CELEBRATING OUR 40th ANNIVERSARY
NAFCU 1967-2007

August 15, 2007

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

RE: Comments on Docket No. OP-1288; Home Equity Lending Market (June 14 HOEPA Hearing)

Dear Ms. Johnson:

I am writing on behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents the interests of our nation's federal credit unions (FCUs), in response to the Board of Governors of the Federal Reserve System's (Board) request for written comments regarding the home equity lending market.

Section 158 of the Home Ownership and Equity Protection Act of 1994 (HOEPA) directs the Board to periodically hold public hearings on the issue of home equity lending and the adequacy of existing regulatory and legislative provisions in protecting consumers, especially low-income consumers. Pursuant to this directive, on June 14, 2007, the Board held a public hearing to examine how the Board might use its rulemaking authority under HOEPA to address growing concerns about abusive lending practices in the mortgage market, particularly the subprime mortgage market. The Board is also soliciting written comment on the issues that were the focus of the hearing: prepayment penalties; escrow for taxes and insurance on subprime loans; "stated income" or "low doc" loans; and unaffordable loans.

NAFCU appreciates the Board's efforts to ascertain public views on these important issues and would like to take the opportunity to submit the following comments.

Prepayment Penalties

Although we acknowledge that prepayment penalties help to mitigate risk and may allow some lenders to provide consumers with lower up-front costs or lower interest rates, NAFCU believes that prepayment penalties are often utilized in an inappropriate manner and should generally be prohibited. Excessive prepayment penalties discourage—and often prevent—borrowers from refinancing or selling their homes and essentially "hand cuff" borrowers to their lenders, undermining consumer choice.

Prepayment penalties also frustrate fair competition between predatory lenders who charge excessive prepayment penalties and honest lenders who are unable or unwilling to charge unduly high fees. Federal credit unions are prohibited from imposing prepayment penalties (12 U.S.C. §1757(5)(A)(viii); 12 CFR 701.21) and are often at a competitive disadvantage in comparison to lenders charging exorbitant prepayment penalties. Generally, consumers are attracted to a particular mortgage product based on the monthly payment or the initial "teaser" rate. Unscrupulous lenders may entice consumers with lower up-front costs, only to impose unaffordable prepayment penalties on the back end when the borrower later wishes to relocate or refinance their loan to receive more favorable terms or to avoid payment shock when the rate resets. Oftentimes, consumers do not anticipate these costs at the outset nor do they factor the prepayment penalty into their decision-making process when choosing a loan product. These factors create an incentive for abusive lenders to impose excessive prepayment penalties on borrowers and results in an uneven playing field for responsible lenders.

At a minimum, NAFCU recommends that reasonable restrictions be placed on prepayment penalties. For example, NAFCU believes that the period during which prepayment penalties apply should not exceed one year, or at most, the initial reset period.

Escrow for Taxes and Insurance

NAFCU believes that escrows for taxes and insurance may benefit both lenders and borrowers and should be required for all subprime mortgage loans. Requiring escrow for subprime loans is prudent to protect the lender's asset. Additionally, escrows for taxes and insurance help to ensure that subprime borrowers, who often lack knowledge or experience with financial management, budget effectively for these costs. Thus, NAFCU recommends that subprime mortgage loans be generally subject to escrow. Some exceptions, however, could be established for certain subprime loans with a low loan-to-value ratio and in other appropriate circumstances. Additionally, consumers should be given the opportunity to opt-out of mandatory escrows.

NAFCU also firmly supports consumer education; as such, we believe that the absence of escrows should be disclosed to consumers early in the loan application process, either at application or within three business days of the receipt of the application. NAFCU does not, however, believe that lenders should be required to provide an estimate of the borrower's tax and insurance obligations. NAFCU recognizes the need for consumers, particularly subprime borrowers, to understand the true costs associated with homeownership; however, we believe that the potential benefit of an estimate of tax and insurance liabilities is outweighed by the burdens and costs to the lender. Tax and insurance may vary greatly by state, county, or city and would place an undue burden on lenders to maintain accurate estimates of varying tax obligations. NAFCU also feels that an estimate of the costs for tax and insurance would be unnecessary if escrows are generally required for all subprime mortgage loans.

"Stated Income" or "No Doc" Loans

In general, NAFCU does not believe that "stated income" or "no doc" loans are appropriate for subprime borrowers and higher-risk loans. Reduced documentation loans are too often exploited to perpetrate fraud and have a higher probability of default in the event that a subprime borrower's income is falsified or "marked up" by a broker or loan officer. Moreover, when a lender is already faced with loan characteristics that create a higher level of risk, it is particularly important for the lender to take prudent steps to ensure that income information is accurate and verifiable in order to fully mitigate the added risk inherent to subprime and higher-risk loans.

Accordingly, NAFCU recommends that lenders be restricted from making subprime and higher-risk loans, including loans with high loan-to-value ratios, without documenting or verifying a borrower's income. However, NAFCU supports the approach taken in the recent interagency *Statement on Subprime Mortgage Lending*, 72 Fed. Reg. 37569 (July 10, 2007), which allows for the acceptance of stated income or reduced documentation where there are mitigating factors that clearly minimize the need for verification of repayment capacity.

NAFCU also maintains that reduced documentation should be available for well-qualified borrowers. For financially sophisticated borrowers with higher credit scores, stated income or no doc loans can be beneficial in providing greater flexibility and the added convenience of an expedited origination process. Further, in circumstances where the credit union offers risk-based pricing, in which the borrower's employment history, credit history, etc. are considered, it may be appropriate to rely on stated income in underwriting a loan.

Additionally, NAFCU suggests that, if a particular borrower is paying a higher rate to obtain a stated income loan, the borrower should be provided with the opportunity to document their income in order to obtain a lower rate. We do not, however, believe that disclosure is otherwise necessary.

Unaffordable Loans

Very few credit unions are currently involved in subprime mortgage lending. Indeed, the Federal Reserve Board's data demonstrates that the percentage of credit union mortgage loans above the Treasury benchmark is very small. *See* FFIEC HMDA data. NAFCU believes credit unions should carefully manage risk exposures when participating in subprime lending activities. Toward this end, it is imperative that credit unions conduct a careful and credible analysis of borrowers' repayment capacity. Accordingly, in most cases, NAFCU feels that lenders should underwrite loans based on the fully indexed rate and fully amortizing payments. For example, NAFCU generally supports the approach taken by the Board and the other financial regulators in the *Interagency Guidance on Nontraditional*

Mortgage Product Risks, 71 Fed. Reg. 58609 (October 4, 2006), and the *Statement on Subprime Mortgage Lending*, 72 Fed. Reg. 37569 (July 10, 2007) (FFIEC Mortgage Guidance).

NAFCU does, however, believe there is a place in the market for nontraditional mortgage products, including adjustable rate loans. In some circumstances a fully indexed, fully amortizing mortgage may not be suitable, for example, where a borrower does not intend to stay in a home for a long period of time, or where a borrower expects their repayment capacity to change due to an increasing income or maturing investments. Additionally, we note that conventional ARMs, which have been present in the marketplace for many years and for which there are already time-tested standards in place to ensure sound underwriting, have a record of acceptable performance, particularly among credit unions where the historical delinquency rate is only 0.17% (1990-2006). Accordingly, NAFCU maintains that while the basic tenets of the FFIEC Mortgage Guidance articulates sound, broad-based underwriting principles that might be considered in underwriting, we do not believe that these principles should be imposed on federal depository institutions via regulation.

Additional Comments

NAFCU firmly believes that while consumers should be protected from abusive lending practices, it is imperative that access to legitimate subprime credit be preserved to ensure that affordable credit is available to those underserved individuals who are most in need of financial services. In its review the HOEPA regulations, NAFCU urges the Board to be mindful of the importance of providing underserved markets with access to credit, and to avoid any action which might adversely affect credit availability.

Subprime lending programs provide an important means by which credit unions may more effectively meet the needs of consumers, particularly low-income consumers, individuals with little credit history or bad credit, and first-time homebuyers. Although subprime borrowers may pay higher rates than borrowers with strong credit histories, subprime mortgage lending is an important tool in helping consumers to achieve the American dream of home ownership. NAFCU strongly believes that subprime lending can provide real benefits to underserved consumers by increasing loan availability for those who might not otherwise qualify for mortgage credit. However, NAFCU feels that it is crucial that borrowers be fully informed of their options so they are able to obtain loan products that are most suitable to their individual needs.

Additionally, NAFCU encourages the Board to consult with Congress and the other regulatory agencies in order to push for increased supervision of unregulated mortgage lenders. Federally-insured depository institutions, including credit unions, are subject to strictly enforced regulatory requirements aimed at protecting consumers. Mortgage brokers and other unregulated entities, however, are not subject to the same level of supervisory oversight. NAFCU believes that all mortgage lenders must be appropriately supervised to prevent abusive lending practices.

NAFCU would like to thank the Board for the opportunity to comment on these important issues. Should you have any questions or require additional information please call me or Pamela Yu, NAFCU's Associate Director of Regulatory Affairs, at (703) 522-4770 or (800) 336-4644 ext. 218.

Sincerely,

B. Dan Berger
Senior Vice President of Government Affairs

BDB/py