MICHIGAN CREDIT UNION LEAGUE

Helping Credit Unions Serve Their Members

July 22, 2011

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

Re: Docket No. R–1417 / RIN No. 7100–AD75

VIA ELECTRONIC MAIL: regs.comments@federalreserve.gov

Dear Ms. Johnson,

The Michigan Credit Union League (MCUL) appreciates the opportunity to comment on the Federal Reserve Board's (the Board's) proposed regulation to implement the ability to repay standards for mortgage loans under Regulation Z, as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act's (Dodd-Frank Act) amendments to the Truth in Lending Act (TILA). MCUL is a statewide trade association representing 95% of the credit unions located in the State of Michigan.

MCUL believes it is in the best interest of lenders to ensure that their respective borrowers have the ability to repay mortgage loans granted to them. It is unfortunate that a law had to be passed in order to ensure proper lending practices that not only necessitated a regulation over 100 pages in length, but has the potential to negatively impact lenders, like credit unions, that have never engaged in predatory mortgage lending practices.

MCUL believes the negative impact of this rule will be a substantial increase in compliance costs, as well as a limitation in the availability of mortgage credit. Potential borrowers that would qualify for a mortgage loan today will face increased difficulties to obtain a mortgage loan, as lenders will attempt to avoid the substantial penalties for failing to follow the specific requirements of this rule in assessing the ability of borrowers to repay mortgage loans.

Discussion

Definition of Finance Charge

Under the proposed rule, "points and fees" would include all items considered to be a finance charge, except mortgage insurance premiums or mortgage guarantee charges or fees, subject to criteria stated in the proposal. MCUL supports this provision in the proposal, as well as the fact that the premiums need not satisfy all of the criteria in order to be excluded from treatment in the points and fees.

Loan Originator Compensation

The proposed rule would require all compensation paid to a loan originator to be added to the points and fees paid by a borrower including, among other things, "awards of merchandise" so long as the compensation amount can be determined at the time of closing. MCUL believes, in an effort to be reasonable and provide clarity, the rule ought provide a de minimis amount that should not to have to be included in points and fees rather than some court providing an interpretation. An award under a de minimis amount is not likely to influence a loan originator to underwrite a mortgage loan that is not in the best interest of a potential borrower.

Real Estate-Related Fees

The Board requested comment on whether there are any fees that should not be included in points and fees if they are payable after closing, such as a loan modification fee. The Board expressed concern that such a fee could not be known before closing and could expose creditors to "excessive litigation risk if consumers were able at any point during the life of the mortgage to argue that the points and fees for the loan exceed the qualified mortgage limits due to fees imposed after loan closing." MCUL believes that lenders will be discouraged from providing qualified mortgages for more important reasons, as outlined in more detail below. However, MCUL agrees with the Board that a loan modification fee is an example of a fee that should never be included in points and fees because it is too theoretical in nature, and urges the Board to specifically add loan modification fees as an example of an exception to "points and fees" in the final rule or the commentary.

MCUL believes the proposed rule contains an error in the text. In its discussion of proposed comment 32(b)(1)(iv)-1, the Board states "Another provision clarifies that upfront credit insurance premiums and debt cancellation or suspension charges must be included in 'points and fees' regardless of whether the insurance or coverage is optional or *voluntary*." [emphasis added] MCUL questions whether this should read "optional or *required*."

Prepayment Penalties That May Be Charged on the Loan

The proposed rule includes "the maximum prepayment penalty...that may be charged or collected under the terms of the mortgage loan." MCUL strongly disagrees with this proposed provision for the following reasons: a scenario may never occur that triggers prepayment penalties and thus the prepayment penalty may never be assessed, the approach reduces the amount of any other fixed fees that can be charged on a mortgage loan (e.g., appraisal fees, recording fees, title insurance fees, etc.), and it presents even greater challenges for lenders providing smaller dollar mortgage loans.

If the Board is concerned that a failure to include this fee in the points, and fee disclosure would not sufficiently call attention to the fact that a prepayment penalty could be charged, TILA Section 129C(c) requires creditors to offer a consumer a covered transaction without a prepayment penalty, if a covered transaction with a prepayment penalty is offered.

Fully Indexed Rate

The proposed rule would define the "fully indexed rate" as "the interest rate calculated using the index or formula at the time of consummation and the maximum margin that can apply at any time during the loan term." MCUL shares the Board's concern that "by requiring creditors to use the maximum interest rate in a step-rate mortgage, the monthly payments used to determine the consumer's repayment ability will be overstated and may inappropriately restrict credit availability." This provision of the proposed rule as written would be detrimental to consumers and is unrealistic, as it fails to address the fact that as the interest rate increases and come into play in the future, the likelihood exists that principal has also decreased in the duration.

MCUL believes that a more realistic assessment would be to require creditors to assess whether a consumer can repay the loan using the maximum interest rate that occurs in the first five (5) years. Mortgage lenders should not be required to expose themselves to potential liability by being forced to demonstrate, even theoretically, that a borrower could repay a mortgage loan ten (10) years after consummation. As the Board reasons in its discussion of balloon mortgages, "The Board believes that five years is a sufficient period of time for consumers to improve personal finances, for example, and that there is an increased likelihood that a consumer may refinance, move or relocate during such time frame."

Prepayment Penalty

Under the proposed rule, a "prepayment penalty" would include any interest a consumer would be required to pay after prepayment in full. MCUL is very concerned that this provision is in conflict with how interest is currently charged under FHA notes. MCUL urges the Board to remove this provision from the final rule until the Consumer Financial Protection Board can have an opportunity to work with the Department of Housing and Urban Development (HUD) to ensure consistency and continued access to FHA loans in the marketplace.

The proposed rule would also require creditors that offer loans with a prepayment penalty to provide consumers with an alternative covered transaction without a prepayment penalty, even if the alternative covered transaction could have a different interest rate. MCUL believes that this provision is inconsistent with other provisions in the proposed rule, as it leaves out the most important consideration that a creditor should also ensure that a potential borrower would likely have the ability to repay the alternative covered transaction that is offered. MCUL urges the Board to add language to this section or cross-reference the current comment to §226.36(e)(2), which states as follows:

> *Transactions for which the consumer likely qualifies.* To qualify under the safe harbor in §226.36(e)(2), the loan originator must have a good faith belief that the loan options presented to the consumer pursuant to § 226.36(e)(3) are transactions for which the consumer likely qualifies. The loan originator's belief that the consumer likely qualifies should be based on information reasonably available to the loan originator at the time the loan options are presented. In making this determination, the loan originator may rely on information provided by the consumer, even if it subsequently is determined to be inaccurate. For purposes of § 226.36(e)(3), a loan originator is not expected to know all aspects of each creditor's underwriting criteria. But pricing or other information that is routinely communicated by creditors to loan originators is considered to be reasonably available to the loan originator, for example, rate sheets showing creditors' current pricing and the required minimum credit score or other eligibility criteria.

MCUL notes that this comment is referenced in §226.43(g)(3)(v) dealing with qualified mortgages, but is not contained in this section dealing with the general ability to repay standard.

Simultaneous Loan

Under the proposed rule, creditors would be required to consider a consumer's ability to repay a mortgage loan, taking into consideration any simultaneous loans that the creditors know or have reason to know exist. Creditors may not have actual knowledge of a simultaneous loan until after loan consummation because, for example, a second lien may not be recorded until after consummation of the covered transaction. Therefore, MCUL requests clarification that a creditor without "actual knowledge" of a simultaneous loan may rely on the information provided by an applicant in an application regarding the existence or non-existence of a simultaneous loan; "actual knowledge" to be defined as information contained in a "third-party record" as defined in the regulation.

Repayment Ability

Income or Assets

Creditors would be permitted under the proposed rule to base a repayment ability determination on current or reasonably expected income. To assess reasonably expected income, creditors could rely on third-party records that provide reasonably reliable evidence of the consumer's expected income, such as "documents demonstrating past bonuses." While MCUL supports the flexibility provided in the proposed rule, MCUL requests additional clarification that creditors would be permitted to rely upon an applicant's assertions of expected bonuses in conjunction with the documentation of consistently received past bonus payments from the current employer.

Current Debt Obligations

The Board requested comment on the feasibility of requiring creditors to independently verify current debt obligations not reflected in the credit report that a consumer has listed on the application. MCUL shares the concern of the Board that "requiring creditors to verify these obligations may result in increased compliance and litigation costs without offsetting benefits." MCUL believes there may be potential barriers to obtaining additional information, and a required investigation to overcome them would render the transaction too costly for a creditor. Additionally, creditors in this case should be permitted to rely on the assertions provided in a consumer's application.

The Board also solicited comments regarding whether creditors should be required to consider debts in forbearance or deferral. MCUL requests flexibility in these instances, as creditors may not realistically know the amount of the required payment of a debt in forbearance or deferral once the amount becomes due and payable at a future date, how much additional debt will be added to this amount after consummation of the mortgage loan, or the outstanding principal balance at the time the additional debt becomes due.

Payment Calculation

MCUL strongly supports the Board's consideration of enabling creditors to calculate the monthly payment using a fully indexed rate based on the outstanding principal balance as of the date the fully indexed rate takes effect under the loan's terms, instead of the loan amount at consummation. While MCUL appreciates the purpose of the proposed rule is to ensure that a consumer can repay a mortgage loan, which would be demonstrated by showing that a consumer would be able to repay even the highest monthly payment, MCUL agrees with the Board that this payment calculation approach would have the deleterious effect of restricting credit, and would also require borrowers to, essentially, be approved for unnecessarily higher overall loan amounts at the time of application.

MCUL also supports this approach regarding step-rate mortgages as well. MCUL agrees with the Board that the complexity involved with determining the proper payment calculation requirements could increase the potential for unintentional errors, making compliance difficult, especially for small creditors that are unable to invest in advanced technology or software needed to ensure that payment calculations are compliant. MCUL appreciates the Board's recognition of the difficulties involved, especially for smaller lenders. In addition, requiring a borrower to demonstrate that it could repay the loan using the maximum rate during the loan term, without taking into consideration the amount of principal due at the time of an increase, would require borrowers to be approved for unnecessarily higher loan amounts at the time of application.

Payment Calculation for Simultaneous Loans

One potential requirement for home equity lines of credit (HELOCs) that are simultaneous loans would be to require creditors to assume a full draw on the credit line. MCUL strongly agrees with the Board that such a requirement would unduly restrict credit access, especially in connection with non-purchasing transactions (i.e., refinancings), because it would require creditors to assume an overstated payment amount. MCUL requests that the Board require creditors to calculate the amount of funds that have been drawn on the date of application. Requiring the simultaneous HELOC payment calculation based on the funds to be drawn by the consumer at *consummation* of the transaction would unduly burden smaller lenders that may not have the software needed to recalculate the ability to repay on the closing date.

<u>Refinancing of Non-Standard Mortgages</u>

The proposed rule provides an exception to the ability to repay standard if a creditor refinances one of its hybrid loans into a standard loan. However, in order for this exception to apply, the monthly payment for the standard mortgage must be "significantly lower" than the monthly payment for the non-standard mortgage, and the creditor must receive the consumer's written application *before* the non-standard mortgage is recast.

MCUL does not support these two criteria. First, a borrower paying an interest-only loan with a payment of $575 per month may want to refinance to a standard mortgage that may require a $650 monthly payment in order to take advantage of a low standard loan interest rate and to achieve payment stability. However, the exception requirements would prevent the borrower from doing so because the $650 is higher than the non-standard loan payment, even if the refinancing would be in the borrower's best interest. Second, the proposed rule assumes that borrowers understand their recast date. Processing a mortgage refinance application and assessing a borrower's ability to repay a new loan may require additional time to determine well before the recast date. MCUL does not believe these criteria are realistic, nor do they adequately protect consumers from facing and preventing "payment shock." MCUL requests that the Board use its legal authority to make adjustments under the TILA to permit streamlined refinancings even after a loan is recast that are in the best interest of consumers.

Standard Mortgages – Points and Fees

The proposed rule would provide for two alternatives to deal with the requirement to limit points and fees to 3% of the loan amount. The second alternative would require an algebraic equation to determine whether this limit is reached. MCUL believes this second alternative is unnecessarily complex for even the most sophisticated lender and would increase the potential for computation errors and increased liability, especially for small lenders.

<u>Qualified Mortgages</u>

The Board requested comments on whether the "qualified mortgage" standard should be a safe harbor or a presumption of compliance. The Board expressed concern that the "safe harbor" approach would limit the consumer's ability to challenge a creditor's determination of repayment ability, and the "presumption of compliance" standard does not provide sufficient legal certainty for creditors.

MCUL believes the "qualified mortgage" standard should be treated as a safe harbor, as it is in the best interest of creditors themselves as financial depositories to ensure that borrowers have the ability to repay mortgage loans, especially those lenders who retain the loans in their respective portfolios. Given that qualified mortgages cannot have any risky features, such as interest-only payments, negative amortization, or balloon payment requirements, consumers would be adequately protected. While "qualified mortgages" have some appeal due to their simplicity, without an assurance of legal certainty, lenders would undoubtedly refrain from them in an effort to reduce liability these products present to the lender.

Limits on Points and Fees for Qualified Mortgages

The proposed rule would provide for two alternatives to deal with the requirement to limit points and fees to 3% of the loan amount. The second alternative would require an algebraic equation to determine whether this limit is reached. MCUL believes this second alternative is unnecessarily complex for even the most sophisticated lender and would increase the potential for computation errors and increased liability, especially for small lenders.

MCUL agrees with the Board that creating a points and fees threshold for small loans may result in qualified mortgages becoming high-cost mortgages, which would discourage creditors from making qualified mortgages for small-dollar loans. What has been proposed in an effort to protect borrowers will actually end up harming them, as creditors will either refuse to provide small mortgage loans to consumers, or increase the interest rate to cover fixed costs. MCUL urges the Board to increase the proposed small dollar loan threshold to at least $100,000.

Exclusion from Points and Fees for Qualified Mortgages

The proposed rule would exclude three types of charges from the points and fees calculation for qualified mortgages. While MCUL appreciates the Board's understanding that certain charges must be excluded from points and fees for certain qualified mortgages in order to ensure their viability, MCUL believes these provisions are too complex and present a compliance minefield. MCUL urges the Board to simplify the exclusion of bona fide points in order to avoid potential errors in calculation that would result in increased creditor liability and less available credit.

Balloon Payment Qualified Mortgages Made by Certain Creditors

Under the proposed rule, a balloon payment mortgage would not be permitted as a qualified mortgage unless certain criteria were met. One of the criteria includes all of the following creditor requirements:

1. The creditor operates predominantly in rural or underserved areas;
2. Together with all affiliates, has total annual residential mortgage loan originations that do not exceed a limit set by the Board;
3. Retains the balloon-payment loans in portfolio; and
4. Meets any asset-size threshold and any other criteria the Board may establish.

The Board provides in the proposed rule that, based on outreach, certain community banks appear to originate balloon-payment loans to hedge against interest rate risk, rather than making adjustable-rate mortgages. Because this strategy may be a viable option for all lenders to hedge against interest rate risk, MCUL does not believe that qualified balloon mortgages should only be an option in rural or underserved areas. Expanding the availability of qualified balloon mortgages achieves the goal of ensuring access to credit in rural and underserved areas, while providing similar access to borrowers outside these areas that may not otherwise qualify for a qualified mortgage. Additionally, the safeguards in place for qualified mortgages, along with the inherent liability risk borne by creditors in offering qualified mortgages ensures a reduction in the risk of any abuses associated with offering qualified balloon mortgages.

Conclusion

MCUL supports the overall goal of ensuring that consumers have the ability to repay a mortgage before a loan is granted. However, MCUL is concerned about the substantial increase in compliance costs and liability risks to be borne by credit unions that have never engaged in predatory mortgage lending practices. The majority of credit unions have a limited amount of staff and resources to respond, prepare and pay for these overwhelming regulatory changes. MCUL is also concerned that the negative impact will also be felt by the consumers this proposal was designed to protect, in that the liability risks borne by creditors will quite possibly favor a reduction in the amount of available mortgage credit for consumers.

Financial institutions have been overwhelmed by regulatory mandates and amendments over the course of the past year: the myriad of changes to credit card programs as a result of the Credit Card Act; the various changes made to the way closed-end and open-end loan programs are disclosed under Regulation Z; and the multitude of regulatory changes as a result of the

Dodd-Frank Wall Street Reform Act of 2010 (Dodd-Frank Act), many of which have yet to be introduced. This impact has been felt more strongly on smaller institutions, which make up the majority of credit unions in this country.

MCUL urges the Board to take takes the points addressed in this letter into serious consideration when deliberating the passage of a final rule, and appreciates the opportunity to provide comment.

Sincerely,

Michael J. DeFors
VP Regulatory Affairs