Comments of the National Consumer Law Center

(on behalf of its low-income clients)

and the National Association of Consumer Advocates

on

Integrated Mortgage Disclosures under the Real Estate Settlement Procedures Act

(Regulation X) and the Truth In Lending Act (Regulation Z)

77 Fed. Reg. 51,116 (Aug. 23, 2012)

Docket No. CFPB-2012-0028

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The National Consumer Law Center[1] ("NCLC") submits the following comments, on behalf of its low-income clients, with the National Association of Consumer Advocates.[2] These comments address the Bureau's proposal to integrate TILA and RESPA's disclosure requirements and the Bureau's proposed changes to the finance charge definition.

I. Overview

The Bureau's proposal includes many important changes. We strongly support the all-in finance charge.[3] This is a long over-due step that will equally benefit creditors and consumers. We also appreciate the Bureau's work on improving and synchronizing the disclosure forms. This endeavor is not for the faint-hearted and has been needed for decades. In many ways, the forms are an improvement over existing disclosures. The proposed regulations and commentary are generally well-written and clear. We particularly applaud the Bureau's inclusion of examples in the commentary. The instructions for using the model forms provide much better guidance than was available in the past. Nevertheless, the proposed disclosure forms are seriously flawed. We fear that

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[1] The **National Consumer Law Center**® (NCLC®) is a non-profit Massachusetts corporation specializing in low-income consumer issues, with an emphasis on consumer credit. Since 1969, NCLC has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness. NCLC publishes a series of consumer law treatises including Mortgage Lending, Truth in Lending and Foreclosures. These comments are written by NCLC attorneys Alys Cohen, Andrew Pizor, Lauren Saunders, Margot Saunders, and Diane E. Thompson. These authors have for many years provided assistance to attorneys and housing counselors helping consumers with problem mortgages across the country. These comments are based on these efforts as well as our knowledge and expertise in Truth in Lending, the Real Estate Settlement Procedures Act, the mortgage market specifically, and consumer law in general. We thank Joshua Wackerly and Beverlie Sopiep for their assistance.

[2] The **National Association of Consumer Advocates** (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

[3] *See generally* National Consumer Law Center, National Association of Consumer Advocates, Consumer Federation of America, Consumer Action, National Fair Housing Alliance, and Center for Responsible Lending, Comments to the Federal Reserve Board, Docket No. R-1366 (Dec. 2009), http://www.nclc.org/images/pdf/foreclosure_mortgage/predatory_mortgage_lending/r-1366-with-app-dec09.pdf.

adopting them will ultimately hinder, rather than promote, the goals of informed borrowing and consumer protection. Burying the APR and promoting multiple metrics that hinder comparison shopping will result in a net loss of transparency and consumer protection.

The revised forms and the all-in finance charge will protect creditors from litigation risk, but they will also reduce homeowners' ability to use violations to save their homes from foreclosure. Precisely for this reason, introduction of the all-in finance charge and revised forms should not be coupled with increased tolerances, raised triggers for HOEPA loans, or other reductions in consumer protections. An all-in finance charge and clearer disclosures can benefit consumers, but not if they are a Trojan horse used to dramatically undermine the protections of TILA.

These comments recommend a number of changes for improving the disclosure forms and the all-in finance charge. We also encourage the CFPB to clarify that RESPA applies to manufactured homes, at least whenever they are treated as real property under state law.

II. The Proposed Disclosure Forms, Although an Improvement in Some Regards, Are Seriously Flawed and Risk Doing More Harm Than Good For Consumers

A. Introduction

The Bureau's proposed Loan Estimate and Closing Disclosure forms are flawed in a number of significant ways. Most importantly, we are deeply concerned by the Bureau's proposal to almost completely abandon the Annual Percentage Rate disclosure. Rather than emphasizing the APR or proposing a substitute, the new forms emphasize the initial or fully-indexed interest rate, monthly payment, and cash to close—multiple price dimensions that are difficult for consumers to resolve and that can easily be manipulated by disreputable creditors. In doing so, the CFPB disregards a clear and enduring expression of congressional intent without providing a rational basis for doing so.

We are also concerned with other aspects of the proposed forms. The preliminary estimates are likely to cause confusion among consumers because the Bureau proposes to let creditors use the official Loan Estimate form without holding creditors to the requirements of accuracy and honesty under TILA and RESPA. The proposed "Cash to Close" and the related "Calculating Cash to Close" disclosures are much more complex than is necessary or appropriate. And the proposed rule provides erroneous instructions for disclosing the maximum possible payment on loans that both have an adjustable rate and permit negative amortization. These and other problems are discussed in more detail below.

While we generally compliment the Bureau on the use of consumer testing to develop the proposed forms, we also caution the Bureau against over-reliance on qualitative testing. The report produced by Kleimann Communications Group[4] is heavily influenced by what the test participants said they would do rather than evidence of what consumers actually do. As one expert in consumer testing and the study of usability has written, "[t]o design an easy-to-use interface, pay attention to what users do, not what they say. Self-reported claims are unreliable, as are user speculations about future behavior."[5]

The Kleimann study was carried out under circumstances that are very different from how consumers would actually receive and interact with loan disclosures. And the nature of qualitative testing required the researchers to encourage participants to think more deeply and thoroughly about the content of the disclosures than would be natural in the absence of such a guiding influence. In contrast, in the real world, nobody would encourage consumers to focus carefully on the forms. Instead, consumers are likely to be distracted by conversations with those around them, the scheduling of the moving vans, or even a loan originator giving them a sales pitch.

We have represented homeowners who closed their loans at McDonald's, at gas stations, on the hood of their car (when they were late for work), and in a room with an angry dog barely restrained by a chain. While disclosures can certainly not overcome all of those distractions, testing must at least account for the possibility that the closing agent will be rushed, that the homeowner will have other engagements (or a sick child) pressing on her mind, and that no one in the room will be looking out for the homeowner's interests. Consumers in the real world, operating under the press of daily obligations and sometimes pushy sales practices, are much more likely to overlook information that conflicts with what they have been told (such as promises about loan terms) than are test subjects in a controlled environment.[6]

For these reasons, we encourage the Bureau to proceed cautiously and to perform additional research on the forms to address the issues discussed in these comments. We also recommend that the Bureau conduct a pilot study, using revised forms with real consumers and industry participants—both prime and subprime lenders—as well as with experienced housing counselors. At the least, the Bureau should conduct consumer testing that mimics real-life loan applications and closings—including some conducted under the assumption that the loan originator wants to obscure certain onerous terms or use bait-and-switch tactics.

B. The APR Should Be on the First Page and More Prominent Than the Interest Rate

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[4] Kleimann Communications Grp., Inc., Know Before You Owe: Evolution of the Integrated TILA-RESPA Disclosures at 7 (July 9, 2012) (hereinafter "Kleimann").

[5] Jakob Nielsen, First Rule of Usability? Don't Listen to Users (Aug. 5, 2001), available at http://www.useit.com/alertbox/20010805.html. Jakob Nielsen is cited in Kleimann's report as a resource on consumer testing. Kleimann at N-2.

[6] *See* Debra Pogrund Stark, Jessica M. Choplin, & Mark A. LeBoeuf, *Ineffective In Any Form: Confirmation Biases and Other Psychological Phenomena Undermine Improved Home Loan Disclosures*, Yale L.J. Online (forthcoming).

1. History and Purpose of the APR

When Congress enacted the Truth in Lending Act in 1968, it intended to address the problems caused by a lack of transparency in credit pricing.[7] Congress was concerned that creditors sometimes camouflaged the true cost of credit with extraneous fees that should have been included in the interest rate.[8] This camouflage rendered "meaningless and deceptive" any interest rate quoted.[9] TILA's APR requirement was adopted to counteract this problem. "Just as the consumer is told the price of milk per quart and the price of gasoline per gallon, so must the buyer of credit be told the 'unit price.'"[10] The APR is the unit price of credit. "Without easy knowledge of this unit price for credit, it is virtually impossible for the ordinary person to shop for the best credit buy".[11]

The APR is "the most important single piece of consumer shopping information."[12] It addresses two serious problems facing consumer borrowers: 1) non-standardized methods of computing interest that result in an apples-to-oranges comparisons of rates; and 2) the fact that rates alone cannot reflect the full cost of credit, given the additional fees charged in connection with most loans.[13] The APR is a simplifying heuristic that allows borrowers to decide between options that are otherwise overwhelmingly complex.[14]

2. The APR Is Widely Recognized

Since adoption of the APR, it has become a widely recognized tool for credit shoppers. A study in the UK found that 83% of those surveyed consider the APR to be the foremost factor in their mind when considering a loan or credit card—second only to the lender's reputation.[15] Other studies have shown that more than 90% of the U.S. population is aware of the APR and that over 70% report using the APR to shop for closed-end credit.[16] According to one study, 78% of homeowners who refinanced their homes reported comparison shopping based on the APR.[17] Even though these figures greatly exceed the percentage of the population that can explain how to calculate the APR, they show that consumers are using the APR as it was intended.

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[7] Elizabeth Renuart and Diane E. Thompson, T*he Truth, The Whole Truth, and Nothing but the Truth: Fulfilling the Promise of Truth in Lending*, 25 Yale J. on Reg. 181, 181-82 (Summer 2008).
[8] 109 Cong. Rec. 2027, 2029 (1963) (statement of Sen. Douglas).
[9] *Id.*
[10] 90 Cong. Rec. S2042 (daily ed. Jan. 31, 1967) (statement of Sen. Proxmire).
[11] *Id.*
[12] Renuart, *supra* note 7, at 184.
[13] *Id.* at 186, *citing* Kathleen E. Keest, *Whither Now? Truth in Lending in Transition—Again*, 49 Consumer L. Q. Rep. 360, 361 (1995).
[14] *Id.* at 190.
[15] Iain Ramsay, Consumer Credit Regulation as 'The Third Way'? at 12 n.45 (unpublished, undated manuscript on web site of Int'l Ass'n of Consumer Law), www.iaclaw.org/Research_papers/Research_papers.html, *citing* The Market and Opinion Research International, Consumer Awareness of Credit Issues – Research Study conducted for the Department of Trade and Industry (Sept. 2003) (London:DTI) (last viewed Nov. 5, 2012).
[16] Renuart, *supra* note 7, at 217.
[17] *Id.* at 217, *citing* 213 Jinkook Lee & Jean M. Hogarth, *Consumer Information Search for Home Mortgages: Who, What, How Much, and What Else?*, 9 Fin. Svcs. Rev. 277, 286 (2000).

3. Consumers Do Not Need Expert Knowledge of the APR to Use It Effectively

Critics of the TILA disclosure rules emphasize problems with the APR as a disclosure tool. Common complaints include:

- the APR is unreliable because there are so many exceptions;
- the APR is not helpful for adjustable-rate loans;
- the APR is inaccurate for consumers who plan to sell or refinance in a few years;[18]
- consumers do not understand the difference between the APR and the contract interest rate;[19] and
- consumers do not understand what goes into the APR.

These criticisms, however, are easily addressed:

Reliability: The reliability problem can be resolved by eliminating the exceptions to the finance-charge definition. The CFPB has already proposed this step,[20] and elsewhere in these comments we urge the Bureau to adopt the all-in finance charge.[21]

Adjustable-Rate Mortgages: While it is true that the APR cannot accurately predict what credit will cost in the future, this criticism applies equally to disclosure of the contract rate or fully-indexed rate. Though the APR is less than perfect in this regard, its value as a standardized, unit price makes it superior to the interest rate as a disclosure tool. Rather than discarding the APR, its weaknesses are better addressed by supplementing it with other disclosures, such as the proposed payment summary and other proposed ARM-specific disclosures.

Consumers May Sell or Refinance Before Maturity: This concern overlooks the central purpose of the APR, which is to serve as a comparison tool. The amount of time a borrower expects to keep a loan has no bearing on the borrower's ability to compare the APR on different loan offers. Furthermore, "concern about the effect of duration is largely irrelevant except for the most sophisticated shoppers."[22] If the Bureau wishes to further facilitate shopping for these financially sophisticated consumers, it could require creditors to provide an APR customized to a consumer's anticipated timeframe, upon request.[23]

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[18] *See* Renuart, *supra* note 7, at 188 n. 20 (describing this issue).
[19] Macro Int'l, Inc., Design and Testing of Effective Truth in Lending Disclosures 9, 26 (2007), *available at* www.federalreserve.gov/dcca/regulationz/20070523/Execsummary.pdf.
[20] 77 Fed. Reg. 51,116, 51,143 *et seq*. (Aug. 23, 2012).
[21] *See* III, *infra*.
[22] Renuart, *supra* note 7, at 188 n.20 (citation omitted).
[23] The APR for a 30 year loan could easily be recalculated for a shorter maturity date by recalculating the final payment at payoff as a balloon payment.

Consumer Comprehension: It does not matter whether consumers understand what goes into the APR or why it is different from the interest rate. What matters is that they can use it to make informed financial decisions. "Most of the U.S. population can compare two stated APRs."[24] As long as consumers can do that, they can use the APR to shop for the cheapest loan.

This particular criticism appears to be one of the major factors behind recent efforts to downplay the APR as a disclosure, but this concern is misplaced. Everyday life is filled with examples of how consumers can successfully use numbers without understanding their derivation.

- FM radio stations
- Light bulb wattage
- Shoe sizes
- Dress sizes
- Blood pressure measurements
- Gasoline octane
- Stock market indices (the Dow Jones Industrial Average or S&P 500)

Consumers routinely make appropriate use of these numbers without the faintest idea of what they mean or how they are calculated. We can look at a label and know whether clothing is our size. We can choose the gas we want by looking at the numbers labeling the pumps. We know a 100 watt bulb is brighter than one with 60 watts. While hardly anyone knows what units blood pressure is measured in, anyone who has visited a doctor knows lower is generally better. And that's all consumers need to know about the APR—lower is better.

4. Neither Prior Research nor the Bureau's Consumer Testing Justify Abandoning the APR

The Bureau has justified effectively abandoning the APR based on research showing consumers do not understand the APR. Whether a consumer understands the APR, however, is beside the point. All that matters is whether consumers can use it. The Bureau did not cite or conduct any studies focusing on the key question: Can the APR help consumers choose the least expensive loan?

Educational scholars have classified three levels of reading comprehension: literal, inferential, and critical comprehension.[25] The literal level is considered the lowest level of comprehension and involves only a basic recall of the facts presented in the text itself.[26] The next level requires orchestration and manipulation of information implied by the text and from the

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[24] Renuart, *supra* note 7, at 209 (extrapolating from research on quantitative literacy).
[25] Timothy Rasinski, *et al.*, Comprehension That Works: Taking Students Beyond Ordinary Understanding to Deep Comprehension 17 (2008); H. Herber, Teaching Reading in the Content Areas ch. 3 (1978).
[26] Rasinski, *supra*.

reader's own background knowledge.[27] The highest level requires greater skill and effort by the reader. Because the APR is intended to facilitate a straightforward comparison between loans without any calculations, a borrower need only look at the APR on one sheet of paper and determine whether it is higher or lower than another. This requires only two basic skills: literal comprehension (the ability to recall the APR), and the ability to count (to know if one number is higher than another). A fourth-grader could compare APRs. The Bureau has set the bar for APR comprehension unreasonably high, so it is not surprising that so few consumers have met it.

The Bureau should investigate a wide variety of methods for disclosing the APR. The Bureau should also investigate whether there are alternatives to the APR that would serve the same function but would be easier for consumers to understand. In contrast, the testing commissioned by the Bureau made only a minimal attempt to improve the APR disclosure. According to the testing report, four variations were used:

a. Annual Percentage Rate [__]% expresses interest and costs over 30 years[28]
b. Annual Percentage Rate (APR) [__]% Your interest combined with fees over 30 years as a yearly rate.[29]
c. Annual Percentage Rate (APR) [__]% This is not your interest rate. This rate expresses your costs over 30 years.[30]
d. Annual Percentage Rate (APR) [__]% This is not your interest rate. This rate expresses your costs over the loan term.[31]

Unfortunately, all four of these variations are relatively similar.[32] Worse, two are flawed by a focus on the differences between the APR and the interest rate, which few consumers understand and which are irrelevant to the core purpose of the disclosure. In contrast, the team drafting the proposed disclosure forms experimented with over 100 variations for the first page of the Loan Estimate.[33] We wish the same creativity had been applied to the APR disclosure.

The CFPB is the most innovative regulatory agency in the federal government. We encourage the Bureau to try new approaches to disclosing the APR rather than throwing in the towel so quickly.

5. The New Disclosures Are Not an Adequate Substitute for the APR

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[27] *Id.*
[28] Kleimann at B-2.
[29] *Id.* at D-2
[30] *Id.* at F-2.
[31] *Id.* at G-8.
[32] One consumer test participant is quoted as saying "I would need an explanation on what that APR rate is exactly because I wouldn't know if higher or lower is good or worse . . . ." Kleimann at 146. But there is no indication that the Bureau ever tested such an explanation as "lower is better."
[33] Kleimann at 41.

The Bureau's proposed disclosure form requires consumers to evaluate multiple price dimensions in order to compare loans. The first page of the form shows the interest rate, monthly payment, "cash to close" and, in smaller print, the total closing costs. On the third page of the Loan Estimate, the form lists several metrics. In addition to the APR, the numbers given include the Total Interest Payment (TIP), total of payments made after five years, and the total principal paid after five years. None of these disclosures, however, is an adequate substitute for the APR.

a. Kleimann's Conclusions Are Not Supported by the Details

The testing report repeatedly asserts that consumer participants were able to make "sophisticated trade-offs" based on these disclosures.[34] Such a conclusion, however, is not fully supported by the underlying details of the report. Instead, the report only shows that consumers recognize that such trade-offs may exist. Some of the participants also articulated a preference for certain terms (such as desiring a lower monthly payment or to preserve savings through a lower "cash to close").[35] But the report does not show that consumers can reliably quantify the impact of those trade-offs on the overall cost of the loan. Quotations from participants and other statements in the report suggest the participants struggled to boil down the various dimensions to a useful conclusion—something the APR is designed to do.

One participant is quoted as saying "Although, this [loan] has more closing costs, after multiplying the amount times 30 years, it's going to be better for me. The amount is going to be less."[36]

Another participant said "You would have to think about closing costs as a one-time fee, and that is great. . . . . But I think life of the loan. . . . . The life of the loan is the same and, yes, the interest rate is lower. So in the long run I am paying less on this loan than I am on this loan [Pecan] even with a $5,000 closing costs."[37]

These consumers are trying juggle—in their heads—the impact of the closing costs, interest rate, and loan term on the total cost of the loan. It is likely beyond the capacity of many consumers to juggle these factors accurately.

Elsewhere, the report states: "Many participants were acutely aware of the trade-offs across the cash needed to close, the interest rate, and the monthly loan payment. When they chose the higher interest rate, they understood it would result in a higher monthly payment. They made this choice, however, because they knew they did not have access to the cash needed to close on a loan with a lower rate and payment. Conversely, other participants were willing to pay the higher closing costs in order to lower the monthly payment."[38]

In both of these cases, the choices described are not so much a sophisticated calculus as a short-term and shorthand assessment of their financial situation. If consumers have sufficient cash

[34] *See* Kleimann at 78, 79, 93, 137, 277, 279.
[35] While these preferences may be valid based on a borrower's personal situation, they are different considerations from whether one loan is better than another in terms of the overall cost of credit.
[36] Kleimann at 79.
[37] *Id.* at 120.
[38] *Id.* at 279.

on hand, they generally prefer the loan with the lower monthly payment; if they don't have sufficient cash on hand, they will accept the costs of a higher loan. Those higher costs, and higher payments, are in the future, after all. Consumers default to short-term gratification,[39] based in part on overconfidence about the future;[40] effective disclosures remind consumers of the long-term costs and real risks of short-term gratification. Implicitly, the Bureau's testing accepts consumer focus on short-term gratification rather than long-term financial health. This is the reverse result of what we need disclosures to do.

Worse, these assumptions will not necessarily apply to every loan. The relationship between the monthly payment and the cash to close is scattershot, not linear or even hyperbolic. The amount of cash needed to close is not the same as "closing costs" because the amount of cash to close may be influenced by the size of the buyer's deposit or cash down payment or by the amount of closing costs being financed. Paying higher closing costs does not automatically lower the monthly payment: higher closing costs may result from additional finance charges other than discount points.[41] While participants may have been aware that there is sometimes a trade-off among these things, that does not mean they can correctly calculate the trade-off or identify when the trade-off is a good one. The APR is designed to simplify that determination by reducing many of these trade-offs to a single number.[42]

Research on quantitative literacy suggests that a significant number of consumers using the proposed disclosures would not be able to identify the most economical loan from among competing loan offers. The available research suggests some consumers would try to compare the loans by evaluating two, three or maybe all of the variables—and would likely end up paying more than consumers who focused on only one variable.[43] Other consumers would simplify the decision

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[39] *See* Ren S. Essene & William Apgar, Joint Ctr. for Housing Studies, Harvard Univ., Understanding Mortgage Market Behavior: Creating Good Mortgage Options for All Americans 20 (2007) (noting that consumers are willing to accept the future risk of higher monthly payments in exchange for a lower payment or lower closing costs now).

[40] Jason J. Kilborn, *Behavioral Economics, Overindebtedness & Comparative Consumer Bankruptcy: Searching for Causes and Evaluating Solutions*, 22 Emory Bankr. Dev. J. 13, 18-19 (2005) (discussing the overconfidence bias in the context of consumer credit); Oren Bar-Gill, *Seduction by Plastic*, 98 Nw. U. L. Rev. 1373, 1375-76 (2004) (discussing the overconfidence bias in the context of consumer credit). This propensity toward optimism is not limited to consumers. For example, at President Herbert Hoover's inaugural address on March 4, 1929, seven months before the stock market crash, he proclaimed: "I have no fears for the future of our country. It is bright with hope." Another example would be the Federal Reserve Board's assurance that mortgage lenders were appropriately managing the risks associated with subprime lending up until the rapid decline in the housing market in 2007. *See, e.g.*, Alan Greenspan, Chairman, Fed. Reserve Bd. of Governors, Remarks at the Credit Union National Association 2004 Governmental Affairs Conference: Understanding Household Debt Obligations (Feb. 23, 2004) ("The ability of lending institutions to manage the risks associated with mortgages that have high loan-to-value ratios seems to have improved markedly over the past decade . . . ."). Consumers (and others) may well have reason to believe that they will perform better in the future than they have in the past; such a belief is not by itself irrational. *See, e.g.*, Leda Cosmides & John Tooby, *Are Humans Good Intuitive Statisticians After All? Rethinking Some Conclusions from the Literature on Judgment Under Uncertainty*, 58 Cognition 1, 10-20 (1996) (discussing data that show that individuals' overconfidence in areas of special knowledge is sometimes justified). Indeed, it may be highly adaptive. Colin Camerer & Dan Lovallo, *Overconfidence and Excess Entry: An Experimental Approach*, 89 Am. Econ. Rev. 306, 306 n.1 (1999). Nonetheless, the failure of consumers to allow for the possibility that they might be acting irrationally can and does get them into trouble.

[41] Such as a higher broker's fee or junk fees.

[42] *See* II.B.1.

[43] Susan E. Woodward, Consumer Confusion in the Mortgage Market 2 (July 14, 2003) (unpublished manuscript), *available at* www.sandhillecon.com/pdf/consumer_confusion.pdf (last viewed Mar. 19, 2007) ("Borrowers attempting more difficult shopping strategies that involve a tradeoff of rates and points pay higher fees on average than borrowers who roll closing costs into the interest rate and thus can shop on the basis of rate alone.")

by ignoring some variables and by approximating what is too difficult to calculate.[44] Some borrowers would inevitably focus on the rate, others the monthly payment, and some would look at the cash to close. However, the only reliable way to decide which loan is the most economical, without extensive calculations, is to know the APR for each loan.

Consumers may well wish to pay more for a loan that lets them retain cash savings or may be willing to trade a lower monthly payment for higher upfront costs, but they should know the rough cost of those choices to their long term financial health. The Bureau proposes to bury this information where few consumers will see it.[45]

b. The Interest Rate Disclosure Is Ambiguous, Easily Manipulated, and Omits Prepaid Finance Charges

The contract interest rate is one of the most prominent disclosures on the proposed forms. Displayed in a large font on the first page, borrowers cannot avoid noticing it. As a result, it will almost certainly have an impact on the borrower's opinion of an offer. This is unfortunate because it is also one of the most easily manipulated and least understood numbers in a loan contract.

The contract interest rate is only part of the cost of credit. Although we are pleased that the proposed regulations require disclosure of the fully-indexed interest rate for ARMs, that is not enough to eliminate problems with making the interest rate such a prominent disclosure. Origination fees and other closing costs add thousands of dollars to the cost of borrowing money and must be factored into the selection of a loan. Yet, by emphasizing the interest rate instead of the APR, the Bureau is emphasizing only one piece of this important equation. Replacing the APR with the interest rate will encourage the market trend toward shifting the cost of credit from the interest rate to prepaid finance charges, where they are invisible to many homeowners.

The interest rate disclosure is also ambiguous because interest can be calculated in different ways: simple interest, add-on interest, and discount interest.[46] Interest can also be calculated over different time periods. So a disclosed rate could be annual or monthly. This means the disclosed interest rate on one loan may not be comparable to other loans. TILA requires use of the APR specifically to provide an apples-to-apples comparison. While the majority of contracts currently reflect the annual rate, usually calculated with the simple interest method, a disclosure form that highlights the contract interest rate rather than the APR will reward deceptive lenders who use other methods. This risk will be even greater in the fringe market, such as for home-improvement loans. But mandating use of the annual, actuarial rate would only be a partial solution because the interest rate does not take into account the cost of prepaid finance charges.

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[44] Oren Bar-Gill, *The Law, Economics and Psychology of Subprime Mortgage Contracts*, 94 Cornell L.R. 1073, 1122 (2009).

[45] The Bureau further diminishes the utility of the APR disclosure by putting it next to the Total Interest Percentage (TIP) disclosure, which will always be dramatically higher than the APR. As a result, the APR will look deceptively low by comparison. The decision to juxtapose the APR and the TIP is one that would delight most bank marketing departments.

[46] National Consumer Law Center, The Cost of Credit: Regulation, Preemption, and Industry Abuses § 4.3 (4th ed. 2009 and Supp.).

The rules governing the interest rate disclosure in the Loan Terms section is also inadequate for certain types of loans. For ARMs, step-rate loans, and loans for which the rate could change for any other reason,[47] proposed Reg. Z § 1026.37(b)(2) requires stating a single number for the interest rate. At first glance, this number would appear the same as the disclosure for a fixed-rate loan.[48] Although the proposed regulations also require the disclosure to state nearby that the rate may change, along with the maximum rate,[49] the maximum rate will appear in smaller text and could be overlooked. Instead, the rate disclosed pursuant to paragraph (b)(2) should also state the maximum rate as prominently as the fully-indexed rate.

A recent study of mortgage loan disclosures demonstrated that consumers may overlook the proposed disclosure of rate adjustments due to the phenomenon of confirmation bias.[50] In this context, confirmation biases may occur when "individuals skim through documents seeking to confirm the truth of what they are told ("Your loan is at 4%"), and fail to skim the document to determine if this statement is false (i.e., that the loan may start at 4% but that it can increase to as high as 8%)."[51] The study found that a well-designed disclosure can help overcome confirmation biases. While the study suggested that the proposed CFPB forms would lower confirmation biases,[52] this area of the form could be improved further. This is particularly so in regard to preferential rates and rate discounts.[53] The proposed rules would not require these terms to be disclosed in the "Loan Terms" section of the form.[54]

c. The TIP and "In 5 Years" Comparisons Do Not Include Closing Costs

The proposed forms include two new disclosures: the Total Interest Percentage and the total of payments at five years. While the latter may be better aligned with how long most borrowers keep their loans, and while test participants like the TIP, neither conveys useful information about the impact of prepaid finance charges. The "In 5 Years" disclosure is dependent on the amount borrowed so loans of different sizes cannot be compared, even if the rates are the

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47 Such as preferential rates for lender employees, rate discounts for timely payments, and discounts to borrowers who sign-up to make payment via automatic electronic transfer.

48 For example, a loan with a fixed-rate of 5% and an ARM having a fully-indexed rate of 5% would both show "5%" as the disclosed rate.

49 Proposed Reg. Z § 1026.37(b)(6)(ii).

50 *See* Debra Pogrund Stark, Jessica M. Choplin, and Mark A. LeBoeuf, *Ineffective In Any Form: Confirmation Biases And Other Psychological Phenomena Undermine Improved Home Loan Disclosures*, Yale L.J. Online (forthcoming).

51 *Id.*

52 *Id.* ("The combined disclosure form proposed by the CFPB is an improvement in that contains both the adjusted rate and monthly payment figures right next to the initial figures and one would expect lower confirmation biases with the new combined form.").

53 Disclosures based on some rate discounts can be highly deceptive, especially rate discounts for timely payments. Because the borrower is required to pay on-time, the creditor is currently allowed to disclose the discount rate based on the assumption that the consumer will earn it. But this creates a back-door to a penalty rate when the consumer makes a late payment. In subprime loans, this is particularly unfair because the creditor often knows that late payments are more likely (either due to the borrower's credit score or the structure of the loan).

54 *See* Proposed Official Interpretation § 1026.17(c)(1)-1 (requiring disclosures to reflect assumption that consumer will abide by the terms of the contract).

same. Both measurements also depend on whether the closing costs are financed, so two loans with identical rates and net proceeds will produce different disclosures if one finances the closing costs and the other does not. Even more problematic is that two loans with the same interest rate and the same principal amount will look the same in these disclosures even if one lender finances substantial closing costs and the other lender charges substantially lower costs (financed or not). While these disclosures convey useful information, they do not help the borrower differentiate between high-cost and low-cost loans.

C. The Bureau Should Require an APR or Interest Rate Comparison Graph

One more way of addressing consumer difficulty with understanding the APR is to disclose it in a way that provides a context for understanding whether the APR on any given loan is good or bad in relation to commonly understood markers. The FRB in August 2009 proposed disclosing the APR on a graph that would compare the disclosed loan to higher rate and prime rate loans. We were disappointed to see that the Bureau has not included this graph on any of the proposed model forms. The effectiveness of such a disclosure has not been adequately tested.[55]

The graph appeared to be a significant improvement for all the reasons described in the FRB's description of the proposal. It alerts consumers to where the pending loan offer fits in relation to other rates available in the market. For consumers who have not adequately shopped for credit, this may encourage the consumer to shop elsewhere or to ask the creditor for a better rate. It also accommodates different learning styles and is likely to help attract the consumer's attention to the importance of the APR.[56] Showing the APR in context could reinforce the concept that a lower APR is better for the consumer.

The mortgage industry reportedly objected that the graph would be misleading because borrowers might not be qualified for the prime rates shown on the left end of the graph, because Freddie's Primary Mortgage Market Survey (PMMS) did not include the same finance charges as the APR, and because they thought it would be technically difficult to produce the graph. None of these objections are valid reasons for omitting the graph.

- Consumers who are not eligible for a better rate—whether due to poor credit or aspects of the loan they have requested—will not know unless they ask. The prevalence of steering creditworthy customers to subprime loans in the years leading up to the crash should be reason enough to require an objective disclosure of the loan pricing.[57] Indeed, consumers in underserved markets, primarily in communities of color, typically underestimate their creditworthiness and assume that the creditor has provided them the best loan for which

[55] Although there have been rumors that the graph was misinterpreted by consumers in tests, we have not been able to identify any documentation of those results.
[56] *See* Kleimann at 7 ("Both our experience and the research show that consumers, whether highly literate or not, can better use information that combines visuals with words.").
[57] *See generally* National Consumer Law Center, The Cost of Credit: Regulation, Preemption, and Industry Abuses § 11.3.3 (4th ed. 2009 and Supp.).

they are eligible.[58] In addition, creditors routinely advertise rates that are only available to highly qualified borrowers, so they already expose their customers to rates for which they may not be qualified.

- Even though the APR/PMMS comparison is not a perfect one, all loans will be subject to the same comparison, putting all creditors on a level playing field. But, even if the APR/PMMS objection was more serious, there are alternative solutions. For example, the Bureau could use data from the recently announced National Mortgage Database[59] to collect APR data on prime loans and use that instead of the PMMS.
- Concerns about technical difficulties could be resolved by allowing a long implementation period.[60]

D. The Bureau Should Eliminate the Provisions Addressing Preliminary Written Estimates/Worksheets Not Subject to the Good Faith Requirements and Require Anyone Using the Proposed Loan Estimate or Closing Disclosure to Follow the Good-Faith and Timing Rules

As proposed, a creditor could use the proposed Loan Estimate form to give consumers a non-binding, preliminary written estimate of loan terms—as long as the creditor added a brief disclaimer to the top of the form.[61] This preliminary estimate would be little more than advertising and would not be subject to any good faith requirement under TILA or RESPA.[62] The proposed regulation only specifies the language and font size of the disclaimer[63] and that it be "clearly and conspicuously state[d] at the top of the front of the first page[.]" The proposed model disclaimer in the appendix is somewhat more prominent,[64] and the appendix includes "an example" of the disclaimer on a form that uses the heading "Worksheet" rather than "Loan Estimate."[65] But it appears that creditors would not be required to use the more prominent format or "worksheet" heading. We urge the Bureau to change this proposal because the disclaimer would be woefully inadequate to protect consumers from confusion and abuse.

The Bureau clearly recognizes, and states in the Federal Register, that consumers could confuse a preliminary estimate with the official disclosures subject to TILA and RESPA's good faith requirements.[66] The Bureau also expresses "concern[] that unscrupulous creditors may use formatting and language similar to the [official] disclosures" to deceive consumers.[67]

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[58] *See generally* National Consumer Law Center, The Cost of Credit: Regulation, Preemption, and Industry Abuses § 11.2 (4th ed. 2009 and Supp.).
[59] CFPB Press Release, Federal Housing Finance Agency and Consumer Financial Protection Bureau to Partner on Development of National Mortgage Database (Nov. 1, 2012).
[60] Or the Bureau could invite the public to invent an effective solution on Challenge.gov.
[61] *See* Proposed Reg. Z § 1026.19(e)(2)(ii); 77 Fed. Reg. at 51164 (supplementary information), 51,402 (proposed model disclaimer H-26(A) and (B)).
[62] *See* 77 Fed. Reg. at 51164.
[63] 12-point minimum.
[64] Proposed Appendix H-26(A) (printed in white letters on a black background).
[65] Proposed Appendix H-26(B).
[66] *See* 77 Fed. Reg. at 51164 (discussing risks).
[67] *Id.*

In addition, consumer testing proves that the proposed disclaimer and sample form are woefully inadequate. Kleimann tested two versions of the preliminary estimate using functionally similar disclaimer language and appearance on a version of the Loan Estimate form (but without the "loan estimate" or "worksheet" heading).[68] In reporting on the test results, Kleimann (referring to the disclaimer as a "label") stated:

> None of the consumer participants noticed the label when initially viewing either [version of the] worksheet. In fact, consumer participants read right over it—going straight into the details without even looking at the label. Therefore, they had no way of comprehending from the disclaimer that the sheet was a worksheet example rather than a Loan Estimate. . . . . Since no consumer participants independently noticed the label in either option without prompting from the moderator, the label should be redesigned to be more noticeable.[69]

These were among the clearest results in the report, yet the proposed disclaimer samples in the appendix are only modestly more noticeable than what Kleimann tested and a disclaimer meeting the minimum requirements in the proposed regulation would be less noticeable.

Preliminary written estimates, as envisioned by the proposed regulation, are dangerous because they would be more than simple direct mail. Instead, they would be provided in response to a specific borrower's request for loan terms. For that reason, consumers would inevitably believe the offer to be personalized for them. Creditors could bait consumers with tempting loan offers, thereby discouraging consumers from shopping elsewhere until they received the binding disclosures. By that time, however, consumers would be closer to their personal deadlines for obtaining a loan and would be less likely to search elsewhere. Furthermore, the mere inclusion of a regulation expressly permitting pre-application, non-binding estimates will send the message that the Bureau condones a practice (non-binding estimates) that has been used for deception.

We urge the Bureau to delete all reference to this preliminary estimate from the proposed regulations and appendices. Instead, the Bureau should require a much clearer and strong disclaimer on all advertising material. In addition, the Bureau should adopt a rule stating that any creditor or broker using the Loan Estimate or Closing Disclosure forms (or anything substantially similar) will be bound by the regulations related to those forms (including the good faith and timing requirements), even if the creditor or broker was not otherwise required to use them.

E. The Disclosures for "Cash to Close," "Closing Costs Financed," and "Funds for Borrower" Should All Be Revised

The proposed model forms would have two new disclosures: "Cash to Close" and "Closing Costs Financed (included in loan amount)." The forms will also disclose the amount of funds

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[68] *See* Kleimann at J-15 and J-16.
[69] *Id.* at 194.

disbursed to the borrower, like the current HUD-1. We agree that these disclosures are useful, but as currently proposed, these disclosures are flawed in numerous ways. Some of them will be confusing and misleading under certain circumstances while others are also insufficiently prominent. Accordingly, they should be redesigned.

1. Remove "Cash to Close" from the First Page Because It Will Distract Consumers from More Important Information

The Bureau proposes to disclose the amount of cash needed to close in large type at the bottom of the first page. This disclosure is far more clear and conspicuous than any of the disclosures mandated by TILA. But, in terms of evaluating the cost of the credit, it is irrelevant. Worse, its placement may encourage consumers who would not otherwise do so to rely on it in choosing between loans.

Yes, consumers do need to know the cash they need to bring to closing. And, as discussed in the Bureau's testing, some consumers choose their loans on that basis. But no financial literacy expert would encourage consumers to decide between two different 30-year loans based on a difference of even a few thousand dollars in closing costs.

The closing costs are likely to be particularly appealing to consumers because they are expressed in dollars, not percentages.[70] This is a concrete disclosure, underlined by the words: "Cash to Close" has an immediacy to it that little else on the disclosure form has. And the numbers are small enough that they are understandable. Large numbers lose their reality, by contrast.

The Cash to Close disclosure should not be on the front page of the loan estimate. Its placement suggests that the CFPB believes consumers should shop for a loan based on the cash to close. This is the opposite of a financially sophisticated analysis of tradeoffs. Moving Cash to Close off the first page will signal that, while it is an important and useful piece of information, it is not one of the key price points for a loan. Consumers for whom the amount of cash to close is determinative can still find the information on the second page, but consumers who are positioned to take a long-term view of their financial health will be less distracted by the short-term loss of the cash needed to close.

2. Do Not Use Negative Numbers

As proposed, when a borrower finances any portion of the closing costs in a transaction or is to receive funds from a transaction, the Closing Costs Financed and Funds for Borrower would be disclosed as negative numbers.[71] The Cash to Close amount will be negative in any transaction in

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70*See, e.g.,* Lauren E. Willis, *Decisionmaking and the Limits of Disclosure: The Problem of Predatory Lending: Price*, 65 Md. L. Rev. 707, 781-82 (2006).

[71] Proposed Reg. Z § 1026.37(h)(2), (h)(5)(ii). *See, e.g.*, 77 Fed. Reg. at 51,377 (page 3 of sample Closing Disclosure with −$2,453.92 Funds for Borrower and statement that "After the disbursements . . ., the funds available to you have increased"). In addition to problems consumers have understanding negative numbers, the statement accompanying the amount is also confusing. If the funds available have increased, why is the amount of funds a negative number? *See also*

which the borrower can expect to go home with a check in her pocket, such as when the loan amount exceeds the total closing costs plus all other disbursements[72] or when the borrower finances all of the closing costs and the loan amount exceeds all other disbursements.

Disclosing these amounts as negative numbers is a bad idea, however, because negative numbers are likely to confuse borrowers.

> Negative numbers do not have a natural intuitive basis, and understanding negative numbers relies more on explicit training than on an automatic cognitive process. The key difference [in comprehension of negative and positive numbers] is that the comprehension of positive numbers is more likely to be [an] effortless cognitive process . . . .[73]

What this means in practice is, even though disclosing sums as negative numbers may be correct as a bookkeeping matter, such a disclosure is likely to confuse the typical consumer.

The amount of closing costs financed and the amount of funds the borrower will receive should also be more conspicuous. The net proceeds of a home equity loan or refinancing transaction is very important to the borrower. For many borrowers, the entire transaction is pointless unless the net proceeds will meet the borrower's needs. The amount of closing costs to be financed is related to the net proceeds of the loan and has a direct bearing on whether the transaction is advisable. Financing closing costs affects the loan-to-value ratio, consumes equity, may lead the creditor to require mortgage insurance, or may result in a higher interest rate. The net proceeds and amount of financed closing costs are important figures that should be more clearly and prominently disclosed.

We recommend two methods of fixing these disclosures. First, whenever the Cash to Close would be a negative amount (indicating that the consumer will receive cash from the transaction), the amount should be disclosed as a positive number and the "Cash to Close" label should be replaced with one stating "Cash to Borrower."[74] Second, the "Calculating Cash to Close" table should be modified to eliminate the need for negative numbers and to display the "Closing costs financed" and "Funds for Borrower" more conspicuously than the other data in the table. We include an example below:

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77 Fed. Reg. at 51,387 (closing costs financed in amount of −$4,500). The proposed appendix does not include a sample with a negative Cash to Close.

72 Loan proceeds used to satisfy debts other than closing costs, such as to pay-off existing mortgages or to consolidate debts, would be listed as "Disbursements to Others" and would be deducted from the loan proceeds before calculating the "Funds for Borrower." *See, e.g.*, 77 Fed. Reg. at 51377 (Model Form H-25(E)).

73 Richard Curten, The Impact of Economic Crisis on Consumers' Knowledge about Economic Statistics at 3 (Oct. 2010) (paper for 30th CIRET Conference), *citing* Stanislas Dehaene, The Number Sense: How the Mind Creates Mathematics (1997) *available at* https://www.ciret.org/conferences/newyork_2010/papers/upload/p_16-231516.pdf (last viewed Nov. 5, 2012).

74 The proposed model form H-25(D) says "Cash To Borrower" but proposed Reg. § 1026.37(h)(5) says "Funds for Borrower." The former will be easier for consumers to understand. In addition the word "for" is more likely to be confused with "from" than the word "to."

Calculating Cash to Close			
	Estimate	**Final**	**Did this change?**
Total Closing Costs (J)	$6,145	$7,145	YES • See Total Loan Costs...
Subtract			
Closing Costs Paid Before Closing	$0	$40	YES • You paid these costs...
Closing Costs Financed (included in loan amount)	**$6,145**	**$7,105**	YES • You included these Closing Costs in your Loan Amount, which **increased your Loan Amount**
Down payment/Funds from Borrower	$0	$0	NO
Funds for Borrower	$3,000	$3,000	NO
Leaving			
Cash to Borrower[75]	**$3,000**	**$3,000**	NO

We have additional concerns about the placement and prominence of the Cash to Close disclosure, which we discuss above.[76]

3. "Calculating Cash to Close" in Model Form H-25(E) Is Confusing

The "Calculating Cash to Close" example in proposed Model Form H-25(E) is confusing because it can be interpreted as showing a cash disbursement to the borrower even though the borrower must also pay cash at the closing. The table is also confusing because it shows $0 of closing costs financed, even though closer analysis of the transaction shows the borrower is financing thousands of dollars in closing costs.

The "Final" column of the table shows $0 for "Closing Costs Financed;" $2,453 for "Funds for Borrower;" and $4,925 for "Cash to Close." But, if the borrower must pay $4,925 in cash at closing, that means the $2,453 received by the borrower must be handed back to the settlement agent. In practice, this means the borrower is financing $2,453 of the closing costs and will not receive any cash at closing.

[75] The extra white space surrounding "Cash to Borrower" and "Closing Costs Financed" is intentional and will make these disclosures more prominent than they otherwise would be.
[76] *See* II.E.1.

What ***really*** happens in this transaction:	
Money loaned to borrower	$121,000.00
Total closing costs	$7,419.48
Closing costs POC	$40.00
Net closing costs owed by borrower	$7,397.48
What borrower does with the loan proceeds:	
Pays-off old mortgage	$118,546.18
Pays part of closing costs owed	$2,453.82
Balance remaining of loan amount	$0
Closing costs still owed by borrower (to be paid in cash at closing)	$4,925.86
Cash borrower receives at closing	$0

Even if the "Calculating Cash to Close" table on the Closing Disclosure is only intended to show what has changed from the Loan Estimate, it is, nevertheless, inaccurate and confusing. As the above analysis of the example in Model H-25(E) shows, the amount of closing costs financed has gone up between the estimate and final while the amount of funds to the borrower has not. This example could lead creditors to produce confusing and (whether intentionally or not) deceptive disclosures. It should be fixed to reflect the outcome of the transaction from the consumer's perspective.

The entry for "Closing Costs Paid Before Closing" is also a problem. It shows $0 paid in the "Estimate" column and $40 paid in the "Final" column. Then, confusingly, the "Did this change?" column says "You paid these costs **before closing**." While it may be possible that the consumer paid the $40 fee after the estimate was issued, it is also likely that this disclosure is the result of proposed Reg. Z § 1026.38(i)(2)(i)—which mandates disclosing $0 in the estimate column for this row. According to the commentary, this is so because "an estimate of such amount is not disclosed on the Loan Estimate."[77]

Clause § 1026.38(i)(2)(i), therefore, poses a problem because creditors are allowed to charge consumers a credit report fee before issuing the Loan Estimate.[78] If a creditor does so, a Closing Disclosure that says $0 in the estimate of "Closing Costs Paid Before Closing" will be boldly wrong. The rule is currently drafted in a manner that puts form over substance. It should be revised.

F. Allow Settlement Agents to Provide the Closing Disclosure (Alternative 2)

[77] Proposed Official Interpretation § 1026.38(i)(2)(i)-1.
[78] 77 Fed. Reg. at 51117; Proposed Reg. Z § 1026.19(e)(2)(i).

The Bureau has raised two alternatives for proposed Reg. Z § 1026.19(f)(1), regarding who may provide the consumer with the Closing Disclosure. The only difference we have identified between the two alternatives is that the second one allows a settlement agent to provide the disclosures, so long as the agent complies with all requirements of paragraph (f) "as if it were the creditor."[79] We recommend that the Bureau adopt this second alternative. This will provide creditors with the flexibility to delegate this responsibility to settlement agents and codifies what is largely already industry practice.

Crucial to our support for this alternative, however, is the provision stating that the "creditor shall ensure that disclosures are provided in accordance with the requirements of . . . paragraph (f)."[80] We interpret this provision as meaning the creditor remains responsible for providing the required disclosures to the same extent as if the creditor had not delegated the responsibility to the settlement agent. Such a bright-line rule for responsibility will simplify enforcement of the rule and will avoid confusion between the lender and other parties to a closing. This will encourage the lender to ensure that the task is done properly by ensuring that someone is clearly accountable for errors. Lenders can adequately protect themselves from settlement agent mistakes by negotiating indemnification agreements with agents and by adopting business procedures that provide sufficient supervision.

G. The Consumer Must Receive a Closing Disclosure Reflecting the Actual Terms of the Transaction at Least Three Business Days before Consummation

We support the proposed rule requiring creditors to ensure that consumers receive a Closing Disclosure reflecting the actual terms of the transaction at least three business days before consummation.[81] It is especially important that the exceptions to this rule are limited.[82] We support the listed exceptions but recommend that one be fine-tuned to avoid abuse.

Clause 19(f)(2)(iv) provides an exception to the revised-disclosure rule for "non-numeric clerical errors, provided the creditor delivers revised disclosures as soon as reasonably practicable and no later than 30 days after consummation." The commentary elaborates, saying "[a]n error is considered clerical if it does not affect a numerical disclosure and does not affect requirements imposed by § 1026.19(e) or (f)."[83] One of these requirements is, for example, to provide consumers with "the disclosures in § 1026.38 reflecting the actual terms of the transaction."[84] The exception for clerical errors is only appropriate if the commentary can be interpreted as excluding from the definition of clerical error any error regarding the "actual terms of the transaction.[85] To clarify this,

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[79] Proposed Reg. Z § 1026.19(f)(1)(v).
[80] *Id.*
[81] Proposed Reg. Z § 1026.19(f)(1)(i)-(ii).
[82] Proposed Reg. Z § 1026.19(f)(2).
[83] Proposed Official Interpretation § 1026.19(f)(2)(iv)-1.
[84] Proposed Reg. Z § 1026.19(f)(1)(i).
[85] For example, if a creditor accidentally types "Yes" to indicate that the creditor will escrow for property taxes when it will not that should not be covered by the clerical exception. The potential for harm to the consumer is too great.

the Bureau should add to the commentary an example of a non-numeric error that would not be considered "clerical" and that would require redisclosure at least three business days before consummation.

In addition, even for bona fide clerical errors, the creditor should be required to provide the revised disclosure no later than consummation if the creditor discovers the need for a correction by that time.

H. Refunds for Exceeding the Good Faith Tolerance Should Be Applied to the Loan Principal

Under proposed § 1026.19(f)(v) creditors must refund any amount paid by a consumer that exceeds the good faith estimated closing costs. Neither the regulation nor the commentary, however, specifies how the refund should be made. The Bureau should add a requirement specifying that, whenever a consumer finances any closing costs, the creditor must apply any refund as a credit against the principal balance of the loan, up to the amount of closing costs financed. This is necessary because, if the creditor issues a cash refund, the consumer will continue paying interest on the financed closing costs. This will unfairly benefit creditors who exceed the tolerance for good faith estimates. For example, if a borrower finances $100 of closing costs in a 30-year mortgage having an 8% fixed annual rate, and the creditor sends the consumer $100 refund check, the creditor will still earn $240 on that refund over the life of the loan unless the borrower sends an extra $100 payment to her mortgage servicer. The typical borrower is unlikely to realize she must use the refund check to pay down the loan to avoid being charged excess interest.

I. Require Use of the Model Forms under RESPA and Set Strict Standards under TILA

We support the Bureau's proposal to require creditors to use standardized model forms. The Bureau has gone to great lengths to develop forms that adequately disclose important information. The final versions will reflect the Bureau's careful testing and development of the language used in the disclosures as well as their appearance. It would be a mistake to then allow creditors to cherry-pick the parts of the forms they wished to use, or to use an entirely different form.

Creditors have an incentive to disclose loan terms in a manner that encourages consumers to overlook or misinterpret information that does not favor the lender. Creditors, in fact, spend a great deal of time and energy in figuring out how to market their products in a way that, if not deceptive, at least puts their products in the most favorable light.[86] Allowing creditors to deviate from carefully developed model forms allows creditors to abuse disclosure to mislead consumers and invite litigation.

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[86] *Cf.* Max H. Bazerman, *Consumer Research for Consumers*, 27 J. Consumer Res. 499, 502 (2001) (discussing systematic marketing to consumers' biases in the sale of mutual funds).

Though 15 U.S.C. § 1604(b) prevents the Bureau from requiring use of the model forms under TILA, we support the Bureau's proposal to mandate use of the forms for all federally related mortgage loans, as defined in Regulation X.[87] We also support the proposal to require all other mortgages subject to Regulation Z to use forms that are substantially similar.[88] The commentary to the rule for non-federally related mortgage loans makes clear that even mortgages that are subject to TILA but not RESPA must use forms that are functionally similar and just as clear as the proposed model forms.[89] This is especially important for disclosures that are particularly sensitive to format or terminology.

Mandating uniformity will produce many benefits. If the format is uniform it means that, as consumers gain experience with the new disclosures, they will become more skilled at finding the information that is useful to them. A uniform format will also make it easier for consumers to make a head-to-head comparison of different loans, which may increase beneficial competition on loan terms.

Mandating the format of disclosures will also save time and money for creditors. The small category of loans subject to TILA but not subject to RESPA are likely to be made by small, fringe lenders who are less likely to attract the attention of regulators. It is these creditors who are most likely to prey upon desperate borrowers. For that reason, the Bureau should leave them as little leeway as possible when designing their disclosure forms.

J. Replace the Definitions of "Business Day" with One That Makes Sense

The Bureau solicits comments regarding the definition of "business day" as used in Regulation Z.[90] Because the proposed regulations address the integration of TILA and RESPA, we believe it is appropriate to also offer comments regarding the definition of "business day" under Regulation X. Currently Regulations X and Regulation Z define "business day" in three different ways:

1. "*Business day* means a day on which the [creditor's offices] / [offices of the business entity][91] are open to the public for carrying on substantially all of its business functions." 12 C.F.R. § 1026.2(6); 12 C.F.R. § 1024.2.

2. "[F]or purposes of rescission under §§ 1026.15 and 1026.23, and for purposes of §§ 1026.19(a)(1)(ii), 1026.19(a)(2), 1026.31, and 1026.46(d)(4), the term means all calendar days except Sundays and the legal public holidays specified in 5 U.S.C. 6103(a), such as New Year's Day, the Birthday of Martin Luther King, Jr., Washington's Birthday, Memorial Day,

[87] Proposed Reg. Z §§ 1026.37(o)(3), 1026.38(t)(3).
[88] Proposed Reg. Z §§ 1026.37(o)(3)(ii).
[89] *See* Proposed Official Interpretation § 1026.37(o)(3)(ii)-1.
[90] 77 Fed. Reg. at 51,141.
[91] Regulation Z refers to the "creditor's offices" and Regulation X refers to the "offices of the business entity."

Independence Day, Labor Day, Columbus Day, Veterans Day, Thanksgiving Day, and Christmas Day." 12 C.F.R. § 1026.2(6)

3. "[T]he 'next business day' means the next day on which the creditor accepts or receives payments by mail." 12 C.F.R. § 1026.10(d) (1).

Using three different definitions for the same term in related transactions is a recipe for confusion and error. Even worse, all three of these definitions deviate from the commonly accepted meaning of the term "business day" in the United States.

The first and third definitions are subjective, will vary by entity, and can be changed without warning. Determining whether any given day qualifies as a "business day" under the first and third definitions requires inside knowledge of how a given business operates—knowledge that the typical consumer is unlikely to have.[92] The second definition is confusing and flawed because it includes Saturday as a business day—contrary to how laymen commonly use the term "business day." As a federal District Court judge observed "it would likely surprise the average person (it certainly surprised this judge) to learn that 'Saturday' is included within TILA's definition of a 'business day.' "[93]

The Bureau should replace all of these definitions with a single, standardized definition that follows the generally understood meaning of the term. Specifically, "business day" should be defined as: "every calendar day except Saturday, Sunday, or the legal public holidays specified in 5 U.S.C. 6103(a)." These changes will simplify compliance and training for businesses and will reduce the possibility of errors and litigation that arise from confusion over whether a particular day qualifies as a business day. While the change will also affect the duration of time periods described in the regulations affected (most likely by extending them by one day), the change will not have a significant impact and any detriment will be outweighed by the benefits.

K. Correct the Rules for Disclosing Maximum Possible Payment on Loans That Both Have an Adjustable Rate and Permit Negative Amortization

Although we are pleased that, as proposed and required under federal law, creditors are required to include the maximum possible payment in the Projected Payments table, the proposal has an error that should be fixed. The current draft includes two key requirements for calculating the maximum payment:

- For loans permitting negative amortization, the payment "disclosure should be based on the assumption that the consumer will make only the minimum payment required under the [contract;]"[94] and

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92 *See* Official Interpretation Reg. Z § 1026.2(a)(6)-1.
93 Aubin v. Residential Funding Co., L.L.C., 565 F. Supp. 2d 392, 397 (D. Conn. 2008).
94 Proposed Official Interpretation § 1026.37(c)(1)(i)(A)-2.

- For ARMs, the proposed rule states "the maximum payment amounts are determined by assuming that the interest rate in effect throughout the loan term is the maximum possible interest rate . . . ."[95] The commentary adds "the creditor assumes that the interest rate will rise as rapidly as possible after consummation . . . ."[96]

In a fixed-rate loan permitting negative amortization, the first requirement will produce the correct maximum payment and the second requirement will not apply. But in a loan to which both requirements will apply (such as a "payment option ARM" (POARM), the second requirement will produce a payment that is less than the maximum. As a result, it is impossible for creditors to comply with both of the two requirements listed above where the loan has an adjustable rate and permits negative amortization.

For ARMs permitting negative amortization, the maximum payment depends on the interplay between the permissible amount of negative amortization, the highest interest rate, and the latest date at which the payments become fully amortizing. For such loans, the maximum payment is triggered when the maximum interest rate is applied to the maximum loan balance for the shortest amortization period. This will happen when the onset of fully amortizing payments is delayed as long as possible, and—in contrast to Proposed Reg. Z § 1026.37(c)(1)(iii)—often results when the interest rate does not immediately go to the maximum rate possible. Indeed, for POARMs, borrowers will ultimately pay lower monthly payments if the interest rate goes quickly to the maximum possible—because of the impact of an extended amortization period.

Instead, for ARMs that permit negative amortization until a contract term triggers a switch to fully amortizing payments, the maximum payment should be calculated by applying the maximum interest rate to the maximum allowed principal balance for the minimum possible number of periodic payments that remain at the end of the time when non-amortizing payments are allowed. For example, assume a POARM has an original loan amount of $200,000, a minimum monthly payment of $690.24, an initial rate of 1.5% for the first payment, a maximum rate of 10.5%, and requires switching to fully amortizing payments at the earliest of reaching 115% of the original balance or 60 months.

A creditor following the proposed rule would calculate the maximum payment by assuming the rate adjusted to 10.5% at the first adjustment. Doing so, this loan would reach the maximum principal balance by the 26th payment, leaving 334 payments remaining to amortize the loan. The maximum payment on such a loan would be $2,118.04.

But the true maximum possible payment under the specified loan terms is $52.60 higher.

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[95] Proposed Reg. Z § 1026.37(c)(1)(iii).
[96] Proposed Official Interpretation § 1026.37(c)(1)(iii)-1.

This would occur under the terms of the note after the 60th payment if the interest rate rose to about 6.77% on the first adjustment and remained the same until the 61st month when it would adjust to the maximum rate of 10.5%. Applying these rates produces a principal balance of $229,896.21, or 114.948% of the original balance, after the 60th payment. That balance amortized over the remaining 300 months, at 10.5% interest, requires a monthly payment of $2,170.64.[97]

The Bureau's rules for calculating the maximum payment for negatively amortizing loans is incorrect, understates the potential risk for homeowners, and simplifies to the point of irrelevance the relationship between the interest rate, other loan terms, and the monthly payment. The difficulty of determining the borrower's maximum payment under a loan with negative amortization highlights the complexity of this loan product. As the Bureau itself states in the Federal Register, part of reason for the recent financial crisis was: "proliferation of more complex mortgage products with terms that were often difficult for consumers to understand. These products included most notably . . . Option ARM products."[98] This is why we have previously recommended banning loans that permit negative amortization, or at least prohibiting creditors from consummating any such loan unless the borrower has received housing counseling on whether it is suitable.

Additionally, given the critical importance of the maximum payment for consumers in evaluating the riskiness of their loans, we believe that this disclosure should be substituted for the monthly payment disclosure on the first page. Low initial monthly payments are often used to bait and switch consumers; most consumers need to know what their overall exposure is.

L. Strengthen and Clarify the Duty to Notify Applicants When an Application Is Denied Within Initial Three-Day Period

According to the proposed regulations, a creditor is not required to provide a Loan Estimate if the creditor denies the consumer's application within three business days of receiving the application or if the consumer withdraws the application.[99] However, the rule says nothing about whether the creditor must notify the consumer of the denial or confirm the withdrawal. The Bureau should require creditors to notify the consumer in writing of any denial by the same deadline for providing the Loan Estimate, along with the reason for denying the application. The Bureau should similarly require creditors to send a written confirmation whenever the creditor does not send a Loan Estimate because the consumer has withdrawn the application.

This requirement is necessary because, without it, creditors that neglect to send a timely Loan Estimate will have an incentive to evade liability by claiming that they denied the application within the initial 3-day period (or that the consumer withdrew it) and were, therefore, excused from sending the Loan Estimate. This requirement will also ensure that consumers understand why they

[97] (with a slight reduction for the 360th payment).
[98] 77 Fed. Reg. at 51118 (footnote omitted).
[99] Proposed Official Interpretation § 1026.19(e)(1)(iii)-3.

are not receiving the requested Loan Estimate while there is still an opportunity to correct errors or to apply elsewhere.

The information regarding any denied application should match the details required under the Fair Credit Reporting Act and the Equal Credit Opportunity Act. But the deadline for providing notice should be the same deadline as applies to the Loan Estimate. Otherwise, some consumers will inevitably delay applying elsewhere (or beginning the process of correcting errors on their credit report). Imposing this deadline on creditors is no more burdensome than meeting the deadline for sending a Loan Estimate and may even pose less of a burden because the denial notice or withdrawal/confirmation will require less detail than a Loan Estimate.

M. Require the Calculation of Estimated Property Taxes to Be Based on What the Homebuyer Will Pay, Rather Than What the Seller Is Paying

The proposed regulations require creditors to disclose the amount payable for estimated taxes, insurance, and assessments—"even if no escrow account for the payment of some or any of such charges will be established."[100] This is an extremely important disclosure that we strongly support. Without this information, it is very difficult to assess whether a transaction is affordable. In the past, the omission of this information has been used by disreputable creditors to deceive consumers into believing a new loan was more affordable than the consumer's existing loan or competing offers from more honest competitors.

But this requirement must be supplemented with an additional provision to ensure that the estimated tax information provided is accurate and reliable. Proposed Reg. Z § 1026.37(c)(5) addresses calculation of the estimated property taxes to be disclosed. The Bureau should add a clause to paragraph (5), or commentary, requiring creditors to calculate the estimated taxes based on what the consumer will pay after consummation. While this requirement may seem obvious, it has proven to be less so for home purchases and transactions involving significant construction or home improvements.

In many states, homeowners may be eligible for exemptions, abatements, or other factors that reduce what the homeowner must pay for property taxes.[101] Often, the creditor determines how much the buyer will pay in property taxes by obtaining information on what the seller is currently paying. If the buyer is not eligible for the credits or exemptions that the seller has, the property tax calculation will be too low and the buyer's escrow for taxes will be increased when the loan servicer does the first annual escrow assessment. This problem can be avoided, however, if the estimated property tax disclosure reflects the taxable assessed value of the property after consummation without any reductions for credits or exemptions. A similar problem arises with loans that fund construction that will increase the value of the property. The estimated property

[100] Proposed Reg. Z § 1026.37(c)(2)(iii) and (4)(ii).
[101] *See, e.g.*, Maryl. Dept. of Assessments and Taxation web site, Tax Credit Programs and Exemption Information, *available at* www.dat.state.md.us/sdatweb/taxcredits.html (last viewed Nov. 5, 2012).

taxes should be based on an assessment that takes into account any improvements financed by the creditor making the loan.

N. Require Creditors to State Whether Homeowner's Insurance Is Required

Proposed Reg. Z § 1026.37(m)(3) gives creditors the option of disclosing whether homeowner's insurance is required. This should be changed to mandate disclosure whenever homeowners insurance is required. Homeowner's insurance is a significant expense and, if it is required, the creditor should not be allowed to conceal that fact. Expressly giving creditors the option to conceal the fact that homeowner's insurance is a condition of the mortgage could result in the force-placement of costly lender-placed insurance and could also be a tactic used by deceptive creditors to make the total monthly cost of a mortgage appear less expensive. This is a simple, common-sense fix.

O. Delete Commentary Implying That the Unit-Period of Payments Does Not Affect the Substance or Clarity of the Disclosure

The proposed regulations and model forms use the word "monthly" to describe the frequency of loan payments. Proposed Reg. Z §§ 1026.37(o)(5) and .38(t)(5) instruct creditors to substitute the correct unit-period to describe payments whenever payments are scheduled for a different unit-period. The commentary to these sections, however, say this mandatory change "does not affect the substance [or] clarity" of the disclosure.[102]

This commentary is seriously flawed and must be deleted or changed. It appears to imply that a creditor will not bear any liability for disclosing the wrong unit-period of payments on a mortgage because the unit period does not affect the substance or clarity of the disclosure. It should be obvious that the unit-period of payments is extremely important. A loan disclosed has having payments of $1,000 per month is vastly different from a loan with payments of $1,000 per week. The unit period will be even more important under the proposed disclosures than it is under the current payment-schedule disclosure because there will be no other indication of how often payments will be required under the loan. The unit-period has substantial bearing on the substance and clarity of the disclosure and creditors must be liable for disclosing it incorrectly. If the intended meaning of the commentary is that modifying the disclosure to reflect the true unit period does not deprive the creditor of the safe harbor for using a model form, it should be much more clearly expressed.

P. Add a Sample Model Form for a Cash-Out Refinance or Home-Equity Loan

Currently all of the sample model forms have borrowers paying cash at the closing. In contrast, many borrowers refinance or obtain home-equity loans for the purpose of obtaining cash that they may use for a variety of purposes.[103] In such a transaction, the borrower typically finances

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[102] Proposed Official Interpretation §§ 1026.37(o)(5)-1, .38(t)(5)-1.
[103] *Cf.* 77 Fed. Reg. at 51119 (in 2011, 65% of mortgage transactions involved refinancing).

all of the closing costs. We recommend that the Bureau add a sample showing the proper method of disclosing such a transaction.

III. The All-In Finance Charge for Closed-End Real-Estate Secured Loans Is an Important Step Forward

A. Introduction

We are generally supportive of the all-in finance charge.[104] This is a long over-due step that should strengthen the Truth-in-Lending disclosure regime, improve consumer understanding of the cost of credit, and ease compliance burdens. The Bureau's bright-line inclusion of all real-estate related fees should dramatically simplify compliance and lower litigation costs, as well as provide consumers with better and more comparable pricing information.

We urge the Bureau in future rulemaking, to synchronize the finance charge definition for all credit—open-end and closed-end, mortgage and non-mortgage credit. The strength of an all-in finance charge is undercut by different definitions for different credit. Such variability complicates compliance and impedes comparison shopping. These divisions create new hurdles for compliance otherwise reduced by the move towards a more inclusive finance charge.

We note as well that the Bureau proposes to further undercut the utility of the all-in finance charge by burying the key disclosure of the cost of credit, the APR.[105] As we discuss elsewhere in these comments, the Bureau's proposed form makes it difficult for consumers to shop on the APR. TILA mandates that the APR be a tool for promoting competition and the informed used of credit.[106] Without effective disclosure of the APR, and with no disclosure of the total finance charge on the Loan Estimate form,[107] the Bureau is unlikely to achieve the great potential of the all-in finance charge as a tool to promote competition and the informed use of credit.[108] Congress mandated clear and conspicuous disclosure of the APR and the finance charge to achieve TILA's goals;[109] we are not persuaded that the Bureau is acting within its statutory authority in omitting (in the case of the finance charge) or obscuring (in the case of the APR) these key disclosures.

B. The Bureau's Proposal Should Restore Vitality to TILA's Disclosure Provisions in the Closed-End Mortgage Market

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[104] *See generally* National Consumer Law Center, National Association of Consumer Advocates, Consumer Federation of America, Consumer Action, National Fair Housing Alliance, and Center for Responsible Lending, Comments to the Federal Reserve Board, Docket No. R-1366 (Dec. 2009), http://www.nclc.org/images/pdf/foreclosure_mortgage/predatory_mortgage_lending/r-1366-with-app-dec09.pdf.

[105] *See* 77 Fed. Reg. 51,1116, 51,349 (Aug. 23, 2012).

[106] 15 U.S.C. § 1601(a).

[107] The finance charge is disclosed in type so small we have to take our glasses off to read it on page five of the Closing Disclosure. 77 Fed. Reg. 51,1116, 51,366 (Aug. 23, 2012). Any disclosure at closing, even if legible to younger borrowers (or those with better bifocals), comes too late for shopping purposes, as the CFPB's predecessor, the Federal Reserve Board, recognized. *See, e.g.,* 73 Fed. Reg. 1672, 1715-1716 (Jan. 9, 2008).

[108] 15 U.S.C. § 1601(a).

[109] 15 U.S.C. § 1632(a).

The Bureau's proposal is a dramatic reversal from decades of whittling away at the finance charge. Since TILA's brave beginning, when its authors hoped it would enhance competition in the marketplace and stabilize the national economy through disclosure,[110] both Congress and the Federal Reserve Board largely undercut TILA's key disclosures, the finance charge and annual percentage rate (APR), by providing creditors with an ever-increasing list of exceptions.[111] The numerous exceptions follow at best a Byzantine logic. These exceptions complicate creditors' compliance efforts, regulators' review, and homeowners' ability to make rational decisions. Failure to provide meaningful disclosure of the cost of credit may have played some role in the subprime mortgage debacle.[112]

The Bureau now proposes to largely undo the damage with respect to closed-end mortgage loans, building on the earlier proposal from the Board. This is a significant step forward in a large segment of the consumer credit market. The Bureau's proposal promises significant relief, at least for closed-end mortgage credit. The new direction—an "all-in" approach—would make the finance charge calculation more true to its basic statutory definition, by eliminating a swarm of exceptions that have undermined the accuracy and utility of the APR.

Under the Bureau's proposal, all fees, except seller's points, taxes, insurance, and the cost of recording a deed on a purchase money mortgage, would be included in the finance charge for closed-end mortgage credit. This bright-line rule should simplify compliance and facilitate comparison. It will eliminate many "gotchas" for unwary lenders, provide consumers with better information about the cost of their loans, and discourage disreputable lenders from manipulating fees to gain an unfair advantage over honest competitors.

The simple analysis proposed by the Bureau comports with the economic reality for most consumers: all the fees incurred in a mortgage transaction are a cost of obtaining the credit. The all-in approach should improve economic rationality in mortgage lending. No longer will the disclosed price of a closed-end mortgage loan depend on how a fee is titled, or whether the lender performs the activity in-house or out-sources it.

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110 *See, e.g.,* H.R. REP. NO. 90-1040 (1967), as reprinted in 1968 U.S.C.C.A.N. 1962, 1970 ("Significantly, no one segment of the industry feels it can afford to reform itself by disclosing an annual percentage rate without incurring a competitive disadvantage. Clearly, the only solution is to require by legislation that all creditors use the same method …."); *id.* at 1999-2000 (Supplemental Views of Leonor K. Sullivan) ("Out of the operations of this legislation should come needed help to the decent elements in this vital industry in overcoming unfair and dishonest competition from an unscrupulous minority engaging in practices which too often discredit credit and dishonor its ethics."); S. REP. NO. 96-368, at 16 (1979), *as reprinted in* 1980 U.S.C.C.A.N. 236, 252 (crediting TILA with a reduction in high cost credit from 1969 to 1979).

111 *See generally* Elizabeth Renuart & Diane E. Thompson, *The Truth, The Whole Truth, and Nothing But The Truth: Fulfilling The Promise of Truth In Lending*, 25 Yale. J. Reg. 181, 209 (2008).

112 Oren Bar-Gill, *The Law, Economics, and Psychology of Subprime Mortgage Contracts*, 94 Cornell L. Rev. 1073 (2009) (arguing that an improved APR could aid consumer-decisionmaking and improve competition and pricing in the subprime mortgage market).

We strongly support the all-in approach to mortgage credit. It offers significant advantages to both consumers and creditors. It reinvigorates the principles on which TILA was based: empowering consumers to make informed choices and maintaining a fair marketplace.[113] A comprehensive APR would allow consumers to make a meaningful choice between products by accurately understanding what their chosen credit product will cost them. Benefits will flow to the economy as a whole as consumers have the information necessary to make prudent decisions, and lenders are required to engage in honest competition. While disclosure is not a substitute for substantive protections, informative and usable disclosures improve market function.

C. Uniform Treatment of Third-Party Fees Is Appropriate

The Bureau proposes to cut the Gordian knot of much TILA litigation since *Rodash v. AIB Mortgage Co.*[114] in 1994. Instead of requiring a case-by-case determination of which fees are in, and which fees are out (a determination that now depends on nearly microscopic analysis of creditors' instructions to third-party agents), the Bureau would promote uniformity and consistency in the marketplace by treating virtually all third-party fees as finance charges (property insurance and taxes would continue to be excluded, as not incident to the extension of credit). This uniform treatment would reduce litigation and improve disclosure, and could lead to reduced costs for consumers.

The current approach requires a "case-by-case" analysis for excluding these charges. This fosters confusion and inconsistency.[115] It has also led to an explosion of bizarre third-party fees, including $50 email fees, multiple charges for courier fees, sometimes amounting to hundreds of dollars, and "fax review fees." Consumers typically discover these fees at closing, if at all, when they are often listed among dozens of other fees. There is virtually no meaningful opportunity for the consumer to negotiate the fees down.

Creditors could negotiate these fees down, because creditors do a significant volume of repeat business with closing agents. But because the creditor doesn't pay the fees (the consumer does) and because the creditor can exclude these fees from the finance charge, creditors have had no incentive to impose rationality on these fees.

D. Elimination of the Comparable Cash-Transaction for Refinancings Simplifies the Finance Charge Analysis

We applaud the Bureau's recognition that there is no comparable cash transaction for refinancing.[116] Adding an Official Interpretation clarifying this issue simplifies dramatically the finance charge analysis for the many closed-end transactions for which there is no comparable cash transaction.

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[113] 15 U.S.C. § 1601(a).
[114] 16 F.3d 1142, 1147, 1148 (11th Cir. 1994).
[115] 74 Fed. Reg. 43246.
[116] 77 Fed. Reg. 51,1116, 51,409 (Aug. 23, 2012) (proposed comment §1026.4(a)-6)).

E. An Inclusive and Uniform Finance Charge Definition Benefits All Stakeholders

1. The Finance Charge Is the Basis for the Annual Percentage Rate—The Key Cost Disclosure That Consumers Need to Evaluate the Total Cost of Credit

As the Bureau recognizes, mortgage credit is of signal importance to many consumers. For most consumers, a mortgage puts their largest asset at risk. Consumers need and want signposts in making these decisions.

The finance charge provides a dollar measure of the total cost of credit. The correct finance charge provides the basis for the calculation of the APR. The APR converts the finance charge into a percentage rate,[117] with the combined total interest and fees charged shown as an annualized percentage of the real benefit obtained from the loan. The APR is the only cost disclosure in the marketplace that allows consumers to comparison shop across categories of credit that vary by term, interest rate, and fees.[118] The more accurate and inclusive the finance charge is, the more accurate the APR. Accurate and meaningful disclosure of the cost of credit is the raison d'etre for TILA. Without an accurate APR, the core purpose of TILA collapses.[119]

As the Federal Reserve Board recognized in its 2009 proposed rulemaking, the APR is the key cost disclosure.[120] Without effective disclosure of the APR, consumers cannot themselves reliably determine the tradeoff among monthly payments, fees, and interest. According to the Federal Reserve Board's testing, if the APR is not disclosed effectively, consumers are often misled by lower payments or a lower interest rate to choose a more expensive loan.[121] The APR can, like other common consumer disclosures such as energy star ratings, help consumers focus on the overall cost of the product and not only one or two price components.[122]

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[117] 15 U.S.C. § 1606(a).

[118] *Cf.* Christopher L. Peterson, *Usury Law, Payday Loans, and Statutory Sleight of Hand: Salience Distortion of American Credit Pricing Limits*, 92 Minn. L. Rev. 1110 (Apr. 2008) (using Truth in Lending calculations to demonstrate that the effective cost of credit permitted on payday loans by state usury caps is much higher than appears from the state statutes).

[119] *See* Matthew A. Edwards, *Empirical and Behavioral Critiques of Mandatory Disclosure: Socioeconomics and the Quest for Truth in Lending*, 14 CORNELL J.L. & PUB. POL'Y 199, 226 (2005).

[120] 74 Fed. Reg. 43,232, 43,243 (Aug. 26, 2009).

[121] *See* ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Closed-end Mortgages 47 (2009).

[122] *Cf.* Matthias Deutsch, The Effect of Life-Cycle Cost Disclosure on Consumer Behavior (unpublished Ph.D. dissertation, Univ. of Md., 2007), *available at* http://hdl.handle.net/1903/6794 (finding that shoppers who received "life-cycle cost" information chose cooling appliances and washing machines that used less energy); *see also* Matthias Deutsch, *Life-Cycle Cost Disclosure, Consumer Behavior, and Business Implications: Evidence from an Online Field Experiment*, *in* Sustainable Consumption and Production: Framework for Action 391, 406 (Theo Geer Ken et al. eds., 2008) ("Disclosing estimated life-cycle costs to shoppers makes them opt for washing machines with, on average, 0.83% less specific energy consumption and 0.74% less specific water consumption.").

The available evidence supports the view that effective disclosure of the APR correlates strongly with lower credit prices and increased competition.[123] Given the widespread evidence of abuses in third-party fees, particularly title insurance,[124] we welcome the downward competitive pressure an all-in finance charge would have on APRs and the market.

2. An Improved Finance Charge Disclosure Will Ease Compliance Burdens

The all-in finance charge will significantly reduce compliance and litigation risks for creditors. Creditors now face significant litigation risk from mis-disclosure of the finance charge. Much Truth-in-Lending litigation in recent years has focused on parsing the finance charge.

Creditors who failed to include a fee in the finance charge could face the loss of their security interest—a powerful incentive to do it right and a powerful tool for homeowners. As a result, many creditors have opted for a de facto all-in finance charge; over-disclosure of the finance charge (which is not actionable) has become the norm.

Many creditors have thus voted for an all-in finance charge with their feet. Making the all-in finance charge the de jure as well as de facto standard in the closed-end mortgage market will further simplify creditors' compliance burdens, as well as facilitating cost-comparison by homeowners.

3. A Streamlined Finance Charge Disclosure Will Simplify Examiners' Work

If all fees are in the finance charge, except for a few clearly delineated fees, the work of examiners should be reduced, allowing time to investigate other abusive practices. Currently, evaluating any given loan for compliance with the finance charge disclosure is a time- and labor-intensive process, often requiring several hours for a preliminary result, subject to revision after further factual investigation. An all-in finance charge reduces this complex legal analysis to a matter of arithmetic. An all-in finance charge should save time and money for supervisory agencies, as well as consumers and creditors.

F. The Bureau Should Protect the Gains Made in the All-in Finance Charge from Erosion

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[123] *See* Victor Stango & Jonathan Zinman, How a Cognitive Bias Shapes Competition: Evidence from Consumer Credit Markets 3-4 (Sept. 5, 2006) (unpublished manuscript, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=928956) (stating that in markets where TILA disclosures are made reliably, consumers who most underestimate APRs given a payment stream do not overpay on credit; in markets where TILA disclosures are not made reliably, same consumers pay 200-400 basis points more for interest compared to consumers who underestimate APRs to a lesser degree); *cf.* Oren Bar-Gill, *The Law, Economics, and Psychology of Subprime Mortgage Contracts*, 94 Cornell L. Rev. 1073 (2009) (arguing that an improved APR could aid consumer-decisionmaking and improve competition and pricing in the subprime mortgage market).

[124] *See, e.g., The Impact of Dodd-Frank's Home Mortgage Reforms: Consumer and Market Perspectives Before the H. Subcomm. on Fin. Institutions and Consumer Credit of the H. Comm. on Fin. Serv's*, 112th Cong. (2012) (statement of Alys Cohen).

1. The Bureau Should Guard against Abuse of the Escrow Exclusion

The Bureau proposes to retain the § 1026.4(c)(7)(v) exclusion from the finance charge for payments into escrow accounts. The Bureau should provide commentary clearly limiting this exclusion to the actual amount of non-finance charge taxes and insurance paid. Homeowners may pay into escrow amounts for mortgage or property insurance products that are not properly excluded from the finance charge, or fees for recording the security interest, which the Bureau properly proposes to treat as a finance charge. Creditors or third-party closing agents could pad these fees—and the case law on whether and to what extent padded fees constitute a finance charge is decidedly mixed.[125] A generous escrow exclusion could erode the all-in finance charge.

Some creditors have also abused the escrow exclusion by escrowing up to a year's worth of periodic payments, deducted from the loan proceeds. The borrower is told that she is not required to make any payments for the first year because the creditor will simply deduct the payments from the escrow account as they come due. This is likely done because the creditor knows the loan is unaffordable but needs to delay default long enough to sell the loan on the secondary market and to evade detection. The consumer is harmed because she is charged interest on loan proceeds that she never receives.

The plain language of the regulation, limiting the excluded escrow amount to those fees that are not otherwise finance charges, is not enough to prevent abuse. The commentary should be strengthened to clearly prohibit these abuses.

2. Seller's Points Should Be Included in the Finance Charge When the Cost Is Passed onto the Borrower

Under the Bureau's proposal, seller's points are the one large remaining loophole in the finance charge definition for closed-end mortgages. Points, in general, are a *per se* example of the finance charge.[126] The analytical difficulty with seller's points is whether or not the consumer pays the points directly or indirectly.

When the seller passes on the cost to the consumer, seller's points are analytically and practically no different than points paid directly by the consumer, which are already a finance charge. Under the exception in the proposed rule, however, seller's points are never part of the finance charge, even when the seller increases the overall price the consumer must pay in a quid pro quo.

The Bureau's blanket exclusion of seller's points assumes that in the majority of cases sellers do not pass on the cost of points to borrowers. This assumption is factually wrong. In most cases, sellers will demand a higher price to offset the cost of points. Advocates from Florida and California report that such practices were routine in the bubble years and may have led to increased inflation of the housing market. In cases of vertical integration, sellers, closing agents, and financers

[125] *See generally* National Consumer Law Center, Truth in Lending § 3.9.6.3.3 (7th ed. 2010 and Supp.).
[126] 15 U.S.C. 1605(a)(1).

may provide cross subsidization—jacking up the price where it is least likely to be noticed by a borrower while luring a borrower in with artificially low prices in other settings. If seller's points become the single exception to the finance charge for closed-end mortgages, pricing distortions involving seller's points will surely increase.

The Bureau should consider creating a *per se* rule, such as it has proposed for third-party charges for closed-end mortgages, that sellers' points are finance charges. Rare indeed will be the circumstance when the seller does not receive compensation in some form for paying the points. Such a blanket rule would avoid the problems of case-by-case analysis. Failing that, the Board could simply return to the basic finance charge definition—that points are a classic example of the finance charge so long as they are paid directly or indirectly by the consumer. This leaves creditors to determine whether or not the borrower paid the points indirectly. Creditors already require an appraisal and a copy of the sales contract. Often, these two pieces of information will indicate whether or not the sales price was increased in exchange for the seller's payment of points.

3. All Taxes Imposed in a Credit Transaction, Whether Imposed on a Creditor or Consumer, Should Be Included in the Finance Charge

The Bureau appears to leave intact comment §1026.4(a)-5, which provides that taxes imposed on the credit transaction are not finance charges if they are assessed jointly on the creditor and consumer, or state law allows the tax to be passed on to the consumer. This comment appears to apply to the proposed Reg. Z § 1026.4(g), because §1026.4(a) remains generally applicable to closed-end mortgage transactions. The confusion mounts, however, when one reads proposed comment § 1026.4(g)-3, which provides that property taxes for recording the mortgage are included in the finance charge, regardless of state law.

The only taxes that should be excluded from the finance charge are those that would be imposed in a comparable cash transaction—transfer taxes or registration fees, for example. Otherwise, the Bureau's logic—simplicity and comparability—suggests that treatment of taxes should not depend on whether state law imposes the fee on the creditor or the consumer in the first order. Nor is there any principled reason to treat taxes incurred in perfecting security interests on homes different from taxes incurred in perfecting security interests on cars, for example.

The Bureau should consider deleting comment § 1026.4(a)-5. At the least, the Bureau should clarify the relationship between that comment and proposed Reg. Z § 1026.4(g).

4. Increased Tolerances Would Undermine the Benefits of the All-in Finance Charge

a. Increased Tolerances Are Not Needed

The Bureau requests comment on whether it should increase the tolerance for error in disclosing the finance charge.[127] In this era of computerization and instant document transfer, there is no reason that a creditor cannot know and fix at least three days before a scheduled closing any fee. Increased tolerances are unnecessary.

As the Bureau notes, this is only relevant for third-party and "voluntary" charges. Creditors' own costs are known to them and fixed early in the process. But even for other charges, creditors must already disclose them within a narrow error range within three days of application and before closing.[128] Moreover, under the existing Real Estate Settlement Procedure Act rules, many third-party charges may be average-cost priced, further reducing any possible ambiguity as to the amount of the charge. Even where a third-party fee unavoidably and unforeseeably changes at the last minute, beyond the tolerances, the creditor can already protect itself: it can notify the borrower of the error and reschedule the closing, thus giving the borrower the opportunity to cancel the transaction if the change is material to the borrower.[129] Creditors are also better able than borrowers to absorb unexpected cost increases.

Innovations in the mortgage market have reduced and should continue to reduce the need for tolerances. The goal of the Bureau should be always to promote more—not less—accurate disclosures. Existing tolerances afford an over-generous protection for good-faith, unavoidable errors. Increased tolerances would only encourage sloppiness on the part of creditors and reduce the incentive for creditors to be careful about their business practices. Increasing the tolerances would also undercut the utility of the finance charge and APR disclosures, by rendering them less precise, less comparable, and therefore less meaningful for both creditors and consumers.

b. Voluntary Charges Can Be Determined Before Closing with Additional Guidance from the Bureau as to Reasonable Assumptions

There are no common, existing, third-party charges of which we are aware that a creditor could not determine three days in advance—at least not ones that would fit in the basic definition of the finance charge. (As the Bureau notes, many truly voluntary, third-party charges, such as home warranty charges, are otherwise excluded from the finance charge definition).[130] Creditors will generally have ready access to information about pricing in the required timeframe. Indeed, most creditors will require such information in order to process their wire transfer of funds to the closing company.

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[127] 77 Fed. Reg. 51,1116, 51,146 (Aug. 23, 2012).
[128] Reg. X § 1024.7(e).
[129] Since borrowers can waive the three-day waiting period between corrected disclosures and closing in the case of a bona fide personal emergency, Reg. Z § 226.19(a)(3), consumers will not be seriously harmed by the delay, although they may be annoyed. The Bureau should not attempt to shield creditors from consumers' annoyance: consumers' annoyance should instead provide creditors with some market incentive to get the disclosures right in a timely way, even if that means checking their numbers in advance.
[130] 77 Fed. Reg. 51,1116, 51,147(Aug. 23, 2012).

Further guidance on the creditor's reasonable assumptions would be helpful. The proposed Official Interpretation directs the creditor to make these disclosures "on the best information reasonably available." This commentary would be strengthened by an illustrative list of information sources that a creditor should consult minimally. The creditor should be required to consult its own records on what other borrowers were charged on similar loans and to pricing information from third-party vendors that the creditor frequently works with regarding the product the borrower has the option of purchasing.

We also question the inclusion of prepaid interest in the list of items that may be disclosed based on the best information available.[131] Only if the closing date or interest rate changes should creditors have any difficulty calculating the interest, and in either of those cases, creditors should be encouraged to provide new, timely disclosures rather than providing misleading disclosures of amounts payable to the creditor and absolutely known to the creditor.

Absent the creditor's best attempts to provide accurate pricing information, the disclosures should not be treated as accurate.

c. Increased Tolerances Undermine the Incentive to Get the Disclosures Right in a Timely Way

Consumers do not have a chance to revisit any given mortgage transaction: most shopping terminates at loan application,[132] and virtually no consumers walk away at closing. There is, as the Board recognized in earlier proposals, no process post-closing for remedying billing errors, as there is with open-end credit.[133] Thus, the pre-closing disclosures are of particular importance. Unless borrowers receive accurate, binding, and comparable disclosures substantially in advance of closing, they cannot and will not shop.

In general, there is every reason to believe that lenders can determine costs before closing. Creditors do not need increased tolerances, indexing, or special treatment of "voluntary" third-party charges in order to get the finance charge right. They need the incentive to get the finance charge right. Until and unless there is a hard deadline for disclosure coupled with meaningful consequences for failure to properly disclose, creditors will not be motivated to make the disclosures correctly.

G. The Bureau Should Consolidate the Definition of the Finance Charge for Closed-End Mortgages and Remove the 1026.4(c)(7) Exceptions Entirely

While the substantive thrust of the Bureau's proposed finance charge definition is an excellent and long-overdue reform, the proposed structure of the regulation is needlessly complex. In order to determine what is and is not a finance charge for closed-end mortgages, creditors, examiners, and homeowner's advocates must cross-reference the rest of the regulation.[134] Rather

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131 77 Fed. Reg. 51,1116, 51,313 (Aug. 23, 2012) (proposed §1026.19(e)(3)(iii).

132 ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Closed-end Mortgages at iii, 6 (2009).

133 74 Fed. Reg. 43,232, 43,251 (Aug. 26, 2009).

134 In reviewing the rule, we were only able to understand what the coverage of the proposed rule was after we put checks by the provisions of the rest of §1026.4 that continue to apply to closed-end mortgages. And then when we

than providing a cross-referenced list of exceptions that do and do not apply, the Bureau should simply provide, in one place, a straightforward listing of the exclusions from the finance charge for closed-end mortgages. The current structure will certainly confuse at least some compliance officers, counsel for homeowners, and likely judges as well.

Additionally, the Bureau should delete the § 1026.4(c)(7) exceptions entirely. Aside from payments into escrow, these rules will not longer have any force for closed-end mortgages.[135] The one remaining exception, for amounts paid into escrow, could easily be folded into the proposed § 1026.4(g), with the other specific details. With the remaining § 1026.4(c)(7) exclusions applying only to HELOCs (where they are irrelevant), retention of § 1026.4(c)(7) is likely only to create confusion.

The only question is whether retaining § 1026.4(c)(7) would serve any purpose for HELOCs. The answer is no. The current disclosure regime for HELOCs, under § 1026.40, is entirely different from the rules for closed-end credit. The APR disclosed for HELOCs is an interest-only APR, so the finance charge calculation is irrelevant to its calculation. And indeed, there is no disclosure of the finance charge as such under the Board's HELOC disclosure, only an itemization of fees. Even if the finance charge calculation still had any meaning for HELOCs, the reasons the Bureau advances for an all-in finance charge for closed-end mortgage loan apply with equal force to HELOCs. Thus, from a principled vantage point, the § 1026.4(c)(7) exclusions should be deleted.

H. The Bureau's Inclusive Approach to the Finance Charge Should Be Extended

1. Property Insurance Should Be Included in the Finance Charge in Appropriate Circumstances

a. Property Insurance May Provide No Benefit to the Borrower And Should Therefore Be Subject to the Same Rules as Credit Life and Disability Insurance

The Bureau proposes to retain the current exclusion for property insurance premiums set forth at § 1026.4(d)(2) for closed-end mortgages. The Bureau should consider inclusion of property insurance in the finance charge where it insures only the creditor's interest, not the borrower's. In addition to force-placed insurance, the sale of regular property insurance may be a profit center for some creditors.[136] Particularly in markets with high concentrations of communities of color, high-cost lenders often couple the sale of insurance with their lending operations.

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looked at our copy of the rule when we were evaluating the finance charge calculation for a car-secured loan, we were confused.

135 77 Fed. Reg. 51,1116, 51,311 (Aug. 23, 2012).

136 National Consumer Law Center, Truth In Lending § 3.9.4.6.1 (7th ed. 2010).

As the Bureau notes, "creditors generally require property insurance as a condition of extending closed-end credit secured by real property or a dwelling . . . ."[137] Thus, property insurance may meet the basic definition of a finance charge, as a cost imposed by the creditor incident to the credit extension. Significant for the Bureau is that "consumers who do not have mortgages also regularly purchase property insurance to protect themselves" from risks of "loss of or damage to the property."[138] The Bureau is correct in that many property insurance plans purchased in connection with a mortgage offer at least some protection to the consumer. But not all of them do.

By definition, single-interest insurance protects the creditor's interest only. And even those property policies that actually are a "hybrid product,"[139] protecting both the consumer and the creditor, typically offer the creditor—as loss payee—more protection. When the required property insurance policy protects the creditor but not the consumer, it is essentially the equivalent of mortgage insurance. The creditor is requiring, as a condition of extending credit, that the consumer provide protection of the collateral securing the transaction. This type of situation falls squarely within the basic statutory definition of the finance charge.

The Bureau should limit the property insurance exclusion to those situations in which the consumer as well as the creditor receives some benefit from the property insurance. One example might be flood insurance. Does the policy include personal property? Is it for more than the creditor's lien interest? While it may not be possible to segregate the portion of the charge that protects the creditor's interest versus the borrower's (although it sometimes is possible),[140] it is possible to determine whether a policy provides protection for both the creditor and the consumer. If the consumer receives no protection under the policy, the property insurance exclusion should not apply. If the consumer receives protection, the exclusion could apply. This change would be consistent with the "all-in" approach, as well as with the Bureau's rationale for the property exclusion, because it would limit the exclusion to those situations in which property insurance truly is a hybrid product rather than a form of mortgage insurance in disguise.

b. The Bureau Should Clarify that Insurance Is Purchased From or Through the Creditor When the Creditor or Its Affiliate Acts as an Agent

The Bureau compounds the problems associated with abusive sale of property insurance by providing that insurance is bought "from" the creditor only if it is available from the creditor or its affiliate.[141] We appreciate the Bureau's explicit inclusion of affiliates in the definition of insurance purchased from or through a creditor. Certainly, some creditors have used affiliates for just such

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137 77 Fed. Reg. 51,1116, 51,149 (Aug. 23, 2012).
138 77 Fed. Reg. 51,1116, 51,149 (Aug. 23, 2012).
139 74 Fed. Reg. 43250.
140 Indeed, the Official Interpretations currently require disaggregation of coverage and premiums under certain comprehensive property insurance policies with components not being eligible for exclusion under the finance charge. Official Interpretations § 1026.4(d)-9.
141 77 Fed. Reg. 51,1116, 51,410 (Aug. 23, 2012) (proposed comment § 1026.4(d)-8).

purposes. But we are concerned that a court could construe the Board's language as limiting the purchase of insurance to only situations where the insurance is not only purchased from the creditor or affiliate but the insurance policy is originated by the creditor or affiliate.

Creditors may act as agents for insurance companies, profiting either through their commissions on the sale of insurance or through less legitimate kickbacks and profit-sharing schemes. Wells Fargo, for example, sells thousands of accidental-death insurance polices to borrowers by acting as an insurance agent, and earns a significant commission on the sales. Whenever insurance is purchased through the creditor, whether the insurance is available from the creditor or the creditor is merely acting as an agent, the insurance premium should be treated as a finance charge. In any circumstance when the creditor profits from the sale of the insurance, that should be sufficient to include the cost of insurance in the finance charge. A rule permitting the exclusion of insurance premiums from the finance charge when the creditor profits from its sale encourages subterfuge.

In addition to the issues described above, the proposed property-insurance disclosure has been buried near the back of the disclosure form. Furthermore, as if putting the last nail in the coffin of clarity, the disclosure of required insurance has been made optional.[142] The entire disclosure of insurance should be revisited.

c. The Bureau Should Conduct Testing to Insure That Consumers Understand Their Options Regarding Property Insurance

The Bureau has proposed changes to the disclosures regarding property insurance purchased through creditors.[143] The gist of the proposal is to ensure that the same disclosure requirements regarding the "premium or charge and term (if less than the term of the obligation)" apply whether the purchase is made from or through the creditor. The proposal also defines "from or through" as covering both the creditor and the creditor's "affiliate" within the meaning of the Bank Holding Company Act, 12 U.S.C. § 1841(k). These proposed changes are both good and necessary.

The Bureau should go further and make sure that consumers understand the voluntary nature of purchasing through the creditor and the very real possibility that such insurance will not provide them as much coverage as they could obtain elsewhere at a lower price. This disjunction between creditors' interests and consumers' is not easily conveyed to consumers. First-time home buyers may be particularly unlikely to understand that they have a meaningful choice and that their interests would be served best by shopping elsewhere for insurance. And even more seasoned homeowners may not pay sufficient attention to property insurance when in the midst of the larger refinancing transaction.

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142 *See* II.N, *supra*.

143 *See* 77 Fed. Reg. 51,1116, 51,410 (Aug. 23, 2012).

2. Inclusion of Credit Insurance in the Finance Charge for Closed-End Mortgage Loans Should Enhance Disclosure, but Substantive Regulation for All Credit Is Still Needed

We applaud the Bureau for its proposal automatically including credit insurance and debt cancellation premiums in the finance charge for closed-end mortgage transactions. Automatic inclusion of credit insurance premiums in the closed-end mortgage context will lead to greater accuracy in terms of the APR disclosed to consumers, thereby leveling the playing field between consumers and creditors in what has long been an area in which creditors have benefited at the expense of consumers.

The Bureau's proposal is a marked improvement in disclosure. And Dodd-Frank's ban of single-premium credit insurance further limits abuses in this area.[144] But disclosure is not enough. The Bureau should use its authority under 15 U.S.C. § 1639(p) to require eligibility screening by creditors, to ban no-benefit insurance in the mortgage context, and to clarify that one basis for the inclusion of no-benefit credit insurance in the finance charge is that such a charge is *per se* not bona fide and reasonable.

3. The Bureau Should Establish One Uniform Finance Charge Definition for All Kinds of Credit

The all-in finance charge definition should apply equally to all forms of credit. Currently—and even with the proposed changes—there are different definitions and exceptions for open-end and closed-end mortgages and for mortgages versus non-mortgages. Thus, while the an all-in finance charge and a more accurate APR will have increased utility within the closed-end mortgage category of credit, consumers may not be able to compare pricing on even closely-related varieties of credit such as HELOCs.

At a bare minimum, the disclosures for HELOCs and closed-end mortgages must be the same. Homeowners are often making decisions between these two kinds of credit: they should be disclosed comparably. The ensuing segmentation of the consumer credit marketplace will likely foster irrational pricing and abuse.

But beyond the mortgage market, abuses in lending are endemic. Creditors have taken advantage of weaknesses in the definition of the finance charge and APR in many other aspects of closed-end consumer lending, particularly to low-income, minority, and other vulnerable consumers. For example, in auto-title lending, an all-inclusive APR is often several times the disclosed APR.[145]

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[144] 15 U.S.C. § 1639c(d).

[145] Amanda Quester & Jean Ann Fox, Ctr. for Responsible Lending & Consumer Fed'n of Am., Car Title Lending: Driving Borrowers to Financial Ruin 6 (2005), *available at* http://www.responsiblelending.org/pdfs/rr008-Car_Title_Lending-0405.pdf (reporting that reported APRs range from 200% to 300% and actual APRs in states without rate caps routinely reach 800%).

Fee-packing, credit insurance, and variants of (often undisclosed) yield spread premiums are commonplace in ordinary auto financing and likewise undercut the accuracy of the APR.[146]

Consumers make choices about how to finance home repairs, college educations, and discretionary spending. When making these choices, they are choosing, often, between open-end and closed-end credit, and real-estate secured and non-real-estate secured credit. Consumers should be able to make rational decisions between the available kinds of credit, but they cannot if the disclosures blessed by the Bureau are not comparable.

The Bureau's current proposal leaves unreformed the same abusive practices in non-mortgage closed-end lending and in real-estate secured open-end lending that it seeks to ferret out of closed-end mortgage lending. For the APR to have maximum utility, it should allow consumers to choose between types of credit—closed versus open-end, secured versus non-secured, car-secured versus home-secured—as well as within categories. The Bureau has authority under 15 U.S.C. § 1604(a) to make such adjustments via regulation as it deems necessary in order to "effectuate" TILA's purposes and "prevent circumvention or evasion thereof." Allowing the APR to mean different things for different kinds of loans will permit creditors to accelerate the trend exemplified by the explosion of fully-drawn HELOCs as second-liens to push borrowers into products with less disclosure. The result is nothing less than an evasion of the purposes of TILA and an end-run around the Bureau's laudable efforts to reform the existing lax disclosure regime.

Many commentators have criticized the Federal Reserve Board for its delay in acting under its 15 U.S.C. § 1639(p) authority. The Bureau should not allow another wave of abusive lending to crest before it provides for an all-in finance charge and APR throughout the credit marketplace. Nothing in history suggests that abuses are confined to mortgage lending; nothing in the Bureau's analysis suggests that an all-in finance charge would lack justification outside of closed-end mortgage lending. The Bureau should establish one uniform finance charge definition for all kinds of credit.

IV. The CFPB Should Clarify That RESPA Applies to Manufactured Homes, at Least Whenever They Are Treated as Real Property under State Law

Manufactured housing is an important segment of the housing market. It is the largest source of unsubsidized affordable housing in the United States. It is a particularly important source of housing for low-income families and elders. Whether manufactured homes are subject to RESPA has been a longstanding problem due to the question of whether they are real property or personal property. In fact, manufactured homes have characteristics of both. Some manufactured homes are on land that the homeowner owns. Others are on land that a family member of the homeowner owns. And yet others are on rented land, often in a manufactured home community.

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[146] *See generally* John W. Van Alst, National Consumer Law Center, Fueling Fair Practices: A Road Map to Improved Public Policy for Used Car Sales and Financing (2009), *available at* http://www.consumerlaw.org/issues/auto/content/report-fuelingfairpractices0309.pdf.

Many states treat manufactured homes as real property even if they are on rented land. For example, in New Hampshire, manufactured homes are treated as real property once they are placed on a site and connected to utilities, even if the homeowner is renting the land.[147] In Nebraska, a manufactured home can be treated as real property if it is on land that the homeowner rents with a lease of at least twenty years.[148] A number of other states, such as Idaho,[149] Nevada,[150] Oregon,[151] and Texas,[152] also allow manufactured homes on leased land to be treated as real property in certain circumstances if the homeowner has a long-term lease for the land.

Nonetheless, for many years HUD has taken the position that a manufactured-home sale is subject to RESPA only if the lender finances the home also has a lien on the land where the home is placed, thereby effectively excluding homes on leased land even if the home is treated as real property under state law. This requirement is stated in a set of Frequently Asked Questions posted on HUD's website:

> Is a loan secured by a manufactured home (mobile home) covered transaction under RESPA?
>
> Yes, but only if the manufactured home is located on real property on which the lender's interest is secured by a lien.[153]

Although the Dodd-Frank Act transferred RESPA rulemaking to the CFPB, this material remains on the HUD website and the HUD website appears to still be the main source for this sort of detailed information about RESPA.

Whether RESPA applies to manufactured homes that are treated as real property under state law but are located on rented land is likely to be a growing issue. In July 2012, the Uniform Law Commission (formerly known as the National Conference of Commissioners on Uniform State Laws or "NCCUSL") adopted a uniform law for titling of manufactured homes. This uniform law allows manufactured homes to be treated as real property even if they are located on land rented with a short-term lease. The Uniform Law Commission's action is likely to spur many states to modernize their laws regarding treatment of manufactured homes on leased land as real property.

The ongoing integration of RESPA and TILA disclosures also increases the importance of applying RESPA to manufactured homes that are treated as real property. The model forms will be more useful if lenders do not have to rework them for transactions involving manufactured homes on leased land.

We urge the CFPB to take this opportunity to clarify the application of RESPA to manufactured-home transactions. First, the CFPB should disavow the statement in HUD's FAQs asserting that RESPA applies to a manufactured-home transaction only if the lender financing the home also has a security interest in the land.

[147] N.H. Rev. Stat. Ann. § 477:44.
[148] Neb. Rev. Stat. § 60-169.
[149] Idaho Code Ann. § 63-304, 63-305.
[150] Nev. Rev. Stat. § 278.02095, 361.244(5).
[151] Or. Rev. Stat. § 446.626.
[152] Tex. Occ. Code Ann. § 1201.2055.
[153] 24 C.F.R. 3500.2(b).

Second, the CFPB should amend Regulation X to provide, at least, that RESPA applies to all manufactured homes treated as real property under state law, regardless of the nature of their connection to the land. One passage in the proposed Regulation Z commentary suggests that the CFPB already views manufactured homes as real property whenever they are treated as such under state law:

> Paragraph 38(j)(2)(iii).
>
> 1. First user loan. For purposes of § 1026.38(j), a first user loan is a loan to finance construction of a new structure or purchase of manufactured home that is known at the time of consummation to be real property under state law, where the structure was constructed for sale or the manufactured home was purchased for purposes of resale and the loan is used as or converted to a loan to finance purchase by the first user.[154]

The CFPB will benefit the marketplace and consumers if it makes this view much clearer and much more general.

Third, the CFPB should explore treating all manufactured homes as real property for purposes of RESPA coverage, even if the home is not treated as real estate under state law. Although manfactured homes are theoretically portable, once set up they are as permanent as site-built homes and are often visually indistinguishable. In cost and function, manufactured homes bear more similarity to condominiums, co-ops, and site-built homes than they do outdated stereotypes regarding travel trailers. The protections of RESPA—not only its disclosure requirements but also its substantive protections—should be extended to owners of manufactured homes whether they are treated as real property or personal property under state law.

This is an important step in simplifying compliance and harmonizing the disclosure regimes under TILA and RESPA. TILA covers all manufactured homes used as dwellings, regardless of their treatment under state law.

The Bureau proposes to harmonize disclosures for vacant land,[155] but not for manufactured homes. This result is counter-intuitive and anti-consumer. Dwelling-secured credit clearly has higher stakes for consumers than credit secured by vacant land. The Bureau must afford all homeowners adequate disclosures, regardless of whether state law denominates the dwelling as real or personal property. This result is even more imperative when one stops to consider that homeowners who live in manufactured housing are particularly susceptible to abusive lending.

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[154] 77 Fed. Reg. 51451 (Aug. 23, 2012).

[155] 77 Fed. Reg. 51,116, 51,137. (Aug. 23, 2012)