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July 22, 2011

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
regs.comments@federalreserve.gov

Re: Docket No. R–1417/ RIN No. 7100–AD75—Regulation Z Proposed Rule to Implement the Dodd-Frank Wall Street Reform and Consumer Protection Act's Ability-to-Repay Mortgage Lending Requirements

Dear Ms. Johnson:

The Credit Union National Association (CUNA) appreciates the opportunity to submit comments to the Federal Reserve Board (Board) in response to the proposed regulation to implement the Truth in Lending Act's (TILA) ability-to-repay mortgage lending requirements as added by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Specifically, these rules would expand TILA's ability-to-repay requirements to any consumer credit transaction secured by a dwelling, except an open-end credit plan, timeshare plan, reverse mortgage, or temporary loan. By way of background, CUNA is the largest credit union advocacy organization in this country, representing approximately 90% of our nation's 7,400 state and federal credit unions, which serve 93 million members.

Summary of CUNA's Views

CUNA generally supports the proposed rule but believes that the agency should make several clarifications and modifications to the proposal to ensure continued consumer access to mortgage credit at fair rates and to avoid unnecessary regulatory burden and unintended consequences. We recognize, however, that many aspects of the proposal are statutory requirements set forth in the Dodd-Frank Act and that concerns about these requirements' regulatory burdens are best directed to Congress.

- **"Qualified Mortgage" Definition[1]:** CUNA generally supports the proposed definition of "qualified mortgage" but seeks clarification regarding lower-

[1] We note that the "Qualified Mortgage" rules are not related to the separate interagency "Qualified Residential Mortgage" (QRM) rulemaking on residential mortgage securitization per se. We urge the Board and Consumer Financial Protection Bureau (CFPB), however, to study the

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documentation loans and opposes the proposed definitions of “prepayment penalty,” “underserved,” and “rural.” CUNA supports the proposed “safe harbor” (“Alternative 1“) for qualified mortgages because the safe harbor approach would provide greater legal protection for credit unions with respect to the borrower’s TILA section 130 rights of action against creditors that do not do sufficient “ability-to-repay” analyses, including the TILA 130(k) defense to foreclosure.

- **Ability-to-Repay Analysis:** CUNA generally supports the proposed ability-to-repay analysis and notes that credit unions—unlike some types of mortgages lenders—have historically engaged in safe and sound mortgage underwriting that includes robust ability-to-repay analyses. Although application of the ability-to-repay requirements to credit unions is therefore generally unnecessary, we recognize that statutory TILA requirements apply to all creditors. Requiring all mortgage lenders to follow similar ability-to-repay mortgage underwriting criteria will help eliminate abusive practices and facilitate consumers’ ability to compare mortgage products.

- **Verification by Third-Party Records:** CUNA supports the proposed official staff commentary clarifying that a credit union’s own deposit account statements fall within the definition of “third-party records.” CUNA also supports the aspects of the proposal allowing consumers to orally verify their employment status, using the Department of Defense personnel database to verify the employment status of military personnel, and not requiring creditors to verify with third-party records debts a consumer lists on the loan application that are listed not on his or her credit report.

- **“Evasion:”** CUNA requests clarification that the proposed “evasion” prohibition with respect to open-end credit does not limit the ability of credit unions to offer Home Equity Lines of Credit (HELOC) and similar open-end credit products as first lien mortgages.

overall compliance horizon created by the qualified mortgage rules and the QRM rules, as well as the resulting balance sheet management needs, in order to determine whether these new regulations result in beneficial consumer protection or an unduly rigid compliance environment where consumers will experience significantly less access to credit on fair and reasonable terms.

Detailed Comments

"Qualified Mortgage" Definition

As noted above, CUNA generally supports the proposed definition of "qualified mortgage" and offers the following comments regarding specific provisions of the proposal.

"Safe Harbor" Alternative

CUNA strongly supports the proposed "safe harbor" alternative ("Alternative 1")—which would treat "qualified mortgages" as a legal safe harbor—because the safe harbor approach would provide greater legal protection for credit unions than "Alternative 2" (a "presumption of compliance") with respect to the borrower's "defense to foreclosure" under TILA section 130(k), 15 U.S.C. § 1640(k), against creditors that do not do sufficient "ability-to-repay" analyses.

Credit unions are concerned that, without a safe harbor, they could be faced with significant amounts of frivolous foreclosure defense litigation with respect to future foreclosures. The "qualified mortgage" underwriting criteria proposed by the Board are robust and a credit union making a qualified mortgage should be entitled to significant legal protections because it will have gone well beyond its statutory obligations under TILA to do an "ability-to-repay" analysis.

Even the most stringent underwriting criteria cannot eliminate all credit risk from a mortgage because unforeseen events that eliminate an expected source of a borrower's income, such as the borrower's death or loss of employment, may occur. It is therefore inevitable that some "qualified mortgages" will become delinquent and be subject to foreclosure.

Allowing consumers who are in default to assert frivolous claims under TILA section 130(k) alleging that a creditor making a "qualified mortgage" failed to do a sufficient ability-to-repay analysis in order to delay the foreclosure process would not be in the public interest. Allowing such claims to be asserted in court—even if those claims are later found to be frivolous—would add new uncertainties to the lending process, especially regarding creditors' ability to repossess collateral in a timely manner. Such claims could have significant, unintended consequences such as a chilling effect on consumer mortgage lending or a significant increase in the cost of consumer mortgage credit resulting from the costs of these new legal liabilities being priced into residential mortgage interest rates for all borrowers going forward.

In addition, CUNA urges the agency to proceed carefully with respect to all rules and policies related to the TILA 130(k) defense to foreclosure given the unique federalism concerns that this new law presents. State courts typically adjudicate foreclosure-related matters and state laws do not generally provide a defense to foreclosure similar to TILA section 130(k). As a federal legal question, delinquent borrowers asserting the TILA section 130(k) foreclosure defense may be permitted to bring this foreclosure defense in federal, rather than state, court. Credit unions are concerned that delinquent borrowers may assert frivolous TILA section 130(k) claims in federal court in order to take advantage of federal courts' limited resources to delay foreclosures without sufficient legal justification.[2]

It is therefore essential that the agency adopt the proposed "safe harbor" alternative for qualified mortgages.

Prepayment Penalties

CUNA does not support the proposal to include within the definition of "prepayment penalties" waived closing costs that can be recouped in the event of prepayment or certain amortized interest because the courts and agencies such as National Credit Union Administration (NCUA) do not consider these items to be "prepayment penalties."

CUNA opposes including within the prepayment penalty definition fees, such as closing costs, that are waived unless the consumer prepays the loan because NCUA has determined that such arrangements are not "prepayment penalties."[3] Federal credit unions are not permitted to charge prepayment penalties pursuant to 12 U.S.C. § 1757(5)(A)(viii). Conflicting regulatory definitions of "prepayment penalty" will lead to increased confusion by credit unions and consumers, and will increase credit union regulatory burden.

CUNA also opposes the proposed treatment as a "prepayment penalty" of amortized interest occurring after prepayment (such as if a mortgage amortizes monthly on the first of the month and the borrower prepays in full on the 5th of the month, but the creditor continues to charge interest as though the loan were still outstanding until the end of the monthly amortization period). The courts

[2] We note that some U.S. district courts that have been flooded by particular types of litigation have from time-to-time decided to a freeze the progress of those cases for years at a time due to limited resources. One example is the U.S. District Court for the Eastern District of Pennsylvania's decision in the 1990s to halt the progress of all asbestos-related disease products liability cases in that court for approximately 10 years (during which the parties had no legal recourse other than to wait for the court to change its policy and hear the cases). A U.S. district court that is overwhelmed by TILA section 130(k) defenses could be forced to make a similar choice to freeze the progress of all foreclosure-related litigation for an indefinite period of time.

[3] See, for example, "Prepayment Penalties - Loan Incentives," Letter of Richard S. Schulman, Associate General Counsel, NCUA, to David A. Jones, VP, Hartford Telephone FCU (June 13, 1996) ("When the FCU waives the closing costs, it confers a benefit on the borrower. If the borrower repays his loan within two years and must reimburse the FCU for closing costs, the borrower has simply lost the benefit."), *available at* http://www.ncua.gov/Resources/RegulationsOpinionsLaws/OpinionLetters/1996/96-0522.html

have held that such computation methods are not “prepayment penalties” [4] and requiring credit unions that use this type of periodic amortization calculation to treat this method as a “prepayment penalty” for disclosure purposes would be confusing to consumers and would impose significant regulatory burdens on credit unions while providing limited benefits to consumers.

Lower Documentation “Qualified Mortgages”

Some credit unions serve significant numbers of self-employed people and/or immigrant populations who may not have documents such as W-2 forms, pay stubs, and so forth. In order to ensure continued access to mortgage credit for these groups, CUNA requests clarification that “qualified mortgages” can be underwritten based primarily or exclusively on financial institution records so long as those records show ability to repay.

30 Year Mortgages

CUNA requests clarification that the proposed limitation of “qualified mortgages” to 30 years can include mortgages that are slightly longer than 360 months, such as if the initial payment on the mortgage does not occur immediately.

“Balloon Payment Qualified Mortgages” for Lenders in Rural and Underserved Areas:

CUNA supports the proposal to allow balloon payment mortgages to be considered “qualified mortgages” if made by lenders under $2 billion in assets that operate predominantly in “underserved” and “rural” areas. This is necessary for maintaining consumer access to mortgage credit in these areas because it allows smaller institutions to control interest rate risk.

CUNA supports the proposed $2 billion asset limitation and believes that no additional limitations regarding to creditor’s total annual number of mortgages made or total dollar annual value of mortgage transactions are needed given the asset size limitation and the other proposed limitations in the rule.

CUNA does not support, however, the Board’s proposed definitions of “underserved” and “rural” because these proposed definitions are far too narrow to be meaningful in practice. We believe that the proposed definitions of “underserved” (i.e. counties where only one creditor makes five or more mortgages a year) and “rural” (i.e. only counties that are not within or adjacent to a metropolitan statistical area or a micropolitan statistical area) are far too

[4] In *Goldman v. First Federal Sav. & Loan Ass'n*, 518 F.2d 1247 (7th Cir. 1975), Judge (and later Supreme Court Justice) John Paul Stevens’s majority opinion specifically held that prepaid unearned interest retained by a federal thrift after the borrowers prepaid their loan was not a “prepayment penalty” within the meaning of Federal Home Loan Bank Board regulations. *See id*. at 1249-54.

restrictive and should be expanded to include areas determined to be "underserved" or "rural" by other federal agencies such as the National Credit Union Administration (NCUA) Board.

CUNA urges the agency to expand the exemption's definition of "underserved" to include areas considered to be "underserved" by the NCUA Board pursuant to 12 U.S.C. § 1759(c)(2)[5] as well as areas served by institutions that the U.S. Department of the Treasury's Community Development Financial Institutions Fund (CDFI Fund) has determined qualify for the Community Development Financial Institutions Program and similar CDFI Fund programs serving underserved communities. The agency should also expand the definition of "rural" to also include areas meeting the NCUA Board's definition of "rural district" as defined by 12 U.S.C. § 1759 and relevant agency interpretations.

In our view, limiting the definitions of "underserved" and "rural" to only the most underserved and the most rural counties will have the effect of limiting access to mortgage credit in other objectively underserved and rural areas in a manner inconsistent with congressional intent. Some counties are objectively underserved even when two or more financial institutions each originate 5 or more mortgages a year, and many rural areas are in counties adjacent to or included within a micropolitan statistical area or a metropolitan statistical area.

The Board also seeks comment on whether, under either alternative, some de minimis number of transfers that may be made without losing eligibility for the exception, such as two per calendar year, and also seeks comment any other situations in which creditors should be permitted to transfer balloon-payment loans without becoming ineligible for the exception, such as troubled institutions that need to raise capital by selling assets or institutions that enter into mergers or acquisitions.

CUNA supports a de minimum exemption but believes that a limit of 10 sales per year would be more meaningful exemption from an operational perspective. CUNA also urges the agency to exempt all sales occurring for safety and soundness purposes, such as when a credit union or other depository institution must reduce assets in order to maintain appropriate capital ratios under Prompt Corrective Action rules.

Third Party Charges and Points & Fees

CUNA generally supports the proposed definition of "points and fees," although we note that limiting points and fees, especially in junior mortgage situations, could result in a credit union not recovering its costs for making the loan unless bona fide third-party charges such as appraisals and title insurance are excluded

[5] *See* 12 C.F.R. pt. 704 app. B ("Chartering and Field of Membership Manual").

from the “points and fees” definition. We ask for clarification that such third-party charges are indeed excluded from the “points and fees” definition.

CUNA strongly supports the proposed exclusion from the definition of “points and fees” for bona fide third party charges not retained by the creditor, including any mortgage insurance or other guarantee protecting the creditor against the consumer’s default or other credit loss so long as the charge is: (1) part of a federal or state program (e.g., Federal Housing Administration (FHA)); (2) is equal or less than the amount payable for an FHA guarantee so long as the premium is refundable on a pro rata basis and the refund is automatically issued upon notification that the underlying mortgage is paid off; or (3) the premiums or other charges payable after closing.

CUNA also supports the proposed exclusion from “points and fees” for amounts escrowed for future payment of taxes and for other “real estate related fees” that: (1) are reasonable; (2) where the creditor receives no direct or indirect compensation in connection with the charge; and (3) the charge is not paid to an affiliate of the creditor.

Ability-to-Repay Analysis

CUNA generally supports the proposed ability-to-repay analysis and notes that credit unions—unlike some types of mortgages lenders—have historically engaged in safe and sound mortgage underwriting that includes robust ability-to-repay analyses. Although application of the ability-to-repay requirements to credit unions is therefore generally unnecessary, we recognize that statutory TILA requirements apply to all creditors. Requiring all mortgage lenders to follow similar ability-to-repay mortgage underwriting criteria will help eliminate abusive practices and facilitate consumers’ ability to compare mortgage products.

<u>Verification by Third-Party Records</u>

CUNA supports the proposed official staff commentary clarifying that a credit union’s own deposit account statements fall within the definition of “third-party records.” CUNA also supports the aspects of the proposal allowing consumers to orally verify their employment status, using the Department of Defense personnel database to verify the employment status of military personnel, and not requiring creditors to verify with third-party records debts a consumer lists on the loan application that are listed not on his or her credit report.

The Board solicits comment on other examples the Board could provide to facilitate creditors’ compliance with the proposed verification requirement with respect to simultaneous loans, such as credit reports, student loan statements, automobile loan statements, credit card statements, alimony or child support court orders, and existing mortgage statements. CUNA supports creditors being permitted to rely on credit reports and loans statement —which would parallel the

2008 Home Owner's Equity Protection Act (HOEPA) final rule's model for consideration and verification of income—because this would reduce regulatory burden and preserve flexibility for creditors.

The Board solicits comment on whether any documents or records prepared by the consumer and not reviewed by a third party, such as a Certified Public Accountant, appropriately can be considered in determining repayment ability, for example, because a particular record provides information not obtainable using third-party records. CUNA supports creditors being able to use non-third-party-reviewed documents prepared by self-employed consumers if those documents are consistent with the consumer's tax records and/or financial institution records because this approach would reduce costs for self-employed consumers, help ensure self-employed persons continue to have access to affordable mortgage credit, and reduce regulatory burden on credit unions.

The Board solicits comment on whether it should narrow the requirement to consider simultaneous loans that are HELOCs to apply only to purchase transactions. We note that existing HELOCs would not serve as a down-payment for the first mortgage and therefore would not be the type of "piggyback" second mortgages that Congress intended to regulate with the Dodd-Frank TILA amendments. CUNA urges the Board to limit the simultaneous loan consideration requirement to apply only to purchase transactions in order to reduce regulatory burden on credit unions and streamline the consumer mortgage refinancing process.

Clarification of "Evasion" Prohibition

The Board should clarify that the proposed section 226.43(h) provision on "Evasion; open-end credit"[6] does not limit the ability of a creditor to offer open-end mortgage products such as Home Equity Lines of Credit as a first lien mortgage. We are concerned that this section's unclear language may be read by some to prohibit creditors from offering many open-end mortgage products to consumers. Additional information should be added to or the corresponding staff commentary to clarify that the rule's "evasion" clause does not limit creditors' ability to offer open-end mortgage products to consumers.

Delayed Compliance Date

We urge the Board to set a compliance date that recognizes creditors' need for additional time to implement these requirements. Credit unions and other creditors are faced with myriad new regulatory compliance requirements they are trying to meet that also will affect their compliance efforts with this rule. Additional

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[6] Proposed section 226.43 (h) reads: "In connection with credit secured by a consumer's dwelling that does not meet the definition of open-end credit in § 226.2(a)(20), a creditor shall not structure a home-secured loan as an open-end plan to evade the requirements of this section."

time will be especially important for credit unions and others that rely on third parties, such as software vendors. These third parties will need time to incorporate the necessary updates, complete the necessary testing, and then include this change into their regularly scheduled releases.

Thank you for the opportunity to comment on the Board's proposed regulation to implement the Truth in Lending Act's ability-to-repay mortgage lending rules that were added by the Dodd-Frank Act. If you have questions about our comments, please feel free to contact CUNA SVP and Deputy General Counsel Mary Dunn, CUNA Assistant General Counsel and Senior Compliance Counsel Mike McLain at (608) 231-4185, or me at (202) 508-6705.

Sincerely,

Michael S. Edwards
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