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dcrac
Your Fair Lending Advocate in Delaware!

DELAWARE COMMUNITY REINVESTMENT ACTION COUNCIL, INC.

Our mission is "to ensure equal access to credit and capital for the under-served populations and communities throughout Delaware through Education, Outreach, Advocacy, and Legislation."

August 6, 2007

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

RE: Docket No. OP-1288

Dear Ms. Johnson:

The Delaware Community Reinvestment Action Council, Inc., (DCRAC) is a not-for-profit fair lending advocacy organization serving the interests of Delawareans for twenty years. On behalf of DCRAC, I thank you for the opportunity to comment on Home Ownership and Equity Protection Act (HOEPA).

Researchers predict that as many as 2 million US homeowners will lose their homes to foreclosure over the next 2 to 3 years. This foreclosure crisis will be the largest the nation has seen in almost 20 years, since the savings and loan debacle of 1989.

We urge the Federal Reserve to expeditiously implement strong protections against abusive lending pursuant to the Federal Reserve's authority under HOEPA because:

1. The Federal Reserve has held hearings, asked for comments, and put a band-aid on a wound that requires emergency surgery. We hope that this time, the Feds will do more.
    a. The predicted mortgage tsunami has hit us hard. The credit standards like the ocean receded. People gobbled up all they could. Then the big wave struck destroying all and then some in its wake. No one heeded the warnings. Especially the Federal Reserve. Time and time again, with every bank merger opposed by consumer groups we raised the issue of predatory lending as a fair lending violation and a safety and soundness issue.
2. We must learn from our past and not repeat our mistakes. Less than 20 years ago we saw something like this. The real estate "bubble" in the mid-1980s led to speculative buying and lower credit standards that resulted in widespread foreclosures. The defaults triggered a credit crunch that

turned into an economic recession in the spring of 1990.

   a. The Federal Reserve abrogated its authority by continued reliance on market forces and refused to implement consumer protections.

3. When local governments stepped in to care for its citizens, the federal government took away the power AND responsibility from the States.
   a. The Federal Reserve has the power to implement regulations.
   b. Abrogation of this responsibility will erode any remaining public trust.
4. Principles-based practices we know now do not substitute for regulations. Besides, a majority of market participants in this foreclosure fiasco have been the unscrupulous lenders.
   a. Other synonyms for the word "unscrupulous" are dishonest, corrupt, unprincipled, crooked, immoral, deceitful, devious, and ruthless.
   b. Confidence that unscrupulous lenders will abide by principles-based practices is misguided.
5. Good disclosures have never prevented bad loans.
   a. Prohibitions through regulation against prepayment penalties, restrictions on stated income loans, requirement to escrow taxes and insurance, and requiring a good faith duty of diligence in determining the ability to repay could on the other hand prevent unsound lending decisions.
6. The largest players in the foreclosure debacle have operated outside the regulatory stream. The Federal Reserve MUST bring them within the fold of regulatory reach through regulations.
   a. When the Federal Reserve analyzed the 2004 HMDA data it found that 200 lenders might be making too many high-cost loans to minorities who might be able to qualify for better deals. Only 35 of those lenders were overseen by the Feds.
   b. The 2005 data raised "red flags" about 270 lenders, 45 under Federal Reserve oversight. After conducting follow-up examinations one lender was referred to the Justice Department.
7. An egregious violation of fair lending has been occurring in the recent past, and the regulators have done nothing except grudgingly permit the disclosure of high cost loans by HMDA reporters.
   a. As for recent immigrants, many are lured into complicated subprime mortgages because of their unfamiliarity with the US mortgage market and sometimes limited English proficiency.
   b. As to the exploitation of the Latino and African-America community, consumer groups like ours are now tired of brining it to the attention of our regulators. Nothing is ever done.
      i. About 46% of Hispanics and 55% of blacks who took out purchase mortgages in 2005 got higher-cost loans, compared with about 17% of whites and Asians.
8. Much of the real problem in the mortgage market today comes in form of refinancing. Each time we talk about predatory lending and reverse redlining we talk about equity stealing from homeowners who owned their homes free and clear or who had first time home mortgages with a down payment and settlement help second loan at reasonable rates from the local governments. These loans were refinanced.
   a. HOEPA protection's distinctions between purchase mortgage and a refinance are meaningless. HOEPA protections must apply in lending (purchase, refinance, line of credit, etc.) where the home is pledged as collateral.
   b. In addition to their primary mortgages, homeowners had $913.7 billion of debt in home equity loans in 2005, more than double the $445.1 billion in 2001, according to a paper by former Federal Reserve Chairman Alan Greenspan and James Kennedy.
9. The HOEPA threshold should be scrapped. All loans secured by a home should be subject to HOEPA protections. It is both a safety and soundness issue given the lenders have proved their incompetence in the market place and a consumer protection issue, given the consumer has demonstrated that they need protections from the lenders as well as themselves.
   a. About half of Adjustable Rate Mortgages fail prior to rate adjustment.
   b. About three-quarters of foreclosures are the result of subprime mortgages where the borrower cannot handle even a small increase in the interest rate.

   c. Approximately 15% of problem loans are conventional mortgages, made with low or no down payment.
   d. The remaining loans were made through "no doc" loans, better known as "liar loans." Originally, developed to help the self-employed, like everything that was allowed to go wrong with the lending market, this practice was allowed to spread beyond this limited clientele.
   e. Then we have prime borrowers who bought with no equity or used their home as an ATM machine and have an ARM.
   f. Freddie Mac expects mortgage originations in 2007 to total $2.75 trillion -- an 8.5 percent decline from the year before.
   g. Refinance loans are expected to make up 42 percent of that business, the lowest level in seven years.
10. During bank mergers, the Federal Reserve and other financial institution regulators must remind themselves that a few critics attribute the foreclosure crisis to a continuing trend of consolidation in the industry.
   a. The top 25 lenders originated 87 percent of single-family mortgages in 2006, compared with a one-third market share in 1994.
   b. This is a safety and soundness issue.
   c. We have warned in the past that "too big to fail" rationale is misguided.
11. Subprime lending is a safety and soundness issue.
   a. Since delinquencies and defaults in subprime loans began a steady rise last year, there have been dozens of headlines about mortgage loan originators closing their doors, declaring bankruptcy or being acquired by their creditors.
12. Loss mitigation must be a requirement. The lender must be required to work out a defaulted/ delinquent loan. The practice of not accepting payments/returning payments should be prohibited.
   a. ALL lenders must be required to attempt a good faith resolution of a mortgage debt that needs to be worked out and stabilized.
   b. Mandatory arbitration clauses must be replaced with MANDATORY WORK OUTS within prescribed guidelines.
13. Abusive lending is occurring in the subprime and the prime markets. Attempt to parse the differences between these two markets for purposes of HOEPA, is not needed.
   a. The FDIC Chairman Sheila Bair testified that in many cases borrowers of exotic loans could have qualified for less expensive and safer fixed-rate loans.
14. Something must be done about bringing the mortgage broker within the reach of HOEPA.
   a. "While police looked for him, he bought three houses at inflated prices in Arapahoe County with the help of lenders who put up the entire $1.9 million. After he was caught and jailed, he managed to buy two more. Until the foreclosures commenced, Lee owned five villas in an affluent gated community while living behind prison bars 150 miles away". *Steal of a Deal*, David Olinger, Denver Post, 10/29/2006.
15. Every borrower should be able to understand the following in the simplest form on one or two pages:
   a. The amount of money they borrowed.
   b. The interest rate they are offered.
   c. Whether the rate is fixed or adjustable.
   d. If fixed, for how many years.
   e. If adjustable, how often and by how much.
   f. The date of the next reset AND the new payment at the time.
   g. The number of times the loan will reset.
   h. The gross monthly income that was used in qualifying them for a mortgage.
   i. Whether there is a prepayment penalty or not.
   j. If there is a prepayment penalty what is the cost and the date when it is no longer binding?

k. What does the payment each month include?
l. What is the housing debt?
m. They have access to a housing counselor by calling 1-800-569-4287.

16. **This devastation was preventable**.

In response to the specific questions posed by the Federal Reserve Board, we believe that strong limits and prohibitions must apply to lending practices when a home is offered as collateral. Every attempt through regulation must be made to prevent unfair and deceptive lending in the housing market.

PREPAYMENT PENALTIES

It is our position that prepayment penalties must be prohibited in all forms of mortgage loans.

1. The higher your interest rate is the greater is your need to refinance this loan. Unfortunately, this is when prepayment penalty traps you. There is no way out.
2. Liquidity in the markets comes from sound products and prudent lending as well as competition.
3. Liquidity does not come from imposition of penalties on a consumer who is in a weaker bargaining position to begin with.
4. Prepayment penalties are harsh when a home owner is attempting to save his/her home.
5. If the lender made a bad decision in extending a loan, lender must pay the consequences.
6. Prepayment penalties reward imprudent lending.

If the Federal Reserve must approve prepayment penalties, stricter guidelines are required.

1. Anytime a prepayment penalty applies, the loan must be treated as a high cost loan and given HOEPA protections (assuming the Federal Reserve will not adopt our request that all mortgage loans receive HOEPA protections).
2. We need substantive regulation that is supplemented by disclosures. Disclosures alone won't do.
3. Regulation is needed to assure the reach of HOEPA to currently unregulated lenders.
4. Instead of checking the box on the TILA form, there should be a clearly and unambiguously dis closed statement that this loan contains a prepayment penalty.
5. When the TILA does not mention prepayment penalty (or draws a line through the statement above), the default assumption is that prepayment penalty does not apply.
6. This disclosure must be made at the time a loan application is made AND at closing.
7. When there is a discrepancy between the two TILAs relative to prepayment penalties, the default presumption is that there is no prepayment penalty.

We need a rule not guidance.

ESCROW FOR TAXES AND INSURANCE

It is our position that lenders MUST escrow for taxes and insurance on ALL loans, prime and subprime, fixed and adjustable rate.

1. A majority of our clients fall behind on their mortgages more than one year after the loan originated. Unbeknown to them they get a bill in taxes and insurance or that the lender purchased a forced-placed insurance on the home.
2. Hanging in the balance is the freedom of a very few to choose to pay taxes and insurance by themselves versus the protection of many who simply cannot conceive of savings thousands of dollars annually to pay their insurance and taxes.
3. We should err on the side of consumer protection.

We need a rule not guidance.

ABILITY TO PAY

It is our position that the Lender must be required to consider a borrower's ability to pay on the amount borrowed on ALL loans secured by a home.

The current limit of 50% debt to income ratio is irrational.

1. From the gross income, the average consumer pays about 25% in taxes, 50% in mortgage, and has 25% left live on.
    a. Many of our clients could not subsist on 25% of their gross income.
    b. Utility has gone up 60%, gasoline prices have gone up, as have costs of everything.
    c. Incomes have not kept pace with the rising costs.
2. Primary drivers in the foreclosure mess have been the 2/28s.
    a. These loans work against both the borrower and the lender.
    b. The consumer will in the long run not be able to pay this loan. So, through consumer protection, the safety and soundness of our financial institutions is also preserved.
3. On 80/20 loans, we suggest a requirement that ability to pay be based on 100% of borrowing; not just the 80% borrowed.
4. We propose that the FRB codify ability to pay similar to VA Loan's residual income consideration for a consumer's ability to repay.
5. There must be a requirement that lenders look for and use alternative means of credit scoring.
6. There must be a requirement that lenders look for and use an alternative means to determine ability to repay for small business home mortgage borrowers.
7. A core plague of predatory lending is lending beyond borrower payment ability.
8. The federal agencies have correctly identified that abusive lenders are underwriting ARM loans at initial and low rates, leaving borrowers vulnerable to rapid rate increases.
    a. The recent guidance on subprime lending requires underwriting at the fully-indexed rate. While this is a step in the right direction, we strongly recommend underwriting requirements at the maximum possible rate or rates above fully-indexed rates.
    b. There are times when the LIBOR or other benchmark rates are low, meaning that the fully-indexed rate may be an artificially low rate for underwriting purposes.
    c. We understand that it was common industry practice to underwrite loans at two percentage points above the fully-indexed rate.
    d. The Federal Reserve must consider either some suitable cushion above the fully-indexed rate or the maximum possible rate stipulated in the loan contract.

We need a rule not guidance.

STATED INCOME, NO DOC, LOW DOC LOANS

It is our position that such loans are specialized loans for the sophisticated borrower. These loans are not meant for the unsophisticated borrower.

1. We agree with the Comptroller of the Currency that stated income or low doc loans are prone to abuse when predatory lenders and brokers inflate borrowers' incomes to qualify them for unsustainable loans.
2. This type of abuse is most prevalent on subprime loans.
3. We have already commented that layering of risk is a dangerous practice.
4. Hence, it is our position that stated income or low doc loans must be prohibited on subprime and/or ARM loans and the sophisticated borrower standard must be applied on such loans.
5. At the very least, the Federal Reserve Board must require a reasonableness standard.
    a. We recognize that certain businesses may have undocumented income, certain employees may get bonuses, some folk may moonlight.
    b. A ban on this product may have an unintended consequence of impeding access to credit

to those who can responsibly borrow.

c. But to prevent abuse, the underwriter must be able to demonstrate due diligence by documenting factors such as FICO scores, tax returns, pay stubs, reserves, etc.

d. We are strong proponents of suitability doctrine. We believe that market is overreaching with this product.

We need a rule not guidance.

OTHER PROTECTIONS NEEDED

Steering prohibition The Federal Reserve Board must declare that steering borrowers qualified for prime loans into subprime loans is an unfair and deceptive practice. The National Community Reinvestment Coalition (NCRC) published a recent study, Income is No Shield against Racial Differences in Lending, which documents that middle- and upper-income minorities are significantly more likely than middle- and upper-income whites to receive subprime loans. Moreover, previous NCRC research and other studies reveal that racial disparities in lending do not disappear after considering creditworthiness and other key variables. Borrowers lose substantial amounts of wealth when they are steered into high-cost loans.

Lender liability The Federal Reserve must hold lenders liable for deceptive and fraudulent practices committed by brokers with whom they do business. Up to 70% of the loans originated start with brokers. Lenders must be motivated to strictly monitor broker behavior. Likewise, lenders and brokers must face serious financial penalties if they intimidate or pressure appraisers to meet certain home values. Fraudulent appraisals have contributed significantly to the rise of delinquencies and defaults.

Mandatory work out to prevent default, delinquency and foreclosure--Loss mitigation must be a requirement. The practice of not accepting payments/returning payments should be prohibited.

a. ALL lenders must be required to attempt a good faith resolution of a mortgage debt that needs to be worked out and stabilized.
b. Mandatory arbitration clauses must be replaced with MANDATORY WORK OUTS within prescribed guidelines.

ENFORCEABILITY

What we need is a substantive regulation that is supplemented by disclosures. Disclosures alone are not enough. Regulation is needed to assure the reach of HOEPA to currently unregulated abusive lenders. The timing of disclosure is not at closing when the consumer is already cornered, unless the disclosure is enforceable when the consumer applied for the loan and got the timely disclosure. We suggest that there must be a requirement to assure that variances between disclosures at the time of application and at closing are reasonable. Specific disclosures include good faith estimate, HUD 1, and TILA. This would ensure more accuracy and honesty at the time a borrower makes an application.

Finally, we hope the Federal Reserve does right by the consumer, by the markets, and by our collective conscious. Thank you for this opportunity to comment on this critical matter. If you have any questions, please contact me at 302-654-5024.

Sincerely,

Rashmi Rangan