

**Empire Justice Center  
Legal Services NYC  
Neighborhood Economic Development Advocacy Project  
South Brooklyn Legal Services  
Western New York Law Center**

December 24, 2009

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

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

Dear Members of the Federal Reserve Board:

The undersigned consumer advocates provide the following comments on the proposed changes to the regulations under the Truth in Lending Act. We work for legal services and advocacy organizations in New York. Our organizations assist thousands of homeowners each year who are at risk of foreclosure. Through litigation and advocacy, we have been able to save hundreds of homeowners from foreclosure.

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

**Ban on Yield Spread Premiums**

We applaud the Board's proposal to ban yield spread premiums. Yield spread premiums (YSPs) provide a perverse incentive to both lender employees and independent brokers to place borrowers in higher cost mortgages than those for which they would have otherwise qualified. Our organizations have seen brokers and lender employees paid tens of thousands of dollars for placing unsuspecting homeowners into unaffordable loans with disadvantageous terms such as higher interest rates, balloon payments and prepayment penalties. Homeowners whose loans included a YSP almost always paid a broker fee, as well. Especially in the subprime market, YSPs have been nothing but a means to further gouge borrowers.

Loans made with up-charged interest rates as the result of the payment of a YSP were tremendously profitable for lenders but entirely unsuitable for homeowners who were at a

substantially increased risk of foreclosure. For example, an elderly New York State homeowner on a fixed income was induced into refinancing his fixed rate mortgage by a broker with the promise of a one percent interest rate which would have reduced his monthly mortgage payments by more than \$700. In reality this homeowner was given a payment option adjustable rate mortgage with a three year pre-payment penalty. The one percent interest rate lasted for one day and then soared to over eight percent with a fully amortizing payment which far exceeded his household income. The broker received an \$11,700 yield spread premium in compensation for placing an elderly homeowner in a loan he could never repay.

FDIC Chair Sheila Bair recognized in an April 7, 2008 letter to Federal Reserve Chairman Ben Bernanke “[d]isclosures alone will not address the fundamental problem with YSPs, which is that they provide an inappropriate financial incentive for mortgage brokers to steer consumers to unaffordable loans.” We support the Board’s proposed ban on all yield spread premiums that are based on loan terms or conditions, including the loan amount. Any weaker regulation would not stop the abuses that have caused the subprime lending crisis and unnecessarily put many homeowners at risk of foreclosure. The Board should adopt the full ban on yield spread premiums. Consumers should not have to deal with loan originators who are going behind their backs to give them worse loans than those for which they qualify.

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

### **Prohibiting Additional Unfair Practices**

While the substantive proposals are a good step toward preventing future lending abuses, they are not nearly enough. Even in the face of the current disaster in the mortgage market, it appears that the Board continues to rely on the discredited notion that better disclosures will prevent dangerous, predatory mortgage lending. In this sweeping rewrite of TILA rules – much of which is driven by recognition of the extent to which predatory lending has played in causing the current economic crisis – the Board still fails to use its authority to prohibit blatant and far-reaching unfair practices. With the important exception of yield spread premiums, the Board continues to allow creditors to write abusive, predatory loans, and is merely reworking the requirements for disclosing the abusive terms.

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

- Ban Payment Option ARM terms for all loans secured by the borrower’s principal residence.
- Extend the requirements currently applicable only to higher cost loans regarding the determination of the borrower’s ability to repay, to *all* mortgage loans secured by a borrower’s principal residence.
- Require underwriting for all adjustable rate loans to determine the borrower’s ability to repay the highest possible payments that may be required under the loan

terms (counting both alternative amortization terms and the highest permissible interest rates).

- Prohibit the initiation of a foreclosure unless the HAMP loan modification analysis and procedure have been completed and all other loss mitigation options have been exhausted.

### **Much Improved Disclosures**

Disclosures will never be sufficient to prevent homeowners from being sold abusive loan products. Even the best disclosures could not replace the need for substantive regulations that prohibit the most egregious and dangerous lending practices. With that said, the proposed changes to disclosures to be delivered to homeowners are a very good improvement over the current disclosures. We appreciate the time and attention that the Board took in testing the disclosures, evident in the new forms and new disclosure requirements.

***Disclosures at application:*** We support the new disclosures to be provided at application, including the “Key Questions to Ask about Your Mortgage” and the Fixed vs. Adjustable Rate Mortgages to be given to homeowners getting adjustable rate mortgages. Our experiences are similar to those found by the consumer focus groups – that homeowners are not regularly given the existing CHARM booklet, and more so, that even if they did receive it, it is too long and confusing to be helpful. Keeping these disclosures to one page is good and both set forth key points in a concise and easy to read format.

Additional points to consider adding to the “Key Questions to Ask About Your Mortgage” disclosure:

- “How much are the lender’s fees (underwriting, application, underwriting, etc)?” It is our experience that many borrowers do not understand that these fees vary from lender to lender, and can vary significantly.
- “Have I hired a broker and if so, how much will I pay them for helping me get the loan?” Many folks who obtain loans through mortgage brokers do not realize they are dealing with a third party and believe the broker is simply working on behalf of and getting paid by the lender. It is essential to alert borrowers that mortgage brokers are getting paid and to disclose the pros and cons of using a mortgage broker versus obtaining financing directly from a lender.

***Disclosures within three days after application:*** In our experiences, borrower rarely if ever receive an early TILA disclosure within three business days after application or at least seven business days before consummation. The law should be strengthened to ensure that borrowers receive these early disclosures. The improvements to the format make the forms easier to read and set forth key terms in a clearer manner. The changes in information to be provided also are very good and will help ensure that borrowers are provided meaningful information in a way they can understand.

We also support the Board’s proposal to require creditors to disclose a mini-chart that shows exactly how the APR offered to a particular consumer compares to the average rate for prime loans and to current rates for higher priced loans. This innovative requirement will help

alert consumers whenever they are offered a bad deal – something that loan originators in the past have been able to obscure.

We recommend the following to further improve the forms:

- Prescribe a uniform format, rather than simply requiring formatting and terminology. The Board should develop one form for each loan type which all mortgage lenders must use, including precise terminology and an exact format.
- The “Total Payments” is currently listed on the back of the form, and not in any conspicuous way. We recommend that the “Total Payments” be listed more prominently, on the front of the form. It is very important for homeowners to understand the total dollar amount they will pay for their home through the life of the loan, as it is a considerably higher amount than the original loan amount.
- On the TILA disclosures for Adjustable Rate Mortgages, there is a critical piece that should be changed under the Interest Rate and Payment Summary. The second column lists the “MAXIMUM at FIRST ADJUSTMENT.” The first adjustment, however, typically does not bring a borrower’s payment to the maximum amount that is going to be in place for the majority of the loan term. (The first adjustment is often limited by a percentage amount over the introductory rate.) Not only does this column fail to disclose the payment that is likely intended, but it may work to incentivize lenders to ensure that the first adjustment is only slightly higher (or even lower) than the introductory rate. Instead, we recommend that this column disclose what has been referred to as the “fully indexed rate,” or essentially, the rate, after any limitations on rate changes expire, essentially the index plus the margin set forth in the note.<sup>1</sup>
- The ARM Payment Option sample is a considerable improvement as there is no way the current TILA form can adequately relay to borrowers that the loan is a payment option form, let alone communicate the ramifications of these loan products. However, as noted above, because disclosure alone is never enough we recommend that payment option ARMS be prohibited altogether.

We support an amending calculation of the finance charge. There is no question that in our experience, evidenced again by the Board’s consumer testing, that the finance charge is a confusing and unknown term to borrowers. The way the finance charge and annual percentage rate are calculated does not lead to any meaningful opportunity for borrowers to shop around and compare the cost of credit from different lenders, as may have been intended. Additionally, the inclusion of some fees and exclusion of others has created vast confusion among lenders and consumer advocates, and has resulted in considerable frustration, as well as litigation, concerning the determination of whether a particular charge is a finance charge.

Regarding the proposed changes, we suggest the following:

- Replacing the term “finance charge with “interest and settlement charges” is not entirely accurate, unless all settlement charges are to be included in the APR.

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<sup>1</sup> Chapter 507 of the Laws of New York, 2009 defines “fully indexed rate” as: (I) for an adjustable rate loan based on an index, the annual percentage rate calculated using the index rate on the loan on the date the lender provides the “Good Faith Estimate” required under 12 U.S.S. S2601 et seq. plus the margin to be added to it after the expiration of any introductory period or periods; or (II) for a fixed rate loan, the annual percentage rate on the loan disregarding any introductory rate or rates and any interest rate caps that limit how quickly the contractual interest rate may be reached calculated at the time the lender issues its commitment.” NY Banking Law Sec. 6-m(1)(b).

- Consider an “all-in” approach – requiring all settlement charges to be included - which would provide obvious clarity and no room for interpretation.

***Disclosures three days before consummation:*** The new requirement that borrowers be provided accurate disclosures of their loan terms at least three days before consummation is very important, and is a regulation we strongly support. It would be impossible for us to count the number of times all of us have been told by clients that the loan terms they were presented at the settlement table differed greatly from what they had been told they would be receiving. It may be easy to wonder in hindsight why a homeowner signed a loan with far different, and worse, loan terms than they were promised but the choices at the table are not so easy.

One New York first-time homebuyer had been assured repeatedly by her mortgage broker that she would be getting a fixed rate mortgage. She had used most of her savings as a down payment on the modest home in upstate New York and invested additional savings in inspections. The closing was to take place in mid-November, in time for her to be in the home for Christmas with her family. Notice was given that she would leave her apartment at the end of December. The closing date got postponed, and postponed again but she was repeatedly assured by her broker that nothing was wrong. When the closing finally took place in the second week of December, the loan she was presented was an adjustable rate mortgage with a fixed rate for three years that would adjust to five margin points over the index – which would mean that her interest would likely go from about 7% to 11%.

She had no choice at that table as to whether to sign the loan documents. If she did not, she would have risked not having a home for her family in the middle of winter, losing her deposit and other money invested already, and risk being sued by the seller, not to mention losing her dream home. The broker was not at the settlement table to answer questions as she was instructed by the settlement agent to “sign here” and told she could refinance if she was unhappy. Her interest rate increases this month and despite attempts to refinance, she has been unable to do so because the value of her home has decreased.

Homebuyers have been caught far too often in the proverbial “Catch 22” situation and effectively coerced into signing loan documents that are different than what they were promised. Requiring that borrowers be given completely accurate final information before the loan closing is critical to helping to ensure that borrowers are not deceived at the moment of signing loan documents.

Regarding the two approaches offered about handling last minute changes that do not exceed a certain tolerance, it is critical to know what could cause terms of a loan to change at the last minute. In looking at the typical terms that are set forth on a HUD1 Settlement Statement, there are no terms that could not, or would not be obtained or known three days before a loan closing. This is certainly true for refinancings and also seems true for purchase money mortgages. For these reasons we recommend the following:

- The Board adopt the first approach offered, that should loan terms change causing the APR to increase, new disclosures be provided and a new three day waiting period be mandated.

- If the lender insists on moving forward with the loan closing because they determine the change to be insignificant, then the lender should absorb the additional cost so that it is not imposed on the borrower.
- Any other changes in loan terms, such as from a fixed rate to an adjustable rate, or from an conventional adjustable rate to a payment option ARM loan, should absolutely require a new three-day waiting period that cannot be waived.

***Improved disclosures of risky loan features:*** We support the proposal to require creditors to make special disclosures regarding some of the riskiest terms. The current disclosures did a poor job of disclosing such features contained in payment-option loans as interest-only payments and negative amortization, as well as prepayment penalties, balloon payments, demand features, and loans that fail to verify the borrower's ability to repay such as has existed in no-documentation or low-documentation loans. Borrowers trust that lenders will not make loans that they will not be able to pay, or loans with these deceptive features that will trip them up along the way. The requirement that these features be more clearly disclosed is a significant improvement.

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

Thank you.

Sincerely,

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 South Brooklyn Legal Services

Kirsten Keefe  
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*On behalf of*  
 Empire Justice Center  
 Legal Services NYC  
 Neighborhood Economic Development Advocacy Project  
 South Brooklyn Legal Services  
 Western New York Law Center