From: Kevin Murphy [kmurphy@homeloanbank.com]
Sent: Monday, May 07, 2007 5:54 PM
To: Comments, Regs
Subject: Docket # 2007-09

Importance: High

Re: Comment on Statement on Subprime Mortgage Lending
Docket Number 2007-09

Ladies and Gentlemen:

Home Loan Investment Bank, F.S.B. (the Bank) appreciates the opportunity to comment on the Agencies' Proposed Statement on Subprime Mortgage Lending. We have addressed the four main questions raised in the Agencies' request for comment.

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 Bank is of the opinion that mortgage lenders, subject to regulatory oversight, that originate loans to borrowers with less than perfect credit (subprime borrowers) have taken into account the customer's ability to repay the debt prior to origination. We submit that requiring regulated lenders to revise underwriting standards by including an evaluation of the borrower's ability to repay the debt by its final maturity date at the fully indexed rate, assuming a fully amortizing repayment schedule, would result in significantly increasing the number of declined applications. Thus, regulations requiring more stringent standards would curtail and/or cut off credit opportunities for a large portion of the subprime market.

In the alternative, it would be an acceptable practice if lenders underwrote mortgage loans based on the maximum rate that the borrower would pay after the first adjustment period. The Bank's experience is that virtually all mortgage loans are refinanced prior to the end of the initial adjustment date at a fixed rate, since maintaining payments current has resulted in a significant increase in the borrower's credit score.

A review of the Home Mortgage Disclosure Data for 2006 showed that the Bank denied almost half of the almost 34,000 applications that were received. The large percentage of declined applications shows that underwriting procedures ensure that applicants are not offered loans they cannot afford. Another 44 percent of the total applications were

approved but not accepted. The percentage of loans that are approved but not accepted indicate that applicants are being provided with sufficient information (e.g. Truth-in-Lending and RESPA disclosures), which enables them to make an educated and informed decision. For almost 40 years, the Bank has prided itself at providing financial assistance to homeowners that have been overextended or had a temporary delinquency problem through no fault of their own.

We have always been a heavily regulated financial institution. Our underwriting procedures are reviewed at every regulatory examination. We would have been severely criticized if loans were made to borrowers who did not have the ability to repay the loan. Any loans originated with "low documentation" or stated incomes are given additional scrutiny. We do not grant stated income loans to applicants who work for an employer and receive a wage and tax statement (Form W-2). Income reported on the application is reviewed to ensure that there is some correlation to the applicant's reported occupation. This category of loans is not approved to applicants with a marginal credit history. In our opinion, the regulatory emphasis should be placed on the relatively small percentage of lenders that grant loans to borrowers that cannot pay. Those lenders are not regulated by a federal agency and the local and state governing bodies lack the resources to properly oversee their lending practices.

The Bank closely monitors its delinquency rate. It is important to note that the Bank's delinquency rate is comparative to other mortgage lenders that would be characterized as "prime lenders". The enhanced collection efforts assist the borrower because maintaining current payments will, in all likelihood, present the borrower with the opportunity to either refinance their adjustable rate mortgage before the initial rate adjustment or refinance during the term of the initial rate adjustment.

The Bank makes every effort to avoid foreclosure by working with borrowers to ensure that all sources of potential repayment have been contemplated. For example, elderly borrowers with sufficient equity are encouraged to consider a reverse mortgage. Another example is that the Bank informs borrowers in Pennsylvania of certain programs offered by the Pennsylvania Housing Authority, which assist individuals experiencing financial distress.

In summary, the vast majority of regulated mortgage lenders that provide financing to individuals with less than perfect credit do underwrite mortgage loans in a prudent manner. For example, the ability to pay and the net tangible benefit to the applicant are taken into consideration before the mortgage loan is approved. The mortgage financing provided to borrowers assists them during times of financial distress. A regulation that would require a change in the way that financial institutions underwrite certain loans could limit the number of options that borrowers may have in terms of correcting a cash flow problem.

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.

The Proposed Statement on Subprime Mortgage Lending, if adopted, could have the effect of restricting the ability of existing subprime borrowers to refinance their existing loans. The Bank has a program, where all borrowers with adjustable rate mortgages are contacted prior to the first adjustment to determine if a more favorable program could be offered. If these borrowers choose to refinance, then their closing costs will be reduced. When these subprime borrowers are able to refinance, the favorable payment history shows that steps have been taken to strengthen their financial situation. Should a favorable payment history be maintained, the borrower will, in all likelihood, be able to qualify for a mortgage at a reduced interest rate in the relatively near future. A significant number of the Bank's borrowers have ultimately improved their financial situation by refinancing to a fixed and/or a reduced interest rate.

The Bank offers more than 70 different programs and, in accordance with regulatory requirements, provides disclosures which explain the loan terms. At closing, the borrower is provided with a separate statement which describes the prepayment penalty. Additionally, on refinanced mortgage loans, the borrower has three days to rescind the transaction. The disclosures are clear and conspicuous and provide the information the applicant needs to understand the transaction. The Bank's loan officers respond to questions applicants may have regarding terms of the loan and there is no financial incentive to steer an applicant towards a specific mortgage product. For example, the Truth-in-Lending Disclosures clearly state the payment changes for the term of the loan based on the initial index and margin. We have found that the preponderance of borrowers have developed alternatives to avoid significant payment shock such as selling the dwelling or refinancing to a fixed rate.

We are concerned that the development of more stringent underwriting standards would allow unregulated or less heavily regulated credit providers to approve mortgage loans to borrowers who would not receive the same consumer protections as regulated lenders.

Should the Agencies revise the manner in which loans to subprime borrowers are underwritten, many of these borrowers would not be able to refinance their existing mortgage loan. In our opinion, the disclosures in place have provided sufficient information for applicants to make an informed decision regarding the product desired. Most lenders will offer the borrower the opportunity to apply for a fixed rate mortgage prior to the end of the initial adjustable rate term. While this rate may be higher than the initial adjustable rate, it offers borrowers the opportunity to fix their principal and interest payment for the term of the loan.

In our opinion, the Agencies' Proposed Statement on Subprime Mortgage Lending could have the affect of restricting existing borrowers' ability to refinance their loans and avoid payment shock. The Bank offers a 2/28 Adjustable Rate Mortgage Product where the initial rate is discounted. These loans provide borrowers with the opportunity to improve their financial situation that was the result of either overspending or circumstances

beyond their control, such as unanticipated health expenses. While the Bank does not profess to be a financial counselor, these borrowers' financial situations are in most cases improved when given the opportunity to refinance to a fixed rate prior to the end of the two-year adjustment period. Historically, these borrowers then qualify for a product before the program adjusts to a fully indexed rate. Thus, we are of the opinion that there are programs in place to assist borrowers in avoiding payment shock. Further, our analysis also found that borrowers that repay in accordance with the terms on a 2/28 Adjustable Rate Mortgage during the initial payment period will have a significantly higher credit score and be able to qualify for a fixed rate mortgage loan at the time of the first adjustment period or shortly thereafter.

The present marketplace is the most significant factor (and potential barrier) that will make it difficult for existing subprime borrowers to refinance their mortgages. Specifically, the depressed real estate market and its continued downward trend will be the most significant impediment to refinance opportunities.

We do not object to informing the borrower regarding the importance of allocating monies for property taxes and insurance if these payments are not escrowed. When any introductory rate expires, borrowers should be provided with the new payment. Further, if a prepayment penalty exists, borrowers should be provided with a written explanation regarding how it will be calculated.

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

In our opinion, any regulatory requirements should apply to all mortgage loans, and not just the subprime ARM market. All lenders must be required to provide complete and full disclosures for each loan. While subprime borrowers have experienced increased financial distress, all borrowers should be aware of the costs, terms, features, and risks associated with the loan. For example, a prime borrower should be no less aware that there is a pricing premium attached to a reduced documentation loan or stated income loan than a prime borrower. While regulatory action that eliminates predatory lending is encouraged, consideration should be given to any regulations that have an adverse effect on all borrowers. For example, Cook County, Illinois repealed a law mandating credit counseling to subprime borrowers because it ultimately had a discriminatory effect upon the very citizens it was trying to protect. This is an example of a well intentioned regulatory change that resulted in negative consequences.

We agree that all financial institutions should develop systems to monitor whether actual practices are consistent with their policies and procedures. There should be procedures to ensure that customers are provided with the best rates and terms. Additionally, we agree that complaints should be reviewed to identify potential compliance problems or other trends.

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.

In our opinion, it would not be prudent to limit prepayment penalties to the initial fixed-rate period of the mortgage loan. Financial institutions incur significant costs in underwriting a mortgage loan, which are taken into consideration when determining the prepayment penalty. The borrower benefits from a longer prepayment penalty since the lender can offer a lower interest rate. Should lenders be required to limit the prepayment penalty to the initial fixed-rate period, borrowers will in all likelihood pay a higher initial interest rate, which will more than compensate for the adjustable rate mortgages, particularly when the first adjustment period is two years or less.

All applicants, in accordance with the Truth-in-Lending Act, are provided with disclosures which describe the cost and terms of the loan. These customers are given ample opportunity to ask questions regarding the mortgage loan product that is being requested prior to consummation of the transaction. Further, regarding mortgage loans that are being refinanced, the borrower may rescind the transaction after closing.

We do agree that borrowers should be provided with a clear and conspicuous notice that describes the prepayment penalty. It is recommended that the penalty be described separately from the legal obligation and that the customer acknowledge that the prepayment penalty notice was received.

We are also of the opinion that lenders could tolerate a maximum prepayment penalty. A number of states limit the prepayment penalty to three years, which would give mortgage lenders sufficient time to recoup the costs associated with originating loans. Also, we would not object to limiting the prepayment penalty to the initial fixed rate period if the borrower refinances with the same lender.

In summary, lenders that deal with subprime borrowers take extensive time to underwrite the application. If regulations restrict the prepayment penalty to less than three years, this will result in higher costs to the borrower. If a practice was adopted to eliminate the prepayment penalty when the borrower refinances the existing mortgage loan with the original lender, in our opinion, this would be more acceptable.

Again, the applicant is provided with numerous disclosures before consummation of the transaction. The applicant has ample time to review and understand these disclosures before the transaction is consummated.

If you have any questions or comments, please do not hesitate to contact me at 1-800-223-1700. Thank you in advance your consideration.

Sincerely,

Kevin M. Murphy, Esquire
General Counsel

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