From: sadams7943@aol.com on 04/08/2008 05:15:02 PM

Subject: Regulation Z

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

RE: Regulation Z, Docket No. R-1305

Dear Ms. Johnson:

My name is Stella Adams and I wish to comment on the Proposed HOEPA Rulemaking. As the former Chair of the Community Affairs and Housing Committee of the Consumer Advisory Council, I want to commend the Board for its thoughtful approach to this rule. However, there have been significant challenges to the Market since these rules were proposed that must be considered as you seek to finalize this proposal. The Federal Reserve Board must now consider each of these proposals based upon safety and soundness, as well as Consumer Protection. As a result of the complete collapse of the housing market and the subsequent broader market failures, America is on the brink of economic recession. Millions of families who are facing a tidal wave of mortgage foreclosures are withdrawing funds from their 401(k)s and other savings, which will inevitably lead to a future economic crisis. Strong action is required and it is required now.

I have spent the last 20 years of my life trying to secure the availability of affordable financial services for African Americans and other underserved populations. I have been an active participant in the regulatory process and have advocated for STRONG regulation of the mortgage industry. I have encouraged the Board on numerous occasions over the years to use its authority under HOEPA to bring order, prudent standards of underwriting, stability and transparency to the sub-prime mortgage market. Homeownership remains the best path to building financial wealth for most Americans. When minority borrowers are forced to pay too much for their home loans they lose the benefits of homeownership. Minority borrowers face higher risks of foreclosure, and will accumulate less equity in their homes than white borrowers not because they were not credit worthy but because they were targeted with inappropriate mortgage products.

Both Fannie Mae and Freddie Mac found that a significant percentage of people who received subprime loans were eligible for prime loans. The placing of first generation African American and other minority homebuyers into inappropriate products loaded with unnecessary risks have trans-generational consequences that will prevent upward mobility and access to the American dream.

The Market has a very very short memory (the S & L crisis) and it is imperative that The Board take strong actions now to prevent future abusive lending practices.

Mortgage loans used to be made by local banks or savings and loans rooted in their communities and because they shouldered the risk they made sure that the borrower had the means to repay the loan. Today most loans are originated by mortgage brokers or unregulated mortgage banks who quickly sell the risk into the secondary market. Well we are seeing the consequences of this unregulated train wreck.

The Ability to repay a loan is just common sense, it requires prudently underwriting the loan as if you had to keep it on your books. A proper analysis would include:

1. provisions that a lender’s ability-to-repay analysis for high-cost and very high-cost loans must

consider a fully-amortizing payment that

a. Includes property taxes and insurance

b. Must be based on the fully indexed rate, not just an initial teaser rate, for adjustable rate mortgages.

2. The proposed residual income analysis is critical to make sure that borrowers have enough income left over after monthly debt payments to afford other basic necessities.

The Federal Reserve must strengthen the ability to pay standard by:

1. Applying ability to pay standards to all loans, not just "high cost" and "very high cost" loans. Any loan that is made without ability to pay is abusive period. These categories are based on either the amounts of points and fees or the extent that the interest rate exceeds the Treasury rates. However many senior citizens have comparatively low fixed retirement incomes and cannot afford high mortgage payments, no matter what the interest rates or points and fees are. They are particularly vulnerable because their low incomes can be "grossed up" without giving them any actual money to make mortgage payments.

2. Eliminating the requirement to prove a "pattern and practice" of making loans without the ability to repay. There is no justification for making any such loans, and any that are made should be fixed to make them affordable. Borrowers can not afford to pay lawyers for the time it takes to discover a lender's patterns and practices. It should be incumbent on the lender or holder in due course to work with the borrower to resolve the abuse. This standard as written is unworkable and will create a "moral hazard" for the lenders who may find it is more profitable to continue an abuse than to stop it.

3. Closing loopholes that take away the requirements that ability to pay be verified, essentially preserving the much-abused "low doc" and "no doc" loans. These loopholes include:

a. allowing 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. § 226.35(b) (2) (ii).

b. Allowing use of dubious methods of verification such as receipts from check cashing stores.

c. Allowing "reasonably expected" income to include assets that will not recur to be used for future payments.

4. Requiring consideration of both the borrower's debt-to-income ratio and residual income. The debt to income ratio should include a requirement that the lender justify a loan when the housing cost will exceed 45% of income.

5. Requiring that lenders to assure that borrowers can repay loans during the entire life of the loan, not just first seven years of a loan's life. Seven years is better than five, but borrowers of modest means do not intend to and often can not refinance out of trouble when payments adjust. They intend to keep paying on the same payment amount.

6. Applying this standard to second mortgages as well as first mortgages. It is common for second mortgages to be abused, in "combo" and similar complex schemes that borrowers rarely understand, so as to create what is essentially an unaffordable loan. It does the borrower no good to have an affordable first loan and an unaffordable second loan. Both loans together must be affordable.

ESCROW REQUIREMENTS

The proposal recognizes the importance of requiring escrows on high-cost and very-high cost loans. The Federal Reserve should not permit lenders to allow a borrower to opt-out of escrow requirements after twelve months. This is a safety and soundness issue, a tax lien trumps a mortgage lien.The Federal Reserve should also apply escrow requirements for loans that exceed both the interest rate trigger and the points and fees triggers for classifying a loan as a very high-cost loan.

PREPAYMENT PENALTIES

The Federal Reserve should apply strict limits to prepayment penalties. Prepayment penalties provide windfall profits for lenders and trap borrowers being trapped in abusive and predatory loans. They are found primarily in the subprime market, indicating that they are exploitative of unsophisticated and vulnerable borrowers.

1. Five years is much too long for prepayment penalties, exceeding the present industry standard.

2. Prepayment penalties must not apply after the expiration of “teaser rate” in adjustable rate loans. At least a 120 day time period is needed so that borrowers have sufficient time to shop for and receive another loan if necessary.

3. For fixed-rate subprime loans, prepayment penalties should not extend beyond two years.

4. Prepayment penalties that exist should be added to the finance charge and be counted towards the points and fees trigger.

YIELD SPREAD PREMIUMS

Yield spread premiums, in the overwhelming majority of cases in the subprime market, are secret fee splitting agreements where the broker sells his borrower customer a higher interest rate loan that is necessary and the broker and lender split the profits. This is contrary to the borrower’s assumption that the broker is acting in his best interests. These YSPs are never bargained for, nor are they in exchange for any reduction in interest rates or other fees. Rather they provide high interest rates and high fees, essentially double dipping by the brokers and higher interest for the lenders.

Yield spread premiums (YSPs) should be banned in all subprime loans and certainly in high-cost and very high-cost loans. This is preferable to the proposed improvements in disclosures of YSPs. Behavioral research shows that people do not process more than three or four key points to a transaction. There are too many documents in mortgage loan transactions for borrowers to understand, comprehend and exercise choice. The subprime market and its pricing are too complicated and opaque for enhanced disclosures of YSPs to be of meaningful assistance to unsophisticated borrowers. Since YSPs are almost always a bad deal that the borrower would not accept if she understood it, they are unfair and deceptive and should be banned accordingly.

The Federal Reserve should eliminate the present disconnect between the conduct of loan originators and the responsibility for fixing the consequences of that conduct and saving the borrower’s home.

Most predatory features have been found within the subprime market. Even if obvious predatory features are not present, subprime loans were made to people with impaired credit history. This is an inherent hazard for people who have temporary or intermittent employment, suffer illness or family breakdowns. When lenders chose to market loans to them, they took on responsibility to make reasonable accommodations to their situations. Subprime loans have shown a high tendency to go into foreclosure. It would be unfair and deceptive to sell cars where 20-40% of them crashed. Accordingly:

1. Lenders should be liable for deceptive and fraudulent practices committed by brokers with whom they do business. Since up to 70% of the loans originated start with brokers, lenders must be motivated to strictly monitor broker behavior.

2. Lenders and brokers must face serious financial penalties if they intimidate or pressure appraisers to meet certain home values. Fraudulent appraisals have contributed significantly to the rise of delinquencies and defaults.

3. The ultimate loan holders and the structured finance agencies that create and fund them, should be responsible for removing predatory features and turning unsuitable loan products into suitable ones. For example if a loan is made for an initial teaser rate that is affordable but then adjusts to a formula rate that is not, the loan should be modified to an affordable fixed rate. The industry should bear the risk of and insure itself against the cost of fixing predatory loans. The Federal Reserve has lowered interest rates, providing industry with the opportunity to do the right thing. However they must be required to take advantage of this opportunity and pass the benefit on to borrowers.

4. The Federal Reserve should require responsible use of loss mitigation techniques to save homes where feasible. It should also require adequate funding and staffing of loan mitigation departments with staff with the knowledge and power to fix loans.

The Federal Reserve should require direct contractual agreements by lenders in a manner similar to the FTC Holder in due course rule, insuring that borrowers have access to the justice system if their rights are violated. In particular it should:

1. Prohibit mandatory pre-dispute arbitration agreements in mortgages;

2. Require loan holders to agree that courts in the borrower's state have jurisdiction over any lawsuit to repair predatory features in a mortgage under the laws of the borrower's state or federal law.

3. Eliminate a "holder in due course" defense for assignees;

4. Prohibit waivers of the borrowers' rights.

5. Prohibit abusive profit taking by loan servicers, foreclosure attorneys and others.

The Federal Reserve should make it an unfair and deceptive practice to steer borrowers qualified for prime loans into subprime loans. In "Income is No Shield against Racial Differences in Lending" the National Community Reinvestment Coalition documents that middle- and upper-income minorities are significantly more likely than middle- and upper-income whites to receive subprime loans. Moreover, previous NCRC research and other studies reveal that racial disparities in lending do not disappear after considering creditworthiness and other key variables. Borrowers lose substantial amounts of wealth when they are steered into high-cost loans.

The Federal Reserve omitted a critical factor that is responsible for this current crisis: structuring loans into first and second liens with a combined loan-to-value (LTV) ratio above 80%. These loans, often called "piggyback mortgages," have structures such as 80-20s, which means the first lien has an 80% LTV and the second has a 20% LTV. Sometimes, the second lien is even higher, resulting in a combined LTV of over 100%. This means that, even with only modest home-price depreciation, the borrower's loan amount is higher than the value of the home.

If we look at this from a safety and soundness standpoint loans with simultaneous second liens should be deemed abusive and not allowed by the Federal Reserve under any circumstances. It is not possible to create a rebuttable presumption related to ability-to-pay or other criteria because, regardless of income, piggyback borrowers are endangered when house prices decline, as evidenced in recent market turmoil. This prohibition would have no adverse impact on borrowers who lack the funds for a large downpayment, as the FHA or private mortgage insurance can and does back high-LTV loans.

Nothing in a prohibition on piggyback mortgages limits the ability of a borrower at some future point to use any home equity that has resulted from home price appreciation through subsequent extensions of credit, but an initial prohibition protects both borrowers and communities from loans that quickly exceed home value during times of price decline.

The Federal Reserve should reexamine the ARM disclosures under TILA such as the “Consumer Handbook on Adjustable Rate Mortgages” that have been approved for lenders to use or modify. The disclosures that are used presently are often incomprehensible to the average borrower. At best they can describe a loan that is much more benign than the one that the borrower is considering, and are therefore deceptive about the risk the borrower faces.

The industry will argue that some of the limitations described above will cut off access to credit for working class and minority communities. We urge you strengthen the Community Reinvestment Act, expand the FHA programs and increase the roles of Fannie Mae and Freddie Mac to increase the access of credit and capital in ways that are not destructive.