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

Re: Docket No. R–1120; Proposed Amendments to Home Mortgage Disclosure Act's Regulation C; 12 CFR Part 203; 67 Federal Register 7252; February 15, 2002

Dear Ms. Johnson:

The Board of Governors of the Federal Reserve System ("Board") has proposed amendments to Regulation C, which implements the Home Mortgage Disclosure Act ("HMDA"). This proposal supplements a final rule amending Regulation C, published by the Board on February 15, 2002, in the Federal Register. The Board seeks comment on three issues: the appropriate price thresholds for determining the loans for which financial institutions must report loan pricing data; whether the lien status of a loan should be reported; and whether lenders should be required to ask telephone applicants their ethnicity, race, and sex. The newly adopted amendments to Regulation C greatly increase the reporting burden on commercial banks and savings associations and the proposed amendments will add even further burden. The American Bankers Association ("ABA") brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership - which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks - makes ABA the largest banking trade association in the country.

While the Board has asked for comments only upon the three issues outlined above, this comment letter will address not only those issues but also a number of issues raised by the Board's recent amendments. Further, ABA has already written separately with seven other mortgage lending trade associations requesting that the Board delay the implementation of the all of these changes to Regulation C.[1]

Comments on the proposed changes

1. Annual Percentage Rate Spread Thresholds
In the final rule amending Regulation C, the Board adopted a requirement that institutions report the spread between the annual percentage rate ("APR") of a loan

[1] See letter to Chairman Greenspan and other members of the Board, dated March 11, 2002.

and the yield on Treasury securities of comparable maturity for loan originations in which the spread equals or exceeds a specified threshold. The Board tentatively set a reporting threshold of three percentage points above the yield on comparable Treasury securities for first lien loans and five percentage points for subordinate lien loans. The Board requests comment on whether these are the appropriate thresholds and on several other issues.

First, most banks only generate the APR for disclosure to customers under Truth-in-Lending Act regulations. Since the APR is generated for no other purpose, most banks do not track the APR or have it captured by their reporting or monitoring systems. Therefore, most banks do not have an easy way of measuring whether the proposed thresholds of three and five percent do not capture significant numbers of prime or near prime mortgages, as the Board has said was its intention in setting the thresholds. However, the few banks that have APR data and have shared their analyses with ABA believe that the proposed thresholds are too low. For example, one bank that does not do any subprime lending told ABA that a three percent threshold captured 95% of their first mortgage originations and a five percent threshold captured over 80% of their junior lien mortgages. Moving the thresholds to three and one-half percent and five and one-half percent reduced the capture percentage to roughly half of their mortgages. Raising the threshold to four percent and six percent dropped the percentage of loans captured to the single digits. Several other banks reported similar results. However, they also stated that in a rising rate environment, such as we expect the Board to create in the next year, one-half point interest rate changes (similar to the several half-point changes the Board instituted in the last year) could well capture at least half of their mortgage loan originations in the following month, even though these mortgages would not be the high cost mortgages that the Board wishes to capture by the APR reporting. Therefore, ABA recommends that the Board set the thresholds at five and seven percent.

The Board also asks commenters to identify circumstances or special credit products that might be particularly subject to misclassification, as loans associated with a higher credit risk than prime loans, should the proposed thresholds be implemented. Bankers that do mobile home lending reported that the proposed thresholds captured virtually all such lending. Apparently the inherent risks in mobile home lending raise the rates for such loans not only above the proposed thresholds but even above the ABA's recommended thresholds. Since most mobile home lending is done on a chattel mortgage basis, ABA recommends that mobile home loans only report APR if the loan is at least eight points above comparable term Treasuries.

<u>2. Reporting Lien Status</u>

The Board proposes to require lenders to report (for all originated loans and applications, but not for purchased loans) whether a loan is or would be (1) secured by a first lien on a dwelling, (2) secured by a subordinate lien on a dwelling, or (3) not secured by a lien on a dwelling. ABA believes that the Board's proposal is unworkable, imposes enormous unnecessary burden on banks, and needs to be amended or withdrawn. Bankers report that they "know" lien status on home purchase loans, because it is a condition of the loan that the bank will have a first lien. Therefore, at the point in the mortgage process that HMDA LAR information is collected, even though the bank does not know it has a recorded first lien, it knows that it <u>will have</u> a recorded first lien. However, with the vast majority of mortgage loans that are not purchase money loans, the bank does not know the lien status for sure at the time the HMDA data is collected and cannot know for sure the final lien status unless someone is hired to return later to the courthouse or recorder of mortgages to conduct a title search for the lien status. For example, most home equity loans are <u>assumed</u> to be junior liens, and all of them may be priced as such or even as unsecured loans, as the bank is recording the mortgage only out of an abundance of caution and is not relying upon the lien for repayment. However, many home equity loans are to older borrowers who have paid off their purchase mortgages. Thus, when the lien is recorded, it actually may be a first lien. If the Board requires lenders to report the actual lien status, this will require a very expensive and burdensome post-recordation search that will add little to the Board's information. ABA recommends as the preferable alternative that the Board require reporting of a proxy of lien status, knowable at the time the rest of the HMDA data is collected, such as whether the loan is a purchase money loan or not (since virtually all purchase money loans are first liens).

3. Collection of race, gender and ethnicity data on telephone applications

The Board proposes to conform the telephone application rule to the rule applicable to mail and Internet applications, so that lenders would be required to request this information from telephone applicants. If an applicant chose not to provide the information, then the lender would enter the existing code indicating that the application was taken by telephone, mail, or Internet. Under the prescribed formulation given in Appendix B to the regulation, loan applicants must be advised that the collection of information about race, ethnicity, and sex is mandated by the federal government to assist in the enforcement of fair lending laws. In addition, applicants must be advised that the lenders are prohibited from discriminating on the basis of the information provided, or on the basis of the applicant's choosing to provide or not provide the information.

The Board has previously requested comment on amending Regulation B to allow voluntary collection of such data on nonmortgage loans. In response to the ANPR, ABA filed comments that continue to bear on this proposed change. In our comments, ABA wrote that most banks felt strongly that ensuring compliance with fair lending laws by their employees was aided by "minimizing the availability of information about race, gender, etc. in the lending process. This avoids overt illegal discrimination as well as any subconscious influence of these factors, particularly on marginal loans. Just trying to collect the data draws attention to and highlights an applicant's race and gender, increasing the opportunity for illegal discrimination. Simply put, if the information is not available, it cannot be used to discriminate. We believe that this protection is a valuable one."[2]

Further, as ABA in its letter noted and as the Board in its preamble to this rulemaking notes, the race, gender and ethnicity data will frequently be inaccurate or incomplete. Some applicants, especially those that HMDA and ECOA are trying to protect, are reluctant to provide this information out of suspicion that the information will be used against them in the loan process, even though the lender recites the fact that the information is required by the federal government. Other applicants view the questions as an intrusion on their privacy and may be offended by the questions. (And concern about privacy has risen enormously since the Board published its Regulation B ANPR in 1998.) Accordingly, they opt to leave the questions unanswered or, worse, complete the form inaccurately. "As the trend toward telephone, mail, and electronic banking grows, there will be fewer face-to-face loan applications and hence less opportunity for banks to supply unfurnished information based on visual observation."[3]

Finally, while mail and Internet forms contain the request for information, the customer may easily ignore it (and often does, apparently). However, in a telephone application, the loan officer must recite all of the information request to the customer. Mortgage application-taking over the phone is lengthy and complicated enough without adding the request for

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[2] Comment letter from ABA to the Board, dated June 9, 1998.
[3] Id.

race, gender and ethnicity, especially with the new multiracial-ethnicity options having to be explained. ABA recommends that the Board not adopt this proposed collection of race, gender and ethnicity data on telephone applications. If the Board does do so, ABA requests that the Board provide a complete script to be used by lending officers, so that even though the customer will not likely provide the information, the lender will be sure that it will not be accused of not correctly requesting the information.

Comments on the Final Rule

Problems with the APR Reporting

In the original proposal, the Board proposed to require that the APR be reported on all loans. ABA and the industry in general strongly objected to such a reporting requirement, not only because of the huge increase in burden but also because raw APR data on all HMDA loans would be misused or misinterpreted by the media and by community and consumer activists. In the final rule, the Board adopted an alternative that had not been suggested: "lenders will report the rate spread between the APR on a loan and the yield on Treasury securities with comparable maturity periods, for loan originations in which the APR exceeds the applicable Treasury yield by a percentage or threshold specified by the Board." The Board stated that it was "adopting this approach to loan pricing information because it will adjust pricing data for changes in market conditions over time, focus on higher cost loans, and limit reporting burden because fewer loans would be subject to the reporting requirement." (67 Federal Register 7229.) The Board then requested comment on the appropriate threshold interest rates for reporting APR under the alternative method adopted by the Board, which ABA has provided above.

However, in seeking comment on the appropriate thresholds, ABA found that banks were divided over the Board's final rule on APR reporting. Lenders with thousands of LAR lines annually were generally pleased by the Board's decision, even though it meant several additional steps of calculation for each application to ascertain which loans would need APR data collected and what that data would be. Lenders with only a few to several hundred LAR lines considered the Board's final rule to be imposing considerably more burden and to be increasing the risk of a compliance failure by the adding of several steps to the process of collecting the information. These banks preferred just reporting the raw APR on all HMDA loans. That is, if these banks had been given a choice between reporting APR on all covered loans or reporting APR only on those loans above certain interest rate thresholds, these banks would have opted to report APR on all loans to avoid the extra training of personnel and the additional steps of calculation necessary to determine on which loans the excess APR would be required. However, they were not given that choice in the rulemaking. If the rough basis for the division between banks suggested above (more than several hundred LAR lines reported annually) is correct, then many more banks would want to report just the APR on all covered loans than there are banks which want to use the Board's alternative approach. On the other hand, those fewer number of banks that prefer the alternative approach represent the overwhelming number of LAR lines reported annually, considering the fact that several institutions report over a million LAR lines a year. Since the actual burden of reporting falls so heavily on the institutions reporting thousands of LAR lines per year, ABA believes that the Board's alternative is to be preferred. Nonetheless, there is a considerable division between banks on this, and ABA urges the Board to consider another alternative for APR reporting that would relieve the burden of the new reporting requirements on both high volume HMDA reporters and low volume HMDA reporters.

ABA suggests that the Board make the method of reporting APR optional: lenders may use the Board's alternative method contained within the final rule or small volume LAR reporters may report APR on all loans (on which high volume lenders have to calculate whether to report the amount the APR exceeds the base). This would require two different versions of HMDA reporting software, one as currently envisioned and one that would have the raw APR and an additional line for the term of the loan. The additional line for the term of the loan would be required so that the Board could take all HMDA reports filed with raw APRs and run a simple conversion program on them to check the applicable Treasury rate, based on the supplied term and the date of the application, identify which LAR lines are for loans that exceed the applicable threshold, and then convert the data into the format used by the large volume reporters. While this would entail some additional burden on the Board's staff, it would, according to our bankers, significantly reduce the burden on them, which cumulatively far exceeds the burden this would add to the Board. ABA staff and the members of its Compliance Executive Committee are available to discuss this alternative further with the Governors or members of Board staff at any time.

Problems with Finding the Treasury Base Rate for the APR Reporting

The Board notes that the APR spread is determined by the difference between the APR on the loan as of the origination date and the yield on the Treasury note of comparable maturity as of the 15th day of the month preceding the month in which the application for the loan was received, as provided for determining HOEPA coverage. The Board asks if there are more appropriate dates for determining the APR spread. Most bankers believed that this was adequate, so that ABA does not object to the date for fixing the thresholds.

However, bankers are greatly concerned about possible confusion in determining the correct base Treasury rate for HMDA reporting. While the number of loan products on which banks make HOEPA loans is relatively small, the overall number of mortgage products is much larger. Several large home mortgage lenders report over 23 different mortgage loan products, with such differences in term as five or seven year fixed with balloon payments, 7/23 fixed/variable, 40-year fixed or variable, 30-year fixed or variable, 5-year, 7-year, 10-year, 15-year, and more. Furthermore, compliance officers have been confused by the instructions for determining comparable term, given that the Board allows them to use either the H-15 Release or the Treasury auction results.[4] Referring to the H-15, compliance officers find that there is no currently listed 30-year Treasury, but the H-15 provides a 20-year Treasury AND a Treasury long-term average (25 years and above). Notes to the Treasury long-term average direct the user to an adjustment factor for a 30-year rate.[5]

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[4] The new official commentary on APR reads:
"Paragraph 4(a)(12) Rate spread information.
1. Treasury securities. To determine the yield on a Treasury security for the pricing information, lenders may use the Board's Selected Interest Rates'' (statistical release H–15) or the actual auction results. Treasury auctions are held at different intervals for the different types of securities. These figures are published by major financial and metropolitan newspapers and are also available from Federal Reserve Banks. Lenders must use the yield on the security that has the nearest maturity at issuance to the loan's maturity. For example, if a lender must compare the annual percentage rate to Treasury securities with either 7-year or 10-year maturities, the annual percentage rate for a 9-year loan is compared with securities that have a 10-year maturity. If the loan maturity is exactly halfway between, the annual percentage rate is compared with the Treasury security that has the lower yield. For example, if the loan has a maturity of 20 years and comparable securities have maturities of 10 years with a yield of 6.501 percent and 30 years with a yield of 6.906 percent, the annual percentage rate is compared with the yield of 6.501 percent, the lower of the two yields." 67 Federal Register 7250

[5] Footnote 13 to the H-15 reads:
"13. A factor for adjusting the daily long-term average in order to estimate a 30-year rate can be found at http://www.treas.gov/domfin/statistics.htm."

Compliance officers cannot determine if the Board is directing them to use the 20-year rate, the 25-year and above long-term average rate, or to go to the Treasury website and factor a 30-year rate. Estimating a 30-year rate seems to be the most appropriate response, but by providing these options, the Board has greatly lessened the comparability of reported APRs, since banks could be using any of these three rates. Therefore, to avoid this confusion, ABA recommends that the Board publish a HMDA rate chart each 15th of the month with rates for 1-year, 3-year, 5-year, 7-year, 10-year, 15-year, 20-year, 30-year, and 40-year mortgages, using Treasuries where they match and using the Treasury adjustment factors to calculate the rate where necessary.

Reporting Whether the Loan is for a Manufactured Home

The final regulation requires lenders to separately identify whether the loan is for a manufactured home and refers the lender to the HUD definition of "manufactured home" at 24 CFR 3280.2.[6] However, under § 3280.7 - Excluded structures, certain structures may be excluded from these standards as modular homes under 24 CFR 3282.12. This latter section allows manufacturers of modular homes to exempt their structures from being a manufactured home, if three pages of fine print are complied with. The Board states in the preamble to the final rule that "The HUD definition is accepted by the manufactured home industry and establishes a clear definition for HMDA reporters. If a lender does not know at the time of application—and cannot determine through reasonable means—whether a loan is for a manufactured home, the lender reports the property type as a one-to four-family dwelling." ABA agrees that the manufactured home industry accepts the definition and that it is clear to each manufacturer. After all, they are building these structures and surely know whether the three or six models of manufactured home being constructed by each manufacturer meets all of the criteria for being a manufactured home. The definition is in fact for the purpose of establishing construction standards. However, to suggest that this means that this is a clear definition for a lender, who may be lending on any one of dozens of manufacturers' various models of manufactured home (or a trailer or a recreational vehicle) is silly. Does the Board envision lending officers out with tape measures checking the square footage of the mobile home? Calling the manufacturer of the modular home and asking whether it has been exempted from being a manufactured home? Will examiners threaten civil money penalties if lenders fail to have in place inspection procedures to confirm that the structure is or is not a manufactured home? There must be an easier and more sensible reporting method than this. ABA recommends that the Board state that "reasonable means" of determining whether the structure is a manufactured home consist of asking the applicant whether it is a manufactured or mobile home and reporting what the customer says.

[6] "Manufactured home means a structure, transportable in one or more sections, which in the traveling mode, is eight body feet or more in width or forty body feet or more in length, or, when erected on site, is three hundred twenty or more square feet, and which is built on a permanent chassis and designed to be used as a dwelling with or without a permanent foundation when connected to the required utilities, and includes the plumbing, heating, air conditioning, and electrical systems contained therein. Calculations used to determine the number of square feet in a structure will be based on the structure's exterior dimensions measured at the largest horizontal projections when erected on site. These dimensions will include all expandable rooms, cabinets, and other projections containing interior space, but do not include bay windows. This term includes all structures which meet the above requirements except the size requirements and with respect to which the manufacturer voluntarily files a certification pursuant to § 3282.13 and complies with the standards set forth in part 3280. Nothing in this subsection should be interpreted to mean that a manufactured home necessarily meets the requirements of HUD's Minimum Property Standards (HUD Handbook 4900.1) or that it is automatically eligible for financing under 12 U.S.C. 1709(b)." From 24 CFR 3280.2.

Conclusion

The Board's amendments to Regulation C, both those that are final and those proposed and likely to be adopted, enormously increase the reporting burden under HMDA, which was one of the most burdensome of the consumer compliance regulations before these amendments. Combined with the many other regulatory changes imposed within the last year, and viewed in light of several more burdensome changes that are likely to be adopted before this year is over, banks and savings associations confront a tidal wave of regulation and regulatory burden. Given that HMDA loans as early as October 1 of this year may need to be reported under the new regulations, since they will close after January 1, 2003, compliance officers have not confronted such a demand upon resources and personnel since the Y2K crisis. For this reason and other good and credible reasons already submitted to the Board, ABA and its member banks and savings associations earnestly request that the Board delay the application of these new HMDA reporting requirements until the following annual report, for loans closed after January 1, 2004. As noted above, ABA and seven other trade associations have made this request. Many of the high volume LAR reporters, on which the burden of these changes will fall most heavily, have also written to the Board requesting such a delay, even while they are rushing to reorder their programming priorities and somehow, someway meet the current compliance deadline. As the Board considers the comments on its proposed rulemaking in this letter, and notes the problems that remain still in its final rule, ABA hopes that the Board soon will announce an extension in the implementation date to allow a more orderly and efficient conversion to the new reporting requirements.

The American Bankers Association appreciates the opportunity afforded it to file comments on this proposal. If members of the Board or staff have any questions about these comments, please call the undersigned.

Sincerely,

Paul Alan Smith

Paul Smith
Senior Counsel