



David A. Paterson
Governor

STATE OF NEW YORK
EXECUTIVE DEPARTMENT
CONSUMER PROTECTION BOARD

Mindy A. Bockstein
Chairperson and Executive Director

April 8, 2008

Via Electronic Mail

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

Re: **Regulation Z**: Docket No. R-1305

Dear Ms. Johnson:

On behalf of the New York State Consumer Protection Board (CPB), I am pleased to submit comments on the proposed amendments to Regulation Z, which implements the Truth In Lending Act and Home Ownership and Equity Protection Act.

The CPB, established in 1970 by the New York State Legislature, is the State's top consumer watchdog and "think tank." The CPB's core mission is to protect New Yorkers by publicizing unscrupulous and questionable business practices and product recalls; conducting investigations and hearings; enforcing the "Do Not Call Law"; researching issues; developing legislation; creating consumer education programs and materials; responding to individual marketplace complaints by securing voluntary agreements; and, representing the interests of consumers before the Public Service Commission (PSC) and other State and federal agencies.

The CPB has been working with public and private-sector entities to assist homeowners at risk of foreclosure. The Agency also conducts educational outreach on predatory lending and purchasing and sustaining homeownership. We acknowledge that the proposed rule amendments are important steps to eliminating unfair, abusive, and deceptive practices in the mortgage lending industry. In addition, they advance a measure of transparency. We set forth our specific comments below.

Good Faith Estimates.

The CPB commends the Federal Reserve Board's (the Board) proposal to ban charging of fees, other than a reasonable fee for a credit report, in order to obtain a



Good Faith Estimate (GFE). (Proposed Section 226.19). If consumers are forced to expend hundreds of dollars in order to receive a single GFE, it is unlikely they will expend more money in the hope that they can get better terms from another lender. The actual language of proposed Section 226.19 could be interpreted to mean, however, that once a consumer receives a GFE, he or she immediately owes a fee to the creditor. This would defeat the purpose of the rule. A creditor/mortgage broker should only be able to charge a fee after the consumer indicates that he or she wishes to go forward with the application process. The proposed rule should specify this requirement.

Prepayment Penalties.

The CPB supports the Board's restriction of prepayment penalties for higher-priced loans. (Proposed Section 226.32(d)(7)). Of particular importance to the consumer is the provision in the proposed rule that the penalty period must end at least sixty days before the first date in which principal or interest is set to increase. (*Id.*) A consumer should be able to refinance out of an unfavorable adjustable rate loan without incurring thousands, if not tens of thousands, of dollars in penalties. The proposed rule should go further, however, and ban prepayment penalties for all loans, rather than just higher-priced loans, as all consumers are potentially adversely affected by this practice.

Yield Spread Premiums.

As a first step, the CPB favors the disclosure of all compensation paid to the mortgage broker, including yield spread premiums. Currently, in the mortgage industry, mortgage brokers/loan originators and consumers have divergent interests. The consumer wants the lowest overall price, while the mortgage broker presumably wants to maximize his or her earnings. To compound matters, the consumer may not realize that the mortgage broker/creditor has divergent or conflicting interests from his or her own. Payments made by the creditor may not be fully disclosed, or if they are, only at settlement and at that point it is too late for a consumer to back out. Thus, the only time disclosure of broker compensation is meaningful to the consumer is if it is disclosed before the consumer has expended significant sums of money; i.e. before the application.

However, there is no reason to limit the proposed compensation disclosures to mortgage brokers. Lender employees and mortgage brokers have the same motivations and temptations. This is because lenders typically have a variety of loan products available to a consumer. Some of the products may be more profitable to the lender than others, and if an employee's compensation were linked to consumers selecting those more profitable loans, one could predict that employees would steer consumers towards those loans, even though they are less beneficial to the borrower. Only by mandating disclosure of all compensation paid in connection with the loan can we eliminate this abusive practice. Further, the disclosure must be clear and in plain language so that a consumer can appreciate its significance.



The proposed rule, as written, has another deficiency in need of addressing. The exception to the compensation disclosure requirement set forth in paragraph (a)(2)(iii) of proposed section 226.36 creates a loophole that will likely be exploited by both creditors and mortgage brokers. The proposed rule provides that no disclosure of a set fee is necessary “where the creditor can demonstrate that the compensation it pays to a mortgage broker in connection with a transaction is not determined, in whole or in part, by reference to the transaction’s interest rate.” While this might eliminate one type of steering, this exception will allow mortgage brokers to continue to direct consumers towards certain lenders who offer other types of incentives to the brokers. For instance, it is foreseeable that in response to this new rule, a creditor would compensate brokers not for each individual loan, but based on the volume of loans that a broker steers to the creditor, thereby avoiding the disclosure requirement and defeating the purpose of the rule. By permitting such an exception, the Board is perpetuating the current divergent interests between the broker and the consumer.

Mandatory Escrows for Property Taxes and Insurance.

The CPB supports the provision of proposed Section 225.35(b)(4), which requires the creditor to escrow property taxes and insurance in higher-priced mortgage loans. In fact, escrows should be mandatory for all types of loans. Too often, first time borrowers may not appreciate the costs of property taxes and insurance, and thus when such payments (which can be considerable) become due, they cannot pay and subsequently go into default. Even if the borrower manages to find the money to pay the property taxes and insurance, the borrower is likely to be financially strained because he or she did not take into account the two largest additional costs of owning a home besides the mortgage. By escrowing taxes and insurance, and disclosing the expected monthly payment, the borrower will not experience these types of “surprises.” Some borrowers, however, may find it more beneficial to pay the taxes and insurance themselves. For this reason, it is important to allow the borrower to opt out of the escrow after 12 months, provided, however, that the borrower is provided clear and early disclosure regarding his or her continued obligations to pay property taxes and insurance.

Income Verification.

The CPB commends the Board’s proposal to require income verification of higher-priced loans. Here in New York, Governor Paterson has put forth legislation that is even more expansive, requiring income verification for all loans.

Advertisements.

The CPB supports the Board’s proposal to amend advertising rules. In particular, the clear and conspicuous requirement for payments, fees and rates will provide



valuable information to the consumer. In relation to Internet advertisements, all information about rates or payments that apply for the term of the plan should be stated in close proximity to any advertised introductory rates or payments, without the consumer having to click onto a link. Advertisements and disclosures should also be user-friendly to the disabled community.

The CPB also supports the provision of the proposed rule that characterizes as misleading all advertisement scenarios where some trigger terms or required disclosures are made in a foreign language while other key terms are only in English. (Proposed Section 226.24 (i)(7).) If a creditor or mortgage broker chooses to advertise in a foreign language, all key disclosures should be made in that language.

Appraisals.

The CPB commends the Board's proposal to specifically bar the coercion of an appraiser. (Section 226.36(b).) Although an appraisal is traditionally used for the lender's benefit, rather than the borrower's, the borrower will often rely upon the appraisal to prove that his or her new home is indeed worth the purchase price. Anecdotal evidence abounds,¹ however, that appraisers have been pressured to provide an inflated appraisal so that the sale will close. Only when the homeowner sells the house, or attempts to refinance, does he or she discover that the original appraisal was overstated and that he or she has less equity in the house. All borrowers must be able to hold accountable those responsible for overstating appraisals.

Servicing Abuses.

The Board's proposed rules are a step in the right direction to curb rampant servicing abuses. Of particular benefit to consumers is the provision banning the pyramiding of late fees. This practice makes it much more difficult for a consumer to become current on his or her payments. The CPB supports the provision requiring creditors or servicers to credit payments as of the date received. While this is not addressed in the proposed rule, there is no reason to treat partial payments differently.

¹ New York's Attorney General recently announced cooperation agreements with Fannie Mae and Freddie Mac, and their federal regulator, the Office of Federal Housing Enterprise Oversight (OFHEO), to only buy loans from banks that "meet new standards designed to ensure independent and reliable appraisals." Press Release, New York Attorney General Cuomo Announces Agreement with Fannie Mae, Freddie Mac, and OFHEO, March 3, 2008. The State of Ohio has sued 9 mortgage brokers and lenders for unlawfully influencing appraisals. See Brian Louis and Sharon L. Crenson, *Ohio Sues Real Estate Firms for Pressuring Appraisals*, June 7, 2007, found at <http://www.bloomberg.com/apps/news?pid=20601087&sid=aQdSUG9peQGM> (last visited April 4, 2008)



Conclusion.

In proposing these above-described rules, the Federal Reserve Board has taken an important first step in protecting consumers in the mortgage market from unfair, abusive, and deceptive lending and servicing practices, while at the same time promoting responsible homeownership. However, we urge the Board to review or study the impact of the final rules on both the marketplace and homeownership to determine whether there is a need for further reform in light of the ongoing subprime and foreclosure crisis. Further, we support the Board's position of continuing to study and test mortgage disclosures to ensure that consumers receive timely, comprehensive information to enable them to make informed decisions.

Thank you for your consideration of our comments.

Sincerely,



Mindy A. Bockstein
Chairperson and Executive Director

