

Sunil K. Dixit

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Cerritos, California 90703

June 6, 2007

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

Re: Written Comments – Docket No. OP-1288

Dear Ms. Johnson:

Please find attached to this letter my written comments in response to the Notice of Public Hearing and Request for Comment dated May 24, 2007.

Sincerely

Sunil K. Dixit

Comments of Sunil K. Dixit before the Board of Governors of the Federal Reserve System, 20th and C Streets, N.W. Washington, DC 20551

Public Hearing; Request for Comment – Date of Hearing June 14, 2007

Home Equity Lending Market – Docket No. OP-1288

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My name is Sunil K. Dixit. I am submitting these written comments to the Board of Governors of the Federal Reserve System.

Rule Making Authority of the Board

The Board should play an active role in formulating rules not only to prevent abusive lending practices but also to ensure that credit is extended to only those borrowers who can establish their ability to repay the loan as per the terms of the loan. Board should exercise its rule making authority over all loan products available in the market including A paper, Alt A, Subprime, 2nd Mortgages, Fixed rate, Exotic, Adjustable Rate Mortgages, and Home Equity Loans. Today there are hundreds of products available in the market but there are no uniform underwriting guidelines used by all lenders. *Therefore, the first and the most important step in the direction of reforming mortgage industry would be to standardize products available and underwriting guidelines.*

There are many lenders or brokers who are licensed to do business in several states. There is a need to make some important changes in the way mortgage lenders and brokers are licensed. **In my view, there should be one federal license for mortgage brokers.** Having one national mortgage license for mortgage brokers would be similar to how stock traders are licensed. State regulations on mortgage brokers and/or lenders are burdensome and make compliance difficult for the brokers who originate loans in several states.

Prepayment penalties

- Should prepayment penalties be restricted? For example, should prepayment penalties that extend beyond the first adjustment period on an ARM be prohibited?

Prepayment penalties should be restricted. For example, no prepayment penalty should be allowed on the loans on borrower's primary residence or first time home buyers or people who have fully documented their income. Borrowers above a certain FICO score should not be subjected to any prepayment penalties on non-investment properties. The amount of prepayment penalty should not be more than 3 months' interest. Prepayment penalty should only be allowed to be calculated on a fixed rate disclosed at the time of origination of the loan.

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- Would enhanced disclosure of prepayment penalties help address concerns about abuses?

Prepayment penalty disclosures need to be improved. In addition to these disclosures the lenders should be asked to provide sample computations for calculation of prepayment penalty for each loan. Prepayment penalties should not be allowed on high LTV/CLTV loans. Prepayment penalties on high LTV/CLTV would make it very *difficult for the borrower to refinance should his/her financial situation and credit scores improve* a period of time. Prepayment penalties should not apply in case of sale of a primary residence.

- How would a prohibition or restriction on prepayment penalties affect consumers and the type and terms of credit offered?

Lenders claim that prohibition on prepayment penalties will limit the availability of loans to borrowers with imperfect credit. Prepayment penalty should not be used to punish the borrower if he/she has taken a loan on his/her primary residence or his credit scores have significantly improved. A borrower should be free to choose any lender during anytime during the life of the loan. However, as a relief to the lenders, a borrower may be subjected to prepayment penalty during the first 9-12 months of the loan. Prohibition on prepayment penalty should not have a negative impact on the mortgage industry. In a competitive market lenders will need to adjust to this reality if prepayment penalty is prohibited or restricted.

Escrow for taxes and insurance on Subprime loans

- Should escrows for taxes and insurance be required for Subprime mortgage loans? If escrow were to be required, should consumers be permitted to “opt out” of escrows?

Due to high debt-to-ratio (DTI) allowance for underwriting Subprime loans it is natural that the Subprime borrowers are left with lesser residual income than the conventional borrowers after payment of mortgage installments, property taxes and insurance. A big step in this direction could be to require the lenders to provide the borrower a “Projected Monthly Cash Flow Statement” with other disclosures highlighting the residual monthly income after payment of borrower’s monthly debt obligations, mortgage payments, property taxes and hazard insurance.

Consumers should be allowed to “opt out” of escrows without paying any extra costs at the time of originations. We know that mortgage interest and property taxes are tax deductible for the purpose of calculating taxable income under the

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IRS rules. The tax deductibility gives borrowers an opportunity to reduce their tax withholding or tax liability at the end of the year freeing up extra money every month going into their pockets. They can use this cash to pay property taxes and insurance. In my view, it will be logical to make escrows mandatory in case of non-primary residence.

- Should lenders be required to disclose the absence of escrows to consumers and if so, at what point during the transaction? Should lenders be required to disclose an estimate of the consumer's tax and insurance obligations?

A big step in this direction could be to require the lenders to provide the borrower a "Projected Monthly Cash Flow Statement" with other disclosures highlighting the residual monthly income after payment of borrower's monthly debt obligations, mortgage payments, property taxes and hazard insurance. This statement can be provided along with other loan disclosures at the time of issuing the loan commitment.

- How would escrow requirements affect consumers and the type of terms of credit offered?

Both mortgage interest and property taxes are tax deductible and provide extra cash to borrowers in shape of lessening their tax liability. Therefore, lenders should not use escrows to increase the cost of home loans or charge extra from the borrowers. Presence or absence of escrow requirement should have no impact on the type and terms of the credit.

"Stated income" or "low doc" loans

Lenders have introduced some very creative loan programs such as "stated income", "no ratio", "no documents", and "super no documents". These programs allow borrowers to state income on the loan application without having to provide documentary proof to support the income so disclosed, or provide little documentation to support income or assets, or show no income on the loan application, or leave income, employment, assets and liabilities blank on the loan application. One would think that these creative loan programs promote homeownership for all Americans. On the contrary, these programs have created an anomaly in our home mortgage system and have opened doors for possible abuse both by borrowers and lenders.

- Should stated income or low doc loans be prohibited for certain loans, such as loans to Subprime borrowers?

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The most important question is that if a borrower cannot document the income, what would be the criteria to ensure that he/she can afford to make housing payments? Or what would be the control procedures to ensure that the borrower has not overstated the income to qualify for the loan?

Few suggestions can be made to address the problems created by “stated income” or “no income” programs:

(1) Availability of “stated income”, “no income”, “no ratio”, “no documents”, and “super no documents” programs must be strictly regulated. These loans should be available to borrowers in very exceptional circumstances and only after thorough scrutiny of income and assets. **These restrictions should apply to all borrowers including the Subprime borrowers. It should be mandatory for all borrowers to sign IRS Form 4506 so that the lender can verify borrower’s income from the IRS. The loan should not be funded unless the IRS verification of income is completed.**

(2) Mortgage interest deductibility is a great tax incentive for homeowners. However, this tax deduction should not be available to all taxpayers. The mortgage interest deductibility of the mortgage interest paid by the borrowers who obtained mortgage using these creative mortgage programs should be subjected to restrictions under the tax laws. Borrowers who cannot document their income should not be entitled to the benefits of the tax laws. If one has to take the benefit of the tax laws, it is important that income shown on income tax returns can be reconciled with the income shown on the mortgage application. If tax deductions are based on actual income then why the mortgage interest deduction should be allowed on a loan obtained by one of the above creative mortgage loan programs?

(3) For stated income borrowers, the income indicated on form 1003 (application for housing loan) should be reported to the IRS database so that the IRS can reconcile borrower’s 1003 income with the taxable income reported on the tax returns for that year and subsequent years.

(4) For all stated income loans, originators must be asked to sign an affidavit confirming that they do not have any knowledge of borrower's income being overstated and they have satisfied that the borrower complies with the underwriting criteria of a borrower’s ability to repay the loan.

- Should stated income or low doc loans be prohibited for higher-risk loans, for example high loan-to-value ratios?

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Stated income or low doc loans should not be prohibited for high-risk loans. Instead, all borrowers' income should be verified using IRS form 4506 for all types of loans.

- How should a restriction on stated income or low doc loans affect consumers and the type and terms of credit offered?

If borrowers' income is verified using IRS form 4506 for all types of loans, there will be no impact on consumers because loans would be made available only to those who have the capacity to repay the loans.

- Should lenders be required to disclose to the consumers that a stated income loan is being offered and allow the consumer the option to document income?

The lenders should be asked to provide a disclosure to the borrowers indicating that their income would be verified with the IRS using IRS form 4506 and that the loan will not be funded if the verified income is not enough to qualify for the subject loan.

Unaffordable loans

- Should lenders be required to underwrite all loans on the fully-indexed rate and fully amortizing payments?

All loans should be underwritten with fully-indexed rate and fully amortizing payments. The debt-to-income ratio with taking into consideration fully-indexed rate should not exceed 50%.

- Should there be a rebuttable presumption that a loan is unaffordable if the borrower's debt-to-income ratio exceeds 50% at loan origination?

From all practical purposes, a loan allowing debt-to-income ratio of more than 50% is unaffordable. Let us assume an average (hypothetical) income tax rate of 25%, an average (hypothetical) state tax rate of 3.5% and 7.65% FICA and Medicare deduction. The total deduction on account of these taxes would be 36.15% of the gross income. After adding 36.15% to debt-to-income ratio of 50%, the borrower would be left with only 13.85% of the gross income to take care of other living expenses.

- Are there specific consumer disclosures that would help address concerns about unaffordable loans?

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None.

- How should such provision affect consumers and the type and terms of credit offered?

Home loan should be offered only to those who can afford to make a full repayment. It doesn't not make sense to stretch the guidelines to give loans to borrowers who are unable to prove that they can pay back the loan.