FIRST CITIZENS
MEMBER FDIC
NATIONAL BANK

December 21, 2009

Jennifer J. Johnson, Secretary

Board of Governors of the Federal Reserve System

20th Street and Constitution Avenue, NW

Washington, DC 20551

Re: Regulation Z; Proposed Rule (Closed-end credit); Docket No. R-1366

Thank you for affording us this opportunity to comment on the proposed rule amending Regulation Z and the Official Staff Commentary to the regulation concerning closed-end credit secured by real property or a consumer's dwelling.

First Citizens National Bank is a community bank with approximately $1 Billion in assets. As such, we offer to customers a variety of loans secured by first and subordinate lien loans on residential real property and mobile and manufactured homes including purchase, refinance, home equity and home improvement loans.

It is our strongly felt conviction that the regulated banking industry, and community banks such as ours in particular, played virtually no part in creating the mortgage crisis which has so affected our economy or the abusive practices employed by some subprime and other lenders which we believe are motivating factors for the Board's proposal. Banks like ours typically do not offer high-risk mortgage products. We work hard to serve our customers and our communities and have every desire to make sure that our customers are fully informed of all of the terms and features of any loan they obtain from us.

In General

We offer fixed rate mortgage loans with terms up to 30 years, as well as fixed rate balloon payment loans with terms of 5 years and monthly payments based on a 15-year amortization. We offer balloon loans of this type in order to offer the lowest rate for the longest term possible and we generally expect to renew the balloon at maturity for the customer absent a loan default.

We support the goals of improving disclosures to consumers and providing important information in simple, understandable terms; however, we believe the proposal calls for unnecessary, complex and costly changes in systems, procedures and disclosures that may be even more confusing to consumers and that will accomplish very little in improving consumers' ability to shop for the best loan terms available. We offer the following specific comments on the various components of the proposal.

## Disclosures at Application

The proposal would require two new, one-page Federal Reserve publications, "Key Questions to Ask About Your Mortgage" and "Fixed vs. Adjustable Rate Mortgages" to be delivered at time of application on all closed-end loans secured by real property or a dwelling. The two documents appear to be relatively simple and easy to understand, but requiring delivery in all instances is unnecessary. We see no reason to require delivery of the "Fixed vs. Adjustable Rate Mortgages" when the applicant is only considering a fixed rate loan. The publication should be required only if an ARM loan is a possibility. Likewise, the information provided in the "Key Questions" document will not apply in many instances. For fixed rate loans with no possibility of negative amortization, questions one through four are meaningless. In light of the current requirements for verification of repayment ability on higher priced mortgage loans, question seven serves little or no purpose in most instances.

We believe requiring delivery of disclosures that do not relate to the loan being applied for simply encourages consumers to ignore the disclosures because of the difficulty in separating meaningful information from information that does not apply to the particular situation. Mortgage loan applications and closings involve substantial paper work. Requiring disclosure of irrelevant terms only encourages consumers to ignore the material. These documents should not be required unless the loan applied for presents one or more of the features identified by the Federal Reserve as "risky."

## Disclosures within Three Days after Application

The proposal would make dramatic changes to early mortgage loan disclosures. The finance charge and APR would include virtually all third party charges presently excluded from those disclosures, including settlement costs, third party fees, and voluntary credit life insurance, PMI or debt cancellation products. We believe the proposal would increase, rather than reduce, consumer confusion, and, as a practical matter, would not improve consumer practices with respect to shopping for the best loan terms. The proposal, if adopted, will also substantially increase compliance and litigation risks for lenders and will cause lenders to incur substantial additional compliance costs unnecessarily.

As stated in the issuance, the Federal Reserve's research indicates that many consumers do not actively shop for a mortgage loan and those that do shop, do so based on the simple interest rate, closing costs and monthly payment amount. The consumer research also indicates that by the time consumers apply for a loan, most have ceased shopping altogether. Those findings are consistent with our own impressions. The proposed changes will be costly to implement requiring substantial computer systems programming, changes to forms and procedures and training of employees with no indication that the changes will actually do anything to improve consumer loan shopping habits.

Consumers understand that payment of closing costs will be required in connection with a mortgage loan. We believe that most consumers do actually consider the dollar amount of those costs when shopping for a loan. With the implementation of HUD's revised RESPA rules on January 1, 2010, consumers will have greater means to shop for the best terms with respect closing costs if they choose to do so. The Federal Reserve should delay any consideration of the proposed changes to APR and finance charge/overall costs disclosure until some time in the future when the effectiveness of the RESPA changes can be evaluated.

We believe that including all costs in the finance charge and APR calculation is not necessary and will not increase consumer understanding of the cost of credit. In fact it will make it more difficult to understand. We believe that consumers understand that the APR represents the costs of credit imposed by the lender and that third party closing costs are an additional cost to the consumer for a mortgage loan. In our case, third party closing costs for things like appraisal, survey, title and attorney's closing fee are totally beyond our control. Including those costs in the APR with the lender's charges will obscure the lender's actual charges rather than making them more evident, despite the proposed requirement to disclose the contract interest rate.

We also believe it will lessen consumers' understanding of the terms "finance charge" and "APR" to have different standards for calculation and disclosure of those terms for closed-end mortgage credit versus other types of consumer credit. The proposal will create confusion by creating, in essence, three different categories of loans and three different standards for determining finance charge and APR: closed-end mortgage loans; open-end mortgage loans (HELOCs); and other consumer credit. In our experience, consumers considering a closed-end home equity or home improvement loan often consider a HELOC as an alternative. Different APR determinations will make a HELOC look cheaper than a comparable closed-end term loan when that may not, in fact, be the case. Using a similar "all costs included" finance charge and APR disclosure for HELOCs is not practical because of the difficulties in making the necessary calculations for an open-end account with no set amount financed and the wide variety of repayment terms offered by creditors. Even if using a similar disclosure standard for HELOCs were practical, different standards for mortgage credit versus other non-mortgage consumer credit would still create confusion for consumers and creditors.

The finance charge and APR disclosures should include only those charges imposed by the creditor as a condition of or incident to the extension of credit. As an alternative, the Fed should consider modifying the list of fees excluded from the finance charge on real estate loans, such as a creditor-imposed documentation fee or other fees to the extent paid to the creditor.

The costs for voluntary credit insurance, PMI and/or debt cancellation products should not be included in the APR. We are concerned that the Board's proposal to include these costs in the APR together with the proposed changes to the required disclosures for the voluntary purchase of credit insurance/debt cancellation products demonstrates a bias against those products generally and is an indirect attempt to ban their sale. While we recognize that the sale of single premium credit life on large, long term loans may have been abused by some predatory lenders, there are better ways to deal with abusive practices. The Fed's proposal to require a preliminary determination that the applicant meets basic qualifications for benefits is one way. Limiting the sale of single premium products on certain types of loans may be another. Credit insurance and debt cancellation products provide many customers with a valuable benefit. For some customers, it may be the only insurance they have. Even those consumers that have existing life insurance may still find benefit in obtaining additional coverage in connection with a new loan. The Federal Reserve's apparent conclusion that credit insurance and debt cancellation products provide little or no useful benefits to consumers is simply not correct.

We believe the proposal to include the cost of voluntary credit insurance or debt cancellation in the APR contradicts the express language of the Truth in Lending Act. Subject to certain specified conditions, Congress expressly excluded costs for voluntary insurance products from the finance charge under Section 106 (b) and (c) of the Truth in Lending Act. The Board's exemption authority under Section 105(f) does not grant the Board the authority to include something Congress expressly excluded.

Using an all-inclusive standard for calculating and disclosing the APR on closed end mortgage loans will create other problems as well. The thresholds for determining whether or not a loan is a higher priced mortgage loan (HPML) are already too low, and capture too large a proportion of prime loans. The indices used for determining the Average Prime Offer Rate (APOR) and the HPML thresholds do not take into consideration closing costs or other fees currently excluded from the APR, only the simple interest rate and discount points. There is no question but that one result of the proposal will be that many more (perhaps, virtually all) mortgage loans will be covered by the HPML and HOEPA requirements without good reason. Likewise, the proposed all-inclusive standard for calculating and disclosing the APR will result in many more loans being reported by lenders on their HMDA LAR as having a rate spread. HMDA LAR rate spread numbers will be skewed as a result and this will result in regulators raising new HMDA outlier and fair lending concerns without good reason. For example, closing costs typically do not vary much in proportion to loan size. Under the proposed rule, small loans will appear to be much more expensive than a larger loan as a result of including closing costs in the calculation. In the event a loan applicant purchases voluntary credit insurance or debt cancellation, the loan will appear to be even more expensive and create an even larger reportable rate spread. Comparisons and analysis of HMDA data will be misleading.

The proposed regulation would require a graphical depiction of a comparison of the loan APR to the Federal Reserve APOR and the HPML threshold based on the APOR for a comparable loan. There are a number of reasons this proposal should not be adopted. First, the proposed regulation prescribes a lengthy and extremely complex set of requirements for the appearance of the graphical depiction. This greatly increases compliance and litigation risks for creditors and will increase the risk to creditors of liability for minor, technical violations of the rules and without good reason.

Second, we disagree with the Board's premise that the graphical depiction presents useful or reliable information to consumers. The Federal Reserve calculation of the APOR is based on the Freddie Mac Primary Mortgage Market Survey (PMMS) rates for four different long term mortgage products: 30 year fixed-rate conventional, 15 year fixed-rate conventional, 1-year ARM and 5/1 hybrid ARM and assume a loan to value of 80%. Of course, the PMMS reported rates do not include all loan fees and charges, only the average rate and lender's origination fees and discount points. A comparison of an all-inclusive loan APR to the Federal Reserve APOR will be misleading. We are not aware of any evidence to support the idea that the Federal Reserve calculations of the APOR for loan types other than the four types covered by the PMMS correctly estimate true market rates for prime loan customers. The graphical depiction of where the loan APR fits on the APOR to HPML spectrum will mislead many consumers into believing they are being overcharged when, in reality, even the most credit worthy applicants may not be able to actually obtain a similar loan in their market area priced at the APOR. Even the language proposed for the required disclosure will give a consumer the impression that the creditor believes the consumer is a poor credit risk and is being charged a higher rate as a result. In most instances, that will simply not be the case.

A requirement for a graphical or other comparison of the loan APR to the APOR and HPML threshold will also present significant programming and systems issues and the incurring of substantial expense to capture and disclose the required information. Preparation of the graph will require that systems capture of the APOR and HPML threshold at the time of preparation of the early disclosure. If the loan interest rate is not locked at that point, the creditor will be required to capture the APOR and HPML thresholds again later in order to determine whether or not the loan is higher priced and, for HMDA reporters, whether a rate spread must be reported on the HMDA LAR. We generally do not lock rates in advance on loans such as consumer home equity and home improvement loans.

We recommend the Board forego the proposed graph comparison as too complex, costly and unreliable. Instead, we suggest the Board issue regulations to implement the risk-based pricing notice requirements under Title III of the Fair and Accurate Credit Transactions Act. Once those regulations have been implemented and in place for a period of time, the Board can then evaluate their effectiveness and whether additional disclosures would be helpful to consumers.

The proposal would extend the application of early disclosure requirements to all consumer loans secured by real estate or a dwelling. Currently, early disclosure requirements apply to dwelling-secured consumer loans that are also subject to RESPA. This means that coverage of the early disclosure requirements would be extended to consumer loans secured by any real property including vacant land and to temporary financing like bridge loans and construction loans. Loans secured by vacant land and temporary financing such as construction loans should remain outside the coverage of the early disclosure requirements. The proposal should focus only on the types of loans secured by the consumer's dwelling that clearly have been the subject of predatory or abusive lending practices and should not unduly burden or restrict other types of loans.

The proposal states that the Board proposes to work with HUD in the future to develop a single combined RESPA GFE and early Reg. Z disclosure form. Creditors have already incurred, and will continue to incur, substantial expense to implement the Mortgage Disclosure Improvement Act/Reg. Z early disclosures and HUD's RESPA rule changes. If adopted, the Board's latest proposal would unnecessarily increase those costs by requiring creditors to implement new changes now followed by additional changes later if and when a unified disclosure is developed. The Board should work with HUD now to develop a unified disclosure, and the effective date of any additional changes to early Reg. Z disclosures should be delayed until that can be accomplished.

Disclosures Three Days before Consummation

The proposal would require final Truth in Lending disclosures to be provided at least three business days before loan closing even if no changes have occurred since the early disclosures were provided. Under the current rules, re-disclosure is required only if the APR changes by more than the permitted tolerance for accuracy or in the event a variable rate feature is added. As noted in the proposal, most creditors additionally provide the usual loan closing disclosures immediately prior to consummation. We understand the Board's concern that consumers may not find out about different loan terms or increased settlement costs until consummation, but those concerns are already addressed by the current Reg. Z early disclosure requirements and the new RESPA GFE disclosure requirements, which will include a tolerance for accuracy. The proposal states as an example that the several participants in the Board's consumer testing said that they had been told at closing that a loan would have an adjustable rate even though they had been told previously that the loan would have a fixed rate. That issue is clearly dealt with in the existing rule. In any event, requiring re-disclosure in all cases even where material terms do not change will do nothing to address the Board's stated concern of consumer surprise at closing. As a practical matter, the result of the proposal, if adopted, will be that disclosures will be given at least three times: within 3 days after application, three business days prior to consummation and immediately prior to consummation. Requiring final disclosures three days before consummation even when no changes have occurred will result in duplicative disclosures, create unnecessary expense and additional compliance, litigation and liability risk to creditors. The current rules should be continued as they presently exist.

With respect to the two alternatives the Board has under consideration for dealing with changes in the loan terms that occur between the time of delivery of the final TILA disclosures and final loan closing, no additional disclosure should be required unless the APR increases by more than a specified tolerance or an adjustable rate feature is added to the loan. The Board should balance the need for consumers to have all material disclosures in advance of closing with the need to avoid unnecessary delays in meeting the consumer's need to close and fund the loan. We already have customers who complain about the length of time they must wait to close and fund their loan. Under the current rules, early disclosures must be provided at least seven business days before the loan can close. Many lenders do not offer early rate locks on loans such as home equity and home improvement loans. If the loan rate changes so that the APR changes by more than the permitted tolerance, re-disclosure and an additional 3 business day delay is required. If you factor in the time period under the current rules for receipt of mailed disclosures and the three day rescission period when it applies, the current rules can easily result in a delay between application and loan funding of 21 calendar days, or more.

The Board's proposal would also have the effect of requiring disclosure of total settlement costs three days before loan closing. This proposal contradicts RESPA, which requires the HUD-1 to be available on request 24 hours prior to closing, and the proposal may exceed the Board's legal authority under the Truth in Lending Act. Also, as a practical matter, final costs for all settlement items are often not known by the closing agent until just prior to closing. Requiring disclosure of total settlement costs three business days prior to closing will most certainly cause additional delays in loan closings. Since there is no tolerance for accuracy of this proposed disclosure, even a slight change in the total dollar amount of settlement costs would trigger re-disclosure and an additional 3 business day delay should the Board adopt Alternative 1 to proposed 19(a)(2)(iii). The Board should not adopt settlement cost disclosure requirements that conflict or overlap with HUD's RESPA rules.

## Disclosures after Consummation

The proposal would require notice to consumers on adjustable rate loans of a change in interest rate and payment amount at least 60 days before a payment at the new amount comes due. The current rule provides for notice at least 25 days in advance. The proposed rule will conflict with the terms of some existing loans. For example, some loans provide for an interest rate adjustment on the first of a particular calendar month each year based on index in effect on that day or the day before, with a payment amount change on the first of the following month. The Board should clarify whether the proposal is intended to apply to existing loans and how a creditor should comply with the requirements if they conflict with existing loan contract terms.

## Creditor Placed Property Insurance

The proposal would require notice to the consumer of the costs of coverage at least 45 days before a charge may be imposed and require that evidence of insurance be provided within fifteen days after imposing a charge. Fifteen days is not long enough to receive evidence of coverage from the insurance company and provide it to the consumer. The time period should be at least 30 days.

## Restrictions on Payments to Loan Originators

The proposal would prohibit payments to loan originators (both third party brokers and employees of the creditor) based on loan terms and conditions, such as interest rate, loan term or loan type. The Board is considering permitting compensation based on the principal amount of the loan. The proposal would also prohibit payment of any additional compensation to a loan broker if the broker is paid any fee directly by the consumer. The Board should not unduly restrict legitimate incentive compensation systems based on overall profitability of the creditor or a unit or division of a creditor. In addition, it is essential that creditors be permitted to pay compensation based on loan volume (amount) in order to provide employees with proper incentives for production. The prohibition against compensating brokers from a combination of direct fee and yield spread seems unnecessary in light of the proposed prohibition on paying yield spreads based on loan rate or other terms.

The Board is also proposing a general prohibition against loan originators steering consumers to a particular loan product if the loan originator will receive greater compensation for that product than any other product the creditor could have offered, unless the transaction is in the consumer's interest. This proposal is too vague to be enforceable. How will improper steering be distinguished from a voluntary choice by a loan applicant? On what basis can a judgment be made as to whether a transaction is in the consumer's interest? If a consumer has to pay a higher rate in order to receive a larger loan or one with a longer term, is that in the consumer's interest? Without clear and specific guidelines, the proposal will lead to subjective, uneven enforcement, create a high risk of litigation and will discourage loan originators from offering the consumer a full array of products and allowing the consumer to make an informed choice.

## Credit Life Insurance and Debt Cancellation Coverage Eligibility

The Board proposal would require that, prior to the sale of any credit life or debt cancellation coverage in connection with any open-end or closed-end consumer credit, the creditor first evaluate whether a loan applicant meets basic eligibility restrictions at the time of enrollment, such as age or employment restrictions. Also, the creditor would be required to provide a disclosure to the consumer that such a determination has been made. We already train employees not to offer the products when it is apparent the customer would not qualify, but it is not always possible to make a yes/no determination at the time of enrollment. Some restrictions are easier than others. Age is easy. Employment may not be. For example, what if the loan customer has started a new job, has not been on the job long enough at the time of enrollment to satisfy the required minimum, but will be able to satisfy that restriction shortly after enrollment?

The language proposed for the required disclosure would require the following statement: "Based on our review of your age and/or employment status at this time, you would be eligible to receive benefits." Or, if there are other eligibility restrictions or exclusions such as pre-existing health restrictions, the creditor would be required to disclose: "Based on our review of your age and/or employment status at this time, you may be eligible to receive benefits. However, you may not qualify to receive any benefits because of other eligibility restrictions." Neither of those statements fits the situation described in the example above. In addition, all insurance policies and debt cancellation contracts contain conditions and exclusions. Even if a loan applicant satisfies basic age and employment restrictions at the time of enrollment, there will still be conditions and exclusions that could later apply and prevent the payment of benefits. A broad statement that the creditor has made a preliminary determination that the consumer qualifies could mislead consumers into believing that benefits will be paid despite legitimate conditions and exclusions in the policy or contract. This will no doubt increase the risk of litigation and potentially expose creditors to contractual liability for telling a consumer he or she is covered when it later appears that a condition or exclusion applies that was beyond the creditor's ability to determine at time of enrollment. This particular disclosure should be limited to a simple statement such as: "There are eligibility requirements, conditions and exclusions that could prevent you from receiving benefits. Read your contract carefully. To learn more about …(followed by language referring the applicant to the Federal Reserve website)."

The proposed disclosures that would be required in order for the purchase of credit life or debt cancellation to be considered voluntary also include the following statements:

"If you have insurance already, this policy may not provide you with any additional benefits. Other types of insurance can give you similar benefits and are often less expensive."

This statement is inaccurate and misleading. Even if a consumer has other insurance, credit life or debt cancellation will still provide the benefits contracted for. The consumer may simply desire additional coverage. Also, use of the general term "insurance" may be misleading depending on the circumstances. For example, just because the consumer has other forms of life insurance doesn't mean he or she has disability protection. Some debt cancellation products provide benefits for events such as divorce or family leave where there may be no similar forms of insurance available.

## In Summary

Thank you for this opportunity to comment. We applaud the Board's general goals of providing consumers with appropriate disclosures and protection against abusive practices. However, we are deeply concerned that the proposal as written is in many respects unduly complex, will create substantial compliance and litigation risks for creditors, and will impose substantial and costly burdens on all creditors. The proposed APR and settlement costs disclosures may well increase confusion among consumers and will not improve consumer loan shopping habits. We think the new benefits added by the proposal will be of limited value for many consumers and are outweighed by the costs and risks that would be imposed on all creditors. We urge the Board to take a more balanced approach to the concerns it cites in the proposal.

Very truly yours,

First Citizens National Bank

/signed/
Rob Kerr
Vice President & Chief Compliance Officer