# Comments On the Home Equity Lending Market
# Docket No. OP-1253

Via Email: regs.comments@federalreserve.gov
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To: Board of Governors of the Federal Reserve System
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I am a certified and registered mortgage originator in Illinois. My company, USA Mortgage Corporation, is also licensed in Michigan, and ruled exempt from licensure in Indiana. Our office is in a suburb close to the City of Chicago.

Illinois is one of the states that adopted a High Risk Loan Act with more stringent triggers than the federal legislation. Pre-payment penalties are also restricted. Many of the comments and recommendations of consumer groups and attorneys who provide counseling and representation to individuals in foreclosure currently are now moot: Changes have already been made to address the abuses they see in mortgages originated prior to the implementation of these federal and state laws; due to the timeline required for the foreclosure process, many of the current foreclosure cases were originated 3-4 years ago**. Further regulations at this time are premature; the full impact of the HOEPA Act Revisions cannot be assessed until a significant number of mortgage loans originated after the implementation of the 2002 revisions have worked through the default into the foreclosure process. The trend toward more restrictive state regulations also negates the need for further federal restrictions at this time: THE ONE EXCEPTION IS LEGISLATION REGUIRING FEDERALLY REGULATED BANKING ENTITIES TO COMPLY WITH STATE AND LOCAL MORTGAGE ORIGINATION AND LENDING REGULATIONS.**

**The revisions to the HOEPA regulations have successfully curtailed high-cost lending, and restricted lending to the highest risk borrowers.** The result is increasing emphasis on the credit scoring models to determine credit worthiness and qualification for mortgage loans, restricting access to even sub-prime loans to those with the lowest credit scores. It is generally assumed that the restriction of sub-prime lending is positive. However, with without consideration for the cause of declining credit scores, some borrowers with only a few recent late payments find themselves unable to access their abundance in home equity to help them make payments during emergencies such as illness, temporary loss or reduction of income, repair of damage to home or car used for transportation to work. In fact**, this restriction to sub-prime lending may be contributing to the increase in defaults and foreclosures, as the "band-aide" loan (a two-year fixed sub-prime loan) typically is no longer available to homeowners who**

**are behind on mortgage payments due to HOEPA restrictions. This impact on the most troubled homeowners requires empirical research.**

While the consumer housing groups call for mandated counseling prior to obtaining a mortgage, **one of the lender representatives that partner with the non-profit housing groups to provide such counseling admitted that the pre-mortgage counseling is <u>not</u> an inaccurate predictor of who will be successful at homeownership** (success defined in the context of making payments on time as agreed). The counseling services that do make a difference seem to be services provided "just-in-time" at time of default. Such services are provided in the Chicago area through an innovative partnership of housing agencies, the Federal Reserve Board and lenders. Unfortunately, these services are provided on a severely limited basis.

Many consumer advocates lamented the decision of Fannie Mae and FHA to drop the pre-purchase counseling requirement for some first-time homebuyer programs as a move to recapture market share from sub-prime lenders. However, the fact that **counseling has no demonstrated effect on successful repayment** makes this a reasonable decision. Housing counseling is an added barrier to homeownership, and in some cases a financial burden on lower income borrowers who need to take time off of work to complete it.

A common refrain is "Not everyone should be a homeowner". Unfortunately, empirical guidelines for a "good" or "worthy" first-time homebuyer do not exist. .

**The trend toward pre-mortgage counseling, which entails funding an entire new industry and restricting the access of homeownership (and the commensurate increase of wealth), requires allocation of substantial resources and increases barriers to homeownership for the very groups with the lowest homeownership percentages in the U.S. <u>Before adding additional costs and barriers to home purchase, research is required to prove the efficacy of such counseling programs.</u>**

**The restrictive effects of the federal and state "high-risk" regulation on consumers, particularly those attempting to access home equity through refinances, requires extensive research. Data analysis should be a guide in revising current regulations or developing further regulations.**

The area of non-traditional, or sub-prime, lending is another area where consumer groups are calling for additional regulations. The main focus seemed to be on loans with reduced income documentation, such as stated income and no-doc mortgage loans. However, the statistics given prove these loans have lower default rates than FHA mortgages, which have far more stringent underwriting guidelines (even though both may have no reserve requirements).

**Prior to enacting legislation to reduce default and foreclosure rates, comprehensive studies into the economic and social causes of foreclosures are required. The universities funded should have finance, business, sociology, psychology and legal**

**departments that can participate in design, implementation and conclusions of the studies.**

One of the non-traditional mortgages receiving a great deal of attention is Reverse Mortgages. While reverse mortgages seem complicated, when explained in the context of an equity conversion where interest is deferred, the terms are more clearly understood. The required counseling provides education about the mortgage and about money long-term management. Unfortunately, for these borrowers the predators that take advantage of them is usually family and caregivers; pre-closing counseling will not protect the elderly from their predatory children. Some risks cannot be reduced with counseling.

The front-loaded fees associated with Reverse Mortgages, resulting from the absence of mortgage payments, are currently under intense scrutiny. These mortgages do not pay originators yield spread or service release premiums, as the note holder must wait an indeterminate amount of time to obtain the return on investment made. Thus the borrower must pay the entire price for the origination of this product. This product is less profitable than other products requiring less processing and origination time; if the origination fee is reduced, the number of originators offering them will decrease at a time when demand is increasing. Elderly consumers will then have limited options: A nontraditional mortgage product or selling their home. Neither of these options is attractive, and may not be realistic for many elderly consumers.

The existing disclosures required by HOEPA and Regulation Z are not extremely effective in helping consumers understand high-cost, high-risk loan products. No regulations require the initial Good Faith Estimate or Truth-In-Lending to be reasonably accurate. **The proposal made by the National Association of Mortgage Brokers, reformatting the Good Faith Estimate to resemble the HUD-1 and require re-disclosure if any figures, payments or rate changes by 10% provides simplification and accountability. The Truth-In-Lending is confusing and vulnerable to manipulation, rendering it ineffective as a tool for comparison.** The APR calculation varies depending on what items are included in the pre-paid financing charges. This seems to vary from lender to lender. **The APR can also be manipulated by changing the line fees are listed on** (i.e. reporting the same amount as an origination fee rather than a mortgage broker fee changes the APR). The current standard Mortgage does not state clearly on the first page if the loan is a fixed or adjustable rate. Most Notes do not clearly state if the loan does or does not have a pre-payment penalty, leaving the specific information to an addendum. The Notes of option arm products do not clearly state whether the adjustment may result in negative amortization, and that negative amortization means the loan balance can be higher than the original loan amount.

**The disclosures required for all mortgage products require simplification and revision, including mortgages, notes, the Truth-In-Lending and Good Faith Estimate.**

Although some nontraditional mortgage products may be difficult to understand, the current record high rates of homeownership can be attributed to the proliferation of these mortgage products. Many consumers, even those who have mortgages, do not understand basic adjustable mortgages or escrow accounts. Disclosures and educational materials are confusing; most consumers do not want long explanations of the details of the mortgage, they want to focus on payment and closing costs or the amount of cash back. Simplification of current disclosures, or elimination of some, would help mortgage applicants focus on the important details of the actual mortgage.

Many of the required disclosures are confusing and distracting**. The Truth-In-Lending is not only confusing; it is inaccurate and vulnerable to manipulation. Important features need to be highlighted, such as negative amortization and interest only. These need to be explained on the mortgage or note, on the first page, in understandable terms, such as: "This mortgage allows negative amortization, which means the loan amount may increase – Your loan balance may grow higher than the original amount you borrowed." "This mortgage requires that only the interest due be paid. The loan balance will never decrease if minimum payments are made. If minimum payments are made, the amount required to payoff the mortgage may be higher than the amount you borrowed." Such statements should require initials or full signature underneath.**

Currently mortgage brokers are required to disclose to the borrower the Yield Spread Premium they receive from the lender they place the loan with. Consumer advocates would like this fee not only disclosed to the borrower, but also actually given to the borrower as a credit. This fee is misinterpreted as the premium the borrower pays for an "over market" interest rate. However, this fee is the difference in wholesale and retail rate pricing. The borrower cannot access the wholesale (or "par") price by going directly to a lender – the borrower must access lenders through retail divisions, where "par", or no premium, rates are not available. Banks do not have to disclose this fee, which they receive as Gain on Sale or Service Release Premium. **The fee is not an additional fee given a mortgage broker**; once the fee for originating, processing and closing loan the loan is established, this fee is one of three ways the broker can be paid. We are required to disclose this to the borrower. **The disclosure of Yield Spread Premiums is confusing to consumers, because only mortgage brokers disclose this "resale" portion of their fees. Consistency would simplify the mortgage pricing process for the consumer and make the entire process more transparent. THEREFORE, BANKS SHOULD BE REQUIRED TO DISCLOSE THEIR GAIN ON SALE OR SERVICE RELEASE PREMIUMS IN THE SAME MANNER AS MORTGAGE BROKERS DISCLOSE YIELD SPREAD PREMIUM. The practice of disclosing this fee is not a burden, but it is misunderstood, as the consumer advocates' proposal indicates. Consistency by ALL mortgage originators, brokers and banks, would clear up the confusion.**

Providing disclosures earlier in the process will only delay the transaction, not educate borrowers anxious to close. Many of these disclosures are inaccurate and misleading. **Eliminating disclosures based on gross estimates and irrelevant examples, and replacing them with accurate and simplified documents that resemble the documents presented at closing will assist consumers in understanding both**

**traditional and nontraditional mortgages. For example, requiring all mortgage originators to use the same Good Faith Estimate that is modeled on the HUD-1, such as the one proposed by the National Association of Mortgage Brokers (NAMB), will facilitate easy comparison at closing. In addition, NAMB proposed mandating re-disclosure if any fees, rate or payment, changed by more than a 10%; this would give consumers accurate figures for comparison and planning during a complicated, expensive and stressful transaction.**

"Predatory lending" definitions usually involve vague descriptions of unethical, unprofessional and often fraudulent activities. A great deal of time and resources goes into identifying and prosecuting fraud. Investigating fraud involves tracking the individuals involved in the transaction(s). **A simple addendum to each mortgage loan, recorded as a Rider to the Mortgage, recording each individual who worked on the real estate transaction, would simplify and shorten fraud investigations, aid in prosecution and thus act as a very real deterrent to fraudulent activity. Listing the following individuals/entities (as applicable) would aid fraud investigations: The Realtors, mortgage broker, banker or company; the loan originator and/or loan officer; the title company; the title company's closer; the lender/funding entity; the account representative of the lender/funding entity; the real estate agent(s); the attorney(s); the underwriter; the appraiser; the home inspector; the sellers; contractors/rehabbers preparing the property for sale; the processor; individuals conducting verification of information on the application; anyone attending the closing.**

As "predatory lending" has no operational definition, it is used to describe a host of fraudulent activities in real estate transactions, some in which the lender is the victim and not the "predator". **While state and local laws, usually more restrictive than HOEPA, have undoubtedly stopped onerous marketing and fraudulent practices of mortgage brokers and originators that they regulate, many unscrupulous mortgage originators have merely moved to banks that are exempt from state and local laws.** This not only restricts consumer access to legitimate sub-prime loans, it leaves the structuring and management of their major financial asset in the hands of potentially less experienced, less qualified and less professional loan officers. **This is especially true in states that require the registration, criminal background check and examination of loan originators; as banks are exempt from these state and local regulations, originators that cannot meet the requirements seek employment with federally regulated banks.**

**The federal licensing of mortgage originators would prevent predatory individuals from "moving shop" to avoid state laws, and would regulate the mortgage lending industry to national standards.** The Certification and Registration process of Loan Originators in Illinois would be an excellent model to start with.

**All mortgage originators and mortgage lenders should be required to comply with state and local regulations, designed to protect consumers from the types of fraud and abusive practices identified on a local and regional basis.** Exempting federally regulated banks harms the entire real estate and mortgage industry, as well as consumers. At best it allows two standards of lending; at worst, it provides a safe “harbor” from state and local regulations for unethical scam artists.

Thank you for the opportunity to comment on these issues. If I can provide clarification on any of the proposals set forth, or be of any service, please contact me:

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