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TILA-RESPA: Working Backwards*

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The Bureau of Consumer Financial Protection (the "Bureau") is working to integrate mortgage disclosure forms into a single document, as required by the Dodd-Frank Act. Bureau officials cite this as a number one priority for the Bureau, and consumer groups and industry associations support the concept.

The Bureau is taking a new approach to this issue, which has plagued the mortgage process for years.[1] This time, however, it is different; instead of the Department of Housing and Urban Development ("HUD") and the Federal Reserve Board (the "Board") having separate authority over RESPA and TILA, respectively, the authority over mortgage disclosures is housed within one agency. When HUD or the Board made modifications to these mortgage disclosures in the past, they would conduct limited consumer testing, issue a proposed rule with new regulatory requirements and forms to match, and then finalize those regulations based on comments received. Instead, the Bureau is starting with what the forms should look like and what information is most critical to consumers, and then, once the forms are finalized, write the regulations to match. Importantly, the Bureau is not waiting until the formal rulemaking process to seek public comment, as they are reaching out for input through a process they call "Know Before You Owe."

This article provides an overview of the process the Bureau is utilizing and offers some commentary on the process and drafted forms.

Background

The purpose of the Truth in Lending Act, enacted in 1968, is to "assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid

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[1] For a commentary on a previous proposal, the Guaranteed Mortgage Package, see ***Robert Barnett's article in the October edition***.

the uninformed use of credit…"[2] Six years later, Congress enacted the Real Estate Settlement Procedures Act to enable "more effective advance disclosure to home buyers and sellers of settlement costs" and to eliminate "kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services."[3] The result of these various disclosures under TILA, RESPA, and the regulations implementing these laws is five pages of disclosures after applying for a mortgage that many believe are confusing and do not help the consumer understand the key terms of the mortgage, which is a disservice to both the consumer and the lender.

The Dodd-Frank Act required the Bureau to combine these requirements:

> Not later than 1 year after the designated transfer date, the Bureau shall propose for public comment rules and model disclosures that combine the disclosures required under the Truth in Lending Act and sections 4 and 5 of the Real Estate Settlement Procedures Act of 1974, into a single, integrated disclosure for mortgage loan transactions covered by those laws, unless the Bureau determines that any proposal issued by the Board of Governors and the Secretary of Housing and Urban Development carries out the same purpose.[4][5]

This is a goal that many support — lenders want to simplify the requirements and eliminate conflicts between TILA and RESPA, and consumers want disclosures that clearly state the key terms of a mortgage loan.

Outreach Efforts

The Bureau conducted five rounds of testing under "Know Before You Owe." Some rounds focused on specific aspects of the form — for example, Round 1 focused on the design, not the content, and Rounds 2 and 3 focused on disclosing closing costs. Rounds 4 and 5 each used the same form and showed how two different products would look on that form. The first four rounds included an interactive online tool for the public to provide, and all

[2] 15 U.S.C. §1601.

[3] 12 U.S.C. §2601.

[4] 12 U.S.C. §5532.

[5] There is some discussion over whether the Bureau has the authority to change statutory requirements. At the very least, the Bureau may utilize the authority under TILA to make exceptions, adjustments, and exemptions (see 15 U.S.C. §1604).

five rounds invited the interested parties to submit comments. Additionally, each round also involved qualitative testing with consumers and mortgage lenders and/or brokers.

Prior to Round 5, the Bureau received over 22,000 comments which included emails, comments to their blog postings about Know Before You Owe, people utilizing the online tool, and the qualitative testing.

A Discussion of the Bureau's Approach

This approach is better than previous attempts; the past approaches have not worked. In large part that was due to a division of responsibilities between two agencies. HUD and the Board never agreed on a combined form, for a variety of reasons. But it also was problematic because of the lack of ongoing dialogue between the agencies and interested parties. For example, after HUD finalized its changes to RESPA two years ago, the industry compiled a list of at least one hundred questions based on the final form. In response, HUD issued several FAQs to address these and other issues, with the result being even more confusing on exactly how to comply with the new forms. In that respect, the Bureau's approach is a positive development for those involved in, and affected by, mortgage disclosures.

Bureau staff started the process by promising a one-page disclosure, and as of Round 5, it is up to three pages. That is more realistic given the amount of information that is required to be disclosed under TILA and RESPA. Looking back to the first round of Know Before You Owe, overall, the document has improved. The last round of disclosures were clearer and more comprehensive than the first round of disclosures. Is it perfect? No. Is it better? Yes.

For example, earlier versions had a section on page one titled "Cautions," which included lines for increasing loan amount, balloon payment, and prepayment penalty, with the question: "Can loan features trigger higher or additional payments?" That language does not exist on the latest draft, and simply lists prepayment penalty and balloon payment under "loan terms" with the question "Does the loan have these features?" This presents the information in an unbiased fashion. Earlier versions also had a section on the front page titled "comparisons," which contained the APR and a statement of how much the borrower will have paid off in five years. Those pieces are now on page three, leaving more space for more critical information on page one. "Important dates," which contains key information about when this estimate expires, moved from the bottom of the second page to the top of the first page, and more language was added regarding what can change unless the interest rate is locked.

Improvements are still needed. For example, in the latest round, the disclosures made a loan without a required escrow seem like a better deal than a loan with an escrow, as it was not clear what additional expenses the consumer would pay. The disclosure of closing costs on the second page is a work in progress. The latest round included itemization of many fees (such as title charges) that are aggregated under current rules; this may lead to confusion as the tolerance level applies in aggregate, not by individual item. The initial escrow payment is itemized, showing the charge for each item per month and how many months are covered (e.g., taxes and assessments — $105.30 per month for 2 months = $211). It is not clear how this itemization will work with the RESPA rule of aggregate adjustment, which would result in the total of the initial escrow payment not equaling the sum of each item. Based on the forms, it is difficult to evaluate the disclosure of closing costs and to fully understand what tolerances apply to which fees and where certain items should be placed on the form.

No Instructions Included

The major obstacle in the Bureau's approach is that these forms are not yet accompanied by regulations or instructions. It is difficult to comment on a form without having the instructions for filling out the form or knowing what disclosures the regulations would require. The Bureau staff said they were abiding by the current RESPA and TILA rules in creating these forms. However, as the rounds progressed, it became clear that combining the requirement of two very different statutes will require modification in the current regulations. Bureau staff has indicated they are working on the regulations to harmonize the requirements of TILA and RESPA and reflect the finalized version of the form.

As noted, it is very difficult to comment on a disclosure without having the instructions attached to it. There are no definitions of the terminology used. Since these are examples of loans, every possible component, fee, or service that may accompany a loan is not listed; thus, it becomes a guessing-game of where certain features would appear if they were part of the loan. For example, page 2 of the form contains categories such as "services you cannot shop for" and "services you can shop for," but the Bureau has not produced a list of what services would fall into these categories. There are certain calculations and assumptions made throughout the form, but the Bureau has not yet described how those calculations are made.

Dodd-Frank Requirements

Another hiccup in this process is that the Dodd-Frank Act is internally inconsistent. While Dodd-Frank directed the Bureau to create a simplified disclosure, it also added new, complex disclosure requirements under TILA. Section 1419 of Dodd-Frank adds four new elements to be disclosed under TILA. Two of these requirements are the most troubling: (1) the total amount of interest that the consumer will pay over the life of the loan as a percentage of the principal of the loan, referred to as Total Interest Percentage or TIP, and (2) the approximate amount of the wholesale rate of funds in connection with the loan, referred to as the Lender Cost of Funds or LCF. These requirements were tested in the last round of Know Before You Owe, and while the results are not public, it seems that these elements will not help consumers understand the terms of a mortgage or compare different loans.

Legislative history contains no explanation as to why Congress felt these disclosures were necessary or how they could assist in a consumer's understanding of a mortgage. There is a general consensus amongst the industry that these elements are complicated and lead to more confusion than clarity, and the industry is uncertain as to how they would even calculate these percentages. Hopefully, the Bureau utilizes its TILA exception authority to remove these provisions from any final disclosure.

Next Steps

The Bureau recently released its final version of "Know Before You Owe" for the disclosures after application. The Bureau now is focused on disclosures at or before closing, and testing of those disclosures has begun. Bureau officials have stated that they plan to meet their statutory deadline (July 21, 2012) to issue a proposed rule which will include harmonizing TILA and RESPA disclosures both after application and before closing.

Prior to the issuance of the proposed regulation, the Bureau is expected to hold a Small Business Regulatory Enforcement Fairness Act (SBREFA) panel. The Bureau will engage in quantitative testing, likely after the proposed rule is issued.

When this process started, Bureau officials indicated that it could serve as a model of how the Bureau will issue new regulations and disclosures in the future. Recently, the Bureau has started a "Know Before You Owe" for student loans. It is clear this model of soliciting public input prior to the issuance of a proposed rule is the Bureau's preferred method. Industry and consumers alike should applaud this approach. While it can be frustrating as key elements are sometimes missing, like the accompanying regulations, it is a far better approach than only asking for public input during the notice-and-comment period. These iterative processes allow for more discussion, more input, and, hopefully, better disclosures.

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