Comments of the National Consumer Law Center
(on behalf of its low-income clients)
and the National Association of Consumer Advocates
on
High-Cost Mortgage and Homeownership Counseling Amendments to the Truth in Lending Act (Regulation Z) and Homeownership Counseling Amendments to the Real Estate Settlement Procedures Act (Regulation X)

77 Fed. Reg. 49,090 (August 15, 2012)
Docket No. CFPB-2012-0029

Submitted
September 7, 2012

Thank you for the opportunity to submit comments on these proposed regulations. These comments are submitted by the National Consumer Law Center[1] (on behalf of our low-income clients) and the National Association of Consumer Advocates[2] ("NACA").

We are pleased to see that the Consumer Financial Protection Bureau is proposing regulations to improve HOEPA by taking a number of steps including, for example, expanding HOEPA's scope to purchase money mortgages and home equity lines of credit. Nevertheless, we are disappointed by other aspects of the Bureau's proposal that risk undermining HOEPA's protections. In particular:

- The Bureau should collect data on whether there is a legitimate need to vary the HOEPA triggers by loan size or collateral type before implementing the

---

[1] Since 1969, the nonprofit National Consumer Law Center® (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 *Truth in Lending*, *Mortgage Lending*, and *Foreclosures*. These comments were written by Andrew Pizor, Alys Cohen, Carolyn Carter, and Diane Thompson.

[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.

variations. Absent a compelling need, these variations are likely to harm the poorest and most vulnerable.

- The Bureau should revisit several aspects of the points-and-fees threshold including:
    - clarifying the inclusion of manufactured-home dealer commissions and compensation in the definition of points and fees;
    - clarifying and standardize the terminology for when points and fees must be payable to be measured against the threshold; and
    - correcting an error in the definition of "total loan amount"
- The Bureau should end the disparity in protections for open and closed-end borrowers by subjecting HELOCs to the same rules as closed-end mortgages. The proposed protections for HELOCs are weaker. This will encourage predatory lenders to steer consumers toward HELOCs, especially HELOCs that are fully (or nearly) drawn at closing.
- The Bureau should clarify that Section 1639(v) may not be invoked after a consumer sends a rescission notice and should otherwise ensure that a creditor's ability to make corrections is not abused.
- The rule requiring counseling for first-time borrowers considering loans with negative amortization is insufficient to protect consumers from this confusing and counter-intuitive feature. Instead, the Bureau should ban negative amortization completely. If the Bureau declines to do so, it should at least consider one of several alternatives that would better protect homeowners.
- The proposed commentary regarding the ban on recommending default appears to undermine the statutory rule and should be deleted.
- The APR trigger (or the Transaction Coverage Rate (TCR) trigger, if adopted) should be based on the maximum possible rate rather than the fully-indexed rate.
- The Bureau should expand the statutory ban on modification and deferral fees to all loans and adopt commentary to ensure that the ban is properly applied.
- The Bureau should address potential confusion over fees for payoff statements.

I. The HOEPA Triggers Should Not Vary by Type of Collateral or Loan Size.

As directed by the Dodd-Frank Act, the Bureau is proposing to set a higher APR/TCR trigger, of 8.5%, for dwellings that are classified as personal property when the total loan amount is under $50,000.[3] In addition, regardless of the type of collateral, the Bureau is proposing to set the points-and-fees trigger at 5% for total loan amounts of $20,000 or more, and 8% for smaller amounts.[4] These rules will primarily affect owners of manufactured homes and lower-income borrowers (who are more likely to purchase manufactured homes and borrow smaller loan amounts).[5]

There are two problems with these variations in the triggers. First, the variations will needlessly complicate application of the rule. Second, they condone giving the poorest, least sophisticated consumers more expensive, higher-risk credit without regard to their underlying creditworthiness.

Before the Bureau accepts the argument that higher triggers are necessary to preserve access to credit, the Bureau should solicit data and research the impact of the higher triggers. If the evidence shows either that there is no valid justification, or that the higher triggers will harm consumers, the Bureau should use its authority under 15 U.S.C. § 1602(bb)(2) to lower the triggers.

A. The same triggers should apply to all loans, regardless of amount borrowed.

The Bureau's proposal to vary the HOEPA triggers by the size of the loan will introduce needless complexity. This complexity will confuse consumers and will create compliance risks.

Allowing the triggers to vary by loan size will make transactions especially complex for transactions that are close to the borderline. As the fees or loan amount on such a transaction vary up and down as the customer and vendors finalize the transaction, the trigger will change. This increases the likelihood of paperwork errors

---

[3] 77 Fed. Reg. 49090, 49100. Proposed Reg. Z § 1026.32(a)(1)(i).

[4] Proposed Reg. Z § 1026.32(a)(1)(ii).

[5] According to CFED's Innovations in Manufactured Homes program: "Owners of manufactured homes are disproportionately low-income: in 2009, the median annual household income for those living in manufactured housing was $30,000, versus a national median of $49,777. Seventy three percent of manufactured home households earn less than $50,000." CFED website, http://cfed.org/programs/manufactured_housing_initiative/about_manufactured_housing/facts_about_manufactured_housing/ (last viewed Aug. 29, 2012) (citing U.S. Census Bureau data).

and may cause last-minute changes as settlement service providers rush to adjust prices to take advantage of or avoid rising and falling triggers.

Reducing borrowers' protections based on loan size is especially problematic because it is, in essence, a tax on the poor. Creditors will be able to charge more to small borrowers without triggering HOEPA than they could for wealthier borrowers (who are likely to qualify for larger loan amounts).

One argument used to support higher triggers for smaller loans is that lenders have fixed costs that that make small loans and chattel lending more expensive for creditors and that result in higher points and-fees percentages or APRs on smaller loans. However, experience with this type of credit suggests that the higher prices are more a product of price gouging and limited competition than any legitimate structural factor.

Further, even if fixed lender costs are a partial explanation of the higher cost of these loans, it does not make the loans more affordable or less risky for borrowers. HOEPA is intended to protect borrowers who obtain high-cost loans. The issue of fixed costs is not a valid rationale for denying small borrowers the disclosures and protections of HOEPA. A high-cost loan is still high cost regardless of the loan amount or collateral type. Higher triggers only serve to give richer borrowers greater protection than the poor.

B. A higher trigger for personal property will harm manufactured-home buyers.

A higher rate trigger for homes classified as personal property is not warranted, would create confusion and uncertainty, and would add incentives for lenders and manufactured-home retailers to steer buyers into classifying their home as personal property. The Bureau, pursuant to section 1602(bb)(2)(A), should reduce the rate trigger for homes classified as personal property to that of other mortgage loans. That will reduce incentives for lenders and retailers to classify homes as personal property when it is not in the homeowner's best interest. And, where personal-property lending occurs, a lower rate trigger will protect buyers who can only obtain high-cost credit.

A higher rate trigger for loans secured by homes classified as personal property would deny the protections of HOEPA to those most in need of them. Loans for homes classified as personal property tend to be more expensive than loans for equivalent homes that are classified as real property. Interest rates on chattel loans are generally 2 to 5 % higher than comparable real estate mortgages.[6] But the factors described below suggest that this is at least partially due to price gouging and a lack of competition among lenders. These same expensive chattel loans are sometimes structured as retail installment contracts and are more likely to have prepayment penalties (such as the use of the rule of 78 to calculate rebates) and other abusive terms. Subjecting these loans to HOEPA would either encourage lenders to lower prices to avoid HOEPA or would give borrowers needed protections.

Lenders often claim that expanding consumer protections will result in reduced access to credit, due to additional challenges in securitizing loans. Yet, the secondary market for manufactured-home loans is unlikely to be inhibited by the possibility of assignee liability that would accompany HOEPA coverage. That is because many manufactured-home sales are already subject to assignee liability under the Federal Trade Commission's "Holder Rule,"[7] so expanding HOEPA coverage would not pose the same increased risk to assignees that arises when extending HOEPA coverage to mortgages on homes classified as real property.

1. The personal property trigger will affect manufactured-home consumers the most.

The rate trigger for homes classified as personal property will primarily apply to manufactured homes.[8] Manufactured homes are the largest source of unsubsidized low-income housing in the United States. This important source of housing has been poorly served by capital lending markets, the Government Sponsored Enterprises, and home manufacturers and dealers. Abuses in the industry, including vastly overpriced homes, perverse incentives to make bad loans, and disregard for ability to pay, resulted in a meltdown well before the wider subprime mortgage meltdown. Irresponsible manufactured-home loan origination and abusive, high-priced loans resulted in a catastrophic downturn in the market in the mid-1990s.

---

[6] Ronald A. Wirtz, *Home, sweet (manufactured?) home*, Fedgazette, July, 2005, *available at* http://www.minneapolisfed.org/pubs/fedgaz/05-07/cover.cfm.

[7] The Holder Rule protects consumers by requiring the insertion of language into the installment contract or loan note that the holder is subject to all claims and defenses that can be raised against the seller in consumer transactions for the sale of goods where the seller is the original lender, refers the consumer to the lender, or has an affiliation with the lender. 16 C.F.R. § 433.

[8] Live-aboard boats may be the next most likely residence to be within the scope of HOEPA. Although neither census data nor other reliable data sources indicate how many households reside on boats or other such housing, the number is dwarfed by the large stock of occupied manufactured homes. The application of HOEPA to boats and other potential homes besides manufactured homes or travel trailers used for permanent occupancy is beyond the scope of these comments.

Several features distinguish the manufactured-home lending market from that of site-built home lending. The homes themselves may be classified as real or personal property. They may be located on owned land, on individual leased lots, or in a leasehold community. Fewer lenders make chattel loans on manufactured homes than conventional mortgage loans on site-built homes. Many chattel lenders are captive lenders of manufacturers or are subsidiaries. In either case, the lender is more likely to make loans as part of a sale from a dealer rather than a refinance or private sale. These factors reduce consumers' opportunity to shop for competitive loans and also have a damaging effect on resale prices and used home values, because potential buyers may have great difficulty in financing the purchase of a unit.

Permitting manufactured homes to be converted to real property can improve financing options. While classifying a manufactured home as real property will not automatically permit the owner or purchaser to obtain favorable home financing, designation as personal property will often preclude more favorable financing terms.[9] Lenders making conventional style mortgage loans will typically require that the home be classified as real property. Conventional lenders are familiar with real property and the current lending market for manufactured homes is too small and the learning curve for chattel titling and other complexities is too high to entice conventional lenders to enter the chattel loan market. The market then is left with a limited number of chattel lenders with a great deal of power over the terms of the loan. That such loans are more expensive is not surprising. This higher cost does not, however, mean the price is justified or that recipients of these loans are any less deserving of the protections of HOEPA.

While a home's classification as real or personal property may impact the cost of a loan secured by the home, there are numerous other characteristics that also change the cost of a loan and likely have more impact on loan performance. Land security that provides comfort to both the homeowner and the lender that the home may remain where it is sited, the ability to freely transfer the home to new purchasers, and protections that lender may sell the home where sited in the event of a default all impact the cost of credit for homeowners. Yet these characteristics do not enable lenders to avoid the protections of HOEPA, nor should they. Similarly, a home's classification as personal property should not provide an excuse to permit lenders to evade HOEPA requirements.

---

[9] *See, e.g.,* Fannie Mae Announcement 07-06, Manufactured Housing Requirements, Clarifications, and New Forms (June 15, 2007) *available at* https://www.efanniemae.com/sf/guides/ssg/annltrs/pdf/2007/0706.pdf (detailing Fannie Mae's standards for manufactured home loans and requiring that homes be classified as real property even though only loans secured by both the home and land are eligible for purchase by Fannie Mae).

Attempts to carve out exceptions to the HOEPA protections may be the result of a misguided belief that providing the protections will reduce the availability of loans. As discussed below, many homes titled as personal property may also be eligible for a real-property title and different, less expensive financing. Some chattel lenders may have the ability to lower the cost of their loan products to avoid the trigger and still profit, as current costs reflect the tremendous market power exercised by chattel lenders. Yet, a rule that treats more expensive, personal property loans differently will result in steering toward those loans, even where these other options are possible.

Moreover, the goal of making credit available does not justify credit at any cost. The purpose of HOEPA is to reduce predatory lending and protect vulnerable consumers.[10] As recent history has shown, some loans are bad loans for consumers, lenders, and the economy. Curtailing the origination of inappropriate loans is a desirable outcome, not something to be avoided.

2. The classification of a manufactured home as real or personal property is often arbitrary, confusing, and out of homeowner's control.

Denying homeowners the protections of HOEPA based upon a home's classification as real or personal property is particularly unjustified due to the complex, confused, and often arbitrary nature of manufactured home classification. The property classification of manufactured homes varies by state so a HOEPA trigger based on property classification would lead to arbitrary and inequitable application of HOEPA for otherwise similarly situated homeowners. Additionally, given the all too confused state of manufactured-home classification, it may be difficult for borrowers, lenders, and the CFPB to correctly determine the applicability of HOEPA based upon a particular home's status. This could result in litigation over whether a manufactured home is personal or real property and would otherwise challenge compliance efforts.

Manufactured homes have historically been titled as personal property based upon their origin as travel trailers in the mid-20th century.[11] Today, manufactured homes are often indistinguishable from site-built homes by the casual observer. And, just as site-built homes are rarely moved from their original location, manufactured

[10] National Consumer Law Center, Truth in Lending § 9.6.1.2 (7th ed. 2010 and Supp.).

[11] Originally these travel trailers were generally used for recreational and temporary purposes. It was expected that they would frequently be found on the road and so they were usually titled with a vehicle certificate of title the same way that cars are generally titled.

homes usually remain where they are originally placed. Estimates are that only 1% of manufactured homes are moved after being sited.[12]

Despite the many similarities to traditional site-built homes, manufactured homes are still typically considered personal property absent affirmative efforts of the homeowner to change that designation. Although a little over three quarters of the states have some statutory method of converting a manufactured home from personal property to real property, these existing conversion statutes are often inadequate. Recognizing the problems in the existing state of manufactured home titling, the Uniform Law Commission recently passed the Uniform Manufactured Housing Act.[13] Hopefully adoption by states will bring clarity and uniformity to this area, but currently this is a very problematic criterion upon which to create loopholes for HOEPA protection.

a. Lack of clarity

The effect of conversion is not always clear. Some state laws say once a home is converted to real property, foreclosure law applies. Others say upon conversion all laws that apply to real estate apply to the home. Some conversion statutes say nothing about the implications of the conversion, or only address some effect on how the home is taxed. Some statutes merely provide that upon completion of the requirements the title may be surrendered, without stating if all real estate laws are to apply to the home thereafter. While some courts have held that when a statute treats a manufactured home as real property for one purpose, such as taxation, it should be treated as real property for other purposes as well,[14] the lack of clarity in the statute can leave homeowners and others concerned with the status of the home vulnerable.

In addition to lacking clarity regarding the effect of conversion, some statutes lack clarity as to whether the statutory conversion procedure supplants common law methods of conversion. These common law methods of conversion, rules created by precedent of prior court cases rather than statutes created by a legislature, typically involved actions of the homeowner that were sufficient to show that the home had become a part of the land on which it was sited. Sometimes common law methods of

---

[12] *See* David Buchholz, "Mobile" Homes No More: Policy Innovations in Manufactured Housing, Fannie Mae Foundation Policy, News and Innovations, 2005, vol. 7, #4, *available at http://www.fanniemaefoundation.org/programs/hff/pdf/HFF_v7i4.pdf*

[13] *See* New Act on Manufactured Housing Completed available at: *http://www.uniformlaws.org/NewsDetail.aspx?title=Uniform%20Manufactured%20Housing%20Act%20Approved.*

[14] *In re* Cluxton, 327 B.R. 612 (B.A.P. 6th Cir. 2005) (where home owner followed title purging procedure, home was real estate for purposes of bankruptcy anti-modification rule).

converting the home to real property remain even after the codification of a conversion process.[15]

b. Arbitrary requirements for conversion

Many state statutes permit a manufactured home to be converted to real property only if the home and the land on which it is placed are both owned by the same person.[16] These statutes reflect the pre-existing common law rule, which typically made the home a part of the existing real property on which it sat, rather than converting the home itself to real property. More recent statutes for the conversion of manufactured homes generally permit the home itself to become real property. As these recent statutes do not simply make the home a part of the land upon which it is sited, they also tend to permit homes to be converted to real property even though the home owner does not own the land upon which it is placed. Unfortunately, many of these recent statutes place severe restrictions on such conversions, requiring that the homeowner have a leasehold interest in the land and that the lease term be of some minimum duration, often between twenty and thirty-five years. Some permit homes on leased land to become real property only if they are being financed according to the guidelines of a federal housing program.[17]

c. Permanent foundation requirements

A majority of states that have a statutory method for converting manufactured homes to real property require that the home be placed upon a permanent foundation before conversion. In some states this requirement is much more stringent than the ordinary installation rules under the federal installation requirements. Some may permit footings and piers while others may require more extensive foundation such as a masonry wall for the entire perimeter of the home. Such foundations can be very costly.[18] This cost can certainly be a hurdle to a homeowner seeking the benefits of a designation as real property.

---

[15] Ford v. Venard, 340 N.W.2d 270 (Iowa 1983) (holding that Iowa's title purging statute was not intended to be the exclusive method to convert mobile home to real property and that common law methods of converting personal to real property remained).

[16] *See, e.g.,* Alabama, Ala. Code § 32-8-30 (the ownership of both the home and land must be identical); *In re* Estate of Parker, 25 S.W.3d 611 (Mo. Ct. App. 2000) (mobile home not converted to real property when the home was held jointly by married couple and placed on land held by only by one spouse as it was not placed on land held by the owner of the home).

[17] *See, e.g.,* Idaho Code Ann. §§ 63-304(2), Iowa Code § 435.26A, Nev. Rev. Stat. § 361.244, Utah Code Ann. § 70D-1-20.

[18] Courtney Weill, *Manufactured Housing in North Carolina: Current Issues and Future Opportunities*, NC Housing Coalition, *available at* http://www.nchousing.org/housing_issues_nc/Man%20Housing%20Issues.pdf.

In addition to cost, a requirement for a permanent foundation can present other difficulties. Few homeowners on leased land would invest in such a foundation without some security of their right to remain on the land. Even in jurisdictions that have a long term lease requirement, the homeowner remains vulnerable to rent increases or other changes that could prevent the homeowner from remaining on the land. In such circumstances the homeowner may not feel that it is wise to invest too much in permanent foundation. Also such extensive foundations may be prohibited by the park owner or in some areas by governmental regulation. When such constraints are present a homeowner on leased land has no opportunity to convert the home to real property.

d. Permission of landowner

A number of states permit homes sited on leased land to become real property. Unfortunately, some of these states require that the homeowner obtain the permission of the landowner, expressed as a clause in the lease, in order to convert the home.[19] While there might be a need for such permission if the designation affected the rights of the property owner, such a conversion of the home to real property need not affect the land owner's rights. Alternatively, the permission of the landowner may be seen as necessary to protect secured lenders. Lenders may fear that landowners will treat the home as a fixture and convey it with the land. Such fraudulent activity can be prevented by clear cross referencing between the land deed and the home deed.

e. Lack of user friendliness

In states with conversion statutes, courts are likely to find that a home continues to be personal property until the statutory procedures are followed. Thus, even if a home is permanently affixed to the land, it may be considered personal property unless the owner has surrendered the title and filed the proper papers to convert it to real property.[20] If the conversion is being completed as part of a

---

[19] Arizona, Ariz. Rev. Stat. Ann. § 33-1501 (in order to convert a home on leased land the owner must have entered into a lease of at least twenty years for the lot and the lease must specifically permit the recording of an affidavit of affixture); Oregon, Or. Rev. Stat. § 446.626 (in order to convert home on leased land, there must be recorded a lease of twenty years or more that specifically permits the structure to be recorded in the county deed records).

[20] *See, e.g., In re* Nowlin, 321 B.R. 678 (Bankr. E.D. Pa. 2005) (citing fact that owner had not surrendered title as factor in holding that mobile home was not real property for bankruptcy purposes), *aff'd*, 2005 WL 26660377 (E.D. Pa. Oct. 17, 2005); Beneficial Consumer Discount Co. v. Gerard (*In re* Gerard), 70 B.R. 505 (Bankr. W.D. Pa. 1987) (even if mobile home is permanently attached to land, rule that security interest is perfected by notation on title continues to apply unless statutory procedure for surrender of title is followed).

financing arrangement it is very likely that the conversion procedure will be properly followed, as the lender wishes to ensure that its security interest in the home is properly recorded and perfected.

When homeowners attempt conversion on their own, successful completion of the required procedures may be less likely. Requirements may be relatively complex for a lay person and many manufactured home owners may not be able to afford the services of an attorney to assist in the conversion.

3. Different triggers for real and personal property will create additional incentives for dealers and lenders to steer.

The use of a higher rate trigger for homes classified as personal property is not only unwarranted and would create confusion, uncertainty, and inequitable outcomes, but it would also add incentives for lenders and manufactured-home retailers to steer buyers into classifying their home as personal property. There are a number of common types of steering found in both site-built and manufactured homes such as:

- steering a consumer to a mortgage that the consumer cannot reasonably afford,
- discouraging a qualified consumer from looking elsewhere for a cheaper loan if the originator is not able to offer that product, or
- steering to a loan that has predatory characteristics or effects.

In manufactured housing though, there is an added opportunity for steering in regards to the classification of the home as real or personal property. As discussed previously, chattel loans are often more expensive and may have predatory characteristics such as the use of the rule of 78s.

Because similarly situated manufactured homes may often be classified as either real or personal property, each time a manufactured home is financed there may be a decision to be made, actively or by default, as to the home's classification. This presents both an opportunity and a danger. There is an opportunity for homeowners to obtain a designation as real or personal property and a home loan that best meets their needs. However, these windows of opportunity also present a danger that the homeowners will be steered into a loan that, rather than being the best alternative for the homeowner, is in fact the most lucrative alternative for the party arranging the loan.

Understanding the effects of a home's classification as real or personal property is extremely difficult for the typical consumer. People trust those who are helping them arrange financing for their home.[21] Efforts must be made to ensure that dealers, loan brokers, and originators are not faced with an extra incentive to place homeowners into loans that harm both the homeowner and the broader market.

Allowing lenders to evade HOEPA protections by structuring the transaction as a chattel loan rather than a real property loan is another incentive for market players to do the wrong thing.

We urge the Bureau to conduct research into the impact and justification for these trigger variations before determining whether to implement them. Data collection should include both pricing information and actual costs to the creditor that provide the basis for such pricing. Consideration of steering and the dynamics of real vs. personal property designations also should be incorporated into the analysis.

C. Any exclusion of manufactured-home dealer commissions and compensation from the points and fees calculation should be very narrowly crafted and viewed skeptically.

The current proposal, found at § 1026.32(b)(2)(i), would exclude from the calculation of points and fees the commissions and compensation paid to sales people of manufactured-home dealers when they arrange financing. The proposal is an attempt to issue a regulation to carry out the provisions of 15 U.S.C. §1602(cc)(2). The statute excludes employees of manufactured-home retailers from the definition of mortgage originator, if they do not take an application, offer or negotiate terms, or advise a consumer on loan terms. The proposed rule would exempt an employee who takes none of those actions, but merely "assists a consumer in obtaining or applying" for a loan.

We urge the Bureau to adopt a rule or interpretation that places a very narrow interpretation on this exemption. The current proposed rule would encourage lenders and dealers and their employees to create a system under which dealers attempt to assist consumers in obtaining financing in order to obtain compensation without falling within the definition of mortgage originator. In practice, assisting consumers to obtain financing without inadvertently advising consumers about the loans and their options is very difficult to do. The current proposed rule would do little to aid compliance or enforcement. Offering loan terms, advising a consumer on loan terms,

[21] ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Closed-End Mortgages, at iii (2009).

and taking a loan application should all be broadly defined, to minimize gray areas that would lead lenders and dealers to create systems that encourage behavior that may result in dealers and employees unintentionally engaging in activities that make them mortgage originators.

II. Clarify and Standardize the Rules for When Points and Fees Must Be Payable for Inclusion in the Definition of Points and Fees.

The statute and regulations are inconsistent and confusing regarding when amounts must be payable to be included in the definition of points and fees:

- The general statutory reference to points and fees refers to "the total points and fees *payable in connection with the transaction*[;][22]
- The statutory reference to points and fees for open-end credit applies to "the total points and fees *known at or before closing*[;]"[23]
- Proposed Reg. Z § 1026.32(a)(1)(ii) uses the general statutory language and refers to "The total points and fees *payable in connection with the transaction*, as described in paragraphs (b)(1) through (5) of this section[;]"[24]
- Proposed Reg. Z § 1026.32(b)(1)(iii) refers to items "*payable at or before consummation*[;]"[25] and
- Proposed Reg. Z § 1026.32(b)(3)(iii) provides that finance charges and other items are only included in the meaning of "points and fees" if they are "*payable at or before account opening*[.]"[26]

To resolve this confusion, all references in the regulations should use the same language. We recommend the phrase "known at or before closing."

As the Bureau notes, the points and fees must be determined no later than the time of closing, and so cannot include, as the statutory language suggests, all fees payable in connection with the transaction, but must be limited to those known at or before closing. Additionally, the statutory language introduces a potential ambiguity, at least in the eyes of some courts, as to whether the payments refer to fees paid in

---

[22] 15 U.S.C. § 1602(bb)(1)(ii) (emphasis added).
[23] 15 U.S.C. § 1602(bb)(5) (emphasis added).
[24] (Emphasis added).
[25] *Id.*
[26] *Id.*

cash at or before closing or fees paid out of the homeowner's monthly payments on the debt.[27]

The language the Bureau uses in proposed Regulation Z § 1026.32(b), that the fees must be payable at or before consummation, has been interpreted by several courts as requiring that points and fees must be paid in cash and cannot be financed.[28] The phrase "payable at or before account opening" is likely to be interpreted the same way by those courts. This result is at odds with the structure of HOEPA. As the Bureau recognizes in its discussion of credit insurance, some points and fees historically have been financed.[29]

Although Dodd-Frank now bans the financing of points and fees for high cost loans,[30] loans outside HOEPA are not subject to a similar limitation, and it will be necessary to accurately determine the points and fees on those loans to protect the boundaries of HOEPA coverage. Moreover, it remains possible that creditors will find creative ways to have borrowers pay the points and fees after closing aside from direct financing. Worse, conceivably, a creditor could escape the ban through the simple sophistry of arguing that, under the regulations, financed points and fees are not points and fees, and thus the high cost loan is not a high cost loan and not subject to the ban.

Whether paid before or after closing, in cash or through financing, matters not at all to the statutory definition of points and fees. What matters is whether the charge was paid in connection with the transaction, and, for purposes of basic fairness to creditors, whether the charge was known by the time of the account opening or loan closing.

The phrase "known at or before closing" clearly protects creditors against uncertainty, reduces litigation, and promotes the intent of Congress to capture all points and fees, whether paid in cash or financed, and whether paid before or after closing. If the Bureau elects to retain the proposed language, the comments should clarify that any charges known at or before the closing are to be included in the points-and-fees calculation, whether paid in cash or financed.

---

[27] *See, e.g.,* Terry v. Community Bank of N. Va., 255 F. Supp. 2d 811, 817 (W.D. Tenn. 2003) (concluding that financed closing costs that would be paid over the course of the loan are not payable at or before closing).
[28] *See, e.g.,* Collins v. Canton Home Improvement (*In re* Canton), 310 B.R. 299 (N.D. Miss. 2004); Mourer v. Equicredit Corp., 309 B.R. 502 (W.D. Mich. 2004).
[29] 77 Fed. Reg. at 49,109.
[30] 15 U.S.C. § 1639(m).

III. End the Disparity Between Protections for Open-End and Closed-End Mortgagors.

Through Dodd-Frank, Congress extended HOEPA to include HELOCs and added mortgage originator compensation to the definition of points and fees. These are important improvements. But the proposed rule would undermine these improvements by increasing a pre-existing and dangerous gap between the rules for open and closed-end mortgages. This gap will encourage lenders to seek the path of least resistance by making HELOCs instead of closed-end loans in order to avoid the more stringent rules for closed-end credit.

Currently, Regulation Z's provisions for HELOCs are closer to the rules for credit cards than closed-end mortgages. The APR for HELOCs is now based on interest alone, omitting all other finance charges. Under the Bureau's proposal, the APR trigger for HOEPA coverage of HELOCs would similarly be based on interest alone. As discussed below, excluding non-interest finance charges from calculation of the APR for HELOCs--and, consequently, from the APR trigger, is a serious flaw.

The proposed HELOC points-and-fees definition is also flawed:

- Like the HELOC APR and the TCR, the points-and-fees definition for HELOCs excludes significant finance charges and will not track the new all-in finance-charge rule.
- The definition for HELOCs would omit originator compensation. This will encourage steering to HELOCs. There is no rational basis for excluding originator compensation from the points and fees trigger, especially given the recent history of abuses in the compensation realm.

A. Many consumers and creditors do not distinguish between open and closed-end home-secured credit.

Consumers and creditors often use HELOCs interchangeably with closed-end home-secured products. FRB testing shows that many borrowers do not know whether they have a HELOC or a closed-end home-secured loan.[31] Borrowers who do know often report that their lender required that the loan be made in the form of a HELOC, at least in the case of junior purchase money mortgages.[32] Even relatively

[31] ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Home Equity Lines of Credit 7, 16, 31 (July 16, 2009).
[32] *See, e.g.*, ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Home Equity Lines of Credit 16 (July 16, 2009).

sophisticated borrowers, such as those in the Board's testing regime,[33] often mistakenly believe they have a closed-end loan[34] or cannot tell which type of mortgage they have, even after the distinction is explained to them.[35] No borrowers, however, expressed uncertainty as to whether there was a security interest in their home.

For homeowners, the crucial information is that they have a loan on their home. The distinctions between open-end and closed-end credit are not distinctions consumers make in their understanding of home-secured credit. The Bureau's regulatory regime should reflect that reality.

B. HELOC borrowers should be given information that enables them to compare a HELOC to a closed-end mortgage loan.

The consequences for a borrower who defaults on a credit card diverge sharply from those for a borrower who defaults on a HELOC. Borrowers put their homes at risk in a HELOC. A default on a credit card, by comparison, may generally be discharged in a bankruptcy and certainly does not put the home in immediate jeopardy.

For borrowers, this is a fundamental difference. The stakes are high for a borrower when taking out a HELOC. No borrower should take out a HELOC without a full understanding of the risks and benefits of doing so—and a comparison of the costs relative to other mortgage loans.

The Bureau's proposal for incorporating HELOCs into HOEPA prevents consumers from comparing HELOCs with their closest competitor—closed-end mortgage loans. In doing so, the Bureau endorses and facilitates misleading pricing for HELOCs.

---

[33] Homeowners were only eligible to participate if they could give a "thoughtful, articulate answer" to the question of why they decided to "take out a line of credit/ home equity loan." ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Home Equity Lines of Credit Appendix A, at 2 (July 16, 2009). In our collective experience representing thousands of borrowers, few of our clients could have given "thoughtful, articulate" answers to that question.

[34] ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Home Equity Lines of Credit 16 (July 16, 2009).

[35] ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Home Equity Lines of Credit 7 (July 16, 2009).

C. The HELOC market holds significant unrealized risk to consumers.

The Bureau acknowledges that there is little data on HELOCs. It should not, however, assume that the absence of smoke means there is no fire. Many homeowners with HELOCs have them as second mortgages that are typically smaller than their first mortgage. Because so many homeowners are underwater, second lien-holders have not had an incentive to foreclose despite defaults. As a result, most public attention to lending abuses has focused on the closed-end, first mortgage holders who are initiating foreclosures.

But high-cost HELOC creditors can be just as abusive as closed-end lenders. MBIA, a mortgage insurer, has filed multiple lawsuits against banks alleging breach of contract and fraud in securitizing home equity loans (including HELOCs) that didn't conform with guidelines.[36] In some cases, according to MBIA, "as many as 90% of the loans reviewed didn't conform with underwriting guidelines."[37] Furthermore, there is reason to believe that HELOC defaults may increase in the near future. Recently the OCC reported that:

> Over the next several years a significant volume of home equity products will reach the end of their draw periods. When these products were originated, most of the contracts required that at the end of the draw period the outstanding balance would require a full amortization over a predetermined period of time. Generally, the term of the home equity contract including both the draw period and full amortization is 30 years although numerous other types of structures are prevalent including those with a draw period and a balloon payment. The end-of-draw volumes significantly increase beginning in 2014 . . . . Approximately 58 percent of all HELOC balances are due to start amortizing between 2014 and 2017. Home equity borrowers face three potential issues: (1) risk from rising interest rates because most HELOCs are adjustable rate and interest rates have been very low (see figure 20); (2) payment shock because loans will move from an interest only period to fully amortizing; and (3) refinancing issues because collateral values have declined significantly since these loans were originated.[38]

[36] Ruth Simon, Officials Heighten Mortgage Scrutiny, Wall St. J., May 23, 2011, *available at* http://online.wsj.com/article/SB10001424052702303654804576339553223077320.html.
[37] *Id.*
[38] OCC, Semiannual Risk Perspective From the National Risk Committee at 20 (Spring 2012).

Over 90% of bank HELOC balances will change from interest-only to fully-amortizing payments during 2014-2018.[39] These looming risks bear a striking resemblance to challenges homeowners faced in the run-up to the current foreclosure crisis.

Some aspects of how HELOCs have been structured are inherently risky. In contrast to conventional first-lien ARMs, periodic rate adjustments on HELOCs are usually not limited by annual adjustment caps.[40] According to a 2005 report, HELOC rates may reset as often as monthly, and lifetime rate caps are typically much higher on HELOCs than on standard ARM contracts, typically on the order of 18 percent."[41] As a result, "borrowers with HELOC second liens have greater exposure to rapidly increasing interest rates and monthly payment burdens."[42]

The risks to borrowers are magnified when the borrower draws all or most of the credit line at closing. This is especially common when HELOCs are used in 80-20 or 80-10-10 financing arrangements. A 2004 study found that borrowers using HELOCs as simultaneous second liens for purchases used nearly the entire credit line at origination.[43] At that time, overall average HELOC utilization (or drawdown) rates exceeded 50 percent for the first time since 1995, with rates ranging as high as 80 percent for some lenders.[44] Around the same time, the FDIC reported that HELOCs were much more common among home equity lending, having nearly an 80% market share compared to 20% for closed-end home-equity loans.[45] Although HELOC use has obviously declined since then, like all other lending, the possibility that it may return to its former prominence means the CFPB cannot down-play the need to ensure safe lending practices among HELOC creditors.

We are especially concerned about the use of fully (or nearly) drawn HELOCs as simultaneous second liens. These extensions of credit are, in effect, no different from closed-end credit. Under the Bureau's proposal, a creditor making such a loan could impose astronomical closing costs without fear of meeting the APR trigger for HOEPA. Exemptions to the points-and-fee definition could also be similarly abused. As the regulatory gap between open and closed-end credit becomes wider, there will

[39] *Id.* (Figure 20).
[40] Charles A. Calhoun, The Hidden Risks of Piggyback Lending 13 (June 2005) (unpublished manuscript, originally written for PMI Mortgage Insurance Co., on file with National Consumer Law Center).
[41] *Id.*
[42] *Id.* at 2.
[43] *Id.* at 5.
[44] *Id.*
[45] *Id.* (citing FDIC Outlook, Winter 2004 at 18).

be a strong incentive for creditors to offer HELOCs rather than closed-end second mortgages--or even first-position mortgages. History continues to show that abuses migrate to the least regulated portions of the market. The Bureau should take action now to prevent the predictable migration of further abuses to the HELOC market.

The Bureau addresses this risk by saying "[t]the Bureau believes that any incentive to evade the closed-end, high-cost mortgage points and fees threshold by structuring a transaction as an open-end credit plan can be addressed through the prohibition in TILA against structuring a transaction as an open-end credit plan to evade HOEPA."[46] But this position is dangerously naive. We only need look at the carnage from the past few years to realize that too many creditors will push the limits of vague or unenforceable regulations in their drive for quick profits. The ban on spurious open-end credit, while important, is vague and difficult to enforce. The more often regulators open the gap in protections between open and closed-end mortgages, the more incentive creditors will have to risk pushing the limits.

D. Subject HELOCs to the same rules as closed-end mortgages.

Congress has made clear that it wants HELOCs covered by HOEPA. We urge the CFPB to respond by subjecting HELOCs to the same HOEPA regulations as closed-end credit. This can easily be accomplished by requiring creditors to assume that HELOCs will be fully drawn at closing. While some consumers will act differently, such an assumption will be no different from assuming a closed-end borrower will keep a mortgage until maturity.

The Bureau is already taking similar steps by defining the "total loan amount" for HELOCs as the credit limit[47] and requiring a maximum payment disclosure based on the assumption that the borrower will draw the full credit line at account opening.[48] Standardizing mortgage product disclosures by subjecting HELOCs to the same rules as closed-end credit is only a minor additional step.

The purpose of standardized disclosure rules is to enable consumers to compare products. The benefits of enabling consumers to make a more accurate comparison between open and closed-end mortgages will outweigh the drawbacks. Creditors and consumers already make these comparisons now. But if the rules are standardized for the two products, comparisons will be more reliable and creditors will no longer have an incentive to seek the path of weakest regulation.

[46] 77 Fed. Reg. at 49111.
[47] 77 Fed. Reg. at 49114.
[48] 77 Fed. Reg. at 49117.

IV. The Bureau Should Issue Regulations and Commentary to Prevent the Mis-Interpretation or Abuse of 15 U.S.C. § 1639(v).

A. Section 1639(v) should be interpreted in a manner that protects consumers.

The Dodd-Frank Act added a new subsection (v) to section 1639 that allows creditors and assignees[49] to correct errors in section 1639 compliance under certain conditions. The Bureau has not proposed any rules or guidance on this provision but has requested comments on it.[50] We believe it is important for the Bureau to issue regulations and commentary to clarify that creditors may only exercise their rights under subsection (v) in a manner that will not thwart consumers' rights, especially the right to cancel under section 1635.

Prior to the addition of section 1639(v), the Truth in Lending Act already included provisions allowing the correction of errors and establishing a bona fide-error defense.[51] Section 1639(v), however, is more restrictive than the pre-existing provisions in a number of ways including:

- It is specifically limited to the requirements set forth in section 1639, so creditors may not invoke it when violating any other requirement in the Act or Regulation Z.
- It imposes a "good faith" requirement. A creditor may correct an error only if it can establish that it was "acting in good faith" when it failed to comply with the requirement.
- Unlike section 1640(c), it does not specifically refer to the right to cancel or section 1635.[52]
- It gives the consumer the choice of remedy.[53]
- Unlike section 1640(c), it requires the creditor to cure the violation as a condition of escaping liability.
- It does not apply if anyone has already instituted "any action."[54]

---

[49] Hereinafter "creditors" for readability.
[50] 77 Fed. Reg. at 49097.
[51] 15 U.S.C. § 1640(b) and (c).
[52] *See* 15 U.S.C. § 1640(c) ("A creditor or assignee may not be held liable in any action brought under this section *or section 1635* . . .") (emphasis added).
[53] *See* 15 U.S.C. § 1639(v)(1) and (2) ("at the choice of the consumer . . .").
[54] 15 U.S.C. § 1639(v)(1) and (2) (emphasis added).

These differences and the language of (v) show that Congress intended (v) to be applied narrowly and sparingly in a manner that would not harm consumers. Section 1639(v) is part of HOEPA, which is intended to provide enhanced protections from high-cost and high-risk lending. Even the creditor's opportunity to cure a violation of section 1639 is designed in a manner that will protect the borrower. The consumer is given two options: 1) to bring the loan into compliance with section 1639—thereby giving the borrower the protections he was originally denied; or 2) to change the loan terms "in a manner beneficial to the consumer so that the loan will no longer be a high-cost mortgage."[55] There is nothing in the language of Dodd-Frank, the legislative history, or section 1639(v) itself to suggest that it may be interpreted in a manner that weakens or detracts from HOEPA's remedial purpose.

B. The Bureau should clarify that Section 1639(v) may not be invoked after a consumer sends a rescission notice.

A consumer's right to cancel a transaction is the most important protection the Truth in Lending Act offers. If a homeowner is trapped in an unaffordable loan, rescission based on Truth in Lending Act violations is often the only way to save that homeowner from foreclosure. High-cost credit poses an especially high risk to homeowners.

The language of section 1639(v) should be interpreted as preserving an aggrieved homeowner's right to rescind. We are concerned that, without guidance from the Bureau, courts and creditors may interpret section 1639(v) as allowing a creditor to cut off a consumer's right to cancel or respond to a cancellation notice by making a correction.

Allowing a creditor to deny the right to cancel by making a correction would be harmful to consumers. Any potential corrections a creditor might make are unlikely to ameliorate the damage caused by predatory lending. A consumer who rescinds a high-cost loan is likely doing so because she has already suffered harm. She is likely already in arrears, with damage to her credit, significant accrued late fees, and on the brink of (or already in) foreclosure. Distressed borrowers may have also depleted their savings or defaulted on other debts to make mortgage payments. Even if the consumer rescinds before going into arrears, the borrower may have paid additional interest or fees on the loan, may have rejected better loan offers based on inaccurate disclosures or due to a prepayment penalty, or suffered other harm that a mere correction will not cure. Subsection (v) allows a creditor to change the terms of a loan but does not require the creditor or servicer to undo the harm caused by the loan.

[55] 15 U.S.C. § 1639(v)(1)(A)-(B) and (2)(A)-(B).

Even if a correction could provide complete, retroactive relief, a creditor should not be allowed to use subsection (v) to avoid rescission once a consumer exercises the right to cancel. The powerful remedy of rescission, and TILA's nature as a strict-liability statute (one that does not require proof of injury, intent, or negligence), are designed to deter violations that would otherwise rarely be uncovered and punished.[56] If creditors could simply avoid rescission by making a correction, the deterrent value of rescission would be eliminated and noncompliance would simply become a cost of doing business.[57] The Bureau currently does not plan to issue any guidance on corrections[58] but we believe guidance is necessary to ensure that this provision is not misinterpreted in a way that harms consumers.

Once a consumer validly asserts the right to cancel a transaction, the mortgage is automatically and immediately void.[59] There is nothing in section 1639(v) that allows a creditor to "un-rescind" a loan. Therefore, if a creditor first learns of its failure to comply with section 1639 after it receives a rescission notice from a borrower, it is too late for the creditor to invoke (v) and correct the error or to avoid liability. The creditor cannot "make the loan satisfy the requirements of [Chapter 41]"

---

[56] *See* Fairley v. Turan-Foley Imports, Inc., 65 F.3d 475, 480 (5th Cir. 1995).
[57] Courts agree that a strict interpretation of TILA is important and effective. "This strict interpretation of the TILA has largely been responsible for the TILA's success in achieving widespread compliance with its requirements." *In re Brown*, 106 B.R. 852, 857 (Bankr. E.D. Pa. 1989). "[T]he technical requirements of the TILA and Regulation Z must be strictly enforced if standardization of terms permitting meaningful comparisons of available credit by consumers is to be achieved." Reneau v. Mossy Motors, 622 F.2d 192 (5th Cir. 1980).
[58] 77 Fed. Reg. at 49097.
[59] The Bureau has taken this position in multiple appeals. *See Rosenfield v. HSBC, Bank USA*, 681 F. 3d 1172 (10th Cir. 2012) (br. filed 3/26/2012); *Sherzer v. Homestar Mortgage Servs*, No 11-4254 (3rd Cir. Docketed 12/2/2011) (br. filed 4/13/2012); *Wolf v. Fed. Nat'l Mortgage Assoc.*, No. 11-2419 (4th Cir. Docketed 12/29/2011) (br. filed 4/13/2012); *Sobieniak v. BAC Home Loans Servicing, LP*, No. 12-1053 (8th Cir. Docketed 1/9/2012) (br. filed 4/17/ 2012). In its amicus briefs the Bureau has expressed this clear view: "Under the plain terms of § 1635—and the Bureau's controlling interpretation of that provision--consumers exercise their rescission right by providing notice to their lender within three years of obtaining the loan. When a consumer has the right to rescind, *timely notice* to the lender *effectuates rescission as a matter of law*. . . ." *Rosenfield* Br. at 10 (emphasis added). As the Bureau further explained, "[t]he issue [that arises in cases litigating rescission] is not whether to grant rescission, but whether rescission was *accomplished* because the party was entitled to rescind in the first place." *Id.* at 16. "§ 1635 entitles consumers to relief upon their exercise of a valid rescission right, which is accomplished by notifying the lender. 15 U.S.C. § 1635(b)." *Id.* at 17. The consumer's notice to the creditor "either effects the rescission as a matter of law (because the consumer had the right to rescind and properly exercised it), or does nothing (because the consumer did not have the right to rescind or improperly exercised it)." *Id.* Therefore, because a valid rescission notice effectuates rescission, without more, it is too late/there is nothing for the creditor to correct any error.

or "change the terms of the loan"[60] because, at that point, the loan no longer exists. Nevertheless, it is important for the Bureau to issue a regulation clarifying that a creditor may not invoke (v) after the consumer rescinds because some courts have ruled that rescission is not effective until the creditor or a court agrees that the loan is cancelled. Such an interpretation could lead to creditors attempting to undo a valid cancellation.

A rule clarifying that a valid rescission precludes a creditor from invoking section 1639(v) is consistent with the language of (v). Subsection (v) does not include any reference to section 1635. In contrast, section 1640(c) specifically says creditors cannot be held liable "in any action brought under . . . section 1635 . . . ." This suggests Congress did not want a correction under 1639(v) to cut off a consumer's rights under section 1635.

In addition, a written notice that a consumer is exercising the right to rescind is not required to include any statement regarding the reason for the rescission. All the consumer must say is "I rescind."[61] In contrast, section 1639(v)(1) and (2) refer to notification or discovery of a "violation" or "error." A consumer could cancel a transaction without giving any notice of a violation or error. This suggests that Congress did not intend section 1639(v) to supersede section 1635.

Interpreting any valid exercise of the right to cancel as terminating a creditor's ability to invoke section 1639(v) would also avoid anomalies in application of the statute. For example, without such an interpretation, a consumer who exercised the right to cancel by **mailing** a cancellation notice to a creditor could lose the right to cancel if the creditor was allowed to invoke section 1639(v), but a correction would not affect a consumer who exercised the right to cancel by filing a **lawsuit**, because initiating a lawsuit is certainly within the definition of "any action." This anomaly would be contrary to the design of section 1635 and Regulation Z's rescission provisions (§§ 1026.15 and .23), both of which envision a rescission process completed amicably and without litigation.

Another potential anomaly involves the difference between cancelling within three days of consummation and the extended right to cancel. Rescission exercised by the consumer within three days of closing could under no circumstances trigger the correction of errors provision. That is because a rescission within three days is not based on any error, good faith or otherwise, but is simply an opportunity for the

[60] *See* 15 U.S.C. § 1639(v)(1)(A)-(B) and (2)(A)-(B).
[61] *See* Regulation Z, App. H, Rescission Model Forms H-8 and H-9 (saying only "I wish to cancel").

consumer to change his/her mind for any reason or for no reason.[62] Moreover, such a rescission is not exercised under "this section [1639]" but is exercised under section 1635(a). However, it is important that the Bureau articulate this view to prevent unnecessary and harmful consequences to consumers who decide to cancel within three days of closing. Should creditors or courts misunderstand that the three-day rescission right is not reliant on error, consumers could lose the cooling-off period.

C. The Bureau should issue commentary clarifying application of the good-faith requirement.

The good-faith requirement in section 1639(v) also indicates Congressional intent that (v) not be wielded in a way that could thwart consumer protections listed elsewhere in TILA. For that reason, the Bureau should interpret the good-faith requirement as applying to any action taken under section 1639(v). Under such an interpretation, a creditor would not be acting in good faith if it attempted to correct an error or violation only after a consumer validly rescinded a loan.

The commentary should also emphasize whose failure to comply and good faith is at issue. Subsection (v) only applies to someone correcting its own error--not one made by a predecessor in interest. An assignee should not be allowed to invoke subsection (v) for an error made by the creditor who originated the loan. If the failure to comply occurred during origination, the assignee cannot be said to have acted in good faith because the assignee did not "act" at all. The assignee could ask the creditor to exercise its rights under subsection (v), but the assignee would not have the right to make a correction.

D. The Bureau should narrowly construe the "good faith" requirement for systemic errors and should require class-wide corrections.

Creditors will, on occasion, commit and seek to correct systemic errors. Such errors may affect large numbers of consumers if not discovered early. The nature of such errors, however, suggests that they should be quickly discovered if the creditor is acting in good faith. A creditor that does not have any system for reviewing the accuracy of the documents it uses and the systems that generate them—or that does not follow up when evidence suggests that errors are systemic--cannot be said to be acting in good faith. Such a review would identify systemic errors before many consumers are affected. The Bureau should specify that systemic errors are not made in "good faith" (and, therefore, not subject to the correction provision) if the creditor

[62] *See* 15 U.S.C. §1635(a); 12 C.F.R. §1026.23(a).

did not take appropriate precautions to avoid the error or to discover and correct it in a timely manner.

To ensure that all affected consumers receive the benefit of the correction, the Bureau should require a creditor discovering any error that meets the "good faith" requirement to take appropriate measures to identify and notify all other consumers affected by the error and to make the correction for all those affected.

E. Corrections should be applied retroactively and should remedy any harm to the consumer.

Subsection (v) gives creditors immunity for violations of section 1639 if they comply with subsection (v)'s provisions. This is a powerful right. In order to ensure that it is exercised fairly, the Bureau should adopt regulations mandating that the corrective measures taken also remedy any injury caused by the underlying violation. This can be accomplished by requiring the corrective measures taken under 15 U.S.C. § 1639(v)(1)(A)-(B) and (2)(A)-(B) to be applied retroactively to the date of consummation (except where the consumer has lawfully exercised the right to rescind--in which case loan is void and there is nothing left to correct).

For example, if the loan terms were changed so that it was no longer a high-cost mortgage, the creditor would be required to refund any interest or points and fees that exceeded the amount due under the new loan terms. If the creditor violated section 1639 by failing to give the disclosures required by subsection (a)(1), and the consumer opted to make a correction by "making the loan satisfy the requirements of th[e] chapter," the creditor would be required to not only make the disclosures, but to give the consumer the same opportunity he or she would have had at consummation had the disclosures been timely provided--i.e. to refrain from completing the agreement and avoid having a mortgage on their home. In particular, the consumer must be provided pre-loan counseling, as required by section 1639(u), and the opportunity to decide not to accept the loan. In addition, the consumer must be given the pre-loan "advance look" disclosures required by section 1639(a) and (b), which provide warnings against accepting the loan, and must be given the opportunity set forth in those warnings to decline the loan. If the creditor's correction does not include pre-loan counseling and advance look disclosures, followed by an opportunity to decline the loan, the loan does not "satisfy the requirements" of section 1639.

F. "Any action," as used in section 1639(v), should be defined to include the initiation of judicial and nonjudicial foreclosure.

A creditor may only invoke section 1639(v) "prior to the institution of *any* action."[63] The statute does not reference who must initiate the action or the nature of the action. Instead, the general reference to "any action" should be interpreted to include any legal proceeding related to the transaction that is initiated by either the consumer, the creditor, an assignee, or their legal representatives. The Bureau should adopt a regulation or commentary expressly stating that this includes a judicial or nonjudicial foreclosure proceeding. A creditor's violation of the Act could cause a foreclosure, and the right to assert a violation may be central to a consumer's ability to defend a foreclosure. Congress' decision to use the broad reference to "any" action suggests that a creditor or assignee's "actions" should have the same impact on the ability to invoke subsection (v) as would a consumer's. The term "action" should include non-judicial foreclosure because it has the same legal implications as judicial foreclosure.

G. Other guidance recommended for section 1639(v):

We also recommend that the Bureau adopt the following as commentary or regulations to implement section 1639(v):

- The two options for corrections could have significantly different consequences so the Bureau should also require creditors to give consumers adequate guidance and recommend that the consumer consult an attorney or housing counselor.
- Consumers should be given at least 90 days to make their choice. While this may seem like a long period of time, a consumer needs adequate time to consult with a professional advisor and may need to apply for replacement financing if the correction entitles the borrower to rescind.
- The Bureau should address what form of notice and by whom triggers section 1639(v). This is particularly important because the statute places the burden of proof on the creditor to establish that a good faith compliance error was discovered within either of the two sets of timing requirements.
- The Bureau should clarify that section 1639(v) is triggered only when the good faith violation has been discovered by the creditor/assignee or someone other than the consumer and that notice of an error by the consumer can never trigger the creditor's right to correct under §1639(v). This is clearly the case with respect to paragraph (2), because it refers to "the creditor's discovery or

[63] 15 U.S.C. § 1639(v)(1) and (2).

receipt of notification[.]" This is a reasonable interpretation of paragraph (1) because it too refers to notifying the consumer.

V. The Housing Counseling Requirements Should Be Clarified and Expanded.

A. The counseling requirement is inadequate for loans that permit negative amortization. Negative amortization should be banned. Alternatively, the Bureau should consider other measures that will protect consumers from the risks associated with negative amortization.

Proposed rule § 1026.36(k)(1) implements the Dodd-Frank requirement that prohibits creditors from extending loans permitting negative amortization to first-time borrowers unless the borrower obtains homeownership counseling before the transaction. This requirement is important but is not enough to protect borrowers from the risks of negative amortization.

Negative amortization poses such a risk to homeownership and is so difficult for borrowers to understand that it should be banned. If the Bureau does not wish to ban negative amortization from all loans, the Bureau should, at least, adopt alternative measures to better protect consumers. There are a number of potential approaches that would protect more consumers than the current proposal:

1. Adopt a new HOEPA trigger based on negative amortization if it is permitted by the terms of a loan.[64] Any loan meeting that criterion would be subject to HOEPA.

Subjecting all negatively amortizing loans to HOEPA would have several beneficial effects. First, HOEPA's special disclosure and assignee liability requirements would apply. Second, risk-layering would be prohibited. And, third, HOEPA itself bans on negative amortization,[65] so any negatively amortizing loan would violate this provision of HOEPA. (The regulations under the Talent-Nelson Military Lending Act are structured in a similar way: the coverage section defines covered loans to include any loan secured by a post-dated check,[66] and the substantive section prohibits the creditor from using a check to access the consumer's account,[67]

[64] In the alternative, the HOEPA trigger could be negative amortization over a certain amount. However, a cleaner and simpler rule would make any amount of negative amortization a HOEPA trigger.
[65] *See* 15 U.S.C. § 1639(f).
[66] 32 C.F.R. § 232.3(b)(1).
[67] 32 C.F.R. § 232.8(a)(5).

thus effectively banning payday loans).HOEPA coverage would benefit consumers because it would deter creditors from extending credit that permitted excessive negative amortization and, where creditors did so, consumers would benefit from the enhanced protections and remedies included in HOEPA.

2. Ban negative amortization from loans secured by a consumer's principal dwelling. This would allow the use of negative amortization for second homes and would protect the consumer's most important asset--her home.

3. Expand the proposed counseling requirement from first-time borrowers to all borrowers.

Negative amortization creates a serious risk of default. This form of credit—predominantly found in Payment Option ARMs (POARMs)—is not only asset-based but depends on the asset appreciating significantly in value. A loan that negatively amortizes is unsustainable unless the economic stars are perfectly aligned to create an environment in which rates remain low, property values climb, or borrowers win the lottery. From an asset-building perspective, negative amortization is worse than renting. The data on recent POARMs illustrates the problem:

POARMs are dangerous for investors.
Moodys anticipates POARM RMBS to sustain cumulative losses of:[68]

- 20% on 2005 RMBS
- 41% on 2006 RMBS
- 51% on 2007 RMBS

POARMs have proven highly detrimental to homeownership.
Serious delinquencies on POARMs:[69]

- 40.4% for 2005 loans
- 47.3% for 2006 loans
- 41.3% for 2007 loans

By creating negative equity, POARMs increase the risk of default.

- Over 80% of borrowers make the minimum payment.[70]

[68] Diana Golobay, *Option ARMs Surpass Subprime Mortgages in Loss Severity*, Housing Wire, Jan. 29, 2010, *available at* www.housingwire.com/2010/01/29/option-arms-surpass-subprimemortgages-in-loss-severity/.
[69] *Id.*
[70] Joint Ctr. for Hous. Studies, State of the Nation's Housing 2007, at 17

- Negative equity "'lowers homeowners' mobility because they can't sell, even if they want to move to get a new job.' Borrowers who owe more than 120% of their home's value . . . [are] more likely to default.."[71]

The 2006 interagency guidance on non-traditional loans[72] was inadequate as an approach to negative amortization. The high losses and default rates on post-2006 loans show either that:

- lenders ignored the guidance because it was voluntary, or
- the guidance was not strong enough.

Either explanation shows the Bureau needs to take clear, strong action to protect consumers from mortgages that allow the accumulation of negative amortization.

The Bureau's proposal would only mandate counseling for first-time borrowers. This leaves all other borrowers vulnerable to this loan feature, regardless of whether they have ever had any experience with it. Experience with a fully-amortizing loan does not prepare a borrower to evaluate the risks of a negatively-amortizing loan. Indeed, borrowers whose experience is with amortizing loans may feel that they understand how mortgage loans work, and may be even less prepared to comprehend negative amortization.

Under the Bureau's proposal, most consumers who already own their homes would not be protected by the counseling requirement.[73] These consumers deserve at least as much protection as first-time borrowers. They have invested in an asset, a home, and a neighborhood. The home may be their primary asset and their primary form of wealth. Refinancing a consumer from a conventional loan into a negatively amortizing loan is a classic form of equity-stripping. Predatory practices invaded the refinance market before they became prevalent in the purchase-money market, and there is no reason to think that this pattern would not repeat itself. For all of these reasons, the Bureau should adopt strong provisions to protect consumers. At a

---

[71] Mark Fleming, chief economist of First American Core Logic, as quoted in Ruth Simon and James R. Hagerty, *One in Four Borrowers is Underwater*, Nov. 24, 2009, *available at* http://online.wsj.com/article/SB125903489722661849.html. *See also* Fernando Ferreira, et al., *Housing Busts and Household Mobility*, NBER Working Paper No. 14310 (Abstract, Sept. 2008) (finding negative equity reduces homeowner mobility by almost 50%).

[72] Interagency Guidance on Nontraditional Mortgage Product Risks, 71 Fed. Reg. 58,609 (Oct. 4, 2006).

[73] A small percentage of consumers who own their homes—for example, those who inherited the home—will be first-time borrowers.

minimum counseling should be mandated for all negative amortization loans, not just those extended to first-time borrowers.

Negative amortization is at least as dangerous a loan feature as the other HOEPA triggers—a high APR, high points and fees, or a prepayment penalty. In some ways, it is more dangerous than a high APR, because it is hidden, it is so difficult for consumers to understand, and it is masked by the low payment amount. Further, one of the purposes of HOEPA is to prevent risk-layering: if a loan meets one of the HOEPA triggers, then it cannot include a number of other risky terms. Negative amortization makes a loan so risky that it should be banned or subject to all the other HOEPA prohibitions.

The alternatives recommended above would be appropriate because consumers have such difficulty understanding negative amortization. The Federal Reserve Board's consumer testing supports this hypothesis. The Board designed enhanced disclosures and conducted tests to determine whether the disclosures adequately warned consumers about negative amortization. Even after thirteen rounds of testing, and many revisions of the disclosure forms, two out of nine participants failed to understand that their minimum payment would increase over time, and increase dramatically once the negative amortization period ended; two out of nine believed the minimum payment covered all the interest earned on the loan; and two out of nine failed to understand that making minimum payments would cause the loan balance to increase over time.[74]

This poor result is particularly striking since almost all of the consumers in the testing had obtained a mortgage within the past two years and half had recent experience with ARMs. In addition, consumers who could not give a "thoughtful, articulate answer" to a question about how they found their current mortgage lender were eliminated from the pool.[75] If this relatively sophisticated group of consumers had this level of misunderstanding, even after the disclosures had been refined through thirteen rounds of testing, it is likely that even counseling will not be enough to protect consumers from this highly complex and counter-intuitive loan product.

Preserving easy access to negative amortization for borrowers serves no legitimate consumer-protection purpose. If the Bureau will not outright ban negative amortization or make it a HOEPA trigger, the Bureau should better protect borrowers by requiring pre-loan counseling for all negative amortization loans.

---

[74] Macro, Design and Testing of Truth in Lending Disclosures for Closed-End Mortgages 70 (July 16, 2009).
[75] *Id.* at Appx. B, Q5.

B. We support the National Housing Resource Center's comments regarding housing counseling.

We support the Bureau's proposal to implement Dodd-Frank's provisions regarding housing counseling. The National Housing Resource Center (NHRC) has submitted detailed comments regarding the Bureau's proposals for housing counseling with recommendations for improvements. We support NHRC's comments on housing counseling and incorporate them into our comments by reference.

VI. Other Topics

A. The proposed commentary regarding the ban on recommending default appears to undermine the statutory rule and should be deleted.

Dodd-Frank amended section 1639 of TILA by prohibiting creditors from encouraging consumers to default on existing debt in connection with a transaction that would refinance that debt.[76] The CFPB, when implementing this provision, wisely expanded that prohibition to include mortgage brokers.[77] This is an important and common-sense rule that should apply to all consumer credit transactions. The proposed commentary on this provision, however, undercuts this protection and renders it virtually unenforceable.

Creditors and brokers have been known to recommend default because a borrower in default is less likely to back out of a new transaction. The default creates pressure and adds a sense of urgency to obtaining the new loan so the borrower can pay off the defaulted debt. A borrower in default is unlikely to do anything that would delay consummation of the transaction, such as negotiating over loan terms or shopping elsewhere.

Once the default appears on the borrower's credit report, the borrower will have difficulty obtaining credit elsewhere or will only find credit on more expensive terms. If the default appears on the credit report before the refinancing transaction is consummated, a creditor may withdraw the credit offer or use the late payment to justify increasing the interest rate or imposing other unfavorable terms. Having defaulted, the borrower is now locked into dealing with the creditor, even if she could have obtained better terms elsewhere absent the default. If the new loan does not close in time, the consumer may be charged late fees, suffer a loss of their utilities, be subject to repossession or foreclosure, or be harassed by debt collectors.

---

[76] 15 U.S.C. § 1639(j). Dodd-Frank § 1433(a).
[77] *See* Proposed Reg. Z § 1026.34(a)(6); 77 Fed. Reg. at 49125.

The proposed commentary is harmful for a number of reasons. The commentary appears to differentiate between recommending default and "advis[ing] the consumer to stop making payments." While there may be a legalistic difference between a default and non-payment, few creditors distinguish between the two when evaluating a consumer's creditworthiness. Credit reports indicate whether consumers have paid on time--not whether they are in default. And creditors may charge late fees or impose other penalties before a consumer is contractually in default. There is no reason to believe Congress intended to ban encouraging defaults but allow creditors to encourage consumers to stop payment.

The first sentence of the proposed commentary is superfluous at best. At worst, courts and creditors may interpret it as blurring the bright-line rule that Congress adopted. The first sentence states: "Whether a creditor or mortgage broker 'recommends or encourages' default for purposes of Sec. 1026.34(a)(6) depends on all of the relevant facts and circumstances."[78] This could be said of compliance with all statutes and regulations. But the plain language of the statute and regulation create a bright-line rule that imposes a standard of strict liability. This sentence of commentary potentially weakens the rule because a canon of statutory construction says that no part of a statute or regulation should be interpreted as being meaningless.[79] A court could apply that doctrine when interpreting this commentary and find that the Bureau would not have included the first sentence if it merely stated a truism and, therefore, the sentence must be intended to modify the bright-line rule in the regulation. This would be a harmful result for consumers and would be contrary to the plain meaning of the statute adopted by Congress. For those reasons, the Bureau should not adopt the proposed sentence of commentary.

A consumer plays with fire when voluntarily missing a due date in the belief that the debt will be paid off by a new, pending transaction. But that is the consumer's choice. In contrast, a creditor or broker who recommends the same conduct is giving reckless advice, may be acting in bad faith and breaching a fiduciary

---

[78] Proposed Off'l Commentary § 1026.34(a)(6)-1.

[79] *See Discover Bank v. Vaden*, 396 F.3d 366, 369 (4th Cir. 2005) ("It is a classic canon of statutory construction that courts must give effect to every provision and word in a statute and avoid any interpretation that may render statutory terms meaningless or superfluous.") (internal quotation marks omitted). *See also Glover v. W.*, 185 F.3d 1328, 1332 (Fed. Cir. 1999) (applying this doctrine to interpretation of a regulation).

duty, and is encouraging the consumer to breach a legally valid contract with someone else. The latter may even constitute a tort in some states.[80]

The proposed commentary is also flawed because it adds a knowledge requirement that does not exist in the statute or proposed regulation. In the first example, a creditor or broker only violates the ban if they advise a consumer to stop making payments "knowing that the . . . cessation of payments will cause the consumer to default." While common sense dictates that stopping payments is always likely to cause a default, from a legal perspective it is not possible to know what constitutes a default without reading the terms of the borrower's contract. As a result, it will be nearly impossible for a consumer to meet this standard of proof. Congress could have added a "knowledge" requirement if it intended one. And the Bureau has indicated no basis for believing such a requirement is appropriate.

The second example is also seriously flawed. The scenario described--an unanticipated delay in consummation--highlights the reason no consumer should ever voluntarily miss the due date on a bill in anticipation of paying it off with another loan. The new loan may not be available when expected. Giving a broker or creditor a free pass when they recommend default under these circumstances undermines one of the key reasons for needing such a rule.

If a consumer pays a bill shortly before the new loan closes, the worst consequence is that the old creditor we be over-paid and will need to issue a reimbursement check. The potential consequences of ceasing payments, however, are much more serious. Given the balance of potential risk, the Bureau's proposal threatens to eviscerate the very protection Congress created. Instead, the Bureau should replace the proposed commentary entirely with a brief statement saying "any recommendation or encouragement of nonpayment violates this ban, regardless of whether the nonpayment constitutes a legal default under the terms of the consumer's contract with the other creditor."

B. The Bureau should carefully implement application of the ability-to-repay rule to high-cost loans.

The Bureau proposes to replace the existing ability-to-repay requirements for HOEPA loans under Reg. Z § 1026.34(a)(4) with a new provision establishing that

---

[80] According to the legal encyclopedia American Jurisprudence "A tort occurs when a person, without a privilege to do so, induces or otherwise purposely causes a third person . . . not to perform a contract with another." 44B Am. Jur. 2d Interference § 1.

creditors must comply with the requirements to be set forth in § 1026.43.[81] This will make Regulation Z more consistent and should simplify compliance and enforcement of the rules. We support the Bureau's proposal *provided that*:

- There are no gaps in coverage due to potential differences in the effective dates of the relevant amendments;
- The final rule and commentary make clear that the new ability-to-repay rule covers high-cost loans to at least the same extent and provides at least the same protections as the rule it will replace; and
- The final rule and commentary clarify that they do not reduce the remedies available for violations of the ability-to-repay rule in regard to high-cost loans.

C. The Bureau should expand the ban on modification and deferral fees for high-cost loans to all mortgages.

We support the Bureau's proposed Reg. Z § 1026.34(a)(7), banning fees to modify, defer payments due, renew, extend or amend high-cost mortgages. This ban is important because such fees can pose a barrier to loss mitigation options that would ultimately benefit the consumer and the mortgage holder. These fees can still act as a barrier even if capitalized because they affect measurements of affordability. They can also affect whether a modification is NPV positive. Even if the consumer can pay the upfront fee, that payment can doom a modification to failure because it overstretches the borrower's resources, leaving the borrower unable to make the regular monthly payments or cover unanticipated emergencies.

NCLC continues to hear reports that these fees are being required. While HAMP generally bans these fees, HAMP will soon be expiring so it is important to ensure that these fees do not become common. The Bureau could better protect consumers--and investors--by extending this ban to all mortgages.

We recommend adopting commentary that will clarify how this rule will be implemented. Specifically, the rule should be interpreted:

- as including unemployment forbearances, even if applied to only a portion of the payment due.
- to apply to modifications that involve a change in the name of the obligor due to an event that would be covered by the Garn St. Germain Act's restriction on

[81] 77 Fed. Reg. at 49119.

due-on-sale clauses or other modifications arising from a death in the family, or divorce.

- to ban fees for any change that converts a HOEPA loan to one not subject to HOEPA.

The rule should also be construed as prohibiting a practice that has caused problems with modifications under HAMP, GSE, and FHA rules. Currently these rules permit mortgage holders and servicers to require consumers to pay a portion of the arrearage as a condition of obtaining a loan modification. This occurs because the incentive structure Treasury, the GSEs, and FHA created gives servicers more money if they modify when the loan is less in default. This was intended to encourage servicers to modify loans early. But instead, servicers often delay approving borrowers' modification requests. As a result, servicers try to alter the numbers by telling homeowners to bring their loan more current by paying part of the arrearage before the servicer will modify the loan. This has the same impact as charging a fee for the modification. NCLC has received many complaints from attorneys in recent months who have said this practice often acts as a barrier to modifications. To avoid this problem, the commentary to § 1026.34(a)(7) should specify that the ban applies to conditioning evaluation for a modification on pre-payment of the borrower's arrearage.

D. The TCR/APR should be based on the maximum possible rate.

Proposed § 1026.32(a)(2) would require the APR or Transaction Coverage Rate (TCR) for most variable rate loans to be based on the index rate at the time of consummation plus the maximum possible margin. This is, in other words, the "fully-indexed rate." While this is better than testing the rate trigger based on artificially low teaser rates, such a calculation still offers little protection for borrowers because it hides the magnitude of potential rate increases.

Borrowers with variable-rate loans already bear the full risk of rate increases. Therefore it is only fair for the creditor to calculate all disclosures and regulatory standards (such as the HOEPA trigger) based on the maximum rate cap for the loan. HOEPA was enacted because Congress recognized the dangers of high-cost loans. In reality, a mortgage payment based on a rate that exceeds the HOEPA trigger is not more affordable or less risky simply because the index went up *after* consummation. Creditors have much greater skill and experience than consumers in predicting interest rate trends. And, even if they don't, they have much greater ability to absorb unexpected rate increases. If a consumer signs a variable-rate contract that is below the HOEPA trigger at closing, based on the proposed rule, but which goes above the trigger soon afterwards, that borrower could be subject to a pre-payment penalty that prevents refinancing into a more affordable loan--even though that penalty would have been prohibited had the trigger been measured based on the new interest rate.

E. The proposed definition of total loan amount introduces an error into the calculation.

Currently the total loan amount is calculated by starting with the amount financed and then deducting any HOEPA points and fees that were not already deducted when calculating the amount financed.[82] The Bureau now proposes to start with the principal amount of the loan and then deduct only financed points and fees.[83] The problem with this approach is that it fails to deduct finance charges that have been paid in cash and that are, under the current rule, deducted from the principal loan balance when calculating the amount financed. This allows the total loan amount to be higher, which increases the denominator for calculating HOEPA points and fees.

This significant departure from the longstanding interpretation of "total loan amount" would harm any borrower who paid closing costs in cash or who used the proceeds of one loan to pay the closing costs on a simultaneous second. It would also fail to capture many loans that have always be considered subject to HOEPA.

Given Dodd-Frank's ban on financed points and fees, 15 USC 1639(m), the Bureau's proposed definition of the total loan amount would likely reduce coverage. If lenders approaching the threshold require the payment of points and fees upfront, under the Bureau's definition, points and fees would not be subtracted from the principal amount in arriving at the total loan amount. The result would be an inflated total loan amount, which would insulate creditors from the full impact of bloated points and fees.

We encourage the Bureau revise proposed § 1026.32(b)(6)(i) and comment § 1026.32(b)(6)(i)-1 to conform to current law and exclude all points and fees from the total loan amount whether or not the points and fees are financed. This could easily be done by deleting the last five words of proposed § 1026.32(b)(6)(i) and conforming the proposed comment accordingly.

---

[82] *See* Official Interpretations § 1026.32(a)(1)(ii)-1.

[83] *See* Proposed Reg. Z § 1026.32(b)(i); Proposed Official Interpretation § 1026.32(b)(6)(i)-1.

F. Address potential confusion over fees for payoff statements.

Proposed comment § 1026.32(b)(6)(i)-3(i) excludes fees for preparing a payoff statement from the prepayment penalty definition. But since 15 U.S.C. § 1639(t)(1)(A) now generally prohibits such fees, this comment could create confusion over when payoff statement fees are permitted. The Bureau should add to the comment a statement that such fees are generally prohibited by statute.