

FINAL STATEMENT OF REASONS
FOR THE ADOPTION OF RULES UNDER THE
CALIFORNIA FINANCE LENDERS LAW AND THE
CALIFORNIA RESIDENTIAL MORTGAGE LENDING ACT

As required by Section 11346.2 of the Government Code, the California Corporations Commissioner (Commissioner) sets forth below the reasons for the adoption of Sections 1436 to Article 3 of Subchapter 6 and 1950.314.8 to Article 9 of Subchapter 11.5 of Title 10 of the California Code of Regulations (10 C.C.R. Sections 1436 and 1950.314.8).

I. In General

The Department of Corporations (Department) licenses and regulates finance lenders and brokers under the California Finance Lenders Law, and residential mortgage lenders and servicers under the California Residential Mortgage Lending Act. These laws require licensees to comply with certain requirements relating to books and records, examinations, and reporting. See Financial Code Sections 22156, 22157, 22159, 22701, 50124, 50302, 50307, and 50314. Moreover, these laws prohibit licensees from engaging in certain unlawful practices such as unconscionable contracts, loans that do not take into consideration the borrowers' ability to repay, fraudulent underwriting practices, unsafe and injurious practices, and false advertising, as specified. Licensees must also provide clear statements concerning loans, as specified. See, as examples, Financial Code Sections 22161, 22163, 22164, 22302, 22714, 50204, 50308, and 50322.

On November 14, 2006, the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR) distributed Guidance to state agencies that regulate mortgage lenders. The Guidance is available on the AARMR website at www.aarmr.org. The Guidance addresses risks posed by nontraditional mortgage products such as interest-only loans. In addition, the Guidance includes directives for lenders involved in mortgage programs directed at subprime borrowers. As stated by CSBS and AARMR in their joint press release, also available on their website, the Guidance serves to inform and protect consumers and enhance the safety and soundness of the industry. Accordingly, CSBS and AARMR encouraged state regulatory agencies to adopt the guidance and to issue it for use by regulated entities. Moreover, on July 17, 2007, CSBS and AARMR published additional guidance in its Statement on Subprime Mortgage Lending, to address similar concerns of risk and payment shock associated with certain adjustable rate mortgage loans. The above-referenced Guidance on Nontraditional Mortgage Product Risks, together with the recent Statement on Subprime Mortgage Lending, are collectively referred to as the "Guidance" below.

In general, this rulemaking is necessary to carry out the above-referenced Guidance for nontraditional and adjustable rate mortgage products. The rulemaking requires licensees operating under the California Finance Lenders Law and the California Residential Mortgage Lending Act to: (1) implement best practices, as

defined, on a continuous basis including the Guidance; (2) report annually to the Department, in relation to the Guidance, on whether they have made or arranged nontraditional and adjustable rate mortgage products, whether they have implemented risk-management best practices, whether they have put into place internal controls or procedures, as specified, and to also report annually on the number of any consumer complaints; and (3) maintain specified documentation as part of their books and records, and make the documentation available to the Commissioner upon request; (4) require clear disclosures for nontraditional and adjustable rate loans, as specified; and (5) prohibit certain false, misleading, and deceptive advertising.

II. The Guidance

The Guidance sets forth various directives for mortgage lenders and brokers offering nontraditional and adjustable rate mortgage loan products, which are designed to influence loan terms and underwriting standards, risk management practices, consumer protection issues, and operating practices. As explained by CSBS and AARMR, the Guidance is needed for several reasons. First, the Guidance assists state regulators of mortgage companies to promote consistent regulation in the mortgage market. Additionally, the Guidance clarifies how mortgage lenders can offer nontraditional and adjustable rate mortgage products in a way that clearly discloses the risks that borrowers may assume. (For example, see Section I, “Introduction,” discussion of the Guidance on Nontraditional Mortgage Product Risks.) Moreover, the Guidance is needed to address risks associated with the growing use of mortgage products that allow borrowers to defer payment of principal and/or interest, given that borrowers may not fully understand the risks of these nontraditional loan products. (See Section II, “Background,” discussion of the Guidance on Nontraditional Mortgage Product Risks.)

Consistent with the stated objectives of the Guidance, Sections 1436 and 1950.314.8 of this rulemaking set forth requirements for best practices that are needed to ensure that mortgage loan providers will effectively assess and manage risks associated with nontraditional and adjustable rate loan products that are defined by the Guidance. Moreover, the rulemaking also sets forth reporting and books and records requirements that are necessary to enable the Department to carefully review the risk-management practices, policies and procedures in this area. This rulemaking also requires certain disclosures and prohibits false advertising, as specified, in connection with nontraditional and adjustable rate mortgage loans.

III. Recent Hearings and Findings

On January 31, 2007, the Senate Banking, Finance and Insurance Committee held an informational hearing on nontraditional mortgage products and published a report entitled, “Sustainability, Not Attainability – An Examination of Nontraditional Residential Mortgage Lending Products and Practices.” In the “Key Findings” discussion of the staff summary report, the following consensus items, as summarized, also support the need for this rulemaking: home ownership should be sustainable; borrowers may not understand the terms of nontraditional loan products; loans may be mismatched for certain borrower profiles; the state should apply the Guidance to state regulated lenders and brokers in a uniform fashion; borrowers should receive

meaningful disclosures concerning nontraditional loan products; and the need for more mechanisms to help protect borrowers from unscrupulous mortgage professionals. The committee report also includes a background paper that makes certain findings concerning recent trends in the California mortgage market such as the increase of nontraditional mortgage loan products, the financial risks assumed by mortgage providers, and the rising level of delinquencies. On March 26, 2007, the Senate Banking, Finance and Insurance Committee held a follow-up informational hearing entitled "Reactions to the Recent Subprime Mortgage Collapse." The Committee's background paper includes additional information about recent problems experienced in the subprime market. The background paper also describes the proposed "Statement on Subprime Mortgage Lending" dated March 2, 2007, proposing additional guidance to help address subprime loan problems including certain adjustable rate mortgages. The Commissioner of Corporations wrote a letter dated May 7, 2007 to the Office of the Comptroller of the Currency, supporting the principles of this Statement on Subprime Lending.

Sections 1436 and 1950.314.8 of this rulemaking are needed to clarify and make specific the manner in which licensees will be required to follow the Guidance, including the recent Statement on Subprime Lending published by CSBS and AARMR on July 17, 2007, thereby helping to help address the findings of the recent committee hearing and the report and background paper prepared in connection with those hearings. Accordingly, pursuant to Government Code Section 11346.2(a)(2), the Department is relying upon and hereby identifies the committee report and the background paper, as described above, in this rulemaking.

Following these hearings, Senator Machado authored and the Governor signed Senate Bill 385 (Chapter 301, Statutes of 2007). Therefore, this rulemaking also helps clarify and make specific the manner in which the Department will apply the Guidance, in accordance with Financial Code Sections 22171 and 50333 as added by SB 385. Sections 22171 and 50333 have been added as additional References to the notes of these proposed rules.

IV. Sections 1436 and 1950.314.8

The Department licenses and regulates mortgage loans under both the California Finance Lenders Law and the California Residential Mortgage Lending Act. Under the Guidance, mortgage providers that do not adequately manage risks associated with nontraditional and adjustable rate loan products will be asked to take remedial action. Accordingly, this rulemaking is needed to clarify the obligations of licensees (e.g., best practices, reports, and books and records), thereby specifying the circumstances under which a violation of a rule may give rise to Department enforcement activity. It is also noteworthy that current law sets forth various limitations and prohibitions on lending activities. For example, current law prohibits finance lenders from failing to take into consideration the borrowers ability to repay, as specified, and prohibits them from making unconscionable loans. See Financial Code Sections 22302, 22714. Moreover, existing law prohibits licensees from engaging in fraudulent underwriting practices, and unsafe and injurious practices, as specified. See Financial Code Sections 50204 and 50322. Given the existing enforcement mechanisms in place to help guard against the risks

associated with loans, including nontraditional and adjustable rate mortgage products, the rulemaking may also enable the Department to detect patterns and practices of other violations of law.

Sections 1436 and 1950.314.8, subsection (a), require licensees to implement best practices, as specified. Deference will be given to the licensees to implement and apply best practices that meet their operational needs so long as they include lawful processes, policies, and procedures, as well as practices set forth in the Guidance. Thus, the rulemaking is needed to provide flexibility and clarity to licensees to help carry out the stated objectives of the Guidance. Additionally, the rules require licensees to implement these practices on a continuous basis. This provision of the rule is needed to ensure that licensees understand that mere adoption of best practices, as specified, is not enough. Licensees also have an obligation to ensure that these practices are implemented on a continuous basis with respect to their nontraditional and adjustable rate mortgage products. Likewise, the rule clarifies the obligation of the Department to check for continued implementation of the Guidance. Although the reference to “including but not limited to” has been deleted from the initial text, subsection (a) still provides licensees with flexibility to adapt to changed circumstances and other future standards that may be adopted including any amendments to the Guidance.

In addition, Sections 1436 and 1950.314.8, subsection (b), specify reporting requirements that are needed to enable the Department to scrutinize the adoption and implementation of best practices required by subsection (a) of the proposed rule. To help clarify and make specific the timing of the special report, subsection (b) requires licensees to submit it as part of the annual report, pursuant to Financial Code Sections 22159 and 50307. This provision will help eliminate the need for submitting two separate reports at different times each year. The rule also requires a separate written report as an addendum to the annual report, to help specify the format of the report required by the rule. In addition, licensees must state whether they have made or arranged nontraditional and adjustable rate mortgage products as defined by the Guidance, explain how they have implemented best practices, explain whether and how they have put into effect specified internal controls and procedures, and indicate whether they have received consumer complaints regarding loans that are subject to the Guidance, including resolved and unresolved complaints, and workout arrangements, as specified. These provisions are needed to help licensees understand their reporting obligations. More importantly, this information will help the Department understand the scope of continuous implementation by each licensee. The Department can also use these reports to assess the level of compliance with the Guidance among the licensees. Therefore, the Department can prioritize examinations, including examinations conducted under Financial Code Sections 22701 and 50302, to review implementation of the best practices, as required by the rule, including any internal controls and procedures.

Under subsection (b), licensees that make or arrange nontraditional or adjustable rate mortgage loans, as specified, must also provide information concerning their products in a form prescribed by the Department. The form (entitled Nontraditional Mortgage Loan Survey and dated 5/1/07) is available on the Department’s website at www.corp.ca.gov. This information is needed because, as described above, certain

nontraditional and adjustable rate mortgage loans pose higher risks than do traditional amortizing mortgage loans. In addition, nontraditional and adjustable rate mortgage lending activities have drawn increased scrutiny from a wide range of sources, with concerns being expressed regarding the possibility that some borrowers are being exposed to undue levels of risk given their financial and repayment capacity, possibly without their full understanding of the terms and features of the mortgage loan products they are obtaining. It is in the interests of the Department, its licensees, and the borrowers to ensure that the needs of mortgage customers are met in a manner that is safe and sound for the licensees, yet does not expose the borrowers to an undue level of risk that they may not fully understand. In order to be able to develop appropriate guidance for its licensees and its examination staff, the Department already conducted a survey to obtain this additional information regarding the extent and nature of the nontraditional mortgage loan products being offered by its licensees. Accordingly, this rule formally adopts the information requirement and form on an ongoing and annual basis.

Sections 1436 and 1950.314.8, subsection (c), require licensees to maintain documentation including copies of complaints and responses or explanations of how the complaints were resolved, documentation of internal controls and procedures, and any loan documentation required by law, as specified. These provisions are needed to clarify and make specific the types of books and records that must be maintained by licensees under various books and records requirements including Financial Code Sections 22156, 22157, 50124 and 50314. Moreover, the rule enables the Department to have access, upon request, to documentation for the purpose of examining compliance by licensees.

Subsection (d) requires licensees to deliver, as specified, certain disclosures to borrowers concerning payment scenarios and loan balance scenarios, among various nontraditional and adjustable rate mortgage loan products. The disclosures may be provided on one of three forms. First, the Department form (entitled Comparison of Sample Mortgage Features: Typical Mortgage Transaction and dated 8/1/07) is available on the Department's website at www.corp.ca.gov. This form of disclosure is needed to help borrowers understand the payment obligations and loan balance obligations of various nontraditional loan products, and to help them make an informed product choice. By requiring the information within three days of loan application or obligation on the note, whichever is earlier, the rules ensure that information is provided to borrowers at the earliest possible time, and to help them avoid misunderstandings before they commit themselves to the loans or pay loan documentation fees. The rule and form of disclosures also help carry out existing laws, which require clear statements concerning charges and other costs of loans, and help ensure that material information is provided in a conspicuous manner. The sample form is based on information proposed by the Department of Real Estate in its Form RE 885, to provide greater uniformity of disclosures in connection with nontraditional and adjustable rate loan products. This table format helps provide a one-page and user-friendly comparison chart with helpful examples, so borrowers can compare payment and loan balance obligations of various loan products including the loan proposed for the borrower. In addition, the licensee may use the Form RE 885 when it is provided by a real estate broker, as specified. Finally, the Department has also provided licensees with the flexibility to use their own form, provided it meets certain conditions.

Subsection (e) prohibits certain advertising that is deemed false, misleading, and deceptive for loans subject to the Guidance. This subsection is needed to help curb misrepresentations in connection with nontraditional mortgage products and to help carry out the consumer protection goals of the Guidance. The provisions also clarify and make specific the types of representations that constitute prohibited advertising, so licensees can understand and guard against them as they implement the Guidance on an ongoing basis. In addition, the proposed rule also achieves greater uniformity among mortgage loan providers, since the Department of Real Estate is proposing the same advertising prohibitions in its rules as well.

Finally, subsection (f) clarifies the application of the rule. This clarification is needed to ensure that lenders understand that the rule does not apply to commercial loan, as specified, and applies to loans secured by residential real property located in this state improved by a one-to-four family dwelling.

DETERMINATIONS

The Commissioner has determined that the adoption of the regulation does not impose a mandate on local agencies or school districts, which requires reimbursement pursuant to Part 7 (commencing with Section 17500) of Division 4 of the Government Code.

ALTERNATIVES CONSIDERED

No alternative considered by the Department would be more effective in carrying out the purpose for which the regulation is proposed, or would be as effective and less burdensome to affected private persons, or would lessen any adverse impact on small businesses.

ADDENDUM, REGARDING PUBLIC COMMENTS

No request for hearing was received during the 45-day public comment period, which ended on July 2, 2007. Accordingly, no hearing was scheduled or held.

REVISIONS IN RESPONSE TO COMMENTS

In summary, the Department received comments raising concerns of necessity and clarity with regard to the proposed rules: 21 comments during the 45-day comment period; 4 comments during the first 15-day comment period; and 4 comments during the second 15-day comment period. In response to concerns of necessity, commentors are directed to the Initial Statement of Reasons describing, in detail, the need for each provision of the rule.

It is noteworthy the Department has incorporated into the rule the principles of the Statement on Subprime Lending. This document was published by CSBS and AARMR on July 17, 2007. This additional Guidance helps complement the existing Guidance on Nontraditional Mortgage Product Risks. As discussed in the Initial Statement of Reasons,

the additional Guidance is incorporated into the rule to help address problems with subprime loans including certain adjustable rate mortgages. The revisions are needed to ensure lenders implement best practices to manage risks associated with these products, in addition to providing reports, making disclosures, avoiding misleading ads, and retaining books and records (including workout arrangements), as specified in the text of the rule. Accordingly, appropriate references have been added in subsections (a), (b), (d) and (e), to accomplish the goal. For the purpose of defining adjustable rate mortgage, the rule incorporates the definition provided by the new Guidance published by CSBS and AARMR on July 17, 2007.

The remaining changes, to address concerns of clarity, are outlined below, including a summary of (and reasons for) each change:

Subsection (a):

- Define “best practices” to mean lawful processes, policies, and procedures to manage risks associated with nontraditional mortgage products and adjustable rate mortgages as defined by the collective Guidance. This change will clarify these terms.
- Delete the reference to “appropriate” and, instead, clarify that best practices to manage loan product risk will include lawful processes, policies, and procedures. This revision also helps clarify the meaning of “best practices.”
- Incorporate a reference to the recent Statement on Subprime Mortgage Lending, and delete the reference to “including but not limited to.” These changes help clarify the best practices implemented by lenders.
- Refer to the Guidance on Nontraditional Mortgage Product Risks and the Statement on Subprime Mortgage Lending collectively as the “Guidance” to ensure clarity throughout the rule provisions.

Subsection (b):

- Provide technical language revisions to conform to other provisions of the rule, and clarify the rule’s application. These changes include adding references to “adjustable rate mortgage,” “processes,” and “any,” and including a reference to “best practices.”
- Require reporting of workout arrangements used for resolved complaints, and provide a definition of workout arrangement.
- Clarify the report to include education of agents as well as employees.
- Delete the reference to “risk management” practices to conform with other provisions of the rule.

Subsection (c):

- Require lenders to retain any workout arrangement with complaint documentation, as specified.
- Add a reference to adjustable rate mortgage to conform to other provisions.

Subsection (d):

- Delete the phrase “readily understood by a person unfamiliar with mortgage loan terms and conditions, material,” and at “a minimum.” In lieu of these phrases, clarify that disclosures must be provided in the forms prescribed by the rule.
- Provide that the Form RE 885 of DRE (provided by a licensed real estate broker) shall satisfy the disclosure requirements. This clarifies the application of the rule, and confirms that either the Department’s form or the DRE form will suffice.
- Apply the disclosure provision to loans that are subject to the Guidance, as specified, to help clarify application.
- Allow the use of any other disclosure form to compare payment scenarios and loan balance scenarios of products that are subject to the Guidance, provided the form compares monthly payments and loan balance of these products offered and reflects the borrower’s proposed loan amount.
- Clarify that statements must be on any one of the specified forms.

Subsection (e):

- Apply the advertising provisions to loans that are subject to the Guidance, as specified, to help clarify application of the rule’s provisions.
- Tailor the provisions to advertisements for sake of clarity, and require disclosures when applicable to the advertised loan products.

Subsection (f):

- Add subsection (f) to clarify that the rule does not apply to commercial loans, and applies to loans secured by residential real property, as specified.

Other Revisions:

- Provide additional code references in the Notes of the text.
- Revise certain headings to refer to Nontraditional, Adjustable Rate, and Mortgage Loan Products, to clarify the scope of the proposal.
- Revise the “Comparison of Sample Mortgage Features: Typical Mortgage

Transaction” form to: provide instructions to lenders on how to complete the form; provide that a lender may add or delete columns to reflect only loan products offered by the lender; add an additional column consistent with DRE’s form, to disclose information concerning the loan product (e.g., an ARM or other product not covered by the other existing columns) proposed by the lender for the borrower; and specify the rule’s requirements for delivery of the form to the borrower. This form is incorporated by reference in subsection (d).

- Revise the “Nontraditional Mortgage Loan Survey” form to: clarify the heading of the form, delete the “other” category in Section 4.g. and, instead, require reporting of adjustable rate mortgages covered by the Statement of Subprime Lending; and provide a definition of adjustable rate mortgage consistent with the Statement on Subprime Lending. This form is incorporated by reference in subsection (b).

The above-reverenced changes are intended to clarify the application of the proposed rules and forms, and to address comments received during the public comment periods.

COMMENTS RECEIVED DURING THE 45-DAY COMMENT PERIOD

The Department received 21 written comment letters during the 45-day public comment period. Those comments are summarized below, together with the Department’s responses.

1. COMMENTOR: E-mail dated May 21, 2007, from Peter Shoobridge on behalf of Aspen Pacific Funding, LLC.

COMMENT: Commentor states the Guidance issued by CSBS and AARMR is intended to protect consumers from the misleading and deceptive practices prevalent within the residential mortgage sector (mostly sub-prime). The proposed regulations appear to have no relevance to the business of commercial real estate finance. Thus, commentor recommends exempting commercial loans from the proposed regulations.

RESPONSE: The Department agrees with the commentor’s suggestion and has revised the rule to exclude commercial loans made or arranged by licensed lenders.

2. COMMENTOR: E-mail dated May 24, 2007, from Rob Pivnick with Goldman Sachs Commercial Mortgage Capital, L.P.

COMMENT: Commentor states that the proposed text would apply to all lenders licensed under the California Finance Lenders Law originating commercial loans and consumer loans in the state of California. Accordingly, commentor suggests that the proposed rules should apply only to consumer loans.

RESPONSE: The Department agrees with the commentor’s suggestion and has revised the rule to exclude commercial loans made or arranged by licensed lenders.

3. COMMENTOR: Letter dated May 24, 2007, from the Honorable Ted Lieu, Chair,

Assembly Committee on Banking and Finance.

COMMENT 1: Commentor states overall support of the proposed regulation to implement the CSBS and the AARMR Guidance on Nontraditional Mortgage Product Risks.

RESPONSE: The Department acknowledges and appreciates the support for the proposed regulations.

COMMENT 2: Commentor recommends the Department further require licensees to forward copies of complaints and their dispositions to the Department to achieve an “early warning system.”

RESPONSE: The suggested change is unnecessary and will not be made at this time. In addition to current examination and complaint systems used to detect patterns and practices of complaints, the proposed rule provides an additional warning system by requiring lenders to report resolved and unresolved complaints. The rule also requires lenders to submit complaint documentation to the Commissioner should it be necessary to investigate consumer complaints filed with licensees. If the new reporting requirement demonstrates the need to create additional warning systems, the Department will revisit this area in the future, as necessary.

COMMENT 3: Commentor recommends that the Department add an advertising disclosure to state what types of products can result in negative amortization, and to guard against advertisement in small type or print.

RESPONSE: The suggested changes are unnecessary and will not be made at this time. Rather than disclosing whether products can result in negative amortization, the proposed disclosure provides meaningful information to understand the impacts of negative amortization. See for example, paragraphs (1)(K) and (L) of subsection (e) of Sections 1436 and 1950.314.8. Additional disclosures concerning a balloon payment and a prepayment penalty are also required by the rule. Moreover, the proposed rule requires an equally prominent disclosure, to help guard against inconspicuous statements in advertisements. Finally, it is noteworthy that the rule sets forth examples of false, misleading, or deceptive advertising practices. This list is not exhaustive. Therefore, the Department retains its authority to prevent violations of current statute while prohibiting false advertising, generally.

COMMENT 4: Commentor recommends that the Department expand the Comparison of Sample Mortgage Features form to include option ARMs that begin with an initial fixed teaser rate.

RESPONSE: The Department agrees with the commentor’s suggestion and has revised the disclosure form to add another column (consistent with the Department of Real Estate or “DRE” form) that enables lenders to provide additional disclosures for other types of loans that may be proposed for the borrowers. It is also noteworthy that column 3 of the proposed form also includes disclosures to address option ARMs.

COMMENT 5: Commentor states that the Comparison of Sample Mortgage Features form should be available in multiple languages.

RESPONSE: The Department agrees and will coordinate with DRE to make its form available in other languages consistent with DRE's current practice, so lenders can utilize the forms for the purpose of avoiding any challenges based on misunderstandings. The Department understands a related issue is also being considered in the Legislature. See, for example, Assembly Bill 512 (Lieber), a bill that is supported and opposed by various stakeholders. The Department remains committed to working with interested parties to consider this issue in the future, and to determine whether an appropriate solution can be provided by statute or rule. In the meantime, the Department will continue to investigate any complaints involving mortgage loans negotiated in languages other than the borrowers' primary language, and will continue to bring enforcement actions as necessary to prohibit misleading or deceptive statements and practices.

4. COMMENTOR: E-mail dated May 31, 2007, from Coleman Gregory with PB Capital Corporation.

COMMENT: Commentor states that the proposed rulemaking, as drafted, would apply generally to all finance companies, regardless of the nature of their respective businesses. Commentor suggests modifying the rulemaking to apply specifically and only to those finance lenders and mortgage lenders that make nontraditional mortgage products.

RESPONSE: The Department agrees with the commentor's suggestion to tailor the rule to various loans that are covered by its provisions. Accordingly, appropriate changes have been made to help address the comments.

5. COMMENTOR: Letter dated June 1, 2007, from Stephen P. Renock, IV with OCTFCU Mortgage Co., LLC.

COMMENT 1: Commentor indicates the Comparison of Sample Mortgage Features disclosure form is cumbersome and confusing, and suggests limiting the form to 1 or 2 comparisons.

RESPONSE: The Department disagrees with the commentor's suggestion and will not make the suggested changes. The proposed disclosure form (developed in coordination with the DRE) is designed to prevent misunderstandings, by providing meaningful information concerning loan products. Limiting the form to one or two product types would decrease the level of disclosure and thereby reduce consumer protection.

COMMENT 2: Commentor recommends excluding the gross income and the projected payment difference from the form, for the 6th year.

RESPONSE: The Department disagrees with the commentor's suggestion and will not make the suggested changes. Excluding the gross income and projected payment differences from the form would reduce the level of disclosure concerning the upcoming maximum loan payment. As proposed, the rule helps guard against payment shock

associated with certain loans with deferred payment options.

COMMENT 3: Commentor suggests amending the 3-day disclosure so that the disclosure is offered after the borrower's income has been verified, perhaps with final documents but no later than 3-days prior to loan funding.

RESPONSE: The Department disagrees with the commentor's suggestion; thus, the suggested change will not be made. The rule (patterned after long-standing disclosure laws applicable to mortgage brokers under the Real Estate Law) provides pertinent disclosures as early as possible, prior to the borrower's commitment. Lenders are able to obtain the borrower's verification of income during the loan application process, and provide a good faith estimate based on information received from the borrower.

COMMENT 4: Commentor states that the advertising items are too numerous, and recommends that advertising should direct borrowers to a website, a phone number or a mailing address for more detailed information.

RESPONSE: The Department disagrees with the commentor. Accordingly, the suggested change will not be made. The Department believes the advertising requirements (developed with DRE) provide necessary information to assist consumers in the product selection process, in addition to curbing fraudulent or deceptive advertising. Steering prospective borrowers to other means of communication would not ensure that consumers receive the requisite disclosures in a timely manner.

6. COMMENTOR: Facsimile and by mail, letter dated June 19, 2007, from John T. Gaiser with Quality Home Loans.

COMMENT 1: Commentor states that providing the information in the "Comparison of Sample Mortgage Features: Typical Mortgage Transaction" model form may prove detrimental if borrowers receive information about loan products that are not offered by the lender.

RESPONSE: Subsection (d) of the proposed rule makes it clear that the disclosures apply to "loan products offered by" the lender. Nevertheless, the Department will revise the form to confirm that lenders may add or delete columns to conform to loans offered by the lender. The form will also be revised to clarify and confirm the lender's obligation to disclose information on a separate column concerning the loan product proposed for the borrower.

COMMENT 2: Commentor indicates the payment scenarios and product information contained in the model form are confusing and could be difficult to explain.

RESPONSE: The Department disagrees with the commenter; therefore, no change will be made to the form, in response to this comment. The model form (patterned after the form prescribed by the DRE) helps provide full disclosure of material information to borrowers, so they can be better informed when making a product choice. To help lenders understand the information disclosed in the model form, the Department will make available an instructional guide. This instructional guide will be consistent with instructions

provided by the DRE to licensed real estate brokers arranging loans.

COMMENT 3: Commentor states that lenders should be able to modify the model form to reflect only loan products offered by the lenders.

RESPONSE: As indicated in its response to Comment 1, above, the Department will adjust the form to confirm that a lender must disclose information on loans offered by the lender, and may add or delete columns to reflect loan products offered by the lenders. More importantly, the Department has amended the Rule to allow lenders to use their own forms, as specified.

COMMENT 4: Commentor states that the model form should be revised to resemble Illustrations promulgated by federal agencies, as specified.

RESPONSE: The Department disagrees with the comment and no change will be made. The model form is more effective than the federal illustrations. For example, the model form contains information that specifically relates to the borrower's transaction; whereas, the federal rule cited by the commentor provides only hypothetical explanations. Moreover, the model form helps achieve uniform and consistent disclosures in the marketplace, since it is patterned after the form developed by DRE for mortgage loan brokers. In addition, the federal agencies are seeking to incorporate the suggested illustrations into Regulation Z in the future; thus, it is unnecessary to duplicate the federal disclosures, and nothing prohibits lenders from including them in their disclosures to borrowers to carry out the objectives of the Guidance.

COMMENT 5: Commentor suggests revising the model form to clarify that information is based on sample information rather than borrower-specific information.

RESPONSE: The Department disagrees with the comment and suggestion, and will not make the requested change. The model form is designed to provide borrower-specific information so consumers can make informed product choices, and understand the risks and rewards of loan products offered by the lender.

COMMENT 6: Commentor indicates that specific loan terms, such as the borrower's interest rate, may not be available or determined within 3 days of application.

RESPONSE: The Department disagrees with the comment; therefore, no change will be made. The 3-day timeframe is based on longstanding provisions of law applicable to mortgage brokers under the Real Estate Law. Lenders are able to estimate the interest rate based on a review of the loan application, and can determine other loan information by obtaining the borrower's verification. The model form demonstrates that the disclosure is an estimate and directs the borrower to carefully review all loan documents to confirm the actual amount, rate, and provisions of the loan.

COMMENT 7: Commenter suggests that lenders should not be required to provide the model form if a real estate broker provides the Form RE 885 when arranging the lender's loan.

RESPONSE: The Department has clarified that the Form RE 885 satisfies the rule when provided by a real estate broker, to address this comment.

COMMENT 8: Commentor suggests that lenders should not be required to confirm the accuracy of information contained in the Form RE 885.

RESPONSE: The Department disagrees with the comment. The Guidance is intended to ensure adequate supervision and due diligence by lenders. The comment would not further the purpose of the Guidance.

7. COMMENTOR: Facsimile and by mail, letter dated June 25, 2007, from D. Steven Blake with Downey Brand Attorneys LLP provides two comments with a detailed memo and attachment to help illustrate the two comments.

COMMENT 1: Commentor states that the proposed regulation may be construed to apply to non-consumer lenders. Commentor suggests amending the proposed regulation to apply only to loans made primarily for personal, familial, or household interests.

RESPONSE: The Department has addressed the commentor's concerns by narrowing the rule's application to consumer loans, as suggested.

COMMENT 2: Commentor further states that the incorporation by reference of the CSBS and AARMR Guidance appears to be improper under the OAL regulation. Commentor suggests that the proposed regulation integrate the pertinent portions of the Guidance into the text.

RESPONSE: The Department disagrees with the commentor; thus, it will not seek to codify the Guidance into the rule. To do so would be unduly burdensome to lenders by taking away their flexibility to adopt best practices that may provide greater protection to consumers. Thus, the Department believes it is unnecessary to take away the lender's ability to adjust its best practices to meet changed circumstances in the marketplace.

8. COMMENTOR: E-mail letter dated June 26, 2007 from David C. Knight on behalf of the California Financial Services Association.

COMMENT 1: Commentor states that the proposed regulations deviate from the CSBS/AARMR adopted guidance by expanding the concept of nontraditional mortgage. Commentor recommends amending the regulation to conform with the CSBS/AARMR guidance.

RESPONSE: The Department disagrees with the commenter. No further clarification is needed at this time because the rule refers to nontraditional mortgage product "as defined" by the Guidance. The model form under subsection (d) includes a comparison of various loan products (traditional and nontraditional) including ARMS, to provide a comparison for borrowers. Although the Nontraditional Mortgage Loan Survey requires lenders to report its home equity lines of credit (HELOCs) and covered loans, this report codifies an existing report sent to lenders in 2007. Given the interest expressed by the Legislature and others in reviewing this loan product information, and to help monitor the risk of loan portfolios, the Department believes it is worthwhile to retain these reporting categories, at this time.

COMMENT 2: According to the commentor, the Department indicated that the rulemaking is needed to provide flexibility to licensees to help carry out the stated objectives of the Guidance. However, California is adding products and layers of requirements that were not contemplated in the CSBS/AARMR guidance.

RESPONSE: The Department disagrees with the comment. The rule is consistent with the Guidance that requires lenders to adopt best practices (e.g., lawful processes,

policies and procedures) to address risks associated with certain loan products. By placing the obligation in the rule, this proposed action ensures continuous implementation of the Guidance by lenders.

COMMENT 3: Commentor points out that the CSBS/AARMR guidance encourages mortgage lenders to adopt robust risk management practices that address product attributes, production, sales and securitization practices. The risk management practices should include enhanced performance measures and management reporting that provides early warning for increased risk. As proposed, the requirement to continuously implement best practices is ambiguous and likely impossible to comply with. It is recommended that the regulation state that any required policies, once implemented by the licensee, must be maintained.

RESPONSE: The Department disagrees with the comment; thus, no change will be made. The rule is intended to require continuous implementation to ensure licensees are following (not merely maintaining) these best practices on an ongoing basis. Nevertheless, to address the concerns of ambiguity, the Department has provided a definition of “best practices.”

COMMENT 4: Commentor states that the annual report form seems to be a form that would be used by an examiner while conducting a branch visit, rather than a report that should be required to be filed annually by a licensee. The annual report form is ambiguous because it includes traditional and nontraditional mortgage products.

RESPONSE: The Department has provided definitions for the loan survey, to help address this comment. The definitions will help clarify “simultaneous second lien loan, “ consistent with the Guidance. Although the survey requires reporting of HELOCs and covered loans, the Department believes the information is useful in determining the scope of risk.

COMMENT 5: Commentor states that the disclosure form to be given to customers is confusing, and many lenders do not offer the nontraditional mortgage products. Also, licensees often do not have the information available to complete this form within the proposed three-day window. Commentor suggests that the regulations be amended to streamline mortgage disclosure so that they are more meaningful to the consumer.

RESPONSE: The Department disagrees with the comments. The model form provides more meaningful disclosures, based on specific information provided by borrowers. The disclosure is an estimate provided to borrowers, as indicated by the precautionary note to borrowers on the model form. Only one disclosure form is expressly required by a date specified in the rule, although lenders still must comply with laws that are designed to guard against misleading statements. The Department has revised the model form to allow lenders to add or delete columns to reflect loan products offered by the lenders.

COMMENT 6: Commentor states that the advertising disclosure in the proposed regulations is not consistent with, and goes beyond, the scope of the Guidance.

Commentor recommends amending the regulations so they are consistent with the CSBS/AARMR Guidance.

RESPONSE: The Department disagrees with the comment. The advertising requirements are based on DRE's proposed rules. The DRE developed its disclosure rule based on the principles of the Guidance. Although the advertising requirements apply to adjustable rate mortgages, the rule helps carry out the objective of the new Statement on Subprime Mortgage Lending. The items of disclosure will provide greater consumer protection by helping to avoid fraudulent statements and to prevent misunderstandings. Additional changes have been made to clarify the rule's application to loan products subject to the Guidance.

9. COMMENTOR: Facsimile dated June 25, 2007, from Gabe del Rio with Community Housing Works.

COMMENT 1: Commentor recommends that the Department should adopt the recent Statement on Subprime Lending as published by AARMR and CSBS on July 17, 2007.

RESPONSE: As suggested by commentor, the Department has revised the rule to incorporate the Statement on Subprime Lending as published by AARMR and CSBS on July 17, 2007.

COMMENT 2: Commentor states that complaint data should be made available to the public, and that the rule should define the resolved and unresolved complaints.

RESPONSE: The Department disagrees that consumer complaints can be made available to the public. In accordance with current law governing privacy and confidentiality, the Department cannot disclose complaint information. Thus, this change will not be made. The terms resolved and unresolved are known to lenders as part of their complaint systems, so further clarification is unnecessary at this time.

COMMENT 3: Commentor states that the Department should ensure adequate broker oversight, promote consumer education and understanding, and support borrowers in distress.

RESPONSE: No further changes are needed to require proper oversight over brokers, because the Guidance requires lenders to exercise such oversight. Moreover, the Department will require information covering education of agents as well as employees. Rather than advising borrowers on the disclosure form to seek assistance from a HUD certified home loan counseling agency, the Department will continue to provide information on counseling and other services available to borrowers through its education efforts, including information on its web page and through local outreach. Finally, the Department remains committed to working with interested parties to help borrowers in distress, and in coordination with federal and state regulators.

10. COMMENTOR: Facsimile dated June 27, 2007, from S. Guy Puccio and Dan Garrett with Wallace, Puccio & Garrett.

COMMENT: Commentors recommend amending the proposed regulations to clarify that Sections 1436 and 1950.314.8 apply only to loan transactions where the intended security properties are dwellings consisting of one to four residential units.

RESPONSE: The Department has revised the rule to apply to loans secured by residential real property, as suggested by the commentors.

11. COMMENTOR: Letter dated June 29, 2007, from Susan DeMars with the California Mortgage Bankers Association.

COMMENT 1: Commentor states that CSBS/AARMR intended that its model Guidance be adopted by state in whole and without variance to create a level playing field. Commentor questions why the Department is proposing to move away from the Guidance and tread its own path.

RESPONSE: The Department disagrees with the comments. The proposed rulemaking carries out the Guidance by ensuring continuous and uniform compliance by licensed lenders. The proposed rules help achieve stated goals of the Guidance including consumer protection.

COMMENT 2: Commentor has serious concerns over the unintended adverse consequences from the proposed rules; and recommends the Department, the Department of Real Estate and the Department of Financial Institutions adopt the CSBS/AARMR Guidance in whole.

RESPONSE: The Department disagrees with the comments because the proposed rulemaking will have a potential benefit on impacted businesses, the marketplace, and the public, by helping avoid risks of loss associated with loans secured by residential real property. See the Department's Economic Impact Statement for further information in this regard. Each state agency (e.g., DOC, DRE and DFI) is adopting the Guidance in a manner that achieves equal and uniform regulation for its respective licensees.

COMMENT 3: Commentor states the proposed rules do not provide either clear definition or intent on the part of the Department to define the scope of coverage. It is recommended that a clear definition of what is, and what is not, a "Non-Traditional Mortgage" be added to the rules.

RESPONSE: The Department disagrees with the comment and believes an additional definition of nontraditional mortgage product is unnecessary at this time. As indicated by subsection (b) of the proposed rule, a nontraditional loan product has the same meaning "as defined" by the Guidance. Page 3 of the commentor's letter acknowledges this definition. However, a similar reference to define nontraditional mortgage product will be made to other provisions for purposes of clarity.

COMMENT 4: Commentor states that the "Nontraditional Mortgage Loan Survey" asks lenders to capture on this form dollar volume of "other" loans that does not conform to the definitions in categories (a) through (d). Commentor recommends defining

nontraditional mortgage products to avoid the “Other” category. Commentor further suggests that items (c) and (d) on the survey be moved into the position of subcategories under items (a) and (b) signifying that reduced documentation loans and simultaneous second lien loans are not nontraditional mortgage loans but, rather, additional risk factors of nontraditional mortgage loans.

RESPONSE: The Department agrees that the “other” category lacks clarity and has revised that category on the survey form to reflect ARMs covered by the new Statement on Subprime Lending. However, the other categories will be maintained to provide sufficient information about the portfolio of risk maintained by each licensed lender, and to provide information to public-policy makers and others.

COMMENT 5: Commentor recommends that the Department amend the books and records provisions relating to consumer complaints to provide time periods specified by the California Finance Lenders Law and the California Residential Mortgage Lending Act.

RESPONSE: The Department disagrees with the comment as it is unnecessary to duplicate the current record-keeping requirements under the law.

COMMENT 6: Commentor states that the disclosure form is too extensive, too complicated, and too late in the loan process, as specified. Commentor recommends that the Department adopt forms and tools recently published by the federal banking agencies in 2007.

RESPONSE: The Department disagrees with the comments and will not delete the loan disclosure. Although commentor indicates that term “completed” application is undefined, the Department believes the term is readily understood in the industry. The proposed loan disclosures provide more meaningful information because they are based on information provided by the borrowers (rather than mere “illustrations” as proposed in the federal agency guidance). The borrower’s specific information (verified by the borrower through the loan application process) provides important information that helps avoid the payment shock experienced in the 6th year of certain loans. Because commentor acknowledges the federal disclosures will be incorporated as part of Regulation Z, licensed lenders may already be required to comply with these disclosures. Thus, the proposed disclosures will complement the ongoing efforts at the federal level.

COMMENT 7: Commentor states that the advertising rules encompass all variable rate mortgage products, and are overly specific for solicitation of nontraditional mortgage characteristics. Commentor recommends that the Department defer to the Federal Reserve Board efforts to formulate new Truth In Lending Act/Regulation Z advertising and promotion requirements for lenders in the nontraditional mortgage product area.

RESPONSE: The Department disagrees with the comment and will not delete the proposed advertising requirements. The proposed requirements (developed in consultation with DRE) provide meaningful disclosures so borrowers can make informed decisions early in the loan solicitation process. The rule provides specific information to help prevent misunderstandings by borrowers. Nevertheless, subsection (e) has been

revised to apply to loan products subject to the Guidance.

12. COMMENTOR: Letter dated June 29, 2007, from Mary Jane M. Seebach with Countrywide.

COMMENT 1: Commentor states that the Department should adopt the CSBS and AARMR Guidance, and not promulgate a new regulation.

RESPONSE: The Department disagrees with the comment and will not abandon the proposed regulation. Consistent with the actions of other jurisdictions, the Department is ensuring ongoing compliance with the Guidance. The regulation ensures that lenders achieve the objectives of the Guidance on an ongoing basis through various requirements including the adoption of best practices. The responsibility for implementing the Guidance should be borne by licensed lenders, with oversight from regulatory agencies.

COMMENT 2: In general, Commentor states that several provisions of the proposed rule are vague and overbroad in attempting to reach products that are not defined as “nontraditional mortgages.”

Specific examples in the comments, and responses, are as follows:

- (i) Subsection (a) includes an unspecified reference to “including but not limited to.”
- (ii) Subsection (d) includes undefined terms such as “completed” application, “person unfamiliar with mortgage loan terms and conditions,” “material information,” “payment scenarios” and “loan scenarios.”
- (iii) Subsection (d) makes a distinction between the DOC’s “minimum” form and DRE’s form that “satisfies.”
- (iv) Subsection (e) is unclear as to whether it applies only to “representations of an installment in repayment” in advertising.
- (v) Subsection (e) should not cover all adjustable rate loans.
- (vi) Subsection (e) contains redundant information.
- (vii) Subsection (e) fails to define equally prominent disclosure.
- (viii) Subsection (b) should not require reporting of reduced documentation, HELOCs, covered loans, or “other” loans.
- (ix) Subsection (d) should not include disclosure of 5/1 ARM loans.

RESPONSE:

- (i) The Department agrees with the comment and will delete the reference to “including but not limited to.” Instead, further clarification will be provided by referencing the additional guidance provided by the Statement on Subprime Loans issued by AARMR and CSBS on July 17, 2007.
- (ii) The Department disagrees with the comment regarding “completed” application, as this is a term that is readily understood by the industry through the application process. Additionally, the Department will adjust subsection (b) to eliminate terms that lack clarity, as suggested by the commentor (e.g. person unfamiliar with loan terms). Moreover, the Department will clarify that the disclosures form satisfies the requirements of the subsection to address remaining concerns

- (e.g., “material” and “scenario”).
- (iii) The Department agrees with the comment and will make changes to address commentor’s concerns.
 - (iv) The Department disagrees with the comment because the rule expressly applies to advertisements by its own terms.
 - (v) The Department disagrees with the comment because the rule is needed to help prevent payment shock associated with uninformed borrowers. However, the rule has been modified to apply to loans that are subject to the Guidance.
 - (vi) The Department disagrees. The information disclosed in subsection (d) provides a comparison of loan product information; whereas, subsection (e) prevents misrepresentation regarding certain loan products. Each subsection serves a different purpose; therefore, the disclosures are appropriate.
 - (vii) The phrase “equally prominent” needs no further clarification. This provision is patterned after the DRE’s proposed regulation to achieve greater uniformity among loan brokers and lenders.
 - (viii) The Department disagrees with the comments because the additional information (reduced documentation, HELOCs and covered loans) is needed to provide an overview of the risks incurred by each lender. The Department will delete “other” from the survey form to address the clarity concerns.
 - (ix) The Department disagrees. Subsection (d) is intended to provide a comparison of loan products to help ensure that borrowers are aware of the risks and rewards of each, and to avoid the “payment shock” associated with certain loans.

COMMENT 3: Commentor recommends that the Department allocate its examination and enforcement resources to avoid duplicating examinations and to promote a level playing field across California lenders.

RESPONSE: The Department acknowledges this comment but it does not relate to the content of the rule. Nevertheless, it will take into consideration the suggestions to coordinate examinations and regulatory efforts with other agencies.

COMMENT 4: Commentor recommends that the Department not adopt the proposed rules. The Department should issue the CSBS and AARMR Guidance as the Department’s guidance.

RESPONSE. The Department disagrees with the comment and will not abandon the rule. Besides the reasons given in the responses to other comments, above, the necessity of the rule is described in more detail in the Initial Statement of Reasons.

13. COMMENTOR: Facsimile dated July 2, 2007, from Kristin M. DeMaria with Terry M. Mallery.

COMMENT 1: Commentor states that implementation of a risk management plan would be an excessive cost to a small CFL licensee, who may rarely make a CFL loan, yet would be required to follow the proposed stringent risk management practices. The increased costs to small CFL brokers is not nominal, but will be significant and an unreasonable cost burden to their businesses.

RESPONSE: The Department acknowledges the comment regarding compliance costs. By definition, licensees are not small businesses, and the Department believes any compliance costs will be offset by potential benefits to licensees that are not identified by the comments. For a more detailed description of the benefits to licensees, please refer to the Economic Impact Statement.

COMMENT 2: Commentor states that the annual reporting on arrangement and number of nontraditional mortgage products, the manner of implementing risk management and internal controls, and the reporting of consumer complaints, is burdensome and would be costly to the small broker and would essentially put them out of business.

RESPONSE: The Department acknowledges the comment regarding compliance costs, and refers to its response in number 1 above, for a description of potential benefits to licensees.

COMMENT 3: Commentor states that the disclosures comparing loan scenarios duplicates regulations already imposed on brokers. The existing disclosures are clear, conspicuous, and understandable by the general public, making the proposed disclosure unnecessary and burdensome. See California Financial Code Section 22332.

RESPONSE: The Department disagrees with the comment because the rule does not duplicate current statutory requirements. Rather, the rule carries out and implements existing statutes that are designed to ensure appropriate loan disclosures.

COMMENT 4: Commentor states that the prohibition of certain false, misleading and deceptive advertising is an unreasonable burden by restricting advertising far too much and duplicating already existing laws. See California Financial Code Sections 22161, 22163 and 22164.

RESPONSE: The Department disagrees with the comment because the rule does not duplicate current statutory requirements. Rather, the rule carries out and implements existing statutes that are designed to prevent false and misleading advertising.

14. COMMENTOR: Letter dated July 2, 2007, from Lynnea J. Olsen with Citi.

COMMENT 1: Commentor recommends that the Department clarify the definition of “nontraditional mortgage products” as used in the proposed rules to be uniform throughout the rules and consistent with the definition adopted by CSBS and AARMR in their November 14, 2006 Guidance.

RESPONSE: The Department disagrees with the proposed suggestion because the rule already refers to nontraditional mortgage product “as defined” by the Guidance. Nevertheless, conforming changes will be made to other provisions to confirm the definition provided by the Guidance, and thereby apply to loans that are subject to the Guidance.

COMMENT 2: Commentor recommends limiting the advertising prohibitions to nontraditional mortgage products.

RESPONSE: The Department disagrees with the commentor's suggestion. The advertising prohibitions are intended to cover adjustable rate mortgages as well. By doing so, the rule helps achieve the goals of the new Statement on Subprime Mortgage Lending that has now been incorporated by reference into the rule. Thus, the rule has been clarified to cover loans that are subject to the Guidance.

COMMENT 3: Commentor recommends revising the "Nontraditional Mortgage Loan Survey and The Comparison of Sample Mortgage Features: Typical Mortgage Transaction" form to clarify that it is consistent with the CSBS/AARMR Guidance.

RESPONSE: The Department disagrees with the suggestion because the survey and disclosure form are intended to incorporate other types of adjustable and high-risk loans designated in these documents, as specified. This information is necessary to provide appropriate disclosure to both borrowers and the Department.

15. COMMENTOR: Letter and facsimile dated July 2, 2007, from Paul Leonard with Center for Responsible Lending.

COMMENT 1: Commentor recommends that the Department broaden the proposed regulations to adopt the CSBS/AARMR Statement on Subprime Lending for State-licensed entities.

RESPONSE: The Department agrees with the suggestion and has revised the proposed rule to incorporate the Statement on Subprime Lending as published by AARMR/CSBS on July 17, 2007.

COMMENT 2: Commentor recommends that the Department expand the section on risk management requirements to include appropriate consumer protections.

RESPONSE: The Department disagrees with the suggested revisions because it is unnecessary. The Guidance already requires compliance with additional consumer protections, and the proposed rules address consumer protection through enhanced disclosure and prohibitions on false advertising.

COMMENT 3: Commentor states that the nontraditional mortgage products comparison chart should be amended to make it consistent with the sample comparison charts by the federal bank, thrift, and credit union regulatory agencies, and should include hybrid ARM products and foreign language translations.

RESPONSE: The Department disagrees with the suggestion of incorporating federal disclosures, because the proposed disclosure form in the rule (developed in coordination with DRE) provides a comparison of products based on the borrower's transaction, rather than mere illustrations as provided under the federal guidance. The Department's proposed rule also helps ensure uniform disclosures by lenders and brokers regulated by DOC and DRE. While no additional changes are made at this time, the

Department will continue to monitor the effectiveness of the proposed disclosures through its regulatory processes, and can make necessary adjustments in the future as necessary and appropriate. It is also noteworthy that the federal disclosures may be incorporated as part of Regulation Z, so licensed lenders may be required to comply with them under federal disclosure laws. Nevertheless, the Department will work with DRE to provide forms in foreign languages (as is the current practice of DRE), and to add an additional column to the form to provide disclosure of loan product proposed for the borrower such as a hybrid ARM.

COMMENT 4: Commentor recommends that the Department include a statement that failure to follow the Guidance will be deemed a violation of the California Finance Lenders Law and/or the California Residential Mortgage Lending Act, and will result in disciplinary action and other enforcement measures by the Department.

RESPONSE: The Commentor's suggestion is unnecessary because violation of a rule is already a violation of law under the California Finance Lenders Law and the California Residential Mortgage Lending Act. The Guidance addresses enforcement by regulators, as well.

16. COMMENTOR: E-mail dated July 2, 2007, from Anne C. Canfield with Consumer Mortgage Coalition.

COMMENT 1: On the "scope" of the rules, commentor suggests: (1) defining "nontraditional mortgage product" consistent with the Guidance, (2) providing that lenders are not liable for engaging in a practice not specifically listed in the Guidance, and (3) adopting the Guidance as informal guidelines rather than binding regulations.

RESPONSE: The Department disagrees with the suggestions, for the following reasons. First, the rule already refers to nontraditional mortgage products "as defined" by the Guidance, so no further definition is needed. (However, technical amendments will be made to confirm the definition.) Second, it would be inappropriate to exclude a lender from liability, and such a suggestion may conflict with existing laws that are designed to prevent deceptive or unlawful practices. Third, it is necessary to incorporate the Guidance, by rule, to help ensure ongoing compliance by lenders.

COMMENT 2: As to the advertising requirements, commentor states they are too extensive, as specified, and urges the Department not to adopt the regulation at this time.

RESPONSE: The Department disagrees with the commentor. As further explained by the Initial Statement of Reasons, the advertising requirements (as developed with DRE) will provide sufficient information to consumers to help prevent misunderstandings. The rule also helps prevent payment shock that can result from insufficient information in advertisements. The advertising prohibitions help carry out the consumer protection objectives of the Guidance, as well.

COMMENT 3: Regarding the disclosures, commentor questions whether the greater level of detail will be helpful to consumers, and recommends the federal disclosure form.

RESPONSE: The Department disagrees with the commentor and will retain the current disclosures because they provide information based on products offered to the borrower, rather than merely illustrations as outlined in the federal guidance. Therefore, the state disclosures will provide more meaningful disclosures, and will help ensure consistency with disclosures used by brokers regulated by DRE. Nevertheless, the Department will continue to work with AARMR and CSBS to determine if additional disclosures are necessary and appropriate, in the future.

17. COMMENTOR: Letter and E-mail dated July 2, 2007, from Jim Gazdecki with Option One Mortgage Corporation.

COMMENT 1: Commentor states that clarification is needed on the Comparison of Sample Mortgage Features: Typical Mortgage Transaction form. Specifically, commentor recommends amending the form to clarify that the minimum comparison applies to loan products currently offered by the lender. Moreover, commentor suggests revising the form to provide that it is based on a hypothetical borrower, and the loan amounts and other information are not based on the consumer's application.

RESPONSE: The Department agrees with the suggestions, in part. Specifically, the Department will revise the disclosure form to allow lenders to add or delete columns to reflect loan products offered by the lender. However, the Department disagrees with the proposed disclosure language because the disclosure form is tailored to the borrower's circumstances (rather than a mere hypothetical). The form already includes a sufficient disclosures to avoid misunderstandings with borrowers, as specified.

COMMENT 2: Commentor notes that the proposed survey form may result in double-counting of some loans because a given loan may have more than one of the features identified in 4 (a) through (g).

RESPONSE: The Department recognizes the comment and understands that some loans may fall into two reporting categories. The Department also acknowledges that the commentor does not view the potential double counting as a problem. Thus, clarification is neither suggested nor needed at this time.

18. COMMENTOR: E-mail dated July 2, 2007, from Danielle Fagre Arlowe with American Financial Services Association.

COMMENT 1: Commentor states that the proposed regulations should not apply to traditional ARM products.

RESPONSE: The Department disagrees with the comment and suggestion. The proposed rule is intended to provide meaningful information to consumers and regulators, including ARM loans. Moreover, the Department is incorporating the Statement on Subprime Mortgage Lending, to help ensure adequate consumer protection with respect to ARM loan products. The rules will reflect loan products subject to the Guidance.

COMMENT 2: Commentor suggests that the Department amend the proposed

regulation to provide more flexibility to mortgage lenders with respect to the assessment of a borrower's repayment capacity.

RESPONSE: The Department disagrees with the suggestion because it is unnecessary. The Guidance requires risk management practices and other controls that enable lenders to evaluate the borrower's ability to repay loans.

19. COMMENTOR: Letter dated July 2, 2007, from George Eckert with California Mortgage Association.

COMMENT 1: Commentor recommends that the proposed regulations be amended to contain a definition relating to the scope of the Guidance that is identical to the definition contained in SB 385 (Machado – 2007).

RESPONSE: The Department disagrees with the suggestion because it is unnecessary. The proposed rule already refers to nontraditional mortgage product "as defined" by the Guidance. Commentor acknowledges the Guidance provides a sufficient definition, and no further definition is needed. Recent state legislation (SB 385 - 2007) also includes a definition of nontraditional guidance that reiterates the Guidance; thus, retaining the definition in the Guidance is also consistent with State law.

COMMENT 2: Commentor states that it is not clear exactly what is meant by "appropriate" and "best" risk-management practices. Commentor recommends that the proposed regulations be amended to make it clear to licensees that they are required to comply with the Guidance.

RESPONSE: The Department agrees with the comment and will incorporate changes, by defining the reference to "best" practices. Moreover the term "appropriate" will be revised to "lawful" to help clarify that the best practices are not appropriate if they violate law.

COMMENT 3: Commentor notes that, as proposed, the Department's requirements in the written compliance report exceed what is contained in the Guidance.

RESPONSE. The Department will not incorporate changes to address this comment, because the provisions are needed to monitor a lender's compliance with the rule.

COMMENT 4: Commentor states that the requirement for licensees to retain copies of consumer complaints, and how the licensee resolved each complaint, is inappropriate.

RESPONSE: The Department disagrees with the comment and will not make the requested change. Access to consumer complaint information, as specified, helps ensure compliance by lenders, and to detect unlawful practices.

COMMENT 5: Commentor states that, as proposed, the comparison of loan scenarios is vague and will not adequately advise licensees of their responsibilities.

RESPONSE: The Department disagrees with the comments. But it will make appropriate revisions to the disclosure form tailored to loans offered by the lender and to allow the lender to use its own form under specified conditions.

COMMENT 6: Commentor states that, as proposed, the advertisement requirements amounts to a de facto ban on advertising installment amounts.

RESPONSE: The Department disagrees with the comment and believes the advertising requirements (as developed with DRE) provide consumer protection, and disclosures that are meaningful and forthright for prospective borrowers.

COMMENT 7: Commentor recommends that the Nontraditional Mortgage Loan Survey should conform to the products defined to be within the scope of the Guidance, as described in SB 385.

RESPONSE: The Department disagrees with the comment because the survey is intended to include other types of high-risk loans. The survey will enable the Department to monitor the extent of risks associated with each lender's portfolio.

COMMENT 8: Commentor states that the Comparison of Sample Mortgage Features is inappropriate and potentially confusing to consumers if it includes products the lender does not offer.

RESPONSE: The Department agrees with the comment and, as suggested, will tailor the disclosure form to products offered by the lender. For example, the rule will be revised to allow lenders to add or delete columns to reflect loan products offered by the licensee.

20. COMMENTOR: Facsimile and e-mail dated July 2, 2007, from Kevin Stein with California Reinvestment Coalition.

COMMENT 1: Commentor recommends that the Department should adopt the recent Statement on Subprime Lending.

RESPONSE: As suggested by commentor, the Department has revised the rule to incorporate the Statement on Subprime Lending as published by AARMR and CSBS on July 17, 2007.

COMMENT 2: Commentor states that complaint data should be made available to the public, and that the rule should define the resolved and unresolved complaints.

RESPONSE: The Department disagrees that consumer complaints can be made available to the public. In accordance with current law governing privacy and confidentiality, the Department cannot disclose complaint information.

COMMENT 3: Commentor states that the Department should ensure adequate broker oversight, promote consumer education and understanding, and support borrowers in distress.

RESPONSE: No further changes are needed to require proper oversight over brokers, because the Guidance requires lenders to exercise such oversight. Rather than

advising borrowers on the disclosure form to seek assistance from a HUD certified home loan counseling agency, the Department will continue to provide information on counseling and other services available to borrowers through its education efforts such as updated information on its web page and ongoing education and outreach. Finally, the Department remains committed to working with interested parties to help borrowers in distress, and will continue to work with other regulators to accomplish these goals.

21. COMMENTOR: E-mail dated July 2, 2007, from Keith Bishop.

COMMENT 1: Commentor states that the proposed regulations improperly incorporate the Guidance by reference. Parts I and II of the Guidance is introductory and background information. Part III of the Guidance is less than 12 pages in length. It appears that it would not be cumbersome, unduly expensive or otherwise impractical to publish the document in the CCR.

RESPONSE: The Department disagrees with the comment; therefore, no change will be made. The Rulemaking is intended to allow flexibility for lenders to adopt best risk management practices based on the Guidance. Codifying the Guidance would be burdensome to licensed lenders by taking away their ability to adopt practices that conform to changed circumstances in the marketplace.

COMMENT 2: Commentor states that proposed Section 1436 is unduly broad and fails to meet the “necessity” standard. It applies to every finance company regardless of whether it makes nontraditional mortgage loans. The Guidance relates to nontraditional mortgage loans and there is no need to apply the Guidance to all lenders.

RESPONSE: The Department acknowledges the comment and has revised the rule to address commentor’s concerns. As revised, the rule does not apply to commercial loans. Further clarification has been provided to apply the rule to loan secured by residential real property, as specified.

COMMENT 3: Commentor states that proposed Sections 1436 and 1950.314.8 fail to meet the clarity standard regarding best risk-management practices. Best risk-management practices is not defined in the proposed regulations and can be reasonably and logically interpreted to have more than one meaning. Commentor also notes that the phrase is not used in the Guidance.

RESPONSE: The Department agrees with the comment and will provide a definition of best practices to avoid the clarity concern raised by the comment.

COMMENT 4: Commentor states that proposed Sections 1436 and 1950.314.8 fail to meet the clarity standard regarding complaints. Unless the term “complaints” is defined, it may be interpreted to mean a consumer communication is a complaint or an inquiry. Commentor further states that it is unclear whether the proposed sections apply to written as well as oral complaints.

RESPONSE: The Department disagrees with the comment because the rule applies to “any” complaint, and the lender can discern the meaning of a complaint without

further clarification. Thus, no change is needed at this time.

COMMENT 5: Commentor states that proposed Sections 1436 and 1950.314.8 would require licensees to maintain information regarding the number of resolved and unresolved complaints. The terms “resolved” and “unresolved” can be reasonably and logically interpreted to have multiple meanings.

RESPONSE: The Department disagrees with the comment because “resolved” and “unresolved” have meaning that can be readily understood by lenders that resolve consumer complaints. Therefore, no change is needed.

COMMENT 6: Commentor states that the proposed regulations would impose significant new policies and procedures, record-keeping, disclosure, advertising and other requirements and the Department failed to adequately describe the cost impacts on representative private person or business.

RESPONSE: The Department disagrees with the comment and believes its Economic Impact Statement adequately addresses all cost impacts associated with the proposed rulemaking, and explains the benefits to licensees as well. It is noteworthy that a licensee is not considered a small business for purposes of determining those impacts.

COMMENTS RECEIVED DURING THE FIRST 15-DAY COMMENT PERIOD

The Department received four public comment letters during the first 15-day public comment period, which ended on September 5, 2007. Those comments are summarized below, together with the Department’s responses.

1. COMMENTOR: Facsimile and e-mail dated September 5, 2007, from Leland Chan with the California Bankers Association.

COMMENT 1: Commentor recommends incorporating the Guidance into its supervisory activities, and withdrawing the regulation.

RESPONSE: This comment raises issues with the original text of regulations; thus, it is unnecessary to respond to this comment. Nevertheless, the Department provided ample responses to similar comments received during the 45-day public comment period, above. Commentor is referred to the preceding information for further information and justification.

COMMENT 2: Commentor suggests clarifying that the regulation does not extend beyond what is covered in the Guidance by, as an example, clarifying that it does not apply to all ARMs.

RESPONSE: To address this clarity concern, the Department has revised the appropriate provisions of the rule to clarify the application to certain adjustable rate mortgage (ARMs) covered by the Statement on Subprime Mortgage Lending.

COMMENT 3: Commentor suggests that the Department's Nontraditional Mortgage Loan Survey title should reflect only subprime loan activity covered by the Guidance, and notes that items c, d, and e describe loan types and features that are not necessarily covered by the Guidance.

RESPONSE: This comment raises issues with the original text of regulations; thus, it is unnecessary to respond to this comment. Nevertheless, the Department provided ample responses to similar comments received during the 45-day public comment period, above. Commentor is referred to the preceding information for further justification. As explained above, the rules are intended to capture other types of loans.

COMMENT 4: Commentor appreciates the concept of the comparison disclosure form to satisfy the provisions of the Guidance. Commentor notes operational challenges posed by the disclosure form:

- (i) It is not always clear at the time that an application for a loan is made that the consumer is seeking a nontraditional or subprime mortgage product. Therefore, a lender that offers both prime and sub-prime products, traditional and nontraditional mortgage products, would be compelled to provide the form disclosure to all borrowers as long as there is a possibility that a nontraditional or subprime product may be offered.
- (ii) The disclosure form as written is likely not appropriate for lenders that do not offer the types of loans listed. The disclosure form may be partially obsolete as the loans listed are already becoming unavailable in the market because of tightening credit policies.
- (iii) The disclosure form requires assumptions about loans that are not applicable to all lenders. Specifically, it requires lenders to disclose the maximum monthly payment in year 6 assuming a 5% rise in rates. There are lenders with caps that would not permit that large of a rate increase in year 6.

Commentor recommends that the disclosure form allow lenders more flexibility in determining the content of the disclosure so that it would be more relevant and useful to the consumer, and to accommodate a lender's particular loan products.

Commentor further suggests a transition period for the adoption of any mandatory form prior to complying.

RESPONSE: In response to the comments, the Department notes the following:

- (i) The rule clearly dictates the disclosure upon receiving an application for a loan covered by the Guidance. Thus, no further revision is necessary.
- (ii) To address this concern, the Department has now added a third option allowing lenders to provide their own form, so long as it meets certain conditions.
- (iii) See response to (ii), above, allowing lenders to use their own form.

Finally, the Department has provided necessary and appropriate flexibility for lenders, as stated above. A transition period is inappropriate and unnecessary since the rules have been published since May 2007, similar rules for mortgage brokers became effective

during September 2007, and statutory provisions requiring application of the Guidance (SB 385, Chapter 301, Statutes of 2007) become effective on January 1, 2008.

COMMENT 5: Commentor suggests modifying the advertising restrictions in subsection (e) so they provide for reasonable disclosure. More specifically, commentor recommends revising “representation” in subsection (e)(1) to provide that this provision addresses only “advertising.”

RESPONSE: To help address this comment, the Department has revised the rules to more closely tailor the advertising limitations to the Guidance, to specifically apply the provisions to advertising, and to require certain disclosures when applicable to the advertised product.

2. COMMENTOR: Letter dated September 5, 2007, from Melissa L. Richards with Buchalter Nemer, on behalf of the California Mortgage Bankers Association.

COMMENT 1: Commentor requests the Department to hold a public hearing in accordance with Government Code Section 11346.8 before any rulemaking regarding nontraditional mortgage products is made final. Commentor further requests that the comment period be extended an additional 30-days.

RESPONSE: The Department has complied with the public notice and comment periods provided by law, and will proceed to adopt the regulations without an extension. Since the rules have been published since May 2007, and there have been three opportunities to comment in writing, an extension is unnecessary.

COMMENT 2: Commentor requests the Department to address the comments and concerns raised in the California Mortgage Bankers Association comment letter dated June 29, 2007, submitted by Susan DeMars. (NOTE: Likewise, Commentor includes the prior June 29, 2007 comment letter verbatim on pages 3 through 11 of her letter.)

RESPONSE: The comment raises issues with the original text of regulations; thus, it is unnecessary to respond to this comment. Nevertheless, the Department provided ample responses to similar comments received during the 45-day public comment period, above. Commentor is referred to the preceding information in response to its first comment letter, for further explanations and justification.

COMMENT 3: Commentor has renewed concerns over the rules regarding advertising and disclosure. As for advertising, Commentor indicates the rule makes no reference to the Guidance and does not define “advertising.” In addition, the disclosure provisions do not refer to the Federal Reserve Board’s disclosures for nontraditional mortgage products and subprime mortgage products.

RESPONSE: The Department has revised subsection (d) to provide lenders with the flexibility to use their own form, provided it meets certain conditions; and to clarify that the advertising provisions apply to advertising, as specified. A definition of advertising is not provided by rule since existing statutes (referenced in the notes to the rule) already

clarify and define advertising. Thus, no further revisions are needed.

COMMENT 4: Commentor recommends that the Department analyze more recent regulatory developments, listed below, concerning nontraditional mortgage products and subprime lending prior to moving forward on this regulation. (NOTE: Commentor's letter includes a discussion of the various documents in pages 11 through 18 of her letter.)

- (i) The Conference of State Bank Supervisors, the American Association of Residential Mortgage Regulators, and the National Association of Consumer Credit Administrators joint statement on Subprime Mortgage Lending dated July 17, 2007.
- (ii) The federal Interagency Statement on Subprime Mortgage Lending issued June 29, 2007.
- (iii) AARMR and CSBS Model Examination Guidelines available on the CSBS website, www.csbs.org.
- (iv) Federal Financial Regulators proposed illustrations of consumer information to support the Statement on Subprime Mortgage Lending on August 14, 2007.

RESPONSE: The Department appreciates the materials and has analyzed them (as well as other information) in the process of proposing the final regulations, as requested by the commentor.

3. COMMENTOR: E-mail dated September 5, 2007, from David C. Knight on behalf of the California Financial Services Association.

COMMENT 1: Commentor recommends deleting Sections 1436(a) and 1950.314.8(a) from the regulations because codifying a generic "best practices" statement could subject regulated institutions to frivolous litigation and would establish a de facto standard for all institutions. Best practices, generally, are goals above and beyond legal requirements.

RESPONSE: This comment raises issues with the original text of regulations; thus, it is unnecessary to respond to this comment. Nevertheless, the Department provided ample responses to similar comments received during the 45-day public comment period, above. Commentor is referred to the preceding responses to the first comment letter, for further information and justification.

COMMENT 2: Commentor states that the loan disclosure form is confusing and the requirement is inconsistent with the Guidance for the following reasons:

- (i) A lender most likely will not have all of the consumer credit information to meet the required loan disclosure three day time period. The information the lender provides to the consumer will likely change and there could be instances where the consumer could receive inaccurate information.
- (ii) The Guidance requires a comparison of loan products; thus, the consumer would be receiving multiple disclosures relating to the same loan products which can lead to confusion. The Department's comparison chart must be generic as it is in the Guidance rather than customer-specific.

- (iii) The CSBS/AARMR and Federal Regulators published model disclosure forms are intended to provide guidance to lenders. The model disclosure forms are not a requirement for lenders. It is recommended that the Department allow the same flexibility in the proposed regulations and the form serve as a “safe harbor” form rather than the exact form required to be provided by the lender.
- (iv) The loan disclosure is confusing as appears to include products beyond those covered in the Guidance. Commentor suggests clarifying the instruction to read “...a nontraditional or adjustable rate loan subject to the Guidance proposed by the lender to” This recommended change would ensure that the comparison disclosure would only be completed for products covered by the Guidance.

RESPONSE: The Department notes these comments were adequately addressed in response to the initial comment letter during the 45-day comment period; however, it adds the following:

As to (i), (ii), and (iii), the Department has provided another option in subsection (d), by allowing lenders to use their own form, so long as certain conditions are met. This additional option will allow lenders the flexibility to tailor the form to loan products offered to the borrower. Although the rule only mandates disclosure one time to the borrower, nothing in the rule prohibits a lender from providing additional disclosures to the borrower. In some instances, re-disclosure may be needed to comply with other laws that are designed to prevent deceptive and fraudulent practices. Finally, it is noteworthy the Department revised the disclosure requirement to tailor them to products covered by the Guidance. For these reasons, the changes made by the Department adequately address the above concerns.

COMMENT 3: The proposed advertising disclosure requirements are confusing and cover products outside the scope of the Guidance. Commentor states that the advertising disclosures should be limited to ARM products subject to the Guidance rather than all ARM products. Commentor also makes the following recommendations to clarify the regulation:

- (i) Sections 1436(e)(1) and 1950.314.8(e)(1) should be amended to read: “Any ~~representation advertisement~~ of an installment in repayment of an adjustable rate, interest only or payment-option loan subject to the Guidance without an equally prominent disclosure of the following information about the loan, if applicable.” This section applies to advertisements and should avoid unnecessary confusion.
- (ii) In Sections 1436(e)(2) and 1950.314.8(e)(1), at the end of the sentence after “documentation” add “, **if applicable.**”

RESPONSE: As suggested, the Department has revised subsection (e) to tailor the provisions to loan products subject to the Guidance. In addition, the Department also agrees with the need to clarify subsection (e)(1); therefore, it has made necessary adjustments, to help satisfy the commentor’s concerns. However, it is unnecessary to add “as applicable” to subsection (e)(2) since the provision applies specifically to certain loan product advertisements.

COMMENT 4: Commentor opposes Sections 1436(b) and 1950.314.8(b) because they extend to products beyond the scope of the Guidance, and believes there are inconsistencies as follows:

(i) Sections 1436(b) and 1950.314.8(b) require written documentation regarding complaints and “workout arrangements.” Defining complaint in this section would be helpful for compliance with the requirement to retain complaints as part of the lenders’ books and records.

(ii) The Nontraditional Mortgage Loan Survey product categories are not in line with the products covered by the Guidance and should be reviewed and revised to provide accurate and relevant information to the Department.

RESPONSE: These comments raise issues with the original text of regulations; thus, it is unnecessary to respond to them. Nevertheless, the Department provided ample responses to similar comments received during the 45-day public comment period, above. Commentor is referred to the preceding information for further explanations and justification in response to the first comment letter. For reasons stated above, it is unnecessary to further define a complaint since its meaning is familiar to licensees, and the survey is intended to include other types of loan products, as further described above.

4. COMMENTOR: E-mail dated September 4, 2007, from Paul Leonard with Center for Responsible Lending.

COMMENT 1: Commentor suggests requiring lenders to provide borrowers, who have not mastered English, with a translated form of the disclosure in one of the five languages covered by Civil Code Section 1632.

RESPONSE: The issue of requiring disclosure of the form in multiple languages, under Civil Code Section 1632, would require an amendment to that code section. To address that issue this year, Assembly Bill 512 was considered but not passed by the Legislature. The Department will continue to work with interested stakeholders to determine whether a feasible option can be achieved during the 2008 legislative session. In the meantime, the Department plans to make its disclosure form available in multiple languages, consistent with the practice of DRE.

COMMENT 2: Commentor notes that, given the rise in delinquencies and foreclosures in non-traditional and subprime adjustable rate loans, the Department should collect data on all workout arrangements, not just those following consumer complaints.

RESPONSE: The Department is currently working with interested stakeholders to achieve the goals of the commentor, without the need for an additional regulation change at this time.

COMMENTS RECEIVED DURING THE SECOND 15-DAY COMMENT PERIOD

The Department received four public comment letters during the second 15-day

public comment period, which ended on October 26, 2007. (Note: The Department published a revised Notice October 10, 2007 to make nonsubstantive changes by modifying italicized or double underlining in the text of language.) Those comments are summarized below, together with the Department's responses.

1. COMMENTOR: E-mail and regular mail letter dated October 24, 2007, from Mary Jane Seebach with Countrywide Financial Corporation makes the following comments:

COMMENT 1: Commentor states the Department should adopt the CSBS Guidance as supervisory guidance, as thirty-six other states and the District of Columbia have done, and should not promulgate a new rule.

RESPONSE: This reiterates a previous comment made during the initial 45-day public comment period. In addition to the Department's previous explanation of necessity above, the rule is needed to clarify the application of SB 385 (Chapter 301, Statutes of 2007.)

COMMENT 2: Commentor states that Sections 1436(a) and 1950.314.8(a) are vague and do not provide more detailed direction regarding how the licensee is to implement the Guidance.

RESPONSE: The Department disagrees. Subsection (a) clarifies and makes specific the lender's responsibility to implement best practices, and defines "best practices." Thus, no further revisions are needed.

COMMENT 3: Commentor states that the rules should provide explicit definitions and standards for the implementation of "best practices."

RESPONSE: The Department disagrees. Again, subsection (a) allows the lender to adopt best practices, as specified, and provides a definition of best practices. No further definition or standards are needed.

COMMENT 4: Commentor states that Sections 1436(b) and 1950.314.8(b) fail to define the terms "consumer complaints" and "workout arrangements" used for "resolved complaints."

RESPONSE: The Department disagrees. A definition of workout arrangement is provided by the rule. The terms "consumer complaint" and "resolved complaints" are subject to a common industry understanding as complaints are addressed by industry through complaint-resolution policies or procedures.

COMMENT 5: Commentor notes that Sections 1436(b) and 1950.314.8(b) contradict the Department's Initial Statement of Reasons by expanding the reporting requirements beyond the Guidance. Commentor recommends that the Department clearly state that loans not subject to the Guidance need not be included in the report.

RESPONSE: The Department disagrees. The reporting form is intended to include

other types of loans (HELOCs and covered loans), for the reasons explained by the Department above. This form codifies a survey provided during March 2007, as explained in the Initial Statement of Reasons.

COMMENT 6: Commentor states that Sections 1436(d) and 1950.314.8(d) fail to define the term “completed application” and recommends that the Department should define this term.

RESPONSE: As previously stated, the Department believes a “completed application” is readily understood as a familiar term in the mortgage loan industry; therefore, no further definition is needed.

COMMENT 7: Commentor notes that the disclosure requirements still create confusion. Commentor recommends that the Department (1) reference only one disclosure form, (2) limit the disclosure to only those nontraditional and subprime loans specifically defined in the Guidance, (3) provide that the disclosures need not be loan or borrower-specific, and (4) declare that completion and delivery of the form would be sufficient to satisfy the disclosure requirement.

RESPONSE: In response, the Department has revised the disclosure provisions by allowing the lender to provide one of the forms, and to tailor these disclosure provisions to the Guidance. The form is intended to provide information that is relevant to the borrower based on specific information, such as the proposed loan amount. It is unnecessary to provide that completion and delivery satisfies the loan provisions, as the rule already obligates the lender to perform these disclosure activities.

COMMENT 8: Commentor raises concerns regarding the advertising requirements in Sections 1436(e) and 1950.314.8(e) and recommends the Department incorporate by reference the definition of “advertisement” used in federal Regulation Z.

RESPONSE: The Department disagrees with the comment because the rules implement existing state law, and are not intended to reflect federal law. In addition, state law defines and clarifies advertising, so no further revisions are needed.

COMMENT 9: Commentor recommends that the Department allocate its examination and enforcement resources to avoid duplicating examinations by endorsing a collaborative federal and state approach that would create a level playing field in which all creditors, whether state or federally regulated, would have to meet the same standards and obligations.

RESPONSE: The Department notes that the comments reiterate commentor’s original comments made during the initial 45-day comment period. Thus, we refer the commentor to previous responses to its 45-day comments.

2. COMMENTOR: E-mail and regular mail letter dated October 25, 2007, from Leland Chan with California Bankers Association.

COMMENT 1: Commentor recommends issuing the Guidance as guidelines rather

than regulations in the same manner that the federal banking agencies did for depository financial institutions.

RESPONSE: This comment reiterates comments and responses made during the previous comment period. Thus, commentor is directed to the Department's previous response to commentor's first comment letter, for further explanations. The rules are intended to require best practices, as specified.

COMMENT 2: Commentor notes that the Guidance does not cover all adjustable rate mortgages (ARMs), but only those that allow for the deferral of interest or principal, or have indicators of being subprime. Commentor suggests clarifying that fully-amortized ARM loans, for example, would not be covered since they are much less likely to pose a risk of "payment shock."

RESPONSE: In response, the Department has tailored the rule to ARMs covered by the Statement on Subprime Mortgage Lending.

COMMENT 3: Commentor states the definition of workout arrangements as proposed is not clear. Commentor recommends that the Department remove any reference to workout arrangements.

RESPONSE: The Department disagrees. The definition of workout arrangements provides sufficient flexibility to lenders, consistent with the Guidance.

COMMENT 4: Commentor states that the Nontraditional Mortgage Loan Survey contains items that are not necessarily covered by the Guidance. Commentor recommends tailoring the survey only to loans covered by the Guidance.

RESPONSE: The Department disagrees and, for reasons stated in its initial response above, has maintained other types of loans (HELOCs and covered loans) to help assess each lender's portfolio of risk.

COMMENT 5: Commentor continues to have concerns regarding the mandatory comparison disclosure form tailored to the applicant. Commentor recommends allowing lenders to use a form that includes representative, non-tailored, loan programs that illustrate payments and loan programs generally. Commentor further recommends that the Department allow lenders a six-month grace period to comply with any newly adopted forms.

RESPONSE: In response, the Department has revised the disclosure provisions to tailor them to products covered by the Guidance, and to allow lenders to use their own form subject to certain conditions. A six-month grace period is unnecessary and inappropriate given the length of publication of this rule since, May 2007, and the January 1, 2008 effective date of SB 385 (Chapter 301, Statutes of 2007), as discussed above.

COMMENT 6: Commentor recommends incorporating by reference the advertisement requirements under the federal Truth in Lending Act and Regulation Z of the

Federal Reserve Board.

RESPONSE: The Department disagrees, since the rule is intended to implement state law. State law defines and clarifies advertising, so no further revision is needed.

3. COMMENTOR: E-mail letter dated October 26, 2007, from David C. Knight with California Financial Services Association.

COMMENT 1: Commentor objects to the loan disclosure comparison form requiring customer-specific information.

RESPONSE: The comment raises concerns addressed during the initial 45-day period. Thus, the Department's previous response provides an explanation. In addition, the Department has revised the rule to allow lenders the flexibility to use their own form, under specified conditions. However, the form is intended to reflect customer-specific information so the disclosure is relevant to the borrower, and so the form can better assist the borrower to make informed decisions, as stated above.

COMMENT 2: Customer-specific information creates concerns with the issue of redisclosure because loan terms may change after the three-day notice requirement.

RESPONSE: The comment raises concerns addressed during the initial 45-day period. Thus, the commentor can consider the Department's previous response. In addition, the Department has revised the rule to allow lenders the flexibility to use their own form, as specified. Although the rule mandates disclosure one time to the borrower, nothing in the rule prohibits a lender from re-disclosing (at its own option) to comply with other provisions of law that are intended to protect against fraudulent or deceptive acts. Moreover, lenders may also consider other appropriate disclosures on their own forms, to help address any misunderstanding with borrowers.

COMMENT 3: Commentor recommends that the proposed regulations become effective 120 days following promulgation.

RESPONSE: The Department disagrees with a 120-day transition period, for reasons stated in previous responses to comments, above. The rules have been published since May 2007, and are needed to clarify the application of legislation that becomes effective on January 1, 2008.

4. COMMENTOR: Letter dated October 26, 2007, from Melissa L. Richards with Buchalter Nemer on behalf of the California Mortgage Bankers Association.

COMMENT 1: Commentor states it is unclear as to the purpose and intent for imposing education requirements in Sections 1436(b) and 1950.314.8(b).

RESPONSE: This requirement is consistent with the Guidance referenced in the rule. Thus, no change is needed.

COMMENT 2: Commentor reiterates concerns requiring completing the Nontraditional Mortgage Loan Survey (published 5/1/07) which is inconsistent with the Guidance as noted in its July 5, 2007 comment letter.

RESPONSE: This comment reiterates the commentor's previous comments; thus, commentor may review the Department's previous responses, above, for further explanations in response to this comment.

COMMENT 3: Commentor reiterates concerns requiring early disclosure as noted in its July 5, 2007 comment letter. Commentor states a loan-specific disclosure is unduly burdensome from an operations and compliance standpoint. Furthermore, early disclosure is not simplistic or meaningful enough that a consumer would want to read or see value in it. Commentor recommends the federal initiatives replace the third option for disclosure.

RESPONSE: This comment raises the same concerns raised previously by the commentor. The commentor is referred to the Department's previous response to this comment. As stated above, the disclosure form is intended to reflect customer-specific information such as loan amount, monthly payments and loan balance scenarios. This information will enable borrowers to make informed choices as early as possible in the loan process.

COMMENT 4: Commentor states the advertising requirements run afoul of Fair Credit Reporting Act and suggests the Department defer to the Federal Reserve Board efforts to formulate a new Truth In Lending Act/Regulation Z.

RESPONSE: The Department disagrees and is unaware of any conflict with federal law. Nor does commentor specify any conflict. Thus, no further changes will be made.

COMMENT 5: Commentor requests extending the effective date to implement rules.

RESPONSE: As stated in previous responses above, it is unnecessary to extend the effective date given that rules have been published since May 2007 and the effective date of SB 385 (Chapter 301, Statutes of 2007) is January 1, 2008. These rules are needed to clarify and make specific that legislation. It is also noteworthy that similar disclosure and advertising rules for mortgage brokers operating under the Real Estate Law have been in effect since September 2007.

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