



State of New Jersey

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JON S. CORZINE
Governor

August 15, 2007

Honorable Ben S. Bernanke, Chairman
Board of Governors of the Federal Reserve System
20th and Constitution Avenue, NW
Washington, DC 20551

Dear Chairman Bernanke:

I write to commend you for joining with other federal regulators in adopting the Final Statement on Subprime Lending on June 29, 2007. The Statement is an important companion piece to the Nontraditional Mortgage Guidance you issued last fall, and I support application of the principles and consumer protections enunciated in both documents to federally regulated entities.

At the state level, I share a growing concern about recent subprime mortgage loan practices by all players in this multi-faceted industry and the resulting increase in foreclosure rates in many areas around the country. A concerted approach to these problems is very important to consumers as well as to the economic future of our states and for the nation as a whole.

The hearing hosted by the Federal Reserve Board on June 14, 2007, which addressed Regulation Z provisions implementing HOEPA restrictions on abusive lending, was a positive development. I urge the Board to use its mandated responsibility under HOEPA to prohibit unfair and deceptive acts or practices with respect to all home loans, whether those acts or practices are performed by entities primarily subject to federal regulatory jurisdiction or by entities more directly regulated by the states.

Our state is concerned about the ramifications of the U.S. Supreme Court's recent decision in *Watters v. Wachovia* upholding the application of federal preemption of state regulatory powers over an operating subsidiary of a national bank. The regulation of predatory, unfair, and deceptive mortgage lending practices is a matter of national

importance, requiring the creation of bedrock national standards, standards that state regulators should be granted equal authority to enforce. Such federal regulations should contain provisions expressly permitting states to enact and enforce additional consumer protections that will not be subject to federal preemption.

Historically, the states have served as the vanguard for consumer protections. A number of states have passed strong laws to curtail abuses in the mortgage market, and have taken swift enforcement action in appropriate cases. States have an invaluable ground-level perspective and the tools available to react in real-time to abuses occurring in our local markets. But the national reach of the current problems, and of the brokers, lenders and investors involved, require action at the federal level to establish a platform of basic consumer protections. Furthermore, if new HOEPA regulations are not extended to those entities that are traditionally subject to primary regulation by the states, they would address considerably less than half of the players involved in the home mortgage lending industry.

The problems in the subprime market have struck certain pockets of the country severely, and no state has escaped the fallout. Lenders have failed, and affected investment firms have been shaken. Of most concern to us, however, is the rising incidence of delinquencies and foreclosures. One study concludes that an estimated 2.2 million families with loans originated between 1998 and 2006 have lost or will lose their homes through foreclosure, resulting in a staggering \$164 billion in lost equity.¹ Shortsighted market incentives rewarded irresponsible lending and made it more difficult for responsible lenders to compete. There is mounting evidence, in fact, that many loan originators placed borrowers into risky hybrid adjustable-rate mortgages with large built in payment shock - even when they qualified for sustainable fixed-rate loans at little or no cost increase - in order to reap a fast, front-end financial pay-off, all done with cold disregard for the consequences the borrower could face over the life of the loan.

Many subprime borrowers go through a loan process and receive loan terms that have been demonstrated to increase the likelihood of a later foreclosure and loss of homeownership, such as: (1) little or no analysis of ability to repay, often without appropriate consideration of available income and/or assets; (2) interest rates that reset higher after a brief teaser rate period as brief as two months or a quick two or three years; (3) the undisclosed absence of an escrow account for taxes and insurance; and (4) contractual prepayment penalties when the borrower tries to refinance to a more favorable product. Borrowers in the conventional market rarely encounter any of these terms. Although segments of the marketplace, especially investors, have begun to adjust and correct for these problems, imposing tightened underwriting standards, many lenders and loan originators are under tremendous pressure to keep their own numbers up and are still making the very same dangerous loans that have largely created the present crisis.

¹ Ellen Schloemer, Wei Li, Keith Ernst and Kathleen Keest, *Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners* (Center for Responsible Lending, December, 2006), <http://www.responsiblelending.org/pdfs/foreclosure-paper-report-2-17.pdf> ("*Losing Ground*") at 3.

Too many of our communities are suffering from widening effects from increased foreclosures, such as lower tax revenues and higher crime rates.

In these difficult circumstances, I urge the Board to use HOEPA to prohibit acts or practices for all home loans that are unfair or deceptive. While HOEPA's high-cost structure was successful in addressing some abuses, the 1994 statute does not adequately address the harmful lending practices that are apparent today. Recognizing that the market would continue to evolve, Congress wisely authorized and charged the Board to identify and address mortgage lending abuses on all loans as time passed.² The Federal Reserve Board is best equipped legally to issue regulations that will require entities traditionally subject to primary regulation by the States to play by the same rules as federally regulated entities and their affiliates. Only in this manner will all consumers receive basic protections.

I also strongly support a national predatory lending law that will protect all consumers, particularly if states were granted co-equal enforcement power with the federal government.

More specifically, I urge you to adopt Regulation Z amendments under HOEPA that would require with respect to subprime loans: (1) the evaluation of a borrower's ability to repay the loan at the fully-indexed rate, with appropriate consideration of available income and/or assets; (2) the establishment of reasonable debt-to-income and debt-to-assets standards for gauging mortgage costs against a borrower's other financial obligations; (3) establishment of an escrow account for taxes and insurance; and (4) the prohibition of prepayment penalties by all lending institutions.

The states will have a large role to play in addressing the problems of the subprime market through enforcement of our existing laws and regulations, through state legislative actions, and through an aggressive campaign to raise public awareness of the risks of unwise borrowing. In addition, prompt and firm action by the Federal Reserve Board in the areas discussed above is critically important to the economy and to American homeowners and homebuyers. I hope you will take this opportunity to expand the ways we can work together in protecting our families and communities, and in returning the subprime market to its rightful place of providing access to credit on fair and sustainable terms.

² 15 USC Section 1639(1)(2). While HOEPA generally applies to a narrow class of mortgage loans, Congress also requires the Board to prohibit unfair or deceptive mortgage lending practices and to address abusive refinancing practices in the context of all mortgage loans, not only loans governed by HOEPA (closed end refinance transactions that meet the definition of "high cost"):

(1) DISCRETIONARY REGULATORY AUTHORITY OF BOARD.--

(2) PROHIBITIONS.--The Board, by regulation or order, shall prohibit acts or practices in connection with--

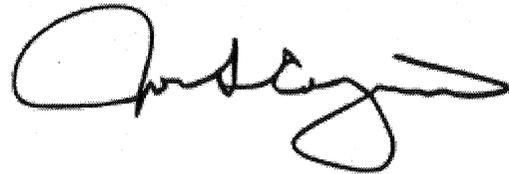
(A) mortgage loans that the Board finds to be unfair, deceptive, or designed to evade the provisions of this section; and

(B) refinancing of mortgage loans that the Board finds to be associated with abusive lending practices, or that are otherwise not in the interest of the borrower.

(Emphasis added). The Board acknowledged this authority in 2001 when considering amendments to HOEPA, see 66 Fed. Reg. 65604, 65612 (December 20, 2001), and cited to it in the final rule.

I look forward to working with you on this important matter. Thank you for your consideration.

Sincerely,

A handwritten signature in black ink, appearing to read "Jon S. Corzine". The signature is fluid and cursive, with a large initial "J" and a long, sweeping tail.

Jon S. Corzine