



May 7, 2007

Regulation Comments  
Chief Counsel's Office  
Office of Thrift Supervision  
1700 G Street, NW  
Washington, DC 20552  
RE: Docket No. 2007-09  
[regs.comments@ots.treas.gov](mailto:regs.comments@ots.treas.gov)

Office of the Comptroller of the Currency  
250 E Street, SW  
Public Information Room  
Mail Stop 1-5  
Washington, DC 20219  
RE: Docket No. 2007-3005  
[regs.comments@occ.treas.gov](mailto:regs.comments@occ.treas.gov)

Jennifer J. Johnson  
Secretary  
Board of Governors of the Federal Reserve  
System  
20<sup>th</sup> St. and Constitution Ave, NW  
Washington, DC 20551  
RE: Docket No. OP-1278  
[regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov)

Mary Rupp  
Secretary for the Board  
National Credit Union Administration  
1775 Duke St.  
Alexandria, VA 22314-3428  
RE: Comments on Statement on Subprime  
Mortgage Lending  
[regcomments@ncua.gov](mailto:regcomments@ncua.gov)

Robert E. Feldman  
Executive Secretary  
Attn: Comments  
Federal Deposit Insurance Corporation  
550 17<sup>th</sup> Street, NW  
Washington, DC 20429  
RE: Statement on Subprime Mortgage  
Lending  
[comments@fdic.gov](mailto:comments@fdic.gov)

Re: Docket No. 2007-3005, 72 Fed. Reg. 10533 (Mar. 8, 2007)

Dear Sir or Madam:

America's Community Bankers (ACB)<sup>1</sup> welcomes the opportunity to comment on the Proposed Statement on Subprime Mortgage Lending ("the Statement") issued by the Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (Board),

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<sup>1</sup> America's Community Bankers is the national trade association committed to shaping the future of banking by being the innovative industry leader strengthening the competitive position of community banks. To learn more about ACB, visit [www.ACB.us](http://www.ACB.us).

Federal Deposit Insurance Corporation (FDIC), Office of Thrift Supervision (OTS), and National Credit Union Administration (NCUA), (collectively “the Agencies”).

ACB commends the Agencies for attempting to identify and curb unfair, deceptive and predatory mortgage lending practices. We unconditionally support measures that will end egregious lending practices that have beleaguered homeowners and affected the safety and soundness of some financial institutions over the past few years.

We want to emphasize that the comments and positions stated in this letter are relevant to subprime lending practices only. There is no evidence of problems in the prime market and we believe that policy-makers have appropriately focused their attention on the subprime market where abuses have taken place.

We have some concerns about the proposed Statement because we believe that mortgage lenders need to have a certain degree of flexibility to offer, and consumers need to have the ability to choose from, the widest range of reasonable and responsible mortgage financing options. In order to accomplish this without taking advantage of borrowers or harming lenders, borrowers must be in a position to make informed choices that are appropriate to their needs and consistent with their ability to repay, as well as with safety and soundness concerns of the financial institutions making the loans.

In the final Statement, it is important for the Agencies to reach a careful balance that increases consumer protections without unintentionally limiting access of credit to credit-worthy borrowers. Creating lending standards that are unreasonably restrictive could have the unintended consequence of bringing the record-high homeownership rate in the U.S. down and impeding extension of credit to low-income and minority consumers.

We also believe that the imposition of additional underwriting and disclosure requirements should be extended equally to all mortgage borrowers regardless of whether the loan is made by an insured depository institution or other institution. Brokers and non-federally insured financial institutions are not uniformly regulated, examined or subject to the same levels of enforcement that are applicable to federally regulated institutions. Restrictions on regulated financial institutions would do nothing to control the practices of these non-federally regulated entities. Therefore, ACB believes that broker licensing, bonding and uniform application of lending standards is crucial to accomplish the goal of consumer protection.

An explanation of our concerns and recommendations follows. In addressing the proposed Statement, we have segmented our comments into five categories: underwriting and loan terms; consumer protection practices; control systems; broker and non-federally regulated lender issues; and questions asked by the Agencies.

## **ACB Position**

ACB generally supports the principles and practices put forth in the guidance regarding subprime lending.

### **Underwriting and Loan Terms**

#### **Payment Shock and Ability to Repay**

Of major concern to the Agencies is the effect on borrowers of “payment shock” caused by setting very high or no limits on how much the monthly payment or interest rate on a mortgage can increase at the reset periods. The ability of a borrower to repay his or her mortgage should be a basic lending principle. Thus, ACB believes that all mortgages should have reasonable limits on how much the payment or interest rate may increase at reset periods to avoid payment shock. Lenders should make sure that the extent and timing of such adjustments are made clear to the borrower before the loan is closed.

The Statement proposes that lenders evaluate the borrower’s ability to repay the mortgage debt by the final maturity at the fully indexed rate. ACB believes this is generally appropriate in underwriting subprime loans. In granting subprime credit, lenders should have a reasonable expectation that the consumer has the income needed to pay back the loan at the fully indexed rate by the final maturity. This is particularly important regarding increases in payments on deeply discounted hybrid adjustable rate loans, such as 2/28 and 3/27 mortgages.

However, the proposal makes no distinction between loans with different lengths of time to the first adjustment. The length of time until a borrower’s payment adjusts is a very important consideration for loan underwriting. We believe it may not be necessary to apply the fully-indexed requirement to subprime ARMs with fixed-rate periods that exceed five years. Within a 5-year period, statistics show that many borrowers will pay off or refinance the original ARM loan.

We strongly oppose the extension of the requirement for fully indexed underwriting for traditional hybrid mortgages, such as 5/1s, 7/1s and 10/1s. We believe this is unnecessary and could result in the consumer making a wrong loan choice.

The underwriting and ability-to-repay decision should take into account tax and insurance payments as well as all normal recurring monthly housing expenses, such as condominium fees. Further, ACB believes that requiring escrow accounts is generally appropriate for subprime mortgages.

#### **Risk Layering**

“Risk layering” on subprime mortgages, such as excessive debt-to-income ratios and simultaneous-second liens, presents clear perils for both the borrower and the lender. ACB agrees with the Agencies that, when a loan involves risk layering features, the institution should be able to demonstrate persuasive compensating factors that support the underwriting decision regarding the borrower’s repayment capability.

### Stated Income/Reduced Documentation

The Statement asserts that the higher a loan's risk, either from a loan's features or from borrower's characteristics, the more important it is to verify the borrower's income, assets and liabilities. It proposes that stated income and low documentation should only be used when there are mitigating factors that clearly minimize the need for direct verification of the borrower's ability to repay. ACB generally believes that subprime borrowers should be qualified with W-2 information to the extent that such information is available. Where such documentation is not available, reduced documentation or stated income should be permitted only when there are compelling mitigating factors. A complete ban on stated income or low documentation loans might limit credit to many borrowers who have the ability to repay, including self-employed consumers and recent immigrants.

## **Consumer Protection Practices**

### Information and Disclosure

ACB believes that it is vital for a consumer to understand the full nature of their credit obligation in order to assure their ability to pay. Mortgage brokers and lenders have an affirmative obligation to be honest and not to misinform prospective borrowers in advertising or product descriptions.

The Statement proposes that mortgage product descriptions and advertisements provide clear, detailed information about all of the costs, terms, features and risks to the borrower.

Specifically, according to the proposal, consumers should be informed of:

- “payment shock,” including how the new payment will be calculated when the fixed payment period expires;
- How prepayment penalties will be calculated and when they will be imposed;
- The existence of any balloon payments;
- Any pricing premium associated with reduced documentation and stated income loans; and
- The borrower's responsibility for paying taxes and insurance premiums and, if they are not escrowed, the fact that they represent substantial additional costs for them.

ACB strongly supports the proposal to provide all of this information to consumers before and during the mortgage transaction. Financial institutions and brokers should provide clear and balanced generic information addressing all of the points proposed in the Statement when a consumer is shopping for a loan.

The disclosure provided during the shopping period can only be generic in nature because the lender does not have sufficient information about the consumer or the specific type of mortgage they desire. The disclosure during shopping should describe generic differences in types of loans, including examples of payment adjustments, prepayment fees, pricing increases for choosing reduced documentation, responsibility for paying taxes and insurance and other key

terms of the loan. Later, when the consumer applies for a mortgage and at closing, they should be provided with clear descriptions of these loan attributes that are loan specific.

To make these types of disclosure most effective, the current TILA (Regulation Z<sup>1</sup>) and RESPA (Regulation X<sup>2</sup>) disclosure requirements should be comprehensively revised and streamlined so that disclosures are uniform, simple and comprehensible to borrowers. Under current disclosure regulations, borrowers confront a daunting array of disclosures and simply adding new disclosures will only compound the problem. Additionally, we are concerned that any new disclosures suggested in the Statement will only apply to insured depository institutions, leaving consumers exposed to misleading claims by lesser regulated entities. Any mandate for new, more elaborate disclosure requirements should apply to all lenders and brokers.

Also, in addition to Regulation Z and Regulation X, consumers are protected by an array of existing federal laws and regulations, including, The Equal Credit Opportunity Act<sup>3</sup> (Regulation B<sup>4</sup>), The Telemarketing and Consumer Fraud and Abuse Prevention Act<sup>5</sup>, The Fair Credit Reporting Act<sup>6</sup>, The Fair Debt Collection Practices Act<sup>7</sup> and various statutes that dictate advertising practices. ACB supports strong enforcement against mortgage brokers and lenders that willfully violate these laws and regulations to the detriment consumers.

#### Prepayment Penalties

In addition to the institution's obligation to disclose the details of any prepayment penalty, the proposed Statement encourages lenders to structure prepayment penalties so that they do not extend beyond the initial reset period. According to the proposal, any prepayment penalty provision should also provide borrowers with a sufficient window of time immediately prior to the reset date to refinance without a penalty. On subprime hybrid ARM loans with significant payment adjustments, ACB believes that prepayment penalties should not extend beyond 60 days before the first payment reset.

ACB believes that borrowers should be given full disclosure and choice regarding prepayment penalties. Specifically, borrowers should be informed if an alternative loan is available with no prepayment penalty, even if the interest rate on such alternative is higher than the loan with the penalty. The borrower should be able to make an informed choice about taking a loan with or without a prepayment penalty.

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<sup>1</sup> 12 CFR Part 226

<sup>2</sup> 24 CFR Part 3500

<sup>3</sup> 15 USC §1691et seq.

<sup>4</sup> 12 CFR § 202.1 et seq.

<sup>5</sup> 15 USC 6101 et seq.

<sup>6</sup> 15 USC §1681 et seq.

<sup>7</sup> 12 USC § 1692 et seq.

## **Control Systems**

### **Compensation and Steering**

ACB supports the Agencies' proposal that lenders should not design compensation programs that provide incentives for originators to make mortgages that are inconsistent with sound underwriting practices or that seek to take advantage of borrowers. Institutions should not steer borrowers to high cost products to the exclusion of other products for which they may qualify. Lending institutions should also ensure that they are not compensating mortgage brokers in a manner that encourages the broker to steer borrowers to high-cost products. ACB supports sound training and control systems on incentive pricing to address these concerns.

### **Compliance and Consumer Complaints**

ACB agrees with the Agencies that institutions should have procedures and systems in place to monitor compliance with appropriate laws and regulations. We believe that ACB members already meet the terms of this proposal. They also have procedures in place to review consumer complaints to identify compliance problems and other negative trends. ACB members' value their reputations and ties to their communities, so these are priority issues for them.

## **Brokers and Non-federally Regulated Lenders**

Additionally, we believe strongly that better controls on mortgage brokers are needed to prohibit them from a panoply of unfair and deceptive lending practices. We believe that this could be accomplished by better broker licensing requirements and required disclosure of who the broker represents in the mortgage transaction. Borrowers should receive a clear disclosure from the mortgage broker of: the broker's role; the maximum amount of any fee the broker may receive from the lender; and the fact that such fee may increase based on a higher rate or other product feature. Although this is outside the purview of the Agencies, in addition to broker licensing, ACB supports minimum net worth requirements for mortgage brokers and/or expanded bonding or insurance to cover borrower losses and claims.

## **Agency Questions**

The Agencies requested public comment on the following 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 general, ACB believes that the types of subprime loan addressed in the Agencies' proposal do present heightened and often inappropriate risks. As we explain earlier in this letter, there may be situations for which mitigating circumstances lessen the risks. For example, subprime hybrid

ARMs with fixed terms of five years or more may be appropriate if the rate reset is reasonably limited.

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.

ACB believes that some subprime borrowers with ARMs that have a high probability of payment shock or have high prepayment penalties will be unable to refinance and may go into foreclosure. Unfortunately, this may be the inevitable consequence of irresponsible lending coupled with a downturn in the housing market.

Some subprime borrowers in these situations will be able to refinance into mortgages with longer fixed-rate terms, such as 40-year mortgages; some will be able to refinance into FHA loans with negligible down payment requirements; some may have improved their credit scores to the extent that they may qualify for prime mortgage products. Unfortunately, we have no data to quantify these populations.

We believe mortgage servicers, lenders and secondary market investors should work together to do everything possible to modify mortgages and provide forbearance to help borrowers save their homes. Some institutions have already announced new initiatives to meet these needs.

We also support FHA reform and expansion of GSE programs to allow refinancing of subprime mortgages. Local nonprofit foreclosure prevention programs that provide financial counseling, help borrowers restructure subprime mortgages and take legal action against egregious predatory lenders can also be useful tools. Many ACB members support such efforts through a variety of partnerships.

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

ACB believes that all borrowers should be protected from unfair and deceptive lending practices. We also believe that it is essential to require full disclosure of mortgage terms to all borrowers.

However, we believe it is totally unnecessary and unwise to apply to prime mortgages the underwriting requirements proposed in the Agencies' Statement. Prime borrowers are well served by the flexible underwriting that is being applied currently.

Based on the experience of ACB members, current and historical lending practices in the prime market have not resulted in excessive defaults or other harm to borrowers. We believe that this holds true for the lending industry at large. Therefore, additional restrictions in the prime market could be counterproductive and would curtail the availability of credit to consumers who are perfectly capable of repaying their mortgages.

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.

For subprime loans, ACB supports restrictions on excessive prepayment penalty practices that inhibit the borrower's ability to refinance a mortgage. Prepayment penalties for nonprime hybrid ARM loans with significant payment adjustments should not extend beyond 60 days before the termination of the term associated with the first payment reset. This 60-day timeframe should give borrowers an opportunity to determine what actions are appropriate for them to take before the initial interest rate adjustment.

Also, full disclosure to borrowers that allows them to make informed choices regarding prepayment penalties is essential. Prepayment fees should continue as a viable option that allows a borrower to obtain a mortgage with a lower interest rate.

## **Conclusion**

In conclusion, it is important to recognize that subprime lending in no way automatically equates to predatory lending. Although subprime lending may be riskier than prime lending, when done responsibly, it does confer substantial benefits to borrowers and to our society. It has significantly increased the number of homeowners, particularly among minority and low-income consumers.

Therefore, it is imperative to strike the proper balance between curtailing lending practices that take unfair advantage of consumers and result in foreclosures, and unduly and inappropriately curtailing the availability of mortgage credit.

ACB believes strongly that it is vital that the Agencies' proposal apply only to subprime mortgage lending practices. Mortgage troubles have not spread to the broader financial marketplace or economy. Treasury Secretary Henry Paulson and Federal Reserve Board Chairman Ben Bernanke, in testimony to Congress, agreed that the fallout from steeply rising subprime lending delinquencies and foreclosures has been limited and contained, and should not significantly affect the overall performance of the nation's economy and financial markets in the months ahead.

Finally, uniform standards for underwriting, disclosure and consumer protection should apply equally to all financial institutions, including non-federally insured lenders. Otherwise, the egregious practices of some lenders will continue. Comparable regulation, examination and enforcement are needed to reign in lenders that have perpetrated the worst offenses.



ACB appreciates the opportunity to comment on this important matter. We would be pleased to continue working with the Agencies in the future to develop appropriate lending and disclosure standards. If you have any questions, please contact the undersigned at 202-857-3129 or via email at [jfrank@acbankers.org](mailto:jfrank@acbankers.org), or Patricia Milon at 202-857-3121 or via email at [pmilon@acbankers.org](mailto:pmilon@acbankers.org).

Sincerely,

A handwritten signature in black ink that reads "Janet Frank". The signature is written in a cursive, flowing style.

Janet Frank  
Vice President, Mortgage Finance