October 9, 2012

VIA ELECTRONIC COMMUNICATION

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

Re: Proposed Regulations on 2012 Truth in Lending Act (Regulation Z) Mortgage Servicing and 2012 Real Estate Settlement Procedures Act (Regulation X) Mortgage Servicing Proposal, RIN 3170-AA14

Dear Ms. Jackson:

The Institute for Policy Integrity submits the following comments on the Bureau of Consumer Financial Protection's ("the Bureau") 2012 Real Estate Settlement Procedures Act Mortgage Servicing Proposal (the "RESPA Rule")[1] and 2012 Truth in Lending Act Mortgage Servicing Proposal (the "TILA Rule").[2]

The Institute for Policy Integrity at New York University School of Law is a non-partisan think tank dedicated to improving the quality of government decisionmaking through advocacy and scholarship in the fields of administrative law, economics, and public policy.

The Bureau has proposed these two mortgage servicing rules, along with several other mortgage regulations, to comply with the requirements of the Dodd-Frank Act[3] and to address many of the concerns from the subprime mortgage crisis. The RESPA Rule lays out requirements for how servicers must interact with the homeowners whose mortgages they service, primarily in the case of default but also during the course of ordinary business. The TILA Rule describes certain disclosures that mortgage servicers must send to their customers at particular points, such as when an adjustable rate mortgage's interest rate is about to increase.

Some aspects of the rules are prescribed by the Dodd-Frank Act, but a number of elements have been left to the Bureau's discretion. In exercising that discretion, the Bureau should utilize best practices for rulemaking so that the final rule is grounded in evidence-based decisionmaking and is tailored to efficiently achieve the regulatory goals.

[1] 2012 Real Estate Settlement Procedures Act (Regulation X) Mortgage Servicing Proposal, 77 Fed. Reg. 57,200 (Sept. 17, 2012) (to be codified at 12 C.F.R. pt. 1024).
[2] 2012 Truth in Lending Act (Regulation Z) Mortgage Servicing, 77 Fed. Reg. 57,318 (Sept. 17, 2012) (to be codified at 12 C.F.R. pt. 1026).
[3] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) [hereinafter "Dodd-Frank Act"].

In order to tailor the outcome of its rulemakings more toward its regulatory goals, as well as work toward maximizing the net social benefit from its regulations, the Bureau should take the following steps:

- First, the Bureau should more clearly define its goals for the servicing regulations. Unless the goals are made explicit, the Bureau will not be able to evaluate which regulatory alternatives will be most efficient or to measure the effectiveness of the regulations post-implementation.
- Second, the Bureau should consider ways to improve the servicing disclosures. For example, the Bureau proposes to set the minimum deadline for the initial interest rate adjustment disclosure at 60 days before adjustment, but it takes an average of 70 days for a consumer to refinance a mortgage. The Bureau should consider whether the timing of disclosures is optimal, as well as whether additional testing of the disclosures is warranted, and whether certain changes to the disclosures might improve their utility (such as discussing the potential benefits of refinancing).
- Third, the Bureau should consider how best to assess the costs and benefits of the proposed regulations in light of limited data. It should conduct a breakeven analysis to determine what level of benefits the rules would have to achieve to justify the cost estimates. Where cost estimates are not available, it should provide a descriptive qualitative analysis. The Bureau should also conduct post-adoption analysis of the regulations to ensure their ongoing effectiveness and to recalibrate them when warranted.

I. The Bureau Should More Clearly Define Its Goals for the Servicing Regulations

The Dodd-Frank Act broadly reformed the financial regulation system in the United States in a number of arenas, including the home mortgage market.[4] Among other changes, the Act institutes certain consumer protections in interactions with servicers[5] and requires servicers to send out notices before an interest rate adjustment on an adjustable-rate mortgage and periodic statements containing particular information about the mortgage loan.[6] Thus, while the statute prescribes some aspects of the rules, such as particular pieces of information that must appear on the servicing disclosures, the statute leaves many other key decisions to agency discretion, such as how to design those disclosures and whether to include additional information in them. The White House has developed guidance on how agencies can exercise their regulatory discretion most efficiently. Though the guidance offered by documents like Executive Order 12,866 and Circular A-4 is not strictly required for independent agencies[7] like the Bureau,[8] these documents lay out the best practices for rulemaking,[9] drawn from years of regulatory experience. Moreover, Executive Order

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[4] *Id.* §§ 1400-1498.
[5] *Id.* §§ 1463 & 1464.
[6] *Id.* §§ 1418 & 1420.
[7] *See id.* §§ 1011 & 1012 ("There is established in the Federal Reserve System, an independent bureau to be known as the 'Bureau of Consumer Financial Protection . . . .'").
[8] Executive Order No. 12,866, 58 Fed. Reg. 51,735 (Oct. 4, 1993); OFFICE OF MANAGEMENT & BUDGET, CIRCULAR A-4 (2003), *available at* http://www.whitehouse.gov/sites/default/files/omb/assets/omb/circulars/a004/a-4.pdf [hereinafter "CIRCULAR A-4"] *See also* Executive Order No. 13,563, 76 Fed. Reg. 3,821 (Jan. 21, 2011) (reaffirming and expanding the principles of Exec. Order No. 12,866).
[9] Among other prescriptions, Circular A-4 states, "If the regulatory intervention results from a statutory or judicial directive, you should describe the specific authority for your action, the extent of discretion available to you, and the regulatory instruments you might use." CIRCULAR A-4 at 3. In describing how to define the goals of a regulation, Executive Order 12,866 instructs, "Each agency shall identify the problem that it intends to address (including, where applicable, the failures of private markets or public institutions that warrant new agency action) as well as assess the significance of that problem." Exec. Order No. 12,866, § 1(b)(1) at 51,735. Circular A-4 clarifies that the agency should "try to explain whether the action is intended to address a significant market failure or to meet some other compelling public need such

13,579 advises independent agencies to carefully analyze likely consequences and to consider the costs and benefits of regulatory decisions (to the extent permitted by law).[10] Therefore, the Bureau should follow the best practices for exercising its discretion, as articulated by the White House.

The most fundamental policy set by Executive Order 12,866 is to define regulatory goals: agencies must identify the problem to be addressed, assess the significance of the problem, and explain why regulation is necessary to address that problem. Defining goals initially is crucial to all subsequent steps in rational rulemaking, such as evaluating the effectiveness of different policy alternatives in meeting those goals, and assessing the actual performance of the rule on an ongoing basis. Only by defining regulatory goals can the agency determine which regulatory structure will be the "best . . . tool[] for achieving regulatory ends."[11]

Wherever the Bureau has exercised regulatory discretion, the agency needs to first define its regulatory goals. Though the Bureau has hinted at a few possible justifications for the rules (discussed further below), it has not explicitly identified the goals, nor has it described the extent of the problem the rules seek to correct and why government intervention is necessary to address those problems.

Market failures present the clearest rationale for regulatory action. As the White House's Office of Information and Regulatory Affairs ("OIRA")[12] has stated, "If the regulation is designed to correct a significant market failure, you should describe the failure both qualitatively and (where feasible) quantitatively" and "show that a government intervention is likely to do more good than harm."[13] The Bureau should assess whether the goals of its regulations stem from a market failure, such as an externality or information asymmetries.[14] Externalities occur when a market transaction results in uncompensated benefits or costs to a party who is not directly involved in that transaction. Inadequate or asymmetric information, where one party has more information about a transaction than the other party, can prevent the market from arriving at efficient outcomes. However, as OIRA explains, "Even though the market may supply less than the full amount of information the amount it does supply may be reasonably adequate and therefore not require government regulation."[15] Even if an adequate quantity of information is available, "people can make mistakes by processing it poorly" due to cognitive biases or an overly complex presentation of information[16] However, the "mere possibility of poor information processing is not enough to justify regulation," and any information processing problem "should be carefully documented."[17]

The Bureau should assess and explain whether market failures are among the goals that it is trying to address with this regulatory action. The preambles to the proposed rules suggest that the Bureau may believe that externalities may exist in the mortgage market due to the negative effects of foreclosures on the value of neighboring properties.[18] The economic literature also discusses the negative externalities that foreclosures can have on homeowners, communities, and the broader

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as improving governmental processes or promoting intangible values such as distributional fairness or privacy." CIRCULAR A-4 at 4.

[10] Executive Order No. 13,579, § 1, 76 Fed. Reg. 41,587, 41,587 (July 14, 2011).

[11] Exec. Order No. 13,563 § 1 at 1.

[12] Executive Order 12,866 tasks the OIRA, an agency within the Office of Management and Budget ("OMB"), with reviewing all significant proposed regulations to ensure that they comply with that Executive Order and other applicable laws and policies.

[13] CIRCULAR A-4 at 4.

[14] *Id.* at 4-5.

[15] *Id.* at 5.

[16] *Id.* at 5.

[17] *Id.* at 5.

[18] The RESPA Rule preamble states, "Some recent research that controls for economic conditions documents the persistent negative effects of foreclosure on borrower's credit scores. Other work establishes substantial negative effects that foreclosed homes have on nearby homes." RESPA Rule, 77 Fed. Reg. at 57,280.

housing market, such as depleted property values, disinvestment, and crime.[19] If avoiding these negative externalities from foreclosure is the justification for the rule, the Bureau should discuss the extent of the impact of foreclosures on neighbors, and explain how this regulation will address that externality, by trying to reduce the number of foreclosures.

The TILA Rule appears to be based on a rationale of inadequate information. The rule primarily involves the provision of disclosures to consumers, which suggests that the Bureau thinks the goal of the regulation is to correct an information imbalance between servicers and homeowners. However, the rule never explicitly states that as a goal, and never explains why the market has failed to provide the necessary information to homeowners and why it is necessary for the government to intervene. Moreover, more information purely for the sake of more information, without an understanding of how market failures or cognitive biases limit the availability or comprehension of that information, will not necessarily lead to desirable results. The Bureau should articulate why an information imbalance exists that justifies regulatory action and how that action will actually promote more informed decisionmaking by consumers.

If some of the regulatory goals are not tied to market failures, the Bureau should articulate those, as well. OIRA instructs that for goals other than a market failure, the agency "should also provide a demonstration of compelling social purpose and the likelihood of effective action. Although intangible rationales do not need to be quantified, the analysis should present and evaluate the strengths and limitations of the relevant arguments for these intangible values."[20] For example, here, the Bureau might be concerned with human dignity or distributional concerns regarding home ownership for low-income individuals. If this is the case, the Bureau should explain its rationale for regulating where market failures alone might not warrant regulation.

II. Servicing Disclosures Should Be Evidence-Based and Tailored Toward Regulatory Goals

The Bureau has proposed three sets of servicing disclosures in the TILA Rule: an initial notice of an interest rate increase for an adjustable rate mortgage, a notice for each subsequent interest rate increase for an adjustable rate mortgage, and periodic mortgage statements. OIRA has issued a memorandum describing the best practices for disclosures as regulatory tools.[21] Among other points, the memorandum emphasizes the careful design of disclosure forms based upon clearly articulated goals, the robust testing of proposed forms before issuance and reevaluation after use, and attention to when and where to best provide the information to consumers. The Bureau should follow OIRA's recommendations, as well as the best practices that it and its predecessor agencies have laid out in prior analyses.[22] In this case, the Bureau should either conduct additional testing or explain why less testing is required here than the Bureau and its predecessor agencies have conducted with other comparable disclosures. It should consider lengthening the minimum

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[19] *See, e.g.*, Zhenguo Lin, Eric Rosenblatt & Vincent W. Yao, *Spillover Effects of Foreclosures on Neighborhood Property Values*, 38 J. REAL EST. FIN. & ECON. 387 (2009) (discussing spillover effects such as disinvestment and vandalism that lower neighborhood property values after foreclosure); Dan Immergluck & Geoff Smith, *The Impact of Single-Family Mortgage Foreclosures on Neighborhood Crime*, 21 HOUSING STUD. 851 (2006) (finding foreclosed properties contribute to violent crime and arson); WILLIAM C. APGAR & MARK DUDA, HOMEOWNERSHIP PRESERVATION FOUNDATION, COLLATERAL DAMAGE: THE MUNICIPAL IMPACT OF TODAY'S MORTGAGE FORECLOSURE BOOM (2005), *available at* http://www.995hope.org/wp-content/uploads/2011/07/Apgar_Duda_Study_Short_Version.pdf (discussing the externalities on municipalities from foreclosures, such as administrative costs and increased crime and fire prevention required).

[20] CIRCULAR A-4 at 4.

[21] Memorandum for the Heads of Executive Departments and Agencies from Cass R. Sunstein, Administrator of the Office of Information and Regulatory Affairs, Regarding Disclosure and Simplification as Regulatory Tools 3 (June 18, 2010), *available at* http://www.whitehouse.gov/sites/default/files/omb/assets/inforeg/disclosure_principles.pdf [hereinafter "OIRA Disclosure Memo"].

[22] *E.g.*, Jeanne Hogarth & Ellen Merry, *Designing Disclosures to Inform Consumer Financial Decisionmaking: Lessons Learned from Consumer Testing*, FED. RESERVE BULL., Aug. 2011, at 1, 4-10.

amount of time before a rate adjustment that the initial notice of increase must be sent to homeowners, in order to allow enough time to refinance if appropriate. The Bureau should also consider adding information to the disclosures, such as the possible benefits a homeowner may obtain from refinancing and links to websites with additional information on the forms and refinancing resources.

The Bureau Should Either Conduct Additional Testing or Justify Its Departure from Past Practices

In selecting the design for its servicing disclosures, the Bureau commissioned a study of the likely effectiveness of the proposed servicing disclosures, for which a consulting firm conducted three rounds of one-on-one interviews with 31 participants around the country, testing certain of the proposed servicing disclosures.[23] The consultant asked homeowners to review the proposed disclosures as if they were reviewing their own mortgage statements. The consultant then interviewed the homeowners to determine whether they understood information presented on the forms. In each of the three rounds, the consultant refined the form based upon what was learned in the prior round, and then at the end of the process, it made recommendations to the Bureau based upon its findings. This study put the Bureau on the path of using evidence-based decisionmaking in selecting a policy approach. However, based upon OIRA's best practices for consumer disclosures and the Bureau's predecessors' own prior practices, the Bureau should consider undertaking additional steps in its evaluation of the proposed forms.

The first step in an effective evaluation of the forms is setting clear goals for what the Bureau hopes the disclosures to achieve. OIRA notes that the explicit identification of goals of disclosures is important "[i]n order to select which information to highlight and how to present that information."[24] As discussed above, the Bureau should more clearly define the goals of the servicing disclosures, whether they are to enable consumers to decide if refinancing is an optimal choice for them, to simply provide additional information to consumers, or to effectuate some other end. The consultant who designed and tested the forms crafted them only to "satisfy the requirements of the Dodd-Frank Act, and to present information to consumers in a clear and understandable way,"[25] meaning the forms were designed to provide information for the sake of information. However, the Bureau bases its claims about the benefits of the interest rate adjustment notices on an illustration of how much money consumers could save from refinancing after receiving these notices.[26] This suggests that one of the main goals of the disclosures is prompting consumers to refinance, if such an option is economically optimal.[27] If so, the Bureau should explicitly note this goal and base the design and evaluation of the proposed disclosures on their ability to satisfy this goal.

The Bureau should also consider whether additional testing of these disclosures is warranted.[28] Many other consumer financial disclosures have undergone more testing than the Bureau conducted here.[29] For example, the Department of Housing and Urban Development conducted six rounds of both qualitative and quantitative testing for the Good Faith Estimate (GFE) and HUD-1

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[23] *See* ICF MACRO INTERNATIONAL, INC., SUMMARY OF FINDINGS: DESIGN AND TESTING OF MORTGAGE SERVICING DISCLOSURES (2012), *available at* http://www.consumerfinance.gov/notice-and-comment/ (report on consumer testing submitted to the U.S. Consumer Fin. Prot. Bureau).
[24] OIRA Disclosure Memo at 3.
[25] ICF MACRO INTERNATIONAL, INC., *supra* note 23, at 3.
[26] TILA Rule, 77 Fed. Reg. at 57,368.
[27] Note, though, that refinancing alone may act simply as a transfer of value between parties and will not necessarily result in efficiency gains to the system. In some cases, however, such as when externalities from foreclosure can be avoided, refinancing can increase efficiency.
[28] OIRA, too, stresses the importance of testing. It extols the benefits of "scientifically valid experiments" over focus group testing, but "[w]hen focus groups are used, they should attempt to elicit information about actual choices and behavior (rather than simply reactions to or preferences for labels and formats)." OIRA Disclosure Memo at 5.
[29] See Hogarth & Merry, *supra* note 22, at 4-10 for a discussion of testing efforts in the United States and abroad.

mortgage disclosures, where it completed one-on-one interviews testing consumer understanding of the disclosures as well as administered assessment tests to 1,200 participants to quantitatively measure consumer understanding.[30] The Bureau itself commissioned a more comprehensive study involving ten rounds of testing for the initial mortgage disclosures (which include different information than the servicing disclosures) under a related proposed rule.[31] The Federal Reserve Board (which administered TILA before Dodd-Frank transferred that authority to the Bureau) typically conducted seven to ten rounds of interviews to evaluate a proposed disclosure form.[32] Yet the Bureau undertook only three rounds of testing here.

The decreased level of testing might be justified. Additional testing would require additional resources and perhaps would not result in sufficient improvements to the forms to be worthwhile. Studies have found that small numbers of individuals in a focus group can identify the vast majority of usability problems.[33] Additionally, the Bureau is working on a tight timescale to promulgate standardized disclosures by the January 21, 2013 deadline when the statutory provisions go into effect. Moreover, there is some evidence in the literature to support the position that homeowners who are refinancing can better understand and employ the information contained in mortgage disclosures than first-time homebuyers can, due to their prior experience.[34] This could potentially justify the Bureau expending less effort on improving the servicing disclosures relative to the initial disclosures.

If the Bureau decides that the level of pre-implementation testing already conducted is the proper level, it should explain why it believes that this testing level is sufficient given the particular circumstances here. Regardless, it should reevaluate the effectiveness of the disclosures after implementation, as described further in the retrospective review section below.

The Bureau Should Conduct a More Robust Analysis of the Timing of Disclosures

The Bureau should more carefully consider the proper timing of an initial interest rate payment change notice. As OIRA advises, "Careful thought should be given to the time and location of summary disclosure."[35] Agencies "should take steps to provide people with relevant information when they are actually making the decision or taking the action in question."[36]

The Bureau proposes to increase the minimum advanced notice of a change in payment level from the 25 days required by the current regulation, to 60 days.[37] The maximum length of time in advance of the payment change that the notice could be sent would remain the same, at 120 days.[38]

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[30] KLEIMANN COMMUNICATION GROUP, INC., SUMMARY REPORT: CONSUMER TESTING OF THE GOOD FAITH ESTIMATE FORM (GFE) (2008), *available at* www.huduser.org/publications/pdf/Summary_Report_GFE.pdf.
[31] *See* KLEIMANN COMMUNICATION GROUP, INC., KNOW BEFORE YOU OWE: EVOLUTION OF THE INTEGRATED TILA-RESPA DISCLOSURES (2012), *available at*: http://files.consumerfinance.gov/f/201207_cfpb_report_tila-respa-testing.pdf (report on consumer testing submitted to the U.S. Consumer Fin. Prot. Bureau).
[32] Hogarth & Merry, *supra* note 22, at 8-9.
[33] *Id.* at 8; Robert Virzi, *Refining the Test Phase of Usability Evaluation: How Many Subjects Is Enough?*, 34 HUMAN FACTORS 457 (1992).
[34] *See* Jinkook Lee & Jeanne M. Hogarth, *Returns to Information Search: Consumer Mortgage Shopping Decisions*, 10 FIN. COUNSELING AND PLANNING J. 49 (1999), *available at* http://6aa7f5c4a9901a3e1a1682793cd11f5a6b732d29.gripelements.com/pdf/vol1015.pdf; and Jinkook Lee & Jeanne M. Hogarth, *Consumer Information Search for Home Mortgages: Who, What, How Much and What Else?*, 9 FIN. SERVS. REV. 277 (2001), *available at* www2.stetson.edu/fsr/abstracts/vol_9_num3_p277.pdf.
[35] Memorandum for the Heads of Executive Departments and Agencies from Cass R. Sunstein, Administrator of the Office of Information and Regulatory Affairs, Regarding Disclosure and Simplification as Regulatory Tools 4 (June 18, 2010), *available at* http://www.whitehouse.gov/sites/default/files/omb/assets/inforeg/disclosure_principles.pdf.
[36] *Id.*
[37] TILA Rule, 77 Fed. Reg. at 57,327-28.
[38] *Id*.

In selecting a range of time for disclosure, the Bureau needs to balance several competing factors, including the salience of the disclosure when received, the ability of the consumer to process and respond to the notice before the rate change, and the ability of the servicer to create the disclosure (based upon market information) as well as respond to any resulting requests from the consumer before the rate change.

The Bureau should take special care to assess whether the timing of the notice will serve the goals of the disclosures. As discussed, one of the goals of the notice of an interest rate increase appears to be enabling homeowners to refinance, if it would be economically efficient to do so. The Bureau itself notes in the preamble that "in the current market, 'it now takes the nation's biggest mortgage lenders an average of more than 70 days to complete a refinance.'"[39] This raises a question of whether the 60 days lead time provided is enough to facilitate the goal of providing information to homeowners so that they can refinance or otherwise prepare for a rate increase by budgeting for additional funds. The Bureau should consider whether it would be preferable to increase the minimum advance notice required, or whether the countervailing costs, such as decreased salience and less reliable information due to uncertain interest rates, warrant leaving the range at 60-120 days.

The Disclosures Should Give Consumers Access to Balanced and Helpful Information

Based on its consumer testing, the Bureau has proposed a table format for the disclosures, comparing the consumer's current payment information to that after the rate increase.[40] The Bureau has tried to limit the information on the disclosures to the most important items to consumers and any items required by the statute. Limiting the amount of data on a disclosure and highlighting the most important points, as the Bureau has attempted to do, is a useful technique to limit consumer confusion.[41]

The Bureau should, however, consider whether certain additions to the disclosures might be beneficial. First, the proposed notices of rate increases currently emphasize that if a consumer pays off the loan, refinances, or sells the home before the term of the mortgage, she may be subject to a prepayment penalty. This is likely useful information for the homeowner to have. However, the disclosure does not mention that the homeowner may save money (possibly more than the prepayment penalty) from refinancing, paying off the loan, or selling her home. If one of the goals of the disclosures is to encourage homeowners to make economically optimal decisions about refinancing, the notice should include a statement that the homeowner might save money from refinancing or, possibly even better, an estimate of how much in dollars the homeowner could save from refinancing based upon average interest rates at that time.[42]

The Bureau should also consider the possibility of integrating the disclosures more with information technology. At the very least, the disclosures should include a link to the Bureau's website, which already includes more information about the forms, as well as links to other helpful resources on the mortgage market. The Bureau could also consider augmenting the disclosures to bring them into the realm of so-called "smart disclosure," which is "the timely release of complex information and data in standardized, machine readable formats in ways that enable consumers to

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[39] *Id.* at 57,328 (quoting Nick Timiraos & Ruth Simon, *Borrowers Face Big Delays in Refinancing Mortgages*, WALL ST. J., May 9, 2012, at A1, *available at* http://online.wsj.com/article/SB10001424052702303459004577364102737025584.html).
[40] TILA Rule, 77 Fed. Reg. at 57,351.
[41] Memorandum for the Heads of Executive Departments and Agencies from Cass R. Sunstein, Administrator of the Office of Information and Regulatory Affairs, Regarding Disclosure and Simplification as Regulatory Tools 3-4 (June 18, 2010), *available at* http://www.whitehouse.gov/sites/default/files/omb/assets/inforeg/disclosure_principles.pdf; Hogarth & Merry, *supra* note 22, at 10-12.
[42] *See* Hogarth & Merry, *supra* note 22, at 13-14 (describing the value of putting information in context in disclosures).

make informed decisions."[43] By doing so, the Bureau would enable third parties to create applications where, for instance, a homeowner could compare potential options for refinancing against one another and instantly calculate how much she could save versus her current mortgage, which could improve consumer understanding and incentivize optimal behavior.

III. The Bureau Should Conduct a Breakeven Analysis Now and Analyze Costs and Benefits More Robustly When Additional Data Becomes Available Post-Implementation

Executive Order 13,579 applies principles for "improving regulation and regulatory review" to independent agencies like the Bureau. Specifically, it incorporates requirements from Executive Order 13,563, advising agencies to base decisions on assessments of costs and benefits (to the extent permitted), to measure and seek to improve the actual results of regulatory requirements, and to develop plans for regular retrospective review.[44] The Bureau currently has limited data about the rules' likely effects on which to base its decisions. Therefore, it should use breakeven analysis now to more transparently assess the costs and benefits, and it should develop a plan for retrospective review to collect the necessary information to reassess the rules on an ongoing basis.

Given the Limited Data, the Bureau Should Conduct Breakeven Analyses Where Possible

The Dodd-Frank Act requires the Bureau to consider "potential benefits and costs to consumers and covered persons [the servicers in this case], including the potential reduction of access by consumers to consumer financial products or services resulting from" these rules.[45] Though the statute does not require broader consideration of costs and benefits, it does not bar the agency from also considering benefits and costs extending beyond the consumers and servicers—notably, mitigating the risk that one mortgagee's foreclosure will impact home values throughout the neighborhood.[46] Executive Order 13,579 advises independent agencies to more broadly assess all costs and benefits to the extent permitted by law. The Bureau should look to OIRA's Circular A-4 for advice on how to comply with these obligations and so make informed, efficient decisions. Assessing costs and benefits also helps to inform the public debate about the regulatory impacts.[47]

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[43] Memorandum for the Heads of Executive Departments and Agencies from Cass R. Sunstein, Administrator of the Office of Information and Regulatory Affairs, Regarding Informing Consumers Through Smart Disclosure 2 (Sept. 8, 2011), *available at* http://www.whitehouse.gov/sites/default/files/omb/inforeg/for-agencies/informing-consumers-through-smart-disclosure.pdf.

[44] The regulatory review requirements apply to "significant" regulations, which are defined by Executive Order 12,866 as a regulatory action that is "likely to result in a rule that may . . . [h]ave an annual effect on the economy of $100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities." OIRA believes the rules are significant; they are described as "other significant" on the reginfo.gov website.

[45] Dodd-Frank Act § 1022(b)(2)(A).

[46] In deciding which costs and benefits to include in the analysis, the Bureau should attempt to include any relevant ancillary benefits and countervailing risks. OIRA instructs that a regulatory analysis should "look beyond the direct benefits and direct costs of [the] rulemaking and consider any important ancillary benefits and countervailing risks." CIRCULAR A-4 at 26. An ancillary benefit is "a favorable impact of the rule that is typically unrelated or secondary to the statutory purpose of the rulemaking," and a countervailing risk is "an adverse economic, health, safety, or environmental consequence that occurs due to a rule and is not already accounted for in the direct cost of the rule." *Id.* at 26. The statute specifically instructs the Bureau to consider a particular countervailing risk, namely "the potential reduction of access by consumers to consumer financial products or services resulting from such rule," which the Bureau does. However, the statute does not prohibit the consideration of ancillary benefits, and the Bureau should incorporate any expected ancillary benefits into the analysis in order to make the assessment more robust and balance out the consideration of countervailing risks.

[47] In order to conduct a regulatory analysis, it is necessary to define the baseline, which is the best assessment of the way the world would look absent the proposed action. In the Circular A-4, OIRA advises that in cases where substantial portions of a rule simply restate statutory requirements that would be self-implementing, even in the absence of the regulatory action, the agency should use a pre-statute baseline. The Bureau has properly chosen to do so here. As the

In the absence of robust data, the Bureau has made rough estimates of potential costs based on data from industry and the Federal Housing Finance Agency.[48] Its estimates of benefits are mostly conjecture at this point.[49] To properly estimate the potential benefits, the Bureau would first need to define the regulatory goals. If the goal is to reduce the externalities from foreclosures, the Bureau will need to quantify the scope of the potential benefit as much as possible. It can start by characterizing the extent of the problem, including how many foreclosures are likely to be avoided and how much in neighborhood home value is lost from these foreclosures. If the goal is correcting an information imbalance, the Bureau can estimate how much money and time consumers are likely to save by having the relevant information presented in a clear and concise way.

Because of limited data, the Bureau may not be able to fully quantify the benefits. In the proposed rule, the Bureau has made guesses about the likely incidence of benefits and value per incidence of various elements of the rule. For example, it has extrapolated from Federal Housing Finance Agency data to estimate that 285,000 adjustable-rate mortgages will have an initial interest rate adjustment in each of the next three years, and then speculated that 1% of these consumers who receive an adjustment notice will refinance and save a hypothetical value of $50 per month, resulting in an annual savings to consumers of $1.7 million, or $6 per notice.[50]

A more rigorous and transparent way to assess and compare costs and benefits would be to follow OIRA's advice on breakeven analysis. Where certain variables are not monetizable, an agency may use breakeven analysis to "specify how high the unquantified or unmonetized benefits would have to be in order for the benefits to justify the costs."[51] This approach is likely to work well in situations where the Bureau has an estimate of the costs of a provision, but less information about its benefits, such as with the proposed disclosures in the TILA Rule. Starting with the Bureau's most educated estimate of costs, the Bureau would assess what the benefits would have to be so that total benefits at least "breakeven" with the costs: how many consumers would have to refinance their mortgages based upon the notices and how much money they (or their neighbors) would have to save in order to justify the costs.[52] The Bureau could then assess, based upon its expertise, whether these values are reasonable and whether the rule is justified.

Where even estimates of the costs are unavailable, such as with certain provisions of the RESPA Rule, the Bureau should "provide a discussion of the strengths and limitations of the qualitative information" including the "key reason(s) why the [variables] cannot be quantified."[53] When the unquantified benefits or costs play a role in the decision, the agency "should provide a clear explanation of the rationale behind the choice" including a "summary table that lists all the unquantified benefits and costs" and uses the agency's judgment to prioritize those that it "believe[s] are most important."[54] This will increase transparency and the ability to understand why one regulatory option was selected over another, as well as prepare the agency to re-evaluate

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Bureau notes, this allows the public to better understand the potential benefits, costs, and impacts of the change in policy. Additionally, though many of the provisions of the Dodd-Frank Act are self-executing, they are not set in stone. By comparing the pre-statute market to the post-statute market, the Bureau can examine the likely ability of the statute to reach its goals efficiently and report back to Congress if certain provisions should be revised.

[48] TILA Rule, 77 Fed. Reg. at 57,369.

[49] *See id.* at 57,368.

[50] *Id.* at 57,368.

[51] OFFICE OF INFO. & REGULATORY AFFAIRS, OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, 2011 REPORT TO CONGRESS ON THE BENEFITS AND COSTS OF FEDERAL REGULATIONS AND UNFUNDED MANDATES ON STATE, LOCAL, AND TRIBAL ENTITIES 69 (2011) [hereinafter "2011 OIRA REPORT TO CONGRESS"].

[52] The nature of the result of the analysis will depend on the goal of the regulation. For example, if the goal of the regulation is to reduce externalities on neighboring households from foreclosures, the analysis would determine how much the reduced externality would need to be worth to justify the regulation.

[53] CIRCULAR A-4 at 27.

[54] *Id.* at 27.

the regulation as appropriate after additional data is available. Some of the costs and benefits the Bureau should try to quantify or at least discuss qualitatively include: externalities (such as effects of foreclosures on neighboring homeowners), benefits of additional information to consumers making decisions about whether to refinance, costs to servicers of the additional service and disclosure requirements, cost to the government to administer the regulations, risk to consumers of higher mortgage rates or mortgage unavailability, and risk of information overload to consumers reading the disclosures.

The Bureau Should Call for Additional Data and Reassess the Efficiency of the Rule After Implementation

The Bureau should ensure that the design of its rules enable it to readily conduct retrospective analysis after implementation. Retrospective analysis to determine whether existing regulations should be modified, streamlined, expanded, or repealed has garnered support in academic literature, OIRA, and Executive Order. As one commentator has argued, "The single greatest problem with the current system is that most regulations are subject to a cost-benefit analysis only in advance of their implementation. This is the point when the least is known and any analysis must rest on many unverifiable and potentially controversial assumptions."[55] OIRA explains that "retrospective analysis can help show what works and what does not, and in the process can help to promote repeal or streamlining of less effective rules and strengthening or expansion of those that turn out to do more good than harm."[56]

Executive Order 13,563 requires retrospective review to enable an agency to "measure, and seek to improve, the actual results of regulatory requirements."[57] Retrospective analysis will enable agencies to "modify, streamline, expand, or repeal regulations in accordance with what has been learned."[58] Executive Order 13,563 requires agencies to develop plans for periodic review of existing regulations through this lens.[59] Executive Order 13,579 advises that independent agencies, such as the Bureau, should adhere to these retrospective review requirements, as well.[60]

It is imperative, then, that the Bureau craft its rules with the goal of making them easily reviewable after implementation. This requires the Bureau to lay out its goals clearly, so it can determine whether they are being met after implementation. It will require continual data collection to assess whether the goals are being satisfied. If possible, the Bureau could also implement the rules gradually in different areas to test whether they are, indeed, having the intended impact. This may not be possible for all of the rules because of statutory requirements or other limitations, but it could be feasible, for example, to implement different versions of the disclosure forms in different regions and see which works best.

Retrospective analysis is particularly important here, where the data at the pre-regulatory stage is so limited. In the proposed rules, the Bureau has called for additional data[61] to conduct a more

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[55] Greenstone, Michael, *Toward a Culture of Persistent Regulatory Experimentation and Evaluation*, *in* NEW PERSPECTIVES ON REGULATION 113 (David Moss & John Cisternino eds., 2009).
[56] 2011 OIRA REPORT TO CONGRESS at 60.
[57] Exec. Order No. 13,563 § 1 at 3821.
[58] *Id.* § 6(a) at 3822.
[59] *Id.*
[60] Exec. Order No. 17,953 at § 2 at 41,587.
[61] The additional data the Bureau explicitly seeks includes: the extent to which servicer operations currently do not comply with the proposed rules; the costs to servicers of the proposed rules (including those costs of revising compliance software and systems); the benefits to consumers of the proposed rules; how consumers might respond to the information proposed for inclusion in the particular disclosures; and the potential impact on servicers and on the functioning of the mortgage servicing market from the disclosures and the prompt crediting requirement. RESPA Rule, 77 Fed. Reg. at 57,275; TILA Rule, 77 Fed. Reg. at 57,375. The Bureau is currently working to gather servicer-level data from

robust regulatory analysis, but some data will likely not be available until after implementation of the regulation. Based upon its obligations under Executive Order 13,579, as well as in the interest of ensuring that the regulations are efficiently tailored toward their goals, the Bureau should set a regular schedule for re-evaluating the effectiveness of these regulations in light of information available after implementation. The rules should be evaluated based upon their ability to satisfy the goals of the regulation. If enough data is available to quantify and monetize the currently unquantified variables, the Bureau should conduct a more comprehensive cost-benefit analysis. If the regulations are not optimally effective in light of future data, the Bureau should at that time consider revising the rule as appropriate or suggesting modifications of the statute to Congress if applicable.

IV. Conclusion

In assessing and implementing its mortgage servicing regulations, the Bureau should employ the best practices of regulatory analysis. The Bureau should ensure that it clearly defines its regulatory goals in order to be able to successfully evaluate the effectiveness of different policy alternatives in meeting those goals and assess the performance of the rule on an ongoing basis. The Bureau should also consider ways to improve the disclosures themselves, such as whether to conduct additional consumer testing, whether to adjust the timing of the notices, or whether to add more balanced information regarding the initial interest rate adjustment disclosure. In the face of limited data, the Bureau should conduct a breakeven analysis on the proposed rules to determine what level of benefits they would need to create in order to justify the cost estimates, and the Bureau should also conduct retrospective analysis of the regulations to determine their effectiveness on an ongoing basis and how they might be improved. By taking these steps, the Bureau will be able to more carefully target these regulations to maximize net social benefits.

Sincerely,

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Denise A. Grab
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the National Mortgage License System, loan-level data from several lenders, and possibly loan-level data from the pilot phases of the National Mortgage Database. RESPA Rule, 77 Fed. Reg. at 57,284; TILA Rule, 77 Fed. Reg. at 57,375-76.