From: "Hirtle Stanley" <shirtle@ablelaw.org> on 12/04/2006 06:25:03 PM

Subject: Nontraditional Mortgage Product Risks

December 4, 2006

Attention: Public Information Room,
Mail Stop 1-5
regs.comments@occ.treas.gov.
Docket No. 06-12
Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

Docket No. OP-1267
Jennifer J. Johnson
regs.comments@federalreserve.gov.
Secretary, Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Robert E. Feldman
Executive Secretary
Comments@FDIC.gov.
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Attention: No. 2006-36
Regulation Comments
regs.comments@ots.treas.gov
Chief Counsel’s Office
Office of Thrift Supervision
1700 G Street NW
Washington, DC 20552

Re: Proposed Interagency Illustrations for Non-Traditional Mortgage Products, 71 F.R. 58672

Dear Regulators:

Edgemont Neighborhood Coalition, Inc. wishes to comment on the proposed Interagency Illustrations for Non-Traditional Mortgage Products. We are glad that regulators are calling attention to these products which have often been abused by predatory mortgage lenders. However we think that regulators need to take stronger action to prevent abuse.

EDGEMONT NEIGHBORHOOD COALITION, INC.

Edgemont Neighborhood Coalition, Inc. is a nonprofit community organization located at 919 Miami Chapel Road, in Dayton, Montgomery County, Ohio. The group consists of residents of the Edgemont neighborhood, a low-income African American neighborhood in Dayton, who have associated in order to foster pride in their neighborhood and address the issues of crime, youth and adult joblessness, inadequacy of educational opportunities, affordability of utilities, and business and community development.

One issue of importance of the Edgemont Neighborhood Coalition, Inc. has been the availability of affordable financial services in the community. Edgemont has been active in Community Reinvestment Act activities in order that residents have access to mainstream financial services at mainstream prices, and not be relegated to high-cost “fringe lenders” such as payday lenders, “subprime” mortgage lenders, rent-to-own vendors and pawnshops.

In furtherance of these goals, Edgemont has commented on proposed regulations by federal agencies and has appeared as amicus curiae in court cases involving payday lending and predatory mortgage lending. Edgemont has been a party in proceedings in the Public Utilities Commission of Ohio, and has also cosponsored conferences concerning payday lenders and their effects on the community. Edgemont supports the work of the National Community Reinvestment Coalition and of the Community Reinvestment Institute Alumni Association here in Dayton.

In addition to being a community organization, Edgemont Neighborhood Coalition, Inc. functions as a small business, operating an office, community garden and community computer center.

LOCAL CONCERNS

Ohio is the center of the mortgage foreclosure epidemic, Montgomery County, Ohio, where we are located, has been at or near the top of the state in mortgage foreclosures. There were more than 4,300 foreclosures in Montgomery County in 2003, approximately 4,000 filed in 2004 and 2005, and 4684 to date in 2006. This is up 250% in seven years.

Minority homeowners, particularly women and the elderly, in our community have frequently been the targets of predatory mortgage lending. Predatory mortgage lending is primarily found embedded in the subprime mortgage market. Even when subprime loans do not contain predatory features, their cost appears to be higher than is justified by the increased risk of loss that the lender faces. Freddie Mac also found that a good percentage of people who got subprime loans were eligible for prime loans. These features suggest that credit markets are segregated in practice and this segregation contributes to high loan cost.

Nontraditional mortgage products have been frequently abused in Dayton, particularly variable rate loans with initial teaser rates. These are unsuitable loans for people with fixed incomes, such as most elderly homeowners in our neighborhoods.

Subprime mortgage lending is more prevalent in minority neighborhoods. A recent study by ACORN found that 23% of all refinance loans to African-Americans in the Dayton/Springfield area were made by higher cost subprime lenders, as opposed to 6% to whites. A study by the National Community Reinvestment Coalition found that African-Americans are more likely to get a subprime loan than whites even if the borrowers' credit scores are the same.

The University of Dayton based study report "Predation in the Sub-Prime Lending marker: Montgomery County – 2001" examined of a random sample of mortgages associated with foreclosure filings and found that a significant minority of sub-prime loans involved with foreclosures exhibit interest rates or other features that are predatory in nature.

Studies from Pennsylvania and North Carolina showed that more than 20% of subprime mortgages will end in the filing of a foreclosure, and most of those will result in loss of a home. Foreclosed homes add to the problem of abandoned properties which blight the neighborhood and contribute to crime.

Minority neighborhoods like ours tend to appreciate less than some suburban areas, and Midwest areas like ours appreciate less than some other parts of the country. Thus while some borrowers can get out of trouble by using their appreciated home value to get a more favorable loan, we can not.

The Federal Reserve Board has found that the median value of financial assets for non-whites is only 1/5 of that of whites. The equity in a family home is the most common financial asset for African Americans. Thus borrowers in our community come to a mortgage transaction at an inherent disadvantage compared to a lender. To the lender, the risk in the transaction is a business risk which it can easily manage by spreading losses over many transactions, improving its servicing, or looking elsewhere for business. Consequences to the lender are comparatively minor.

However, to the borrower the home may be her sole major financial investment as well as the center for family life and the social capital that accompanies it.

Our community and state continue to suffer from hard economic times, and there is concern that jobs in the auto industry may be lost.

Unreasonably high cost mortgage loans with predatory features attack the equity in the home, prevent upward mobility and ultimately can result in losing both the home and what the home means to the American dream.

NONTRADITIONAL MORTGAGE PRODUCTS ARE DANGEROUS

We are glad that the regulators have issued guidances on the problems inherent in “nontraditional” mortgage products. This is a first step in the adequate regulation of these products.

A problem with regulating predatory mortgage lending is that many mortgage products are suitable for some customers but unsuitable for others. A number of these, such as adjustable rates and balloon payments, became widespread in the inflationary 1970s, and some were given special legal protections at that time. These products were suitable for some borrowers, particularly during a period of inflation. Adjustable rates and balloon payments are good for younger people at early stages of their careers whose incomes are going to increase. They are, however, unsuitable for people on fixed incomes. “No doc” income stated loans may have originated to benefit entrepreneurs who have income but are not paid a salary. However they also enable predatory lenders to make loans that are certain to fail.

Recently it appears that new nontraditional mortgage products are proliferating. There are interest only loans, negative amortization loans, and others. This makes it difficult for people who have “old-time” expectations about what a mortgage should be to keep up, particularly when they are getting bad advice from a lender or mortgage broker.

The dynamics of predatory lending are often that lenders or brokers seek to turn the borrower’s home equity into fees for themselves. Predatory mortgage lending exists because loan originators can make very large short term profits by selling a borrower on a loan. However these originators have no long term stake in the success of the loan, or in the loan’s effects on the community. Mortgage loans used to be made and then held by local banks or savings and loans rooted in their communities. But today many loans are originated by commissioned salespeople and then eventually held by distant institutions, sometimes “securitization trusts” with no real independent existence at all.

In practice, originators profit by making as many loans as possible, whether or not they are suitable for the borrower. Often they do this by finding people who have been refinanced previously and are vulnerable to doing so again, a practice known as “loan flipping.” In fact a loan that has been unsuitable and gotten the borrower in trouble often results in repeat business for loan originators.

PREDATORY LENDERS SEEK TO LOWER THE INITIAL MONTHLY PAYMENT. NONTRADITIONAL MORTGAGE PRODUCTS MAKE THIS POSSIBLE

In such a dynamic, the ability to generate a lower monthly payment is often crucial to selling the loan. Adjustable rate loans and their cousins interest-only loans have proven to be crucial to selling loans that are otherwise highly unfavorable to the borrower, and getting origination fees. Adjustable rate loans tend to have lower monthly payments than fixed rate loans.

Particularly pernicious is an initial “teaser rate” that is artificially lower than the formula for computing the loan interest. Such a teaser rate generally insures that the loan payment will eventually increase regardless of what changes occur in interest rates.

While we have had a relatively long period of comparatively low interest rates, many expect that a costly war, high budget and trade deficits and other economic factors will cause interest rates to go up, and with them monthly payments for ARM borrowers. Thus any adjustable rate mortgage is risky for the borrower. Mortgage loan obligations last for long periods, 30 years in many cases, and elderly people face probable increases in health care costs and other expenses in the foreseeable future.

Many subprime ARMs are “one sided”, that is interest rates can increase but not decrease as interest rates fluctuate. This disadvantage to borrowers has not been a factor with historically low rates but is likely to become so as rates fluctuate in the future.

THE ILLUSTRATIONS

We are concerned that illustrations be able to communicate to borrowers the dangers of non-traditional mortgage products. Many borrowers do not have high reading levels, or the ability to process complex and sophisticated information about mortgage products, particularly in the legalese of loan documents.

Unfortunately the Federal Reserve’s Consumer Handbook on

Adjustable Rate Mortgages and its lender created substitutes under the Truth in Lending Act have not been helpful in explaining the dangers of these loans. They are very hard to understand. If anything these are often deceptive, since the loan in the illustration is often much more benign than the one the customer is being ask to undertake.

Any disclosure illustrations need to be distributed at the time of the loan application process so that borrowers have sufficient time to review and fully understand the warnings and notifications being supplied to them, and possibly comparison shop for other products.

For the most part these illustrations are helpful. We have the following suggestions.

Illustration 1:

Illustration 1 is the most reader friendly of the proposals. However it does not apply to a number of products, including the “2/28” with an artificially low initial teaser rate that plagues many subprime borrowers.

1. It would also be much better if the print is larger.
2. Under the Interest Only provision, it might be better to separate the two “ask” instructions at the end, as you did with the payment option ARM.
3. Under “Additional Information” under the bullet for “Home Equity” for the third sentence, we recommend adding the following italicized lines so that the sentence reads:

    > “And, if you make only the minimum payments on a mortgage with a payment option feature, you maybe increasing the amount you owe *(therefore reducing your equity)* because unpaid interest is added to the loan balance.”

Illustration 2:

This chart is very difficult to understand, particularly by people who are not used to charts like this. It may be useful if a trained credit counselor leads the borrower through it, but is unlikely to be useful if the borrower is dealing with someone who has a self interest in selling the loan. You really have to know how the chart is organized and what it is trying to do if you are to make sense of it. The footnotes in small print are particularly bad. We suggest you take this chart to a readability specialist, particularly those who deal with people with below average reading ability.

Many people are getting Adjustable Rate Mortgages that last only 2 years, or even 6 months. There should be a chart for 2/28 adjustable rate mortgages with initial teaser rates. The actual payments should be emphasized by color or bold type.

The cell under the "Option Payment" column and the "Minimum Monthly Payment Year 1-5" row is very confusing to follow, especially as these details are only described under the footnote which many readers might not notice. The example shows the rate changing after the first month (which would indicate a change in the monthly payment), but then says that the payment stays the same through the first year.

If the monthly payment changes after the first year (despite the rate changing after the first month), then there should be another dollar amount listed next to "$600" to reflect the minimum monthly payments for year 2-5 (the rate for these years is 6.4%). If the monthly payment changes after the first month, then the example should clearly illustrate that $600 is the payment for the first month only and should also display the payment for the second month through the end of year 5. It may also be good to have something calling attention to the columns. In general, it is essential to list out this projected minimum monthly payment as option ARMS are a highly complicated product to understand given their constantly changing rates and the varying amounts of payments a borrower can make.
Since illustration 2 shows monthly payments in year 8, displaying total amounts owed and loan balances through year 8 would complete the illustration and make it more understandable.

CONCLUSION: DISCLOSURES ARE NEVER ENOUGH

We believe that your new guidelines and proposed illustrations will help raise consumer awareness about the truth behind these risky products. However, even the best disclosure requirements are not enough. The process of purchasing a home or refinancing a mortgage tends to be overwhelming, chaotic, and often does not provide an ideal environment for thoroughly and clearly explaining all of the available options and their extensive impacts to borrowers. There is often an imbalance of knowledge and power between the mortgage professional and the borrower. The psychology and pressures are to get the closing over with, not to proceed with caution and reflection. Because of this, strong consumer disclosure requirements need to be augmented with tough regulations and enforcement. We ask the regulators to be vigilant in implementing their guidelines on nontraditional mortgages.

Thank you for consideration of our comments.

Sincerely,

Stanley A. Hirtle
Attorney for Edgemont Neighborhood Coalition

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cc: Edgemont Neighborhood Coalition