Comments on
Proposed Statement on Subprime Mortgage Lending
Docket Number: OP-1278

Submitted by:
Enterprise Corporation of the Delta / HOPE Community Credit Union
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Summary

Enterprise Corporation of the Delta and HOPE Community Credit Union (ECD/HOPE) support the Proposed Statement on Subprime Mortgage Lending and urge the Agencies to further strengthen the language limiting irresponsible lending practices in the subprime ARM and other lending markets. As a Credit Union regulated by the National Credit Union Administration, we regularly work with borrowers who have been victims of irresponsible lending practices. We believe that the standards outlined in the proposed Statement describe the consumer protections and underwriting standards that should be implemented industry-wide.

General Comments

- We share the Agencies' concerns about ARM products with "teaser" rates that expire after a short initial period, no or reduced documentation, steep rate increases, prepayment penalties, features that increase the likelihood of refinance, and/or lack of information provided to borrowers. These product characteristics strip wealth from homeowners, threaten their economic stability, and often contribute to foreclosure. In addition to the concerns expressed in the proposed Statement, we recommend that the Agencies provide more direct guidance on each of these product characteristics, including when/if they are appropriate and action to be taken by the lender when they are utilized. Each of these characteristics has the potential, individually or together, to strip the wealth that homeowners have worked so hard to build and jeopardize their financial security for years to come.

- Based on our experience as a Credit Union working regularly with borrowers who have been victims of irresponsible lending practices, we agree that subprime borrowers often do not fully understand the risks and consequences of obtaining certain adjustable rate mortgage products. Therefore, it is critical that financial institutions provide consumers with timely, accurate information about all of the products that are available to them, so that they can make an informed decision.

- We request that the Agencies expand the proposed Statement to apply to subprime fixed rate products in addition to subprime ARMs. While the content of the Statement is especially applicable to the ARM market, it applies to all subprime loans.

- We encourage the Agencies to take a stronger stand against irresponsible lending practices, in the subprime ARM market and other lending markets. We ask that the Agencies incorporate language such as "The Agencies strongly encourage institutions to" in place of "Institutions should".

- While we applaud the Agencies for the proposed Statement on Subprime Lending, there are many institutions that are not regulated by any of the Agencies. Some of these institutions are subsidiaries or affiliates of regulated institutions. Therefore, we ask that the Agencies include more direct language encouraging regulated institutions to curb irresponsible lending practices occurring within these sister companies.

- All lenders that engage in subprime lending should be subject to increased levels of ongoing examination to ensure that they are following all subprime lending guidance that has been issued by the Agencies, including the 1993 Interagency Guidelines for Real Estate Lending, the 1999 Interagency Guidance on Subprime Lending, the 2001 Expanded Guidance for Subprime Lending Programs, the 2006 Interagency Guidance on Nontraditional Mortgage Product Risks, and any other applicable guidance.

- We recommend that the Agencies integrate the Community Reinvestment Act (CRA) into the proposed Statement. CRA requires lenders to serve the credit needs of borrowers in a safe and sound manner. The proposed Statement should specify that issuing subprime mortgages in an unsafe and unsound manner violates CRA and will result in lower ratings on CRA exams. In addition, the Agencies should incorporate into the proposed Statement the content of their recent letter encouraging financial institutions to work with borrowers who are having trouble making loan payments. This letter incentivizes lenders to transition borrowers into lower cost loans, by providing CRA points for doing so.

<u>Risk Management Practices</u>

- In addition to the *Predatory Lending Considerations* listed, the Agencies should add the following practice: Engaging in marketing tactics that steer prime borrowers to subprime loans in order to earn higher points and fees than required by their credit history.

- We support the underwriting standards outlined in the proposed Statement. We would especially like to emphasize our support for the following:
    - Each institution's analysis of every borrower's repayment capacity should include an evaluation of the borrower's ability repay the debt by its final maturity at the fully indexed rate, assuming a fully amortizing repayment schedule.
    - The debt-to-income analysis for each borrower should assess the borrower's total monthly housing-related payments, including principal, interest, taxes, and insurance, as a percentage of gross monthly income.
    - When underwriting higher risk loans, stated income and reduced documentation should be accepted only if there are mitigating factors that clearly minimize the

need for direct verification of repayment capacity. A higher interest rate is not considered an acceptable mitigating factor.

- We recommend that the Agencies add the following clarifications/recommendations to the *Underwriting Standards*:
    - Strongly encourage lenders to require borrowers to escrow funds for real estate taxes and insurance.
    - Define "higher risk loans" as referenced in the statement related to stated income and reduced documentation.
    - Define the situations in which stated income and reduced documentation loans should be acceptable, and define specific policies and procedures for lenders to adopt that will prevent fraud associated with these loans. We believe that allowing low documentation and stated income loans to be used in combination with any subprime or nontraditional mortgages is rarely beneficial to the borrower or the lender. Stated income and reduced documentation loans should be restricted only to those borrowers who are self employed and therefore do not have documentation. By limiting the use of these loans, the Agencies will protect both lenders and borrowers from the risks associated with stated income and reduced documentation loans.

Consumer Protection Principles

- We agree that consumer protection principles are critical to ensuring that subprime ARMs as well as fixed rate products are marketed and consumed responsibly. As is included in the proposed Statement, "mortgage product descriptions and advertisements should provide clear, detailed information about all of the costs, terms, features, and risks of the loan to the borrower". The Agencies should emphasize the responsibility of the lending institution in providing this information.

- We would like to emphasize the importance that the lender provide information to consumers BEFORE an application is submitted or a closing is scheduled. Lenders should provide consumers with detailed information about potential payment shock, prepayment penalties, balloon payments, cost of reduced documentation loans, and responsibility for taxes and insurance while they are evaluating and selecting which product(s) for which to apply.

- We would also like to emphasize the importance of clear and concise communication of the costs, terms, features, and risks of all products. Communication from the lender to the borrower of each of these items must be thorough and complete as well as clear and concise. If information is presented in a confusing or incomplete manner, it will not achieve its purpose of informing the consumer about the costs, terms, features and risks of the products.

Control Systems

- We believe that it is especially critical to implement control systems that ensure responsible lending practices. We agree that institutions should "design compensation programs that avoid providing incentives for originations inconsistent with sound underwriting and consumer protection principles, and that do not steer consumers to these products to the exclusion of other products for which the consumer may qualify."

- As stated in the 1999 Interagency Guidance on Subprime Lending, the Agencies should re-emphasize that subprime lending requires specialized knowledge and skills. In addition, the Agencies should encourage financial institutions to continuously reevaluate their subprime lending program. Particularly, the Agencies should regularly evaluate if a financial institution's subprime program has met the needs of the community that it was created to address. In many cases, the goal of maximizing earnings has led financial institutions to engage in predatory lending practices, including those described in the proposed Statement.

Requested Comments

1. **The proposed qualification standards are likely to result in fewer borrowers qualifying for the type of subprime loans addressed in this Statement, with no guarantee that such borrowers will qualify for alternative loans in the same amount. Do such loans always present inappropriate risks to lenders or borrowers that should be discouraged, or alternatively, when and under what circumstances are they appropriate?**

   In the cases in which a borrower is not approved for a subprime ARM based on the standards outlined in this proposed Statement, the loan denial will likely be beneficial to the borrower in the long run. If their income cannot support the fully indexed payments, if they cannot afford taxes and insurance, or if they refused the loan because they were provided accurate information about product features, this is a successful avoidance of a loan that could result in eventual foreclosure or costly refinancings. If a potential borrower cannot immediately qualify for alternative loans in the same amount, financial counseling should be readily accessible to enhance his or her chances of qualifying for a loan in the future. We believe that even though the standards discussed in the proposed Statement may result in fewer borrowers qualifying for the type of subprime loans addressed in this Statement, that this Statement outlines responsible lending standards which all financial institutions should follow.

2. **Will the proposed Statement unduly restrict the ability of existing subprime borrowers to refinance their loans and avoid payment shock? The Agencies also are specifically interested in the availability of mortgage products that would not present the risk of payment shock.**

   Regarding products that do not present the risk of payment shock:

- Fixed rate products offer the best way to prevent payment shock.
- Among ARM products, we use products that limit the annual increase in interest rate to 2% or less and cap the total rate increase over the life of the loan to 5%.

We believe that curbing abusive lending will not restrict access to credit. Instead, we believe that if abusive loans are squeezed out of the marketplace by regulation and/or legislation, responsible lending will meet the demand of customers who are now receiving loans from abusive lenders.

We believe that ARM loans posing payment shock dangers could be refinanced into 30 year fixed rate loans without risky features. We believe that programs and products can be developed and utilized that will assist subprime borrowers in need of refinancing their loans to avoid payment shock. First, financial institutions should develop or refer borrowers in distress to foreclosure prevention programs, to provide temporary assistance and counseling to borrowers in need of assistance. Secondly, for borrowers who have experienced payment shock due to a predatory subprime loan, Fannie Mae, Freddie Mac and other GSE's should develop products that would allow lenders to underwrite refinance loans based on the borrowers credit history pre-payment shock.

3. **Should the principles of this proposed Statement be applied beyond the subprime ARM market?**

   Yes, we recommend that the principles of this proposed Statement be applied beyond the subprime ARM market. While the content is especially applicable to the ARM market, it applies to all subprime loans. Predatory lending practices occur among fixed rate as well as adjustable rate products. The underwriting standards outlined in the Statement, including conducting a thorough evaluation of the borrower's repayment capacity at the fully indexed rate, verifying the borrower's income, assets, and liabilities, and including taxes and insurance in the DTI analysis, should be followed for all loans.

4. **We seek comment on the practice of institutions that limit prepayment penalties to the initial fixed rate period. Additionally, we seek comment on how this practice, if adopted, would assist consumers and impact institutions, by providing borrowers with a timely opportunity to determine appropriate actions relating to their mortgages. We also seek comment on whether an institution's limiting of the expiration of prepayment penalties such that they occur within the final 90 days of the fixed rate period is a practice that would help meet borrower needs.**

   As a credit union, we do not impose prepayment penalties on borrowers. We believe that the practice of requiring the expiration of prepayment penalties at least 90 days prior to the end of the fixed rate period would be extremely beneficial to borrowers and the communities in which they live. The expiration will give borrowers the opportunity to refinance without incurring harmful prepayment penalties, which can contribute to foreclosure in extreme circumstances.