

CANICCOR

AN INTERFAITH COUNCIL ON CORPORATE ACCOUNTABILITY

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tion purposes only.

Executive Director:
John E. Lind

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

Re: Docket No. OP-1288

CANICCOR Comments on:

Home Equity Lending Market

CANICCOR serves as a consultant to institutional investors with social concerns and/or social criteria for their investments. It prepares reports on the social responsibility of the lending of corporations in which a given investor has equity investments. CANICCOR then serves as their consultant in meetings with the corporation in which the corporation's lending policies and procedures are discussed. These discussions are held with the major mortgage lenders once every year or two.

These comments arise out of these reports and discussions. In particular we have discussed the policies and procedures for subprime and Alt-A mortgage products with a number of major corporations, several of which have both depository and subprime finance subsidiaries. A major concern beyond the basic underwriting standards has been their methods of due diligence for the vetting and up-dating the information on the brokers that supply loan applications through their wholesale lines. The brokers are the weakest link (the agency problem) and they are often the only persons directly in contact with the borrowers.

In other areas we have also urged some corporations that provide refinance loans without escrow accounts to develop the structures to provide such accounts. Finally when servicing is farmed out, we have asked for the corporation's methods of checking on the adequacy of the servicing organization.

On the basis of these discussions, CANICCOR supported the "Statement on Subprime Mortgage Lending" by the federal regulators, including the Federal Reserve, and supports the further rule making by the Federal Reserve under HOEPA, especially because of its broader coverage.

Prepayment penalties:

Prepayment penalties should be restricted to no more than 60 days before the end of the initial rate period of the ARM. This policy should be clearly disclosed under Truth in Lending so the borrower may clearly understand that refinancing is possible at the end of the initial rate period before any rate increase. But the borrower must also be warned that any refinancing at that time may be at a higher rate, depending on the market. Obviously some consumers would possibly not contract for the loan realizing that they might suffer payment shock even if they try to refinance at the end of the initial rate period. Thus the loans should be made on borrower's ability to repay the debt by the final maturity based upon the fully indexed rate. See the section below on "Unaffordable Loans".

The institutional investors, for whom CANICCOR consults, have discussed this issue with a number of lenders and are pleased that some have already limited their prepayment penalties to at least 60 days before the end of the initial rate period of the ARM.

Escrow for Taxes and Insurance on subprime loans:

Subprime lenders should be required to make escrow accounts available to borrowers, with omission of such accounts permissible only at the option "opt out" of the borrower, who is fully informed as to the estimated tax and insurance obligations. Even the initial advertisement of the loan should have an estimated escrow included in it, but the borrower must be fully informed of the estimate at the time of the offering. Including escrows will obviously deter a few clients from borrowing and rightly so because they cannot afford the loan.

The institutional investors have pressed several major lenders to provide escrow accounts and are pleased that they have instituted similar policies to provide these accounts.

"Stated Income" and "Low Doc":

Stated Income and low doc subprime loans are prone to abuse since real incomes can be inflated to permit qualification by a borrower for a loan that is not sustainable. Thus stated income and low doc loans should be prohibited for certain loans, such a subprime loans.

Exceptions might be made for low loan-to-value loans with borrowers with low loan-to-debt ratios. In such cases, the lender must disclose that fact that such a loan is being offered and allow the consumer the option of documenting the income for a lower priced loan.

Such restriction would undoubtedly reduce the number of subprime stated income and low doc loans in a healthy manner. It would also be helpful if the HMDA reporting included an indication of stated income and low doc loans for the CANICCOR analysis. This analysis is used in preparing reports on the lenders before meetings with the lenders.

Of related concern is the lending to investors for single-family housing. There has been an obvious increase of small entrepreneurs receiving loans for housing in a rising price market in hopes of rapid turnover. A classic case is a suit by DLJ Mortgage Capital, a unit of Credit Suisse, against Infinity Home Mortgage seeking compensation for "four mortgage loans totaling

\$838,00 made to the same individual borrower on the same street in Irvington, NJ”¹. The investors for whom CANICCOR consults have met with one major lender of Alt-A loans to investors and were pleased by their careful methods of screening clients. It appears that not all such lenders are so careful.

Unaffordable loans:

CANICCOR supports the recent federal regulatory guidance on subprime loans, which states that the lender should use the borrower’s ability to repay the debt by the final maturity based upon the fully indexed rate.

If such a policy is applied to all loans, there should be specific consumer disclosures that might permit an exemption. For example, I know personally of an older couple purchasing a condominium in which they plan to stay only 5 years with an interest only loan. They see no reason to build up equity and are willing to take any loss on the property at the end of 5 years. Thus so long as the borrower has assets to cover a reasonable loss, an interest only loan is useful.

Obviously all of the above-suggested changes in HOEPA will restrict the market somewhat. However, considering the recent excesses of the market, such restrictions are necessary.

Brokers and Correspondent Lines:

An additional concern that the institutional investors, for whom CANICCOR consults, raise at every recent meetings with lenders is the screening of brokers and correspondent lines. The recent closings of wholesale and correspondent lines exemplify the problem. An example is Wells Fargo’s closing of some of its nonprime wholesale lines.² Certainly, the major lenders have been working on these problems over the past several years as the wholesale and correspondent lines increased. Since brokers providing loans for wholesale lines and mortgage companies selling into correspondent lines are the entities directly in contact with the borrower, the liability of any violations of the Truth in Lending Act and HOEPA must ultimately be passed on to them as the basic arrangers of the loan.

Unfair and Deceptive and Deceptive Lending Practices:

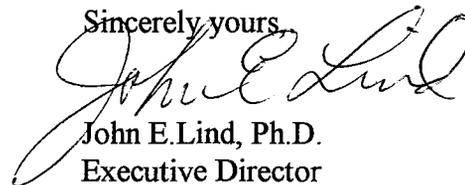
CANICCOR would urge the Federal Reserve Board to take a broader look at the general area of unfair and deceptive lending practices as is the Office of Thrift Supervision in its Advance Notice of Proposed Rulemaking (RIN1550-AC17) just issued. These areas include rule making on the basis of further issues raised in the interagency Guidelines on Nontraditional Product Risks and on Subprime Mortgage Lending. For example the prohibition of single payment credit insurance, necessity of clearly informing a borrower of points and fees, and whether the loan is self amortizing and for ARM loans cap rates and the maximum cap rate. Whether points and fees are incorporated into the principal, etc.

¹ Scholtes S and White B, “Subprime lending trio face law suits”, *Financial Times*, 30 March 2007.

² “Wells Fargo Closes Nonprime Wholesale Lending Business”, Wells Fargo Press Release, 26 July 2007.

Many thanks for this opportunity to comment on possible regulatory changes under HOEPA.

Sincerely yours,



John E. Lind, Ph.D.
Executive Director

cc:

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