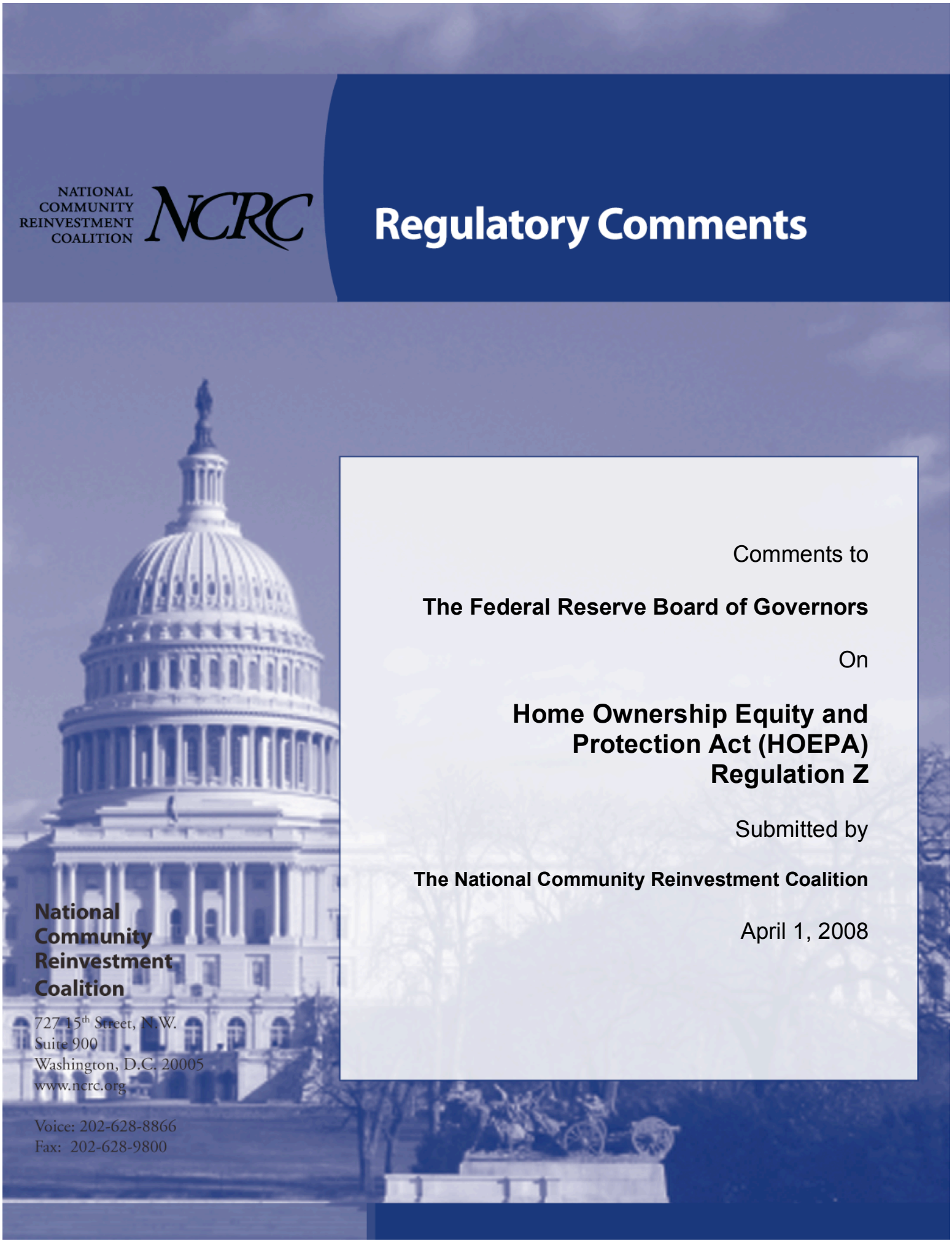


NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

Regulatory Comments

Comments to

The Federal Reserve Board of Governors

On

Home Ownership Equity and Protection Act (HOEPA) Regulation Z

Submitted by

The National Community Reinvestment Coalition

April 1, 2008

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NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

April 1, 2008

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

RE: Regulation Z, Docket No. R-1305

Dear Secretary Johnson:

The National Community Reinvestment Coalition (NCRC) believes that the Federal Reserve Board has taken an important step in proposing changes to its Regulation Z that are intended to make unfair and deceptive practices on high-cost loans illegal. The nation faces a foreclosure crisis in large part because risky lending was not constrained due to a lack of consumer protections and safety and soundness standards. Record foreclosure rates translate into more than 1 million foreclosures in each of the last two years. Foreclosures are projected to be at least 2 million in the next couple of years.

NCRC is an association of more than 600 community-based organizations that promote access to basic banking services, including credit and savings, to create and sustain affordable housing, job development and vibrant communities for America's working families. Our members include community reinvestment organizations, community development corporations, local and state government agencies, faith-based institutions, community organizing and civil rights groups, minority and women-owned business associations, local and social service providers from across the nation.

NCRC operates a program called the National Homeownership Sustainability Fund (NHSF). The NHSF assists victims of predatory lending modify or refinance their loans. NHSF has helped more than 5,000 families and has saved more than $500 million in equity. The program has encountered a number of practices addressed in the Federal Reserve proposal including appraisal fraud, inflated incomes in low documentation lending, onerous prepayment penalties, unsustainable debt-to-income ratios, and servicing abuses.

Based on NCRC's NHSF program, we can attest that the Federal Reserve's proposal is critical and timely. The proposal, however, has significant openings and exceptions in its major provisions dealing with unfair and deceptive lending practices. The proposal has commendable aspects, but the exceptions could make a number of the provisions unenforceable and/or relatively ineffective. We urge the Federal Reserve to address these provisions.

Our comments on specific aspects of the proposal include the following:

NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

Ability-to-Repay Requirements

Elements of Ability to Repay Proposal Supported by NCRC

We support the proposal that a lender's ability-to-repay analysis for high-cost and very high-cost loans must consider a fully-amortizing payment that includes property taxes and insurance.[1] In addition, we support the proposed underwriting based on the fully-indexed rate and the maximum possible rate as specified in loan contracts for step-rate adjustable rate mortgages (ARMs) with an initial teaser rate. The proposed residual income analysis is also vital since lenders must make sure that borrowers truly have enough income left over after monthly debt payments to afford other basic necessities. The proposed standards will curb the dangerous practice of qualifying borrowers on the initial, teaser rate – a practice that has contributed to "payment shock" and borrowers becoming delinquent after the loan's rate increases dramatically from the initial rate.

NCRC asks the Federal Reserve to consider strengthening the ability to pay standard by requiring consideration of the borrower's debt-to-income ratio and residual income. As proposed, the regulation uses the word "or" after the debt-to-income clause and before the residual income clause. NCRC suggests replacing the "or" with an "and" so it is clear that both a debt-to-income and residual income analysis is required when assessing borrower ability to repay. Otherwise, a borrower may appear able to repay under a debt-to-income analysis but actually have few absolute dollars left over for monthly expenses for food and other necessities.

Exceptions and Openings in Ability to Repay Proposal

Unfortunately, other aspects of the proposed ability-to-repay standard have the potential to undermine protections against unfair and deceptive lending. For example, the proposal requires lenders to verify borrowers' income with tax documents and pay stubs. However, the proposal then allows lenders to avoid documentation requirements if they can demonstrate that assumed borrower income and asset levels were not significantly greater than levels the lender could have documented when approving the borrower's loan application. This exception essentially permits the risky practice of limited documented lending to continue.

The proposal also allows lenders to use receipts from check cashing stores to verify borrower income. NCRC asks the Federal Reserve whether check cashing receipts are reliable sources for determining income. How would the lender know, for example, whether the consumer has cashed his or her paycheck rather than another check?

[1] As defined in the proposal, high-cost loans are first-lien and subordinate-lien loans with an APR three and five percentage points, respectively, above Treasury rates of comparable maturities. Very high-cost loans are first-lien and subordinate-lien loans with an APR eight and ten percentage points, respectively, above Treasury rates of comparable maturities or with fees exceeding 8 percent of the loan amount.

The proposed regulation and staff commentary veer into allowing problematic underwriting standards in an effort to provide flexibility in the ability-to-repay standards. For example, the proposal allows lenders to take into account "reasonably expected" income. Under this standard as discussed in the preamble to the proposed rule, lenders could make loans to consumers without current income but with reference to assets other than collateral in the form of the house. In other words, lenders would be permitted to make loans to consumers who were without a steady source of income but with some assets. This proposal would appear to perpetuate the risky lending practices of the last few years in which loans proved to be unaffordable because they were made to people without adequate or steady incomes. NCRC asks the Federal Reserve to reexamine its efforts to provide flexibility and to tighten up proposed standards that could perpetuate risky lending.

The proposed rule allows lenders to assure that borrowers can repay loans during the first seven years of a loan's life. Many borrowers of limited means will not refinance after seven years, meaning this proposed underwriting standard will not provide them with sufficient protections. The Federal Reserve asks whether the standard should be lowered to five years. Instead, NCRC urges the Federal Reserve Board to require lenders to assure that borrowers can repay loans for their entire terms. An ability-to-pay standard for the entire term of the loan is the most sensible approach for assuring that consumers can repay their loans.

Questions the Federal Reserve Asks about Ability-to-Repay Standard

Subordinate lien loans must not be exempt from verification of income requirements. Even though the Federal Reserve's proposal does not provide an exemption for junior lien loans, the Federal Reserve asks if these loans should be exempt. An exemption of this nature would seem to only perpetuate risky lending. A borrower's income and asset levels may have changed significantly from the borrower's receipt of a first lien loan, meaning that safe and sound lending should automatically check the income and asset levels when subordinate lien loans are being considered.

Currently, the media reports that lenders with junior liens have been unwilling to allow modifications of the junior liens when such modifications could prevent foreclosures. Given the reluctance of lenders with second liens to restructuring, risky practices associated with second lien loans would only intensify the possibilities of borrowers not being able to afford their loans. Moreover, if lenders are reluctant to re-work their second liens in the future, then the second liens must be underwritten with the utmost care and prudence so they do not contribute to unaffordable loans.

The Federal Reserve also asks if a debt-to-income ratio should be established as a threshold for determining a borrower's ability to repay. NCRC believes that such a threshold would establish a bright line that would facilitate compliance by lenders and provide extra protections for consumers. A common approach in anti-predatory lending legislation is to presume that a borrower has the ability to repay if the debt-to-income

(DTI) ratio is below 50 percent. The lender is not necessary liable for a violation if the DTI is above this ratio, but the lender must demonstrate how the loan is affordable if the DTI is above the threshold. This construct provides consumer protection, offers some flexibility to lenders, and also appropriately shifts the burden to lenders to prove that loans with high DTI ratios are affordable.

The 50% threshold is employed in the Board's current HOEPA provision concerning prepayment penalties. Therefore, the Board must have considered this threshold to be reasonable and to have weathered the test of time. NCRC's experience with our NHSF program suggests a ratio of 45% is needed since the median ratio of a sample of problematic loans in the NHSF program was 50%. Regardless of whether the Federal Reserve chooses 45% or 50%, a DTI ratio is needed for the ability-to-repay standard.

Pattern and Practice Standard of Proof is Too High

The proposed ability-to-repay standard requires borrowers suing lenders to prove that the lenders exhibited a pattern and practice of making unaffordable loans. This is a very difficult standard for borrowers of few resources to prove. Existing state law does not raise the bar this high. The Federal Reserve should at least allow individual lawsuits under a standard that is not so difficult to prove. It would seem that a regulation that allows individual lawsuits, if not class actions, should not establish such an onerous standard to defend oneself against unfair and deceptive lending.

The Federal Reserve offers a helpful clarification that a pattern and practice violation does not have to be proved by a statistical process but can demonstrated by a lending policy. In some cases, NCRC has successfully resolved complaints filed at HUD by illustrating an unfair practice as documented by the institution's own lending policies. Yet, in many other cases, a lending policy cannot be obtained or only through very time consuming and resource intensive methods. While the clarification is helpful, it still results in a standard of proof that is too high in many cases. NCRC maintains that a borrower should be able to secure relief if he or she can demonstrate that a loan was clearly unaffordable without having to prove pattern or practice.

Escrow Requirements

The proposal recognizes the importance of requiring escrows on high-cost and very-high cost loans. Yet, it permits a lender to allow a borrower to opt-out of escrow requirements after twelve months. Borrowers not familiar with the loan process can be swayed to opt-out of escrow requirements and then face unaffordable expenses that they were not advised to anticipate. The proposal should not allow for the elimination of escrow requirements on high-cost and very high-cost loans.

The Federal Reserve should also apply escrow requirements for loans that exceed HOEPA's fee triggers for classifying a loan as a very high-cost loan. Currently, the proposed regulation applies the escrow requirement only to loans that exceed the Annual

Percentage Rate (APR) trigger of 3 or 5 percentage points above Treasury rates for first lien and second lien loans, respectively. While this proposal will provide the escrow protection to loans with relatively high APRs, it does not provide the escrow proposal to loans that have very high fees and lower APRs. For loans with very high fees, borrowers need the extra protection of escrows to ensure that the high fees do not render them unable to handle tax and insurance payments.

Prepayment Penalties

The proposal to ban prepayment penalties after 5 years is too long of a time period for high-cost and very high-cost loans. Some borrowers may need to refinance before that time to escape unaffordable loans. Others may have significantly improved their credit scores, and should not be penalized by paying thousands of dollars in prepayment penalties to refinance out of high-cost loans. Major lending institutions have voluntarily adopted a three year limit as they stated in the Federal Reserve hearings on HOEPA. We urge the Federal Reserve to follow these best practices and set a limit of between two to three years.

The prepayment penalty should also be limited to a reasonable dollar amount so that the penalty does not pose a barrier preventing a refinance into a lower cost loan. In the Interagency Statement on Subprime Lending, the agencies express concerns that loans with "substantial" prepayment penalties and other onerous terms present borrowers with "substantial" risks.[2] It would seem, therefore, that the other agencies would be supportive of a Federal Reserve move to limit the amount of a prepayment penalty so it would not present a financial barrier to refinancing.

We agree with the Federal Reserve that prepayment penalties must cease before the initial rate expires on an ARM loan. But we urge the Federal Reserve to require prepayment penalties to cease 90 days before the expiration of the initial rate, not 60 days as proposed, so that borrowers truly have enough time to shop for another loan. As the Federal Reserve reports in the proposal, the time period between application and origination for 90 percent of first lien loans is about 50 days. The proposed 60 day time period therefore allows only about 10 days of shopping before submission of an application. This is not a sufficient time period for shopping.

Finally, in response to a Federal Reserve question about disclosures of prepayment penalty and initial rate expiration dates, NCRC suggests that the Federal Reserve require a disclosure to borrowers concerning the expiration of prepayment penalties. This disclosure should occur considerably before the expiration of the prepayment penalty (120 days before the expiration of the initial rate) so that borrowers can process the disclosure, ask any questions of the lender, and prepare themselves for shopping for another loan if they desire to refinance.

[2] Federal Register, Vol. 72, No. 131, July 10, 2007, p. 37572.

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Yield Spread Premium Disclosures

Yield spread premiums (YSPs) must be banned on high-cost and very high-cost loans instead of the proposed improvements in disclosures of YSPs. When YSPs are used, interest rates on a loan are raised beyond the rate a borrower qualifies for so that brokers can be paid. In exchange for the higher interest rates, YSPs are supposed to significantly lower broker fees and other fees. However, the experience of NCRC's NHSF program suggests that YSPs on subprime loans are 'double-dipping' opportunities for brokers and lenders: higher interest rates and usurious fees are imposed. The subprime market is too complicated for borrowers unfamiliar with the loan process to be assisted in a meaningful way by enhanced disclosures of YSPs.

If the Federal Reserve Board proceeds with its disclosure and broker agreement proposal, it needs to enhance this proposal. YSPs need to substantially reduce if not eliminate broker fees and other third party fees. YSPs that do not reduce fees in this manner should be defined as unfair and deceptive since they serve a double-dipping function of saddling consumers with high fees and with high interest rates. S. 2452 or the Home Ownership Preservation and Protection Act of 2007 has a sensible procedure regarding YSPs that the Federal Reserve should consider adopting. For loans that are not high-cost or non-traditional, a YSP is allowed by S. 2452 only if the broker does not receive any other compensation, the loan does not include discount points or origination points, the loan does not include closing costs, and the loan does not include a prepayment penalty.

NCRC agrees with the Federal Reserve that the disclosure of YSP costs in the form of a dollar amount should occur before a consumer has paid any loan-related fees so that the consumer can use the disclosure to shop and compare fees charged by various brokers. In addition to disclosing the dollar amount, NCRC recommends that the increase in the Annual Percentage Rate (APR) as a result of the YSP also be disclosed. The total costs due to the increased APR would be quite valuable in the consumer's shopping and decision-making process. Under NCRC's proposal, the disclosure would inform the consumer if, for example, the YSP increased the APR from 6% to 7.5% and the increase represented $50,000 in additional payments over the life of the loan.

The Federal Reserve's proposal would provide an exemption to the broker disclosure requirement if the broker's compensation is not determined in reference to the interest rate. NCRC believes that borrowers should receive disclosures regarding broker compensation regardless of whether the compensation is tied to the interest rate. One intention of the disclosure requirement is for consumers to determine if the broker compensation is paying for a decent level of services. The proposal, however, would allow borrowers to compare broker services against compensation only in the case of YSPs. This could exclude compensation information for a considerable subset of brokered loans and thus frustrate one of the purposes of the proposed disclosure requirement.

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Protections for All Loans

We support the proposed protections against appraisal fraud and unfair servicing practices. NCRC's NHSF program has encountered numerous instances of appraisal inflation. In fact, a few years ago, NCRC issued a report, *Predatory Appraisals: Stealing the American Dream*, in which we calculated significant appraisal inflation. In a sample of 54 NHSF loans with inflated appraisals, NCRC found that 22 percent of the homes were overvalued by more than 50 percent of the home's true value, and that 65 percent were overvalued by 15 to 50 percent of their true value. Therefore, NCRC appreciates the Federal Reserve proposal making it illegal for a lender or broker to influence an appraiser's valuation of a home.

NCRC also applauds the Federal Reserve's proposal combating servicing abuse. We fully support the proposal to require prompt crediting of a borrower's payment, prohibitions against "pyramiding" of late fees, a requirement to provide a full list of fees, and prompt provision of payoff statements. We ask the Federal Reserve to change the provision that payoff statements are required within 3 business days unless servicers are experiencing unusually heavy volume of requests. The clause allowing for exceptions to the 3 day limit for high volumes of requests can turn into broad exemption. NCRC urges the Federal Reserve to put an upper limit such as 5 business days for providing payoff statements.

The Federal Reserve's proposals stemming appraisal and servicing abuse are needed but remain incomplete. For example, in the area of servicing, the Federal Reserve must require reasonable loss mitigation efforts before foreclosure proceedings are commenced. Protections against appraisal fraud must require a new appraisal and an adjusted loan amount in cases when the original appraisal was inflated.

NCRC supports the Federal Reserve proposal to outlaw various deceptive advertisements for closed-end and open-end loans. For example, a lender would have to advertise both the teaser and final rate for ARM loans, not just the teaser rate. Other prohibitions include a prohibition on characterizing loans as government loans when they are not FHA or VA loans, advertising a loan as a debt elimination product and creating a false impression that a broker has a fiduciary relationship with the borrower when the broker does not. While NCRC believes these proposals are helpful, we caution that they are no substitute for prohibitions of and enforcement against inherently unfair and deceptive loan products and practices.

NCRC also supports the proposed requirement that good faith estimates (GFE) of loan costs for refinance and other non-home purchase loans be supplied to borrowers before payment of application fees. After payment of application fees, borrowers are much less likely to use the GFE to shop for the best deal.

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Non-Traditional Prime Loans not Covered

The Federal Reserve has proposed protections regarding ability-to-repay, escrows, and prepayment penalties for high-cost loans only. It has not proposed these protections for exotic prime loans such as option ARM loans that have proven to be very problematic. The Federal Reserve Board was one of several agencies that wrote guidance requiring ability-to-repay standards for non-traditional prime loans that are very similar to the Federal Reserve's proposed standards for high-cost loans. Since the Federal Reserve has already agreed to these standards for non-traditional loans in guidance that applies to banks, it would be inconsistent to not apply these protections for non-traditional loans made by all types of lenders. This uneven regulation would allow mortgage companies and other non-banks to continue to engage in dangerous non-traditional lending while banks would be prohibited from doing so. It allows non-banks to compete through unscrupulous practices, to the detriment of borrowers and responsible banks.

The Federal Reserve should amend its proposed rule to mandate that option ARM prime loans and other prime loans whose monthly payment does not cover principal and interest rates must adhere to the protections proposed for subprime and Alt A loans (high-cost loans). In the proposal, the Federal Reserve establishes a threshold for defining high-cost loans as first lien loans with Annual Percentage Rates (APRs) three percentage points greater than Treasury rates of comparable maturities. The Federal Reserve asks if a higher threshold should be established such as four percentage points above Treasury rates. NCRC asks the Federal Reserve to maintain its proposed thresholds. The higher thresholds the Federal Reserve asks about would exclude too many high-cost loans from the proposed consumer protections. In addition, the proposed threshold is consistent with Regulation C, implementing the Home Mortgage Disclosure Act (HMDA). The proposed threshold therefore eases regulatory compliance by making Regulation Z consistent with Regulation C. Finally, the Federal Reserve needs to add to its proposal that any prime loans with APR lower than the proposed threshold but with monthly payments that do not cover principal and interest rates are also covered by the proposed protections.

Finally, NCRC applauds the Federal Reserve for extending Regulation Z protections to home purchase loans since the Federal Reserve correctly observes that consumers, especially first time homebuyers, need protections as they are often not familiar with financial markets. NCRC believes that the same logic applies to Home Equity Line of Credits (HELOCs). The Federal Reserve reports that predatory lending does not seem to have afflicted HELOC loans and that the majority of lenders making HELOCs are banks and thrifts that are subject to the highest levels of regulatory scrutiny. Yet, by providing an exception for HELOCs, a new rule could encourage predatory practices to migrate from covered loans to HELOCs. For these reasons, NCRC hopes the Federal Reserve reconsiders its proposal and extends coverage to HELOCs.

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Liability for Secondary Market

Aside from violations for very high-cost (HOEPA) loans, the secondary market's liability under federal anti-predatory lending law is quite limited. In the proposed rule, for high-cost loans and all other loans, secondary market liability for substantive violations appeals to be limited to the Truth and Lending (TILA) standard for disclosure violations apparent on the face of loan documents.

In order to provide additional protections for consumers, NCRC asks the Federal Reserve to hold assignees liable for violations apparent on the face of a broad array of documents in the loan file, not simply the TILA disclosures. An ability-to-repay analysis must include the loan application as well as any other documents the creditor relied upon to determine affordability. The Good Faith Estimate and HUD-1 provide information on fees and YSPs, enabling an analysis of whether a borrower confronts high fees and YSPs. In addition, the documents will provide information on whether limits on prepayment penalties and other loan terms and conditions were exceeded.

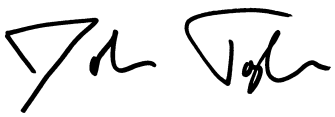
Since most subprime loans are sold to investors, the limited liability for investors provides no effective redress for borrowers. At the very least, the Federal Reserve should broaden liability and allow individual borrowers to seek redress, if not class action lawsuits.

Conclusion

We urge the Federal Reserve to significantly strengthen its proposal and to swiftly implement it. Inadequate consumer protection regulation has significantly contributed to the foreclosure crisis and the current economic uncertainty. At the same time, Congress must pass a strong anti-predatory lending bill since even a strengthened Federal Reserve amendment of Regulation Z is unlikely to be as comprehensive and strong as needed in covering all parts of the lending industry.

If you have any questions, please feel free to contact myself or Josh Silver, Vice President of Research and Policy, on 202-628-8866. Thank you for this opportunity to provide comments on this important matter.

Sincerely,



John Taylor
President and CEO