Consumers Union
Nonprofit Publisher of Consumer Reports

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Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
Via email: regs.comments@federalreserve.gov
VIA FACSIMILE: (202) 452-3819

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

Dear Chairman Bernanke, Members of the Board, and Board Secretary Johnson:

Consumers Union,[1] the nonprofit publisher of *Consumer Reports*, appreciates the opportunity to comment to the Federal Reserve Board regarding the Board's proposal to amend the Truth in Lending Act's disclosure rules on closed-end credit. This letter addresses only our comments regarding the changes proposed by Docket No. R-1366. Consumers Union's comments regarding the changes proposed to the disclosures governing open-end credit, Docket R-1367, are filed under separate correspondence.

I. Summary of Consumers Union's Comments

The changes in the disclosure rules proposed by the Board regarding closed-end lending are significant and are ones which Consumers Union supports. We also support an expansion of the substantive rules to prevent mortgage lending abuses. In this letter, we comment briefly on our position regarding the Board's most important proposed changes. We also encourage the Board to use its authority to ban unfair mortgage practices more aggressively. In addition to our comments, we also support those provided by the California Reinvestment Coalition and the comprehensive comments submitted by the National Consumer Law Center.

II. Substantive Regulations Proposed by the Board

A. We support the Board's proposal to ban the payment of any yield spread premiums that are based on loan terms or conditions, including the loan amount.

The payment of yield spread premiums by lenders to brokers has long created perverse incentives that motivate brokers to act in their best interest ahead of those of the borrower. By placing borrowers in loans with higher interest rates and pre-payment penalties in order to earn higher yield spread premiums, brokers can cause borrowers to unwittingly pay more for mortgage credit than they deserve. Compounding this, trusting

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[1] Consumers Union of United States, Inc., publisher of *Consumer Reports*®, is a nonprofit membership organization chartered in 1936 to provide consumers with information, education, and counsel about goods, services, health and personal finance. Consumers Union's publications and services have a combined paid circulation of approximately 8.3 million. These publications regularly carry articles on Consumers Union's own product testing; on health, product safety, and marketplace economics; and on legislative, judicial, and regulatory actions that affect Consumer welfare. Consumers Union's income is solely derived from the sale of *Consumer Reports*®, its other publications and services, fees, noncommercial contributions and grants. Consumers Union's publications and services carry no outside advertising and receive no commercial support.

borrowers reasonably expect their professional brokers to act as fiduciaries and are easily taken advantage of by brokers who are under no legal obligation to do so. Disclosing the payment of a yield spread premium to a borrower is not enough to stem abuses or to educate borrowers on how to avoid abuses. The Board should adopt the full ban on yield spread premiums as proposed, and should not adopt any weaker versions of this prohibition. Without a full ban on yield spread premiums, the significant problems and abuses that consumers experience with yield spread premiums will not be adequately addressed.

B. We support the Board's proposal to ban payments to loan originators from two sources—both the consumer and the lender. Borrowers are easily confused by the compensation system for brokers and how this relates to the cost of their loan. Allowing compensation from only one source makes the amount of the total compensation more transparent to the borrower, allowing the borrower to more fully appreciate how much the broker is being paid to facilitate a loan. We agree with the Board that disclosure of dual compensation has proven insufficient to protect borrowers and is simply not enough to stem abuses in this area. Unless loan originators are restricted to receiving payment from either the lender or the consumer, not both, loan originators will continue to have incentives to increase the price of loans.

III. The Board Should Add More Substantive Protections for Borrowers

While the two changes noted above demonstrate important improvements to the TILA rules, Consumers Union believes the Board needs to use its authority to go further to prohibit creditors from originating abusive, predatory loans. Abusive loan terms and conditions are at the heart of many failed predatory loans and have contributed greatly to the wide-scale collapse of the mortgage market and ensuing economic crisis. Based upon the many stories consumers have shared with Consumers Union, we believe it is absolutely critical for the Board to take further action to address, at a minimum, four key areas of abuse. We include the personal stories[2] of Mr. Vernon Frontz and Mr. Langdon McAlpin to illustrate the ways in which the abusive lending practice we highlight have taken a huge toll on individuals and communities and compel the need for stronger Board action.

To prevent further abuses in this area, the Board should:

A. Ban payment option adjustable rate mortgage (ARM) terms for all loans secured by the borrower's principal residence.

The story of Vernon Frontz illustrates the dangers of inadequately regulated payment option ARM loans.

Mr. Frontz is 93 years old and was on the verge of losing his Atlanta, Georgia home of 44 years until his attorney prevailed after a long struggle to keep Mr. Frontz in his home. Prior to receiving an abusive payment option ARM loan, Mr. Frontz had existing mortgage payments of approximately $900 per month. In 2007, Mr. Frontz was sold a new 40 year payment option adjustable rate mortgage by telephone. He said an individual called him offering to refinance his existing mortgage with a new loan with lower monthly payments. Mr. Frontz said it sounded like a good offer and agreed to a new loan with monthly payments he thought he could afford.

Mr. Frontz said he was shocked to learn that the low monthly payments he thought he would have for the life of the loan were only initial monthly payments and that his

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[2] To view the *Faces of Foreclosure* video stories produced by Consumers Union, go to http://www.defendyourdollars.org/video.html

minimum payments would go up one year after the loan was made. He said that a few months after he got the loan, his daughter reviewed his papers and told him that the loan application had incorrectly listed his monthly income as $4,480. Mr. Frontz said he had no idea where that number had come from, especially since his only income, from a railroad retirement pension and other social security income was only about $1,400 per month.

Mr. Frontz' daughter then consulted a lawyer about her father's mortgage and discovered that he had been given an interest only payment option, 40 year ARM in the amount of $231,000. The first month's payment on the mortgage starting April 1, 2007 was $669.52, which was based on the teaser rate of 1.75 for the first month only. After that, the minimum payment was still $669.52 for the remainder of the first year. However this payment amount no longer paid the full amount interest accruing monthly. As a result, even though Mr. Frontz continued to make mortgage payments, his loan was negatively amortizing which meant his principal balance increased each month that he paid the minimum payment, slowly reducing his equity, even while he was making payments. Further, once Mr. Frontz' principal loan balance reached 115% of the principal amount borrowed, a certain eventuality given the negative amortization feature of his loan, his minimum payment would increase substantially, making it even more difficult for him to pay this loan.

According to the loan terms, on April 1, 2008, one year after the loan closed and every year thereafter, the payment amount would change. After the first year, his minimum payment increased to $719.73 and he could no longer afford the payments. After the first three years of the loan, had Mr. Frontz' attorney not prevailed, Mr. Frontz would have been obligated to make a minimum payment of $1,958.55 for the next 37 years, on an income of about $1,400 per month. Additionally, Mr. Frontz would have to pay a $6,121 prepayment penalty if he refinanced the loan before February 27, 2010.

B. Extend the requirements currently applicable only to higher cost loans regarding the determination of the borrower's ability to repay, to all mortgage loans secured by a borrower's principal residence; and

C. Require underwriting for all adjustable rate loans to determine the borrower's ability to repay the highest possible payments that may be required under the loan terms (counting both alternative amortization terms and the highest permissible interest rates).

The case of 68 year old Langdon McAlpin, a disabled police officer from Loganville, Georgia illustrates why these are important steps for the Board to take.

Mr. McAlpin had been a city of Decatur police officer for 23 years when he was struck by a vehicle while directing traffic in 1989. He suffered severe physical injuries including a significant head injury and is permanently disabled from work as a result. In 2004, the McAlpins refinanced and were sold an adjustable rate mortgage (ARM) that they could not afford. Mr. McAlpin said the lender told them they were qualified for the loan, but in fact that was not true. The ARM they received had a fixed initial interest rate for the first two years that continued to change every six months thereafter. His income, on the other hand, was limited and fixed and Mrs. McAlpin was unemployed. The only household income came from Mr. McAlpin's pension disability check in the amount of $2,039.62. After a deduction of $250 for Mr. McAlpin's medical insurance, the McAlpins had $1,789.62 net monthly income available to pay the new mortgage payments and their other household expenses.

After the loan was made, the McAlpin's initial monthly principal and interest payments on the new mortgage were $888.71. After the city and county property taxes and homeowners insurance were escrowed into the payment ($221.91 per month), the total monthly housing payments for the McAlpins were $1,110.62. The initial mortgage payment consumed a staggering 62.06% of the McAlpin's net monthly income and the McAlpins struggled to make the payments. Two years later, the interest rate adjusted and the escrow payments increased inflating their monthly mortgage payments to $1,378.52. Six months, later their monthly mortgage payments rose again to $1,487.92. Six months later, on July 1, 2007 the total mortgage payment effective on August 1, 2007 was $1,576.46, or over 88% of the McAlpin's net monthly income.

On October 26, 2007, the Georgia Department of Banking and Finance revoked the mortgage lending license of the original lender involved in the McAlpin mortgage loan and entered into a consent order with its owners to resolve allegations pertaining to violations of the Georgia Residential Mortgage Act and agency rules. However, the McAlpin loan has been transferred and assigned to another lender who is not subject to the Georgia Department of Banking and Finance action against the original lender. Through his lawyer, Mr. McAlpin alleged that the purchaser of the loan knew or should have known of the legal claims against the original lender and should have more closely inspected the documents in the loan files it purchased. Had it done so, the McAlpin's alleged, it would have discovered that that this was a clearly unaffordable loan that had not been underwritten to determine the borrowers' ability to repay the highest possible payments that may be required under the loan's terms.

Earlier this year, Mr. McAlpin was on the verge of losing his home of 19 years to foreclosure until the lender holding his mortgage agreed to allow Mr. McAlpin to pay off the loan with a new reverse mortgage. The Board can and should require lenders to determine borrowers' ability to repay to prevent more cases like Mr. McAlpin's. Ultimately, both lenders and borrowers will benefit from such a protection, with a lender being assured the borrower is qualified to repay the loan as agreed and the borrower knowing that the loan was made because the borrower could afford to pay. The protection also assures that in the case of an adjustable loan, the borrower can afford the loan at the highest payment rate.

D. Prohibit the initiation of a foreclosure unless the Home Affordable Mortgage Program (HAMP) loan modification analysis and procedures have been completed.

The HAMP program was launched in March 2009 to minimize the number of unnecessary foreclosures to prevent home loss and the further erosion of the national economy. The Department of the Treasury (Treasury) released the latest statistics on HAMP modifications on December 10, 2009. According to the data, the lender/servicer performance continues to be very disappointing and supports the need for the Board to exercise its power to encourage greater participation by eligible lenders and servicers. After seven months of HAMP activity, of the estimated eligible loans that are reported 60 or more days delinquent, active HAMP trial loan modifications have been offered to only 21 percent, trial plan offers have been extended to 31 percent and permanent modifications have been offered to less than one percent. [3] This is the first reporting period where Treasury has published statistics regarding the number of permanent modifications. As for the percentages of trial loan modifications and trial plans, these

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[3] U.S. Dept. of the Treasury, *Making Home Affordable Program, Servicer Performance Report through November 2009*, available at http://www.financialstability.gov/docs/MHA%20Public%20121009%20Final.pdf

numbers have increased only very slightly from the previous month,[4] indicating that progress is sluggish at best. Consequently, the vast majority of homeowners who hold loans that are estimated by Treasury to be eligible for HAMP modifications have not been helped and continue to be at risk of foreclosure. Additional action by the Board will create an important new incentive for servicers and lenders to take advantage of HAMP before resorting to foreclosure.

IV. Disclosures Have Been Improved

Disclosures alone will not adequately protect consumers from most abusive mortgages and the single best way to prevent abusive practices is to ban them altogether. However, enhancing the disclosure rules is still very important so that consumers will be assisted in determining the true costs and risks of the loans they may be considering. Up until now, the Board's rules required only weak, obscure disclosures, or no disclosure at all, of some of the most significant loan features that can impact the quality of a mortgage. The new disclosures proposed by the Board significantly enhance the weak mortgage disclosures that mortgage borrowers have received.

A. We support the Board's proposed improvements which include:

1. **Much more meaningful definition of the APR.** Consumers Union supports the Board's proposal to create a more meaningful APR that reflects the true cost of borrowing by capturing all loan costs, including not just interest but also hidden fees that boost the cost of credit. We support the Board's proposal in which the finance charge will always include credit insurance premiums when charged, fees for recording and releasing the security interest, nearly all closing costs and all settlement agent charges.

2. **Innovative, targeted disclosure of the particular APR offered to the consumer.** We support the Board's proposal to require creditors to disclose to consumers a chart demonstrating how the APR offered to that consumer compares to the average rate for prime loans and to current rates for higher priced loans. For too many years, loan originators have been able to conceal this information from unsuspecting consumers who place their trust in the lender or their broker to get them the best deal. With this new rule in place, borrowers will be able to review a very simple, highly visual representation of the deal they are being offered as compared to what is currently being offered to those with excellent credit and to those with poorer credit. This will be especially useful for those who qualify for better credit but are put into expensive loans because the broker or lender believes the borrower will never know the difference and the monetary incentives for doing so benefit the lender or broker.

3. **Final disclosures 3 days before closing.** Consumers Union supports the Board's proposal to require the re-disclosure and a three-day waiting period if any loan term changes. This change will provide consumers with the ability to carefully consider the significance of any last minute changes that can alter the quality and value of the loan being offered. This is a much better alternative than the other proposed by the Board which would only require re-disclosure and a three-day waiting period if the APR changed or an adjustable rate feature was added.

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[4] U.S. Dept. of the Treasury, *Making Home Affordable Program, Servicer Performance Report through October 2009*, available at http://makinghomeaffordable.gov/docs/MHA%20Public%20111009%20FINAL.PDF

4. Major improvements in format and understandability of mortgage disclosures, but creditors must be required to use them. The new Truth in Lending disclosure form proposed by the Board is a significant improvement over the currently mandated TILA disclosure forms. We support these proposals which include the elimination of disclosures which consumers do not find useful and replacing them with user friendly tables and plain language information specific to the borrower's actual loan product**.** Unless the Board requires creditors to use these improved disclosures, borrowers will not realize the benefit of these much needed enhancements.

5. At a minimum, provide consumers with much better disclosure of risky loan features. Consumers Union supports the elimination of risky loan features which lure and trap borrowers into impossible loans they cannot afford to repay. Failed predatory loans commonly include features such as prepayment penalties, interest-only payments, negative amortization, balloon payments and demand features. Often they are stated income loans which require little or no documentation. Sometimes they involve loans in which the lender or a third party demands shared equity or shared appreciation. We respectfully urge to Board to use it's authority to prohibit these loan features as the single most effective way to eliminate predatory mortgage loans which have decimated the mortgage marketplace. Short of prohibiting these practices, the Board's rules requiring creditors to make special disclosures regarding these risky loan terms is an improvement we support.

V. Conclusion

Consumers Union appreciates the Board's careful consideration of the improvements it has proposed to protect consumers in the mortgage marketplace. As the events of the last year and half demonstrate, the safety and soundness of the mortgage market is a critical and integral component of a sound national economy. Individuals, whole communities and local and state governments have likewise been severely impacted by the failure of the U.S. mortgage market. For this reason, we support the Board's proposed changes which add more safeguards to the mortgage lending marketplace and urge the Board to use the authority given by Congress to go further to protect consumers from unfair and abusive mortgage lending practices.

Please do not hesitate to contact me should you have any questions regarding Consumers Union position concerning *Docket No. R-1366*.

Very truly yours,

Norma P. Garcia

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