March 15, 2006

Docket No. 05-21
Attention: Public Information Room, Mail Stop 1-5
Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

Docket No. OP-1246
Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

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

Attention: Docket No. 2005-56
Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street NW
Washington, DC 20552

Re: Interagency Guidance on Non-traditional Mortgage Products

Dear Officials of Federal Bank and Thrift Agencies:

The National Community Reinvestment Coalition (NCRC), the nation's economic justice trade association of 600+ community organizations, appreciates that the Agencies have formalized their warnings to the lending industry on the risks and potential harm of inappropriately and excessively issuing nontraditional mortgages. NCRC shares your concern about these exotic products that pose serious threat to borrowers and the stability of homeownership when not used with discretion. While we support the proposed Interagency Guidelines, we also urge you to further tighten some aspects of your advisory to strengthen the chances of borrowers maintaining their homeownership and building wealth and equity.

A Market Flooded with Risky Products

The market that borrowers see today is flooded with enticing mortgage products boasting record-low introductory rates, interest-only loans, option adjustable-rate mortgages (ARMs), no money down, and no income documentation required. Originally considered "nontraditional" mortgages because of their high risk and small pool of qualifying borrowers, these products are now cropping up nationwide and becoming mainstream. In 2005, 63% of new mortgages were interest-only and adjustable-rate mortgages.[1] Over an 18-month period in 2004 and 2005, approximately one-third of homebuyers did not put any money down for their loan.[2] And in California, Nevada and New Jersey, negative amortization loans accounted for 27.5%, 20.1%, and 14.2% of non-agency securitizations in the state.[3]

As lenders increasingly and excessively target borrowers with these dangerous products, the potential risk of payment shock, negative amortization, loss of equity and ultimately loss of home will also continue to escalate for borrowers. Due to this rising trend, NCRC urges the Agencies to prevent lenders from making unnecessary and inappropriate loans and to protect borrowers from these dangerous risks.

Comments on Assessing Borrowers' Repayment Capacity

The Agencies requested specific comments on the proposed analysis of borrowers' ability to repay and how to consider specific factors in this calculation, including: whether or not to assume the borrower makes only minimum payments; circumstances under which to permit stated income; and consideration of future events, such as change in income and interest rates. NCRC believes that borrowers' repayment capacity must be conservatively assessed through carefully reviewing loan-to-value (LTV) and debt-to-income (DTI) ratios, credit scores, and borrowers' income levels. In addition, lenders should conduct stress tests that include assessing borrower ability to repay at interest rates higher than the fully indexed rate.

Minimum Payments

NCRC agrees with the Agencies that lenders must underwrite loans involving minimum payments with extreme caution. Lenders need to assume that large and increasing outstanding balances will confront borrowers who choose minimum payments. It is probably the case that the industry is not currently underwriting with large outstanding balances as real possibilities for these borrowers. As the regulatory agencies suggest in the proposed guidance, we agree that the lending industry must underwrite assuming large outstanding balances for loans with minimum payments.

In addition, we ask the regulators to set a limit on the amount the outstanding loan balance can increase as the loan negatively amortizes. Through our Consumer Rescue Fund (CRF), we have

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[1] Michael Powell, "A Bane amid the Housing Boom: Rising Foreclosures," *Washington Post*, May 30, 2005.
[2] Edmund L. Andrews, "A Hands-Off Policy on Mortgage Loans," *New York Times*, July 15, 2005.
[3] "Infographic: Tracking Neg-Am Loans," *American Banker*, December 22, 2005.

worked with consumers with loans with outstanding balances that are 125% of the original loan amount.[4] However, these loans have not been tested during an economic downturn. To safeguard borrowers and lenders against additional risk, we ask the Agencies to suggest that outstanding balances be capped at 105% of the original loan amount for loans permitting negative amortization.

Stated Income

NCRC does not see any benefits to combining stated income loans or loans with reduced income documentation with *any* nontraditional mortgages and/or subprime mortgages. Stated income loans provide too many opportunities for mortgage fraud and over-estimating borrowers' ability to repay, which in turn leads to unaffordable loans. However, if the regulators allow stated income loans, they should prohibit risk layering with this mortgage feature in efforts to reduce unneeded risk to borrowers.

NCRC also supports the proposed guidance that lenders not rely solely on credit scores as a substitute for income verification. Instead, stated income loans should only be permitted with the combined factors of low LTV and DTI ratios and high credit scores.

Consideration of Future Events

Actual figures from borrowers' financial history and current situation should be used in the assessment of borrowers' ability to repay. Future events should only be considered in borrowers' ability to repay to the extent that they are predictable, likely, and relevant. Estimating future incomes, for example, should not be considered in this calculation as it is not a reliable, foreseeable or necessarily likely event.

In addition, we applaud the Agencies for directing lenders to recognize the potential impact of payment shock and assess borrowers' repayment capacity based on their ability to repay the debt by final maturity of the fully indexed rate. However, NCRC believes that the Agencies must urge financial institutions to consider future interest rates to a reasonable extent as well. Unlike future incomes for an individual, future interest rates are widely predicted by economists. While interest rates have been at an all-time low in nearly fifty years, they have also slowly but steadily increased for the past year and a half and are predicted to increase further in years to come.[5] Given this likely continuing trend, NCRC believes it is the Agencies' responsibility to prepare lenders and borrowers for this change.

While borrowers may be able to repay their monthly mortgage payments at introductory low interest rates and even at record-low fully-indexed rates, many may face severe difficulty making monthly payments as rates adjust according to loan terms and increase beyond the current

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[4] Through its National Anti-Predatory Lending Consumer Rescue Fund (CRF), NCRC works with victims of predatory lenders so their mortgage payment becomes more affordable and foreclosure can be avoided. NCRC's member groups and their communities are encouraged to tap into this program. For more information, visit www.fairlending.com.

[5] "Fed Cuts Interest Rates to Lowest Level since 1958", *USA Today*, June 25, 2003.

record-low rates. When ARMs first came out in the 1980s, lenders protected themselves and borrowers from risk by calculating some extra cushion into the analysis of the borrower's ability to repay. Lenders should continue this responsible lending effort by assessing borrowers' ability to repay at 2 percentage points beyond the fully indexed rate or at the capped rate, whichever is greater.

NCRC remains steadfast in its mission to increase homeownership but also fully believes it must be done safely and soundly. Only through appropriate and safe product options will borrowers be able to realize their dreams of homeownership and maintain them. Adopting our recommendations would help protect borrowers from being financially stretched past their limits if interest rates were to (and as they are expected to) rise, and ultimately protect lenders from increased risk as well. NCRC urges the Agencies to include our stress testing recommendation in the proposed guidance.

Strong Agency Guidelines

Underwriting Standards

NCRC is specifically pleased with several of the proposed guidelines to set higher industry standards on underwriting, consumer protections, and portfolio management practices. For example, NCRC was pleased that Agencies asked lenders to avoid making unrealistic loans that effectively force borrowers to refinance or sell their homes once amortization begins. Collateral-dependent loans, while briefly aiding borrowers into homeownership, set borrowers up to fail to maintain their homeownership and to quickly lose wealth. Lenders falsely reason that property values will keep increasing and serve as a safety net for borrowers who did not have the capacity to repay their debt in the first place. NCRC commends the Agencies for directing lenders to avoid this risky behavior. For similar reasons, NCRC agrees with the Agencies' proposal to curb lenders from making simultaneous second-liens that allow for negative amortization when there is minimal or no invested equity.

NCRC strongly supports the Agencies' proposals to require lenders to sufficiently compensate for risk layering and to carefully come up with ways to minimize impending payment shock for borrowers with low introductory rates. NCRC supports the Agencies' request to compensate for risk layering through a combination of higher credit scores, lower LTV and DTI ratios, and credit enhancement. In addition, NCRC agrees that in order to minimize the risk of unnecessary default, lenders must develop strategies for managing the payment shock by eliminating large disparities between low introductory rates and adjustable rates.

Managing Portfolio Practice

NCRC was pleased with several of the suggested guidelines for managing portfolio practices, including requiring lenders to consider the effects of employee incentive programs to increase levels of nontraditional mortgages and closely monitor and enforce their practices on their third-party originators. Focused on incentives that reward loan volume above all else, brokers and loan

officers may feel pressure to ease up on qualifying standards and disclosure requirements and offer risky products to borrowers.

NCRC strongly endorses the Agencies' requirement that lenders monitor their third-party relationships to ensure that these agents follow lenders' policies and procedures. We also agree that lenders must immediately sever ties with third-party originators if harmful lending practices are discovered. Such a task will, however, require strong oversight and enforcement from the regulators to ensure these guidelines are being followed. NCRC recommends that regulators review lenders on their compliance with these guidelines during their fair lending and safety and soundness reviews.

Consumer Protection Issues

The consumer disclosure sections of the proposed guidelines stress ample disclosure. We appreciate the Agencies' clarification that lenders should provide clear, balanced and timely communication, explain available options and their associated increases and impacts in monthly payments, and specifically describe features such as payment shock, negative amortization and prepayment penalties. However, even the best disclosure requirements are not completely sufficient. The process of purchasing a home tends to be overwhelming, chaotic, and often does not provide an ideal environment for thoroughly and clearly explaining all of the available options and their extensive impacts to borrowers. Because of this, strong consumer disclosure requirements need to be augmented with tough regulations and enforcement. We ask you to keep this in mind when finalizing these proposed guidelines.

NCRC also commends the regulators for reminding lenders about their continued legal responsibilities to borrowers, even after loans are sold or securitized. The legal obligations of financial institutions to comply with the Truth in Lending Act (TILA), Regulation Z, the Fair Trade Commission Act (FTC Act), Real Estate Settlement Procedures Act (RESPA) and state laws, which protect consumers' rights, should always be strictly enforced.

Need to Strengthen Guidelines for Nontraditional Mortgages Made to Subprime Borrowers

Nontraditional mortgages pose heightened risk to subprime borrowers. Already beginning with higher interest rate loans due to credit blemishes, subprime borrowers are often more sensitive to rate fluctuations than prime borrowers. For instance, an analysis of nearly 23,000 foreclosures in Pennsylvania revealed that most of the homeowners were lower-income and barely making ends meet. Seventy percent of the homeowners had subprime loans and 40% cited medical costs as reason for their financial troubles.[6] Given that subprime borrowers are often already in precarious financial situations, adding risk through providing nontraditional mortgages products must be avoided.

Despite this, lenders still inappropriately target subprime borrowers for these risky products, offering alluring deals of option ARMs, low introductory rates, no money down and low or no-

[6] Michael Powell, "A Bane amid the Housing Boom: Rising Foreclosures," *Washington Post,* May 30, 2005.

documentation requirements. In 2005, 73.4% of subprime securitizations were adjustable-rate mortgages, 23.5% were interest-only loans, and 37.2% were stated loans.[7] In offering these features in subprime mortgages, lenders are setting the stage for vulnerable consumers to sustain payment shocks and sudden increases in their mortgage payments which they may not be capable of bearing. Several of these dangerous loan features provided to subprime borrowers also overlap, heightening the risk layering further. In addition, nearly two-thirds of the subprime securitized loans in 2005 carried a prepayment penalty making it more difficult for borrowers to escape these hazardous loans before rates reset and increase.

Some lenders have acknowledged the associated risk of providing nontraditional mortgages to subprime borrowers. In a recent *Inside B&C Lending* article, many lenders discussed their concern with providing products to subprime borrowers with limited income documentation, interest-only ARMS with quickly approaching reset periods, and second-lien mortgages. As one lender put it, “negative amortization with a subprime product is a scary proposition.”[8]

NCRC urges the Agencies to prohibit lenders from offering risky nontraditional mortgages to subprime borrowers that allow for negative amortization, risk layering or similarly dangerous features.

Need to Incorporate CRA & Fair Lending in the Guidance

We urge the Agencies to incorporate the Community Reinvestment Act (CRA) into the proposed guidance. CRA mandates lenders to respond to credit needs in a safe and sound manner. The guidance must therefore stipulate that issuing nontraditional mortgages in an unsafe and unsound manner violates CRA.

Lenders must be penalized via lower ratings on their CRA exams for making exotic mortgages that are unsafe and unsound. The recent changes to the CRA regulation include a new provision that penalizes lenders for discriminatory, illegal and abusive loans. Therefore, regulators must ensure that lenders are not targeting minorities and other protected classes with dangerous and ill-suited exotic mortgages. Lenders targeting minorities, women, elderly, or low-income borrowers must be given a lower rating on their CRA exams and reported for violations of fair lending and equal credit opportunity laws.

In Conclusion

NCRC remains concerned that risky nontraditional mortgages are becoming commonplace for the average borrower, and too common for low- and moderate-income and subprime borrowers who are extremely vulnerable to risky products. While NCRC’s mission is to increase equal access to credit and capital, we believe that this must be done in a responsible and appropriate manner for all parties involved. Borrowers, particularly traditionally underserved ones, demand a safe market in which lenders thoroughly explain products, options are understood, and

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[7] “What Else is New? ARMs Dominate Subprime MBS Mix,” *Inside B&C Lending*, January 20, 2006.
[8] “Doubts Persist About Alt Products in Subprime Space,” *Inside B&C Lending,* February 3, 2006.

responsible decisions can be made. NCRC hopes that through these interagency guidelines, financial institutions will be held accountable to help create that safe environment in which borrowers can realize and maintain their dreams of homeownership.

NCRC sincerely appreciates the Agencies' efforts to gain control of the ever-growing trend of risky nontraditional mortgage products and requests that you keep borrowers' best interests in mind when finalizing the guidelines. Thank you for the opportunity to comment on this proposal. If you have any questions about our recommendations, please contact myself or Noelle Melton, Research & Policy Analyst, at (202) 628-8866.

Sincerely,

John Taylor
President and CEO