April 8, 2008

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

Re: Comments on Proposed Rule
Regulation Z, Truth in Lending
Docket No. R–1305

## I. INTRODUCTION

The Securities Industry and Financial Markets Association (SIFMA)[1] and the American Securitization Forum (ASF)[2] appreciate the opportunity to provide comments in connection with the proposed rule issued by the Board of Governors of the Federal Reserve System (the Board), referenced above. Mortgage-backed investment vehicles are an important part of the American and global securitization markets, which in turn play a central role in the formation of capital needed to finance mortgage lending and borrowing. For that reason, SIFMA and ASF have studied, discussed with their members, and provided comments on numerous prior state and federal initiatives to address the widespread challenges in the mortgage industry. The Board's current proposals are an important and timely contribution to the existing body of mortgage lending and financing policy guidance, and we

[1] SIFMA brings together the shared interests of more than 650 securities firms, banks, and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services, and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington, D.C., and London. Its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

[2] ASF is a broad-based professional forum of over 360 organizations that are active participants in the U.S. securitization market. Among other roles, ASF members act as issuers, investors, financial intermediaries and professional advisers working on securitization transactions. ASF's mission includes building consensus, pursuing advocacy and delivering education on behalf of the securitization market and its participants. This letter was developed principally in consultation with ASF's Regulatory Committee and Subprime Mortgage Finance Task Force, with input from other ASF members and committees. Additional information about ASF, its members and activities may be found at ASF's website, located at www.americansecuritization.com. ASF is an adjunct forum of SIFMA.

welcome the opportunity to share our collective views, which represent a consensus among a wide range of securitization market participants.

We wish to begin by expressing our profound concern that, in light of current market dislocations and the range of legislative, regulatory and other policy responses now under consideration, credit be available for borrowers who can not qualify for residential mortgage loans that are eligible for sale to Fannie Mae or Freddie Mac or for insurance or guaranty by the Federal Housing Administration or the Department of Veterans Affairs. At this point, the availability of nonconforming loans is sharply limited, in large measure due to the market's reaction to the performance of those loans over the last few years. Regulatory uncertainty, though, is another factor that affects the willingness of lenders to make, and the capital markets to purchase and securitize, nonconforming residential mortgage loans. We hope the issuance of new regulations by the Board will lessen the risk of regulatory uncertainty and provide some measure of comfort that loans will be underwritten on sustainable terms and conditions. As we note below, however, certainty is not necessarily helpful if penalties for violations bear no rational relationship to actual harm, and if penalties can be imposed on good faith errors in judgments and simple, immaterial mistakes.

In this regard, when the Board requested input in the summer of 2007, through public hearings and requests published in the *Federal Register*, SIFMA and ASF expressed concern, through both oral testimony and written comments, about potential regulatory determinations that certain loan products or terms are inherently "unfair," "deceptive," or "abusive." Our members continue to believe that the multitude of regulatory initiatives in the past year on both the state and federal level have had, and will continue to have, their intended effect of tightening subprime[3] mortgage underwriting, due diligence, and loan purchase and securitization criteria. As a result of those initiatives – including the Nontraditional Mortgage Guidance; the Statement on Subprime Mortgage Lending; the adoption of those guidance documents by state regulators, Fannie Mae, and Freddie Mac – coupled with corrective market responses, the availability of subprime credit and the liquidity support for that credit from the capital markets has already diminished considerably. Indeed, one might question whether certain regulatory and related legislative efforts, particularly among the states, went too far in dissuading responsible lenders and investors from participating in the subprime market. As a result, we review the Board's proposal based on our belief that additional regulations must impose no more regulatory burden than is reasonably necessary to protect borrowers and the marketplace.

Our members also continue to believe that, rather than issuing regulations determining that certain underwriting practices and loan terms are inherently unfair, deceptive, or abusive, the Board could better and more effectively assert its authority by acting on its acknowledgement that comprehensive reform of mortgage disclosures is needed. Uniform clear and effective disclosures (which lie at the heart of the Truth in Lending Act (TILA)) would assist borrowers in making informed choices and promote market efficiency – an effort the benefits of which will persist as the mortgage market reinvents itself through innovation and technological advances. While the Board proposes expanding the requirement to provide early disclosures, as we detail below that proposal is at best a "patchwork" solution (and is wholly inconsistent with the explicit statutory provisions of TILA). Comprehensive disclosure reform is needed, rather than a scattershot approach under the guise of addressing unfair or abusive lending practices.

Nonetheless, with certain notable exceptions, we believe the proposed rule is generally consistent with the principles that we articulated above. We recognize the Board's efforts in attempting to

[3] Although there is no universally accepted definition of "subprime" mortgage loans, we use the term in this comment letter to refer generally to residential mortgage loans to borrowers who represent a somewhat heightened credit risk, and thus would not generally be eligible for a 30-year, fixed-rate, conforming, conventional mortgage loan. The prices for those loans are typically higher than those for conforming mortgage loans. We note that the Board also uses the term "subprime" in its proposed rule in that manner, and as its target when setting the thresholds for "higher-priced mortgage loans." Thus, in this comment letter, our use of the term "subprime" also refers to the set of loans to which the Board seeks to apply additional requirements and prohibitions.

propose a rigorous yet workable regulation. It appears that the Board tried earnestly to balance the legitimate interests of consumers and the mortgage finance industry, and the proposed rule reflects an understanding of the complexity and nuances that surround the issues and a commitment to the preservation of subprime loans as a source of credit for underserved borrowers. Within that broader context, we offer the following comments on specific provisions of the proposed rule, some of which we believe are critical in ensuring the availability of subprime mortgage credit in the future, and some that will improve the rule's workings and correlate it more appropriately with its focus on improving the provision of those loans.

## II. COMMENTS ON PROPOSED REGULATIONS

### A. Overriding Principles

In addition to our specific comments on various topics, we have one overarching issue that affects both the scope of the proposed regulations and the money damages that would be available for violations – namely, whether errors in judgment made in good faith or even simple mistakes should give rise to liability under the revised regulations. The preamble to the proposed regulations provides that the Board is looking to the standards employed for interpreting state unfair and deceptive trade practices acts and the Federal Trade Commission (FTC) Act. It further notes that Congress has codified standards developed by the FTC for determining whether acts or practices are unfair under the FTC Act, writing that "an act or practice is unfair when it causes or is likely to cause substantial injury to consumers, which [injury] is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competitors." The preamble cited an FTC interpretation of the term "unfair" to provide that "consumer injury may be substantial if it imposes a small harm on a large number of consumers, or if it raises a significant risk of concrete harm." We believe that certain of the proposed regulations do not meet that FTC standard for what is unfair, as described below, and we believe the Board should revise those provisions to account for those basic principles, both in terms of the way the prohibited conduct is drafted and the types of damages that may be available for violations.

### B. Preemption

Before we move to the specific elements of the proposal, we must first address the most important issue this rule raises for our members. Not just for the past year, but for the past 10 years or more, state legislatures and regulators have been enacting and promulgating anti-predatory lending laws and rules in an effort to extend the reach of the federal Home Ownership Equity Protection Act (HOEPA). As the Board is aware, however, the mortgage finance market is national in scope (to the significant benefit of individual borrowers throughout the United States). When operating on a national scale (or even on a regional scale), it is increasingly difficult to reconcile and comply with widely varying state and local requirements across the nation. It is not an exaggeration to say that compliance with those widely varying requirements significantly raises the cost of subprime mortgage credit and restricts its availability. One uniform national standard for subprime mortgage lending (or even better, for all mortgage lending), particularly one that is robust yet well-considered and balanced, would not only provide better protection for consumers, but also promote competition among mortgage providers in a greater number of markets, increasing availability and bringing down costs. Chairman Bernanke has stated in the past that a national predatory lending standard makes sense. Our members stress that its time has certainly come, so we urge the Board to expand the preemptive effect of its new regulations.

Section 111 of TILA states that the provisions of Section 129 do not affect the laws of any state with respect to the requirements for mortgages referred to in Section 103(aa) (i.e., HOEPA loans), <u>except</u> to the extent those state laws are <u>inconsistent</u> with any provisions of Section 129, and then only to the extent of the inconsistency. Section 111 of TILA also provides limited preemption for TILA's disclosure requirements. Section 226.28 of Regulation Z provides that a state law is inconsistent if it requires a creditor to make disclosures or to take actions that contradict the requirements of applicable provisions of TILA or Regulation Z. The Board does not propose to amend that section in this rule.

We believe that the Board should assert its authority under Section 111 of TILA to establish that the requirements under its proposed regulations applicable to higher-priced mortgage loans preempt state law to the extent state law attempts to impose more burdensome requirements or remedies. Section 111 specifically addresses the extent of preemption in connection with HOEPA loans, but obviously did not contemplate the Board's expansion of requirements for non-HOEPA loans, and so did not mandate the Board's actions in that regard. Thus, we believe the Board has the statutory authority to amend its regulations in section 226.28 specifically to address the requirements (particularly the requirements that do not relate to disclosures of information) that would apply to higher-priced mortgage loans, and to provide that those requirements preempt state law.

At a minimum, the Board should revise section 226.28 expressly to provide that state requirements will be deemed inconsistent with the provisions of this proposed rule applicable to higher-priced mortgage loans to the extent that they have the effect of restricting the availability or cost of credit to the consumer. This revision is consistent with the Board's repeated recognition of the importance of not unduly restricting the availability of mortgage credit or raising its cost.

The Board's requirements, with certain important revisions as described in this letter, generally represent a workable regulatory regime for subprime mortgage lending. Nationwide uniformity in those requirements is critical as lenders determine whether to make subprime mortgage loans available in the future. Thus, in finalizing this proposal, we urge the Board to adopt it as a nationwide standard by revising section 226.28 to preempt more burdensome state requirements in connection with higher-priced mortgage loans.

### C. Remedies

Another important issue to our members is the set of remedies available under HOEPA, particularly as they would be extended under the proposal to apply to the newly defined "higher-priced mortgage loans." We strongly agree with the Board's apparent determination that it should not create new remedies that are not otherwise authorized under TILA. For example, we agree that assignees should not be liable to the consumer for violations of the newly proposed substantive restrictions with respect to higher-priced mortgage loans, and that the extended right of rescission should not be available for those violations, against either the creditor or the assignee, except in the narrow circumstance of an impermissible prepayment penalty. However, we describe two important improvements to the rule that will protect borrowers' legitimate interests while not unduly punishing lenders or their assignees. We also detail, in Section II.J below, our strong opposition to the creation of expanded assignee liability for the proposed early disclosure requirements.

#### 1. Right to Cure Violation and Defense for Borrower Fraud

As mentioned above, the rule has the potential to impose extraordinary penalties (including the rescission of the loan) for violations of largely technical requirements. The rule would be greatly improved by providing assignees the right to cure a violation that gives rise to the rescission right – by amending the loan documents to delete or modify the impermissible prepayment penalty, or by notifying the consumer in writing that it will not enforce the provision to the extent it violates applicable law. For example, the regulations should provide that an assignee is not liable in any action for rescission if, within ninety (90) days after the discovery of an impermissible prepayment penalty in the loan documents, the assignee notifies the borrower in writing of the impermissible penalty and either: (a) amends the loan documents to delete or modify the impermissible prepayment penalty, or (b) notifies the borrower in writing that the prepayment penalty will not be enforced to the extent it violates applicable law.

In the same vein, a borrower should not be awarded significant monetary damages for a violation of the rule's protective requirements when the borrower procured the loan through fraud or deception. As under Chairman Frank's mortgage reform bill that passed the U.S. House of Representatives late last year (H.R. 3915), the rule should provide that a creditor is not liable for remedies to the borrower in the event of borrower fraud or deception.

2. No Expansion of Exorbitant "Enhanced" Damages When No Commensurate Borrower Harm

Further, enhanced monetary damages, which are available to a consumer with respect to HOEPA violations pursuant to Section 130(a)(4) of TILA, should not be extended to the newly defined higher-priced mortgage loans. Aggrieved consumers under those higher-priced mortgage loans would be eligible to receive full relief through actual and statutory damages. Refunding all finance charges and fees paid by the consumer under those loans would provide an economic windfall to the consumer and serve as a powerful disincentive for lenders to make higher-priced mortgage loans (as it has proven to be for HOEPA loans). High penalties certainly encourage lawful lending, but if the damages for a violation bear no rational relationship to the actual harm a consumer suffers, particularly when the substantive requirement the lender is found to have violated is ambiguous and subjective, lenders are much less likely to take the risk to lend at all. We respectfully request that the Board revise the rule so that this extreme remedy continues to apply only to HOEPA's "high cost" loans as defined in Section 103(aa) of TILA.

**D. Higher-Priced Mortgage Loans**

Along with those extremely important overarching issues that concern our members, as described above, we offer comments on the details of the Board's proposed rule. First, the Board proposes to define a new set of "higher-priced mortgage loans," and to subject those loans to certain new requirements and restrictions (some of which are familiar for high cost loans subject to HOEPA). In accordance with the Board's proposal and subject to certain exceptions, a higher-priced mortgage loan would be a consumer credit transaction that is secured by the consumer's principal dwelling in which the annual percentage rate (APR) at consummation will exceed the yield on comparable Treasury securities by three or more percentage points for loans secured by a first lien on a dwelling, or by five or more percentage points for loans secured by a subordinate lien on a dwelling. The regulations would provide specifics as to the Treasury securities that are determined to be comparable for a fixed-rate loan (depending upon the loan's term) and for a variable rate loan (depending upon the duration of an initial fixed-rate period). The idea is to use a quantitative proxy for subprime loans, we understand.

1. Thresholds

Our members have raised questions regarding whether the thresholds of three and five points above Treasury securities are appropriate. We understand the goal is to capture a set of loans regarding which there is evidence that consumers have been injured. The Board stated in its preamble that it seeks, through its thresholds, to include subprime loans and to exclude prime loans, although the Board specifically requests comments as to whether those thresholds are too low (i.e., whether they are over-inclusive, and extend into the prime market).

In general, of course, this rule would likely expand artificial pricing boundaries in a way similar to HOEPA – lenders may determine that the regulatory hurdles or product restrictions are too onerous and will seek to avoid making loans that meet the thresholds. That will limit lenders' ability to price their loans based upon risk, and will consequently stifle product offerings for subprime and Alt-A borrowers.

In proposing these thresholds for "higher-priced mortgage loans," the Board is relying upon the thresholds it created in its regulations under the Home Mortgage Disclosure Act (HMDA). In very general terms, those regulations require applicable lenders to report, among other data, the APR "spread" over comparable Treasury securities for loans with an APR at least three points (for first-lien loans) or five points (for subordinate-lien loans) greater than the yield on those securities. Although commenters on the proposed HMDA rule reported that those thresholds were too low, and suggested five and seven percentage points above Treasuries, the Board did not accept that suggestion when finalizing its regulations. The final HMDA rule did not discuss the basis for that decision, other than simply to state that "the data available to the Board . . . indicated that these thresholds would exclude the vast majority of prime loans and include the vast majority of other loans."[4] It did not define the phrase "vast majority," but one can infer the Board's concession that a material percentage of prime loans would be included in the thresholds. Thus, the public has no information to analyze the basis for those thresholds, the level of scrutiny the Board applied in adopting them, or the rationale to impose substantive restrictions based on a methodology that presently is used solely for reporting purposes.

Unlike under HMDA, in which those thresholds resulted in a requirement to report data on a greater number of loans on the margin, in the Board's current rulemaking, those thresholds impose serious compliance burdens and the risk of substantial remedial liability. More importantly, the enhanced damages for violations that apply to higher-priced mortgage loans increase the possibility that some lenders will not make, and some investors will not purchase, higher-priced mortgage loans. Using a filter that permits prime loans to seep into the higher-priced mortgage loan category would likely result in some prime loans being shut out of the market. Thus, we urge the Board to employ greater scrutiny of the inclusiveness of the thresholds, and to provide and explain the data on which it is relying, providing the public an opportunity to comment.

In analyzing those threshold spreads (three and five over Treasuries) in relation to recent loan data, our members have confirmed what the Board apparently already knew several years ago when it promulgated HMDA—namely, that the proposed thresholds will capture a material number of prime mortgage loans, including many that may be FHA insured. We respectfully request that the Board adopt in the final regulations a methodology that minimizes the inclusion of prime loans within the threshold. While we discuss below the need for a more accurate measuring index as an alternative to Treasury securities, we strongly believe that even in comparison to Treasury securities, a higher threshold would better satisfy the objectives of capturing the subprime market without imposing unnecessary regulatory restrictions on the prime and near-prime market and increasing the risk that responsible lending will be curtailed. The evidence and data of our members indicate that a threshold of four percentage points for first-lien loans, and six percentage points for subordinate-lien loans, still captures the subprime market but materially reduces the inclusion of prime loans.

Regardless of the number of points that will comprise the final threshold, we are concerned that the threshold is tied to the APR. We understand that this formula is derived from HMDA, but the Board is aware that changes in fees and charges (often unanticipated) can obviously cause changes in the resulting APR up to the time of closing. We respectfully request that the final regulations allow a tolerance of 1/8% in the calculation of the APR, consistent with the tolerance allowed in the current regulations (i.e., §§ 226.17(f)(2), 226.22(a)(2)) to account for such scenarios.

2. Comparable Treasury Securities

Another important aspect of accurately capturing the subprime market through the Board's proposed definition of "higher-priced mortgage loans" is the cost index to which the loans must be compared. The Board proposes to use Treasury securities of comparable maturities, depending on the loan's term or initial fixed-rate period, as prescribed in the proposal. As we posited above, the Board is following the base line index it applies in the HMDA regulations. (The HOEPA regulations, which are now over a decade old, also rely upon Treasury securities with comparable maturities, but look back to the 15th of the preceding month, while the Board's proposal (similar to the HMDA regulations) would look either to the 15th of the preceding month or the current month, depending upon when the creditor receives the application.)

Clearly, relying on an appropriately reflective mortgage pricing index is a critical component of distinguishing a set of subprime loans from Alt-A or prime loans. However, our members believe (based on an analysis of recent loan pricing data in comparison with multiple different pricing indices) that relying upon Treasury securities is not the most accurate reference measurement of mortgage loan pricing, even when comparing loans to Treasury securities with maturities based upon the typical life of a loan or on the

[4] 67 Fed. Reg. 43,218, 43,219 (June 27, 2002).

initial fixed-rate period. We believe that mortgage loan pricing is systemically higher than the Treasury securities to which the Board would require comparison, thus producing an over-inclusive threshold that captures a high number of loans considered to be Alt-A or even prime loans. Further, we believe the Treasury security rates do not always move consistently with mortgage rates – those securities change based on different circumstances and conditions than mortgage prices. One way to address that disparity is to use an even greater margin or spread than that recommended above to account for the inherent valuation differences; that would mean raising the thresholds to four and six points, as described above.

We understand that several diversified financial services companies have developed a less drastic alternative to the formula proposed by the Board—a methodology that more precisely captures subprime loans and excludes prime loans. We understand that the alternative relies in part on publicly available and regularly published pricing data of Freddie Mac and takes into account the spread between the 7-year Treasury and the Freddie Mac 30-year conforming rate as a means of accounting for market volatility. While not a government agency, Freddie Mac is a government sponsored enterprise, and its mortgage securities by definition will track mortgage loan pricing more closely than Treasury securities. We have not had the opportunity to review this research in detail, but the initial results appear encouraging, and we strongly urge the Board to give the alternative serious consideration. While a more accurate index may be provided by a non-government entity (such as Fannie Mae or Freddie Mac), those entities nonetheless are government-sponsored with a public housing mission, specialize in mortgages and the unique movement of their pricing, and make their yield measurements publicly available.[5] Although those yield measurements/indices are publicly available, the Board could post periodic announcements of the index, and could even post the exact threshold triggers as of the 15th of each month. In that way, the public would have easy access to the correct threshold triggers, and those triggers would be accurate and more stable indicators of higher-priced mortgage loans (without erring too far on the side of capturing prime (even conventional and conforming) mortgage loans).

We urge the Board also to explore the feasibility of amending HMDA's Regulation C for the 2009 calendar year and beyond so that the same methodology (and trigger) is used for both. The Board has a window of opportunity to do this for the 2009 year, which will reduce compliance burden, since 2009 HMDA data will not be reported until 2010.

## E. <u>New Ability to Repay Standard for HOEPA and Higher-Priced Mortgage Loans</u>

### 1. <u>Pattern and Practice</u>

The Board proposes to revise its ability to repay standard and to expand its applicability not just to HOEPA loans, but also to the newly-defined higher-priced mortgage loans. The proposed rule would prohibit a creditor extending HOEPA mortgages or higher-priced mortgages from engaging in a pattern or practice of extending that credit to consumers based on the value of consumers' collateral without regard to consumers' repayment ability as of consummation, including consumers' current and reasonably expected income, current and reasonably expected obligations, employment, and assets other than the collateral.

We generally support the Board's proposal to qualify the ability to repay obligation by a "pattern and practice" standard. We are very concerned that the new regulations will facilitate a torrent of private wrongful lending claims, asserted individually and through class actions both affirmatively and defensively. By limiting such claims to a "pattern and practice" standard, we believe the regulations will reduce the number of claims based on isolated, random, or accidental acts, but preserve a consumer's ability to bring claims where the failure to determine a borrower's repayment ability was a standard operating procedure of the defendant lender.

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[5] *See, e.g.,* http://ww3.freddiemac.com/ds1/sell/rnyhistory.nsf/frmHisRNY?OpenForm&year=2008&month=04&day=03&RN=8902.

2. Presumptions of Violation, But No Safe Harbor

The Board proposes a substantial list of presumptions indicating that a creditor has engaged in a pattern or practice of extending HOEPA or higher-priced mortgage loans without regard to consumers' ability to repay – in other words, presumptions of violations. Those presumptions include a pattern or practice of failing to: (A) verify and document consumers' repayment ability in accordance with the regulations; (B) consider consumers' ability to make loan payments based on the interest rate (which, in the case of a loan in which the interest rate may increase after consummation, must be determined in accordance with the regulations); (C) consider consumers' ability to make loan payments based on a fully-amortizing payment that includes, as applicable, expected property taxes, insurance premiums, and other specified amounts; (D) consider the ratio of consumers' total debt obligations to consumers' income; or (E) consider the income consumers will have after paying debt obligations.

A presumption of a violation, such as those described above, is largely unprecedented, particularly in light of the serious remedies bestowed upon the borrower under the proposed rule (and under existing regulations for HOEPA loans). While the "pattern or practice" standard is somewhat helpful, our members fear that those presumptions will lead to extensive litigation. Unlike typical enforcement actions or borrower civil actions, borrower claims will be bolstered by the weight of a presumption in their favor, while creditors are forced to overcome that weight by proving their compliance. It is not clear from the proposal whether creditors would be forced to prove, against the presumption, that they did in fact engage in a pattern or practice of considering the correct interest rate, for example, or that they as an ultimate matter engaged in a pattern or practice of extending credit that their borrowers could reasonably repay. Obviously the proposal leaves much for the courts to decide, which means the proposal leaves much to be desired in establishing clear, objective and practicable compliance standards. We believe that it is appropriate for the party asserting non-compliance to bear the burden of overcoming a presumption of compliance that can be established by the lender. Among other things, this would strengthen lenders' ability and provide affirmative incentives to develop and implement policies that support the establishment of "pattern and practice" presumptions of compliance.

While the rule proposes several presumptions of noncompliance, it does not establish any presumptions that a creditor has <u>not</u> engaged in a pattern or practice of failing to consider consumers' ability to repay. A "safe harbor" of that manner, which would clearly specify that a creditor's patterns or practices that fall outside the safe harbor would not create a presumption of a violation, would foster certainty, compliance, and efficiency in the new subprime market.

We recommend that the Board adopt a framework for implementing its ability to repay standard in a manner similar to that adopted by the House of Representatives in H.R. 3915, in which the presumptions are stated in a positive light – in other words, as presumptions of compliance. Thus, section 226.34(a)(4) of the rule would provide, in subparagraph (i), that "[t]here is a presumption that a creditor <u>has complied</u> with this paragraph (a)(4) if the creditor engages in a pattern or practice of:

(A) Verifying and documenting the consumers' repayment ability in accordance with § 226.35(b)(2)(i);

(B) Considering consumers' ability to make loan payments based on the interest rate, determined as follows in the case of a loan in which the interest rate may increase after consummation.

(1) For a variable rate loan, . . . [as provided in proposed rule];

(2) For a step-rate loan, . . . [as provided in proposed rule];

(C) Considering consumers' ability to make loan payments based on a fully-amortizing payment that includes, as applicable: expected property taxes; . . . [as provided in proposed rule];

(D) Considering the ratio of consumers' total debt obligations to consumers' income; <u>and</u>

(E) Considering the income consumers will have after paying debt obligations."

As in H.R. 3915, that positive framework would also require an express statement that no negative presumption or implication may arise if the creditor failed to engage in one or more of those practices in a given instance. Specifically, the section should state that no provision of section 226.34(a)(4)(i) may be construed as implying that a creditor <u>has</u> engaged in a pattern or practice of extending credit to consumers without regard to consumers' repayment ability if the Board or a court finds that a creditor has failed to satisfy the presumption.

3. <u>Time of Consummation</u>

The rule proposes to require a creditor to consider consumers' repayment ability <u>as of consummation</u>. Proposed changes to the Official Staff Commentary to the regulations would state, however, that events after consummation may be relevant to determining whether a creditor has violated the ability to repay requirement (although they may not, by themselves, establish a violation). For example, a violation is not established if borrowers default after consummation due to serious illness or job loss. That text would not appear in the codified regulations themselves, but just in the Commentary.

We disagree with allowing events after consummation to be used in demonstrating that a creditor violated the ability to repay requirement. The creditor must make its lending decisions based on the information it has at the time of final underwriting, and should not be required to base its decisions on crystal ball predictions about unknowable circumstances (such as the borrower's health, his or her job stability, or the future prospects for declining property values). A creditor should not be subject to hindsight determinations that it should have based its decision on circumstances about which it could only guess. Thus, we believe that statement in the Commentary providing that post-consummation events may be relevant in determining whether a violation has occurred should be stricken.

We also recommend revising the rule to provide that the creditor must determine borrowers' ability to repay the loan <u>at the time of final underwriting</u>, and is not required to determine whether any change of circumstances may occur between that time and the time of consummation. In order to ensure orderly and timely closings, a creditor must move from loan underwriting and approval to loan funding. The creditor must not be required to continually reunderwrite the loan until the time of consummation. Assuming that a closing occurs within a reasonable time after loan approval (e.g., thirty (30) days) and the lender does not acquire actual knowledge of a material change in the applicant's circumstances, we believe that a creditor should be able to close a loan in reliance on the underwriting information obtained at the time of loan approval. Any changed circumstances that occur after final underwriting should not be relevant to determining whether the creditor violated the ability to repay requirement.

4. <u>Reasonably Expected Income and Obligations</u>

The proposal provides that a determination of a borrower's repayment ability must include consideration of "reasonably expected" future income and obligations. While we generally support the Board's recognition that underwriting can and should include a consideration of reasonably expected future income, we nonetheless have concerns with this standard. As written, it appears that lenders could be held liable for predictions about economic factors that could affect the borrower's future income. For example, given the economic slowdown and job losses in various geographic areas and industry sectors, we can imagine a wrongful lending claim by an enterprising class action plaintiff who asserts that the lender should have known of the adverse plight of the industry in which the applicant works and should have discounted the reasonable likelihood of future employment when considering the borrower's "reasonably expected" future income. We ask that the final regulations expressly clarify that the lender is <u>not</u> required to make any predictions about the stability of an applicant's job, particularly with respect to external circumstances, in determining whether income is "reasonably expected."

Similarly, it is not clear whether lenders would be required to predict what the future income and obligations may be given the borrower's profile at the time of loan origination. For example, should a lender assume that a borrower will run up credit card debt, even if the loan proceeds are being used to pay off existing credit card debt? Should a lender assume that the borrower may have to take out student loans to pay for college tuition if the applicant has children who will be of college age over the next five years? May a lender assume that an applicant's salary will grow at a fixed annual rate, such as pegged to the consumer price index? In other words, any legal obligation to predict correctly an applicant's reasonably expected income and obligations could lead to wrongful lending claims based on allegations that the lender failed to extrapolate the future from the applicant's existing circumstances, and we respectfully request that the final regulations expressly clarify that they do not require a lender to predict a borrower's future circumstances.

We also remain concerned that low and moderate income borrowers who do not rely solely on W-2 reportable income will not qualify for credit under these criteria because of those borrowers' inability to prove through third-party sources the likelihood of income that by definition is irregular. We understand the reluctance to authorize lenders to rely on irregular income in determining applicants' future ability to repay. However, one could read this proposed section to prohibit any reliance on irregular income, and we believe that will materially impair the ability of those who rely on seasonal income, tips, real estate commissions, or compensation from other types of jobs that may not lend themselves to working eight hours a day, twelve months a year. We believe the rule requires express clarification to authorize a creditor to consider irregular income in determining borrowers' ability to repay.

5. <u>Verification of Income and Assets</u>

The proposal would prohibit creditors of higher-priced mortgage loans from relying on unverified amounts of income, expected income, or assets. The rule would provide that creditors must verify amounts of income, including expected income, or assets through W-2s, tax returns, payroll receipts, financial institution records, or other third-party documents that provide reasonably reliable evidence of the consumer's income and assets. We request that the Board clarify in the final rule that creditors may rely on third-party data bases of primary credit information to satisfy this verification standard, such as aggregators of individual-specific employment and income information, which data bases the creditor has no reason to believe are inaccurate. We also question specifically what level of verification and documentation is required for compliance with this provision.

In addition, while this prohibition contains a materiality standard, such that a creditor would not be deemed to have violated the prohibition if the amounts of income and assets upon which the creditor relied in approving the transaction are <u>not materially greater</u> than the amounts the creditor <u>could have verified</u>, this prohibition is not subject to the rule's pattern and practice standard. Thus, a creditor could fall prey to a violation of this prohibition based on a single loan that was underwritten contrary to its policies and practices, and regardless of whether the borrower in fact had the reasonable ability to repay the loan. The Board should revise this provision to reflect the rule's recognition that creditors should be held accountable for their patterns and practices, and should not be held liable for extreme amounts of damages based on minor or technical violations that do not cause material harm to borrowers.

6. <u>Requirement to Escrow</u>

The proposed rule would require creditors to create escrow accounts for higher-priced first-lien loans, and allow creditors to cancel the accounts only after 12 months (and only upon the borrower's written request). Unfortunately, unlike many laws of this nature, the Board does not allow the borrower to opt out of this requirement, and it does not provide any exemption to this requirement for low loan-to-value ratio loans.

The Board seeks comments on whether the benefits of this proposal outweigh the costs. We believe the costs of mandating escrow accounts on every higher-priced mortgage loan, without regard for the loan-to-value (LTV) ratio, indeed imposes costs that do not justify the benefits. Clearly the establishment and maintenance of escrow accounts add to the costs of servicing the loans, including fees imposed by some taxing jurisdictions. These servicing expenses will raise the costs of higher-priced loans, and may not in every case be justified. We suggest the Board impose its mandatory escrow account requirement only to higher-priced mortgage loans with an LTV that exceeds a certain threshold, such as 80 percent, which would also more effectively target that subset of subprime loans for which taxes and insurance payments present more pronounced affordability concerns.

7. Automated Underwriting Systems

The proposal provides a list of factors that must be considered in determining a borrower's ability to repay. It provides no express recognition of the value of automated underwriting systems and other technological tools that, based on empirical research, are reasonable predictors of default. Several reliable systems are pervasive in the industry, and are used by originators as well as investors as an important component of their underwriting analysis. We hope the final regulations will not turn the technology clock backwards by impairing the ability of lenders and investors to rely on the results of bona fide automated underwriting systems, particularly those of Fannie Mae and Freddie Mac. We request that the final regulations explicitly authorize lenders to rely on the then current Fannie Mae and Freddie Mac automated underwriting systems to determine a borrower's ability to repay and to use bona fide private automated underwriting systems as a material component in underwriting decisions.

8. Relative Weighting of Factors

The proposal gives no guidance on the relative weighting that a lender must give to the consideration of the enumerated factors that are relevant to the determination of a borrower's ability to repay. The experience of each lender legitimately guides the level or amount of consideration that it gives to any one factor in relation to other factors. We recommend that the final regulations explicitly state that a lender may give the level of consideration it believes is appropriate with respect to any one factor as long as the lender makes a good faith, reasoned judgment. Also, consideration of any one factor or all of the credit factors ultimately requires a subjective judgment, and the final regulations should state explicitly that lenders are not responsible for errors in judgment made in good faith.

9. Seven-Year Repayment Period

The Board would establish that a creditor does not violate the ability to repay requirement applicable to higher-priced mortgage loans if it has a reasonable basis to believe consumers will be able to make loan payments for at least seven years after consummation of the transaction, considering the factors identified in the regulations and any other factors relevant to determining repayment ability. The Board does not provide much information as to the data or analysis upon which it bases its seven-year period of repayment ability. Based on information provided by our members, however, we have learned that the typical life span of a subprime mortgage loan (as well as many prime mortgage loans) is shorter than seven years, and is in fact closer to five years. We request the Board to adopt that duration in its ability to repay presumption in section 226.34(a)(4)(ii).

Nonetheless, it is reasonable to presume that a creditor who relies upon a repayment period shorter than that described in the above presumption would not be committing a per se violation of the ability to repay standard for higher-priced mortgage loans. However, the proposed rule should be clarified on that point. In any event, it appears that the Board may be proposing to require that a creditor that relies (as a pattern or practice) upon a repayment period that more closely reflects the average loan life would be forced to justify its decision, against the weight of the presumption, in order to avoid liability. We believe such a requirement would be unduly burdensome and unnecessary, and would serve only to raise the costs of compliance and consequently the cost of credit, for no benefit to consumers. For that reason, we suggest that in addition to shortening the time period (to provide that a creditor does not violate the ability to repay requirement if it has a reasonable basis to believe consumers will be able to make loan payments for at least five years), the regulation should state that no negative presumption or implication may arise if the creditor relies upon a different repayment period in a given instance. As with the main presumptions of an ability to repay that we describe above, this subsection of the regulations should state that no provision of section 226.34(a)(4)(ii) may be construed as implying that a creditor has engaged in a pattern or practice of extending credit to consumers without regard to consumers' repayment ability if the Board or a court finds that the creditor has failed to satisfy the presumption.

10. Simultaneous Seconds

A creditor is presumed to have violated the prohibition on lending without regard to repayment ability if the creditor has engaged in a pattern or practice of failing to verify and document repayment ability. The rule would provide that a pattern or practice of failing to verify consumers' other obligations would trigger that presumption. Proposed additions to the Commentary would provide that where two different creditors are extending loans simultaneously, one a first-lien loan and the other a subordinate-lien loan, each creditor is expected to verify the obligation the consumer is undertaking with the other creditor, and a pattern or practice of failing to do so would create a presumption of a violation. However, the proposed rule does not mention limiting this requirement to circumstances in which the creditor reasonably knows of the existence of the other transaction. There is simply no way a creditor can comply with a requirement to consider simultaneous obligations consumers may be pursuing, when the creditor is not aware of those obligations and has no reason to know of their existence. We note that the federal legislative proposal passed by the U.S. House of Representatives, H.R. 3915, requires creditors to consider "the combined payments of all loans on the same dwelling," but only if the creditor knows or has reason to know that another residential mortgage loan secured by the same dwelling will be made to the same consumer. We request the Board require the creditor to consider other residential mortgage obligations to be secured by the same property only to the extent the creditor knows or has reason to know of their existence.

**F. Regulation of Mortgage Brokers**

As a preliminary matter, while it may go beyond the specific scope of the proposed regulations, SIFMA and ASF generally support federal encouragement of state licensing standards for mortgage brokers on a nationwide basis, to ensure a minimum level of competence and oversight. We believe that national licensing standards for mortgage brokers would meaningfully advance the goal of uniform national regulation of the mortgage lending process, consistent with our views on the need for national lending standards and preemption generally.

The Board proposes to address concerns about the fairness and transparency of creditor payments to mortgage brokers, known as yield spread premiums. Rather than prohibiting outright any compensation paid by the lender to the broker that is affected by the terms of the loan, the Board proposed that a creditor is prohibited from making any payment, directly or indirectly, to a mortgage broker in connection with any consumer credit transaction secured by a consumer's principal dwelling unless the broker enters into a written agreement with the consumer that satisfies the conditions set forth in the regulations. Upon ensuring that the broker and consumer entered into a written agreement, the creditor still may only make a payment to a mortgage broker that does not exceed the total compensation amount stated in that agreement, reduced by any amounts paid directly by the consumer or by any other source. The Board would not prohibit a creditor's payments to a mortgage broker if the creditor can demonstrate that the compensation it pays to a broker in connection with a transaction is not determined, in whole or in part, by reference to the transaction's interest rate.

Our members believe that creditor payments to brokers are a legitimate financial tool for borrowers who seek to minimize their up-front origination costs. So long as the broker fully discloses his or her fees, the borrower should have that option. However, the Board's proposed restrictions on those payments seem exceedingly difficult to implement. First, the proposal appears to prohibit any type of broker fee except a flat fee, locked in place before the transaction is finalized. While the Good Faith Estimate recognizes that disclosing a range of amounts is acceptable in such an early disclosure, it appears the Board would change that notion and require an early disclosure of a specific guaranteed dollar amount for the broker fee. We believe the Board's rule should allow for a disclosure of a range for the broker's fee, or for some level of tolerance for a change in the amount between the time of the broker agreement and the time of closing (at which time the actual fee is disclosed on the HUD-1). A tolerance of the greater of ten percent or a fixed dollar amount would be reasonable. Quite often, a broker will not know how much work will be performed on a loan application, or even what the contemplated transaction will look like, until the borrower and third parties provide full, complete, and accurate information. We recommend that any initial ceiling on compensation be explicitly predicated on the borrower providing or causing to be provided full, accurate, and complete information requested by the broker.

Second, the exception for certain state law mortgage broker requirements is ambiguous and unworkable. Many states have enacted laws, or issued regulations or other guidance, imposing certain responsibilities upon mortgage brokers. Those requirements may apply broadly, or they may apply only to a certain set of loans or a certain set of brokers (e.g., licensees). They may be enforceable and mandatory, or they may be more in the nature of best practices or subjective guidance. A creditor will be very hard-pressed to identify with certainty which broker requirements will come within that exception, on a state-by-state, loan-by-loan, and broker-by-broker basis. Again, while creditor payments to brokers can be a legitimate and beneficial financial option for borrowers, this exception language does not serve to make that option viable.

The Board's proposal essentially requires a written agreement with the consumer that includes clear and conspicuous information to be specified in the regulations regarding the broker's compensation. We understand that certain trade organizations have prepared or endorsed a uniform Mortgage Broker Disclosure. While we have not had the opportunity to review that or any other standard agreement or disclosure, we fully support the concept of a standard form for brokers to disclose information regarding their compensation and services to be provided. Borrowers nationwide must receive that important information, and a standard form will facilitate comparison shopping as well as compliance. This is another area where the Board should preempt state law requiring an alternative form so as to minimize the likelihood of customer confusion.

### G. <u>Advertisements</u>

The Board proposes some significant amendments to Regulation Z's advertising requirements. For example, the Board would prohibit advertisements for credit secured by a dwelling from using the terms "counselor" or "financial advisor" to refer to a for-profit mortgage broker or lender, its employees, or persons working for the broker or lender that are involved in offering, originating or selling mortgages. The preamble recognizes that rule should not prohibit advertisements for bona fide consumer credit counseling services or bona fide financial advisory services, such as services provided by certified financial planners.

We agree that clear advertisements are important, and that the Board is right to use its authority to address misleading and deceptive sales techniques in connection with residential mortgage loans. However, we believe that the Board's advertising regulation should expressly state that it does not apply to bona fide consumer credit counseling services or bona fide financial advisory services, and that the Board should expressly recognize an exception for registered securities broker-dealers.

### H. <u>Appraisal-Related Requirements</u>

#### 1. <u>Undue Pressure on Appraisals</u>

The Board's proposal provides that in connection with all consumer credit transactions secured by a consumer's principal dwelling, creditors and mortgage brokers are prohibited from directly or indirectly coercing, influencing, or otherwise encouraging an appraiser to misstate or misrepresent the value of the dwelling. This represents a stretch beyond TILA's reach, as the statute otherwise is founded upon providing consumers with important and reliable information about the costs of credit and addressing certain unfair loan terms. Nonetheless, the Board has deemed pressured appraisals as unfair or abusive and has proposed regulations to address appraiser independence.

The entire mortgage financing market depends upon reliable appraisals, so our members recognize the importance of appraiser independence from coercion. In fact, we assert that lenders and investors are the least likely parties to seek to coerce an appraiser into a faulty evaluation, since they are the parties (along with the borrowers) who will be hurt the most when they find the collateral is insufficient to cover the debt. However, the language of the proposed rule's appraisal provision is unnecessarily vague and broad. First, terms such as "influence" and "encourage" do not have established legal definitions, so there is no certainty or clarity about the types of activities that will constitute a violation. They are largely subjective terms, and their meanings may vary among appraisers, enforcement agencies and courts. Second, the addition of "indirectly" to that phrase opens up a whole host of undefined activities.

In order to promote clarity and thereby strengthen the appraiser independence provision, we recommend the Board revise it to make use of terms that have an established legal meaning. The provision should be revised to read as follows: "In connection with a consumer credit transaction secured by a consumer's principal dwelling, no creditor or mortgage broker, and no affiliate of a creditor or mortgage broker, shall coerce, extort, or bribe an appraiser to misstate or misrepresent the value of such dwelling." We believe that will capture the conduct the Board is seeking to prohibit, particularly considering the examples the Board provides, without creating unnecessary ambiguity.

We worry that, in the ordinary course, there will be no objective proof that an illegal act occurred, and consumers will make unsubstantiated claims in order to obtain statutory damages and enhanced damages, particularly in the context of foreclosures. Any such claim will devolve into a "he said/she said" debate, and it will be virtually impossible to dismiss the claim at an early stage since a judge initially will be required to assume that the facts as pled are true.

The appraisal has historically been intended for use by the lender in determining whether to extend credit and how much to extend. Accordingly, the appraiser's legal duty of care has most often been construed by courts and federal regulators as being to the lender, not to the borrower/purchaser.[6] A minority of courts, however, have held that the appraiser has a duty to the borrower and thus can be held liable to the borrower for a bad appraisal. By giving borrowers an express private right of action to challenge the appraiser/lender relationship, the Board may be opening a "Pandora's box," enabling borrowers to sue lenders any time a remorseful buyer feels that he or she paid too much for a house or blames the lender for the poor condition of the property.

We respectfully request that any final regulations clarify that nothing in the regulations is intended to create an implied right of action by a consumer against a lender for an appraisal that proves to be inaccurate. Moreover, the regulations should expressly clarify that the creditor or mortgage broker has not committed a violation of this section if it is determined that the appraiser was coerced, bribed, or extorted by someone other than the creditor or mortgage broker, respectively, or if the appraiser produced a reasonably accurate appraisal.

2. Impermissible Relationships with Appraisers

The Board surely is aware of the efforts by the New York Attorney General to establish a Home Valuation Code of Conduct (the Code) for use by Fannie Mae and Freddie Mac (the GSEs), which Code includes stiff provisions for appraiser independence. Like the Board's proposed revisions to Regulation Z, the Code seeks to prohibit undue pressure on appraisals. Unlike the Board's proposals, however, the Code goes further and seeks to prohibit anybody other than appraisal companies from preparing or causing appraisals to be prepared. This controversial feature would prohibit lenders from performing their own appraisals, owning an affiliated appraisal company, and perhaps even contracting to procure an appraisal from an unaffiliated vendor management company.

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[6] *See, e.g.*, *U.S. v. Neustadt*, 366 U.S. 697 (1961); *Nymark v. Heart Savings & Loan Ass'n,* 283 Cal. Rptr. 53, 56-57 (Cal. Ct. App. 1992); *Hughes v. Holt*, 435 A.2d 687, 689 (Vt. 1981); *Emmons v. Brown*, 600 N.E.2d 133, 134-135 (Ind. Ct. App. 1992); *Brushwitz v. Ezell*, 757 So. 2d 423 (Ala. 2000); *Balance v. Rinehart*, 412 S.E.2d 106, 109 (N.C. Ct. App. 1992); Real Estate Appraisals, 59 Fed. Reg. 29,482-29,503, 29,485 (codified at 12 C.F.R. Parts 34, 225, 323, 545, 563, 564).

Although the GSEs are accepting public comments on their proposed Code from "market participants," and they have agreed to a "good faith review" of those comments, their ability to amend the Code in response to comments is sharply limited under the agreement with the New York Attorney General. In this regard, the process is unlike a formal rulemaking process pursuant to the Administrative Procedures Act and its progeny, under which an agency is obligated by law to give due consideration to comments when issuing final regulations. Some of our members have nonetheless submitted comments on the proposed Code.

The Board, of course, long has been involved in the question of appraiser independence. For example, in response to the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, the Board was one of the federal banking agencies to promulgate the Interagency Appraisal and Evaluation Guidelines in 1994, and subsequent statements attempting to address appraiser independence. Our members uniformly believe that appraiser independence is essential to ensure the integrity of the appraisal process. How such independence is defined, however, is an area where reasonable people may differ. They believe that the Board in particular has an expertise on the issue that should be used, and they have expressed concern that the rules regarding who can prepare or procure appraisals should be vetted in a thorough, thoughtful way and not solely as a result of a privately negotiated cooperation agreement. We respectfully request that the Board stay involved in the process surrounding the Code to minimize the likelihood that a well intentioned, but privately negotiated, cooperation agreement will not unwittingly have a material adverse effect on the ability of lenders to procure quality appraisals in a timely manner.

## I. Servicer Requirements

### 1. General Comments

The Board would also impose certain requirements upon servicers. Once again, while the Real Estate Settlement Procedures Act (RESPA) and its regulations address certain elements of servicing a mortgage loan, TILA is generally an origination-related statute. Nonetheless, the rule sets out several servicing practices the Board deems unfair or abusive. Quite frankly, we do not believe that servicing errors or omissions should be actionable at all under HOEPA, and we believe that the imposition of exorbitant damages on servicers for immaterial mistakes will clog the courts with trivial claims and ultimately provide monetary defenses to foreclosure for the return of all sums previously paid. Assuming servicing errors or omissions will be actionable, we believe that the final regulation should parallel the treatment of the ability to repay requirements. Specifically, we believe that only a pattern or practice of engaging in prohibited servicing activities, evidenced by policies and procedures that are not compliant, should constitute a violation of the rule. In the servicing area, it appears the rule would snag a servicer, and subject it to substantial federal penalties, for a single error (e.g., an inadvertent delay in providing one borrower's fee schedule), although the borrower may have suffered no measurable damages. We do not believe the Board intended to impose such a trap for legitimate servicers. Thus, we recommend the Board revise the servicing provisions to prohibit a servicer from engaging in a pattern or practice of prohibited activities. In addition, the rule should allow a servicer to cure a violation within a reasonable period of time, including the timely reversal or crediting of any wrongful charges.

Our suggested changes are consistent with the Board's rationale as articulated in the preamble relating to the regulation of unfair practices. As mentioned above, the preamble cited an FTC interpretation of the term "unfair" to provide that "consumer injury may be substantial if it imposes a small harm on a large number of consumers, or if it raises a significant risk of concrete harm." A loan level mistake, particularly one that is corrected once the servicer learns of it, imposes no harm on a large number of consumers, and, assuming the servicer cures its mistake, is not likely to cause concrete harm to the consumer. Even an unintentional, systematic mistake that is corrected when caught does not raise a significant risk of concrete harm. We ask that the servicing proposals be judged against that standard, both in terms of the proposals' scope and the availability of statutory and enhanced damages for violations. Indeed, we would be less concerned if the damages were not so significant. If the mistake can be cured, then there would be no actual damages. But should a borrower be entitled to substantial statutory and enhanced damages as a result of a simple mistake? We do not believe so.

2. Crediting of Payments

Our members also have raised questions specifically about the Board's proposal to require servicers to credit a consumer's payment immediately (except when the delay will not result in a charge to the consumer or the reporting of negative information to a consumer reporting agency). If a servicer specifies in writing requirements for the consumer to follow in making payments, but accepts a payment that does not conform to the requirements, the servicer would be required to credit the payment within five days of receipt. The proposed Commentary would explain that the payment crediting requirement would not force the servicer to post the payment to the consumer's loan account on a particular date. The servicer would only be required to credit the payment as of the date of receipt. Accordingly, the Commentary would explain, a servicer that receives a payment on or before its due date and does not enter the payment on its books or in its system until after the payment's due date would not violate the requirement as long as the entry does not result in the imposition of a late charge, additional interest, or similar penalty to the consumer, or in the reporting of negative information to a consumer reporting agency. This prohibition is intended to address circumstances in which an unscrupulous servicer seeks to increase its servicing income by delaying the crediting of payments and imposing late fees.

However, the rule does not provide specific guidance as to what constitutes receipt of a payment (beyond providing in the Commentary that "date of receipt" is the date the payment reaches the servicer). It is not clear, for example, how a servicer must handle a partial payment (other than a full payment that is missing only a late fee that is due and payable). In fact, the Board seeks comment on whether (and if so, how) partial payments should be addressed in this provision. Depending upon the loan's terms, a servicer may have the contractual authority to place those funds in a suspense account. The final regulation should clarify that such an action is permissible, and recognize that after placing a partial payment in suspense, a servicer may take other action, in accordance with the loans' terms, with those borrowers' suspended funds (i.e., if sufficient funds do not subsequently arrive to equal a full payment). Similarly, the final regulations should provide that a lender should not be required to credit a payment as to which there is a bona fide dispute under the loan documents, including, without limitation, short payments in the case of loans in default.

3. Schedule of Fees

The proposed rule also would prohibit a servicer from failing to provide to the consumer, within a reasonable time after receiving a consumer's request, a schedule of all specific fees and charges that the servicer may impose on the consumer in connection with servicing the consumer's account, including a dollar amount, an explanation of each fee, and the circumstances under which the servicer would impose it. However, beyond the fees or charges "the servicer may impose," the proposed Commentary would provide that the fee schedule must include any third-party fees or charges assessed on the consumer (e.g., attorneys' hourly rates).

Our members agree that servicers can and should disclose their own fees for the services they provide. However, the Board states in its preamble that it would be promulgating this disclosure requirement pursuant to its authority under Section 129(l)(2) of TILA to prohibit unfair or deceptive acts or practices. Violations of Section 129 are subject to enhanced monetary damages equal to the sum of all finance charges and fees paid by the consumer. While this extreme remedy provides an exception for nonmaterial violations, the Board should promulgate this disclosure requirement (and many other requirements of the Board's proposed rule) more appropriately under its Section 105 authority. Section 105 provides the Board broad authority to prescribe regulations to carry out TILA's purposes, and it does not subject lenders (or servicers) to exorbitant penalties for technical or minor violations. We urge the Board to issue this schedule of fees requirement (and to consider carefully issuing many of its other requirements) under the authority of Section 105 of TILA, rather than Section 129.

Further, it is an unreasonable burden to force a servicer to continually investigate and correctly disclose, subject to a federal cause of action, fees and charges the servicer is not responsible for setting, but is authorized to charge under the security instrument, particularly those that arise as a result of the borrower's default. The Board recognizes the difficulty of identifying third-party charges and specifically seeks comment on whether the benefit of increasing the transparency of third party charges would outweigh the costs associated with a servicer's uncertainty as to such charges. Our members firmly respond that the compliance burden and risk of penalties far outweigh the marginal disclosure benefits. TILA and Regulation Z should not hold servicers responsible for disclosure of third-party fees.

Let's take an example. A borrower defaults on the loan and abandons the property. The servicer hires a property inspection company to determine whether the property is vacant and third-party service providers to board up and secure the property, clean and repair the property, value the property for sale, and then market and sell the property. Should it really be a federal cause of action resulting in statutory and enhanced damages if the servicer does not disclose to the consumer the out-of-pocket costs that the servicer may incur due to the borrower's default under the loan and abandonment of the property? This provision more certainly will turn into a "gotcha" defense to foreclosure, where the borrower will seek a return of all sums paid simply because the servicer did not disclose the cost to wash the floor of an abandoned property.

We also ask that this provision exclude fees for services voluntarily requested by the consumer or the consumer's authorized representative that are not governed by the loan documents. We do not believe that a servicer should be prohibited from charging a fee for a discretionary service requested by the borrower simply because the servicer did not think in advance to disclose the possibility of providing a service that the borrower might request.

Additionally, the final regulations should clarify that a servicer can satisfy this obligation by posting its charges on its website or by providing an annual disclosure as part of the annual escrow analysis provided under RESPA.

4. <u>Payoff Statement</u>

The proposed rule would prohibit servicers from failing to provide an accurate payoff statement within a reasonable time after receiving a request. A proposed addition to the Commentary would state that three business days would normally be a reasonable time within which to provide the payoff statements, although it mentions that a longer time may be reasonable when servicers are experiencing an unusually high volume of refinancing requests. However, the proposed rule and/or the Commentary also should expressly recognize that other legitimate activities may increase the amount of time in which a servicer may reasonably be able to respond to a payoff statement request. For instance, when the servicer does not have the promissory note readily available (the promissory note in most instances is held by a custodian), the servicer may need as many as 10 business days to obtain the note, review it, and provide an accurate payoff statement. In circumstances when more research or document review is required, the Commentary should recognize that a servicer's reasonable response may take up to 10 business days.

There is much litigation concerning payoff statements, and we are concerned that this new requirement may unwittingly fan that litigation's flame. For example, many servicers agree to provide for free one written payoff statement within any month but charge for subsequent ones, although they may also provide phone updates and web view statements for free. Would this practice be prohibited under this regulation? Could a servicer refuse to respond to repeated requests from title agents for written payoff statements unless the title agent paid a fee? What if the payoff statement proved to be immaterially inaccurate; would the servicer be subject to statutory damages? Clarifying details like these will be essential in preventing unnecessary litigation.

**J. <u>Mortgage Loan Disclosure</u>**

The proposed regulations provide that the early disclosure requirement now applicable under TILA for purchase money residential mortgage loans would be extended to other types of closed-end residential mortgage transactions, including refinancings, home equity loans, and reverse mortgages. Creditors would be required to satisfy this early disclosure requirement before they could charge the consumer a fee for the transaction, except for obtaining information on the consumer's credit history. The purpose of that proposal reportedly is to enhance consumers' ability to shop before selecting a lender and loan terms.

Late last century, the Board (along with HUD) issued a report calling for the rationalization of the residential mortgage loan federal disclosure process. It described the awkward relationship between TILA and RESPA and suggested that Congress consider a comprehensive overhaul of the disclosure requirements in the two federal consumer credit laws. Now, the Board is seeking to impose a regulatory "patchwork" solution to a larger problem. In so doing, the Board appears to be abandoning the explicit language of TILA and imposing new requirements, the violation of which could lead to substantial monetary damages. While we fully support the Board's goals to enhance consumers' ability to comparison shop and to make educated and informed choices, we question the approach of unilaterally promulgating regulatory requirements that conflict with the statute and that Congress saw fit not to impose.

Section 128(b) of TILA creates two types of disclosure obligations for two types of closed-end loans: one disclosure that is triggered at loan closing, and another that is triggered within three days of loan application. The former applies to virtually all residential mortgage transactions, while the latter currently applies only to purchase money loans.[7] The proposed regulations would disregard the explicit statutory distinction and make the early disclosure obligation applicable to virtually all residential mortgage transactions. We respectfully assert that Section 105 of TILA on which the Board relies to propose this change does not give the Board the proper delegation of authority simply to rewrite the statute to support a laudable public policy goal that effectively throws out the limiting language of the statute.

Similarly, Section 128(b) of TILA imposes explicit conditions on the timing of those two sets of disclosures. One set of disclosures must be given before credit may be extended, and the other must be given within three days after loan application. Thus, the statute specifically addresses when the disclosures must be given, and neither disclosure requirement conditions the ability to assess a fee on the giving of the disclosures. Once again, we question the Board's authority to create a condition precedent to the charging of a fee to the consumer when the statute already specifically addresses when the disclosures must be given.

In raising the question of delegation of authority, we again want to reiterate our support for comprehensive RESPA/TILA disclosure reform, which the Board and HUD have historically recognized would require legislative amendments. We do not believe, however, that the Board should act unilaterally to create regulations that are inconsistent with the existing statute. We believe that this sets a dangerous precedent to which we must object.

Our interest in this topic is more than a purely academic analysis of administrative law. Mortgagors routinely file legal claims against creditors and assignees for disclosure violations under TILA, in part because the availability of statutory damages and attorneys' fees without regard to actual damages provides that economic incentive. Section 131 of TILA then authorizes consumers to bring claims for disclosure violations against assignees if the violation is apparent on the face of the disclosure document. **As a result, the Board's decision to expand the scope of disclosure requirements under TILA would appear to expand assignee liability under TILA.** We are opposed to any such expansion, and believe that it is contrary to the intent of Congress.

Moreover, we are concerned that conditioning the imposition of fees on consumers to the delivery of the required TILA disclosures could harm consumers more than help them. Whether a consumer

[7] We are aware of efforts to revise TILA to expand this disclosure requirement. Specifically, the Mortgage Disclosure Improvement Act of 2008, which is part of the Foreclosure Prevention Act of 2008 being actively considered in Congress, would if enacted amend Section 128(b)(2) of TILA to expand the applicability of the early disclosure requirements to any extension of credit secured by a consumer's dwelling. *See* H.R. 3221, § 502(a).

applies for a mortgage loan on line, by phone, or in person, consumers often select a particular lender and initiate the origination process before receiving and digesting the TILA disclosures. This may involve, for example, the payment of a fee in order to lock in a favorable interest rate, or the payment of an application fee to initiate the origination process. We believe that consumers should have the right to select a lender and start the origination process, without waiting to receive and evaluate the TILA disclosures. Congress could have elected to prohibit the collection of advance fees, but it chose not to do so. Instead, it created a specific system of disclosures to provide consumers with timely information about the costs of certain mortgage loans. We respectfully request that the Board not prevent a consumer from electing to initiate the origination process, including the right to lock in interest rates and points, until the consumer has received the early TILA disclosures.

### K. Effective Date

The proposed regulations ask for guidance on a proposed effective date. Our members are concerned about the practical ability to implement various provisions of the proposed rules. For example, the requirement that a servicer must escrow for taxes and insurance is not that difficult for servicers who already have systems in place, but will be quite burdensome for those who have to create or license a software capability to escrow in the first place. We believe that six months is an appropriate time period for the proposed rules relating to appraisals, advertising and mortgage brokers, but that a twelve-month period is more appropriate for the changes related to higher priced mortgage loans, escrows and disclosures.

## III. CONCLUSION

Consumers should be provided clear disclosures allowing them to understand material terms, costs, and risks of loan products to help them select products and choose among payment options. Legal certainty in the primary contractual process is critical in large-scale securitization markets. The efficiency and liquidity gains that securitization provides to the housing finance economy depend on the basic assumption that the underlying agreement is valid and enforceable. For that reason, SIFMA and ASF support enhanced borrower education and information, and the Board's authority to prohibit unfair or deceptive competitive practices would be rightly directed to that end.

To the extent, however, that the Board issues regulations imposing additional regulatory requirements to curb subprime lending abuses, without unduly restricting legitimate mortgage credit, the Board should make certain revisions before finalizing its proposal. The revisions we discuss in this comment letter will align the proposed requirements more accurately with the target subprime mortgage lending market and will facilitate creditor compliance without unnecessarily burdening the prime mortgage market or the secondary market. SIFMA and ASF appreciate this opportunity to provide their views on the Board's proposed regulations, and urge the Board to adopt the modifications recommended in this letter.

Should you have questions, or desire additional clarification of the matters discussed in this letter, please contact Sean Davy, Managing Director of the Mortgage-Backed Securities and Securitized Products Division of SIFMA, at 212.313.1118, or George Miller, Executive Director of ASF, at 212.313.1116.

Sincerely,

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