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October 15, 2012

Monica Jackson
Office of the Executive Secretary
Bureau of Consumer Financial Protection
1700 G Street, N.W.
Washington, DC 20552

Subject: Proposed Appraisals for Higher-Risk Mortgage Loan ("HRML") Rule Pursuant to Section 1471 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act")
Docket No. CFPB-2012-0031
RIN 3170-AA11

Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW.
Washington, DC 20551

Subject: Proposed Appraisals for Higher-Risk Mortgage Loan ("HRML") Rule Pursuant to Section 1471 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act")
Docket No. R-1443
RIN 7100-AD90

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation ("FDIC")
550 17th Street NW.
Washington, DC 20429

Subject: Proposed Appraisals for Higher-Risk Mortgage Loan ("HRML") Rule Amending the Truth in Lending Act (Regulation Z) Pursuant to Section 1471 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act")

Alfred M. Pollard
General Counsel,
Federal Housing Finance Agency
Eighth Floor, 400 Seventh Street SW.
Washington, DC 20024

Subject: Proposed Appraisals for Higher-Risk Mortgage Loan ("HRML") Rule Pursuant to Section 1471 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act")
RIN 2590-AA58

Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314–3428

Subject: Proposed Appraisals for Higher-Risk Mortgage Loan ("HRML") Rule Pursuant to Section 1471 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act")
RIN 3133–AE04

Office of the Comptroller of the Currency ("OCC")
250 E Street SW.
Mail Stop 2–3
Washington, DC 20219

Subject: Appraisals for Higher-Risk Mortgage Loan ("HRML") Proposed Rule Pursuant to Section 1471 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act")
Docket ID OCC–2012–0013

Dear Sirs and Madams:

Thank you for the opportunity to comment on the proposed higher-risk mortgage loan amendments to the Truth-in-Lending Act and implementing Regulation Z.[1] These proposed regulatory amendments were published by the Consumer Financial Protection Bureau ("CFPB"), the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("FRB"), the Federal Deposit Insurance Corporation (the "FDIC"), the National Credit Union Administration ("NCUA"), and the Federal Housing Finance Agency ("FHFA") (collectively, "the Agencies") in the Federal Register on September 5, 2012, and will be referred as the "2012 HRML Proposal."[2] Our comments relate to several items contained in the 2012 HRML Proposal: (A) Questions 6, 7, 8, and 9; (B) Question 12; (C) Question 13; (D) Question 42; (E) Question 43; and (F) Question 44.

We are submitting these comments on behalf of our client, which provides loan origination software and loan origination documentation solutions for depository institutions.[3] Among other things, our client is in frequent contact with lenders and believes that it reasonably understands the prudent lending practices followed by its customers.[4]

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1 15 U.S.C. § 1601 *et seq.*; 12 C.F.R. § 1026.1 *et seq.*

2 77 *Fed. Reg.* 54722 (September 5, 2012).

3 Statements made in this letter are those of our client, and may not reflect other comments submitted by our firm relating to the 2012 HRML Proposal.

4 As more completely discussed below, while our client believes that the suggested changes are supported by the practices followed by their lending clients, the short period of time provided by the

(... continued)

A. Question 6, 7, 8, and 9: How should the Agencies account for a more inclusive finance charge in relation to the final rule relating to higher-risk mortgage loans?

As the Agencies point out, designation of a loan as an HRML under Section 1471 of the Dodd-Frank Act depends on a comparison between the annual percentage rate (the "APR") and an average prime offer rate (the "APOR"). The APOR is based on the Freddie Mac Primary Mortgage Market Survey, which reflects the values of interest rate and points consistently, but reflects other pricing terms inconsistently and generally omits third-party title and closing costs.[5] This creates a somewhat distorted comparison even based on the current APR calculation. However, in the CFPB's proposal integrating Truth-in-Lending Act disclosures and the Section 4 and 5(c) disclosures required by the Real Estate Settlement Procedures Act (the "2012 TIL-RESPA Integration Proposal"), the CFPB has proposed a more inclusive APR disclosure that would incorporate almost all closing costs, whether they be pricing terms or third-party closing costs.[6] This expanded APR would increase the distortion when comparing the APR to the APOR, causing significantly more loans to exceed the HRML threshold than would otherwise be contemplated under the current APR finance charge schema. In the proposal, the Agencies ask for commentary on various aspects of the proposed expansion of the finance charge schema for the APR calculation and its impact on HRML evaluations. On behalf of our client, we are merging the discussion of this topic for all four questions referenced above in order of our client's preference for the proposed solutions to this issue.

Preferred Option: Do not make significant changes to the APR calculation because it would have unintended state-law impacts that are not justified by the limited to non-existent benefit to consumers. Either retain the existing APR calculation for testing and disclosure purposes or retain the existing APR calculation for testing purposes and remove the APR disclosure.

As our client intends to comment in relation to the 2012 TIL-RESPA Integration Proposal, the simplest approach altogether would be to retain the current definition of

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(... continued)

Agencies to respond to the 2012 HRML Proposal has not afforded our client the time needed to assemble statistical and other supporting data for the positions contained in this letter.

[5] 77 *Fed. Reg.* 54730 (September 5, 2012).

[6] 77 *Fed. Reg.* 51116 (August 23, 2012).

finance charge for purposes of calculating the disclosed APR. Alternatively, the APR and APR-based disclosures could be removed from the integrated TIL-RESPA disclosures altogether. However, the existing finance charge schema and APR calculation should be retained. This APR calculation would continue to be used for loans for the purpose of performing APR-to-APOR tests on mortgage loans (and for disclosure for those loans that would not be subject to an integrated TIL-RESPA disclosure such as personal property residential mortgage transactions). This would be preferable to creating a new "all-in" APR with additional corrective remedies for HRML and other testing purposes for the following reasons:

1. The CFPB indicated in the 2012 TIL-RESPA Integration Proposal that two decades of consumer testing by the FRB, the U.S. Department of Housing and Urban Development ("HUD") and the CFPB has indicated that consumers do not understand the APR nor, when it is explained to them, use it as a tool when evaluating, comparing, or verifying loans.[7] In addition, the CFPB noted consumer confusion existed in relation to other items that relate to the APR calculation, such as the Amount Financed[8] and the Finance Charge[9], both of which have been removed from the Loan Estimate, and all three of these disclosures have been moved to the final page of the Closing Disclosure. Therefore, the benefit to consumers in updating the APR calculation and disclosure is extremely limited. In fact, the CFPB's consumer testing indicates that including information in disclosures that consumers do not understand or are not likely to use makes the disclosures as a whole less beneficial. Accordingly, the CFPB should consider eliminating the APR, Finance Charge, and Amount Financed disclosures altogether. The APR-to-APOR tests should then be based on either the existing APR calculation or a transaction coverage rate ("TCR") that is based on a slight modification to the existing finance charge rules.

2. The existing APR calculation is relied on heavily for a number of state purposes, such as tests for state high-cost mortgage loan laws and state usury calculations. Corrections that are applied for specific tests based

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[7] 77 *Fed. Reg.* 51223-51225 (August 23, 2012).

[8] 77 *Fed. Reg.* 51124, 51221, 51226-51228 (August 23, 2012).

[9] 77 *Fed. Reg.* 51226-51228 (August 23, 2012).

on Federal law will not affect these state laws. However, updating the definition of finance charge could result in the unexpected expansion of state high-cost home loan laws and the unintentional lowering of state usury ceilings since many of these state laws reference the definition of finance charge or the rules relating to calculation of the APR as set forth in the Truth-in-Lending Act and Regulation Z. This means that state legislatures and state regulators will have to undertake significant reviews and amendments of legislation and regulations that rely on the Federal law. Otherwise, for example, many loans that were not intended by the original state legislation to be subject to state high-cost mortgage loan laws and restrictions could become high-cost mortgage loans. This could have a significant impact on state economies, including the availability of mortgage credit.

For example, New York imposes certain disclosures and substantive requirements for loans designated "high-cost home loans" and lesser disclosure and substantive requirements for "subprime home loans."[10] The thresholds for such loans are based on comparing the APR "...calculated according to the provisions of the Federal Truth-in-Lending Act...and the regulations promulgated thereunder..." with the U.S. Treasury yield for "high-cost home loans" or the APOR for "subprime home loans," with similar rate thresholds for first-lien high-cost home loans as found in current Section 32 of Regulation Z, slightly lower thresholds for junior-lien high-cost home loans than found in current Section 32, and slightly higher triggers for "subprime home loans" than found for higher-priced mortgage loans ("HPMLs") under Section 35 of Regulation Z.[11] Obviously, significant consideration has been given by the New York legislature regarding the types of loans that they wish to regulate. New York is not the only state with laws that similarly rely on the finance charge definition and APR calculation rules found in Regulation Z. Modifying this definition and these rules in Regulation Z will have a significant ripple effect that will not be resolved by any "corrections" put into place for Federal tests. Our client believes that the proposed "all-in" finance charge definition for mortgage loans places a substantial burden on these state

[10] N.Y. Banking Law §§ 6-l and 6-m.

[11] *Id.*

legislatures and regulators and, if they fail to react in a timely and appropriate manner, state economies. According to Bankrate.com's report on its annual survey of closing costs, average title and closing costs on a $200,000 mortgage vary from a low of $1,453 in Missouri to a high of $3,622 in New York.[12] Obviously, changing to an all-in APR would automatically impose a significant increase in the mortgage loans covered by various high-cost home loan laws, including New York's high-cost home loan law. That same law would not otherwise be affected by any correction applied by the Agencies for the HRML test or by the CFPB to other tests. Since New York's closing costs are so high, so many loans would become high-cost home loans under New York law (which are not eligible for purchase by Fannie Mae or Freddie Mac), that it will be hard for any but the very highest income parties with the best credit ratings to obtain a mortgage loan in the state of New York without drastic changes to New York's law if the all-in APR is adopted at the Federal level. New York is but one example; this issue would affect many other states. All this to modify a disclosure that the CFPB has indicated provides almost no consumer benefit, as described above.

3. The Dodd-Frank Act mandates that the rules regulating HRMLs become effective no later than one year from the final rule, which must be promulgated by January 21, 2013. Yet, the "all-in" finance charge is being contemplated as part of the rules integrating the TIL-RESPA disclosures pursuant to Section 1032 of the Dodd-Frank Act, which is likely to take effect later. The changes integrating the TIL-RESPA disclosures are significant. The work involved in updating the APR calculation—and re-validating the existing APR calculation tests embedded in various systems—is significant. Furthermore, the change to the APR calculation will require significant additional updates to existing HRML, HPML, Escrow, and HOEPA calculations and re-validation of the accuracy of the updated tests. Changing the approach to the treatment of finance charges at this time when so many other changes are being required significantly adds to the burden on loan origination systems, financial institutions and examiners. This might be worthwhile if the consumer benefit was sufficient. However,

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[12] http://www.bankrate.com/finance/mortgages/2012-closing-costs/closing-costs-by-state.aspx.

consumer testing by multiple agencies indicates that the disclosures that are being affected are not even used by consumers for evaluating loans, as discussed above.

Second Option: If an all-in APR calculation is pursued, update the rate thresholds as opposed to adding a second TCR calculation schema

Although inferior to the above solution with regard to the probable impact on state consumer protection laws, legislatures and regulators, there is a simpler correction to the effects of changing to an all-in APR calculation on the various tests that compare an APR to an APOR than the adoption of an additional transaction coverage rate ("TCR") schema. That would be an increase in the rate thresholds that apply to mortgage loans for all such tests. The CFPB is proposing a fairly elaborate system with an all-in APR fee designation schema and a separate TCR fee designation schema that will be used for the tests comparing the APR to the corresponding APOR. In addition, an entirely separate fee designation system that starts with the traditional APR finance charge schema will be applied for determining what is a point and fee for HOEPA testing. Therefore, the CFPB is proposing not only to create two new fee schemata (all-in APR and TCR), it is also continuing the existing APR finance charge schema. Consequently, there will now essentially be three separate fee schemata for mortgage loans when previously there was one base fee schema. Given that the various compliance consultants, banking agencies, etc. already have a significant challenge educating their experts, including examiners, on the current system, by proposing this more complicated system, the CFPB is potentially increasing the costs not only of the market in general, but also of the Federal and state governments in enforcing the proposed, additional schemata.

Least Preferable Option: An HRML test based on an all-in APR calculation is not an acceptable solution

The Agencies sought comment on the impact of an all-in APR calculation if it were to be used for testing purposes. In the 2012 TIL-RESPA Integration Proposal, the CFPB has proposed that lenders optionally be permitted to use the all-in APR instead of the TCR and even suggested that the all-in APR could be used without a TCR for testing purposes. Assuming that an all-in APR calculation is adopted, use of such an all-in APR for the purpose of the Federal tests would not accomplish the goals for which those tests were created, which is to protect those consumers with greater vulnerability. As our client has already pointed out, the change to the APR calculation would place an extraordinary burden on state economies alone for very little consumer benefit regardless of any correction adopted for the tests. However, if the CFPB is not willing to consider this, the CFPB and the Agencies must consider the effect on the various tests over which the CFPB and the Agencies have responsibility.

As described above, the Agencies have acknowledged that the APOR is based on the Freddie Mac Primary Mortgage Market Survey, which only consistently factors in interest rates and discount points. As also previously mentioned, average non-origination title charges and closing costs on a $200,000 loan range from a low of $1,453 in Missouri to a high of $3,622 in New York. Therefore, including all of these costs as finance charges for the purpose of calculating the APR would result in a significant increase in the APR for mortgage loans. This means that, if this change is made and the various APR-to-APOR tests are based on an all-in APR, many prime rate mortgage loans and even better-than-prime rate mortgage loans would become HRMLs and HPMLs, and many prime rate mortgage loans might even become HOEPA loans and no longer eligible for purchase by Fannie Mae or Freddie Mac. For certain HRMLs, the lender would be required to provide a second appraisal at the lender's expense. According to a Spring/Summer 2010 article of the *Appraisal Press,* the average cost of an appraisal based on their survey ranged from a low of $296 for Illinois to a high of $615 in Alaska.[13] This is not an insignificant cost by any measure, and it is extremely hard to see the benefit of imposing such a fee on lenders when making loans at prime and better-than-prime rates. Doing so would mean that there would be no mortgage market for properties that had been acquired in the last six months, regardless of the value of the property, whether it had been improved, the quality of the consumer's creditworthiness, or the excellence of the loan terms.

B. Question 12: To what extent, if any, should the HRML requirements apply to construction loans?

Our client believes that construction loans should be exempted entirely from coverage under the HRML rule. Although our client does not feel its expertise is sufficient to comment on the nature and value of appraisals for construction loans, our client does point out that interest rates and fees tend to be significantly higher for construction loans and, therefore, covering such loans under the HRML rules is likely to result in application of the appraisal requirements to prime borrowers and not just borrowers who need extra protection.

Construction-only loans are temporary financings with the higher interest rates associated with such temporary financings and construction-permanent loans include

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[13] http://www.appraisalpress.com/documents/StateRegionalFees.pdf , available at http://www.appraisalpress.com/ and published by a la mode (http://www.alamode.com/).

a temporary financing phase. As noted by the Agencies, short-term loans include higher rates.[14] Beyond the short-term financing costs, construction loans have higher costs associated with the risk that may arise during construction, the fact that the loan is undersecured until construction is complete, and the risk of liens on the property by contractors, subcontractors, and providers of construction material. Furthermore, construction loans involve considerable administrative overhead due to the need to actively monitor the construction and disbursement process. Such loans often include additional fees, such as inspection fees and interest reserve accounts. Therefore, any rate or rate and fee threshold test that is designed for regular mortgage loans is bound to be overly inclusive in relation to a construction loan.

All of the concerns that the Agencies indicated as applicable to not excepting bridge loans from being covered by the HRML rules would also be applicable to construction loans. Indeed the risk of covering loans to prime borrowers rather than consumers who need additional protections would be even higher for construction loans than for bridge loans, because of the additional risks, and therefore costs, associated with construction loans. However, these loans clearly have benefits for some consumers, since these loans give consumers the opportunity to take control over the construction of their own home, without having saved sufficient funds to build the home in its entirety.

C. Question 13: To what extent, if any, should the HRML requirements apply to bridge loans?

As discussed in this section, our client strongly urges the CFPB to consider exempting bridge loans from the 2012 HRML Proposal. The Agencies have acknowledged in the 2012 HRML Proposal the difficulties of applying a test comparing the APR or even a TCR on a loan for temporary financing such as a bridge loan to a comparable APOR based on average prime rates in the typical mortgage market:

> Bridge loans are short-term loans typically used when a consumer is buying a new home before selling the consumer's existing home. Usually secured by the existing home, a bridge loan provides financing for the new home (often in the form of the downpayment) or mortgage payment assistance until the consumer can sell the existing home and secure permanent financing. Bridge loans normally carry higher

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[14] 77 *Fed. Reg.* 54733 (September 5, 2012).

> interest rates, points and fees than conventional mortgages, regardless of the consumer's creditworthiness.
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> The Agencies are concerned about the burden to both creditors and consumers of imposing TILA section 129H's heightened appraisal requirements on short-term financing of this nature. As noted, the Agencies recognize that rates on bridge loans are often higher than on long-term home mortgages, so bridge loans may be more likely to meet the "higher-risk mortgage loan" triggers. However, these loans may be useful and even necessary for many consumers. Higher-risk mortgage loans under TILA section 129H would generally be a credit option for less creditworthy consumers, who may be more vulnerable than others and in need of enhanced consumer protections, such as TILA section 129H's special appraisal requirements. However, a bridge loan consumer could be subject to rates that would exceed the higher-risk mortgage loan thresholds even if the consumer would qualify for a non-higher-risk mortgage loan when seeking permanent financing. It is unclear that Congress intended TILA section 129H to apply to loans simply because they have higher rates, regardless of the consumer's creditworthiness or the purpose of the loan.[15]

These temporary financing loans, despite their expense, bestow important benefits to consumers. Bridge loans enable consumers to obtain short-term financing, often to facilitate the purchase or construction of a new house, before they leave their existing home. This can give homeowners a great deal of flexibility in arranging the terms of the sale of their current home or provide homeowners time to make critical improvements to their new home prior to moving into that residence. For example, the homeowner might wish to continue to live in his or her current home while making changes to the new home to make it more accessible for family members having mobility impairments and other disabilities. Obviously, there are significant costs, but there are also significant benefits.

D. Question 42: What changes, if any, should be made to the proposed notice language?

[15] 77 *Fed. Reg.* 54733 (September 5, 2012).

Our client believes that the proposed notice language provides a clear communication of the consumer's rights and does not recommend any changes.

E. Question 43: What changes, if any, should be made to the proposed timing rules?

Our client believes that the proposed timing rules, which would make provision of the notice consistent with the timing for the delivery of the Preliminary Truth-in-Lending disclosure and the Good Faith Estimate required under RESPA, are the appropriate timing (soon to be combined as the "Loan Estimate"). This is necessary to allow for time to prepare the disclosure for applications taken by telephone, facsimile, or electronically. However, even if the application is taken in person, since determination of the loan's HRML status depends on having an estimate of the APR and the APR may vary based on an evaluation of the factors contained within the application and the credit report, our client believes that it is not realistic to expect that the loan officer will be able to evaluate those factors, calculate the APR, determine the APOR, and determine the loan's likely HRML status while the applicant sits in front of him or her. Furthermore, since the applicant cannot be charged any fees other than the credit report fee until the applicant has received the other key disclosures and expressed his or her intent to proceed with the application, there is no disadvantage to the consumer in receiving this disclosure at the same time that he or she receives other key disclosures. Our client also believes that, generally, most people would prefer to receive as many of their key mortgage application disclosures as possible at the same time.

F. Question 44: Whether creditors who have a reasonable belief that the transaction will not be an HRML at the time of application, but later determine that the applicant only qualifies for an HRML, should be allowed an opportunity to cure and give the required disclosure at some later time in the application process?

A closed-end mortgage loan is an HRML if it is not exempt and the APR (or TCR) for the loan exceeds the APOR by a certain threshold. However, at the time the application disclosures are provided, the interest rate may not be locked. Therefore, the true APR (which depends on the interest rate) and the true APOR (which depends on the date that the rate is set) may not be known, and therefore the loan's HRML status at application is merely a good faith estimate of what the HRML status will be by the time the loan is closed. If the final rule does not offer the lender a means to comply with the notice requirements and the appraisal requirements at a later time in the application process, when it is discovered that the consumer does not qualify for a specific interest rate or the market rates have changed while the rate was not yet locked, this would make the actual evaluation of the loan as an HRML moot. Failure to allow for a cure procedure would effectively apply the requirement to provide the HRML notice and thus the automatic copy of the appraisal to a much broader swath of loans than appears to be contemplated by the statutory requirement.

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We trust that the comments set forth in this letter are responsive.

Please contact the undersigned if we can provide any additional information or detail in connection with this submission.

Sincerely,

Joseph T. Lynyak III

Joseph T. Lynyak III