Freddie Mac
We make home possible℠

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April 8, 2008

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

Re: *Proposed Rule to Amend 12 CFR Part 226 (Docket No. R-1305)*

Dear Ms. Johnson:

The Federal Home Loan Mortgage Corporation ("Freddie Mac") appreciates the opportunity to provide comments on the proposed revisions to Regulation Z, 12 CFR Part 226, which implements the Truth in Lending Act ("TILA") and the Home Ownership and Equity Protection Act ("HOEPA"). The issues that the Board of Governors of the Federal Reserve System ("the Board") is confronting in the proposed revisions are important to borrowers, mortgage lenders, and the secondary mortgage market.

Freddie Mac has been in the business of purchasing residential mortgages for 37 years and has financed more than 50 million homes over that time. In connection with these business activities, Freddie Mac has continued to provide low-cost mortgage credit in all economic conditions in support of our mission of providing liquidity, stability and affordability. We have a longstanding commitment to helping finance homes that families can both afford and keep. Our credit policies and anti-predatory lending requirements have made us a leader in the secondary market.

BRIEF SUMMARY OF COMMENTS

We are submitting comments on a number of issues covered by the proposed rule. First, and most importantly, we are commenting on the Board's definition of "higher-priced mortgage loan." We believe that the Treasury securities identified by the Board are not sufficiently connected to the mortgage market to provide an accurate benchmark for that definition. We propose instead that the Board use a benchmark that tracks prime mortgage rates, and we discuss the advantages and disadvantages of two such benchmarks, the Primary Mortgage Market Survey® and Required Net Yields. Second, we discuss the proposed requirements for higher-priced mortgage loans, which we generally support. We request clarification on a number of technical issues, including the requirement that borrowers be able to pay the highest interest rate during the seven-year period following origination. Third, we have a few minor suggestions concerning the requirements applicable to all mortgage loans.

GENERAL STATEMENT OF INTEREST

Freddie Mac constantly evaluates market conditions and the credit environment to ensure that our underwriting standards, policies and business practices serve our mission to provide liquidity and stability to the conforming mortgage market. In 2007, the credit environment and financial markets deteriorated rapidly, beginning with subprime mortgages, expanding to Alt-A, and finally affecting the prime market. In response, Freddie Mac acted to mitigate the impact of higher-risk products, provide mortgage credit risk leadership in the marketplace, and help lenders make mortgage financing available at terms that are likely to lead to successful homeownership.

For example, Freddie Mac:

(1) announced stricter standards for short-term subprime hybrid ARMs;

(2) committed to buy $20 billion of mortgages that offered potential subprime borrowers better financing opportunities. During 2007, we purchased approximately $43 billion of prime mortgages, representing families whose credit profiles might previously have relegated them to the subprime market;

(3) implemented additional requirements for nontraditional mortgage products consistent with the federal financial institution regulators' Interagency Guidance on Nontraditional Mortgage Product Risks, as directed by our safety and soundness regulator, the Office of Federal Housing Enterprise Oversight ("OFHEO"). Such requirements obligate lenders to (i) determine a borrower's capacity to repay such mortgages using the fully indexed rate, assuming a fully amortizing payment schedule; and (ii) disclose the details of these products, including potential for a payment shock, prepayment penalties and fees, to borrowers in writing and in a timely manner. We require such compliance regardless of whether the originator of the mortgage is subject to the Nontraditional Mortgage Guidance. Likewise, as directed by OFHEO, Freddie Mac announced that we would require compliance with the federal bank regulators' Interagency Statement on Subprime Mortgage Lending, again regardless of whether the originator is subject to the Subprime Statement; and

(4) took further steps to confirm that the credit terms of business provided to our customers align with our corporate credit risk tolerance. As a result of these and other changes, many of the credit terms negotiated with our customers have been tightened.

In addition, Freddie Mac has an extensive set of anti-predatory lending requirements that derive from both Freddie Mac's voluntary policies and the affordable housing goal regulations of the Department of Housing and Urban Development (24 CFR Part 81). Freddie Mac policy is not to purchase or invest in mortgages that were originated using the following practices, features and terms:

- Failure to provide regular full-file credit reporting
- Steering toward higher-priced products, and failure to upstream prime-qualifying borrowers to prime products
- Failure to comply with fair lending requirements
- Refinance or purchase money mortgages with rates or points and fees in excess of thresholds set under HOEPA
- Excessive fees, *i.e.,* fees that exceed 5% of total loan amount

- Prepayment penalties, unless they meet the following requirements:
    - Benefit to the borrower (usually a rate or fee reduction)
    - An offer of a non-prepayment mortgage
    - Adequate disclosure
    - No prepayment penalty upon default
    - For subprime mortgages, the prepayment penalty term is not greater than three years

- Failure to adequately consider the borrower's ability to repay (the lender cannot rely primarily on the value of the collateral)
- Arbitration clauses
- Single-premium credit insurance

As demonstrated both by our response to credit conditions in the current market, as well as by our anti-predatory lending standards, we share the Board's concerns about consumer protection, responsible lending, and sustainable homeownership. In particular, we are concerned about the dilution of underwriting standards that the Board seeks to address, particularly in the subprime market sector. We also appreciate that the Board, in focusing primarily on the subprime market sector, is attempting to avoid regulatory over-correction.

Once again, we appreciate the opportunity to comment on the Board's proposed revisions to 12 CFR Part 226. Our comments are attached hereto. Please let us know if we can provide any additional information.

Sincerely,

Robert E. Bostrom

Enclosures (6):

Freddie Mac's Comments to the Board of Governors of the Federal Reserve System on the Proposed Rule to Amend 12 CFR Part 226

Exhibit A – Historical Interest Rates for January 2007 through March 2008, comparing Freddie Mac's weekly PMMS® to selected Treasury securities plus three percent
Exhibit B – Historical Interest Rates for January 2007 through March 2008, comparing Freddie Mac's weekly PMMS® to selected Treasury securities plus four percent
Exhibit C – Comparison of Subprime and Prime Conforming 30-Year Fixed Mortgage Rates
Exhibit D – Historical Freddie Mac Required Net Yields for April 4, 2006, April 4, 2007, and April 4, 2008

Exhibit E – Graphs of Market Volatility for Selected Treasury Securities Over the Period from 1984 through 2008

FREDDIE MAC'S COMMENTS TO THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM ON THE PROPOSED RULE TO AMEND 12 CFR PART 226

I. COMMENTS ON PROPOSED HIGHER-PRICED MORTGAGE PROVISIONS

We generally support the Board's proposals to realign incentives and improve controls for "higher-priced mortgage loans." Our comments are divided into two areas: (A) Alternatives to the Board's proposed threshold for higher-priced mortgage loans; and (B) Comments and recommendations of a technical or clarifying nature.

A. Alternatives to the Board's proposed threshold for higher-priced mortgage loans

The Board has acknowledged that it seeks to exclude the prime market sector from its regulation of loan terms and underwriting practices. In support of this position, the Board writes that, "[i]n addition, the Government Sponsored Enterprises (GSEs) continue to play a major role in the prime market, and they are accountable to regulators and policy makers for the standards they set for loans they will purchase."[1] We agree with the Board's reasoning and offer the following suggestions.

In general, the Board's proposed rule raises several important issues regarding the definition of higher-priced mortgage loans. The Board proposes to define higher-priced mortgage loans as consumer credit transactions secured by the consumer's principal dwelling for which the APR on the loan exceeds the yield on comparable Treasury securities by at least three percentage points for first-lien loans, or five percentage points for subordinate lien loans. In addition, the proposed definition would include home purchase loans, refinance loans and home equity loans. In the Preamble, the Board acknowledges the difficulty in defining a subprime loan. Particularly given varying market conditions and the effect of the yield curve (normal, flat or inverted), the Board appropriately seeks comments on whether a different threshold from the one proposed would better satisfy the objectives of covering the subprime market, excluding the prime market, and "captur[ing] at least the higher-priced end of the Alt-A market[,]" while avoiding unintended consequences for consumers in the Alt-A market.[2] We provide information below that may prove useful to the Board as it continues to consider how best to achieve its stated objectives.

1. The Board's proposed thresholds

Consistent with the Board's concern about the difficulty of selecting a threshold for higher-priced mortgage loans, we believe that the proposed threshold of 3% above the yield of the designated Treasury rates would have the effect of an over-inclusive definition of higher-priced mortgage loans under current market conditions. To illustrate this over-inclusiveness, we have prepared historical rate graphs (attached as Exhibit A) for the period January 2007 through March 2008, comparing the average 30-year fixed rate mortgage based on Freddie Mac's weekly Primary Mortgage Market Survey® (PMMS) to the yield on the 10-year constant-maturity Treasury security (CMT) +3%, the 5/1 Hybrid ARM to the 5-year CMT +3%, and the 5/1 Hybrid ARM to the 1-year CMT +3%. As the graphs illustrate, assuming the revisions had been in

[1] 73 Fed. Reg. 1672, 1683 (January 9, 2008).
[2] 73 Fed. Reg. at 1684-85.

effect in 2008, some prime loans, especially ARMs, would have been defined as higher-priced mortgage loans. Further, since the PMMS covers only conforming rates and other surveys (such as conducted by HSH Associates) show jumbo rates for prime borrowers averaged between 0.25 and 1.40 percentage points higher over this period, many prime jumbo borrowers would have been inappropriately tagged.

In response to the Board's request for information on alternative thresholds, attached Exhibit B assumes the Board's alternative proposal of 4% above the same comparable Treasury yields had been in effect for the same time period. The 4% spread would exclude more prime loans from the higher-priced mortgage loan definition, although under the type of market conditions experienced recently, some prime ARMs would still be covered. Under other conditions, this spread may be under-inclusive. Therefore, under either of the proposals, some prime loans would fall within the "higher priced mortgage loan" definition.[3]

2. Alternative benchmarks

Treasury securities are not sufficiently connected to the mortgage market to function as an accurate benchmark for higher-priced mortgage loans in all market conditions. As a consequence of this phenomenon, the proposed rule would cause many prime loans to fall within the "higher-priced mortgage loan" definition. We therefore suggest that the Board consider an alternative that avoids "basis risk," considers the shape of the yield curve, and is based on mortgage yields.[4]

For example, the Board could use a mortgage market index, which will ensure the necessary connection with the mortgage market. In order to meet the Board's stated objective of excluding the prime market sector, while including the subprime and higher-priced Alt-A sectors, we propose that the Board define higher-priced mortgage loans by selecting a prime mortgage index and adding a margin. The index will rise and fall with rates in the market, and the margin will have the effect of excluding other prime mortgages.

There are a number of sources of data for prime mortgage interest rates. More important than the particular source of information is the general concept that a measure of prime mortgage interest rates plus a margin can serve as an accurate and workable definition of the higher-priced mortgage loan category that the Board seeks to regulate. We discuss two such benchmarks below – Freddie Mac's PMMS and the Required Net Yields of Freddie Mac – the Federal Housing Finance Board is another potential source, and there are a number of private vendors of such information as well.

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[3] If the Board were to decide to use Treasury securities as a benchmark, the Board should consider using the yields of Treasury securities with comparable maturities. This is the methodology used for both HOEPA and the Home Mortgage Disclosure Act (HMDA), and we believe that the operational simplicity that would result from use of this familiar benchmark would avoid a significant amount of confusion for creditors. We acknowledge that the Board has articulated its reason not to use this methodology.

[4] "Basis" is "[t]he uncertain relationship between price or rate in two or more related but not identical markets." "Basis risk" is "[t]he variability of return stemming from possible changes in the price basis, or spread between two rates or indexes." Gary L. Gastineau and Mark P. Kritzman, <u>The Dictionary of Financial Risk Management</u>, 32-33 (1999).

The source of prime mortgage interest rate data with which we are most familiar is the PMMS. The PMMS is a survey conducted by Freddie Mac of various types of mortgage lenders (national banks, thrifts, credit unions, and mortgage companies) from all regions of the United States that participate on a voluntary and confidential basis. We gather data on mortgage rate quotes, that is, the interest rate a lender would offer to a qualified prime borrower for four conventional conforming products with an 80 percent loan-to-value ratio: a one-year Treasury-indexed ARM, a 5/1 Treasury-indexed ARM, a 15-year fixed-rate mortgage, and a 30-year fixed-rate mortgage. The results are expressed as an average interest rate for each of the four products, together with the average number of points charged at that rate and the average margin for each of the two ARM products.

We propose that for such a metric, a two-percent margin be added to the Board's estimated APR for first-lien loans of each of the products, and we propose a four-percentage point margin for subordinate lien loans. The resulting percentage rate would then be compared to the APR for a mortgage loan.

We believe that two percentage points is the correct margin and is supported by empirical research and mortgage rate surveys over a number of years. Cutts and Van Order cite mortgage rate levels in September 2002 based on then-current posted rates by a major subprime lender; A-rates were approximately 3 percentage points above prime, with lower-rated subprime loans at a much wider spread.[5] Courchane presents average APR rates for 2004 and 2005 and concludes "[m]ean APRs are substantially higher in the subprime market – generally on the order of about 200 basis points in 2004 and about 275 basis points in 2005…."[6] Further, *Inside B&C Lending* published subprime mortgage rates by grade at a biweekly frequency until November 2007; Exhibit C summarizes annual average spreads which are consistently above the 2 percentage-point margin that we have proposed.[7] We believe that subprime mortgages would fit comfortably within the definition of a higher priced mortgage loan that we propose. It should be noted that the use of prime conforming mortgage index rates as indices is inherently conservative because it excludes jumbo interest rates quoted to prime borrowers. The Board proposes to cover all single-family mortgages, including jumbo mortgages; the current spread between conforming (with loan balances for one-unit properties up to $417,000) and jumbo 30-year fixed-rate mortgages to prime borrowers was 1.4 percentage points for the weeks ending March 21 and March 28, 2008.[8] The two-percent margin will cover these higher-balance (and more expensive) mortgages to prime borrowers as well as regular conforming mortgages.

One obvious drawback to a prime mortgage index such as the PMMS is that it does not cover all mortgage products. In particular, it does not cover three- or seven-year ARMs or 20-year fixed-rate mortgages. Thus, if the Board were to adopt this proposal, it would have to address this gap.

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[5] Amy Crews Cutts and Robert A. Van Order, "On the Economics of Subprime Lending," *Journal of Real Estate Finance and Economics*, 30:2, 2005, Table 1, p. 171.
[6] Marsha J. Courchane, "The Pricing of Home Mortgage Loans to Minority Borrowers: How Much of the APR Differential Can We Explain?" *Journal of Real Estate Research*, 29:4, 2007, p. 406.
[7] *Inside B&C Lending* published "composite subprime rates based on rate quotes from broker web sites."
[8] Source for jumbo and conforming 30-year fixed-rate mortgage rate quotes was HSH Associates (www.hsh.com).

One way in which to do so would be to interpolate rates from the one- and five-year ARMs and the 15- and 30-year mortgages. A second way in which to fill this gap would be to supplement the index from other data sources. And third, the Board could rely on the data from the existing products to cover the others (for example, use the five-year ARM rate for ARMs longer than one-year and shorter than five years).

Another alternative prime mortgage market benchmark the Board may wish to consider is the higher of the Freddie Mac Required Net Yield (RNY) and the equivalent Fannie Mae secondary market yield plus 2.25% (the RNY is net of the servicing fee retained by the loan servicer; the typical servicing fee retained by loan servicers has been about 0.25 percentage points, thus the spread should be about one-quarter percentage point higher than if the benchmark was a primary market interest rate). Attached as Exhibit D are Freddie Mac Historical Required Net Yield tables for April 4, 2006, April 4, 2007, and April 4, 2008. The Freddie Mac RNY is the yield Freddie Mac expects from purchasing a conventional conforming mortgage; the RNY is a par price.

The Board should consider basing a benchmark on the higher of the Freddie Mac and Fannie Mae 90-day RNY, which is published daily for 15-, 20-, and 30-year fixed rate mortgages, and for 5- and 7-year balloons. Two and a quarter percentage points above these yields would set a threshold for higher-priced first-lien mortgages that would rise and fall with prime mortgages. (We propose a four-and-a-quarter percentage point margin for subordinate lien loans.) The advantage of using RNYs as a source of the index, as opposed to the PMMS, is that RNYs are more transparent: no survey is involved, yields are based on actual capital market yields for mortgage pass-through securities, and the data are available daily. The RNYs are the direct result of market activity. The disadvantage of RNYs relative to the PMMS is that there are no ARM product categories published by Freddie Mac. Given the lack of ARM data, interpolation does not appear to be a realistic approach to filling the gaps. Another source of data would be necessary.

3. Volatility of one-day yields

The Board should consider the effect of market volatility associated with whatever benchmark the Board decides to use. Recently, the yield of Treasury securities has swung dramatically from week to week, and even from day to day. Other potential one-day benchmarks could be volatile as well. We would recommend, as a means to manage mortgage market volatility, that the Board consider using a weekly average. The use of a mortgage market index, like the PMMS, would build in this stabilizing factor, since it is a weekly nationwide survey of mortgage rates. If the Board chooses to use Treasury yields, then the weekly average Treasury yield could be used as a benchmark for loan applications taken during the following week, with the benchmark yield updated each week.

The graphs attached as Exhibit E show that there is a great deal of volatility in market yields over the period from the 15th of one month to the 14th of the next month. For example, on average, from the 15th of one month to the 14th of the next month, the 10-year Treasury yield has been 18 basis points above, and 20 basis points below the yield on the previous 15th, with many episodes where the yield has been one-half percentage point above or below the yield on the 15th during the subsequent one-month period. This degree of 30-day volatility would mean that some loan applicants that are prime borrowers could be tagged as "high-cost" solely because they had the misfortune of placing their application on a day when market rates were high relative to the previous 15th; likewise, some applicants for subprime products may not be tagged as high-cost simply because their applications were placed on a day when market rates were very low compared to the previous 15th. Using a weekly average, updated each week and published by the Board, would reduce the likelihood of such occurrences.

4. Operational issues

Any definition of "higher-priced" mortgage loans that is based on a rate spread will raise operational complexities for creditors. One way to simplify the matter for creditors would be for the Board to publish the threshold on its website. The Board could post all of the minimum rates for various types of products with application dates during the relevant time period in one place. This would simplify compliance for creditors, and mortgage purchasers could use the same information. This approach would result in more certainty, and fewer errors, than requiring creditors and mortgage brokers to attempt to calculate the thresholds. In addition, publication of the thresholds by the Board would increase transparency for borrowers, brokers and others that counsel borrowers because they would have direct access to reliable information as to whether a loan was a higher cost mortgage loan, with the additional consumer protections afforded borrowers in such cases.

B. Comments and recommendations of a technical or clarifying nature

1. Determination of borrower ability to repay

We agree that a creditor should consider the type of objective factors that the Board sets forth in determining the borrower's ability to repay. Freddie Mac has taken the same approach toward subprime mortgages. For example, on February 27, 2007, we announced tougher underwriting standards for short-term subprime hybrid ARMs, which include the requirement that the borrower be qualified based on a fully indexed rate and a fully amortizing payment schedule that includes property taxes and insurance. Likewise, our model subprime product, SafeStep Mortgages℠, has underwriting standards that include these requirements, as well as consideration of the borrower's debt-to-income ratio and residual income.

a. Consideration of income, assets and debt

Freddie Mac agrees with the Board that creditors should be required to evaluate both borrower income or borrower non-collateral assets and debt in predicting default and loss severity for higher-priced mortgage loans. Nevertheless, we are concerned with the potential impact proposed § 226.34(a)(i)(D)-(E) may have on automated underwriting systems such as Freddie Mac's Loan Prospector®. Under the Board's proposed rule, a creditor must consider both borrower "total debt obligations to income" (or "total DTI") and borrower income after payment of "debt obligations." A failure to consider either DTI or debt obligations creates a presumption that a creditor has violated the ability to repay requirement. Eligibility of a mortgage for sale to Freddie Mac through LP includes a determination that a borrower is creditworthy (acceptable credit reputation and capacity including ability to repay) and that the proposed value of the mortgaged premises (collateral) is consistent with the market. If one of these components is unacceptable, regardless of the other component's strengths, or if there is excessive layering of risk across components, the mortgage is not eligible for sale to Freddie Mac through LP. LP delivers a decision to the lender that Freddie Mac will purchase a particular loan under certain conditions. In doing so, LP eliminates many of the manual processing and underwriting requirements of manual mortgage processing.

We believe that an AUS as we described satisfies the Board's requirement to consider the borrower's ability to repay. We further believe that the Board is interested in supporting a flexible approach to determine a borrower's ability to repay as long as the approach is rational, reasonable and satisfies the Board's objective. Higher-price mortgage loans that receive a purchase decision through the use of LP or other AUS that take into account borrower ability to repay should be deemed to meet the Board's ability to repay requirement. Therefore, we request that the Board confirm our understanding that an underwriting decision based on an AUS as we described meets the Board's requirements for determination of borrower ability to repay.

Moreover, we propose that total DTI and residual income not be absolute prerequisites for avoiding the presumption of failure to determine ability to repay. Other measures of income, assets, or debts may be valid methods to assess ability to repay. For example, mortgage DTI may be a more predictive ratio than total DTI, or reserves (such as money in a bank account) may be predictive when coupled with other underwriting criteria. We would respectfully recommend that subparagraph (D) in § 226.34(a)(i) be read to include both income/assets and debt so long as creditors are provided with flexibility. Therefore, we propose a final subparagraph (D) that would read:

"Consider:

- the ratio of consumers' total debt obligations to consumers' income,
- the income consumers will have after paying debt obligations, or
- one or more other objective factors regarding both borrower income or non-collateral assets and debt that can be used when determining the borrower's ability to repay."

b. Seven-year time horizon

The Board writes that a borrower's ability to repay an ARM or fixed-rate interest-only mortgage should take into account the monthly payment not only at origination but also for seven years thereafter. The Board proposes that a creditor be presumed to violate the ability to repay provision if it fails to consider ability to repay at the highest interest rate possible within the first seven years of the loan, but conversely does not violate the provision if it has a reasonable basis to believe that the borrower will be able to make loan payments under that scenario for at least seven years (although the Board questions whether a five-year horizon would be more realistic).[9]

[9] 73 Fed. Reg. at 1689-90 (discussing proposed §§ 226.34(a)(4)(i)(B), 226.34(a)(4)(ii)). The Nontraditional Mortgage Guidance, by contrast, requires that the ability to repay determination at the fully indexed rate consider the entire lifetime of the loan. See 71 Fed. Reg. at 58614 (requiring the use of the fully indexed rate for "all"

It is unclear whether the Board's proposal that the payment scenario "at the highest interest rate possible" within the first seven years, means the *highest monthly payment* amount during that period as well as whether that payment should take into account not only the highest interest rate during that period and the potential for negative amortization (if any), but also tax and insurance payments (with current tax and insurance payments used as a proxy for future ones). With respect to the seven-year time horizon, we seek further clarification from the Board.

In addition, we seek the Board's clarification regarding whether the seven-year horizon test relates solely to the issue of whether the borrower's current income is sufficient to support the highest monthly payment amount during that period or if the board intends for it to be a test to determine whether the borrower's current income will continue (or increase) during the seven-year period. We believe the Board's intention is to ensure that, as long as there is no evidence to the contrary and as long as the borrower's current income can reasonably be expected to be sufficient to make the highest monthly payment during the seven-year time horizon, the requirement should be deemed satisfied. We note, however, that as written, it may be subject to a different interpretation.

c. Nontraditional Mortgages

Since late 2006, the federal financial institution regulatory agencies (including the Board) have, through the Nontraditional Mortgage Guidance,[10] required that all nontraditional mortgages, regardless of whether they are prime or subprime, be underwritten at the fully indexed rate, and assuming a fully amortizing payment schedule. The Nontraditional Mortgage Guidance, however, only imposed this requirement on the institutions regulated by the federal financial institution regulatory agencies, although many states have followed suit with guidance or regulations. Freddie Mac requires compliance with the Guidance and Subprime Statement[11] regardless of whether the originator is federally regulated or unregulated. The Board, through binding notice-and-comment rulemaking under Regulation Z, now proposes to apply the requirement of fully-indexed, fully amortizing underwriting to higher-priced mortgage loans, including nontraditional mortgage loans. Subject to the proposal being finalized, the regulatory landscape for the underwriting of nontraditional mortgage loans will look as follows:

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nontraditional mortgage products). The Board should make clear that this provision in Regulation Z permitting ability to repay determinations to be limited to a seven-year horizon will supersede any provision to the contrary in the Guidance or in the Subprime Statement, which generally requires evaluation of the borrower's ability to repay the loan at maturity at the fully indexed rate. See 73 Fed. Reg. at 37573. We believe that a seven-year horizon is a more reasonable time horizon than five years. Seven years will provide borrowers with more of an opportunity to refinance, if necessary, because the longer horizon will provide for a greater variety of interest rate and home price conditions.

[10] Interagency Final Guidance on Nontraditional Mortgage Product Risks, 71 Fed. Reg. 58609 (October 4, 2006) ("Nontraditional Mortgage Guidance").

[11] Statement on Subprime Mortgage Lending (Interagency Final Guidance), 72 Fed. Reg. 37569 (July 10, 2007) ("Subprime Statement").

	Prime mortgages	**Subprime/ higher-priced mortgage loans**
Federally chartered institutions, affiliates, and state-charted, FDIC-insured institutions	Nontraditional Mortgage Guidance	Regulation Z
Mortgage lenders	Guidance in some states, regulation in others	Regulation Z

We seek the Board's guidance regarding whether the ability to repay standard set forth in § 226.34(a)(4) should apply to all nontraditional mortgage loans, regardless of whether they are higher-priced.

2. Income Verification

We support the Board's requirement of income verification for higher-priced mortgage loans. For SafeStep, our model subprime product, we do not permit no-income verification loans, and we only permit stated-income loans in very limited circumstances. Moreover, for SafeStep mortgages that are ARMs with introductory periods of three years or less with margins exceeding 400 basis points (we permit a maximum margin of 450 basis points), we require that all lenders doing business with us comply with the Subprime Statement. As discussed above, so long as the threshold is set at a level high enough to avoid covering prime mortgages and lower-priced Alt-A mortgages, we agree that the borrower's current and expected income should be verified.[12]

3. Prepayment Penalties

The Board's proposal restricts the duration of the prepayment penalty period to no longer than five years. In 2002, Freddie Mac announced that it would not invest in private-label securities backed by subprime mortgages with prepayment penalties where the prepayment penalty period exceeds three years. Between 2004 and 2007, the three-year prepayment penalty period became the industry standard. Accordingly, our SafeStep product limits prepayment penalty periods to three years. Based on these experiences, we believe that the Board could limit the prepayment penalty period to three years without causing any significant curtailment in credit.

We support the Board's proposal to end the prepayment penalty term for higher-priced mortgage loans 60 days before the ARM or interest-only mortgage resets. We are particularly supportive

[12] If the Board were to decide to keep the current definition for higher-priced mortgage, we would propose to exclude two classifications of mortgages from the verification requirement. First, for mortgages with low risk attributes (including very high FICO scores and/or low LTVs), the borrower should be permitted to borrow without being subject to income documentation of all income, provided the source of the income is verified or the primary source of income is documented. Second, for mortgages such as streamlined refinances, where the creditor is the same and the new interest rate or product lowers the borrower's payment or risk attributes (for example, the borrower refinances from an ARM to a fixed-rate mortgage), the borrower's ability to repay is necessarily enhanced by the transaction, regardless of any income verification requirement. In that circumstance, the creditor should not be required to verify the borrower's income.

of the fact that this provision, which appears in the Subprime Statement as guidance, would be uniformly applied to all creditors.

In addition, based on our current practices, we propose four additional provisions for the Board's consideration that are imposed by the Department of Housing and Urban Development on Freddie Mac and Fannie Mae as a condition of counting a mortgage toward the affordable housing goals. See 24 C.F.R. § 81.2 ("Mortgages with unacceptable terms or conditions or resulting from unacceptable practices"). First, any borrower who chooses a prepayment penalty should be offered a mortgage without a prepayment penalty. The Board discusses the "principle" of a lender offering a choice between a loan with a prepayment penalty and a loan that does not have a prepayment penalty but has a higher interest rate.[13] Second, a prepayment penalty should provide a benefit to the borrower (*e.g.*, a rate or fee reduction for accepting the prepayment penalty). Third, the prepayment penalty should be adequately disclosed to the borrower. Fourth, a prepayment penalty should not be imposed when the mortgage is accelerated as a result of the borrower's default. Freddie Mac requires these provisions of the mortgages that we purchase. If the Board decides not to include these provisions in the final rule, we suggest that language be added to the Staff Commentary that encourages creditors to adopt these practices.

4. Escrow

The Board proposes to require creditors to establish escrow accounts for taxes and insurance, but permit creditors to allow borrowers to opt out of escrows 12 months after loan consummation. We support the Board's proposal to require escrow for higher-priced mortgages. With respect to subprime mortgages we purchase, if such mortgages (*i.e.*, SafeStep Mortgages) have an escrow account when sold to Freddie Mac, we require the servicer to represent and warrant that it will not discontinue or waive collected escrowed items.

II. COMMENTS ON PROPOSED PROVISIONS FOR ALL MORTGAGE LOANS

A. Servicing

Freddie Mac agrees with the Board's objective of providing for greater transparency in servicing.[14]

The Board proposes to prohibit a servicer from: (1) failing to credit a consumer's periodic payment as of the date received; (2) imposing a late fee or delinquency charge where the only late fee or delinquency charge is due to a consumer's failure to include in a current payment a delinquency charge imposed on earlier payments; (3) failing to provide a current schedule of servicing fees and charges within a reasonable time of request; or (4) failing to provide an accurate payoff statement within a reasonable time of request.[15]

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[13] 73 Fed. Reg. at 1693.
[14] 73 Fed. Reg. at 1702.
[15] 73 Fed. Reg. at 1701-1703.

Freddie Mac already imposes most of the same requirements offered in the Board's proposed rule on its servicers. With respect to the Board's proposed requirement that the borrower be provided accurate payoff statements within a reasonable time,[16] we agree and request the Board clarify that for schedule of fees and for payoff statements, a borrower's request must be in writing. We believe that written communication from the borrower, or the borrower's representative, is the best way to determine what the borrower is requesting.

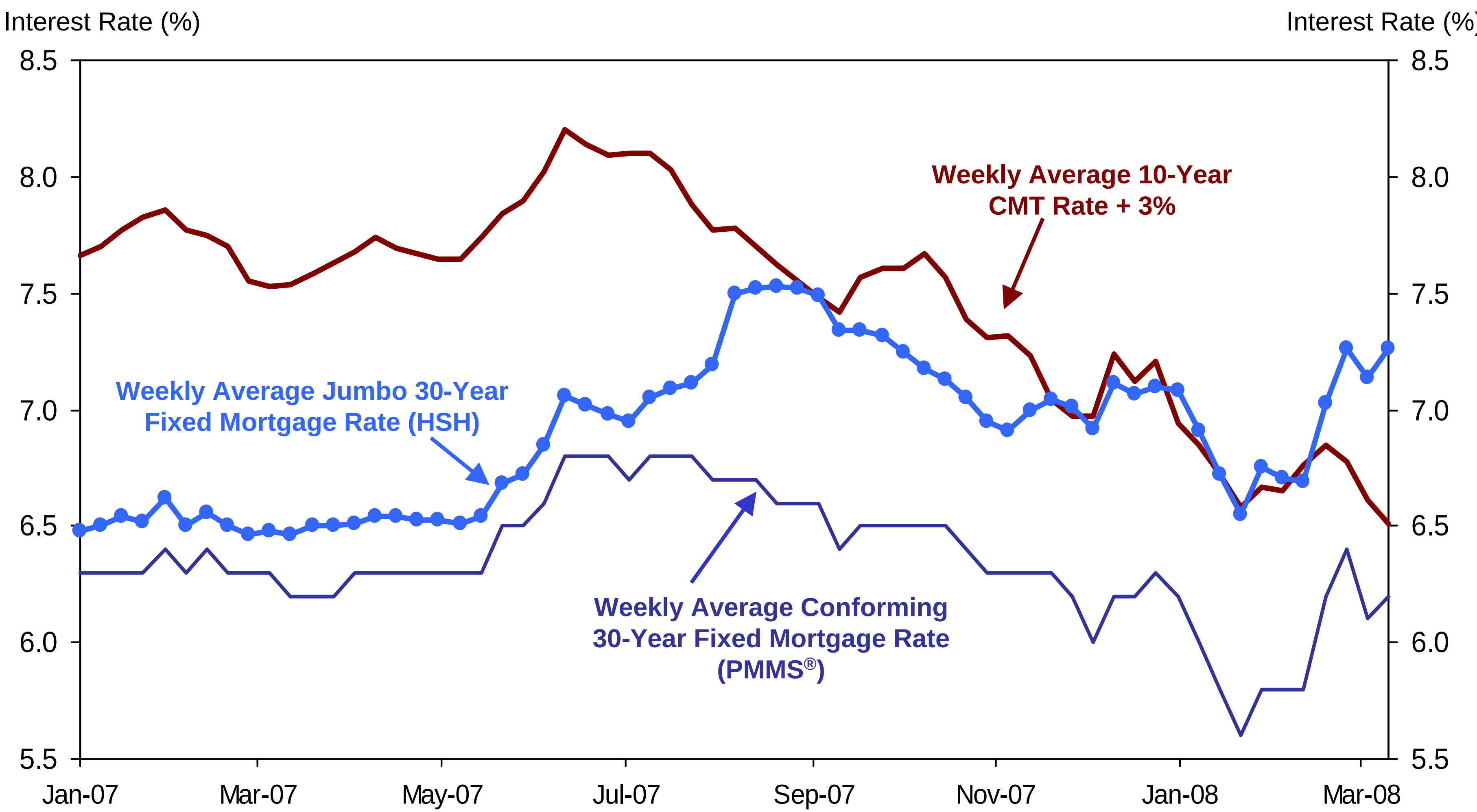
B. Appraisals

We would like to bring to the Board's attention that Freddie Mac, along with the Office of Federal Housing Enterprise Oversight (OFHEO), has tentatively agreed with the Attorney General of New York to implement the Home Valuation Code of Conduct (the "Code"), which sets out standards designed to enhance appraiser independence. (Fannie Mae has entered into a similar agreement.) These standards encompass rules addressing appraisal selection, solicitation, compensation, conflicts of interests, and independence. We note that the Code of Conduct, as proposed, would not permit lenders to accept appraisals ordered by mortgage brokers or real estate brokers.

As of January 1, 2009, Freddie Mac will only purchase mortgages from lenders who adopt the Code with respect to mortgages sold to Freddie Mac. Freddie Mac, Fannie Mae, OFHEO and the Attorney of New York are soliciting comments on the Code. Because the 45-day comment period for the Code will not expire until after comments on the Board's proposed rule are due, Freddie Mac respectfully refers the Board to the Code, which is available at http://www.freddiemac.com/singlefamily/docs/030308_valuationcodeofconduct.pdf.

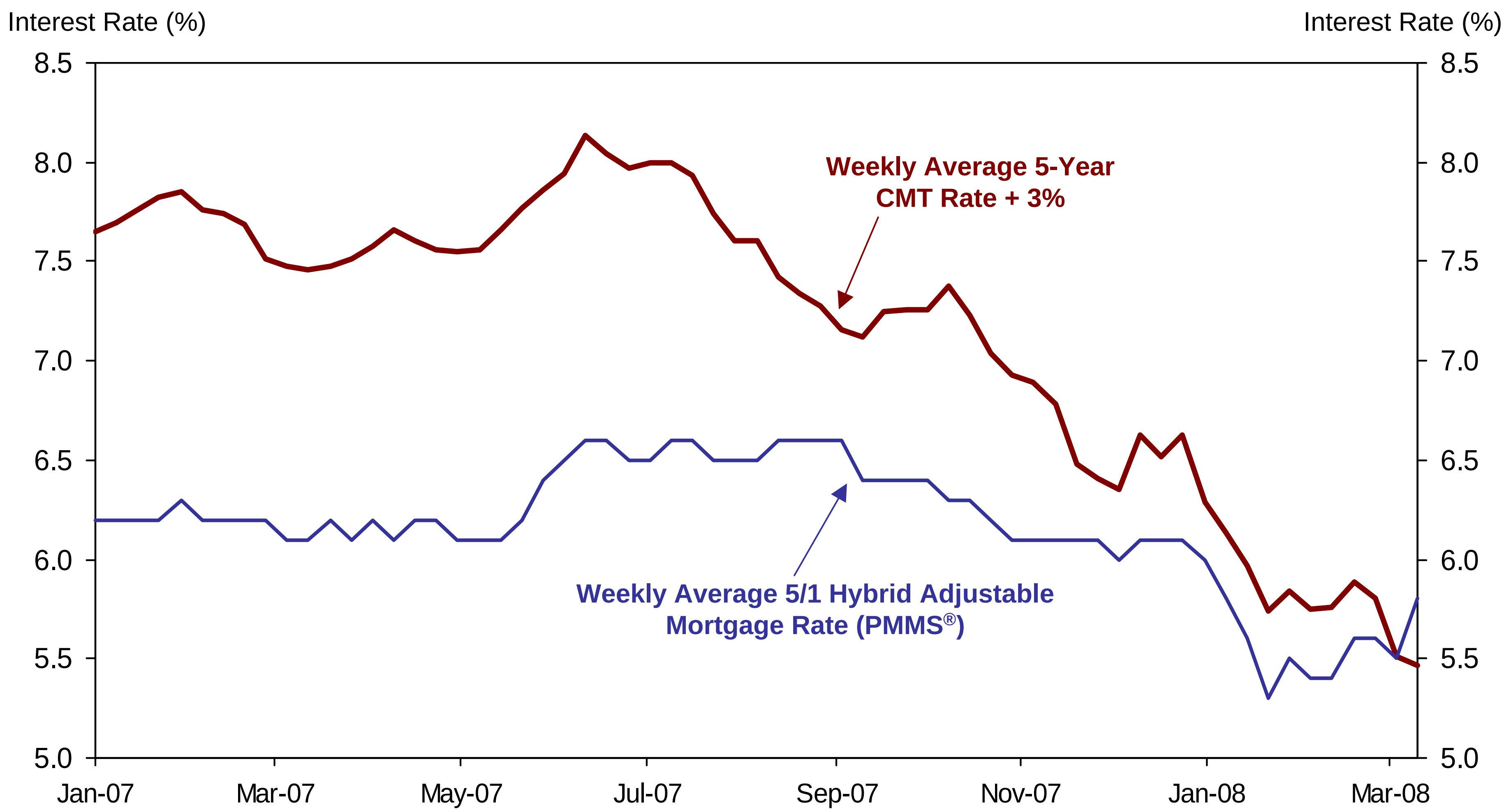
[16] 73 Fed. Reg. at 1703.

Exhibit A: Historical Interest Rates
January 2007 - March 2008
Level of Effective 30-Year Fixed Mortgage Rates and 10-Year CMT + 3%



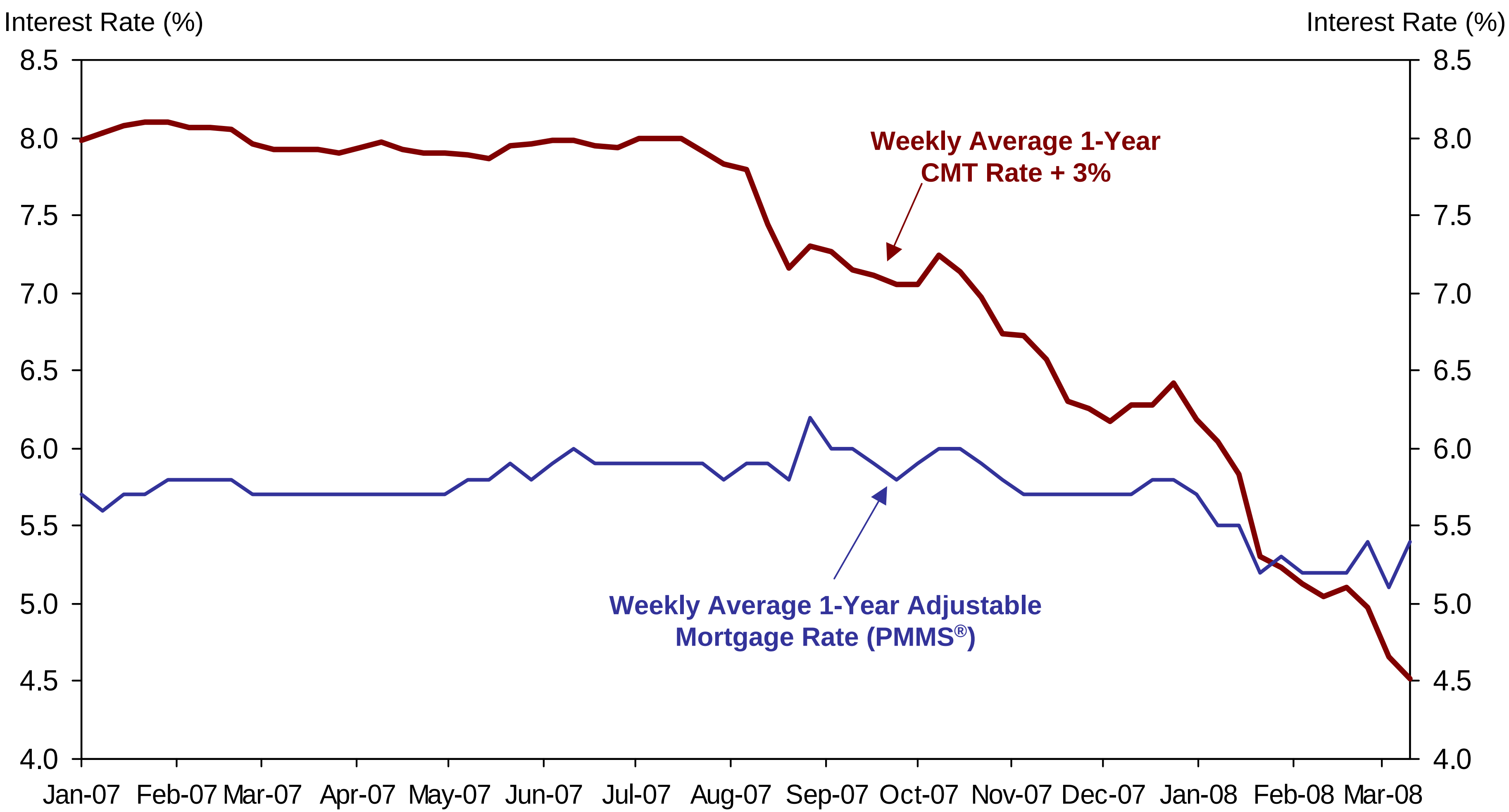
Source: Federal Reserve Board, Freddie Mac, HSH Associates

Exhibit A: Historical Interest Rates
January 2007 - March 2008
Level of Effective 5/1 Hybrid Adjustable Mortgage Rates and 5-Yr CMT + 3%



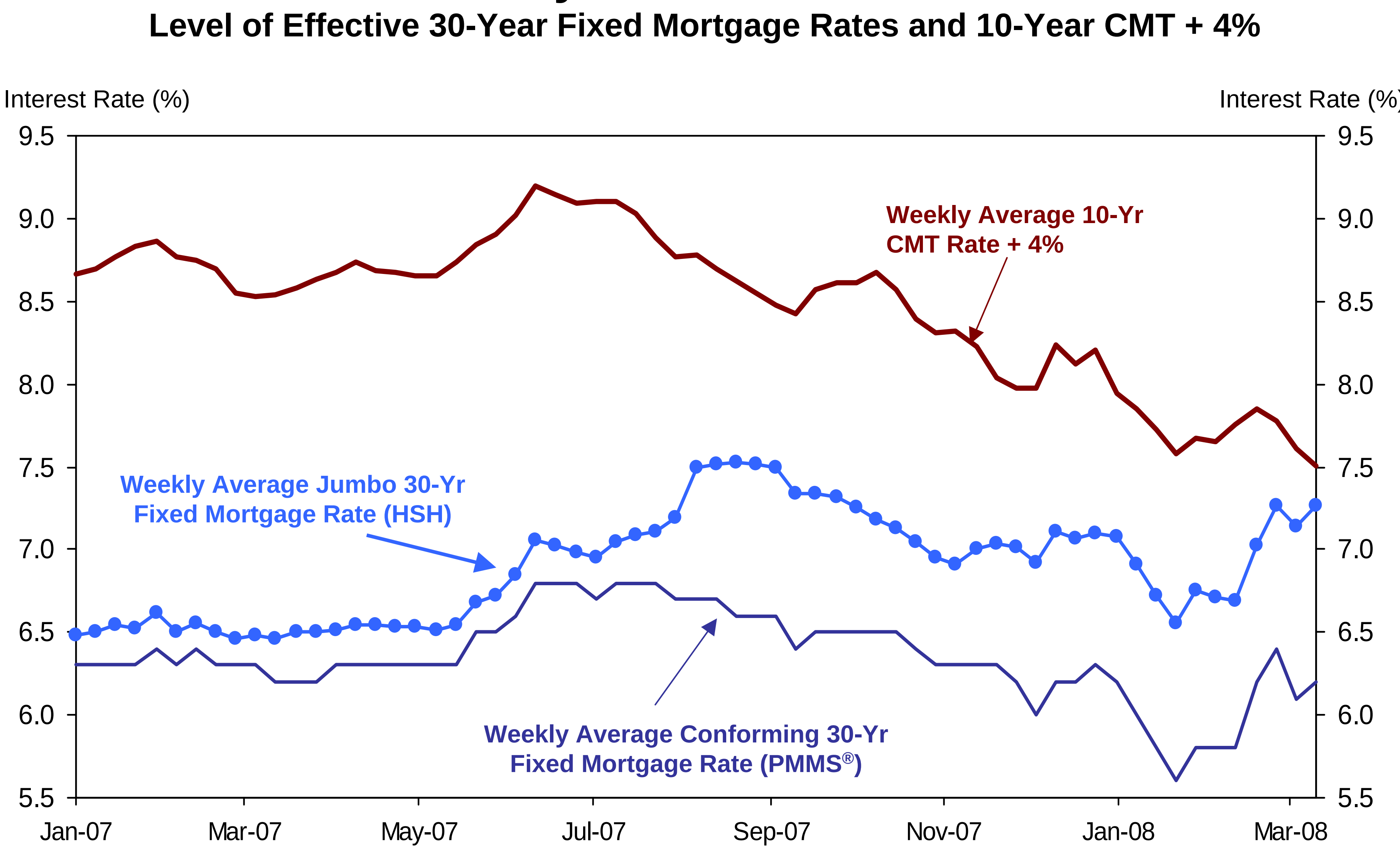
Source: Federal Reserve Board, Freddie Mac

Exhibit A: Historical Interest Rates
January 2007 - March 2008
Level of Effective 1-Year Adjustable Mortgage Rates and 1-Yr CMT + 3%



Source: Federal Reserve Board, Freddie Mac

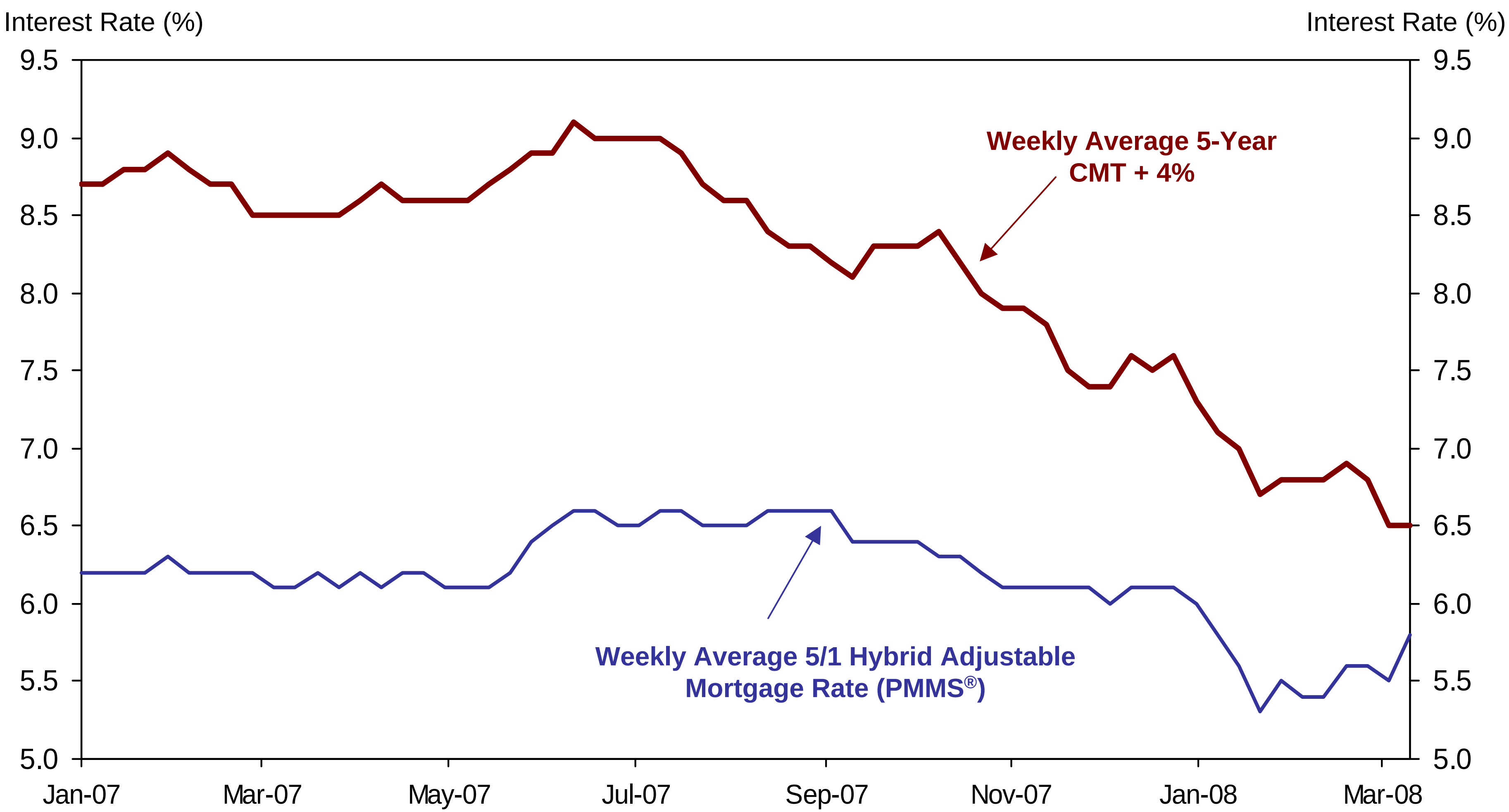
Exhibit B: Historical Interest Rates
January 2007 - March 2008



Source: Federal Reserve Board, Freddie Mac

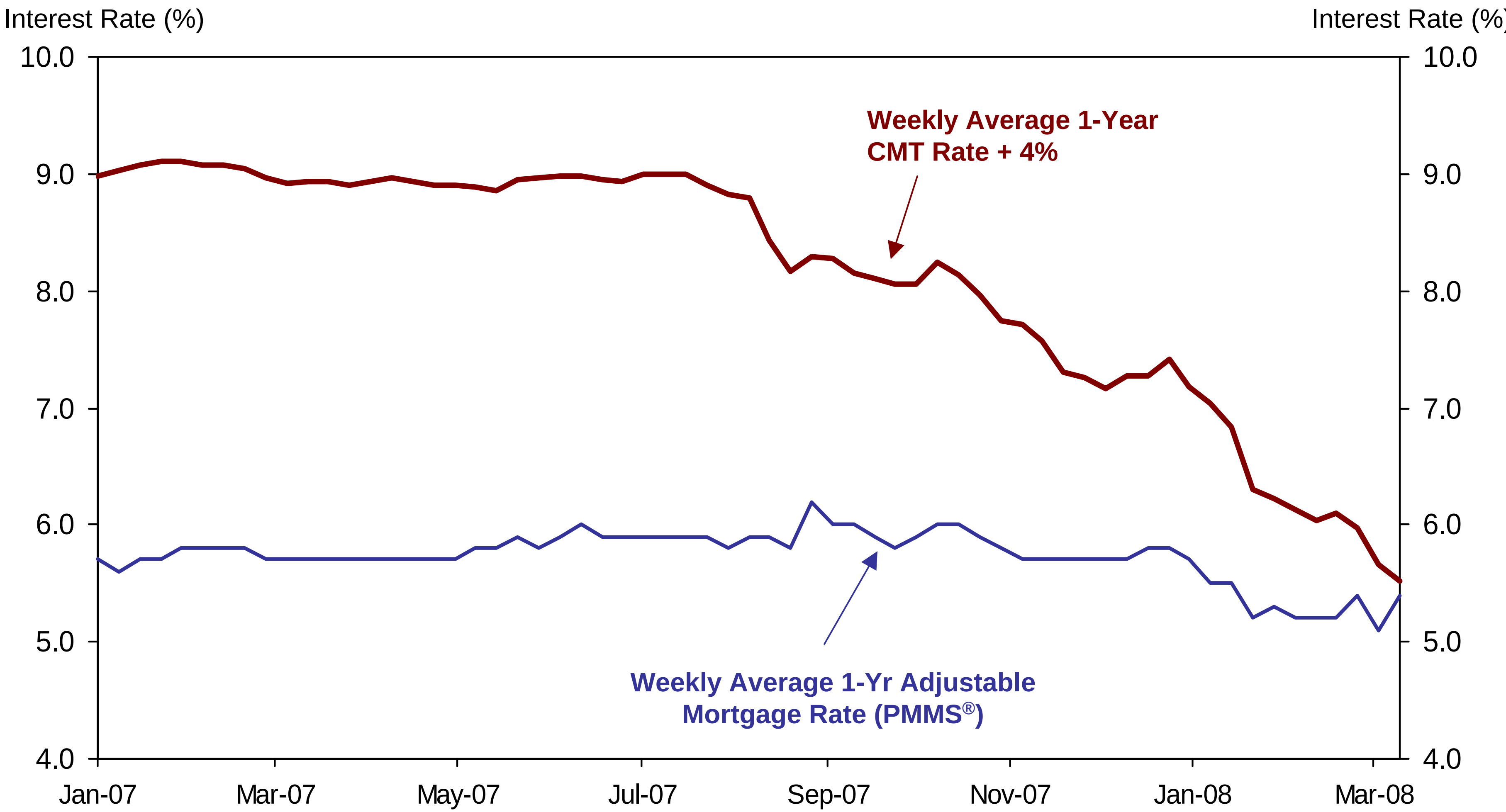
Exhibit B: Historical Interest Rates
January 2007 - March 2008

Level of Effective 5/1 Hybrid Adjustable Mortgage Rates and 5-Yr CMT + 4%



Source: Federal Reserve Board, Freddie Mac

Exhibit B: Historical Interest Rates
January 2007 - March 2008
Level of Effective 1-Year Adjustable Mortgage Rates and 1-Yr CMT + 4%



Source: Federal Reserve Board, Freddie Mac

Exhibit C: Spreads Between Subprime and Prime-Conforming 30-Year Fixed Mortgage Rates

In Basis Points

Subprime Rating	2006 Average	2007 Average
A-	207	340
B	252	376
C	318	395

Sources: Freddie Mac's PMMS®, Inside B&C Lending (2007 data through November 1, 2007.)

Exhibit D: Freddie Mac Required Net Yields

Par Price - Excludes Servicing Fees of 0.25%

RNYS For 04/04/2006

Delivery Commitment	30-Year FRM	15-Year FRM	7-Year Balloon	5-Year Balloon	20-Year FRM
10 Day	6.33	5.92	6.53	9.03	6.15
30 Day	6.26	5.88	6.17	8.02	6.07
60 Day	6.30	5.90	6.41	8.67	6.12
90 Day	6.28	5.89	6.28	8.25	6.09

RNYS For 04/04/2007

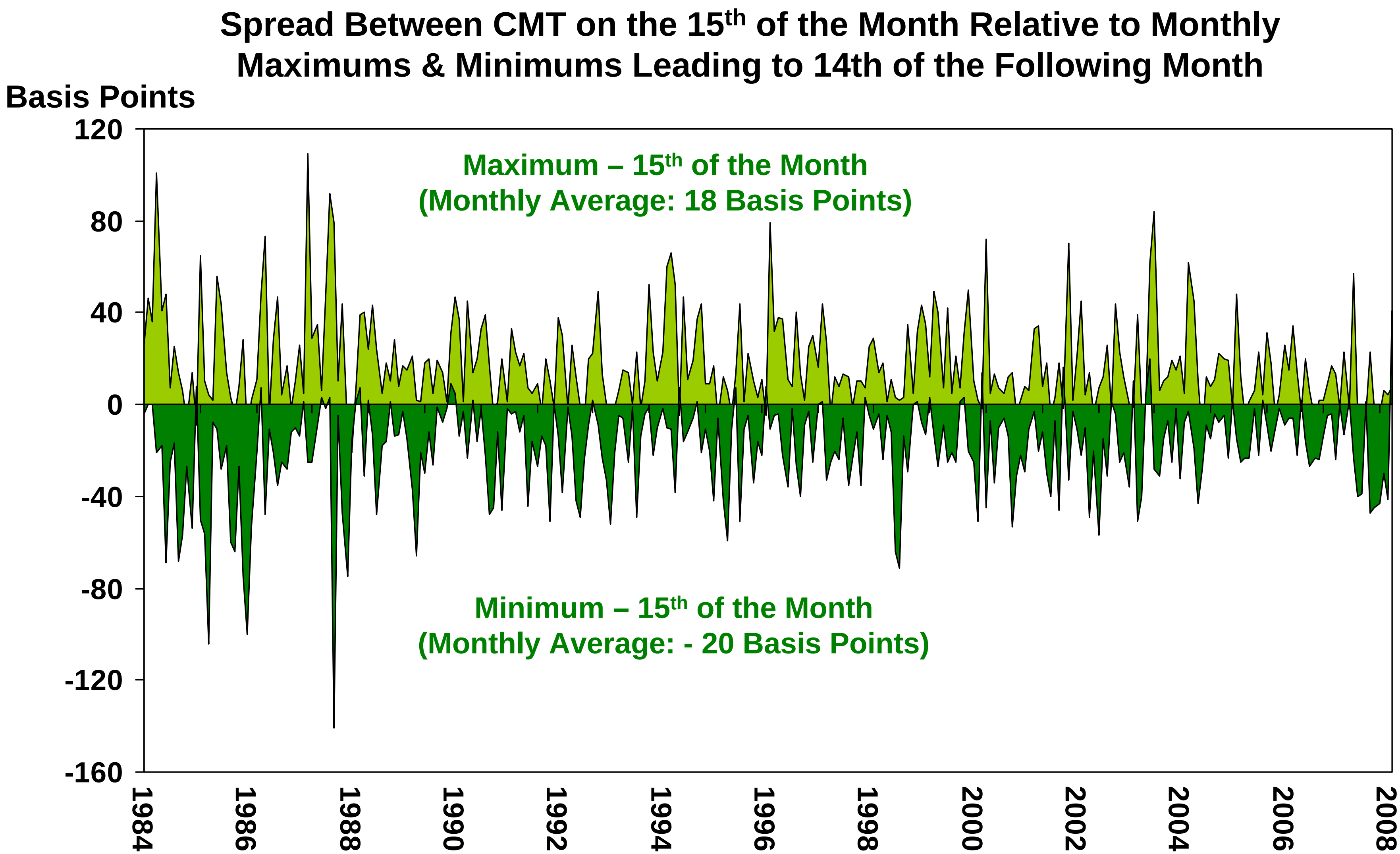
Delivery Commitment	30-Year FRM	15-Year FRM	7-Year Balloon	5-Year Balloon	20-Year FRM
10 Day	6.03	5.63	5.78	5.75	5.89
30 Day	6.03	5.64	5.87	5.83	5.90
60 Day	6.04	5.64	5.96	5.92	5.91
90 Day	6.05	5.65	6.04	6.01	5.92

RNYS For 04/04/2008

Delivery Commitment	30-Year FRM	15-Year FRM	7-Year Balloon	5-Year Balloon	20-Year FRM
10 Day	5.29	4.88	6.07	5.86	5.14
30 Day	5.35	4.92	6.10	5.88	5.20
60 Day	5.43	4.99	6.13	5.93	5.29
90 Day	5.50	5.06	6.18	5.97	5.38

Source: Freddie Mac (http://ww3.freddiemac.com/ds1/sell/rnyhistory.nsf/frmHisRNY?OpenForm Accessed April 4 & 6, 2008)

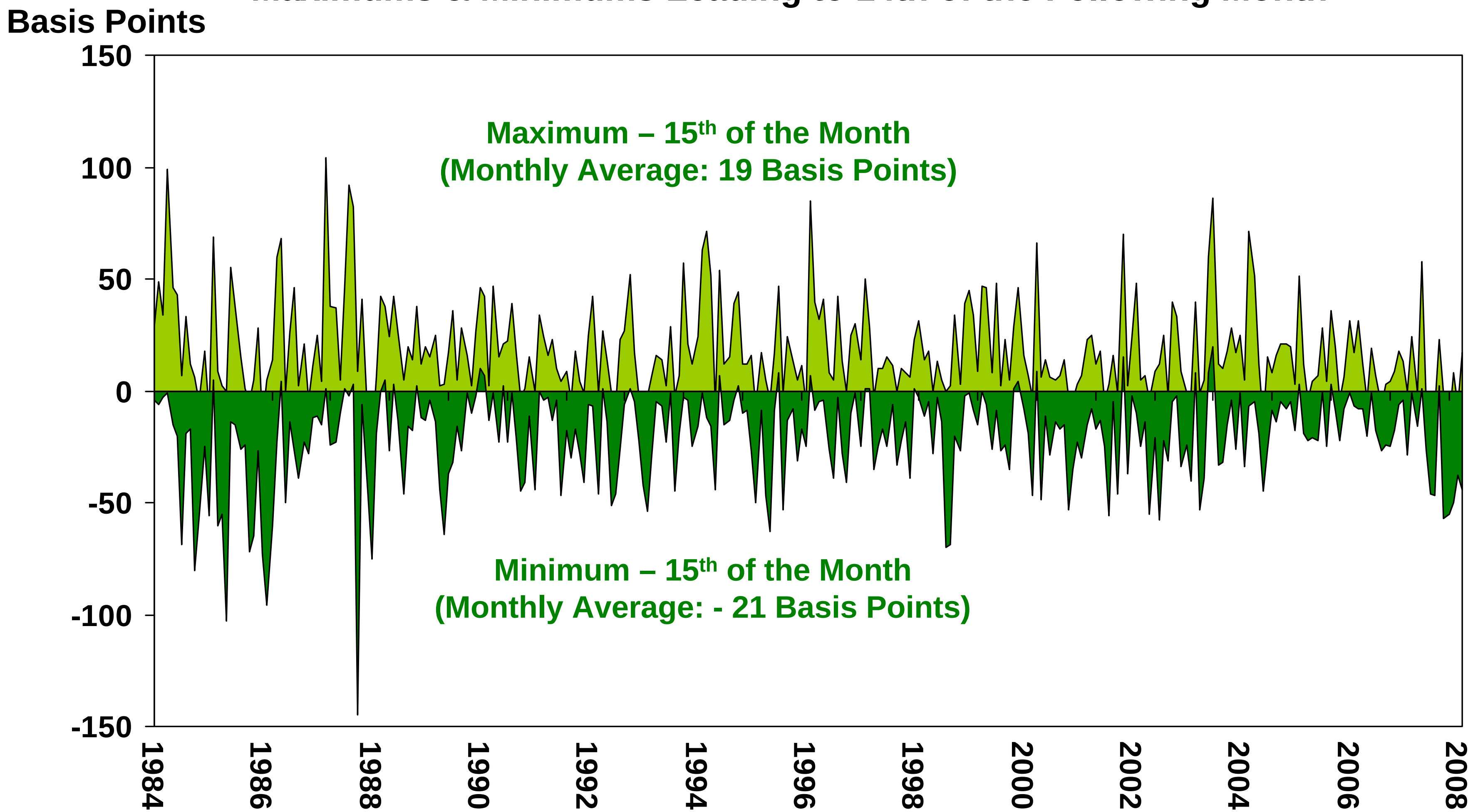
Exhibit E: 10-Year Constant-Maturity Treasury Monthly Rate Volatility



Source: Federal Reserve Board

Exhibit E: 7-Year Constant-Maturity Treasury Monthly Rate Volatility

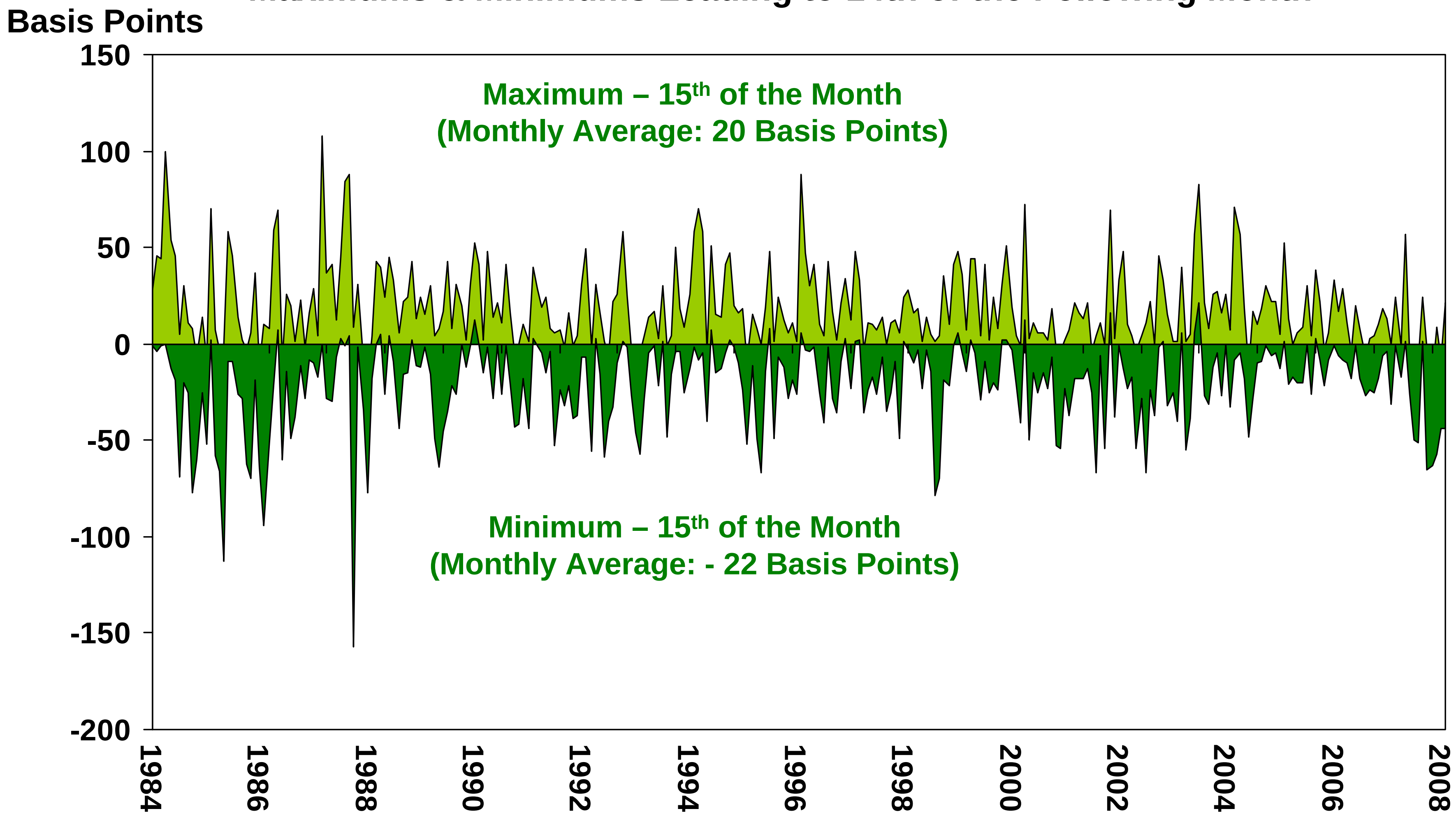
Spread Between CMT on the 15th of the Month Relative to Monthly Maximums & Minimums Leading to 14th of the Following Month



Source: Federal Reserve Board

Exhibit E: 5-Year Constant-Maturity Treasury Monthly Rate Volatility

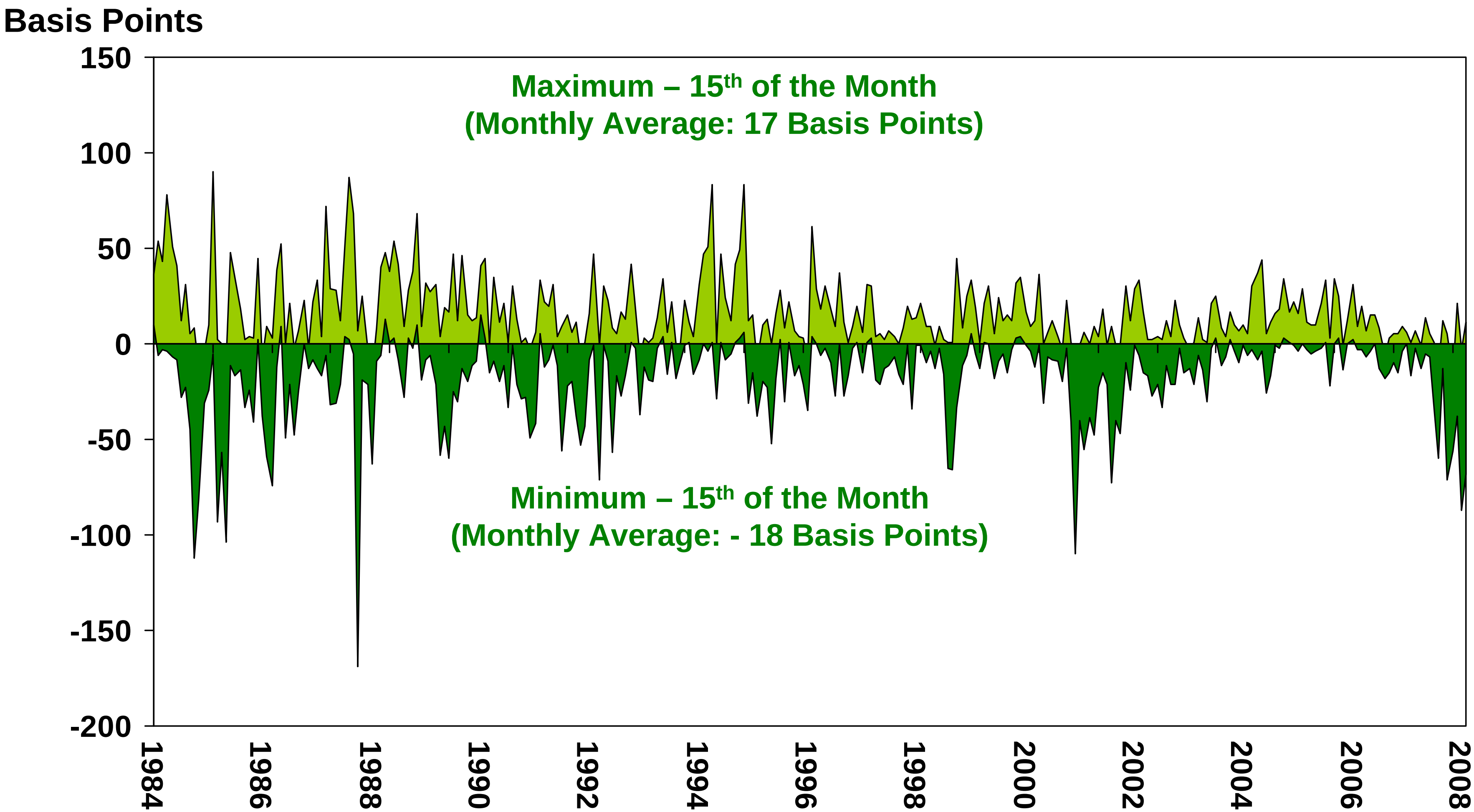
Spread Between CMT on the 15th of the Month Relative to Monthly Maximums & Minimums Leading to 14th of the Following Month



Source: Federal Reserve Board

Exhibit E: 1-Year Constant-Maturity Treasury Monthly Rate Volatility

Spread Between CMT on the 15th of the Month Relative to Monthly Maximums & Minimums Leading to 14th of the Following Month



Source: Federal Reserve Board