ACORN

May 7, 2007

John M. Reich, Director
Office of Thrift Supervision
700 G Street, NW
Washington, DC 20552

Sheila C. Bair, Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

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

John C. Dugan, Comptroller of the Currency
Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

JoAnn Johnson, Chairman
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Docket Number OCC-2007-0005, OP-1278, OTS 2007-09

Dear Director Reich, Chairwoman Bair, Chairman Bernanke, Comptroller Dugan, and Chairwoman Johnson, :

I am submitting these comments on behalf of the more than 350,000 ACORN member families in over 100 cities across the country. ACORN, the Association of Community Organizations for Reform Now, is the nation's largest grassroots community organization. We work to empower low and moderate-income people to have a greater voice in the decisions, structures, and policies that affect their lives. Since 1970 ACORN has taken action and won numerous victories on issues of concern to our members particularly improved access to credit on fair terms.

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Thank you for the opportunity to share our opinions regarding the Proposed Statement on Subprime Lending. We applaud the Agencies for taking on the serious problems addressed in this Statement and in the Interagency Guidance on Nontraditional Mortgage Product Risks, and we urge you to finalize the Statement without any weakening of its standards.

Adjustable Rate Mortgages

We were very glad to see that the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators recommended that states adopt the Guidance. It is in this context of applying the Guidance on the state level, that we believe the Statement is especially important, since it clearly addresses the nontraditional mortgage products commonly found in the Subprime market, such as 2/28 and 3/27 Adjustable Rate Mortgages. Although these products might not be very common among federally supervised institutions, they have become the loan originated by state supervised subprime lenders. While ARMs represent about a quarter of all home loans nationwide, they made up three-quarters of all subprime loans originated in 2005.

Abuses are prevalent in the origination of subprime ARMs, and these abuses demand the attention of federal and state regulators. If subprime lenders adhere to the principles in the Guidance, this will help in reducing these abuses.

We have interviewed hundreds of subprime ARM borrowers, and none of them were given a choice about whether they wanted a fixed or adjustable rate. For lenders who insist their customers are choosing adjustable rates, we would ask these lenders how their customers could make a choice since we have never seen any forms that a broker or loan officer might use to help a borrower decide.

We asked borrowers about when they learned they would be getting an adjustable rate and how it was explained to them. Their answers can be grouped into the following categories:

- Some customers were given an ARM and told it was the only or best way to go.
- Some customers were told they didn't qualify for a fixed rate, but weren't told why
- Some customers expressed concern when they learned they were getting an ARM, but were told not to worry because they could refinance in a year or two.
- Some customers did not learn until closing that they were getting an ARM
- Some customers did not know they had an ARM until an ACORN representative reviewed their loan documents.
- Some customers didn't find out they had an ARM until their payment went up.

In addition, none of the borrowers received an accurate explanation of how their LIBOR-based, teaser-rate ARM worked. The most common type of subprime ARM is one in which the borrower's initial rate will increase after two years even if rates stay the same or decrease, but in no case will it go below the starting rate. Typically, the rate can increase up to a maximum of 700 basis points above the starting rate. The borrower's maximum possible payment is not listed anywhere in the disclosures.

However, the borrowers we interviewed were not given any explanation or were told incorrectly that :

- the rate may just go up a little
- the rate may go up or down
- the payments will only go up as shown on the TIL statement
- the lender will refinance them before the rate changes

While we believe that there are many ways that the existing disclosures can be improved, it is clear that improved disclosures alone will not adequately stem the predatory practices that are pervasive in the origination of subprime ARMs.

When three quarters of borrowers in the subprime market are receiving ARMs, it is hard not to believe that they are being steered to these products, especially given the nominal benefit of a 2/28 ARM. In our analysis, subprime ARMs provide minimal monthly savings compared to their added costs and greater risks.

1) For instance, at New Century Mortgage, which had been the largest 2/28 subprime lender, there was only a 70 basis point difference between a fixed and adjustable rate. On a $100,000 loan the difference in a monthly payment between a 7.9% and 7.2% rate is just $48.02. On a $200,000 loan the difference is less than $100.

The minimal savings in these examples immediately begins to reverse after two years when the interest rate and payment increase, often by several hundred dollars. In most cases, the savings are completely eclipsed if the borrower stays in the loan a year after the first change date.

2) Borrowers with ARMs will pay more <u>closing costs</u> since they will refinance sooner than borrowers with a fixed rate (the average life of a New Century ARM was 2.3 years, compared to 4.6 for a fixed rate). The typical closing costs of $5,000-$6,000 on a $100,000 loan or $10-$12,000 on a $200,000 loan far outweigh the minor payment savings.

3) Additionally, it appears that a number of ARM borrowers refinance prior to the two-year mark and so also must pay a <u>prepayment penalty</u> of several thousand dollars.

4) Borrowers who remain in their ARMs after the first change date are very likely to fall behind on their mortgage.

In the subprime market, lenders typically will allow borrowers to have a larger debt-to-income ratio than in the prime market. It is common for subprime lenders to qualify a borrower with a 50% or 55% debt ratio, using a monthly payment based on a teaser-starting rate that is almost guaranteed to increase in two years. It is clearly unsound for both borrower and lender when loans are underwritten with no consideration beyond the first two years of the loan. Instead, subprime ARM lenders are relying on the likelihood that these borrowers will be forced to refinance before their payments become unaffordable, a practice strongly discouraged in the Guidance.

Underwriting adjustable rate loans to ensure affordability based on the fully-indexed rate will help address this problem, but it will not solve it, especially during periods when the index rate that is used is very low, such as in 2004 with the LIBOR rate. 2/28 ARMs that were made that year often had starting interest rates and a floor above the fully-indexed rate.

As in the case of this borrower from San Antonio, Texas, who closed on her loan in June 2003.

The LIBOR rate at that time was about 1.2%.
The margin on her loan was 7.0%.
Thus, The fully-indexed rate was 8.12%.
The starting rate on her loan was 8.69%.
The minimum rate on her loan was 8.69%.

Underwriting her loan at the fully-indexed rate would not have prevented the affordability problems that she experienced when her rate increased in July 2005 and again six months later.

Stated Income Loans

We appreciate that the Agencies are addressing the problem of stated income loans. This product has been overused and abused, accounting for almost half of the mortgages of subprime lenders.

We have been extremely concerned with the proliferation of loans that were being made with no verification of the borrower's ability to pay the loan.

We saw numerous cases of brokers and loan officers submitting applications for a supposed self-employed borrower, who was actually a wage-earners or even social security recipient and whose income was much less than on the application.

We have been shocked by the lack of any effort to substantiate that a borrower was indeed self-employed, such as at least reviewing a borrower's tax return to see if they filed a Schedule-C or phoning the borrower.

The introduction of a new category, "stated wage earner", was a disturbing development in this area. Brokers or loan officers no longer had to lie about a borrower's source of income, only the amount of their income.

In all of the cases we have seen, the borrower provided the required income verification – paystubs and tax returns – but the broker or loan officer submitted the application as a stated income loan without the borrower's knowledge.

We believe that this was done not only to get loans through that otherwise would not have been made, but also because the resulting loan had a higher rate, a particularly abusive practice.

It appears that some of the changes that have been made recently in the underwriting of these loans has only been done to protect the lender and investor, but not the homeowner. For instance, lenders have begun to require a lower loan-to-value for stated income loans, which protects their investment, but does not make a difference to the homeowner if the payment is unaffordable.

Sincerely,

Maude Hurd
ACORN National President