

**Comments of the National Consumer Law Center  
(on behalf of its low-income clients)  
and the National Association of Consumer Advocates**

**on**

**High-Cost Mortgage Amendments to the Truth in Lending Act (Regulation Z)**

**77 Fed. Reg. 49,090 (August 15, 2012)**

**Docket No. CFPB-2012-0029**

**Submitted**

**Nov. 6, 2012**

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Thank you for the opportunity to submit comments on these proposed regulations. These comments are submitted by the National Consumer Law Center<sup>1</sup> on behalf of our low-income clients and by the National Association of Consumer Advocates<sup>2</sup> (“NACA”).

We are pleased that the Consumer Financial Protection Bureau is proposing regulations to improve the Homeownership and Equity Protection Act (HOEPA). Nevertheless, we are disappointed by aspects of the Bureau’s proposal that risk undermining HOEPA’s protections. These comments will focus only on the aspects of the proposal not already covered in our Sept. 7 comments.<sup>3</sup> In particular:

- The Bureau has asked for comments on two alternative ways of measuring whether a mortgage loan exceeds the APR trigger and is therefore subject to HOEPA. The Bureau should adopt the first alternative, which retains the APR as the benchmark for HOEPA’s rate triggers. It should abandon the “transaction coverage rate” (TCR) alternative and use the APR trigger even if the Bureau adopts, as we support, the all-in finance charge

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<sup>1</sup> Since 1969, the nonprofit National Consumer Law Center® (NCLC®) has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC’s expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness. NCLC publishes a series of consumer law treatises including *Truth in Lending*, *Mortgage Lending*, and *Foreclosures*. These comments were written by Andrew Pizor, Alys Cohen, and Diane E. Thompson.

<sup>2</sup> The National Association of Consumer Advocates (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA’s mission is to promote justice for all consumers.

<sup>3</sup> <http://www.nclc.org/images/pdf/rulemaking/comments-cfpb-hoepa-49090.pdf>.

- If the Bureau is concerned that the all-in finance charge will cause an undue expansion of HOEPA coverage under the APR test, the Bureau should first collect data and then adjust the percentage triggers to compensate rather than adopting the proposed work-arounds.
- The APR trigger (or the TCR trigger, if adopted) should be based on the maximum possible rate rather than the fully-indexed rate.
- The Bureau should implement the statutory definition of points and fees as amended by Dodd-Frank. Clarification that the definition of points and fees excludes bona fide third party fees paid to unaffiliated parties, even where they are otherwise included under the all-in finance charge, may be useful.
- If the Bureau is concerned that the points and fees test, including the all-in finance charge but excluding third party fees as required by the statute, will cause an undue expansion of HOEPA coverage, the Bureau should first collect data and then adjust the percentage triggers to compensate rather than adopting the proposed work-arounds.
- Late-fee restrictions should remain classified as prohibited terms, rather than reclassified as prohibited conduct.

## **I. The Bureau Should Retain the APR Benchmark for High-Cost Loans**

The Bureau proposes two alternatives for the HOEPA rate trigger.<sup>4</sup> Alternative 1 would retain the APR as the metric used to determine whether a loan triggers HOEPA's high-cost loan provisions.<sup>5</sup> Alternative 2 would replace the APR with the "transaction coverage rate" (TCR).<sup>6</sup> The TCR would be the same as the APR under the current, pre-Dodd-Frank rules but the prepaid finance charges would only include charges retained by the creditor, its affiliate, or a mortgage broker. The TCR would not include the proposed all-in finance charge.

The APR trigger is far better than the TCR alternative. The TCR proposal is misguided and harmful to consumers. It should not be adopted. The TCR would be contrary to the guiding principle of transparency inherent in TILA, would increase the risk of compliance errors, and would contradict Congress's desire, as expressed in the Dodd-Frank Act, to expand consumer credit protections.

The Bureau should, instead, retain the APR as the metric for the HOEPA rate trigger. If the Bureau is concerned about inappropriate expansion of HOEPA coverage via the APR trigger, the Bureau should collect data and adjust the HOEPA triggers accordingly. Given the importance of ensuring access to affordable and sustainable credit to our communities, the Bureau should not adjust the triggers based on speculation and limited data, but on documented evidence demonstrating that a reduced trigger reduces the supply of desirable credit to vulnerable communities. Conjecture should not be grounds for leaving homeowners unprotected from abusive lending.

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<sup>4</sup> The alternative that is ultimately adopted would become Reg. Z § 1026.32(a)(1)(i).

<sup>5</sup> 77 Fed. Reg. 49090, 49100 (Aug. 15, 2012).

<sup>6</sup> 77 Fed. Reg. at 49100. Alternative 2 (the TCR) is functionally the same as the FRB's previous proposal.

## A. The TCR Proposal Is Contrary to the Purpose of TILA and Is Inherently Problematic

TILA is intended to simplify the process of shopping for credit. The APR is designed to be a comprehensive measurement for comparing credit products that cuts through the numerous and complicated variations that otherwise make comparison nearly impossible for all but the most sophisticated consumer.

In a separate proposal, the Bureau has proposed to redefine the finance charge for TIL disclosure purposes so that it includes all the costs of credit.<sup>7</sup> This proposed change, applicable to closed-end mortgage loans, will be a great step forward toward achieving the goals underlying TILA. We agree with the Bureau's view that:

the expanded definition could have significant benefits to consumers by making the APR a more useful and accurate tool for comparing the overall cost of credit. At the same time, the proposal could benefit creditors by reducing compliance burden and litigation risk because the finance charge calculation would be easier to perform.<sup>8</sup>

But the proposed TCR would detract from the role of the APR and the finance charge as the central tools for evaluating the cost of credit, without providing any benefit. While the APR would still be used for disclosure, this separate measure of the TCR would be used, behind closed doors, by creditors to determine whether a loan is subject to certain protections. Failing to disclose the TCR metrics to consumers would prevent consumers from confirming their creditor's compliance with the law and hinder enforcement. Supervisory agencies would also be put in the position of having another metric to check, with increased odds of error or omission in the supervision process. These added layers are inconsistent with TILA's goal of transparency.

The TCR proposal would create opportunities for creditors to game the system. Creditors who outsource will be at a competitive advantage over creditors who perform work in-house. Mortgages from a lender who outsources are less likely to be covered by section 32 even though the APR and cost to the consumer will be identical to loans from a non-outsourcing lender. As the Federal Reserve Board has said, whether a consumer receives HOEPA protections should not depend on which creditor extends the credit.<sup>9</sup> Yet that is precisely the result that the TCR proposal would introduce. This potential disparity is particularly troubling given the lending industry's sordid history of steering communities of color, via separate channels, to the priciest and most abusive loans.<sup>10</sup>

TILA and Regulation Z will be more effective if creditors are required to use a uniformly defined finance charge and APR for all disclosures and all measurements, including coverage triggers. The proposed TCR would be a step backwards, preventing consumers and creditors from

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<sup>7</sup> We have submitted separate comments on that proposal.

<sup>8</sup> 77 Fed. Reg. at 49100.

<sup>9</sup> 75 Fed. Reg. 58539, 58661 (Sept. 24, 2010).

<sup>10</sup> See generally National Consumer Law Center, *Why Responsible Lending Is a Fair Housing Issue* (Feb. 2012), [http://www.nclc.org/images/pdf/credit\\_discrimination/fair-housing-brief.pdf](http://www.nclc.org/images/pdf/credit_discrimination/fair-housing-brief.pdf); National Consumer Law Center, *Mortgage Lending* §§ 1.8, 6.3 (2012).

realizing any of the benefits of uniform, streamlined disclosures in high-cost credit, precisely where transparency and bright lines are most important to both consumers and creditors.<sup>11</sup>

Introducing another measure of the cost of credit, the TCR, would undermine the APR as a shopping tool. Consumers comparing two seemingly identical loans will not understand why one is labeled “high-cost” and the other is not.<sup>12</sup> Instead of having the shopping choice simplified by an all-in finance charge, the creation of the TCR will multiply the opportunities for abuse and confusion.

The Bureau’s proposed new TILA/RESPA disclosure form will not solve this problem. Loans could have the same interest rates and total closing costs but differ in HOEPA coverage because exemptions in the proposed finance-charge definition mean some costs will count toward HOEPA coverage and others will not. Subjecting all loans to the all-in finance charge through a standardized APR eliminates this problem.

The difference between the TCR and APR will also limit improvements in financial literacy. If the disclosed APR and the HOEPA trigger use the same measurements, the CFPB could have a web page that says “Today any loan with an APR over X% is a high-cost loan.” But that would be impossible if the HOEPA trigger is no longer tied to the disclosed APR. Nor could a housing counselor consulted about a loan know whether a loan was subject to the protections of HOEPA.

These differences have real-life implications for homeowners and creditors. The remedies available to a homeowner facing foreclosure on a HOEPA loan are vastly different from those available on a non-HOEPA loan and can save a family from homelessness. Creditors whose loans are near the line may rightly fear expensive and protracted litigation over the correct calculation of the TCR, even if the loan is, in fact, not a HOEPA loan. Indeed, the complexity and lack of transparency inherent in the TCR proposal would make protracted discovery into the elements of the TCR a standard feature of any foreclosure defense case—cases that competent attorneys might otherwise reject as lacking tenable defenses. The Bureau’s proposal not only multiplies consumer confusion but amplifies the risk and expense of litigation

The fundamental purpose of TILA is to promote the informed use of credit.<sup>13</sup> The TCR’s potential for confusion is contrary to Congress’ dictate: “The informed use of credit results from an awareness of the cost thereof by consumers. It is the purpose of this subchapter 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[.]”<sup>14</sup>

The proposed TCR would also reproduce the same problems that led the FRB and CFPB to propose clarifying the finance charge definition in the first place. And it does so for the most expensive types of loans. While the Bureau attempts to characterize this change as maintaining the status quo and preserving access to credit, in reality these rules will do nothing more than deprive consumers of the protections offered by section 32 and protect creditors who make expensive loans.

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<sup>11</sup> The Bureau’s proposed disclosure forms, which relegate the APR to the fine print, would eliminate the all-in finance charge’s benefits for other closed-end creditors and consumers as well.

<sup>12</sup> Disclosing the TCR will not solve this problem. Instead it will only create more confusion because it will differ from both the interest rate and the APR.

<sup>13</sup> 15 U.S.C. § 1601(a).

<sup>14</sup> *Id.*

Rather than adopt the TCR, the Bureau should keep the APR as the benchmark. If the Bureau has or obtains accurate data showing that the all-in definition would cause an unwarranted expansion of HOEPA coverage via the APR trigger, the Bureau could exercise its authority under 15 U.S.C. § 1602(bb)(2)(A) to adjust the rate triggers.<sup>15</sup> Doing so would be a much more efficient, effective, and transparent method of addressing concerns about unduly expanding HOEPA’s coverage. In contrast, the TCR would be a nightmare of complexity as well as a failure at meeting the statute’s goals. In the absence of data, the Bureau should move with greater caution and circumspection.

While we oppose adopting the transaction coverage rate, the Bureau requested comment on whether use of the TCR should be optional.<sup>16</sup> We recommend that—if the TCR is adopted—its use should be mandatory, as the Federal Reserve Board recommended when it made a similar proposal in 2010.<sup>17</sup> Introducing a new metric would cause enormous confusion in and of itself; introducing a new metric and then allowing creditors to use it or not at their discretion would simply multiply these problems.

## **B. The TCR Proposal Will Cause Compliance Problems**

The Bureau has separately proposed to adopt an all-in definition of the finance charge. We agree with the Bureau that expanding the definition of the finance charge in this way has the potential to benefit creditors by simplifying the finance charge calculation.<sup>18</sup> Yet the proposal to create a new TCR metric would eliminate this benefit.

Currently, in order to meet existing requirements, creditors must calculate the finance charge, APR, and points and fees for each mortgage. The first two are required for disclosure and the latter two test for HOEPA coverage. The finance charge definition is the basis for the other two: the points and fees pre-Dodd-Frank included all finance charges (less interest), and the APR cannot be determined without knowing the prepaid finance charge. Thus, there is a significant overlap between the basic calculations required for all mortgages and testing for HOEPA coverage. Indeed, consumers, their advocates, enforcement personnel (whether state or federal), and supervisory agencies can calculate *de novo* the HOEPA triggers based solely on the disclosures given the consumer, without recourse to the creditor’s records.

The Bureau’s proposal, however, eliminates that overlap. Under the proposal there will, in essence, be two definitions of “finance charge”—one for disclosure (calculating the APR) and another for testing HOEPA compliance. Creditors will need to apply both definitions of “finance charge,” and calculate two different APRs (one dubbed the “TCR”). The complexity increases further when considering the different triggers and definitions among varying loan products and loan amounts, as well as the other protections to which these rules apply, such as the Qualified Mortgage definition.

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<sup>15</sup> See 77 Fed. Reg. at 49101 (discussing this option).

<sup>16</sup> 77 Fed. Reg. at 49102.

<sup>17</sup> See 75 Fed. Reg. 58539, 58661 (Sept. 24, 2010).

<sup>18</sup> 77 Fed. Reg. at 49100.

Even though many lenders will rely on sophisticated computer software to perform these calculations, the fiendish complexity of the proposed rules creates the risk of program errors. And, even if the software is programmed correctly, lenders must still understand the regulations well enough to set up the software in a manner that will correctly process the myriad of fees and loan products available today—and to adjust the programming for the inevitable market innovations.

Equally troubling is the difficulty in verifying compliance with the proposed regulations. State and federal bank examiners, attorneys, and judges will need to manually calculate most of these measurements. While software to calculate an APR is widely available and accepted (and presumably would work to calculate a TCR as well), anyone checking compliance will need to manually determine which rule applies and then weigh each underlying charge against the appropriate definition. The complexity of the proposed rule increases litigation risk, makes compliance more difficult, and makes enforcement even harder than it currently is.

### **C. Access to Credit Does Not Justify Preserving Exorbitantly Priced Credit**

According to the Bureau, creditors expressed concern that the Federal Reserve Board's 2009 closed-end proposal would cause more loans to fall under HOEPA.<sup>19</sup> While some argue that the TCR is necessary to preserve access to credit, consumers neither need nor want access to over-priced subprime loans. Sky-high APRs are not acceptable examples of risk-based pricing. Instead, they more often indicate price gouging and opportunism. In fact, over a decade ago the Federal Reserve Board concluded that expanding HOEPA's scope (by lowering the APR trigger) would not hurt access to credit. In 2001, the Board said:

Anecdotal evidence suggests that subprime borrowers with rates below the current HOEPA triggers also have been subject to abusive lending practices. . . . There is no evidence that the impact on credit availability will be significant if the APR trigger is lowered. Accordingly, the Board believes that lowering the APR trigger to expand HOEPA's protections to more loans is consistent with consumers' need for credit, and therefore, warranted.<sup>20</sup>

It is questionable whether anyone, in any community, wants these loans. Most assuredly, the communities of color that saw these loans made in abundance in the years leading up to the crash and are now suffering through a loss of wealth of unprecedented proportions<sup>21</sup> are not seeking greater access to high-priced credit that narrowly evades HOEPA coverage.

In addition, the number of new loans covered under Dodd-Frank's revised triggers and the all-in finance charge is minuscule. In 2009, the Board estimated that the proposed all-in finance charge would increase the share of first-lien refinance and home improvement loans covered by HOEPA by only 0.6 percent.<sup>22</sup> While the absolute number of covered loans would increase, the total number would still be low. In fact, comments submitted to the Board on the all-in finance charge proposal focused more on the impact of the points-and-fees test (which, then, still included

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<sup>19</sup> 77 Fed. Reg. at 49101.

<sup>20</sup> 66 Fed. Reg. 65604, 65607 (Dec. 20, 2001).

<sup>21</sup> Rakesh Kochhar, Richard Fry and Paul Taylor, *Wealth Gaps Rise to Record Highs Between Whites, Blacks, Hispanics*, Pew Research Center (2011), available at <http://www.pewsocialtrends.org/2011/07/26/wealth-gaps-rise-to-record-highs-between-whites-blacks-hispanics/>.

<sup>22</sup> 74 Fed. Reg. 43232, 43244 (Aug. 26, 2009).

many third-party fees<sup>23</sup>) than the impact on the APR of the all-in finance charge.<sup>24</sup> The increase in HOEPA coverage occasioned by the APR is slight.

Concern about expanding HOEPA's scope also fails to recognize the possibility that creditors may react to an expansion by offering more affordable credit rather than by withdrawing credit products from the market—a highly desirable result.<sup>25</sup> Time after time the industry has argued that needed restrictions on abusive credit terms will dry up credit. Then, after the restriction became law, creditors restructured their products and continued to extend credit — on a more sustainable basis. For example, this exact scenario happened in the early 2000's with the inclusion of single premium credit insurance in the points and fees test. Industry predicted it would sweep a large portion of subprime loans into the HOEPA category. It did not. Creditors predicted that the Credit CARD Act would dry-up access to credit cards, but that has proven untrue too.

The number of additional loans that would fall under HOEPA is particularly likely to be small in light of the convention of lending just below the triggers. To avoid HOEPA coverage, many of the lenders that currently hover just under the HOEPA trigger will simply reduce the APR so that the loan is slightly below the lower trigger. The result would not be an increase in HOEPA-covered loans but a decrease in APRs—a positive development.

Adopting the proposed TCR to preserve access to credit will only protect a dangerous form of credit that helped produce the ongoing foreclosure crisis. As triggers have lowered, lenders have continued to lend; high-cost mortgage triggers have not significantly deterred lending. The Bureau has not cited any evidence that preserving access to high-cost credit serves a measurable consumer protection purpose. In contrast, the risks of high-cost credit are well documented. The TCR proposal will not protect consumers or preserve access to safe, affordable credit. Instead, it will only help the subprime lending industry edge back toward abusive lending.

#### **D. Extending the Scope of HOEPA and Other Laws Will Benefit Consumers**

The Bureau, like the FRB, notes that the all-in approach to the finance charge is likely to make more loans subject to additional laws and regulations at both the state and federal levels.<sup>26</sup> To the extent this is true, this is a positive potential outcome. The all-in finance charge, after all, reveals the true cost of the loan. Whether or not a loan should be subject to increased regulation on the basis of its price should depend on as accurate, comprehensive, and comparable determination of its price as possible. Gamesmanship with the APR in order to escape scrutiny under federal or state legislation benefits neither consumers nor honest lenders.

Any line separating high-cost credit from more affordable credit is necessarily arbitrary. The Bureau's proposal of an all-in finance charge makes the determination of that line less arbitrary—surely a result to be welcomed—and reveals as high-cost those loans that are, in fact, high-cost. The existing lack of clarity in the finance charge definition has allowed many high-cost loans to masquerade as affordable products. The Bureau's improvement to the finance charge should help

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<sup>23</sup> Dodd-Frank has addressed this issue, as discussed in section III, *infra*.

<sup>24</sup> 75 Fed. Reg. 58539, 58637 (Sept. 24, 2010) (discussing comments on 2009 proposal).

<sup>25</sup> 77 Fed. Reg. at 49132-33.

<sup>26</sup> 77 Fed. Reg. at 49093 (discussing FRB's 2009 proposal). *See* 74 Fed. Reg. 43232, 43244 (Aug. 26, 2009).

increase clarity in the marketplace.

As the Board noted, coverage under state statutes is, in most instances, not a bar to purchase on the secondary market.<sup>27</sup> Indeed, in many states, the restrictions imposed on loans that trigger the high-cost standard are not significantly more onerous than those the Board imposed on all higher-priced mortgage loans in its 2008 rulemaking.<sup>28</sup> In others, state high-cost mortgage statutes have been designed to fill gaps in HOEPA coverage and may have lower thresholds than the pre-Dodd-Frank HOEPA.<sup>29</sup> For this reason, it is unlikely that applying the all-in finance charge to the HOEPA triggers will cause a significant change in the scope of state laws. To the extent any change occurs, states can account for this as they choose.

Additionally, the state statutes do not cover all the loans made over the triggers now nor will they in the near future. Many lenders are exempted from state statutes because they are federally-regulated lenders, and other lenders may in some circumstances claim the protection of state parity laws granting state-regulated lenders protection from state legislation to the same extent as national banks or thrifts. Thus, generalizing from HMDA data disclosure may overstate the number of loans subject to state regulation.

Estimates of how many new loans will be covered in any event are imprecise, at best (and as noted above, estimates to date indicate the raw numbers are modest). Some lenders who are near the thresholds will doubtless shift their costs down lower, just as they did when the state and federal statutes were first enacted. Indeed, in most cases, the creditors affected will be those who have deliberately sought to come as close to threshold as possible—to charge as much as they can while still evading coverage. The market has already shown flexibility in closing costs, with costs recently declining.<sup>30</sup>

Moreover, other factors will be contributing to lower finance charges in general, and thus the number of loans included in HOEPA may be overestimated. Yield spread premiums were, until they were banned, widely prevalent in the high-cost market and usually resulted in a higher APR for borrowers because the interest rate is increased, often without any decrease in total broker compensation.<sup>31</sup> Although mortgage brokers will now receive different forms of compensation, it is likely that the total cost to consumers will still be lower than it has been. Based on mortgage research, one would expect both total mortgage broker compensation and other closing costs to decrease in the absence of yield spread premiums, thereby reducing the finance charge and APR. This is because total broker compensation and other closing costs increase when the broker is paid a yield spread premium.<sup>32</sup> As a result, even an all-in finance charge with the lower triggers may not

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<sup>27</sup> 74 Fed. Reg. 43232, 43244 (Aug. 26, 2009).

<sup>28</sup> See Truth in Lending, 73 Fed. Reg. 44522, 44524 (July 30, 2008).

<sup>29</sup> See National Consumer Law Center, *Mortgage Lending* § 4.4.1 (2012) (overview of state high-cost mortgage statutes).

<sup>30</sup> Vickie Elmer, Closing Fees Ease Up, N.Y. Times, Aug. 12, 2012, at RE5, available at [www.nytimes.com/2012/08/12/realestate/mortgages-closing-fees-ease-up.html?\\_r=1&hp](http://www.nytimes.com/2012/08/12/realestate/mortgages-closing-fees-ease-up.html?_r=1&hp) (citing 2012 survey of closing costs from bankrate.com).

<sup>31</sup> See generally National Consumer Law Center, *Mortgage Lending* § 7.3.3 (2012).

<sup>32</sup> See Office of Pol'y & Dev., Dep't. of Hous. & Urban Dev., RESPA: Regulatory Impact Analysis and Initial Regulatory Flexibility Analysis, FR-5180-P-01: Proposed Rule to Improve the Process of Obtaining Mortgages and Reduce Consumer Costs, 2-24 - 2-43 (2008); Susan Woodward, A Study of Closing Costs on FHA Mortgages, U.S. Department of Housing and Urban Development, Office of Policy Development and Research. (2008), available at [www.urban.org/UploadedPDF/411682\\_fha\\_mortgages.pdf](http://www.urban.org/UploadedPDF/411682_fha_mortgages.pdf).

result in an increase in loans reaching the HOEPA APR trigger. The impact on state triggers is even greater because many state laws included yield spread premiums in their points and fees triggers.<sup>33</sup>

The number of loans that will trigger HOEPA and state high-cost loan coverage under the new finance charge and APR measurements may also be affected by other restrictions on loan-originator compensation. The rule barring the creditor and borrower from simultaneously compensating the loan originator should put downward pressure on finance charges by eliminating a form of double compensation that was not fully understood by borrowers. The ban on YSPs also eliminates the broker's incentive to increase the interest rate above par. These factors are likely to mitigate the expansion of the finance charge definition and decrease the likelihood of meeting the APR triggers.

## **II. The TCR/APR Should Be Based on the Maximum Possible Rate**

For the reasons discussed in the preceding section, the Bureau should abandon the TCR alternative. It should require the HOEPA APR trigger to be based on the APR. However, regardless of which metric the Bureau adopts, it should require the calculation to be based on the maximum possible interest rate over the life of the loan

Proposed § 1026.32(a)(2) would require the APR or TCR for most variable rate loans to be based on the index rate at the time of consummation plus the maximum possible margin. This is, in other words, the “fully-indexed rate.” While this is better than testing the rate trigger based on artificially low teaser rates, such a calculation still offers little protection for borrowers because it hides the magnitude of potential rate increases. Congress recognized the need to go beyond the fully-indexed rate in Dodd-Frank requirements to underwrite to the maximum payment.<sup>34</sup>

HOEPA was enacted because Congress recognized the dangers of high-cost loans. The HOEPA triggers were set to catch risky, high-rate loans. They are often made to borrowers with little sophistication who, unless they still have equity to be extracted in a loan flip, are likely to hold their loans for the duration—or foreclosure, which too often comes first. The extra disclosures and protections provided for HOEPA loans are warning signals of particularly risky loans to borrowers with fewer than average resources to defend against predation.

Borrowers with variable-rate loans already bear the full risk of rate increases. In measuring and disclosing the risk of those loans, all disclosures and regulatory standards (such as the HOEPA trigger) should be based on the maximum rate cap for the loan. A mortgage payment based on a rate that exceeds the HOEPA trigger is not more affordable or less risky simply because the index went up after consummation. Creditors have much greater skill and experience than consumers in predicting interest rate trends. And they have much greater ability to absorb unexpected rate increases.

Drawing the lines right has particular urgency considering the prevalence of prepayment penalties in higher-priced loans. Prepayment penalties are generally banned in HOEPA loans, but may not be in loans just below the triggers. But a consumer whose HOEPA protections are

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<sup>34</sup> 15 U.S.C. § 1639c(b)(2)(A)(v).

<sup>34</sup> 15 U.S.C. § 1639c(b)(2)(A)(v).

determined by the fully-indexed rate is likely to find herself paying a HOEPA-level interest rate, after the rate adjusts, with only limited ability to refinance into the more affordable credit her payment history would merit.

Whether the Bureau adopts the TCR or maintains the APR for determining the triggers, the Bureau should use the maximum rate over the life of the loan to measure coverage.

### **III. The Bureau Should Follow the Statutory Guidance for the Points and Fees Definition Rather Than Engineering Complexity**

For many years, most of the action in determining HOEPA coverage has been in the points and fees calculation and not the APR. (With an APR trigger of eight percentage points above comparable Treasuries, in the current interest rate climate, no loan will meet the HOEPA APR trigger). Back-of-the-envelope estimates suggest that an all-in finance charge might increase the APR by between 1/10 and 1/2 of one percent—not enough to make any significant difference. Using the all-in finance charge to calculate points and fees might raise the points and fees as much as 3 1/2 percentage points, however—more than enough to tip many loans over into coverage. As described in the Board’s 2010 proposal, creditors and others commented that the biggest impact of the all-in finance charge would have been on the points and fees test.<sup>35</sup>

But the Dodd-Frank Act, passed a year after the Federal Reserve Board first publicly contemplated the all-in finance charge, addressed this real risk (as opposed to the chimera of excessive coverage caused by an increase in the APR). The statutory changes enacted by Dodd-Frank provide a more expansive definition of points and fees than that in the statute currently, but remove from the points and fees those bona fide charges paid to entities with which the creditor has no relationship, and thus no control.<sup>36</sup> This definition in Dodd-Frank tracks very nearly what the Bureau is trying to do with the TCR and points and fees definition, but with more elegance and simplicity.

The points and fees definition and the finance charge have always had a complicated relationship. While the points and fees definition starts with the finance charge, it takes some fees out (interest) and adds others. Providing for a different definition of points and fees and the finance charge is not more complicated than existing law, which creditors, consumers, and regulators have all lived with for nearly twenty years. The Bureau should implement the statutory definition of points and fees as amended by Dodd-Frank.

The Federal Reserve Board trod part of this road before. The Board’s 2009 proposal regarding the all-in finance charge<sup>37</sup> had proposed to incorporate the all-in finance charge into the points and fees test with no exemption for third party fees. It was pre-Dodd-Frank. In response to comments from creditors, when the Board released a proposal on the points and fees in 2010, on the same day Dodd-Frank was passed, the Board re-instated, much like the Bureau is proposing to do, the pre-all-in finance charge points and fees definition. But the Board, unlike the Bureau, did not have the advantage of having the settled and stream-lined language of the statute to work from. The Bureau is positioned to do better than the Board, at least in this respect.

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<sup>35</sup> 75 FR 58539, 58637 (Sept. 24, 2010).

<sup>36</sup> 15 U.S.C. § 1602(bb)(1)(A)(ii).

<sup>37</sup> 74 FR 43232, 43321–23 (Aug. 26, 2009).

The Bureau’s approach, like the Federal Reserve Board’s 2010 proposal and in contrast with the statute, relies on a multi-layered definition. It introduces unnecessary complexity. In doing so, it will undermine compliance, enforcement, and supervision. The Bureau proposes in § 1026.32(b)(1) to apply the pre-existing points and fees test if an all-in finance charge is adopted. Instead of tracking the statute, and backing out only those third-party fees over which the creditor has no control (as contemplated by the statute), the Bureau would have creditors’ compliance officers parse through the various components of the finance charge as currently defined—definitions that will have no meaning outside of the points and fees test once the all-in finance charge is adopted. As a result, this calculation would have to be *de novo*, ignoring the simplicity of the all-in finance charge in proposed § 1026.4(g).

The loans that meet the HOEPA points and fees trigger under an all-in finance charge with the Dodd-Frank exclusion for genuine third party fees are not substantially different in number or kind from those that would be covered under the Bureau’s proposal. Fees that are brought into the all-in finance charge but not excluded under Dodd-Frank—and that would therefore be part of the points and fees test—are generally very small fees. Some filing fees for recording a deed might be brought in, for example. But the big ticket items—the title insurance and closing agent costs—would continue to be excluded so long as the fee was bona fide and paid to an unaffiliated third party.

Indeed, these big ticket items are already in the points and fees test if the fee is paid to the creditor or its affiliate, or is not bona fide. There simply is no expansion of the points and fees coverage occasioned by the statute in this respect. (The statute does include prepayment penalties in the points and fees test, which would be a potentially significant addition, if, by doing so, the statute did not in effect ban prepayment penalties for high-cost loans). Dodd-Frank’s exclusion of mortgage insurance—a much larger cost than recording taxes—from the points and fees definition more than offsets any expansion of the points and fees coverage as a result of the inclusion of these small fees.

This same points and fees test, with the third-party fee exclusion, but including the all-in finance charge, will apply to a variety of other rules, including the Qualified Mortgage Definition. Because that “QM” definition will be a core component of how lending and investment decisions are made, moving to a simpler yet similar approach, as contemplated in the statutory language, is warranted. The smaller fees included in points and fees under the Dodd-Frank definition combined with an all-in finance charge have not themselves raised any concerns in the public debate.<sup>38</sup> Releasing several versions of the points and fees definition will only complicate understanding and compliance.

The complexity in the Bureau’s proposal changes the substantive result little, but may serve to obscure abuses because of compliance burdens. HOEPA has traditionally served as a check on the most abusive lending in the mortgage market. The ability to ascertain whether a loan is covered

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<sup>38</sup> While industry efforts to affect the points and fees test for the QM test have focused on third party fees paid to affiliates, the statute speaks clearly on this and the Bureau surely should follow Congressional intent on this matter. Title insurance abuses are well known and excluding affiliated title fees from the points and fees test would be a mistake. *See* Testimony of Alys Cohen before the Subcommittee on Financial Institutions and Consumer Credit, Financial Services Committee, House of Representatives, July 11, 2012, *available at* [http://www.nclc.org/images/pdf/foreclosure\\_mortgage/dodd-frank/testimony-qm-july2012.pdf](http://www.nclc.org/images/pdf/foreclosure_mortgage/dodd-frank/testimony-qm-july2012.pdf).

by HOEPA is essential to homeowners and to government. The Bureau proposes a scheme in which, as with the TCR, one set of rules applies for disclosure purposes and another set of rules applies for purposes of determining coverage under various legal provisions, including the high-cost points and fees test. A simpler approach is warranted. Any loan brought into the high-cost loan category because of the all-in finance charge is a loan that is truly high-cost and should trigger the additional protections associated with such loans. Homeowners need to be able to ascertain whether a loan is a HOEPA loan, and doing so based on available disclosures is a more transparent approach that will lead to greater accountability. As noted above, adoption of a shadow set of tests for HOEPA coverage will increase litigation risk and compliance costs.

As discussed further below, if the Bureau is concerned about an over-inclusive trigger, further data collection and research should be done and any changes should be made by adjusting the numerical trigger, not by changing what is included in the trigger. Clarification that the definition of points and fees excludes bona fide third party fees paid to unaffiliated parties, even where they are otherwise included under the all-in finance charge, is a better approach to the points and fees test than adopting the more complex test the Bureau proposes.

The Board's initial proposal to retain the older points and fees threshold while adopting an all-in finance charge was based on comments from industry submitted in response to an earlier Board proposal that did not incorporate the third-party fee exclusion added by Dodd-Frank. The Bureau should not base the adoption of a complex scheme on inapposite analysis by industry, especially when the complexity stands to undermine consumer protection. The Bureau lacks sufficient data and has not presented a sufficient basis for these changes.

The Bureau has a clear statutory mandate in Dodd-Frank. It should adopt the statutory definition of points and fees. Further complexity is not helpful.

#### **IV. Instead of Adopting the TCR, and Reverting to the Former Points and Fees Definition, the Bureau Should Implement the All-In Finance Charge Along with Dodd-Frank as Written, Require Creditors to Report Data on Closing Costs, and Then Consider Adjustments of the Triggers Rather Than Alternative Triggers**

As the Bureau states, there is currently insufficient data to evaluate the proposed changes. Rather than tinker with the rules and hope for the best, the Bureau should ask industry to provide the necessary data to determine how the revised finance charge will affect the scope of HOEPA. The recently announced National Mortgage Database is a perfect opportunity to obtain the data needed for this analysis. If necessary, the Bureau could adopt a rule requiring creditors to report accurate data on closing costs. Creditors that are concerned about the scope of section 32 should be willing to present a complete data set for the Bureau to evaluate. The Bureau should only rely on data that is sufficiently complete and representative to allow a study that will reach a scientifically valid conclusion. Data selectively chosen by lenders could easily be skewed to produce pro-industry results. The data should be made publically available to allow peer review and to ensure the impartiality of any study.<sup>39</sup> After obtaining sufficient data, the Bureau can address any coverage problems by raising or lowering the triggers. This course of action will produce reliable regulations based in fact rather than speculation.

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<sup>39</sup> The data could easily be aggregated and made anonymous to protect lenders' competitive positions.

Or, if the lending industry continues to insist that it will be hurt by the proposed rules but also refuses to provide impartial data to validate its assertion, the resulting uncertainty should be construed in favor of protecting consumers. Congress has clearly expressed its intention to protect consumers by adopting TILA and by responding to the recent debacle with Dodd-Frank. Moreover, Congress was aware of the all-in finance charge proposal when it passed Dodd-Frank. The Bureau should not use its exemption authority absent clear data showing deviation from the statutory language is necessary to achieve Congress' goals.

## **V. Late Fee Restrictions Should Be Classified as Prohibited Terms**

The Bureau proposes categorizing HOEPA's restrictions on late fees as a prohibited practice, rather than a prohibited loan term. The consequence of this categorization is that the remedy of rescission is unavailable. The statute already is structured to impose this remedy on prohibited loan terms. Moreover, such a strong remedy tends to extract better compliance. Because late fees can spiral out of control and put homeowners in default and foreclosure, and can preclude them from qualifying for a loan modification, restrictions on them should be placed in their proper category as a loan term that is prohibited.

Late fees on high-cost mortgages are described in the contract; they are a loan term. Indeed, the Dodd-Frank language on late fees, although it is couched in terms of a creditor imposing such fees, clearly refers to the loan documents and uses that terminology several times.<sup>40</sup> Under the new rule, no creditor may impose a late payment charge or fee in connection with a HOEPA mortgage unless all of the following conditions are met:

- The amount is at or below 4% of the amount of the payment due;
- The loan documents specifically authorize the charge or fee;
- It is imposed on or after the end of the fifteen-day period beginning on the date the payment is due, or in the case of a loan on which interest on each installment is paid in advance, it is imposed on or after the end of the thirty-day period beginning on the date the payment is due;
- It is imposed only once with respect to each single late payment.
- In addition, if a payment is otherwise a full payment for the applicable period and is paid on its due date or within an applicable grace period, and the only delinquency or insufficiency of payments is attributable to any late fee or delinquency charge assessed on any earlier payment, no late fee or delinquency charge may be imposed on that payment. Where a loan agreement provides that any payment shall first be applied to any past due principal balance, and the consumer fails to make an installment payment and the consumer then resumes making installment payments but has not paid all past due installments, the creditor is permitted to impose a separate late payment charge or fee for any principal due (without deduction due to late fees or related fees) until the default is cured.

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<sup>40</sup> 15 U.S.C. § 1639(k).

Terms complying with these rules will be included in contracts. Any terms contrary to these terms would be a prohibited term under the Dodd-Frank rules. These rules stand in stark contrast to the typical types of prohibited practices under HOEPA, such as asset-based lending or evading HOEPA through open-end credit, which are both more generalized and require greater factual development. The late fee rules are, instead, much more similar to the rules on balloon payments, negative amortization, and prepayment penalties (and the other prohibited terms) under HOEPA. They are contract terms.

The language of the statute makes the rescission remedy available whenever a prohibited term is “contained” in a high-cost mortgage. Late fee terms are surely contained in the mortgage. The rules on late fee terms should be placed in the prohibited terms category. By miscategorizing the late fee rules as prohibited practices, homeowners facing abusive terms prohibited by the statute will be unable to secure their full rights under HOEPA and creditors may be more likely to violate the rule.

Lastly, the difference in remedies for practices versus terms is likely related to the clarity with which the rules on terms are delineated, whereas any finding of a violation of the rules on the prohibited practices will be related to a more flexible analysis of all the facts in the case. By this standard, the late fee rules are, again, clearly a prohibited term.