March 27, 2006

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

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

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

Jennifer Johnson
Secretary
Board of Governors of the
Federal Reserve System
20th St. and Constitution Ave, NW
Washington, DC 20551
Attn.: Docket No. OP-1246

Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Proposed Guidance- Interagency Guidance on Nontraditional Mortgage Products
70 FR 77249 (December 29, 2005)

Dear Sir or Madam:

America's Community Bankers (ACB)[1] appreciates the opportunity to comment on the Proposed Guidance – Interagency Guidance on Nontraditional Mortgage Products[2] ("Proposed Guidance") issued by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision and the National Credit Union Administration (collectively, the "Agencies").

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[1] America's Community Bankers is the member driven national trade association representing community banks that pursue progressive, entrepreneurial and service-oriented strategies to benefit their customers and communities. To learn more about ACB, visit www.AmericasCommunityBankers.com.
[2] 70 Fed. Reg. 77249 (December 29, 2005)

ACB commends the Agencies for issuing the guidance for comment, as we had requested. We believe that the experience of bankers that have been making these types of loans for a number of years will provide valuable insights as the Agencies continue their consideration of this issue.

Mortgage lending is the central function of many community banks. It is critical to meeting the needs of their communities and it is essential to the health of the American economy. For many decades, community mortgage lenders have offered and consumers have chosen alternative mortgage products[3] that differ from 30-year fixed interest rate mortgages.

When properly underwritten, alternative mortgage products, including those with payment options that can result in negative amortization, confer benefits to both financial institutions and homebuyers. The American consumer could suffer greatly from any guidance that imposes unduly restrictive standards on the use of these mortgage products. Such restrictions could result in lenders being less willing to offer alternative mortgage products and this would severely limit the flexibility in financing options that consumers enjoy today. Financial institutions also benefit from varieties of ARM products because they protect institutions from the interest rate risk associated with holding long-term, fixed rate mortgages in their portfolios.

ACB Position

ACB appreciates the Agencies' concern that the industry's underwriting standards at some institutions may have been relaxed at the same time that real estate markets, in some areas, are showing signs of cooling. We agree that institutions must use care and prudent practices to originate alternative mortgage products and to manage portfolios containing these products, but we do not believe it is necessary to issue guidance to depository institutions to reiterate these points. If the Agencies, nevertheless, deem it appropriate to issue a final guidance, we believe that several revisions are needed to avoid excessive regulatory burdens and restrictions that would hamper the ability of depository institutions to offer the widest array of products available to serve all of their customers appropriately. In this comment letter, we explain our recommendations for these revisions to the Proposed Guidance.

We believe that the types of mortgages that are the subject of the Proposed Guidance should be referred to as "alternative" mortgages instead of "nontraditional" mortgages. For many institutions, these products are not "non-traditional" because they have been offering these products successfully for many years. In fact, Congress authorized and encouraged origination of "Alternative" mortgages when it passed the Alternative Mortgage Transaction Parity Act of 1982.[4]

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[3] As defined by the Agencies, these products include Interest Only ARMs ("IOs"), Hybrid ARMs, Option ARMs, and mortgages with relaxed requirements for verification of income.
[4] 12, U.S. C , sec. 3801 et seq.

ACB opposes a one-size-fits-all approach to originating and managing alternative mortgage products. Institutions may have unique and well-managed mortgage operations, which are safe, sound and appropriate. We believe the Agencies should continue to evaluate each institution individually to identify portfolio risks.

ACB believes that when underwritten appropriately, alternative mortgages do not pose undue risks, either singly or in combination. ACB believes that lenders can protect themselves against market downturns through careful management and sensible underwriting practices. Thus, ACB believes that restrictive standards on the use of these mortgage products are unnecessary for regulated financial institutions.

We are also very concerned that the imposition of restrictive guidelines on insured depositories might force such institutions to cease making these types of loans, leaving non-regulated lenders and brokers as the only providers. These entities do not undergo bank-like examination and supervision and have used these products, in some cases, to get borrowers into homes they could not otherwise afford. Restrictions on regulated financial institutions would do nothing to control the practices of these non-regulated entities.

While we support appropriate disclosure to potential borrowers about the terms of these alternative mortgage products, we have concerns about the way the Agencies address disclosure in the Proposed Guidance. We believe that the safety and soundness of regulated institutions should be the paramount concern of the Agencies. The Proposed Guidance, however, extends into the notion of requiring lenders to determine the "suitability" of mortgage products for the individual consumer. While it is the lender's responsibility to provide borrowers with sufficient information for them to clearly understand the loan terms and associated risks, we do not believe it is appropriate or possible for the lender to identify or dictate the best mortgage product for individual consumers. One borrower may place a higher priority on retiring of debt, while another may place a higher priority on current cash flow.

Our explanation for these recommendations follows. In addressing the Proposed Guidance, we have segmented our comments into four areas: Loan Terms and Underwriting Standards; Portfolio and Risk Management; Consumer Protection; and Questions Posed by the Agencies.

Loan Terms and Underwriting Standards

As is the case with all types of lending, the most important component is the underwriting. The guidelines in the Proposed Guidance for loan terms and underwriting standards generally are consistent with the current practices of most of ACB's members. However, we are concerned that the Agencies' approach is too prescriptive and could limit appropriate use of alternative mortgage products.

For many ACB members, the loans designated in the Proposed Guidance as "non-traditional" actually are mortgage products that they have originated for decades and

which have been long-term staples in their portfolios. Negative amortization home loans have been in wide use in some markets since the early 1980s with no increased incidence of non-performance or default. These products create unacceptable risks only when not underwritten properly, just as with fixed rate mortgages. The regulators have been examining banks that have been originating such loans over this same long period.

Increased flexibility in mortgage loan features does not equate to greater risk. Alternative mortgage products can reduce, rather than increase, risks to lenders and borrowers if they are properly managed. Holding ARMs, including IOs and Option ARMs, in portfolio is a long-standing method for institutions to manage risks associated with fluctuating interest rates. The lower minimum monthly payment associated with IOs and Option AMRs also may reduce risk, because they keep mortgage payments affordable during periods of temporary financial difficulties, or seasonal income cycles, or when interest rates are rising.

The Proposed Guidance warns against making loans based on collateral value alone, and irrespective of the borrower's demonstrated ability to repay a loan. We agree with the general concept that there should be balancing factors when a lender accepts a lesser level of documentation and we believe that examiners should evaluate all elements of a lender's criteria in determining whether a specific program feature, such as a relaxed documentation requirement, is justified.

Further, we believe that equity is a key determinant of risk and, therefore, we do not believe the Agencies should issue any blanket admonition against lending to borrowers who cannot demonstrate a particular income level. ACB agrees with the provision in the Proposed Guidance that loans with short-term "teaser" rates should be underwritten at the fully indexed rate. That is consistent with current industry practice. However, this concept should not be extended to require all loans to be underwritten assuming an increase in the balance because if the borrower makes the fully-indexed payments that he is qualified to make, the loan balance will not increase.

We generally agree that underwriting standards should address the impact of substantial payment increases on the borrower's ability to repay an ARM loan. However, the Proposed Guidance 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 that the Agencies should recognize that ARMs, with or without negative amortization, that have a long time to the first payment adjustment pose substantially less risk than mortgages with a short period until payment adjustment. For example, loans with a 10-year interest-only period should be treated differently from loans with a three-year interest-only period. Within a 10-year period, there is a high likelihood that a borrower will sell his home or refinance the original ARM loan. There is also a high probability that within a 10-year period, the property securing the mortgage will increase significantly in value.

The Agencies' concerns about tighter underwriting standards for Interest Only and Option ARMs may be unwarranted. Our members report that borrowers with Interest

Only and Option ARMs tend to have higher incomes and higher FICO scores than borrowers with traditional mortgages. The Proposed Guidance also cautions lenders to assume that borrowers make only minimum payments during the deferral period when calculating the amount that the loan balance can increase. There is no evidence to support this assumption. While no aggregate database exists for alternative mortgages at this time, our members have reported that such alternative mortgage loans are amortizing more quickly than traditional mortgages. This would suggest that these alternative mortgage borrowers are making much more than minimum payments.

When assessing an institution's exposure on mortgages with simultaneous second-lien loans, the Agencies should consider all mitigating factors, including whether the institution has retained all the risk or sold or insured a portion of it. For example, a home purchase financed with an interest-only adjustable rate loan for 80 percent of the purchase price combined with a second trust for the remaining 20 percent of the purchase price could be a prudent lending practice if, for instance, the lender sells the second trust to an investor or obtains mortgage insurance on it. Broad prohibitions on such financing should not be part of the guidelines.

Portfolio and Risk Management

ACB generally agrees that the proposed guidelines for the management of an institution's portfolio risk are prudent. However, like the guidelines for underwriting, they are too prescriptive and broad in scope. They do not take into account the experience and management practices of lenders that have been originating and holding these alternative products for many years. As noted above, many lenders have held large concentrations of mortgages with negative amortization for decades through periods of economic difficulties without negative consequences.

We believe that the Agencies should continue to evaluate on a lender-by-lender basis the existing risk management processes of each financial institution for the identification of portfolio risk segments and the setting of concentration limits. We oppose the Proposed Guidance's insistence that concentration limits be set for certain loan types, for loans with certain characteristics, and for loans acquired through third parties. We agree that concentrations should be monitored for riskier exposures and that some level of portfolio diversification may be appropriate for some institutions. This monitoring can be done in the form of concentration triggers that result in a management response, rather than limits set down as part of board policy. These concentration triggers should be based on each institution's portfolio and business model.

The Proposed Guidance prescribes stress testing of key performance drivers such as interest rates, employment levels, economic growth, housing value fluctuations, and other factors beyond the control of the institution. ACB believes that depository institutions already generally employ adequate risk management practices appropriate for the size of their institutions. Therefore, the Agencies should allow flexibility in this area and not impose stress-testing guidelines that necessitate sophisticated financial software and databases where they may not be warranted.

Stress tests should make "reasonable" worst-case assumptions for default and run-off rates. The Proposed Guidance should make clear that the need to consider the borrower's ability to absorb higher payments does not require unrealistic, worst-case assumptions about the whole portfolio. Lenders should be able to consider realistic ranges of default rates and prepayments in their stress testing.

The Proposed Guidance states that "… the repurchase of mortgage loans beyond the selling institution's contractual obligations is, in the Agencies' view, implicit recourse" and that "under the Agencies' risk-based capital standards, repurchasing mortgage loans from a securitization in this manner would require that risk-based capital be maintained against the entire portfolio or securitization." If an institution decides to repurchase loans because it is in the best interest of the business at the time and not due to contractual recourse, we do not believe the entire portfolio should be considered to have implicit recourse. The Agencies should not impose such recourse when it does not legally exist between the principals to the transaction (i.e. the buyer and seller). This aspect of the Proposed Guidance could have unnecessary, negative ramifications for all regulated institutional lenders regarding their capital requirements.

Consumer Protection

ACB believes that lenders should provide consumers with sufficient information so they clearly understand the loan terms and features associated with all mortgage products, including alternative mortgages. In fact, through regulations such as Regulation Z[5] and Regulation X[6], the regulators already have the authority to require appropriate disclosures. Therefore, we have several concerns about the way in which the Proposed Guidance addresses consumer protection.

In order for disclosures to be effective, they must be received and understood by consumers before they accept the loan. However, as with other aspects of this proposal, we are concerned that these disclosures will only apply to regulated depository institutions, while leaving consumers exposed to misleading claims by less regulated entities. Any mandate for new, more elaborate disclosure requirements should apply to all lenders. To accomplish this, any new mortgage disclosure requirements should be implemented with amendments to Reg Z, the regulations implementing the Truth in Lending Act[7]. The Proposed Guidance should not call for special disclosures for alternative mortgages that effectively amend Reg Z only for insured depository institutions. We understand that the Federal Reserve Board intends to initiate a review of Reg Z this summer and we recommend that any changes in disclosure requirements be considered as part of that review.

Further, we find the disclosure guidelines in the Proposed Guidance too detailed to be easily understood by consumers. It would be useful for the Federal Reserve Board to

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[5] 12 CFR Part 226
[6] 24 CFR Part 3500
[7] 15 U.S.C. 1601 et seq.

consider disclosure requirements that are simple, understandable statements of the crucial terms of the mortgage.

The Proposed Guidance also suggests mystery shopping and call monitoring as good methods to ensure that appropriate information is being given to consumers. While lenders should have in place appropriate techniques as part of an overall compliance program, we believe lenders should be given broad discretion to use methods that are effective for their operations. For example, we understand that mystery shopping has diminished in popularity, while programs for training loan officers have become more common, as a means to maintain compliance.

The Proposed Guidance calls for institutions to monitor third-party originated loans to ensure compliance with the institutions' policies and procedures regarding disclosures. ACB believes that it is not possible for institutions to monitor the disclosure practices of brokers and correspondents to the same extent as employees. What regulated institutions are able to do is control the disclosures provided in conjunction with the settlement transaction. Also, the Proposed Guidance seems to imply that this disclosure monitoring requirement is not limited to the third-party originators and the regulated institutions that buy the loans, but to subsequent purchasers of the mortgages, including secondary market purchasers, such as Fannie Mae and Freddie Mac, that have no mechanism to police all the activities of third parties.

It is also impractical to require lenders to provide disclosure documents to borrowers while they are "shopping." A typical mortgage broker offers products from many lenders, and during the "shopping period," it is impossible to determine which lender ultimately will fund the loans.

Questions posed by the Agencies

In the Proposed Guidance the Agencies specifically request comments on three sets of questions. The questions and our responses follow:

Question 1: Should lenders analyze each borrower's capacity to repay the loan under comprehensive debt service qualification standards that assume the borrower makes only minimum payments? What are current underwriting practices and how would they change if such prescriptive guidance is adopted?

Answer: As noted above, we do not believe it is necessary to assume that every borrower would make only minimum payments over the life of the loan. The experience of ACB members does not seem consistent with this assumption.

We believe that it is current industry practice for institutions to underwrite loans with short-term teaser rates to the fully indexed rate. We do not think there should be a requirement for all loans to be underwritten

assuming fully amortized payments. Similarly, we believe it is unreasonable and unnecessary to assume worst-case scenarios for all loans and that requiring an assumption that all borrowers make only minimum payments would significantly inhibit institutions' willingness to make these loans.

Question 2: What specific circumstances would support the use of the reduced documentation feature commonly referred to as "stated income" as being appropriate in underwriting alternative mortgage loans? What other forms of reduced documentation would be appropriate in underwriting alternative mortgage loans and under what circumstances? Please include specific comment on whether and under what circumstances "stated income" and other forms of reduced documentation would be appropriate for subprime borrowers.

Answer: This question appears to reflect the Agencies' opinion that combining an alternative mortgage product with other alternative features automatically involves "layering" of risk, rather than an assessment of separate risks. The use of "stated income" in combination with an alternative mortgage product such as an IO or Option ARM is a good example of why this might not be true. "Stated income" is often used to spare self-employed borrowers from onerous documentation requirements, in situations where other factors, such as credit score or down payment, indicate low risk. A lower payment during the early years of the loan, a common feature of alternative mortgage products, allows a self-employed borrower to devote resources to building a business rather than to paying down a mortgage and makes it easier to cope with an uneven cash flow. This example shows that, in some instances, an alternative mortgage combined with a "stated income" mortgage may be less risky than "stated income" loans combined with a traditional ARMs or fixed-rate mortgages.

Generally, ACB does not believe "stated income" and other forms of reduced documentation would be appropriate for subprime borrowers.

Question 3: Should the Guidance address the consideration of future income in the qualification standards for alternative mortgage loans with deferred principal and, sometimes, interest payments? If so, how could this be done on a consistent basis? Also, if future events such as income growth are considered, should other potential events also be considered, such as increases in interest rates for adjustable rate mortgage products?

Answer: Generally, institutions do not assume increases in future income when underwriting a mortgage. We do not believe this could be done on an accurate or consistent basis. We also do not believe that institutions should be expected to consider repayment ability far into the future for

traditional or alternative or types of mortgages. This is unnecessary for proper risk management.

Conclusion

ACB believes that the financial health of regulated institutions should be the main concern of the Agencies. Prudent underwriting, careful portfolio management and informed borrowers are factors essential to the safety and soundness of lending institutions. The Proposed Guidance seeks to ensure that insured depository institutions have adequate controls to make certain that these factors are applied to their alternative mortgage portfolios. We do not believe the Proposed Guidance is necessary because depository institutions already employ sufficient controls to confirm that these necessities are fulfilled.

However, if the Agencies intend to issue a final regulation on alternative mortgage instruments, it should be substantially modified before adoption. We believe that the Proposed Guidance imposes excessive regulatory burdens and restrictions that may impede an insured depository institution from offering the widest array of products available to serve their communities responsibly, without demonstration of a corresponding benefit to consumers.

Prudent underwriting practices are the first line of defense against portfolio risk. Regulated financial institutions already protect themselves adequately against market downturns through responsible underwriting practices and sound portfolio management. Therefore, we oppose the imposition of such restrictive standards on the use of alternative mortgage products by regulated institutions.

We also believe that it is unreasonable to impose on insured depository institutions restrictive guidelines for alternative products that do not apply to non-regulated brokers and lenders.

We strongly support simple, informative disclosure of all loan terms to all consumers by all lenders. We believe that the types of disclosure prescribed in the Proposed Guidance are unnecessarily complicated and would impose an undue burden on insured institutions that would not apply to other lenders. In order to make proper disclosures applicable to all lenders, we recommend that any new mortgage disclosure requirements be implemented with amendments to Reg Z. The Agencies should not attempt to make lenders responsible for determining the suitability of mortgage products for individual consumers. Consumers are protected by a comprehensive array of existing federal and state laws and regulations.

ACB appreciates the opportunity to comment on this important matter. If you have any questions, please contact Janet Frank at 202-857-3129 or via email at jfrank@acbankers.org, or Patricia Milon at 202-857-3121 or via email at pmilon@acbankers.org.

Sincerely,

Diane Casey-Landry
President & CEO