

Corrected Version

**COMMENTS to the Federal Reserve Board
[Regulation Z; Docket No. R-1390]
12 CFR Part 226: Truth in Lending – Proposed Rule**

**by the National Consumer Law Center
on behalf of its low-income clients**

and for

**Americans for Financial Reform
California Reinvestment Coalition
Center for Responsible Lending
Consumer Action
Consumers Union
National Association of Consumer Advocates
National Community Reinvestment Coalition
National Fair Housing Alliance
and the
Neighborhood Economic Development Advocacy Project**

December 23, 2010

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Introduction

The National Consumer Law Center¹ ("NCLC") respectfully submits the following comments on behalf of its low income clients, as well as Americans for Financial Reform, California Reinvestment Coalition, the Center for Responsible Lending, Consumer Action, Consumers Union, National Association of Consumer Advocates, National Community Reinvestment Coalition, National Fair Housing Alliance and the Neighborhood Economic Development Advocacy Project,² regarding the Federal Reserve Board's proposals to revise

¹ The **National Consumer Law Center, Inc. (NCLC)** is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of eighteen practice treatises and annual supplements on consumer credit laws, including *Truth In Lending*, (7th ed. 2010 (forthcoming)), *Cost of Credit: Regulation, Preemption, and Industry Abuses* (4th ed. 2009), and *Foreclosures* (3rd ed. 2010), as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low-income people, conducted training for thousands of legal services and private attorneys on the law and litigation strategies to address predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. NCLC's attorneys have been closely involved with the enactment of the all federal laws affecting consumer credit since the 1970s, and regularly provide extensive comments to the federal agencies on the regulations under these laws. These comments were written by NCLC attorneys Carolyn Carter, Alys Cohen, Andrew Pizor, John Rao, Margot Saunders, Diane E. Thompson, Tara Twomey, and Odette Williamson; Center for Responsible Lending attorneys Kathleen Keest and Nina Simon; and Center for Responsible Lending Vice President for Federal Affairs Susanna Montezemolo.

² **Americans for Financial Reform** is a coalition of more than 250 consumer, labor, civil rights, senior, community, business, academic, and other groups working together to hold Wall Street accountable and reforming our financial system so it serves our families and our communities. AFR played a leading role in strengthening and winning passage of the Dodd-Frank Consumer Protection Act, and is now focused on tough and effective implementation to fulfill the promise of that legislation, and on continuing efforts to transform our financial system.

The **California Reinvestment Coalition** advocates for the right of low-income communities and communities of color to have fair and equal access to banking and other financial services. CRC has a membership of more than 280 nonprofit organizations and public agencies across the State.

The **Center for Responsible Lending** is a non-profit organization focused on policy research and advocacy to stop predatory lending practices. We are an affiliate of Self-Help, one of the nation's largest nonprofit community development lenders, whose mission is to create and protect ownership opportunities for low-

numerous regulations under the Truth in Lending Act (“TILA”) governing home-secured lending.³

In these comments we address the range of subjects included in this complex docket. We believe that some of the Board’s proposals are constructive and will further consumer protections for homeowners, or could do so if revised. However, some of the proposals are extremely damaging to consumers and to preservation of homeownership, and – we believe – are beyond the Board’s authority.

Because of the extensive damage that the Board’s proposal would cause to consumers seeking to exercise the extended right of rescission, we already have made – and now repeat – the unprecedented request that the Board withdraw this docket. In the face of

wealth families through home and small business ownership. Self-Help has provided \$3.8 billion in financing to help over 30,000 low-wealth borrowers buy homes, build businesses and strengthen community resources. Additionally, our affiliate Self-Help Credit Union maintains deposit accounts for individuals, nonprofit and religious organizations, and foundations.

Consumer Action has been a champion of underrepresented consumers since 1971. A national, nonprofit 501(c)3 organization, Consumer Action focuses on financial education that empowers low to moderate income and limited-English-speaking consumers to financially prosper. It also advocates for consumers in the media and before lawmakers to advance consumer rights and promote industry-wide change particularly in the fields of credit, banking, housing, privacy, insurance and utilities. www.consumer-action.org

Consumers Union of United States, Inc., publisher of *Consumer Reports*®, is a nonprofit membership organization chartered in 1936 to provide consumers with information, education, and counsel about goods, services, health and personal finance. Consumers Union's publications and services have a combined paid circulation of approximately 8.3 million. These publications regularly carry articles on Consumers Union's own product testing; on health, product safety, and marketplace economics; and on legislative, judicial, and regulatory actions that affect consumer welfare. Consumers Union's income is solely derived from the sale of *Consumer Reports*®, its other publications and services, fees, noncommercial contributions and grants. Consumers Union's publications and services carry no outside advertising. Consumers Union does not accept donations from corporations or corporate foundations.

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.

The **National Community Reinvestment Coalition** (NCRC) is an association of more than 600 community-based organizations that promote access to basic banking services including credit and savings, to create and sustain affordable housing, job development and vibrant communities for America's working families. NCRC member organizations and our Housing Counseling Network work with thousands of families each year in efforts to save their homes from imminent foreclosure and problematic lending. NCRC counselors observe that a lack of consumer protections and rampant fraudulent residential and consumer lending practices was one of the major causes of the foreclosure crisis.

Founded in 1988, the **National Fair Housing Alliance** is a consortium of more than 220 private, non-profit fair housing organizations, state and local civil rights agencies, and individuals from throughout the United States. Headquartered in Washington, D.C., the National Fair Housing Alliance, through comprehensive education, advocacy and enforcement programs, provides equal access to apartments, houses, mortgage loans and insurance policies for all residents of the nation.

NEDAP is a resource and advocacy organization, based in New York City. NEDAP’s mission is to promote community economic justice in New York and to eliminate discriminatory economic practices that harm communities and perpetuate inequality and poverty. NEDAP employs multiple strategies – including community outreach and education, advocacy, coalition organizing, policy research and analysis, technical support for community groups, and direct legal services – to ensure that communities have access to fair and affordable credit and financial services, and to address inequities in the financial services system.

³ 75 Fed. Reg. 58539 (Sept. 24, 2010).

an unparalleled foreclosure crisis, with foreclosure rates more than three times higher than those in the Great Depression,⁴ now is the time to reinforce the fundamental importance of TILA rescission. Instead, the Board has proposed rules aimed at reducing the “litigation risk” for mortgage companies by eviscerating the single most effective tool that homeowners have to stop foreclosures and avoid predatory loans: the extended right of rescission.

Summary of Comments

Rescission. The Board has proposed a set of changes to homeowners’ use of the extended right of rescission, which are not justified by the statute and evidence a lack of concern for homeowners. The proposed changes are so profound that they could end the vitality of TILA’s disclosure regime and further destabilize the markets by exacerbating the foreclosure crisis. They should be withdrawn.

Reverse Mortgages. The Board’s proposals to change the way reverse mortgages will be disclosed and governed are also highly troubling and should be withdrawn. To be sure, some of these changes will be quite helpful to consumers. For example, we applaud the Board’s new disclosure regime for reverse mortgages. Although some significant improvements are still needed, we think that the proposal to require counseling for all reverse mortgages, not just federally insured products, is a good thing.

However, the core proposals regarding reverse mortgages will be promote abusive lending to elderly homeowners and are potentially illegal and beyond the Board’s authority. For example, the safe harbor proposed for cross-selling products is unjustified and purports to make some predatory creditor behavior legal when it is already illegal under other law. The Board’s proposal to include recourse products within the definitions for -- as well as the exemptions for -- reverse mortgages undermines the beneficial effect of reverse mortgages. It is also alarming that the Board would amend the definition of “consumer” so as to exclude from the requirement of pre-loan counseling the person who most needs it: the spouse who is relinquishing her ownership interest in her home so as to maximize the income from the reverse mortgage. Also, the Board has failed to address the predatory practices rampant in the reverse mortgage marketplace.

Changes to HOEPA Points and Fees Trigger. The Board’s proposed changes to the HOEPA points and fees calculation and the APR trigger for defining higher-priced mortgage loans are misguided and should not be adopted. The changes are contrary to the guiding principle of transparency inherent in TILA and contradict Congress’ recently-expressed desire to expand consumer credit protections. The Board lacks sufficient data and has not presented a sufficient basis for these changes.

Refundable Fees Following Early Disclosures. The Board’s proposal regarding refundable fees following early mortgage disclosures would enhance transparency and

⁴ The U.S. foreclosure rate (percentage of outstanding mortgage loans in foreclosure) at the end of the third quarter of 2010 was 4.39%. Mortgage Banker’s Ass’n, National Delinquency Survey Q3 2010, at 3. The foreclosure rate for non-farm mortgages peaked in 1933, below 1.4%. David C. Wheelock, *The Federal Response to Home Mortgage Distress: Lessons from the Great Depression*, 90 Federal Reserve Bank of St. Louis Rev. 133, 138–39 (2008).

consumer shopping. The refundable period should be extended, however, at least for consumers with the right of rescission, until the end of the three-day rescission period in order to avoid any undermining of the rescission period. The Board’s other proposals in connection with early disclosures also are generally constructive, although the waiver of the waiting period should be limited to the seven-day waiting period, since waiver of the three-day waiting period is not supported by the statute and is contrary to the purposes of the early disclosures.

Loan Modifications Triggering New Disclosures. The proposal to require new disclosures for some creditor modifications is a welcome step forward, but the proposed exceptions—for modifications that occur as part of a court proceeding, that happen when the homeowner is in default, or that result in a lowered interest rate— could swallow the rule. Unless the Board changes the definitions used in these exceptions, borrowers will continue to enter into modifications without knowledge as to their terms.

Overall. While the docket includes some proposals that would improve the protection of consumers – for example, the proposed requirement that a servicer respond within a reasonable time to a homeowner’s request for the identity of a holder – the docket as a whole contains so many harmful provisions that we urge the Board to withdraw it.

The following table provides an overview of the positions taken in these comments. It does not include certain limited areas where the comments propose additional action not yet proposed by the Board.

Description of Proposed Regulation	Reg. Z or OSC Section	Board’s Authority and Effect on Consumers	Section in these Comments Addressing Provision
Reordering of procedure for exercising right of rescission	§ 226.15 & § 226.23	The Board has exceeded its authority and this policy would be harmful to consumers.	II. B.
Enlargement of the list of events that terminate the right of rescission	§ 226.15 & § 226.23	The Board has exceeded its authority and this policy would be harmful to consumers.	II. C.
Requirement that each consumer be given only one copy of the rescission notice, and to use a tear-off form	§ 226.15 & § 226.23	This proposed change would be harmful to consumers.	II. D.
Definition of material disclosures for HELOCs	§ 226.6	This proposed change would be harmful to consumers.	II. E.
Tolerances for open and closed-end disclosures, including for payment and loan amounts	§ 226.31(d)	The Board has exceeded its authority and this proposed change would render the disclosures meaningless.	II. F.
Broad leeway for creditors regarding formatting and content of statutorily-mandated	§ 226.23(b)(2)-(4); OSC §§ 226.15(a)(5)(i)-3;	These proposed changes would undermine the utility of uniform mortgage disclosures.	II. G. & H.

disclosures	226.23(b)(2)-1; 226.23(b)(4)-1		
Specific changes to rules regarding notice of right to cancel; clarification of exemption from rescission for same-creditor refinancing	§§ 26.23(b)(3)(iv); 226.23(f)(2); OSC § 226.23(c)-4;	These proposed changes would be helpful to consumers.	II. I.-1
Model notice of right to cancel-- language and process changes; List of material disclosures; Creditor provision of longer rescission period; Tender amount reduced by damage award; Clarification regarding waiver.	§ 226.23(a)(2); OSC §§ 226.23(d)(2)(ii)(A)-1 & 226.23(e)-2.iii; Proposed Forms G-5(B), G-5(C), H-8(B), H-9.	These proposed changes could be helpful to consumers with substantial revisions, but would be harmful in their current form.	II. I-2
Change in the HOEPA points and fees definition	§226.32(b)(1) & § 226.4(g)	This proposed change would be harmful to consumers.	III. A.-E.
Replacement of APR for higher-priced mortgage loan trigger with new metric	§ 226.35(a)	This proposed change would be harmful to consumers.	III. A.-E.
New disclosures for reverse mortgages	§ 226.33	This new construct would be helpful with improvements.	IV. C.
Changing the definition of the term "Reverse Mortgage" to include recourse loans	§ 226.32	This proposed change would be harmful to consumers.	IV. D.
Ten-day safe harbor in proposed anti-tying rule	§ 226.40(a)	This proposed change would be harmful to consumers.	IV. E.
Proposal to require counseling for all reverse mortgage borrowers	§ 226.40(b)	This proposed change would be helpful to consumers with some clarifications and improvements.	IV. F.
Proposed change to definition of "consumer" to exclude non-borrowing spouses who relinquish ownership interest	§ 226.40(b)(7))	This proposed change would be harmful to consumers.	IV. G.
Proposed advertising rules	§ 226.33(e)	These proposed rules are very weak and would facilitate deception.	IV. H
Addition of post-early disclosure refundable fees period	§ 226.19(a)	This proposed change will help consumers, but would be stronger and less likely to undermine the rescission right if the refundable fees period were extended for homeowners with the right of rescission.	V. A.
Commentary on when a fee has been imposed	OSC § 226.19(a)1)(ii)-4	With one minor exception this proposal would be helpful for consumers.	V. B.
Exempting legally required	§ 226.19(a)(1)(ii)	This proposed change would be	V. B.

counseling fees from the definition of “fees” for purposes of the refundable fees rule		helpful for consumers.	
Clarification that the special mortgage tolerances under Reg. Z § 226.22(a)(4) & (5) apply to early APR disclosures when determining whether redisclosure is required	§§ 226.22(a)(4)& (5); 226.19(a)	This proposal would be helpful for consumers.	V. C.
Requirement to include certain additional disclosures when redisclosing prior to consummation	OSC. § 226.19(a)(2)(iii)-2	This proposal could be helpful for consumers but would be stronger with full redisclosure to enable comparisons.	V. C.
Clarification that consumer can only waive waiting period after disclosures have been received; bona fide personal emergency typically involves imminent loss or harm to the dwelling	§ 226.19(a)(3); OSC § 226.19(a)(3)-1	These proposed clarifications are helpful to consumers as they apply to the seven-day waiting period, but application of the waiver to the three-day waiting period is harmful to consumers and not supported by the statute.	V. D.
Requirement that closed-end ARMs must be linked to an index that is both public and not in creditor’s control		This proposal would be helpful for consumers.	V. E.
Clarification that early disclosures only need to be provided to one consumer with primary liability	OSC § 226.19(a)-1	This proposed change would be harmful to consumers.	V. F.
Requirement to provide certain loan modification disclosures, with exceptions	§ 226.20(a)	This proposal would be helpful for consumers only if the exceptions were significantly narrowed.	VI. A.-F.

Because of the overriding importance of the proposed changes to the extended right of rescission, the proposed tolerances for material disclosures, and the proposed safe harbors for limits on reverse mortgage cross-selling, we first focus on the Board’s authority to deviate from the statute. Successive sections will address the proposed regulatory changes in the order in which they appear in the docket.

I. THE PROPOSED RULE EXCEEDS THE BOARD’S LIMITED AUTHORITY TO DEVIATE FROM THE CONSUMER PROTECTIONS MANDATED IN THE STATUTE.

A. The Board Has Limited Authority to Deviate from TILA’s Mandatory Consumer Protections.

The proposed changes to the regulations on rescission, material disclosures and tolerances exceed the Board’s statutory authority. These are to be distinguished from the

other proposed regulatory changes that are also bad policy, but are not impermissible exercises of the Board's regulatory authority.

The Board's authority to regulate under the Truth in Lending Act stems from section 105(a)⁵ of TILA. Congress provided the Board with the regulatory authority to flesh out the statute's provisions. In addition to the broad regulatory authority provided in the first sentence, Congress gave the Board the power to make "classifications, differentiations, or other provisions" and to make "adjustments and exceptions."

(a) The Board shall prescribe regulations to carry out the purposes of this title. Except in the case of a mortgage referred to in section 103(aa), these regulations may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of this title, to prevent circumvention or evasion thereof, or to facilitate compliance therewith.⁶

The Board's authority is not open-ended. There are essentially three important limitations on the Board's exception authority:

- All regulations issued by the Board must serve the ultimate goal of furthering the purposes of TILA.
- The classifications, differentiations, adjustments, and exceptions the Board is permitted to make to the statutory requirements are only permissible if they also further the purposes of the statute.
- No classifications, differentiations, adjustments or exceptions are permissible at all with regard to the transactions covered by section 103(aa), commonly referred to as "HOEPA loans."

These limitations are discussed in the subsections that follow.

B. The Purpose of TILA Is the Informed Use of Credit, Which Requires Accurate and Full Disclosure.

The Truth in Lending Act is a cornerstone of consumer credit legislation. The statute is Congress's effort to guarantee the accurate and meaningful disclosure of the costs of consumer credit and thereby to enable consumers to make informed choices in the credit marketplace.⁷ As Congress explicitly articulated in Section 101 of TILA:

⁵ 15 U.S.C. § 1605.

⁶ 15 U.S.C. § 1605(a).

⁷ 15 U.S.C. § 1601(a) (congressional findings and declaration of purpose). *See, e.g.*, *Williams v. Chartwell Fin. Servs., Ltd.*, 204 F.3d 748 (7th Cir. 2000) ("Congress enacted TILA to ensure that consumers receive accurate information from creditors in a precise and uniform manner that allows them to compare the cost of credit."); *Rodash v. AIB Mortgage Co.*, 16 F.3d 1142 (11th Cir. 1994) (TILA intended to promote informed use and awareness of cost of credit; ensure meaningful disclosure to enable ready comparison of credit terms); *First Nat'l Bank v. Office of the Comptroller*, 956 F.2d 1456 (8th Cir. 1992) (fundamental purpose of the Act is to require disclosure of true cost of credit so consumers can make informed choice); *Frazier v. Washington Mut.*, 2006 WL 1579559 (W.D. Tenn. June 1, 2006) (TILA's meaningful disclosures intended to promote informed

(a) Informed use of credit. The Congress finds that economic stabilization would be enhanced and the competition among the various financial institutions and other firms engaged in the extension of consumer credit would be strengthened by the informed use of credit. The informed use of credit results from an awareness of the cost thereof by consumers. *It is the purpose of this subchapter to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit, and to protect the consumer against inaccurate and unfair credit billing and credit card practices.* (Emphasis added).⁸

This means that each of the material credit terms – the amount financed, the finance charge, the payment schedule, the total of payments, the term of the loan, the total of payments – must be specifically and accurately disclosed. Consumers must be able to “readily” compare the different forms of credit.

When TILA passed the U.S. Senate, Senator Proxmire explained the principles represented in the statutory provisions:

The first principle of the bill is to insure that the American consumer is given the whole truth about the price he is asked to pay for credit. The bill would not regulate interest charges, but would rather aim at a full disclosure of the cost of credit so that the consumer can make intelligent choices in the marketplace.

...

The second principle is that the whole truth about the cost of credit really is not meaningfully available unless it is stated in terms that consumers in our society can understand. Just as the consumer is told the price of milk per quart and the price of gasoline per gallon, so must the buyer of credit be told the “unit price.”

....

A third principle is that the definition of finance charge, upon which an annual percentage rate is calculated, needs to be comprehensive and uniform. It needs to be uniform to permit a meaningful comparison between alternative sources of credit.⁹

use of credit); *Betancourt v. Countrywide Home Loans*, 344 F. Supp. 2d 1253 (D. Colo. 2004); *Landreneau v. Fleet Fin. Group*, 197 F. Supp. 2d 551 (M.D. La. 2002) (enacted to promote informed borrowing by requiring disclosures, to protect consumers from hidden and unreasonable charges, and to allow comparison of credit terms); *Martin v. Equity One Consumer Discount Co.*, 194 F. Supp. 2d 469 (W.D. Va. 2002); *Mourer v. Equicredit Corp.* (*In re Mourer*), 287 B.R. 889 (Bankr. W.D. Mich. 2003) (purpose is to promote informed use of credit by requiring creditors to make uniform disclosures so consumers can compare credit terms), *aff'd in part, rev'd in part on other grounds*, 309 B.R. 502 (W.D. Mich. 2004); *In re Cox*, 114 B.R. 165 (Bankr. C.D. Ill. 1990) (TIL purpose is to promote informed use of credit through meaningful accurate disclosure of credit terms). See also Matthew A. Edwards, *Empirical and Behavioral Critiques of Mandatory Disclosure: Socio-Economics and the Question of Truth in Lending*, 14 Cornell J.L. & Pub. Pol'y 199, 209–210 (2005) (discussing the goals listed in the Act and the goals ascribed to TILA); Kathleen E. Keest, *Wither Now? Truth in Lending in Transition—Again*, 49 Consumer Fin. L.Q. Rep. 360 (Fall 1995).

⁸ 15 U.S.C. § 1601.

⁹ *Introductory Remarks to Accompany S. 5*, Cong. Rec. S1202 (Jan. 31, 1967).

The meaningful disclosure of credit terms requires truthful and accurate statements about the costs and the terms of credit. Disclosures that are permitted to be different from the actual terms of the contract do not further the purposes of the Act.

The essential test that must be applied to determine the legality of the Board’s regulatory proposals, whether these proposals are in the form of simple regulations, or posed as exceptions, adjustments, or exemptions, is whether the proposal furthers these consumer protection purposes of TILA. If the Board’s proposals do not further the informed use of credit, if they remove incentives for creditors to make full and accurate disclosure, then the Board’s proposals must not go forward.

C. All of the Board’s Regulations Must Be Designed to Carry Out the Purposes of TILA.

As is clear from the first sentence of section 105(a), the regulations must further the ultimate purposes of the title. All regulations the Board adopts, including those that create adjustments or exceptions, are governed by this first sentence. The fact that the last sentence of the subsection permits “adjustments and exceptions . . . to prevent the prevent circumvention or evasion, or facilitate compliance therewith” should not diminish the importance of the primary limitation on the Board’s authority – which is to effectuate the purposes of the title.

Judicial decisions evaluating the extent of the Board’s authority to promulgate regulations under TILA have granted the Board wide discretion in its implementation of subsection 105(a). However, the essential test for whether the Board has exercised its regulatory authority properly is grounded in whether the Board’s regulations further the consumer protection purposes of TILA.¹⁰ As the Supreme Court held in *Mourning v. Family Publications Service, Inc.*:

The Board was thereby empowered to define such classifications as were reasonably necessary to insure that the objectives of the Act were fulfilled . . .
”¹¹

The only legal basis for the Board’s exercise of its regulatory authority under section 105(a) is to further the purposes of TILA.

¹⁰*Ford Motor Credit Co. v. Millhollin*, 444 U.S. 555 (1980) (interpreting Official Staff Commentary to determine whether TILA’s goal of consumer protection met, and finding that “deference” to the Board and staff are appropriate where the express language in the statute is unclear); *Consumers Union of U.S., Inc. v. Federal Reserve Bd.*, 938 F.2d 266, 269 (D.C. Cir. 1991) (“The Board’s authority to issue regulations interpreting TILA is designed to enhance the purpose of the statute – to achieve ‘meaningful disclosure’ for the consumer”); *American Bankers Ins. Group, Inc. v. Board of Governors of Federal Reserve System*, 3 F. Supp. 2d 37, 44 (D.D.C. 1998) (Ultimate test of whether Board properly exercised its authority under section 105(a) was whether the purposes of the Act were furthered). *But see* *Ortiz v. Rental Management*, 65 F.3d 335 (3d Cir. 1995) (applying the “demonstrably irrational” test from *Millhollin* to the Board’s pronouncements without any limitation on the goal of the regulation).

¹¹ *Mourning v. Family Publications Service, Inc.*, 411 U.S. 356, 366 (1973).

D. The Board’s Classification and Adjustment Authority Does Not Authorize It to Issue Regulations That Do Not Further the Purposes of TILA.

The Board is clearly enabled to provide for “classifications, differentiations, . . . other provisions, . . . adjustments and exceptions,” under the second sentence in subsection 105(a). However, this authority is subject to the general rule set forth in the first sentence of section 105(a) that all regulations must carry out the purposes of TILA. This limitation also appears in the second sentence:

(a) . . . these regulations may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, *as in the judgment of the Board are necessary or proper to effectuate the purposes of this title*, to prevent circumvention or evasion thereof, or to facilitate compliance therewith. (Emphasis added.)

Reading the second sentence of section 105(a) to permit classifications or differentiations which are not designed to further the purposes of TILA, but only to facilitate compliance, would not jive with the Congressional intent evident from both this section and the entire statute. Such a reading would mean that on the one hand Congress required all regulations to effectuate the purposes of TILA, but intended to allow the Board to allow exceptions for other reasons, which do not further its purposes of TILA. There is no basis in the legislative history for that. In fact – just the opposite. In 1996, Congress added the very strictly worded exemption provisions in section 105(f).¹²

In section 105(f), Congress added an extensive list of requirements for the Board to evaluate before the Board would be permitted to exempt any “class of transactions,” Exemption under section 105(f) is only permitted when the Board finds no meaningful benefit to consumers from the provision being exempted. The Board is required to evaluate five separate factors (one of which includes three subparts) before proposing – by regulation – any exemption for classes of transactions from the requirements of the statute.¹³

¹² Sept. 30, 1996 (110 Stat. 3009-399, 401).

¹³ (f) (1) In general. The Board may exempt, by regulation, from all or part of this subchapter any class of transactions, other than transactions involving any mortgage described in section 1602(aa) of this title, for which, in the determination of the Board, coverage under all or part of this subchapter does not provide a meaningful benefit to consumers in the form of useful information or protection.

(2) Factors for consideration. In determining which classes of transactions to exempt in whole or in part under paragraph (1), the Board shall consider the following factors and publish its rationale at the time a proposed exemption is published for comment:

(A) The amount of the loan and whether the disclosures, right of rescission, and other provisions provide a benefit to the consumers who are parties to such transactions, as determined by the Board.

(B) The extent to which the requirements of this subchapter complicate, hinder, or make more expensive the credit process for the class of transactions.

(C) The status of the borrower, including--

(i) any related financial arrangements of the borrower, as determined by the Board;

(ii) the financial sophistication of the borrower relative to the type of transaction; and

(iii) the importance to the borrower of the credit, related supporting property, and coverage under this subchapter, as determined by the Board;

(D) whether the loan is secured by the principal residence of the consumer; and

(E) whether the goal of consumer protection would be undermined by such an exemption.

15 U.S.C. § 1604(f).

Congress has specifically required in the first sentence of subsection 105(a) that the Board write all regulations under the statute to further the consumer protection purposes. And Congress has closely limited the Board’s authority to provide exemptions from those regulations only when the Board has found – after extensive inquiry -- that consumers would be better protected from the exemptions. It makes little sense that at the same time, Congress would have allowed classifications, adjustments or exceptions to be based on reasons other than consumer protection.

Yet, it appears from the Supplementary Information to this docket that the Board’s proposals relating to the new rules for rescission, tolerance and changes in material disclosures are not based on serving the consumer protection purposes of the statute. Instead, the Board summarizes its rationale for these proposals in this way:

The objectives of the proposed revisions are to update and clarify the rules for home-secured credit that provide important protections to consumers, *and to reduce undue compliance burden and litigation risk for creditors.* (Emphasis added.)¹⁴

The Board has articulated this goal of relieving burdens on creditors multiple times in the Supplementary Information. Other examples of this *stated* reason for undermining essential consumer protections provided specifically by the statute are –

The Board proposes several changes to Regulation Z that are designed to preserve the right to rescind while *reducing undue litigation costs and compliance burden for creditors.* (Emphasis added.)¹⁵

....

The Board does not believe that an extended right of rescission is appropriate if a creditor overstates or slightly understates the loan amount, the total settlement charges, the prepayment penalty, or the payment summary. *Creditors would incur litigation and other costs of unwinding transactions based on the extended right of rescission, even though the overstatement or slight understatement of the disclosure was not critical to a consumer's decision to enter into the credit transaction, and, in turn, to rescind the transaction.* (Emphasis added.)¹⁶

The Board refers to “conserving judicial resources” as one reason for proposing the changes in these important consumer protections:

Creditors have expressed concern that it is difficult to prove, if challenged, that the consumer received two copies of the notice at loan closing. *Such case-by-case determinations consume judicial resources and increase credit costs.* (Emphasis added.)¹⁷

¹⁴ 75 Fed. Reg. 58539, 58546, (Sept. 24, 2010).

¹⁵ 75 Fed. Reg. 58539, 58548, (Sept. 24, 2010).

¹⁶ 75 Fed. Reg. 58539, 58613 (Sept. 24, 2010).

¹⁷ 75 Fed. Reg. 58539, 58621 (Sept. 24, 2010).

While conserving judicial resources is a laudable goal for all agency endeavors, it is not a legal basis for undermining statutory consumer protections provided in the Truth in Lending Act. Moreover, the case-by-case determinations the Board cites as problematic are precisely what the judicial branch is designed to do. Case-by-case determinations are not an improper use of judicial resources; they are the very reason the judicial branch exists.

The current proposals reordering the extended right of rescission, denying extended rescission whenever a consumer has refinanced the loan in question, providing tolerances to protect creditors from litigation, and declassifying statutorily mandated disclosures as material do not advance the informed use of credit.¹⁸ These proposals undermine the informed use of credit in several important ways. First, through the use of tolerances, creditors will be able to avoid penalties for misstating the real costs of the home-secured credit. Second, creditors will have far less incentive to carefully disclose the true costs, because the penalties for violating the disclosure rules will be much less severe. As a result the reliability of the TILA disclosures will be far lower – and the goal of informed use of credit will be diluted. Most importantly, the ability of homeowners to use the extended right of rescission to protect themselves from foreclosure – after creditors have failed to comply with TILA’s explicit disclosure requirements – will be effectively rendered useless. Those results do not conform to the purposes of TILA.

The Board simply does not have the authority to promulgate exceptions, adjustments, classifications or exemptions to the statutory requirements unless by doing so, the purposes of TILA are furthered. The exception, classification and adjustment authorities were provided to the Board to ensure that it has the power to protect consumers from attempted evasions.¹⁹ This authority was not provided to protect creditors from lawsuits and litigation initiated by consumers who are enforcing their statutory rights under the Act.

E. The Board Is Not Permitted to Promulgate Any Adjustments or Exceptions for Any Provision Affecting HOEPA Loans.

The Board’s attempt to use its exception authority under section 105(a) to change the order for the procedure after a homeowner has exercised the extended right of rescission additionally exceeds the Board’s authority to the extent it affects remedies provided for violations of HOEPA loans.

Under TILA, the extended right of rescission is triggered by two separate types of violations made by creditors. One is the failure to provide the material disclosures or the proper notice of the right to rescind at loan origination.²⁰ The other is a creditor’s illegal

¹⁸ These issues are developed with much greater detail and specificity in sections II. B, C, F, G & H, *infra*.

¹⁹ *Mourning v. Family Publications Service, Inc.*, 411 U.S. 356 (1973) (“The language employed evinces the awareness of Congress that some creditors would attempt to characterize their transactions so as to fall one step outside whatever boundary Congress attempted to establish. It indicates as well the clear desire of Congress to insure that the Board had adequate power to deal with such attempted evasion. In addition to granting to the Board the authority normally given to administrative agencies to promulgate regulations designed to ‘carry out the purposes’ of the Act, Congress specifically provided, as noted earlier, that the regulations may define classifications and exceptions to insure compliance with the Act.” At 365, 366).

²⁰ 15 U.S.C. § 1635(a).

inclusion of prohibited terms in a HOEPA loan.²¹ The same remedy is applicable, and both are covered by the same section of TILA – section 125 – and the same provisions in the regulations – section 226.23. The rules for the exercise of extended right of rescission are the same, regardless of which violation of TILA triggered the right.

Both the classification/adjustment/exception authority in subsection 105(a), as well as the exemption authority in subsection 105(f), are expressly inapplicable to HOEPA loans (those referred to in section 103(aa)). Instead, in the statutory sections governing HOEPA, Congress has specified the matters about which it allows the Board to exercise its discretion. For example, the Board has clear authority to make adjustments to the APR trigger for HOEPA loans under section 103(aa)(2)(A); to make other adjustments in section 129(b)(3) regarding the timing of disclosures; and to exempt “specific mortgage products or categories of mortgages from any or all of the prohibitions specified in subsections (c) through (i) if the Board finds that the exemption (A) is in the interest of the borrowing public; . . .”²² But the Board is nowhere permitted to change the rules for the exercise of the extended right of rescission when a creditor violates HOEPA.

When Congress passed HOEPA in 1994, it contemplated that the extended right of rescission – as articulated in the statute, and the Board’s regulations at the time – would be an important part of the enforcement regime for HOEPA loans. As the conferees noted in the Conference Report:

Subsection (b) defines the specific disclosures required for 103(aa) loans as “material disclosures”, *thereby providing the consumer with a right of rescission (as with other TILA disclosures) for up to three years* in the event that the required disclosures are not provided. (Emphasis added).²³

In section 129(j), Congress also explicitly made the consequences for including prohibited terms (such as a balloon term or prepayment penalty) in a HOEPA loan, a “material violation” triggering the extended right of rescission. The conferees pointed out:

Inclusion of any of these prohibited terms is deemed a failure to deliver “material disclosures” as required by the TILA *thereby providing the borrower with rescission rights under §125 of that Act*.²⁴

The failure to deliver material disclosures triggers the extended right of rescission under section 125. The three day right of rescission after origination is automatic for all loans secured by the home which are not used to purchase the home. So adding the HOEPA prohibited terms to the definition of material disclosures could only be for the purpose of triggering the extended right of rescission. And it was clearly this extended right

²¹ “Any mortgage [described in § 103(aa)] that contains a provision prohibited by this section shall be deemed a failure to deliver the material disclosures required under this title, for the purpose of section 125.” 15 U.S.C. § 1639(j).

²² 15 U.S.C. § 1639(l)(1).

²³ H.R. Conf. Rep. No. 652, at 136, 103d Cong. 2d Sess. 147, 159 (1994); 1994 U.S.C.C.A.N. 1987, 1989 (accompanying H.R. 3474).

²⁴ H.R. Conf. Rep. No. 652, at 138, 103d Cong. 2d Sess. 147, 161 (1994); 1994 U.S.C.C.A.N. 1987, 1991 (accompanying H.R. 3474).

of rescission – as it was fashioned in 1994 – that Congress intended for homeowners to use for relief after creditors violated HOEPA by illegally including the prohibited terms in loan contracts.

At the same time, Congress explicitly amended section 105(a) to prohibit the Board from applying any exceptions to any provisions affecting HOEPA loans. The language excepting loans defined by section 103(a) was added to section 105(a) in the same bill.²⁵

(a) The Board shall prescribe regulations to carry out the purposes of this title. *Except in the case of a mortgage referred to in section 103(aa), these regulations may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of this title, to prevent circumvention or evasion thereof, or to facilitate compliance therewith.*²⁶ (Emphasis added).

The Congressional prohibition against the Board’s providing any classifications or adjustments for regulations affecting HOEPA loans means that the Board cannot use its exception authority in section 105(a) to change the statutory rules for HOEPA loans. Yet, the reordering of the extended right of rescission process – as is proposed in this docket for section 226.23 of Regulation Z – unquestionably changes the rules for the enforcement of HOEPA loans.²⁷ These changes are proposed by the Board under its “exception” authority,²⁸ which is explicitly inapplicable to HOEPA loans. As such, even if the Board determines that the changes to the procedure for the extended right of rescission are still appropriate for non-HOEPA loans, the Board cannot apply these changes when the extended right of rescission is exercised for violations of HOEPA.

II. THE BOARD’S RESCISSION PROPOSAL WOULD EVISCERATE HOMEOWNERS’ MOST POWERFUL PROTECTION AGAINST PREDATORY LENDING AND SHOULD BE WITHDRAWN.

A. The Board Should Preserve and Strengthen the Rescission Right, Not Weaken It.

The Board has missed an opportunity to strengthen TILA. Instead, the Board’s proposed rulemaking would weaken TILA’s core enforcement mechanism and endanger homeownership.

The importance of Truth in Lending rescission cannot be overstated. Homes are a key part of family stability, the largest asset most families have, and a stepping stone to upward mobility. Giving consumers the opportunity to reflect and reconsider before placing

²⁵ H.R. Conf. Rep. No. 652, at 30, 103d Cong. 2d Sess. 147 (1994); 1994 U.S.C.C.A.N. 1987 (accompanying H.R. 3474).

²⁶ 15 U.S.C. § 1605(a).

²⁷ See section II, *infra*, for more discussion of the ways the proposed changes to Reg. Z § 226.23 eradicate the protections Congress intended to be provided by the extended right of rescission.

²⁸ 75 Fed. Reg. 58539, 58629 (Sept. 24, 2010) (citing 15 U.S.C § 1604(a) as authority).

their homes on the line offers some protection from fast-talking salesmen and brokers.²⁹ The extended right of rescission offers homeowners provided with false or misleading disclosures a chance to undo the harm of a predatory loan. Rescission acts as a buffer against hasty or unsound decisions that place the family's home at risk.

Rescission is important in part because consumers cannot evaluate the loan in the midst of a loan closing. Closings are often characterized by a tremendous number of complex legal documents, most of which the homeowner is encountering for the first time, including the promissory note and security instrument. Closings are often rushed, without sufficient time to carefully read all the documents or compare final documents to initial disclosures. The social dynamics of a closing often pressure the consumer to sign the documents presented, regardless of misgivings or reservations.³⁰

TILA's extension of the right to rescind past the initial three-day period is especially important in protecting against creditor malfeasance. Without such a right, a creditor that misrepresented the credit terms or the right to rescind would be home free as long as the misrepresentation remained undiscovered for the first three days. For consumers, who typically trust their lenders and believe that the lenders are looking out for their best interests,³¹ uncovering such misrepresentations is always difficult. For borrowers in the recent explosion of predatory lending and exotic mortgage products that led up to the collapse of the mortgage market, uncovering lender misrepresentations within three days was nearly impossible. Teaser rates hid exploding ARMs and other unconscionable terms. Loans that kept payments at a low level while increasing the interest rate left many homeowners unaware that the loan was negatively amortizing – a concept that consumers find difficult to understand even when disclosure is attempted. Few homeowners realize that they have been the victim of predatory lending until a threatened foreclosure forces them to seek legal help.

The extended right of rescission is often the only way that a consumer can escape a predatory loan. Without the ability to use rescission to strip away improper and excessive finance charges, those charges prevent homeowners from refinancing out of predatory loans.

The rescission right also has an effect on the overall credit marketplace. It deters bait and switch tactics, as creditors know that consumers will have the right to rescind if they discover that the credit terms differ from those promised. It motivates accurate disclosures and protects honest creditors as well as consumers.

The right of rescission could have deterred the irresponsible lending that led to the current mortgage crisis. However, mortgage disclosure requirements were too weak, enabling creditors to conceal highly risky terms such as exploding adjustable rates and

²⁹ See U.S. Rep. No. 368, 96th Cong. 2nd Sess. 28, *reprinted in* 1980 U.S.C.C.A.N. 236, 264 (“This provision was enacted to give the consumer the opportunity to reconsider any transaction which would have the serious consequence of encumbering the title to his home.”).

³⁰ See 73 Fed. Reg. 1672, 1715-1716 (Jan. 9, 2008).

³¹ See, e.g., ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Rescission Notices 6, 12 (2010) (majority of participants in consumer testing believe creditor gives borrowers the right of rescission in case the borrower has second thoughts).

negative amortization. Dangerous, exotic mortgage products that exploited these weaknesses grew to become a substantial part of the mortgage market.

In our experience, creditors often downplayed or undermined the right of rescission. For example, the creditor may have mailed the loan papers to the consumer after closing, so that the rescission notice arrived after the rescission period had already expired. In many cases the creditor failed to fill in the rescission deadline on the rescission notice or failed to give each borrower two copies of the rescission notice. Many creditors routinely had the consumer sign, at closing, a statement that three days had passed and the consumer had decided not to rescind. It is also very common for creditors to seek to talk the consumer out of rescinding – often by misrepresenting the implications of rescission, or by falsely promising to refinance the loan to give the consumer the promised terms.

Creditors should have realized that it was in everyone's best interests—including the creditor's—to let the homeowners cancel unsound mortgage transactions before the creditor disbursed any funds to the borrower. However, the rewards for generating loans during the mortgage bubble were a far more powerful incentive. Whether deliberate or merely sloppy, common practices by creditors and brokers combined to undermine the right of rescission that could have had some braking effect on irresponsible lending. Decisions from some courts excusing these violations or placing obstacles in the way of rescission have compounded the problem.

Rescission is particularly important as a means of deterring and remedying irresponsible lending because most loans are sold on the secondary market or securitized, where they are effectively exempt from accountability for predatory practices—except for rescission. Rescission gives the secondary market incentive to police originators. A key part of this deterrence function is strict liability. Three of the most important factors in deterring violations are the swiftness, certainty and severity of punishment. Strict liability facilitates both swiftness and certainty by making the law easier to enforce and reducing ambiguity. The severity of rescission creates an economic incentive to comply—it makes compliance less expensive than noncompliance.

Two examples illustrate the importance of rescission as a remedy for consumers caught up in predatory loans:

Jane Borrower³² arranged to refinance the mortgage on her home in New York City. When she arrived at the closing, however, she discovered that the loan was far different from what she had originally been offered. The loan called for bi-weekly payments instead of monthly payments; the interest rate was wrong; and the lender had structured the loan in a manner that required her to pay the creditor for a grant she was receiving from the City. She told the closing attorney and the mortgage broker in attendance that she did not want the loan but they talked her into consummating the transaction anyway, telling her she had three days to cancel after the closing. She received all the mandatory TILA disclosures *except* the Notice of Right to Cancel.

³² All identifying information regarding this borrower has been withheld for reasons of confidentiality.

Had the creditor given Ms. Borrower proper notice of her right to cancel, she would have known that she had to notify the creditor in writing of her intention to cancel the transaction. Instead, because she never received that information, she tried to cancel the loan within the three-day period by sending a text message to the mortgage broker. The broker talked her out of canceling, and the loan ultimately ended up in foreclosure.

Timothy Swafford³³ is a retired, illiterate laborer with a sixth grade education living in Martinsville, Indiana. In 2002 he was facing foreclosure on his family home, where he had lived since childhood. Needing a loan for \$52,000 to pay off the existing mortgages, make some home repairs, and pay other debts, he sought the advice of a mortgage broker. The broker arranged a foreclosure rescue scam in which the broker's brother bought Mr. Swafford's home for much less than it was worth and offered sell it back to him in a transaction that an Indiana court later found to be an unconscionable, undisclosed HOEPA loan with an estimated 49% APR.

A year after the closing Mr. Swafford was able to rescind the transaction with help from an attorney because the creditor had failed to provide the mandatory TILA and HOEPA disclosures. The creditor refused to comply with his rescission letter, but a court ultimately enforced Mr. Swafford's extended right to rescind by ordering the creditor to deed the property back to Mr. Swafford and converting Mr. Swafford's tender obligation to an unsecured promissory note. The TILA right to rescind was critical in unwinding this transaction; without it, Mr. Swafford would likely have lost his home.

In this rulemaking, the Board had the opportunity to return the right of rescission to the robust consumer protection that Congress intended and ensure that homeowners like Ms. Borrower and Mr. Swafford are able to remain homeowners. The Board's proposal would, however, so undermine the right of rescission as to render it of little use to consumers or the marketplace. Had the Board's proposed reordering of tender been in effect when Mr. Swafford's case was heard, he would likely have lost his home, to the benefit of the foreclosure rescue scammer. The Board should withdraw its rescission proposal.

B. The Board's Proposal to Rewrite the Statute on Tender Is Unwarranted, Unjustified, and Unwise.

The Board's proposed changes regarding the effects of rescission and tender are of grave concern. Whatever the Board's intent, these changes will assuredly be interpreted and applied as though the Board had adopted as the default norm a requirement that the consumer tender the net loan proceeds at the beginning of the rescission process. Such a rule would be directly contrary to the unequivocal dictate of the statute, which requires the consumer to tender only after the creditor performs its obligations.

³³ This case study is a summary of *Hodges v. Swafford*, 863 N.E.2d 881 (Ind. App. 2007), *modified by* 868 N.E.2d 1179 (Ind. App. 2007).

The Board's proposed charges are highly likely to be seen as sanctioning some very recent lower court cases from a few jurisdictions that go so far as to impose the obligation to plead ability to tender at the outset. These outlier cases, in effect, deprive homeowners of due process, denying them even the right to be heard on the merits and the equities. Like the Red Queen in Alice's Wonderland, they presume, as a matter of law prior to hearing, that the equities would favor the creditor: "Sentence first – verdict afterwards."

The Board cites the added cost to both consumers and creditors of litigation,³⁴ yet the certain impact of this proposed rulemaking will be to make litigation more necessary, more expensive, and more risky for consumers.

The Board states that the proposed changes adopt the position of a majority of courts.³⁵ As we discuss below, the Board overstates and oversimplifies the case law. However, even if the Board were correct, the function of the Board is not to codify court decisions, particularly not anomalous court decisions decided contrary to long-standing precedent and clearly expressed congressional intent. Rather, the Board's function is to implement the statute. Where, as here, congressional intent is clearly and unambiguously expressed in the statute, the Board should not deviate from that intent.

Courts, not the Board, are equipped to do a case-by-case weighing of the equities. Where the equities justify a step such as imposing a lien on the property for the tender amount, courts have done that.³⁶ Where the equities have not warranted such a step, courts have refused to do so.³⁷ The Board should not usurp the power of the courts to make these case-by-case, equitable determinations on the facts.

The impact of the Board's proposed rule will be to encourage more decisions that are directly contrary to the statute. Rather than acquiescing in the decisions misinterpreting TILA, the Board should reiterate and strengthen its 2004 position that *Yamamoto*³⁸ represented a wrong turn. Any revision to the rescission rules should reaffirm the statutory language and purpose, rather than ratify and extend the recent erosion of this crucial right of homeowners. This is especially the case now, when the importance of the extended right of rescission is as great as ever it has been.

³⁴ See, e.g. 75 Fed. Reg. 58,539, 58628 (Sept. 24, 2010).

³⁵ 75 Fed. Reg. 58,539, 58,629, 58578 (Sept. 24, 2010).

³⁶ See, e.g., *In re Lynch*, 170 B.R. 26 (Bankr. D.N.H. 1994).

³⁷ See, e.g., *Bilial v. Household Fin. Corp.*, (*In re Bilial*), 296 B.R. 828 (D. Kan. 2003); *Williams v. Gelt Fin. Corp.*, 1999 U.S. Dist. LEXIS 12512 (E.D. Pa. 1999), *aff'g* 237 B.R. 590 (E.D. Pa. 1999); *In re Gurst*, 79 B.R. 969, 978 (Bankr. E.D. Pa. 1987).

³⁸ *Yamamoto v. Bank of New York*, 329 F.3d 1167 (9th Cir. 2003).

1. The Board's proposal is an unjustified rewrite of the statute that will deprive homeowners of their statutory rights and remedies.

a. The Board improperly ignores congressional intent.

The Board states that it does not believe that Congress intended to leave mortgagees unsecured.³⁹ Yet this is precisely what the statute does and has done by its terms for over 40 years. The Board cites no authority for its belief that congressional intent is other than that clearly expressed in the statute.

There is a clear distinction between common law rescission and the Truth in Lending rescission remedy designed by Congress. The former does require tender first; the latter does not. If Congress had wished to codify the common law rescission process, it certainly could have. It did not. Instead, Congress specifically and intentionally re-ordered this process, as the majority of courts for most of the 40 years since its enactment have recognized.⁴⁰

Congress has enacted major revisions to TILA three times: in Simplification, in 1980; in setting tolerances, in 1995; and in the Dodd-Frank Act, in 2010. None of those times did Congress revisit the question of the statutory ordering of rescission, although rescission has been used by homeowners since the Act's inception and creditors' concerns about the abuses of rescission motivated at least in part the 1980 and 1995 amendments. Indeed, 1995 was another period when industry carelessness and thoughtlessness resulted in widespread material violations that consumers relied upon to rescind loans. Yet Congress not only left the rescission procedures untouched, but it reinforced the importance of rescission as a viable avenue to deter non-compliance and provide a remedy to homeowners, especially in foreclosure where the value of rescission to the homeowner is paramount.⁴¹

Congress set out the order of rescission procedures in the statute. Congress also granted the courts all the equitable authority it deemed they needed, including the authority to modify the rescission procedures based on the particular equities of the case. Congress has chosen not to change that equitable authority in the thirty years since it first made the grant explicit.⁴² The Board should not presume that Congress did not mean what it said and reach beyond Congress' intent to reverse the statutory procedure.

³⁹ 75 Fed. Reg. 58,539, 58629 (Sept. 24, 2010).

⁴⁰ See, e.g., *Williams v. Homestake Mtg. Co.*, 968 F.2d 1137 (11th Cir. 1992), *Cornerstone Mtg., Inc., v. Ponzar*, 254 S.W.3d 221, 227 (Mo. App. E.D. 2008). See generally National Consumer Law Center, *Truth in Lending*, 6.7.2.1 (6th ed. 2007); Daniel Morgan, *Rescission Under the Simplification Act: What's New (And Not So New) for Creditors*, 7 Okla. City U. L. Rev. 355 (1982); Lea Shepherd, *It's All About Principal: Preserving Consumers' Right of Rescission Under the Truth in Lending Act*, 89 N. C. L. Rev. 172, 188-189 (forthcoming 2010).

⁴¹ Limited and temporary relief from rescission for certain violations was provided in 15 U.S.C. § 1649, but the crucial role that rescission plays by limiting the tolerance to \$35 when rescission is used as a foreclosure defense. 15 U.S.C. §1635(i).

⁴² Depository Institutions Deregulation and Monetary Control Act, Pub. L. 96-221, § 612 (a)(4), 94 Stat. 175 (Mar. 31, 1980).

b. The Board overstates and oversimplifies the overall body of case law regarding tender.

The first circuit decision to allow a trial court to require a showing of tender before consideration of the merits was in 2003, thirty-five years after the law was passed. Even so, *Yamamoto v. Bank of New York*,⁴³ involved factual circumstances that were critical to its decision: by the homeowner's own statement in the discovery phase of the case, it was an undisputed fact that he could not tender even if grounds for rescission were established. Though the *Yamamoto* trial court – in contravention of the statute – invoked the equities prior to adjudication on the merits rather than following it, that court nevertheless did so in a factual situation where tender was, on the record, out of the question. Indeed, the trial court even gave the homeowner time to try to tender anyway. The two other circuits to follow *Yamamoto* did so in similar factual situations.⁴⁴ Neither the Ninth Circuit in *Yamamoto* nor the two circuits that followed it required that consumers always prove their ability to tender before rescission was granted, much less that consumers always (or even usually) tender before rescission was granted. Instead, *Yamamoto* and the circuit cases that followed it authorized trial courts to exercise their equitable discretion over the automatic voiding of the lien, as well as the equitable adjustment authorized by the statute for the procedures effectuating rescission.

The Board understood *Yamamoto* to be contrary to the statute at the time, amending the Commentary in 2004 in response to “state expressly that the sequence of procedures [in the second and third subparagraphs of the rescission rules] or a modification of those procedures . . . does not affect consumers’ substantive right to rescind and to have the loan amount adjusted accordingly, which may be necessary before consumers are able to establish how they will refinance or otherwise repay the loan.”⁴⁵ The OCC also reinforced the statute as written.⁴⁶

Rather than giving *Milbollin* deference to this Board clarification,⁴⁷ some lower courts – primarily within the Ninth Circuit -- more recently have taken *Yamamoto* even further. These courts have not only rewritten the statute, but effectively denied homeowners the right to even be heard as to the merits of their claim and the equities.⁴⁸ By judicial fiat, they revert to the common law rescission process that Congress rejected.

⁴³ 329 F.3d 1167 (9th Cir. 2003). The history, and recent distorting developments, are discussed at length in National Consumer Law Center, *Truth in Lending* § 6.7 (6th ed. 2007).

⁴⁴ *American Mortgage Network, Inc. v. Shelton*, 486 F.3d 815 (4th Cir. 2007); *Jobe v. Argent Mortgage Co.*, 373 Fed. Appx. 260 (3rd Cir. Apr. 2, 2010) (unpublished; unrepresented borrowers.) Cases are collected in National Consumer Law Center, *Truth in Lending* § 6.7.5 (6th ed. 2007).

⁴⁵ 69 Fed. Reg. 16769, 16772 (March 31, 2004) (emphasis added).

⁴⁶ See Comptroller of the Currency, OCC Bulletin 2004-19 (May 7, 2004), available at www.occ.treas.gov/ftp/bulletin/2004-19.doc.

⁴⁷ The Supplemental Information notes that these decisions ignore the 2004 Commentary. 75 Fed. Reg. 58629, 58628 (Sept. 24, 2010).

⁴⁸ The first court to take this approach was *Garza v. Am. Home Mortg.*, 2009 WL 188604 (E.D. Cal. Jan. 27, 2009). The court offered no explanation for breaking new ground, only citing *Yamamoto*. Dismissal of TIL rescission cases on this ground has now become commonplace in California, although other district courts in California have declined to extend *Yamamoto* in this way. See, e.g., *Agustin v. PNC Fin. Servs. Group, Inc.*, 707 F. Supp. 2d 1080, 1090 (D. Haw. 2010) (“The court is not convinced that Plaintiffs are required to plead an ability to pay back the loan.”); *Pelayo v. Home Capital Funding*, 2009 WL 1459419 (S.D. Cal. May 22, 2009)

When one looks at the timing and location of the cases demanding that homeowners prove their ability to tender before they have their day in court, something other than judicial objectivism is clearly at play. Instead, what we see is what one law review author has characterized as “judicial nullification.”⁴⁹

These cases are best understood as a function of today’s unprecedented financial crisis. The first expansion to require that the consumer plead ability to tender as a condition of being heard on the merits was in a lower court in California less than two years ago.⁵⁰ States in the Ninth Circuit were among those where the housing bubble blew highest and burst hardest. And on its way up, the bubble was fed by an unusually high concentration of non-prime and exotic mortgages.⁵¹ Add to this mix the fact that California is a non-judicial foreclosure state. The predictable result is an uptick in the use of what has for decades been the single most valuable tool that homeowners harmed by improper mortgage origination practices have had. With record numbers of foreclosures – judicial or non-judicial – defensive responses will obviously rise, too. Unfortunately, these cases, and the Board’s embrace of them, will have the impact of disarming one side of a two-party dispute. And that party is the one that the statute is supposed to protect.

The Board’s proposed rewrite of the rescission procedures would go even beyond *Yamamoto* and the other two Circuit decisions that allowed trial courts to require the consumer to prove ability to tender before obtaining a decision on the merits.⁵² Far from requiring tender before rescission as a general matter, as the Board’s proposal would do, these decisions allow trial courts, in the exercise of their equitable discretion, after a weighing of the specific facts of the case, to deny rescission when the consumer has confessed to an inability to tender. The Board’s characterization of its proposal as following the majority of courts, then, is a dangerous overstatement and oversimplification.⁵³

(declining to exercise discretion to alter rescission-tender chronology at motion to dismiss stage); *Harrington v. Home Capital Funding, Inc.*, 2009 WL 514254 (S.D. Cal. Mar. 2, 2009) (tender does not have to be pleaded to state a rescission claim); *Phleger v. Countrywide Home Loans, Inc.*, 2009 WL 537189, at *25 (N.D. Cal. Mar. 3, 2009) (proof of ability to tender is not an element of a rescission claim).

⁴⁹ Lea Shepherd *It’s All About Principal: Preserving Consumers’ Right of Rescission Under the Truth in Lending Act*, 89 N. C. L. Rev. 172, 199-200 (forthcoming 2010). Other jurisdictions have responded to the foreclosure surge with other forms for judicial nullification. For example, in another bubble location, Florida, the courts responded to the overwhelming number of cases by creating “rocket dockets” to clear foreclosures rapidly, with little or no attention to normal pleading and proof requirements that apply to ordinary civil litigation. See, e.g. Michael Corkery, *A Florida Court’s ‘Rocket Docket’ Blasts Through Foreclosure Cases*,” WSJ Online (February 18, 2009), <http://online.wsj.com/article/SB123491755140004565.html>.

⁵⁰ *Garza v. Am. Home Mtg.*, 2009 WL188604 (E.D. Cal., Jan. 27, 2009).

⁵¹ For example, California had nearly one-quarter of subprime loan originations in 2006. *I Mortgage Market Statistical Annual 2009*, p. 232, twice as large a share as # 2 Florida (12%). It had a nearly 45% market share of Alt-A, with a 56% market share of POARMs in 2007. *Inside Alternative Mortgages*, p. 7 (April 4, 2008). Over 60% of POARMs with piggy-back seconds were concentrated in California, *Drivers of 2006-2007 Alt-A Collateral Performance*, p. 6 Fitch Ratings (May 7, 2008).

⁵² *Jobe v. Argent Mortgage Co., LLC* 373 Fed. Appx. 260 (3d Cir. Apr. 2, 2010) (unpublished); *American Mortg. Network, Inc. v. Shelton* 486 F.3d 815, 820 (4th Cir. 2007); *Yamamoto v. Bank of New York*, 329 F.3d 1167 (9th Cir. 2003).

⁵³ Ironically, in its proposal to add refinancing as a termination event, the Board does not follow the weight of the case law. See *Section IV-B(1)*, below.

Congress has not given non-compliant lenders a “get-out-of-jail free card.” And it is inappropriate for a few courts, concentrated in a few locations where the market was at its wildest, to drive the regulatory response to go where Congress has not.⁵⁴ Consequently, as a matter of law, it is unsupportable for the Board to ratify those cases which have turned the statute on its head.

It is also unwarranted as a matter of policy. It will have the consequence of making this crucial tool ineffective in serving its purpose of providing accountability and deterrence. A root cause of the crisis we are still struggling with is that there was too little accountability, not too much. To further reduce accountability is not the right response for the Board or for courts.

c. The Board’s proposed changes regarding tender would effectively deprive homeowners of their statutory rights and insulate law-violating creditors from accountability.

The Board explains its reversal of the law by saying that it does not believe that Congress intended for a secured creditor to lose its status if the consumer “does not return the amount of money provided or the property delivered.”⁵⁵ But this is not the problem that the Board’s proposal would address in practice. In fact, as formulated, it is not generally a problem at all.

To reiterate, Congress, in the plain words of the statute, tells us that, for TILA rescission, unlike common law rescission, it is the creditor’s obligation to take the first step.⁵⁶ To eliminate that as the standard default rule is to eliminate the incentive for creditors to comply with the design of a self-enforcing mechanism. Moreover, as the Board’s ruling will be interpreted and applied as ratifying the “judicial nullification,”⁵⁷ it will lessen incentives for creditors to comply with TIL in the first place, by reducing the odds of being held accountable.

As a preliminary matter, there is a great difference between being left in position as an unsecured creditor and having the tender obligation wiped out entirely. Outside of bankruptcy, an unsecured creditor has many avenues for collection, including getting the debt reduced to a judgment lien, which then attaches to the home. Only rarely, and only when the equities favored it, have courts allowed the tender obligation to be wiped out entirely.⁵⁸ Even in bankruptcy, courts have restructured the tender obligation in order to

⁵⁴ As the year 2010 ends, a complete morass from beginning to end stands revealed: origination shortcuts; transfer shortcuts; servicing shortcuts; collection and foreclosure shortcuts. In the end, we find that indulgence of these shortcuts for too long by those who should be gatekeepers – courts and regulators -- has been good for no one.

⁵⁵ 75 Fed. Reg. 58629, 58629 (Sept. 24, 2010).

⁵⁶ Congress added the language authorizing the courts to modify “the procedures” in 1980. The Senate explained that the courts may impose equitable conditions to insure that the consumer meets his obligations after the creditor has performed his obligations under the act.” S. Sep.No. 368, 96th Cong., 2d Sess. 29 (emphasis added), *reprinted in* 1980 U.S.C.C.A.N. 236, 265.

⁵⁷ Lea Shepherd *It’s All About Principal: Preserving Consumers’ Right of Rescission Under the Truth in Lending Act*, 89 N. C. L. Rev. 172, 199-200 (forthcoming 2010).

⁵⁸ See e.g. *Family Fin. Serv. v. Spencer*, 677 A.2d 479 (Conn. App. Ct. 1996) (creditor’s failure to respond to rescission notice negated consumers’ obligation to tender in a transaction that involved an unconscionable,

ensure its payment.⁵⁹ In general, courts have taken great care, when ordering rescission, to ensure that creditors are repaid.⁶⁰

Moreover, although the statute requires an automatic voiding of the lien, it allows courts to modify the timing of the creditor's actions to reflect the lien release in the public records. Thus, although the lien is, as a matter of law, void upon mailing of a valid rescission notice, the creditor's filing of a public release of the lien can be delayed by a court of competent jurisdiction while rescission is adjudicated. Practically, the creditor's secured status is not placed in jeopardy so long as it does not file a release of lien in the local land records office: no title company will insure a new mortgage or sale without requiring a written release of the lien from the prior creditor. Courts also have the authority to order a new lien on the tender amount as a way of securing payment. Thus, the main effect of the automatic voiding of the lien is to force creditors to the negotiating table and to halt a scheduled foreclosure sale while a resolution on the merits can take place.

The ordinary course of rescission (prior to the recent efforts to rewrite the statute) has been as follows. First, the homeowner identifies an alleged material violation that gives rise to the extended rescission right. Quite often, the "material" violation of TIL is not the only one involved. Other claims are frequently at issue which, if established, would give rise to additional damages which should also be credited against the homeowner's net obligation to the creditor.⁶¹ The consumer notifies the appropriate party by sending a letter exercising the right of rescission (often after investing significant effort in determining the identity of that party). Often, this letter is sent after foreclosure has been initiated by the servicer. The creditor typically either ignores the notice (as the Board recognizes)⁶² or sends an acknowledgement letter saying it does not believe a rescindable violation occurred. In either case, in practice, consumers are typically forced to go to court to enforce their rights. The issue of tender—and a creditor's duty to take steps to reflect the voiding of the lien in the public record—arise only when there are credible allegations of material violations of the law in the first place. And the court's equitable authority is sufficient to protect the creditor's status from an unfulfilled tender, once the merits of the matter have been determined and terms of tender set.

In contrast with the statute, the Board's proposed change puts the mortgage holder in the drivers' seat, without any regard for the actual equities of any given case. Under the proposal, the creditor makes the calculation of the tender amount, the creditor dictates the timing of tender, and the creditor, in effect, limits the method of tender available to the homeowner.⁶³ The proposal does not even require the creditor to release the lien

overreaching transaction and an uneducated consumer).

⁵⁹ See, e.g., *Williams v. Bank One (In re Williams)*, 291 B.R. 636 (Bankr. E.D. Pa. 2003) (ordering the consumer to classify the tender obligation separately from other unsecured claims and to pay it in full over the life of the chapter 13 plan).

⁶⁰ See, e.g., *Coleman v. Crossroads Lending Group, Inc.*, 2010 WL 4676984 (D.Minn. 2010) (collecting cases on judicial flexibility in addressing consumer tender and allowing tender by partial lump sum through reverse mortgage and the balance through installment payments). See generally NCLC, *Truth in Lending*, 6.7.6.2 .

⁶¹ These frequently include origination claims such as unfair, deceptive acts and practices claims, fraud, unconscionability, breach of contract, etc.

⁶² 75 Fed. Reg. 58539, 58630 (Sept. 24, 2010).

⁶³ Proposed Reg. §§226.15(d)(2), 226.23(d)(2).

contemporaneously with tender, but allows the creditor up to 20 days after tender to take steps to release the lien.⁶⁴ No lender will consent to refinancing a consumer's tender obligation if it will have to wait 20 days after tender before receiving clear title. The Board's proposal gives every incentive for the non-compliant mortgage holder to dictate tender terms unlikely to be met, forcing homeowners to abandon their rights, or to institute litigation in order to preserve their rights. This is completely contrary to the letter, spirit, and purpose of TILA that the rescission right should be fundamentally self-enforcing.

Once the consumer is forced to litigation, the Board's proposal will almost assuredly be read as adopting the controversial and narrowly concentrated line of "judicial nullification" cases requiring proof of ability to tender first. While the Board may presume that the Commentary regarding judicial modification should suffice to counteract this effect, that is highly unlikely to be the case.⁶⁵ First, its Commentary is overshadowed by its clear articulation in the proposed regulation of a "tender first" process for both non-judicial and judicial proceedings. That is particularly so given the timing of this proposal in relation to the emergence of recent cases that require proof of ability to tender at the pleading stage. Second, courts who were reluctant to follow the existing Commentary and allow the homeowner her day in court are unlikely to be persuaded by the proposed Commentary, which is little different in substance from the existing Commentary. Instead of reinforcing and strengthening its 2004 position on *Yamamoto*, the proposed changes strengthen the "tender first" message. In this context, the very mild and minor proposed Commentary provisions are wholly insufficient to counter the impression that the proposal ratifies the "tender first" principle.⁶⁶ Indeed, the proposal may create a presumption of "tender first."

The Board's proposed changes will lead to a reading of the statute that will in fact protect the violating creditor from the injured consumer, even as it deprives that consumer of any effective remedy. In short, the Board hands all the leverage to the non-compliant mortgage holder.

2. It is neither necessary nor appropriate to rewrite the statute and effectively deprive many homeowners of their legal remedies in order to provide adequate protection to mortgage holders.

The Board has expressed concerns for the creditors' secured position, but its proposed solution puts the cart before the horse. As the law is written, *when the equities warrant*, a court can protect the creditor's secured position – as courts have for most of the

⁶⁴ *Id.*

⁶⁵ *See, e.g.* Proposed OSC §§ 226.23(d)(2)(i)-1 (the process set forth does not affect the consumer's ability to seek a remedy in court, such as an action to recover damages under section 130 of the act, and/or an action to seek tender in installments), 226.23(d)(2)(ii)(C) ("the procedures...may be modified by a court. For example, when a consumer is in bankruptcy proceedings and prohibited from returning anything to the creditor, or when the equities dictate, a modification may be made. A court may modify the consumer's form or manner of tender, such as by ordering payment in installments or by approving the parties' agreement to an alternative form of tender.")

⁶⁶ It is by no means clear that the proposed commentary would even be read to leave broad equitable authority in the court. For example, the language of Proposed OSC § 226.23(d)(2)(ii)(C)-2 giving the example of a court's authority to "approve the parties' agreement to an alternative form of tender" might be read to imply a limitation on the court's authority..

past 40 years. Where a court approves tender by means other than an immediate lump sum payment, a new or modified security interest may be imposed to secure an adjusted principal amount after adjudication on the merits or settlement negotiations. This option vindicates the legal rights of the homeowner and provides the accountability and deterrent value the statute was designed to create, while still leaving the holder with a mortgage.⁶⁷

Courts also have authorized tender by installments, an option that takes on increasing importance as the credit crunch and housing price deflation have made tender through refinancing with a different creditor more difficult. Installments, same-creditor refinancing, or loan modification are all perfectly legitimate methods of tender. (In fact, given the massive amounts of effort that policy makers and lenders are putting into loan modifications not tied to law violations, it is particularly inexplicable for the Board to make the loan modification method of tender even more rare than it is now.⁶⁸) But the current economic crisis makes it important to allow (even encourage) more flexibility in tender methods, not less, as the Board's proposal will do by giving the non-compliant creditor extra leverage.

The Board notes that creditors argued that tender by installments, short-sales, modifications, or deed-in-lieu are not mentioned in the statute.⁶⁹ Setting aside the irony of arguing for a strict construction of the statute in this regard while simultaneously urging that the statute be turned on its head with respect to when the consumer must tender, this is a specious argument. First, unlike the timing of the lender's obligations then the consumer rescinds (20 days), which is established by statute, there is no statutory direction on how quickly or in what form the homeowner's tender must occur.⁷⁰ The statute simply directs that the consumer's obligation kicks in "[u]pon performance of the creditor's obligations." Second, the consumer's tender obligation must be read in conjunction with the court's equitable authority, which gives courts considerable flexibility to adjust the tender requirement. The Board could assist courts by identifying some of the ways in which the courts could adjust the tender requirement, such as loan modifications. While courts are in the best position to perform case-by-case determinations of the merits and equities, the Board could and should make clear the possibilities courts have in exercising their discretion in favor of consumers. The law as it stands has ample room for a thoughtful, balanced

⁶⁷ See, e.g. NCLC, *Truth in Lending*, §6.7.4.1, discussing *Williams v. Homestake Mtg. Co.*, 968 F.2d 1137 (11th Cir. 1992) (substitute security interest on the tender amount obligation); *In re Lynch* 170 B.R. 26 (Bankr. D. N.H. 1994) ("continuing security interest" but on the amount determined to be due as tender); *FDIC v. Hughes*, 684 F. Supp. 616 (D. Minn. 1988) (homeowners given a year to tender; creditor permitted to delay filing release of security interest.) Note that some of these modifications address concerns about loss of lien priority, as well as securing the proper tender obligation .

⁶⁸ Though Proposed OSC § 226.23(d)(2)(ii)(C)-2 does explicitly reference the possibility of installments, after reference to bankruptcy, as explained above, this will be lost white noise in the current context. The more prominent "tender first" requirement in the proposed regulation will mean that few homeowners make it through that screening.

One commentator has noted that allowing tender of underwater mortgages in installments is akin to a mortgage modification, and would benefit consumers, lenders and communities. Lea Shepherd *It's All About Principal: Preserving Consumers' Right of Rescission Under the Truth in Lending Act*, 89 N. C. L. Rev. 172, 231-3 (forthcoming 2010).231-233.

⁶⁹ 75 Fed. Reg. 58629, 58628 (Sept. 24, 2010).

⁷⁰ *Coleman v. Crossroads Lending Group, Inc.*, 2010 WL 4676984, *7 (D.Minn. 2010).

calibration of the rights of the parties, after considering the equities, and the Board should not undermine this equitable authority in its rule.

3. Concerns for litigation risk do not justify a rule that would undermine consumers' remedies under a statute that relies primarily on private enforcement for accountability and deterrence.

It is not surprising that the wild-west atmosphere of mortgage originations which fed the housing bubble, which in turn led to the collapse of both credit and housing bubbles, had as one consequence an increase in the volume of litigation. There was too little accountability as the bubbles grew, which encouraged more recklessness and carelessness in originations, which unsurprisingly prompted more litigation. That is a direct consequence of the direction the market took in the last decade.

It would be wrong to react by undermining one of the most key remedies for consumers, and, conversely, protecting creditors from accountability where, by definition, violations of material provisions of the law are involved. (A creditor who does not believe those violations occurred can defend on the merits, and there will be no rescission right at all if there are no material violations.) While we recognize that the securitization explosion separated many mortgages from their originators, we also recognize that another lesson of the crisis is that a well-functioning secondary market must have its own incentives to protect the integrity of the loans they buy.

It is particularly curious that, at a time when the weight of informed opinion is that more loss mitigation must be done in order to restore the health of the housing market, the Board would roll back the one process that has a long history and an established procedure (only recently begun to be disrupted) that by definition allocates and balances questions of accountability and moral hazard. The Board should enhance, not reduce, the functionality of this process.

4. If the Board prescribes any procedures for tender, it should adopt ones that promote the purposes of rescission.

Elsewhere, we have urged the Board to withdraw its proposal regarding rescission in its entirety. See Section II. A of these comments, *supra*. The proposal is too deeply flawed to be easily remedied. Stepping completely back and approaching the issues with a fresh eye is the proper step to take. Nevertheless, we offer a few illustrations of changes which might help assure that the rescission right retains some integrity.

- If the Board adopts pre-suit rescission procedures, it should make it clear in the rule itself that the procedures are merely a structure for settlement, with no prejudicial effect on either party; that the consumer may dispute the tender amount requested, demand documentation, or propose alternative methods and timing of tender; and that the pre-suit procedures are wholly inapplicable once the matter goes to court. Given the recent history of some courts' failure to even acknowledge, much less provide deference to the Board's Commentary, we do not believe that the Commentary proposal as drafted will assure that courts and creditors do not presume that the consumer who does go to court

still must tender first. In addition, the Board should state that it is an unfair practice, subjecting the creditor to statutory damages, for the creditor to make an inflated tender demand in the pre-suit context.

- If the Board adopts rules regarding tender in a court proceeding, it should make it clear that the homeowner is not required to tender before the homeowner's right to rescission is determined. Tender should never be addressed unless the threshold issue of the homeowner's right to rescind is determined, either through the creditor's concession or a court ruling that the homeowner is entitled to rescission. It should also make clear that, in either circumstance, if the consumer has other damage claims, the court should resolve them before requiring tender.
- Tender should not be required prior to the creditor's release of the lien.
- The Board should provide more examples of how a court might use its equitable modification authority, including ones which are appropriate to today's market, such as loan modification to reflect the appropriate tender amount. It should also illustrate how, when equities warrant, the plan may balance the interests of both parties, such as with a substitute security interest for the proper tender amount due.

C. The Board's Proposed Enlargement of the List of Events that Terminate the Right of Rescission Is Overbroad, and Generally Contrary to the Statute and the Weight of Authority.

The Board proposes to "clarify" whether four named events terminate the extended rescission right. Under the proposal, the death of the obligor, loan pay-off, and refinancing by a different creditor would be added as terminating events, while the rule would make clear that the consumer's bankruptcy filing is not.⁷¹ The proposed "clarification" with respect to bankruptcy is consistent with long-standing practice, precedent, and sound policy; the remaining proposals are not. Not only are they inconsistent with statute and policy, they are directly contrary to precedent, including the Third, Fifth, Sixth, Seventh, and D.C. Circuit Courts of Appeals.⁷² It is unclear why the Board would feel compelled to follow what it terms a majority of courts that deviate from the statute in the case of tender, while simultaneously ignoring a clear and long-standing majority of courts that follow the statute with respect to terminating events.

The Board's articulated basis for this turn-around, unfortunately, reflects a skewed view of the purpose and effect of rescission that these courts have considered and specifically rejected.

⁷¹ 75 Fed. Reg. 58629, 58612 (Sept. 24, 2010).

⁷² James v. Home Constr. Co., 621 F.2d 727 (5th Cir. 1980) (upholding exercise of extended right of rescission by decedent's estate); Smith v. Fidelity Consumer Discount Co., 898 F.2d 896 (3d Cir. 1989) (approving of exercise of extended right of rescission by successors-in-interest to ownership of decedent's property); Duren v. First Gov't Mtg and Investors' Corp., 2000 WL 816042 (D.C. Cir. 2000) (unpublished) (upholding the extended right of rescission after loan payoff via refinancing by a different creditor); Barrett v. JP Morgan Chase, 445 F.3d 874, 875 (6th Cir. 2006) (same); Handy v. Anchor Mortgage Corp., 464 F.3d 760, 765-66 (7th Cir. 2006) (same).

1. The Board’s articulated basis for expanding the list of terminating events to include pay-off, refinancing, and death of the borrower misunderstands the purpose and effect of rescission.

In laying the groundwork for its proposal, the Board describes both refinancing and pay-off as accomplishing “substantively similar” results to rescission —“namely, voiding of the prior creditor’s security interest, release of the borrower from the obligation to make payments to that creditor, and return to the creditor of money borrowed.”⁷³

This framing is skewed. In fact, rescission does something quite different from pay-off or refinancing: rescission refunds to consumers amounts not owed and ensures that the holders of that transaction, who otherwise would profit from an illegal transaction, do not retain those fees. As the Sixth Circuit explained in *Barrett v. JP Morgan Chase Bank*,⁷⁴ the statutory right is to rescind the transaction, not just to remove the security interest, “and also gives [the homeowner] the right to recover certain fees incurred in the transaction.” The Seventh and D.C. Circuits have similarly recognized the financial ramifications of rescission, and given them effect in the very contexts the Board’s proposal would deny.⁷⁵

The statute cites only the expiration of three years and “the sale of the property,” whichever occurs first, as events terminating the right to rescind when the designated material violations of law have occurred.⁷⁶ Until this proposal, the Regulation has only expanded on the statute’s “sale of the property” to add “transfer of all the consumer’s interest in the property.”⁷⁷ The statute, and the historic regulatory extension of it, both sever the right only when the consumer’s tie to the home itself is fully severed. Rescission protects the homeowner’s interest—financial, legal, and emotional—in the home; as long as the homeowner or her heirs have an interest in the home, rescission is available to protect that interest.

Rescission does more than remove the security interest; it also reverses the transfer of wealth from the homeowner to the creditor. Payoff and refinancing do not reverse that transfer, but cement it. As the court in *Barrett* noted, refinancings are “rarely” “complimentary”—they impose costs.⁷⁸ Moreover, there is no policy reason that a creditor should profit from the death of a homeowner; from a policy standpoint, it is more appropriate to return the fees and interest paid to the decedent’s estate. The Board’s basis for termination of the extended right of rescission is fallacious.

⁷³ 75 Fed. Reg. 58629, 58612 (Sept. 24, 2010).

⁷⁴ 445 F.3d 874, 875 (6th Cir. 2006)

⁷⁵ *Handy v. Anchor Mortgage Corp.*, 464 F.3d 760, 765-66 (7th Cir. 2006); *Duren v. First Gov’t Mtg and Investors’ Corp.*, 2000 WL 816042 (D.C. Cir. 2000) (unpublished.) One 9th Circuit case, nearly a quarter a century ago, *King v. California*, 784 F.2d 910 (9th Cir. 1986), ruled otherwise. However, there was no analysis whatsoever of the financial impact of rescission, and it was this lack of analysis and understanding that led all three of these other circuits, among other courts, to specifically reject *King* as persuasive.

⁷⁶ 15 U.S.C. §1635(f).

⁷⁷ Reg. Z § 226.15(a)(3), 226.23(a)(3).

⁷⁸ *Barret*, 445 F.3d at 880.

2. The Board’s proposal to add different creditor refinancing to the list of terminating events is contrary to the statute, to the weight of authority, and to sound policy.

Refinancing, certainly an event known to Congress at the time of TILA’s enactment, was not, and never has been, adopted as a terminating event. Significantly, even in 1995, when widespread violations during a refinancing boom occurred and Congress provided other relief from accountability to the industry,⁷⁹ Congress did not exempt refinancings from rescission.

Refinancing – whether by the same creditor or a different creditor – means the consumer is still paying the costs of the prior loan, and is paying those costs for the same home. If the refinanced mortgage was subject to rescission because of material violations, the amounts that should have been refunded to the consumer upon rescission are instead rolled into the pay-off amount for the new loan. Thus, the holder of the refinanced mortgage receives a payoff amount larger than that to which it is legally entitled, irrespective of whether it is an in-house accounting entry or a pay-off from a competitor.

The Board very rightly proposes that same-creditor refinancing will not be considered a terminating event – a proposal we strongly support, and that is consistent with case law. The Board’s rationale – concern over abuse by serial refinancing to benefit the creditor but not the borrower – is well founded.⁸⁰ Certainly the conduct of some of the nations’ largest nonprime lenders over the past twenty years provides ample justification for that fear. “Loan-flipping” – serial refinancing – was a hallmark of predatory lending practices by major finance-company lenders in the 90s and early 2000s.⁸¹

Yet loan flipping is not limited to same-creditor refinances. Just as the Board wisely acknowledged the risks of abuse involved in same creditor refinancing, there are similar risks in different-creditor refinancing. Serial refinances can be engineered by brokers – and different creditors may be used. Some of the signatories to these comments have represented elderly victims of predatory lending caught up in serial refinancings involving multiple lenders.⁸² These are just as devastating to the homeowners as same-creditor refinancing and unraveling them is far harder. Many courts have allowed victims of equity-skimming scams that involved brokers and multiple creditors to rescind the prior loans and

⁷⁹ See Section II(B)(1) of these comments.

⁸⁰ *Id*

⁸¹ Loan flipping – serial refinancings of their own customers, with each new loan stripping more equity out of the property, was a hallmark of the home equity lending practices of some of the major finance-company lenders in the 90s and early 2000s, prior to law enforcement crack-downs, and regulatory and legal changes. Associates, though not alone, was the most notorious. Ameriquest, similarly, used the teaser re-set period to encourage refinancings of its 2/28 loans.

⁸² See, e.g. Howard v. Countrywide Home Loans, Civ. No. 08-0510 (D.D.C). In addition to the litigation experience, a former broker explained to one of the authors of this comment that one reason 2/28s were popular with brokers was that they generally meant a repeat customer sometime within the next two years. But even if the broker was not foresighted at the time of the first, the predatory nature of one loan in the series gave brokers a clear shot at soliciting opportunistic refinancings later. For example, as a former regulator, one of the authors heard that brokers would review public records for mortgages held by notorious high-rate lenders and cold-call the borrower to solicit a refinancing – unfortunately too often to be placed in yet another bad loan.

adjust the financial obligations of the consumer, as long as the earlier loans were within three years.

Homeowners may also make rational choices to refinance a predatory loan to obtain more favorable terms. Exercise of that option should be encouraged; homeowners should not be penalized if they take steps to mitigate their damages.

The right of rescission after refinancing with a different creditor did not, unfortunately, do much to slow the refinancing frenzy that led to the current market collapse. Indeed, rescinding a refinanced loan is a cumbersome and difficult process; neither homeowners nor their advocates rescind refinanced loans without strong grounds to do so. Retaining this right is unlikely to put a damper on legitimate lending going forward. There is no legitimate reason for the Board to strip homeowners of the right to exercise the right of rescission after refinancing.

3. The Board's articulated rationale for adding loan pay-off as a termination event is wholly unjustified.

The Board uses the same rationale to support adding loan pay-off to the list of termination events that it did to different-creditor refinancing: “[P]aying off the loan largely accomplishes the results of rescission – namely, voiding of the prior creditor’s security interest, release of the borrower from the obligation to make payments to the creditor, and return to the creditor of the money borrowed.”⁸³

But, as explained above, this articulation misses fundamental points: rescission entitles consumers to a refund of fees and interest, and assures that the holder of tainted mortgages retain only the actual proceeds of the loan, not the fees and interest that should have been refunded to the consumers whose loan was tainted. The loan rescinded in *Handy v. Anchor Mortgage* had in fact been paid off by the borrower’s estate.⁸⁴ While the defendant argued that rescission was impossible, under those circumstances, the homeowner argued that “[a]n opposite rule ... would encourage creditors “to delay for as long as possible” the resolution of a borrower's rescission request in the hope that the borrower will pay off the subject loan and relieve the creditor of at least some of its liability under TILA.” The court agreed that “the remedies associated with rescission remain *available even after the subject loan has been paid off.*” 464 F.3d at 765 (emphasis added).

Only small dollar balance mortgages are likely to be paid off outright within three years of origination. Indeed, for consumers with these small loans the rescission remedy may be particularly important. Prior to the credit bubble, home equity loans (firsts and junior) were often taken out in smaller amounts. Smaller mortgages arranged by contractors, or home equity loans used to help out relatives were frequently fraught with abuses – sometimes with the cooperation, or even instigation of the creditor, or, at the least, a wink and a nod.⁸⁵

⁸³ 75 Fed. Reg. 58629, 58612 (Sept. 24, 2010).

⁸⁴ 464 F.3d 760, 765 (7th Cir. 2006)

⁸⁵ In fact, one finance company, known locally as a “used car mortgage company” in Pennsylvania routinely required its used car purchasers to have a home-owning signatory on the loan. The purpose was so that it

As with refinancing, there are adequate protections in place to assure that the interests of the lenders and the market are protected. The extended right does not exist in the first place absent material violations of law; as a practical matter, the merits and the equities are refereed by the courts; and the fact that the loan was somehow paid off significantly reduces the odds of the matter coming up in three years in any event.⁸⁶ Balancing all these legal and functional protections for the lender against the consumer who has paid the refundable fees and interest under a tainted loan, the Board should not expand the statute beyond its terms to embrace this additional termination event.

4. Bankruptcy is not a termination event, nor should it be, as the Board recognizes.

In its proposal, the Board recognizes that bankruptcy does not constitute a termination event. Neither law nor policy would support any other conclusion.

Bankruptcy has been a common forum for the adjudication of rescission claims. Under either a Chapter 13 or Chapter 7 bankruptcy, if the homeowner wants to keep the home, the financial calculus of rescission is crucial to determining the amount of the mortgage holder's allowed secured claim on the property.⁸⁷ In a Chapter 13, the determination of the amounts to be paid under the consumer's plan requires a determination of the relative obligations of the parties. This is typically done in an adversary proceeding in which the court determines the amount the creditor is legally entitled to after considering any claims, including rescission. Consumers in a Chapter 7 case may seek a similar determination if they intend to reaffirm the mortgage obligation. In either case, the consumer retains both an interest in the property, and, most times, a live obligation to pay something. As the Board notes, in most cases, the homeowners will be claiming an exemption in their interest in the home.

While a few courts have said that the rescission cause of action transfers to a Chapter 7 trustee,⁸⁸ the right itself remains. If the trustee does not proceed, the consumer can claim the cause of action as exempt, and seek an abandonment order to proceed on its own.

In sum, nothing about bankruptcy should result in a termination of a homeowner's right to rescind. Homeowners have often exercised their rights to rescission in bankruptcy proceedings as part of restructuring their overall debt obligations and reaffirming their obligations to the existing mortgage holders. Removing the right of rescission from homeowners in bankruptcy would interfere with their right to bankruptcy and the

could take a first lien on a home (yes, to secure a used car!) to take advantage of DIDA's first-lien interest rate preemption and charge interest rates in the 30% range. *See, e.g.* Laubach v. Fidelity Consumer Discount Co., 686 F. Supp. 504, 507 (E.D. Pa. 1988) (81-year old mother required as co-signer so the loan would be secured by a mortgage).

⁸⁶ As most homeowners are unaware of what constitutes material violations, they commonly only learn of them when consulting an attorney because of problems with the live mortgage. This learning event is absent when the loan is paid off. .

⁸⁷ *See generally*, National Consumer Law Center, *Truth in Lending* §6.8.4 (discussing rescission tender in bankruptcy.)

⁸⁸ *Id.*, §6.3.2.2.2.

bankruptcy court's powers to determine the relative obligations of all the parties with an interest in the debtor's estate.

5. Terminating the rescission right upon the homeowner's death is without statutory support, against long-established precedent, and dangerous policy.

The Board's articulated rationale for adding death as a per se event that terminates the rescission right is that it transfers all the consumer's interest to the estate or heirs.⁸⁹ However, the only event listed in the statute terminating the right of rescission is the homeowner's sale of the home – not transfer of all the consumer's interest in the home. The Board does not even attempt to justify this new proposed restriction of the right to rescind by reference to the purposes of TILA.

Death, even less than refinancing, is not a new occurrence; Congress was surely aware of the at least theoretical possibility of death when it enacted the statute in 1968. Yet Congress did not include death as an event terminating the right of rescission when it drafted the statute in 1968, nor when it made major changes to the statute as part of TIL Simplification in 1980, nor again when it addressed creditor concerns about rescission in 1995.

The question whether the rescission right survives death is not a new one. Courts of appeal have ruled favorably on the survival of a homeowner's rescission claims since at least 1980 when the Fifth and Seventh Circuits ruled in *Smith v. No. 2 Galesburg Crown Finance Corp.*, 615 F.2d 407, 415 (7th Cir. 1980) and *James v. Home Const. Co. of Mobile, Inc.*, 621 F.2d 727, 729 (5th Cir. 1980) that this right survives death and may be pursued by the borrower's estate.⁹⁰ The Board has articulated no reason for reversing this longstanding judicial conclusion now, over thirty years later.

There are strong policy arguments for preserving the right to rescind past a homeowner's death. The usual heirs attempting to assert the right to rescind on behalf of the homeowner's estate are children, spouses, or partners, who lived in the home, but were not on the deed, and who are seeking to preserve their homes. Heirs in general, even if they do not live in the home, have the right under federal law to assume the mortgage.⁹¹ If they have the right to assume the mortgage, they ought to have the right to rescind it. Forbidding exercise of that right by the surviving homeowner would produce a windfall for the creditor and result in the loss of the home for the survivor. The stress of a predatory loan can exacerbate underlying health issues and speed a homeowner's demise, thus shortening the time in which to exercise the right of rescission. Indeed, several of the authors of these comments have represented homeowners whose death was clearly hastened by a predatory loan.

The elderly in particular are too often vulnerable to a variety of unfair and deceptive

⁸⁹ 75 Fed. Reg. 58,539, 58612 (Sept. 24, 2010) (explaining Proposed OSC §226.15(a)(3)(ii)(A)-1; §226.23(a)(3)(ii)(A)-1).

⁹⁰ *Accord*, *Abel v. Knickerbocker Realty Co.*, 846 F.Supp. 445, 448 n. 1 (D.Md.1994); *see also Handy v. Anchor Mortgage, Inc.*, 464 F.3d 760,, (7th Cir. 2006) (allowing rescission in appeal by estate of homeowner).

⁹¹ 12 U.S.C. §1701j-3(d).

tactics by unscrupulous lenders and originators that put their homes at risk.⁹² Their deaths within three years of consummation should not offer an escape hatch to predatory lenders who prey upon the elderly. Such a perverse result would encourage lenders to seek out the ill and the elderly for their most abusive loans.

Having the homeowner's death end the rescission rights on the loan is particularly troubling in the reverse mortgage context. A reverse mortgage originated shortly (within three years) before a homeowner's death will always raise concerns about the propriety of the transaction and should trigger a careful legal review. Moreover, since the homeowner's death is an event of default for reverse mortgages, the family will have to review the loan documents, often for the first time, as they determine whether they can or should pay off or refinance the mortgage. The Board's decision to deprive spouses and families of this important remedy is unwarranted, particularly since it runs headlong into the Board's expressed objective in this proposed rule to increase protections for reverse mortgage borrowers using its unfairness authority.

Given the longstanding judicial ruling that rescission survives a homeowner's death, the Board's failure to articulate why this interpretation should be disturbed at this late date, and the significant risk to the interests of homeowners and their heirs, there is no reason for the Board to penalize homeowners' estates and withhold this valuable right. Courts are and will continue to be fully capable of exercising their equitable authority to protect all parties when an estate exercises the right.

D. The Board's Proposal to Require Each Consumer to Be Given Only One Copy of the Rescission Notice, and to Use a Tear-Off Form, is Ill-Advised.

The Board is proposing, for both open- and closed-end mortgages, to remove the requirement that consumers be provided with two copies of the notice of the right to cancel. This requirement has been in place since 1968. The only reason the Board gives for removing the requirement is creditors' concerns about litigation risk.⁹³

1. Creditors' concerns about litigation risk are an impermissible red herring.

Fundamentally, the reason creditors face litigation risk for failing to deliver two copies of the notice of the right to cancel is because creditors frequently fail to deliver two copies of the notice of the right to cancel.⁹⁴ Consumer protection would be better served if the Board instructed creditors to comply with the law rather than attempting to remove compliance requirements. A standard in place for over 40 years has not suddenly become unworkable.

⁹² See, e.g., *Jackson v. Byrd*, 2004 WL 3130653 (D.C. Super. Ct. May 11, 2004), *later op.* 2004 WL 3249693 (D.C. Super. Ct. June 30, 2004) (awarding damages), *later op.*, 2004 WL 3249692 (D.C. Super. Ct. Sept. 2, 2004), *aff'd*, 902 A.2d 778 (D.C. 2006), for an example of a highly abusive credit transaction with a bedbound elderly woman whose heirs discovered the transaction and brought suit only after her death.

⁹³ 75 Fed. Reg. 58539, 58572, 58620-1 (Sept. 24, 2010).

⁹⁴ See, e.g., *In re Jaaskelainen*, 391 B.R. 627 (Bankr. D. Mass. July 7, 2008) (closing attorney testified that in cases involving two borrowers, if both borrowers' names appeared on the notice of the right to cancel, he normally only received two copies of the notice of the right to cancel from the lender to deliver to the borrowers), *aff'd in relevant part, rev'd in part on other grounds*, 407 B.R. 449 (D. Mass. 2009).

In support of the proposition that litigation about undelivered notices is increasing to unmanageable proportions, the Board cites seven cases from the last five years. Seven hundred and forty-seven TILA cases were filed in the Ninth Circuit alone in 2009 alone; seven cases over five years hardly represents a significant fraction of the TILA litigation universe. Indeed, reported cases on this issue from the 1980s suggest that whatever litigation risk creditors face for their noncompliance is not a new problem.⁹⁵

Nor is the litigation risk an insurmountable problem for creditors. Homeowners face an uphill battle in trying to prove that they did not receive two copies of the notice of the right to cancel. A signed acknowledgment of receipt creates a presumption that both copies have been received.⁹⁶ Borrowers who prevail on these claims typically must testify to a chain of custody of the closing documents few homeowners can achieve.⁹⁷

TILA litigation has increased dramatically in recent years. But it has increased in response to the worst foreclosure crisis this country has ever known, not because new claims in TILA have suddenly been discovered. Creditors could avert much of this litigation by complying with the statute, and more by offering homeowners loan modifications where appropriate. Creditors have failed to comply with their obligations; indeed, creditors' overreaching is largely responsible for triggering the crisis. The Board should not use a crisis of creditors' making to excuse them from compliance.

As discussed above, it is not the job of the Federal Reserve Board to protect creditors from the consequences of their noncompliance with the statute. The Board's authority only extends to regulations in furtherance of the purpose of TILA—the informed use of credit.⁹⁸ Allowing creditors to withhold copies of the notice of the right to cancel is hardly in furtherance of the informed use of credit, nor does it facilitate compliance with the underlying purposes of the Act. Removing all compliance requirements might be said to facilitate compliance, but such overreaching by the Board threatens to vitiate the Act altogether.

2. Providing consumers with two copies of the form protects the right to rescind.

Courts have long recognized that provision of two copies of the notice of the right to cancel is not a technicality. As one court noted over twenty years ago, effective exercise

⁹⁵ See, e.g., *In re Underwood*, 66 B.R. 656 (Bankr. W.D. Va. 1986).

⁹⁶ 15 U.S.C. § 1635(c). See, e.g., *Jobe v. Argent Mortgage Co.*, 2008 WL 450432 (M.D. Pa. Feb. 15, 2008), *later op. at* 2009 WL 2461168 (M.D. Pa. Aug. 11, 2009) (borrower's denial of receipt of two copies insufficient to rebut presumption where they were not credible and closing agent testified as to his routine practice), *aff'd*, 2010 WL 1255683 (3d Cir. Apr. 2, 2010).

⁹⁷ Compare *Cooper v. First Gov't Mortgage and Investors Corp.*, 238 F. Supp. 2d 50 (D.D.C. 2002) (consumer placed documents in lockbox; lockbox produced in discovery contained only one copy of the notice of the right to cancel) with *Stanley v. Household Fin. Corp. (In re Stanley)*, 315 B.R. 602, 609 (Bankr. D. Kan. 2004) (criticizing consumer's affidavit that he stored all closing documents in envelope, unopened and undisturbed, until it was opened by his attorney who discovered it contained only one copy of notice).

⁹⁸ See §15 U.S.C. §§ 1601(a), 1604(a).

of the right of rescission “obviously depends upon the delivery of one copy of the rescission notice to the creditor and the retention by the obligor of the other copy.”⁹⁹

Indeed, most consumers who attempt to exercise their right to rescind pro se use the rescission form.¹⁰⁰ The Board discounts the possibility that consumers would be left without a copy of the rescission notice, since many of the participants in the Board’s consumer focus group testing reported that they would make copies of the notice before sending it.¹⁰¹ But responses in a focus group are not a real-world test of what consumers actually do.

Many consumers do not have the easy access to copiers and scanners that the Board staff does. Homeowners who get their internet at the public library are unlikely to have a copier/scanner at home.¹⁰² Even homeowners who do have access to a copier are likely to fail to make a copy in the press of the moment, especially given the short and rigid deadlines for exercising rescission. The deadline may fall on a Saturday or on a state holiday when libraries and most businesses are closed. Since the deadline extends to midnight, all nearby locations where copies can be made may be closed even on weekdays at the point when the consumer needs to take the notice to the post office or put it in the lender’s mail slot.

While consumers’ access to photocopiers has surely increased over the last 40 years,¹⁰³ the access creditors have to scanners, photocopiers, email, and automated document assembly programs has also increased. Making copies of documents is a trivial process for creditors. Creditors also have operational systems for ensuring that copies get made and retained. Yet the Board proposes to shift the burden of copying from creditors to consumers.

The Board expresses the belief that creditors will rise to the occasion, should borrowers misplace their rescission notice or fail to make a copy, and provide borrowers with a copy of the rescission notice. There are three problems with the Board’s speculation. First, the substance of the rescission notice is often at issue in rescission cases—what dates were on it? was it signed? was it completely filled out? Even the most honest creditor may be tempted to correct an error before providing a consumer with a “copy” of the rescission notice. Consumers who believe that the right to cancel is itself granted by a wise and beneficent creditor are unlikely to be sufficiently on guard against such a possibility.¹⁰⁴

Second, in an era when homeowners report hour-long waits on voice mail to reach a person at the servicer, and servicers confess to the frequent loss of borrower documents,

⁹⁹ *Stone v. Mehlberg*, 728 F. Supp. 1341, 1353 (W.D. Mich. 1989).

¹⁰⁰ *See* ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Rescission Notices 7 (2010).

¹⁰¹ 75 Fed. Reg. 58539, 58620 (Sept. 24, 2010).

¹⁰² While 57% of households with less than \$30,000 annual income access the internet from home, only 42% own a desktop computer and 38% a laptop computer. Jim Jansen, Pew Research Ctr., Use of the Internet in Higher-Income Households, 2, 9 (2010), *available at* <http://pewinternet.org/~media/Files/Reports/2010/PIP-Better-off-households-final.pdf>.

¹⁰³ 75 Fed. Reg. 58539, 58620 (Sept. 24, 2010).

¹⁰⁴ *See, e.g.*, ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Rescission Notices 21 (2010) (none of the consumers in the final round of testing understood that the right to cancel was guaranteed by federal law, despite language on the notice to that effect; most thought creditors did this as a service for consumers).

assuming that borrowers will be able to obtain any document from a servicer in a timely manner is naive at best.

Third, as illustrated by the first case example set forth in Section II(A) of these comments, the typical response of the creditor, broker, or servicer when a consumer seeks to rescind is not “Certainly, we’ll be happy to help you.” The parties that the consumer is likely to contact to get a rescission form all have a substantial vested interest in avoiding rescission. Instead of providing the form the consumer seeks, they are likely to engage the consumer in lengthy discussions about why the consumer should or cannot rescind.

Providing consumers with two copies of the rescission notice allows consumers to return the rescission notice and maintain a copy. In addition, as the Board’s testing shows, many consumers are unfamiliar with the right of rescission.¹⁰⁵ Providing two copies of the notice of the right to cancel helps draw consumer’s attention to this unfamiliar right.

3. A tear-off form is not an adequate replacement for two notices to the consumer.

The Board’s proposal to substitute a tear-off form for the provision of two copies of the notice of the right to cancel would, if adopted, likely undermine the exercise of the right of rescission by unrepresented consumers, as well as increasing litigation over whether the creditor in fact received a properly executed notice of the right to cancel.

Participants in the Board’s consumer testing indicated a strong preference for using a preprinted form.¹⁰⁶ A standard rescission form facilitates the exercise of the right of rescission by unrepresented consumers and increases the likelihood that an employee of the creditor will properly process the rescission form. Consumers who return the entire form may be left without a copy of their notice of the right to cancel; consumers who return only the tear-off form are consigned to using something less than an “official,” preprinted form. The tear-off slip will scarcely look official, particularly if the servicer chooses not to pre-print any information on it. The informal appearance and small size of the tear-off slip may lead to a creditor disregarding the notice of the right to cancel.

Tear off forms can be easily lost or mislaid at the creditor’s offices. A tear-off form does not clearly convey to low-level employees or agents of the creditor, including people processing payments, loan brokers, or a loan officer, the significance of the form, or what should be done with the form. A tear-off form invites brokers or loan officers who are unfamiliar with rescission to drop the notice of rescission in the nearest waste basket. We hear, every day, stories of documents lost at servicers’ offices—entire loan modification applications are routinely mislaid. In that vast mass of paper tumbling through a servicer’s office, a handwritten slip of paper, measuring only 2-3 inches across, is unlikely to ever be recognized and processed.

¹⁰⁵ *See, e.g.*, ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Rescission Notices 5 (2010) (60% of the consumers tested did not know they had a right to rescind).

¹⁰⁶ *See, e.g.*, ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Rescission Notices 7 (2010).

The Board's failure to require creditors to complete the tear-off portion further undermines the reliability of the tear-off form. Consumers who return the tear-off form are unlikely to type the information on the form (while access to photocopiers may have increased, access to typewriters has decreased), and a handwritten form, besides looking unofficial, may be illegible. Even if the form is not actually illegible, a handwritten form may be easily misread, or incompletely filled out, with the result that the creditor fails to realize which homeowner has exercised her right of rescission.

The tear off form increases the risk that consumers will provide the notice of the right to cancel to the wrong person and that mistakes in the delivery of the notice of cancellation, once made, will be more difficult to correct. Once the tear-off form is separated from its sheet, there is no indication on the tear-off slip where the form should be delivered. Most consumers stated they would give the form to the person they dealt with originally—often a broker.¹⁰⁷ But providing a notice of the right to cancel to the broker will not result in a proper exercise of the right of rescission. A consumer who tears off the slip to mail or hand deliver later has no reminder on the form where it should go, no check at all to prevent delivery to the wrong person.

Moreover, the person who receives the torn-off slip of paper will have only the barest of indications as to what it is about—neither the creditor's name nor the address to which the notice should be sent will be on the paper. Thus, a broker who wants to forward the notice to the proper party may be unable to do so. Indeed, the information on the tear-off slip may be insufficient for servicers to identify the loan being rescinded—loan numbers sometimes change over the course of a loan or from servicer to servicer—and addresses are not always unique identifiers for loans.

The Board is once again proposing to shift the burden from creditors to consumers, in contravention of Congress's intention. For over 40 years, creditors have been required to provide borrowers with two copies of the notice of the right to cancel. Providing two copies of the notice is less burdensome than ever for creditors. The Board's proposal, a tear-off slip, is, at best, a solution in search of a problem. At worst, it undermines the right of rescission.

E. The Board's Proposed Definition of Material Disclosures for HELOCs Contains Major Omissions and Would Perpetuate Flaws in Its Disclosure Proposal.

1. The Board should treat the penalty APR as a material disclosure.

Penalty rates have been a major abuse, a significant profit center for creditors, and an enormous source of consumer anger in the credit card context. Penalty rates are one of the worst tricks and traps that make the disclosed cost of credit illusory. Yet the Board proposes not to treat penalty rates as material disclosures.¹⁰⁸

¹⁰⁷ See, e.g., ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Rescission Notices at iv-v (2010).

¹⁰⁸ Proposed Reg. Z § 226.15(a)(5)(i)(a); Proposed OSC 226.15(a)(5)(i)-4; 75 Fed. Reg. 58629, 58565 (Sept. 24, 2010).

The Board's rationale for this omission is that its August 2009 HELOC proposal would place some much-needed limits on HELOC penalty rates, allowing them to be imposed only if the consumer's payment is more than 30 days late.¹⁰⁹ However, these are not "very limited circumstances" as the Board posits.¹¹⁰ Millions of consumers in the United States are more than 30 days late on their mortgage payments right now because of the foreclosure crisis.¹¹¹ Imposing a penalty rate for a HELOC likely dooms the home to foreclosure. Accurate and prominent disclosure of the existence of a penalty rate is extremely important to consumers and should be treated as a material disclosure. In addition, treating a penalty rate as a material disclosure, so that rescission is available if it is misdisclosed, gives creditors a greater incentive to disclose it accurately.

2. The Board should treat the proposed disclosure of the of payment amount as a material disclosure.

The Board's August 2009 proposal would require HELOC lenders to disclose the amount of the consumer's monthly payment, calculated on the assumption that the consumer borrows the maximum credit line available at account opening.¹¹² The Board proposes not to treat this disclosure as material, on the theory that the payment amount is merely hypothetical because the consumer may not borrow the maximum amount at account opening.¹¹³ This view disregards the fact that the monthly payment amount is one of the most important pieces of information that consumers want and need when shopping for credit.¹¹⁴ Further, our experience is that, for the low-income clients we and our colleagues represent, HELOCs have been almost exclusively provided as part of an 80-20 deal, with the full credit line drawn down at account opening. The weak HELOC disclosures, and particularly the weak disclosure of the payment amount, have been one of the greatest problems with these HELOCs. At least where the line of credit is fully or almost fully drawn down at account opening, the disclosure of the payment amount should be treated as a material disclosure.

3. The Board should treat HELOC transaction charges as material disclosures.

The Board proposes not to treat HELOC transaction charges as material disclosures because its research has shown that HELOC creditors today do not typically impose transaction charges except on cash advances and foreign transactions.¹¹⁵ This reasoning is

¹⁰⁹ Proposed OSC § 226.5b(f)(2)(ii)-2; 74 Fed. Reg. 43428, 43473 (Aug. 26, 2009). As noted at pp. 49-50 of our comments submitted on Dec. 24, 2009 in Docket No. R-1367, the proposed Regulation Z language regarding a 30-day limit on the imposition of penalty rates does not match the Board's description of it. Our comments regarding the rescission notice are based on the assumption that the Board clarifies the proposed HELOC Regulation Z language, so that it is clear that penalty rates can be imposed only if the consumer is more than a certain number of days late in making a payment.

¹¹⁰ 75 Fed. Reg. 58629, 58565 (Sept. 24, 2010).

¹¹¹ As of September 30, 2010, of the 43,967,725 mortgage obligations nationwide, 9.39%, or 4,128,569, were delinquent by 30 days or more. Mortgage Bankers Assoc., National Delinquency Survey, Q3 2010, at 4.

¹¹² Proposed Reg. Z § 226.5b(c)(9)(iii). See 74 Fed. Reg. 43428, 43467 (Aug. 26, 2009).

¹¹³ 75 Fed. Reg. 58629, 58568. (Sept. 24, 2010).

¹¹⁴ Ren S. Essene & William Apgar, Joint Ctr. for Housing Studies, Harvard Univ., *Understanding Mortgage Market Behavior: Creating Good Mortgage Options for All Americans* (2007); Lauren E. Willis, *Decisionmaking and the Limits of Disclosure: The Problem of Predatory Lending*, *Price* 65 Md. L. Rev. 707 (2006).

¹¹⁵ 75 Fed. Reg. 58629, 58570 (Sept. 24, 2010).

faulty. If the credit card experience teaches nothing else, it is that fees that are disclosed less prominently and for which there are no statutory caps tend to grow. For example, late fees and overlimit fees became significant profit centers for credit card lenders. Regulation Z should be written with not just today's fee patterns in mind, but also the direction in which lending may evolve. Transaction fees could easily become a major part of the cost of credit, and should be treated as a material disclosure.

4. The Board Should Not Build Its Definition of Material Disclosures Around Its Ill-Conceived Proposal to End the APR as a Uniform Measure of the Cost of Credit.

a. The Board's August 2009 proposal for disclosure of HELOC APRs was fundamentally flawed.

Until February 2010, when the Board revised the HELOC disclosure rules on an interim basis, HELOC lenders were required to disclose the applicable interest rates at account opening, and the "effective," fee-inclusive APR in periodic statements. Effective February 22, 2010, the Board revised these rules on an interim basis.¹¹⁶ Under the revised rules, creditors still need not disclose a fee-inclusive APR when a HELOC account is opened.¹¹⁷ Instead, they are to disclose the interest rate, without including fees. Yet this disclosure is to be termed the "APR." Moreover, under the interim rule, HELOC creditors no longer need disclose the fee-inclusive APR even in periodic statements.¹¹⁸

The interest-only APR understates the true cost of credit by an unknown amount that depends on the amount of non-interest finance charges, so consumers cannot use the APR to compare the cost of one HELOC to another. The problem is even worse if a consumer wants to compare use of a HELOC to use of a closed-end mortgage, because the HELOC "APR" is only the interest rate, while the closed-end APR comes closer to the true, full cost of credit.¹¹⁹ The APR makes open-end credit appear less expensive than closed-end credit and is thus deceptive.

NCLC experienced the full impact of these problems when preparing a recent report comparing the cost of various payday loan alternatives.¹²⁰ Some of the alternatives were credit cards or other small-dollar open-end loan products, some were closed-end, and some were overdraft loans for which the Board requires no TIL disclosures. Since the Board does not require disclosure of a uniform, accurate APR for these loan products, NCLC had to spend many days doing individual, sometimes complex, calculations of fee-inclusive APRs for all of these loan products. If NCLC had to spend days doing these calculations, no consumer will have the information to compare the cost of these loan products.

¹¹⁶ 75 Fed. Reg. 7800 (Feb. 22, 2010).

¹¹⁷ Reg. Z § 226.6(a)(3)(vi).

¹¹⁸ Reg. Z § 226.7(a)(7) (making disclosure of effective APR optional on the part of the lender).

¹¹⁹ However, even in the closed-end context there are loopholes for some fees that can result in distortion of the APR. In other comments we have urged the Board to close those loopholes. *See also* Elizabeth Renuart & Diane E. Thompson, *the Truth, the Whole Truth, and Nothing But the Truth: Fulfilling the Promise of Truth in Lending*, 25 Yale J. Reg. 181 (2008).

¹²⁰ National Consumer Law Center, *Stopping the Payday Loan Trap: Alternatives that Work, Ones that Don't* (June 2010), available at www.nclc.org/issues/payday-loans.html.

One of the important goals of the Board – and of the Consumer Financial Protection Bureau – is and should be to make disclosures uniform so that consumers can compare one credit product to another. Indeed, this was one of the original premises of the Truth in Lending Act, and why the Act adopted the APR as a disclosure of the cost of credit: unlike the interest rate, the APR took non-interest finance charges into account, which otherwise would silently raise the true cost of credit.

The Board should not continue on its path of undermining the APR as a true measure of the cost of credit by extending its credit card errors to HELOCs. Instead, it – or the CFPB – should restore the APR in the credit card context, require a fee-inclusive APR to be disclosed for overdraft loans, and require disclosure of the true, fee-inclusive APR for HELOCs. Comparability is particularly important between HELOCs and closed-end mortgages, as consumers will often be choosing between a HELOC and a closed-end mortgage product.

b. The Board should require disclosure of a fee-inclusive APR for HELOCs.

As detailed in our December 24, 2009, comments on the HELOC disclosure proposal, the Board should retain the APR as an accurate measure of the cost of credit for HELOCs and improve upon the APR by mandating a fee-inclusive APR at account opening. A fee-inclusive APR should be disclosed not just in the periodic statement, as was required until February 2010, but also at account opening, using the assumption that the full amount is drawn down at closing and making a reasonable assumption about the repayment term. The Board should then, in the current proceeding, revise the proposed definition of “material” disclosures to include the fee-inclusive APR.

The Board’s proposal to base its definition of “material” disclosures on APRs that do not include fees is one more step in the erosion of meaningful disclosure of the cost of credit. The Board should put this proposal on hold until it rethinks its abandonment of the true APR. The Board should not cement its abandonment of the true APR by writing the definition of “material” disclosures around the abandonment of the fee-inclusive APR.

F. The Board’s Proposed Tolerances Would Give Creditors a License to Lie.

1. Introduction

The Board proposes to adopt an unprecedented range of tolerances for both open- and closed-end mortgage credit, including tolerances on amounts, such as the loan amount, that are fixed and determined at the time of disclosure and not subject to calculation error. The Board for the first time introduces tolerances beyond the limited tolerances authorized by the statute. Worse, the Board ignores congressional policy of setting lower tolerances for homeowners facing foreclosure.

The Board’s proposal is both illegal and bad policy. Increasing tolerances, particularly tolerances for fixed amounts, provides no meaningful protection for honest and diligent creditors but does encourage lenders to lie in disclosures.¹²¹

The less accurate the disclosures are, whether due to careless or deliberate misstatement, the less consumers will use them. This is why the statute requires the Board to create only narrow tolerances and why the statute itself only provides for limited tolerances of two disclosures. The Board’s approach wholly disregards this limited statutory scheme, by proposing tolerances for a wide range of disclosures, many of which are for loan terms that are certain in amount and determined under the note.

2. The proposed tolerances exceed the Board’s authority.

a. The Board’s proposed tolerances violate the statutory framework that only permits narrow tolerances.

As discussed above, the Board’s rulemaking authority is bounded by the statute. The Board can only create exceptions or exemptions when doing so is in furtherance of the statute’s purposes—the informed use of credit. Implementing additional, unauthorized tolerances does not support the informed use of credit.

The Board relies on 15 U.S.C. § 1631(d) for its authority to adopt tolerances for disclosures other than the APR. Section 1631(d) does not give the Board carte blanche to gut TILA disclosures: rather the Board may only introduce tolerances that “are narrow enough to prevent such tolerances from resulting in misleading disclosures or disclosures that circumvent the purposes of this subchapter.”¹²² The proposed tolerances are certainly “broad enough to alleviate creditors’ compliance concerns,” as the Board opines,¹²³ but they are not narrow, they invite creditor misrepresentation of the key terms of the loans, and they would encourage creditors to circumvent the core purpose of TILA—the informed use of credit. The proposed tolerances are not even necessary to facilitate compliance, extending as they do to terms that are known absolutely by the creditor at the time credit is extended.

The Board claims that it is “modeling” these tolerances on the existing statutory structure.¹²⁴ But the Board’s proposed tolerance rules cannot be said to be modeled on the statute, omitting as they do any lowered tolerances for rescission in foreclosure and expanding the list from two disclosures requiring legal judgment to a whole host of disclosures that are either known absolutely to the creditor or require nothing more complicated than arithmetic. Rather than deviating from the statute in the name of “modeling,” the Board should implement the existing statutory structure. At base, the statute is not a model for the Board to improvise on, but a template to implement.

¹²¹ See Cong. Rec. S14567 (Sept. 28, 1995) (statement of Sen. Sarbanes) (expressing concern that the congressionally-enacted tolerances not be interpreted to permit loan padding but only honest mistakes).

¹²² 15 U.S.C. § 1631(d).

¹²³ 75 Fed. Reg. 58539, 58564 (Sept. 24, 2010).

¹²⁴ 75 Fed. Reg. 58539, 58564 (Sept. 24, 2010).

The statute provides for tolerances in only three places: 15 U.S.C. § 1605(f)(2) (setting the basic finance charge tolerances for rescission), 15 U.S.C. § 1606(c) (setting the APR tolerances), and 15 U.S.C. § 1635(i)(2) (providing reduced tolerances for underdisclosure of the finance charge and related disclosures for purposes of rescission when the homeowner is in foreclosure). The Board does its most serious violence to the statutory scheme in its persistent refusal to implement reduced tolerances for foreclosure, as mandated by 15 U.S.C. § 1635(i)(2). Nothing in 15 U.S.C. § 1635(i)(2) permits the Board to increase the tolerances in case of foreclosure, yet that is, in effect, precisely what the Board is proposing to do.

b. The proposed tolerances run counter to TILA's statutory scheme for promoting informed use of credit.

The Board misreads its authority when it claims that it may adopt tolerances for any amount that “was not critical to a consumer’s decision to enter into the credit transaction.”¹²⁵ This turns the principles of TILA on their head and adopts, whole cloth, the arguments advanced by the credit industry against TILA’s enactment over 40 years ago.

TILA is designed to provide information to consumers so that they can make informed decisions. TILA was explicitly not designed to respond to existing consumer demands for information. As Senator Paul Douglas, the author of TILA explained, creditors create confusion over fees and rates, with the result that consumers do not shop as wisely or as carefully for credit as they might. Indeed, Senator Douglas analogized the Board’s present argument, that consumers should be deprived of information because they aren’t clamoring for it, to “the logic surrounding a Salem witch trial where the silence of the accused was held to be evidence of her guilt.”¹²⁶ Providing more complete information, Douglas argued, leads to more efficient markets, even if only a small minority of consumers shop on the disclosed information.¹²⁷

Except where Congress has explicitly relieved lenders of liability for noncompliance, TILA is a strict liability statute.¹²⁸ It is “[t]his strict interpretation of the TILA [that] has

¹²⁵ 75 Fed. Reg. 58539, 58564 (Sept. 24, 2010).

¹²⁶ *Hearings Before the Subcomm. on Fin. Institutions of the S. Comm. on Banking & Currency on S. 5*, 90th Cong. 42 (1967) (testimony of Sen. Paul Douglas).

¹²⁷ *Hearings Before the Subcomm. on Fin. Institutions of the S. Comm. on Banking & Currency on S. 5*, 90th Cong. 49-50 (1967) (testimony of Sen. Paul Douglas).

¹²⁸ *In re Hamm v. Ameriquest Mortgage Co.*, 506 F.3d 525, 529 (7th Cir. 2007); *Community Bank*, 418 F.3d 277, 305 (3d Cir. 2005) (“strict liability is imposed on lenders and on their assignees if the APR of a loan is materially misstated”); *Smith v. The Cash Store Management, Inc.*, 195 F.3d 325 (7th Cir. 1999) (creditors are strictly liable for TIL inaccuracies, even if they are not misleading); *Purtle v. Eldridge Auto Sales, Inc.*, 91 F.3d 797 (6th Cir. 1996); *Rodash v. AIB Mortgage Co.*, 16 F.3d 1142 (11th Cir. 1994) (strict compliance required; liability will flow from minute deviations from requirements); *Porter v. Mid-Penn Consumer Discount*, 961 F.2d 1066 (3d Cir. 1992); *Smith v. Fidelity Consumer Discount Co.*, 898 F.2d 896 (3d Cir. 1990) (“A creditor who fails to comply with TILA in any respect is liable to the consumer under the statute regardless of the nature of the violation or the creditor’s intent.”); *Jackson v. Grant*, 890 F.2d 118 (9th Cir. 1989); *Shroder v. Suburban Coastal Corp.*, 729 F.2d 1371, 1380 (11th Cir. 1984) (liability will flow from “even minute deviations”); *Rush v. Am. Home Mortgage, Inc.*, 2009 WL 4728971 (D. Md. Dec. 3, 2009); *Phleger v. Countrywide Home Loans, Inc.*, 2009 WL 225416 (N.D. Cal. Jan. 29, 2009); *Greene v. Benefit Mortgage Corp.*, 2009 WL 56056, at *8 (E.D. Mich. Jan. 8, 2009); *Amparan v. Plaza Home Mortgage, Inc.*, [rule] F. Supp. 2d [rule], 2008 WL 5245497 (N.D. Cal. Dec. 17, 2008); *Altamirano v. Copiague Funding Corp.*, 2008 WL 3845362

largely been responsible for the TILA's success in achieving widespread compliance with its

(D. Conn. Aug. 18, 2008); *Jeffries v. Ameriquest Mortgage Co.*, 543 F. Supp. 2d 368, 378 (E.D. Pa. 2008); *Egipciano-Ruiz v. R. & G Mortgage Corp.*, 2005 WL 3830967, at *3-4 (D. P.R. Sept. 21, 2005); *Kitchen v. Ameriquest Mortgage Co.*, 2005 U.S. Dist. LEXIS 43937 (N.D. Ga. Apr. 29, 2005); *Vaden v. IndyMac Bank*, 2003 WL 22136306 (N.D. Ill. Sept. 16, 2003); *Bilal v. Household Fin. Corp.* (*In re Bilal*), 296 B.R. 828, 832 (D. Kan. 2003); *Davison v. Bank One Home Loan Servs.*, 2003 WL 124542 (D. Kan. Jan. 13, 2003); *Kurz v. Chase Manhattan Bank*, 273 F. Supp. 2d 474 (S.D.N.Y. 2003); *Gibbons v. Interbank Funding Group*, 208 F.R.D. 278 (N.D. Cal. 2002) (technical or minor violations of TILA or Reg. Z impose liability); *Decos v. Jojo Motors*, 2002 WL 598520 (N.D. Ill. Apr. 18, 2002) (failure to provide copy of TIL disclosures that consumer can keep is not a de minimis violation); *Floyd v. Security Fin. Corp.*, 181 F. Supp. 2d 1137 (D. Nev. 2001); *Basnigt v. Diamond Developers*, 146 F. Supp. 2d 754 (M.D.N.C. 2001) (technical violations of TILA impose liability; creditor liable for misdated notice of right to rescind); *Fabricant v. Sears Roebuck*, 202 F.R.D. 306 (S.D. Fla. 2001) (“black letter law” that once a court finds a TIL violation, even if technical, it must impose liability); *Gilkey v. Central Clearing Co.*, 202 F.R.D. 515 (E.D. Mich. 2001) (lenders are generally strictly liable under TILA for inaccuracies, even absent a showing that the inaccuracies are misleading); *Lifanda v. Elmhurst Dodge*, 2001 WL 755189 (N.D. Ill. July 2, 2001) (TILA requires absolute compliance and even technical violations form the basis for liability); *Riopta v. Amresco Residential Mortgage Corp.*, 101 F. Supp. 2d 1326 (D. Haw. 1999); *Acevedo v. Bally Total Fitness Corp.*, 1999 U.S. Dist. LEXIS 18029 (N.D. Ill. Nov. 9, 1999); *Clay v. Johnson*, 77 F. Supp. 2d 879 (N.D. Ill. 1999) (damages are mandatory for technical violation), *rev'd on other grounds*, 264 F.3d 744 (7th Cir. 2001); *Pinkett v. Moolah Loan Co.*, 1999 WL 1080596, 1999 U.S. Dist. LEXIS 17276 (N.D. Ill. Nov. 1, 1999); *Johnson v. Tele-Cash, Inc.*, 82 F. Supp. 2d 264 (D. Del. 1999) (failure to comply with simplified TIL requirements, no matter how technical, is a violation), *rev'd on other grounds*, 225 F.3d 366 (3d Cir. 2000); *Pollice v. National Tax Funding*, 59 F. Supp. 2d 474 (W.D. Pa. 1999), *aff'd in part, rev'd in part on other grounds*, 225 F.3d 379 (3d Cir. 2000); *Newton v. United Cos. Fin. Corp.*, 24 F. Supp. 2d 444 (E.D. Pa. 1998); *Yazzie v. Ray Vicker's Special Cars, Inc.*, 12 F. Supp. 2d 1230 (D.N.M. 1998); *Barlow v. Evans*, 992 F. Supp. 1299, 1307 (M.D. Ala. 1997); *Noel v. Fleet Fin., Inc.*, 971 F. Supp. 1102 (E.D. Mich. 1997) (creditors are liable for technical or minor violations); *Brodo v. Bankers Trust Co.*, 847 F. Supp. 353 (E.D. Pa. 1994) (TILA imposes strict liability for failure to disclose any mandated information, even if the violation is technical and unintended; borrower is not required to allege or prove any injury resulting from a TIL violation); *Rowland v. Magna Milliken Bank*, 812 F. Supp. 875 (C.D. Ill. 1992); *In re Norris*, 138 B.R. 467 (E.D. Pa. 1992) (TILA must be strictly construed and liability imposed even for technical violations); *In re Wright*, 133 B.R. 704 (E.D. Pa. 1991); *Shepherd v. Quality Siding & Window Factory Inc.*, 730 F. Supp. 1295 (D. Del. 1990); *Smith v. Wells Fargo Credit Corp.*, 713 F. Supp. 354 (D. Ariz. 1989); *Nichols v. Mid-Penn Consumer Discount Co.*, 1989 WL 46682 (E.D. Pa. Apr. 28, 1989), *aff'd without op.*, 891 F.2d 282 (3d Cir. 1989); *Ramirez v. Household Fin. Corp.* (*In re Ramirez*), 329 B.R. 727, 731-732 (Bankr. D. Kan. 2005); *Stanley v. Household Fin. Corp.* (*In re Stanley*), 315 B.R. 602, 612 (Bankr. D. Kan. 2004); *Finch v. Household Fin. Corp.* (*In re Finch*), 2003 WL 23777744, at *3 (Bankr. D. Kan. Nov. 7, 2003); *Armstrong v. Nationwide Mortgage Plan* (*In re Armstrong*), 288 B.R. 404 (Bankr. E.D. Pa. 2003); *Rodriguez v. U.S. Bank* (*In re Rodriguez*), 278 B.R. 683 (Bankr. D.R.I. 2002) (courts must impose strict liability for technical or minor violations of TILA); *Wolfe v. IMC Mortgage Co.*, Clearinghouse No. 53,025 (Bankr. D. Md. May 19, 2000); *In re Moore*, 117 B.R. 135, 137 (Bankr. E.D. Pa. 1990) (in light of Simplification, violations that remain must be subject to full force of penalties, even if they are technical); *In re Steinbrecher*, 110 B.R. 155 (Bankr. E.D. Pa. 1990); *In re Brown*, 106 B.R. 852 (Bankr. E.D. Pa. 1989); *In re McElvany*, 98 B.R. 237 (Bankr. W.D. Pa. 1989); *Johnson v. Thomas*, 794 N.E.2d 919, 926 (Ill. App. Ct. 2003) (even technical violations provide basis for liability); *Kocsis v. Pierce*, 480 N.W.2d 598 (Mich. Ct. App. 1991) (creditor gave one copy of rescission notice rather than two); *Manor Mortgage Corp. v. Giuliano*, 251 N.J. Super. 13, 596 A.2d 763 (1991) (TIL penalty “is not limited to punishment of egregious conduct but is intended to deter all violations of the Act”); *Equity Plus Consumer Fin. & Mortgage v. Howes*, 861 P.2d 214 (N.M. 1993) (unnecessary for borrowers to demonstrate actual damages or that they were actually misled); *Patterson v. Bob Wade Lincoln-Mercury*, 55 Va. Cir. 499, 2000 Va. Cir. LEXIS 619 (Va. Cir. Ct. Sept. 29, 2000) (Consumer Leasing Act is a strict liability statute; once a court finds a violation, no matter how technical, it has no discretion regarding the imposition of liability). *See also* *Cowen v. Bank United of Texas F.S.B.*, 70 F.3d 937 (7th Cir. 1995) (\$10 fee that was improperly excluded from the finance charge fell within the tolerances of Reg. Z § 226.18(d), but noting general rule that “hypertechnicality reigns” with respect to TIL violations); *Steele v. Ford Motor Credit Co.*, 783 F.2d 1016 (11th Cir. 1986) (“unearned” interest should have been disclosed and was not de minimis because finance charge “is somehow more important than other required disclosures”).

requirements.”¹²⁹ Without strict compliance, including limited tolerances, TILA’s goal of standardized, uniform disclosures that consumers can use to compare credit offers would be quickly eroded.¹³⁰

The tolerances contained in the statute were enacted in 1980, as part of Truth-in-Lending Simplification, and in 1995, when Congress again addressed creditors’ concerns about “hypertechnicality.” The Simplification Act and the 1995 amendments strengthen the understanding of the statutory scheme as one of strict compliance. Since the Simplification amendments reduced the technical burdens of disclosure on creditors, and the 1995 amendments created immunity for certain specific, narrow areas of noncompliance, they were presumably all that Congress considered necessary to remedy any inequities in favor of consumers arising from litigation under TILA.¹³¹ These decisions were the result of extended political negotiation and compromise; the Board should not substitute its judgment for Congress’ in this matter.

c. The Board may not ignore the special tolerances provided for rescission when the homeowner is in foreclosure under 15 U.S.C. §1635(i)(2).

While 15 U.S.C. § 1631(d) discusses the basic tolerances for all loan violations, it does not address the special tolerances set for rescission. The Board is not free to create tolerances that undermine the specific limitation, set forth in 15 U.S.C. § 1635(i)(2), of the tolerance to \$35 for a finance charge underdisclosure when rescission is raised in the context of a homeowner’s foreclosure. The Board’s proposed tolerances--for the credit limit and total account-opening fees in HELOCs, and the loan amount, settlement costs, and payment summary in closed-end mortgages--effectively allow creditors to underdisclose key loan terms by far more than \$35. Worse, homeowners will be left without recourse even in foreclosure.

The special foreclosure tolerances underscore the Board’s misapprehension of the relationship between rescission and the disclosures. The Board repeatedly asks whether a given variance would be relevant to a homeowner’s decision to rescind.¹³² But clearly this is not the question Congress asked. The statute only allows for tolerances when they will not result in misleading disclosures, whether or not those disclosures lead to the decision to rescind. An underdisclosed finance charge is not more relevant to the decision of a homeowner to rescind when the homeowner is in foreclosure. Instead, the homeowner will look for rescission as a method of preserving the home. Congress not only recognized this possibility but approved it by setting the lower threshold for rescission when the homeowner is faced with foreclosure.

¹²⁹ *In re Brown*, 106 B.R. 852, 857 (Bankr. E.D. Pa. 1989). *Accord* *Nichols v. Mid-Penn Consumer Discount Co.*, 1989 WL 46682 (E.D. Pa. Apr. 28, 1989), *aff’d without op.*, 893 F.2d 1331 (3d Cir. 1989).

¹³⁰ *See* *Brown v. Marquette Sav. & Loan Ass’n*, 686 F.2d 608 (7th Cir. 1982); *Reneau v. Mossy Motors*, 622 F.2d 192 (5th Cir. 1980) (“the 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”).

¹³¹ *In re Brown*, 106 B.R. 852 (Bankr. E.D. Pa. 1989).

¹³² *See, e.g.*, 75 Fed. Reg. 58539, 58614 (Sept. 24, 2010).

The lower tolerance for rescission in foreclosure set forth in 15 U.S.C. § 1635(i)(2) clearly indicates Congress' understanding that the preservation of homeownership is of paramount importance, and that even small deviations from the mandated disclosures should provide defenses to foreclosure. Nothing in 15 U.S.C. § 1631(d) or elsewhere in the statute authorizes the Board to ignore the congressional intent embodied in 15 U.S.C. § 1635(i)(2).

2. The Board's proposed tolerances are bad policy.

a. The Board's proposed tolerances would facilitate creditor non-compliance and reduce competition.

It is true, as the Board notes, that the tolerances will reduce the availability of extended rescission rights. Whether that is good public policy is another question. Extended rescission rights are often the only meaningful protection borrowers have against predatory lenders. The extended right of rescission is one of just a few tools to halt a pending foreclosure and allow a court adjudication of the merits. Moreover, the extended right of rescission is an important part of the statutory scheme designed to enhance "economic stabilization" and strengthen competition, by enforcing accurate disclosure.¹³³ Limiting the extended right of rescission weakens the incentives for creditors to comply with TILA's disclosure scheme and threatens its core purposes.

It is not true, as the Board asserts, that the tolerances cover only "inconsequential" disclosure errors.¹³⁴ The Board is proposing new tolerances for key disclosures, such as the credit limit and monthly payment amount. The tolerances proposed are large, without any protection for homeowners facing foreclosure. Tolerances are proposed for amounts that the creditor knows with certainty.

The Board's proposed tolerances will make shopping harder for consumers. Consumers who discover that their disclosures do not match the terms of their loan documents are likely to discount the disclosures for that and all future transactions. Worse, consumers should discount the disclosures under the Board's proposed tolerance regime. A disclosure that understates the amount of a \$100,000 loan by \$500, understates the payment amount by \$100, and overstates the settlement costs by \$1000, as would be allowed under the Board's proposal, is useless if not actively misleading. Under the Board's proposal, no reputable financial educator could advocate that consumers rely on the terms of their disclosures for shopping purposes.

Even if the dollar differences are small in any given case, the end result is not "inconsequential." Small differences in dollar amounts can result in the transfer of millions of dollars of wealth from consumers to lenders. Lenders should not be allowed to camouflage those differences and profit from the deception because the differences are small in any given case. The goal of disclosure should be ever-increasing precision and simplification, to promote more informed use of credit and greater market competition. The

¹³³ 15 U.S.C. § 1601(a).

¹³⁴ 75 Fed. Reg. 58539, 58547 (Sept. 24, 2010).

easier it is to shop the more likely it is that consumers will shop, and shop effectively.¹³⁵ Tolerances only facilitate creditor noncompliance with the statute.

b. The proposed tolerances are unnecessary, as they relate to disclosures that creditors can make accurately without difficulty.

The only two disclosures for which the statute creates tolerances are the finance charge and annual percentage rate. No tolerance is provided in the statute for any of the other mandated disclosures, including the payment amount, the number of payments, or the total of payments. This is so even though the calculations to derive these amounts from the note can be complex, particularly in the case of an adjustable rate mortgage.

Despite these limited existing tolerances, creditors are not currently suffering a wave of litigation based on the incorrect disclosure of the payment amount or the total of payments. Creditors can correctly perform the calculations required to make these disclosures.

In this age of computerization, there is virtually no need for tolerances. For example, creditors can easily determine an accurate APR down to any arbitrarily small tolerance. The proposed tolerance for the loan amount makes a mockery out of the very notion that the disclosures comport with the legal obligation: a creditor will know, down to the dollar, what the loan amount is at the time of disclosure. Creditors are already complying with RESPA requirements that remove most tolerances from the settlement charge disclosures for closed-end mortgages; creditors can determine the actual cost of the loan sufficiently in advance of closing to produce accurate disclosures.

The finance charge and the annual percentage rate – the only two disclosures for which the statute creates tolerances -- are significantly different from the other disclosures at issue in this proposal. To determine the finance charge and annual percentage rate, the creditor must not only perform some calculations, but must also exercise legal analysis to determine which charges should be allocated to the finance charge as opposed to the amount financed. Indeed, the 1995 tolerances were added because of concerns about widespread misallocation of a particular fee – a fee for express delivery – to the amount financed. By contrast, the disclosures at issue here involve simple mathematical calculations at most.

c. No tolerance should be allowed for amounts that are fixed and certain.

The Board proposes to add tolerances for the loan amount, the monthly payment, the account opening fees, and the credit limit. All of these are terms the creditor knows with certainty in advance. Indeed, the Board notes that requiring disclosure of the loan amount should not pose any great burden to creditors since the information will be contained in the

¹³⁵ As Herbert Simon points out, the easier it is to discover a satisfactory solution, the higher the standard for an acceptable solution becomes. Herbert A. Simon, *A Behavioral Model of Rational Choice*, 69 Q. J. Econ. 99, 111 (1955). See also Yu-Chun, Regina Chang & Sherman Hanna, *Consumer Credit Search Behavior*, 16 J. Consumer Studies and Home Economics 207 (1992) (consumers seek a solution that meets minimum requirements without expending too much energy).

note.¹³⁶ Although the Board does not propose to add a tolerance for the loan term, noting that the loan term is “a fixed number that is not dependent on other aspects of the transaction,” it solicits comment on whether tolerances are “necessary.”¹³⁷

The creditor knows how much the loan amount is; the creditor knows how much the monthly payment is. Tolerances in these amounts should only be permitted if the creditor also regards the difference as inconsequential. If creditors were willing to accept \$100 less a month, or accept ½ of 1 percent less of the loan amount in order to pay off a loan in full, then we would have no objection to the creation of tolerances. But if these amounts are in fact consequential to creditors, known with certainty, and not dependent on the finance charge disclosure, then no tolerance should be permitted.

Introduction of tolerances for loan terms that the creditor knows with certainty only encourages creditors to underdisclose key terms, whether from fraudulent intent or gross carelessness. Either result undermines the utility of the disclosures. Imprecision in the TIL disclosures necessarily erodes their utility.¹³⁸

d. Overdisclosure undermines the utility of the disclosures.

There is no question that overdisclosure is misleading and undermines a competitive marketplace for credit. Overdisclosure hides the actual cost of credit, and prevents comparison shopping, just as surely as underdisclosure.

It is no answer to argue that competitive pressures will force creditors to rein in disclosures; increasingly in recent years we have seen creditors undermine the utility of the disclosures by gross overdisclosure of the finance charge. Such overdisclosure may insulate the creditor from liability, but it makes it difficult, if not impossible, for consumers to shop, and thus frustrates the core purpose of TILA, the informed use of credit.

The end result has been a cheapening of the finance charge disclosure for all mortgage loans: finance charge disclosures are no longer comparable on face value, but consumers must revert to comparing individual fees to determine the price of their credit. The end result is that the TIL disclosures themselves become inconsequential. The Board should not bless overdisclosure per se.

e. Any dollar tolerances should not be linked to the Consumer Price Index.

The Board should encourage creditors to take advantage of improving technology and better practices to provide ever more accurate disclosures. The goal of TIL disclosure should be precision. Indexing tolerances sets a permanent standard of sloppiness, and provides no incentive to creditors to work to improve the precision of their disclosures.

¹³⁶ 75 Fed. Reg. 58539, 58615 (Sept. 24, 2010)

¹³⁷ 75 Fed. Reg. 58539, 58616 (Sept. 24, 2010).

¹³⁸ See *Hearings Before the Subcomm. on Fin. Institutions of the S. Comm. on Banking & Currency on S. 5*, 90th Cong. 49 (1967) (testimony of Sen. Paul Douglas).

Tolerances should be designed to protect creditors from good faith errors, not deliberate misstatements. Inflation does not, by itself, increase the difficulty of computing the monthly payment, the settlement costs, or the loan amount. (In fact, those amounts do not rise in uniform response to inflation, in any event). Creditors do not have increased difficulty calculating the total of the monthly fees as the amount of the fees increase over time. Rather, creditors' calculation tasks simplify over time with the introduction of new technology. Keeping the tolerance amount fixed at a low level encourages creditors to produce ever more accurate and therefore useful disclosures. Indexing would, in effect, give creditors an ever wider margin for falsifying the disclosures.

Moreover, indexing the tolerances is one-sided. Few figures in TILA, whether damages amounts or tolerances, are linked to inflationary measures. Tolerances should not be linked to the CPI unless all TIL statutory damages are as well. Otherwise, the ultimate result will be a degradation of the TIL standards, with the real penalty for violations shrinking while the scope of the violation remains large.

3. Analysis of specific tolerances

The Board proposes to add several disclosures to the list of material disclosures and to add additional tolerances. Several of the disclosures the Board proposes to add—the interest rate and the total settlement charges, for example—likely obscure TILA's core price disclosures, the APR and the finance charge. We have elsewhere discussed our concerns with the Board's outstanding disclosure proposal.¹³⁹ We continue to believe that the Board's disclosure proposal must be reworked. If the disclosure proposal were re-worked in accordance with our comments, some of the new proposed material disclosures would no longer be disclosed on the TIL disclosure, while the material disclosures the Board proposes to remove—the payment schedule and amount financed—would be reinstated.

Adding tolerances encourages sloppy disclosures and reduces the utility of TILA's disclosure regime. The Board's decision to import the existing finance charge closed-end tolerances into the HELOC disclosures and the new closed-end material disclosures (the settlement charges, loan amount, prepayment penalty, and monthly payment amount) is particularly troubling in light of the Board's failure to set a lower threshold for tolerances in the context of foreclosure. As the Board notes, all of these disclosures will be for a lower amount than the finance charge disclosure, yet the Board sets the proposed tolerance at the same level required for an affirmative case for the much-larger finance charge and fails to hold foreclosing creditors to a higher standard. For many of these disclosures, the proposed minimum tolerance of \$100 guts the disclosures of any utility whatsoever.

a. HELOC Account Opening Fees

The Board proposes to create a \$100 tolerance for the HELOC account-opening fees. The Board believes this tolerance is necessary because 1) creditors may have difficulty doing the arithmetic necessary to add the various fees together and 2) the account opening

¹³⁹ Comments of National Consumer Law Ctr., et al., to the Fed. Res. Board (Dec. 24, 2009), http://www.nclc.org/images/pdf/foreclosure_mortgage/predatory_mortgage_lending/r-1366-with-app-dec09.pdf.

fees may vary depending on the individual loan transaction.¹⁴⁰ Neither of these is a legitimate reason to introduce a tolerance, let alone a \$100 tolerance. Ultimately, there is no legitimate reason for any tolerance for the account-opening fees. These are fees that are known to the creditor in advance of the closing and should be disclosed with precision to the consumer.

Creditors are not adding columns of numbers by hand in a back room: numbers are entered into (and often generated by) computer programs. Computer programs do not make arithmetic errors. Allowing a tolerance for non-existent arithmetic error encourages creditors to deliberately and systematically underdisclose the total account-opening fees.

Similarly, the fact that fees are “customized” is no reason to create a fudge factor for creditors. The customization of these fees is itself highly automated. The whole point of disclosures is to provide individual, loan specific disclosures—those are the disclosures that are useful to consumers.¹⁴¹ Creditors who wish to collect these fees will need to determine them in advance of closing, even if they are customized; creditors should be required to tell consumers what, exactly, they are going to charge them.

Account opening fees are not like the finance charge—disclosing the total account-opening fees does not require any legal analysis. Nor is it like determining the APR, which requires complicated math. Determining the account opening fees, even “customized” account opening fees, only requires addition—and honest disclosure, of course. Neither should be a strain for any creditor.

Creditors, not consumers, must bear the burden of this addition. Unlike creditors, consumers do not usually have their loan parameters entered into a software program, which automatically generates comparative tables and final loan documents. Instead, consumers must manually compare the various disclosed costs. Only 13% of consumers have the quantitative literacy to add fees in order to compare prices,¹⁴² even if they were willing and could take the time to do so. Aside from the math, borrowers are likely to miss fees that are not aggregated. For example, when reviewing model disclosure forms with focus groups, half of the respondents in a survey conducted for the Federal Reserve missed at least one fee charged on a sample credit card statement.¹⁴³ Similarly, in a survey conducted for the Federal Trade Commission (FTC), consumers reviewing mortgage disclosures were unable to identify or aggregate fees, although there were fewer than 20 listed fees.¹⁴⁴

¹⁴⁰ 75 Fed. Reg. 58539, 58566 (Sept. 24, 2010).

¹⁴¹ See, e.g., ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Home Equity Lines of Credit, at iii, 24 (July 16, 2009) (consumers willing to wait until after application and payment of a fee to receive loan specific disclosures in preference to generic disclosures).

¹⁴² See Mark Kutner, Elizabeth Greenberg & Justin Baer, U.S. Department of Education, Institute of Education Sciences, National Center for Education Statistics, A First Look at the Literacy of America’s Adults in the 21st Century 3, 4 (2005), available at <http://nces.ed.gov/NAAL/PDF/2006470.PDF> (only 13% of the adult population has quantitative proficiency; a “sample task[] typical of level” is “computing and comparing the cost per ounce of food items”).

¹⁴³ Macro International, Inc., Design and Testing of Effective Truth in Lending Disclosures 12, 40-41 (2007), <http://www.federalreserve.gov/dcca/regulationz/20070523/Execsummary.pdf>. Only when the researchers grouped and totaled the fees did the borrowers consistently find the fees.

¹⁴⁴ James M. Lacko & Janis K. Pappalardo, Fed. Trade Comm’n, Improving Consumer Mortgage Disclosure: An Empirical Assessment of Current and Prototype Disclosure Forms 32-33 (2007), available at <http://www.ftc.gov/os/2007/06/P025505MortgageDisclosureReport.pdf>.

A tolerance for the total account opening costs effectively allows creditors to continue an unbundled, fee-by-fee disclosure of the total fees. This unbundling of fees hides the magnitude of the cost of credit from consumers. Unbundled fees, in addition to challenging quantitative literacy skills, can evade cognitive notice altogether.¹⁴⁵

The Board must require honest and accurate disclosure of account-opening fees. There is no reason to allow creditors to misstate in their disclosure forms the actual amount of account-opening fees.

b. HELOC Credit Limit

The Board proposes to allow tolerances for the credit limit in HELOCs, essentially equivalent to the existing tolerances for the finance charge. In disclosing the finance charge a creditor can make two errors—an error of legal judgment as to what is and is not included in the finance charge and an error of arithmetic. No such error is possible in the case of the credit limit. The credit limit, like the loan amount, is a term fixed and known to the creditor. There is neither mathematical calculation required nor any exercise of legal judgment. All that is required is extracting the relevant term from the loan documents and displaying it prominently so that a consumer can see it.

The Board opines that these tolerances for the credit limit are “necessary” because creditors customize the credit limit to the customer.¹⁴⁶ But, in fact, customized disclosures are precisely what disclosures are supposed to be. Generic disclosures do not provide consumers the information they need to compare loan terms.

The Board suggests that creditors will still make accurate disclosures because failure to make the correct disclosures will be a violation under Reg. Z §226.6, and thus subject the creditor to statutory damages.¹⁴⁷ There are two problems with this approach. First, the statutory damage amount for HELOC disclosure violations remains only \$1,000.¹⁴⁸ This is nothing like the penalty imposed by rescission, and is unlikely to be a sufficient deterrent to a dishonest lender. Second, this approach is at odds with the statutory scheme of imposing lower tolerances for rescission, at least when rescission is exercised in foreclosure to save the home.

The Board also proposes that unlimited understatement of the credit limit be allowed and solicits comment on this approach. First, as stated above, no tolerance should be allowed for the credit limit: it is a known number; there is no legitimate reason for a creditor to misstate it in disclosures. Allowing a tolerance of the credit limit simply encourages inaccurate and misleading disclosures. But second, as the Board itself notes, understatement of the credit limit may in fact cause serious harm to homeowners, particularly those who are

¹⁴⁵ See Macro International, Inc., Design and Testing of Effective Truth in Lending Disclosures at vii (2007), <http://www.federalreserve.gov/dcca/regulationz/20070523/Execsummary.pdf> (consumers do not notice cumulative effect of paying small amounts of fees every month); Richard H. Thaler, *Mental Accounting Matters*, 12 J. Behavioral Decision Making 183, 194 (1999) (small disaggregated fees ignored).

¹⁴⁶ 75 Fed. Reg. 58539, 58659 (Sept. 24, 2010).

¹⁴⁷ 75 Fed. Reg. 58539, 58659 (Sept. 24, 2010).

¹⁴⁸ 15 U.S.C. § 1640(a)(2)(A)(ii), amended by Pub. L. No. 111-203 § 1416 (July 21, 2010) (increasing the limit to \$2,000, with an uncertain effective date).

not borrowers on the loan and foolishly rely on the Truth-in-Lending disclosures to advise them as to the risk to which their home is put.¹⁴⁹

The credit limit is not “inconsequential.” To the contrary, it is one of the features of a HELOC that is most important to consumers. For a consumer who takes out a HELOC in order to make a specific purchase, accurate disclosure of the credit limit is critical.

c. Loan amount

The loan amount, like the account-opening fees or credit limit for a HELOC, is known with absolute certainty. There is no reason to allow any tolerance, not even the \$100 tolerance that is allowed for HOEPA loans. Creditors are generally required under TILA to conform their disclosures to the terms of the loan note.¹⁵⁰ There is no reason to provide an exception to this general rule for the loan amount.

Application of the existing tolerances for the finance charge is inappropriate. Calculation of the finance charge requires both arithmetic and legal judgment, while disclosure of the loan amount requires neither.

d. Payment amount

Perhaps the most egregious of all the Board’s proposed tolerances is the proposal to create a \$100 tolerance for disclosure of the payment amount.

The payment amount is absolutely known to creditors at the time of the initial disclosures. No legal judgment is required to determine what the monthly payments will be. Indeed, for fixed rate mortgages, the monthly payment is almost always set out in dollar amounts in the note. There is, therefore, no reason that creditors should make mistakes in the disclosure of the payment amount in the normal course of events.

For all these reasons, the statute provides no tolerance for the disclosure of the payment amount. And creditors have, so far, survived. Despite the prevalence of adjustable rate mortgages with their complicated payment schedules, there is no surge of litigation challenging creditors’ disclosure of the correct payment amount. The Board’s concern for creditors’ litigation risk is without foundation.

The Board does not even attempt to assert a consumer protection rationale for the tolerance and instead suggests that the test is a weighing of the benefit of the disclosure versus the risk of litigation.¹⁵¹ But 15 U.S.C. § 1631(d) does not provide a balancing test: the Board is only permitted to adopt additional tolerances if they do not result in the uninformed use of credit.

As the Board notes, there is substantial evidence that consumers shop on the monthly payment amount and regard it as the single most critical piece of information in

¹⁴⁹ 75 Fed. Reg. 58539, 58569 (Sept. 24, 2010).

¹⁵⁰ Reg. Z § 226.17(c)(1).

¹⁵¹ 75 Fed. Reg. 58539, 58618 (Sept. 24, 2010).

deciding whether or not to take out a loan.¹⁵² A \$100 tolerance for the payment amount cannot be characterized as narrow or “insignificant.” The most recent census data available indicates that the median monthly mortgage payment in 2009 was \$878.¹⁵³ The median for African-Americans is lower, at \$739 a month, while the median for manufactured homes is even lower, \$403. Thus, the Board is proposing that manufactured home lenders, for example, would have a tolerance of 25% on the disclosure of a key loan term to homeowners—and one that is known with absolute and mathematical certainty at the time the lender makes the disclosure.

There is no way in which this proposed tolerance can be said to be modeled after the narrow tolerances that exist in the statute currently. Unlike those tolerances, which provide for protection of legal judgment or deviation due to the calculation of the APR, a tolerance of \$100 on the payment amount cannot be justified as necessary for creditors and will make a mockery of the “truth” in the TILA disclosures.

e. Settlement Fees

The Board is also proposing to create a tolerance for disclosure of the settlement costs. This approach, as the Board notes, puts TILA at loggerheads with RESPA,¹⁵⁴ and likely will complicate compliance, not facilitate it, without improving consumer disclosure one whit. If anything, the existing RESPA tolerances for disclosure are too generous; the Board should not create different and more generous tolerances.

f. Prepayment penalty

There appears to be no good reason for not requiring accurate disclosure of the maximum possible prepayment penalty. The Board asserts that there is some risk of “error” in this disclosure,¹⁵⁵ but does not provide the basis of that belief. Creditors routinely bundle and sell securities based on projected prepayment penalty income.¹⁵⁶ Surely, if those projections can be provided to investors, creditors can tell borrowers what the maximum penalty is. In most cases, this is a simple calculation, easily performed using an amortization schedule and a handheld calculator.

Creditors will know what the maximum prepayment penalty is. They will be basing their income projections on that figure as well as the likelihood that the homeowner will incur it. Consumers are much less likely to understand how to calculate it, and the actual dollar amount may be important to a homeowner assessing the risk of any particular loan.

¹⁵² 75 Fed. Reg. 58539, 58618 (Sept. 24, 2010).

¹⁵³ Am. Housing Survey, T 3-13 (2009), *available at* <http://www.census.gov/hhes/www/housing/ahs/ahs09/ahs09.html>.

¹⁵⁴ 75 Fed. Reg. 58539, 58617 (Sept. 24, 2010).

¹⁵⁵ 75 Fed. Reg. 58539, 58617 (Sept. 24, 2010).

¹⁵⁶ Eric Stein, Ctr. for Responsible Lending, *Quantifying the Economic Cost of Predatory Lending* 8 (July 25, 2001).

4. The Board should withdraw the current proposal and should not adopt any tolerances by regulation.

The current proposal's tolerances exceed the Board's authority and would do great harm. The Board should remove the entire rescission proposal from consideration. If it undertakes revisions to the rescission provisions of Regulation Z, it should not adopt any tolerances beyond those specified by the statute.

G. The Board Must Narrowly Circumscribe Creditors' Ability to Deviate from the Substance and Format of the Model Rescission Notices.

1. The format of disclosures is critical to consumer understanding.

The Board's consumer testing has consistently shown that the format in which disclosures and notices are presented has an enormous effect on consumer understanding.¹⁵⁷ For example, consumer comprehension rose markedly when credit card disclosures were designed in tabular rather than narrative format.¹⁵⁸ Yet the Board disregards these lessons in its proposed rule.

Under 15 U.S.C. § 1604(b), the Board cannot "require a creditor or lessor to use any ... model form or clause prescribed by the Board under this section." That section also protects a creditor that rearranges the format of a model form, but only if, in doing so, the creditor "does not affect the substance, clarity, or meaningful sequence of the disclosure." Given the importance of the format and the substance of the rescission notice, and the Board's special expertise in the formatting issues, we ask that the Board narrowly define the changes that will not affect the substance, clarity, or meaningful sequence of the disclosure and that the Board not permit creditors to vary the substantive information disclosed in the rescission notice. The Board should not allow creditors to make variations that would undermine the utility of the model forms it has devised.

2. Creditors should not be allowed options about what information to disclose.

The Board proposes to allow creditors to decide whether the NRTC should include two provisions – a statement about the effect of rescission where there are two owners, and an acknowledgment of receipt.¹⁵⁹ The Board gives no rationale for its failure to decide whether these provisions should or should not be included. We urge the Board not to leave these decisions to creditors' discretion.

With respect to the statement about the effect of rescission where there are two owners, perhaps the Board's reasoning was that this information would be relevant only

¹⁵⁷ See, e.g., ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Rescission Notices 4 (July 2010), available at <http://www.federalreserve.gov/newsevents/press/bcreg/20100816e.htm> (stressing importance of using simple, plain language, prioritizing information on a form, structuring disclosures so that most important information is easiest to find, and using plain-language headings and short, easy-to-read, accurate titles).

¹⁵⁸ See ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Rescission Notices 6 (July 2010), available at <http://www.federalreserve.gov/newsevents/press/bcreg/20100816e.htm> (none of participants noticed information about fee refunds when notice was in narrative form).

¹⁵⁹ Proposed Reg. Z § 226.23(b)(4); 75 Fed. Reg. 58629, 58625 (Sept. 24, 2010).

where there were in fact two owners. If that is the rationale, the Board should require the provision where there are two owners and prohibit it where there is only one owner. As written, the proposed rule would allow creditors to include this provision when there was only one owner. In that case, the information would be completely irrelevant and would detract from the other, relevant information on the notice. At the same time, the Board's proposal would allow creditors to exclude this information when there were two or more owners, even though in that case the information would be highly relevant and important.

The acknowledgment of receipt may seem minor, but it has significant potential to mislead consumers. The Board's consumer testing showed that some consumers confused the signature line for the acknowledgment of receipt with the signature line for canceling the transaction, and one did not understand that signing the acknowledgment line indicated only receipt.¹⁶⁰ These findings echo those regarding the disclosure of loan terms: the Board's consumer testing repeatedly showed that a substantial percentage of consumers believed that by signing an acknowledgment of receipt of a disclosure statement they were committing themselves to the loan.¹⁶¹ For these reasons, the Board should not give creditors control over whether to include an acknowledgment of receipt.

Moreover, should the Board permit creditors to include an acknowledgment line, the Board should in its rulemaking circumscribe the potential harm done by an acknowledgment. The Board's decision to locate the acknowledgment line at the bottom of the model form was based on two factors: 1) the belief that doing so would increase the chance that consumers' would read the rescission notice before signing the acknowledgment and 2) other formatting changes to the rescission notice that clarified the difference between signing an acknowledgment and canceling the loan.¹⁶² Consumer testing seems to support the Board's decision: more participants understood the function of the acknowledgment line in its subsequent rounds of testing.¹⁶³ Moving the acknowledgment line on the page or failing to provide a clear demarcation between the sections of the form could result in significant consumer confusion.

3. The Board should not allow creditors to include additional information in the NRTC.

The Board compounds its failure to mandate the full substantive content of the NRTC by adding a general statement that "at the creditor's option, other information directly related to the disclosures required by § 226.23(b)(3) may be included in the notice."¹⁶⁴ This proposed Commentary section would allow the creditor to swamp the

¹⁶⁰ ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Rescission Notices, 9, 19 (July 2010), available at <http://www.federalreserve.gov/newsevents/press/bcreg/20100816e.htm>.

¹⁶¹ ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Closed-end Mortgages 52, 63, 85 (July 16, 2009).

¹⁶² ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Rescission Notices 15 (July 2010), available at <http://www.federalreserve.gov/newsevents/press/bcreg/20100816e.htm>

¹⁶³ ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Rescission Notices 19 (eight of ten understand difference between acknowledgment line and canceling the loan), 23 (all participants saw and would initial acknowledgment line) (July 2010), available at <http://www.federalreserve.gov/newsevents/press/bcreg/20100816e.htm>

¹⁶⁴ Proposed OSC § 226.23(b)(4)-1; 75 Fed. Reg. 58629, 58625 (Sept. 24, 2010).

disclosure of the right to rescind with non-essential detail – even the exact information that the Board’s consumer testing showed that consumers cannot understand.¹⁶⁵

The Board’s consumer testing unequivocally shows that the addition of more information – even if accurate and germane – can mislead and confuse consumers. For example, only when the information about the three alternate events that start the rescission clock ticking was removed from the rescission notice were consumers consistently able to identify the correct deadline.¹⁶⁶

The Board has conducted many rounds of testing to get as close as possible to the right balance between too little information and so much information that consumers are overwhelmed or misled. By leaving the door wide open for additional information, the Board allows creditors to nullify its careful crafting of an understandable notice. If the Board allows any variation at all in the content of the notice, it should strictly limit this variation to a closed list of examples.

4. The Board’s “substantially similar” and “clear and conspicuous” standards introduce too much variability into formatting and undermine consumer understanding.

Even after its extensive testing of the format for rescission notices, the Board proposes to give creditors a lax standard on complying with the standards it has developed. Instead of requiring creditors to comply with the formatting requirements that the Board is proposing to adopt, the Board would allow them to ignore those requirements, and substitute a notice in any format that a court finds “substantially similar”¹⁶⁷ or “clear and conspicuous.”¹⁶⁸ We fail to understand why the Board engaged an outside firm to design and consumer-test the format of the NRTC if the Board is going to let creditors make their own decisions about format.

A form deemed “substantially similar” or “clear and conspicuous” by a district court judge or even a circuit court panel might well not be understandable. For example, the Board’s consumer testing has shown that most homeowners cannot calculate the deadline

¹⁶⁵ See ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Rescission Notices 8, 12, 18 (July 2010), *available at* <http://www.federalreserve.gov/newsevents/press/bcreg/20100816e.htm>,

¹⁶⁶ For example, the consumer testing showed that consumers cannot calculate the rescission deadline when all three triggers do not occur on the same day, and were confused and misled by the explanation of the three triggers, so after four rounds of testing the design consultants recommended deletion of this information. ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Rescission Notices 8 (only two of ten participants understood notice’s statement that deadline would be later if they signed loan documents later than the day when they received the notice), 12 (noting that one participant had difficulty determining the rescission deadline because he was confused by language referring to the “later of” the three trigger events), 18 (where rescission notice mentioned three-year rescission period, one participant thought she would always have three years to cancel), 22 (when rescission notice simply stated the deadline, without other information, all consumers understood what the deadline was) (July 2010), *available at* <http://www.federalreserve.gov/newsevents/press/bcreg/20100816e.htm> .

¹⁶⁷ Proposed Reg. Z §226.23(b)(2).

¹⁶⁸ Proposed Reg. Z § 226.23(b)(3); Proposed OSC § 226.23(b)(2)-1; 75 Fed. Reg. 58629, 58621 (Sept. 24, 2010).

date for rescission from the description of that date on the current rescission notice.¹⁶⁹ Yet the First Circuit has twice held that rescission notices that omit or misstate the date are nonetheless “crystal clear.”¹⁷⁰ Under its precedents, the First Circuit could well find that a form omitting the calendar date and substituting a description of how to calculate that date was “substantially similar,” despite the Board’s Commentary language specifying that the date be included.

Likewise, a court could regard a form without either the notation “cut here” and the dashed line as substantially similar to the Board’s form, despite the Board’s considered judgment that those demarcations are important to signal the difference between the acknowledgment and the cancellation sections and to remind consumers exercising their right to cancel to retain the top part of the form, the notice of their rights.

These are only a few examples of variations that a court, lacking any consumer testing, might deem “substantially similar” to the model forms or “clear and conspicuous,” but which could render them incomprehensible to many homeowners.

Nothing in § 15 U.S.C. 1604(b) requires the Board to adopt a substantial compliance or clear and conspicuous standard. TILA gives the Board authority to be more prescriptive about formatting. As noted above, 15 U.S.C. § 1604(b) protects a creditor that changes the format of a model form, but only if the changes do not “affect the substance, clarity, or meaningful sequence of the disclosure.” This is a stricter standard than either the proposed substantial compliance or the proposed clear and conspicuous standard. The Board should delete the substantial compliance and clear and conspicuous standards from the proposed rule.

5. The Board’s “substantially similar” and “clear and conspicuous” standards introduce needless litigation risk.

The Board proposes to deny rescission where the creditor has made material disclosures that contain the correct information but do not meet Regulation Z’s formatting requirements, as long as the disclosures meet the much looser “clear and conspicuous” standard.¹⁷¹ Failure to mandate the format of the NRTC increases uncertainty and litigation risk. Different courts will likely reach different conclusions as to what is substantially similar or clear and conspicuous.

Worse, the Board’s language in Proposed OSC § 226.23(b)(2)-1 suggests that it is proposing a subjective “clear and conspicuous” standard that depends on the understanding of the particular consumer, rather than an objective standard that looks to the understanding of consumers in general. (“The clear and conspicuous standard generally requires that disclosures be in a reasonably understandable form and readily noticeable to *the* consumer.)

¹⁶⁹ ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Rescission Notices, 8, 13-4, 18 (July 2010), *available at* <http://www.federalreserve.gov/newsevents/press/bcreg/20100816e.htm>.

¹⁷⁰ *Melfi v. WMC Mortgage Corp.*, 568 F.3d 309 (1st Cir. 2009) (rescission notice that omits transaction date and deadline date meets TILA standards); *Palmer v. Champion Mortgage*, 465 F.3d 24, 29 (1st Cir. 2006) (notice stating rescission deadline that has already expired is “crystal clear”).

¹⁷¹ Proposed OSC §§ 226.15(a)(5)(i)-3, 226.23(a)(5)(i)-2, 75 Fed. Reg. 58563, 58613 (Sept. 24, 2010).

(Emphasis added). This is a change from existing TILA law, which generally imposes an objective standard, of the ordinary consumer.¹⁷² Basing the standard on the particular consumer’s understanding would create a host of problems. What was clear and conspicuous to one consumer might not be to the next, creating endless compliance headaches for creditors. Such a standard would lead to retrospective consumer testing on the witness stand, with the consumer trying to reconstruct what he or she understood or failed to understand when a form was provided at closing years earlier. More importantly, the litigated cases would represent only the smallest tip of the iceberg. Most of the consumers affected by a poorly-designed, unclear NRTC would simply fail to understand or exercise their rescission rights, and the matter would never reach the courts.

We may be reading more into the Board’s choice of language than the Board intended. But even if the Board makes it clear that it did not intend to suggest a subjective standard, it should reject the proposal to make any NRTC, no matter how formatted, acceptable as long as it was clear and conspicuous.

H. A Ten-Point Font Is Insufficient for the Rescission Notice.

The Board’s proposal would, for the first time, specify a minimum font size for rescission notices, requiring them to be printed in a 10-point font.¹⁷³ While we welcome the specification of a font, 10-point text is still too small. The cliché regarding important details being hidden “in the fine print” does not exist without reason. The Board should impose a 12-point minimum font for the disclosures in the rescission notice.

In the context of HELOC disclosures, the Board specifically rejected calls for adopting a 12-point minimum by noting that testing shows consumers can “read and notice information in a 10-point font.”¹⁷⁴ The appropriate question, however, is not merely whether consumers can read and notice information. Many consumers can—if given sufficient time and light—probably read and notice information in much smaller fonts as well. The question should be whether a 12-point font minimum would increase consumers’ ability to read and identify important information. To the best of our knowledge, the Board has not conducted any consumer testing on this question.

Testing has already shown that font size has an impact on the effectiveness of disclosures.¹⁷⁵ Consumers will be more likely to read and identify information if disclosures are made in a larger font. The FRB itself has noted: “Consumer testing . . . showed that . . . the use of small print led many participants to miss or disregard key information about the

¹⁷² See *Edmondson v. Allen-Russell Ford, Inc.*, 577 F.2d 291 (5th Cir. 1978); *Mize v. Joe’s Auto Sales, Inc.*, 2005 WL 280343 (S.D. Ind. Jan. 26, 2005) (holding that the disclosure must be viewed through the eyes of an ordinary consumer, an objective test); *Murray v. Flexpoint Funding Corp.*, 2005 WL 1463500 (N.D. Ill. June 17, 2005) (observing that TILA’s clear and conspicuous standard is applied through the eyes of an ordinary consumer in the context of a Fair Credit Reporting Act claim); *In re Cook*, 76 B.R. 661 (Bankr. C.D. Ill. 1987) (TIL disclosures should be construed through the eyes of the borrower and not those of the lender or an attorney).

¹⁷³ Proposed Reg. Z § 226.23(b)(2)(ii); 75 Fed. Reg. 58629, 58621 (Sept. 24, 2010).

¹⁷⁴ 74 Fed. Reg. 43428, 43441 (Aug. 26, 2009) (HELOC proposed rule).

¹⁷⁵ Macro International, Inc., *Design and Testing of Effective Truth in Lending Disclosures* iii, 7, 12, 15, 20 (May 16, 2007).

loan transaction.”¹⁷⁶ The National Eye Institute at the National Institutes of Health reports that 66% of adults wear some type of eyewear, including glasses, contact lenses, both glasses and contact lenses, or reading glasses only. Among older adults, 94% report wearing eyewear.¹⁷⁷ Imposing a minimum 12-point font size for the rescission notices would set a simple bright-line rule that would be benefit consumers and at the same time be easy for creditors to follow.

A 12-point minimum would also address an issue created by widespread use of the Adobe PDF format among computer users. Many creditors and settlement agents transfer mortgage documents by e-mail documents in Adobe PDF format.¹⁷⁸ Consumers receiving electronic disclosures are also likely to receive them in this format. The Adobe Reader software, a free, commonly used program for reading and printing PDF documents¹⁷⁹ has a printing feature called “Page Scaling” which allows the user to control the size of the electronic document as it appears on the printed page. The default Page Scaling setting is “Shrink to Printable Area,” which reduces the size of the original document so it can be printed without risk of the edges being cut off by the printer (to 96% of the original size for one printer we tested, 94% for another). This means any rescission notice written in a 10-point font may ultimately be printed in a manner that results in the consumer receiving a 9-point or smaller font. Imposing a 12-point minimum would mitigate this problem.

I. There Are Elements of the Proposed Rule that the Board Should Adopt, or That Could Be Helpful If Revised.

As noted above, the proposed rule is fundamentally flawed and would do great harm to consumers and to the financial marketplace. However, there are several features of the current proposal that would be improvements. In addition, several elements of the proposed rule are promising but require substantial revision.

1. New provisions in proposed rule that should be adopted.

Prohibition against obtaining premature statement that consumer has not rescinded. The Board’s proposal includes codification of the rule, adopted by many courts, that a creditor violates TILA and extends the rescission period if it has the consumer sign a statement declining to rescind before the three-day rescission period has passed.¹⁸⁰ Having the consumer sign such a statement at closing has been a common tactic that obscures and undermines the right to rescind. The Board should adopt this proposed provision.

Clear rule that NRTC with incorrect deadline date is inadequate. The Board has proposed to revise Regulation Z to remove all doubt that the creditor must calculate the correct deadline date for rescission and state it clearly on the notice, and that provision of a

¹⁷⁶ 74 Fed. Reg. at 43,287.

¹⁷⁷ Fact Sheet: Refractive Errors, Nat’l Eye Institute, National Institutes of Health, *available at* http://www.healthyvision2010.nei.nih.gov/hvm/pdfs/HVM09_Fact_Sheet_Final_tagged.pdf.

¹⁷⁸ The FRB also uses PDF files on its own web site. *See* <http://www.federalreserve.gov/faqs.htm> (FAQ entitled “Why are some files in PDF format, and how can I read them?”).

¹⁷⁹ The manufacturer of Adobe estimates “about half a billion people are running Adobe Reader.” E-mail from Rick Borstein, Business Development Manager, Adobe Systems Inc. (Nov. 23, 2009).

¹⁸⁰ Proposed OSC § 226.23(c)-4; 75 Fed. Reg. 58539, 58627 (Sept. 24, 2010).

rescission notice without the proper deadline extends the rescission period.¹⁸¹ In our view, Regulation Z has always been clear on this point, but the First Circuit held otherwise in *Melfi v. WMC Mortgage Corp.*, 568 F.3d 309 (1st Cir. 2009). The Board’s consumer testing makes it crystal clear that consumers cannot accurately calculate the date, and that it is necessary for the creditor to provide the date if the rescission right is to be meaningful. This element of the Board’s proposal is greatly needed and should be adopted.

Bright-line definition of same-creditor refinancing. The current proposal carefully works through the underlying reasons that same-creditor refinancings are exempt from rescission except to the extent of a new advance, and concludes that this exemption should be limited to refinancing by a creditor who made the original loan and still holds the obligation.¹⁸² We agree with the Board’s analysis and with its conclusion. This bright-line rule will also benefit creditors by removing any possible uncertainty about whether a transaction qualifies for this exemption. The Board should adopt this proposed revision.

2. New provisions in proposed rule that could be positive but require substantial revision

Several other features of the current proposal are worth pursuing in a revised proposal, but require significant changes:

Plain language rescission notice. The proposed revision to the language of the model notice of right to cancel notice includes very significant improvements. For some of the key information, it has replaced dense legalistic language with plain-English language that communicates the same essential information. Mandating tabular format is also a great improvement.

However, the language of the model form also includes several major flaws. First, the model form includes a statement that a consumer who wants to rescind “must” submit the bottom portion of the notice.¹⁸³ This statement is inaccurate and misleading. The Board has not proposed to change, and should not change, the rule that the consumer can cancel by any form of written communication.¹⁸⁴ Stating that the consumer “must” use the bottom portion of the form is simply wrong. This problem is especially serious given the inherent problems with a tear-off form discussed earlier in these comments.

Second, the form gives no guidance to the consumer about how to “submit” the rescission notice: by U.S. mail, by a private delivery service, by email, by fax, or by personal delivery. Nor does it disclose the absolutely critical information that delivery is complete upon mailing only if the consumer uses U.S. mail.¹⁸⁵ Deleting this information from the model form has the potential to cause great harm, as consumers are likely to rescind in the “wrong” way.

¹⁸¹ Proposed Reg. Z § 226.23(b)(3)(iv). 75 Fed. Reg. 58539, 58624 (Sept. 24, 2010)

¹⁸² Proposed Reg. Z § 226.23(f)(2); 75 Fed. Reg. 58539, 58633-4 (Sept. 24, 2010).

¹⁸³ See, e.g., Proposed Form G-5(B), 75 Fed. Reg. 58539, 58713 (Sept. 24, 2010).

¹⁸⁴ Reg. Z § 226.23(a)(2) See also Proposed OSC § 226.23(a)(2)(i)-1 (“The consumer ... may, but is not required to, use the notice supplied under § 226.23(b)”).

¹⁸⁵ Reg. Z § 226.23(a)(2).

Even worse is the proposed language in Regulation Z that the creditor may, at its option, specify other methods the consumer can use to send the rescission notice.¹⁸⁶ The creditor does not and should not have any control over the method the consumer uses to send the rescission notice. Under Regulation Z, both in its current form¹⁸⁷ and under the Board's proposal,¹⁸⁸ the consumer can use any reasonable method of delivery. This should be stated in all rescission notices. The creditor should have no control over the method of delivery or the information the consumer gets about these methods.

We also have concerns about the model form language "You are giving us the right to take your home if you do not repay the money you owe under this [line of credit/loan/new loan]."¹⁸⁹ We strongly support the Board's effort to improve on the previous model form language, which consumers had difficulty understanding. However, this language could mislead consumers, as nonpayment is only one of many types of default that can lead to foreclosure. This is particularly true in the HELOC context. We understand that the Board's consumer testing showed that consumers had trouble understanding what other types of default could lead to foreclosure, but in our view this only demonstrates the importance of communicating this information. We urge the Board to do further consumer testing about ways to communicate this information.

In addition, as discussed in detail above, the Board's failure to require creditors to use the exact language of the model form and the ill-advised proposal for a tear-off form must be corrected.

If these serious deficiencies are corrected, and if the Board restores the requirement that each consumer be given two copies of the notice, the revised model form would have the potential to improve the rescission notice significantly.

Improved rules regarding the entity to whom the consumer should send the rescission notice. The Board's proposal to set clear guidelines about the entity to whom the consumer should send the rescission notice is a step in the right direction. The Board's proposal recognizes that consumers cannot reasonably be expected to know who actually owns their loans. It recognizes that the servicer is the note owner's agent, and states that during the extended rescission period, delivery of the consumer's rescission notice to the servicer is effective.¹⁹⁰ Setting forth this clear rule will eliminate a great number of baseless objections to the delivery of rescission notices, and a great deal of needless activity on the part of consumers trying to verify the current holder and sending duplicate rescission notices to multiple entities. For example, NCLC's *Truth in Lending* treatise includes a list of seventeen recommended steps practitioners should take – including searching the registry of deeds, searching the websites of the SEC, Fannie Mae, Freddie Mac, and MERS, sending qualified written requests under RESPA, sending duplicate rescission notices to attorneys

¹⁸⁶ 75 Fed. Reg. 58539, 58624 (Sept. 24, 2010).

¹⁸⁷ Reg. Z § 226.23(a)(2)

¹⁸⁸ Proposed Reg. Z § 226.23(a)(2)

¹⁸⁹ Proposed Model Forms G-5(C), H-8(B), H-9.

¹⁹⁰ Proposed Reg. Z § 226.23(a)(2)(ii); 75 Fed. Reg. 58539, 58610-11 (Sept. 24, 2010).

and servicers, and naming “John Doe” parties in the complaint -- to avoid the objection that the notice has not been sent to the proper party.¹⁹¹

We agree with the Board’s view that the same rule should apply to HELOC lenders as to closed-end lenders.¹⁹² First, even if only a small percentage of HELOC loans are securitized, a clear and workable rule about who should receive the rescission notice is important for those borrowers. Second, as the Board points out, the holder of a HELOC may change for reasons other than securitization. The great wave of bank failures and lender bankruptcies in the past three years demonstrates this point. And finally, whenever possible the Board should avoid adopting a multiplicity of different rules, which add needless complexities to an already complex regulation.

However, the Board’s proposal regarding the entity to whom the rescission notice should be sent has serious flaws that need to be corrected. First, by specifying so narrowly the parties to whom the rescission notice should be sent, the Board’s proposal could lend weight to the view that prior holders of the obligation are not subject to rescission. In fact, prior holders have often received many of the consumer’s payments that must be refunded to make rescission work. In many cases, prior holders are essential parties in a rescission suit. The rule must make clear that the consumer may rescind against prior holders, and address the question of notice to them.

Second, the Board’s attempt to adopt a clear rule about the party to whom the rescission notice should be sent during the initial three-day rescission period is unsuccessful. The rule that the Board proposes is that, if the creditor has filled in its name or address, or the name or address of an agent to whom the consumer’s rescission notice should be sent, then the consumer should send the notice to that address.¹⁹³ If the creditor violates Regulation Z by failing to fill in this information, then the proposed rule would provide that the consumer can rescind by sending the rescission notice to the servicer. The problem is that the consumer will have no relationship with the servicer during the first three days. The creditor may not even have identified the servicer that soon. A better approach would be that any reasonable, good faith attempt to send the rescission notice to a responsible party is effective.

Finally, the Board should state in Regulation Z that it is not intending to require rigid adherence to the rules about the entity to which the consumer should send the rescission notice, and that notice is effective if it does reach, or is reasonably calculated to reach, the party in question. For example, there may be pitfalls for consumers in the bright-line rule that the consumer should send the rescission notice to the servicer or the note holder after the initial three-day period. As the Board points out, the consumer may not know the identity of the holder, making this option unavailable. The servicer may have two addresses, one for receiving payments and one for receiving other correspondence. To which address should the consumer send the rescission notice? Is it ineffective if sent to the address where the consumer sends payments? (Note that the language of the model form, instructing the consumer to send the rescission notice “to the person to whom you send payments,” subtly

¹⁹¹ National Consumer Law Center, Truth in Lending § 6.6.2.4.2 (6th ed. 2008 and Supp.).

¹⁹² 75 Fed. Reg. 58539, 58561 (Sept. 24, 2010).

¹⁹³ Proposed Reg. Z § 226.23(a)(2)(ii); 75 Fed. Reg. 58539, 58611 (Sept. 24, 2010).

suggests that the notice should be sent to the same address as payments are sent.) If servicing rights have been transferred, or a default servicer has just been appointed, the consumer may not know the name or address of the current servicer.

While it would be appropriate to indicate that the creditor has a defense to a claim for statutory damages for failing to respond properly to a rescission notice that it received late because of such an error, the purpose of the rescission rules is to enable consumers to cancel loans that were not appropriate for them. Conditioning this right upon punctilious adherence to the rules about where to send notice elevates form over substance if the appropriate parties in fact receive notice.

Requirement that creditor provide rescission notice before consummation of transaction. The Board's proposal to require the creditor to provide the rescission notice prior to consummation of the transaction is a good idea, but without further clarification it could have the collateral effect of worsening a different problem. Two courts have ruled that a consumer who rescinds before consummation is not entitled to a refund of fees, on the theory that TILA allows rescission only after consummation.¹⁹⁴ If the Board requires creditors to give the rescission notice before consummation, it must expressly disapprove of these poorly-reasoned decisions. Otherwise, consumers who want to cancel a mortgage loan may do so immediately upon receipt of the rescission notice, only to find that the creditor refuses to return their up-front payments.

Expansion of list of "material" disclosures. The Board proposes to expand the list of disclosures deemed "material" for closed-end loans to include some of the important, meaningful new disclosures that its August 2009 proposal would add.¹⁹⁵ Setting aside the issue of tolerances for these disclosures, discussed in Section II(F), *supra*, most of the additions to the list are sensible and helpful, and should be adopted.

The explosion of irresponsible lending that led to the financial meltdown was facilitated by non-disclosure or weak disclosure of key features of loans, such as the worst-case-scenario payment amount, the fact that a loan carries an adjustable rate, and the fact that a loan is an interest-only loan or will negatively amortize. Defining these disclosures as material could deter irresponsible lending, as lenders would be less likely to include these highly risky loan features if they knew that they would increase the likelihood that the consumer would rescind the loan.

However, the Board has also proposed to delete three important disclosures from the list of material disclosures in closed-end credit: the amount financed, the number of payments, and the total of payments.¹⁹⁶ All of these disclosures are specifically defined by the statute, 15 U.S.C. § 1602(u), as material. The Board offers no justification for deleting them from the list of material disclosures except to reduce compliance costs for creditors and reduce the number of loans that are rescinded.¹⁹⁷ Neither rationale furthers the

¹⁹⁴ *Sandifer v. Freedom Mortgage Corp.*, 2010 WL 1463478 (N.D. Ill. Apr. 8, 2010); *Sampanette v. E*Trade Mortgage Corp.*, 2002 WL 31478269 (N.D. Ill. Nov. 5, 2002).

¹⁹⁵ Proposed Reg. Z § 226.23(a)(5) 75 Fed. Reg. 58539, 58613 (Sept. 24, 2010).

¹⁹⁶ 75 Fed. Reg. 58539, 58619-20 (Sept. 24, 2010).

¹⁹⁷ 75 Fed. Reg. 58539, 58615 (Sept. 24, 2010).

consumer protection purposes of the statute, so neither is a legally adequate justification under 15 U.S.C. § 1604(a). In addition, redefining these disclosures as non-material would affect the rights of HOEPA loan consumers, contrary to § 1604(a)'s proviso that the Board's exception authority does not extend to HOEPA loans.

The Board's proposal to redefine these disclosures as non-material is also indefensible on the merits. The amount financed is a critical disclosure. TILA requires disclosure of the amount financed and the APR, and makes these disclosures material, because they – unlike the loan amount and the interest rate – capture the amount that the consumer will receive and the true cost of credit. By downplaying the amount financed and the APR in favor of the loan amount and interest rate, the Board is eroding TILA's key goal of communicating the true cost of credit to consumers. The fact that consumer testing shows that most consumers cannot explain how the APR differs from the interest rate does not undercut the importance of the APR as a price tag. People can use a price tag to compare one price to another without understanding how the price is computed or what its components are.

The number of payments is also a highly important disclosure. While we understand that the Board is proposing to require creditors to disclose the loan term, details about the payment schedule serve additional functions. This is particularly true in the case of transactions with fringe lenders such as foreclosure rescuers. Payment schedules for those loans may be highly irregular, or even weekly, and communication of no more than the correct term of the loan may leave the consumer without essential information.

The total of payments is another very important disclosure. While for a non-predatory loan it may add little information beyond other disclosures, it can operate as a red flag that a loan is predatory.

The Board's proposed definition of "material" disclosures also has the function of conforming that definition to the revisions the Board proposed in August 2009 to the disclosure requirements. In our comments in response to that proposal, we urged that the Board, among other things, not require disclosure of the interest rate, as this disclosure is likely to detract attention from the much more meaningful APR. We reiterate those comments here. If the Board agrees with those comments and revises the disclosure requirements it proposed in August 2009, it should revise the definition of "material" disclosures accordingly.

Creditor's provision of longer rescission period. The Board's proposal provides that a creditor does not violate Regulation Z by giving the consumer a rescission notice that states a deadline for rescission that is more than three days after consummation, as long as the creditor in fact permits the consumer to rescind up until the stated deadline.¹⁹⁸ We have no objection to this concept, and understand that there may be exceedingly rare circumstances in which the creditor cannot determine the date of consummation.¹⁹⁹

¹⁹⁸ 75 Fed. Reg. 58539, 58624 (Sept. 24, 2010).

¹⁹⁹ The Board gives as an example loans consummated by mail. 75 Fed. Reg. 58539, 58622 (Sept. 24, 2010). In the 42 years since TILA was enacted we have are not sure that we have ever heard of a consumer mortgage loan that was consummated by mail, so we view this example as theoretically possible but not a significant

However, the Board should provide not only that the creditor must permit the consumer to rescind up until the stated deadline, but that all of the provisions of TILA rescission apply if the consumer rescinds after the three-day period but within the stated deadline. For example, provision of a longer notice period would do a great deal of harm if it enabled creditors to offer a watered-down form of rescission during the “extra” days, enforceable only as a contract term. If this were allowed, it would lead consumers to pass up their valuable, enforceable, right of rescission under TILA, under which they are entitled to a full refund of fees and which is enforceable through a private cause of action that allows attorney fees and statutory damages. If the Board has any concern about its ability to apply these TIL duties and remedies to the “extra” days in a longer rescission period, it should adopt a rule under section 1639(l) that failure to afford the consumer the full rights of TIL rescission during the “extra” days is unfair or deceptive.

Recognition that court may reduce tender amount by any damage award. The Board’s proposal to revise the Commentary to recognize that the court may reduce the tender amount by any damage award should be retained in the revised rule.²⁰⁰ It seems obvious that the consumer’s tender amount should be reduced by any damage award, so that the consumer tenders the net amount, but courts have occasionally failed to recognize this.

When it rewrites the rule, however, we urge the Board to strengthen this statement, for example by stating that “normally the court will reduce the tender amount by any damage award.” Only in the rarest of circumstances would it ever make sense for the consumer and the creditor each to make payments that net each other out in whole or in part. Both parties would incur needless transaction costs, and the consumer would have to borrow an amount larger than actually needed, possibly making tender impossible.

We also urge the Board to rethink the reference to netting out attorney fees and costs. Normally, attorney fees should be paid to the attorney, and most of the court costs will probably be owed to the court. When there are three or four obligees involved – not just the creditor and the consumer, but also the consumer’s attorney and the court – netting out the awards among just two of the parties would be inappropriate.

Waiver for bona fide personal financial emergency. We support the Board’s proposed examples of what does and does not constitute a bona fide personal financial emergency, and urge the Board to retain these in the rewritten proposal. However, in the section-by-section analysis, the Board raises but does not answer the question whether an imminent increase in an adjustable rate for an existing mortgage loan is a bona fide personal financial emergency.²⁰¹ The answer may be implicit in the Board’s proposed statement that an imminent price increase for goods and services is not a personal financial emergency, as an imminent rate reset is a price increase for an extension of credit, which many would regard as a service. Nonetheless, we urge the Board to state such a rule explicitly in the Commentary.

issue. The Board’s other example is loans that are closed by an escrow agent, but we see no reason why the escrow agent cannot fill in the date, and we believe that this is in fact a common practice. Nonetheless, we recognize that there may be circumstances in which giving a longer rescission period may help creditors.

²⁰⁰ Proposed OSC 226.23(d)(2)(ii)(A)-1, 75 Fed. Reg. 58539, 58631, 58771 (Sept. 24, 2010).

²⁰¹ 75 Fed. Reg. 58539, 58632 (Sept. 24, 2010).

We also strongly support the addition of the statement that a waiver is ineffective if it is inconsistent with facts known to the creditor.²⁰² However, this statement should be expanded to say that a broker's knowledge is attributed to the creditor. Creditors can choose which brokers to do business with, and should not be allowed to shield themselves from the consequences of a broker's unlawful obtaining of a waiver.

J. The Board Should Address Several Additional Gaps and Ambiguities in Regulation Z.

When it returns to this rulemaking, there are several additional improvements to Regulation Z that the Board should adopt:

Require parties involved in the closing to transmit any rescission notice to the appropriate party. The central figure in a closing is typically a closing agent, and the central figure in obtaining a loan is typically a broker or an employee of the creditor. Often consumers quite reasonably assume that these people can act for the creditor with respect to rescission, just as they acted for the creditor in arranging and closing the loan. The Board should amend Regulation Z to provide that the consumer's rescission notice is effective if given in writing to one of these persons. At the very least, the Board should require any closing agent, broker, creditor employee, or real estate agent involved in the transaction to 1) transmit any rescission request, even if oral, to the creditor, and 2) advise the consumer to notify the creditor in writing at the address on NRTC. If the Board has any concern about its ability to apply these TILA duties to these non-creditor entities, it can adopt a rule under section 1639(l) that failure to take these steps is unfair and deceptive.

Clarify the ambiguities about the extent to which state exemptions apply to the rescission remedy. Section 226.29 of Regulation Z, and the parallel Commentary section, set forth the extent to which Connecticut, Maine, Massachusetts, Oklahoma, and Wyoming are exempt from TILA because they have adopted substantially similar state laws. These provisions are, however, highly ambiguous as to whether there is still a right in those states to bring a federal claim to enforce rescission. As the First Circuit stated, the "question of whether the exemption vitiates the possibility of bringing a federal claim to enforce the right of rescission raises very difficult issues of regulatory and statutory construction; the Federal Reserve regulations lack clarity on this point."²⁰³

Allowing these ambiguities to persist increases the cost and complexity of litigation, as the litigants may face a series of motions and appeals about whether they are in the right court before they can ever have a hearing on the merits of the claim. The Board should take the opportunity to clarify these ambiguities when it returns to a redraft of the rescission proposal.

Clarify that only the actual sale of the home, not a sales contract, cuts off the rescission right. TILA provides that the right of rescission terminates "upon the sale of the property." 15 U.S.C. § 1635(f). Despite this clear language, some courts have held that

²⁰² Proposed OSC 226.23(e)-2.iii, 75 Fed. Reg. 58539, 58633 (Sept. 24, 2010).

²⁰³ Bellini v. Washington Mut. Bank, 412 F.3d 17, 19 (1st Cir. 2005).

simply entering into a contract to sell a home cuts off the rescission right.²⁰⁴ The Board should expressly disapprove of this expansion of the statutory language. In addition, if the purpose of the statutory provision is to avoid clouds on title, rescinding a mortgage loan while a home is subject to a sales contract does not affect title.

Provide guidance on the use of the class action procedure for rescission.

Several courts have held that rescission issues can never be resolved in a class action, because they involve too many individual issues.²⁰⁵ Class actions can, however, be an efficient means of resolving common issues. To the extent that individual issues are litigated in the class action, courts have many tools available to make resolution of those issues manageable. For example, a court could use its equitable modification authority to create a streamlined process to determine the tender amount. The Board should provide guidance on these issues in a revised proposal.

Revisit Whether Sale/Leaseback Transactions Terminate the Right to Rescind. The last few years have seen an explosion of foreclosure rescue scams, including many sale/leaseback transactions. Such transactions are often poorly understood by homeowners. Preserving the right of rescission against the original lender in these circumstances would facilitate the unwinding of abusive transactions and recognize the economic reality of the transaction. At the least, the Commentary should make clear that sale/leaseback transactions do not terminate the right of rescission unless the transactions are a valid transfer of title, without coercion, misrepresentation, or fraud on the part of the purchaser.

III. THE PROPOSALS TO CHANGE THE POINTS AND FEES DEFINITION AND HIGHER-PRICED MORTGAGE LOAN METRIC ARE FLAWED.

The Board proposes to change the HOEPA points and fees definition in Proposed Reg. Z § 226.32(b)(1) to exclude the finance charges described in Proposed Reg. Z § 226.4(g). The Board has also proposed replacing a loan's APR with the "transaction coverage rate" (TCR) as the metric used in section 226.35(a) to determine whether a loan qualifies as a higher-priced mortgage loan (HPML). The TCR would be the same as the APR but would only include prepaid finance charges assessed by the creditor, its affiliate, or a mortgage broker.

Both of the proposed changes are misguided and should not be adopted. The changes are contrary to the guiding principle of transparency inherent in TILA and contradict Congress' desire to expand consumer credit protections, as done in Dodd-Frank. The Board lacks sufficient data and has not presented a sufficient basis for these changes. The changes are poorly timed because the Board will need to amend these sections again to implement Dodd-Frank.

²⁰⁴ *See, e.g.*, *Hefferman v. Bitton*, 882 F.2d 379 (9th Cir. 1989).

²⁰⁵ *See, e.g.*, *McKenna v. First Horizon Loan Corp.*, 475 F.3d 418 (1st Cir. 2007).

A. The Proposals Are Contrary to the Purpose of TILA and Inherently Problematic.

TILA is intended to simplify the process of shopping for credit. The APR is designed to be a comprehensive measurement for comparing credit products that cuts through the numerous and complicated variations that otherwise make comparison nearly impossible for all but the most sophisticated consumer. The proposed changes to section 226.4 for mortgages will be a great step forward toward achieving the goals underlying TILA. But the proposed changes to the points and fees definition and the HPML measurement represent a step backwards because they detract from the role of the APR and the finance charge as the central tools for evaluating the cost of credit. Whether the metrics at issue in this discussion are disclosed to consumers or not, the Board's proposal will complicate compliance and enforcement, and increase the risk of error. TILA and Regulation Z will be more effective if creditors are required to use a uniformly defined finance charge and APR for all disclosures and all measurements, including coverage triggers.

The proposed points-and-fees change and the proposed transaction coverage rate will reintroduce the problems that led the FRB to clarify the finance charge definition in the first place, and it reintroduces these problems for the most expensive types of loans. While the Board attempts to characterize this change as maintaining the status quo and preserving access to credit, in reality these rules will do nothing more than protect creditors making expensive loans and deprive consumers of the protections offered by sections 32 and 35.

The proposed changes also create opportunities for creditors to game the system. Compare two lenders making expensive loans that are identical in every regard except that one lender outsources as much work as possible while the other keeps all work in-house. Mortgages from the lender who outsources are less likely to be covered by sections 32 and 35 even though the APR and cost to the consumer will be identical to loans from the non-outsourcing lender. That makes no sense. The Board itself explicitly said: "The Board does not believe that whether a consumer receives the 2008 HOEPA protections should depend on which creditor extends the credit."²⁰⁶ Yet that is precisely the result these changes will introduce for both HOEPA and HPML protections.

While we oppose adopting the transaction coverage rate, the Board requested comment on whether use of the TCR should be optional.²⁰⁷ We agree with the Board's opinion that, if the TCR is adopted, its use should be mandatory.²⁰⁸

B. Access to High-Cost Credit Does Not Justify Preserving High-Cost Credit.

The Board justifies the proposed points-and-fees change in part by claiming the proposal is necessary to preserve access to credit. Such a justification, however, is unsupported and harmful to consumers. In the Federal Register notice, the Board asserts that the more inclusive finance charge will cause more HPMLs to exceed the points and fees trigger, thereby becoming subject to HOEPA. The Board next observes that lenders make

²⁰⁶ 75 Fed. Reg. 58539, 58661 (Sept. 24, 2010).

²⁰⁷ 75 Fed. Reg. 58539, 58661 (Sept. 24, 2010).

²⁰⁸ See 75 Fed. Reg. 58539, 58661 (Sept. 24, 2010).

very few HOEPA loans, and then leaps to the conclusion that the points-and-fees change “is necessary to avoid unduly restricting access to credit.”²⁰⁹

This conclusion is unreasonable because consumers neither need nor want access to high-rate subprime loans that have so many fees they would be HOEPA loans but for the current loopholes in section 226.4. This conclusion also contradicts the Board’s previous statement that bringing more loans into the scope of HOEPA (by lowering the APR trigger) would not hurt access to credit. In 2001 the Board said:

Anecdotal evidence suggests that subprime borrowers with rates below the current HOEPA triggers also have been subject to abusive lending practices. . . . There is no evidence that the impact on credit availability will be significant if the APR trigger is lowered. Accordingly, the Board believes that lowering the APR trigger to expand HOEPA’s protections to more loans is consistent with consumers’ need for credit, and therefore, warranted.²¹⁰

The Board also fails to recognize the possibility that creditors may react to an expansion of the HOEPA triggers by offering more affordable credit rather than by withdrawing credit products from the market – a highly desirable result. Time after time the industry has argued that needed restrictions on abusive credit terms will dry up credit, but then, after the restriction was adopted, has restructured loans to avoid the harmful terms, and continued to extend credit -- just on a more sustainable basis. For example, this exact scenario happened in early 2000’s with the inclusion of single premium credit insurance in the points and fees test. Industry predicted it would sweep a large portion of subprime loans into the HOEPA category. It did not.

By justifying the proposed points-and-fees change as preserving access to credit, the Board will only protect a dangerous form of credit that helped produce the ongoing foreclosure crisis. The proposal will not protect consumers or preserve access to safe, affordable credit but will only help the subprime lending industry.

C. The Proposal Is Not Adequately Supported.

The Board lacks adequate data to evaluate the proposed changes and is relying on an insufficient factual record. When the Board issued the proposed more inclusive finance charge rule, it acknowledged that it “lacked adequate data to quantify the impact but believed that the more inclusive finance charge would benefit consumers.”²¹¹ Now the Board is completely reversing itself, apparently based on no more than comments from creditors complaining about the expanded HOEPA and HPML coverage.²¹²

²⁰⁹ 75 Fed. Reg. 58539, 58549 (Sept. 24, 2010).

²¹⁰ 66 Fed. Reg. 65,604, 65,607 (Dec. 20, 2001).

²¹¹ 75 Fed. Reg. 58539, 58638 (Sept. 24, 2010). When adjusting the HOEPA APR trigger downward, the Board then “stated that it is appropriate to err on the side of covering somewhat more than the subprime market. 73 FR 43522, 43533, July 30, 2008.” 75 Fed. Reg. 58539, 58660 (Sept. 24, 2010).

²¹² 75 Fed. Reg. 58539, 58638 (Sept. 24, 2010).

The Board now believes the more inclusive finance charge rule will unduly expand the scope of sections 32 and 35. Yet the Board presents no reliable statistical evidence to support its new position. The only evidence mentioned are general references to the Board's own analysis and creditors' comments.²¹³ The Federal Register notice includes no details regarding the Board's analysis and no data except for one unidentified creditor²¹⁴ that asserted 30% to 50% of its subprime loans would become subject to section 32 under the proposed revision of Reg. Z § 226.4.²¹⁵ Therefore, it would seem that the Board is now relying almost exclusively on unaudited, summary descriptions of creditors' private data.²¹⁶

It is inappropriate to rely on this type of evidence without confirmation from an unbiased source of data. A 2001 investigation into the extent of HOEPA coverage illustrates the potential problem with the data the Board relies on now. In 2001 the Board proposed lowering the APR triggers for HOEPA coverage. The Office of Thrift Supervision provided data suggesting the change would expand HOEPA coverage from 1% to 5% of subprime mortgage loans.²¹⁷ An industry-funded report, however, claimed coverage would grow from about 9% of subprime loans to about 26% of first liens.²¹⁸ The industry study was unreliable because it was based on the portfolios of unidentified, selected—rather than random—subprime lenders. Here, the Board relies on similarly flawed data--the creditors most likely to submit comments are those most likely to be impacted by the more inclusive finance charge. That creates a data pool that is much more likely to show a large expansion of HOEPA and HPML coverage than if the Board had used a reliable statistical sample.

According to the Federal Register notice, the Board determined that it was not possible to obtain reliable data on closing costs. Even if true, that does not justify reliance on unreliable data such as the comments cited in the notice. Nevertheless, we believe the Board could have obtained more reliable data by statistical sampling or by requiring creditors to report closing costs.²¹⁹ The internet web site Bankrate.com, for example, uses sampling each year to gather information about average closing costs by state.²²⁰

²¹³ 75 Fed. Reg. 58539, 58661 (Sept. 24, 2010).

²¹⁴ We eventually obtained a copy of comments filed by Citigroup, which appear to be the comments cited for the 30% to 50% estimation. The comments do not explain how the estimate was calculated nor do they provide any other data supporting it. The amount of non-affiliated, non-broker third party fees is typically low enough that a creditor would have to be charging very close to the 8% fees and points limit for that category of fees to make the difference. Our reviews of loans originated by Citigroup's subprime originator CitiFinancial confirms that at least historically this was the case. Given the lack of support for Citigroup's estimate, the Board should not have accorded the estimate any weight, particularly without reviewing the underlying loans.

²¹⁵ 75 Fed. Reg. 58539, 58637 (Sept. 24, 2010). While comments on proposed rules are typically made available to the public, the Board does not identify the specific comments on which it relies. Of equal concern is that the comments submitted in response to the August 2009 closed-end proposal appear to have been removed from the Board's web site, thereby making it difficult for the public to rebut the Board's characterization or reliance on the creditors' comments.

²¹⁶ 75 Fed. Reg. 58539, 58638 (Sept. 24, 2010).

²¹⁷ 66 Fed. Reg. 65,604, 65,608 (Dec. 20, 2001).

²¹⁸ 66 Fed. Reg. 65,604, 65,608 (Dec. 20, 2001).

²¹⁹ The North Carolina Banking Department, for example, requires reporting GFE-required information, including "itemization of settlement charges," as well as the HUD-1 if maintained electronically, 04 N.C. Admin. Code 03M.0401(c)(4).

²²⁰ Holden Lewis, "Study: N.Y. has highest closing costs" (Aug. 19, 2010) available at www.bankrate.com/finance/mortgages/2010-closing-costs (last viewed Dec. 16, 2010). We acknowledge that

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

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

D. The Proposal Should Be Coordinated With the Implementation of the Dodd-Frank Act.

Considering that the Board will soon need to implement Dodd-Frank requirements that impact sections 32 and 35, the proposed changes are ill-timed. While the Board downplays the cost of compliance, there can be no dispute that the proposed changes will require additional compliance training and software reprogramming. When the Board implements Dodd-Frank, creditors will need to do more training and reprogramming. This will increase costs and create the risk that creditor employees will make more errors while trying to learn two sets of rule changes. Instead of making changes piecemeal, the Board should delay the proposed changes until the Board is prepared to implement Dodd-Frank so all changes can be coordinated and implemented at once.

Through Dodd-Frank, Congress has decided to expand consumer protections involving high- and higher-cost loans. It makes no sense to limit or narrow coverage, as the Board now proposes, only to expand coverage a short time later when implementing Dodd-Frank. The pending proposal is contrary to the will of Congress.

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

Rather than tinker with the rules based on unsupported assumptions, the Board should:

- 1) Adopt a rule requiring creditors to report accurate data on closing costs so the Board has a valid basis for evaluating how the proposed finance charge will affect the number of loans subject to sections 32 and 35.

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

2) After obtaining sufficient data, address any coverage problems by raising or lowering the HPML trigger and asking Congress to adjust the points and fees trigger.

This course of action will produce reliable regulations based in fact rather than speculation. Implementing a process to regularly gather closing cost data would also help the Board replace the APOR as a metric for HPMLs. As the Board itself notes, the APOR is a flawed measurement tool because it does not include most closing costs, among other cited reasons. Using the TCR rather than the APR as a metric for HPMLs will not resolve this problem. Regular data collection will enhance the Board's to develop a more appropriate metric and adjust Regulation Z as the market changes over time.

The public record suggests the Board failed to properly consider a mandatory closing cost survey as a more appropriate alternative to the proposed rule changes. We urge the Board to reconsider this omission before adopting a final rule.

IV. The Board's Reverse Mortgage Proposal Should Be Withdrawn.

A. Introduction to Comments on Board's Proposals on Reverse Mortgages.

We appreciate the review and array of disclosure and substantive proposals relating to reverse mortgages included in this docket. We applaud the Board on its proposals for the new reverse mortgage disclosures, although we do have some important suggestions for improving the accuracy of those disclosures. We also support the Board's use of its unfairness authority to require counseling for all reverse mortgages, regardless of whether they are federally insured mortgages for which counseling is required.

On the other hand, the Board has exceeded its authority in several important ways. The Board does not have authority to create a safe harbor for the sale of products after ten days from closing. These sales are already flatly illegal. The safe harbor serves to legalize behavior that is otherwise statutorily prohibited. The Board has also made a serious error by including recourse mortgages within the definition of reverse mortgages. This proposal is ill-conceived and needs to be withdrawn.

We are also disappointed that the Board is squandering this opportunity to address serious problems in the reverse mortgage marketplace.

In this section of the comments, we will address all of these concerns, as well as a number of additional specific concerns with the Board's proposed changes in regulations for reverse mortgages.

We have previously requested that the Board withdraw the rule and make way for the Consumer Financial Protection Bureau to provide for reverse mortgage protections, as mandated in Dodd-Frank. We have submitted these comments with recommendations to improve the Board's proposed rule because the Board has not acted on our request to withdraw the rule.

B. Background: The Market for Reverse Mortgages Today.

The dangers to elderly homeowners from reverse mortgages range from huge losses – such as when the home’s entire equity is depleted to purchase a worthless annuity – to confusion and overpricing, which occur when interest rates are far higher than the market requires. Disclosures alone are rarely effective in protecting consumers from abusive loan products, even when the product is relatively simple and transparent. The complexity and opacity of the reverse mortgage product makes disclosure a singularly ineffective approach.

Reverse mortgages are counter-intuitive; they work differently from any other loan product American consumers are used to seeing. These loan products are opaque; even when one learns the basic principles, one cannot easily determine the effective costs and risks. As a result, reverse mortgages, while sometimes valuable, can be truly dangerous to elderly homeowners who do not have the tools to protect themselves from the ultimate risks: using up one’s life savings and even homelessness. The potential benefits of a reverse mortgage, when appropriately used, support its continued availability. But the potential for tremendous gains to the industry, which currently operates under few real restraints, dictate the need for substantial new substantive protections.

One disturbing trend in the reverse mortgage marketplace is the high percentage of borrowers who elect to take a fixed-rate Home Equity Conversion Mortgage (HECM). For those who do not need all of the available equity immediately, fixed-rate HECMs are much more expensive than variable-rate products in which money is withdrawn over the course of the loan. Fixed-rate HECM reverse mortgages require borrowers to withdraw the entire available balance (initial principal limit) at origination. Borrowers then have to pay both compounding interest and the ongoing mortgage insurance premium on this growing amount owed over the life of the loan.

In the past 18 months alone, there has been an enormous increase in the percentage of borrowers receiving fixed-rate HECM reverse mortgages – and paying interest on the highest possible initial draw over the life of the loan. According to data provided by the Department of Housing and Urban Development (HUD), in March 2009, 2.7% of HECM originations were fixed-rate and 97.3% were variable rate.²²¹ In October 2010 (the latest data available), 70.7% were fixed rate, while only 29.3% were variable rate.²²²

Between March 2009 and October 2010, over 60% of the HECM market switched from variable rate to fixed rate. It seems highly unlikely that the 26-fold increase in the percentage of borrowers receiving a fixed-rate mortgage can be explained because borrower need changed so drastically within an 18-month time period. It is much more likely that the industry is pushing more borrowers to withdraw the full amount available at closing – even when they do not need it.

²²¹ See HUD Single Family Portfolio Snap Shot – HECM Loans, available at <http://www.hud.gov/offices/hsg/rmra/oe/rpts/hecmsfsnap/hecmsfsnap0309.xls>.

²²² See HUD Single Family Portfolio Snap Shot – HECM Loans, available at <http://www.hud.gov/offices/hsg/rmra/oe/rpts/hecmsfsnap/hecmsfsnap1010.xls>.

In addition to the increased direct costs of borrowing for fixed-rate loans (in terms of additional interest and mortgage insurance premium over the loan terms), these borrowers likely face additional indirect fees. If the funds drawn down from the reverse mortgage are used to buy unnecessary investments (such as annuities) or insurance products (such as long-term care insurance) the borrowers are paying for their own money twice – once in interest and fees on the reverse mortgage, and again for the costs of the annuities or long-term care insurance. In fact, reverse mortgage originators often profit from such borrowers by selling lists of borrowers who took out fixed-rate HECMs and have large amounts of liquidity to potential insurance brokers and financial salespeople.

Borrowers who are of limited means and receive certain means-tested public benefits programs, such as Medicaid and Supplemental Security Income (SSI), may lose their benefits with these reverse mortgages. This would happen, for example, if the lump sum cash payment pushed their liquid assets above the \$3,500 asset limit, unless the funds were to be fully disbursed at closing to refinance and stop a foreclosure or to address some other pressing and expensive immediate emergency.

Originators have strong direct incentives to steer borrowers into these potentially higher-cost loans. Compensation to originators is greater from fixed-rate loans sold on the secondary market. (Investors like fixed-rate HECMs because they provide higher interest payments from a high initial balance, and the investment is less risky because of the FHA insurance.) Most originators sell the loans soon after closing them and are paid a percentage of the balance owed at that time. In addition, as all the money is drawn out up-front, originators earn more from the sale of servicing rights on loans with higher balances. They also can make money by selling the list of fixed-rate borrowers to third parties, as information on people with large liquid assets is valuable to financial and insurance companies. For no additional work, originators receive the greatest compensation if borrowers take all of the money out up-front. This incentive is particularly worrisome in the wake of reports of former subprime originators moving into the reverse mortgage origination business.²²³

Why might older Americans choose to take out loans that are not in their best interest? Part of it is simply the multifaceted nature of reverse mortgage transactions. As the Board itself writes in its proposed rule, “reverse mortgages are complex loan products whose requirements and characteristics tend to be unfamiliar even to the most sophisticated consumers. Thus, many consumers may be easily misled or confused about the costs of other products and services and the potential downsides to using their home equity to pay for them.”²²⁴ Older Americans are also more likely to have cognitive impairments than younger Americans and are therefore less likely to be able to make the best decision for themselves when it comes to complex financial transactions.²²⁵ These deficits make them

²²³ National Consumer Law Center, *Subprime Revisited: How Reverse Mortgage Lenders Put Older Homeowners' Equity at Risk*, at 7-9 (October 2009)

²²⁴ 75 Fed. Reg. 58539, 58665 (Sept. 24, 2010); *see also id.* at 58550, 58669.

²²⁵ A December 2007 study published in the *Annals of the New York Academy of Sciences* provides evidence for this. The study found that 35-40 percent of seemingly normal participants in fact had “deficits in reasoning and decision making due to dysfunction in a neural system.” Natalie L. Denburg, Catherine A. Cole, Michael Hernandez, Torricia H. Yamada, Daniel Tranel, Antoine Bechara, and Robert B. Wallace, “The Orbitofrontal

susceptible to believing false claims from reverse mortgage originators and in advertising. As a 2007 study points out, “complex decision making . . . would be a challenge even for intelligent young adults; however, when one considers possible executive dysfunction, in conjunction with fraudulent and vicious marketing extant in the social system, the degree of decision-making difficulty is greatly augmented for older adults.”²²⁶

The incentive for originators to steer borrowers into fixed-rate loans, combined with the greater cognitive impairments among older Americans, helps to explain why such a high percentage of HECM borrowers are taking out loans that are likely not in their financial interest. We view the Board’s reverse mortgage proposals through this lens.

With the exception of reverse mortgages for purchase, there are few justifications for the withdrawal of a major amount of one’s life savings. Yet, unlike withdrawals from bank accounts, the effects of the withdrawals are very difficult for most consumers to understand. We recommend in section E.6 that the Board – or the CFPB – closely restrict these withdrawals.

C. The Board’s Proposed New Reverse Mortgage Disclosures Are a Helpful Innovation for Consumers and Should Be Adopted But Only With Significant Improvements.

We support the Board’s proposal for Proposed Reg. Z § 226.33 to replace the existing reverse mortgage disclosures with a two-page disclosure titled “Key Questions to Ask about Reverse Mortgage Loans” and three new consolidated disclosures: an early disclosure for open-end reverse mortgages; an account-opening disclosure for open-end reverse mortgages; and a closed-end reverse mortgage disclosure (collectively “Consolidated Disclosures”).²²⁷ The new disclosure regimen would eliminate the table of Total-Annual-Loan-Cost rates and replace it with a table that demonstrates how the reverse mortgage loan balance grows over time.²²⁸

The Board’s new disclosures would be an improvement over the current standard. However, there are significant gaps in the proposed new disclosures that would undermine the Board’s goal of having consumers receive meaningful information in an understandable format.²²⁹ We suggest that the Board make changes to the timing, format and content of the disclosures. Most importantly, the proposed new Loan Balance Growth table, while an important new tool, is flawed and should be improved.

Cortex, Real-World Decision Making, and Normal Aging,” *Annals of the New York Academy of Sciences*, December 2007.

²²⁶ *Id.* at 2.

²²⁷ Proposed Reg. Z § 226.33.

²²⁸ 75 Fed. Reg. 58539, 58,645 (Sept. 24, 2010).

²²⁹ *See* 75 Fed. Reg. 58539, 58,641 (Sept. 24, 2010).

1. We support the replacement of the table of Total-Annual-Loan-Cost rates with the Loan Balance Growth table, but it should be improved significantly

The Board proposes to eliminate the table of Total-Annual-Loan-Cost (TALC) rates and replace it with a table that demonstrates how the reverse mortgage loan balance grows over time.²³⁰ We support the elimination of the TALC as borrowers are confused by this disclosure and often incorrectly interpret it.

TILA Section 138 requires disclosure of a good faith estimate of the projected total cost of the reverse mortgage to the consumer expressed as a table of annual interest rates, to be provided at least three business days before consummation.²³¹ This table was developed to facilitate comparison of the costs of various loan products to provide consumers with an "apples-to-apples" way of evaluating and comparing the cost of reverse mortgage alternatives.

Instead of providing a meaningful way of evaluating the cost of the loan, the TALC table has confused many potential borrowers.²³² Borrowers have difficulty understanding the rates disclosed on the TALC table. Consumers guess that it is the interest rate of the loan, and incorrectly assume that the rate on their loan will decrease over time. The Board's consumer testing has borne out this common misunderstanding.²³³ Consumers also have difficulty comparing the cost of the reverse mortgage over two horizons, time and appreciation. The paragraph explaining the table on the bottom of the chart, although accurate, does not provide a meaningful explanation that is understandable to most borrowers. We agree with the Board's assessment that consumers either do not consistently use this table or they are misled by its contents.²³⁴

In addition, a few key assumptions may limit the value of a TALC disclosure for consumers who choose the line of credit option. Though fixed-rate, full-draw reverse mortgages are popular today, in fiscal year 2008 approximately 89% of HECM borrowers chose the line of credit option under the adjustable-rate loan.²³⁵ If the consumer has a credit line, the disclosures will be based on an assumption that 50% of the principal loan amount is advanced and that no further advances are made during the remaining term of the loan. Although this assumption provides a convenient way to compare different credit lines, it masks the true cost of the loan, which depends in large part on the size and timing of the cash advances requested by the borrower. It also does not show the value of a growing versus non-growing credit line.

²³⁰ 75 Fed. Reg. 58539, 58,645 (Sept. 24, 2010).

²³¹ 15 U.S.C. § 1648.

²³² See Victoria Wong and Norma Paz Garcia, *There's No Place Like Home: The Implications of Reverse Mortgages on Seniors in California*, at 18 Consumers Union (August 1999)(complexity of the disclosure reflects the complexity of the loan itself). This report notes that TALC rates are used by HUD-approved reverse mortgage counselors to help borrowers understand whether the loan is beneficial. However, the TALC calculation has caused some confusion even among counselors themselves.

²³³ ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Reverse Mortgages, at iv, 11, 18, 27 (July 2010).

²³⁴ See 75 Fed. Reg. 58539, 58,642 (Sept. 24, 2010).

²³⁵ See Government Accountability Office, *Reverse Mortgages: Product Complexity and Consumer Protection Issues Underscore Need for Improved Controls Over Counseling for Borrowers*, GAO-09-606, at 8 (June 2009) available at <http://www.gao.gov/new.items/d09606.pdf>.

The Board proposes to replace the TALC table with the Loan Balance Growth table, which shows how the reverse mortgage loan balance grows over time. This table is much better calculated to provide meaningful information to consumers. It answers quite succinctly one of the chief questions borrowers have up front – how much will I owe at the end of this loan – expressed as a dollar amount. The Board notes that consumers consistently expressed a preference for a disclosure providing total costs as a dollar amount.²³⁶ We support the inclusion of the Loan Balance Growth table as a replacement to TALC but believe that certain key improvements should be made to this new table.

a. The Loan Balance Growth table should use assumed loan periods based on life expectancy, not standardized intervals of time.

The information disclosed in the proposed Loan Balance Growth table, Proposed Reg. Z § 226.33(c)(8), is based on loan periods of one year, five years, and ten years. We recommend preserving the current standard under TILA and using assumptions based on life expectancy. Current Reg. Z § 226.33(c)(6) requires disclosures of three periods: a two year term, a period equal to the youngest borrower's life expectancy, and a period equal to 1.4 times the youngest borrower's life expectancy. Creditors may also include a loan period based on the consumer's life expectancy multiplied by 0.5. The use of life expectancy rather than standard time intervals is more informative and accurate. A 95-year-old borrower, for example, may be misled by the inclusion of a loan balance based on a ten-year projection. On the other end of the spectrum, a 62-year-old borrower may live well beyond the ten-year framework specified in the chart and will likely owe much more than the maximum amount stated on the table. In weighing the risks and benefits of a reverse mortgage, consumers need information tailored to their specific demographics, not generic information. This is especially important when comparing reverse mortgages to other loan products such as home equity loans. The Board's goal of encouraging the informed use of credit is more likely to be achieved if consumers are provided with a simplified disclosure regimen based on their life expectancy.

b. The calculation of the balance in the Loan Balance Growth table should not include the cost or payments from an annuity, as doing so would legitimize this harmful and illegal practice.

The cost of and payments from an annuity should not be included in the loan balance information disclosed in the proposed Loan Balance Growth table; to do so would legitimize this harmful practice and undermine the Board's prohibition on the cross-selling of financial products with reverse mortgages.²³⁷

The aggressive selling of unsuitable annuities to borrowers has long been recognized as one of the most common abuses associated with reverse mortgages.²³⁸ With the stroke of

²³⁶ 75 Fed. Reg. 58539, 58,645 (Sept. 24, 2010).

²³⁷ See Proposed Reg. Z §§ 226.33(c)(8); 226.40.

²³⁸ See Norma Paz Garcia, Prescott Cole, Shawna Reeves, *Examining Faulty Foundations in Today's Reverse Mortgages*, Consumers Union, at 19 (December 2010); National Consumer Law Center, *Subprime Revisited: How Reverse Mortgage Lenders Put Older Homeowners' Equity at Risk*, at 14 (October 2009); *Reverse Mortgages: Polishing not Tarnishing the Golden Years*, Hearings before the Senate Special Committee on Aging, 110th Cong., 1st Sess. (2007) (statement by Prescott Cole on behalf of the Coalition to End Elder Financial Abuse); *Building Sustainable*

a pen, equity is drained from the elder's home through the expensive combination of a reverse mortgage loan and annuity contract, whose payout, especially if deferred beyond the borrower's life expectancy, will likely yield no benefit to the borrower.²³⁹ Moreover, there is no financial justification for investing in these insurance products if the guaranteed rate of return is less than the rate charged to borrow the money. Many elders are unaware of these risks, and the complexity of both products makes them especially vulnerable to the misrepresentations of unscrupulous brokers, lenders and insurance agents who receive hefty commissions (sometimes as high as 12%)²⁴⁰ on the sale of the annuity. If elders try to back out of the annuity contract, they are hit with high fees or penalties for early withdrawal.

Though Congress has banned the selling of other financial and insurance products, such as annuities, in conjunction with HECM loans, abuses persist.²⁴¹ Brokers and originators ignore the law, or put up barriers between their insurance division and mortgage sales force that are ineffectual at best.²⁴² As discussed in section B, borrowers today are taking out fixed-rate HECM reverse mortgages and withdrawing all the money up front. Elders with large sums of available cash are lucrative targets for insurance salesmen and others (who are sold lists of fixed-rate HECM borrowers). Thus far, oversight by regulators on the new law has been lax;²⁴³ HUD has yet to issue further guidance on the law.²⁴⁴

Proposed Regulation Z § 226.40(a) rightly prohibits creditors from requiring that consumers purchase financial or insurance products, including annuities, as a condition of obtaining reverse mortgages. As discussed in section E, we strongly oppose the ten-day safe harbor provision and it should be removed. The inclusion of the cost of and payments from an annuity in the balance disclosed in the proposed Loan Balance Growth table would further undermine the compliance with, if not spirit of this regulation. It would encourage

Homeownership: Responsible Lending and Informed Consumer Choice, Public Hearing on the Home Equity Lending Market before the Federal Reserve Bank of San Francisco, at 183 (2006) (statement by Shirley Krohn, Board Chair, Fair Lending Consortium); Victoria Wong and Norma Paz Garcia, *There's No Place Like Home: The Implications of Reverse Mortgages on Seniors in California*, Consumers Union at 20 (August 1999).

²³⁹ See e.g., *Reverse Mortgages: Polishing not Tarnishing the Golden Years*, Hearings before the Senate Special Committee on Aging, 110th Cong., 1st Sess. (2007) (statement by Carol Anthony, daughter of an 80 year old reverse mortgage borrower with a 20 year annuity).

²⁴⁰ Lori Swanson, the Attorney General of Minnesota, told the Senate Special Committee on Aging on Sept. 5, 2007 that "some insurance agents make very high commissions for selling some of these long-term deferred annuities of up to 9 to 12%, plus other incentives. An agent who sells a \$100,000 annuity may receive a commission of \$9,000 to \$12,000 for just a few hours of work." *Senior Fraud and the Sale of Annuities: Hearing Before the S. Special Comm. on Aging*, 110th Cong. (2007) (testimony of Lori Swanson, Att'y Gen. of Minnesota) available at <http://www.gpo.gov/fdsys/pkg/CHRG-110shrg301/html/CHRG-110shrg301.htm>.

²⁴¹ Housing and Economic Recovery Act of 2008 (HERA), Public Law 110-289 (July 30, 2008), § 2122 (amending Section 255 of the National Housing Act, 12 U.S.C. 1715z-20).

²⁴² See Government Accountability Office, *Reverse Mortgages: Product Complexity and Consumer Protection Issues Underscore Need for Improved Controls Over Counseling for Borrowers*, GAO-09-606, at 8 (June 2009) available at <http://www.gao.gov/new.items/d09606.pdf>, at 28.

²⁴³ The GAO found that "at least 26 states have adopted the National Association of Insurance Commissioners (NAIC) model regulation for suitability in annuity transactions" and that "at least 10 other states have adopted other legislation or regulations related to the suitability of insurance products." However, more than half these states do not provide the consumer with a private right of action to enforce this suitability standard. See Government Accountability Office, *Reverse Mortgages: Product Complexity and Consumer Protection Issues Underscore Need for Improved Controls Over Counseling for Borrowers*, GAO-09-606, at 8 (June 2009) available at <http://www.gao.gov/new.items/d09606.pdf>, at 28.

²⁴⁴ Dep't of Housing and Urban Dev. Mortgage Letter 2008-24 (Sept. 16, 2008).

originators to promote this product, even if they cannot make an immediate sale. The inclusion of this information in the early disclosures, which are given just three days after application, legitimizes the sale of these products when they are not suitable for consumers. Moreover, it confuses consumers, who are told in the “Key Questions to Ask about Reverse Mortgage Loans” disclosure that such a purchase is not required. We believe a ban on the inclusion of this information in the Loan Balance Growth table is the most effective way to discourage the unsuitable sale of this product.

c. The calculation of the future balance in the Loan Balance Growth table is highly misleading and should assume that the property will appreciate and not include any consideration of liability limits.

The proposed Loan Balance Growth table would not include disclosures related to the appreciation of the property value.²⁴⁵ The creditor must assume “that the dwelling’s value does not change.”²⁴⁶ The Board also requires that the creditor include any limitation on the consumer’s liability (such as a non recourse limit) in the disclosure of the amount owed by the consumer.²⁴⁷ A disclosure based on limitations on the borrower’s liability, when coupled with an assumption of zero appreciation in the value of the property, significantly understates the borrower’s potential repayment obligation, which can easily grow to exceed the home’s value at closing. In terms of the items disclosed on the Loan Balance Growth table, this is one of the most important disclosures and one that consumers will pay attention to in order to understand the full scope of their repayment obligation.

The Board should require that the calculation of the loan balance include an assumption that the property will appreciate in value. In calculating the consumer’s available loan amount, creditors assume that the property will appreciate in value. It would be inconsistent for them to disclose a potential future loan balance based on an assumption that the property will not appreciate in value.

Moreover, to reflect the consumer’s true potential future obligation, the Loan Balance Growth table should not include any potential liability limits. Instead, to make the consumers aware of potential liability limits, the Board should undertake consumer testing on a statement such as “The loan balances in this table may be subject to limits related to your home’s future value.”

d. Credit line growth is an important feature and should be disclosed.

The disclosures should reflect any credit line growth feature that the creditor offers on the loan.²⁴⁸ The credit line growth feature is an important benefit currently provided to borrowers of HECM reverse mortgages and should be disclosed so that borrowers can properly weigh the benefits of various payout options.

²⁴⁵ 75 Fed. Reg. 58539, 58,645 (Sept. 24, 2010).

²⁴⁶ 75 Fed. Reg. 58539, 58,646 (Sept. 24, 2010); see also Proposed Reg. Z § 226.40(c)(8); Proposed OSC § 226.33(c)(3)-6.

²⁴⁷ Proposed OSC § 226.33(c)(4)-7.

²⁴⁸ See Proposed Reg. Z § 226.33(c)(8).

The credit line growth feature allows the unused portion of a line of credit to grow at a specified rate.²⁴⁹ The existence of this feature means consumers do not have to withdraw a lump-sum up front and put that money into a savings account at a low yield or into an unsuitable investment product.²⁵⁰ As discussed in section B, however, borrowers today are taking out fixed-rate HECM reverse mortgages and withdrawing all the money up front. This is in part due to a price war that has heated up among several large reverse mortgage lenders. Lenders are waiving their origination fees and other charges on certain HECM reverse mortgages. For the HECM products with the most attractive pricing – fixed-rate reverse mortgages – lenders require immediate withdrawal of all the proceeds in a lump-sum.²⁵¹ Lenders are not offering discounts on adjustable rate loans that can be taken as a line of credit or in monthly payments.²⁵² As discussed in section B, originators have strong incentives to steer borrowers to fixed-rate HECM reverse mortgages, with lump-sum draws. This is at the expense of consumers who pay a higher cost in the long term.

The Board requests comments on whether the creditor should assume that the consumer draws the entire amount at closing or at account opening in all cases, or whether the creditor should demonstrate a credit line growth feature.²⁵³ We believe the creditor should be required to demonstrate a credit line growth feature. Consumers are ill-served by disclosure schemes where an important feature of the product – that will benefit the consumer – is not disclosed properly. The current popularity of fixed-rate HECM reverse mortgages is due in part to lenders pushing these products on consumers through aggressive pricing and push marketing. When consumers have a more fairly presented choice, they are more likely to choose the HECM line of credit with the credit growth feature. Indeed, just two years ago almost 90% of the HECM reverse mortgages borrowers chose to receive their money *solely* as a line of credit.²⁵⁴ Consumers, especially those who would lose eligibility for federal or state benefits upon receipt of a large lump-sum payment, are being swayed to make lump-sum withdrawals up front. The Board can help level the playing field by requiring that creditors demonstrate any credit line growth feature that is applicable to the loan being sold. If the Board requires the creditor to assume, in all instances, that the consumer will withdraw the full amount up front, it would legitimize creditors' push of a payout option that is unsuitable for many borrowers.

²⁴⁹ For HECM reverse mortgages, that rate is specified in the regulations. 24 C.F.R. §§206.3; 206.25(d). The remaining funds in the line of credit grow by the same rate as the interest rate on the mortgage, plus 0.5%.

²⁵⁰ See AARP, *Home Made Money: A Consumer's Guide to Reverse Mortgages*, at 11 (2007)

²⁵¹ Rachel L Sheedy, *Reverse Mortgage Lenders Cut Fees*, Kiplinger (July 13, 2010), available at <http://www.kiplinger.com/features/archives/krr-reverse-mortgage-lenders-cut-fees.html>; Tara Siegel Bernard, *Reverse mortgages Still Costly, but Less So*, April 16, 2010 available at <http://www.nytimes.com/2010/04/17/your-money/mortgages/17money.html?8dpc>

²⁵² Rachel L Sheedy, *Reverse Mortgage Lenders Cut Fees*, Kiplinger (July 13, 2010), available at <http://www.kiplinger.com/features/archives/krr-reverse-mortgage-lenders-cut-fees.html>;

²⁵³ 75 Fed. Reg. 58539, 58,647 (Sept. 24, 2010).

²⁵⁴ See Government Accountability Office, *Reverse Mortgages: Product Complexity and Consumer Protection Issues Underscore Need for Improved Controls Over Counseling for Borrowers*, GAO-09-606, at 8 (June 2009) available at <http://www.gao.gov/new.items/d09606.pdf>, at 8.

2. The Board should require that the new early disclosures for open-end reverse mortgages be provided earlier in the process.

Under the Board's proposal, creditors are required to deliver or mail to consumers the early open-end reverse mortgage disclosures the earliest of three business days after application or three business days before the first transaction under the plan.²⁵⁵ The Board should require that this disclosure be delivered with the application, as is consistent with current standards.

The early open-end reverse mortgage disclosures contain key information regarding the terms of the loan. Most critically, they include the cost information, the APR and the total account-opening and monthly fees charged on the loan. This information is essential if the consumer wants to shop for a loan. If the consumer has not obtained counseling, a copy of the early open-end reverse mortgage disclosure will be valuable so that the counselor can explain the particular features of the loan program the consumer is considering. Most importantly, consumers would then be able to evaluate key terms of the loan earlier in the process and demand a refund of the fees if the transaction does not meet their needs.

Under the Board's proposal, the only disclosure the consumer will receive with the application is the two-page "Key Questions to Ask about Reverse Mortgage Loans" disclosure. This is inadequate. Although this disclosure itself is informative and answers basic questions about reverse mortgages, it is not enough for consumers to make an informed comparison if they are shopping for a loan. Currently, consumers receive disclosures of the key terms of the loan up front.²⁵⁶

Providing the early open-end reverse mortgage disclosures with the application will not be burdensome to creditors. Much of what is included on the early open-end reverse mortgage disclosure is already required to be disclosed at application.²⁵⁷ Other key information, such as the value of the property, can be reliably estimated through the existing automated valuations systems used by the industry.

3. The Board should add a statement to the Consolidated Disclosures regarding the tax deductibility of interest payments on reverse mortgage loans.

The Board should not exempt reverse mortgages from the requirement of TILA Sections 127(a)(13) and 128(a)(15) to provide a statement regarding tax deductibility of interest payments on reverse mortgage loans.²⁵⁸ As is evidenced in the Board's consumer testing, consumers are simply confused about this important issue.²⁵⁹ Many consumers assume, or they are told, that the interest accruing but not paid on a reverse mortgage loan is deductible each year or that there are no tax implications. Such confusion is ripe for exploitation by brokers and originators interested in profiting off the sale of this loan

²⁵⁵ Proposed Reg. Z § 226.33(d).

²⁵⁶ See 12 C.F.R. § 226.5b.

²⁵⁷ See 12 C.F.R. § 226.5b.

²⁵⁸ 15 U.S.C. §§ 1637(a)(13); 1638(a)(15).

²⁵⁹ See ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Reverse Mortgages, at 24, 32 (July 2010).

product. In the forward mortgage market, tax deductibility has been a key selling point in many advertisements. During the subprime boom, lenders touted the tax deductibility of mortgage interest as a key reason to consolidate unsecured debt. Many American consumers, schooled on this belief, assume that interest on any mortgage loan is deductible annually. Brokers and originator may misstate the features and details of the program in order to close the loan. The Board's consumer testing features one such example of an originator providing a borrower with misinformation about the tax implications of reverse mortgages.²⁶⁰ Consumers should be told that they would not be allowed to deduct interest payments until the reverse mortgage ends and the consumer makes a single payment. A simple statement as to when the interest is tax deductible would not hinder or complicate the information already disclosed on the Consolidated Disclosures. Moreover, this disclosure would provide a meaningful benefit to consumers by clearing up a common misperception about the tax implications of the product. We recommend that the disclosures include a statement that the interest added to the balance of a reverse mortgage loan is not deductible until paid and that the consumer should consult a tax advisor for further information.

4. The “Key Questions to Ask about Reverse Mortgage Loans” disclosure is helpful but flawed.

Overall, we support the “Key Questions to Ask about Reverse Mortgage Loans” disclosure.²⁶¹ With some improvements, this disclosure will alert consumers to the important features of reverse mortgages and some of the risks these loans pose. We recommend that information on the tax deductibility of interest on reverse mortgages be further explained and not just referenced, and that the statement that the loans may impact eligibility for assistance from some federal and state programs receive more prominence. As is evidenced in the consumer testing conducted for the Board, consumers are confused by these two important issues.²⁶²

This disclosure should more fully highlight the adverse impact of reverse mortgages on eligibility for government benefits. The Board's consumer testing revealed that after consumers reviewed an earlier version of the “Key Questions to Ask about Reverse Mortgage Loans” they still had questions about the loan's impact on benefits, such as Social Security.²⁶³ Consumers receiving need-based government benefits such as SSI or Medicaid must carefully consider the impact reverse mortgage payouts may have on these benefits. Money retained by the borrower may be considered an asset if retained beyond the month in which it is received. Given that consumers are being incentivized to take out fixed-rate HECM reverse mortgages and withdraw all the money up-front, as discussed above, further information on this issue is critical.

Finally, this disclosure does not mention that consumers may obtain a refund of fees three business days after they receive the early disclosures; three business days after they

²⁶⁰ See *id.* at 32 (one consumer who held a reverse mortgage said her loan officer told her reverse mortgages had no tax implication).

²⁶¹ Proposed Reg. Z § 226.33(b).

²⁶² See ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Reverse Mortgages, at 24 (July 2010).

²⁶³ See *id.* at 32.

receive counseling; and any time before their account is opened if any of the terms (other than the APR) change.²⁶⁴ Creditors may collect application and other fees prior to the expiration of three business days, and consumers may feel locked in once they have submitted an application and a fee is collected. They may believe that the decision to go ahead with the loan is irrevocable. The Board proposes to disclose information regarding the refund options on the early-disclosure. However, the disclosure of a consumer's right to a refund is not given any prominence in that document and may be easily overlooked. Moreover, creditors are not required to inform consumers about their right to a refund. We recommend that this important information also be disclosed earlier on the "Key Questions to Ask about Reverse Mortgage Loans" disclosure so that consumers understand that even though they have made an application and paid money, they can still obtain a refund.

D. The Board's Proposal to Change the Definition of the Term "Reverse Mortgage" to Allow for Recourse is Wholly Inappropriate and Should Be Withdrawn.

The Board proposes to redefine "reverse mortgage" to allow recourse mortgages.²⁶⁵ This is a breathtaking and dangerous change. It would deprive consumers of the longstanding protections afforded to their personal assets and their estates by the nonrecourse limitation. Yet the Board proposes to take this enormous step – rewriting the longstanding and well-recognized Congressional definition of reverse mortgage – without fully considering the highly dangerous consequences, without reconciling the conflicts this proposal has with other parts of the Board's regulations, and without considering the conflicts with the Dodd-Frank Act.

Unlike its proposal to revise disclosures, here there is no discussion that the Board evaluated or conducted research to examine the possible impacts of this proposal on consumers or on the competitive market for reverse mortgages. The Board does not even consider the significant consumer confusion that would ensue if recourse mortgages may be called "reverse mortgages," if recourse mortgages may be originated and sold to consumers using the same name and the same disclosures that have been applied for years to products which were "nonrecourse." The Board does not discuss the impact of this proposal on the ability of consumers to engage in financial decision-making for their older years or to engage in estate planning. Similarly, the Board does not address how recourse mortgages would impact the reverse mortgage market: would they inhibit or enhance competition, would they inhibit or advance predatory or deceptive marketplace practices. Not only were these questions unanswered; they were apparently never even asked.

The Board likewise did not consider the impact of allowing recourse mortgages on its newly adopted counseling, advertising or disclosure rules. No recourse disclosures were proposed either as model or sample forms. *See* Model Forms K 1-3, Model Clause K 7; Sample Forms K-4-6.²⁶⁶ There was no discussion of how housing counselors would or

²⁶⁴ *See* Proposed Reg. Z §§ 226.33, 226.40.

²⁶⁵ We use "recourse mortgages" throughout to distinguish them from traditional reverse mortgages, which are exclusively nonrecourse. *See e.g.* 15 U.S.C. §1602(bb); 12 U.S.C. § 1715z-20(b).

²⁶⁶ An examination of the Board's proposals makes clear that it has not suggested language that informs a borrower his or her estate will be liable for any mortgage balance in excess of the home or that the borrower or his/her spouse could be liable for any overage if they trigger a condition of default such as moving out of the home to a nursing home, assisted living or even to an independent living accommodation somewhere else.

could incorporate this concept into their counseling session, and the significant additional risks to consumers and the market were not even among those considered and rejected in its consideration of a suitability standard.

1. Conflicts with protections in Dodd-Frank

The Board's broad brush redefinition of reverse mortgages to include recourse loans runs headlong into the Dodd-Frank Wall Street Reform and Consumer Protection Act's²⁶⁷ much broader application of restrictions on the origination of recourse mortgages. In Dodd-Frank, Congress exempted only nonrecourse mortgages from several protections otherwise applicable to home secured mortgages. For example, the newly established ability to pay requirement applicable to all closed-end home secured mortgages exempts reverse mortgages.²⁶⁸

The targeted provision in Dodd-Frank's section 1412 specifically contemplates that the Consumer Financial Protection Bureau (CFPB) may establish standards for recourse mortgages to qualify them as presumptively meeting the ability to repay standard.²⁶⁹ Additionally, Congress specifically directed the CFPB to conduct a study to identify unfair and abusive practices in connection with reverse mortgages.²⁷⁰

Given these instructions, it seems inappropriate and potentially extremely confusing for the Board to rewrite the definition of reverse mortgage at this juncture to include recourse products.

2. Counseling and disclosures

The Board's research, its proposed disclosures and counseling requirements, and its reasoning throughout its reverse mortgages proposal depend on reverse mortgages being nonrecourse. For example, after testing a variety of disclosures, the Board developed its "Key Questions to Ask about Reverse Mortgage Loans" which must be provided to each prospective reverse mortgage borrower. This document was crafted to counteract common misconceptions about reverse mortgages revealed by the participants in its reverse mortgage disclosure study.²⁷¹ One important misconception identified by the Board addressed recourse: "Some participants also believed that if the amount owed on a reverse mortgage exceeds the value of the home, the borrower is responsible for paying the difference and that if at any point a borrower 'outlives' their reverse mortgage—that is, if the equity in their home decreases to zero—they will no longer receive any payments from the lender."²⁷²

Consistent with that concern, question 8 of the nine key questions posed and answered in the "Key Questions to Ask about Reverse Mortgage Loans" disclosure addresses recourse:

²⁶⁷ Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010) (Dodd-Frank).

²⁶⁸ Dodd-Frank §1411; 15 U.S.C. §129C(a)(8).

²⁶⁹ 15 U.S.C. §129C(b)(2)(A)(ix).

²⁷⁰ Dodd-Frank §1076(a), (b)(2)(A).

²⁷¹ 75 Fed. Reg., 58539, 58549 (Sept. 24, 2010).

²⁷² 75 Fed. Reg. 58539, 58544 (Sept. 24, 2010)

“8) What happens at the end of the loan? What if I owe more than my home is worth when the loan comes due?”

A reverse mortgage loan is usually repaid by selling the home. If the money earned through selling the home isn’t enough to repay the reverse mortgage, almost all lenders will absorb the difference. These lenders will not be able to sue you or your heirs for more money. . . .”²⁷³

The Board identifies its “Key Questions to Ask about Reverse Mortgage Loans” disclosure as “simple, straightforward and concise” which will be used to “inform consumers about how reverse mortgages work and about terms and risks that are important to consider when selecting a reverse mortgage.”²⁷⁴ But the Board fails to address how the “Key Questions to Ask about Reverse Mortgage Loans” disclosure – which stresses the nonrecourse aspect of reverse mortgages -- will inform or protect consumers who are being offered a recourse mortgage. In fact, the opposite is true; the “Key Questions to Ask about Reverse Mortgage Loans” disclosure will affirmatively mislead prospective recourse borrowers into believing that they and their estates are *not* at risk if the mortgage balance exceeds the value of the home.

The Board repeatedly stresses and relies upon the nonrecourse aspect of reverse mortgages in its discussion of various proposed changes throughout the proposed rule.²⁷⁵ The safe harbor for compliance with the counseling requirement provides a perfect example. Throughout the proposal, the Board extensively discusses the complexity of the reverse mortgage product and its conclusion that consumers cannot be sufficiently informed about the risks of these mortgages in the absence of counseling:

- “particularly complex loan products that carry special risks; consumers need ample time before and after the transaction to understand them;”²⁷⁶
- “consumers . . . may not be sufficiently aware of the risks, obligations, and financial implications of reverse mortgages solely through disclosures provided during the origination process;”²⁷⁷
- “consumer testing of reverse mortgage disclosures revealed that even more sophisticated consumers do not readily understand how reverse mortgages work and their impact on a consumer’s financial future;”²⁷⁸
- “the [banking] agencies stated further that counseling for borrowers of proprietary reverse mortgage is necessary to ‘promote consumer understanding and manage compliance risks’”²⁷⁹

²⁷³ 75 Fed. Reg. 58539, 58787 (Sept. 24, 2010).

²⁷⁴ 75 Fed. Reg. 58539, 58549 (Sept. 24, 2010).

²⁷⁵ For example: “Reverse mortgages generally are nonrecourse.” 75 Fed. Reg. 58539, 58639 (Sept. 24, 2010) (“In most cases, the total repayment amount will be subject to a nonrecourse limit.” *Id.* 58652.

²⁷⁶ 75 Fed. Reg. 58539, 58668 (Sept. 24, 2010).

²⁷⁷ 75 Fed. Reg. 58539, 58669 (Sept. 24, 2010).

²⁷⁸ 75 Fed. Reg. 58539, 58669 (Sept. 24, 2010).

²⁷⁹ 75 Fed. Reg. 58539, 58670 (Sept. 24, 2010).

- “Without counseling, prospective reverse mortgage borrowers may not reasonably be able to avoid these injuries”.²⁸⁰

At the same time, the Board identified the following risks of consumer injury to justify its imposition of a mandatory counseling requirement:

- (1) loss of “substantial equity in their most valuable asset—their home—at a time when they may be least able to recover financially;”
- (2) foreclosure;
- (3) compromised estate planning goals;
- (4) limited options combined with special vulnerability to pressure.²⁸¹

The Board concluded that these injuries are not reasonably avoidable in the absence of counseling. Yet, in proposing a safe harbor for meeting this important counseling requirement, the Board completely neglected to consider the significantly heightened risks to borrowers of recourse mortgages.

The Board’s safe harbor would allow a lender originating a recourse mortgage to have satisfied the mandatory counseling requirement without any requirement that the consumer be counseled about the features, terms, costs or the severely enhanced risks associated with a recourse mortgage. To the contrary, the following suffice to meet this obligation: (1) the borrower has been provided with the “Key Questions to Ask about Reverse Mortgage Loans” disclosure and (2) the counseling session complies with the HECM counseling requirements. Proposed OSC § 226.40(b)(3)-1 provides a safe harbor for the content requirement for counseling that conveys the information required by HUD for the HECM program. Since recourse HECM mortgages are prohibited, there is no reason to expect a HECM counseling session to address the risks associated with recourse mortgages, and indeed, that type of discussion might be more likely to sow confusion than to inform HECM borrowers. But recourse borrowers will not be protected and may well be affirmatively deceived by safe-harbor-protected counseling sessions.

The problem is exacerbated because the Board requires only one counseling session in a six-month period and does not require additional counseling if a borrower switches products.²⁸² A counseling session that appropriately addressed the risks of a prospective borrower’s plan to enter into a HECM line of credit, would not be adequate to protect that borrower who ultimately selects a recourse mortgage, but it would still provide the lender with a safe harbor from liability. This failure to protect recourse borrowers is in direct conflict with the Board’s “primary purpose [in mandating counseling]. . . to ensure that the consumer freely chooses a reverse mortgage, based on an informed conclusion that the reverse mortgage is truly suitable for that consumer.”²⁸³

²⁸⁰ 75 Fed. Reg. 58539, 58671 (Sept. 24, 2010).

²⁸¹ 75 Fed. Reg. 58539, 58671 (Sept. 24, 2010).

²⁸² 75 Fed. Reg. 58539, 58675 (Sept. 24, 2010); see also § 226.40(b)(4).

²⁸³ 75 Fed. Reg. 58539, 58671 (Sept. 24, 2010).

3. Suitability determination

The Board's suitability analysis is similarly fatally flawed with respect to recourse borrowers. The Board evaluates whether to impose a suitability requirement for reverse mortgages, considering the following risks: that lenders might pressure consumers to purchase financial products, that lenders might steer consumers to particular counseling agencies and/or engage in lender/counselor communications.²⁸⁴ However, the Board never even discusses the risk that a borrower might be pressured to or unknowingly enter into a recourse mortgage – with potentially much more serious consequences than any of the risks it did identify.²⁸⁵

Consider a 75 year old woman living in Florida in a house appraised at \$625,500. She would be eligible for a draw of \$432,102 on a standard fixed rate HECM using the current rates of interest of 4.99%.²⁸⁶ If she withdrew her entire eligible draw at origination, and then died after five years, her loan balance would have grown to \$533,713.²⁸⁷ Yet, if the real estate market in Florida plunged by 40% during those years -- as occurred during the recent crisis -- at her death her home would only be valued at \$375,300. When compared to a loan balance of \$533,713, this borrower's estate would *owe* \$158,413.

Having decided that it was too risky to rely on creditors to provide counseling to consumers, because “their guidance and information may be biased by an economic interest in steering the consumer to a reverse mortgage,”²⁸⁸ the Board does not even consider this considerable self-interest with respect to recourse mortgages in its suitability analysis. The Board's stated reasons for rejecting a suitability requirement never address this concern. And the Board's stated reliance on “enhanced” . . . disclosures,” “new advertising rules” and mandatory counseling to “provide protections for consumers . . . [and to] render a suitability assessment by the originator unnecessary,” simply does not apply in the context of recourse mortgages.²⁸⁹ Although we do not advocate the origination of recourse mortgages, at a minimum, they should never be originated without tailored and appropriate counseling and a mandatory suitability analysis.

4. Deception

The Board fails to recognize that its proposal to allow mortgages with *recourse* to be marketed as reverse mortgages – a product name that has heretofore been defined as exclusively *nonrecourse* -- is affirmatively deceptive and will engender significant consumer

²⁸⁴ 75 Fed. Reg. 58539, 58675 (Sept. 24, 2010).

²⁸⁵ 75 Fed. Reg. 58539, 58675 (Sept. 24, 2010).

²⁸⁶ This information was developed using the reverse mortgage calculator on the National Reverse Mortgage Lenders Association website, 12/20/10. A birthdate of 1/1/1935 and zipcode of 33331 were used. http://rnc.ibisreverse.com/default_nrmla.aspx

²⁸⁷ This figure was derived using a simple Excel spreadsheet and compounding loan formula.

²⁸⁸ 75 Fed. Reg. 58539, 58671 (Sept. 24, 2010).

²⁸⁹ 75 Fed. Reg. 58539, 58678 (Sept. 24, 2010).

deception. What is worse, the Board affirmatively asserts that this definitional change is intended to *promote* consumer protection.²⁹⁰

The Board's suggestion that it promotes consumer protection to allow recourse mortgages to masquerade as reverse mortgages, to offer borrowers a mandatory disclosure document that misleads as to recourse, to use the same cost and risk disclosures and the same counseling for recourse and nonrecourse is simply not credible. Nor can it be reconciled with the Board's expressed concerns about recourse mortgages or with their real life impact on recourse borrowers. First, the Board expresses that, "Reverse mortgages that allow for recourse against the consumer present even greater consumer protection concerns than nonrecourse reverse mortgages because the consumer or consumer's estate could be liable for significantly more than the home is worth when such a reverse mortgage becomes due."²⁹¹ For this reason, the Board proposes to "preserve the narrow exemption for nonrecourse reverse mortgages from the high-cost loan provisions in section 226.32(a)(2)(ii)."²⁹²

At the same time, the Board would retain Congress's nonrecourse definition and would continue to subject recourse loans that trigger HOEPA to its prohibitions.²⁹³ And while admitting that recourse mortgages that fall below its triggers and are therefore not prohibited by HOEPA "present even greater consumer protection concerns than nonrecourse reverse mortgages" and that "[t]he consumer or the consumer's estate could be liable for significantly more than the home is worth when a reverse mortgage that allows for recourse against the consumer becomes due," the Board proposes to go no further.²⁹⁴ It would exempt recourse loans from all other prohibitions currently in Regulation Z and to which they are now subject, seemingly relying on disclosure alone to remedy that concern. A conclusion that disclosure can suffice to protect borrowers and ensure their understanding of the significant risks and complexities of recourse mortgages flies in the face of the Board's study of consumer understanding of reverse mortgages and disclosures, as well as with its proposal as a whole. It cannot be reconciled with the Board's repeated concern, that "consumer testing of reverse mortgage disclosures revealed that even more sophisticated consumers do not readily understand how reverse mortgages work and their impact on a consumer's financial future."²⁹⁵

It is wholly inappropriate for the Board to include recourse products within the protections and definitions of reverse mortgages. The Board should drop this proposal.

E. We Strongly Oppose the Board's Ten-day Safe Harbor in its Proposed Anti-tying Rule and Urge the Board to Withdraw It.

We agree with the Board's statement that "consumers who are required to use reverse mortgage proceeds to purchase ancillary financial or insurance products stand to lose

²⁹⁰ 75 Fed. Reg. 58539, 58641 (Sept. 24, 2010).

²⁹¹ 75 Fed. Reg. 58539, 58637, 58641 (Sept. 24, 2010)

²⁹² 75 Fed. Reg. 58539, 58637 (Sept. 24, 2010).

²⁹³ 75 Fed. Reg. 58539, 58637 (Sept. 24, 2010).

²⁹⁴ 75 Fed. Reg. 58539, 58641 (Sept. 24, 2010).

²⁹⁵ 75 Fed. Reg. 58539, 58669, 58550 (Sept. 24, 2010).

substantial equity in their most valuable lifetime asset for little or no benefit. This can take away from their ability to cover daily living expenses, medical costs and other needed expenses at a time when their income sources are most limited.”²⁹⁶

We were therefore dismayed with the Board’s proposal for Proposed Reg. Z § 226.40(a) to implement the cross-selling ban through a ten-day safe harbor. We believe this might legitimize a deceptive and unfair practice as long as it is done ten days after the loan closing. We strongly oppose the safe harbor and urge the Board to withdraw it from the final rule.

1. The Board’s proposed rule is inconsistent with two federal laws.

The Board’s proposed anti-tying safe harbor violates the plain language of the Housing and Economic Recovery Act (HERA) of 2008, which states: “The mortgagee or any other party shall not be required by the mortgagee or any other party to purchase an insurance, annuity, or other similar product as a requirement or condition of eligibility.” This law applies to HECM reverse mortgages insured by the Federal Housing Administration and is to be implemented by HUD.

Congress did not limit HERA’s cross-selling ban to a ten-day period after closing. In fact, this language was inserted into HERA by Senator Claire McCaskill after she chaired a Senate Aging Committee hearing on abuses in the reverse mortgage market,²⁹⁷ which included testimony on the abusive cross-selling of insurance and investment products, such as the tying of annuities and reverse mortgages.²⁹⁸ Senator McCaskill summarized the reasons why she worked on the language in a Floor speech:

It will prohibit someone who is marketing one of these products, one of these reverse mortgages, from being able to sell another product. Believe it or not, there are actually people sitting down with elderly people right now in America who are saying, ‘we’re going to get you a reverse mortgage and, by the way, at the same time, we are going to sell you a deferred annuity.’ Now, I don’t know how these people look themselves in the mirror. We had a witness in front of our committee whose mother was in her 80s and was sold a deferred annuity and a reverse mortgage at the same time. Unconscionable! To make this sale and to make this money. It is a get-rich-quick scheme for some of the sales people.²⁹⁹

The legislative history and plain language of HERA make it clear that a ten-day safe harbor is not adequate. Although HERA only covers HECMs, Congress has also made clear that broader regulations (applying to proprietary loans as well as HECMs) related to cross-selling are desirable and has specifically have authorized the Consumer Financial Protection Bureau to do so. The Dodd-Frank Act requires the CFPB, not the Board, to conduct a

²⁹⁶ 75 Fed. Reg. 58539, 58665 (Sept. 24, 2010).

²⁹⁷ Special Committee on Aging, United States Senate, “Reverse Mortgages: Polishing not Tarnishing the Golden Years,” 12/12/07, chaired by Senator Claire McCaskill. Testimony copy available at: http://aging.senate.gov/hearing_detail.cfm?id=316275&.

²⁹⁸ Prescott Cole, Coalition to End Elder Financial Abuse, testimony before Special Committee on Aging, United States Senate, 12/12/07, pp. 2-3. Available at <http://aging.senate.gov/events/hr185pc.pdf>.

²⁹⁹ See <http://www.mccaskill.senate.gov/newsroom/record.cfm?id=295550>.

study on the cross-selling issue and issue regulations if appropriate. It is premature and inconsistent with the Congressional mandate for the Board to complete a rulemaking in this area.

We recommend that the Board *withdraw the proposal* and allow the CFPB to do its statutorily-mandated study and regulations. If the Board moves forward with this part of the rule, it should at the very least prohibit an originator, creditor, or affiliate from financially benefiting from reverse mortgage borrowers, whether directly (e.g., by selling a product to borrowers), or indirectly (e.g., by selling borrowers' names to a third party, which could then sell them a product). A broad ban on the cross-selling of products is especially important today, when so many borrowers are taking out fixed-rate loans requiring a 100% draw at closing and are especially vulnerable to fraud or abuse.

2. Buying insurance/financial products with reverse mortgage proceeds is not in borrowers' interests.

It is simply not in an older homeowner's interest to take out a loan, such as a reverse mortgage, for the purpose of buying a financial or insurance product. The cost of the reverse mortgage must be added to the cost of the financial or insurance product to calculate the true cost to borrowers -- and the benefit-cost ratio is often negative, particularly in the area of annuities, in which payments sometimes are deferred until after the life expectancy of the borrower. In fact, this is an area where reverse mortgage borrowers are most susceptible to fraud.

Indeed, the Board itself notes that "reverse mortgages are complex loan products whose requirements and characteristics tend to be unfamiliar even to the most sophisticated consumers. Thus, many consumers may be easily misled or confused about the costs of other products and services and the potential downsides to using their home equity to pay for them."³⁰⁰ This is consistent with a 2009 Government Accountability Office report, which highlighted abuses in this area and provided several examples of abusive cross-selling uncovered by state regulators.³⁰¹ It is also consistent with a Federal Bureau of Investigation 2009 fraud bulletin that highlighted several ways reverse mortgages are used to perpetrate fraud and outright theft, including investment schemes. The FBI document states that "investment schemes . . . are used by mortgage fraud perpetrators to steal the HECM loan proceeds under the guise of investing it in an annuity, real estate, or other investment product. The perpetrators of this scheme are often affiliated with the originator of the HECM loan and cross-sell the investment product to the victim."³⁰²

Long-term care insurance is very costly for people in the 62-and-over age bracket, and it continues to rise in cost each year as borrowers age. Borrowers could easily exhaust their reverse mortgage proceeds to pay for insurance premiums without ever getting a

³⁰⁰ 75 Fed. Reg. 58539, 58665 (Sept. 24, 2010); *accord, id.* at 58550, 58669.

³⁰¹ Government Accountability Office, *Reverse Mortgages: Product Complexity and Consumer Protection Issues Underscore Need for Improved Controls Over Counseling for Borrowers*, GAO-09-606, at 8 (June 2009) available at <http://www.gao.gov/new.items/d09606.pdf>.

³⁰² "Home Equity Conversion (Reverse) Mortgages Exploited to Defraud Senior Citizens," Federal Bureau of Investigation Bulletin, 3/24/09. Available at: http://www.fbi.gov/scams-safety/fraud/seniors/intelbulletin_reversmortgages.

benefit from them. Instead of buying long-term care insurance with reverse mortgage proceeds, borrowers with long-term care needs are better off using the proceeds to pay directly for long-term care as needed.

Similarly, deferred annuities are not in the interest of reverse mortgage borrowers. According to testimony from the Inspector General for the Department of Housing and Urban Development, a key problem is that “in the case of annuities, the victims are unable to get access to their savings for many years or even past their projected life expectancy.”³⁰³

A report from the Government Accountability Office (GAO) found that despite at least 26 state suitability laws to protect borrowers from purchasing unsuitable products, such as annuities, “a number of state insurance regulators have reported recent examples of violations of their state insurance laws that involved HECM funds.”³⁰⁴ The report details several disturbing examples of borrowers harmed through cross-selling, such as an 81-year-old Maine widow who was sold a deferred annuity earning only 3.25%, compared with the 4.12% interest rate on her reverse mortgage.³⁰⁵

With 70% of today’s borrowers taking out the full available balance at closing, borrowers are more vulnerable than ever to being sold these products, and the Board needs to react much more strongly to the practice.

3. Allowing marketing and solicitation during the safe harbor period is harmful to consumers.

The staff commentary makes clear that, although an originator/creditor/affiliate would not be able to take an application for a financial or insurance product during the safe harbor period, it could aggressively market or talk up the benefits of these harmful products during that time. This loophole is inconsistent with what is best for seniors, who may face some difficulty with evaluating their best options. Allowing the marketing of these products to borrowers throughout the process simply does not make sense.

4. Sale of borrower lists to third parties would lead to direct consumer harm.

The staff commentary specifically excludes the selling of the list of reverse mortgage borrowers from the safe harbor. Thus, a mortgage originator could on the day of closing sell a list of all borrowers who took a fixed-rate, 100% draw HECM to an insurance company, which could then market and sell long-term care insurance or an annuity to the borrower during the safe harbor time period, making it even more likely that borrowers would be placed into investments and loan products not in their interests. The injury to the borrower caused by the sale of inappropriate financial products does not depend on the identity of the seller; it would be just as great no matter who sold the insurance or annuity – the originator,

³⁰³ Anthony G. Medici, Office of the Inspector General, U.S. Department of Housing and Urban Development, testimony before the Special Committee on Aging of the U.S. Senate, 6/29/09, p. 2.

³⁰⁴ Government Accountability Office, *Reverse Mortgages: Product Complexity and Consumer Protection Issues Underscore Need for Improved Controls Over Counseling for Borrowers*, GAO-09-606, at 8 (June 2009) available at <http://www.gao.gov/new.items/d09606.pdf>.

³⁰⁵ 75 Fed. Reg. at 28-29.

creditor, an affiliate of the originator or creditor, or an unaffiliated third-party. The Board fails to address why this cross-selling exemption is appropriate or consistent with the unfairness determination it has made with respect to cross-selling.

5. Actions outside the safe harbor might still be legal.

Since the Board has proposed its anti-tying rule as a safe harbor, it would allow a case by case analysis of whether an originator, creditor, or affiliate who acted outside the safe harbor (by, for example, selling long-term care insurance to the borrower before the end of the ten-day period) was in compliance with the regulation. Using the mortgage proceeds to purchase a long-term care insurance or annuity product during the 10-day period creates an even riskier situation for reverse mortgage borrowers and should not be permitted.

6. Recommended action

We believe the Board should withdraw this entire section and allow the CFPB to engage in its statutorily-mandated task of studying cross-selling and proposing regulations after the July 2011 transfer date. If the Board does move forward, however, we recommend that the Board use its mandate under section 129(l)(2) to prohibit unfairness in mortgage transactions to require a healthy suitability standard to be applicable whenever there is a lump sum distribution of more than 50% of the maximum draw, *unless* there is a certification from an independent party (like a HUD certified housing counselor) that the withdrawal is necessary for: a) saving the house, b) a health need of one of the owners, or c) some other bona fide reason, not to include any financial planning. The certification must be accompanied by independent verification: a foreclosure notice, a pending lawsuit, an unpaid medical bill, or similar real needs which justify the depletion of one's life savings.

F. The Board's Proposal to Require Counseling for All Reverse Mortgage Borrowers Should be Adopted, But With Substantial Improvements.

The Board proposes to extend the counseling requirements for HECMs to proprietary mortgages with Proposed Reg. Z § 226.40(b). Given the complexity of the product, counseling is necessary to ensure that consumers are aware of all the risks posed by these loans. As the Board acknowledged, "even sophisticated consumers seeking reverse mortgages may not be sufficiently aware of the risks and obligations of reverse mortgages solely through disclosures provided during the origination process."³⁰⁶

We applaud the Board for extending a counseling requirement to proprietary reverse mortgages. However, we are deeply concerned that the proposed rule, as written, would water down the current federal standards and invite unsavory players into the counseling industry who would give biased advice and assistance to consumers. HUD has developed extensive qualification and counseling guidelines to ensure the quality and integrity of the counseling network and the counseling process. We recommend that the Board establish this federal standard as the benchmark.

³⁰⁶ 75 Fed. Reg. 58539, 58,550 (Sept. 24, 2010).

1. HUD's current requirements for the structure and content of reverse mortgage counseling under the HECM program are strong and should be the benchmark.

To be eligible for a FHA-insured HECM reverse mortgage loan, borrowers must obtain adequate counseling from an independent third party that is neither directly or indirectly associated with the mortgage transaction.³⁰⁷ Lenders are required to provide every potential HECM borrower with a list of at least ten HUD-approved counseling agencies.³⁰⁸ Five of these counseling agencies must be in the borrower's local area or state and at least one agency must be located within a reasonable driving distance. The other five referrals must be to national intermediaries and multi-state organizations specified by HUD.

In order to ensure the independence of the counselor, borrowers must initiate communication with a counseling agency on their own. In a 2009 Mortgage Letter,³⁰⁹ HUD indicated that lenders who dial a counseling agency's phone number and hand the phone to the borrower to schedule counseling violate the directive requiring borrowers to initiate contact. Similarly, lenders are not permitted to enter information into a web-based system that then automatically puts the borrower's name in a queue to be called by a counselor.

The HECM enabling statute details information that must be discussed with the borrower during the counseling session.³¹⁰ Specifically, counselors are required to:

- review options other than a HECM that are available to the homeowner, including other housing, social service, health, and financial options;
- discuss other home equity conversion options that are or may become available to the homeowner, such as sale-leaseback financing, deferred payment loans, and property tax deferral;
- disclose that a HECM may have tax consequences, affect eligibility for assistance under Federal and State programs, and have an impact on the estate and heirs of the homeowner; and
- review the financial implications of entering into a HECM loan.

Furthermore, in order to evaluate possible alternatives to a HECM loan, counselors must perform a budget analysis based on the borrower's income, assets, debts, and monthly expenses.³¹¹

Counseling agencies may charge up to \$125 for the counseling session.³¹² The fee may be paid directly to the agency, or it may be paid from the borrower's HECM proceeds at closing. Lenders are not permitted to pay HUD-approved counseling agencies directly or

³⁰⁷ 12 U.S.C. § 1715z-20(d)(2)(B). Counseling may not be provided by any party that is directly or indirectly associated with or compensated by a party involved in 1) originating or servicing the mortgage, 2) funding the loan, or 3) the sale of annuities, investments, long-term care insurance, or any other type of financial or insurance product. *Id.*

³⁰⁸ *See* 12 U.S.C. 1715z-20(f); Dep't of Housing and Urban Dev., Mortgage Letter 2009-10 (March 27, 2009).

³⁰⁹ Dep't of Housing and Urban Dev., Mortgage Letter 2009-10 (Mar. 27, 2009).

³¹⁰ 12 U.S.C. § 1715z-20(f).

³¹¹ Dep't of Housing and Urban Dev. Mortgage Letter 2009-10 (Mar. 27, 2009).

³¹² Dep't of Housing and Urban Dev., Mortgage Letter 2008-12 (May, 6, 2008).

indirectly for counseling services.³¹³ Lenders previously were permitted to pay for borrower counseling through a lump sum or on a case-by-case basis. However, the independence requirement for counseling imposed by the Housing and Economic Recovery Act of 2008, now precludes such payments.³¹⁴

2. The Board should revise Proposed Regulation Z § 226.40(b)(1), delete the “substantially similar” standard, and require that counseling be provided by individuals who are certified and employed by a HUD-approved agency.

Proposed Regulation Z section 226.40(b)(1) would require counseling prior to the origination of a reverse mortgage from a counselor or counseling agency that meets the qualification standards established by HUD, pursuant to 12 U.S.C. section 1715z-20(f), or “substantially similar” qualification standards. Although we applaud the Board for extending the counseling requirement to all reverse mortgage transactions, we are concerned that the standard proposed would substantially weaken the current federal counseling protocols and invite rogue operators into the reverse mortgage counseling industry. We recommend that the Board remove the “substantially similar” standard and simply require that the counselor and agency meet or exceed the current federal standard. Moreover, we recommend that the Board require that only individuals certified and employed by a HUD-approved counseling agencies perform the required counseling.

a. The “substantially similar” standard for qualification of counselors and agencies under Proposed Reg. Z § 226.40(b)(1) is imprecise and confusing.

The Board proposes that individuals or agencies providing the required counseling meet the qualifications standards established by HUD or “substantially similar” standards.³¹⁵ The proposed rule does not define the phrase “substantially similar,” and it is unclear why this language is necessary. The Board’s Official Staff Commentary, which provides a safe harbor to creditors, does not shed light on what kinds of standards or requirements would be considered “substantially similar” to current federal standards.³¹⁶ In the absence of such guidance, the counseling industry (and indeed the lending industry if it sets up a counseling arm) is left to craft its own weaker standards which may undermine current HECM standards.

Adopting a standard that requires counselors and agencies to meet or exceed the current federal standard would provide a more prudent and bright-line test. It would make clear that the current federal standard is the base on which to build stronger, more protective qualification standards. Of the states that require counseling, some defer to or reference the federal standards.³¹⁷ The federal qualification standard includes a number of quality assessment measures for individual applicants, including an exam and required training and education. The Board itself defers to the federal standard and “recognizes that HUD has

³¹³ Dep’t of Housing and Urban Dev., Mortgage Letter 2008-28 (Sept. 29, 2008).

³¹⁴ See Housing and Economic Recovery Act of 2008 (HERA), Public Law 110-289 (July 30, 2008), § 2122 (a)(3) (amending Section 255 of the National Housing Act, 12 U.S.C. 1715z-20)

³¹⁵ Proposed Reg. Z § 226.40(b)(1).

³¹⁶ See Proposed OSC § 226.40(b)(1)-2.

³¹⁷ See e.g., Ariz. Rev. Stat. § 6-1602; Cal. Civ. Code §§ 1923.2(j) and (k); Mass. Gen. Laws Ch. 184 § 17B 3/4; N.Y. Real Property Law §§ 280(2)(g); Tenn. Code Ann. § 47-30-102(4); Vt. Stat. Ann. Tit. 8 § 10702.

developed and continues to improve a comprehensive system of certifying counselors to provide required counseling on reverse mortgages under the HECM program.”³¹⁸ Under the program, agencies are also vetted to ensure they are community-based counseling organizations.

It appears from its statements that the Board intends to establish the federal standards as the floor. “The Board proposes to require that counselors meet HUD’s qualification standards for HECM counselors, or standards that would require a similar level of training and knowledge to those required for HUD-approved counselors.”³¹⁹ However, as drafted, it is unclear from the Board’s articulation of its “substantially similar” standard if any or all of the current federal standards would be required. We recommend that the Board remove the “substantially similar” standard and simply require that the counselor and agency meet or exceed the current federal standard. As the Board notes, “proprietary reverse mortgage creditors have routinely required borrowers to obtain counseling from HUD-approved counselors, indicating that the Board’s proposal would not be unduly burdensome.”³²⁰

b. The Board should require that consumers obtain counseling from an individual certified and employed by a HUD-approved agency.

The Board’s counseling requirement may unintentionally invite rogue, fly-by-night individuals into the reverse mortgage counseling industry. Under Proposed Regulation Z section 226.40(b)(1), counseling would be provided by an individual or counseling agency that meets the qualification standards established by HUD or substantially similar standards. As discussed above, it is not clear whether or to what extent individuals or organizations must comply with current federal standards.

Current federal standards require that any individual seeking to provide HECM counseling be employed by a HUD-approved housing counseling agency.³²¹ This common-sense requirement helps to ensure that individual counselors receive appropriate supervision and oversight. It also increases accountability, as the individual counselor and the supervising agency are responsible for the implementation of HUD standards. The absence of this requirement would open the door to fraud and abuse, as individuals (whether qualified under HUD or “substantially similar” standards) would be able to set up shop to provide reverse mortgage counseling motivated by the counseling fees they would obtain. There would be no guarantee that these unsupervised individuals would abide by the Board’s proposed counseling standards, which require independence and prohibit steering.³²²

Indeed, it is likely that individuals providing reverse mortgage counseling outside the umbrella of an organization will be more vulnerable to solicitations from unscrupulous lenders seeking to boost loan volume and cut corners by putting pressure on individuals to water down the counseling process. These are the very pressures the Board acknowledged

³¹⁸ 75 Fed. Reg. 58539, 58,671 (Sept. 24, 2010).

³¹⁹ 75 Fed. Reg. 58539, 58,671 (Sept. 24, 2010).

³²⁰ 75 Fed. Reg. 58539, 58,671 (Sept. 24, 2010).

³²¹ 24 C.F.R. § 206.304.

³²² See Proposed Reg. Z § 226.40(b)(6).

when it stated that “given certain incentives, counselors may provide guidance that favors a particular reverse mortgage product, regardless of its appropriateness for the consumer.”³²³ We agree with the Board’s statement that “counselor impartiality is essential to ensuring that counseling affords meaningful consumer protection.”³²⁴ The Board should change its proposal to ensure that all counselors work under the supervision and oversight of a HUD-approved agency.

The current federal standards also tightly regulate housing counseling organizations. To become a HUD-approved agency, the organization must be a community-based non-profit with at least one year’s experience successfully administering a housing counseling program.³²⁵ Organizations are subject to extensive record keeping and reporting requirements. Oversight by HUD has kept most of the bad actors out of the counseling industry. There is no such requirement for oversight by any state or federal agency in the proposed regulation. This may put consumers at risk.

We have seen this pattern before. In the wake of the foreclosure crisis, a whole industry of loan modification scam companies has developed to swindle desperate homeowners out of thousands of dollars.³²⁶ This is due in large part to the lending industry’s inability or unwillingness to help homeowners. A similar pattern could emerge with the reverse mortgage counseling industry under the proposed rule, as cash-strapped elders could be funneled to sham counselors and organizations just intent on collecting a fee. To preempt such a problem, we suggest that the Board make a bright-line rule that only organizations meeting current HUD guidelines may provide counseling.

c. The content of the reverse mortgage counseling under Proposed Reg. Z § 226.40(b)(3) should, at a minimum, conform to HECM program requirements.

As the lending industry has acknowledged, HECM counseling rules are the “best and prudent practices” for institutions offering proprietary products.³²⁷ Any counseling standard that does not meet the federal HECM standards would not provide a meaningful benefit to consumers. As described above, the standards cover a range of issues critical for consumers to understand, including the tax consequences of reverse mortgages and the loan’s impact on an elder’s eligibility for state or federal assistance. Counselors discuss the alternatives and financial implications of reverse mortgages. An AARP funded survey found that counseling sessions by exam-tested counselors who followed detailed counseling protocols took on average two to three hours.³²⁸

³²³ 75 Fed. Reg. 58539, 58,676 (Sept. 24, 2010).

³²⁴ 75 Fed. Reg. 58539, 58,676 (Sept. 24, 2010).

³²⁵ HUD Housing Counseling Program Handbook, 7610.1 at 8.

³²⁶ See National Consumer Law Center, *Desperate Homeowners: Loan Mod Scammers Step in When Loan Servicers Refuse to Provide Relief* (July 2009)

³²⁷ 75 Fed. Reg. 58539, 58670 (Sept. 24, 2010) (statement of the National Reverse Mortgage Lenders Association).

³²⁸ Donald Redfoot, Ken Scholen and S. Kathi Brown, AARP, *Reverse Mortgages: Niche Product or Mainstream Solution? Report on the 2006 AARP National Survey of Reverse Mortgage Shoppers* (2007) at 90-95, available at http://assets.aarp.org/rgcenter/consume/2007_22_rev mortgage.pdf.

We suggest that under Proposed Regulation Z section 226.40(b)(3), content of counseling, that the Board specifically require that the counseling should, *at a minimum*, include all information required by the Secretary of HUD pursuant to 12 U.S.C. § 1715z-20(f) and implementing regulations. To impose any other standard would water down the current federal standard that has evolved and been improved upon for decades. Moreover, it establishes a clear standard, one that the industry is already familiar with and accepts.

3. The Board should prohibit fees from being charged prior to counseling.

Under the proposed rule, a creditor may accept an application for a reverse mortgage and begin to process the application (for example, by ordering an appraisal and title search) before the consumer has obtained the required counseling.³²⁹ In addition, a creditor may collect fees, including application fees, prior to the consumer receiving counseling. The proposed rule states that the fee is refundable if the consumer decides not to enter into a reverse mortgage transaction within three business days of having received counseling, but the originator only has the obligation to tell the borrower this through a single line at the end of the proposed three-page “Open-End Reverse Mortgage Early Disclosure Form.” Borrowers who do not carefully read the disclosures probably will not understand that the fees are refundable. Consequently, borrowers who pay early fees are likely to feel locked into paying those fees and therefore feel pressure to move forward with the reverse mortgage, even though the fees are refundable.

The proposed rule represents a significant step back from HUD’s current requirements and policies regarding reverse mortgages. Currently, the lender may not charge the borrower an application fee, an appraisal fee, or charge for any other HECM-related services prior to the completion of counseling: “The mortgagee may only proceed to process the initial HECM loan application once the counseling is complete, as evidenced by the signed and dated counseling certificate.”³³⁰

The practical impact of the proposed rule would be to severely limit meaningful consumer choice because many potential borrowers feel a sense of obligation to proceed with the transaction once the lender has incurred expenses and/or the consumer has advanced his/her own funds. The Board should prohibit creditors from collecting fees prior to counseling for all reverse mortgages.

4. The Board should allow for the completion of a reverse mortgage application only after counseling.

The Board states that “the proposed rule is intended to establish a bright line basis for determining the time by which counseling must have occurred – origination.”³³¹ This would allow originators to do everything except sign on the dotted line prior to counseling. This is contrary to the best interest of borrowers. Counseling is most effective when it is provided *before* a borrower speaks with an loan officer or broker, as counselors are truly independent and do not have a stake in the outcome of the loan, and counseling sessions include an overview of *all* the borrower’s options, not just a reverse mortgage. When

³²⁹ 75 Fed. Reg. 58539, 58711 (Sept. 24, 2010).

³³⁰ Dep’t of Housing and Urban Dev., Mortgagee Letter 2004-25 (June 23, 2004).

³³¹ 75 Fed. Reg. 58539, 58672 (Sept. 24, 2010).

counseling sessions take place after borrowers have had extensive dealings with originators, in particular after an application has been taken, they are not as useful, as these borrowers have been primed by the originator to request a reverse mortgage. Borrowers may not pay as much attention to or even dismiss information the counselor provides regarding alternatives to reverse mortgages. Originators may even provide borrowers with the answers to the questions counselors pose to determine whether a borrower understands the basics of a reverse mortgage, and thus borrowers who do not really understand what they are getting into may receive a counseling certificate.

The Board should make clear that counseling should happen early in the process, and certainly before an originator takes an application.

G. The Definition of Consumer Must Protect Non-Borrowing Spouses Who Might Relinquish Their Ownership Interest. (Proposed Regulation Z § 226.40(b)(7))

The Board proposes without explanation to revise the definition of consumer.³³² First, the Board proposes to require that counseling only be provided to borrowers who will be on the deed at the time the reverse mortgage is originated and second, to allow borrowers not obligated on the reverse mortgage to pay a non-refundable fee at any time even if the lender is prohibited from charging a non-refundable fee to the obligor on the reverse mortgage.³³³ These proposals are dangerous to consumers and would exacerbate the risks and complexities associated with reverse mortgages.

As we understand it, this proposal means that if one spouse was contemplating a reverse mortgage that would deprive the other spouse of his or her ownership interest in the home, the spouse who would lose the ownership interest would not need to be counseled about the risks of this decision. This is exactly the opposite direction on this issue from the one the Board should be taking. The Board should be prohibiting this activity altogether instead of enabling and facilitating it.

Similarly, if a lender stands to profit more from a reverse mortgage to the older spouse, the lender would be able to use this provision to its advantage by convincing the older spouse to be the sole borrower. This provision would then deprive the younger spouse even of the counseling necessary for her to understand the risk of the mortgage and the deprivation of her ownership interest. The Board does not explain how it reached this decision or how it can be legitimately in the interest of any of the parties to the transaction for a couple to proceed with a reverse mortgage that deprives one spouse of ownership, a step that creates risks over and above those of an ordinary reverse mortgage.

The removal of the younger spouse from ownership of a home may be a legitimate prerequisite to obtaining a reverse mortgage in some very few situations. It will generally provide for a larger line of credit and/or monthly payment or lump sum than a loan with two obligors of differing ages. If so, that is a decision that should be reached only after careful consideration by both spouses and with the benefit of counseling. As the Board has explained, one of the primary reasons for imposing a counseling requirement for all reverse

³³² See Proposed Reg. Z § 226.40(b)(7).

³³³ 75 Fed. Reg. 58539, 58553 (Sept. 24, 2010).

mortgages is that, “reverse mortgages are complex transactions, and even sophisticated consumers seeking reverse mortgages may not be sufficiently aware of the risks and obligations of reverse mortgages solely through the disclosures.”³³⁴

The decision to remove one spouse’s ownership interest layers an additional complicating factor for a couple considering a reverse mortgage. This situation is fraught with the opportunity for abuse and poses significant risks to the potential non-owner spouse, who will lose his/her home if the owner spouse predeceases him/her or needs to be placed in long term care or otherwise leave the home.³³⁵ The Board’s study did not consider the impact of eliminating the counseling requirement for homeowners who would lose their homeownership interest. The Board’s consumer testing also did not test reverse mortgage disclosures on couples, and in fact focused its study on homeowners who identified themselves as the decision-maker on mortgage issues.³³⁶ These apparently more sophisticated subjects still had considerable difficulty understanding the concept of reverse mortgage leading the Board to require counseling for all reverse mortgage borrowers. But the redefinition of consumer leaves a big hole in this process. The Board should delete its changed definition of consumer, ensure that all owners of the home are required to be provided counseling for a reverse mortgage – regardless of who eventually receives the loan – and prohibit the transfer of ownership interests from one spouse to the other in all but a few limited circumstances (see discussion in section I.2 regarding this recommended substantive limitation).

H. The Board’s Proposed Advertising Rules are Weak – Deceptive Advertising Should Be Banned. (Advertising Rules for Reverse Mortgage - § 226.33(e))

We appreciate the Board’s research into the problems of reverse mortgage advertising and agree with the premise that many reverse mortgage advertisements are misleading. An investigation by the GAO of HECM marketing materials found “examples of claims that were potentially misleading because they were inaccurate, incomplete, or employed questionable sales tactics.”³³⁷

The GAO report is consistent with the study published in the *Annals of the New York Academy of Sciences*, which found that 35-40% of seemingly healthy older adults had cognitive impairments significant enough to lead to bad decision-making.³³⁸ The study notes that “not only are older adults less likely to decipher implied claims, but older adults are more vulnerable to the ‘truth effect’ (the tendency to believe repeated information more than new information) because older adults have relatively poor context or source memory, but

³³⁴ 75 Fed. Reg. 58539, 58550 (Sept. 24, 2010); *see also id.* at 58665, 58669

³³⁵ *See* Norma Paz Garcia, Prescott Cole, Shawna Reeves, *Examining Faulty Foundations in Today’s Reverse Mortgages*, Consumers Union, at 27 (December 2010);

³³⁶ *See* ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Reverse Mortgages, at ii (July 2010).

³³⁷ Government Accountability Office, *Reverse Mortgages: Product Complexity and Consumer Protection Issues Underscore Need for Improved Controls Over Counseling for Borrowers*, GAO-09-606, at 8 (June 2009) available at <http://www.gao.gov/new.items/d09606.pdf>, at 19.

³³⁸ Natalie L. Denburg, Catherine A. Cole, Michael Hernandez, Torricia H. Yamada, Daniel Tranel, Antoine Bechara, and Robert B. Wallace, “The Orbitofrontal Cortex, Real-World Decision Making, and Normal Aging,” *Annals of the New York Academy of Sciences*, December 2007.

relatively intact familiarity of repeated claims.”³³⁹ This leads them to be more likely to believe inaccurate claims in advertisements, even when presented with new information. In the context of reverse mortgages, if prospective borrowers have repeatedly heard false claims from advertisements, seminars, and the like, the counseling session is unlikely to disabuse them of the incorrect information. It becomes even more important in this context to regulate how advertisers and marketers describe reverse mortgages.

Unfortunately, the Board’s proposed advertising rule is weak and would not adequately address these concerns. The rule does not cover a broad enough range of advertising and marketing; for example, many seniors find out about reverse mortgages through marketing seminars that offer free meals. We also are very concerned with the statements that the proposed rule would allow; many of the statements for which the Board requires a “clarifying statement” are in fact not true.

1. The rule should cover a broader range of advertising and marketing materials.

The proposed rule would create new advertising standards for “any advertisement for a reverse mortgage, including promotional materials accompanying applications.”³⁴⁰ We urge the Board to clarify that for these purposes, marketing seminars or lunch and dinner events in which seniors are offered information about reverse mortgages are included in this definition. Such seminars, lunches, and dinners are a key way that older homeowners are offered misinformation about reverse mortgages. For example, the Federal Bureau of Investigation issued an alert in 2009 stating the following:

Unscrupulous loan officers, mortgage companies, investors, loan counselors, appraisers, builders, developers, and real estate agents are exploiting Home Equity Conversion Mortgages (HECMs) – also known as reverse mortgages – to defraud senior citizens. They recruit seniors through local churches, investment seminars, and television, radio, billboard, and mailer advertisements, and commit the fraud primarily through equity theft, foreclosure rescue, and investment schemes. HECM-related fraud is occurring in every region of the United States, and reverse mortgage schemes have the potential to increase substantially as demand for these products rises in demographically dense senior citizen jurisdictions.³⁴¹

2. The rule should bar inaccurate statements from advertising and marketing materials.

Throughout the detailed summary of the rule, the Board provides evidence that reverse mortgage advertising includes deceptive and in some cases patently false statements. We support a few of the proposed rules in this area. Unfortunately, however, overall the rule would do more harm than good by explicitly allowing advertising and marketing

³³⁹ Id. at 7.

³⁴⁰ 75 Fed. Reg. 58539, 58709 (Sept. 24, 2010).

³⁴¹ “Home Equity Conversion (Reverse) Mortgages Exploited to Defraud Senior Citizens,” Federal Bureau of Investigation Bulletin, 3/24/09. Available at: http://www.fbi.gov/scams-safety/fraud/seniors/intelbulletin_reversmortgages.

materials to include inaccurate statements as long as some “clarifying information” is provided. Instead, the Board should ban the inaccurate statements altogether.

a. HECM as a “government benefit”

The Board should ban advertisements which describe a HECM as a “government benefit.” Instead, under the current proposal, as long as this statement is paired with a statement “that a reverse mortgage is a loan that must be paid back,”³⁴² this deception seems to be permitted. Although HECMs are backed by FHA, the government provides no subsidy to the program. The GAO report makes this same point: “While HECMs are government-insured, the product is a loan that borrowers or their heirs must repay, not a benefit.”³⁴³ If the borrower sells the home and the proceeds do not cover the cost of the loan, FHA does pay the difference, but it uses monies funded through borrower-paid mortgage insurance premiums to do so.

It is therefore puzzling why the Board would allow an advertisement to call the program a government benefit, even with the clarifying statement. The Board should simply prohibit the description of a HECM as a government benefit.

b. Reverse mortgage having “no payments for life”

The Board’s rule would allow advertisers to state that there is “no payment for life” as long as they include a clarifying statement that “a reverse mortgage will end sooner in certain circumstances,” including sale of the home and moving out for a specified time period.³⁴⁴ As the Board itself points out, borrowers face foreclosure if they do not pay taxes or required insurance,³⁴⁵ or if they fail to properly maintain the property. In addition, as the Board also points out, the loan must be repaid if the borrower(s) move out for one year, before the end of their lives.

The statement that reverse mortgages have “no payments for life” also implies that a reverse mortgage is “free money” that does not ever have to be repaid; it is especially pernicious when paired with the claim that it is a “government benefit,” as borrowers are led to believe that the government is giving them a free ride. Rather than allowing advertisers to make false claims that will inevitably mislead consumers (even with clarifying statements), the board should simply prohibit them from doing so.

³⁴² 75 Fed. Reg. 58539, 58709 (Sept. 24, 2010).

³⁴³ Government Accountability Office, *Reverse Mortgages: Product Complexity and Consumer Protection Issues Underscore Need for Improved Controls Over Counseling for Borrowers*, GAO-09-606, at 8 (June 2009) available at <http://www.gao.gov/new.items/d09606.pdf>, at 21.

³⁴⁴ 75 Fed. Reg. 58539, 58709 (Sept. 24, 2010).

³⁴⁵ The Board separately adds the requirement that advertisements disclose that payments for taxes and insurance are required if the advertisement states that payments are not required. Although we would affirm an affirmative requirement for advertisements to highlight that borrowers are responsible for taxes and insurance, we once again believe that a statement that payments are not required is misleading and simply false.

c. “Cannot lose your home”

The Board proposes to allow advertisers to state that there is “no risk” to losing a home through a reverse mortgage as long as the statement is paired with a clarifying statement. Instead, the Board should simply ban the statement, as it is patently false, since foreclosure is possible for failure to pay taxes or insurance and failure to maintain the property. In fact, foreclosures are a looming problem with this product; an August 2010 report from HUD’s Office of the Inspector General found that almost 13,000 HECMs serviced by just four companies are in default for failure to pay taxes and insurance and are therefore at risk of foreclosure.³⁴⁶ Now seems like a terrible time for the Board to sanction misleading statements about the risk of foreclosure in reverse mortgage advertisements. Instead, the Board should prohibit describing a reverse mortgage as a loan that does not have to be repaid in a borrower’s lifetime or that a borrower cannot lose his or her home.

d. “Government limits fees”

The Board correctly points out that advertisements claiming that the government limits fees may mislead consumers into thinking that the government has fixed the cost of the loan and that they cannot negotiate. Although HERA does limit origination fees for HECMs specifically, origination fees on proprietary loans are not limited. In addition, non-origination fees, such as the margin added to the indexed interest rate by the lender, are not mandated by the government for any loans.

Given this, the Board should not allow the statement “the government limits the fees charged” in an advertisement, even with a clarifying statement that fees are negotiable. Instead, the Board should prohibit such a statement, or limit it to the following verbatim: “The government has limited the maximum origination fee that may be charged for Home Equity Conversion Mortgages. This fee can still vary by lender, so it makes sense to shop around.”

e. “Never owe more than your home is worth”

The Board rightly points out that advertisements provide misleading information about the non-recourse nature of the loan, as borrowers or their heirs can end up paying the full amount of the loan, even if it is more than the value of the home, if they choose to pay off the loan without selling the home. This is a problem that we hope that HUD will fix for HECMs, as we do not believe it is consistent with Congressional intent. For recourse mortgages, which the Board proposes to allow, this statement is patently untrue and should be barred. The risk of confusion engendered by the Board’s proposal to allow recourse mortgages to be identified as “reverse” comes into sharp focus when considering this “promise.”³⁴⁷

f. “Does not affect eligibility for government benefits”

³⁴⁶ Audit Report from Gerald R. Kirkland, Office of the Inspector General for the Department of Housing and Urban Development (HUD), to Vicki B. Bott of HUD, 8/25/10, available at <http://www.hud.gov/offices/oig/reports/files/ig1060003.pdf>.

³⁴⁷ See section IV. D, *supra* discussing the dangers of the Board’s proposed changes on recourse mortgages.

As the Board states, advertisements that state that reverse mortgages do not affect eligibility for government benefits are not accurate. Although reverse mortgages do not affect eligibility for Social Security and Medicare, large draws from reverse mortgages can render borrowers previously receiving SSI and Medicaid ineligible for these programs. Misleading statements about the impact on eligibility for government benefits are especially concerning today, when 70% of reverse mortgages are fixed-rate loans that require a full draw at closing and could potentially render borrowers ineligible for some programs.

We appreciate the Board's requirement that any such statement must mention that reverse mortgages can render borrowers ineligible for Medicaid and SSI specifically. In addition, we hope the Board will prohibit a broad statement such as "reverse mortgages do not affect eligibility for government benefits" even with the clarifying language; instead, the statement should say exactly what programs are not affected. Any statement should also suggest talking to a mortgage counselor about the issue.

Following is an example of an adequate statement in this area: "Reverse mortgages do not affect your eligibility for Social Security and Medicare. They can, however, affect your eligibility for some government benefits, such as Medicaid and Supplemental Security Income (SSI). If you qualify or receive Medicaid or SSI, careful planning is needed to remain eligible if you take out a reverse mortgage. Talk to your reverse mortgage counselor about this."

g. The rule should bar misrepresentations about government affiliation

The rule should also bar advertisements that imply a government endorsement of or affiliation with the loan. The GAO review of advertisements found that some were deceptive and misleading through the inclusions of government symbols or logos, and the FTC has received complaints about HECM advertisements that appear to be from government agencies.³⁴⁸ Today, borrowers receive letters in the mail that appear to be solicitations directly from the government but are in fact advertisements.³⁴⁹ The Board should bar the use of government symbols and logos, or any text that might make someone think that the government is the lender or the government has endorsed a product.

h. Counseling

We support the Board's requirement that an advertisement containing a reference to counseling must also provide the proper phone number and website for finding HUD-approved counselors.

³⁴⁸ Government Accountability Office, *Reverse Mortgages: Product Complexity and Consumer Protection Issues Underscore Need for Improved Controls Over Counseling for Borrowers*, GAO-09-606, at 8 (June 2009) available at <http://www.gao.gov/new.items/d09606.pdf>, at 22.

³⁴⁹ For an example, see *id.* at 23.

I. The Board Should Exercise Its Unfairness Authority More Aggressively.

The dangers of reverse mortgages are well documented. The Board – and, in the future, the Consumer Financial Protection Bureau – should exercise their respective authorities to mandate fair procedures in the reverse mortgage market. Our suggestions follow.

1. The Board should require creditors to assess whether the borrower has the resources to pay property taxes and insurance.

As the Board acknowledged, elders are at serious risk of losing their home due to defaults on their property taxes and insurance.³⁵⁰ Elder advocates report that older homeowners with reverse mortgages are struggling to pay their ever increasing property taxes and insurance as the price of other goods and services and medical care rises. Others may not understand that they have an obligation to pay the property taxes and insurance. The Board’s testing revealed that some consumers do not understand that the reverse mortgage loan would come due if they failed to pay insurance and taxes.³⁵¹

We are encouraged that HUD will revisit this issue in the near future. We urge the Board to do the same. Simply addressing the concerns about consumer defaults for failure to pay property taxes and insurance through the proposed disclosure and advertising rules is not adequate.³⁵² Instead the Board should require that creditors who originate reverse mortgages assess the borrower’s available resources to ensure that the borrower can pay taxes and insurance after they receive the loan proceeds. It makes little sense to originate the loan if the elder will soon default because he or she runs out of money to pay property taxes or insurance. The Board should also consider requiring creditors of proprietary mortgages to adopt HUD’s rules on set-asides, which, if the borrower so elects, will have a portion of the monthly payments set aside to pay property charges.

2. The Board’s should impose substantive protections for the non-borrowing spouses of reverse mortgage borrowers.

As discussed more fully above, non-borrowing spouses are increasingly being forced out of their homes upon the death of the mortgagor-spouse.³⁵³ Lenders and brokers encourage the non-borrowing younger spouse (generally the wife) to deed over her share of the house to the husband prior to originating a reverse mortgage so that more funds will be available from the loan. According to officials at HUD, who are receiving a lot of complaints, “these borrowers were told the loan was assumable, or a loan officer said that it was alright to remove a spouse from title because they could refinance or add the spouse

³⁵⁰ See 75 Fed. Reg. 58539, 58678 (Sept. 24, 2010).

³⁵¹ See ICF Macro, Summary of Findings: Design and Testing of Truth in Lending Disclosures for Reverse Mortgages, at 14 (July 2010).

³⁵² See 75 Fed. Reg. 58539, 58678 (Sept. 24, 2010).

³⁵³ See Norma Paz Garcia, Prescott Cole, Shawna Reeves, *Examining Faulty Foundations in Today’s Reverse Mortgages*, Consumers Union, at 19 (December 2010); *As Complaints Increase, HUD to Address HECM Non-Borrowing Spouse Issue*, Reverse Mortgage Daily, Apr. 29, 2010, available at <http://reversemortgagedaily.com/2010/04/29/as-complaints-increase-hud-to-address-hecm-non-borrowing-spouse-issue/>

back to title later without any problem.”³⁵⁴ These blatant misrepresentations echo some of the promises that brokers made during the subprime boom. The result of this strategy, of course, is that when the older spouse dies, the younger spouse is not only widowed, but now with substantially reduced income and possibly homeless.

The non-borrowing spouse is at a particular disadvantage in the loan process. HUD’s HECM program does not require the non-borrowing spouse to receive counseling.³⁵⁵ Thus, the non-borrowing spouse may not be told of or understand the risks posed by quitclaiming his or her interest in the home. The eviction from the home puts the non-borrowing spouse, mainly women, at risk not only for homelessness, but premature entry into long-term care facilities, like nursing homes. The premature displacement of elders is clearly counter to the purpose of the reverse mortgage product, and to public policy, which supports having older Americans “Age in Place” and should simply be banned.

The rule should be simple: If a couple is married when the reverse mortgage is originated, the life expectancy runs for the youngest member of the couple, and the termination of the reverse mortgage for death applies to both spouses *regardless of who actually owns the home*. This resolution furthers the traditional and sensible homestead rule of preserving the home for the spouse after widowhood, regardless of legal ownership of the home.

V. THE PROPOSALS REGARDING REFUNDABLE FEES AND OTHER MDIA-RELATED CHANGES SHOULD BE FINALIZED WITH SOME MODIFICATIONS.

A. Fees Should Be Refundable From Early Disclosure Until the Three-Day Right of Rescission Expires.

We support the Board’s proposed changes to Reg. Z § 226.19(a) on refundable fees related to Mortgage Disclosure Improvement Act early disclosures.³⁵⁶ However, we request that the period for refunding be extended for consumers who avail themselves of the three-day right of rescission so that such consumers do not face an “on-off-on” rhythm regarding fee refunds.

While the new rule on refunding of fees may foster better comparison shopping, the removal of the payment schedule in the Board’s recent MDIA rulemaking will drastically undermine the usefulness of any information provided in these early disclosures. We

³⁵⁴ *As Complaints Increase, HUD to Address HECM Non-Borrowing Spouse Issue*, Reverse Mortgage Daily, Apr. 29, 2010, (statement of Erica Jessup, Program Specialist at the Dep’t of Housing and Urban Dev.) available at <http://reversemortgagedaily.com/2010/04/29/as-complaints-increase-hud-to-address-hecm-non-borrowing-spouse-issue/>

³⁵⁵ Dep’t of Housing and Urban Dev. Mortgagee Letter 2006-25 (Sept. 28, 2006) (HUD recommends but does not require counseling for the non-borrowing spouse who quitclaims their interest in the property).

³⁵⁶ 75 Fed. Reg. 58539, 58588 (Sept. 24, 2010).

addressed the removal of the payment schedule and other proposed changes in our comments submitted under the MDIA rulemaking, Docket No. R-1366.³⁵⁷

The Board proposes to provide consumers a right to a refund of fees for three business days after the consumer receives early disclosures for closed-end mortgages.³⁵⁸ Such a refund would be provided if the consumer decides not to proceed with the transaction. The early disclosures are mandated under the Mortgage Disclosure Improvement Act's amendment to TILA Section 129(b)(2), which prohibits charging any fee, except for a bona fide and reasonable fee for obtaining credit history, prior to the good faith TILA estimates provided within three business days after receipt of a consumer's application and at least seven days business before consummation.

The Board observes that this rule will ensure that consumers "do not feel financially committed to a transaction before they have had a chance to review the disclosures and consider other options." Currently, a fee may be charged as soon as the early disclosures are provided. Consumers are likely to feel financially committed once they have paid money, even though they have not had the opportunity to review the disclosures.

The fee restriction was created to ensure that consumers feel free to comparison shop before incurring fees such as application fees, appraisals and rate lock fees. The establishment of a refund period after early disclosure better enables this intent to be implemented. The consumer will be free to review the early disclosures free of a feeling of financial commitment to this particular transaction. The fees would be refundable if a consumer decides not to proceed with the transaction during the three business days following receipt of the early disclosures.

We support the Board's proposal for the reasons discussed above. It is also essential that the proposal's coverage of both creditor and third-party fees be maintained. Third party fees are a significant cost to real estate consumers and the incurring of a nonrefundable fee will substantially affect a consumer's options and review of the loan. Further, as the Board notes, this right already applies to HELOC loans. Extending it to closed end mortgages better fulfills the MDIA's goals of providing meaningful and usable early disclosures, as well as the core purposes of TILA—transparency and informed shopping. It will also provide greater market uniformity. The Board properly concludes that the rule will better protect consumers than RESPA, which allow an originator to impose a nonrefundable fee as soon as the consumer receives early RESPA disclosures and has agreed to go forward with the transaction.

The Board asks whether the fee structure of closed end mortgages makes the proposed rule difficult for compliance purposes. While creditors generally have been free to structure their process and the timing of their fee generation with little oversight, the delay is

³⁵⁷ http://www.nclc.org/images/pdf/foreclosure_mortgage/predatory_mortgage_lending/comments-mortgage-disclosure-act.pdf.

³⁵⁸ The Board takes the reasonable position that a bona fide and reasonable fee for obtaining the consumer's credit history is not required to be refundable under this rule, since it is also permissible to charge such a fee prior to the early disclosures (when other fees may not be imposed at all). Such a fee is necessary in order to obtain key information for providing meaningful early disclosures.

only three days. This is not significant, especially when the bona fide emergency exception exists. Any inconvenience or even delay in a lock-in is outweighed by the substantial improvement to transparency and shopping provided by the proposed rule. The Board notes that creditors may refrain from imposing any fees (and thus refrain from doing an appraisal or a rate lock) until four days after a consumer receives the early disclosures, to avoid having to refund fees. Yet, this is only about a week after initial application and thus rarely will it have any substantial effect on the timeline for processing a consumer's application.

While we support this improvement upon the fee rule under MDIA, we strongly encourage the Board to create more consistency regarding the refundable fee timeline for homeowners who have the three-day right of rescission. Under the proposal, the period for refunding of fees extends to the third day after receipt of the early disclosures. Accordingly, a homeowner who receives the early disclosures in person has the right to a refund of fees for the first three days of the (at least) seven day period prior to consummation. Homeowners obtaining refinancings, however, will again have this right, in the form of the three-day right of rescission upon consummation. Thus, the consumer has a refund donut hole—three days with the right to a refund, followed by a period of at least four days without it, and then three more days after consummation. This same donut hole is less pronounced for refinancing consumers who receive their early disclosures by mail, since the refund period will last for six of the at-least seven days prior to consummation. For both groups, however, this on-off-on refund situation is likely to generate confusion—the type of confusion that is not easily explained in a disclosure. Worse, it may actually undermine the three day right of rescission if homeowners believe their right to a refund terminated three days after the early disclosures, if they do not realize it is essentially revived upon consummation.

In order to preserve the effectiveness of the statutory three-day right of rescission, we recommend that the Board provide that homeowners eligible for rescission retain the right to a refund of fees from the time of the early disclosures through consummation and then through the three day right of rescission—uninterrupted. This will reduce confusion and ensure that there is no inadvertent interference with the three day right of rescission. It does not appear that any consumer testing was done on this issue and thus taking the risk of consumer confusion is unwarranted, especially as the credit markets begin to re-establish themselves and consumers find themselves faced with a fresh-looking set of options.

While homeowner's without the right of rescission (home purchase borrowers—a key portion of the market, especially after the current foreclosure crisis) would not face the roller coaster of “refund-no refund-refund” (because the later refund would not be available after consummation as part of the three-day right of rescission), limiting the refund to three days may inadvertently encourage creditors to game the system. When nonrefundable fees are charged on day four after the refundable fee period expires, homeowners may pass a mental boundary and decide they are now committed to the transaction (even if disclosures tell them they are not yet committed). A creditor then would be able to redisclose with significant cost increases, and the nonrefundable fees might limit a consumer's view of whether she can withdraw from consummating the loan. While the chance for redisclosure with higher fees has always been a possibility in the early disclosure regime, the addition of refundable fees for only a portion of that period, may create a new and troublesome

dynamic. We strongly support the inclusion of all consumers (including those without the right to rescind) within the new rule on refundable fees while raising this question regarding how to minimize destructive incentives.

The Board also proposes a brief disclosure at application regarding the right to refundable fees after the early disclosures. While advance notice is helpful so homeowners (if they receive and read such a disclosure) will know they can shop without incurring substantial non-refundable costs, such a disclosure also should be provided with the transaction-specific early disclosures, which is the time when the right is actually triggered. We recommend that the Board test such a disclosure, although the plain language proposed by the Board lays out the issues well. In addition, the Board proposes using the precise definition of “business day” for applying the refundable fee rule. We support this approach, as it provides uniformity and predictability. The instances where an office will be closed when the rule assumes it is open will be limited. It is likely that more opportunities to transact with the creditor will be available, due to the internet and other customer service developments. For parties seeking to enforce or monitor compliance with the rule after-the-fact, a uniform rule also will enable better enforcement and compliance.

B. Whether a Fee Has Been Imposed Should Be Determined By Whether a Consumer Is Obligated.

We strongly support the Board’s realistic definition of “imposing” a fee in the proposed changes to OSC § 226.19(a)(1)(ii)-4,³⁵⁹ as it relates to the requirement to provide early disclosures prior to imposing any fees except one for checking credit history.³⁶⁰ The proposal includes added commentary with examples of when a fee is imposed.³⁶¹ Proposed OSC § 226.19(a)(1)(ii)-4, with one small exception described below, is essential because it clarifies that whether a consumer is obligated determines whether a fee has been imposed. Thus the comment explains that a fee is considered to have been imposed if a consumer is obligated to pay a fee or pays a fee, even if the fee is refundable. As the Board notes and has noted in the past, limiting the fee restriction to nonrefundable fees would undermine the intent of the rule. While the Board now adopts rules regarding refunding of fees imposed after the early disclosures, the whole point of the disclosures is that they occur before the homeowner has a sense of obligation that would limit shopping. Thus, the question at the

³⁵⁹ 75 Fed. Reg. 58539, 58587 (Sept. 24, 2010).

³⁶⁰ While we welcome the Board’s inclusion of reverse mortgages in portions of this refundable fee rule, including the proposal to prohibit the imposition of a nonrefundable fee for three business days following the consumer’s completion of required counseling, we address the Board’s proposed rules regarding reverse mortgages in Section IV. of these comments.

³⁶¹ The Board separately seeks to clarify the comment regarding compliance for subsequent creditors with the rule regarding imposition of fees and early disclosures. The Board proposes to revise comment 19(a)(1)(ii)-3.iii to make clear that not only a second creditor, but any subsequent creditor receiving an application through a third party where the consumer previously paid fees in connection with other application through that same third party that were denied or withdrawn, complies with the MDIA rule regarding imposition of fees if it does not collect or impose any additional fee, other than for obtaining a credit history, until the consumer receives any early mortgage loan disclosure from the new creditor. The subsequent creditor is not precluded from accepting the consumer’s application even though the consumer may have paid fees to other creditors through the same broker or other third party. This is a reasonable clarification, provided the broker is not simply submitting additional applications for the primary reason to increase the broker’s income from the fees.

moment of early disclosure is not whether the fees are refundable but whether they have been incurred in any fashion.

The Board further provides clarification in Proposed OSC § 226.19(a)(1)(ii)-4 that a fee has been imposed when a consumer provides to a creditor or other party a negotiable instrument. The Board notes that this applies whether or not the check is post-dated and/or the creditor agrees to wait until the consumer receives the disclosures to deposit the check. This is an important clarification because, as the Board notes, under U.C.C. 4-401(c) post-dating does not prevent the creditor or other party from depositing the check immediately unless a consumer has given the bank notice of such post-dating and describes the check with reasonable certainty. Turning back to the mindset of the shopping consumer, the Board rightly notes that, in addition, providing the check is an act that itself may feel like a financial commitment.

The Board also proposes a comment that states that a fee is imposed if a creditor uses a consumer's credit card or debit card to initiate payment or if the creditor places a hold on the consumer's account.³⁶² As with the check example, initiation of payment or placing a hold does limit the consumer's ability to apply for multiple mortgages simultaneously, which defeats the entire purpose of the early disclosure rule.

The Board proposes to draw a line where a creditor accepts account information but does not initiate a charge. While this lesser act does not directly limit credit availability, it certainly shares one characteristic with other actions categorized as an imposition of a fee: the consumer likely feels that a financial commitment has been made, even if payment has not been initiated. While it is true, as the Board notes, that many applications require provision of account information, the point of providing such information is that the provider is assuming the account information will be used to obtain payment. We recommend that this portion of the comment be altered to align with the rest of the comment.

Of course, the Board's proposal to revise OSC § 226.19(a)(1)(ii)-1 regarding the timing of fees to cross-reference the right to a refund of fees is a helpful improvement.

Finally, the Board proposes to clarify that certain bona fide and reasonable counseling-related fees required by applicable law are not a "fee" for purposes of § 226.19(a)(1)(ii). Thus, a counselor or counseling agency may charge a bona fide and reasonable fee for housing counseling required for a reverse mortgage insured by HUD or other housing or credit counseling required by applicable law before the consumer receives the early disclosures. As the Board notes, counseling is intended to help a consumer avail herself of available disclosures and other information in order to make better-informed credit decisions. Thus, allowing such a fee to be imposed in these limited circumstances will further the purposes of the early disclosures. The fee is paid directly to the non-profit counseling agency and is less likely to be viewed as a financial commitment to a particular transaction. Lenders are not permitted to accept payments for counseling or to pay counselors. The Board asks whether other fees should be exempted. The hard rule about providing early disclosures before imposition of fees should not be watered down by an

³⁶² Proposed OSC § 226.19(a)(1)(ii)-4.

expansion of exceptions. Doing so would defeat the purposes of the early disclosures and the statute itself.

The Board asks whether the proposed commentary on imposition of a fee properly balances consumer convenience and ability to shop among loan offers without feeling financially committed to a particular transaction. As the Board observes repeatedly, the goal of the MDIA early disclosures, and the related limitation on imposition of fees, is to allow for shopping and the mental freedom to view other options as still available at the time of reviewing the early disclosures. The Board's comments further this goal because they take a realistic view of whether a consumer will feel committed if they have provided access to their own funds, whether or not they are refundable. The addition of the requirement, above, to charge only refundable fees for three days after receipt of the early disclosures enhances this approach by ensuring that the consumer can review early disclosures with the notion that other options are still available. Moreover, this limitation only applies for the three days after application when the early disclosures are provided. It is appropriate at this stage for the creditor to refrain from causing the homeowner to incur significant costs. As the Board notes, some creditors will simply delay charging the fees at all until the refund period is over. In addition, especially because of the availability of the bona fide emergency exception, creditors will have plenty of time to process transactions for homeowners taking the traditional route. The small wait will translate into a more transparent market where the bargaining relationship between consumers and creditors is less unequal.

C. Redisdisclosure Should Include Fully Revised Forms and Accompanying Annotation.

The Board proposes to clarify that the special mortgage tolerances under Reg. Z § 226.22(a)(4) & (5) apply to early APR disclosures when determining whether redisdisclosure is required, a clarification that lends consistency to implementation.³⁶³ The Board further proposes to state in OSC § 226.19(a)(2)(iii)-2 that if a complete set of new, corrected disclosures is not provided at the time of redisdisclosure under Reg. Z § 226.19(a)(2)(iii) as required under Alternative 2, corrected disclosures must contain both the changed terms and certain previously proposed general disclosures, including those regarding “no obligation,” security interest, “no refinance guarantee” and tax deductibility, rather than only the changed terms, as required in the current rule.³⁶⁴ While we support adding these disclosures to the corrected disclosures if not complete, we recommend that the Board require full redisdisclosure (rather than just allowing it as an alternative), in order to facilitate optimal comparisons of information. For the untrained eye, finding key pieces of information on complex disclosures is not necessarily easier than receiving the whole disclosure again with certain items highlighted.

³⁶³ 75 Fed. Reg. 58539, 58592 (Sept. 24, 2010). We discuss the new proposal regarding tolerances in Section II of these comments.

³⁶⁴ 75 Fed. Reg. 58539, 58592 (Sept. 24, 2010).

D. The Waiver Rules Should Remain Narrow, However They Should Never Apply to the Three-Day Redisdisclosure Rule.

The Board also proposes additional guidance on waivers of the waiting periods under Reg. Z § 226.19(a)(3) and OSC § 226.19(a)(3)-1.³⁶⁵ We support the clarification that a consumer can only waive a waiting period after receipt of the required disclosures, rather than after the creditor makes them. We also support the Board's emphasis that a bona fide personal emergency typically involves imminent loss of or harm to a consumer's dwelling or imminent harm to the health or safety of a consumer.³⁶⁶ In fact, it is not clear that the "not always" proviso is useful if it encourages a too-broad reading of the bona fide emergency provision.

However, as we have said elsewhere, we do not believe the statute supports waiver of the three-day waiting period after redisdisclosure at all. Allowing this essentially allows a homeowner to enter into a transaction without the benefit of knowing whether there has been a bait and switch. In fact, such a policy encourages this practice. The final redisdisclosure period guarantees consumers a three-day cooling-off period (or a final shopping period), before they are obligated on the note, should the lender change the APR between application and closing. This is a critical period of time that allows the borrower to look for alternatives if the lender changes the loan terms from what the borrower bargained for. In addition, failure to require redisdisclosure before consummation when the early disclosures are inaccurate undermines the validity of early disclosures. Without mandatory redisdisclosure before closing, lenders have no incentive to deliver accurate early disclosures, making a mockery of TILA's core purposes of market efficiency and transparency. A homeowner will know if there is an emergency at the time of application. Allowing waiver only of the three-day redisdisclosure allows a creditor to lean on a homeowner to waive this period. Creditors can easily manage to make timely redisdisclosures in the rare instances when redisdisclosure is required without occasioning a delay in the consummation. The Board should not excuse creditors from compliance with the statute.

E. The Closed-End ARM Index Should Be Outside of the Creditor's Control and Should Be Publically Available, Without The Broad Exception Adopted by the OCC and OTS.

We support the Board's proposal to expand existing rules on control and availability of an index to closed-end ARMs, thus requiring that the index for an adjustable rate mortgage be outside the creditor's control and publically available.³⁶⁷ Such an addition will limit volatility (to some extent) and create more publically available and transparent loan transactions. Expanding this rule also will bring uniformity with TILA's rule on this issue regarding open-end ARMs. Moreover, it is too easy for a creditor to manipulate the cost of funds with its own actions and an internal index is never transparent. As the Board notes, the OCC and OTS already have adopted rules that require the index to be outside of the creditor's control and that bring with it the ability of a consumer to verify the index independently. We do not support an exception, however, such as the one OCC and OTS

³⁶⁵ 75 Fed. Reg. 58539, 58592 (Sept. 24, 2010).

³⁶⁶ 75 Fed. Reg. 58539, 58593 (Sept. 24, 2010).

³⁶⁷ 75 Fed. Reg. 58539, 58593 (Sept. 24, 2010).

have established, which allows that an index violating these rules can be used if the creditor notifies the regulator and the regulator raises no supervisory concerns or issues of law or policy. Such an exception could potentially swallow the rule and makes consistency more difficult.

F. Early Disclosures Should Be Provided To Each Consumer With the Right to Rescind.

The Board proposes to clarify to which consumers MDIA disclosures must be made when multiple consumers are involved. Proposed OSC § 226.19(a)-1 states that creditors should utilize comment 17(d)-2 to determine to which consumers a creditor must provide the required disclosures.³⁶⁸ That comment provides that while final disclosures and the notice of right to cancel must be provided to every party with the right to rescind, the early disclosures only need to be provided to one consumer who will have primary liability on the obligation.

The Board should require that each consumer must receive the early disclosures if they have a right to rescind. Just as each party who can rescind should get a disclosure, with early disclosures, each party has the right to review the disclosures and analyze the transaction in the context of the shopping process. Further, some co-borrowers may not reside together and thus can not easily share one set of disclosures. Moreover, requiring the creditor to essentially “make the copies” instead of the consumer makes the whole process more manageable for the consumer (while creating little burden for the creditor). It also is more efficient because it provides for earlier provision of information to the consumers.

VI. THE BOARD’S PROPOSED REVISIONS TO THE TREATMENT OF LOAN MODIFICATIONS COULD, IF REVISED, BE BENEFICIAL.

The Board proposes to require new disclosures for some creditor modifications. This would be a welcome step forward. Existing modification programs result in significant changes in the payment terms, the amount owed, and the interest rate, without standardized disclosure. The government’s flagship program, HAMP, routinely creates large balloon payments without any disclosure to consumers whatsoever.

Under the Board’s proposal,³⁶⁹ new disclosures will be required when the following terms of a mortgage are modified by the same creditor and same consumer: (a) increasing the loan amount; (b) imposing a fee on the consumer in connection with the modification, (c) changing the loan term; (d) changing the interest rate; (e) increasing the periodic payment amount; (f) adding an adjustable-rate feature or other risk features listed in § 226.38(d)(1)(iii) or (d)(2); or (g) adding new collateral that is real property or a dwelling. These are appropriate term changes that should trigger new disclosures. However, we believe that the scope of the proposed rule should not be narrowed by several limitations contained in the proposed Commentary.

³⁶⁸ 75 Fed. Reg. 58539, 58756 (Sept. 24, 2010).

³⁶⁹ Proposed Reg. Z § 226.20(a).

What the Board giveth, the Board taketh away, however. The Board’s proposed exceptions—for modifications that occur as part of a court proceeding, that happen when the homeowner is in default, or that result in a lowered interest rate— could swallow the general rule. Unless the Board changes the definitions employed in these exceptions, borrowers will continue to enter into modifications without knowledge as to the terms of those modifications.

The Board appears to misapprehend the pernicious role of fees. Fees are a common source of abuse in mortgage servicing. Disclosure must be required when fees, earned or unearned, finance charge or non-finance charge, are present.

A. Coverage of “Same Creditor” Modifications Will Be an Improvement.

The Board’s Proposed Reg. Z § 226.20(a) to expand coverage of the subsequent disclosure requirements to include a mortgage modification by the same creditor could provide important information to consumers. The “refinancing” approach taken in current Regulation Z, which turns on whether an existing obligation is satisfied and replaced with a new obligation as determined by state law, excludes most mortgage modifications from disclosure requirements. The Board properly proposes that, for mortgage transactions, this standard should be replaced with one that applies more broadly to modifications of mortgage terms by the same creditor.

The Board appropriately proposes to define “same creditor” for purposes of this rule to mean the current holder of the mortgage or a servicer acting on behalf of the current holder.³⁷⁰ Most consumer mortgages are assigned by the original creditor soon after loan origination. The current holder of the mortgage or its servicer would be the party most likely to enter into a loan modification. In fact, for mortgages that have been securitized and are held by a trust on behalf of investors, the servicer generally will have primary responsibility for negotiating the modification and providing any required disclosures. For example, loan modifications under the Home Affordable Modification Program (HAMP) may be obtained only through a participating servicer.³⁷¹

B. The Proposed Commentary Inappropriately Narrows the Scope of the Loan Modifications for Which Disclosures Would Be Required.

1. The proposed Commentary inappropriately excludes earned unpaid non-finance charges and certain payments into escrow in determining whether the loan amount has increased.

In determining whether there has been an increase in the loan amount as part of a modification under Proposed Reg. Z § 226.20(a)(1)(i)(A), the Board is proposing that the new loan amount would include any cost of the transaction that is financed, but would exclude any capitalization of arrearages and funds advanced for escrow accounts. With respect to arrearages, Proposed OSC § 226.20(a)(1)(i)(A)–1 states that an increase in the loan amount occurs when the new loan amount exceeds the unpaid principal balance plus any

³⁷⁰ Proposed Reg. Z § 226.20(a)(1)(iii).

³⁷¹ See Making Home Affordable Program, Handbook for Servicers of Non-GSE Mortgages.

earned unpaid finance charge or earned unpaid non-finance charge on the existing obligation. We urge the Board to reconsider the inclusion in this formula of earned unpaid non-finance charges.

In the case of a modification entered into to avoid a foreclosure, the amount of pre-modification expenses related to foreclosure, which may include attorneys' fees, advertising costs, appraisal fees, property maintenance costs, court costs, and auctioneer fees, can be quite substantial. The capitalization of these advances can add thousands of dollars to the new loan amount. In many cases, these foreclosure-related advances will far exceed the amount of any transaction costs for the modification. Moreover, these fees are themselves often inflated. For example, a Maine practitioner reported to us recently that a servicer charged a homeowner \$600 for each of the several times the servicer mowed the homeowner's quarter-acre lot during the pendency of a foreclosure.

Nor is the distinction between transaction costs, which would trigger disclosure, and other earned unpaid non-finance charge, which would not trigger disclosure, clear. For example, the Board lists attorneys' fees and appraisal fees as examples of transaction costs that would trigger the disclosure requirements. But servicers routinely charge both of these costs as part of the foreclosure costs and require repayment of those costs as a condition of the modification.

Finally, the use of finance charge terminology is needlessly confusing here. Many of the fees servicers charge in connection with a foreclosure or a loan modification would be denominated as finance charges in an origination.³⁷² In order to avoid needless litigation and extended analysis, the Board should limit the excluded fees to those normally and properly capitalized in a loan modification: past-due interest.

Thus, Proposed OSC § 226.20(a)(1)(i)(A)-1 should be redrafted to state that an increase in the loan amount occurs when the new loan amount (which is commonly referred to in loan modification agreements as the new "unpaid principal balance") exceeds the existing unpaid principal balance plus any earned interest. All other fees should trigger the issuance of new disclosures.

Proposed OSC § 226.20(a)(1)(i)(A)-3 also states that amounts advanced to the consumer to fund an existing or a newly established escrow account are not considered in determining whether there has been an increase in loan amount. As justification for this exclusion, the Board notes that RESPA limits the amounts collected for escrow accounts and it is therefore unlikely that large advances will be financed. While this generally may be true for existing escrow accounts, the transition from a non-escrow loan to one having a newly established escrow account, particularly following a default or delinquency, can produce substantial advances. Any amounts that the servicer may have advanced based on the borrower's nonpayment of taxes, insurance (including force-placed insurance premiums) and other escrow items during the pre-modification period will need to be financed in the new loan amount, and RESPA places no limitations on these amounts. In addition, RESPA

³⁷² Processing fees, for example, are normally finance charges under Reg. Z § 226.4, and many of the appraisal and property maintenance fees charged by servicers would fail the bona fide and reasonable test of Reg. Z § 226.4(c)(7) and thus be included.

permits the creditor to demand an initial deposit before establishing a new escrow account, and this amount will likely be financed in the new loan amount (as it is in virtually all new loan transactions). See Reg. X, 24 C.F.R. § 3500.17(c)(1)(i). Depending upon the timing of when the account is set up and the projected disbursements, and the amount of the cushion, the initial deposit alone can be several thousand dollars.³⁷³

If the Board retains the proposed test for determining an increase in the loan amount, many workout modifications currently being offered to consumers will not be subject to the new disclosure requirement. This is because the other terms referenced in Proposed Reg. Z § 226.20(a) typically do not apply or are not modified in a manner that would compel new disclosures under the proposal. As a result, many workout modifications in which substantial amounts are being capitalized will be offered to consumers without any disclosure of the components of the new unpaid principal balance. Moreover, some servicers currently do not provide this information to consumers in any form. For example, the HAMP program guidelines do not require that an itemization of the amounts capitalized be provided to the consumer, and the information is not provided on the Multistate Home Affordable Modification Agreement used for HAMP modifications.³⁷⁴ New disclosures in this situation, primarily through TILA's disclosure of the amount financed and an itemization of the amount financed, will help consumers understand the impact of the modification on their credit obligation.

For servicers who do currently provide consumers with a breakdown of what is capitalized in the new unpaid principal balance, the change we suggest will not involve additional compliance costs. Copied below is an example of a disclosure that one major servicer provided as an attached Exhibit to its modification agreement:

DESCRIPTION OF TOTAL AMOUNT DUE	TOTAL DUE
Current Principal Balance	\$157,070.46
Plus Delinquent Interest Through 01/01/2009	12,047.45
Plus Advances Made for Annuity Fees/Contributions	1,200.00
Plus Prepaid (for and including) Escrow (including reserve advances if applicable)	62,100.26
Plus Unpaid Late Charges	1,200.70
Modification Fee	50.00
Plus Other Accrued and Unpaid Fees	50.00
Less Suspense Balance (funds held that will reduce amount owed)	50.00
Total Amount to be Capitalized (added to the current principal balance)	514,850.41
New Principal Balance	\$671,920.87

This information could easily be converted into a disclosure that would comply with TILA. If all modifications that increase the loan amount are required to comply with

³⁷³ In an example provided by HUD as Appendix E to Regulation X, 24 C.F.R. § 3500, using relatively low annual amounts for property taxes (\$1,200) and a school tax (\$360), the total initial deposit is \$1,040. A consumer having annual property taxes in the range of \$2,500-4,000, and insurance in the range of \$1,000-2,000 would obviously be required to pay an initial deposit of several thousand dollars.

³⁷⁴ See Multistate Home Affordable Modification Agreement – Single Family – Fannie Mae/Freddie Mac Uniform Instrument, Form 3157 3/09 (rev. 10/10), available at: <http://www.freddie.com/uniform/unifspecial.html>.

Proposed Reg. Z § 226.20(a), servicers and consumers will benefit from the standardization of these disclosures.

We urge the Board to include earned unpaid non-finance charges, and the amounts advanced to fund a newly established escrow account, in the calculation of the new loan amount. All amounts capitalized into the new unpaid principal balance, other than the pre-modification unpaid principal balance plus any earned unpaid finance charge, should be treated as an increase in the loan amount. An increase in the loan amount based on these charges presents risk to the consumer through further erosion of equity (or addition to negative equity) and new disclosures can assist the consumer in weighing the merits and risks of the modification.

2. New disclosures should be required when the consumer's payment is increased because of a newly established escrow account.

Proposed Reg. Z § 226.20(a)(1)(i)(E) provides that an increase in the periodic payment would trigger new disclosures. However, Proposed OSC § 226.20(a)(1)(i)(E)-2 states that amounts advanced to the consumer to fund an existing or a newly established escrow account are not considered in the determination of whether there is an increase in payment. As noted above, the switch from a non-escrow loan to one with an escrow account can produce a large increase in the consumer's monthly payment. Although the switch to an escrow account may benefit the consumer, it involves a significant change in the legal obligations of the parties that merits new disclosures.³⁷⁵ We urge the Board to delete this exclusion from the Commentary with respect to a modification involving a newly established escrow account.

C. The Proposal Appropriately Preserves the Extended Right of Rescission on Existing Obligations, But Should Be Clarified.

If a mortgage modification meets the new transaction test set out in Proposed Reg. Z § 226.20(a)(1), the current holder or its servicer must provide a complete set of new disclosures and comply with other applicable closed-end transaction requirements. In discussing the new transaction requirements, the Commentary notes that some changes may give rise to the right of rescission. For example, Proposed OSC § 226.20(a)(1)(i)-3(iii) states that if a creditor advances new money that is secured by the consumer's principal residence, this would be a new transaction subject to rescission under § 226.23, whether the creditor is the original creditor or an assignee. In that case, the creditor must provide the rescission notice required by § 226.23(b). Similarly, Proposed OSC § 226.20(a)(1)(i)-3(iv) notes that the right of rescission and the required rescission notice would apply if the same creditor adds a security interest in the consumer's principal residence to an existing legal obligation. Relying upon the exemption in existing § 226.23(f)(2), Proposed OSC § 226.20(a)(1)(i)-3(v) correctly provides that a transaction involving an extension of the loan term and a modification fee would compel new disclosures but would not be subject to the right of rescission if the same creditor, that is the current holder, is also the original creditor.

³⁷⁵ In effect, the creditor is revoking its waiver of the clause in the uniform mortgage requiring that an escrow account be established and funded through required payments by the consumer. Nonpayment of the escrow portion of the monthly payment can be an event of default.

We agree that the examples provided in the Commentary are appropriate and that the current rules for when transactions are exempt from the right of rescission should apply without change to mortgage modifications treated as new transactions under Proposed Reg. Z § 226.20(a)(1).

In a similar vein, we believe that the current rule for when the extended right of rescission is terminated with respect to the existing legal obligation should not be changed. If a modification of the existing legal obligation occurs within the three-year extended rescission period, and is treated as a new transaction for purposes of Reg. Z § 226.20(a)(1), it should not cut off the consumer's right of rescission as to the initial transaction which gave rise to the existing legal obligation. Our reading of the proposed rules suggests that the Board agrees that the right of rescission should be retained in this situation. Although the Board's Proposed Reg. Z § 226.23(a)(3)(ii)(A) adds a loan refinancing as a new event that terminates the extended right of rescission, which we strongly oppose (*see* section II(C), *supra*), this proposed rule change would not apply to a mortgage modification under Proposed Reg. Z § 226.20(a)(1) because refinancings are treated separately under Reg. Z § 226.20(a)(2). Moreover, Proposed Reg. Z § 226.23(a)(3)(ii)(A) would apply only to a refinancing with a creditor other than the current holder, which would therefore make it inapplicable to a mortgage modification by the current holder.

To avoid any ambiguity on this point, however, we urge the Board to include a comment in the Commentary clarifying that the extended right of rescission does not expire upon a modification of the existing legal obligation that would give rise to new disclosures. The current holder or its servicer should not be permitted to terminate a consumer's rescission rights by modifying a loan in which the original creditor violated TILA and failed to provide material disclosures. This is consistent with the Treasury Department's HAMP guidelines, which provide that servicers may not include provisions in a loan modification agreement that would waive the consumer's existing legal rights.³⁷⁶

D. The Exception for Workout Agreements Should Be Deleted or Significantly Narrowed.

Proposed Reg. Z § 226.20(a)(1)(ii)(B) provides an exception to the new disclosure requirement if the mortgage modification is entered into in connection with the consumer's default or delinquency, unless there is an increase in the loan amount or interest rate, or a fee is imposed on the consumer in connection with the modification. The Board should delete this exception or draft it more narrowly.

The apparent justification for the exception is that consumers who are in default or delinquency are not likely to have other credit options and therefore new disclosures will not help them shop for credit.³⁷⁷ However, in the workout context in which consumers may be seeking alternatives to save their home from foreclosure, TILA disclosures can serve an important function in providing the information needed by the consumer to compare the

³⁷⁶ *See* Making Home Affordable Program, Handbook for Servicers of Non-GSE Mortgages, Chapter 2, § 1.2 (“The servicer may not require a borrower to waive legal rights as a condition of HAMP.”).

³⁷⁷ 75 Fed. Reg. 58539, 58602 (Sept. 24, 2010).

modification offer with the existing obligation and determine whether the modification will truly assist them in avoiding future payment problems. Moreover, consumers are currently being offered various types of modifications, under both government-sponsored modification programs, such as HAMP, and under servicers' own proprietary modification programs.³⁷⁸ In many instances consumers have been confused as to whether the offer they have received is a true HAMP modification or something else. Disclosures can therefore assist the consumer in comparing the various modification offers and perhaps even in determining whether they have been properly evaluated for the various programs.

In addition, the Board decided not to extend this exception to modifications offered when the consumer is in "imminent" default or delinquency. While we agree with the decision that disclosures should be provided when borrowers are in imminent default, we believe that it poses difficult compliance issues for servicers if the broader workout exception is also retained. Consumers who are in imminent default are eligible for HAMP, other government-sponsored modification programs, and servicers' own proprietary modification programs. Servicers are also permitted under HAMP to use their own test for imminent default, and individual servicers may apply more than one test depending upon the investor on the loan. Also, consumers in some cases may transition from imminent default to actual default during the application process. Uncertainty about whether the consumer is in imminent default will create compliance issues. Servicers and consumers would benefit from a rule that treats all workout modifications the same and the Board should therefore eliminate the workout exception in its entirety.

If the Board decides to retain the exception, the proposal should be revised. Our reading of the limitation on the exception concerning increase in the loan amount is that it will apply the same test used for making this determination as found in Proposed Reg. Z § 226.20(a)(1)(i)(A). As stated above, we urge the Board to reconsider its position and amend the proposal to provide that earned unpaid non-finance charges on the existing obligation which are capitalized into the new unpaid principal balance should be treated as an increase in the loan amount.

We also have concerns that the workout exception is too broad. Proposed Reg. Z § 226.20(a)(1)(i)(F) provides that a new transaction occurs when one or more of the risk features listed in § 226.38(d)(1)(iii) or 226.38(d)(2) is part of the mortgage modification, such as: (1) a prepayment penalty; (2) interest-only payments; (3) negative amortization; (4) a balloon payment; (5) a demand feature; (6) no documentation or low documentation; and (7) shared equity or shared appreciation. The Board correctly points out that "these features can change the fundamental nature of a loan transaction and may significantly increase the cost of the loan or risk to the consumer."³⁷⁹ The addition of terms such as negative amortization and a balloon payment "pose a significant risk of payment shock."³⁸⁰

Despite the Board's justified concern over these risk features, they are conspicuously absent from the list of terms that would remove a mortgage modification from the default or

³⁷⁸ A Congressional Oversight Panel report notes that based on the 2010 year-to-date figures, there have been more than twice as many proprietary modifications as HAMP modifications. *See* Congressional Oversight Panel, *A Review of Treasury's Foreclosure Prevention Programs*, December 14, 2010, p 34.

³⁷⁹ 75 Fed. Reg. 58539, 58600 (Sept. 24, 2010).

³⁸⁰ *Id.*

delinquency exception. Under the Board's proposal, a workout modification that adds one of these high risk terms to the existing obligation would not require new disclosures so long as the default or delinquency exception otherwise applies.

Although several of these terms are not likely to appear in mortgage modifications as part of a workout, others such as a balloon payment or negative amortization may be included to reduce the consumer's payment obligation. In fact, approximately 30% of the 519,648 permanent HAMP modifications (through October 2010) have included the forbearance of principal.³⁸¹ The HAMP guidelines provide that the amount of principal forbearance results in a balloon payment.³⁸² However, the uniform Home Affordable Modification Agreement does not provide a disclosure of the balloon term in the payment schedule chart or anywhere else in the text of the agreement.³⁸³ Requiring TILA disclosures when a balloon payment requirement is added to the existing obligation will greatly assist consumers in evaluating the modification offer and informing them about their new credit terms if the offer is accepted.

E. There Should Be No Exception, or Only a Much Narrower Exception, for Court Proceedings.

Proposed Reg. Z § 226.20(a)(1)(ii)(A) provides an exception to the new disclosure requirement if the mortgage modification is agreed to as part of a court proceeding. The two reasons given by the Board for advancing this exception contain factual inaccuracies and do not reflect current practice. We urge the Board to delete this exception or limit its scope in a manner that is consistent with its purpose.

The first reason given by the Board for the exception is that "consumers entering into these arrangements typically are in bankruptcy and attempting to avoid foreclosure, and consequently have few credit options."³⁸⁴ While it may be fair to say that currently consumers in bankruptcy have few credit options, that is probably due to general economic conditions affecting all consumers rather than simply those in bankruptcy. When consumer credit was readily available, many consumers in chapter 13 repayment plans were able to obtain mortgage financing to pay off their plans early. In fact, some creditors engaged in marketing directed to consumers who had established a record of making timely payments under their chapter 13 plans. It is very likely that as economic conditions improve, consumers in bankruptcy will again have credit options and new disclosures will assist them in comparing these with modification offers.

Moreover, this exception as drafted applies to all court proceedings, not simply bankruptcy cases. Twenty-three states have implemented some form of mediation and loss

³⁸¹ See Congressional Oversight Panel, *A Review of Treasury's Foreclosure Prevention Programs*, December 14, 2010, p 25.

³⁸² See Making Home Affordable Program, Handbook for Servicers of Non-GSE Mortgages, Chapter 2, § 6.3.4.

³⁸³ See Multistate Home Affordable Modification Agreement – Single Family – Fannie Mae/Freddie Mac Uniform Instrument, Form 3157 3/09 (rev. 10/10), available at: <http://www.freddiemac.com/uniform/unifspecial.html>.

³⁸⁴ 75 Fed. Reg. 58539, 58601 (Sept. 24, 2010).

mitigation programs to assist consumers in avoiding foreclosure.³⁸⁵ This group even includes several non-judicial foreclosure states (California, Oregon, Maryland, Michigan, and Nevada) in which the legislatures have enacted forms of conference and mediation requirements for foreclosure cases, with varying degrees of court involvement. Given the expansion of these programs since the Board first included a court proceeding exception to the subsequent disclosure requirements, it no longer seems accurate to state that “these arrangements are typically in bankruptcy.”

Irrespective of whether the consumer is in a bankruptcy or state foreclosure proceeding, the consumer’s lack of credit options should not be the basis for the Board’s decision to retain the court proceeding exception. In the context of a mortgage modification, a new disclosure requirement is warranted to effectuate TILA’s goal of enabling consumers to make informed credit decisions, so that they may effectively compare the modification offer with their existing legal obligation. While the Board may wish to consider whether a different set of disclosures should be required to meet this goal, the Board should not include a broad exception that would deprive large numbers of consumers in court proceedings from receiving any form of disclosure.

The second reason given by the Board for the exception is that “these workouts occur with judicial oversight and benefit from safeguards associated with court proceedings.”³⁸⁶ This statement is not accurate with respect to chapter 7 bankruptcy cases. A mortgage modification entered into during a chapter 7 case will either be in the form of a reaffirmation agreement or an agreement in which the parties expressly provide that the consumer will not be personally liable for the mortgage debt.³⁸⁷ If the mortgage modification is in the form of a bankruptcy reaffirmation agreement, it will be treated differently than other reaffirmation agreements. While the bankruptcy court ordinarily reviews reaffirmation agreements to ensure that they comply with the statutory requirements and will not impose an undue hardship on the consumer, the Bankruptcy Code exempts reaffirmation agreements secured by real property from this court supervision. *See* 11 U.S.C. § 524(c)(6)(B) and 524(d)(2).

If the mortgage modification is a non-recourse type agreement that is not a reaffirmation, it is unlikely that a bankruptcy court will conduct a hearing to approve the agreement or otherwise review it if it is not presented in connection with a contested matter or an adversary proceeding.³⁸⁸ Thus, mortgage modifications in chapter 7 cases, except perhaps those filed to resolve a motion for relief from the automatic stay, are likely to escape review by the bankruptcy court.

³⁸⁵ A summary of these programs is available on NCLC’s website, at: <http://www.nclc.org/issues/foreclosure-mediation-programs-by-state.html>

³⁸⁶ 75 Fed. Reg. 58539, 58601 (Sept. 24, 2010).

³⁸⁷ For example, the HAMP guidelines provide that the following language should be added to the modification agreement if the consumer has received a chapter 7 discharge and the debt was not reaffirmed: “I was discharged in a Chapter 7 bankruptcy proceeding subsequent to the execution of the Loan Documents. Based on this representation, Lender agrees that I will not have personal liability on the debt pursuant to this Agreement.”

³⁸⁸ *See In re Smith*, 409 B.R. 1 (Bankr. D. N.H. 2009) (finding that the motion for approval of loan modification did not present the court with a case or controversy).

More importantly, though, the Board should consider that the parties to court proceedings, and the judges who may be asked to approve modifications, will all benefit from a uniform set of disclosures that can be quickly reviewed for essential terms. This would include trustees in chapter 13 cases and mediators in state foreclosure cases who are often called upon to review modifications. A complaint often heard by these parties, and even judges, is that the modification agreements themselves do not include important information needed to understand the new legal obligations and to evaluate whether the agreement will assist the consumer in avoiding foreclosure. As mentioned earlier, the uniform Multistate Home Affordable Modification Agreement used for HAMP modifications does not even disclose whether there is a balloon payment associated with principal forbearance or provide an itemization of the amount being capitalized as part of the new unpaid principal balance.

The Board has authority under TILA to address this problem and should exercise that authority by deleting the court proceeding exception. Alternatively, the Board should consider requiring more “streamlined” disclosures for modifications entered in court proceedings that, at a minimum, highlight the changed terms in the consumer’s legal obligation.

F. The Imposition of Any Fees in a Loan Modification Should Trigger New Disclosures.

The Board solicits comment on whether it should allow creditors to charge a fee and take advantage of the exceptions to the general rule requiring that same creditor modifications trigger new disclosures.³⁸⁹ The Board is concerned that the weight of having to provide disclosures to borrowers would discourage creditors from entering into modifications.

Investors are currently losing over \$145,000 on every foreclosed loan (on average).³⁹⁰ This should provide ample room to make far more modifications than are being made, and certainly indicates that the cost of providing disclosures would, in most cases, be more than offset by savings to the investor. Yet servicers are not now making modifications. Whatever the reasons servicers do not now make modifications, it is not because of the currently nonexistent required disclosures.³⁹¹

The current industry standard for mortgage modifications, as enunciated by HAMP, is that no fees are charged for a mortgage modification.³⁹² Indeed, a Federal Reserve Board

³⁸⁹ 75 Fed. Reg. 58539, 58601 (Sept. 24, 2010).

³⁹⁰ ³⁹⁰ See Alan M. White, Sept. 26, 2010 Columbia Collateral File Summary Statistics, http://www.valpo.edu/law/faculty/awhite/data/sep10_summary.pdf.

³⁹¹ See generally Diane E. Thompson, Why Servicers Foreclose When They Should Modify and Other Puzzles of Servicer Behavior (Oct. 2009), available at www.consumerlaw.org (arguing that servicers fail to modify because they make more money by foreclosing and because there is no mandate that they make modifications).

³⁹² See 15 U.S.C. § 1639a(c) (“The qualified loss mitigation plan guidelines issued by the Secretary of the Treasury [i.e., HAMP] . . . shall constitute standard industry practice . . .”); Making Home Affordable Program, Handbook for Servicers of Non-GSE Mortgages, v. 3.0 at 81 (Dec. 2, 2010) (“Servicers may not charge the borrower to cover the administrative processing costs incurred The servicer . . . will not be reimbursed for any actual out-of-pocket expenses, including, but not limited to, any required notary fees,

working paper reports that few servicers expressed any interest in being compensated for doing modifications, at least by investors.³⁹³ The Board's belief that there are necessary and appropriate fees to be charged for underwriting and processing a modification is baseless.

Homeowners need disclosure the most when creditors or their agents, the servicers, propose to charge fees. Fees are a common and widespread source of abuse,³⁹⁴ as well as a profit center for servicers.³⁹⁵ Obtaining disclosure of the fees charged is nearly impossible. TIL was enacted to make visible the hidden cost of credit. The widespread profiteering in mortgage modifications cries out for disclosure. It is the fees, more than the modifications themselves, that are abusive and increase the cost of credit. It is the fees that most need to be disclosed. Any modification where fees are charged should require new disclosures.

VII. SEVERAL PROPOSED CHANGES TO PROVISIONS DEALING WITH TOPICS OTHER THAN RESCISSION WOULD IMPROVE CONSUMER PROTECTION.

A. The Board's Inclusion of Transactions with Revocable Living Trusts in the Definition of "Consumer Credit" Is an Important Improvement.

Consistent with the only judicial decision known to have reached the question,³⁹⁶ the Board is proposing to include consumer-purpose credit transactions with revocable living trusts in the definition of "consumer credit."³⁹⁷ We strongly support this proposal. The Board properly proposes that loans to revocable living trusts in fact share all the essential characteristics of loans to individuals.

Including loans to living trusts in the definition of "consumer credit" is particularly important because a transfer of the property to a living trust is the first step in one type of foreclosure rescue scam. The scam artist induces the consumer, knowingly or unknowingly, to transfer the property to an inter vivos trust as a way of avoiding a due-on-sale clause.³⁹⁸ Any loans against the property after that point will be loans to the living trust, not to the individual consumer.

recording fees, title costs, property valuation fees, credit report fees, or other allowable and documented expenses.").

³⁹³ Larry Cordell, Karen Dynan, Andreas Lehnert, Nellie Liang, & Eileen Mauskopf, Fed. Reserve Bd. Fin. & Econ. Discussion Series Div. Research & Statistical Affairs, *The Incentives of Mortgage Servicers: Myths and Realities* 30-31 (Working Paper No. 2008-46)

³⁹⁴ See NACA & NCLC, *Servicers Continue to Wrongfully Initiate Foreclosures*, Dec. 15, 2010, at 2 http://www.nclc.org/images/pdf/foreclosure_mortgage/mortgage_servicing/wrongful-foreclosure-survey.pdf (discussing the prevalence of the connection between improper fees and foreclosure); *Problems in Mortgage Servicing From Modification to Foreclosure: Hearing Before the Senate Comm. on Banking, Housing & Urban Affairs*, 111th Cong. (Nov. 16, 2010), at 1-20 (testimony of Diane E. Thompson).

³⁹⁵ See generally Diane E. Thompson, *Why Servicers Foreclose When They Should Modify and Other Puzzles of Servicer Behavior* (Oct. 2009), available at consumerlaw.org.

³⁹⁶ *Amonette v. Indymac Bank*, 513 F. Supp. 2d 1176 (D. Haw. 2007).

³⁹⁷ Proposed OSC §§ 226.2(a)(11)-3, 226.3(a)-8; 75 Fed. Reg. 58539, 58553-4 (Sept. 24, 2010).

³⁹⁸ See National Consumer Law Center, *Foreclosures* ch. 15 (3d ed. 2010).

Before finalizing the language of these new proposed Commentary provisions, however, the Board should survey the law of living trusts in the various states to make sure that its description captures all the trust devices in common use.

B. The Proposed Revised Disclosures for Credit Insurance and Debt Cancellation Are a Good Step, But Disclosures Should Be Required Even When the Premiums Are Per Se Included in the Finance Charge.

The Board proposes extensive and new disclosures for voluntary credit insurance and debt cancellation charges. Proposed Reg. Z § 226.4(d). These new disclosures will be required for the creditor to avoid having these premiums and charges included in the finance charge. We generally applaud the Board's language for these proposed changes. We endorse the more detailed comments submitted by the Center for Economic Justice.

We urge the Board to require these improved disclosures for mortgage credit as well as non-mortgage credit. If the proposal included in the August, 2009 Closed End Proposal is promulgated, all premiums and charges for credit insurance and debt cancellation insurance will be included in the finance charge when sold in connection with credit secured by real property or a dwelling. In this docket, the Board proposes that the new disclosures required in §226.4(d) will not be required to be provided for credit secured by real property. Presumably this is because the Board believes that these extensive disclosures are no longer necessary if the premiums are included in the finance charge.

However, even though the finance charge will include the charges for any credit insurance and debt cancellation products, that does not mean that the consumer would not benefit from the information included in these disclosures. For example, to the extent that the credit insurance is for a shorter term than the term of credit, this is important information for the consumer to know. Likewise if coverage for the insurance will only be provided if the consumer is a certain age, or in a certain physical condition, that fact should be disclosed to the consumer as well. The insurance is still voluntary, and the overall cost of the loan would still be reduced without the insurance. There is no reason to exclude this information from real estate secured loans.

C. The Commentary Should Be Amended as the Board Proposes Regarding Evaluating Ability to Repay for Short Term Balloon Loans.

We applaud the Board's proposed changes to the Commentary excluding the eligibility of any high cost mortgage with a short term balloon term from the presumption of compliance for determining repayment eligibility. Proposed OSC §226.34(a)(4)(iv)-3. The proposed Commentary section also requires the creditor making such a balloon loan to verify "that the consumer would likely be able to satisfy the balloon payment by refinancing the loan or through income or assets other than the collateral." These are wise and good proposals.

D. The Board Is Correct to Require that Servicers Respond within a Reasonable Time to Section 1641(f)(2) Requests.

We very much appreciate the Board's Proposed Reg. Z § 226.41 to require servicers to provide the consumer the name, address, and telephone number of the owner of a loan. Section 1641(f)(2) has long required servicers to answer homeowners' questions as to who owns the note:

Upon written request of the obligor, the servicer shall provide the obligor, to the best knowledge of the servicer, with the name, address, and telephone number of the owner of the obligation or the master servicer of the obligation.

Despite the clear, mandatory language, this provision has never worked. Servicers have routinely flouted the law with impunity.³⁹⁹ Because of these repeated and systemic problems experienced by homeowners who were unable to obtain information about the holder of their loans, in 2008 Senator Boxer sponsored an amendment to TILA addressing the problem.⁴⁰⁰

Senator Boxer's amendment, adopted by Congress, sought to ensure that homeowners are apprised of the name, address and telephone number of the owner of their loan by making three separate changes in TILA:

1. Enacting new §1641(g) requiring ownership information upon transfer of the ownership of the note;
2. Explicitly creating a private right of action for violating §1641(g); and
3. Explicitly endorsing a private right of action for violating §1641(f)(2).

The Board has already provided interpretations and instructions for transferees of loans to comply with the new § 1641(g) requirements.⁴⁰¹ In this rulemaking, it proposes to adopt § 226.41 to implement § 1641(f)(2).

The Board is right not to neglect the importance of §1641(f)(2). Even with the new §1641(g) requirements, there will be many situations in which consumers will still need to use §1641(f)(2). The transfer of the loan may have occurred before the effective date of the new requirement in 2009, or the consumer may have misplaced or never received a transfer notice. Consumers in litigation may also need to use these provisions to confirm the chain of title or the current holder. The Board's rulemaking on §1641(g) is only one part of

³⁹⁹ See 155 Cong. Rec. S5098-99 (daily ed. May 5, 2009)(statement of Sen. Barbara Boxer) (: “[F]ederal law does require that the servicer tell the homeowner the identity of the person holding their mortgage. ... While servicers are required to disclose this information, there are no penalties in the law for noncompliance and no remedies for a homeowner faced with a recalcitrant servicer.”); see, e.g., Meyer v. Argent Mortgage Co. (*In re* Meyer), 379 B.R. 529 (Bankr. E.D. Pa. 2007) (discussing servicer's failure to respond to §1641(f)(2) letter and denying rescission since the rescission letter was not mailed to the holder before the expiration of the three-year limitations period, but only the servicer).

⁴⁰⁰ See Helping Families Save Their Homes Act, Public Law 111-22, tit. IV, § 404(a), 123 Stat. 1632, 1658 (2009).

⁴⁰¹ §226.39; 75 Fed. Reg. 58539, 58489 (Sept. 24, 2010).

Congress's effort to ensure that homeowners have access to the critical information of who owns the loan secured by their home.

The proposed new regulation § 226.41 affirmatively requires that the servicer provide the homeowner with the requested information about the name and address of the owner within a "reasonable time." The Board also is proposing a "safe harbor" of ten days as a measurement for what should be considered a reasonable time in the Official Staff Commentary.⁴⁰² Rather than a safe harbor floor, the Board must make this a ceiling, to conform with recent amendments to the Real Estate Settlement Procedures Act (RESPA).

The Dodd-Frank Act amended RESPA to require servicers to respond within 10 business days to borrower requests for information as to the ownership of the loan:

(k) SERVICER PROHIBITIONS.—

(1) IN GENERAL.—A servicer of a federally related mortgage shall not—

(D) fail to respond within 10 business days to a request from a borrower to provide the identity, address, and other relevant contact information about the owner or assignee of the loan;⁴⁰³

As the result of RESPA's unmistakable mandate, the servicer will have violated RESPA. The safe harbor provided by the Official Staff Commentary makes it appear that it is permissible to take longer than ten days to provide the information. This conflict is unnecessary and will lead to confusion and needless litigation. The Board must conform the TIL requirement to the RESPA requirement.

The additional requirement that the ownership information be provided within a reasonable time is helpful and should be retained in the regulation. For example, if the correspondence is entirely over the internet, ten days seems a unreasonably long time to respond with the name and address of the owner of the loan – information which should be well-known to the servicer. In that case, a response in a shorter period of time would be reasonable.

To give full effect to Congressional intent, the Board still needs to clarify two remaining issues under §1641(f)(2):

- 1) Given the mandate in RESPA's § 2605(k)(1)(d) for a servicer to provide the name and address of the owner of the loan, there should never be any circumstances that would justify the servicer's provision of the name of the master servicer rather than the owner of the loan. To ensure that both laws are interpreted in a completely consistent manner, the Board should explicitly say this in either the new regulation § 226.41, or in the Commentary. Homeowners need to know who the owner is to serve notices or complaints or confirm the authority of the party initiating a foreclosure action or offering a loan modification.⁴⁰⁴

⁴⁰² Proposed OSC § 226.41-1, 75 Fed. Reg. 58539, 58783 (Sept. 24, 2010).

⁴⁰³ Pub. L. No. 111-203, 124 Stat. 1376, § 1463 (July 21, 2010) (codified at 12 U.S.C. § 2605(k)(1)(D)), .

⁴⁰⁴ Reports of homeowners sued multiple times on the same note by different entities are increasing.

- 2) The liability of servicers for failing to comply with the requirements of § 1641(f)(2) should be articulated by the Board. We suggest that both servicers and their principals—the owners of the obligations—are liable under the statute. Although the language of 15 U.S.C. §1640 only refers to creditors, Congress’s addition of a reference to §1641(f) in 15 U.S.C. §1640 only has meaning if servicers are liable for violations of 15 U.S.C. §1641(f)(2), since 15 U.S.C. §1641(f) only applies to servicers.

The Board clearly has the authority to provide guidance for §1641(f)(2). The Board should take this opportunity to further clarify this important provision. Doing so does not impose an undue burden on servicers: servicers have long been required to provide this information; servicers will always have this information; and servicers may often be providing this information to borrowers under §1641(g) as agents of the owner. Servicers are also already required to provide this information under RESPA’s new requirement in § 2605(k)(1)(D). The Board should provide additional guidance to reduce costs and facilitate compliance for all parties.