March 29, 2006

Office of the Comptroller of the
Currency
250 E Street, SW
Public Reference Room
Mail Stop 1-5
Washington, DC 20219
Attn: Docket No. 05-21

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attn.: Docket no. 2005-56

Mr. Robert E. Feldman
Executive Secretary
Attn: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Ave., NW
Washington, DC 20551
Attn.: Docket no. OP-1246

Ms. Mary Rupp,
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314–3428

Re: Proposed Interagency Guidance on Nontraditional Mortgage Products; 70 Federal Register 77249; December 29, 2005; **FDIC** (No docket number provided); **FRB** Docket No. OP-1246; **OCC** Docket No. 05-21; **OTS** Docket No. 2005-56; **NCUA** (No Docket number provided)

Dear Ladies and Gentlemen:

The Mortgage Bankers Association (MBA)[1] appreciates the opportunity to comment on the Proposed Interagency Guidance on Nontraditional Mortgage Products (hereafter "Proposed Guidance") issued by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit

[1] **The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 500,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 3,000 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.**

Insurance Corporation, the Office of Thrift Supervision, and the National Credit Union Administration (the "Agencies").

MBA believes that the creation of guidance on nontraditional mortgage products is a positive development, given increasing consumer interest in these products and the increasing number of lenders offering such products to meet this consumer demand. The Proposed Guidance developed by the Agencies identifies issues that all lenders should consider in originating such products.

However, MBA finds that the Proposed Guidance is overly prescriptive in mandating specific underwriting standards, suggests a third-party oversight standard for Federally-regulated institutions that is inappropriate, and does not sufficiently use the authorities of Board of Governors of the Federal Reserve System ("Federal Reserve") to improve consumer disclosures for all borrowers. We are concerned that these deficiencies will stifle mortgage product innovation and hurt consumers' access to homeownership financing.

Mortgage lenders, operating within this country's sophisticated real estate finance system, respond to a number of influences in determining their ability to originate mortgages in manner that is profitable, as well as safe and sound. The primary influence for lenders are the signals received from secondary mortgage market investors. A lender originating a large number of mortgages with an unacceptable level of risk will find itself facing significant price disadvantages in the market. These signals prompt lenders to alter product features, introduce new features and remove features that do not work. These product changes are immediate. In this manner, the private market can and does correct for excess risk more quickly than can a regulator who necessarily must move at a more deliberate pace. MBA believes that market signals have already addressed many of the concerns expressed by the Agencies in the Proposed Guidance.

The past 15 years has been marked by dramatic changes in mortgage originations which have significantly lowered the cost of homeownership for consumers and developed a broad range of products that meet a diversity of homebuyer needs. The evidence of success of these changes is the record high homeownership rate the U.S. currently enjoys.

Where guidance or regulation imposes a standard that is not aligned with mortgage markets, the net effect is to limit the ability of mortgage lenders to create viable products that respond to consumer demand. MBA believes that particular provisions of the Proposed Guidance threaten to do this and we suggest certain clarifications and modifications in order to ensure that the Proposed Guidance meets its stated goal of clarifying "how institutions can offer these products in a safe and sound manner," without disrupting mortgage market innovation or curtailing consumer access to financing.

Overview

MBA will comment on each section of the Proposed Guidance, but first would like to offer some general observations about nontraditional products and today's mortgage markets. In reviewing the Proposed Guidance, MBA believes specifically addressing these observations in the guidance would help to create clarity of perspective on the issue of nontraditional mortgage products.

First, the Proposed Guidance should explicitly recognize that Federally-regulated institutions have successfully offered these nontraditional products for decades and should not be disadvantaged in the marketplace from continuing to do so. Secondly, interest-only and payment-option loans are different products that require different underwriting standards and risk management practices. Finally, though defined as products, interest-only and payment-option are actually *loan features* that, in and of themselves, do not inherently pose significant risks.

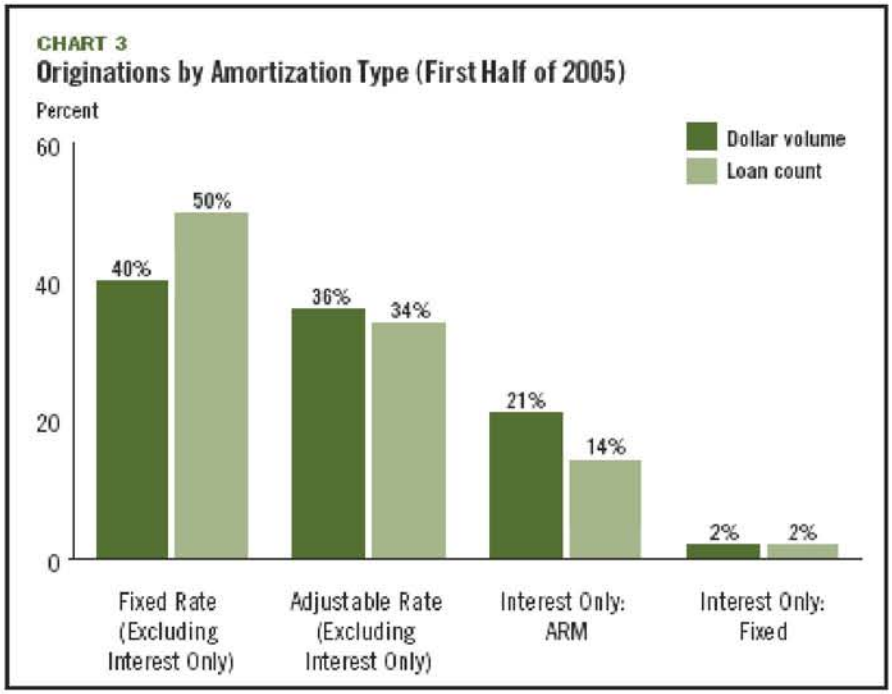
Nontraditional mortgage products have a long and successful history.

The Proposed Guidance defines "nontraditional mortgage products" solely as "interest-only" and "payment-option" mortgages. Such a definition indicates that the key to the nontraditional label is a non-amortizing or potentially negatively amortizing period in a mortgage product. Ironically, though currently being termed "nontraditional", non-amortizing mortgages predate amortizing mortgages. In the U.S., it was not until the creation of the Federal Housing Administration (FHA) in 1934 that the now ubiquitous 30-year, fixed-rate, amortizing mortgage gained nationwide acceptance. Prior to the FHA, non-amortizing 5-year mortgages with a balloon payment at the end of the term were the market norm.

Over the past several decades, as mortgage lenders have sought to adapt to changing market conditions and changing consumer preferences, mortgage products have developed beyond the 30-year, fixed-rate, amortizing mortgage. Notably, in the early 1980s, in response to prohibitively high interest rates, the Adjustable Rate Mortgage (ARM) began to gain wide acceptance. More recently, hybrid ARMs, where the initial interest rate is fixed for a period of time and then adjusts annually, have gained wide acceptance. This is evidence that the primary mortgage market is constantly developing loan features that may be termed "nontraditional" but that are beneficial to consumers.

Some Federally-regulated institutions were at the forefront of responding to this consumer demand for product diversity and began to offer, in addition to ARMs, interest-only and payment-option mortgages. Mortgage lenders have successfully offered such products for decades, through different market cycles, without a threat to their safety and soundness. It is prudent for the Agencies to look to the practices of their Federally-regulated institutions in developing guidance on nontraditional mortgage products, but not to impose prescriptive requirements that would force them to change proven standards and disadvantage such institutions from effectively participating in this market.

Consumer demand for interest-only mortgage products is significant, as is demonstrated by MBA's Midyear 2005 Single Family Originations Survey:



If Federally-regulated institutions are hampered by prescriptive underwriting standards, it would restrict the availability of these products by some of the mortgage lenders that have the longest experience in offering such products. MBA believes such a curb on consumer choice would be an unfortunate development.

Interest-only and payment option mortgages are different.

Interest-only and payment-option mortgages are two different products. Each is treated differently by lenders in terms of credit policy, underwriting standards, and risk management.

An interest-only mortgage is commonly a loan for which a borrower is only required to make interest payments for a certain period of time, after which the loan begins to amortize, based on the remaining years on the mortgage. The interest rate may be fixed or adjustable during the interest-only period and may be fixed or adjustable after amortizing payments are required. Borrowers are typically allowed to make amortizing payments during the interest-only period.

A payment-option mortgage is a loan for which a borrower typically has an option each month to make one of four payments: an amortizing payment based on a 15 year repayment schedule, an amortizing payment based on a 30 year repayment schedule, an interest-only payment, or a minimum payment based on a start rate which may be below the fully-indexed accrual interest rate. In the case where the minimum payment

is made while the interest rate is below the accrual interest rate, negative amortization occurs. Negative amortization means that the principal balance owed by the borrower increases. Typically, the minimum payment is fixed 12 months, after which it adjusts annually based on the fully-indexed rate. Payment increases though are usually limited to no more than a 7.5% in any one year. The amount of negative amortization is usually limited to 12-15% of the original mortgage amount, at which time the loan is recast, requiring payments that will amortize the outstanding balance over the remaining term of the mortgage.

Thus the features and purposes of each product are very different. The Proposed Guidance does not appear to recognize these differences and seems to infer that lenders should apply the same policies equally to both products. MBA does not support this view and would suggest that the final guidance explicitly recognize that these products are different and ensure that guidance on credit policy and underwriting does not treat the two products the same.

Interest-only and payment-option mortgages do not pose unmanageable risks.

It is appropriate for regulators to note the increase in the use of these products by consumers and to review the underlying reasons for this growth. MBA commends the regulators for quickly issuing guidance for comment given the growing acceptance of these products by consumers. We caution, though, that the guidance should not start from the premise that the risks of these products are somehow more unmanageable than the risks of any other mortgage products.

Reports by MBA members and other data reviewed by MBA indicate that interest-only and payment-option mortgage borrowers generally have higher credit scores and lower loan-to-value (LTV) ratios. These reports confirm that mortgage lenders understand that risk-layering, as is pointed out in the Proposed Guidance, requires lenders to contemplate mitigating factors.

Loan Terms and Underwriting Standards

MBA believes that the Proposed Guidance appropriately identifies the primary credit policy and underwriting concerns that lenders should consider in developing loan terms and underwriting standards. Mortgage lenders, though, are constantly refining credit policies in response to risk analysis, market conditions, and consumer behavior. Therefore, we do not think it is appropriate for specific credit policy criteria or thresholds to be prescribed in the Proposed Guidance. We believe that the Proposed Guidance would be strengthened by clarifying certain sections and being less specific in others. Our subsection comments are outlined below.

Qualification Standards

In developing qualification standards for nontraditional mortgage products, lenders should account for possible risks associated with the non- and/or negative amortizing features of a mortgage product. Mortgage lenders that have successfully offered these products have used credit reports, credit scores, and sophisticated modeling to ensure that the non-amortizing features of nontraditional loans are mitigated with features that reduce risk.

MBA agrees with the Proposed Guidance's recommendation that borrowers should not be underwritten at teaser rates that are substantially below the fully-indexed accrual rate and are in effect for just the first few months of the mortgage.

However, MBA is concerned the language in the Proposed Guidance goes too far in detailing underwriting standards. The Proposed Guidance asserts:

> *For all nontraditional mortgage loan products, the analysis of borrowers' repayment capacity should include an evaluation of their ability to repay the debt by final maturity at the fully indexed rate, assuming a fully amortizing repayment schedule*

MBA believes this language is too prescriptive, will force lenders to apply credit policies inconsistent with risk, and, as written, will likely be applied differently by different regulators at different times.

Though contained in guidance, the qualification standards language is written such that it can be interpreted as restrictively rewriting a Federally-regulated institution's credit policies and underwriting standards. Traditionally, the establishment of underwriting standards is the responsibility of a Federally-regulated institution itself. Certainly, the experience of many such institutions that have offered nontraditional mortgage products for decades has demonstrated an ability to develop safe and sound underwriting standards.

As written, such prescriptive language disadvantages products of various terms in a manner which is inconsistent with the risks associated with these products. For instance, under the language in the Proposed Guidance, a 10/1 hybrid ARM with a 20-year amortization starting in year ten would be disadvantaged against a 3/1 hybrid ARM with a 27 year amortization starting in year 3, despite the fact that most lenders would consider the 10/1 hybrid ARM a lower risk product.

A key risk factor of any hybrid mortgage is the initial length of time during which the interest rate is fixed, an interest-only payment is required, or a loan does not amortize. As written, the Proposed Guidance may require lenders to invert this risk analysis and treat loans with a longer fixed rate or payment timeframe as higher risk than those with shorter timeframes. Nor do the qualification standards differentiate between interest-only and payment-option mortgages in this matter, despite the fact that lenders differentiate the two products in underwriting.

The fact that many Federally-regulated institutions have experience in successfully offering nontraditional products and that regulator guidance has traditionally left specific underwriting standards up to the institution is in contrast to the prescriptive language in the qualification standards section. This contrast may lead to inconsistent implementation of the guidance during examinations as one regulator may apply the language literally, while another may follow standard practice and take into account a lender's prudent risk analysis of the nontraditional product's features.

Additionally, MBA is concerned about the language in the following sentence concerning underwriting standards specific to payment-option mortgages. The Proposed Guidance asserts:

> *In addition, for products that permit negative amortization, the repayment analysis should include the initial loan amount plus any balance increase that may accrue from the negative amortization provision. The amount of the balance increase should be tied to the initial terms of the loan and estimated assuming the borrower makes only minimum payments during the deferral period.*

MBA believes that this language is inconsistent with the sentence in the Proposed Guidance previously cited and establishes a severe standard not applied to other products.

If a lender establishes an underwriting standard qualifying a payment-option borrower at the fully-indexed rate, it is inconsistent to then additionally assume they make only the minimum payments and qualify them a second time.

The above standard effectively requires underwriting to a worst-case scenario that is not standard practice for other products with variable rates, such as a hybrid ARMs, where a borrower's interest rate (and therefore payment) is fixed for a number of years and then adjusts annually within certain prescribed caps. Lenders do not underwrite to a worst-case scenario wherein the interest rate increases to the lifetime cap at the first adjustment. The language used in the Proposed Guidance effectively requires Federally-regulated institutions to do this for nontraditional mortgage products. Such a standard may not reflect actual performance by experienced lenders and might preclude borrowers who could benefit from the product from qualifying for it.

Finally, MBA strongly disagrees with the apparent bias in the Proposed Guidance's caution that lenders "should avoid over-reliance on credit scores as a substitute for income verification in the underwriting process." Credit scores have proven to be highly predictive in determining a borrower's capacity and intent to repay a debt. While no mortgage lender should consider only one factor in underwriting any mortgage, MBA is concerned that the term "over-reliance" can be defined too narrowly as requiring the consideration of other less predictive underwriting policies.

In today's dynamic primary mortgage market, to regress to prescriptive and rigid underwriting standards would be to stunt innovation and limit borrower's access to credit. Mortgage lending today does not need to solely rely on rigid debt to income (DTI) ratios because automated tools and advanced risk modeling have allowed lenders to go beyond simple thresholds for borrowers that exhibit risk mitigating characteristics, such as a high credit score or sufficient cash reserves.

MBA believes the Proposed Guidance's language in the Qualification Standards should be rewritten to remove any prescriptions to specific credit policies that a Federally-regulated institution should adopt. Lenders could instead be advised to consider the length of the interest-only period in determining whether or not to qualify the borrower on the interest-only payment or the amortizing payment.

Collateral-Dependent Loans

MBA is concerned that the Proposed Guidance's language concerning "collateral-dependent loans" may be interpreted by certain examiners as going beyond the current guidance concerning the consideration of collateral in underwriting the mortgage. The OCC, for example, in its Comptroller's Handbook on Retail Lending Examination Procedures (December 2004) indicates that lenders should avoid "lending predominantly on the value of the collateral rather than the borrower's ability to service the debt,…" The Proposed Guidance, though, goes further and instructs lenders to avoid "loan terms and underwriting practices" that may force a borrower to sell or refinance once amortization begins and that borrowers must demonstrate an ability to make loan payments from "sources other than the collateral pledged." The Proposed Guidance asserts that such loans are "unsafe and unsound" and that the Agencies may hold Federally-regulated institutions subject to "criticism, corrective action, and higher capital requirements."

MBA is concerned the language is creating a standard whereby the tools available to lenders to asses a borrower's capacity to manage a mortgage payment is restricted. It is possible that the prohibition on certain "loan terms" and "underwriting practices" may be interpreted to prohibit the use of credit scores, reduced documentation and/or relaxed DTI loans. Additionally, the word "sources" appears to directly relate to income. As is expanded upon elsewhere in this comment letter, MBA believes that such loan features all carry advantages to borrowers and can be offered by mortgage lenders in a safe and sound manner. The key is the risk mitigating features that are incorporated into the loan product. Certainly, a so-called "collateral-dependent loan" with a low LTV and to a borrower with a high credit score would not create undo financial risk to the Federally-regulated institution.

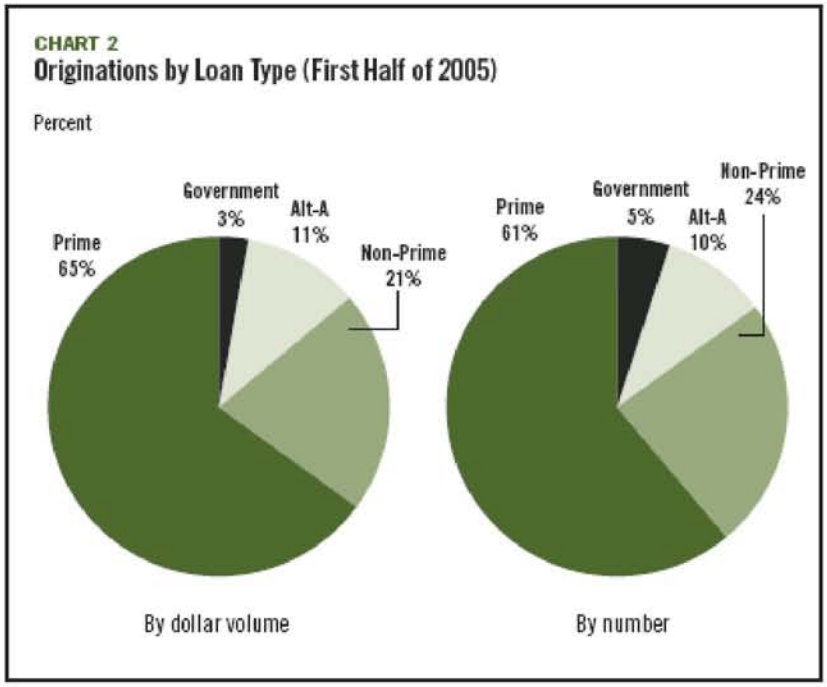
Risk layering

MBA supports the Proposed Guidance's call for lenders to adequately account for all risk factors on loan products they offer. Overall, the Loan Terms and Underwriting Standards section of the Proposed Guidance does an excellent job of enumerating some of these risk factors. Federally-regulated institutions with experience in these

products have done a good job in managing the various risks that accompany their products and, to date, MBA has not been given any indication that problems exist with their ability to adequately identify risks and establish mitigating factors.

Reduced Documentation

Reduced documentation loans, such as "stated income" loans, have been offered for well over a decade and have grown in popularity with borrowers in recent years, as MBA's Midyear 2005 Single Family Mortgage Originations Survey demonstrates:



Lenders have been able to accommodate consumer interest in these "Alt-A" products because tools have been developed that can accurately gauge risk without requiring certain documents to be provided by the borrower. As credit history data and credit scoring models have become more robust and predictive, mortgage lenders have been able to lower costs and streamline processes for certain borrowers while effectively managing any additional risks these products pose.

MBA takes exception with the Proposed Guidance' language that these loans "substitute assumptions and alternate information for the waived data in analyzing a borrower's repayment capacity and general creditworthiness,…" as such language infers that reduced documentation loans are incompatible with nontraditional mortgage products. MBA does not believe this to be the case. Mortgage lenders should prudently assess the risk and look to other risk mitigating factors. Wherein alternate information is a credit score, especially in conjunction with an Automated Underwriting System (AUS), MBA would argue that a lender is equipped with a strongly predictive indicator of general creditworthiness.

Reports from MBA members indicate that portfolios of nontraditional mortgages typically have higher credit scores, lower LTV ratios, and/or other risk mitigating characteristics. Additionally, credit scores are obtained from a third-party and are beyond the influence of the borrower or any party to the transaction, which means these scores are generally free from fraud or misrepresentation. Credit scoring sophistication has allowed lenders to protect the performance of the mortgages they originate while relaxing reliance upon strict income verification requirements or rigid debt to income standards.

MBA believes that regulators will find that the guidance that "Reduced documentation, such as stated income, should be accepted only if there are other mitigating factors, such as lower LTV and other more conservative underwriting standards." is met by mortgage lenders that have a successful track record with these products. Federally-regulated institutions often find that customers with a long history with the bank request these mortgages for their convenience and many mortgage lenders apply reasonableness tests to stated-income loans.

Simultaneous Second-Lien Loans

Simultaneous second-lien mortgages have been developed in response to market demand. Mortgage lenders have been able to meet this demand and manage the higher risks associated with lower borrower equity, even when the combined loan-to-value (CLTV) is up to 100%.

MBA believes that the Proposed Guidance's language on simultaneous second lien loans is too prescriptive. As written, the language would prohibit interest-only and payment-option features on simultaneous second-lien loans when the CLTV is 100%. MBA does not support such a strict prohibition because it does not allow Federally-regulated institutions sufficient flexibility to manage risks by offering these loans with other risk mitigating factors. Additionally, the language suggests that interest-only and payment-option mortgages should be treated the same in this regard. MBA members report that CLTV policies are typically different for interest-only products than for payment-option products.

The risk of a simultaneous second mortgage to a Federally-regulated institution depends on what they do with the second trust. If the second trust is sold or insured in a pool, then the risk is much closer to that of an 80% LTV loan. Furthermore, a Federally-regulated institution that originates an 80% first trust has no guarantee whether, and under what terms, a borrower will not subsequently obtain second trust from a different lender. Thus, MBA does not believe that the Proposed Guidance should categorically exclude the use of nontraditional mortgage products with simultaneous seconds where the CLTV is 100%.

MBA would suggest changing the Proposed Guidance's language to indicate that borrower equity is one of many factors a mortgage lender should consider in evaluating the risk of a particular mortgage loan.

Introductory Interest Rates

MBA supports the Proposed Guidance's call for mortgage lenders to consider the spread between the introductory rate used to determine the initial minimum payment and the fully-indexed accrual rate in offering payment-option mortgages. The introductory rate is distinct from what is called a "teaser" rate, which is typically used in interest-only mortgages and is extended to the borrower for a very short period of time and is significantly below the fully-indexed rate that will be in effect for the vast majority of the mortgage's life.

Current literature on payment-option mortgages indicates that the largest risk for payment shock occurs when the spread between the introductory rate and the fully-indexed rate is too large. The Proposed Guidance appropriately steers clear of establishing a specific spread threshold but sufficiently outlines the responsibility of mortgage lenders to consider payment shock when establishing an introductory rate.

Lending to Subprime Borrowers

MBA agrees that lenders should carefully consider the *Interagency Guidance on Subprime Lending* (issued March 1, 1999) and *Expanded Guidance for Subprime Lending Programs* (issued January 31, 2001) when determining the credit policies under which nontraditional mortgage products will be offered to non-prime borrowers.

Non Owner-Occupied Investor Loans

MBA notes that interest-only mortgages are a "traditional" loan feature in investment property lending. MBA believes the term "sufficient owner equity," while not a definition, is too prescriptive as it infers that a 100% CLTV interest-only investor mortgage would be prohibited. A mortgage lender may apply other risk mitigating credit policies to such a product that would address risk issues, such as those identified under the simultaneous second-lien loan section of this comment letter.

MBA would suggest changing the Proposed Guidance's language to indicate that borrower equity is one of many factors a mortgage lender should consider in evaluating the risk of a particular mortgage loan.

Portfolio and Risk Management Practices

Concentrations

MBA believes that lenders should pay particular attention to those products in their portfolios that may carry higher risks and change credit policies and risk management practices when performance problems arise or risk analysis indicates there may be a problem. MBA does not support the imposition of strict concentration limits by loan types, third-party originations, geographic area, property occupancy status, high LTV loans, high debt-to-income (DTI) ratio loans, loans with potential negative amortization,

loan to borrowers with credit scores below established credit scores, and nontraditional mortgage loans with layered risks.

The proportion of loans with one or more of the above characteristics should be monitored, but immediately stopping the pipeline of loans with certain features may be impractical and unnecessary for many lenders. Large mortgage lenders with several origination channels and who actively sell loans may have difficulty ensuring that none of the concentration limits are exceeded in changing markets. Such concentration limits may be unnecessary if an increase in a portfolio's risk in one line is matched by a decline in risk in another area.

MBA believes that Federally-regulated institutions should work with their regulators to ensure that the loan loss reserve is adequate given the risks in their portfolio.

Controls

MBA agrees that mortgage lenders should have appropriate controls in place for the types of mortgage products they originate and that nontraditional mortgage products may require controls that others products do not. MBA asks the Agencies to clarify that such controls are not expected in those cases where the loan is sold without recourse.

Third-Party Originations

MBA believes that mortgage lenders should have "…strong approval and control systems to ensure the quality of third-party originations…" but believes that the Proposed Guidance's requirement of Federally-regulated institutions to ensure that third party originators (TPOs) are originating in "…compliance with all applicable laws and regulations, with particular emphasis on marketing and borrower disclosure practices.", if interpreted literally, is too expansive. Holding a Federally-regulated institution responsible for the marketing practices of TPOs is significantly beyond current industry practices and beyond these institutions' reasonable ability to comply.

When mortgage lenders use TPOs, they are essentially outsourcing some portion of the origination process to a separate mortgage professional. As such, they do not have the same ability to monitor employees of the TPO as they do their own employees. The language of the Proposed Guidance appears to indicate that the Agencies expect that the institutions they monitor will have the same ability to oversee the employees of TPOs as they do their own retail staff. Such a standard is not in place for traditional mortgage products and should not be implemented for nontraditional mortgage products.

Mortgage brokers and many loan correspondents are governed by state law and regulated by state agencies. These agencies have jurisdiction and authority to subpoena records and audit these state-regulated entities. Mortgage lenders, even those who are federally-regulated, simply do not have the legal authority to enforce state or federal laws. Federally-regulated institutions should not be held responsible for

the actions of unrelated third parties of whom they are not in control, and for whom they may be one of many counterparties.

An unintended consequence of such a requirement might be to disadvantage Federally-regulated institutions in comparison to other mortgage lenders in working with TPOs, if such institutions are forced to implement invasive monitoring procedures not required by other mortgage lenders.

Secondary Market Activity

MBA does not agree with the assertion that voluntary repurchase of loans constitutes "implicit recourse" requiring risk-based capital be maintained against the entire portfolio. The Proposed Guidance's language appears to infer that if a Federally-regulated institution repurchases a mortgage for reasons other than contractually-binding reasons, that risk-based capital be maintained against the entire portfolio. Regulators should not impose such strict recourse where contract law does not require it. Under this requirement, a Federally-regulated institution would be hampered in its ability to repurchase mortgages for business reasons. MBA would suggest removing the concept of "implicit recourse" from the guidance and the additional risk-based capital requirement beyond that which is legally required.

MBA would note that the secondary market has weighed in on current and expected performance of nontraditional mortgage products through pricing and decisions by rating agencies, such as Standard & Poor's June 20, 2005 announcement of changes to its ratings criteria. Secondary market feedback in this manner can mollify concerns of excessive risk.

Consumer Protection Issues

MBA shares the view that the features of mortgage products offered to consumers should be fairly represented so that consumers can decide for themselves which product makes the most sense given their personal financial position. Additionally, we recognize that it is possible that some consumers may not fully understand the features of some of the interest-only or payment-option mortgage products they are considering and that reasonable improvements to current disclosure requirements may be warranted.

However, this guidance may not be the best way to address these improvements. Under the Proposed Guidance's "Recommended Practices", the Agencies are using their oversight authority to establish an additional set of disclosures to be added by Federally-regulated institutions to the current pile of related disclosures given to consumers. This will effectively create an even more duplicative and fragmented system than the current one and will arguably add confusion rather than clarity. MBA recommends that any attempt to improve the present system of disclosure be undertaken on an industry-wide basis so that consumers are informed of product features in a consistent and uniform manner while choosing their mortgage.

For these reasons, MBA suggests removing the "Recommended Practices" section completely and instead using the Federal Reserve's regulatory authority under the Truth in Lending Act (TILA) to improve and standardize disclosures that would benefit *all* consumers.

There are a number of initiatives currently underway that are consistent with this approach. One initiative currently underway is the Federal Reserve's proposed studies of consumers and lenders in order to develop and test consumer regulatory disclosures, as detailed in the Federal Register on March 15, 2006. The Federal Reserve is authorized by Congress for creating implementing regulations for a number of Federal laws that are intended to protect all consumers in mortgage transactions. The proposed studies coupled with this authority ideally positions the Federal Reserve to create a uniform and streamlined disclosure system that could provide clear and appropriate disclosures to the benefit of all consumers.

Another initiative is the Department of Housing and Urban Development's (HUD) work to reform RESPA to simplify the mortgage process. HUD and the MBA recognize that the current RESPA requirements need reform in order to simplify the settlement process for consumers and lenders. Mandating only some mortgage lenders to add an additional disclosure to the current web of related and often unread disclosures is counter to this effort.

Finally, MBA, along with others from the mortgage industry, has responded to a request by the Federal Reserve for feedback on a consumer publication on nontraditional mortgage products that is being developed. The publication would be available on the Federal Reserve's website for access by lenders and consumers. Such a booklet may provide a model disclosure that could be incorporated into any of the above mentioned initiatives.

As the Agencies move beyond a their traditional concern for the safety and soundness of the institutions they regulate and into consumer protection issues, MBA believes it is important that they use the appropriate authorities they have in order to create a standard that truly improves consumer information about nontraditional mortgage products. To do otherwise is to disadvantage certain mortgage lenders without a corresponding improvement in consumer information as a whole.

Recommended Practices

Reinforcing the above recommendation to remove this section from the guidance and develop a solution that will help all consumers are MBA's specific comments on the "Recommended Practices" outlined below.

MBA believes that some of the recommended practices may actually detract from consumers' ability to make good decisions. For instance, in offering worst-case scenarios as opposed to likely or generic scenarios, consumers will not be given an adequate picture of these products' benefits or risks. Some consumers who may have

a good reason to choose one of these products may choose a product that will cost them more in the long run because of an exaggerated worst-case scenario.

The recommended practices indicate that a Federally-regulated institution should give a consumer full and fair product descriptions "when shopping." Such a term is much too vague and would be difficult to comply with. A typical mortgage broker offers the products of many lenders and may well not know which lender's product the borrower will ultimately select, making it impossible for the lender to ensure that the borrower received information about the lender's product while he was shopping for the loan.

Furthermore, the information recommended to be included on monthly statements will be very difficult and costly for Federally-regulated institutions to comply with, as payments are often not made in time to be calculated prior to the mailing of the next month's statement. It is reasonable for lenders servicing option-payment mortgages to include on each monthly statement a generic message indicating the potential impact of choosing a certain payment option on the unpaid principal balance (UPB).

If implemented, the Recommended Practices will result in a large number of lenders each developing a different disclosure of varying quality. Consumers choosing among Federally-regulated institutions will not receive consistent disclosures and will receive no disclosures if choosing among lenders that are not Federally-regulated institutions.

Control Systems

Mortgage lenders have a strong incentive to monitor the performance of their third-party originators. In this section, the Proposed Guidance, though, dictates that lenders must ensure that "actual practices" are consistent across all origination channels (retail, third-party, and purchased). This standard is a practical obstacle, doesn't account for the nature of third-party originations, and could create a standard of strict liability.

As indicated before, in using third-party originators or purchasing loans, mortgage lenders are essentially "outsourcing" the origination process to varying degrees. While lenders conduct extensive quality control on loans they receive through the broker or correspondent channels, they may not review the actual practices of the originators. In fact, brokers and loan correspondents, as separate mortgage professionals, do not necessarily know the loan they are advertising and originating will end up with a Federally-regulated institution. To mandate such oversight is to create a strict standard of liability, despite the fact that the brokers are not the lenders' agents.

MBA strongly opposes the expansion of liability for Federally-regulated institutions for actions of third-party originators, beyond reasonable oversight. Brokers and loan correspondents have state regulators whose role it is to oversee their practices. Additionally, brokers and loan correspondents must also abide by UDAP.

The effect of requiring such impractical oversight is to disadvantage Federally-regulated institutions in relation to other mortgage lenders in the marketplace.

Specific questions asked in proposed Guidance

The Proposed Guidance seeks comments on three questions. The questions, and MBA's responses, are below.

1. **Should lenders analyze each borrower's capacity to repay the loan under comprehensive debt service qualification standards that assume the borrower makes only minimum payments? What are current underwriting practices and how would they change if such prescriptive guidance is adopted?**

   MBA does not support prescriptive guidance on comprehensive debt service qualification standards based on the assumption that a borrower makes only the minimum payment. Such prescriptive guidance ignores actual experience and would be impossible to apply fairly across various product types. Such a single standard would more readily allow a borrower to qualify for a 2/28 Interest-only hybrid ARM over a 10/1 interest-only hybrid ARM, though most lenders would consider the latter to have lower risk.

   Currently, each mortgage lender establishes their own underwriting standard concerning a borrower's capacity to manage mortgage payments. These standards include credit history as an indicator of ability to manage debt and credit scores as a strong predictor of a borrower's performance on debt going forward. Some lenders use DTI ratios, although experience has indicated that strict DTI limits unfairly exclude certain borrowers.

2. **What specific circumstances would support the use of the reduced documentation feature commonly referred to as "stated income" as being appropriate in underwriting nontraditional mortgage loans? What other forms of reduced documentation would be appropriate in underwriting nontraditional mortgage loans and under what circumstances? Please include specific comment on whether and under what circumstances "stated income" and other forms of reduced documentation would be appropriate for subprime borrowers.**

   MBA believes specific circumstances that would support the used of reduced documentation features in a loan application for a nontraditional mortgage loan would be the same circumstances that would support such use in traditional mortgage products. The question for any lender is: if experience indicates that reduced documentation carries higher risk, how can that risk be mitigated by other underwriting characteristics? As the industry advances, the ability to reduce documentation without significantly increasing risk also advances.

   Another form of reduced documentation might be the ability to rely upon an AVM for lower LTV mortgages in certain markets in lieu of a full appraisal. MBA is supportive of any reduction in the documentation process that does not significantly

increase overall risk.

The circumstances under which a reduced documentation loan would be appropriate for nonprime borrowers would likely be similar to the situations where a reduced documentation loan is appropriate for prime borrowers: when a mortgage lender applies other appropriate risk mitigating features. The fact that a particular borrower has a lower credit score is but one of many risk factors to be considered by a lender in establishing credit policies. As the Guidance states very well, managing risk layering with mitigating factors is the key to maintaining a safe and sound portfolio.

3. **Should the Guidance address the consideration of future income in the qualification standards for nontraditional mortgage loans with deferred principal and, sometimes, interest payments? If so, how could this be done on a consistent basis? Also, if future events such as income growth are considered, should other potential events also be considered, such as increases in interest rates for adjustable rate mortgage products?**

   MBA does not believe the Proposed Guidance should address the consideration of future income in qualification standards, if the intent is to establish specific credit policies that should apply across all Federally-regulated institutions. Predicting the future movement of household income, interest rates, and house price appreciation is typically not a part of underwriting. It would not be productive for mortgage lenders to explicitly predict future household income as a criterion, such as a future DTI, for approving or not approving an application for a mortgage. It does seem appropriate, however, to consider the likelihood of increased income as a compensating factor for the increase in payment when a mortgage with a sufficient fixed payment period begins amortization.

MBA appreciates the opportunity to offer our perspective on nontraditional mortgage products and our specific comments on the Proposed Guidance. We believe that the innovative primary mortgage market has created a wide range of products to serve consumer needs. The net effect of this innovation has been an increase in the U.S. homeownership rate to record levels. As the Agencies seek to ensure the safety and soundness of the institutions they regulate, we would caution against blanket prohibitions or prescriptive guidelines that might lead to certain product withdrawals by Federally-regulated institutions and adversely affect homeownership opportunities.

We look forward to working with you to develop guidance that protects the safety and soundness of this country's Federally-regulated institutions without diminishing these institutions' ability to meet consumer demand for nontraditional mortgages and to compete fairly with non-Federally-regulated mortgage lenders.

For further information about MBA's comments or to discuss efforts to improve consumer disclosures to accommodate nontraditional mortgage products, please contact Tim Doyle at by phone at (202) 557-2860 or by email at tdoyle@mortgagebankers.org.

Sincerely,

Kurt Pfotenhauer
Senior Vice President