Comments of the Center for Responsible Lending

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. 49089 (August 15, 2012)
Docket No. CFPB-2012-0029
September 7, 2012

Thank you for the opportunity to submit comments on the high-cost mortgage amendments to the Truth in Lending Act. These comments are submitted by the Center for Responsible Lending (CRL). CRL is a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, one of the nation's largest nonprofit community development financial institutions.

CRL welcomes the opportunity to comment on the rulemaking now underway at the Consumer Financial Protection Bureau (Bureau) to implement the high-cost mortgage amendments as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). High-cost mortgages and the predatory practices associated with these mortgages have long victimized the most vulnerable consumers and have put their homeownership at risk.

Dodd-Frank has significantly amended the Home Ownership and Equity Protection Act (HOEPA) to provide enhanced protections and impose additional prohibitions on terms and practices associated with high-cost loans. These amendments and the Bureau's proposed rule implementing those amendments should significantly improve the marketplace for consumers who must borrow at high rates. We remain concerned, however, about the many subterfuges that creditors, particularly subprime creditors, have employed in the past and will likely engage in the future to disguise HOEPA loans as loans that are not high-cost. Creditors who originated these disguised HOEPA loans often engaged in the most harmful practices and included the most egregious terms, such as high interest penalty and default rates and due on demand clauses that they fully expected to be triggered, and that would otherwise have been prohibited if the loans had been identified as subject to HOEPA. We therefore urge the Bureau to be vigilant about evasions of HOEPA and to adopt a regulation that is expansive enough to capture all loans structured to evade HOEPA.

Our comment makes the following recommendations:

- The Bureau should adopt regulations and comments to provide guidance regarding the proper interpretation and operation of §1639(v) regarding

corrections and unintentional violations, and to make clear that a consumer's rescission notice can never trigger a creditor or assignee's right to correct.
- The Bureau should adopt an expansive interpretation of §1639(r) to capture all loans structured to evade HOEPA.
- The Bureau should revise its proposed definition of total loan amount to capture all loans subject to HOEPA under current law and to avoid incenting evasions of HOEPA.
- The Bureau should treat loan originator compensation from up-front fees and creditor payments to brokerage firms uniformly as points and fees for open-end as well as closed-end loans.

I. The Bureau should amend Regulation Z, 12 C.F.R. Part 1026, to provide guidance to consumers, creditors and courts regarding the application and interpretation of 15 U.S.C. §1639(v).

The Bureau has requested comment as to whether it should issue guidance regarding the application of 15 U.S.C. §1639(v), "Corrections and unintentional violations," a provision embedded in HOEPA, the high-cost mortgage provisions of the Truth in Lending Act, 15 U.S.C. §1601 et. seq. (TILA) by Dodd-Frank. 77 Fed. Reg. at 49097. This provision, §1639(v), permits a creditor or assignee—under identified circumstances and then only consistent with the consumer's choice—to make certain corrections to a high-cost mortgage to bring that mortgage into compliance with the law.

Section 1639(v) is complex and somewhat opaque, and, as a result, requires careful parsing to clarify its meaning. Given that complexity and the risk that misinterpretation of that provision by creditors, assignees and courts could cause significant harm to consumers, we believe that the Bureau's guidance on this matter is important to ensuring Congress's intent is effectuated. Moreover, because it is embedded in HOEPA, which provides enhanced protections to borrowers as well as imposing prohibitions on some loan terms and conditions, §1639(v) must be strictly interpreted to effectuate Congress's intent to protect the most vulnerable consumers who borrow at the higher rates and fees under which high-cost loans are originated.

The statute, 15 U.S.C. §1639(v) provides:

> (v) CORRECTIONS AND UNINTENTIONAL VIOLATIONS.—A creditor or assignee in a high-cost mortgage who, *when acting in good faith, fails to comply with any requirement under this section* will not be deemed to have violated such requirement if the creditor or assignee establishes that either—
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> (1) within 30 days of the loan closing and prior to the institution of any action, the consumer is notified of or discovers the violation, appropriate

> restitution is made, and whatever adjustments are necessary are made to the loan to either, at the choice of the consumer—
>
> (A) make the loan satisfy the requirements of this chapter; or
>
> (B) in the case of a high-cost mortgage, change the terms of the loan in a manner beneficial to the consumer so that the loan will no longer be a high-cost mortgage; or
>
> (2) within 60 days of the creditor's discovery or receipt of notification of *an unintentional violation or bona fide error* and prior to the institution of any action, the consumer is notified of the compliance failure, appropriate restitution is made, and whatever adjustments are necessary are made to the loan to either, at the choice of the consumer—
>
> (A) make the loan satisfy the requirements of this chapter; or
>
> (B) in the case of a high-cost mortgage, change the terms of the loan in a manner beneficial so that the loan will no longer be a high-cost mortgage.

15 U.S.C. §1639(v) (emphasis added).

First, §1639(v) allows the correction of unintentional errors only by "a creditor or assignee" of a high-cost mortgage whose failure to comply was an "act[] in good faith." Second, that act in good faith must have been with respect to compliance with a requirement of "this section" namely a requirement imposed by §1639. Third, §1639(v) is time-limited, establishing different rules depending on when the creditor/assignee discovers the "good faith" failure to comply.

One set of rules is applicable to good faith compliance errors that are discovered "within 30 days of the loan closing" *and* "prior to the institution of any action." §1639(v)(1). A second and more complex set of rules is not tied to the date of the loan closing, but is instead applicable during a 60 day time period that runs from the creditor/assignee's discovery of its good faith compliance error. §1639(v)(2). Moreover, §1639(v)(2) imposes an additional hurdle for the creditor/assignee. Section 1639(v)(2) requires not only that the compliance error was made in good faith, but also that the error was either "unintentional" or "bona fide." As with violations subject to §1639(v)(1), the creditor's opportunity to correct pursuant to §1639(v)(2), is cut off by "the institution of any action."[1] Finally, only if the creditor has satisfied all of the applicable preconditions, including the creditor having met its burden of proof regarding the timing requirements, and that its failure to comply was in "good faith" and as applicable, "unintentional or bona fide," only then may it correct its error subject to the consumer's election. *See* §1639(v)(1)(A, B) & §1639(v)(2)(A,B). At that point, under either timing scenario, the

[1] The Bureau should clarify that "any action" includes actions initiated by the consumer, as well as actions initiated by the creditor, assignee, servicer, or any other entity acting on behalf of these parties, including a non-judicial foreclosure action.

consumer may require the creditor/assignee to make whatever changes are required to bring the loan into compliance or to make beneficial changes in the loan terms and eliminate the high-cost characteristics of the loan. *See id.*

In order to make this complex statutory provision workable and to ensure its uniform application across the country, the Bureau should adopt regulations and comments. At a minimum, these regulations and comments should define or clarify what it means for a creditor to act in good faith in making a compliance error for purposes of §1639(v). For example, the Bureau should clarify that for §1639(v), as for §1640(c), "an error of legal judgment" does not qualify as a good faith failure to comply. The Bureau should cross-reference and rely upon §1640(c) "Unintentional violations; bona fide errors" to interpret the requirement in §1639(v)(2) that good faith compliance errors be bona fide or unintentional.

The Bureau should provide examples in the Official Interpretations, 12 C.F.R. §1026, Supplement I, that illustrate creditors acting in good faith in failing to comply with §1639 as well as examples of creditors failing to act in good faith in failing to comply with §1639. For example, a creditor's inclusion of a term, such as a prepayment penalty provision that allows collection of a prepayment penalty after 36 months, which is both prohibited by Dodd-Frank and a HOEPA trigger, should under no circumstances be considered a "good faith" compliance failure. Similarly, it is unlikely that a systemic or widespread error could be a good faith failure to comply. Systemic or widespread errors should not occur or should be caught by creditors who maintain "procedures reasonably adapted to avoid any such error" in accord with §1640(c). Therefore, if these errors occur and show up in consumers' documents, they are not errors that occurred in good faith. Illustrations such as these would guide the development of the law under this provision and aid parties in assessing their rights and obligations, and courts in determining whether §1639(v) is applicable and how to apply it.

In addition, it would be helpful for the Bureau to provide guidance as to the requirement that a creditor/assignee present the required choice of correction to consumers and to assure the consumer understands his/her choice. §1639(v)(1); §16399v)(2) ("at the choice of the consumer--"). This is particularly important because in some circumstances, one choice may present a clear benefit to the consumer that is not available with the alternative choice. For example, each consumer must be presented with the option provided in §1639(v)(1)(A) & (v)(2)(A), that the creditor/assignee will "make the loan satisfy the requirements of this chapter." For some violations of §1639, the creditor/assignee will be required to provide new disclosures of the loan terms and present the consumer with a new notice of right to cancel in order to bring the loan into compliance with "the requirements of this chapter." A new opportunity to rescind the loan may provide a significantly enhanced advantage to some consumers over the option of revising the loan terms to bring them out of HOEPA's coverage. For other consumers, the second option that must be presented by creditors/assignees pursuant to §1639(v)(1)(B) & (v)(2)(B)—to change the loan terms to benefit the consumer and to remove the loan from coverage by HOEPA—may be a more advantageous choice for the consumer. In that case, it is also essential that the creditor/assignee explain that the beneficial changes are made retroactive to the loan closing so, for example, interest paid on fees that are refunded will also be refunded. It is important that consumers have the option of availing themselves of the option that best meets their needs. The Bureau's guidance will help ensure that the consumer's interests are protected.

Finally, the Bureau should address what form of notice triggers §1639(v) as well as whose notice triggers §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. To this end, the Bureau should clarify that §1639(v)(2) 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)(2).

Rescission

It is essential that the Bureau address the interaction of rescission and §1639(v) to clearly articulate that a rescission notice *does not*, under any circumstances, trigger a creditor's right to correct under §1639(v). As explained below, this is simply an expression of the Bureau's public position on the effect of a valid rescission notice. However, given the widely divergent interpretations courts have applied to a consumer's notice of rescission, it is important that the Bureau clearly address rescission in the context of this rulemaking. *Compare e.g., Gilbert v. Residential Funding, LLC*, 678 F.3d 271, 277 (4th Cir. 2012) ("a borrower exercises her right of rescission by merely communicating in writing to her creditor her intention to rescind"); with *McOmie-Gray v. Bank of America Home Loans*, 667 F. 3d 1325, 1327 (9th Cir. 2012) (notice of rescission simply advances a claim of rescission).

In amicus briefs filed in four U.S. Courts of Appeal, the Bureau explains that rescission is effectuated through notice. *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). The Bureau states: "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); *accord, Sobieniak* Br. at 10. The Bureau's position is supported by the Federal Reserve Board's longstanding Regulation Z, 12 C.F.R. §226.23(a)(2). This same provision was adopted by the Bureau in its renumbered Regulation Z, 12 C.F.R. §1026.23(a)(2). 76 Fed. Reg. 79772, Dec. 22, 2011. Section 226.23(a)(2), now §1026.23(a)(2) provides: "*[t]o exercise the right to rescind*, the consumer shall notify the creditor of the rescission by mail, telegram or other means of written communication. Notice is considered given when mailed . . . ." (emphasis added).

The Bureau makes clear that rescission "is accomplished by notifying the lender. 15 U.S.C. §1635(b)." *Rosenfield* Br. at 17; *accord, Sobieniak* Br. at 19. 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)." *Rosenfield* Br. at 17; *accord, Sobieniak* Br. at 17. Because a valid rescission notice effectuates rescission and there is nothing of the original loan left to cure once rescission occurs, after the consumer notices rescission there is nothing for the creditor to correct. Upon receiving a rescission notice, the creditor can and should assess the validity of the consumer's rescission and either honor the valid rescission by unwinding the transaction as required by 15 U.S.C. §1635(b) or, if the creditor believes the rescission is not valid, by seeking a judicial ruling on the merits of the consumer's rescission claim. Given the critical importance of the right of rescission to consumers and to the proper functioning of the statute, the Bureau should make clear that a consumer's rescission notice will never trigger the creditor/assignee's correction of error rights under §1639(v).

Moreover, we have a related concern that creditors or courts misunderstand the difference between a rescission exercised within the three days following closing and a rescission pursuant to the extended right to rescind. Therefore we believe it would be helpful for the Bureau to explain that rescission exercised by the consumer within three days of closing can never trigger §1639(v) because a rescission within three days is not based on any error, good faith or otherwise, but is simply an opportunity for the consumer to change his/her mind for any reason or for no reason. *See* 15 U.S.C. §1635(a); 12 C.F.R. §1026.23(a). Moreover, such a rescission is not exercised under "this section [1639]" but is exercised under section 1635(a). It is important that the Bureau articulate this view to prevent unnecessary and harmful consequences to consumers who change their minds and decide not to proceed with a refinancing transaction by rescinding within three days of closing.

II. The Bureau's proposal to amend Regulation Z, 12 C.F.R. §1026.34(b), to prohibit structuring loans to evade high-cost mortgage requirements is a much needed and welcome improvement, but originator compensation should be included as points and fees for open end-credit, not simply treated as an evasion of HOEPA.

The Bureau proposes to implement the prohibition in Dodd-Frank, 15 U.S.C. §1639(r) on evading the high-cost mortgage protections and prohibitions by amending Regulation Z, §1026.34(b). This is a welcome and much needed amendment that will significantly benefit consumers who unwittingly enter into high-cost mortgages that have been camouflaged as non-high-cost transactions. In CRL's experience, in the past, certain lenders have directed their ingenuity toward structuring loan transactions to avoid HOEPA's coverage and have deprived consumers of the protections Congress intended to provide them through HOEPA. The Bureau's proposed amendment prohibiting creditors from "structur[ing] any transaction that is otherwise a high-cost mortgage in a form, for the purpose, and with the intent to evade the requirements of a high-cost mortgage" should advance the law to capture HOEPA loans that have been structured to make them appear to fall outside of HOEPA's triggers. We encourage the Bureau to adopt an expansive view of §1639(r) to ensure that consumers are protected from a wide variety of practices designed to evade HOEPA.

The Bureau, in its proposed comments to its Official Interpretations, §1026.34(b)-1(i &ii), provides two examples of transactions structured to evade the high-cost requirements. We believe these comments would have even more utility for consumers, creditors and courts if the Bureau would provide additional examples of transactions structured to evade HOEPA. We suggest that the Bureau expand upon its loan splitting example, §1026.34(b)-1(i), to provide that all forms of loan splitting should be evaluated as follows to determine whether they are HOEPA loans. The Bureau should explain that if a loan is split into two or more loans, and any of the resulting split loans is a high-cost loan, then all of the split loans are high-cost loans. Similarly, if the aggregated fees for the split loans exceed the points and fees trigger on the combined principal balance of those loans, then each of the split loans should be treated as a high-cost loan.

We are also concerned that creditors may revive what was a common practice of certain subprime lenders to send "live checks" to consumers. These "live checks" created unsecured loans that the subprime lender then flipped into a mortgage loan. Unsecured loans created by devices such as "live checks" could provide funds to consumers to enable them to pay cash for points and fees at consummation of the subsequent mortgage loan. Although these transactions are functionally loan splitting over time, if the funds from the live check are used to pay in cash for points and fees on the subsequent mortgage loan, under the current proposal, those points and fees would not be excluded in calculating the total loan amount. Proposed comment §1026.32(b)(6)(i)-1. That raises the concern that creditors, their affiliates and agents, may seek to evade HOEPA using the "live check" and similar devices. We therefore suggest that the Bureau require that loans made within three months of the mortgage transaction by the creditor, parties affiliated with or agents of the creditor, be evaluated as loan splitting subject to HOEPA.[2] This

[2] We are also concerned that the Bureau, in redefining how to calculate the total loan amount, may have inadvertently redefined total loan amount to include (rather than exclude) points and fees that are not financed. *Compare* Proposed §1026.32(b)(6)(i) and proposed comment §1026.32(b)(6)(i)-1 *with* Comment §1026.18(b)(3)-1 ("Prepaid finance charges that are paid separately in cash or by check should be deducted . . .in calculating the amount financed.") and Comment §1026.32(a)(1)(ii)-1 ("the total loan amount is calculated by taking the amount financed . . . and deducting"). This error seems to have occurred because the Bureau proposes to skip the step of starting with amount financed in calculating the total loan amount based on its assumption that it will adopt the all in finance charge. Although an all in finance charge would result in a lower amount financed than under current law, and may suggest the Bureau should redefine how to calculate the total loan amount, there is no reason to significantly depart from longstanding regulatory interpretation of total loan amount by failing to exclude all points and fees from the total loan amount. The Bureau in its proposal has overcompensated for its expressed concern that an all in finance charge would capture too many loans within HOEPA, with a proposal that would allow many loans subject to HOEPA under the current definition of total loan amount to escape HOEPA's coverage. This proposal would encourage devices such as live checks to evade HOEPA, and would fail to capture many loans that have always be considered subject to HOEPA. For example if the principal loan amount is $200,000 and, assuming an all in finance charge definition, all finance charges are $15,000, the amount financed would be $185,000. If $5,000 of those finance charges are bona fide third party closing costs not paid to the creditor or affiliate, under current law the total loan amount would be $190,000 and the points and fees calculation would be based on a percentage of $190,000 rather than a percentage of $185K. But, if $5,000 of the points

suggestion builds on the Bureau's excellent proposed comment §1026.34(a)(10)-2, that explains that a creditor finances points and fees if they are *financed through a separate note* payable to the creditor or an affiliate.

In addition, to prevent evasions through the origination of open-end loans, the Bureau should require lenders to evaluate as closed-end loans *for purposes of evasion of HOEPA analysis*, all open-end loans that meet any of the following criteria: (1) the credit-line is substantially fully drawn at account opening; or (2) the loan was originated as a second lien simultaneously with either a purchase or refinancing first mortgage transaction. If this evaluation reveals that the open-end loan would be a HOEPA loan if it were originated as a closed-end loan, then it would be considered a HOEPA loan.

Finally, we are concerned that creditors may seek to originate loans with performance-based interest rate reductions to evade HOEPA coverage. The origination of loans that include scheduled reductions in interest rates if all payments have been made on-time, has become increasingly common. *See e.g. In re DiVittorio*, 670 F. 3d 273 (1st Cir. 2012). This practice allows a lender to calculate a blended APR based on the reduction in the interest rate that is scheduled to occur if the borrower makes all payments on-time. For loans that would meet high-cost triggers but for the interest rate reduction that is scheduled to occur if all payments are made on-time, we suggest those loans should be treated as subject to HOEPA under §1639(r).

We further suggest that the Bureau adopt a more straightforward approach to addressing loan originator compensation in open-end mortgage transactions. The Bureau has proposed a second example of a loan designed to evade HOEPA, that is, structuring a high-cost loan as an open-end loan to avoid including loan originator compensation. §1026.34(b)-1(ii). However, instead of simply counting loan originator compensation as points and fees for all open-end credit mortgage loans, *see* §1026.32(b)(3), the Bureau imposes a cumbersome process. Consumers would first be required to prove that an open-end loan is "in fact a closed-end home equity loan" and only then could the consumer seek to prove that his/her loan was an evasion of HOEPA by showing that including the loan originator compensation as points and fees would trigger coverage as a high-cost mortgage. *See* §1026.34(b)-1(ii). Only a sophisticated consumer or, more likely, one represented by counsel, would be able to take advantage of this provision. Moreover, proof would be both costly and burdensome, allowing many similarly structured loans to effectively evade HOEPA coverage. CRL is concerned that excluding originator compensation paid upfront by consumers or by creditors to brokerage firms from open-end points and fees could drive creditors to structure more loans as open-end credit in an effort to evade high-cost triggers, and that this would deceive consumers. In contrast, providing the same treatment of originator compensation as points and fees for

and fees are paid in cash at closing, under CFPB's proposal the total loan amount would be only $195,000 so a greater number of points and fees would be required to trigger HOEPA than under current law. The Bureau can easily close this loophole and conform its proposal to current law by revising its proposed regulation §1026.32(b)(6)(i) to delete the last five words. Proposed comment §1026.32(b)(6)(i)-1 should also be conformed to exclude all points and fees from total loan amount whether or not the points and fees are financed.

both closed and open-end credit would eliminate that form of gaming by creditors and allow consumers to make better informed decisions about whether or not closed and open-end credit is comparably priced. The Bureau should amend §1026.32(b)(3) to include originator compensation in open-end points and fees.

In summary, we believe the Bureau should adopt regulations and comments to guide creditors, assignees, courts and consumers regarding the proper interpretation of §1639(v), and to make clear that a rescission notice will never trigger the creditor/assignee's right to correct. In addition, we suggest that the Bureau should interpret §1639(r) expansively, to capture all loans structured to evade HOEPA and require their evaluation as HOEPA loans. In this way, the Bureau can fulfill its mandate to protect consumers from the most pernicious terms and harmful effects of disguised HOEPA loans. The Bureau should retool its total loan amount definition to conform it to current law by requiring creditors to deduct all points and fees in calculating the total loan amount. In this way, the Bureau will avoid creating a loophole that will otherwise occur, and would cause the undercounting of HOEPA loans, such that some consumers will lose the benefits of HOEPA's prohibitions and consumer protections, and also promote evasions of HOEPA through the use of "live checks" and other devices. Finally, the Bureau should take a straightforward approach to loan originator compensation and count it as points and fees in the same way for both closed and open-end loans.

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