American Financial Services Association

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May 7, 2007

By Electronic Mail

Office of the Comptroller of the Currency
250 E Street, SW
Public Information Room
Mail Stop 1–5
Washington, DC 20219
Attention: Docket Number OCC–2007–0005
regs.comments@occ.treas.gov

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attention: No. 2007–09
regs.comments@ots.treas.gov

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Attention: Docket No. OP–1278
regs.comments@federalreserve.gov

Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314–3428
regcomments@ncua.gov

Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
comments@fdic.gov

Re: Proposed Statement on Subprime Mortgage Lending, 72 Fed. Reg. 10533 (March 8, 2007)

Ladies and Gentlemen:

The American Financial Services Association ("AFSA") hereby submits this comment letter regarding the proposed Statement on Subprime Mortgage Lending issued for public comment on March 8, 2007, by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, the National Credit Union Administration, and the Office of the Comptroller of the Currency (collectively, the "Agencies").

AFSA, founded in 1916, is the trade association for a wide variety of consumer finance companies. AFSA's mission is to protect and improve the consumer credit business, maintain a positive public image, and create a legislative climate in which reasonable credit regulation can and will be enacted. AFSA operates in the public interest, encourages and maintains ethical business practices, and supports financial education for consumers of all ages.

INTRODUCTION

For the past several years, lenders have focused increased attention to serving the subprime market. This previously underserved market is estimated to represent 25 percent of American homeowners. With the advent of risk-based pricing, access to mortgage credit was extended to millions of Americans with less-than-perfect or non-existent credit histories, first-time homebuyers and those with little cash or no cash to invest. Long-standing barriers to homeownership were eliminated; literally opening a door to millions of deserving people.

In addition to first-time homeowners, millions of other subprime borrowers elected to refinance and take advantage of the positive equity in their existing homes. The reinvestment of this equity was one of the primary drivers of the overall economy during the first half of this decade.

AFSA firmly believes that strict implementation of the Proposed Statement on Subprime Mortgage Lending could adversely impact hundreds of thousands of credit-worthy subprime borrowers, preventing them from buying a home or refinancing before reset. Striking a balance between sensible regulation and continued access to credit should be the goal of government, industry and consumers.

To this end, AFSA believes that underwriting should be dependent on the borrower’s ability to repay and that future regulatory action, such as the proposed federal subprime statement, should be based upon this central axiom. Further, it is extremely important for any regulatory action that establishes mortgage lending standards and practices to be consistent, uniform and national in scope and purpose.

Lastly, AFSA firmly believes that financial literacy is this country’s greatest weapon in preventing mortgage delinquency and foreclosure. AFSA Foundation’s MoneySKILL Program and the Jump$tart Coalition are examples of successful financial education initiatives directed toward young adults. Industry, consumers and government *must* continue to work together to bring financial literacy to all Americans.

SUBPRIME LENDING’S HISTORY OF INCREASING HOMEOWNERSHIP

Subprime loans are typically made to consumers who pose a higher credit risk. Consumers receive significant benefits due to the availability of subprime credit.

Subprime credit has increased the number of homeowners and allowed many consumers to repair their credit, thereby qualifying them for prime loans. These practices, which have led to record numbers of homeowners, should be applauded, not limited.

Prior to the 1990s, the vast majority of lenders would make only prime loans. Moreover, there were only limited mortgage products available to consumers. With improvements in technology, underwriting tools became more sophisticated and lenders were able to offer a wider selection of products that were better tailored to borrowers' varying circumstances. In the fourth quarter of 2006, the U.S. Census Bureau reported that U.S. homeownership was at a near-record level of 68.9%, up from 65.4% from the same quarter in 1996. Approximately 9.7 million more people own homes today than did in 1996. This time period roughly correlates with the development of the secondary market for subprime mortgages and consequent expansion of the availability of subprime mortgages.

GENERAL COMMENTS

AFSA commends the Agencies in their endeavor to provide greater clarity for consumers attempting to better understand the mortgage process so that they can choose the best product that meets their individual financial circumstances. AFSA believes that the decision to issue this statement on an interagency basis will lead to greater uniformity and minimize confusion. In addition, the decision to issue these principles in a statement format allows the greatest amount of flexibility for the Agencies to work with industry and other interested parties in addressing consumer protections without eviscerating access to credit.

AFSA encourages the agencies to incorporate into the Statement an express recognition that compliance with the Statement, or any particular aspect of the Statement, may be waived by an agency on a case-by-case basis with respect to a depository institution that it supervises. This would give the agencies clear authority to apply the Statement as they determine to be appropriate as lending practices evolve over time. Further, it would promote communications between depository institutions and the agencies with respect to possible lending practices that may be safe and sound, and beneficial to consumers, but that vary in any respect from the Statement.

As to the specific aspects of the proposed statement, AFSA agrees with the Agencies responsible lending considerations: (1) a mortgage loan should be based on a borrower's ability to repay rather than on the foreclosure value of the property; (2) consumers should not be induced to repeatedly refinance a loan; and (3) lenders must not engage in fraud or deception to conceal the true nature of the mortgage loan obligation.

AFSA and its members believe that underwriting standards should evaluate the borrower's ability to service the debt. However, we believe that a blanket requirement for all loans being underwritten at the long-term rate or assuming fully-amortized payments, regardless of the period to which the initial rate applies does not provide the flexibility that is needed to meet the individual financial needs of many deserving consumers.

AFSA concurs with the Agencies’ assessment that risk layering calls for more conservative underwriting. We also agree that the added risk that may be created by risk-layering features should be balanced by features that mitigate risk such as better debt-to-income and loan-to-value ratios. It is already the practice of many responsible lenders to weigh such factors.

AFSA also believes that agencies must exercise caution in setting forth the "ability to repay" standard, as unanticipated legal risk can arise by virtue of how such standard is articulated in any final issuance. In particular, we point out that the proposal lists "ability to repay" as an element to be considered in the "Consumer Protection" section of the statement. This unfortunate placement appears to be an oversight, and we ask that this be fixed.

The elements comprising "ability to repay" are fully discussed in the existing "Underwriting Standards" portion of the statement, which is where such discussion belongs. As written, however, the statement gives room to confusion by re-listing this element under the "Consumer Protection" section of the issuance. In substance, this latter section deals exclusively with marketing and proper disclosure of mortgage products; the inclusion of "ability to repay" appears wholly misplaced here.

In summary, we caution that, if allowed to stand, this oversight will lead to confusion, and could result in raising "ability to repay" as a stand-alone consumer "right" whose remedies and liabilities are completely undefined in either statute or regulation. Without a doubt, the lender's determination that a borrower has an ability to repay can result in a consumer benefit, but such a standard exists primarily as a credit underwriting standard.

ANSWERS TO 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?*

The products addressed in the Statement have a long and successful track record, beyond the current rate environment, that has made them attractive for some borrowers. The products addressed in the Statement are appropriate for borrowers in a number of circumstances including, but not limited to: (1) borrowers who expect an increase in income, such as professionals entering their field; (2) borrowers who reasonably expect a significant decrease in expenses; (3) borrowers who reasonably expect to sell their homes before the fixed rate expires. Additionally, borrowers have used hybrid adjustable rate mortgage ("ARM") products as an important cash flow management tool.

Moreover, subprime credit helps consumers to repair their credit scores and overcome financial setbacks. The main financial difficulties experienced by consumers are the same as they were before the wide availability of subprime credit. These difficulties include: job loss, divorce, and major health care expenses. In the past, these events made many consumers ineligible for credit. One national lender recently testified to Congress that 80% of its borrowers who obtained a hybrid ARM between 2000 and 2006 refinanced within 36 months of origination. Of those borrowers who refinanced with that lender, 50% refinanced into a prime loan and 25% refinanced into a subprime fixed-rate loan. The borrowers who refinanced into a prime loan had improved their FICO scores by an average of almost 50 points and benefited from lower interest rates on their new loans.

Additionally, despite increased foreclosures, 93% of subprime borrowers have never had a serious delinquency and have been utilizing these products for their personal benefit, even in the current environment. As the Agencies have noted, the standards proposed in the Statement will eliminate these important products as a financial option for many borrowers who successfully utilized them both at their introductory rate and in the long term.

Furthermore, any limitations or restrictions the Agencies' impose on subprime lending products should not apply to "jumbo" loans. Borrowers who obtain "jumbo" loans possess higher incomes and tend to have a greater degree of financial sophistication—and consequently are less in need of protection—than other consumers. This is been recognized by many states and is reflected in the express exclusion for jumbo loans from the provisions of many state high cost loan laws.

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.*

It is currently the practice of many AFSA members, as well as many other lenders, to reach out to borrowers before the date the loan is scheduled to reset, in an effort to minimize payment shock wherever possible. In fact, many lenders call all borrowers several months before a scheduled reset if the reset is likely to result in a significantly increased payment, to determine if the borrower is likely to be able to handle the payment. Lenders are in a position to offer either temporary forbearance or repayment plans – where the borrower will eventually catch up on the payment – or permanent loan modification, in which the legal terms of the loan are permanently changed. It is imperative that the Agencies recognize the lenders' need for flexibility in helping their borrowers avoid payment shock.

AFSA is concerned that a requirement for lenders to underwrite to a fully-indexed rate will limit the choices available to those who need an ARM, or a lower rate, in lieu of a higher fixed rate due to affordability needs. Historically, this loan choice has been around for decades and should not be severely curtailed. This requirement would most likely greatly exacerbate default and foreclosure rates by preventing borrowers who have already been successfully carrying a subprime loan, such as a hybrid ARM, from refinancing that loan. Requiring that loans be underwritten at the fully-indexed rate will drastically increase the maximum debt-to-income ratio for many products—likely to a level so high that few consumers who currently have subprime loans will be able to qualify. Many consumers obtain subprime hybrid ARMs fully intending to refinance prior to or upon adjustment. However, if this requirement is imposed, many of these consumers—consumers who otherwise are making their payments on a timely basis—will be unable to qualify for refinancing. Thus, the effect of this requirement will be to harm, not help, consumers. The Agencies should also consider allowing lenders additional discretion, especially in circumstances where lenders are dealing with existing borrowers in subprime hybrid ARMs. This allowance could be phased out after a certain period of time that the Agencies deem acceptable.

The Agencies should recognize that many typical hybrid ARMs have lower payments than the fully-indexed rate after the initial fixed payment expires as a result of rate cap language in the contract terms. Thus, the borrower often receives a reset payment that is lower than a fully-indexed rate payment. The Statement should allow lenders to compute a fully-indexed debt-to-income ratio that reflects the savings the borrower received as a result of the initial rate and any rate cap feature. Moreover, the Statement should reflect the Guidance by allowing lenders to underwrite to a blended rate that reflects the lower interest rates in the early years. Finally, hybrid ARMs continue to meet the individual financial needs of many borrowers. In order to serve these particular borrowers, lenders should be afforded the flexibility to use alternative compensating factors to qualify these borrowers.

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

No. As discussed above, AFSA believes that the Statement, if not amended to provide greater flexibility in its application, will impact the availability of many credit-worthy consumers to access affordable mortgage product options. Furthermore, the Agencies should limit the scope of the Statement to a subset of hybrid ARMs that have been identified as having the characteristics that the agencies have identified as being problematic. Limiting the scope of the statement will allow the market to continue the development of innovative products that meet the needs of individual borrowers.

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 appropriate actions relating to their mortgages. We also seek comment on whether an institution's limiting of the expiration of prepayment penalties such that they occur within the final 90 days of the fixed rate period is a practice that would help meet borrower needs.*

AFSA commends the Agencies for the proposal to limit prepayment penalties to the initial fixed period associated with hybrid ARM products. AFSA believes that the uniform application of this proposal will ensure that borrowers facing reset have the greatest number of credit options to meet their changing financial needs and believes that a Statement that requires the prepayment penalty terminating 30 days prior to the end of the initial fixed rate term for all newly originating subprime hybrid ARMs would be a reasonable period to adopt. This gives the borrower the 30 days prior to the reset, as well as the additional 30 days after the reset before the payment increases to find refinancing. There is often a direct relationship between the rate charged to the borrower and the length of time the prepayment penalty period is in effect, and so the cost to the borrower at origination may very well be less if the prepayment penalty terminates 30 days before the reset, as opposed to 90 days prior to the reset. As noted above, AFSA member companies are actively engaged in reaching out to borrowers before the end of the fixed period to review borrowers' options and work with them to maintain or improve their credit situation and minimize the impact of rate reset.

CONCLUSION

AFSA wishes to emphasize that the Statement should apply only to hybrid ARMs originating beginning at a time after the adoption of the Statement. A change for hybrid ARMs originated before the adoption of the Statement would after the fact change pricing assumptions made by lenders at the time of origination of hybrid ARMs already on their books and the pricing assumptions of the secondary market when acquiring the hybrid ARMS, causing them to incur additional costs and risk that were not then anticipated.

AFSA appreciates this opportunity to provide its views to the Agencies in connection with the important topics addressed in the Statement. If it would be helpful to the Agencies, we would be happy to make AFSA staff and member firm personnel available to meet and discuss any of the points raised in this letter. Please address any questions or requests for additional information to the undersigned at (202) 296-5544.

Respectfully submitted,

Chris Stinebert
President & CEO
American Financial Services Association