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Chairman Ben S. Bernanke
Vice Chairman Donald L. Kohn
Governor Kevin M. Warsh
Governor Randall S. Kroszner
Governor Frederic S. Mishkin

Dear Governors:

We were pleased to learn at October's Consumer Advisory Council meeting that the Board is considering, as part of its HOEPA rulemaking initiative, requiring early disclosures for non-purchase money loans. We are very concerned, however, that this new requirement will be rendered meaningless by a failure to correct the existing early disclosure rules.

At present, if an early disclosure becomes inaccurate, the creditor need only provide a corrected disclosure *at closing*. Reg. Z § 226.19(a)(2). At that point, even if the consumer notices the corrected disclosure amid the mass of documents presented at closing, the consumer's time for shopping for credit or backing out of the loan has passed.

In our experience, most early disclosures bear little resemblance to the terms of the loan that is actually presented to the consumer at closing. Whether this is because they are given so early in the process that the lender's estimates turn out to be inaccurate in the normal course of events, or because the lender is using bait-and-switch tactics, is irrelevant. The fact is that, despite the existing early disclosure rule for purchase money mortgage loans, the consumer does not get information about the actual terms of the loan until it is too late to do any good. If the Board broadens the early disclosure rule without correcting this problem, the new rule will likewise do no good.

We strongly recommend that the Board add a requirement that, when estimated disclosures become inaccurate in closed-end home-secured transactions, corrected disclosures must be given before closing as well as at closing. We recommend that a new § 226.19(a)(3) be added to Regulation Z as follows:

If there are material changes in the terms disclosed in the early disclosures, the creditor shall disclose all the changed terms no later than seven days before consummation or settlement.¹

¹ A corresponding revision would need to be made to Reg. Z § 226.17)(f) and footnote 39.

A corresponding provision should be added to the Commentary that defines “material change” to include:

- any change in the annual percentage rate that exceeds 1/8 of 1 percentage point in a regular transaction or 1/4 of 1 percentage point in an irregular transaction;
- any change from a fixed rate to a variable rate or from a variable rate to a fixed rate;
- the addition of a prepayment penalty;
- any change greater than 1% or \$100, whichever is smaller, in the amount of the monthly payment, or any other change in the payment schedule;
- any change in the amount financed that exceeds 1% or \$100, whichever is smaller;
- any change in the variable rate terms of a loan, such as changes in the margin (even if this would not translate into a change in the APR beyond the tolerance);
- a change from one type of ARM to another;
- any addition or elimination of a payment option or negative amortization feature;
- any change in the loan term.

This addition to Regulation Z is within the Board’s authority under Section 105(a) of the Act, which allows the Board to promulgate regulations that implement Congressional mandates or fill in gaps where Congress was silent. In § 128(b)(2), Congress requires early disclosures for certain transactions within three days of application and at consummation if the early disclosures are not accurate. This provision does not prohibit additional disclosures at other times.

In addition, we ask that the Board incorporate this redisclosure requirement as part of the rule it is drafting under 15 U.S.C. § 1639(1)(2), which requires the Board to prohibit “acts or practices in connection with ... mortgage loans that the Board finds to be unfair, deceptive, or designed to evade the provisions of this section... .” Giving pre-closing disclosures that *do not reflect the terms of the loan that is actually offered* is the quintessence of deception. This bait and switch ploy has been a key part of the predatory lending tactics that have led to the current subprime mortgage crisis. We ask the Board to include language along the following lines in a rule adopted under § 1639(1)(2):

Failure to comply with the redisclosure requirements of § 226.19(a)(3) is an unfair and deceptive act prohibited by this regulation.¹

Defining failure to comply with the redisclosure requirement as an unfair and deceptive practice under § 1639(1)(2) is particularly important since then consumers would have a remedy under § 1640(a) for noncompliance. Experience has shown that creditors are far

¹ As an alternative, the entire redisclosure requirement could be placed within a rule adopted under § 1639(1)(2). However, the regulatory scheme will be more transparent if the redisclosure requirement is located among the other rules regarding the timing of disclosures in mortgage transactions. In addition, if the Board confines its new rule under § 1639 to some subset of the mortgage market, placing the redisclosure requirement there would mean that consumers entering into mortgage transactions not covered by the new rule would still receive inaccurate early disclosures that were not corrected until closing.

more likely to comply with requirements that are enforceable by consumers than those that are not.

Finally, we ask that the Board define failure to comply with the redisclosure requirement as grounds for rescission, by amending Reg. Z § 226.23 note 48 to read:

The term “material disclosures” means the required disclosures of the annual percentage rate, the finance charge, the amount financed, the total payments, the payment schedule, the redisclosure requirements of section 226.19(a)(3), and the disclosures and limitations referred to in sections 226.32(c) and (d).

Switching the terms of the loan at the last minute should be grounds for rescission.

Making these additions to Regulation Z would strengthen the potential use of the estimated disclosures for shopping, and would ensure that the consumer had the opportunity to examine the terms of the loan before becoming bound. Without changes along these lines, however, extending the requirement of early disclosure to non-purchase money mortgage loans will have no effect on the mortgage problems we are seeing.

Thank you for considering these views.

Sincerely,



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