MORTGAGE BANKERS ASSOCIATION
Investing in communities

August 15, 2006

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

RE: **Home Equity Lending Market - Comments in Response to Questions Posed: Board Docket No. OP-1253 (71 Fed. Reg. 26513 [May 5, 2006])**

The Mortgage Bankers Association[1] (MBA) appreciates the opportunity to provide comments in response to the request of the Board of Governors of the Federal Reserve System (FRB) for additional information concerning the 2002 revisions to the Home Ownership and Equity Protection Act (HOEPA), state and local predatory lending laws, nontraditional mortgage products, reverse mortgage lending, and informed consumer choice in the subprime market.

These topics are extremely important to MBA. We have worked to assist the FRB's efforts, by testifying at three of the four recent public hearings on HOEPA and by submitting comments to the questions posed in this notice. We look forward to working with the FRB going forward.

There are two very important points MBA would like to begin with as a back drop to the comments that follow. First, the mortgage market is thriving. More Americans own homes than ever before – due in large part to risk-based pricing and product innovation. As a result, Americans are building tremendous wealth. According to the Federal Reserve's own Flow of Funds data, the value of residential real estate assets owned by households has increased from $10.3 trillion in 1999 to $20.4 trillion as of the first

[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 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.**

quarter of 2006, and aggregate homeowners' equity now exceeds $10 trillion. According to the 2004 Survey of Consumer Finances, the median net worth for homeowners was $184,000. For renters, it was $4,000. Clearly, many homeowners have been successful in accumulating wealth, both by steadily building up equity through their monthly payments, and through the impressive rate of home price appreciation we have seen in recent years.

The second important point is that default and foreclosure rates are low. Some argue that default and foreclosure rates are at crisis levels and that a greater percentage of borrowers are losing their homes. MBA's data does not support this – in fact it tells quite a different story. MBA's first quarter 2006 National Delinquency Survey showed that the seasonally adjusted delinquency rate stood at 4.41 percent at the end of the first quarter, down 29 basis points from the fourth quarter of 2005. The foreclosure inventory rate was 0.98 percent at the end of the first quarter, a drop of one basis point from the fourth quarter of 2005.

For several quarters, MBA has been noting a number of factors, including the aging of the loan portfolio and increasing short-term interest rates, which are putting upward pressure on delinquency rates. On the other hand, the strong economy and labor markets are offsetting positive factors that were particularly important in the first quarter. Going forward we expect these same factors will continue to be important. Additional modest increases in delinquency and foreclosure rates are likely in the quarters ahead.

The following responds to the questions posed in the above referenced federal register notice.

A. <u>HOEPA AND PREDATORY LENDING PRACTICES</u>

1. Have the revisions to the HOEPA regulations been effective in curtailing predatory lending practices? What has been the impact of these changes on the availability of subprime credit? Have other abusive practices emerged since the 2002 revisions? If so, what are they?

MBA believes the existing HOEPA regime is working well in the marketplace to protect consumers and should not be changed. While the 2002 revisions to the regulatory regime had the effect of cutting off an increased share of lending above the new triggers, there has been considerable lending activity beneath the triggers. Also, as a result of the increased availability of credit in the subprime market, homeownership has increased. At the same time, as a result of competition, the differences between interest rates available in the prime versus the subprime market have compressed or narrowed considerably.

Some of the most important 2002 HOEPA revisions include: (1) lowering the annual percentage rate (APR) trigger on a mortgage loan from 10 percentage points to 8 percentage points for first liens, (2) adjusting fee-based triggers to include amounts paid at closing for optional credit life, accident, health, or loss-of-income insurance and other debt-protection products, and (3) treating assignees holding or servicing a HOEPA loan as if they were the original creditors.

Since 2002, the nation's homeownership rate has risen to nearly 70 percent as a result of the growth of the non-prime mortgage market. This market serves families for whom homeownership has been traditionally out of reach. Non-prime borrowers commonly have low to moderate income, less cash for a down payment and credit histories that range from less than perfect to none at all. These borrowers include first-time homebuyers, immigrants, borrowers whose credit has been damaged by divorce or illness, single parent households, as well as business and professional people who have gone through difficult times, but whose credit needs and dreams of homeownership have not abated. Before the advent of this new market, these borrowers were either simply denied homeownership or, in a limited number of cases, served exclusively by FHA or other government subsidized financing.

The subprime market has evolved dramatically in recent years, providing significant benefits to consumers. Today, there is little distinction between the prime and subprime markets. No credit score threshold or interest rate or other loan term defines a loan as subprime. Fitch Ratings examined securitized loan data and noted the spread between weighted average coupons on loan pools identified by the issuer as prime is only 200 basis points lower than pools identified as subprime. In 1999, this spread was about 300 basis points. The major factor accounting for this compression is competition. MBA cautions against increasing existing federal regulation in this market as it could decrease competition and increase rates that the subprime market offers consumers.

The use of prepayment penalties has become common in the subprime market. Some contend that on their face they are abusive – but this is not the case. A borrower can negotiate a lower rate in exchange for a prepayment penalty, i.e., a promise not to refinance out of the loan before an agreed upon date. Prepayment penalties also benefit borrowers because they are attractive to investors. With a prepayment penalty, an investor can be assured of receiving the stated interest on the loan for a minimum period. Investors are typically willing to pay more for a mortgage with this feature and this premium is passed on to the borrower in the form of a lower rate on the loan. It is important to note that in some cases the investor would not purchase the loan if it did not include some protection against prepayment as an offset to increased credit risk, and if investors are unwilling to buy a loan, it is unlikely that the financing would be available. MBA supports transparency in communicating the terms of a prepayment penalty though clear disclosure.

2. What has been the impact of state and local anti-predatory lending laws on curbing abusive practices? Have these laws adversely affected consumers' access to legitimate subprime lending? Have certain provisions been particularly effective, or particularly likely to negatively affect credit availability?

MBA has long been committed to the eradication of predatory lending from the marketplace and enhanced protections for consumers. States and localities have enacted over 30 widely different anti-predatory lending standards to protect borrowers. While MBA recognizes that these initiatives are well intended, the creation of widely disparate and overbroad standards limits mortgage lending and loan terms, creates a significant compliance burden on lenders, increases their exposure to liability and increases the cost of homeownership.

While some advocacy groups contend that state laws are working well to prevent predatory lending, MBA questions this conclusion. The Center for Responsible Lending (CRL) issued a study titled, "The Best Value in the Subprime Market: State Predatory Lending Reforms." This study concludes that: (1) state laws have produced no significant effect on subprime mortgage volume, (2) states with significant reforms show a reduced incidence of loans with "predatory terms," and (3) in states with predatory lending laws, borrowers paid lower rates. MBA finds these conclusions to be flawed in several respects. The study bases its conclusions on the premise that state laws that limit certain loan terms, such as prepayment penalties, are in effect limiting predatory lending. MBA disagrees. In the first place, prepayment penalties are not predatory. (Please see MBA's comments above on prepayment penalties.) Moreover, mortgage volumes have, in fact, declined where there are state "predatory lending laws" reducing the availability of credit not just limiting "predatory" features. In addition, there are sampling problems with the data used, omitted variables in the pricing analysis, and selective citing of findings in the headlines and conclusions.

MBA commissioned a study of the effectiveness of the North Carolina anti-predatory lending law, a law which has been cited by some advocates as the most successful of such state laws. Abt and Associates of Cambridge, Massachusetts conducted the study and found that the North Carolina law has caused a decline in lending in minority and low-income neighborhoods and has had negative effects on the availability of credit to all income and racial groups.[2]

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[2] The study performed by ABT and Associates of Cambridge, Massachusetts looked at changes in lending in North Carolina and neighboring states of Tennessee and South Carolina before and after passage of the North Carolina law. Abt and Associates looked at lending volumes on a neighborhood by neighborhood basis for prime and subprime lenders. Among the industry's major findings are:

- There was a 1.2 percent decline in overall lending in predominately minority neighborhoods in North Carolina after passage of the law, compared with a 5.2 percent increase in minority neighborhoods in the comparison states. Loans by subprime lenders declined by 8.1 percent and loans by prime lenders increased 0.7 percent. In the comparison states, loans by subprime lenders increased 4.6 percent and loans by prime lenders increased 5.4 percent.
- Subprime lending grew at a slower rate in North Carolina than in the comparison states for all neighborhoods regardless of racial or income composition, but prime lending in the predominately white neighborhoods grew sufficiently so that the growth of total lending in predominately white neighborhoods matched the growth in the comparison states.
- There was a decline of 11.4 percent in subprime refinance loans in North Carolina, compared to a 4.0 percent increase in the comparison states. However, subprime loans to purchase homes also grew at a much slower pace in North Carolina than in the comparison states, up 123.9 percent versus 145.8 percent.

In addition, MBA also has found that many state laws have restricted the availability of important financing tools. These states have modeled their predatory lending laws on HOEPA but lowered the federal HOEPA triggers, including the point and fee threshold. They have then included yield spread premiums and prepayment penalties in the point and fee calculation, which has had the effect of limiting their use. This approach forces cash-poor borrowers to face higher up-front closing costs *and/or* higher interest rates and monthly payments, and at the same time risks lessens the supply of mortgage credit. MBA respectfully cautions the FRB from taking a similar approach which would effectively eliminate these financing tools from the national market. Such an approach would lessen borrowers' choices, making it more difficult for borrowers to access the equity in their homes and forcing them to get their financing from expensive and sometimes questionable sources.

In addition, there are other approaches that some states have embraced that are also cause for concern. Some of the most troubling include:

- assignee liability standards that are unnecessarily applied to the whole market, limiting the availability of financing to lower consumer costs;
- tangible net benefit standards that are subjective and unclear as to what constitutes such a benefit;
- unnecessary restrictions on a borrower's ability to choose to refinance his or her loan;
- restrictive or overly conservative "ability to repay standards" that threaten mortgage financing for very capable borrowers; and
- significant limitations on consumers' use of discount points to buy down their rates and lower their monthly payments, a particularly attractive option in a rising rate environment.

Another major concern for the mortgage industry is that some states are considering the imposition of a suitability standard on mortgage lenders. A suitability requirement or standard would mandate that a lender not offer a loan product to a borrower unless the lender determines that the particular product with its features is suitable for that borrower. This would force lenders to make decisions on non-financial information, which a lender is just not equipped to do. At the same time, because of the subjective nature of such a standard, the lending industry would be exposed to significant liability

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> Thus, laws primarily aimed at refinance practices caused subprime lenders to withdraw completely from North Carolina and reduce credit available for purchasing a home.

While overall subprime lending decreased in North Carolina, subprime lending by firms owned by federally regulated financial institutions increased. While lending by independent subprime firms dropped 41.5 percent, lending by subsidiaries of bank or thrift-owned companies increased 110.5 percent. A similar pattern occurred in the comparison states, although not of the same magnitude. This suggests that whatever increases in subprime lending took place did so under the presumption of a federal preemption of the North Carolina law and a potential spread of that law, and reduces consumer choice and competition.

by virtue of its imposition. It would be nearly impossible for a lender to know objectively when the standard has been met. Also, the imposition of a suitability standard would either increase the price or threaten the availability of mortgage credit as secondary market investors consider whether and on what terms to purchase loans subject to such a standard. MBA strongly cautions the FRB and the states against embracing a suitability approach.

If the goal of a suitability standard is to ensure that a borrower is getting a good deal, then there is no better approach than to empower the borrower to make that determination for himself or herself. To give borrowers the tools they need to negotiate a good deal and to bridge any information asymmetry that might exist between a borrower and a mortgage originator, MBA urges the FRB (in conjunction with other agencies) to take three actions: (1) create a simple, one page disclosure of material mortgage terms, (2) commit resources to financial literacy, and (3) encourage borrowers to shop and compare mortgages. MBA also fully supports the prosecution of bad actors.

It is unfortunate that victims of abusive practices are usually among the most vulnerable in our communities – including the elderly, the disenfranchised and members of immigrant populations. While abusive lending can be tragic for individual, vulnerable consumers, there is a lack of credible evidence about the national prevalence of abusive lending; most of the information is anecdotal. MBA would caution against the FRB making policy decisions for the broader market based on anecdotal information.

As noted, compliance with a patchwork of state standards is enormously expensive and requires lenders, among other things, to hire and train additional staff to track the new laws, purchase systems to ensure compliance and to develop and maintain oversight capacity. When a lender fails to comply with a state requirement – which may just be the inadvertent failure to make a timely disclosure – lenders can face significant liability even where the borrower may be uninjured. Notwithstanding, CRL issued a study concluding that compliance with the patchwork of state predatory lending laws cost lenders only $1 per loan.[3] Not only does MBA demur, questioning both the methodology used in this study and the resulting conclusions, but it must reiterate that the significant compliance costs and liability exposure created by regulatory requirements substantially increase the cost of homeownership.

In light of the difficulties with complying with a myriad of state laws and the limitations that compliance places on financing options, MBA supports enactment of a uniform national mortgage lending standard that would create strong consumer protections and objective compliance requirements. The institution of a national standard would create a single standard to facilitate both consumer and lender education. It would result in market efficiencies and streamlined processes that would increase competition and lower the cost of homeownership.

[3] Center for Responsible Lending, Strong Compliance Systems Support Profitable Lending While Reducing Predatory Practices, July, 2005.

3. Since the 2002 revisions to HOEPA, what efforts to educate consumers about predatory lending have been successful? What is needed to help such efforts succeed?

Please see our responses to the questions related to informed consumer shopping.

4. Should the existing HOEPA disclosures in Regulation Z be changed to improve consumers' understanding of high-cost loan products? If so, in what way?

Generally, MBA members do not make HOEPA loans. MBA, therefore, has no substantive comments about HOEPA disclosures.

B. NONTRADITIONAL MORTGAGE PRODUCTS

1. Do consumers have sufficient information (from disclosures and from advertisements) about nontraditional mortgage products to understand the risks (such as payment increases and negative amortization) associated with them?

Nontraditional mortgage products encompass a variety of new financing options which have been developed by the lending industry to increase affordability and otherwise meet the needs of borrowers. These products include flexible payment loans that, at the option of the borrower, permit little or even negative amortization in the interest of lowering the borrower's payments.

It is in the interest of mortgage lenders to assure that their customers are provided necessary information to facilitate their understanding of these products. Because there is no single, uniform, mandated disclosure for nontraditional products, lenders have developed their own disclosures to inform borrowers about the characteristics of these products. Many mortgage lenders have been originating these products for a considerable amount of time and have significant experience with them. This experience has informed the development of disclosures.

Lenders also provide borrowers the range of information and disclosures mandated under the Real Estate Settlement Procedures Act (RESPA) and the Truth in Lending Act (TILA) including the Consumer Handbook on Adjustable-Rate Mortgages (CHARM) booklet.

MBA has reviewed the disclosures developed by several MBA members who originate significant volumes of nontraditional mortgages and have found them to be quite detailed and comprehensive in providing consumers the information they need to fully understand the mortgage product they are considering.

Mortgage lenders that successfully offer these products constantly review the performance of these loans. They make changes as warranted to credit policies and other practices to improve performance and to facilitate customer understanding.

2. Should any disclosures required under Regulation Z be eliminated or modified because they are confusing to consumers, unduly burdensome to creditors, or are simply not relevant to nontraditional mortgage products? Do the required disclosures present information about nontraditional mortgage products in an understandable manner?

RESPA Regulation X and TILA Regulation Z require the provision of borrower information including the Special Information Booklet and the CHARM booklet. In addition, these laws require disclosures at the time of mortgage application and at settlement.

MBA has long believed that the borrower information provided under RESPA and TILA should be streamlined and improved. It also could be usefully updated to provide all borrowers information on nontraditional mortgage products. Consideration could also be given to providing a single uniform disclosure for these products.

MBA cautions, however, that any attempt to establish or improve disclosures for mortgage products, including non-traditional products, must be comprehensive and take into account the present system of required borrower information and disclosures. This necessarily would include consideration of the patchwork of non-Federal disclosures and how to present beneficial information in a form and format that will best serve and not overload borrowers. MBA would suggest that such an effort be undertaken on a comprehensive, industry-wide, basis so that consumers are informed of product features, while choosing their mortgage, in a consistent and uniform manner.

MBA believes that the best method for achieving the above objectives is for the FRB to use its regulatory authority under TILA to improve and standardize disclosures following a regulatory process where key stakeholders from the mortgage industry have a meaningful opportunity to participate. The FRB should work closely with HUD to assure that any changes are consistent with any efforts at RESPA reform.

Notably, one initiative currently underway is the FRB's proposed study to include consumers and lenders for the purpose of developing and testing consumer regulatory disclosures that was detailed in the Federal Register on March 15, 2006. The proposed study can assist the process of improving disclosures to benefit consumers.

Another initiative is HUD's effort to reform RESPA to simplify and improve the settlement process. If the FRB chooses to exercise its authority under TILA to simplify and improve consumer disclosures, the FRB and HUD should coordinate their efforts to assure that they are complementary and accomplish their goals in a manner that truly improves the mortgage process.

3. Are there some Regulation Z disclosures that should be provided earlier in the mortgage shopping and application process to aid consumers' understanding of key credit terms and costs for these products?

MBA believes that borrower education to help consumers navigate the home buying and mortgage finance process is extremely important and should come as early as possible before a borrower shops for a home and enters the mortgage process. Effective education aids consumer understanding of key credit terms and differences of cost and use of various types of products.

Earlier provision of cost disclosures to borrowers for a specific loan product, including the disclosures required under both Regulation X and Regulation Z, as distinguished from the provision of general information, raises several concerns assuming that such disclosures are to be meaningful.

The provision of such a disclosure necessitates the development of information on the borrower's credit and collateral. This information is costly to obtain and requires payments to third parties, including credit repositories and appraisers. Any early disclosures provided with limited underwriting information must by nature be estimated and conditioned on final underwriting. Also, unless a disclosure requirement is tied to a specific event, such as a borrower's submission of an application, the requirement is too vague and raises significant compliance concerns.

For all of these reasons, any proposal for early disclosure would require very careful review to assure that the proposal is workable for the industry and consumers alike.

C. <u>REVERSE MORTGAGES</u>

1. Are current Regulation Z disclosures adequate to inform consumers about the costs of reverse mortgages and to ensure that they understand the terms of the product.

MBA believes that the current disclosures are meaningful and communicate necessary information to consumers about reverse mortgages.

2. Has counseling (under the HUD program) been effective in educating consumers about reverse mortgages and in preventing abuses from occurring?

While counseling under the HUD program has been extremely effective in educating consumers about reverse mortgages, HUD's funding for these efforts runs out early in the year. MBA would support the allocation of additional resources for counseling purposes. In addition, MBA would also support training additional counselors as there is a shortage in the marketplace.

3. In reverse mortgages that are not insured by HUD, is counseling offered to applicants? Do borrowers of these loans have difficulty understanding their loan terms or encounter other difficulties? Do these lenders employ alternate disclosure approaches that have proven effective?

Consumers are provided counseling for reverse mortgages that are not insured by HUD. It is the experience of lenders that most seniors conduct fairly extensive research in advance of taking a reverse mortgage. Lenders encourage seniors to consult with a trusted third party about the best way to access the equity in their homes before taking a reverse mortgage. Often, seniors will seek the help of a family member or estate planner for guidance and to assist them through the reverse mortgage process.

D. INFORMED CONSUMER CHOICE

1. How do consumers who get higher priced loans shop for those loans? How do they select a particular lender?

MBA's research has shown that homebuyers, particularly first-time homebuyers, rely on a trusted advisor to guide them through the mortgage process. Such an advisor may be a family member but it also may be a person who has an incentive at cross purposes with the borrower. Too often, these new buyers, and particularly minority first-time homebuyers, either contact only one lender or mortgage broker, or are referred by a real estate agent to only one lender or broker while shopping for a mortgage. Borrowers more experienced in the process are generally more likely to seek additional rate quotes.

MBA believes that borrowers would be far better off if they educated themselves about the mortgage process and shopped among lenders for the best loan product to meet their needs before they begin the process of finding a home. During the educational process, it is best for a consumer to learn about the range of loan products and the importance of his or her own credit profile in arriving at the mortgage's costs. Consumers can then determine what type of financing is both suitable and realistic. MBA believes that armed with a basic understanding of the mortgage process, an ability to compare loans, and a willingness to shop, a consumer will be in a far better position to choose the right mortgage for his or her financial situation and family needs.

MBA's conclusions are grounded in our understanding of the preferences of Americans. A recent consumer survey conducted by MBA found that four out of five Americans would like to have access to home buying information that is easy to understand. One third of Americans want that information delivered in a step-by-step format.

In order to address consumers' needs for information on the mortgage process, MBA has created an educational Web site at www.HomeLoanLearningCenter.com . The Home Loan Learning Center Web site provides helpful tips and suggestions on finding the loan that is right for each consumer, guides for choosing a mortgage banker and general information on the mortgage process. In addition, MBA has been working to put together meaningful mortgage disclosures that contain relevant, easily understood information that a consumer can use to shop and compare mortgage loans. Then, by comparing products from several different lenders, the consumer can shop for the best overall deal.

MBA recognizes that there is concern that people in minority neighborhoods have fewer loan choices at hand. But a well-informed consumer can shop beyond his or her immediate community and, through the internet, even across the nation.

MBA released a consumer credit survey in June 2006 that dramatizes the importance of helping assist borrowers in improving their credit qualify. This information was released to the news media as part of our Homeownership Month efforts in June. Key results are as follows:

- 81 percent of homeowners and 79 percent of renters know someone who has been in serious trouble with their credit. When asked if they personally had been in serious trouble with their credit, 40 percent of homeowners and 54 percent of renters said yes.

- 71 percent of homeowners and 72 percent of renters believe that Americans do not manage their credit responsibly. 70 percent of homeowners and 74 percent of renters also feel that Americans don't pay off their debt in a timely fashion. Additionally, 93 percent of homeowners and renters think that Americans have too much consumer debt.

- 76 percent of homeowners and 54 percent of renters have no debt or pay off debts in full every month, while 12 percent of homeowners and 31 percent of renters find it very difficult to pay the minimum monthly payments and make ends meet.

- 39 percent of homeowners and 54 percent of renters believe that they have more debt than they should.

- Of the homeowners who had a cash-out refinance, more than three-quarters used the funds to pay off or consolidate debt or make home improvements. 71 percent believe that this action helped improve their overall financial situation. 50 percent of respondents who have a home equity line of credit (HELOC) feel the same way.

- Over two-thirds of homeowners and renters believe that credit cards are the most difficult type of debt for consumers to pay off.

- Of the 50 percent of homeowners and 52 percent of renters who discovered errors in their credit report, 78 percent of homeowners and 73 percent of renters were able to correct those errors.

In light of these findings, MBA added new content to HomeLoanLearningCenter.Com to help borrowers better understand the importance of their credit quality to their ability to qualify for a mortgage and achieve homeownership.

2. What do consumers understand about the role of mortgage brokers in offering mortgage products? Has their understanding been furthered by state required mortgage broker disclosures?

As indicated, MBA believes that too often consumers rely on a single mortgage broker or a recommendation from a real estate agent rather than shopping for the best loan. Those who consumers may regard as trusted advisers may have their own business incentives that might be at cross purposes with the consumer's own. MBA believes that consumers would be better off learning about the mortgage process, considering their own credit and shopping for the best deal.

It is not clear to MBA that state required mortgage broker disclosures have increased borrower understanding of mortgage brokers' functions or offerings. MBA offers two important observations. Based on our experience, the practice of providing numerous disclosures to consumers is often counterproductive in meeting the goal of ensuring that consumers are well informed. Consumers are inundated with disclosures during the mortgage process, so in order to get their attention, disclosures should be carefully conceived, well focused and limited in number. Moreover, in MBA's experience, a patchwork of diverse state requirements ordinarily accomplishes little more than an increase in compliance costs and harm to competition by reputable providers who may choose to avoid particular markets because of local requirements.

Currently, there are Federal requirements for disclosures of mortgage broker fees applicable to all federally related mortgage loans. Mortgage brokers are required to disclose lender payments to mortgage brokers as yield spread premiums (or YSPs) paid outside of closing (POC). MBA acknowledges that this disclosure is not a model of clarity. To better address this issue, MBA has been developing approaches to RESPA reform that would offer all borrowers an improved Good Faith Estimate (GFE) and Settlement Statement (HUD-1) that would include improvements to the mortgage broker disclosure requirements to make these disclosures more comprehensible to consumers without undermining competition in the marketplace. MBA believes that, ultimately, disclosures along these lines under RESPA should be harmonized, if not combined, with improved disclosures under TILA.

MBA maintains that the patchwork of laws at the state and local level requiring mortgage broker disclosures, like the patchwork of state and federal predatory lending laws, is a poor approach to serving the interests of consumers. As indicated, such an approach increases compliance costs and lessens competition from lenders outside the local area, depriving consumers of lower costs. Rather than providing additional state disclosures to consumers, it would be far preferable to establish uniform national standards for disclosure.

3. What strategies have been helpful in educating consumers about their options in the mortgage market? What efforts are needed to help educate consumers about consumers about the mortgage credit process and how to shop and compare loan terms and fees?

Financial education is described as the solution to many different problems. The fact that this is so doesn't diminish its value. MBA and its members have developed a number of strategies to educate consumers about their options in the mortgage marketplace.

As noted above, MBA established the Home Loan Learning Center Web site to provide an opportunity for consumers to explore the mortgage options available to them and to become better informed about the mortgage process. In preparation for Homeownership Month this year, MBA increased the content of the Home Loan Learning Center by creating a homeownership quiz in order that site visitors could test their own knowledge on the home buying process. MBA also added the following materials:

- Top Ten Tips for Home Buyers,
- Homeownership Statistics,
- "Who Say's You Can't - a Real Life Story,"
- Mortgages from A to Z kit…Understanding the Home Buying Process,
- Your First Steps toward Homeownership,
- It's Your Credit, Make it Work for You,
- Someone Wants to Give You Money. Help Them.,
- Coming to Grips with Settlement, and
- How to Live with Your Mortgage. Not for it.

MBA will continue to enrich the content of the Home Loan Learning Center going forward.

MBA has also established a Stop Mortgage Fraud program to help protect consumers from deceptive and fraudulent sales practices when taking out a mortgage or a home equity loan. Under the program, MBA has established a Web site at www.stopmortgagefraud.com that provides consumers a vehicle to report instances of predatory lending and fraud to appropriate consumer protection agencies.

Consumers may also call (800) 348-3431 to request that this information be mailed to them. The print version of this material has been translated into Spanish and Arabic and the website has been translated into Spanish as well.

4. What are some of the "best practices" that lenders, mortgage brokers, consumer advocates and community development groups have employed to help consumers understand the mortgage market and their loan choices?

MBA's membership includes over 3,000 companies from across the real estate finance industry. Our lender members range from the largest institutions in the nation to small, local businesses. Our membership has devoted very significant resources to developing effective practices to help consumers understand the mortgage process. Some individual MBA member companies have publicized their own sets of "best practices" tailored to their business models.

5. What explains the differences in borrowing patterns among racial and ethnic groups? How much are the patterns attributable to differences in credit history and other underwriting factors such as loan-to-value? What other factors may explain these differences?

The 2004 HMDA data show higher denial rates and a greater incidence of "spread loans" among some African American and Hispanic borrowers, as compared to other borrowers. These data also show differences in borrowers' choices of lenders with greater use of non-prime lenders by African Americans and Hispanics. These differences are explicable with an understanding of how mortgage loans are priced and borrowers' choices. Indeed, the 2005 Report of Federal Reserve Staff accompanying the release of the 2005 HMDA data (the Fed Report) made clear that the Federal Reserve's own analysis found that nearly two-thirds of the differences could be explained using HMDA data, such as the income of the borrower, along with data on the lender chosen. The 2005 Fed Report also indicated that the remaining differences may be explained by non-public pricing factors.

As the 2005 Fed Report pointed out, several factors impact the mortgage rate that a particular borrower receives. Most important is the overall level of interest rates in the economy. The traditional benchmark for the 30-year fixed mortgage rate has been the 10-year Treasury rate.[4] (The 10-year Treasury rate reflects the risk-free credit of the United State government. The 10-year also cannot be called; investors can expect to receive the stated interest rate on their investment for the full 10 years.) Mortgages typically trade at a spread above Treasuries due to the fact that they bear both credit risk – which is the risk that a borrower may default – and prepayment risk – which is the risk to the investor that the borrower may refinance or move – thereby paying the loan off well ahead of its stated maturity.

Thus, the second factor in the price is a premium to account for a borrower's expected credit and prepayment risk. Subprime borrowers tend to have both a greater level of credit risk, i.e., higher expected levels of delinquency and default, as a result of their prior credit problems, and greater prepayment risk. The reasons for their higher rates include greater prepayment risk; subprime borrowers frequently prepay their loan if their credit improves and they qualify for a lower rate. Objective risk factors, including credit scores and other items from a borrower's credit report, such as payment history on prior mortgages, loan-to-value ratios, debt-to-income ratios, and other underwriting variables,

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[4] In fact lenders use a variety of indices to determine their cost of funds and help price their loans including the LIBOR/swap index.

are powerful predictors both of a borrower's likelihood to pay on their loan and their likelihood to refinance. Notably, it is illegal to include any racial, ethnic, or other such demographic variables in the pricing decision.

A third factor in the price is the amount of administrative expenses associated with the loan. Loan applications that take additional time for an originator to complete are more costly. Additionally, small loans are more expensive to originate from the point of view of the originator, as the fixed costs are spread over a smaller balance. Subprime loans tend to be significantly smaller on average relative to prime loans.

Typically, the price is determined by using a statistical model that may be embedded in an automated underwriting system. There is no place for race in this modeling. Moreover, the use of automated underwriting for most borrowers allows lenders to concentrate their attention on helping borrowers with unique credit histories or other characteristics qualify for financing.

The final factor in the determination of a borrower's mortgage rate depends to some degree on the borrower's actions. As indicated, the choice of a lender does make a difference. Borrowers who aggressively shop among more than one lender are likely to get a better rate than borrowers who visit only one lender or mortgage broker. Borrowers need to make the competitive marketplace work for them and help wring out any excesses in pricing through their efforts. The 2004 HMDA data showed more than 8,800 lenders who offered more than 100 loans over the course of the year. These lenders are competing for the borrower's business.

Beyond limited data to assess risk such as income, HMDA data do not contain any of these relevant loan pricing data, such as credit scores, down payments, degree of documentation, cash-out information, loan-to-(property)-value (LTV) ratios and debt-to-income ratios (both front-end ratios comparing mortgage payments to income and back-end ratios – comparing total debt payments to total income).[5] The data also do not measure the degree that borrowers shop among the many originators available, a factor that is also highly relevant to the price of a loan. For these reasons, the current HMDA data set cannot be used to draw definitive conclusions about why a loan was refused or made at a particular rate.

In sum, it is clear that differences in borrower rates are a function of the cost of funds, legitimate business related factors applied in underwriting, administrative costs and borrower behavior. The challenge is to assure that industry, government and consumer groups are doing all we can to assure that borrowers know what they need to know about the process, their own financial situation and that they shop for the most competitive loan product to suit their needs and situation.

[5] Historically, lenders employed 28 percent front-end and 36 percent back-end ratios in their underwriting. Today, as risk modeling has become much more sophisticated, there is greater flexibility in underwriting to qualified borrowers.

One additional point is also clear. Mortgage markets are dynamic and so are the underwriting models. That dynamism and innovation have increased the supply of credit to borrowers with a wider range of means than ever before, resulting in the highest levels of homeownership in our Nation's history.

CONCLUSION

MBA appreciates the opportunity to provide comments to the FRB on HOEPA and predatory lending, nontraditional mortgage lending, reverse mortgage lending and informed consumer choice. These are critical areas of importance and we look forward to working on these issues with the FRB. For questions or further information, please do not hesitate to contact Mary Jo Sullivan at msullivan@mortgagebankers.org or at (202) 557-2859.

Sincerely,

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Chairman
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