



October 16, 2012

Submitted through the Federal eRulemaking portal at:

www.regulations.gov

Monica Jackson, Office of the Executive Secretary
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, DC 20552

RE: RIN No. 3170-AA13

Comments on the Proposed Rule Amending Regulation Z (Truth in Lending) to Implement Amendments to the Truth in Lending Act

AMERICAN CIVIL
LIBERTIES UNION
WASHINGTON
LEGISLATIVE OFFICE
915 15th STREET, NW, 6TH FL
WASHINGTON, DC 20005
T/202.544.1681
F/202.546.0738
WWW.ACLU.ORG

LAURA W. MURPHY
DIRECTOR

NATIONAL OFFICE
125 BROAD STREET, 18TH FL.
NEW YORK, NY 10004-2400
T/212.549.2500

OFFICERS AND DIRECTORS
SUSAN N. HERMAN
PRESIDENT

ANTHONY D. ROMERO
EXECUTIVE DIRECTOR

ROBERT REMAR
TREASURER

Dear Ms. Jackson:

On behalf of the American Civil Liberties Union (ACLU), over half a million members, countless additional activists and supporters, and fifty-three affiliates nationwide, we write to urge the Consumer Financial Protection Bureau to adopt additional safeguards against discrimination in the final rule creating an exemption from the statutory prohibition on upfront discount points, origination points, and fees under Regulation Z. These safeguards for consumers include requiring that they receive a competitive trade-off for the imposition of points and fees on their loans, and providing protections for individuals who the loan originator thinks are unlikely to qualify for the comparable, alternative loan – including notice in writing to the consumer, and reporting such determinations to the Bureau. Further, the ACLU writes to oppose the Bureau’s proposed expansion of the use of criminal records, financial responsibility, character, and fitness requirements on loan originators, also under Regulation Z.

Introduction

The ACLU supports the right of every American to access housing and housing financing free of discrimination on the basis of race, sex, sexual orientation, religion, national origin, familial or marital status, age, disability, status as a recipient of public assistance, or a past criminal conviction. Throughout our history, the ACLU has worked to dismantle barriers to housing by both governmental and private actors, and to promote residential integration nationally. In our work, we have advocated at both the state and federal level for increased enforcement of civil rights in the housing context, greater choice in housing options for those who receive governmental assistance, the development of housing programs that promote integration, including among those with a disability that necessitates

reasonable accommodations, and for the removal of housing restrictions on people with past convictions or people who reside in housing where illegal activity has occurred (such as victims of domestic violence). Through litigation, the ACLU has also challenged violations of the Fair Housing Act¹ and the Equal Credit Opportunity Act² by private actors, and brought challenges to discriminatory government policies on site selection, tenant selection and relocation, Section 8 Voucher administration, and exclusionary suburban housing and zoning policies.

Housing and the opportunity for residential mobility is inexorably related to diversity throughout society, including in schools and the workplace. Conversely, residential segregation – particularly by race or ethnicity – remains one of the most significant impediments to equality in the United States.³ Unfortunately, the housing boom and subsequent bust exacerbated long-term inequality, due to discrimination in housing finance and a lack of government oversight and regulation sufficient to check the unscrupulous practices in mortgage lending or meaningfully deter wrongdoing. It is for this reason that the implosion of the housing industry hit minority households hardest. From 2005 to 2009, Hispanics and African Americans lost 72 percent of home equity, while whites lost 52 percent.⁴ Since minority households relied on home equity for a greater proportion of their household wealth, these losses substantially increased the wealth gap between whites and minorities during that same time period.⁵ Further, communities impacted by high foreclosure rates – which are disproportionately communities of color – confront a reduced tax base and an increased demand for services.⁶

The potential impact of the Bureau’s rulemaking in mortgage finance is significant for all Americans, as the mortgage market is the largest for consumer financial products and services nationally, and more than one in five homeowners either owe more on their mortgage than their home is worth or are in the foreclosure process.⁷ However, the ACLU submits these comments to urge the Bureau to account in particular for the pernicious, and often covert, impact of discrimination in housing and housing finance. It is projected that minority households will

¹ The FHA prohibits both discrimination by housing providers, such as landlords, or even local governments, as well as discrimination by banks and other financial institutions whose practices have a disparate impact on individuals based on race, religion, sex, national origin, familial status, or disability. 42 U.S.C. §§3601- 3619 (2006).

² The ECOA prohibits discrimination against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age, receipt of income from a public assistance program, or because an individual has exercised, in good faith, any right under the Consumer Credit Protection Act. 15 U.S.C. §1691 (2006).

³ See, e.g. DOUGLAS S. MASSEY & NANCY A. DENTON, *AMERICAN APARTHEID: SEGREGATION AND THE MAKING OF AN UNDERCLASS* (1993); WILLIAM JULIUS WILSON, *THE TRULY DISADVANTAGED: THE INNER CITY, THE UNDERCLASS, AND PUBLIC POLICY* (1990).

⁴ JOINT CTR. FOR HOUSING STUDIES, *STATE OF THE NATION’S HOUSING 15* (2012), *available at* <http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/son2012.pdf> [hereinafter Joint Center].

⁵ *Id.* at 14-15 (“In 2005, the median wealth of white households was 11 times that of black households. At last measure in 2009, the differential had increased to 20 times. Over the same period, the median wealth of whites jumped from seven times the median wealth of Hispanics to 18 times.”).

⁶ See ELLEN SCHLOEMER ET AL., *CTR. FOR RESPONSIBLE LENDING, LOSING GROUND: FORECLOSURES IN THE SUBPRIME MARKET AND THEIR COST TO HOMEOWNERS 24* (2006), *available at* <http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosure-paper-report-2-17.pdf>.

⁷ Joint Center at 1 (“The backlog of roughly two million loans in foreclosure means that distressed sales will remain elevated, keeping prices under pressure.”); *Id.* at 11 (“Corelogic reports that the number of underwater loans rose in the fourth quarter of 2011 to 11.1 million – representing more than one in five mortgages and some \$717 billion in negative equity.”).

produce more than 70 percent of net household growth through 2020,⁸ so it remains critical that the government provide strong regulatory oversight to ensure that individuals can access housing and financing on the basis of their credit qualifications. The ACLU asks the Bureau to adopt safeguards in the final rule that account for potential discrimination against people on the basis of race, sex, sexual orientation, religion, national origin, familial or marital status, age, disability, status as a recipient of public assistance, or a past criminal conviction.

I. Rulemaking Is Necessary to Address Predatory Lending and Discrimination in the Mortgage Finance Market

Predatory lending blossomed during the lead up to and culmination of the housing boom, and these abusive loans were disproportionately targeted and made to minority consumers, so they have borne a disproportionate share of the economic fallout of the housing bust.⁹ It is estimated that African American and Latino families are twice as likely as white families to lose their home through foreclosure during the downturn in the housing market,¹⁰ and due to residential segregation, these foreclosures are highly clustered in communities of color.¹¹

Historically, and even today, minorities were denied access to the housing finance market on the basis of redlining, which is discrimination in lending based on the location of the residential property in certain neighborhoods (usually with a significant residential population of racial and ethnic minorities).¹² Redlining, along with discrimination in housing generally, has

⁸ *Id.* at 4.

⁹ Although there is not a universal definition of what constitutes a “predatory loan,” since the presence or absence of any particular loan feature is not dispositive, here are characteristics often associated with predatory loans: “(a) enticing borrowers into adjustable rate loans with low “teaser rates” that would automatically reset to much higher market rates after an introductory period, often with false promises to refinance the loan before the introductory period ended; (b) encouraging borrowers to refinance loans unnecessarily for the purpose of collecting closing costs, fees, and higher interest rates; (c) charging “yield spread premiums” that allow the lender to profit from interest rates that are higher than the rate the borrower qualifies for and can actually afford; (d) ignoring traditional underwriting criteria such as debt-to-income ratio, loan to value ratio, FICO score, cash reserves, and work history, against the borrower’s best interest, all for the purpose of maintaining the short term profit that comes from high loan volumes, closing costs, and transaction fees; (e) charging excessive points and fees; and (f) requiring substantial prepayment penalties to prevent borrowers with improved credit or equity from moving from a subprime to a prime loan.” John R. Relman, *Foreclosures, Integration, and the Future of the Fair Housing Act*, 41 IND. L. REV. 629, 635 (2008), available at <http://www.iulaw.indy.indiana.edu/ILR/pdf/vol41p629.pdf>.

¹⁰ DEBBIE GRUENSTEIN BOCIAN ET AL., CTR. FOR RESPONSIBLE LENDING, LOST GROUND, 2011: DISPARITIES IN MORTGAGE LENDING & FORECLOSURES 3 (2011), available at <http://www.responsiblelending.org/mortgage-lending/research-analysis/Lost-Ground-2011.pdf>.

¹¹ *Id.* at 28.

¹² STEPHEN L. ROSS & JOHN YINGER, THE COLOR OF CREDIT: MORTGAGE DISCRIMINATION, RESEARCH METHODOLOGY, & FAIR LENDING ENFORCEMENT 228 (2002) (“[T]here are two different definitions of redlining. The first definition, which focuses on the loan denial process, is that redlining exists when otherwise comparable loans are more likely to be denied when they apply to housing in a minority rather than a white neighborhood. Redlining by this definition is illegal according to [the Equal Credit Opportunity Act]. The second definition, which focuses on lending outcomes, is that redlining exists when minority neighborhoods receive a smaller flow of mortgage loans than comparable white neighborhoods. Redlining by this definition is illegal according to the [Community Reinvestment Act].”).

produced high levels of residential segregation nationally.¹³ In fact, the existence of both factors “combined to create ideal conditions for predatory lending to poor minority group members in poor minority neighborhoods.”¹⁴ Much of the current discrimination in lending may be classified as “reverse redlining,” which is the targeting of communities of color for loans that are unfair, predatory, and often likely to result in a default leading to foreclosure.¹⁵

Reverse redlining in the housing finance market was motivated by the convergence of three main structural factors: (1) the introduction of risk-based pricing in the housing finance market, leading to the growth of sub-prime loans, (2) the impact of the secondary mortgage market, and (3) the changing compensation structure for loan originators. Previously, the housing finance market structured incentives for the origination of mortgages that would be profitable in the long-term, as the homeowner would typically make fixed payments over a period of years while building equity. When mortgage originations were driven by the primary mortgage market, lenders emphasized adherence to underwriting standards that minimized the risk that the homeowner would default on the mortgage – because the lender would suffer a loss on their balance sheet.

However, the convergence of the growth in the sub-prime market¹⁶ and the increasing demand for mortgage-backed securities¹⁷ occurred during a sustained increase in U.S. home values nationally, and fueled a speculative-like focus on the short-term profits of mortgage origination and securitization.¹⁸ This resulted in an inversion of the typical incentive structure for lenders, because not only could they pass on the risk of the mortgage defaulting, but they could also realize an immediate short-term profit from the discount points and origination points and fees on the loan, as well as the proceeds from the rapid sale of the mortgage to the secondary market. During the housing boom, both loan originators and housing finance organizations had an incentive to steer borrowers into costlier subprime loans with points and fees. Loan originators, including brokers, received commissions (referred to as “yield spread premiums” or “overages”) based on the type and amount of loan they were able to sell to a borrower, with financial incentives to steer a consumer into a costlier loan than the individual qualified for, based on their credit criteria and the lender’s underwriting standards.¹⁹ Similarly, housing

¹³ See, generally Jacob S. Rugh & Douglas S. Massey, *Racial Segregation and the American Foreclosure Crisis*, 75 AM. SOC. REV. 629 (2010), available at http://blogs.reuters.com/felix-salmon/files/2010/10/10ASR10_629-651_massey-2.pdf.

¹⁴ *Id.* at 630.

¹⁵ Gregory D. Squires, Nat’l Hous. Inst., *Predatory Lending: Redlining in Reverse*, SHELTERFORCE ONLINE, Jan.-Feb., 2005, <http://www.nhi.org/online/issues/139/redlining.html>.

¹⁶ From 1998 to 2006, subprime loans went from comprising 1 in 10 mortgages to almost 1 in 4 (23 percent). *Subprime Mortgage Origination Indicators*, INSIDE B&C LENDING, Nov. 10, 2006.

¹⁷ During the 2002 to 2006 period, less-than-prime loans increased from 43 to 71 percent of securitizations. U.S. GOV’T ACCOUNTABILITY OFFICE, HOME MORTGAGE DEFAULTS AND FORECLOSURES: RECENT TRENDS AND ASSOCIATED ECONOMIC AND MARKET DEVELOPMENTS 48 (2007), available at <http://www.gao.gov/new.items/d0878r.pdf>.

¹⁸ *Chain of Fools: Hard evidence that securitisation encouraged lax mortgage lending in America*, ECONOMIST, Feb. 7, 2008, available at http://www.economist.com/node/10641119?story_id=10641119&fsrc=RSS.

¹⁹ KATHLEEN C. ENGEL & PATRICIA A. MCCOY, THE SUBPRIME VIRUS: RECKLESS CREDIT, REGULATORY FAILURE, AND NEXT STEPS 32 (2011) [hereinafter *Subprime Virus*].

finance organizations were able to realize a profit based on points and fees and the securitization proceeds – even when there was a significant likelihood that the mortgage would default.²⁰

As loan originators expanded their marketing and targeting efforts to satisfy the volume demand for subprime mortgages, both to earn points and fees through origination and to sell as a Mortgage-Backed Security, the underwriting standards became looser and the borrower's ability to pay off the mortgage over the course of the loan was not as closely scrutinized. Minority borrowers were disproportionately targeted, since “the old inequality in home lending made the new inequality possible by creating geographic concentrations of underserved, unsophisticated consumers that unscrupulous mortgage brokers could easily target and efficiently exploit.”²¹ Ultimately, this targeting resulted in minority borrowers being saddled with a disproportionate share of these predatory loans, and their communities experienced a much higher concentration of foreclosures – resulting in the draining of resources from families and neighborhoods that were too often already economically distressed.²²

Many of these minority borrowers would have been able to stay in their homes, if they had received a competitive mortgage or re-finance loan that matched their credit qualifications – i.e. a prime rate loan, or a loan with a lower interest rate, or no prepayment penalty. Based on an analysis by the *Wall Street Journal*, approximately 6 in 10 subprime borrowers were eligible for prime loan rates based on their credit score.²³ African Americans were statistically more likely to receive these subprime loans than white borrowers with similar credit qualifications, down payment ratios, and residential property locations; this statistical disparity in subprime lending spans all income levels, and is actually more pronounced for wealthier African Americans.²⁴ Notably, there are different lending rates for prime loans in communities of color, independent of the race or ethnicity of the borrower – which means that white borrowers living in a majority-minority neighborhood are less likely to receive a prime loan, regardless of their credit qualifications.²⁵ One analysis of data reported under the Home Mortgage Disclosure Act determined that while prime loans comprise 70 percent of all mortgage loans, and 57 percent of such lending in lower-income census tracts, the proportion of prime loans going to African Americans in predominantly African American neighborhoods is only 27.7 percent.²⁶ Indeed,

²⁰ WILLIAM C. APGAR & ALLEGRA CALDER, THE DUAL MORTGAGE MARKET: THE PERSISTENCE OF DISCRIMINATION IN MORTGAGE LENDING 116, IN THE GEOGRAPHY OF OPPORTUNITY: RACE & HOUSING CHOICE IN METROPOLITAN AMERICA (Xavier de Souza Briggs ed., 2005) [hereinafter Dual Mortgage Market].

²¹ Rugh & Massey, *supra* note 13, at 632.

²² Elvin K. Wyly et al., *American Home: Predatory Mortgage Capital and Neighborhood Spaces of Race and Class Exploitation in the United States*, *Geografiska Annaler: Series B, Human Geography*, Mar. 2006, at 126, available at <http://www.geog.ubc.ca/~ewyly/u400/Wyly%282006%29.pdf> (“Our empirical findings are simple. Econometric models of subprime mortgage segmentation reveal persistent racial targeting and disparate impact, even after controlling for applicant income and underwriters’ evaluation of borrower risks. For large, non-local mortgage companies – many of them subsidiaries of global financial services firms – serving the African American market is becoming synonymous with specialization in subprime credit. Qualitative case studies and reviews of investor prospectuses demonstrate that inner-city landscapes of subprime targeting are closely tied to national and transnational capital markets.”).

²³ Rick Brooks & Ruth Simon, *Subprime Debacle Traps Even Very Credit-Worthy: As Housing Boomed, Industry Pushed Loans to a Broader Market*, *WALL ST. J.*, Dec. 3, 2007, at A1.

²⁴ Rugh & Massey, *supra* note 13, at 632-33.

²⁵ Dual Mortgage Market at 110-11.

²⁶ *Id.*

even the usage of the term “subprime” shifted during the housing boom from characterizing a borrower with a limited or negative credit history to describing a set of loan products, also known as Alt-A or non-prime loans.²⁷

There is nothing inherently predatory about subprime loans, as long as they are extended on a non-discriminatory basis using uniform, sound underwriting criteria, with full disclosures to potential borrowers of the full repayment schedule and any terms unique to the loan (e.g. prepayment penalties).²⁸ However, subprime loans – often with adverse features, like prepayment penalties and balloon payments – are more frequently identified with predatory and abusive lending and discrimination in the housing finance market. In addition to being more likely to receive a subprime loan than similarly situated white borrowers, minority borrowers are also more likely to receive loans with these features (prepayment penalties, balloon payments, etc.).²⁹ A study of loans underwritten by the Federal Housing Administration found that African American and Latino borrowers paid on average more in loan fees (\$414 and \$365, respectively) than white borrowers with similar credit qualifications and home property values.³⁰

II. Proposed Rule on Upfront Points and Fees on Mortgage Loans

The ACLU does not object to the Bureau using its authority³¹ to create an exemption from the prohibition on upfront discount points, origination points, or fees,³² provided that the final rule promulgated provides sufficient protections to guard against discrimination in lending and access to credit. These proposed safeguards will advance transparency in the lending process and accountability for financial institutions that violate civil rights and consumer protection laws, in addition to furthering the Bureau’s stated objectives of facilitating consumer choice on loan products and better enabling consumers to assess the trade-offs of loans with points and fees versus loans with higher interest rates.³³

A. The ACLU Supports Imposition of the Requirement that Consumers Receive a Competitive Trade-Off for the Imposition of Points or Fees on Mortgage Loans

The ACLU supports the Bureau’s proposed rule (§ 1026.36(d)(2)(ii)), which prohibits the imposition of points and fees on a loan transaction secured by a home, unless there is a “bona fide” reduction in the interest rate in comparison with the interest rate for the “comparable,

²⁷ Subprime Virus at 34.

²⁸ DANIEL LINDSEY ET AL., NAT’L CONSUMER LAW CTR., WHY RESPONSIBLE MORTGAGE LENDING IS A FAIR HOUSING ISSUE 3 (2012), available at http://www.nclc.org/images/pdf/credit_discrimination/fair-housing-brief.pdf.

²⁹ Rugh & Massey, *supra* note 13, at 632-33.

³⁰ SUSAN E. WOODWARD, U.S. DEP’T OF HOUSING & URBAN DEV., OFF. OF POLICY DEV. & RES., A STUDY OF CLOSING COSTS FOR FHA MORTGAGES 46, 2008.

³¹ Truth in Lending Act (Regulation Z), 77 Fed. Reg. 55,272 (proposed Sep. 7, 2012) (to be codified at 12 C.F.R. pt. 1026).

³² In these comments, the terms “points and fees” will be used interchangeably refer to discount points and cash rebates and origination points or fees. Under the Bureau’s proposed rule, “[d]iscount points are paid by consumers to the creditor to purchase a lower interest rate,” and “origination points or fees [are] typically presented as charges to apply for the loan.” The origination cost can be “a flat dollar amount,” (i.e. a fee), “a percentage of the loan amount,” (i.e. a point), or potentially both in combination. Truth in Lending Act (Regulation Z), 77 Fed. Reg. 55,272 at 55,275.

³³ *Id.* at 55,312.

alternative” loan that does not include points and fees. Under this rule, the comparable, alternative loan would not include points and fees, but would be functionally equivalent to the loan with points and fees.³⁴

This proposed rule is necessary to address the prevalence of predatory lending during the past few decades, when many lenders attached points and fees to loans without lowering the interest rate that the individual borrower could qualify for based on his or her credit qualifications. Due to the existence of the secondary mortgage market, loan originator organizations now typically make their profits on the points and fees on the loan, as well as the profits from the securitization process, which also give “lenders the security of being paid in advance, instead of having to wait for uncertain monthly payments over the life of loans.”³⁵ Even after significant reforms to loan originator compensation through the Dodd-Frank Wall Street Reform and Consumer Protection Act³⁶ (Dodd-Frank) and this rulemaking, organizations in the housing finance industry will still prioritize the making of loans with points and fees because of this profit structure.

In predominant minority communities, which are often targeted for predatory loans, the historic lack of access to credit has left many residents “without the knowledge or experience required to identify loan products and lenders offering products with the most advantageous terms for which they qualify.”³⁷ Many of these individuals are susceptible to accepting the first loan offer they are extended, without conducting any comparison loan shopping or inquiring whether they receive a benefit from the points and fees on the loan³⁸ – particularly when they are targeted during a time of economic vulnerability.³⁹ Indeed, the housing finance market is not an efficient market, “since households with similar economic, demographic, and credit risk characteristics do not pay the same price for mortgage credit.”⁴⁰ The lack of efficiency in the housing finance market means that loan originators – and by extension, housing finance market players – do not confront competition pressure sufficient to ensure that they offer the best loan pricing – which, when combined with the consumer’s asymmetries of information,⁴¹ means that it is possible for consumers to take out mortgages with points and fees without receiving a comparable drop in the interest rate. The Department of Housing and Urban Development (HUD) and the Treasury Department (Treasury) highlighted this exact phenomenon in a joint

³⁴ *Id.* (“The term ‘comparable, alternative loan’ would mean that the two loans for which quotes are provided must have the same terms and conditions, other than the interest rate, any terms that change solely as a result of the change in the interest rate (such as the amount of regular periodic payments), and the amount of any discount points and origination points or fees.”).

³⁵ Subprime Virus at 41.

³⁶ Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub.L. No. 111-203, § 941, 124 Stat. 1376 (2010).

³⁷ Relman, *supra* note 9, at 637.

³⁸ *Id.*

³⁹ Ellen Seidman, *CRA in the 21st Century*, MORTGAGE BANKING 6, Oct. 1, 1999.

⁴⁰ Dual Mortgage Market at 114.

⁴¹ *Id.* at 120 (“[I]n the language of economics, there exists an ‘asymmetry of information’ between buyers and sellers, particularly with respect to the price of mortgage credit. Mortgage industry professionals participate in numerous transactions over the course of weeks and months and have ready access to information on fees, rates, and terms comprised by the overall pricing of the mortgage credit in the marketplace. In contrast, consumers only occasionally search for a loan to purchase or refinance a home and hence begin shopping with limited prior experience and equally limited access to the information needed to make an educated choice.”).

report published over a decade ago.⁴² The report identified many mortgages with “fees that far exceeded what would be expected or justified based on economic grounds, and fees that were ‘packed’ into the loan amount without the borrower’s understanding.”⁴³

Finally, the ACLU objects to the Bureau’s proposal to exempt creditors from this requirement to provide a “comparable, alternative” loan with no points and fees, if the quote for the loan with points and fees is given prior to when the creditor provides the consumer with the Good Faith Estimate required under the Real Estate Settlement Procedures Act (RESPA) or any other disclosure required under RESPA or the Truth in Lending Act (TILA).⁴⁴ The Bureau bases this proposed exemption on the belief that “consumers generally ask for, and are provided, quotes from creditors prior to application.”⁴⁵

However, in many instances of predatory lending, the consumer is targeted with one type of loan application, which was typically the type of loan that would accrue the greatest immediate profit to the loan originator – regardless of what other loans the consumer could have qualified for. Under the proposed rule, lenders would be permitted to present an application for a loan with points and fees to a consumer, and they would not be required to inform the consumer of her or his ability to qualify for a comparable loan without points and fees, if the consumer completes and submits the loan application.

It is for this reason that the ACLU supports the Bureau’s TILA-RESPA Integration Proposal, which would require loan originators to provide a “Loan Estimate” within three business days after receipt of the consumer’s loan application, and urges the Bureau to extend this requirement of creditors to provide the same “Loan Estimate” for a comparable, alternative loan with no points and fees. Under the TILA-RESPA Integration Proposal, the “Loan Estimate” would include “information about the interest rate, the regular periodic payments, and the amount of money the consumer would need at closing including the total amount of closing costs,” and “a detailed list of closing costs.”⁴⁶ Implementation of this requirement to provide a “Loan Estimate” for both a loan with points and fees, and a comparable, alternative loan without points and fees would increase transparency in the lending process. In turn, this transparency would decrease the instances of predatory lending and further the Bureau’s objective of helping consumers understand the trade-offs in taking out a loan with points and fees.⁴⁷

⁴² U.S. DEP’T. OF HOUS. & URBAN DEV. & U.S. DEP’T. OF TREASURY, CURBING PREDATORY HOME LENDING: A JOINT REPORT (2000).

⁴³ *Id.* at 2.

⁴⁴ Truth in Lending Act (Regulation Z), 77 Fed. Reg. 55,272 at 55313.

⁴⁵ *Id.*

⁴⁶ *Id.* at 55,317.

⁴⁷ *Id.* at 55,312.

B. The ACLU Supports Protections for Individuals Who the Loan Originator Thinks Are Unlikely to Qualify for the “Comparable, Alternative Loan” Requirement

Under the Bureau’s proposed rule, a loan originator is not required to present the consumer with a comparable, alternative loan without points and fees, if the loan originator believes the consumer is “unlikely to qualify for that loan.”⁴⁸

The ACLU is concerned that this rule could countenance the continuation of discrimination in housing finance lending, for the following reasons. First, the proposed rule does not clarify on what informational basis the loan originator will determine that the individual is unlikely to qualify for a loan without points and fees, which opens the door to the differential – and discriminatory – treatment of individuals with similar credit qualifications.⁴⁹ Second, the proposed rule does not require the loan originator to document and report its decision to not offer the alternative, comparable loan with no points and fees to a particular individual, which prevents the Bureau and other government agencies from investigating and challenging discrimination in housing finance and credit. Third, the proposed rule does not provide notice to the consumer that the loan originator believes that he or she is unlikely to qualify for a comparable loan without points and fees. Such notice would better enable a consumer to identify and report suspected instances of discrimination in housing finance and credit access, as well as to encourage discussions with the loan originator about their credit qualifications – which would permit the consumer to correct or explain any negative information that the loan originator relied upon.⁵⁰

The ACLU urges the Bureau to adopt a final rule mandating that the loan originator disclose in writing to the consumer that he or she was not provided with information about a comparable, alternative loan without points and fees, based on the presumption that the consumer would not qualify for such a loan.⁵¹ Further, the Bureau could develop a standard form with plain language that loan originators (brokers and employees of lending institutions) provide to consumers under this circumstance to explain that the loan originator would be

⁴⁸ *Id.* at 55,313.

⁴⁹ Under the Bureau’s proposed rule, a “creditor must have a good-faith belief that a consumer will not qualify for a loan that has the same terms and conditions as the loan that includes discount points and origination points or fees, other than the interest rate, any terms that change solely as a result of the change in interest rate (such as the amount of regular periodic payments) and the fact that the consumer will not pay discount points and origination points or fees. Under this proposed comment, the creditor’s belief that the consumer is likely not to qualify for such a loan must be based on the creditor’s current pricing and underwriting policy. *In making this determination, the creditor may rely on information provided by the consumer, even if it subsequently is determined to be inaccurate.*” *Id.* at 55,322 (emphasis added).

⁵⁰ The Bureau explained “that in these circumstances, a creditor would not be required to provide an adverse action notice to the consumer under the Bureau’s Regulation B, 12 CFR part 1002, which implements the Equal Credit Opportunity Act, because the creditor’s denial of the loan that includes discount points and origination points or fees would be required by law. *See* 12 CFR. 1002.2(c).” *Id.* at 55,315, fn. 63. However, the ACLU notes that this is premised on the loan originator making such a determination solely based on consideration of the consumer’s credit qualifications and the lender’s underwriting criteria – not on a protected class characteristic of the consumer.

⁵¹ The ACLU notes that the Bureau specifically solicited comment on “whether it would be useful for beneficial to consumers to be informed that they did not qualify in these circumstances” and “if such notification would be useful or beneficial, what form such a notice should take.” *Id.*

obligated to provide a quote on a comparable, alternative loan with no points and fees to the consumer if they were likely to qualify for this loan option. The form should also contain clear and conspicuous language to inform the consumer on what basis this determination was made by the loan originator (e.g. low credit score, etc.).

Further, the ACLU would recommend that the Bureau adopt a final rule requiring the loan originator to maintain records on the decision not to extend an offer for a comparable, alternative loan with no points and fees to the consumer, the basis on which such a decision was made, and the characteristics of the consumer (including whether the consumer is a member of any class protected under the Fair Housing Act or the Equal Credit Opportunity Act). This reporting requirement would address the Bureau's concern that "creditors who do not wish to make loans that do not include discount points and origination points or fees available to particular consumers could possibly manipulate their underwriting standards so that those consumers do not qualify for such a loan."⁵²

If loan originators are required to keep records of the decision not to offer a consumer a comparable, alternative loan without points and fees, and to report that decision and the characteristics of the borrower, it would serve as a strong deterrent to discrimination in lending. The reporting requirement would also facilitate the Bureau taking enforcement action against a lender that appears to be engaging in discrimination in housing finance and access to credit, and it would better enable consumers to avail themselves of the protections provided under federal and state civil rights statutes. Again, it would be beneficial for the Bureau to develop a standard form that loan originators may use to report this information, both to ensure consistency and to reduce the costs of compliance on loan originators.

III. Loan Originator Qualification Requirements

The ACLU opposes the unnecessary expanded use of criminal records, financial responsibility, character, and fitness requirements on loan originators who are not already licensed under the Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act)⁵³ or State SAFE Act implementing laws under proposed section 1026.36(f).⁵⁴ Proposed rule §1026.36(f)(3)(i) subjects unlicensed loan originators to a State and national criminal background check, credit report, and the collection of any information about administrative, civil, or criminal findings by any court or government agency.⁵⁵ Upon implementation of the proposed rule, loan originator organizations would also be required to make the subjective determination that an individual's financial responsibility, character, and general fitness are "such as to command the confidence of the community," based on "reasonably available, relevant information."⁵⁶

⁵² *Id.* at 55,313.

⁵³ According to the Bureau's proposed rule, institutions impacted by these additional requirements would include organizations that qualify as bona fide non-profit organizations under State law, in accordance with Regulation H, as well as depository institutions. *Id.* at 55,325.

⁵⁴ *Id.*

⁵⁵ Per Section 1026.36(f), these additional requirements would not apply to government agencies and State housing finance agencies, whose employees are also exempted from the SAFE Act. *Id.* at 55,325.

⁵⁶ *Id.* at 55,327.

Prior to the collapse of the housing market, there were unscrupulous practices by loan originators that sometimes rose to the level of predatory lending and discrimination. However, these practices were driven in large part by two structural aspects of the lending system: 1) the compensation incentives of loan originators, as established by the policies and practices of lenders and the financial institutions engaged in the secondary mortgage market, and 2) the lack of risk retained by lenders for making loans that were doomed to default and result in foreclosure (referred to colloquially as “skin in the game”). After passage of Dodd-Frank, and the implementation of many reforms to the housing finance system through the rulemaking process by the Federal Reserve and the Bureau,⁵⁷ loan originators may no longer receive compensation tied to any term of a mortgage loan – such as the interest rate – and lenders retain more of the financial risk that a loan will default.⁵⁸ These key reforms, in concert with other changes to the housing finance system that increase transparency and accountability for financial institutions, significantly reduce the likelihood that loan originators will engage in misleading practices.

Thus, it is unnecessary – and at the very least, premature – to expand the use of criminal records to restrict the employment of individuals on the basis of information in their background that has no bearing on their current or future job functions as a loan originator. Further, the ACLU is concerned about the wide-ranging scope of the character and fitness requirement and that the subjective component of its implementation could result in bias against minority applicants, especially among racial and ethnic minorities and women. The ACLU is well positioned to comment on these proposed requirements, because we have both a strong institutional interest in protecting minority groups from exploitation by lenders and ensuring equal access to credit, and in the removal of unnecessary or duplicative employment barriers for people with past convictions.

A. Criminal Background Check Requirements and Restrictions

The proposed standards set out in §1026.36(f)(3)(ii)(A) would require a loan originator organization to “determine” that the individual originator had not been convicted, pleaded guilty to, or pleaded *nolo contendere* to a felony involving fraud, dishonesty, a breach of trust, or money laundering at any time, or any other felony within the preceding seven-year period.⁵⁹ The ACLU opposes the blanket ban on employment of individuals with felony convictions during the previous seven-year period, as it is overbroad. The provision would expand the scope of disqualifying crimes to include felonies other than those involving dishonesty, money laundering, or breach of trust, if the conviction occurred in the previous seven years.⁶⁰ Finally, the proposed rule would apply to current, as well as prospective employees, since employing financial institutions would be required to perform the proposed background examination before an individual employee could serve as a loan originator in a covered transaction.⁶¹

⁵⁷ *Id.* at 55,324. (“Section 1026.36(e)(1) provides that a loan originator may not direct or ‘steer’ a consumer to consummate a transaction based on the fact that the originator will receive greater compensation from the creditor in that transaction than in other transactions the originator offered or could have offered to the consumer, unless the consummated transaction is in the consumer’s interest.”).

⁵⁸ Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub.L. No. 111-203, § 941, 124 Stat. 1376, 1890-96 (2010).

⁵⁹ Truth in Lending Act (Regulation Z), 77 Fed. Reg. 55,272 at 55,326.

⁶⁰ *Id.*

⁶¹ *Id.* at 55,326.

We urge the Bureau to modify the proposed blanket employment ban on individuals who have been convicted of any felony within the past seven years. Rather, employers should be able to consider all the factors related to the conviction, including: the time that has passed since the offense, conviction, or completion of sentence; whether the conduct is related to the job sought and whether excluding the worker based on the conduct is justified by business necessity; whether the worker or applicant can demonstrate rehabilitation or a good work record since the offense occurred; and other potentially relevant factors, such as the worker's age at the time of the conduct. Further, such a blanket ban on hiring anyone who has ever been convicted of a felony has a disparate impact of workers of color, due to significant disparities in our criminal justice system⁶² rooted in discrimination.⁶³ Individuals should not be subjected to additional barriers to employment that bear no relation to their past conviction and their ability to perform the job.

In addition, the proposed rule would permit employer loan originator organizations without access to the NMLSR database to conduct criminal background checks through either a law enforcement agency or commercial service.⁶⁴ Both options could result in the review of inaccurate or outdated information for a job applicant or current employee, and could lead to negative employment actions or hiring decisions on the basis of such information.

First, allowing organizations to use criminal background information from law enforcement agencies leaves open the risk of employers viewing error-filled background reports, some containing arrest information or investigations that did not lead to a charge or a conviction.⁶⁵ These law enforcement background reports sometimes include incorrect information, and also can include non-relevant information that an employer could use to make an employment determination without providing the individual with an opportunity to explain or provide corrected information.⁶⁶

Second, the use of commercial background check services could result in the issuance of an incomplete judgment about an applicant based on a pass/fail ruling, without employer loan originator organizations ever receiving the details on the conviction that supposedly disqualifies the applicant.⁶⁷ Over the last two years, the ACLU has received more than 850 reports from individuals who have been refused or dismissed from employment because of their criminal

⁶² THE SENTENCING PROJECT, TRENDS IN U.S. CORRECTIONS (2010), available at

http://sentencingproject.org/doc/publications/inc_Trends_in_Corrections_Fact_sheet.pdf.

⁶³ *EEOC Enforcement of Title VII Protections Regulating Criminal Background Checks*: Hearing on Public Input into the Development of EEOC's Strategic Enforcement Plan (July 18, 2012) (statement of Laura W. Murphy, Director of the Washington Legislative Office, Deborah J. Vagins, Senior Legislative Counsel, & Ariela Migdal, Senior Staff Attorney of the Women's Rights Project, American Civil Liberties Union), available at http://www.aclu.org/files/assets/aclu_statement_to_eoc_on_criminal_records_discrimination_7_25_11_corrected.pdf.

⁶⁴ Truth in Lending Act (Regulation Z), 77 Fed. Reg. 55,272 at 55,326.

⁶⁵ Justin Casson, ACLU, FBI Background Checks and Misinformation: Barriers to Reentry for the Formerly Incarcerated, <http://www.aclu.org/blog/prisoners-rights/fbi-background-checks-and-misinformation-barriers-reentry-formerly> (last visited Oct. 5, 2012).

⁶⁶ *Id.*

⁶⁷ See Letter from ACLU to U.S. Equal Employment Opportunity Commission, *supra* note 76 at 2.

record.⁶⁸ One of those intakes illustrates the problematic nature of commercial services providing pass/fail rulings:

Ms. W, a Native American woman in Washington State, was convicted in 2008 for possession of marijuana. After applying for a job at a discount retail store and receiving a conditional offer of employment, Ms. W received a call from the manager telling her that a background check company had given her a failing evaluation, without providing the employer with any further information. As a result of this evaluation, the employer rescinded the conditional offer of employment. When Ms. W investigated, she found out that her background check erroneously reflected a more serious offense. Although the background check company subsequently corrected Ms. W's report, the damage had been done. Ms. W's experience demonstrates why it is essential that employers give applicants the opportunity to explain or correct any mistakes. For many job seekers, the background check does not tell the whole story or even the correct story.⁶⁹

Finally, leaving the criteria to "determine" whether a conviction occurred to a loan originator organization that is unfamiliar with variations in criminal justice convictions, on a state-by-state or federal basis, creates an element of uncertainty in interpretation and application. The inconsistent application of these background checks could be aggravated by the use of information in the report to disqualify individuals under the character and fitness requirements for the position, even if the conviction does not fall into one of the proposed categories of the rule. For instance, an individual with a felony conviction for drug possession ten years ago would presumably not be barred from employment under the proposed criminal records criteria, but it is possible that such information could be used to bar the individual from employment under the new proposed character and fitness requirements.⁷⁰ Moreover, it is unclear how convictions that are later overturned or expunged would be assessed under the new criminal background check requirements. For all of these reasons, the ACLU opposes the imposition of a blanket employment ban on individuals with felony convictions within the past seven years.

B. Character and Fitness Requirements

Proposed §1026.36(f)(ii)(B) authorizes a loan originator organization to determine that an individual loan originator has demonstrated "financial responsibility," character, and general fitness to warrant an assessment that the individual will not only operate, "honestly, fairly, and efficiently," but "such as to command the confidence of the community."⁷¹ There are three main problems with this subjective standard.

First, it is difficult for employer loan originator organizations to implement in a consistent manner. The proposed rule does not provide sufficient guidance as to how the loan

⁶⁸ *Id.*

⁶⁹ *Id.*

⁷⁰ Truth in Lending Act (Regulation Z), 77 Fed. Reg. 55,272 at 55,327. ("As an example, the comment states that conduct revealed in a criminal background report may show dishonest conduct, even if the conduct did not result in a disqualifying felony conviction.").

⁷¹ *Id.*

originator organizations would account for determinations on, for instance, “financial responsibility,” or “character, and general fitness.” The proposed rule suggests that such a determination will distinguish “delinquent debts that arise from extravagant spending from those that arise, for example, from medical expenses.”⁷² However, the determination of whether an individual is in debt due to profligate spending, as opposed to circumstances beyond their control, is rarely so easily made. Consider an individual who must stop working for a year to care fulltime for an ailing family member. Review of this individual’s financial circumstances could reveal a large amount of credit card and other debt which appears unwarranted, and could result in a negative employment decision. As the proposed rule is drafted, employer loan organizations are given a vast amount of discretion to assess an individual, with very little guidance on how to weigh competing considerations or the totality of circumstances of an individual’s “financial responsibility,” or “character, and general fitness.”

Second, the ambiguity in this standard could lead to pretextual negative employment determinations. For instance, an employer could decline to hire or retain an employee allegedly based on their failure “to command the confidence of the community,” due to information disclosed in the character and fitness tests, although the negative employment decision actually stems from an impermissible motive – like discrimination.

Third, the proposed rule states that employer loan organizations may assess “reasonably available, relevant information” in making a determination that “individual loan originators meet common minimum qualification standards for financial responsibility, character and general fitness.”⁷³ Again, the ACLU opposes the adoption of a final rule with the proposed character and fitness test, but if the Bureau does not modify the proposed language, then we would ask that the rule clarifies how “reasonably available, relevant information” is defined. We would also caution against the adoption of a rule that would permit employers to request traditionally personal and private information from an employee that has no basis or relation to employment.⁷⁴

C. Additional Training Requirements

Finally, the ACLU supports the additional training programs proposed under §1026.36(f)(3)(iii), which would help ensure that loan originators who are not already licensed under the SAFE Act⁷⁵ or State SAFE Act implementing laws are trained and informed about federal and state law requirements applicable to the specific loan origination activities taken by

⁷² *Id.*

⁷³ *Id.*

⁷⁴ ACLU, Your Facebook Password Should Be None of Your Boss’ Business, <http://www.aclu.org/blog/technology-and-liberty/your-facebook-password-should-be-none-your-boss-business> (last visited Oct. 5, 2012); Ateqah Khaki, ACLU, New Examples of Facebook Password Demands, Facebook’s Response, and the Need for a New Law, <http://www.aclu.org/blog/technology-and-liberty/new-examples-facebook-password-demands-facebooks-response-and-need-new> (last visited Oct. 5, 2012).

⁷⁵ According to the Bureau’s proposed rule, institutions impacted by these additional requirements would include organizations that qualify as bona fide non-profit organizations under State law, in accordance with Regulation H, as well as depository institutions. Truth in Lending Act (Regulation Z), 77 Fed. Reg. 55,272 at 55,326.

that individual.⁷⁶ Additional training could further compliance with civil rights laws protecting individuals from discrimination in lending or access to credit.

Conclusion

The ACLU recommends that the Bureau adopt additional safeguards against discrimination in housing finance, if the final rule provides an exemption for lenders from the statutory restriction on upfront discount points, origination points, and fees. These safeguards for consumers include requiring that they receive a competitive trade-off for the imposition of points and fees on their loans, and providing protections for individuals who the loan originator thinks are unlikely to qualify for the comparable, alternative loan – including notice in writing to the consumer, and reporting such determinations to the Bureau. Further, the Bureau’s final rule on Regulation Z should not expand the use of criminal background checks, and character and fitness requirements on loan originators.

Please feel free to contact Demelza Baer, ACLU Policy Counsel, at dbaer@dcaclu.org or (202) 544-1681 with any questions.

Sincerely,



Laura W. Murphy
Director, Washington Legislative Office



Demelza Baer
Policy Counsel

⁷⁶ *Id.*