Board of Governors of the Federal Reserve System

Testimony at the Federal Reserve Board's June 14, 2007 public hearing

on the Home Ownership and Equity Protection Act

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Good morning. I am Susan Davis, and I lead the consumer real estate lending activities of Wells Fargo Home Mortgage.

I would like to first address the general questions the Board has asked. Given the rapidly changing real estate lending environment, Wells Fargo believes guidance is more appropriate than rules, and existing and contemplated guidance should be given the chance to work. Any action taken by the Board should be designed to create uniform standards that apply to all lenders, including federal and state-regulated lenders, and others.

You have asked whether specific terms or practices should be regulated across the board, or just for subprime lending. We believe that truly unfair, deceptive, and abusive practices should be eliminated for *all* mortgage loans. We believe that all consumers, prime and subprime alike, should be protected from the unscrupulous and unregulated loan originators who offer irresponsible loan products.

It is also important to note that the specific loan terms and practices being examined by the Board are not, by themselves, unfair, deceptive, or abusive. Lenders who adhere to responsible lending principles can develop responsible loan products that incorporate some of these loan terms for certain customers. At Wells Fargo we have chosen to not make pay option ARMS or loans with negative amortization. The problem with the loan terms in question is that irresponsible lenders without a shared interest in the long-term financial success of the consumer and investor can abuse each of these loan terms and practices.

Next, I will address the Board's questions on specific loan terms or practices. With respect to prepayment penalties, Wells Fargo believes that they are useful and appropriate when provided in a responsible fashion. Prepayment penalties allow consumers who intend to stay in their homes for an extended period of time the option of a lower interest rate. The existence of prepayment penalties has also contributed to the liquidity of the secondary markets by assuring a minimum return to investors. We agree that limiting the term of prepayment penalties to the initial fixed period of an adjustable rate loan, as Wells Fargo does currently, would be an appropriate standard for the industry. And we agree that providing additional disclosures about the nature of prepayment penalties and the availability of loans without such terms, as Wells Fargo does currently, would be appropriate. The consumer should also receive a clear benefit, such as a reduced interest rate, if he or she chooses a prepayment penalty.

On the topic of requiring escrows for subprime loans, we believe lenders should clearly disclose the absence or availability of escrows and, regardless of the consumer's choice, should underwrite the loan assuming the full amount of principal, interest, taxes and insurance.

Regarding any restriction on stated or low documentation loans we believe these loans need to be tied to a bright line test that can be consistently documented. Several years ago, Wells Fargo implemented such a bright line test when it chose to eliminate the availability of stated income loan products to all consumers whose FICO scores were below 620.

With respect to the affordability of credit, there has been a great deal of discussion about how to determine a borrower's ability to repay an ARM loan and what rate and payment amount should be used in underwriting an ARM. The FFIEC, in its interagency guidance and statements, has recommended that a fully indexed rate be used except in those cases where, because of the interest rate environment, another rate such as a fixed rate may be more prudent. Wells Fargo strongly believes that the evaluation of a consumer's ability to repay an ARM loan should be determined in accordance with the interagency guidance. Capping the debt-to-income ratio at 50% does lenders and consumers a disservice as interest rates move up and down, new types of mortgage products evolve, and the credit environment changes. This is an area where guidance is more appropriate than bright line rules. The Board should avoid any rule-making that unnecessarily limits the availability of innovative lending products, should allow the market to make necessary corrections, and should not overreact to the current wave of concerns.

In conclusion, the Board should focus on creating a regime of uniform consumer protection requirements that consistently applies to both federally-regulated lenders and others. Recognizing the constantly changing mortgage environment, we urge the Board and the other Agencies to maintain an ongoing dialogue with mortgage market participants.

Thank you for this chance to provide you with our comments and I would be pleased to answer any questions you might have.

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