April 17, 2007

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

Re: Comment - Docket No. OP-1278
Topic: The Proposed Statement on Subprime Mortgage Lending

Subprime comment

Westamerica Bank (Bank) is in a unique position to comment on the "Statement on Subprime Mortgage Lending" (Statement). WAB is a large Bank and a mortgage and consumer loan lender. Additionally, the Bank teaches financial literacy seminars (Basic Budgeting for Families). The Bank has taught this seminar to approximately 1,000 low and moderate-income (LMI) families per year for the past ten years. The seminars are interactive between Bank employee trainers and the families. This interaction allows the Bank to hear directly from LMI consumers about their financial loan experiences. This dialogue has given the Bank insight into the impact that subprime lending and other loan products have had in its communities.

- From teaching financial literacy we have learned that foreclosure is probably the worst financial event that any consumer can experience. Within the same month a consumer will loose their home, their place to live, generally they will have depleted all of their savings and the foreclosure will have caused a significant blemish on their credit record. Such a financial event is devastating to consumers and many low and moderate-income families simply never recover. For this reason, the consumer impact caused by unaffordable subprime loans can not be underestimated.

- Clearly, unfairly denying a low or moderate-income applicant credit is an injustice. However, it is time to recognize that providing any loan to a consumer who can not repay is as great an injustice.

- We have also learned from our seminars that the majority of consumers are struggling with large consumer debt. It is unfortunately a common occurrence for families to discover, in the process of developing a budget during our seminars, that their debt payments exceed their income. The Bank supports the subprime statement in recognizing that extending credit without any consideration of repayment ability is a predatory loan practice.

- It is important to note, that we have learned from the families attending the seminars that most consumers who obtain unaffordable subprime loans do so in an attempt to consolidate revolving debt that has grown a level that they could no longer repay. The primary purpose for most subprime loans and the primary marketing focus for the subprime industry are "debt consolidation". Unfortunately, in many instances, consolidating debt into a subprime mortgage results in replacing unaffordable revolving debt with an unaffordable mortgage debt. After obtaining subprime loans consumers frequently find that they can not refinance their subprime loans into prime loans because of the fees and charges added to their loans and the credit issues associated with previous consumer debt. If they become delinquent with the subprime loan they are forced to refinance again with another subprime loan and incur further fees. "Loan flipping" is simply an attempt to avoid an already unaffordable loan. The subprime statement is correct in observing that frequently refinancing existing subprime loans is a predatory practice. It is a method that has the result of depleting the equity from a consumer's property. For many, which are in the subprime loan cycle, their only recourse was a hope that housing appreciation would ultimately salvage their equity. The observation in section III of the Statement that subprime loans "are intended at their outset to be temporary credit accommodations in anticipation of early sale or refinancing . . ." is correct and is evidenced by the average loan life of subprime mortgage backed securities.

- The risk mitigation practices of subprime lenders consisted in the belief that housing appreciation would mitigate foreclosure risk. It did for a time and when it ceased the subprime collapse occurred. The full impact of the collapse on both the companies and on the individual consumers can not be underestimated. The "subprime statement" is correct in noting that basing repayment ability solely on the value of the collateral is a predatory loan practice. Eliminating this practice would probably be the single most effective regulatory achievement.

- Regulatory oversight has placed too much emphasis in the belief that full disclosure of the terms and conditions of a loan can prevent abusive loan practices. Few consumers fully understand all the terms of a subprime loan. The average number of pages in any subprime loan is large, and subprime loans are by nature complex. Almost all borrowers simply do not have the time or skill set to evaluate the documentation and must rely on the representations of the lender. It is unheard of for a consumer to leave an escrow signing saying they have read the documents and elected not to sign. For this reason, all subprime lenders should be required to determine the suitability of the consumer for a subprime loan prior to loan commitment.

- This raises the more significant issue of "If consumers were offered multiple loan programs, would this allow them to choose the best program?" Could this help to stop the practice of herding consumers into subprime loans?" The subprime statement ignored a significant practice of offering subprime loans to consumers that would otherwise qualify for loans without subprime characteristics. Consumers have frequently expressed the frustration that they were not informed that they qualified for a loan program with less abusive terms.

- To a certain extent subprime interest rate shock is the end result of the trend of steadily pushing interest rate risk from the financial institutions and security markets to the consumers. The question now becomes: "Are consumers better or lesser equipped to cope with interest rate fluctuations?" And if so "To what extent?". The assumption that wage increases will offset interest rate fluctuations does not appear to hold up to recent economic events. For example, even non-subprime ARM loans can produce significant interest rate shock. The payment amount can increase 46% (from the fully indexed amount) for the typical ARM loan with 2% annual rate increase and 5% life of loan cap. The real underwriting test is "How much interest rate risk can a borrower sustain?" Such an analysis is fundamental in determining a consumers ability to repay debt.

- It is a common subprime practice to offer consumers a teaser adjustable rate mortgage in order to produce a lower initial payment rate. Lower initial payments make the loan much more attractive when marketing, especially for those consumers seeking relief from high revolving loan payments. Lower initial payment rates have been instrumental in helping first time homebuyers, unfortunately they have also been used to justify the funding of loans to consumers that have no ability to pay the fully indexed payment. Building steep interest rate increases into subprime loans results in the borrowers with the least ability to repay being given loans with the highest interest rate increases. Many consumers were forced into the prospect of accepting payment shock as the price of homeownership. However, subprime consumers were not afforded the choice, almost all subprime loans have either rate shock or payment shock and negative amortization. When housing pricing declines the motivation to continue paying mortgage with increasing rates and negative amortization declines. Crucial to the underwriting of any subprime loan is the analysis of the borrowers ability make payments after rate adjustments. The practice of some lenders' reliance on negative amortization as risk mitigation technique should be considered a predatory loan practice. It makes the assumption that home appreciation will continue indefinitely and does not consider the consequences on the consumer if negative amortization occurs for an extended period and home prices remain unchanged or decline.

The Bank believes the Statement should reflect the following:

1. Banks that provide to households, financial literacy training, should be given more recognition under the CRA service test. Clearly, consumers need more financial literacy training to help them make better selections when choosing a lender and loan programs. The existing CRA service test offers inadequate incentive and recognition.

2. Providing any loan to a consumer (including credit card loans) without an analysis of the consumers' ability to repay the loan throughout the life of the loan is potentially financially damaging the consumer. There is no doubt that instituting loan qualification standards will reduce the availability of credit. This will have a positive

impact because it will have the effect of reducing the availability of loans to consumers that do not have the capacity to repay the loan and eliminate those lenders that promise loans to anyone regardless of their credit or capacity to repay.

3. Eliminate the erroneous concept of underwriting ARM loans based on the initial rate or fully indexed rate without consideration future rate adjustments. Underwriting based only on the initial fully indexed rate falsely assumes that any borrower that qualifies at the fully indexed rate would have the future capacity to make any payment after future interest rate adjustments. The only solution available is to introduce an interest rate sensitivity analysis to be applied to each borrower.

4. Prior to closing subprime loans, the lender should be required to disclose to a consumer the availability of any other loan programs, offered by the lender, of which the consumer is qualified. Since subprime loans are initially very profitable, consumers are routinely herded into negative amortization, adjustable rate loans with prepayment penalties believing that they have no other alternative. They do not have a real understanding of the complexity of the loans, and will believe the representations of the subprime lender that the loan is best for their financial condition. Recent events have demonstrated that the long term regulatory assumption, that any loan type can be the right loan for a consumer, provided that the consumer was given clear disclosure of the loan terms, has proven to be ineffectual in preventing abusive practice in lending.

5. Require a realistic analysis of the consumer's ability to repay adjustable rate loans without reliance on negative amortization. Prohibit deeply discounted initial payment amounts that are subsidized by negative amortization.

6. Require that a subprime lender determine if a subprime loan is a suitable alternative for the consumer applicant. The suitability standard would simply answer the question: "Is the subprime loan a viable alternative to consumer mortgage loan needs."

The Bank supports the effort to stop the abusive practices in subprime lending. The existing subprime practices have resulted in widespread financial ruin for large numbers of consumers and bankruptcies for numerous companies. Existing subprime practice are fundamentally flawed and existing laws alone and current regulatory oversight are not effective enough to prevent the subprime collapse from occurring again.

The Bank appreciates the opportunity to comment on the statement and hopes that new legislation will help restore consumers' confidence in the integrity of mortgage lending in America.

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