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Attn.: Docket No. 05-21
Regs.comments@occ.treas.gov

Regulation Comments
Chief Counsel's Office
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Attn.: Docket No. 2005-56
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Attn.: Comments/Legal ESS
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Jennifer Johnson
Secretary
Board of Governors of the
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Re: **FDIC** (No docket number provided); **FRB** Docket No. OP-1246; **OCC** Docket No. 05-21; **OTS** Docket No. 2005-56; Proposed Interagency Guidance on Nontraditional Mortgage Products; 70 Federal Register 77249; December 29, 2005

Ladies and Gentlemen:

Chevy Chase Bank appreciates the opportunity to comment on the Proposed Guidance – Interagency Guidance on Nontraditional Mortgage Products ("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, and the Office of Thrift Supervision (collectively, the "Agencies").

Chevy Chase Bank is a federally chartered thrift with a long standing and large component of our business devoted to making nontraditional mortgage loans on a national basis. In addition to making such loans directly, we purchase loans from a large number of correspondents and brokers. Each year we fund billions of dollars of such loans. Our focus is the prime borrower market. We are not a subprime lender. Our loss experience in this business has been exceptionally low and continues to be so.

In light of our long and deep experience with these products, we are both significantly affected by the proposed Guidance and well positioned to offer commentary on it.

We agree with the twofold thrust of the Guidance of ensuring that (i) business is pursued in a manner that is consistent with safety and soundness and (ii) consumers are availing themselves of these products understanding and appreciating their nontraditional features.

As a longstanding lender of nontraditional products, we already incorporate several positive aspects of the Guidance. Our practices serve to answer, for us, some of the specific questions posed in the Guidance. For example:

- <u>Underwriting</u> In underwriting Option ARMs, we qualify borrowers at the fully indexed rate using a fully-amortizing payment. We believe all lenders should do so as a matter of prudent underwriting. This is one area where a uniform mandate is appropriate.

- <u>Stated Income</u> We do not permit stated income procedures to be used by salaried wage earners. The rationale for stated income is that verifying income is unduly burdensome for some persons, such as self-employed persons and persons with fluctuating income, and is unnecessary if other risk mitigants, such as high credit score and low LTV, are present. This rationale is not present for salaried wage earners where the production of a recent payroll stub is straightforward. Permitting stated income for such persons invites unwarranted risk.

- <u>Disclosure</u> To ensure that borrowers understand and appreciate the most significant differences between a traditional fixed rate mortgage and an Option ARM, we provide borrowers within three days of application and again at closing a “plain English” one page, large print “flyer” which they sign at closing, that highlights the adjustable interest rate and negative amortization features of the product. However, any mandated change in this area, particularly as to the timing of its distribution, should be implemented through an amendment to Regulation Z.

We have participated in the formulation of the comment letters of the American Bankers Association, the Mortgage Bankers Association and America’s Community Bankers and strongly concur in the comments of those letters.

Without restating the thoughtful commentary of those letters, we would like to emphasize several points.

I. Nontraditional Products Should Not Become Less Attractive To Make as a Result of Guidance Mandates That Are Unnecessary.

There are several ways in which the Guidance, if implemented as written, would effectively make nontraditional mortgages prohibitively difficult to make and retain.

For example:

- Mandatory Stress Testing and Underwriting With Worst Case Scenarios.

The Guidance seems to envision a requirement to use “worst case” assumptions in underwriting and portfolio stress testing, such as the assumptions that all loans will remain outstanding for their maximum term and that borrowers of Option ARMs will always make minimum payments. Our experience over many years demonstrates such assumptions are not valid. On a portfolio basis, most of these loans will, like traditional mortgage loans, pay off prior to their maximum term, often prior to the set time period at which the loan payment terms are recast. Also, in our experience, many Option ARMs have principal repayments in the early years which approximate the principal amortization of 30 year fixed rate mortgages, as borrowers avail themselves of the flexibility to make minimum payments in some months and amortizing payments in others. Requiring a lending institution to use assumptions dramatically inconsistent with its own experience is punitive and inappropriate.

- Imposing a New Suitability Requirement.

For reasons entirely unrelated to safety and soundness, the Guidance suggests the imposition of a new “suitability” standard for the mortgage product a borrower should select. This will impose an enormous cost on such products by requiring an entirely new and different compliance scheme - one that does not seek to ensure objective adherence to clear legal requirements but rather one that pursues a subjective quest to know what is “suitable”, presumably based on a myriad of factors such as a borrower’s complete financial circumstances, his future expectations for the length of time he may own his house, and the financial sacrifices or trade-offs he might or wants to make to own the home he has selected. Moreover, a suitability standard creates a new set of legal uncertainties, creating fair lending claims from those who were denied a product they desired by a financial institution which “knew better” and a new class of claims from borrowers who later allege that the product they knowingly understood and selected was, nevertheless not “suitable” for them. The end result of imposing a new suitability standard would be either to force lenders from this arena or to price the products higher to the detriment of the consumer and perhaps to the point of being uncompetitive.

- Correspondent Lender and Broker Monitoring.

The Guidance contemplates the creation of a costly and almost certainly impractical responsibility on regulated lenders to closely monitor and discipline the marketing practices of the broad broker and correspondent community, effectively transforming financial institutions into a quasi-regulator of this community. This burden would be felt particularly by smaller institutions, like ours, which depend on brokers and correspondents for a meaningful portion of their loan volume in order to achieve economies of scale that allows them to be competitive.

Currently, under Regulation Z borrowers coming to us through correspondents and brokers receive appropriate disclosures so that we can be confident that they are appropriately informed about the product for which they are applying. For brokers, our disclosures are delivered within three days of our receiving a borrower's loan application and then again at closing. For correspondents, while we encourage their use of our disclosure materials and periodically audit their use of them, the legal responsibility for their use ultimately is theirs, and not ours.

Imposing a new regime which requires each regulated lender to control the marketing materials and procedures used by each broker and correspondent, which are marketing a variety of different products from different lenders, and to be potentially liable for deviations will add a significant new cost for these products. Furthermore, compliance with such a regime would be realistically almost impossible to achieve when applied to a wide broker and correspondent network. Regulated financial institutions almost certainly would reduce the use of brokers, to the detriment of their loan volume and their economies of scale. The inevitable effect would be a significant detriment to smaller institutions like ourselves and ultimately to our borrowers.

Any change in this area should be implemented only through an amendment to Regulation Z. Such an amendment should set forth a specific disclosure mandate and this disclosure should apply only at a point in time when the institution first comes into contact with the borrower and not at some amorphous earlier point of "shopping."

II The Guidance Should Not Result in Borrowers Selecting Less Regulated Lenders or Being Denied Choices.

The twofold goals of the Guidance are to ensure the safety and soundness of the regulated financial institutions by reducing imprudent lending in nontraditional mortgage products and to protect consumers from utilizing inappropriate mortgage products.

We applaud both goals.

But we fear that the Guidance, through unintended effects, could be counter to both goals.

If the principles of the Guidance unnecessarily raise the costs of such products for regulated financial institutions, the business in such products, even if it can be pursued in a safe and sound manner by regulated institutions, will be driven to less regulated or unregulated lenders, such as mortgage REITS. This would detrimentally affect the financial position of financial institutions such as ourselves which have pursued this business in a safe and sound manner and be detrimental to consumers. Any Guidance should seek to be coordinated with the overall legal framework of obligations and responsibilities applicable to all entities operating in the competitive arena, so that the effect of the Guidance is not to injure the profitability and safety and soundness of the regulated financial sector to the windfall benefit of the unregulated sector or to steer borrowers toward lenders with lesser disclosure obligations. Thus, for example, the modified or enhanced disclosure obligations, if deemed warranted, should be equally applicable to all market participants through an amendment of Regulation Z.

Also, the Guidance should not eliminate cost competitive choices for consumers who wish to avail themselves of new products which they deem appropriate for their needs. If the unregulated financial sector can offer nontraditional products in a more streamlined, cost effective manner, consumers will eventually lose choices and ultimately competition in these products.

Conclusion

We believe that the Guidance must not substitute mandates for the individualized examination of the practices and experience of institutions, like ours, which have conducted business in nontraditional mortgage products for long periods. Doing so will make these products unnecessarily costly and therefore less attractive to the detriment of ourselves and other institutions which have managed their businesses in a safe and sound manner.

Any new disclosure obligations should be implemented as changes to Regulation Z to ensure both clear and uniform compliance standards.

Finally, the Guidance should be coordinated with other regulatory efforts to ensure that the competitive marketplace is equally affected and that informed consumers retain mortgage choices.

Sincerely,

Thomas H. McCormick
Executive Vice President and General Counsel