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VIA E-MAIL: regs.comments@federalreserve.gov

August 7, 2007

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

Re: Docket No. OP-1288 – Home Equity Lending Hearings

Dear Ms. Johnson:

The Credit Union National Association (CUNA) appreciates the opportunity to comment on the public hearings that the Federal Reserve Board (Board) recently held regarding home equity lending and the adequacy of existing regulatory and legislative provisions in protecting the interests of consumers. CUNA represents approximately 90 percent of our nation's 8,500 state and federal credit unions, which serve over 87 million members.

SUMMARY OF CUNA's COMMENTS

- CUNA would support restrictions on prepayment penalties, as well as prohibiting these penalties for loans that target subprime and first-time borrowers. CUNA would also support enhanced disclosure of prepayment penalties.
- CUNA believes sound underwriting of mortgage loans requires consideration of the borrower's ability to pay the taxes and insurance, along with other factors in the loan process, and that escrow accounts are the best approach for ensuring these payments are made, especially for subprime loans. We believe that the disclosure of the loan payments should indicate whether this includes tax and insurance payments.
- Reduced documentation is inappropriate for subprime borrowers, although may be acceptable in certain circumstances for other types of borrowers.
- For adjustable-rate subprime loans, we believe that an institution's analysis of the borrower's ability to repay the loan should include an evaluation of the ability to repay the loan by its final maturity at the fully indexed rate. A similar approach should be used for other home loans, although lenders should have flexibility to tailor these analyses. For subprime loans, we also agree there should be a rebuttable presumption that a loan is unaffordable if the debt-to-income ratio

exceeds 50% and that the burden of overcoming the presumption is considerable.

CUNA's Comments

Prepayment Penalties

The Federal Credit Union Act prohibits federal credit unions from imposing prepayment penalties on loans to their members. The practice of imposing prepayment penalties is also uncommon among state-chartered credit unions. We do not believe that the prohibition of prepayment penalties is a barrier to the effective delivery of mortgage loans by federal credit unions.

The purpose of providing subprime loans should be to provide borrowers with blemished credit with an opportunity to obtain a loan, as well as an opportunity to improve their credit so they may then qualify for a prime loan.
Prepayment penalties hinder this process to the extent they discourage or prevent borrowers from refinancing to a prime loan when the opportunity arises.

For this reason, CUNA would support restrictions on prepayment penalties. These penalties are very common for subprime loans and are often not prominently disclosed. Even if borrowers are aware of them at the time the loan is made, they rarely anticipate that they would ever actually have to pay the penalties, which may amount to thousands of dollars.

However, many borrowers with adjustable rate mortgages (ARMs) are currently facing sharply higher payments, as the interest rates on these loans have increased. Many of these borrowers would benefit from refinancing into a fixed rate loan, but many are not able to do so because of these prepayment penalties and, therefore, face much higher loan payments that may escalate further if rates continue to increase.

For this reason, we would support limitations as to how long these penalties may remain in effect after the loan is made. This could include a prohibition on prepayment penalties that extend beyond the first adjustment period on an ARM loan. We would also support time limitations for fixed-rate mortgages as well, such as prohibiting prepayment penalties that extend more than 24 months after the loan is made. We would also support prohibiting these penalties for loans below a certain amount as a means of targeting the prohibition to subprime and first-time borrowers, and this threshold should vary depending on regional housing prices. These borrowers may not be as sophisticated as prime borrowers who may be better able to assess whether to accept the prepayment penalty. Credit scores and other similar information could also be used as a means of targeting the prepayment prohibition.

CUNA would also support enhanced disclosure of prepayment penalties. Unlike most fees, this penalty is not paid at the time the loan is made and, therefore, borrowers may not be aware of or understand that these are very substantial penalties that would be incurred if the borrower later decides to refinance the loan. Enhanced disclosures would help borrowers understand the consequences and the extent of these prepayment penalties. However, we strongly encourage that any new disclosures be subject to consumer testing before they are approved for use by

lenders. This will be the only means to ensure that these new disclosures will be effective.

Escrow for Taxes and Insurance on Subprime Loans

We believe that sound underwriting of mortgage loans requires consideration of the borrower's ability to pay the taxes and insurance. An escrow account for these payments is the best approach for ensuring that these payments are made on a timely basis, and we agree that escrow accounts are essential for subprime loans in which the loan-to-value ratios are usually high and the mortgage payments represent a relatively large percentage of income. We also note that both Fannie Mae and Freddie Mac require escrows for the mortgages they purchase that have loan-to-value ratios that exceed 80%.

Without escrow accounts, borrowers with unexpected expenses may decide or be forced to use funds that would otherwise be used to pay their tax and insurance payments. This is especially true for subprime borrowers who may have lower incomes than prime borrowers. Overall, loans with escrow accounts are likely to perform better than loans without these accounts, which benefit both the lender and the borrower.

However, escrow accounts should not be mandated for all loans. For other types of loans, such as prime loans, the decision to place tax and insurance payments in escrow accounts is best determined by consumer and lenders, based on their specific needs.

We also believe it is essential that any disclosure of loan payments clearly indicate whether they include tax and insurance payments. These tax and insurance payments are very significant and borrowers need to understand their significance as they proceed with obtaining a mortgage for their new home. We would support both written and verbal disclosures by the lender to emphasize the borrower's responsibilities with regard to these payments.

"Stated Income" or "Low-Doc" Loans

We believe that documenting income is prudent, although there may be situations in which it would not be necessary, such as when the borrower clearly documents significant net worth, impeccable credit, or other strong evidence of repayment ability. In these situations, lenders should have flexibility to determine whether the income should be verified. However, we agree that reduced documentation would generally be inappropriate for subprime borrowers, and we would not oppose a regulatory prohibition to that effect.

We also agree that if lenders charge a higher interest rate for reduced documentation loans, then borrowers should have the option of providing documentation in exchange for a lower rate. A disclosure that provides borrowers with this option should be provided at the beginning of the loan process.

Unaffordable Loans

For adjustable-rate subprime loans, we believe that an institution's analysis of the borrower's ability to repay the loan should include an evaluation of the ability to repay the loan by its final maturity at the fully indexed rate. For non subprime adjustable-rate loans, such an analysis would certainly be prudent but there should also be some flexibility to take into account other factors, such as the borrower's expectation of increased income or investments, as well as borrowers who only plan to remain in their home for a relatively short period of time, which may often be the situation for military families.

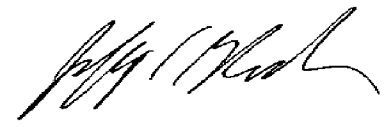
For example, the lender could underwrite such a loan based on the borrower's ability to make the payments on a traditional 30-year fixed rate loan at the rate that applies at the time the loan is underwritten. Many lenders may choose this alternative not only because it is a simple approach, but also because it would also ensure that these types of loans are made to borrowers who choose to minimize their payments for reasons other than because they could not otherwise afford the payments on a fixed-rate loan. There may be other alternatives as well, and the lender should have the flexibility to choose the appropriate option.

The Board has also requested comment as to whether there should be a rebuttable presumption that a loan is unaffordable if the debt-to-income ratio exceeds 50%. We certainly believe this presumption is generally appropriate for subprime borrowers. This presumption would also be appropriate for prime loans in many situations. However, we envision that there may be situations in which such a limit would not be necessary, such as when the borrower has a very high level of income or significant investments.

Financial education is essential to ensure that borrowers do not consider loans that are unaffordable. This, along with providing the necessary disclosures, will ensure that consumers are aware of the different mortgage loan products that are available and to select the product that may best meet their needs. Federal, state, and local governments should support credit unions and other lenders in their efforts to improve financial education by developing and sponsoring these types of programs.

Thank you for the opportunity to comment on these issues regarding home equity lending. If you have questions about our comments, please contact Senior Vice President and Deputy General Counsel Mary Dunn or me at (202) 638-5777.

Sincerely,



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