Freddie Mac
We make home possible℠

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By Electronic Mail

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

RE: Board of Governors of the Federal Reserve System Proposed Rule on Amendments to Regulation Z - Docket No. R-1390

Dear Ms. Johnson:

Freddie Mac appreciates the opportunity to comment on the proposed rule to amend Regulation Z, which implements the Truth in Lending Act ("TILA"), published by Board of Governors of the Federal Reserve System (the "Board") on September 24, 2010 (the "Proposed Rule").[1]

The Proposed Rule would revise existing regulations: (i) for determining when new Regulation Z disclosures are required to be provided to a borrower as a result of certain transactions between a borrower and a creditor under § 226.20(a) of the Proposed Rule; (ii) pertaining to a consumer's right to rescind certain closed-end mortgage loans under § 226.23 of the Proposed Rule; and (iii) for determining whether certain closed-end mortgage loans are "higher-priced" mortgage loans subject to special consumer protections, under § 226.35 of the Proposed Rule.

Freddie Mac is an active participant in the secondary mortgage market working with mortgage brokers, bankers and other primary mortgage market counterparties to fulfill the company's statutory mission of providing liquidity, stability and affordability to the nation's housing market. Freddie Mac has made it a priority to identify and address borrower defaults and delinquencies before they become foreclosures, and has actively developed ways to identify, contact and help defaulting and delinquent borrowers navigate the loss mitigation process.

Freddie Mac recognizes that the overall mortgage process, particularly the mortgage modification process, can sometimes be confusing for borrowers and we support the Board's efforts to "bring uniformity to creditor's practices," to "facilitate compliance", and to enhance disclosures and borrower awareness of the cost of mortgage credit.[2] The informed use of mortgage credit through adequate disclosure is paramount to maintaining economic stability for borrowers and the housing market; however we believe the objective of enhanced disclosure and awareness of the cost of credit for borrowers must be balanced against the need to assist struggling homeowners quickly and efficiently through loan modifications and other foreclosure alternatives.

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[1] 75 Fed. Reg. 58539.
[2] *Id.* at 58596.

Our comments on the Proposed Rule seek to balance the Board's objective of enhanced disclosures with the importance of facilitating an accurate and efficient modification and rescission process. Our comments are intended to clarify further the roles and responsibilities of creditors and other parties involved in mortgage transactions. We believe this balance will help promote stability in the market, avoid potential borrower confusion associated with interacting with multiple parties, and assist in streamlining the modification and rescission process overall.

I. *Disclosures for Closed-End Mortgage Loan Modifications – Proposed § 226.20(a)*

Under section 226.20(a) of the Proposed Rule, in general, a "creditor" must provide new Regulation Z disclosures to a borrower if the same creditor and borrower agree to modify certain terms of an existing legal obligation secured by real property or a dwelling (for purposes of this comment letter, the "Disclosure Requirement").[3] The Proposed Rule also sets forth a number of exceptions to this requirement. Freddie Mac believes that the Board may want to consider the impact of the Disclosure Requirement on borrowers' ability to obtain modifications quickly and efficiently, and the practical impact on creditors and servicers that offer modifications.

A. "Creditor" and "Current Holder" – Proposed § 226.20(a)(1)

Regulation Z currently defines a "creditor" as "[a] person who regularly extends consumer credit...and to whom the obligation is initially payable..."[4] For purposes of the Disclosure Requirement, the Proposed Rule considers the current holder or servicer to be "a creditor when it modifies key terms to the existing obligation, whether the current holder is the original creditor, an assignee or the servicer."[5]

Freddie Mac supports the Proposed Rule's recognition of the need to provide adequate disclosures to borrowers in order for a borrower to make informed credit decisions. However, Freddie Mac does not believe that the "current holder" should always be treated as a "creditor" for purposes of the Disclosure Requirement because once a borrower's mortgage loan has been sold or assigned to a secondary mortgage market investor, which may be a securitization vehicle such as a trust, the "current holder" would not meet the current definition of "creditor" under Regulation Z; the "...person who regularly extends consumer credit...and to whom the obligation is initially payable..."[6] More specifically, secondary mortgage market investors are involved in buying and selling mortgage loans and mortgage backed securities, and do not serve as a "creditor" regularly extending mortgage credit to a borrower. Therefore, we suggest the Board clarify that a "current holder" is a creditor for purposes of the Disclosure Requirement only if such current holder is also the original creditor.

In addition, we suggest the Board clarify that the Disclosure Requirement rests with the applicable servicer of the mortgage loan because the servicer is the entity that typically communicates with the borrower and generally handles daily processing of transactions affecting a borrower's mortgage loan. We further suggest applying the definition of "servicer" as

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[3] *Id.* at 58697-98.
[4] 12 C.F.R. § 226.2(a)(17).
[5] 75 Fed. Reg. at 58597.
[6] 12 C.F.R. § 226.2(a)(17).

set forth in the Department of Housing and Urban Development's ("HUD") regulations[7] implementing the Real Estate Settlement Procedures Act ("RESPA").[8] We believe this definition would be consistent with the general industry definition of servicer, and would be consistent with the Board's reference to this definition for purposes of defining a servicer under section 226.23(a)(2)(ii)(B) of the Proposed Rule related to delivery of a borrower's notice of rescission.[9]

Because of the relationship the servicer has with a borrower, we believe borrowers are more familiar with their servicer, and a servicer is better equipped at providing any necessary disclosures. A "current holder" that is a secondary mortgage market investor and that is not in the business of servicing mortgage loans does not have a primary relationship with the borrower, and does not have the necessary infrastructure or oversight in place to provide new disclosures.

B. Increase in the loan amount – Proposed §§ 226.20(a)(1)(i)(A) and (a)(1)(ii)(B)

Section 226.20(a)(1)(i)(A) of the Proposed Rule provides that "[i]ncreasing the loan amount" is a modification to the terms of a borrower's existing mortgage obligation, thereby triggering the Disclosure Requirement.[10] The Board clarifies that an increase in the loan amount for these purposes occurs when the new loan amount exceeds the unpaid principal balance plus any earned unpaid finance charge or earned unpaid non-finance charge (such as a late fee) on the existing mortgage obligation.[11] In addition, an increase in the loan amount would include any cost of the transaction that is financed, except for amounts attributable to capitalization of arrearages and funds advanced for existing or newly established escrow accounts.[12] Section 226.20(a)(1)(ii)(B) provides that a modification of a borrower's loan in delinquency or default will not trigger the Disclosure Requirement unless there is an increase in the loan amount or interest rate, or a fee is imposed.[13]

Freddie Mac suggests that the Board clarify in section 226.20(a)(1)(i)(A) and (a)(1)(ii)(B) of the Official Staff Interpretations that amounts advanced for delinquent property taxes, insurance and Homeowners Association/Planned Unit Development ("HOA/PUD") fees (whether or not advanced for existing or newly established escrow accounts) may be advanced to a third-party taxing authority, insurer and/or HOA/PUD on behalf of the borrower and capitalized without triggering the Disclosure Requirement.

It would seem incongruous for Regulation Z to treat borrowers who do not have an escrow account any differently than borrowers who do have an escrow account. Generally, a delinquent borrower who did not maintain an escrow account is just as likely as a delinquent borrower who did maintain an escrow account to require the servicer to advance funds to pay past due property taxes, insurance and HOA/PUD fees. Thus, servicers would be inclined to advance and, upon modification, capitalize the delinquent property taxes, insurance or

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[7] 24 C.F.R. § 3500.2(b). *Servicer* means the person responsible for the servicing of a mortgage loan (including the person who makes or holds a mortgage loan if such person also services the mortgage loan).
[8] 12 U.S.C. § 2601 *et seq.*
[9] 75 Fed. Reg. at 58700. The Board references 12 C.F.R. § 226.36(c)(3) which states that "servicer" has the same meaning as provided in [HUD regulation] 24 C.F.R. § 3500.2(b), as amended.
[10] 75 Fed. Reg. at 58697-98.
[11] *Id.* at 58598 and 58762.
[12] *Id.*
[13] *Id.* at 58698.

HOA/PUD fees in order to keep the borrower who did not maintain an escrow account current and further preserve the applicable investor's first lien position. While it appears that such advances arguably would fall under the category of an "earned unpaid non-finance charge" on the existing mortgage obligation, it would be prudent for the Board to clarify that capitalization of such amounts, when required to be advanced in accordance with the mortgage modification, would not trigger the Disclosure Requirement.

C. Informal Forbearance Arrangements – Proposed § 226.20(a)(1)(i))2

Official Staff Interpretation 226.20(a)(1)(i)-2 indicates that certain types of "informal" forbearance arrangements to defer or reduce a monthly mortgage loan obligation followed by subsequent increases in the monthly payment "do not result in a change in the terms of the existing legal obligation," and therefore would not trigger the Disclosure Requirement.[14]

Freddie Mac suggests deleting the word "informal" from Official Staff Interpretation 226.20(a)(1)(i)-2. We believe that describing forbearance and repayment arrangements as "informal" may create ambiguity as to whether such arrangement must be verbal or written or for a specified period of time. Freddie Mac, for example, permits certain repayment arrangements to be verbal, but generally requires forbearance and repayment arrangements to be in writing. Because forbearance and repayment arrangements often address a borrower's temporary hardship, such as unemployment, natural disaster or emergency medical issues, we believe such arrangements should not be subject to the Disclosure Requirement to enable borrowers who are suffering from a temporary hardship to be provided timely relief.

In addition, we suggest the Board further clarify in Official Staff Interpretation 226.20(a)(1)(i)-2 that *all* forbearance and payment arrangements which do not result in a change to the terms of the existing legal obligation, would not trigger the Disclosure Requirement. We believe this clarification would assist servicers in facilitating the efficient implementation of forbearance and repayment arrangements generally, without the added burden of complying with the Disclosure Requirement. This may be particularly true during exigent circumstances such as a natural disaster or medical emergency, where immediate forbearance relief may be necessary; however, the borrower may not be able to physically receive, sign and return such Regulation Z disclosures such as occurred in 2005 in the aftermath of Hurricane Katrina.

D. Imposing Fees – Proposed § 226.20

Under section 226.20 of the Proposed Rule, the imposition of any fee in connection with modifying an existing mortgage obligation, regardless of how the fee is denominated or paid, or whether the fee is reflected in any agreement between the parties, triggers the Disclosure Requirement.[15] However, the Board acknowledges that the utility of several of the exceptions to the Disclosure Requirement is constrained by the requirement that the creditor not impose a fee on a borrower in connection with an agreement to modify an existing obligation.[16]

Freddie Mac suggests that where a fee is imposed on a borrower in connection with a mortgage loan modification, the Disclosure Requirement should *only* be triggered when the servicer, creditor, holder, or any of their respective affiliates retains such a fee, and does not pass the fee

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[14] *Id.* at 58761.
[15] *Id.* at 58597, 58697-98.
[16] *Id.* at 58597.

on to unaffiliated third parties. There are often a host of third party fees necessary to modify a mortgage loan, including, but not limited to, credit report, title, appraisal and recordation fees. We believe that the inability to charge a borrower these fees without triggering the Disclosure Requirement may discourage servicers from performing mortgage loan modifications.

II. ***Borrower Right of Rescission – Proposed § 226.23***

Section 226.23 of the Proposed Rule revises the processes and procedures, and the related creditor obligations concerning a borrower's right of rescission. Freddie Mac appreciates the Board's efforts to clarify the different processes associated with the three-day and extended right of rescission. We believe the Proposed Rule's amendments and clarifications will help streamline and provide better assurance of required compliance in this process. However, much like the Proposed Rule's revisions applicable to creditors providing new Regulation Z disclosures for certain closed-end mortgage transactions (as discussed in Section I. above), Freddie Mac believes the Board may want to consider further the practical impact these revisions will have on borrowers who seek to exercise their rescission right, particularly with respect to a rescission of a modification, and the creditors and servicers seeking to facilitate the rescission process.

A. Rescinding Modifications – Proposed §§ 226.23(d)(2)(i)(D) and (ii)(B)

Under section 226.23(d)(2) of the Proposed Rule, where a borrower asserts a right of rescission and has provided sufficient tender, the Board requires a creditor to terminate its security interest in the property collateral securing the borrower's mortgage loan.[17] Freddie Mac suggests that the Board clarify in section 226.23(d)(2), that strictly for purposes of rescinding a mortgage loan modification, only the modification terms are rescindable, and the terms of the borrower's *pre-modification* mortgage obligation would continue as if the modification never occurred, thereby allowing the creditor or applicable current holder to retain its security interest in the borrower's property collateral securing the borrower's mortgage loan.

We believe that when rescission of a borrower's mortgage loan is warranted, such as a result of defective disclosures, the intent of TILA and Regulation Z[18] is to restore the borrower (and the creditor or applicable current holder) to the position of such parties immediately before the transaction, the status quo ante. Therefore, in the case of a mortgage loan modification, this would include restoring the original mortgage obligation and maintaining the creditor's security interest in the borrower's collateral. This procedure would provide certainty surrounding the borrower's right of rescission process related to mortgage modifications and likely encourage servicers to undertake more borrower mortgage modifications. To provide otherwise is inconsistent with TILA and Regulation Z, and would likely discourage a servicer, creditor or applicable current holder from providing modifications to borrowers given the considerable risk associated with rescission and resulting loss of a security interest.

B. Providing Notice of Rescission – Proposed § 226.23(a)(2)(ii)(B)

Under section 226.23(a)(2)(ii)(B) of the Proposed Rule, where a borrower undertakes to rescind a mortgage transaction after the three-business-day period following consummation of such mortgage transaction (for purposes of this comment letter, the "Extended Right of Rescission"), the Proposed Rule requires the borrower to mail or deliver written notice of the Extended Right

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[17] *Id.* at 58702-03.
[18] *See* 15 U.S.C. § 1635 and 12 C.F.R. § 226.23.

of Rescission to the current owner of the mortgage obligation.[19] In the alternative, a borrower may mail or deliver the Extended Right of Rescission notice to the applicable servicer, which shall constitute delivery to the current owner.[20]

A servicer, unlike a current owner who may be a secondary mortgage market investor, has the primary relationship with a borrower for purposes of facilitating the borrower's mortgage obligation. Specifically, a servicer collects and accounts for a borrower's mortgage payments, communicates with and handles any loss mitigation activities for the borrower, and is generally the entity a borrower would contact first with questions or concerns about the borrower's mortgage loan. Because of this relationship, Freddie Mac suggests that references to the current owner be deleted under section 226.23(a)(2)(ii)(B) of the Proposed Rule and its accompanying Official Staff Interpretations to minimize borrower confusion and to facilitate the processing of the borrower's rescission notice. We believe the Extended Right of Rescission notice should be sent *only* to the applicable servicer, and that the borrower should *not* have the option of sending such notice to the current owner of the mortgage obligation.

Borrowers are more accustomed to dealing directly with the servicer, and as the Board points out, borrowers may "have difficulty identifying the current owner of their loan, and may be reasonably confused as to whom they should correspond with about rescinding their loan."[21] Moreover, even when the TILA required notice that the borrower's mortgage loan has been sold, assigned or otherwise transferred has been sent to the borrower,[22] the borrower may have not retained the notice or may continue to believe that "the original creditor or an assignee that once held the [borrower's] loan continues to hold the loan."[23] As a result, a borrower may have believed he or she adequately exercised his or her right to rescind the mortgage loan when sending a rescission notice to an assignee in the loan's chain of ownership that is no longer the current owner of the mortgage loan. Further, many secondary mortgage market investors who are owners of mortgage loans, such as securitization vehicles, are not equipped to handle or process a rescission notice submitted by a borrower.

A borrower that sends the Extended Right of Rescission notice directly to the servicer, rather than the current owner, would not circumvent the borrower's right to rescind a mortgage transaction against an assignee of the mortgage obligation; as such a borrower right is explicitly enumerated in TILA.[24] Rather, sending an Extended Right of Rescission notice to the servicer will create less confusion for the borrower given the borrower and servicer's existing relationship, and, because the servicer generally retains the borrower's loan file, will facilitate the processing of the rescission notice, as further discussed in Section II.C below. As a result, we believe that requiring the borrower to send the Extended Right of Rescission to a servicer will not create operational or compliance issues for servicers.

Companion federal disclosure statutes such as RESPA,[25] and related implementing regulations,[26] already successfully place the responsibility for post-settlement borrower

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[19] 75 Fed. Reg. at 58700.
[20] *Id.*
[21] *Id.* at 58611.
[22] Such notice is required to be provided to a borrower under the *Helping Families Save Their Homes Act of 2009*, Pub. L. 111-22, tit. IV, § 404(a) (May 20, 2009), and Regulation Z, 12 C.F.R. § 226.39.
[23] 75 Fed. Reg. at 58610.
[24] *See* 15 U.S.C. § 1641(c). (Any consumer who has the right to rescind a transaction....may rescind the transaction as against any assignee of the obligation).
[25] 12 U.S.C. § 2601 *et seq.*

interaction upon the servicer.[27] We believe the rescission right provisions of the Proposed Rule, as discussed above, should call for a similar borrower-servicer relationship.

C. Acknowledgement of Rescission – Proposed § 226.23(d)(2)

Under section 226.23(d)(2) of the Proposed Rule, where a borrower sends an Extended Right of Rescission notice after the creditor has disbursed funds, the Board requires a creditor, within 20 calendar days after receipt of such notice, to send the borrower a written statement (for purposes of this comment letter, a "Written Acknowledgment").[28] The Written Acknowledgment must indicate whether the creditor will agree to cancel the transaction, and if so, the amount of money or description of property the creditor will accept as tender; a reasonable date to tender such money or property; and that within 20 calendar days after receipt of sufficient tender, the creditor will take whatever steps are necessary to terminate its security interest.[29]

Freddie Mac suggests that section 226.23(d)(2) of the Proposed Rule state that the servicer, rather than the creditor, is responsible for providing the Written Acknowledgement to the borrower. In accordance with our suggestion in Section II.B above, the servicer will have directly received the borrower's Extended Right of Rescission notice, and therefore practically, it is more efficient for the servicer to provide the Written Acknowledgement. More importantly, the servicer is better equipped to prepare the Written Acknowledgement as the servicer generally has possession of the borrower's loan file and related information for purposes of gathering information and determining whether to accept the rescission notice and rescind the mortgage transaction.

Freddie Mac also believes that the 20 calendar day period under section 226.23(d)(2)(i)(A) of the Proposed Rule to provide the Written Acknowledgment should be extended, particularly given that the borrower is not required to state the basis for the rescission, and a longer time period will provide a servicer adequate time to completely review the borrower's loan file and prepare the Written Acknowledgement.

In determining an appropriate timeframe for responding to an Extended Right of Rescission notice, we believe the Board may want to consider the operational complexities associated with evaluating a rescission claim, including any necessary communications with secondary market investors, and preparing the Written Acknowledgment. Freddie Mac proposes a bifurcated notice in which the servicer initially has a 10 - 20 calendar day period to acknowledge receipt of the borrower's Extended Right of Rescission notice (for purposes of this comment letter, the "Initial Acknowledgement"). Following the Initial Acknowledgement, the servicer would then have a 30 - 45 calendar day period to evaluate the borrower's loan file and make a determination whether the servicer will accept the borrower's Extended Right of Rescission.

Finally, Freddie Mac suggests section 226.23 require the borrower to identify specifically the reason for exercising the Extended Right of Rescission to assist the servicer with evaluating the borrower's loan file and preparing the Written Acknowledgement. Failing to require the borrower

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[26] 24 C.F.R. § 3500.21(d) and (e).
[27] 12 U.S.C. § 2605(b) (A servicer is required to notify a borrower in writing of any assignment, sale or transfer of the servicing of the borrower's loan); and 2605(e) (A servicer is required to respond to a borrower's qualified written request for information relating to the servicing of such loan).
[28] 75 Fed. Reg. at 58702.
[29] *Id.*

to provide this information may complicate such evaluation, thereby prolonging the rescission process.

III. Higher Priced Mortgage Loans – Proposed § 226.35

Freddie Mac appreciates the Board's effort to address the impact of its August 2009 Closed-End Proposal ("2009 Proposal")[30] on the coverage of Regulation Z's restrictions on higher priced mortgage loans ("HPMLs"). However, we believe the Proposed Rule's revisions with respect to HPMLs may add additional complexity to Regulation Z and are no longer necessary. If the Board chooses to carry out these proposed revisions, the final rule should clarify the treatment of certain fees.

A. *Transaction Coverage Rate – Proposed § 226.35(a)*

Under section 226.35 the Proposed Rule, the Board proposes to revise the test for determining HPML coverage by replacing the current APR metric with a new "transaction coverage rate" metric.[31] Under the proposed "transaction coverage rate," prepaid finance charges would include only those prepaid finance charges that will be retained by the creditor, its affiliate, or a mortgage broker.[32] Freddie Mac respectfully suggests that rather than adopt the "transaction coverage rate" metric for HPMLs, the Board may want to consider dropping its previously proposed changes to the definition of finance charge set forth in the 2009 Proposal.

While the proposed "transaction coverage rate" may help to avoid the improper classification of prime loans as HPMLs, it adds unnecessary cost and additional complexity to compliance efforts by requiring three different finance charge calculations on every mortgage transaction subject to regulation. In addition, the Dodd-Frank Act already requires the creation of a new integrated disclosure under TILA and RESPA that will include disclosure of settlement costs.[33] These new disclosure requirements under the Dodd-Frank Act should satisfy the Board's original goal of improving borrowers understanding of the cost of credit. At a minimum, the new Dodd-Frank Act disclosure creation process should be given a chance to proceed before making such significant changes to Regulation Z's finance charge calculation and HPML determination provisions.

Finally, the Board has recently simplified the rate spread rules by aligning the HPML rate spread determination and the Home Mortgage Disclosure Act rate spread reporting requirements. The proposed change to create a transaction coverage rate for HPML determinations would reverse this simplification.

B. *Prepaid Finance Charge – § 226.35(a)(2)(i)*

If the Board proceeds with adopting the use of the "transaction coverage rate," the Board should further clarify whether certain fees would be considered prepaid finance charges for purposes of calculating the "transaction coverage rate." In particular, for certain loans, Freddie Mac may charge its lenders delivery fees, calculated as a percentage of the loan amount, and based on the individual risk characteristics of the mortgage being purchased, such as for loans with higher

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[30] 74 Fed. Reg. 43232, 43321-23 (Aug. 26, 2009).
[31] 75 Fed. Reg. at 58709-10.
[32] *Id.*
[33] Pub. L. 111-203, tit.10, § 1032 (July 21, 2010).

loan-to-values, lower credit scores or secondary financing. Most lenders choose to pass these fees on to the borrower at the time of loan closing either by charging a higher interest rate on the loan or by charging the borrower a separate fee at loan closing. Lenders pay the applicable delivery fees to Freddie Mac upon Freddie Mac's purchase of the loan subsequent to loan closing. For transactions where the lender charges the borrower a separate fee at loan closing, the Board should clarify whether these type of delivery fees would be considered retained by the creditor for purposes of calculating the "transaction coverage rate."

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Thank you for providing us with the opportunity to comment on the Proposed Rule. Freddie Mac supports the Board's efforts in the Proposed Rule to bring uniformity to creditor's practices, facilitate regulatory compliance and to further enhance disclosures and borrower awareness of the cost of mortgage credit. Our comments are intended to achieve these objectives while at the same time avoiding potential borrower confusion and helping to streamline the loan modification and borrower rescission process. We appreciate the Board's consideration of our views.

Sincerely,

Lisa M. Ledbetter