ACORN

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th & Constitution Avenue, NW
Washington, DC 20551-0001

Re: Docket No. OP-1267

December 1, 2006

Dear Members of the Board of Governors:

I am submitting these comments on behalf of the more than 230,000 ACORN member families in 103 cities across the country. ACORN, the Association of Community Organizations for Reform Now, is the nation's largest grassroots community organization. We work to empower low and moderate-income people to have a greater voice in the decisions, structures, and policies that affect their lives. Since 1970 ACORN has taken action and won numerous victories on issues of concern to our members particularly improved access to credit on fair terms.

Thank you for the opportunity to share our opinions regarding the Proposed Illustrations of Consumer Information for Nontraditional Mortgage Products. We applaud the Federal Reserve and other Agencies for taking on the serious problems addressed in the Interagency Guidance on Nontraditional Mortgage Product Risks. We were further encouraged when the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators recommended that states adopt the guidelines.

However, it is in this context of applying the guidelines on the state level, that we believe the Guidance and Illustrations have one major omission – the lack of information pertaining to 2/28 and 3/27 Adjustable Rate Mortgages.

Although these products might not be very common among federally supervised institutions, they have become <u>the</u> loan originated by state supervised subprime lenders. While ARMs represent about a quarter of all home loans nationwide, they

Association of Community Organizations for Reform Now
National Office: 739 8th Street S.E., Washington, D.C. 20003 • 202-547-2500 FAX 202-546-2483

make up three-quarters of all subprime loans originated in 2005 -- a huge increase from 1999 when half of all subprime mortgages were ARMs.

The Proposed Illustrations are designed for a market in which there is discussion and deliberation in the decision-making process – practices which do not exist in the subprime world.

We have interviewed hundreds of subprime ARM borrowers throughout the country, and none of them were given a choice about whether they wanted a fixed or adjustable rate. While lenders may not wish to believe this and may insist their customers are choosing adjustable rates, we would ask these lenders how their customers could make a choice since we have never seen any forms that a broker or loan officer might use to help a borrower decide.

We asked borrowers about when they learned they would be getting an adjustable rate and how it was explained to them. Their answers can be grouped into the following categories:

- Some customers were given an ARM and told it was the only or best way to go.
- Some customers were told they didn't qualify for a fixed rate, but weren't told why
- Some customers expressed concern when they learned they were getting an ARM, but were told not to worry because they could refinance in a year or two.
- Some customers did not learn until closing they were getting an adjustable rate.
- Some customers did not know they had an adjustable rate until an ACORN representative reviewed their loan documents.
- Some customers didn't find out they had an ARM until their payment went up.

In addition, none of the borrowers received an accurate explanation of how their LIBOR-based, teaser-rate ARM worked. The most common type of subprime ARM is one in which the borrower's initial rate will increase after two years even if rates stay the same or decrease, but in no case will it go below the starting rate. Typically, the rate can increase up to a maximum of 700 basis points above the starting rate. The borrower's maximum possible payment is not listed anywhere in the disclosures.

The borrowers we interviewed were not given any explanation or were told:

- the rate may just go up a little
- the rate may go up or down
- the payments will only go up as shown on the TIL statement
- the lender will refinance them before the rate changes

When three quarters of borrowers in the subprime market are receiving ARMs, it is hard not to believe that they are being steered to these products, especially given the minimal benefit of a 2/28 ARM.

For instance, at New Century Mortgage, curently the largest 2/28 subprime lender, there is only a 70 basis point difference between a fixed and adjustable rate. On a $100,000 loan the difference in a monthly payment between a 7.9% and 7.2% rate is just $48.02. On a $200,000 loan the difference is less than $100.

The minimal savings in these examples immediately begin to reverse after two years when the interest rate changes. New Century has a cap of 150 basis points for the maximum change that can occur on the first change date. In the above examples, the starting rate would increase from 7.2% to 8.7% and the corresponding monthly payments for the ARMs would then be higher than for the fixed rate.

On a New Century loan, the ARM rate would continue to increase by 100 basis points every six months until it reached the fully indexed rate. The lowest margin on an ARM at New Century is 5.9%. At today's six-month LIBOR rate of 5.34%, the fully indexed rate would be 11.24%, which would be reached in the above example in just 18 months after the first change date.

The corresponding payments at 11.24% for the loans in these examples would be almost $600 a month higher than the starting payment for a $200,000 loan, and almost $300 a month higher for a $100,000 loan.

We strongly believe that no one should be given an ARM without also being the choice for a fixed rate loan. Attached is a sample ARM vs. fixed rate disclosure that we have designed. Any disclosure that is used to show comparisons should use the actual numbers from the individual's proposed mortgage – loan amount, interest rate, loan term, etc.

We do not believe however that the use of improved disclosures alone will adequately stem the predatory practices that are pervasive in the subprime market. We believe that the abusive origination of 2/28 ARMs demands the attention of federal and state regulators, and that many of the guidelines for interest-only loans and option ARMs should apply equally to 2/28's.

In the subprime market, lenders typically will allow borrowers to have a larger debt-to-income ratio than in the prime market. It is common for subprime lenders to qualify a borrower with a 50% or 55% debt ratio, using a monthly payment based on a teaser-starting rate that is almost guaranteed to increase in two years. It is clearly unsound for both borrower and lender when loans are underwritten with no consideration beyond the first two years of the loan. Instead, the 2/28 lenders are relying on the likelihood that these borrowers will be forced to refinance before their payments become unaffordable, a practice strongly discouraged in the Guidance.

Sincerely,

Maude Hurd
ACORN National President

Fixed vs. Adjustable Rate Comparison Disclosure

Based on your loan application, you can qualify for either a Fixed rate or an Adjustable Rate Mortgage (ARM). Each type of loan has different benefits and risks.

While you may get a lower starting interest rate and starting monthly payment with an ARM, you risk a substantial increase in your monthly payments after (x) years. This new payment amount may be unaffordable for you.

Based on the proposed loan amount, here is a comparison of the terms of your loan if you chose to take out a fixed rate vs. an adjustable rate mortgage.

Loan Amount: _$100,000__ Number of years of loan: ___30_

Loan Terms	With an **ARM**, you qualify for	With a **fixed rate**, you qualify for
APR	10.06%	8.17%
Starting Interest Rate	7.0%	7.85%
Starting Monthly Payment (Not Including Taxes or Insurance)	$665.70	$723.33
Maximum Interest Rate	14.0%	7.85%
Maximum Monthly Payment	$1184.87	$723.33
Projected Interest Rate in 2 years *(based on current interest rates)*	8.5%	7.85%
Projected Monthly Payment in 2 years *(based on current interest rates)*	$768.91	$723.33
Projected Monthly Payment in 3 years *(based on current interest rates)*	10.5%	7.85%
Projected Monthly Payment in 3 years *(based on current interest rates)*	$914.74	$723.33