February 14, 2006

Ms. 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-1246

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

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

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

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

RE: Interagency Guidance on Nontraditional Mortgage Products

Dear Sir or Madam:

The Conference of State Bank Supervisors (CSBS)[1] appreciates the opportunity to offer comments on the proposed *Interagency Guidance on Nontraditional Mortgage Products* (Guidance). CSBS commends the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the National Credit Union Administration (collectively, the Agencies) for this Guidance which addresses innovations in mortgage lending that have surfaced in recent years. These innovations, while beneficial to many financial institutions and consumers, could potentially lead to safety and soundness issues and create confusion among consumers who do not understand the unique risks associated with these products. CSBS supports the Agencies' Guidance.

CSBS shares the Agencies' concerns with nontraditional mortgage products, including "interest only" mortgages and "payment option" adjustable rate mortgages, due to the inherent risks attributed to these products. In addition, the risks associated with these products are exacerbated by the risk-layering

[1] CSBS is the national organization of state officials responsible for chartering, regulating and supervising the nation's 6,250 state chartered commercial and savings banks and over 400 state-licensed branches and agencies of foreign banks.

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lending practices employed in underwriting these mortgages even while residential real estate values are exhibiting signs of peaking.

The Guidance notes that many nontraditional mortgage loans are increasingly being underwritten with less stringent or no income and asset verification requirements ("reduced documentation" or "stated income"). These underwriting practices clearly can elevate risk levels, if not done prudently and with the requisite controls in place, and may not be appropriate for lending to higher risk borrowers or borrowers who might not otherwise qualify. CSBS agrees with the Guidance that nontraditional mortgage lending use of these less stringent requirements must be governed by clear policy guidelines coupled with other mitigating factors, such as lower loan-to-value and debt-to-income ratios and higher credit scores. CSBS further agrees that lenders who choose to underwrite these nontraditional mortgage loans with these less stringent requirements should be expected to maintain appropriate capital levels, strong loan administration practices (including policy and concentration limits), robust management information and reporting systems, and allowances for loan and lease losses that accurately reflect the additional risks that this type of lending poses.

While the use of more comprehensive debt service qualification standards (including the evaluation of the borrowers' ability to repay the debt at maturity at the fully indexed rate, as well as increasing the principal balance for any negative amortization and the consideration of future income) appears prudent on the surface, these qualification standards would essentially require that borrowers qualify under the most stringent scenario with information that may not accurately reflect future circumstances. If the analyses are not meaningful, lenders risk denying homeownership to qualified borrowers. Additionally, the use of more comprehensive debt service qualification standards, unless also required of nonbank lenders, could place insured financial institutions and their affiliates at a competitive disadvantage.

CSBS recognizes the diverse businesses engaged in mortgage lending and appreciates their varied business models, loan products, and qualification standards, and, rather than being overly prescriptive in the qualification standards, subscribes to lenders being individually responsible for determining the suitability of their products, their qualification standards for their customers, and the necessity for full and timely disclosures to their borrowers. With this approach, lenders using conservative underwriting guidelines would not be penalized and would be less impacted, and lenders utilizing more aggressive business and underwriting models to which this Guidance in part is targeted, would be held accountable for their operations and to their customers.

The current evolution in nontraditional mortgage products has resulted in increasingly complex loan terms and an equally increasing difficulty in informing consumers on the benefits and the disadvantages of their loan choices, including terms that potentially change with economic conditions and payments schedules that are varied by the borrower. The combination of these factors makes it unlikely that current disclosure methodologies will provide consumers with timely and adequate information and sufficient understanding to protect their self-interest by comparing products and/or lending institutions.

Disclosures, as the industry has known them—written pieces of paper presented at various points in the process—need to be moved forward in the decision making process. Technology also needs to be used to tailor these disclosures to the specifics of each consumer's situation. CSBS believes that an entirely

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new disclosure process is necessary to help the consumers keep pace with an ever expanding array of mortgage related products.

CSBS therefore recommends a movement of these nontraditional mortgage products, and for that matter, all residential mortgage products, to a marketplace where disclosures: (1) are tailored to the exact characteristics of the loan in question; (2) are sufficiently detailed to permit consumers redress if there are variances in the final loan offering; (3) involve models that are standardized between institutions so consumers can compare product offerings; (4) are "front" loaded in the borrowing process and required the first time a discussion is made regarding loan terms; and (5) have not more than three or four key summary items highlighted to reduce the potential for information overload. Companies may wish to include web based models to address these issues.

CSBS, in cooperation with the American Association of Residential Mortgage Regulators (AARMR) and the National Association of Consumer Credit Administrators (NACCA), has taken the lead in responding to the particulars of the proposed Guidance. CSBS views the proposed Guidance as a valuable tool for financial service providers grappling with the influx of innovative mortgage lending techniques that are now available. As the Interagency Guidance is directed toward insured financial institutions and their subsidiaries and their affiliates, it appears that nonbank lenders, most of which are licensed and regulated by state authorities and control a large share of the mortgage origination market, may not be subject to this proposal. CSBS will encourage its members to determine the best course of action for distributing this Guidance, or guidance that is similar in nature and scope, to the financial service providers under their supervision.

Thank you for your consideration, and we invite you to call on us if we can provide additional information on the proposed Guidance.

Best personal regards,

Neil Milner

Neil Milner
President and CEO