



April 8, 2008

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

Re: Regulation Z: Truth in Lending
Federal Reserve: Docket Number R-1305

Dear Ms. Johnson:

The Office of Advocacy of the U.S. Small Business Administration (Advocacy) submits this comment on the proposed rulemaking on *Regulation Z: Truth in Lending*. The Office of Advocacy believes that the Federal Reserve System (hereinafter “the Board”) has not analyzed properly the full economic impact of the proposal on small entities or considered meaningful alternatives as required by the Regulatory Flexibility Act (RFA). Advocacy recommends that the Federal Reserve prepare a revised initial regulatory flexibility analysis (IRFA) to address the concerns presented below.

Advocacy Background

Congress established the Office of Advocacy under Pub. L. 94-305 to represent the views of small business before Federal agencies and Congress. Advocacy is an independent office within the Small Business Administration (SBA), so the views expressed by Advocacy do not necessarily reflect the views of the SBA or of the Administration. Section 612 of the RFA requires Advocacy to monitor agency compliance with the Act, as amended by the Small Business Regulatory Enforcement Fairness Act.¹

On August 13, 2002, President George W. Bush enhanced Advocacy’s RFA mandate when he signed Executive Order 13272, which directs Federal agencies to implement policies protecting small entities when writing new rules and regulations. Executive Order 13272 also requires agencies to give every appropriate consideration to any comments provided by Advocacy. Under the Executive Order, the agency must include,

¹ Pub. L. No. 96-354, 94 Stat. 1164 (1980) (codified at 5 U.S.C. §§ 601-612) amended by Subtitle II of the Contract with America Advancement Act, Pub. L No. 104-121, 110 Stat. 857 (1996). 5 U.S.C. § 612(a).

in any explanation or discussion accompanying the final rule's publication in the Federal Register, the agency's response to any written comments submitted by Advocacy on the proposed rule, unless the agency certifies that the public interest is not served by doing so.

The Proposed Rule

On January 9, 2008, the Board published a proposed rule in the Federal Register entitled *Regulation Z: Truth in Lending*.² The proposed rule implements the Truth in Lending Act and the Home Ownership and Equity Protection Act. The goals of the proposal are to protect consumers in the mortgage market from unfair, abusive, or deceptive lending and servicing practices while preserving responsible lending and sustainable homeownership; ensure that advertisements for mortgage loans provide accurate and balanced information and do not contain misleading or deceptive representations; and provide consumers transaction-specific disclosures early enough to use while shopping for a mortgage.

The proposed revisions would apply four protections to a newly-defined category of *higher-priced* mortgage loans secured by a consumer's principal dwelling, including a prohibition on a pattern or practice of lending based on the collateral without regard to consumers' ability to repay their obligations from income, or from other sources besides the collateral. The proposed revisions would also apply three new protections to mortgage loans secured by a consumer's principal dwelling *regardless of loan price*, including a prohibition on a creditor paying a mortgage broker more than the consumer had agreed the broker would receive. The Board also proposes to require that advertisements provide accurate and balanced information, in a clear and conspicuous manner, about rates, monthly payments, and other loan features; and to ban several deceptive or misleading advertising practices, including representations that a rate or payment is "fixed" when it can change. Finally, the proposal would require creditors to provide consumers with transaction-specific mortgage loan disclosures before the consumers pay any fee except a reasonable fee for reviewing credit history.

The Office of Advocacy supports the consumer protection goals of the proposed rule and understands the importance of the Board's policy objectives. However, Advocacy is concerned that the Board has not complied with the analytical requirements of the RFA; and as a result, the Board has not adequately assessed the impact of the proposed rule on small entities.

Requirements of the RFA

The RFA requires agencies to consider the economic impact that a proposed rulemaking will have on small entities. Pursuant to the RFA, the federal agency is required to prepare an initial regulatory flexibility analysis (IRFA) to assess the economic impact of a proposed action on small entities. Under Section 601(3) of the RFA "small business" has the same meaning as the term "small business concern" under section 3 of the Small Business Act. The IRFA must include: (1) a description of the impact of the proposed

² 73 Federal Register 1672, January 9, 2008.

rule on small entities; (2) the reasons the action is being considered; (3) a succinct statement of the objectives of, and legal basis for the proposal; (4) the estimated number and types of small entities to which the proposed rule will apply; (5) the projected reporting, recordkeeping, and other compliance requirements, including an estimate of the small entities subject to the requirements and the professional skills necessary to comply; (6) all relevant Federal rules which may duplicate, overlap, or conflict with the proposed rule; and (7) all significant alternatives that accomplish the stated objectives of the applicable statutes and minimize any significant economic impact of the proposed rule on small entities.³ In preparing the IRFA, an agency may provide either a quantifiable or numerical description of the effects of a proposed rule or alternatives to the proposed rule, or more general descriptive statements if quantification is not practicable or reliable.⁴ The RFA requires the agency to publish the IRFA or a summary of the IRFA in the Federal Register at the time of the publication of general notice of proposed rulemaking for the rule.⁵

Pursuant to section 605(a), an agency may prepare a certification in lieu of an IRFA if the head of the agency certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities. A certification must be supported by a factual basis.

The Board's Compliance with the RFA

The Board prepared an IRFA for the proposed rule and solicited comments from the public regarding the information in the IRFA. Advocacy, however, is concerned that the IRFA may not have sufficient information about the economic impact of the proposal. Advocacy is also concerned about the Board's failure to consider alternatives.

The Board Fails to Provide Sufficient Information about the Economic Impact of the Proposed Rule

Although the IRFA submitted by the Board identifies types of small businesses that are affected by the proposal, it fails to provide information about all of the small entities affected or the nature of the impact as required by the RFA. Moreover, the Board acknowledges that the projected reporting, recordkeeping, and other compliance requirements will be quite costly, but states that the precise costs are difficult to ascertain. Instead of providing information about costs, the Board states that it did not have sufficient information and requests that the information be provided by the public.

Advocacy appreciates the fact that the Board may need to obtain additional information and commends the Board for engaging the public in this endeavor. However, Advocacy is concerned that the Board may be shifting its responsibilities to fully analyze the economic impact of the proposal to the public and in doing so may be implementing a proposal without fully considering the costs or economic burden on small entities.

³ 5 USC § 603.

⁴ 5 USC § 607.

⁵ 5 USC § 603.

Small entities have informed Advocacy that compliance with the proposal will be costly. For example, in terms of the escrow section of the proposal, it is our understanding that some small banks do not require escrows because they are expensive to maintain. As such, small banks may need additional resources to deal with the escrow issue as well as obtain new software. In addition, some small banks are concerned that based on the proposed definition of higher priced loans, some prime loans may actually be classified as higher priced, which could have a negative impact on their business.

Mortgage brokers are also concerned about the costs of the proposal. They are particularly concerned about the broker agreement portion of the proposal because it would require brokers to enter into contracts with consumers before they know anything about the consumer. According to small brokers, the proposal does not provide an opportunity for new disclosures, and it limits the options that may be available for the consumer. As such, the brokers believe that the proposal may lead to brokers being less competitive in the marketplace and may result in many small brokers exiting the marketplace.

These are only a few of the concerns that the industry has about the potential costs of the proposed regulation. Advocacy encourages the Board to carefully review the comments submitted by the industry as well as perform outreach to the small business community, so that the Board can fully ascertain the economic impact of this proposal on small entities. A less costly, workable rule is not only good for small business, it will also benefit consumers.

The Board Fails to Provide Sufficient Information on the Number of Small Brokers that May be Impacted by the Proposed Rule

Advocacy is also concerned about the Board's failure to provide complete information about the nature of the industry to be regulated as required by the RFA. Although the Board provides information about the number of small banks that are affected by the proposed rule, the Board does not provide complete information about the number of small mortgage brokers that may be affected. Advocacy contacted SBA's Office of Size Standards for information about the mortgage broker industry. The appropriate SBA size standard for mortgage brokers is \$6.5 million in average annual receipts. The 2002 Economic Census data indicates that there are 15,590 mortgage broker firms in the United States. Of those firms, 15,195 would be classified as small using SBA's size standard of \$6.5 million.⁶

Alternatives

As noted above, the RFA requires agencies to consider less burdensome alternatives that still meet the statutory objectives. The Board states that it considered improved

⁶ Source: 2002 Economic Census. For information on confidentiality protection, sampling error, nonsampling error, and definitions, see <http://www.census.gov/econ/census02>.

disclosures, but argues that improved disclosures alone would not address unfair, abusive, or deceptive practices. There is no discussion about the economic impact of improved disclosures. Nor is there any indication that the Board considered any other alternatives. Instead, the Board solicits comments from the public on significant alternatives.

Simply soliciting information about alternatives from small entities does not relieve the Board of its obligation to consider less burdensome alternatives as part of the IRFA (in the proposed rule). It is unfortunate that the Board did not put forward a meaningful discussion of alternatives in its proposal. It would have allowed small entities an opportunity to comment on the alternatives considered and perhaps suggest additional ones, building on the Board's consideration of alternatives to minimize the impact on small entities.

One possible alternative is a later implementation date. The Board states that it has the discretion to lengthen the implementation period for creditors to adjust their forms to accommodate the new requirements.⁷ Advocacy encourages the Board to consider a later implementation date because it may allow small entities more time to make changes to software, forms, etc.

Advocacy understands that small entities have additional alternatives to this proposal. For example, the small bankers believe that changing the definition of higher priced loans so that prime loans are not included in the definition or using an index that better reflects market rates would minimize the economic impact.⁸

Similarly, mortgage brokers also have put forward alternatives. For example, small mortgage brokers support the 2007 Federal Trade Commission prototype disclosure form as an alternative.⁹ These are only a few of the possible alternatives.

Advocacy understands the urgent nature of this proposal given the current state of the real estate market. However, consumers benefit from competition. Consumers will suffer if the proposal forces businesses to exit the market. Advocacy encourages the Board to give full consideration to all of the alternatives suggested by the industry and develop a less costly rule that would not result in such a negative impact on affected industries.

Identification of Duplicative, Overlapping, or Conflicting Federal Rules

The RFA also requires an agency to identify duplicative, overlapping, or conflicting federal rules. Recently, the Department of Housing and Urban Development (HUD) published its proposed rules pertaining to the Real Estate Settlement Procedures Act (RESPA). HUD's proposal will also impact the way that mortgage brokers and lenders conduct business with the public. Advocacy encourages the Board to work with HUD to assure that the agencies' new rules do not duplicate, overlap, or conflict with each other, or with rules and guidances from other agencies.

⁷ Federal Register, at 1717.

⁸ Comments from the American Bankers Association forthcoming April 2008.

⁹ Comments from the National Association of Mortgage Brokers forthcoming April 2008.

Other agencies may also have rules or guidances that overlap, duplicate, or conflict with other agencies. Advocacy encourages the Board to carefully review the other agencies' regulations and guidances to prevent consumer confusion and over burdensome regulations on small entities.

Conclusion

The RFA requires agencies to consider the economic impact on small entities prior to proposing a rule, to provide the information on those impacts to the public for comment, and to consider less burdensome alternatives. Advocacy encourages the Board to prepare and publish for public comment a revised IRFA to address the issues discussed above before going forward with the final rule.

Thank you for the opportunity to comment on this important proposal and for your consideration of Advocacy's comments. Advocacy is available to assist the Federal Reserve with its RFA compliance and with community outreach. In the past, Advocacy worked with HUD to assure small entity stakeholder involvement in the regulatory process. Advocacy is available to assist the Board as well. If you have any questions regarding these comments or if Advocacy can be of any assistance, please do not hesitate to contact Jennifer Smith at (202) 205-6943.

Sincerely,

/s/

Thomas M. Sullivan
Chief Counsel for Advocacy

/s/

Jennifer A. Smith
Assistant Chief Counsel for
Economic Regulation and Banking

cc: The Honorable Susan E. Dudley, Administrator
Office of Information and Regulatory Affairs, OMB