ECD/HOPE
Enterprise Corporation of the Delta
Hope Community Credit Union

4 Old River Place, Suite A, Jackson, MS 39202-3434
Voice: 601-944-1100 • Fax: 601-944-0808
www.ecd.org • www.hopecu.org

Comments in Response to
2007 HOEPA Hearings
Docket Number: OP-1288

Submitted by:
Enterprise Corporation of the Delta / HOPE Community Credit Union
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Enterprise Corporation of the Delta (ECD) and HOPE Community Credit Union (HOPE) appreciate the opportunity to submit comments regarding how the Federal Reserve Board can most effectively use its rulemaking authority under HOEPA to address concerns about abusive lending practices in the prime and subprime mortgage markets. ECD is a private, not-for-profit organization dedicated to strengthening communities, building assets and improving lives in economically distressed areas in the Mid South by providing access to high-quality financial products and related services. ECD's affiliate Hope Community Credit Union (HOPE) is a low-income designated, community development credit union that converts federally-insured deposits into financial services for low-wealth communities. Together ECD and HOPE have generated more than $300 million in financing and assisted more than 30,000 entrepreneurs, homebuyers and nonprofits. ECD/HOPE respectfully submits the following comments to the Federal Reserve Board in response to the 2007 HOEPA hearings.

We are extremely concerned about abusive lending practices, particularly in the subprime mortgage market. Our concern focuses on several prevalent loan terms and characteristics: loan products with "teaser" rates that expire after a short initial period, steep rate increases, no or reduced documentation loans, prepayment penalties, lack of escrow for taxes and insurance, and lack of information provided to borrowers. Each of these characteristics has the potential, individually or together, to strip the wealth that homeowners have worked so hard to build and jeopardize their financial security for years to come.

ECD/HOPE supports the joint guidance that was recently issued by the Agencies on subprime mortgage lending. However, we believe that the Federal Reserve should issue a rule in addition to the recent guidance, which would apply to all lending institutions across the country. For the financial institutions that came under regulatory authority of the Federal Reserve Board and other bank agencies, the guidance serves an important purpose. However, it is important to note that many of the practices described in these comments are the most prevalent – sometimes standard practice – among un-regulated lenders. The guidance that was recently issued actually makes the playing field more uneven, making the regulated lenders, who are generally not using harmful lending practices, more regulated, and leaving the unregulated institutions without any consequences for irresponsible practices. Thus, we urge that the Federal Reserve Board issue a rule requiring ALL lenders to:

- Underwrite all loans based on the fully-indexed rate and fully amortizing payments;
- Restrict the use of prepayment penalties;
- Escrow for taxes and insurance;

- Restrict the use of “stated income” or “low doc” loans; and
- Provide consumers with timely, accurate information about all of the products that are available to them, and disclose information about all of the terms and conditions of any products they are considering.

ECD/HOPE believes that there are several important steps that the Federal Reserve Board can take to address predatory lending in a way that preserves incentives for responsible lenders to provide credit to subprime borrowers. These include recommendations in the four areas requested: prepayment penalties, escrowing for taxes and insurance, “stated income” loans, and unaffordable loans, as well as our comments on the importance of sufficient disclosure of all loan terms to borrowers.

A. Prepayment Penalties

As a credit union, HOPE does not impose prepayment penalties on borrowers. We believe that prepayment penalties are harmful to borrowers, particularly subprime borrowers. These penalties effectively trap borrowers in high cost loans, or require them to lose home equity in order to get out of the loan. They also limit the ability of responsible lenders who do not impose prepayment penalties to help these trapped borrowers get out of their high-cost loans. Below are our recommendations on the requested questions.

- **Should prepayment penalties be restricted? For example, should prepayment penalties that extend beyond the first adjustment period on an ARM be prohibited?**

  Prepayment penalties should be restricted as follows:
  - Prepayment penalties that extend beyond the first adjustment period on all ARMs should be prohibited.
  - Prepayment penalties on all ARMs should be required to expire at least 60 days prior to the end of the fixed rate period. This would give borrowers the opportunity to refinance without incurring harmful prepayment penalties, which can contribute to foreclosure in extreme circumstances.

- **Would enhanced disclosure of prepayment penalties help address concerns about abuses?**

  We believe that many borrowers are not aware that their loan terms include a prepayment penalty, or they do not understand the implications of the prepayment penalty clause. Almost two-thirds of subprime loans have prepayment penalties. It is unlikely that such a large number of borrowers would choose to borrow funds subject to a prepayment penalty, if they understood the implications of such a term. The Federal Reserve should require all lenders to clearly disclose, both verbally and in writing, using plain language that is easy to understand, all terms of the loan, including all terms related to prepayment penalties, before the borrower signs all loan closing papers. We believe that such a disclosure requirement would help address concerns. However, we believe that the most effective way of addressing the harmful nature of prepayment penalties clauses is to impose the restrictions listed above.

- **How would a prohibition or restriction on prepayment penalties affect consumers and the type and terms of credit offered?**

  We believe that curbing prepayment penalties by following the recommendations outlined above will not restrict access to credit. Instead, we believe that it will prevent borrowers from getting trapped in loans that they cannot afford without the flexibility to find another option.

B. Escrow for taxes and insurance on subprime loans

As has been recognized by the Federal Reserve Board, prime loans typically escrow for taxes and insurance, while subprime loans typically do not. We believe that failing to escrow for taxes and insurance is an irresponsible practice because many subprime borrowers are deceived by the mortgage payment quoted to them. Many are first time homebuyers and they are surprised to find that the cost of the home will be much higher when taxes and insurance are included. Many subprime lenders do not conduct a full repayment analysis to the fully indexed rate. And those that do conduct a repayment analysis usually do not account for taxes and insurance. Our recommendations in response to the questions are as follows:

- **Should escrows for taxes and insurance be required for subprime mortgage loans? If escrows were to be required, should consumers be permitted to "opt out" of escrows?**

  The Board should require lenders to do the following on <u>all</u> loans:
  - Escrow funds for real estate taxes and insurance
  - Include taxes and insurance along with principal and interest payments in the repayment analysis conducted prior to extending a loan to a borrower.

- **Should lenders be required to disclose the absence of escrows to consumers and if so, at what point during a transaction? Should lenders be required to disclose an estimate of the consumer's tax and insurance obligations?**

  ECD/HOPE believes that lenders should be required to escrow for taxes and insurance on all loans. If there are certain lenders or certain products on which lenders are not required to do so, these lenders should absolutely be required to disclose the absence of escrows to consumers once at the time that the application is submitted and a second time at least three days before the loan closing. In addition, lenders should be required to disclose an estimate of the consumer's tax and insurance obligations.

- **How would escrow requirements affect consumers and the type and terms of credit offered?**

  Requiring lenders to escrow for taxes and insurance and to requiring lenders disclose the amount of the customer's tax and insurance obligations should not decrease the amount of credit available. It will only ensure that borrowers who receive loans have a better

understanding of the terms of the loan and that they have a greater chance of being able to repay the loan.

C. "Stated income" or "low doc" loans

We believe that allowing low documentation and stated income loans to be used in combination with any subprime or nontraditional mortgages is rarely beneficial to the borrower or the lender. By limiting the use of these loans, the Federal Reserve Board will protect both lenders and borrowers from the risks associated with stated income and reduced documentation loans. Our responses to the questions posed are as follows:

- **Should stated income or low doc loans be prohibited for certain loans, such as loans to subprime borrowers?**

  Stated income and reduced documentation loans should be prohibited for all loans to higher risk borrowers, including:
  - Those with loan-to-value ratios above 95%;
  - Those with FICO scores below 620; and
  - Those who do not pass a "reasonable" test, in which their stated income is compared with wages in their industry.

  We believe that extending a loan to a higher risk borrower without conducting a repayment analysis using their actual income is irresponsible and potentially has negative consequences for both the borrower and for the lender.

- **Should stated income or low doc loans be prohibited for higher-risk loans, for example for loans with high loan-to-value ratios?**

  Yes, stated income and low doc loans should be prohibited for higher-risk loans, including those with loan-to value ratios over 95%. Stated income or low doc loans present an opportunity for fraud by both the borrower and the lender. We believe that prohibiting all higher-risk loans from using stated income or low documentation is consistent with the safety and soundness principles that all financial institutions should be striving for, and will protect them from fraud.

- **How would a restriction on stated income or low doc loans affect consumers and the type and terms of credit offered?**

  Limiting the use of stated income and low doc loans will protect consumers from obtaining a loan that they cannot actually repay. In addition, it will protect lenders from making a loan to a borrower with an inability to repay the loan.

- **Should lenders be required to disclose to the consumer that a stated income loan is being offered and allow the consumer the option to document income?**

  We do not believe that allowing lenders to offer stated income loans to higher risk borrowers, even if they provide extensive disclosure, is an adequate protection against

fraud. Low documentation loans should only be used as a last resort. However, in the cases where a stated income loan is offered, we urge the Federal Reserve Board to require lenders to make the following disclosures to borrowers, both verbally and in writing, using plain language that is easy to understand:

- Tell potential borrowers if a loan is a stated income loan or not.
- Explain that the repayment analysis will be the most accurate if they will provide as much documentation as possible of their income.
- Show borrowers the total income that was used to conduct the repayment analysis.
- Explain the importance of basing the loan underwriting on their actual income.
- Tell borrowers what their total monthly payments will be, broken into the following categories: principal, interest, taxes, insurance, and other.

D. Unaffordable loans

Some lenders, particularly in the subprime market, make loans without adequately considering the borrower's ability to repay the loan. This is particularly harmful with adjustable rate mortgages and loans with teaser rates that reset after two or three years. Failing to fully evaluate a borrower's ability to pay at the fully indexed rate is an unfair and deceptive practice because borrowers believe that they will be able to afford the payments, but after the rates reset they are faced with unaffordable payments that often result in the loss of their home and the equity that they have built.

- **Should lenders be required to underwrite all loans based on the fully-indexed rate and fully amortizing payments?**

We urge the Federal Reserve Board to issue a rule requiring all lenders to underwrite all loans based on the fully-indexed rate and fully amortizing payments. The repayment analysis should include an assessment of the borrower's total monthly housing related payments, including principal, interest, taxes, and insurance, as a percentage of gross monthly income.

- **Are there specific consumer disclosures that would help address concerns about unaffordable loans?**

In addition to requiring all lenders to underwrite all loans based on the fully-indexed rate and fully amortizing payments, we urge the Federal Reserve Board to require all lenders to make the following disclosures to borrowers, both verbally and in writing, using plain language that is easy to understand:

- Give borrowers an explanation of the repayment analysis conducted by the lender.
- Tell borrowers how much their total monthly payments will be, broken into the following categories: principal, interest, taxes, insurance, and other.
- If the loan is an adjustable rate mortgage, explain to borrowers that their payments may increase over the life of the loan. Demonstrate to borrowers what their payments will be if the interest rate is 6%, 10% and 14%.

- Disclose any and all fees that may be charged at any point during the life of the loan.
- Tell borrowers whether they have included an escrow for taxes and insurance.
- Give borrowers an estimate of their tax and insurance obligations.

- **How would such provisions affect consumers and the type and terms of credit offered?**

  Requiring all lenders to underwrite all loans based on the fully-indexed rate and fully amortizing payments may cause some borrowers to not qualify for a loan. However, if the borrower is not approved for a loan based on the requirement to underwrite all loans based on the fully-indexed rate, the loan denial will likely be beneficial to the borrower in the long run. If their income cannot support the fully indexed payments or if they cannot afford taxes and insurance, this is a successful avoidance of a loan that could result in eventual foreclosure or costly refinancings. We believe that underwriting all loans based on the fully-indexed rate and fully amortizing payments is a responsible lending standard which all financial institutions should follow.

E. Disclosure

Based on our experience as a Low Income Community Development Credit Union working regularly with borrowers who have been victims of irresponsible lending practices, we believe that borrowers often do not fully understand the risks and consequences of obtaining certain subprime and adjustable rate mortgage products, and products with potentially harmful loan terms. Therefore, it is critical that financial institutions provide consumers with timely, accurate information about all of the products that are available to them, so that they can make an informed decision.

We recommend that the Federal Reserve Board require clear and concise communication of the costs, terms, features, and risks of all products from the lender to the borrower. All communication should be made verbally and in writing, using plain language that is easy to understand. The Federal Reserve Board should emphasize the responsibility of the lending institution in providing information about all of the terms of the loan.

We would like to emphasize the importance that the lender provide information to consumers at the time that the application is submitted, if not before, and prior to the time that a closing is scheduled. Lenders should provide consumers with detailed information about potential payment shock, prepayment penalties, balloon payments, cost of reduced documentation loans, and responsibility for taxes and insurance while they are evaluating and selecting which product(s) for which to apply.

Communication from the lender to the borrower of each of these items must be thorough and complete as well as clear and concise. If information is presented in a confusing or incomplete manner, it will not achieve its purpose of informing the consumer about the costs, terms, features and risks of the products.

Conclusion
Thank you for the opportunity to comment on how the Federal Reserve Board can most effectively use its rulemaking authority under HOEPA to address concerns about abusive lending practices in the prime and subprime mortgage markets. We believe that the recommendations included in these comments will prevent many of the unfair and deceptive practices that are so prevalent, especially in the subprime mortgage market. ECD/HOPE strongly urges the Federal Reserve Board to issue a rule requiring all lenders to follow the recommendations outlined in these comments, including: requiring all lenders to underwrite all loans based on the fully-indexed rate and fully amortizing payments and to escrow for taxes and insurance, and restricting lender's use of prepayment penalties and stated income and low doc loans. In addition, the Federal Reserve Board should require that lenders provide consumers with timely, accurate information about all of the products that are available to them, and disclose information about all of the terms and conditions of any products they are considering.