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April 29, 2011

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

RE: Docket No. R–1406 and RIN No. 7100–AD65

Dear Ms. Johnson:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents the nation's federal credit unions, I am writing to provide NAFCU's comments on the Board's proposed changes regarding escrow accounts. NAFCU understands that several aspects of the Board's rule are required by statute under the Dodd-Frank Consumer Protection and Wall Street Reform Act (Dodd-Frank). As such, the Board has relatively little flexibility regarding those aspects of the rule. Nonetheless, NAFCU remains concerned with portions of the proposal. The measure for "rural or underserved" areas is unduly narrow and the exemption for lenders operating in rural or underserved areas is of virtually no value for lenders currently in the market. NAFCU also has more general concerns regarding the amount of disclosures required throughout the mortgage process.

The Board's proposed definition for "rural or underserved" is problematic as it is quite narrow. In order to qualify as a "rural" area, a county may not be in a metropolitan area or a micropolitan area and must also satisfy one of the two following requirements: (1) not be adjacent to any metropolitan or micropolitan area; or (2) is adjacent to a metropolitan area with fewer than one million residents or adjacent to a micropolitan area, and it contains no town with 2,500 or more residents. As the proposed rule states, this definition would essentially encompass all "urban influence codes" numbered 7, 10, 11 and 12 by the Economic Research Service (ERS) of the United States Department of Agriculture. This definition, as the rule states, certainly encompasses the most rural counties "where ready access to the resources of larger, more urban communities and mobility are most limited." Truth in Lending, 76 Fed. Reg. 11,598, 11,612 (proposed March 2, 2011) (to be codified at 12 C.F.R. pt. 226). However, the proposed exemption would do little for some lenders operating in large rural counties that may happen to be located adjacent to a metropolitan or micropolitan area. For example, simply because the far eastern edge of a county is adjacent to a micropolitan area does not mean that people living in the far western edge of the county have easy access to the services available in that micropolitan area. The Board should expand the definition of "rural" areas to include all "noncore" counties, as defined by the ERS, which would include codes 4, 6, 7, 10, 11 and 12.

The definition for "underserved" areas is equally problematic. In order to qualify as an "underserved" county, the county, in the previous calendar year, must have no more than two creditors that make more than five first lien mortgages. This definition is extremely narrow.

Under the proposed rule if two lenders make a total of twelve loans in a calendar year, the county would not qualify as underserved. The Board's delineation, both in terms of the number of lenders making loans, and the five loan floor, are both extremely narrow. The Board states that the purpose of the exemption is to permit smaller lenders to continue offering credit rather than forcing them to exit the market, and that the exemption "should be implemented in a way that protects consumers from losing meaningful access to mortgage credit." *Id.* at 11,613. The logic of limiting the term "underserved" only to counties with two or fewer lenders, however, is based on a likely faulty assumption. Simply put, a county with three lenders that made five or more loans in the last year would not qualify as "underserved." However, the escrow rule may very well lead two lenders to leave the market as the income derived from just five loans a year may not warrant the additional cost of operating escrow accounts, particularly in light of all of other recent changes to Regulation Z. At the very least, the Board should alter the definition of "underserved" so that a county with three lenders may qualify. Additionally, the Board should increase the number of loans the lenders may make. A mere five loans a year may not be sufficient to justify continuing to offer mortgage loans with new escrow requirements. Accordingly, NAFCU recommends the Board increase the loan threshold to ten mortgage loans per lender each year. Taken together, altering the definition to encompass counties with three or fewer lenders that make ten or fewer loans per year would better balance the Board's interest in effectively enforcing the escrow requirements without driving lenders from underserved markets.

Next, the proposed exemption is problematic as it only applies to institutions that currently do not maintain any escrow accounts for loans they service. Under the Board's 2008 Home Ownership and Equity Protection Act (HOEPA) rule, lenders are required to establish an escrow account for any "higher-priced mortgage." Truth in Lending, 73 Fed. Reg. 44,522 (July 30, 2008) (to be codified at 12 C.F.R. pt. 226). If a lender establishes an escrow account for any loan it makes, it is barred from making use of the exemption. Consequently, the proposed exemption will likely decrease the amount of credit available, at least in the short term, for consumers with sub-prime credit scores. Lenders that currently would be able to make use of the exemption would be foolish to make any loans before the effective date of the proposed rule that would require an escrow account, as that would extinguish their right to use the exemption. In addition to creating a perverse incentive to lenders not to make loans in the interim, the proposal also effectively punishes small lenders that chose to spend the time and money to ensure compliance with the existing escrow requirements for higher-priced mortgages. If those lenders had simply chosen to exit the market altogether, they would have been better off as they would potentially be able to re-enter the market and employ the exemption. Instead, the only issuers that benefit from the exemption are those that previously decided to exit the market or those that have stopped making covered loans as a result of the Board's 2008 HOEPA rule.

NAFCU recommends the Board revise the exemption. For example, the Board could broaden the exemption to apply to any lender that currently services 20 or fewer mortgages for which an escrow account is established. The Board justified the proposed exemption by stating that lenders that already establish or maintain escrow accounts have the capacity to do so and thus have no need for the exemption. 76 Fed. Reg. at 11,612. This, however, ignores the fact that it is a considerable burden for smaller issues to establish escrow accounts. Granted, many smaller lenders chose to establish escrow accounts rather than exit the market. However, just because the lenders have the ability to do so does not mean that establishing escrow accounts is cost-effective. For small issuers that maintain escrow accounts but that do not have economies of scale sufficient to make the accounts cost-effective, the ultimate costs are passed on to the very consumers this rule seeks to protect.

Taken together, the extremely narrow definitions for "rural" and "underserved" and the limited number of lenders to which the exemption applies render the exemption virtually useless. The Board should expand the definition of both "rural" and "underserved" and should modify the exemption so that it applies to lenders who are still active in the market.

Finally, NAFCU is generally concerned with the amount of disclosures required during the mortgage process. The proposed disclosures regarding escrow accounts do not appear unreasonable and the underlying policy for the disclosures is quite understandable. Nonetheless, the mounting number of disclosures required during the mortgage process is a prime example of the law of diminishing returns. Viewed in isolation all of the disclosures required by Regulation Z are rational. However, taken together, the several TILA disclosures – not to mention the often duplicative disclosures required by the Real Estate Settlement Procedures Act (RESPA) – only serve to confuse consumers; or at best provide little additional value. NAFCU understands many of the changes made to the mortgage process over the last several years are required by statute. Nonetheless, TILA provides the Board considerable authority to oversee the Act, its provisions and compliance as it sees fit. With that in mind, NAFCU encourages the Board to use its discretion, working within the confines of the statute, to simplify and streamline the multiple disclosures currently required. Doing so would not only alleviate burdens for lenders, but would also benefit consumers who would prefer a limited number of clear concise disclosures regarding the most important terms of a mortgage, rather than page after page of disclosures covering every aspect of the mortgage process.

NAFCU appreciates the opportunity to share our thoughts on the proposal. Again, I would urge the Board to reconsider the proposed exemption as it would prove of little value to lenders currently operating in the mortgage market. If you have any questions or concerns, please feel free to contact me.

Sincerely,

Dillon Shea

Dillon Shea
Associate Director, Regulatory Affairs