Please note that the comments expressed herein are solely my personal views

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- 12 CFR Part 226
- Docket No. R-1417
- Regulation Z; Truth in Lending

Dear Jennifer Johnson.

Thank you for giving us the opportunity to comment on your proposed rule: Regulation Z; Truth in Lending.

You (the Board) are proposing a rule amending Regulation Z (Truth in Lending) to implement amendments to the Truth in Lending Act (TILA) made by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). Regulation Z currently prohibits a creditor from making a higher-priced mortgage loan without regard to the consumer's ability to repay the loan. The proposal would expand the scope of the ability-to-repay requirement to cover any consumer credit transaction secured by a dwelling (excluding an open-end credit plan, timeshare plan, reverse mortgage, or temporary loan). In addition, the proposal would establish standards for complying with the ability-to-repay requirement, including by making a "qualified mortgage". The proposal also implements Dodd-Frank's limits on prepayment penalties. Finally, the proposal would require creditors to retain evidence of compliance with this rule for three years after a loan is consummated.

I support the intent and spirit of the proposals, which require creditors to determine a consumer's ability to repay a mortgage before making the loan and references widely accepted mortgage underwriting standards. The proposals are rules-based and very factual, which will demand robust monitoring and compliance oversight. However, there is ambiguity in several places which may cause uncertainty and legal problems in the future. For example:

- rulemaking authority for TILA will transfer to the Consumer Financial Protection Bureau (CFPB) on 21 July 2011. Accordingly, this rulemaking will become a proposal of the CFPB and will not be finalized by the Board. Herein lies the risk that the CFPB will have a different agenda and that the final rules may be very different from these proposals.

- Widely accepted standards: the commentary states that the creditor is permitted to consider and verify the eight main underwriting factors based on "widely accepted underwriting standards". The proposals additionally refer to "widely accepted governmental or non-governmental underwriting standards" when evaluating a consumers repayment ability under § 226.43(c). This is vague and subjective, which will lead to uncertainty for creditors. It is also too organic, in that what would be considered unacceptable today, and unacceptable under the spirit of the rules, may be widely accepted in the future. After all, no-one fifteen years ago would have considered it acceptable to grant mortgages to consumers with no income, job, assets or credit history, but this practice was widely accepted a few years later. And therein lies the problem.

I also note that the reference to "widely accepted underwriting standards" is weaker than recommended by, for example, the Basel Committee on Banking Supervision[1], particularly recommendations 7, 8 and 9. Recommendation 7 states that:

> Supervisors should ensure that mortgage originators adopt minimum underwriting standards that focus on an accurate assessment of each borrower's capacity to repay the obligation in a reasonable period of time. The minimum standards adopted should be published and maintained in a manner accessible to all interested parties.

I think that you should have taken this opportunity to propose the use of minimum rather than "widely accepted" underwriting standards. These would then be updated under regulatory oversight, and would thus ensure the use of more robust standards in this arena.

Reasonable and good faith determination

The proposed rule states that:

> A creditor shall not make a loan in a covered transaction unless the creditor makes a reasonable and good faith determination at or before consummation that the consumer will have a reasonable ability, at the time of consummation, to repay the loan.

The current proposal requiring a "reasonable and good faith" determination is weaker than fiduciary duty, which had been considered before. See for example the requirement under the original Borrower's Protection Act of 2007, which stated that "mortgage brokers shall have a fiduciary relationship with the consumer, and each such mortgage broker shall be subject to all requirements for fiduciaries otherwise applicable under State or Federal law". It would be interesting to hear your views on the relative merits of "good faith" over fiduciary duty in terms of the current proposals.

Scope

§ 226.43(a) Scope explicitly excludes home equity lines of credit (HELOCs). This is a flaw, given that HELOC abuse was a contributory factor to the financial crisis. This is also not consistent with the mandate under Dodd-Frank, and therefore I would strongly recommend that you specifically include HELOCs in the scope of the proposed rules.

[1] See BCBS: Joint Forum, Review of the Differentiated Nature and Scope of Financial Regulation – Key Issues and Recommendations (2010), www.bis.org/publ/joint24.htm

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Automated underwriting systems

I would suggest that you should not provide a safe harbour for creditors relying on automated underwriting systems that use monthly debt-to-income ratios, if the system developer certifies that the system's use of monthly debt-to-income ratios in determining repayment ability is empirically derived and statistically sound. "Statistically sound" is not very objective as this determination would depend on the data used, the distribution fitted to the data, and the confidence levels assumed. There would be a wide range of plausible outcomes, with the risk that developers would relax standards as much as possible. Furthermore I would not accept self-certification in this area, as this raises conflict of interest issues.

Qualified mortgages

The proposed rules outline two alternatives to qualified mortgages – the safe harbour and the presumption of compliance approaches. I would recommend adoption of the presumption of compliance approach, as this would allow borrowers to challenge the ability to repay principle, which is more aligned to the intention and spirit under Dodd-Frank.

Balloon-payment qualified mortgages

Creditors operating in predominantly rural or underserved areas would be allowed to offer balloon-payment qualified mortgages (BPQMs) under certain conditions. I think that this proposal is a mistake, as it permits high-risk lending in more deprived areas to less knowledgeable consumers. I suggest that you should reconsider this proposal, and stimulate debate on how reasonable low-risk lending could be made in such areas.

Summary

In summary, I welcome your proposals, which are sufficient for the majority of mortgage lending. I would have preferred it had you taken this opportunity to mandate minimum mortgage standards. I would only recommend that you scope in HELOCs directly into the proposed rules, and I recommend that you should adopt the presumption of compliance approach to qualified mortgages.

Yours sincerely

Chris Barnard