Consumer Mortgage Coalition

February 1, 2011

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Truth in Lending Proposed Rule – Inflation Adjustment
Docket No. R-1399, RIN No. 7100-AD59

Dear Ms. Johnson:

The Consumer Mortgage Coalition (CMC), a trade association of national mortgage lenders, servicers, and service providers, appreciates the opportunity to submit comments on the proposed rule. The Board of Governors of the Federal Reserve System (the Board) proposes to amend Regulation Z to implement a required inflation adjustment.

The Board proposes to implement section 1100E of the Dodd-Frank Act,[1] which increases the dollar threshold for an exemption from the Truth in Lending Act (TILA) for certain credit transactions. The dollar amount is doubled from $25,000 to $50,000, and it is required to be adjusted for inflation annually. Section 1100E becomes effective on the designated transfer date.[2] As revised, the statute would exempt from TILA the following:

> Credit transactions, other than those in which a security interest is or will be acquired in real property, or in personal property used or expected to be used as the principal dwelling of the consumer and other than private education loans (as that term is defined in section 140(a)), in which the total amount financed exceeds $50,000.[3]

The Board states that, for open-end credit, it "believes it is appropriate to determine whether an account is exempt under § 226.3(b) at account opening."[4] We agree with the Board. Creditors need to know whether an account will be subject to Regulation Z before opening it because Regulation Z affects how the account must be originated and how it must be serviced.

The applicability of Regulation Z also affects the pricing for the account. Accounts

[1] Dodd-Frank Act, Pub. L. No. 111-203, § 1100E, 124 Stat 1376, 2111 (2010) (to be codified at TILA § 104(3)).
[2] Dodd-Frank Act, Pub. L. No. 111-203, § 1100H, 124 Stat 1376, 2113 (2010).
[3] TILA § 104(3), as revised by the Dodd-Frank Act.
[4] 75 Fed. Reg. 78636, 78638 (December 16, 2010).

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subject to Regulation Z are more expensive to open and to maintain, and creditors price in these costs when first extending credit.

However, contrary to the Board's belief that application of Regulation Z should be known at account opening, the proposal would subject some open-end loans that are exempt from Regulation Z at consummation to Regulation Z later, depending on events not contemplated by section 1100E. If an open-end account were to become subject to Regulation Z after it is opened, the proposal would require creditors either to begin to comply with Regulation Z "within a reasonable period of time" or permit the consumer to fully repay the extension of credit, if permissible. Creditors would be required to provide account-opening disclosures under § 226.6 and periodic statements under § 226.7.

Retroactive application of Regulation Z to preexisting open-end accounts is not feasible because neither TILA nor Regulation Z were designed for that purpose. A number of issues would arise, which the proposal does not consider. We do not believe this is what Congress required when it added an inflation adjustment to TILA. Nor do we do believe it would be advisable policy because creditors would be unable to comply. We urge the Board not to apply TILA and Regulation Z retroactively when Congress simply mandated an inflation adjustment.

Background

For loans not secured by real property or a consumer's principal dwelling and that are not private education loans, under the proposal, the exemptions would be eliminated in the following circumstances:

- An existing open-end account would become newly subject to Regulation Z if the creditor were to reduce an express written commitment to extend credit below $25,000 before July 21, 2011.[5]

- If an account were opened before July 21, 2011 with a required initial extension exceeding $25,000, and if the extension has not occurred by July 21, 2011, the account would lose its exemption, unless the creditor, before that date, makes a firm commitment to extend credit in excess of the threshold.

- If an open-end account were exempt at account opening because a firm commitment to extend credit exceeds the applicable threshold, to remain exempt, either (a) the commitment would need to continue to exceed the threshold even as the threshold increases with inflation, or (b) an initial, single, advance would need to exceed the threshold applicable at the time of the advance. If an initial advance were below the then-applicable threshold, the exemption based on the amount of the credit outstanding would be permanently gone, even if the same day a second advance were to bring the outstanding loan amount above the threshold.

[5] July 21, 2011 is currently the scheduled Dodd-Frank "designated transfer date." It is possible that the date will change. We recommend that the Board avoid writing a regulation that would need to be revised in the event the designated transfer date is changed.

The Proposal Exceeds the Mandated Inflation Adjustment and Would Be Unworkable

Congress mandated an inflation adjustment in a dollar figure, not a retroactive application of TILA.

The Board explains that its proposal would prevent an "anomalous" result that one loan made before an inflation adjustment in the threshold would be exempt from TILA while another loan made after the adjustment would be subject to TILA.

> [A]n account opened in December might qualify for an exemption based on a firm commitment while an identical account with the same firm commitment opened in January would not because the applicable threshold amount had increased.[6]

This result is not anomalous, it is *exactly* what Congress mandated – the exemption threshold must increase. The exemption must increase based on the dollar amount of the loan or loan commitment at consummation. We do not believe the Board has the authority to avoid the Congressional mandate.

This proposed rule would draw a distinction in the applicability of TILA between a loan with an initial advance in excess of the threshold and a loan with two advances close together, perhaps just hours apart, that exceed the threshold combined but the first of which does not. The proposed rule would apply TILA to the second account but not the first.

The proposal does not address the statutory language that underlies the design of TILA. TILA was designed to require disclosures of loan terms before a loan is consummated so that consumers can understand the terms before they agree to the loan. To apply TILA pre-consummation disclosures retroactively to loans that were made months or years before the preconsummation disclosures are required would run counter to the purpose of the statute, the language of the statute, and indeed the design of the statute. To try to apply TILA in this manner would lead to some very anomalous results. Compliance would be impossible.

The statute applies the exemption threshold to certain loans "in which a security interest is *or will be* acquired in real property, or in personal property used *or expected to be used* as the principal dwelling . . . ."[7] That is, the statute directs the Board to apply the exemption to loans at or just before origination, *before* the security interest is in place. It does not direct the Board to extend the time for application of the dollar threshold long after loan consummation. A loan's dollar amount must make the loan either subject to or exempt from TILA at consummation.

Elsewhere, TILA makes clear that the exemption applies or does not apply based on the

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[6] 75 Fed. Reg. 78636, 78639 (December 16, 2010).
[7] TILA § 104(3) (emphasis added).

dollar amount at consummation:

"It is the purpose of this title 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 . . . ."[8] TILA disclosures can only assist shopping for credit, the purpose of TILA, if they are provided before a consumer signs and accepts a loan.

TILA requires that "[b]efore opening any account under an open end consumer credit plan, the creditor shall disclose to the person to whom credit is *to be extended* each of the following items . . . ."[9] "Before" cannot mean "after." Credit that is "to be extended" has not yet been extended. TILA clearly requires those disclosures only before the account is opened, not after.

The TILA definition of "finance charge" is "the sum of all charges, *payable* directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit. The finance charge does not include charges of a type *payable* in a comparable cash transaction."[10] After a loan closes, origination charges that have been "paid" and are no longer "payable" cannot be included in the finance charge. TILA was not designed to disclose a finance charge months after a loan has closed.

TILA sets out accuracy tolerances for the dollar amount of certain disclosures. There can only be one reason for this – that the amounts may not be knowable when the disclosure is required. That is, TILA is not designed to require origination disclosures months or years after consummation.

TILA defines the annual percentage rate on closed-end loans as "that nominal annual percentage rate which *will* yield a sum equal to the amount of the finance charge when it is applied to the unpaid balances of the amount financed[.]"[11] This definition is of a rate that will yield a sum in the future. This definition is not intended to apply to a loan months after consummation.

The proposal would require creditors to comply with § 226.6, which requires account-opening disclosures, within a reasonable time of an existing account becoming subject to TILA.

It is not clear what a reasonable amount of time might be. We recommend that this be clarified, but the Board should understand the complexities involved. For example, the creditor may need to readjust the billing cycle, retrieve underwriting documents, and determine whether state law incorporates Regulation Z requirements by reference. The loan may also need to be moved from a system that cannot comply with TILA origination or servicing disclosures to a system that that has that functionality. If the creditor does

[8] TILA § 102(a).
[9] TILA § 127(a) (emphasis added).
[10] TILA § 106(a) (emphasis added).
[11] TILA § 107(a)(1)(A) (emphasis added).

not have that system, the creditor may be required to sell the loan at a fire sale price. If the creditor does retain the loan, the loan will need more than one layer of review because of the number of complicating issues that arise in making consummation disclosures long after consummation. In summary, creditors will need substantial time to complete this complex set of undefined disclosures.

It is very unclear how a creditor could do so in connection with a loan consummated earlier. The Board states that a creditor must provide the disclosure required by § 226.6 reflecting the current terms of the account. It is not clear what date to use. We suggest that it should be no sooner than the current date after the creditor has enough time to prepare the disclosure.

Section 226.6 requires disclosure of a finance charge. The finance charge definition includes certain charges that are "payable" by the consumer. If they have already been paid, they are no longer payable. What would the definition of the finance charge be for loans made subject to Regulation Z long after closing?

Section 226.6(a)(1)(i) requires disclosure of "when finance charges begin to accrue[.]" This does not require disclosure of when finance charges "began" to accrue. Does the Board intend to require disclosure that finance charges began to accrue at consummation, a fact that consumers already know? Or does the Board intend to require disclosure only of finance charges that will accrue after Regulation Z applies to the account, as under the regulatory language? Without clarity, creditors would need to consider disclosing both, in the hope that one of the disclosures might be compliant.

Section 226.6(a)(1)(ii) requires disclosure of "each periodic rate that may be used . . . ." Does this require disclosure of rates that were used in the past and that will no longer be used? If so, consumers are sure to be misled.

Section 226.6(a)(1)(iii) requires disclosure of "the method used" to determine the balance on which a finance charge may be computed. This time, the operative verb is in the past tense. For purposes of preconsummation disclosures prepared long after consummation, is there to be a distinction under § 226.6 between disclosures described by verbs in the past tense and those described by verbs in the future tense? If not, which is the proper tense, past or future? If it is the future tense, that is, if creditors are required to make the disclosures prospectively, from which date must the disclosures be made?

Section 226.7(b)(6)(iii) would require creditors to begin disclosing fees imposed during a billing cycle and for the year to date. Would this include fees imposed before the loan was subject to Regulation Z? Does Regulation Z require disclosures for loans not subject to the regulation?

TILA can subject creditors to great litigation risk and liability. Creditors therefore require clear disclosure requirements. The current proposal would leave extreme uncertainty about what would be required.

Moreover, the proposal to require retroactive application of Regulation Z would put

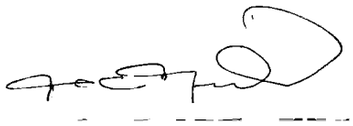
creditors in an inappropriate dilemma. Faced with TILA litigation risk in trying to resolve the issues described in this letter, creditors may be able to avoid that risk by increasing a loan commitment or amount. That is, this proposal would force creditors to select between an unsafe and unsound litigation risk or an unsafe and unsound increase in a loan commitment. This does not seem to be appropriate federal policy.

Alternatively, creditors could comply by selling the loan. However, potential buyers would know that the creditor is selling under duress and would be able to lower the price, especially as the Regulation Z compliance date draws near. Implementing a rule that would effectively result in lenders incurring losses on performing loans also seems to be inappropriate federal policy.

Conclusion

We respectfully urge the Board to implement the Regulation Z inflation adjustment in a manner that will permit compliance. A retroactive requirement for origination disclosures is beyond the design of TILA and of Regulation Z and would therefore not be feasible. Retroactively requiring Regulation Z periodic statements, while well-intentioned, would not be feasible without a significant rulemaking to address the myriad issues, such as the definition of the finance charge, the amount of time creditors would need to come into compliance, and options for those creditors unable to comply.

Sincerely,



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Executive Director