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NHEMA

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VIA EMAIL - regs.comments@federalreserve.gov

VIA U. S. MAIL

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

Re: Docket No. OP-1246; Comments upon Proposed Interagency Guidance on Non-Traditional Mortgage Products

Ladies and Gentlemen:

I have the privilege of serving as General Counsel of the National Home Equity Mortgage Association ("NHEMA"). NHEMA is the nation's largest trade association exclusively representing the non-prime mortgage lending industry. Our membership consists of approximately 250, including the nation's largest non-prime lenders. In 2005, our members accounted for approximately 80% of the $600 billion non-prime mortgage loans originated in the United States. Some of our members are supervised by the agencies which have proposed the Guidance. Others are not. Because of the significant impact that the proposed Guidance will likely have on all non-prime lenders, NHEMA offers its comments with respect to your proposed Guidance.

Let me first commend the agencies for considering whether guidance is appropriate in connection with non-traditional mortgage loan products. As you have noted, the agencies issued Interagency Guidance on Subprime Lending in March of 1999, and expanded upon that Guidance in January of 2001. We do recognize and appreciate the very important mission of the agencies in protecting the safety and soundness of the financial institutions which are the backbone of the financial services industry.

This comment letter will address the three specific issues that you have requested be addressed. First, however, I would like to make some general observations with respect to the approach of the proposed Guidance:

1. NHEMA does not think it appropriate to include within the same Guidance both the safety and soundness matters which predominate in the proposal, and the consumer protection matters. These are substantially different matters, and require substantially different approaches. Simply speaking, we do not think it appropriate to marry safety and soundness and consumer protection. With respect to safety and soundness, certainly the portfolio and risk management practices that are discussed in the Guidance are appropriate to lending in non-traditional products, just as such practices are important in managing the portfolio of all other mortgage loan products.

   The institutions that are the subject of the Guidance are already highly regulated, by both the government sector in the form of your agencies and often by the public sector by virtue of the rating agencies that review and advise investors with respect to the purchase of mortgage loan portfolios. While your Guidance suggests that there may be a problem in safety and soundness, there actually appears to be little evidence that the problem even exists. If, as and when a problem develops with non-traditional mortgage products, the safety and soundness issue can be addressed with traditional methods of protection used by the agencies, such as increasing capital requirements.

2. With respect to consumer protection, it should be recognized that any additional requirements that the agencies wish to impose on their regulated lenders with respect to non-traditional mortgage loans, will leave an entire segment of the mortgage lending community outside of such requirements. It seems logical that to the extent that additional disclosures should be required, they ought to be required as part of the Truth-in-Lending Act or the Real Estate Settlement Procedures Act, in order to have binding effect on all mortgage lenders, and not merely supervised lenders. Further, "guidance" as opposed to regulation can lead to a misunderstanding of the legal effect and binding nature of the Guidance.

3. We take this opportunity to point out that the federal Truth-in-Lending Act already requires a high degree of disclosure. We question whether additional disclosure is warranted. We believe that it would only add to the mountain of disclosure information already presented to the borrower. Interest-only loans and home equity lines of credit have been in existence for many years, and there is an existing and well understood disclosure regimen for both of these types of products. Any new "non-traditional products" must still undergo significant disclosure under existing regulations. There is ample information disclosed that explains the loan terms.

   Having said this, we do understand that promotional materials that describe non-traditional mortgage products should provide clear information to consumers. The information in such materials should clearly articulate potential increases in repayment obligation in connection with both interest rate increases and the effect of negative amortization. However, we do not agree that such information should be a part of every monthly statement provided to consumers. Perhaps a semi-annual reminder of the program description initially disclosed under the Truth-in-Lending Act would be more appropriate.

4. To create a disclosure regimen that anticipates events that may never occur (e.g., the 30-year payout of a worst-case scenario, non-traditional mortgage product) will serve only to frighten the consumer away from utilizing the product, when it may be a very good product for the particular need of the customer. Further, to the extent that there is any problem with the marketing or advertising of a non-traditional mortgage product, the Truth-in-Lending Act already has advertising requirements; and, each state already has an unfair and deceptive acts and practices statute that can address any deceptive advertising. Enforcement of existing laws, with the involvement of the Department of Housing and Urban Development and the Federal Trade Commission, is a far better answer to the perceived problem of the need for greater consumer protection, than the layering on of a new regimen of disclosure.

   We fully understand the problem with consumers making "bad choices". Industry has worked tirelessly to educate the borrowing public. Every major trade association and lender in the country has a consumer education initiative. NHEMA actively supports The BorrowSmart Public Education Foundation, which is a nationwide § 501(c)(3) organization dedicated to educating the nation's housing counselors, so that they may in turn assist consumers in making wise choices about mortgage loan products. The reality is that uninformed consumers may not make the best choice in a product. The answer to this, however, is not the additional layering of disclosure. Rather, it is consumer education. The marketplace corrects unscrupulous lenders who will push any mortgage product whether or not in the best interest of a consumer. Such practices are often in violation of current law, the enforcement of which can help mightily in alleviating the perceived problem. In any event, we urge the agencies that have proposed the Guidance to coordinate with the Federal Trade Commission, the Department of Housing and Urban Development, and the Federal Reserve Board with respect to the consumer protection part of this initiative.

I now wish to address the three specific questions set forth in the Federal Register:

1. *Should lenders analyze each borrower's capacity to repay the loan under comprehensive debt service qualification standards <u>that assume the borrower makes only minimum payments</u>?* [emphasis added] *What are current underwriting practices, and how would they change if such proscriptive guidance is adopted?*

It is not appropriate for a lender to assume that every borrower will make only minimum payments to maturity. That is not reality. An appropriate test should take into account the lender's actual experience and industry's actual experience with prepayments and with those borrowers choosing to amortize payments even if not required. Statistics tell us that even in the prime market, where loans are frequently amortized over 15, 25 and 30 year periods, very few loans ever go the distance. Accordingly, an appropriate stress test should take into account the fact that non-traditional products also will not be paid to their stated maturity.

2. *What specific circumstances would support the use of the reduced documentation feature commonly referred to as "stated income" as being appropriate in underwriting non-traditional mortgage loans? What other forms of reduced documentation would be appropriate in underwriting non-traditional mortgage loans and under what circumstances? Please include specific comment on whether and under what circumstances "stated income" and other forms of reduced documentation would be appropriate for subprime borrowers.*

"Stated income" is often used to spare self-employed borrowers from documentation requirements that do not readily fit their condition. Certainly there is the issue of convenience for more highly paid or highly compensated borrowers who have complicated tax returns. Then, there are buyers whose income can be difficult to prove because they have self-employment income from side businesses, and sometimes these same borrowers deal in cash. The issue of stated income is not unique to non-traditional mortgage loan products. The same potential for a problem exists in prime and fixed-rate loans. A capitalist society, by its very nature, has entrepreneurial borrowers. Such borrowers sometimes have sources of income that do not fit nicely into the production of a W-2 or even a 1099-C. That does not mean such borrowers are not entitled to mortgage loans. So-called "subprime borrowers" often turn into prime borrowers because a non-prime lender is willing to make a stated income loan.

The "evil" of a stated income loan results from the situation where the borrower comes to a broker or lender for a fully documented loan, but is steered to a stated income loan because of the failure of the borrower to qualify for a fully documented loan. This circumstance is inappropriate not only for subprime borrowers, but for prime borrowers as well.

3. *Should the Guidance address the consideration of future income in the qualification standards for non-traditional mortgage loans with deferred principal and, sometimes, interest payments? If so, how could this be done on a consistent basis? Also, if future*

events such as income growth are considered, should other potential events also be considered, such as increases in interest rates for adjustable-rate mortgage products?

ARM disclosures already disclose future interest rate adjustments. However, as we have seen just over the period that the ARM disclosures have been required under Truth-in-Lending, it is virtually impossible to accurately predict interest rate increases and decreases, much less income growth. There is no meaningful predictor of income growth that has withstood the test of time, whether the loan is non-prime or prime. There is no meaningful way of disclosing a concern about income growth other than a generic, and generally meaningless statement as to the consumer's need to consider such matter.

If the agencies maintain that the Guidance must include the consideration of future income, the language of the Guidance must be broad enough to allow each lender to develop its own standards for determining future income, with a view to not prejudicing the opportunity for younger people to obtain mortgage loans. It is certainly reasonable to expect that the income of younger persons will increase, particularly when influenced by years of education achieved. There are so many extraneous factors and lifestyle choices that come into play. This makes virtually impossible the creation of a "one size fits all" standard that can be consistently applied. While capacity will always be one of the important ingredients in evaluating the risk to a particular borrower, its difficulty to measure into the future is what mandates the lender's emphasis on credit score, character and collateral.

I thank you for allowing us to offer our comments on the proposed Guidance.

Very truly yours,

Maurice L. Shevin

Maurice L. Shevin
GENERAL COUNSEL

MLS/jsm

c: Jeffrey L. Zeltzer, Executive Director, National Home Equity Mortgage Association