a more inclusive APR will increase the number of loans that have reportable rate spreads under HMDA and HOEPA. Additionally, an all-in APR will also have the effect of making the current finance charge and APR tolerances for calculation errors narrower since APRs will be greater and more fees that are beyond the creditor's control will be included. MBA strongly believes these factors warrant both changes to the HMDA and HOEPA triggers as well as the tolerances. The matter of the effect to this change on state and other federal laws must be carefully considered to ensure that the effort here is not ultimately counterproductive for the market and for consumers. Various lenders are developing or have developed data on the effects on their books of business of changes to the APR and calculation of points and fees under federal and state laws. MBA would welcome an opportunity to work with the Board on this important issue.

Finally, if the Board decides to adopt the all-in APR concept, it also should adopt an express overstatement tolerance for the APR, as indicated.

[24] 12 C.F.R. § 226.19.

2. H-19 (A) Fixed Rate Mortgage Model Form

Generally, MBA believes that the new form is a vast improvement over the current TILA disclosure. In MBA's view, the new form succeeds in providing consumers with key information they need to understand their loans, including a summary of key terms, a description of the APR as well as the interest rate and the total monthly payment. Consistent with earlier generic information they also provide, in a question and answer format, key information on the risks presented by the particular loan and more information about payments including whether the payments may change, whether an escrow account is required, and whether PMI is required. MBA does, however, have several comments to improve the form including the exclusion of some of the items on the form.

The proposed form requires disclosure of the name of the creditor along with the originator's unique identifier. This approach appears inconsistent with the RESPA GFE since it requires disclosure of the name of the originator company (mortgage broker or lender). While we understand that the TIL is to be provided by the creditor, we believe that this difference necessitates further collaboration between the Board and HUD to avoid consumer confusion.

Loan Summary

MBA supports the inclusion of the Loan Summary of amount, term, type, total settlement charges and prepayment penalty on the form. Even though the MBA urged HUD to refrain from requiring the disclosure of loan terms on the GFE and HUD-1, HUD ignored these recommendations and adopted as final GFE and HUD-1 forms that include disclosures of loan terms. Given this, to the extent possible, MBA again urges the Board and HUD to use identical language on Form H-19(A) and on the GFE and HUD-1. As previously noted, since creditors provide the RESPA and TILA disclosures at the same time at key stages of the financing process, MBA is concerned that inconsistent language will cause consumer confusion as well as unnecessary costs. We make this recommendation bearing in mind that, in the longer term, MBA urges the Board to work with HUD to combine RESPA and TILA disclosures into a single form. Our experience is that "less is more;" and the more borrowers are bombarded with information, because they are busy with the other demands of life, the less likely they are to read it.

Form H-19(A) permits creditors to omit the disclosure of a prepayment penalty, (which we recommend should be described as a "prepayment fee") when the loan does not include a prepayment fee. MBA members advise that it would be less costly, from a systems perspective, and easier for borrowers to compare loans if Form H-19(A) included a standard disclosure for prepayment information with an opportunity to "check the box" if the loan contains a prepayment fee. Consider the following:

Prepayment Fee

☐ This loan does not include a prepayment fee.

☐ This loan includes a prepayment fee of up to $__ if you pay off you loan, sell the property or refinance, or sell this property within [specified period].

We note here that prepayment fees are not ordinarily disclosed as a flat dollar amount or maximum. Creditors tend to follow the California disclosure regimen. MBA urges that, before a final form is developed, such a regimen should be considered.

Annual Percentage Rate

While MBA supports disclosure of the APR and the interest or note rate, it opposes the requirement that a graph be included on the form and that the APR be displayed next to it along with text depicting the average prime offer rate for borrowers with excellent credit and APR threshold for Higher-Priced Mortgage Loans.

From a systems perspective, creating and maintaining these graphs (especially given the gradations in shading) will be a significant cost burden; and one that MBA does not believe would be outweighed by the benefit of the disclosure to consumers. Further, the characterization of rates in the higher-priced mortgage loan category as rates that are in the “high-cost zone” is not appropriate and will lead to confusion over whether the loan is a HOEPA loan.

The only way borrowers can ensure that they get the "best" rate is to know their credit profile and other risk factors, how those factors affect the availability of loans, and then use that information to shop for loan products and rates. Pursuant to the requirements set forth under the Fair and Accurate Credit Transactions Act (FACTA),[25] creditors must provide applicants for credit with information regarding the applicants' credit scores. It is not clear that the graph adequately arms the consumer with the information necessary to shop for the "best" loan product. It is also not

[25] Pub. L. 108-159, 111 Stat. 1952 (which added new sections to the Fair Credit Reporting Act).

clear, however, that the Board can construct a simple disclosure – whether via a graph or otherwise – that conveys this necessary information. Ultimately, the consumer needs to focus on disclosures provided under FACTA relating to his or her creditworthiness to properly understand his or her ability to shop for rates.

MBA recommends that the Board require a side-by-side comparison of the note or interest rate with the APR, along with a discussion of the difference between these rates, as a substitute disclosure for the graph. Assuming the Board adopts an all-in APR, the explanation could read as follows:

> The APR is greater than the interest rate or note rate for your loan because the APR includes both the interest rate and settlement charges. Since settlement charges are included in the calculation of the APR, you may use the APR to compare the cost of loans, provided the loans have comparable terms (i.e., 15 or 30 years), loan-to-value ratios and features (fixed v. adjustable).

Interest Rate and Payment Summary

For the following reasons, MBA believes that the disclosures relating to taxes and insurance are not clear. First, the reference to "escrow" may be confusing to consumers when "escrow agents" are involved in closing the loan. Second, the form should include a better explanation that the taxes and insurance figure is an estimate. Third, the form should include a reference to the back of the form concerning whether an escrow account will be established so that your payment will include an amount for taxes and insurance or whether you will be responsible for paying them separately.

It appears, under proposed section 226.38(c), that the disclosure of the estimated amounts of taxes and insurance is only required if the creditor requires the establishment of an escrow account. We recommend for first lien loans that a disclosure of the estimated amount of taxes and insurance be required whether or not the creditor will require an escrow account. In determining whether the consumer can afford the loan, the consumer should consider the cost of taxes and insurance whether or not they are escrowed. The consumer cannot accurately compare the cost of credit between different creditors if some creditors disclose taxes and insurance and others do not.

Key Questions about Risk

As we have noted previously, we recommend a "check-the-box" system of disclosure for prepayment fees and modifying the language to be identical to that used by HUD on the GFE and HUD-1. Additionally, the "yes" and "no" leading answers should either both be in bold type or neither should be in bold type.

More Information About Your Payments

Again, consistent with earlier comments, disclosure of private mortgage insurance should be a "check the box" type of disclosure, as follows:

☐ This does not apply to this loan.

Additionally, although we understand that the disclosure of "Total Payments" is an essential TIL disclosure, MBA does not believe it is useful information**.** In fact, considering that most borrowers either move or refinance within seven years of purchasing a home, the dollar amount for total payments generally is neither relevant nor helpful. As such, we recommend omitting this language altogether.

The instruction language should not indicate that the borrower is required to sign the form. HUD does not permit a borrower signature on the GFE and creditors may or may not seek a signature or a separate acknowledgement of receipt for that disclosure. For consistency purposes, we recommend that the Board omit this instruction and instead simply state: “You have no obligation to accept this loan.”

MBA does not believe that the tax deductibility disclosure is useful information at the time creditors provide this disclosure; however, it may be useful if disclosed generically at the time of application.

3. H-19 (B) Adjustable-Rate Mortgage Model Form

MBA supports the Board’s creation of special disclosures for adjustable-rate or step-rate loans that show the interest rate and payment at consummation, the maximum interest rate and payment at first adjustment, and the highest possible maximum interest rate and payment. Additional special disclosures apply to loans with negatively-amortizing payment options, introductory interest rates, interest-only payments, and balloon payments.

We incorporate by reference our above comments on the H-19(A) Fixed Rate Mortgage Model Form and apply them to the H-19(B) Adjustable-Rate Mortgage Model Form. However, in the disclosure of the "Interest Rate and Payment Summary," we recommend that the Board include an explanation that the comparison chart presents a worst case scenario.

We note that while we generally favor identical terms on the RESPA and TILA forms, the ARM adjustment information in the new RESPA forms is not flexible enough for lenders to describe adjustments. Where, as here, RESPA terms are inadequate, the Board and HUD should consult to develop suitable, common terms.

Also, we recommend that the "Rate Calculation" and "Rate Change Limits" narrative discussion include language indicating whether the provision applies (via a check-the-box format). Also, to avoid confusion, in expressing percentage increases, the term "percentage points" should be used rather than merely the "%" sign.

IV. Disclosures Three Days Before Consummation

A. Background and Proposal

Under Regulation Z today, a creditor is required to provide the early TILA disclosure to the consumer within three business days after receiving the consumer's application and at least seven business days before consummation, and before the consumer has paid a fee other than a fee for obtaining the consumer's credit history.[26] The new rules implementing MDIA also provide that if the APR on the early TILA disclosure exceeds a specific tolerance, the creditor must provide corrected disclosures that the consumer must receive at least three business days before consummation (referred to as the "Waiting Period"). If any term other than the APR becomes inaccurate, the creditor must give the corrected disclosure no later than at consummation. The rules provide the consumer may waive the seven- and three-day waiting periods for a *bona fide* personal financial emergency.[27]

Under this proposal, for the stated purpose of addressing long-standing concerns about consumers facing different loan terms or increased settlement costs at closing, the Board proposes to require creditors provide a "final" TILA disclosure at least three business days before consummation (the "Additional

[26] 12 C.F.R. § 226.19(a).

[27] 12 C.F.R. § 226.19.

Waiting Period") in all cases.[28] The proposal offers two alternatives regarding the circumstances for this redisclosure:

- Under alternative 1, if any terms change during the Waiting Period, the creditor would be required to provide a "final" TILA disclosure and wait an additional three business days before consummation could occur.

- Under alternative 2, creditors would be required to provide a final TILA disclosure, but would have to wait an additional three business days before consummation only if, during the Waiting Period, the APR increased beyond 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.

B. Comments on Proposal

MBA supports efforts to assure consumers receive simpler, clearer disclosures and have a reasonable time to consider them during the mortgage process closing. Nonetheless, MBA believes that before the Additional Waiting Period is added to the loan origination timeline, efforts must be made to: (1) eliminate the three-day rescission period if a pre-consummation waiting period is added; and (2) make the new RESPA redisclosure requirements consistent with the Board's requirements.

If borrowers received a HUD-1 and final TILA disclosures three days before consummation, borrowers would have a meaningful review period before being committed to a loan, thereby negating the need for a three business day post closing rescission period. As such, MBA would consider supporting the new disclosure paradigm if the Board were to eliminate the post-closing rescission period.

Assuming that the Board goes forward with its proposal, MBA urges the Board to adopt Alternative 2. Under that alternative, the Additional Waiting Period applies only if the APR increases beyond 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.

[28] 74 Fed. Reg. at 43,393 (to be codified at 12 C.F.R. § 226.19(a)(2)(ii)).

Specific Comments

The value of the proposed requirement for a final disclosure three days before consummation in all cases is unclear at best. As indicated, under current law, consumers already receive disclosures at application and now, pursuant to the Board's recent MDIA rules, whenever the APR changes. When the APR does change, the borrower is given three days before closing to review the disclosures. Additionally, for certain refinance transactions, as the Board is aware, there also is a three-day right of rescission following consummation (however only a small population of borrowers ever exercise this right).[29] Notwithstanding the rarity with which borrowers exercise this right, none of the millions of borrowers obtaining refinanced mortgage loans each year can receive any loan funds during the three day rescission period absent a waiver. As we will discuss, given the lack of guidance on what consumers and creditors must demonstrate to show the need for a waiver, waivers are even rarer than instances where borrowers exercise the right to rescind. Therefore, in the context of refinance transactions, imposing an additional three-day waiting period arguably is not to the benefit of the consumer.

Regulation X further complicates the matter. Regulation X provides that originators may provide a new GFE to an applicant whenever there are "changed circumstances" affecting settlement costs,[30] and permits borrowers to request to review the HUD-1 as of the business day prior to consummation. Given the differences in the timing requirements for RESPA disclosures and TILA disclosures, creditors will find complying with these two laws difficult under the new rules. Unfortunately, it is the consumer who ultimately suffers because the disclosures provided can be confusing and given at different times. This is another reason why harmonization of the laws is essential and we urge that differences between TILA and RESPA regarding timing as well as terms be resolved before the Proposal is finalized.

In the past, the Board has provided little guidance concerning the waiver of the three-day right of rescission or the new seven-day and three-day periods prescribed under MDIA. Accordingly, the addition of a new three-day waiting period should be accompanied by Board commentary establishing examples of circumstances such as an expiring rate lock that establish a *bona fide* financial emergency so borrowers are not denied needed funds because of unduly limiting provisions. Guidance should also make clear that lenders should be able to rely on borrower statements and claims of financial emergency when considering the merit of a request for waiver or modification of a waiting period. Lenders should not be required to look behind or

[29] 12 C.F.R. § 226.23.

[30] 24 C.F.R. § 3500.7(f)(1).

otherwise police borrowers' certifications to determine the extent to which a borrower has a financial emergency.

As indicated, If the Board adopts this new disclosure requirement, MBA urges that creditors be required to provide another final TILA disclosure and wait an additional three business days before consummation only if the APR exceeds a designated tolerance or the creditor adds an adjustable-rate feature. In fashioning such an exception, the Board should make clear that only an increase in the APR beyond the tolerance and not a decrease in the APR beyond the tolerance should trigger the redisclosure obligation.

Currently, under MDIA, creditors must provide a borrower redisclosure of the TIL three days prior to closing when the APR changes beyond the prescribed tolerance, whether or not the change represents a decrease or increase in the borrower's costs. Under the circumstances, decreased costs for a borrower ironically lead to a three-day delay in closing and the concomitant unavailability of needed funds during this period. Provisions to protect consumers should not become harmful "Catch 22's." **Whether or not the Board adopts this new required disclosure, the Board should clarify that only increased costs beyond the tolerances should result in a redisclosure and an additional three days to avoid harm to borrowers.**

V. Disclosures After Consummation: Section 226.20

A. <u>ARM Adjustment Notices - 60-Day Notice Period</u>

The Proposal would require that creditors provide ARM adjustment notices to borrowers at least 60 days, but not more than 120 days, prior to the payment change due date. Existing rules currently require that such notices be given 25 days, but not more than 120 days, prior to the payment change due date.[31] The proposal appears to apply to all existing loans, although the Proposal does not expressly state this fact.

Today, many notes do not provide sufficient time between the date the index is tested (called the "Current Index" in most notes) and the payment change due date to offer a 60-day notice. Existing notes simply cannot be changed without unilaterally breaching contracts and subjecting servicers to liability. As a result, MBA strongly opposes a rule that would change the current 25-120-day notice requirement on existing mortgages.

To achieve a 60-day notice *going forward*, standard notes would have to be rewritten to extend the "Look-back Period." As stated in the preamble, the "Look-

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[31] 12 C.F.R. §226.20.

back Period" is the time between the "Current Index" date and the "Change Date" (the date the new interest rate is applied). Because interest is paid in arrears, the borrower does not see a payment change until the due date of the following month after the Change Date. Of course, the timing can vary from 28 days or 31 days depending on the month and whether the Current Index date must be tested on the previous or following business day if the Current Index falls on weekend or holiday.

MBA asked several members to evaluate the cost of making changes to their ARM notes. We were told by two large servicers that the upfront cost would be about $1 million per institution if this rule applied prospectively. The cost involves making system changes to capture the new information and calculations, changing the notes, changing existing disclosures, making sure all business partners and staff are trained, and increasing due diligence and quality control especially on brokered or correspondent loans. The cost to apply this retroactively would be more financially burdensome and require more resources and time to comply as more procedures would have to adjusted than if applied only to newly originated loans. Given the current housing crisis and the competing obligations on servicer's time and resources, we urge the Board to apply this requirement prospectively only to newly originated loans.

While we have been unable to do a full review of all ARM notes, we know that FHA and VA ARM notes, some GSE and bank ARM notes provide a 30-day look back, meaning the total time from Current Index to payment change due date is 60 days or less (depending on holidays, weekends, etc). The proposed policy, therefore, cannot apply to these existing notes. Despite what appears to be a 60-day timeframe in the notes mentioned above, ARM notices cannot be sent the date the new index is tested and certainly not before the new rate is known. Servicers require at least 15 days to verify the index once established before any notice can be sent to the borrower and thus any final proposal must embed an additional 15 days into the timeline to conduct the appropriate quality control tests and process the notices. As a result, any effort to apply this new notice requirement retroactively is problematic and should not be implemented.

A problem has also surfaced with servicing transfers and the lengthening of the notice period from 25 days. Generally, it takes about a week for loans to be boarded on a servicer's system and 15 days for the index to be verified and documents to be created and mailed. With the lengthening of the notice requirement, servicers could be subject to technical non-compliance during servicing transfers. Below is an example of the timing problem to help illustrate the concern. This example assumes a 60-day notice requirement (and 45-day look back):

Servicing transfer date	01/16/10

Payment change date	04/01/10
Interest rate change date	03/01/10
45 day look back date	01/16/10
Loan boards	01/25/10
System calculates new rate	01/27/10
60-day notice mail date	02/01/10

As you can see, there is insufficient time to verify the index and to allow for the file to be sent to the print vendor, the notices printed and returned to the servicer for review and mailing. The same problem could occur with a 45-day notice period (i.e., with 30-day look-back) and we are unsure how to best solve this problem. One approach would be to allow a shorter notice cycle in the event of servicing transfers. For example, if the Board adopts a 60-day notice requirement, permit a 45-day notice for those loans were the servicer has less than 15 days from loan boarding to issue the notice. Likewise if the Board adopts a 45-day notice requirement, allow a 30-day notice cycle. Only a small segment of notes will have this problem and thus the exception would be limited.

First, and foremost, the Proposal should not be applied retroactively. Any change to the timing of the ARM adjustment notice should be prospective to loans originated after the *effective date.*

Second, to reduce the number of notes that need to be changed and the associated costs, we suggest that the Board consider a 45-day notice provision on prospective originations rather than the 60-day period proposed. We also believe some exception should be offered for servicing transfers where the servicer has less than 15 days from loan boarding to issue the notice.

Third, in determining the effective date, lenders, servicers, service bureaus/technology vendors, form vendors, attorneys etc. indicate they need at least 12 months to implement the requirement given the competing demands on internal system staff. This time would be in addition to the time Fannie Mae, Freddie Mac, HUD and VA may need to make official changes to the notes and release revised documents and guidance, if applicable. In all, we recommend a total of 18-24 months before any new ARM notice timeline becomes effective.

B. <u>ARM Adjustment Notice – Content of Notice</u>

Interest Only and Negatively Amortizing Loans

For interest only (I/O) and negatively amortizing loans, the Proposal requires the ARM notice to include a statement of how the first payment is allocated between principal and interest (P&I) and taxes and insurance (T&I).[32]

First, MBA seeks clarification that this is limited to I/O and negatively amortizing loans.

Second, we urge the Board to reconsider this requirement on several grounds:

(i) The Proposal would require substantial system changes. Servicing systems today are not programmed to feed the allocation information into the ARM change notice. As a result, servicers will be faced with incurring significant costs to program their systems to execute the new notice content for what we believe is little value to the borrower and duplicative with the billing statement.

(ii) Consumers already receive this information in their monthly billing statements where it can be provided accurately and on a real time basis. There is no need, therefore, to provide it in the ARM change notice. Given that the stated objective of the ARM change notice is to alert borrowers of potential payment increases, this goal can be accomplished without the added complexity of defining allocations of PITI. Borrowers receive a monthly billing statement approximately 30 days prior to the due date of the new payment.

(iii) The ARM change notice offers projections based on assumed principal balance. The information would be an approximation, at best, as the principal balance can change based on borrower payments between the notice and due date.

(iv) Allocation of a payment between principal and interest changes monthly. As a result, the statement, in addition to being an approximation, would be accurate for only one month. This is especially true for monthly adjusting ARMs and borrowers who vary their Option ARM payments. Also for I/O loans, it should be obvious that the payment is interest only. We are concerned that borrowers could mistakenly assume that the disclosure of the first month's allocations will apply to all payments going forward irrespective of rate changes, principal payments, and amortization. The Proposal, therefore, calls for significant programming investment for what may confuse or mislead the borrower.

(v) Similar problems exist for the T&I breakdown. There is currently no feed to provide this information to the ARM notice. Any reference to tax and insurance will be an approximation and could conflict with information in the

[32] 74 Fed. Reg. at 43,330.

annual escrow analysis and monthly statements.[33] Again this has the potential of confusing the borrower.

Maximum Prepayment Penalty

The proposal calls for servicers to disclose the maximum prepayment penalty applicable to the mortgage.[34] Providing this prepayment penalty information is very difficult for the same reasons as providing the PITI allocations. Systems do not calculate the prepayment penalty in this manner. A date must be selected to determine the amount of the prepayment penalty. Also the proposal would require the prepayment penalty to be calculated on hypothetical information, which will result in the information being stale or inaccurate. Ideally, we recommend that the servicer state that there is a prepayment penalty, when applicable, and suggest the consumer call a provided toll free number for loan-specific information. Alternatively, we suggest the Board allow servicers to select a date certain to calculate the prepayment penalty, including the date of the "Current Index" (e.g., when the date of the index is tested) up until the due date of the new payment adjustment. The date that was selected would be disclosed but at the discretion of the servicer.

MBA also recommends adding a Comment to Section 226.20(c)(4)(i) clarifying that the "two-stage penalty calculation" as described in proposed Comment 38(a)(5)-6 may be used to calculate the maximum penalty amount.

In some cases the loan documents may provide that a prepayment penalty will not be charged if the loan is sold or if the loan is refinanced by the same creditor or an affiliate. Indeed, if a higher-priced mortgage loan with a prepayment penalty is refinanced by the original creditor or an affiliate the penalty may not be charged. Servicers should be given the option of including on the notice an explanation of the circumstances under which a penalty would not be charged.

Description of Interest Rate

The language provided in Model Form H-4(G) indicates that the following language is required: "Your rate will change due to an [increase] [decrease] in the (index)."[35] This language does not appear to take into consideration the following situations: (1) the current and new rates are the same, (2) the old and new index values are the same, or (3) the current rate is a premium or discount rate so that the change in rate if any, is not entirely due to a change in the index

[33] Escrow allocations in billing statements are sums of total tax and insurance items, not allocations to each.

[34] 74 Fed. Reg. at 43,330

[35] 74 Fed. Reg. at 43,344.

value (or may be directionally different if the amount of the premium or discount exceeds the amount of the change in the index). We request that the language be changed to reference the *index* rather than the *rate* as follows "The index on your mortgage [increased], [decreased] [stayed the same], which may affect the interest rate."

C. Creditor-placed Property Insurance

The Proposal would establish a new requirement under TILA that servicers provide borrowers with advance notice of the servicer's intent to impose lender-placed property insurance. In particular the Proposal would prohibit a creditor from charging borrowers for lender-placed insurance unless:

1. The creditor makes a reasonable determination that the required property insurance had lapsed.

2. The creditor mails or delivers to the borrower a written notice containing price and coverage information at least 45 days before a charge is imposed, and

3. During the 45-day notice period, the consumer did not provide the creditor with evidence of adequate property insurance.[36]

In general, MBA supports the clarification that servicers can charge the borrower for coverage provided during the waiting/notice period if there was no other insurance.

The Proposal mirrors current practices for first lien mortgages, with a few exceptions (discussed below). Having said that, it is puzzling why the Board feels the need to cover existing practice within the scope of TILA. There appears to be no empirical evidence that a problem exists in this area. Ultimately, we do not believe the creditor-placed insurance provisions are necessary for mortgagees because there is no need to influence or change industry behavior. The Proposal will limit the servicer's contractual rights to deal with exception-based situations that would otherwise protect it from loss or costs. If the Board pursues finalization of this proposed standard several changes should be made.

Insurers currently provide notice to the servicer as a mortgagee listed on the policy that the policy has lapsed or has been cancelled. This is the primary means by which the servicer is alerted to the fact that insurance may no longer be present on the property. At that point, the servicer notifies the borrower that it does not have current evidence of insurance and that a lender-placed policy will

[36] 74 Fed. Reg. at 43,331

be imposed unless evidence of a replacement policy is provided by the deadline. We believe this practice is appropriate, fair and efficient. The borrower can easily contact his or her insurance provider and receive a declaration page as evidence of alternate and sufficient insurance.

The Proposal requires the creditor to make a "reasonable determination that the required property insurance has lapsed."[37] The Board, however, does not specify what is a "reasonable determination." In addition, there are situations where the servicer receives no insurance information at all. It is imperative that this standard be defined to avoid litigation.

Further, we suggest that the Board state in the Commentary that a notice from the insurer that the policy has lapsed, has been cancelled, is underinsured, or if the servicer receives no insurance information (after requesting it from the borrower or insurer) is sufficient to be considered a reasonable determination that the property is uninsured or underinsured.

Special Exceptions

Lender-placed insurance is intended to protect the lender against uninsured loss. As a result, lender placed carriers generally commit to "automatic coverage" for the lender when the lender becomes aware that a property is uninsured or underinsured. In some instances, such coverage lapse is discovered only after a loss occurs to the secured property. The lender-placed insurance carrier verifies that no other insurance existed at the time of the loss, and issues a lender placed policy effective as of the lapse date in order to provide coverage for the loss. Given this fact, it is not appropriate to require lenders to wait until the 45-day notice has expired to request coverage, nor is it appropriate to prohibit the creditor from charging the borrower a premium in order for the loss to be insured. We believe that under these circumstances it is not only appropriate, but in the best interest of the lender and borrower, to waive the 45-day requirement in order to immediately issue a lender-placed insurance policy and proceed with the loss adjustment. Repairs can, therefore, occur more timely and further damage can be avoided.

It is important to remember that lender-placed insurance is *only* issued during a lapse in voluntary insurance coverage and remains in force only for the period during which the borrower does not provide adequate evidence of insurance coverage. Lender-placed insurance policies are cancelled and premiums refunded on a pro rata basis whenever the lender receives evidence of adequate voluntary insurance.

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[37] 74 Fed. Reg. at 43,331

Application of Premiums

We support the Proposal's clarification that servicers may impose a premium after the expiration of the 45-day notification period; and most importantly, that the creditor can charge for insurance coverage extended during this 45-day waiting period. The industry is fortunate that force-placed providers cover this waiting period as investors and regulators prohibit gaps in insurance. Allowing servicers to ensure continuous property insurance coverage is a safe and sound financial business practice. Servicers must have the right to recoup insurance premiums for the gap period on all property insurance, including flood and hazard insurance, and for the entire period of the lapse. To clarify this, we suggest the following changes to the Commentary (underlined text is new language) and rule:

> Amend regulation Section 226.20(e): [38] "(3) Creditors are not subject to subsection (2) if there has been an uninsured loss in which case the notice period is waived and the creditor may retroactively charge a consumer for the cost of any required property insurance for any period when the property is uninsured or underinsured." Remaining sections should be renumbered.
>
> Revise Commentary 226.20(e):[39] "1. ...After expiration of the 45-day notice period the creditor may retroactively charge a consumer for the cost of any required property insurance obtained during the 45-day notice period for any period when the property is uninsured or underinsured, if such charge is not prohibited by applicable state or other law."

2. Creditors are not subject to the 45-day notice period if there has been an uninsured loss in which case the notice period is waived and the creditor may retroactively charge a consumer for the cost of any required property insurance for any period when the property is uninsured or underinsured.

This language clarifies that servicers may impose the cost of lender-placed insurance on borrowers for any lapse in coverage, after proper notice to the borrower. The Proposal indicates that the lender must provide at least 45-days notice to the consumer "before charging the consumer for the cost of creditor placed insurance"[40] and clarifies that the creditor "may charge the consumer for the cost of any required property insurance obtained during the 45-day notice period if such charge is not prohibited by applicable State or other law."[41]

[38] 74 Fed. Reg. at 43,331.

[39] 74 Fed. Reg. at 43,406.

[40] 74 Fed. Reg. at 43,276.

[41] 74 Fed. Reg. at 43,276.

Although lenders generally are made aware of voluntary coverage lapses through receipt of cancellation or non renewal notices, these notifications are not always received timely. Due to errors in the mortgage clause, postal issues, or failure of the insurance carrier to provide timely notice to the mortgagee, the lender may not become aware of a lapse in coverage for days, weeks, or months after the effective date of the lapse. Most lender-placed insurance provides automatic coverage for these lapses in order to comply with the requirements for continuous coverage by the secondary market, investors, and federal regulators. The proposed 45-day notice to the borrower is acceptable because it requires at least 45 days before **charging** the borrower.

Content of Notices

MBA does not object to the content of the notice as drafted in the CFR section of the Proposal, with one correction. The Proposal focuses solely on policy lapses. Specifically, the proposed rule states in 226.20(e)(2):

> "[t]he creditor may not charge a consumer for obtaining property insurance on property securing a credit transaction, unless: (i) the creditor has made a reasonable determination that the required property insurance has *lapsed[.]*"[42]

The reality is that some policies must be lender placed when the property is *underinsured.* As a result, servicers must have the ability to pass through the cost of the lender-placed insurance to the borrower when there is no evidence of insurance or when there is evidence of insufficient coverage. This correction must be addressed in the body of the regulation and the model notice.

We suggest that the Board amend 226.20(e)(2)(i)[43] to read as follows (underlined text is new):

> "Require the creditor make a reasonable determination that the required property is uninsured or underinsured."

It would be helpful if the Board would clarify that the disclosure language in the proposed Model Clause is suggested, but that language "substantially similar to the language in the Model Clause would meet the requirement of Reg Z. In addition, the Board should indicate that the servicer may include other information that is not mandated by the regulation. There are many states that have very specific statutes that address creditor-placed property insurance that require specific disclosures. If Board includes a mandated Reg. Z disclosure (or if lenders interpret the proposed language as a strict requirement) on top of the

[42] 74 Fed. Reg. at 43,331. (Emphasis added).

[43] 74 Fed. Reg. at 43,331.

state disclosures lenders are already required to include, borrowers will become confused and might fail to take any action to obtain voluntary insurance.

Miscellaneous

The Board solicits comment on whether the creditor should also establish a local or toll-free number. We do not object to including a toll-free number provided this number does not have to be dedicated solely to questions on lender-placed insurance. Customer service representatives can route insurance calls and questions to the right party.

The Board also solicits comment on whether the notice should disclose when the servicer receives some compensation for placing the insurance. MBA does not believe it is necessary to provide such information because the consumer is informed of the premium cost. The information is not helpful to the borrower since he/she cannot influence the compensation structure. In addition, state insurance regulations in many states already regulate both what entities can be compensated and what disclosures need to be made.

The Board solicits comment on whether creditors should disclose that an escrow account will have to be established when applicable. This information will be provided by separate notice and thus we believe it is not necessary to include this information here. Details as to the escrow account must be sent according to RESPA and thus RESPA should prevail and allow for separate notice. Both the information about the escrow account and creditor compensation could distract the consumer from the compelling need to obtain coverage to avoid the need for higher cost lender-placed coverage. However, if the servicer feels compelled to provide this information it should not be prohibited.

Finally, the Board inquires whether the policies should apply to home equity lines of credit. Home equity lines of credit should not be subject to this proposal because generally those loans fall in a junior position and the first lien holder places the amount of hazard insurance based on the insurable value of the property so as to avoid a co-insurance risk. To the extent that flood insurance is covered by this Proposal (which is unclear), existing federal law, banking agency rules, Fannie Mae, Freddie Mac and government program rules apply.

VI. Loan Originator Compensation

A. Background

In 2007, the Board proposed to amend HOEPA to establish new disclosure requirements for mortgage brokers.[44] The amendment addressed the Board's concern that yield spread premiums can create financial incentives to steer consumers to riskier loans for which loan originators will receive greater compensation. Further, the proposed amendment addressed the Board's additional concerns that consumers did not understand the effects if compensation to brokers from mortgage lenders. Specifically, the proposed amendment would have prohibited a creditor from paying a mortgage broker more than the consumer had previously agreed in writing that the mortgage broker would receive.[45] The broker would have been required to enter into a written agreement with the consumer, before accepting the consumer's loan application and before the consumer paid any fee in connection with the transaction (other than a fee for obtaining a credit report).[46] The agreement also would have disclosed that (1) the consumer ultimately would bear the cost of the entire compensation even if the creditor paid part of it directly; and (2) a creditor's payment to a broker could influence the broker to offer the consumer loan terms or products that would not be in the consumer's interest or the most favorable the consumer could obtain.[47]

The Board, however, withdrew this proposal because of comments on the proposed rule and consumer testing.[48] That testing in the Board's view raised concerns that the proposed agreement and disclosures would confuse consumers and undermine their decision-making rather than improve it. When the provision was withdrawn, Board members requested that staff continue to explore alternatives to address this concern.

B. The Current Proposal

The Board proposes to exercise its authority over unfair and deceptive acts or practices to prohibit a creditor or other party from paying compensation to a loan originator based on the credit transaction's terms or conditions.[49] The

[44] 73 Fed. Reg. 1,672 (Jan. 8, 2008).

[45] 73 Fed. Reg. at 1,725.

[46] 73 Fed. Reg. at 1,725 - 1,726.

[47] 73 Fed. Reg. at 1,726.

[48] The test report states that the Board's contractor working with Board staff conducted four rounds of consumer testing in March through May 2008: two in Washington, DC, and one each in Los Angeles, CA and Kansas City, KS. A total of 35 separate interviews were completed with individuals and 4 with couples who had jointly made mortgage decisions. Interviews lasted between 60 and 90 minutes. *Consumer Testing of Mortgage Disclosures,* Summary of Findings, Submitted to the Board of Governors of the Federal Reserve, Macro International, Inc. July 10, 2008.

[49] 74 Fed. Reg. at 43,332 (to be codified as 12 C.F.R. § 226.36(d)).

Board proposes the amendment due to concerns that mortgage brokers and loan officers will steer consumers to riskier loans if the broker's and officer's compensation increases with higher loan rates and terms.[50] This prohibition would not apply to payments that consumers make directly to a loan originator. However, if a consumer directly pays the loan originator, the Proposed Rule would prohibit the originator from also receiving compensation from any other party in connection with that transaction.[51] The Board is soliciting comment on an alternative that would allow loan originators to receive payments that are based on the principal loan amount.[52]

The Board is also soliciting comment on whether it should adopt a rule that seeks to prohibit loan originators from directing or “steering” consumers to loans based on the fact that the originator will receive additional compensation, unless that loan is in the consumer’s interest.[53] In this connection, the Board proposes a safe harbor that would require an originator to present the consumer with at least three loan options for each type of transaction in which the consumer expressed an interest.[54] The Board is soliciting comment on whether the rule would be effective in achieving the stated purpose.[55] Comment is also solicited on the feasibility and practicality of such a rule, its enforceability, and any unintended adverse effects the rule might have.[56]

The earlier proposal had covered only mortgage brokers, but the Board pointed out creditor’s loan officers “frequently have the same discretion as mortgage brokers over loan pricing that enables them to modify the loan’s terms to increase their compensation, and there is evidence that creditors’ loan officers engage in such practices.”[57] It also notes that “yield spread premiums may provide some benefit to consumers because consumers do not have to pay loan originators’ compensation in cash or through financing. However, the Board believes that this benefit may be outweighed by costs to

[50] 74 Fed. Reg. at 43,279 - 43,281.

[51] 74 Fed. Reg. at 43,332 (to be codified as 12 C.F.R. § 226.36(d)(2)).

[52] 74 Fed. Reg. at 43,284.

[53] 74 Fed. Reg. at 43,332 – 43,333 (to be codified as 12 C.F.R. § 226.36(e).

[54] 74 Fed. Reg. at 43,409 – 43,410 (to be codified at 12 C.F.R. § 226.36(e)(2)).

[55] 74 Fed. Reg. at 43,286.

[56] 74 Fed. Reg. at 43,286.

[57] 74 Fed. Reg. at 43,283.

consumers, such as when consumers pay a higher interest rate or obtain a loan with terms the consumer may not otherwise have chosen, such as a prepayment penalty or an adjustable rate."[58]

C. General Comments

MBA strongly opposes broad restrictions against loan officer compensation based on the rate and terms of loans. Commission based compensation occurs throughout the nation's economy and results in good service to consumers. Before the Board moves to dismantle such compensation in the mortgage markets, MBA believes a far better approach than restricting such compensation in the mortgage market would involve continuing on the path the Board originally embarked on, of greatly improving disclosures so consumers could avoid any steering and understand and negotiate the best compensation to serve their lending needs.

If, nonetheless, the Board determines to proceed with restrictions on compensation based on the terms of loans, MBA believes that any restrictions should be narrowly tailored to protect vulnerable borrowers and to protect against steering to loans with risky features as the Board intends. Prime mortgage lending markets are highly competitive with thin margins and there is little room for compensation to drive steering. Government programs offer sustainable mortgage products. For these reasons compensation restrictions on these loans are unnecessary.

Whether or not the Board takes a narrower, more targeted approach, we strongly urge that it explicitly except a variety of practices from any restriction. These include practices to enable consumers to reduce their upfront closing costs and to provide sustainable credit to those who have been underserved. MBA also favors permitting compensation based on the loan amount.

MBA has profound concerns about the imposition of a subjective restriction against mortgage brokers receiving additional compensation when the loan "may not be in the consumer's interest." Such a standard invites litigation – the costs of which will ultimately be borne by consumers. If a restriction against steering is established, MBA believes that bright line safe harbors empowering consumers and/or reasonable limits on compensation will be more effective.

D. Restrictions on Loan Originator Compensation

[58] 74 Fed. Reg. at 43,240.

MBA has long held that the best means of protecting consumers against steering by mortgage brokers is a clear and complete disclosure of the mortgage broker's total compensation prior to the consumer's retention of broker services. It has taken that position for nearly 15 years, from the time that the lending industry first confronted claims regarding yield spread premiums. For this reason, MBA supported the Board's earlier effort to propose an agreement to clarify originator compensation for borrowers and avoid steering. MBA was disappointed in the Board's withdrawal of this earlier proposal and we do not believe that the Board's testing was sufficient to dismiss this option.

In contrast to the Proposal, HUD's new RESPA rules establish new requirements for disclosure of mortgage broker fees on a new standard Good Faith Estimate and HUD-1 and -1A Settlement Statements. HUD says its consumer testing shows consumers understood the disclosure. Specifically, HUD's approach is to require that yield spread premiums be included in the origination charge which may not vary from the time the GFE is issued through closing absent "changed circumstances." MBA urges the Board to evaluate the success of HUD's efforts going forward before broadly proscribing term-based originator compensation. HUD's effort may prove both the effectiveness of an improved disclosure and an upfront commitment regarding brokerage fees as originally proposed by the Board under the HOEPA rules.

In MBA's view, mortgage brokers and mortgage bankers are functionally different and for this reason it is appropriate to require greater disclosure concerning mortgage broker fees. Mortgage brokers classically hold themselves out as shopping for borrowers among mortgage lenders. Mortgage bankers, on the other hand, offer their own products which borrowers shop and compare. Considering this difference, it is appropriate to require greater disclosure of brokers when they are also obtaining compensation from a firm which they shop. MBA's paper on the difference between mortgage bankers and mortgage brokers would be instructive to review as you consider these comments. The paper is located on MBA's Web site at http://www.mortgagebankers.org/files/News/InternalResource/62646_Paper.pdf.

Since the central purpose of the Proposal is to prevent compensation incentives from resulting in steering consumers to riskier loans, MBA strongly urges that if restrictions on compensation are established, any restrictions be targeted toward vulnerable borrowers and risky products. Any restrictions should only cover higher-priced loans and high-cost mortgages, as well as other loans with risky features shown to have increased default rates, which might include loans that have prepayment fees, balloon payments or may result in negative amortization.

Prime mortgage lending markets generally, however, are highly competitive with thin margins and there is little room for compensation to cause steering. Borrowers also are more likely to shop in the prime market. Consequently, loans that are eligible for purchase by Fannie Mae and Freddie Mac should not be subject to restrictions against term-based compensation. At the same time, because the Federal Housing Administration (FHA) and Veterans Affairs (VA) are subject to significant controls and oversight, term-based compensation prohibitions should not pertain to these programs.

Whether or not the Board takes a narrower, more targeted approach or establishes a broader restriction, we strongly urge that it explicitly except a variety of practices from any restriction. First and foremost, any restriction against compensation based on the terms of a loan should expressly apply only to loan originators. The restriction should not apply to compensation to managers and executive personnel nor should it apply to secondary market payments to lender companies, not originators. Managers and executive personnel do not interact with customers. The secondary market prices mortgages efficiently based on a variety of factors including the mortgages' terms. TILA, in our view, is not intended to reach these transactions and interference in secondary market payments would harm the secondary market for loans. Any restrictions on originator compensation should only apply to amounts that the individual loan officer retains. The restrictions should not apply to any of the funds which may flow through the individual and to the company itself or to third parties.
The following other forms of compensation should be explicitly deemed permissible:

- **Reductions in loan officer compensation within specified limits to meet competitive offers.** While it is clear from the Proposal that "upcharges" or "overages" to loan originators may be prohibited if based on the rate or terms of loans, the Proposal should treat "underages" differently. In order to meet or beat lower prices of competitors, loan originators may cut their prices based on the rate or terms under guidelines provided by their companies. In such cases, companies must be able to reduce their compensation to the loan officer. Such price concessions help borrowers receive lower prices and as such should be permissible. Fair lending laws provide appropriate protections against unlawful discrimination.

- **Providing compensation to originators on a quarterly or other reasonable basis based on originator's performance.** If restrictions on compensation on a per loan basis are prohibited, such a prohibition should not inadvertently restrict bonus compensation based on the broader metrics of an originator. Such compensation would not be tied to particular terms of individual loans. However, the compensation could vary based on loan amounts, for example, or other appropriate metrics.

- **Compensating originators as a percentage of loan amount.** The Proposal asks for comment on an alternative scheme that would allow loan originator compensation to be based on the loan amount.[59] The Proposal also asks if the final rule permits compensation based on the loan amount, should creditors be permitted to apply different percentages to loans of different amounts[60] Further, it asks should creditors be allowed to pay a larger percentage for smaller loan amounts, which could be an incentive to originate loans in lower-priced neighborhoods and ensures that the originator receives an amount that is comparable to loans originated in high-priced neighborhoods?[61] If so, should creditors also be permitted to pay originators a higher percentage for larger loan amounts?[62]

- MBA supports permitting compensation that varies based on loan amount. This would allow for reasonable compensation for loans, including loans with smaller principal balances. A percentage of loan amount, such as one percent of the loan value, has proven to be a reasonable proxy for the compensation needed to defray origination costs for most loans. In applying such an approach, a greater percentage charge should be permissible to ensure that customers receive service for smaller loans. As the Board observed, the compensation received by others in the mortgage market, such as creditors, mortgage insurers, and other service providers, is based on the loan amount.[63] MBA does not believe that originators have an incentive to steer originators to larger loan amounts to increase their compensation when compensation is in the neighborhood of one to three percentage points.

[59] 74 Fed. Reg. at 43,332 (to be codified at 12 C.F.R. § 226.36(d)).

[60] 74 Fed. Reg. at 43,284.

[61] 74 Fed. Reg. at 43,284.

[62] 74 Fed. Reg. at 43,284.

[63] 74 Fed. Reg. at 43,284.

- **Permitting the payment of direct borrower fees and indirect fees to the loan originator in the same transaction so that some of the borrower's closing costs may be paid through the rate.** MBA strongly believes that "yield spread premiums" and credits to borrowers from lenders based on the loan rate, if properly disclosed, benefit borrowers by reducing the upfront cash or financing costs needed to pay the loan originators' compensation and other settlement costs. For several years, consumers have frequently sought to increase their interest rates to pay some or all of their closing costs through "low-cost" or "no-cost" loans. A restriction on compensation should not take away these options from borrowers.

- **Paying increased charges based on increased originator time to complete the loan process for a particular borrower or to provide expedited service.** Although the matter is not addressed in its Proposal, in the event the Board does restrict compensation, it should clarify that charges for additional or expedited processing of particular loans is wholly acceptable. The first-time homebuyer who may also have a thin credit file requires additional service to achieve homeownership.

- **Additional reasonable compensation to incentivize originators to provide low balance loans and loans for special programs that assist moderate-income borrowers and first-time buyers.** In order to ensure that companies can continue to provide incentives to originators who originate loans for special loan programs, the Proposal rule should explicitly provide that such compensation is acceptable.

- **Other similar reasonable practices which facilitate mortgage lending and benefit consumers.** Considering the potential breadth of a restriction on compensation based on terms, the Board should detail all other reasonable compensation practices that it regards as acceptable.

E. Prohibiting Steering

1. MBA opposes the prohibition against steering consumers to loans based on the originator receiving additional compensation, when that loan may not be "in the consumer's best interest," because the standard is too subjective. Subjective requirements will result in costly litigation directed against lenders, the costs of which will ultimately be borne by borrowers.

If such a prohibition is adopted, the prohibition should expressly apply only to mortgage brokers and their loan originators. Mortgage lenders' loan originators do not steer their loans to a range of funding sources; they simply originate loans for their own companies. Moreover, lenders products are shopped and compared by consumers whereas borrowers cede shopping responsibility to brokers.

2. Further, if such a prohibition is adopted, bright line safe harbors should be established to avoid unnecessary liability. Towards this goal, MBA believes that safe harbors offer sufficient protections to borrowers and clear standards for mortgage broker loan originators. Under a safe harbor, the mortgage broker would be required to:

a. Present the consumer with a choice of loan products for which the consumer likely qualifies which may be appropriate to the consumer's existing circumstances, based on information obtained from the consumer; and make full and timely disclosures to each consumer of the comparative costs and benefits of each loan product offered or discussed;

b. Provide the borrower a disclosure of the mortgage broker's total compensation from the lender and the borrower and whether the originator is or is not acting as an agent for the consumer; and

c. Assure a consumer freely opts-in, in writing *prior to closing*, to a nontraditional mortgage product[64] after the mortgage broker discloses the costs and benefits of the loan to the borrower, also in writing; OR

d. As an alternative to these provisions, the Board could allow originators to limit mortgage broker compensation to 200 or possibly 300 basis points total for the transaction, including all direct and indirect compensation. These limits would be established so that the greater number would be a permissible but reasonable increase in compensation for low balance loans.

Establishment of a safe harbor along these lines would provide the consumer what he or she needs to know to avoid steering or, in the alternative, it could allow objective limits on mortgage broker compensation to address concerns. While these approaches would be preferable to the Board's proposal, we again strongly urge the Board – before it moves forward to implement any provisions in

[64] A nontraditional mortgage product is a mortgage product that allows a borrower to defer principal or interest, such as a payment option ARM or an interest-only loan.

this area--to evaluate the success of HUD's new RESPA rule to improve disclosures and stem abuses, to make certain further action is necessary.

VII. Other Concerns

A. Legality of Key Aspects of these Proposals

While MBA is supportive of many of the Board's proposals, it has questions about the legality of key provisions of this rule, including the provisions that would revise the calculation of the finance charge and the APR.

Under TILA, the definition of Finance Charges specifically excludes certain items when the extension of credit is secured by an interest in real property.[65] Under the Board's proposal, while a "Finance Charge" would continue to be defined as a fee or charge that is payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to the extension of credit, the proposed definition would also include charges by third parties if the creditor requires the use of a third party as a condition of or incident to the extension of credit (even if the consumer chooses the third party) or if the creditor retains a portion of the third-party charge (to the extent of the portion retained).[66] A host of fees which are currently *excluded* when calculating a Finance Charge will now be *included*.

The Board cites its exemption authority as the basis for these provisions.[67] No matter how laudable an all-in APR may be, however, MBA questions whether the Board can use this authority to effectively rewrite the statute to achieve this end.

In a similar vein, the Board cites its authority to prohibit unfair or deceptive acts or practices as the basis for its proposed prohibition against originator

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[65] 15 U.S.C.A. § 1605(e) provides:

> Items exempted from computation of finance charge in extensions of credit secured by an interest in real property - The following items, when charged in connection with any extension of credit secured by an interest in real property, shall not be included in the computation of the finance charge with respect to that transaction:
> (1) Fees or premiums for title examination, title insurance or similar purposes.
> (2) Fees for preparation of loan-related documents.
> (3) Escrows for future payments of taxes and insurance.
> (4) Fees for notarizing deeds and other documents.
> (5) Appraisal fees, including fees related to any pest infestation or flood hazard inspections conducted prior to closing.
> (6) Credit reports.

[66] 74 Fed. Reg. at 43,323 (to be codified as 12 C.F.R. § 226.4(g)).

[67] 74 Fed. Reg. at 43,245.

compensation based on the terms of the loan.[68] However, MBA does not believe that payment of a yield spread premium or similar compensation is in itself an unfair or deceptive act or practice. Notably, while HUD has never specifically considered the issue of whether such compensation is an unfair or deceptive act or practice, HUD consistently, in several policy statements, has cited yield spread premiums as a reasonable means for borrowers to pay their closing costs and reduce their cash to close.[69]

Considering the immense cost of implementing this rule, litigation that successfully strikes down some or all of these provisions could render these resources wasted, while at the same time destabilize mortgage lending.

B. Ensuring TILA and RESPA Disclosures Are Compatible and Complementary

As indicated, MBA appreciates the Board's comment that the Board anticipates working closely with HUD to ensure that TILA and Real Estate Settlement Act 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.[70] MBA urges, however, that it is essential that the Board and HUD work together *now* to make key features of this rule and HUD's RESPA rules (Regulation X) consistent before this rule is finalized. This includes, but is not limited to, the format for loan terms and operation of the tolerances, as well as the timing of disclosures.

Consumers should receive both TILA and RESPA disclosures together since the former describes the cost of the credit and the latter the cost of settlement. Yet, under this proposal and the RESPA rules, consumers would receive RESPA and TILA disclosures at different times. Under the new RESPA rule, borrowers will receive a new GFE when "circumstances change," while the Board would require a final TIL three days before closing.

Also, loan terms such as rate, payments and any interest rate increases, are presented slightly differently in the "loan terms" provisions of the respective agencies' forms. While it would be optimal for both forms to be combined and employ one set of terms, if two forms are maintained, the term descriptions must be identical and the Board and HUD should work toward that end. Otherwise, borrowers will be confused when costs appear to increase.

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[68] 74 Fed. Reg. at 43,279.

[69] U.S. Dept. of Housing and Urban Development, RESPA Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers (Mar. 1999), *available at* 64 Fed. Reg. 10,080 (Mar. 1, 1999).

[70] 74 Fed. Reg. at 43,233.

Finally, under RESPA, originator and third party fees are treated differently for purposes of the applicable tolerances against increased charges. The Board's proposed approach, however, to calculating an all-in APR makes no such distinction.

C. Translation of Documents

MBA does not believe the Board should require that creditors translate disclosures into a variety of languages other than English. Instead, MBA urges that the Board arrange translation of key documents, such as "Key Questions" and "Fixed v. Adjustable Mortgages," into several languages and make the translations widely available through the Board's Web site.

Lenders do not currently have the capability to translate documents into a wide range of languages. Duplicative, high costs could be avoided, however, if the Board took the initiative to translate these generic forms into a range of languages. Such translations could be made available through the Board's Web site to creditors, real estate brokers, mortgage brokers and other sites. Additionally, these documents could state in a variety of languages that, if the reader is not able to read and speak English, the borrower should arrange for an interpreter or counsel at his or her own expense to review the documents and represent the borrower.

The presence of an interpreter at closing is a far more economical approach to ensuring that borrowers understand the documents they sign than a wide-scale effort by each and every originator to translate loan documents.

Conclusion

MBA again appreciates the opportunity to comment on the proposed amendments to Regulation Z. We look forward to working with the Board on improving the mortgage process for consumers, a matter of central importance to our industry. Should you have questions or wish to discuss any aspect of these comments further, please contact Ken Markison, Associate Vice President and Regulatory Counsel at (202) 557-2930 or kmarkison@mortgagebankers.org.

Sincerely,

John A. Courson

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President and Chief Executive Officer
Mortgage Bankers Association