Capital One

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Public Reference Room, Mail Stop 1-5
Washington, DC 20219
Attn: Docket No. 05-21
regs.comments@occ.treas.gov

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

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

Ms. Jennifer Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Attn: Docket No. OP-1246
regs.comments@federalreserve.gov

Ms. Mary Rupp
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428
regcomments@ncua.gov

Re: Proposed Interagency Guidance on Nontraditional Mortgage Products

Ladies and Gentlemen:

Capital One Financial Corporation ("Capital One") is pleased to submit comments on the federal banking agencies' (the "Agencies") proposed guidance on nontraditional mortgage products (the "Guidance"). Capital One commends the Agencies for the attention that they are focusing on these important products.

Capital One Financial Corporation is a financial holding company whose principal subsidiaries, Capital One Bank, Capital One, F.S.B., Capital One Auto Finance, Inc., and Hibernia National Bank, offer a broad spectrum of financial products and services to consumers, small businesses, and commercial clients. Capital One's subsidiaries collectively had $47.9 billion in deposits and $105.5 billion in managed loans outstanding as of December 31, 2005, and operated more than 300 retail bank branches.[1]

Through its subsidiaries, Capital One Home Loans, LLC,[2] and Hibernia National Bank, Capital One offers first and subordinated mortgage loans, including traditional fixed-rate mortgage loans, adjustable-rate mortgage loans and home equity lines of credit. Among our loan offerings are "interest only" home loans by which the borrower may pay only interest on the loan for up to ten years. We do not offer any payment-option ARMs. The vast majority of our home loans are sold into the secondary market shortly after the loan closes.

<u>General Comment: A Simple Clarification of Scope is Necessary</u>

The Guidance addresses two kinds of mortgages under the umbrella of "nontraditional mortgage products:" "interest-only mortgages and "payment option" adjustable-rate mortgages. The various elements of guidance that the Agencies propose are comprehensible as applied to those two kinds of mortgages. However, the Guidance defines "nontraditional mortgage loans" to "*include* 'interest-only' mortgages . . . and 'payment option' adjustable-rate mortgages (ARMs)" (emphasis added). Hence the Guidance leaves some ambiguity about whether there might be other products, not identified, that might be covered. For example, reverse mortgages are negatively amortizing, may require a balloon payment, and are often repaid by sale of the collateral – all aspects that are identified as subjects of concern in the Guidance – but they are fundamentally different products from the nontraditional mortgages that the Guidance addresses specifically, are designed for a fundamentally different market segment, and would not raise the underlying concerns that the Agencies have expressed. They should not be included in the scope of the Guidance and in fact are never mentioned in the Guidance. We urge that the Guidance be clarified by confirming that the products it refers to are interest-only mortgages and payment-option ARMs, and that other products may be covered only if the Agencies so determine upon further notice and opportunity to comment.

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[1] Earlier this month, Capital One announced that it has agreed to acquire North Fork Bancorporation, Inc., which operates over 300 bank branches throughout New York, New Jersey, and Connecticut and is the third-largest depository institution in the greater New York region. Capital One's comments on the Guidance are based on consideration of Capital One's current mortgage business and do not include consideration of North Fork's mortgage business. That acquisition is projected to close in the fourth quarter of this year.

[2] Capital One Home Loans, LLC, is an indirect subsidiary of Capital One, F.S.B.

The consequences of a mortgage product being covered by this Guidance without the lender knowing it can be severe: The lender's practices could be condemned as unsafe and unsound in an examination, possibly subjecting the institution to enforcement action or disruptive business changes, and the failure to have made some of the many disclosures described in the Guidance could subject the institution to the risk of large liability at the hands of aggressive plaintiffs' attorneys. Hence the existence of the Guidance if adopted in its current form is likely to have a chilling effect on the development and marketing of new mortgage products, like reverse mortgages, and could deprive many consumers of the benefits of those products. For these reasons we believe that the scope clarification we suggest is of critical importance.

Loan Terms and Underwriting Standards

We agree that underwriting standards should take into account the " layering" of risk associated with nontraditional mortgages.

Capital One agrees that institutions should carefully balance the increased risk associated with these nontraditional mortgages when combined with higher loan-to-value loans, lower credit scores, and reduced documentation of income. We also agree that institutions should not look to the collateral as the primary means of repayment. Because of the many variables involved in properly assessing and balancing the overall risk, we recommend that the Guidance generally allow institutions to use their experience and insight to set the level of risk appropriate to the individual institution in the context of the particular transaction, having regard to the entire combination of risk-related factors, including credit scores, loan-to-value ratios, documentation levels, and overall risk in the institution's mortgage portfolio.

Qualification standards for interest-only loans should consider adjustments to the introductory interest rate, but should not be required to incorporate assessment of the borrower's current ability to pay the principal due at the end of the interest-only period.

The Guidance recommends that an institution's assessment of a borrower's ability to repay a loan include an analysis of the borrower's ability to "repay the debt by final maturity at the fully indexed rate." The Guidance, however, is not clear as to application of the recommendation.[3]

Capital One agrees that the underwriting of introductory-rate mortgage loans should include an assessment of the borrower's ability to service the loan at the rates that are likely to apply at the end of the introductory period. However, an institution underwriting an interest-only loan should not be required to assess the borrower's ability to make principal payments at the end of the deferral period. Interest-only loans are often structured to defer principal payments for ten years or more, and it would be unreasonable to expect an institution to be able to assess a borrower's repayment ability

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[3] It appears that this section of the Guidance is directed only toward adjustable-rate products. *See, e.g.,* footnote 5 discussing the expiration of an introductory interest rate – not the expiration of the interest-only period.

that far into the future -- or to now deny a borrower's request for a loan because he or she may not now be able to make principal payments that will not come due for ten years. Such a requirement would effectively make long-term, interest-only loans unavailable to typical deserving borrowers who, in the average case, would not even be living in the home at the end of the deferral period.

Effectively prohibiting interest-only loans, when many borrowers may reasonably believe that their income will have increased by the end of the interest-only period or that they will have moved to different homes and possibly different geographic locations, is not a policy decision that we believe it appropriate for the Agencies to make. We submit that, as long as:

- an institution manages credit risk appropriately in the context of its overall portfolio, and
- the risks and benefits of interest-only loans are appropriately disclosed to borrowers (a subject discussed below),

then the Agencies' legitimate concerns with respect to interest-only loans should be satisfied. The Guidance should be clarified by including such a statement. The same should be true of simultaneous second-lien loans, a common device for saving the borrower the cost of mortgage insurance on the first-lien loan, in order to facilitate the lender's sale of the loan in the secondary market and obtaining for the borrower a lower rate on it.

Portfolio and Risk Management Practices

Assessing loan performance is difficult for institutions that do not normally retain a portfolio, and therefore it should not be required of those institutions.

Institutions that sell their mortgage loans into the secondary market generally do not have available to them the type of information necessary to fully assess their loans' performance once they are sold. Occasionally, institutions may repurchase a defaulted loan as required under the terms of the agreements with investors (for example if it did not meet the documentation standards required in the sale agreement) but, for the most part, investors do not share information on the financial performance of mortgage loans sold to them. Accordingly, that portion of the Guidance directed toward performance reporting and stress testing of nontraditional mortgage loans should be clarified to take such relationships into account.

Consumer Protection Issues

The proposed Guidance would add another layer of disclosures, a practice that does not necessarily provide additional protection to consumers. The better approach is to revise home loan disclosures through amendments to Regulation Z.

A profusion of additional disclosures, whether oral or written and whether in advertisements or on monthly statements, is not the most effective means of protecting consumers. Rather, the focus should be on the quality of existing disclosures, and on revising them so that they are more useful to the consumer. As observed last year by

OCC Chief Counsel Julie Williams in her testimony before the Senate Banking Committee:

> In recent years, bank regulators and Congress have mandated that more and more information be provided to consumers in the financial services area. New disclosures have been added on top of old ones. The result today is a mass of <u>disclosure requirements</u> that generally do not <u>effectively communicate</u> to consumers, and impose excessive burden on the institutions required to provide those disclosures.

Testimony of Julie L. Williams before United States Senate Committee on Banking, Housing and Urban Affairs, June 21, 2005 (emphasis in original).

Depending on how one counts, the Guidance recommends as many as a dozen new disclosures in the advertising of nontraditional mortgage products alone, and it appears that these disclosures should, in most instances, be even more prominent than the disclosures already required by Regulation Z. Hence the Guidance poses the risk that Chief Counsel Williams warned against, that excessive layering of disclosures dilutes their effectiveness and adds compliance burdens (and litigation exposure) without providing meaningful protection to consumers.

Crafting appropriate disclosures for nontraditional mortgage products should be done within the context of revisions to Regulation Z. Doing so has several important advantages over announcing the disclosure requirements by means of regulatory guidance:

1. Implementing appropriate disclosure requirements through Regulation Z will ensure that the disclosures are made by all mortgage lenders, not just those regulated by the Agencies. A significant portion of mortgage lenders are state-licensed mortgage companies that are not subject to the jurisdiction of the Agencies and hence not subject to the Guidance. Their borrowers are as worthy of protection as are the customers of the financial institutions that the Agencies regulate. In fact, if the disclosures required by the Guidance result in cumbersome and off-putting communications with prospective borrowers, it is plausible that the non-regulated lenders' offerings will appear more attractive and that nontraditional business will migrate to them, resulting in borrowers receiving *less* protection, not more.

2. Implementing appropriate disclosure requirements through Regulation Z will facilitate melding the nontraditional mortgage disclosures with the disclosures already required by Regulation Z, offering a chance to minimize disclosure-

overload and dilution while making all the disclosures work meaningfully together.

3. Clear disclosure requirements set out in Regulation Z will channel the discretion of examiners, who in applying the Guidance institution by institution might not apply it consistently. Differing disclosures from one institution to another would defeat one of the main purposes of disclosure as identified by the Truth in Lending Act, which is to facilitate the ability of consumers to comparison-shop among different lenders – "to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him [or her] …."[4]

4. Just as an amended Regulation Z will give clear direction to examiners, it will provide clear direction to lenders, who are otherwise left to their own judgment of what the Agencies would consider "clear, balanced and timely" and what constitutes "information important to the consumer." In addition, clear direction in Regulation Z would provide lenders with a necessary safe harbor, so that they may market their products without worrying whether they are interpreting the Guidance in the same way as plaintiffs' attorneys or trial judges (or juries, if the Guidance's standards of clarity, fullness, fairness, and appropriateness of timing are regarded as matters of fact).

5. Implementing disclosure requirements through Regulation Z will enable the Agencies to craft those disclosure within the well-defined timing framework that Regulation Z provides, removing some of the ambiguities that arise from the Guidance's admonition that communications be "timely" and that a large number of disclosures be included in "promotional materials." Regulation Z includes particular requirements for disclosures provided (a) in advertisements, (b) with an application, (c) after the application is received and before closing, (d) in some cases, at least three business days before closing, and (e) subsequent to closing when a variable rate changes. We urge the Agencies to identify the points on this timeline at which they conclude that particular disclosures with respect to nontraditional mortgages must be made – or to specify any new disclosure times that they believe are necessary (for example, the payment-option ARM disclosures that the Guidance identifies for periodic statements). Certain disclosures in advertisements are required only if the advertisement includes specified "triggering terms," a concept that we strongly urge the Agencies to include in any additional advertising disclosure requirements for nontraditional mortgages, in light of the practical marketing constraints around what can effectively be included in advertisements.

For all of the foregoing reasons, a regime of detailed new disclosures requirements around a set of lending products cries out for incorporation in Regulation Z through a rulemaking process conducted by the Federal Reserve Board, and we urge the Agencies to remove those requirements from the guidance and re-propose them through a

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[4] Truth in Lending Act § 102(a), 15 U.S.C. § 1601(a).

Regulation Z rulemaking – such as the process that the Board is currently undertaking under its Docket No. R-1217.

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Capital One appreciates the opportunity to comment on the Proposed Interagency Guidance on Nontraditional Mortgage Products. If you have any questions about this matter and our comments, please call me at (703) 720-2255.

Sincerely,

Christopher T. Curtis
Associate General Counsel
Policy Affairs