COMMENTS
of the
National Consumer Law Center®
on behalf of its low-income clients

and

Consumer Action, National Association of Consumer Advocates,
National Community Reinvestment Coalition,
National Fair Housing Alliance, Public Justice Center,
Community Legal Services, Inc. of Philadelphia,
Connecticut Fair Housing Center, Financial Protection Law Center,
Florida Legal Services, Inc., Jacksonville Area Legal Aid, Inc.,
NC Justice Center, and
Neighborhood Economic Development Advocacy Project (NEDAP)

to

Board of Governors of the Federal Reserve System
Regarding Regulation Z, 12 C.F.R. Part 226
Docket No. R-1406, RIN No. 7100-AD 65
76 Fed. Reg. 11598 (Mar. 2, 2011)

Submitted May 2, 2011

I. Introduction

The National Consumer Law Center[1] respectfully submits the following comments on behalf of its low income clients, with Consumer Action,[2] National Association of Consumer

[1] The **National Consumer Law Center, Inc. (NCLC)** is a non-profit Massachusetts corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of eighteen practice treatises and annual supplements on consumer credit laws, including *Truth In Lending*, (7th ed. 2010), *Cost of Credit: Regulation, Preemption, and Industry Abuses* (4th ed. 2009 and Supp.), and *Foreclosures* (3rd ed. 2010), as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low-income people, conducted training for thousands of legal services and private attorneys on the law and litigation strategies to address predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. NCLC's attorneys have been closely involved with the enactment of the all federal laws affecting consumer credit since the 1970s, and regularly provide extensive comments to the federal agencies on the regulations under these laws. These comments were written by NCLC attorney Andrew Pizor.

Advocates,[3] National Community Reinvestment Coalition,[4] National Fair Housing Alliance, Public Justice Center, Community Legal Services, Inc. of Philadelphia,[5] Connecticut Fair Housing Center, Financial Protection Law Center, Florida Legal Services, Inc.,[6] Jacksonville Area Legal Aid, Inc., NC Justice Center, and Neighborhood Economic Development Advocacy Project (NEDAP). We welcome the opportunity to comment on the Board of Governors' proposed implementation of Section 1461 of the Dodd-Frank Act[7] and other provisions included in the Board's notice of proposed rulemaking.

As much as we support the escrow requirement and notice provisions embodied in the Board's proposal, there are significant flaws that must be addressed before the rule is finalized. The escrow requirement should include all mortgage-related obligations commonly escrowed for prime, conforming loans—not just taxes and insurance but also similar expenses such as homeowner association dues. The notice requirements, while an important improvement, do not go far enough. The Board should require notice for escrow accounts imposed beyond 45 days after closing and should require disclosure of mortgage-related obligations for no-escrow loans, not just for loans with escrow accounts as the Board proposes.

In addition, the three-day advance notice requirement is too short for no-escrow loans and for the cancellation of existing escrow accounts. Instead, the pre-consummation escrow disclosures should be delivered at the same time as the Good Faith Estimate and Truth in Lending disclosures. Creditors should be required to give 45 days advance notice when canceling

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[2] **Consumer Action** (www.consumer-action.org) is a national non-profit education and advocacy organization that has served consumers since 1971. Consumer Action serves consumers nationwide by advancing consumer rights in the fields of credit, banking, housing, privacy, insurance and utilities. Consumer Action offers many free services to consumers and communities, including an assistance/referral hotline. Consumer Action also develops free consumer education modules, training, and multi-lingual materials for its network of more than 8,000 community based organizations. Consumer Action's publications are offered in Chinese, English, Korean, Spanish and Vietnamese.

[3] 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.

[4] The **National Community Reinvestment Coalition** (NCRC) is an association of more than 600 community-based organizations that work to promote access to basic banking services including credit and savings. Our members, including community reinvestment organizations, community development corporations, local and state government agencies, faith-based institutions, community organizing and civil rights groups, and minority and women-owned business associations help create and sustain affordable housing, job development and vibrant communities for America's working families.

[5] **Community Legal Services of Philadelphia** provides free legal services to thousands of low-income households each year, including hundreds of households facing mortgage foreclosure.

[6] **Florida Legal Services** is a statewide support center for Florida legal services and legal aid programs, dedicated to ensuring poor people have equal access to justice.

[7] Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010) (hereinafter "Dodd-Frank").

an existing escrow account and should be required to explain the reason for the cancellation. These requirements will promote transparency and facilitate the resolution of errors.

In designing the proposed escrow-requirement exemption, the Board should have focused more on fashioning an exemption that will protect communities lacking access to quality credit and focused less on protecting subprime creditors. The parameters of the proposed escrow-requirement exemption exceed the narrow authority Congress granted the Board. The Board's criteria ignore the statutory requirement to consider *all* of a creditor's mortgage originations and operations (not just first-lien mortgages or higher-priced mortgage loans). The Board also substantially weakened the Congressional mandate that originators hold all exempt transactions in their portfolios. The result will allow large creditors to abuse the exemption. The Board should re-write the exemption criteria and more closely adhere to the statute.

The Board should also clarify that creditors always bear the ultimate responsibility for ensuring that transactions comply with the rule and that the appropriate escrow notices are provided in a timely fashion—even when these obligations are delegated to the servicer.

We are disappointed to see that the Board has re-issued the "transaction coverage rate" proposal, which is intended to replace the Annual Percentage Rate ("APR") as the metric for identifying higher-priced mortgage loans. This change will complicate compliance and is detrimental to the original goals of TILA. Although the Board asserts that the existing metrics are defective, the Board lacks adequate data to justify the change. Instead the Board relies on unsubstantiated and self-servicing creditor assertions for support and cites inappropriate statutory authority for this change. The Board should drop this proposal and replace it with a new data reporting requirement sufficient to gather the information needed to rectify any uncertainties in the existing higher-priced mortgage loans ("HPML") metrics.

II. Mandate Escrow of All Mortgage-Related Obligations

HPML creditors are currently required to establish escrow accounts for property taxes and mortgage-related insurance required by the creditor.[8] While we continue to support this requirement, the rule should be extended to include all other expenses traditionally escrowed by mortgage lenders. The escrow requirement was imposed to prevent the predatory practice of hiding mortgage-related obligations so that higher cost loans would appear more affordable. Limiting the regulation to taxes and insurance thwarts the purpose of the rule by leaving other similar expenses uncovered. This problem is easily resolved by using the existing definition of "mortgage-related obligations" found in § 226.34(a)(4)(i).

"Mortgage-related obligations" are the same expenses currently described by § 226.35(b)(3)(i) with the addition of "similar expenses."[9] The commentary says "similar mortgage-related expenses include homeowners' association dues and condominium or cooperative fees."

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[8] Reg. Z § 226.35(b)(3)(i); Proposed Reg. Z § 226.45(b)(1).

[9] "Mortgage-related obligations" is defined as "expected property taxes, premiums for mortgage-related insurance required by the creditor as set forth in § 226.35(b)(3)(i), *and similar expenses*." Reg. Z § 226.34(a)(4)(i) (emphasis added).

Other "similar expenses" include school district taxes and special assessments, which are typically assessed against the property. HPML creditors should escrow for "similar expenses" to the same extent as creditors for prime, conforming loans, except where specifically exempt by the statute.

III. The Proposed Notice Requirements Are Inadequate

The Board's proposed notice requirements fail to give consumers sufficient advance notice or information to enable them to make informed decisions and take necessary steps to protect themselves, particularly for loans without escrow accounts and in the event that an existing escrow account is canceled. In summary, we believe the Board's proposal falls short in the following ways:

- Three days is not enough warning that a new loan will not have an escrow account, nor is it sufficient warning before cancelling an existing account.
- Lenders should disclose the estimated escrow cost when the loan will not have an escrow account.
- Creditors and servicers must be required to explain why they are canceling an escrow account, to minimize errors and misconduct.
- Servicers should provide notice before establishing an escrow account, even beyond 45 days after loan origination.

A. Borrowers Need To Know the Mortgage-Related Obligations-—Even When No Escrow Will Be Established.

The proposed pre-consummation notice is flawed because it will not disclose the dollar amount of estimated mortgage-related obligations on loans exempt from the mandatory escrow requirement. Consumers need to know these costs to determine whether the loan is affordable. A common deceptive practice among subprime, predatory lenders has been to extend mortgage credit without imposing an escrow account. This tactic concealed the fact that borrowers were, nevertheless, required to pay mortgage-related obligations under the note in addition to principal and interest. The resulting deception made the total housing costs appear more affordable to unwary borrowers. The proposed "no-escrow" notice will not adequately protect consumers unless the notice discloses the dollar amount of mortgage-related obligations on the same annual and monthly basis required for loans with escrow accounts.

Even for creditors that do not escrow, such a requirement is reasonable because all creditors extending higher-priced mortgage loans are already required to obtain information regarding the cost of mortgage-related obligations. According to Regulation Z § 226.35(b)(1),[10] HPML creditors must consider the consumer's repayment ability, including the consumer's ability to afford mortgage-related obligations. Those mortgage-related obligations include "expected property taxes [and] premiums for mortgage-related insurance required by the creditor as set

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[10] "A creditor shall not extend credit based on the value of the consumer's collateral without regard to the consumer's repayment ability as of consummation as provided in § 226.34(a)(4)." Reg. Z § 226.35(b)(1).

forth in [proposed] § 226.45(b)(1), and similar expenses."[11] As a result, non-escrowing creditors are required know the amount of these expenses and could easily add that information to the "no-escrow" form required by the proposed rule. Any additional burden on creditors is outweighed by the decreased risk of default by borrowers who would otherwise underestimate the escrow costs.

B. Three Days Advance Notice Is Not Enough

1. Pre-consummation Notice

Under the current proposal, a consumer will receive only three days advance notice of whether the transaction will include an escrow account. As explained above, extending credit without an escrow account has been a common deceptive practice among subprime lenders. Too many consumers underestimated the difficulty of paying mortgage-related obligations in addition to principal and interest and, consequently, defaulted. While the Board and Congress have recognized the need to warn consumers of no-escrow loans, in reality three days is not enough time for consumers to take appropriate measures upon receiving the no-escrow notice.

A consumer receiving such a notice may want to apply for a loan elsewhere, to negotiate with the same creditor for a loan having an escrow account, or to negotiate for a less expensive loan. At the same time, the consumer will be under great pressure to just accept the loan as offered. In addition, unless the Board adopts our recommendation to disclose the cost of mortgage-related obligations, even a diligent consumer will need time to investigate the cost of those obligations upon receiving the no-escrow notice. As proposed, consumers will be notified but will receive the notice too late for it to make a difference.

Instead, creditors should provide the escrow disclosures at the same time they provide the early Truth In Lending ("TIL") disclosure and the Good Faith Estimate ("GFE"). Providing consumers with all the relevant cost and escrow information at one time will facilitate shopping for credit and should ease compliance. Thus, the escrow disclosure should be provided within three days of application, along with the GFE and early TIL disclosure. If the escrow disclosures change, redisclosure should happen on the same time-frame as required for the other pre-closing TIL disclosures.

2. Cancellation Notice

Three days is far too little advance notice for cancellation of an existing escrow account. The Board should require sufficient notice to allow borrowers to dispute the cancellation or to make arrangements to begin saving for the formerly escrowed costs. As the recent and repeated failures in the mortgage servicing industry have demonstrated, servicers make mistakes. Servicers are likely to cancel escrow accounts erroneously, at least occasionally, either in the mistaken belief that the consumer requested cancellation, that the mandatory five-year escrow period has expired, that loans are in default, or through some other error.

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[11] Proposed Reg. Z § 226.34(a)(4)(i).

The Board's proposal is at odds with the provisions of the Real Estate Settlement Procedures Act ("RESPA"). Under RESPA, as amended by Dodd-Frank, servicers have 30 business days to respond to a consumer's qualified written request to correct a servicing error.[12] But under the Board's proposed rule, a consumer's escrow account will have been long canceled before the servicer is required to correct any mistake.

The Board compounds this problem by failing to require creditors and servicers to state their reason for deciding to cancel escrow accounts. Thus, consumers, faced with a short time-frame and deprived of their main tool for disputing servicing errors (the qualified written request), will lack the information needed to determine whether the escrow cancellation is legitimate. Just as the Equal Credit Opportunity Act's adverse-action notice requirement discourages discrimination, requiring creditors to disclose why they are cancelling escrow accounts will promote transparency and reduce servicer errors.[13] Providing the reason, in conjunction with more advance notice, will also facilitate informal dispute resolution. We recommend a minimum notice period of 45 days, with an automatic extension while servicers investigate qualified written requests disputing cancellation notices.

C. Provide Account-Establishment Notices To Borrowers, Even Beyond 45 Days After Loan Consummation.

Where the underlying mortgage contract permits the creditor or servicer to impose an escrow account after consummation, there is no rational basis for limiting the notice requirement to escrow accounts established within 45 days following consummation. Creditors should be required to provide advance notice whenever an escrow account is imposed--regardless of when such an event occurs. We are aware of no law that currently requires creditors to give borrowers advance notice of the imposition of an escrow account on an existing loan. While default or delinquency are the most common reasons for imposing escrow accounts after consummation, creditors may do so for other reasons, such as a change in business practices (by the current creditor or upon assignment to an entity with different practices), after an audit that discovers loans without necessary escrow accounts, or upon the direction of a regulator for safety and soundness reasons.

Imposing an escrow account causes the borrower's monthly payment to increase--sometimes dramatically. Servicers also have the right to request a deposit for new escrow accounts. RESPA only requires notice within 45 days *after* adding an escrow account.[14] Increasing a borrower's monthly payment in this manner without an appropriate amount of

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[12] Dodd-Frank § 1463, *codified at* 12 U.S.C. § 2605(e)(1)(A), (e)(2), and (e)(4).
[13] The ECOA notice requirement was designed to fulfill the dual goals of consumer protection and education. *Fischl v. Gen. Motors Acceptance Corp.*, 708 F.2d 143, 146 (5th Cir. 1983). The Senate report for the ECOA amendments said a strict notice provision was: "A strong and necessary adjunct to the antidiscrimination purpose of the legislation, for only if creditors know they must explain their decisions will they effectively be discouraged from discrimination. . . . [In addition] [i]n those cases where the creditor may have acted on misinformation or inadequate information, the statement of reasons gives the application a chance to rectify the mistake." S. Rep. No. 94-589 (1976), *reprinted in* 1976 U.S.C.A.A.N. 403, 406.
[14] *See* 12 U.S.C. § 2609(c); Reg. X § 3500.17(g)(2).

advance notice can easily drive a borrower into default. Moreover, as discussed above, servicers may impose an escrow account by mistake and homeowners should have an opportunity prior to the establishment of the account to correct any errors.

IV. The Board Should Clarify Liability

Proposed § 226.20(d), requires "the creditor or servicer" to provide notice when an escrow account will be cancelled. The Board should make explicit that, ultimately, the creditor always bears responsibility for providing the escrow notice, even when the creditor delegates authority for the notice to a servicer. While some loans are serviced by the creditor, the right to service a loan is often sold to another entity. Clarifying that the creditor faces liability under 15 U.S.C. § 1640 for violations of the notice requirement will encourage creditors to monitor their servicer's performance and will simplify enforcement of the notice requirement.

V. The Board Has Exceeded the Exemption Authority Granted By Dodd-Frank

A. The Board Has Failed to Consider the Proper Factors in Creating the Exemption.

Congress authorized a narrow exemption that is based on a complete picture of the creditor as a whole. The Board, in contrast, has proposed a broader exemption based only on a keyhole view of the creditor's first-lien, subprime loan product. We disagree with the Board's assertion regarding the purpose of the exemption.[15] The exemption is not intended to protect creditors who wish to remain in the HPML market or to turn rural communities into havens for over-priced loans. The exemption is to protect communities that need credit but cannot find terms better than HPMLs. Like the escrow requirement and TILA itself, the exemption was designed to protect consumers. The Board should redraft the exemption to make it as strict as Congress intended.

Furthermore, we question the Board's analysis of when escrowing becomes financially feasible. According to the Federal Register notice, "[t]he Board believes . . . that the economies of scale necessary to escrow cost-effectively, or else to satisfy the escrow requirement by outsourcing . . ." require a portfolio of approximately 500 loans.[16] A hypothetical $75,000 mortgage with a fixed rate of 7.5%, however, would generate over $440 of interest each month for the first five years (the minimum period for escrowing under the statute). According to data cited by the Board, the monthly per-loan cost of servicing--*including* escrowing--is between $17

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[15] "The Board believes the purpose of the exemption is to recognize that maintaining escrow accounts is burdensome, and not cost-effectively feasible, unless a servicer maintains at least a certain minimum portfolio size. The proposed exemption thus permits creditors that do not possess these economies of scale to continue to offer credit to consumers, rather than leave the higher-priced mortgage loan market, provided the other criteria for the exemption also are satisfied." 76 Fed. Reg. at 11611.

[16] 76 Fed. Reg. at 11611.

and $20 for approximately 500 loans, or $21 for a 250-loan portfolio. The Board does not appear to have collected data on the difference between the cost of servicing with and without escrow. Nevertheless, it appears likely that the monthly interest generated by even a modest loan is more than sufficient to pay the cost of servicing mortgages with escrow accounts. This indicates that the 100-loan-per-year limit in proposed § 226.45(b)(2)(iii)(B) is too high (based on the Board's assumption that a 100-mortgage-per-year limit will correspond to a portfolio of 500 or fewer loans).

The Board has also failed to consider the countervailing benefit that escrowing provides holders by reducing the risk of default from non-payment of mortgage-related obligations. The prevalence of escrow accounts among prime loans suggests that any burden is sufficiently balanced by the associated benefits. These factors suggest that the Board is incorrect to use the burden of escrow as the driving factor behind the Board's blueprint for the exemption. Instead the Board should reexamine the exemption criteria with focus on the narrowest exemption needed to preserve access to credit in communities with no better options.

B. The Exemption Should Consider All of the Creditor's Business Activities and All Mortgage Originations

Dodd-Frank authorized the Board to permit an escrow exemption for creditors meeting several criteria:[17]

1) "operat[ing] predominantly in rural or underserved areas;"

2) having "total . . . mortgage loan originations that do not exceed a limit set by the Board;"

3) "retain[ing] its mortgage loan originations in portfolio;" and

4) meeting any size or other criteria established by the Board.

In doing so, Congress intended the exemption to be available only for creditors—including their affiliates—that are relatively small in size and which conduct most of their business in rural or underserved areas. The Board's proposal deviates from the statutory language by ignoring part of the above criteria.

The exemption set forth in Dodd-Frank only applies to creditors that "*operate[] predominantly* in rural or underserved areas."[18] But the Board has interpreted "operates" as being limited to first-lien, higher-priced mortgage lending operations. This decision was based on the Board's desire to be consistent with the scope of the escrow requirement (which is limited to such loans).[19] Yet there is no basis for imposing such a narrow construction on the statutory language. The escrow requirement is part of TILA, which applies to a much broader range of credit. Other provisions of the statutory exemption language also show a broader perspective.

[17] Dodd-Frank § 1461(a) (TILA § 129D (c)).
[18] Dodd-Frank § 1461(a) (TILA § 129D (c)(1)) (emphasis added).
[19] 76 Fed. Reg. at 11611.

Section 129D(c)(2) mandates consideration of "*total*" mortgage originations for not just the creditor but "*all* affiliates." Nevertheless, instead of including *all* mortgage originations in the exemption metrics, the Board has utterly ignored the word "total" as used in the statute.

If the Board declines to revisit the exemption in depth, the undue breadth of the exemption could be mitigated with two changes. The Board could change the disjunctive "rural *or* underserved" phrase in proposed § 226.45(b)(2)(iii)(A) (emphasis added) to a conjunctive "rural *and* underserved." That change would ensure that HPMLs made in well-served rural areas would be subject to the escrow requirement. There is no justification for preserving no-escrow, higher-priced credit in such areas when the same HPMLs in non-rural areas will be subject to the escrow requirement. The Board could also add a cap on the total number of originations in the two preceding calendar years for the criteria used in proposed § 226.45(b)(2)(iii)(B). That would reduce the risk of creditors trying to game the system by extending many loans in alternating years.

C. Close the Loophole For Subsequent Note Transfers

Dodd-Frank says creditors using the escrow exemption must keep the exempt loans in their portfolio.[20] The Board's version of the exemption omits that requirement based on the belief that it creates operational problems.[21] The Board's replacement for (c)(3) merely says the exemption does not apply to loans originated subject to a forward commitment. This creates a gaping loophole for creditors to transfer loans after consummation. The Board's suggested alternative—prohibiting a pattern and practice of such transfers[22]—would be very difficult to enforce and raise compliance problems. How many transfers are permitted before becoming a pattern and practice? And under what circumstances?

Instead the Board should adopt the requirement specified in the statute: loans made without escrow accounts pursuant to the exemption may not be transferred. The creditor must instead retain them in its portfolio. In the commentary the Board should say the requirement means the loan cannot be subject to a forward commitment at consummation, or transferred at anytime thereafter, unless it has an escrow account at consummation per the rest of the rule. Allowing creditors to sell exempt loans after consummation will encourage non-exempt lenders to use small lenders as fronts to evade the escrow requirement.

VI. The Annual Percentage Rate Is a Better Metric Than the Transaction Coverage Rate

The Board proposes replacing a loan's APR with the "transaction coverage rate" ("TCR") as the metric used to determine whether a loan qualifies as a HPML. According to the Board, the TCR would be the same as the APR but would only include prepaid finance charges assessed by the creditor, its affiliate, or a mortgage broker.[23] But, based on the Board's discussion of the TCR

[20] Dodd-Frank § 1461(a) (TILA § 129D (c)(3))
[21] 76 Fed. Reg. at 11613.
[22] 76 Fed. Reg. at 11613.
[23] 76 Fed. Reg. at 11609-10.

in a previous Notice of Proposed Rulemaking, this change may potentially reduce the number of loans subject to the protections mandated for HPMLs.[24] Regardless, the proposal would also decrease transparency in the disclosure process and increase the risk of compliance errors. The Board should not adopt the TCR because the proposal is misguided, unauthorized, and will harm consumers.

A. The Board Lacks Authority for This Change

The reason for this proposal is unclear. Furthermore, the record suggests that the Board lacks authority to make the proposed change. In 2010 the Board made the same proposal and said it was necessary to compensate for a proposed change in the finance-charge definition that would (allegedly) have increased the number of transactions meeting the HPML rate trigger.[25] At that time the Board also noted that the revised finance-charge definition would "widen the disparity between the APR and the average prime offer rate."[26] The Board, therefore, proposed adopting the TCR in order to address concerns that the revised finance-charge definition would result in prime loans being wrongly classified as HPMLs.[27]

This time the Federal Register notice says the Board is proposing the TCR "for the same reasons" even though the revised finance charge definition was never finalized.[28] Unlike the last proposal, the Board now asserts that it is acting "pursuant to its authority under Section 1461(b) of the Dodd-Frank Act[.]"[29] It is doubtful, however, that Section 1461(b) was intended to authorize the change now proposed. Section 1461(b) states in full: "The Board may prescribe rules that revise, add to, or subtract from the criteria of section 129(D)(b) of the Truth in Lending Act if the Board determines that such rules are in the interest of consumers and in the public interest." Section 129(D)(b) of TILA establishes rules for imposing escrow accounts on HPMLs. Accordingly, Section 1461(b) authorizes the Board to modify the rules for imposing escrow accounts on HPMLs—it does not by any stretch authorize the Board to redefine the definition of HPMLs. Furthermore, even if Section 1461(b) was applicable, the Board has entirely failed to demonstrate that the TCR is in the interest of anyone other than the mortgage lending industry.[30]

B. The TCR Proposal Is Contrary to the Purpose of TILA and Is Inherently Problematic.

TILA is intended to simplify the process of shopping for credit. The APR is designed to be a comprehensive measurement for comparing credit products that cuts through the numerous

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24 75 Fed. Reg. 58539, 58660-62 (Sept. 24, 2010).
25 75 Fed. Reg. at 58660.
26 75 Fed. Reg. at 58660.
27 75 Fed. Reg. at 58661 ("The Board believes that a modified approach is appropriate, however, given the disparity between the average prime offer rate and the more-inclusive APR that the Board has proposed.")
28 76 Fed. Reg. at 11609.
29 76 Fed. Reg. at 11609.
30 The exemption and modification authority in Section 1461(b) requires a determination that the "rules are in the interest of consumers *and* the public interest." (Emphasis added.)

and complicated variations that otherwise make comparison nearly impossible for all but the most sophisticated consumer. The proposed mechanism for defining HPMLs represents a step backwards because it detracts from the role of the APR and the finance charge as the central tools for evaluating the cost of credit. Whether the metrics at issue in this discussion are disclosed to consumers or not, the Board's proposal will complicate compliance and enforcement, and increase the risk of error. The proposal is contrary to the guiding principle of transparency inherent in TILA.

TILA and Regulation Z will be more effective if creditors are required to use a uniformly defined finance charge and APR for all disclosures and all measurements, including coverage triggers. The Board previously advocated revising the finance-charge definition to promote clarity and ease compliance.[31] While the finance-charge proposal was a welcome step toward achieving the goals behind TILA, the transaction coverage rate will be detrimental to those goals by adding an unnecessary complication to the process of evaluating whether a loan meets the HPML rate trigger.

The proposed changes also create opportunities for creditors to game the system. Compare two lenders making expensive loans that are identical in every regard except that one lender outsources as much work as possible while the other keeps all work in-house. Under the proposed rule, mortgages from the lender who outsources are less likely to be meet the HPML rate trigger even though the APR and cost to the consumer will be identical to loans from the non-outsourcing lender. That makes no sense. The Board itself explicitly said: "The Board does not believe that whether a consumer receives the 2008 HOEPA protections should depend on which creditor extends the credit."[32] Yet that is precisely the result these changes will introduce.

C. The Proposal Is Not Adequately Supported.

The Board lacks adequate data to evaluate the proposed changes and is relying on an insufficient factual record. When the Board proposed the revised finance-charge definition, it acknowledged that it "lacked adequate data to quantify the impact but believed that the more inclusive finance charge would benefit consumers."[33] The Board subsequently made a complete reversal, apparently based on no more than unsupported comments from creditors complaining about the expanded HOEPA and HPML coverage that would result from the change.[34]

Now, the Board appears to rely solely on the misalignment of the APOR and APR but still lacks any statistical evidence to support its new position. The only evidence mentioned consists of general references to the Board's own analysis and creditors' comments (from the previous Federal Register notice).[35] Neither the previous nor the current notice includes any

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[31] 74 Fed. Reg. 43232, 43321-23 (Aug. 26, 2009).
[32] 75 Fed. Reg. 58539, 58661 (Sept. 24, 2010).
[33] 75 Fed. Reg. 58539, 58638 (Sept. 24, 2010). When adjusting the HOEPA APR trigger downward, the Board then "stated that it is appropriate to err on the side of covering somewhat more than the subprime market. 73 FR 43522, 43533, July 30, 2008." 75 Fed. Reg. 58539, 58660 (Sept. 24, 2010).
[34] 75 Fed. Reg. 58539, 58638 (Sept. 24, 2010).
[35] 75 Fed. Reg. 58539, 58661 (Sept. 24, 2010).

detail regarding the Board's analysis, and the Board presents no data except for one unidentified creditor[36] that asserted 30% to 50% of its subprime loans would become subject to section 32 under the proposed revision of Reg. Z § 226.4.[37] Therefore, it would seem that the Board is now relying almost exclusively on unaudited, summary descriptions of creditors' private data.[38]

It is inappropriate to rely on this type of evidence without confirmation from an unbiased source of data. A 2001 investigation into the extent of HOEPA coverage illustrates the potential problem with the data the Board relies on now. In 2001 the Board proposed lowering the APR triggers for HOEPA coverage. The Office of Thrift Supervision provided data suggesting the change would expand HOEPA coverage from 1% to 5% of subprime mortgage loans.[39] An industry-funded report, however, claimed coverage would grow from about 9% of subprime loans to about 26% of first liens.[40] The industry study was unreliable because it was based on the portfolios of unidentified, selected—rather than random—subprime lenders.

Here, the Board relies on similarly flawed data—the creditors most likely to submit comments are those most likely to be impacted by the more inclusive finance charge. That creates a data pool that is much more likely to show a large expansion of HOEPA and HPML coverage than if the Board had used a reliable statistical sample.

According to the Federal Register notice, the Board determined that it was not possible to obtain reliable data on closing costs. Even if true, that does not justify reliance on unreliable data such as the comments cited in the notice. Nevertheless, we believe the Board could have obtained more reliable data by statistical sampling or by requiring creditors to report closing costs.[41] The internet web site Bankrate.com, for example, uses sampling each year to gather information about average closing costs by state.[42]

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[36] We eventually obtained a copy of comments filed by Citigroup, which appear to be the comments cited for the 30% to 50% estimation. The comments do not explain how the estimate was calculated nor do they provide any other data supporting it. The amount of non-affiliated, non-broker third party fees is typically low enough that a creditor would have to be charging very close to the 8% fees and points limit for that category of fees to make the difference. Our reviews of loans originated by Citigroup's subprime originator CitiFinancial confirms that at least historically this was the case. Given the lack of support for Citigroup's estimate, the Board should not have accorded the estimate any weight, particularly without reviewing the underlying loans.
[37] 75 Fed. Reg. 58539, 58637 (Sept. 24, 2010). While comments on proposed rules are typically made available to the public, the Board does not identify the specific comments on which it relies. Of equal concern is that the comments submitted in response to the August 2009 closed-end proposal appear to have been removed from the Board's web site, thereby making it difficult for the public to rebut the Board's characterization or reliance on the creditors' comments.
[38] 75 Fed. Reg. 58539, 58638 (Sept. 24, 2010).
[39] 66 Fed. Reg. 65,604, 65,608 (Dec. 20, 2001).
[40] 66 Fed. Reg. 65,604, 65,608 (Dec. 20, 2001).
[41] The North Carolina Banking Department, for example, requires reporting GFE-required information, including "itemization of settlement charges." as well as the HUD-1 if maintained electronically, 04 N.C. Admin. Code 03M.0401(c)(4).
[42] Holden Lewis, "Study: N.Y. has highest closing costs" (Aug. 19, 2010) available at www.bankrate.com/finance/mortgages/2010-closing-costs (last viewed Dec. 16, 2010). We

We disagree with the Board's conclusion that it would be too burdensome to obtain more comprehensive data from creditors. All but the smallest creditors have computerized loan origination and document production, meaning they already retain loan-level closing-cost data in electronic format. In addition, most creditors already report extensive amounts of data under HMDA, to Freddie Mac's mortgage market survey, and to private data-collection services like First American's CoreLogic. Reporting additional data would probably not be more burdensome than implementing the Board's proposed Regulation Z changes. All the information is already maintained electronically by the creditors.

The benefits of collecting comprehensive data on closing costs would also vastly outweigh the burden. This data would enable the Board to accurately assess the impact of these and future Regulation Z changes rather than speculating or relying on biased data. Consumers and the market as a whole would benefit from more "evidence-based" regulation.

D. Instead of Adopting the Proposal, the Board Should Require Creditors to Report Data on Closing Costs, and Then Address Adjustments of the Trigger.

Rather than tinker with the rules based on unsupported assumptions, the Board should adopt a rule requiring creditors to report accurate data on closing costs. That will enable to Board to address any coverage problems by raising or lowering the HPML trigger. This course of action will produce reliable regulations based in fact rather than speculation. Implementing a process to regularly gather closing cost data would also help regulators replace the APOR as a metric for HPMLs. Using the TCR rather than the APR as a metric for HPMLs will not resolve this problem. Regular data collection will enhance the Board's ability to develop a more appropriate metric and adjust Regulation Z as the market changes over time.

The public record suggests the Board failed to properly consider a mandatory closing cost survey as a more appropriate alternative to the proposed rule changes and is misusing the authority Congress granted under Dodd-Frank § 1641(b). We urge the Board to reconsider these defects before adopting a final rule.

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acknowledge that Bankrate's methodology may not be suitable for evaluating the proposed rule, however, their work suggests the Board could develop a sample that improved upon existing efforts.