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The Voice For Real Estate®

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December 23, 2009

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Docket No. R-1366

Transmitted by E-mail to: regs.comments@federalreserve.gov

Dear Ms. Johnson:

I am writing on behalf of the 1.2 million members of the National Association of REALTORS® (NAR) to provide comments on proposed changes to the Truth in Lending Act (TILA) Regulation Z (Docket No. R-1366). The National Association of REALTORS® is America's largest trade association, including NAR's five commercial real estate institutes and its societies and councils. REALTORS® are involved in all aspects of the residential and commercial real estate industries and belong to one or more of some 1,400 local associations or boards, and 54 state and territory associations of REALTORS®. REALTORS® have a strong stake in preventing abusive lending practices and support the purposes of TILA to promote the informed use of consumer credit by requiring disclosures about terms and costs to help prevent abusive lending practices.

The Proposed Rule includes new and amended disclosure obligations for creditors, restrictions on loan originator compensation, and requirements to prevent adverse steering based on loan originator compensation, among other changes. TILA does not apply to transactions that are primarily for business, commercial, or agricultural purposes.

NAR strongly supports the Proposed Rule's overall reform of the TILA Regulation disclosures, to focus the consumer on the most meaningful terms in a simple, tabular format that should prove much easier for consumers to understand. That, in turn, should help consumers find fair and affordable mortgages, resulting in a reduction in default rates and foreclosures and helping to stabilize communities. NAR also supports the Board's efforts to eliminate adverse steering of consumers to loan products that may not be in their best interests. NAR has been at the forefront of advocating for such mortgage reform, consistent with our Responsible Lending Principles adopted in 2005 (enclosed).

REALTOR® is a registered collective membership mark which may be used only by real estate professionals who are members of the NATIONAL ASSOCIATION OF REALTORS® and subscribe to its strict Code of Ethics.

EQUAL HOUSING OPPORTUNITY

Under the Proposed Rule, disclosure obligations and other requirements concerning the extension of credit appropriately are imposed on the lender, mortgage broker or servicer, and not on real estate agents or brokers. But anything that affects mortgage lending affects REALTORS® and their clients, and we are writing to comment on some of the proposed changes and make suggestions for improvements. Several features of the rule's proposed changes to the calculation of the APR (annual percentage rate), the disclosure requirements, and restrictions on loan originator compensation could inadvertently hurt the market for home loan originations.

I. Disclosures

The Proposed Rule would change the format, time and content of disclosures at the four closed-end credit disclosure stages under Regulation Z:

(i) at application;

(ii) within 3 business days of application (early disclosures);

(iii) at least 3 business days before consummation; and

(iv) post-consummation.

The Proposed Rule would apply to all closed-end credit transactions secured by real property or a dwelling, and would no longer be limited to credit secured by the consumer's principal dwelling. Accordingly, the protections will also apply to consumer financing related to acquisition of land and to construction financing.

As a general, technical suggestion, we believe it would be extremely useful to organize the model disclosure forms in a table to make it clear which forms apply to each of the four stages.

A. Disclosures at Application

The Proposed Rule would include the following disclosure requirements:

- A new Board-published, one-page "Key Questions to Ask About Your Mortgage" document explaining potentially risky loan features would need to be provided to all applicants.

- A new Board-published, one-page "Fixed vs. Adjustable Rate Mortgages" document explaining the differences between fixed rate and adjustable rate mortgages (ARMs) would need to be provided to all applicants. This disclosure would replace the Consumer Handbook on Adjustable-Rate Mortgages (known as the CHARM booklet) that Regulation Z currently requires be given to ARM applicants.

- A new format and content for the ARM loan program disclosure, including: a requirement that the disclosure be in a tabular question and answer format; streamlined plain-language disclosure of interest rate and payment information; and a new disclosure of potentially risky features (e.g., prepayment penalties).

Comment

NAR strongly supports these new disclosures. We believe it is critical that consumers understand the risks of the loans they obtain, and we commend the Board, in particular, for its extensive consumer testing.

The Preamble notes continuing concerns created by the requirement of separate good faith estimates under the Real Estate Settlement Procedures Act (RESPA) and TILA. The Board acknowledges that separate disclosures create considerable overlap, and duplicative and inconsistent information that can lead to information overload and confusion for the consumer. We once again urge you to work with HUD and, if necessary, Congress, to complete the 1996 Congressional directive to combine and simplify the two disclosure forms.

We are unclear whether the TILA disclosure requirements apply to mortgage brokers. If they do not, we do not understand why this is so. Clarification would be helpful. We also have several specific recommendations, as follows.

Attachment A, Key Questions to Ask About Your Mortgage. While we understand that this is designed as a document of general questions consumers should ask about any mortgage they are considering, it may be confusing because it leaves out the basic “key questions” about any mortgage: “what’s the rate, what’s my payment, and how much am I borrowing?”. It may be helpful to add a sentence explaining that the specifics of mortgages consumers will consider will be disclosed separately.

Attachment B, Fixed vs. Adjustable Rate Mortgages.

- NAR recommends that you consider amending Attachment B to make it more even-handed about the choice between products. The current draft seems to focus on the risk to the consumer that an ARM poses in rising interest rate environments. It does not point out the value that an ARM provides in falling rate environments, allowing the consumer to benefit from falling rates without the cost, uncertainty, or longer amortization period usually involved in a refinance transaction, or note that the consumer pays a price for the interest rate protection inherent in a long-term fixed rate loan. As you may know, NAR has warned consumers about risky ARMS since 2005, but believes there is a role for traditional ARMS with reasonable annual and lifetime caps.

- We recommend adding “with equal monthly payments throughout the life of the loan” after “fixed rate mortgage” in the text of the box. This avoids any confusion with stepped-rate mortgages.

- In the ARMs box, we recommend you give an example of what you mean by plans to sell the home within a "short period" of time. For example, you give 5 years as an example of what you mean by "short term" in another context in a discussion at the bottom of the second column on page 43282 of the Proposed Rule. Otherwise, consumers may think in terms of months, not years.

- In the paragraph after the boxes, we suggest that you add an increase in interest rates as another reason the consumer may not qualify for refinancing.

- The suggestion to visit the home page of the Board's internet site is too general. While there are links to consumer information, a more specific link would be much more consumer friendly. And as for a list of counselors in the area, the www.HUD.gov/counseling site would be more helpful and easier to find.

B. Early Disclosures (within 3 Business Days of Application)

The Proposed Rule would amend or add to creditors' early disclosure obligations with respect to: (i) calculation of finance charge; (ii) disclosure of finance charge and APR; (iii) disclosure of interest rate and payment summary; and (iv) disclosure of other terms.

i. Calculation of Finance Charge

The Proposed Rule would revise the calculation of the finance charge, which is used to compute the APR, to include many fees and charges that are not currently included in the Regulation Z disclosure. Currently, TILA and Regulation Z permit creditors to exclude several fees or charges from the finance charge, including: certain fees or charges that third party closing agents impose, if the creditor meets certain conditions; security interest charges; and real-estate related fees, such as title examination, title insurance, survey, pre-closing inspection fees, appraisal, notary and credit report fees, and document preparation fees. The Proposed Rule would remove the exemption for these fees, thus resulting in a higher finance charge amount, and a higher APR.

In connection with the Proposed Rule, the Board is soliciting comments as to whether it should increase the finance charge tolerance, for example to $200, in light of its proposal to require more third-party charges to be included in the finance charge. Currently, a disclosed finance charge is treated as accurate if it does not vary from the actual finance charge by more than $100 or is greater than the amount required to be disclosed. 15 U.S.C. § 1605(f).

Comment

While NAR supports the goal of the more inclusive finance charge definition, to make it easier for consumers to compare the relative costs of mortgages, we are concerned that eliminating the current exemptions would cause many more loans to cross the threshold of being a "higher priced mortgage loan" or even a HOEPA loan under 12 CFR 226.32 of Regulation Z, as well as a "high cost mortgage loan" under many state laws. As discussed below, we understand that the Board believes the effect will be small, but it will unnecessarily keep some families from becoming homeowners. And if lenders or other commenters determine that many

more families will be affected than estimated by the Board, our concern would be even greater, of course.

Based on the Board's own studies, it is clear that the new finance charge calculation would cause more loans to be subject to the additional restrictions applicable to "higher priced mortgage loans," special disclosures and restrictions for HOEPA loans, and two state anti-predatory lending laws. The Board estimates that the new approach would increase the share of first-lien refinance and home improvement loans subject to HOEPA rules by about 0.6 percent. While this increase is small, the Board notes that, because very few HOEPA loans are originated overall, the absolute number of loans covered would increase markedly – more than 350 percent. The Board also estimates that about 3 percent of the first-lien loans in the loan amount range of the typical home purchase or refinance loan ($175,000 to $225,000) that are below the 12 C.F.R. § 226.35's APR threshold (the Board's recently adopted protections for higher-priced mortgage loans) would exceed the threshold if the Proposed Rule's finance charge calculation were in effect.

Additionally, the Board reviewed the APR tests for coverage of first-lien mortgages under the anti-predatory lending laws in the District of Columbia (DC), Illinois, and Maryland -- the only three State anti-predatory lending laws with APR coverage thresholds that are lower than the federal HOEPA APR threshold, for first-lien loans of 800 basis point over the U.S. Treasury yield on securities with comparable maturities. The Board estimates that the Proposed Rule's new approach to finance charge calculation would convert the following percentages of first-lien loans that are under the applicable APR threshold into loans that exceed that threshold and thus would become covered by the applicable State anti-predatory lending law: DC, 2.5%; Illinois, 4.0%; Maryland, 0.0%.

In addition, the Board notes that the impact of the proposed finance charge definition on APRs varies among loans based on two significant factors: (i) because many of the affected charges are fixed dollar amounts, the impact is significantly greater for smaller loans; and (ii) the impact likely will vary geographically because such charges, notably title insurance premiums and recording fees and taxes, vary considerably by state.

We are concerned that creditors will seek to avoid making loans that are subject to the special protections and additional liability and compliance burdens associated with "higher priced mortgage loans" under Regulation Z. We know that many lenders shy away from the very high cost HOEPA loans as well as state high cost loans. This could result in a shrinking availability of credit that is solely the result of changing a regulatory definition and not because the newly covered mortgages are in a class that needs special protections.

One recommendation to consider is to raise the tolerances somewhat to take into account the inclusion of these additional fees. Higher tolerances could also minimize transactions getting delayed or rejected because of lenders ensuring that third party charges are not inaccurate.

Another possibility is to maintain the foregoing fee exclusions for calculation of the finance charge, but remove them for the calculation of the APR. While this would not remove the likelihood of more loans qualifying as "higher priced mortgage loans," which is triggered by an average prime offer rate (APOR) test, it would ameliorate the issue of pushing more loans into the HOEPA or state high cost loan categories, which are most often triggered by a "points

and fees" test, rather than APR or APOR test. Similarly, the Board could keep the fee exclusions for the purpose of calculating the HOEPA loan threshold. Adjusting these thresholds is important, especially for smaller loans, so as not to constrain lending in lower income and lower property value communities due to an unrelated change in the regulatory definition of APR.

Seller-Paid Points

Comment. NAR supports the Board's retention of the exemption of seller-paid points from the finance charge calculation. Often a buyer is able to afford a loan because of negotiations in which the seller agrees to pay certain points and fees in connection with the mortgage transaction, and including these in the APR could make the loan subject to HOEPA or "higher priced mortgage loan" requirements which can be a problem for the reasons explained above.

State Recording Charges and Escrow Charges

Comment. NAR recommends that the Board simplify computation of the finance charge by excluding fees paid to the local government to record the mortgage and similar charges, which will be uniform for all consumers. Likewise, it should be clarified that funds paid into escrow for taxes and insurance should not be included in the finance charge.

Real Estate Commissions

Comment. NAR recommends that the Board expressly confirm, for clarity, that real estate broker fees are not part of the finance charge, because they would be paid in a comparable cash transaction.

Regulatory Confusion

The definition of finance charge in section 226.4 is extremely confusing. Paragraphs (a) through (f) explain what is and what is not included. Paragraph (g) then excludes specified provisions for purposes of closed-end transactions covered by the Proposed Rule, except that some provisions are not excluded after all. Though it would add some columns to an already lengthy rule, a separate definition of finance charge for purposes of the Proposed Rule without having to exclude and then re-include would be most welcome and we suspect would avoid many implementation errors made in good faith.

ii. Disclosures

Finance Charge and APR. The Proposed Rule states, on page 43239 (second column), that it replaces the term "finance charge" with "interest and settlement charges" to make clear that the finance charge includes more than interest. In addition, the Proposed Rule will require creditors to disclose the APR in 16-point font in close proximity to a graph that compares the consumer's APR to the average prime offer rate (APOR) for borrowers with excellent credit and the Regulation Z threshold for "higher-priced mortgage loans."

Interest Rate and Payment Summary. The Proposed Rule requires creditors to disclose, as a table, the contract interest rate together with the corresponding monthly payment,

including escrows for taxes and insurance. Special disclosure requirements would be imposed for adjustable-rate or step-rate loans to show the interest rate and payment at consummation, the maximum interest rate and payment at first adjustment, and the highest possible maximum interest rate and payment. Additional special disclosures would be required for loans with negatively-amortizing payment options, introductory interest rates, interest-only payments, and balloon payments. The Proposed Rule provides that, if an escrow account is established, the creditor must disclose the estimated payment amount for taxes and insurance.

Other Terms. The Proposed Rule would require creditors to provide, as a table, information about the loan amount, the loan term, the loan type (e.g., fixed-rate), the total settlement charges, and the maximum amount of any prepayment penalty. In addition, creditors would be required to disclose in a tabular question and answer format the "Key Questions About Risk," which would include information about potentially risky loan features (e.g., prepayment penalties, interest-only payments, and negative amortization).

Comment

NAR supports replacing the term "finance charge" with "interest and settlement charges" in making consumer disclosures and disclosing prominently the APR in a manner that allows comparison with average prime rates and the "higher priced mortgage loan" rate. This should enhance consumers' understanding of where they stand on the spectrum of rates, and encourage them to shop for the best rate they can obtain, or take steps to improve their credit standing so they will be able to obtain a lower rate. However, because the APR is now an "all-in" APR, it would be appropriate to recalculate the APOR to include similar benchmark costs. As a technical point, it is confusing to say the term "finance charge" is being replaced because it is still used in the regulation (section 226.4, etc.). Apparently the change is only to the consumer disclosure form. Clarification would be useful.

NAR also generally supports the other changes in the disclosures proposed by the Board. While the new APR-APOR comparison may be helpful to some borrowers, it may be overly focused on credit score and credit history as the principal determinant of loan pricing. There are many other factors, including especially loan-to-value ratio, as well as debt-to-income ratio, loan amount, and product choice, that bear on the pricing of a borrower's loan. It may be useful to include a sentence explaining this to consumers.

C. Disclosures at Least 3 Business Days before Consummation

The Proposed Rule would require creditors to provide a final TILA disclosure to consumers at least 3 business days before consummation, even if no terms have changed since the early TILA disclosure was provided. Two alternatives are being considered to address changes to loan terms and settlement charges during the 3 business-day waiting period. Under the first approach, if any terms change after the creditor provides the "final" TILA disclosures, then another final TILA disclosure would need to be provided so the consumer would receive it at least 3 business days before consummation. Under the second approach, only if the APR exceeds a certain tolerance or an adjustable-rate feature is added after the "final" TILA disclosures are provided would another final TILA disclosure need to be provided so that the consumer receives it at least 3 business days before consummation. All other changes could be disclosed at consummation.

Comment

NAR generally supports the above-described redisclosure obligations, although the need to continuously provide another 3-day waiting period upon any disclosure discrepancy would likely become burdensome on homebuyers who have scheduled their closing to coincide with moving schedules, living arrangements, and other time-sensitive activities involved in acquiring a new home. We support the second alternative to minimize this problem. In addition, we suggest a modification to this alternative that would require redisclosure if any feature identified in the "Key Questions to Ask About Your Mortgage" disclosure is added to the loan, not just a change from a fixed rate loan to an adjustable rate loan. These types of changes (negative amortization, a new prepayment penalty, a balloon payment, or a switch to no-doc or low-doc loans) warrant additional time for the consumer to consider them.

D. Post-Consummation Disclosures

The Proposed Rule provides new requirements for post-consummation disclosures relating to ARM adjustment notices, payment option statements, and creditor placed property insurance.

ARM Adjustment Notices. With respect to ARMs, the Proposed Rule would increase the time required for advance notice of a payment change from 25 days before payment at the new level is due to 60 days before payment at the new level is due. Additionally, the Proposed Rule would revise the format and content of the ARM adjustment notice, so that the following disclosures would be provided in the form of a table: (i) the current and new interest rates, (ii) if payments are interest-only or negatively amortizing, the amount of the current and new payment allocated to pay interest, principal, and property taxes and mortgage-related insurance, as applicable, and (iii) the current and new periodic payment amounts and the due date for the first new payment.

Comment. The Board believes that the 60 day notice will be feasible for most if not all loans. If lenders identify situations where this is not true, NAR believes that the borrower should still receive a notice 60 days before the increase will take effect, with a statement that the increase as of the date of the notice is based on the best available data, but that the lender will notify the borrower of the actual amount as soon as possible. The change is likely to be small, barring another financial markets catastrophe that would again result in a huge jump in LIBOR rates, so the preliminary disclosure will be adequate to help the borrower decide on other options, such as refinancing.

Payment Option Statement. For payment option loans with negative amortization, the Proposed Rule would require creditors to provide a periodic statement. Such statement would contain a table with a comparison of the amount and impact on the loan balance and property equity of a fully-amortizing payment. The Proposed Rule would require that this disclosure be provided not later than 15 days before a periodic statement is due.

Comment. NAR supports this requirement. The burden is likely to diminish over time since this type of mortgage is currently rarely used and should not be permitted for most borrowers as a general rule.

Creditor-Placed Property Insurance. The Proposed Rule would require that creditors provide notice to consumers of the cost and coverage of creditor-placed property insurance at least 45 days before imposing a charge for such insurance. Creditors would also be required to provide consumers with evidence of such insurance within 15 days of imposing a charge for the insurance.

Comment. NAR supports these change to help consumers avoid unnecessarily high insurance costs. We assume, however, that insurance coverage gaps would be avoided. In addition, problems arise when servicers fail to promptly (1) acknowledge proof submitted by consumers that they do, in fact, have insurance in place and (2) issue refunds when they charge the consumer for insurance by mistake. NAR recommends that the Board consider issuing rules to require prompt action by servicers in these situations.

III. Loan Originator Compensation

The Proposed Rule would prohibit certain payments to mortgage brokers and loan officers based on the terms or conditions of loans, but it would not prohibit payments that consumers make directly to originators. The Board also is soliciting comments on an alternative proposal that would allow loan originators to receive payments that are based on the principal loan amount, which is common practice today. If a consumer directly pays the loan originator, the proposal would prohibit the loan originator from also receiving compensation from any other party in connection with that transaction.

The Board notes that prohibiting compensation based on the loan amount would eliminate an incentive for the originator to steer consumers to a larger loan amount. Such steering maximizes the originator's compensation and also increases the transaction's loan-to-value ratio and decreases the consumer's equity in the property. If the loan-to-value ratio increases sufficiently, the consumer may incur additional costs in the form of a higher interest rate or additional point and fees. The consumer's monthly payment would also be larger.

Comment

NAR has long been on record as being concerned that many families receiving nontraditional mortgages, including hybrid ARMs and payment option ARMs, did not understand the inherent risk of a mortgage with negative amortization and/or steep payment increases. We support the objective of the Board's proposals designed to reduce any incentives to steer families to such mortgages.

With respect to compensation based on loan amount, NAR believes that the Board should allow payment to a loan originator based on loan amount, for several important reasons.

The principal way in which loan officers at independent mortgage banks and other smaller lending institutions are compensated today is based on the loan amount. This commission-based payment attracts the best loan officers to these mortgage firms. Prohibiting this type of compensation would favor large retail financial institutions with salaried loan officers operating out of "9 a.m. -5 p.m." branches. This would reduce competition and drive experienced loan officers to other industries.

The result of less experienced or capable loan officers would also harm consumers. A salaried loan officer at a bank branch has less financial incentive to help a consumer negotiate the myriad challenges of completing a mortgage application and real estate transaction. Today, when faced with such a situation, consumers often turn to independent mortgage bankers (or in some cases brokers) and their experienced loan officers who work much harder to clear conditions, address credit inconsistencies, and resolve regulatory issues (such as whether a condo is HUD- or GSE-approved for example or a home has a certificate of occupancy for an addition). They work harder because they are compensated to do so. They do not get paid until the transaction is completed. If this type of compensation were prohibited, consumers would have fewer choices in mortgage lending. They would not have access to the diverse programs, such as those that are still available for under-served and first time homebuyers, often offered by an alphabet soup of federal, state, and local agencies and a spectrum of programs with which the best lenders and their representatives are familiar.

The Board's concern that originators may steer consumers to larger mortgages is mitigated by the much-improved consumer disclosure regime being established and the fact that such increases are unlikely to result in such large compensation increases that they would tempt many originators to try to steer their clients to unaffordable or otherwise inappropriate mortgages.

Thus, we strongly favor the alternative which permits compensation to be paid based on loan amount.

We also have concerns about the provision that restricts the lender from paying any compensation to the broker, if the consumer pays the broker. This seems unduly restrictive, and prohibits a consumer from partially paying up front costs with her or his own money, but electing to have the broker receive the balance of its fees from the lender. The Board indicates its belief that "consumers reasonably may believe that when they pay a loan originator directly, that amount is the only compensation the originator will receive." We believe that the new RESPA good faith estimate disclosures help to alleviate that concern by identifying for the consumer changes to origination charges as "credits" and "charges (points)", and that you should consider filling in any additional gaps through disclosures. We agree that the lender-paid portion of the broker's compensation should not be tied to the interest rate, but there are many brokers or loan officers who, to keep up front costs down, will want to offer borrowers the option of paying a portion of a flat percentage-based commission directly, with the balance of such commission being paid from the lender. It certainly takes some options away from sharing the burden of up-front closing costs.

III. Anti-Steering Proposal

The Board is considering whether it should adopt a rule that seeks to prohibit loan originators from steering consumers to loans based on the fact that the originator will receive additional compensation, when that loan may not be in the consumer's best interest. Under the proposal, originators would violate the rule, for example, if they directed the consumer to a fixed-rate loan option from a creditor that maximizes the originator's compensation without providing the consumer with an opportunity to choose from other available loans from other

creditors that have lower fixed interest rates with the equivalent amount in origination and discount points.

A safe harbor would be created, and there would be no violation if the loan was chosen by the consumer from at least three loan options for each type of transaction (fixed-rate or adjustable-rate loan) in which the consumer expressed an interest, provided the following conditions are met. The loan originator must obtain loan options from a significant number of creditors with which the originator regularly does business. The proposed staff commentary indicates that three creditors would satisfy this "significant number" requirement. For each type of transaction in which the consumer expressed an interest, the originator must present and permit the consumer to choose from at least three loans that include: the loan with the lowest interest rate, the loan with the second lowest interest rate, and the loan with the lowest total dollar amount for origination points or fees and discount points.

The loan originator must have a good faith belief that these are loans for which the consumer likely qualifies. If the originator presents more than three loans to the consumer, the originator must highlight the three loans that satisfy the lowest rate and points criteria in the rule.

Comment

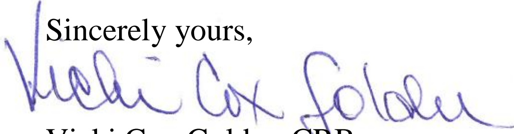
Since May of 2005, NAR has supported requiring mortgage originators to offer consumers greater choice among mortgage products in which they may be interested, focusing on the lowest-cost options. While it remains the responsibility of borrowers to decide which is the best mortgage for their needs and circumstances, they may only do so if they understand all the facts so they can make an informed decision.

NAR suggests that the Board consider requiring originators who offer loans with nontraditional features, such as negative amortization, interest only, balloon payments, or low/doc or no/doc underwriting, to (i) offer all borrowers a choice of several significantly different mortgage options; and (ii) include at least one traditional loan product as one of the options for the borrower to consider, if the borrower qualifies for such a product offered by the originator. While this requirement would have little practical effect in the current or foreseeable mortgage market, should such products return, consumers should receive as much information and as many choices as possible.

Does the requirement that the loan originator must obtain loan options from a significant number of creditors with which they regularly do business apply where the loan originator is the lender? It does not appear to be reasonable to require an FDIC-insured bank to offer the products of a competitor, though they should, of course, still be required to offer consumers a range of products. Clarification would be beneficial.

Thank you for the opportunity to present the views of the National Association of REALTORS®. If you have any questions or comments regarding this letter please contact Jeff Lischer, Managing Director for Regulatory Policy, at 202.383.1117/jlischer@REALTORS.org.

Sincerely yours,



Vicki Cox Golder, CRB
2010 President
National Association of REALTORS®

Enclosure

NATIONAL ASSOCIATION OF REALTORS®

RESPONSIBLE LENDING POLICY

Adopted May 2005

Why Do REALTORS® Seek to Prevent Abusive Lending?

REALTORS® have a strong stake in preventing abusive lending because:

- Abusive lending erodes confidence in the Nation's housing system.
- In a credit-driven economy, the legislative and regulatory response to lending abuses can go too far and inadvertently limit the availability of reasonable credit for prime as well as subprime borrowers.
- Citizens of communities, including REALTORS®, are harmed whenever abusive lending strips equity from homeowners, especially when the irresponsible lenders concentrate their activities on certain neighborhoods and create a downward cycle of economic deterioration.

Responsible Lending Principles

NAR supports the general principle that all mortgage originators should act in "good faith and with fair dealings" in a transaction and treat all parties honestly. NAR's Code of Ethics already imposes a similar requirement on REALTORS®, who are required to treat everyone in the transaction honestly. NAR encourages policy makers to use such a standard of care as a guiding principle when drafting anti-predatory lending legislation and regulations rather than using the phrase to create a new federal duty that would be too general and, therefore, too difficult to enforce.

1. Affordability. NAR supports strong underwriting standards that require all mortgage originators to verify the borrower's ability to repay the loan based on all its terms, including taxes and insurance, without having to refinance or sell the home.[1] Lenders should consider all relevant facts, including the borrower's income, credit history, future income potential, and other life circumstances. Lenders should not makes loans to borrowers that make loss of the home through sale or foreclosure likely if the borrower is unable to refinance the mortgage or sell.

- Underwriting Subprime Loans with "Teaser Rates." Some loans are structured with a significant jump in monthly payments often resulting in "payment shock" for the borrower. While these mortgages may be a reasonable choice for borrowers who can afford them, a majority of subprime borrowers do not understand the unique terms and conditions of these risky mortgage products that can result in a significant "payment shock." Therefore, lenders (including mortgage brokers) should exercise more caution when underwriting such loans to subprime borrowers to make sure the borrower is able to afford the mortgage. Examples of these risky mortgage products include loans with a short-term interest "teaser" rate for the first two or three years (known as 2/28s and 3/27s), loans with an initial interest-only period, and mortgages that negatively amortize.[2]

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[1] The limited exceptions to this general principle would include prime borrowers with sufficient verifiable assets to handle a balloon mortgage or a significant jump in mortgage payment.

[2] Negative amortization ordinarily results if the mortgage permits a borrower to pay less than the interest on the mortgage for a limited time, in which case the difference is added to the total amount of the loan the borrower must repay.

NAR will carefully monitor the debate on underwriting standards for subprime loans and will support policies consistent with the goal of assuring that borrowers who have demonstrated the financial capacity to meet their mortgage obligations, taking into account all relevant circumstances, continue to have access to mortgage loans made by responsible lenders.

- Reasonable Debt-to-Income Ratio. NAR supports requiring lenders to make subprime loans that have a reasonable debt-to-income ratio. Borrowers should have enough residual income after making their monthly mortgage payment, including taxes and insurance, to meet their needs for food, utilities, clothing, transportation, work-related expenses, and other essentials. Requiring underwriting at a fully amortizing, fully indexed rate is meaningless if the lender uses such high debt-to-income ratios that the family doesn't have enough income remaining to pay for other necessities.

- Escrow/Reserve for Payment of Taxes and Insurance. Lenders that make subprime mortgage loans should generally require that the monthly payment include an amount to be held by the mortgage servicer in an escrow/reserve/impound account for the payment of the borrower's periodic payments, such as taxes, insurance, and homeowner association/condominium fees. Similar to the exception for prime loans in some jurisdictions, borrowers that make at least a 20 percent downpayment should have the option to budget for these payments independently.

2. Limit Stated Income/Stated Assets Underwriting. Because mortgages underwritten based on "stated income" and/or "stated assets" (also known as "no income verification" or "no doc" loans) typically have higher rates, lenders making subprime loans should, as a general rule, underwrite loans based on verified income and assets.

3. Flexibility for Life Circumstances. NAR believes that a standard for determining a borrower's ability to repay must be flexible to accommodate borrowers with unique circumstances, such as:

- ✓ Borrowers who have demonstrated the ability to make monthly payments, over a long term, that are higher than underwriting standards would otherwise allow. Lenders should consider, for example, the borrower's history of making rent and student loan payments.
- ✓ Borrowers with high assets but low income who, for cash management or other financial planning reasons, elect a mortgage with a monthly payment that their current income is not sufficient to cover.
- ✓ Borrowers who anticipate a jump in income or assets due to life events such as graduation, completion of professional training, completion of payment obligations for student or car loans, another member of the household entering the work force when young children start school, or an inheritance.

4. Anti-Mortgage Flipping Policy. NAR supports an anti-mortgage-flipping rule requiring mortgage originators making or arranging for a loan that refinances an existing residential mortgage to verify that the new loan provides a significant benefit to the borrower (one test often proposed is the loan must provide a "reasonable net tangible benefit" to the borrower). The lender should consider the circumstances of the borrower, as discussed above, all terms of the new loan including taxes and insurance, the fees and other costs of refinance, prepayment penalties, and the new interest rate compared to that of the refinanced loan.

5. Bar Prepayment Penalties. NAR opposes prepayment penalties for all mortgages. Prepayment penalties often work to trap borrowers in loans they cannot afford by making it too expensive to

refinance. If complete prohibition of prepayment penalties is not feasible, NAR supports permitting prepayment penalties for the shortest time and the lowest amount possible. For example, a borrower in a 2/28 mortgage should be able to refinance by the end of the initial two-year "teaser" rate period without having to pay a prepayment penalty.

6. Improvements for Assessing Creditworthiness. Borrowers with little or no credit history, as traditionally measured, usually have lower credit scores and must pay more every month for their mortgage than those with higher scores. NAR supports ongoing efforts to take into account consumer payment history not typically considered, such as rent, utility, telephone, and other regular payments and urges HUD, the regulators, the GSEs, and lenders to work to strengthen these efforts. Use of alternative credit approaches will be especially beneficial for low- and moderate-income first-time homebuyers and borrowers with problematic loans that need to refinance their mortgage to avoid foreclosure.

Another public policy issue associated with credit histories is the failure of furnishers to report good payment histories to the consumer reporting agencies. NAR has heard reports that many problematic subprime lenders purposefully withhold information on timely mortgage payments from the credit bureaus in order to prevent their customer from refinancing with another lender. The result is obvious—the borrowers with no positive payment histories for their subprime loan keep treading the waters of high-interest rates and expensive credit products. NAR supports requiring all institutional mortgage lenders, or the mortgage servicers acting on their behalf, to report payment history of all borrowers to at least the three national credit bureaus on a monthly basis.

7. Mortgage Choice for Borrowers. NAR supports requiring mortgage originators to offer borrowers one or more mortgages with interest rates and other fees that appropriately reflect the borrower's credit risk. It remains the responsibility of borrowers to decide which is the best mortgage for their needs and circumstances, but they may only do so if they understand all the facts so they can make an informed decision. The following are suggested principles for consideration of Congress and the regulators:

- For originators who offer nontraditional mortgage products, the originator should:
  - offer all borrowers a choice of several significantly different mortgage options;
  - include at least one traditional loan product as one of the options for the borrower to consider, if the borrower qualifies for such a product offered by the originator; and
  - before application acceptance, disclose information about the maximum potential payment over the life of the loan and the date the initial payment will increase to a fully amortizing, fully indexed payment amount.

- For subprime borrowers, originators that offer FHA-insured mortgages or VA home loan guaranty mortgages should consider whether these types of mortgages should be offered as an appropriate option.

- If the originator does not offer mortgages with rates and fees appropriate for the borrower's credit risk, the originator should inform the borrower a lower interest rate may be available from another originator or that the borrower may wish to seek housing counseling, to allow the borrower an opportunity to shop elsewhere or receive counseling before proceeding. For example, a prime borrower that applies for a loan to a lender that only makes subprime loans should be advised that other options may be available.

- For loans originated by a mortgage broker, the broker should offer mortgage options that are among the lowest-cost products appropriate for the borrower.

8. Enforcement/Remedies. NAR supports enactment of strong remedies and penalties for abusive acts by mortgage originators. Among the options for consideration are:

- Criminal penalties similar to those under RESPA.

- Civil penalties similar to those under RESPA.

- Assignee liability that balances the need to protect innocent borrowers with problematic loans against the risk that increasing the liability of innocent holders of mortgages in the secondary market could reduce the availability of mortgage credit.

- Prohibition of mandatory arbitration clauses that bar victims' access to court.

9. **Strengthen Appraiser Independence**. NAR believes that the independence of appraisers should be strengthened to ensure that appraisals are based on sound and fair appraisal principles and are accurate. There are reports that appraisers have been pressured to meet targeted values or risk losing business. Appraisal pressure undermines the integrity of the mortgage lending process if the result is a mortgage loan made based on an inaccurate property valuation. NAR recommends the following measures to strengthen the appraisal process:

- Require lenders to inform each borrower of the method used to value the property in connection with the mortgage application, and give the borrower the right to receive a copy of each appraisal at no additional cost.

- Establish enhanced penalties against those who improperly influence the appraisal process. Those with an interest in the outcome of an appraisal should only request the appraiser to (1) consider additional information about the property; (2) provide further detail, substantiation, or explanation for the appraisal; and (3) correct errors.

- Provide federal assistance to states to strengthen regulatory and enforcement activities related to appraisals.

- Support enhanced education and qualifications for appraisers.