

**Comments  
to the  
Federal Reserve Board  
Docket No. R-1267  
Home Equity Lending Market  
November 28, 2006**

**by  
Center for Responsible Lending  
Consumer Action  
Consumer Federation of America  
Consumers Union  
National Consumer Law Center  
National Association of Consumer Advocates  
National Coalition for Asian Pacific American Community Development  
National Fair Housing Alliance**

The **National Consumer Law Center ("NCLC")**<sup>1</sup> submits the following comments on behalf of its low income clients, as well as **Center for Responsible Lending**,<sup>2</sup> **Consumer Action**,<sup>3</sup> **Consumer Federation of America**,<sup>4</sup> **Consumers Union**,<sup>5</sup> **National**

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<sup>1</sup> **The National Consumer Law Center, Inc. (NCLC)** is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of sixteen practice treatises and annual supplements on consumer credit laws, including *Truth In Lending*, (5th ed. 2003) and *Cost of Credit: Regulation, Preemption, and Industry Abuses* (3d ed. 2005) and *Foreclosures* (1st ed. 2005), as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low income people, conducted training for thousands of legal services and private attorneys on the law and litigation strategies to deal predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. NCLC's attorneys have been closely involved with the enactment of the all federal laws affecting consumer credit since the 1970s, and regularly provide extensive comments to the federal agencies on the regulations under these laws. These comments were written by Alys Cohen, Elizabeth Renuart and Margot Saunders.

<sup>2</sup> The **Center for Responsible Lending** is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is affiliated with Self-Help, one of the nation's largest community development financial institutions.

<sup>3</sup> **Consumer Action** ([www.consumer-action.org](http://www.consumer-action.org)) is a national non-profit advocacy and education organization that has served consumers since 1971. CA has a national reputation for multilingual consumer education and advocacy in the fields of credit, banking, privacy, insurance and utilities. During its more than three decades, Consumer Action has continued to serve consumers nationwide by advancing consumer rights, referring consumers to complaint-handling agencies through its free hotline, publishing educational materials in Chinese, English, Korean, Spanish,

**Association of Consumer Advocates,<sup>6</sup> National Coalition for Asian Pacific American Community Development,<sup>7</sup> and National Fair Housing Alliance<sup>8</sup>.** We appreciate this opportunity to provide the Board with our views and concerns regarding the Proposed Illustrations of Consumer Information for Nontraditional Mortgage Products (“Proposed Illustrations”). We also briefly respond to the Interagency Guidance on Nontraditional Mortgage Product Risks (“Guidance”) and reiterate our key recommendations.<sup>9</sup>

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Vietnamese and other languages, advocating for consumers in the media and before lawmakers, and comparing prices on credit cards, bank accounts and long distance services.

<sup>4</sup> The **Consumer Federation of America** is a nonprofit association of about 300 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance the consumers’ interests through research, advocacy and education. CFA published a research report earlier this year, entitled: *Exotic or Toxic? An Examination of the Non-Traditional Mortgage Market for Consumers and Lenders* (see [www.consumerfed.org](http://www.consumerfed.org)).

<sup>5</sup> **Consumers Union** of United States is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education, and counsel about goods, services, health and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's mission is "to work for a fair, just, and safe marketplace for all consumers and to empower consumers to protect themselves." Consumers Union's income is solely derived from the sale of *Consumer Reports*, its other publications and services, and from noncommercial contributions, grants, and fees. In addition to reports on Consumers Union's own product testing, *Consumer Reports*, *ConsumerReports.org* and *Consumer Reports on Health*, with a combined paid circulation of approximately 7.4 million, regularly carry articles on health, product safety, marketplace economics, and legislative, judicial, and regulatory actions which affect consumer welfare. Consumers Union's publications and services carry no outside advertising and receive no commercial support.

<sup>6</sup> The **National Association of Consumer Advocates (NACA)** is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA’s mission is to promote justice for all consumers.

<sup>7</sup> The **National Coalition for Asian Pacific American Community Development** is the first national advocacy organization dedicated to addressing the community development, organizing and advocacy needs of the diverse and rapidly growing Asian American and Pacific Islander communities nationwide. Our mission is to be a powerful voice for the unique community development needs of AAPI communities and to strengthen the capacity of community-based organizations to create neighborhoods of hope and opportunity.

<sup>8</sup> Founded in 1988, the **National Fair Housing Alliance** ([www.nationalfairhousing.org](http://www.nationalfairhousing.org)) is a consortium of more than 220 private, non-profit fair housing organizations, state and local civil rights agencies, and individuals from throughout the United States. Headquartered in Washington, D.C., the National Fair Housing Alliance, through comprehensive education, advocacy and enforcement programs, provides equal access to apartments, houses, mortgage loans and insurance policies for all residents of the nation.

<sup>9</sup> The National Consumer Law Center’s full comments on the proposed guidance are available at [http://www.nclc.org/action\\_agenda/predatory\\_mortgage/content/HOEPACommentsAug06.pdf](http://www.nclc.org/action_agenda/predatory_mortgage/content/HOEPACommentsAug06.pdf).

## **The Proposed Illustrations**

Our primary concern with the Proposed Illustrations is that they shift the burden further toward the borrower to dissect the loan market rather than requiring creditors to fully evaluate credit decisions. Moreover, the Proposed Illustrations point out the inadequacy of existing TILA disclosures, as well as the limits of the Guidance itself, by suggesting that consumers consider factors not required in current disclosures or in the underwriting portion of the Guidance. The Proposed Illustrations also are too complex to be useful. Rather than voluntary, confusing disclosures, the Board should mandate binding, advance disclosures. Finally, it is strong underwriting and the introduction of other substantive protections that will truly transform the marketplace.

First, the Proposed Illustrations suggest that borrowers ask questions of lenders. This is at odds with how the market actually works. It is highly inappropriate for the federal regulatory agencies to recommend to consumers that they verbally request information from lenders which lenders are not required to provide to them, and then be expected to rely on the verbal responses to these requests. Assuming more stringent federal regulation *is* coming, consumers should be provided a specific list of the information they should expect to receive in writing from their originator. Consumers must not be encouraged to rely on oral representations from lenders or brokers. Oral representations are not necessarily binding. They are – at best – open to misconstruction, and – at worst – the basis for deliberate deception (something that we see all too often).

Second, there is a significant disjunction between the information the Proposed Illustrations tell consumers they should get and the information that lenders are required to give in a uniform, loan-specific fashion to consumers under TILA. The Proposed Illustrations correctly advise consumers that they should ask about what monthly payments could be after interest-only periods, negative amortization, or interest rate rises on an adjustable rate mortgage (beyond the amount already contemplated on the date of origination). Yet this is *not* information that is currently provided to consumers by lenders. Rather, it is information that lenders resist giving to consumers, and that the Board and the other agencies have so far not required.<sup>10</sup> There is an urgent need to revise Regulation Z to require this information to be disclosed. Until such changes are made, the Proposed Illustrations will only mislead consumers by leading them to believe that they will be given this information. The text at the end of the chart encourages the borrower to use the chart to discuss loans with the lender, but the burden should be on the lender to provide useful and relevant information about what is affordable and appropriate.

Third, the content of the Proposed Illustrations, specifically the comparison of sample mortgage features in Proposed Illustration 2, is too complicated to be useful. Any disclosure should present a limited number of affordable and appropriate loans for the borrower in question. The proposed loan products could be compared with a 30-year, fixed-rate mortgage with no discount points. Any chart with 25 payments to compare

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<sup>10</sup> The Guidance is also deficient in that it does not require lenders to consider all of these elements in the recommended underwriting process.

and three footnotes is not useable, even by the most educated and savvy consumer. Proposed Illustration 3, although providing different information, is closer to the size and structure that would be potentially useful. While the information supplied in Proposed Illustration 3 does provide useful information to a borrower with a payment option ARM, these key loan characteristics, including increased principal due to negative amortization and escalating monthly payments, are not sufficiently included in existing mandatory early disclosures or underwriting requirements. Also, any illustration along these lines assumes a certain level of financial literacy. It would be useful to consumers without such an understanding to include a sentence stating, “If you do not understand these illustrations, this type of loan is probably not right for you.”

Finally, by the regulators’ own words, “[u]se of the Proposed Illustrations would be entirely voluntary. Accordingly there is no Agency requirement or expectation that institutions must use the illustrations in their communications with consumers.” The failure to mandate use of any particular illustration or any particular format means that there is no reason to expect any uniformity from lender to lender. Even worse, lenders may make subtle changes in the illustrations so that they appear to resemble other lenders’ illustrations but in fact lead consumers to compare apples to oranges. The failure to mandate the content and format of the illustrations also allows creditors to manipulate the illustrations to steer consumers into disadvantageous loans.

Instead of suggesting that lenders make confusing, non-uniform disclosures, the Board should, as we discussed in our comments on the Proposed Guidance, mandate that consumers receive advance, binding, loan-specific disclosures that include (in addition to what is already required):

- the fact that the credit involves a variable rate and that the consumer’s
- interest rate and monthly payment can change substantially over time;
- the number of months to which the initial interest rate applies;
- the maximum interest rate and monthly payment that could result from variable rate increases, based on the initial principal; and
- a reference to an Internet site or a widely-circulated newspaper feature where the consumer can find the index.

The creditor also should be required to state whether property taxes and homeowner’s insurance are included in the payment schedule and the current annual amount due of any separate payment for taxes and insurance. For all loans that expressly permit or could result in negative amortization despite regular, timely payments by the borrower, the creditor should be required to state whether the loan permits negative amortization, a clear description of negative amortization, and the expected consequences of negative amortization. For all loans with prepayment penalties, creditors should be required to provide information regarding the time period during which the penalty is applicable, how the penalty is calculated, and the maximum amount of the penalty.

By suggesting that creditors individually create non-uniform illustrations, the Proposed Illustrations actually undermine the goal of requiring uniform, binding, loan-specific

disclosures. Once creditors invest the time and effort to create their own illustrations they will be more likely to resist efforts to impose uniform disclosure requirements by regulation.

Moreover, the whole process of considering illustrations, or even disclosures, without looking at substantive protections that include these same considerations misses the point. As the Board and the other members of the FFIEC have recognized, disclosures cannot take the place of underwriting. As was stated in the recently issued Guidance:

[I]nstitutions should maintain qualification standards that include a credible analysis of a borrower's capacity to repay the full amount of credit that may be extended.

Nothing in any disclosure (or illustration) should relieve lenders of their basic responsibility to fully evaluate a borrower's ability to repay the loan. Disclosures should not provide any lender with an argument that the information provided through the loan documents and any supplementary materials, including those required by federal law, can supplant the lender's duty to undertake a critical and thorough analysis of the borrower's ability to make all of the payments due under the loan.

Even with detailed disclosures, few consumers are able to:

- *comprehend* the complex variety of mortgage products available;
- *appreciate* the costs and benefits of these different products;
- *calculate* the effect of this risk analysis for their own families' situation;
- *shop* efficiently in the nationwide mortgage marketplace to find alternatives;
- *ask* the necessary questions of the mortgage originators to determine all of the risks and benefits of the mortgage product being offered;
- *negotiate* effectively with the originator to obtain the chosen product; and
- *examine* the documents closely enough at closing to make sure that the final loan terms are the same as those disclosed.

For the rest of us – consumers who do not have this combination of financial savvy and access to alternative loan sources – substantive regulation of the mortgage origination process is still essential.

### **The Guidance**

As we discussed in our recent comments on the Proposed Guidance, the current epidemic of foreclosures and lost equity requires bold action. This only can be achieved through broad substantive regulation by the federal regulators and comprehensive federal legislation. While the result should be a market that curbs its predatory practices, strong remedies for abusive conduct—not disclosures—are the avenue to that end.

The Guidance takes a good step forward by emphasizing the central role of evaluating the affordability of a prospective loan. Unfortunately, this only is the first of many needed

steps. Huge numbers of unaffordable loans with exploding monthly payments have already been made—with prepayment penalties that make it impossible to refinance.<sup>11</sup> Moreover, working families and others who are strapped financially still likely will be sold these products by the 60% of lenders not covered by the Guidance. The Board should expand the Guidance, under 15 U.S.C. 1639(l), to apply to all mortgage creditors. Further, many abusive loan products that impose significant payment shock on the borrower are not clearly covered by the Guidance and need to be addressed directly. For example, loans that do not formally defer interest payments but that involve low one- or two-year teaser rates—a dominant product in today’s subprime market—will soon be pushing borrowers into default and foreclosure. The regulators should clarify that 2/28 mortgages and similar products are covered by the Guidance.

Even adjustable rate mortgages without teaser rates are beginning to reset at unaffordable levels. In one case, a client received a purchase money loan in June 2004, where the initial loan rate was fully indexed – 5 points over the 6-month LIBOR. The current LIBOR at the time was 1.94%, so the fully indexed rate was 6.94%. Two years later, when interest rates had climbed substantially, the index was at 5.63%. The interest rate on the loan would have climbed to 11.63% but for the limit of 3% for the first change. Subsequent changes made every six months had a 1% limit on change. However, the effect on payments was still dramatic. The new mortgage payments jumped 27% in 30 months and took up almost 10% more of the borrower’s monthly income. Consider these numbers:

First 24 payments: \$842.66  
25th – 30th payment: \$1066.14  
31st - 36th payment: \$1156.08 (assuming rates do not change)

Loans like these also need substantive regulation.

Further, even where the Guidance does apply to a loan, a homeowner cannot use any of its provisions to protect the home directly because they do not provide for a private cause of action. Extension of the Guidance under Regulation Z would solve this problem. Most importantly, the rules as they stand are insufficient. Analysis of loan affordability should consider a borrower’s ability to make adjusted payments, including adjustments resulting from increases in the loan index interest rate. For example, the loans should be underwritten based on the maximum possible payment during a certain number of years, such as seven years, or by using a forward-looking stress test. Loans should not be underwritten based only on the fully indexed rate. In addition, the Guidance is too permissive regarding no-doc loans. These products are often used to push unaffordable

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<sup>11</sup> A recent study by First American Real Estate Solutions reported that \$368 billion in adjustable rate mortgages that were originated in 2004 and 2005 (one in eight) are sensitive to interest rate adjustments that would lead to default and \$110 billion are expected to go into foreclosure. Cagan, Christopher L., First American Real Estate Solutions, “Mortgage Payment Reset: The Rumor and the Reality,” Feb. 8, 2006, at 38.

loans on borrowers with readily verifiable limited incomes. Loans originated without documentation of the borrower's ability to repay should be banned.

We ask the Board to recognize that the abuses in the mortgage market continue and --

- 1) Recommend to Congress that significant changes be made to the regulation of mortgage lending;
- 2) Use the Board's authority under 15 U.S.C. 1602(aa)(4)(D) to continue to broaden the triggers for HOEPA loans; and
- 3) Use the Board's expansive powers – under both the Truth in Lending Act and the Federal Trade Commission Act – to expand the principles in the Guidance regarding affordability and prohibit unfair and deceptive activities in mortgage lending.

### **Conclusion**

The gravity of the current situation calls for serious steps to create a level and fair playing field both for consumers and responsible lenders. These steps must include the extension of the principles in the Guidance, the introduction of additional regulation to curb a never-satiated mortgage market, and the requirement of early, firm, useful disclosures. The Proposed Illustrations would serve to confuse consumers on the products available and, more importantly, on the question of whether a lender has a responsibility to properly evaluate the affordability of a loan. We hope the Board will seize this unique moment to help create an environment where people can seek economic stability through sustainable homeownership.