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April 7, 2008

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

RE: Truth in Lending, Regulation Z; Docket No. R-1305
[transmitted by e-mail to regs.comments@federalreserve.gov]

Dear Ms. Johnson:

On behalf of 1.3 million members of the National Association of REALTORS® (NAR), I am pleased to provide comments on the proposed rule[1] of the Federal Reserve Board (Board) to amend the Truth in Lending Act (TILA) Regulation Z to protect consumers in the mortgage market from unfair, abusive, or deceptive lending and servicing practices. The proposed rule is often called the HOEPA rule, since the authority for many of its provisions was enacted as part of the Home Ownership and Equity Protection Act of 1994 (HOEPA).

The National Association of REALTORS® (NAR) 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 1,500 local associations or boards, and 54 state and territory associations of REALTORS®.

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

- Abusive lending erodes confidence in the Nation's housing system.
- Abusive lending strips equity from homeowners and harms citizens of communities, including REALTORS®, especially when the irresponsible

[1] 73 Fed. Reg. 1672 (January 9, 2008).

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> lenders concentrate their activities on certain neighborhoods and create a downward cycle of economic deterioration that affects the entire community.

PROTECTIONS FOR HIGHER-PRICED MORTGAGE LOANS

The proposed rule proposes four protections for consumers with higher-priced mortgage loans. This creates a new category of mortgages that would include any closed-end loan that is secured by a consumer's principal dwelling and that has an annual percentage rate (APR) that exceeds the comparable Treasury security by at least three percentage points for first mortgages or five percentage points for subordinate mortgages. For these higher-priced mortgages, the rule would protect consumers by establishing underwriting rules related to repayment ability, requiring verification of income and assets, conditioning the use of prepayment penalties, and requiring creditors to establish escrow/reserve accounts for taxes and insurance.

NAR supports the proposal to establish special protections for the newly-defined higher-priced mortgage loans. As a general principle, we believe that the government and private sector response to abusive mortgage lending should focus on the segments of the mortgage market that have much too often failed to meet the needs of consumers for fair, affordable, and sustainable mortgages. Any regulation, of course, imposes costs on creditors that are typically passed on to consumers, so restrictions should be narrowly tailored. The preamble explains that the Board believes that the new definition will cover the subprime market and the higher cost end of the Alt-A market. As explained in the preamble, Alt-A mortgages are made to borrowers who have higher credit scores than subprime borrowers but who do not qualify for a prime mortgage because the borrower makes a small downpayment or the creditor underwrites the loan without documenting the income and/or assets of the borrower. The Board's intent is to cover the lower end of the Alt-A market, and NAR has no reason to believe this approach is not correct.

However, the Board should carefully review its definition of higher priced mortgages. The proposed system based on the number of percentage points above comparable Treasury securities may not achieve the intended result because the spread between Treasury securities and mortgage rates can vary significantly, especially during times, such as these, of relative instability in the credit markets. The effect of the proposed definition may be to cover too many mortgages or too few, depending on the spread at any given time.

As a general comment, the banking agencies should address inconsistencies between this proposed rule and the Interagency Guidance on Nontraditional Mortgage Product Risks[2] and the Statement on Subprime Mortgage Lending[3]. In our comments on those documents, NAR asked the agencies to clarify their enforceability but that suggestion was not addressed. The importance of removing that ambiguity, and now removing inconsistencies, is now even more critical.

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[2] 71 Fed. Reg. 58609 (Oct. 4, 2006)
[3] 72 Fed. Reg. 37569 (July 10, 2007)

In the following sections, we will comment on each of the protections the Board proposes for higher-priced mortgages.

Ability to Repay

Under the proposed rule, creditors could not engage in a pattern or practice of extending credit without regard to the ability of the borrowers to repay other than from the equity in the home, including current and reasonably expected income and obligations, employment, and other assets. The proposal includes rebuttable presumptions of a violation if the creditor engages in a pattern or practice of failing to:

- Verify and document the consumers' repayment ability;
- Consider the ability of consumers to make loan payments based on the interest rate computed under the regulation (the purpose of this is to avoid qualifying the borrower based on artificially low "teaser" rates);
- Consider the repayment ability of consumers based on fully-amortizing payment including taxes, insurance, and other periodic payments related to homeownership or the mortgage;
- Consider consumers' debt-to-income ratio; or
- Consider the residual income of consumers.

NAR supports strong underwriting standards that, as a general rule, require all mortgage originators, for all types of mortgages, to verify the borrower's ability to repay the loan based on all its terms, including taxes, insurance, and other periodic payments, without having to refinance or sell the home.[4] The objective of the proposed rule is consistent with this NAR policy, except that it is limited to higher-priced mortgages. We do, however, have concerns about the rebuttable presumption feature, for the reasons explained below.

We are pleased to see that the proposed regulation would allow lenders to consider not only the current income of the borrower, but reasonably anticipated income. (We suggested this flexible approach in connection with the Statement and the Guidelines, but do not understand those final documents as permitting the flexibility we recommended then and now support in the proposed rule.) While there is a risk that some lenders may abuse this authority, we think that without it underwriting standards would be tighter than necessary and would intensify the overreaction we are now seeing as market participants respond to the extremely serious weaknesses in recent underwriting.

Another feature NAR strongly supports is requiring creditors to determine, for higher-priced mortgages, that consumers will have a reasonable debt-to-income ratio. In addition, we support the proposal to require creditors to consider whether borrowers will have enough residual income after making their monthly mortgage payment, including

[4] 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.

taxes and insurance, so they will have sufficient resources to meet their needs for food, utilities, clothing, transportation, work-related expenses, and other essentials. The debt-to-income ratio that is appropriate will vary considerably among consumers because their incomes and expenditures vary so much. NAR urges you not to tie the hands of creditors by establishing a safe harbor or otherwise adopting a policy that could result in the setting of a hard maximum ratio that would unnecessary deny credit to some borrowers. However, we repeat the suggestion we submitted last August that the Board provide guidelines for creditors that take into account income, family size, and regional cost of living to help lenders in developing their policies. A sample grid could go a long way to helping creditors understand how to establish policies in this area that contribute to sustainable homeownership.

With respect to the proposed rebuttable presumptions, NAR strongly recommends that you reconsider the approach taken in the proposal. As we understand the proposed system, a rebuttable presumption would only arise if the consumer demonstrates that the creditor has engaged in a pattern or practice of failing in one of the five categories. It would not be an easy matter for a consumer, with relatively few financial or legal resources compared to most creditors, to prove that a creditor has engaged in a pattern or practice in any one of these categories (or based on another problematic policy, for that matter). It is the creditor, not the consumer, who knows whether or not there has been a pattern or practice. The difficulty of proving there is a pattern or practice is inadvertently suggested by the preamble when it explains a consumer could show there is a pattern or practice by showing that the creditor is acting under an unwritten lending policy. It would be hard enough to obtain a written lending policy to document a violation, much less one carried on informally, possibly for the very reason of making it harder to discover and stop.

NAR recommends an alternative approach. The presumption of a violation of the repayment ability underwriting requirement should arise if the creditor fails to meet any one of the tests with respect to any one consumer. Then the burden should be on the creditor to demonstrate that the violation was an isolated, random, or accidental occurrence. Otherwise, it will be extremely difficult for a consumer to prevail. We believe that creditors that apply written underwriting criteria that comply with the final rule should have nothing to fear.

Verification of Income and Assets

The proposed rule would require creditors to verify the income and assets of prospective borrowers in deciding whether to make higher-priced mortgage loans. If the creditor fails to verify income and assets, it may avoid a violation if it can show, after the fact, that it could have verified at least as much income and assets as it relied on in approving the loan.

NAR strongly supports the requirement for creditors to verify income and assets. Stated income/stated asset loans became a much larger share of the subprime market than could be justified, especially since almost all borrowers are able to provide

documentation of their income and assets. Too often, consumers have been steered into a stated income loan because the higher rates generated higher compensation for the creditor or mortgage broker. Consumers did not understand that there was a significant trade-off between saving a few days during the loan approval process and paying a higher interest rate every month for the life of the loan.

The proposed rule permits verification to be based not only on standard documents such as W-2s, tax returns, and pay stubs, but also on financial institution records and other third-party documents. We support this approach, which gives creditors flexibility in the relatively few cases where W-2s, tax returns, and pay stubs are not available. The Board should, however, require creditors to use the best documentation available, such as W-2s, tax returns, and pay stubs.

Prepayment Penalties

The rule would permit prepayment penalties for higher-priced mortgages only if:

- The penalty period expires after five years.
- The source of funds to prepay the mortgage is not from refinancing by the same creditor or its affiliate.
- The debt-to-income ratio of the consumer does not exceed 50 percent of gross income.
- The penalty period ends 60 days or more before the first reset date, if any, for principal or interest.

In May 2005, NAR adopted policy opposing prepayment penalties for all mortgages, without exception. Prepayment penalties often trap borrowers in loans they cannot afford by making them too expensive to refinance. While some lenders may, in fact, offer lower rates in exchange for a borrower agreeing to a prepayment penalty, in the experience of many REALTORS®, that option is rare. A 2005 study by the Center for Responsible Lending concluded that borrowers with subprime loans and prepayment penalties do not receive lower interest rates, and may actually pay higher rates.[5] Professor Kathleen Engel, a member of the Consumer Advisory Council, also recommended to the Board during its March 6, 2008, public meeting that it abolish prepayment penalties, noting that there has not been a major negative impact on credit availability in states that have done so.

If the Board determines not to prohibit prepayment penalties for all mortgages, NAR urges the Board to bar their use for higher-priced mortgages. Failing that, the Board should permit prepayment penalties only for the shortest time and the lowest amount possible. The maximum repayment period should not exceed two years, with a maximum amount on a decreasing scale of two percent for the first year and one percent for the second. The other limitations as proposed should be retained.

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[5] "Borrowers Gain No Interest Rate Benefits from Prepayment Penalties on Subprime Mortgages," Center for Responsible Lending (January 2005).

The use of prepayment penalties with terms that extend beyond the initial fixed interest rate period that is a feature of many adjustable rate mortgages is particularly egregious, and NAR is glad the Board would prohibit this for higher-priced mortgages. But the problem occurs for other mortgages as well, and prepayment penalties should not trap any borrower in a loan they cannot afford. This element of the prepayment penalty criteria should apply to all mortgages.

If you do decide to permit prepayment penalties, NAR recommends that where a creditor offers a consumer any mortgage with a prepayment penalty it be required also to offer a mortgage without a prepayment penalty so the consumer can have a reasonable opportunity to compare the terms. Such a requirement could, ideally, result in prepayment penalties that do, in fact, offer consumers a benefit.

Escrows/Reserve for Taxes and Insurance

Finally, in connection with higher-priced mortgages, creditors would be required to establish an escrow/reserve account for the payment of taxes, insurance, and other periodic payments related to homeownership or the mortgage. Creditors would have the option to give borrowers the option to opt out of the escrow/reserve requirement after 12 months.

NAR strongly supports requiring creditors to establish escrows/reserves. Unlike lenders making prime mortgage loans, subprime lenders typically do not. NAR knows of no reasonable explanation for this counter-intuitive practice. One inappropriate reason is to make refinancing, together with another round of fees, necessary for many borrowers as they face unplanned-for tax and insurance bills they cannot afford to pay. Another possible explanation is that lenders have intentionally chosen to underwrite subprime loans without considering the costs of taxes and insurance in order to approve more loans and, in turn, receive more fee income.

NAR opposes giving creditors the option to allow borrowers to opt out of the escrow/reserve provision after one year. This proposal does not adequately protect consumers, especially first-time homeowners, who after only one year will often still not be in a position to budget for these amounts on their own. We are not aware that this is a typical approach used for prime loans. Accordingly, we urge the Board to tighten the opt out feature, using an exception like that available for prime loans in some jurisdictions. Once a borrower's loan-to-value ratio is less than 80 percent, the borrower should have the right to budget for these costs without the mandatory escrow/reserve.

NAR recommends an additional exception. Borrowers who make at least a 20 percent downpayment should have the option to budget for these payments on their own from the beginning. Some jurisdictions give consumers this right already, and we believe it is appropriate for the relatively few borrowers who make a large down payment in connection with a higher-priced mortgage.

PROTECTIONS FOR ALL MORTGAGE LOANS

The rule also proposes three new protections to all mortgage loans secured by a consumer's principal dwelling. These relate to yield spread premium payments to mortgage brokers, appraisals, and servicing.

Creditor Yield Spread Premium Payments to Mortgage Brokers

The proposed rule prohibits creditors from paying mortgage brokers a yield spread premium unless the payment is no more than the dollar amount the broker has disclosed to the consumer pursuant to a written agreement with the consumer. In addition to the maximum amount of compensation the broker will receive, the agreement must inform the consumer that (1) the consumer is, in fact, making the payment to the broker, indirectly, and (2) the payment to the broker can influence the broker to offer the loans to the consumer on terms that are not in the consumer's best interest or not the most favorable that the consumer could obtain. The broker must make this disclosure before the consumer pays any fee to anyone in connection with the loan or submit a written application to the mortgage broker.

The new requirements would not apply to a transaction:

- Subject to a state law or regulation that imposes a duty on mortgage brokers not to offer mortgages that are not in the interest of the consumer or are less favorable than the consumer could obtain and that the broker must give consumers a written agreement describing the broker's role as defined by state law; or

- Where the creditor can demonstrate that the amount it pays the broker is not determined by reference to the interest rate on the loan (i.e., where the payment is not a yield spread premium).

The proposed rule has the potential to harm consumers:

- The Board explains that it believes mortgage brokers, under this proposal, would be likely to use an average cost pricing approach. We are concerned that, instead, many mortgage brokers would elect to disclose a very high amount to be on the safe side. This amount will be of no use to a consumer who wants to comparison shop, and it will be virtually impossible to negotiate at this early stage since the broker does not know if a consumer has good credit and will easily qualify for a wide range of affordable mortgages.

- The high amount disclosed under the proposed system would tend to increase, not decrease, yield spread premiums. Many consumers, once they file an application or pay a fee, will no longer shop for a better

mortgage or a lower mortgage broker fee. And it is even less likely they will shop after the broker offers them a mortgage. This reduces incentives for a mortgage broker to reduce the fee. The result could be that even a prime borrower with a large down payment and low debt-to-income ratio could pay more than necessary or appropriate.

- The goal of structuring the requirement as a limitation on creditors that may only pay mortgage brokers up to the amount disclosed in the agreement with the consumer may not have the intended result. Creditors will have no incentive to intervene to assist consumers avoid the problems described in the preceding two bullets. In fact, the incentive is not to do so since the creditor has an interest in the consumer paying a higher interest rate on the loan.

Appraisal Standards

The proposed rule would prohibit mortgage brokers and creditors from coercing appraisers to misrepresent the value of a consumer's principal dwelling. Further, creditors would be prohibited from extending credit when creditors know, or have reason to know, that an appraiser has misstated a dwelling's value on any consumer credit transactions secured by the consumer's principal dwelling. The proposed rule gives examples of acts that would violate the regulation and examples of acts that would not. For example, failing to compensate an appraiser because a dwelling was not appraised at a specific value would violate the regulation but requesting that an appraiser consider additional information for, provide additional information about, or correct factual errors in valuation, would not violate the regulation. The regulation could provide enforcement agencies at the state level with a basis for action on alleged appraiser coercion.

NAR strongly supports the independence of appraisers and the integrity of the appraisal process. The improper influencing of appraisers can distort the lending process when appraisals are inflated and understated. Consumers are harmed by inflated appraisals because they can lead borrowers to believe there is more equity in the home than is actually available. Conversely, understated appraisers can result in consumers being denied credit. Improperly influenced appraisers can also impact entire neighborhoods since appraisers consider the value of comparable properties in their analyses.

Servicing Practices

The proposed rule would prohibit servicers from engaging in specified activities:

- Failing to credit a payment as of the date of receipt.
- Imposing late fees in connection with a payment when the only delinquency relates to late fees relating to earlier payments—a practice known as pyramiding.

- Failing to provide a list of fees and charges within a reasonable time, upon request.
- Failing to provide an accurate statement of the outstanding principal balance of the loan, (pay-off statement)

NAR is concerned that some servicing practices are contributing to current high level of foreclosures and delinquencies and supports the Board's proposals to prevent unfair servicing practices.

INCONSISTENCIES WITH HUD'S PROPOSED RESPA RULE; REQUEST FOR PARTIAL REPUBLICATION OF PROPOSED RULES

As a final general comment, NAR is concerned that conflicts exist between the Board's proposed HOEPA rule and HUD's proposed RESPA rule. Creditor, mortgage broker, and consumer confusion appear inevitable.

As described above, the HOEPA rule would prohibit a creditor from paying a mortgage broker a yield spread premium unless the broker and the consumer have entered into an agreement specifying the maximum payment to the broker and making several required disclosures. The written agreement must be entered into before the consumer pays a fee to any person or submits a written application to the broker, whichever occurs first. This is intended to promote transparency and improve competition by giving consumers the tools they need to shop for the best deal before they become "locked in" to a relationship with the broker by paying a fee or submitting an application.

HUD's proposed RESPA rule creates a new "GFE application" for which a fee may be charged. The application is comprised of six elements that would allow a mortgage loan originator to arrive at a preliminary credit decision. The interest rate stated on the GFE would be available until a date set by the loan originator. After that date, the interest rate and some of the broker's loan origination charges could change until the interest rate is locked.

There are several conflicting provisions which will need to be addressed. First, the Board's rule does not permit total broker compensation to increase once a fee or application is submitted, while the RESPA proposed rule allows a broker to change both the interest rate and its compensation after a specific period determined by the broker as stated in the GFE. A borrower will be confused by entering into an agreement with a mortgage broker that establishes a maximum amount of broker compensation, and receiving a different RESPA document which allows for the possibility that it will be exceeded.

A borrower will also be confused by the Board's proposal to require a broker to commit to total compensation before any fee or application is submitted, and the RESPA proposed rule that would allow a broker to require the borrower to pay a fee before providing a GFE containing a temporary commitment.

Lenders have a responsibility to ensure that consumers understand the loans they receive, including their terms and all associated costs. NAR recommends that consumers receive a summary GFE, accompanied by a detailed GFE that explains each subcategory of fees to help consumers more fully understand the services they are receiving and the cost of each service. The detailed GFE should track the HUD-1 settlement form to simplify comparing the up-front estimate and actual costs at closing.

The two rules seek the same goals of promoting fair and transparent markets for mortgage loans and allowing consumers to shop for the best mortgage. Both the Board and HUD are aware of the overlapping proposed rules and have expressed their intention to work together to achieve shared goals. The agencies should resolve these inconsistencies before publishing the final rules.

Thank you for the opportunity to submit comments on the proposed rule to address unfair, deceptive, and abusive lending practices in the mortgage markets. Please contact Jeff Lischer, Manager, Financial Services (202.383.1117; jlischer@realtors.org) if you have any questions regarding our comments.

Sincerely yours,

Richard F. Gaylord, CIPS, CRB, CRS, GRI
2008 President, National Association of REALTORS®

cc: The Honorable Brian D. Montgomery, Assistant Secretary for Housing - Federal Housing Commissioner