MARY JANE M. SEEBACH
MANAGING DIRECTOR
PUBLIC AFFAIRS

Countrywide®

4500 PARK GRANADA
MS CH-11B
CALABASAS, CA 91302
(818) 225-3361
(818) 225-4055 FAX

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Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street NW
Washington, D.C. 20552
Regs.comments@ots.treas.gov

Re: Proposed Statement on Subprime Mortgage Lending, Docket No. 2007-09

Dear Sir/Madam:

Countrywide Financial Corporation, on behalf of its subsidiaries Countrywide Home Loans, Inc. and Countrywide Bank, FSB ("Countrywide"), is pleased to offer comments on the federal banking agencies' (the "Agencies") proposed Statement on Subprime Mortgage Lending ("Proposed Statement"). Countrywide is predominantly a prime lender that is able to offer our customers both prime and subprime loans. In the subprime arena, one of our focuses is on helping borrowers transition from subprime to prime and our experience to date is that the hybrid ARM product has enabled many borrowers to make such a transition. Many subprime borrowers had "prime" credit in the past but due to events often out of their control (e.g., medical issues, loss of job, etc.), they are seeking credit that will help them address their current problems and help them improve their credit. In many cases, only the availability of the hybrid ARM product has successfully enabled these borrowers to get back on their feet.

We completely agree that the consideration of mitigating factors in underwriting loans is beneficial to borrowers and is consistent with safe and sound lending practices, and therefore we support most of the guidance contained in the Proposed Statement. The market has already imposed such discipline by sharply curtailing the expanded underwriting guidelines that created the current instability in the subprime market (e.g., loans with loan to value ratios above 90% combined with stated income documentation). The market once again realizes that it is reasonable to expect a down payment from borrowers who have not proven their ability to manage their credit.

Until a few years ago, however, the majority of our subprime borrowers had loan to value ("LTV") ratios of 85% or lower. As very few subprime credit borrowers with little or no cash for the down payment were buying homes prior to 2002, the majority of subprime lending was to formerly prime borrowers with equity in their homes who were going through a difficult period. The hybrid ARM product has been a very useful tool in assisting these borrowers to rectify their financial challenges by getting the cash they need to pay off their debt, lower their overall monthly payments and improve their credit. We believe strongly that the final guidance must preserve access to credit for subprime borrowers who want to improve their credit, as well as those most in need of assistance in preserving their homes in today's market.

Limited applicability
As we noted in our response to the Nontraditional Guidance proposal, issuing guidance applicable only to federally regulated institutions creates a dual market for certain mortgage products: one governed by the detailed risk management, underwriting and consumer disclosure standards of the Agencies, and the other driven by the dictates of the secondary mortgage market. This dual market will inhibit product innovation and flexibility in the federally regulated sector, as these institutions become constrained by prescriptive, product-related guidance while the non-regulated sector will be able to respond more quickly to market risks and opportunities. We recognize the efforts of the Conference of State Banking Commissioners to encourage states to adopt the Nontraditional Guidance, and we assume they will do likewise with the Agencies' final guidance. To date, 31 states and the District of Columbia have adopted the Nontraditional Guidance but it is still unclear how their adoption is impacting non-federally regulated institutions. Until all lenders are required to comply with the same requirements for these products, there will be inequity in the market and potentially negative consequences for consumers.

Our comments on the Proposed Statement are divided into two parts: general comments on the requirements of the proposed guidance and specific responses to the questions posed by the Agencies.

I. General Comments

Underwriting Standards

Fully indexed rate
The Proposed Statement articulates an underwriting standard intended to "recognize the potential effect of payment shock in evaluating a borrower's ability to service debt." We agree with the Agencies that prudent underwriting requires that lenders assess a borrower's ability to repay the total monthly housing-related payments (including amounts for taxes and insurance) and we agree that lenders should properly balance underwriting factors with appropriate mitigating factors that support the underwriting decision and the borrower's repayment capacity. We also know, however, that qualifying borrowers at reduced payment levels has allowed a large percentage of our subprime hybrid ARM customers to transition to prime loans. We note that between 2000 and 2005, for our customers that refinanced their subprime hybrid ARM loans with Countrywide, almost 50% received a prime loan. Almost 60% received a fixed rate loan – either prime or subprime. For these reasons, as Countrywide has taken steps over the

past few months to tighten our underwriting guidelines, we have focused on mitigating risk without eliminating beneficial product features and we urge the Agencies to take a similar approach.

As we noted above, the increase in LTV ratios above 90% combined with the increased reliance on stated income documentation, especially with first time homebuyers, is where we have seen problems with the performance of this product. The market has now effectively limited the availability of the subprime hybrid ARM product at higher LTV ratios, especially when combined with reduced documentation. We fully agree that requiring lenders to qualify borrowers at the fully indexed rate is appropriate when the LTV ratio exceeds 90%. Further, if the borrower is relying on stated income documentation, we believe qualifying borrowers at the fully indexed rate is appropriate if the LTV ratio exceeds 85%.

The ability to access the hybrid ARM product should not be eliminated, however, as it is a useful tool for those borrowers with equity in their homes who want a product as an interim solution that will help them improve their current financial situation. We urge the agencies to provide that lenders can qualify borrowers at the start rate when the LTV ratio is less than 90% and when the borrower is relying on full loan documentation. This allows borrowers the benefit of lower monthly payments than they would have with a fixed rate loan for a period of time that may be sufficient to rectify their current financial challenges. If borrowers make their mortgage payments on time (and stay current on all other debt) during the two or three year fixed rate period, they will most likely be able to qualify for a prime loan prior to the reset. Borrowers should have a product available that will allow them to upgrade from subprime to prime status.

Finally, even with our suggested modifications to the requirement, we remain concerned that rigidly imposing this underwriting requirement on higher LTV ratio subprime ARM loans will worsen conditions in the housing market and may put some borrowers who are seeking to refinance subprime loans at greater risk of losing their homes. We strongly encourage the Agencies to allow lenders to apply flexibility for existing subprime hybrid ARM borrowers who may have been adversely impacted by declines in market values and cannot qualify at the fully indexed rate and cannot qualify for a comparable fixed rate loan provided lenders have otherwise mitigated risk.

We encourage the Agencies to be clear in articulating the limits of the requirement to underwrite at the fully indexed rate. The Proposed Statement implies that the guidance would apply to subprime ARM products "offering low initial payments based on a fixed introductory or "teaser" rate that expires after a short initial period then adjusts to a variable index rate plus a margin for the remaining term of the loan." We agree with the Agencies that the timing and likelihood of potential payment increases plays a major role in the degree of additional risk inherent in an ARM product and underwriting should not ignore this fact. As many aspects of the economy, real estate market, and a borrower's financial life change -- especially over longer time periods -- assessing the impact of potential payment increases one year after origination should be treated differently than payment changes taking place 3 to 5 years out. Assessing risk and the ability to pay based on payments long in the future is inconsistent with previous strides made by the industry to improve affordability while maintaining sound risk management principles. Specifically, the industry convention is to assess income and other debt levels generally three years out, but no further.[1] We urge the regulators to clarify that the requirement to underwrite at the fully indexed rate applies to products that do not have fixed periods equal to or greater than three years.

Finally, the Agencies should clearly articulate the definition of "fully indexed rate" in the final guidance. We have interpreted it consistent with the definition set out in the 2006 Interagency Guidance on Nontraditional Mortgage Products or as "the index rate prevailing at origination plus the margin that will apply after the expiration of an introductory interest rate."[2] A clear statement of the definition will avoid uncertainty and eliminate other possible interpretations. For example, some would insert the word "maximum" in the phrase so as to always compel underwriting at the lifetime cap. Such a standard would have a tremendously negative impact on the availability of credit, and is unnecessary to properly mitigate risk.

Qualifying based on total monthly housing-related payments

Countrywide agrees that lenders should assess a borrower's total monthly housing-related payments (e.g., principal, interest, taxes, and insurance, or "PITI") as a percentage of gross monthly income. We have long maintained this practice and believe it to be a long time industry practice.

Reduced documentation

Countrywide believes that reduced documentation can play an especially valuable role for those borrowers that have difficulty documenting all of their income and/or those for whom the W-2 does not adequately reflect their full earnings and therefore their ability to repay the loan. Rather than propose an outright ban, as some have recommended, the

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[1] For example:

- Alimony and Child Support income is included as income if it can be expected for at least three years. However, nearly all such income is far from indefinite.
- Community Seconds programs with delayed payment provisions are not included in debt-to-income ("DTI") calculations if the payment delay is equal to or greater than three years. Thus, when the payment provisions begin, there is a payment increase that is unaccounted for.
- Student loan debt delayed for more than 1 year is not included in DTI calculations.
- Income from government assistance programs can be counted as long as the income is expected to continue for only three years
- Recognition of income from boarders who may be living in the borrower's home; and income from Medicaid Waiver Funds (which are available to borrowers with disabilities and live-in medical assistants), are available without any assessment or guarantee about the duration of such arrangements
- FHA and VA 1 yr ARMs calculate DTI at the initial rate (initial rate + 1 if the LTV >95) and not the fully indexed rate.
- Borrowers nearing retirement age are assessed based on their current income, not post-retirement income. Certainly there are many borrowers who will retire in 3-20 years that will not maintain their current income level in retirement and thus will experience a DTI increase.

[2] The example in Footnote 10 of the Proposed Statement uses this methodology for computing the fully indexed rate and suggests that this more complete articulation from the Nontraditional Mortgage Guidance is what the agencies intended.

Proposed Statement appropriately places the burden on the lender to "demonstrate the existence of effective mitigating factors that support the underwriting decision and the borrower's repayment capacity." When present, one or more of these factors, like cash reserves, larger down payments, higher credit scores and a credit history which evidences the borrower's historical ability to support similar debt service, allow lenders to meet customer needs without eliminating lending opportunities entirely or increasing their costs so as to effectively deny credit to creditworthy borrowers. Countrywide supports the balanced approach taken by the Agencies regarding reduced documentation and other forms of risk layering, and would oppose efforts to impose an overly broad ban on the use of reduced documentation features.

Consumer Protection Principles

Consumer disclosures

As noted above, the issuance of guidance applicable only to federally regulated institutions creates a dual market. This is particularly problematic from a consumer protection standpoint as only mortgage applicants of regulated institutions and their affiliates will benefit from the enhanced disclosures anticipated by the Proposed Statement. Disclosures between the two markets would not be comparable, making it difficult for consumers to shop.

We again urge the Agencies to maximize the effect of consumer protection disclosures and other measures by making them available to all borrowers and not merely those borrowers who, by happenstance, are dealing with a lender regulated by one of the Agencies. To ensure one set of disclosure and consumer protection standards, the Board of Governors of the Federal Reserve System should amend Regulation Z and make the requirements applicable to all mortgage lenders.

Countrywide believes that in addition to the disclosures outlined in the Proposed Statement, the Agencies should encourage lenders to make available to borrowers multiple product options for which they can qualify. Specifically, the guidance should require that all subprime borrowers that qualify for a fixed rate loan should be offered that option. We also believe that the guidance should encourage lenders to provide comparison disclosures to borrowers with the amount of a payment for a loan with a prepayment penalty and one without so that borrowers can determine for themselves whether the savings is sufficient to undertake the obligation.

The Agencies have proposed requiring a disclosure of whether there is a pricing premium attached to a reduced documentation or stated income program. Countrywide fully agrees with the importance of making this disclosure.

Mandatory escrows

The Proposed Statement encourages lenders to warn borrowers about the substantial costs of taxes and insurance payments if such amounts are not escrowed by the lender. Footnote 11 provides that "[I]nstitutions generally can address these concerns most directly by requiring borrowers to escrow funds for real estate taxes and insurance."

While we strongly support the use of escrow accounts, we note that mandatory escrow accounts are not currently permissible in all states.

Prepayment penalties

The Proposed Statement strongly encourages institutions that impose prepayment penalties to structure them in such a way that they do not extend beyond the initial reset period and to provide borrowers a sufficient window of time immediately prior to the reset date to refinance without penalty. Countrywide has for some time limited the prepayment penalty period on its subprime hybrid 2/28 and 3/27 ARMs to no longer than the initial reset period. Even with this short period, we are able to offer borrowers rate savings by accepting a prepayment penalty. This would be more problematic for products with fixed periods that are shorter than two years. Such products are not prevalent in today's subprime market but remain fairly commonplace in the prime market. The significant impact on the availability of such prime products should be a major consideration for the Agencies in deciding whether to extend the guidance beyond subprime products.

Countrywide also supports allowing borrowers to refinance without penalty for a limited period of time, thirty days for example, prior to the reset. Obviously, the longer the window period, the more of a negative impact there will be on savings from taking the prepayment penalty. This change must be prospective as it will require a change to pooling and servicing agreements which currently provide for a prepayment penalty to be assessed in the event of a prepayment at any time during the prepayment period and for the amount of any penalty to be passed on to investors. These provisions do not currently provide for any exceptions.

II. Responses to the Agencies' Specific Questions

1. The proposed qualification standards are likely to result in fewer borrowers qualifying for the type of subprime loans addressed in this Statement, with no guarantee that such borrowers will qualify for alternative loans in the same amount. Do such loans always present inappropriate risks to lenders or borrowers that should be discouraged or alternatively, when and under what circumstances are they appropriate?

In reviewing our own production, we know that fewer subprime borrowers will be able to qualify for loans under the proposed standard. Specifically looking at originations in the fourth quarter of 2006, we know that almost 60% of the borrowers who obtained subprime hybrid ARMs would not have qualified at the fully indexed rate. While it is likely that many of these borrowers would have qualified for other products, we know that almost 25% of the borrowers would not have qualified for any other product. This means that many first time homeowners would be precluded from home ownership and existing homeowners prohibited from improving their financial status. On the other hand, if hybrid ARMs continue to be a viable option, they will be able to remain in their homes and, if they make their mortgage and other payments on time, have the opportunity to move up into a prime or fixed rate product.

Generally, we do not believe that the all subprime hybrid ARM product underwritten at the start rate present inappropriate risks to lenders and borrowers. As we noted above and as the market has already addressed, the loans which have presented inappropriate risks such as those with higher LTV ratios and reduced documentation have been curtailed or eliminated. Our overall experience with the subprime hybrid ARM product demonstrates that these loans, in many instances, are appropriate to enable families with blemished credit to become homeowners and to help borrowers transition from subprime to prime credit or to fixed rate loans. For example:

- **Borrowers who need or want the opportunity to own while they rehabilitate their credit** -- A loan that has a shorter initial fixed rate period gives such borrowers time to build a solid payment history, repair their credit, and secure a prime or even a subprime fixed rate loan that was out of reach at the time of their initial application. As discussed above, our experience demonstrates that many subprime borrowers successfully use this product for that very purpose.

- **Borrowers who need affordability features that hybrid ARMs offer --** The hybrid ARM product involves a better matching of loan duration with actual borrower repayment experience. Thus the mortgage industry can offer borrowers who may not be able to afford a more conventional loan product a purchase money product like the hybrid ARM with a lower initial rate than a 30-year fixed rate loan. The current market challenges, including the tightening of underwriting guidelines and the leveling or decline of housing prices in some areas have exacerbated affordability issues for many prospective homebuyers. Though sometimes forgotten, this important category of borrowers includes both first-time homebuyers and those who wish to or need to move to different homes for a variety of reasons (e.g., size, or different job or educational opportunities). For Countrywide, the percentage of people using subprime loans to purchase homes almost doubled from 20% in 2002 to 38% in 2006. These people are better off enjoying the benefits of homeownership than they would have been as renters.

- **Existing subprime hybrid ARM borrowers who do not qualify to refinance through any prime product or a subprime non-hybrid ARM product** —As discussed earlier in the letter, if the Agency guidance is adopted, we strongly believe that lenders must be allowed to make exceptions that will allow borrowers to be qualified under strengthened but still flexible underwriting standards. If this product is eliminated altogether, many borrowers will be left with no alternative and the foreclosure problem will be needlessly exacerbated.

2. Will the proposed Statement unduly restrict the ability of existing subprime borrowers to refinance their loans and avoid payment shock? The Agencies also are specifically interested in the availability of mortgage products that would not present the risk of payment shock.

As we noted in our response to the first question, the guidance in the proposed Statement will restrict the ability of existing subprime borrowers to refinance their loans. The 23% of borrowers that would not qualify for another product are specifically borrowers that would not qualify even for our 40-year fixed rate product. Countrywide and other lenders are examining use of even longer amortization schedules as a way to preserve elements of affordability and eliminate the borrower's interest rate risk and exposure to payment adjustments. However, such alternatives will not be immediately available for existing subprime hybrid ARM borrowers and we encourage the agencies to be wary of any actions that would eliminate the subprime hybrid ARM as a refinancing option under all circumstances.

3. Should the principles of this proposed Statement be applied beyond the subprime ARM market?

Countrywide opposes a more expansive application of the Proposed Statement to areas of the mortgage market other than subprime hybrid ARMs. Aside from the fact that significant additional analysis of the potential effects would be required, simply extrapolating from the subprime ARM market to other parts of the mortgage market and applying prescriptions from one set of circumstances to another is not only unwarranted but we strongly believe to be potentially quite harmful.

4. We seek comment on the practice of institutions that limit prepayment penalties to the initial fixed rate period. Additionally, we seek comment on how this practice, if adopted, would assist consumers and impact institutions, by providing borrowers with a timely opportunity to determine the appropriate actions relating to their mortgages. We also seek comment on whether an institutions' limiting of the expiration of prepayment penalties such that they occur within the final 90 days of the fixed period is a practice that would help borrower needs.

As noted above, Countrywide already matches the length of prepayment penalty periods with the length of the fixed rate period for our subprime hybrid 2/28 and 3/27 ARM products. As noted above, we believe limiting the expiration of prepayment penalties to thirty days prior to the payment reset would be appropriate and beneficial to borrowers so long as they have sufficient and timely information on the upcoming payment change at least ninety days before the payment change. As a practical matter, if borrowers apply for a refinance after receipt of the notice, the closing can be scheduled so that it occurs during the thirty day period before the reset. For this reason, we do not believe it is necessary to stipulate that the prepayment penalty expire earlier than thirty days prior to the reset.

We currently comply with the notice requirements of Regulation Z (12 CFR 20(c)) to advise of an upcoming payment change. Countrywide will soon provide our borrowers even earlier notice to ensure they have time to determine whether action on their part is appropriate based on their individual circumstances. We plan on providing a notice ninety days before the payment change to alert borrowers to the upcoming payment change and give them more time to decide on a course of action.

We believe this multiple notice approach will help us prepare our borrowers for the change. We believe Regulation Z should be amended to standardize such an approach across the industry. If the final guidance requires the use of a "prepayment penalty free window" in advance of a payment reset, we believe an amendment to Regulation Z is needed to require the timing of the payment adjustment notice that will make it most useful for borrowers.

We thank the Agencies for considering our comments and we would be pleased to discuss them in greater detail if you desire. If you have any questions, please feel free to contact me.

Sincerely,

Mary Jane M. Seebach

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