CHASE

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250 E Street, SW
Public Reference Room
Mail Stop 1-5
Washington, D.C. 20219
Docket No. 05-21
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Re: Proposed Interagency Guidance on Nontraditional Mortgage Products

Ladies and Gentlemen:

JPMorgan Chase Bank, N.A. ("Chase") appreciates the opportunity to comment on the Proposed Interagency Guidance on Nontraditional Mortgage Products issued by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation (collectively, the "Agencies") at 70 Fed. Reg. 77249 on December 29, 2005 ("Proposed Guidance").

Consumers and lenders have long recognized nontraditional mortgage products as effective and flexible cash management tools. Many nontraditional mortgage products allow consumers to realize the benefits of lower payments without adding any more risk than would otherwise exist under fully amortizing, fixed-rate loans. However, given the wide acceptance of these products, we share the Agencies objective to ensure that nontraditional mortgage products are fully understood and properly managed by the mortgage industry and the public.

Housing lenders strive to provide consumers with a broad range of mortgage products priced to reasonably reflect the risks associated with the borrower's credit profile, the collateral at issue and the features of the mortgage product chosen. We therefore applaud the Agencies decision to recognize the complexity of this risk management process by offering guidance rather than imposing strict regulation. Our Comment Letter notes areas where we believe that amendments to existing federal regulation would more effectively address some aspects of the Proposed Guidance, as well as areas where the Proposed Guidance is, in our opinion, overly prescriptive. As Chase does not offer negative amortization products, our comments are focused on interest only product characteristics.

I. Scope of Proposed Guidance

Applicable to all mortgage lenders. - In order to effectively address the safety and soundness and consumer protection concerns raised by the Agencies, all mortgage lenders should be made subject to the underwriting and disclosure provisions of the Proposed Guidance, not just federally chartered lenders. Limiting the scope only to federally chartered lenders would place these lenders at an extreme competitive disadvantage. Non-federally chartered lenders would be free to continue to offer nontraditional mortgage products without the consumer protections and regulatory burdens imposed by the Proposed Guidance. The unintended end result may be fewer federally regulated lenders offering nontraditional mortgage products, and fewer brokers and correspondent lenders selling into federally regulated lenders. The overall effect on consumers and the housing industry would be negative, and may even serve to destabilize certain geographies that may be heavily weighted towards nontraditional mortgage products.

Extending the reach of the Proposed Guidance to all mortgage lenders would be accomplished to a great extent through modification of existing federal disclosure laws and regulations that apply to all mortgage lenders, such as the Truth and Lending Act and its implementing regulations (collectively "TILA"). We welcome the opportunity to join with other industry lenders to participate in a review process to ensure that the TILA properly reflects today's mortgage marketplace.

Exclusion of certain products. Safety and soundness and consumer protection concerns are considerably less significant in connection with mortgage products that do not result in payment shock shortly after origination, and do not involve negative amortization. Therefore, we suggest excluding certain products from the Proposed Guidance, such as home equity lines of credit, second mortgages, and loans with extended interest only periods (greater than five years).

We also strongly recommend excluding mortgage loans above the conventional market thresholds ("Jumbo" mortgages). Jumbo loans are currently those in the range of $500,000 and up. Jumbo borrowers are more sophisticated and better equipped to understand and evaluate nontraditional mortgage products. Moreover, these customers have long taken advantage of products offering cash flow management options as part of their overall financial planning.

Guidance clarification. Again, we applaud the Agencies' decision to offer guidance rather than impose strict regulation. Guidance offers a degree of flexibility in tailoring practices to meet the specific risk profile of the financial institution. However, given the highly directive nature of the Proposed Guidance, we believe that it would be strengthened by clarifying certain terms such as "collateral dependant loan." For example, a low or no documentation loan should not be able to be characterized as a collateral dependent loan. Product exclusions and clarifications would provide for a more specific line of demarcation as to coverage under the Proposed Guidance when compared to existing regulatory guidance on home equity and mortgage lending.[1]

Finally, the Agencies should consider whether the newly imposed substantive requirements are so onerous, or may be enforced in such an onerous manner, that they effectively result in an outright ban on nontraditional mortgage products. To mitigate this risk we strongly recommend the Proposed Guidance affirmatively state that: (i) nontraditional loan products are not per se impermissible; and (ii) the identified risk factors are not individually or collectively (when layered), per se impermissible. The Proposed Guidance is not crafted as regulation, therefore departure may be appropriate for lenders as they evaluate the risk characteristics of individual borrowers. As such, the risk factors identified in the Proposed Guidance should operate as flags for further analysis, and should not be construed as prohibitions.

II. <u>Underwriting Standards</u>

Chase supports an overall restriction on qualifying borrowers based solely on aggressive short term teaser rates. However, Chase also believes that the underwriting standard in the Proposed Guidance (fully indexed rate, fully amortizing term) is too conservative for many interest only products. Given the five to seven year average life of a residential mortgage loan, most borrowers using interest only products will never experience any form of payment shock. The five to seven year average life minimizes the difference between interest only mortgage loans and thirty year amortizing mortgage loans, as the principal reduction in the early years of a loan is quite small. Moreover, mortgages with interest-only features do not create negative amortization risks. In addition, Chase does

[1] Interagency Credit Risk Management Guidance for Home Equity Lending, Docket No. SR 05-11 (May 16, 2005); OCC Guidelines Establishing Standards for Residential Mortgage Lending Practices 12 CFR Part 30 Docket No. 05-02.

not agree with the blanket assertion that it is improper for a bank to underwrite an interest-only loan with a high loan to value ratio. The unique aspects of each borrower's credit profile and overall financial characteristics must be evaluated.

Chase clearly recognizes the need for prudent underwriting of nontraditional mortgage products. In fact, virtually all banks already have policies and procedures in place that require consideration of mitigating factors when underwriting mortgages with increased risk or unique features. The availability of sophisticated credit scoring and historical credit information make for robust and highly predictive credit underwriting. FICO scores are produced by unrelated third party vendors beyond the influence of borrowers or lenders. Overall risks can be managed properly in a manner that enables lenders to continue to serve consumers' needs for nontraditional mortgage products, even when coupled with additional risk characteristics.

In addition, Chase is concerned that the Proposed Guidance could be read to impose an obligation on a lender to ensure that a borrower chooses the most suitable product. Though banks possess the tools and ability to adequately consider all credit and collateral risk factors, product suitability is ultimately the borrower's determination based on additional considerations.

Finally, the Proposed Guidance places an unreasonable obligation upon a lender to estimate future borrower income and long-term market risks. We cannot conceive of a practical, stable, consistent and reliable methodology for predicting borrower income. Lenders may in fact run a foul of many equal credit opportunity and fair lending laws, regulations and practices when attempting to comply with the underwriting standards in the Proposed Guidance.

III. Risk Management

Certain features of nontraditional mortgages necessitate more conservative underwriting practices, and negative amortization products may be inappropriate for certain depository institutions. However, the Proposed Guidance is overly prescriptive in nature. It should be more principles based; allowing a financial institution to manage risk in the manner that most appropriately fits its needs and best serves its customers.

Monitoring and controls. The Proposed Guidance recommends many monitoring and control practices at loan and product level. Institutions should be permitted the flexibility to manage portfolio risks on a portfolio basis, rather than loan by loan. The ability to originate and manage consumer credit on a portfolio basis is essential to the continued development of the wide-spread, low-cost, consumer credit market that exists in the United States today. Reserve levels and concentration limits should not be dictated by product type, but rather, should be set exclusively by each lender, based upon its internal risk assessment. Note that borrowers in traditionally underserved areas often possess multiple risk attributes. Requiring concentration limits could have the unintended effect of forcing banks to restrict access to credit in these markets. Institutions must be permitted to monitor and manage their portfolios in a manner that avoids potentially distracting issues associated with excessive concentrations and recognizes the particulars of their unique portfolios with respect to diversity of borrowers, products and geographies.

Requiring lenders to consider particular product or borrower features when establishing reserve methodologies is generally unworkable and may result in a sub-optimal risk management position for the institution. Individual institutions should be permitted to prudently and continuously review the adequacy of capital and loss reserves and underwriting guidelines, guided by their industry experience and knowledge of their own unique portfolio characteristics.

In addition, the stress testing methodology called for in the Proposed Guidance requiring analysis of specific performance drivers is impractical under currently available models. Current stress testing and loss reserve procedures utilized by financial institutions serve to adequately identify, monitor and manage portfolio risks taking into account many pertinent factors, some but not all of which are noted in the Proposed Guidance. The creation of stress-testing and loss reserve models is by nature a subjective process requiring the exercise of judgment.

Secondary Market Activities. Overhauling current industry practices to require risk based capital to offset relationship repurchase transactions is unnecessary. Existing financial accounting practices adequately address repurchase transactions as they occur. Investors are aware of and price for the risks that exist in pools containing nontraditional mortgage products. Financial institutions are not subject to pressure to rescue such pools in the event that defaults exceed investor expectations. Capital markets manage safety and soundness issues through collateralization levels, credit enhancements, and other tools; thus the secondary market is an effective risk management tool for financial institutions. Rather than calling for additional capital requirements, the Proposed Guidance should distinguish between investment portfolios and held for sale portfolios.

Third Party Originators. Lenders have a responsibility to appropriately monitor the activities of third party originators. Generally accepted standards and controls for approving and monitoring third party originators include licensing reviews, experience requirements, net worth requirements, public records searches, watch and exclude lists, fraud product screening; quality control reviews, due diligence file reviews and contract representation, warranty and remedy provisions. The Proposed Guidance seems to call for obligations in excess of the generally accepted industry standards. It is not reasonable to require financial institutions to ensure that third party originators are in full compliance with all laws and regulations pertinent to the lender. It is virtually impossible to effectively monitor up-front marketing and borrower disclosure practices by third party originators on a real-time, loan-level basis. Marketing and disclosure practices should be dictated by modifications to existing federal laws and regulations applicable to all originators and lenders.

The United States' residential mortgage market is dependent on the ability of lenders to easily buy and sell mortgages in the secondary market. It is impossible to adequately monitor disclosure practices of all third party originators. The Proposed Guidance would force the industry to manually review every loan file at significant cost, which, even if done successfully, would only identify issues after the fact. This is contrary to the well established provisions of the TILA that notice of violations must appear "on the face" of the documentation when purchasing in the secondary market[2].

IV. Consumer Protection Issues

Chase agrees that lenders should provide clear and concise information about the relative benefits and risks of loan products. Borrowers can then weigh the benefits and risks, and make informed product choices. However, the Proposed Guidance may result in lenders attaching warning labels to particular products that confuse borrowers and lead them to overlook the benefits of nontraditional products.

Disclosure requirements should be set forth in regulations rather than in guidance so as to insure the consistency and quality of the disclosures. In addition, effective disclosures should disclose reasonable case rather than worst case situations.

Disclosure requirements should be consistent with existing law and apply equally to all lenders. Many marketing practices giving rise to the Agencies' concerns expressed in the Proposed Guidance are already violations of existing regulations (FTC Act, OTS false advertising, OCC predatory lending rule, UDAP and TILA). In addition, some required disclosures are trigger terms under the TILA.[3]

Chase again suggests that any required disclosures be implemented through amendments to existing federal laws and regulations, such as the TILA, rather than layering on additional ambiguous disclosure requirements. We note the Federal Reserve Board's recent request for comments on a nontraditional products consumer disclosure document.

Once again Chase appreciates the opportunity to comment on the Proposed Guidance. We believe that the answers to the particular questions asked in the Proposed Guidance have been generally addressed by our comments as a whole. We look forward to further discussions and or comments on future statements.

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[2] Truth In Lending Act, Section 131

[3] Regulation Z, Sections 226.16 and 226.24

Feel free to contact Marguerite Sheehan, General Counsel - Chase Mortgage at (732) 452-8365 or Denise DesRosiers, Associate General Counsel - Chase Mortgage at (813) 881-2908 with any questions or concerns you may have with respect to the matters addressed in this comment letter.

Sincerely,

JPMorgan Chase Bank, N.A.

By:____________________________
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By:____________________________
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