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Our File Number

May 3, 2007

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
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Re: **Comments on Proposed Statement on Subprime Mortgage Lending Docket no: OP-1278:**

Dear Ms. Johnson,

The Legal Aid Foundation of Los Angeles submits the following comments in response to the Proposed Statement on Subprime Mortgage Lending. It is essential to homeowners in the greater Los Angeles area, and to homeowners throughout California and the nation, that brokers and lenders be obligated to reasonably underwrite loans so that borrowers are not at risk of losing their homes. LAFLA respectfully urges the Board of Governors and all sister agencies to adopt policies and regulations that provide protection and relief to homeowners. In addition, we urge the agencies to impose a six-month moratorium on new foreclosures in order to slow the rising cascade of foreclosures and to prevent families who have been victimized by abusive lending practices from losing their homes.

The Legal Aid Foundation of Los Angeles is the largest Legal Services provider in the western states area. LAFLA is the primary provider of legal services to low income persons in the County and City of Los Angeles. Via our Greater Watts Homeowners Outreach Center and more recently through our consumer advocacy unit, we have devoted considerable resources over many, many years to the protection of homeowners and to the education of prospective homebuyers. Additionally, our Community Economic Development advocates have developed a unique expertise in creative and varied affordable housing strategies.

Subprime mortgage abuse has been an issue for our homeowner clients since the days when the discriminatory "redlining" of low income neighborhoods was the chief manifestation of mortgage abuse. A large percentage of our clients are African Americans who have been homeowners for decades. A second significant population of our client homeowners are Latino immigrants who have worked hard to purchase homes in low income neighborhoods. Too many of these homeowners are threatened with the loss of their homes due to the onslaught of high pressure sales of refinances and purchase loans that contained prepayment penalties, high fees, misleading adjustable interest rates, etc.

LAFLA's history with respect to combating predatory lending include participation in HUD hearings on subprime lending abuse, local and state legislative advocacy, and litigation, as well as community education efforts. These have all been strategies to address the patterns of subprime lending abuse. As you no doubt are well aware, stable homeownership enhances community stability. On the other hand, subprime loan abuse has contributed to the deterioration of many neighborhoods due to the loss in equity and, in too many instances, to the loss of homes through foreclosure. Families, individuals, and working class communities as a whole suffer the impact of threatened and actual increased foreclosures. In a region where both rental and homeownership costs have brought about a real housing crisis, the situation can only become more desperate.

We share the concerns expressed in the proposed Statement regarding teaser rates on 2/27 and 3/28 loans, high interest rate caps on adjustable rate loans (or no caps at all), loan product features that are likely to result in refinances, prepayment penalties that trap borrowers in unaffordable loans, and failures to provide borrowers sufficient and accurate information on which to base their loan decisions.

Current protections are not adequate to protect consumers from abusive lending practices in the subprime market. The federal regulatory agencies must take action to blunt the impact of these practices which, at best, rob unsuspecting consumers of millions of dollars in valuable home equity and, at worst, propel homeowners into a downward spiral towards default and foreclosure.

The Problem: In March 2007, foreclosures in California rose 36% to 31,434 or 21% of activity nationwide. Of the 10 metro areas with the highest foreclosure rates, 6 were in California. This March figure was nearly triple the figure for the same period last year.

And things will only get worse. In 2007, 1 million loans are expected to see interest rates reset, with 800,000 additional resets coming in 2008. Up to 13% of Adjustable Rate Mortgages originated in 2004, 2005 and 2006 will end up in foreclosure as rates reset. For loans made in 2006, 19.4% may end in foreclosure, or 450,000 in California alone. And 21 of California's 26 metro areas suffered price declines in the fourth quarter of 2006, further heightening the vulnerability of borrowers who have relied on increases in their homes' value to offset their increased mortgage payments.

Many of these loans are the result of malfeasance by subprime brokers and lenders. Brokers pushed loans that, at best, did not make sense for the borrower, and at worst were fraudulent. In particular, stated income loans have been sold aggressively in California, resulting in borrowers being unwittingly placed in unaffordable and costly hybrid and option ARM loans, where brokers have inflated borrowers incomes and left them with monthly payments that often exceed half of their true monthly income.

I recently represented a widow, a senior with a small business that consisted of a swap meet stall. She spoke only limited English and relied on the lender to arrange a refinanced loan via a telephone application. She never met with the broker, only with the contract notary who told her where to sign. She was charged in excess of $28,000 in loan fees for an adjustable rate loan that offered essentially no benefit to her. She not only paid prepayment penalties on her existing loans, a feature she did not understand and which was not explained to her, her new loan contained a prepayment penalty that locked her into the “bad” subprime loan. In this “stated income loan,” the loan arranger prepared the loan application so that it reflected an income hugely inflated from my client’s actual and rather meager income. The original lender asserted that this client asked for a stated income loan! Relying on the loan broker and because she could not read English, the homeowner signed the loan documents and only later discovered what a bad loan she had received and that several assurances regarding what she would get from the loan were totally illusory. Unfortunately, this senior citizen’s story is not a rarity.

The explosion in the subprime loan market and the fact that these loans became Wall Street marketable in loan pools, led lenders to respond to growing competition by lowering underwriting standards and creating incentives for brokers to aggressively sell stated-income loans which were ripe for abuse. This was all done to feed the appetite of Wall Street investors and securities providers, who failed to exercise any due diligence to screen out the financing of predatory loans. And the regulators watched it all happen. The time for regulators to act is now before scores more of avoidable borrower delinquency and default result.

LAFLA supports the following solutions to mitigate the problems facing home loan borrowers:

1. Extend the Guidance.

The agencies must extend the federal guidance on nontraditional loans to all loans with low initial teaser rates. Loans should be underwritten to the fully indexed rate so lenders and borrowers have some confidence that the homeowner will be able to make mortgage payments when the rate adjusts. Extending the guidance in this way will not unduly restrict credit; however, it would be appropriate to allow for exceptions to the guidance if it can be shown that a particular refinance loan is clearly in the interest of a distressed borrower and the refinance loan will not unduly benefit the originator, servicer, issuer of, or investor in, a potentially abusive loan.

2. Restrict prepayment penalties.
The agencies should prohibit prepayment penalties on ARMs that extend beyond the initial interest rate period of the loan. Consumers should not be penalized for having been tricked into an unsuitable loan by incurring a prepayment penalty to refinance out of that loan after their rates go up. Additionally, borrowers should be encouraged to plan ahead for imminent rate increases by being able to refinance out of their loans 90 days before the rate adjusts without incurring a prepayment penalty. Beyond this, as a general guidance, all income stated and negative amortizing or option ARM mortgage products should not have pre-payment provisions that exceed more than, at most, a one year period.

3. Enforce fair lending laws.
Minority neighborhoods in California are nearly four times as likely to get higher-cost home purchase loans; it is estimated that people of color in the state are paying over $1 billion more per year as a result of such loans. This means that many homeowners of color are being robbed of additional equity they could have used to support their families, send a child to college, or plan for retirement. HUD recognized this deplorable reality years ago when it reported that a significant percentage of African American homeowners in Los Angeles who qualified for prime rate loans were being steered to subprime products.

The Board should: develop anti-steering guidance and delineate the steering of borrowers to higher-priced products as an unfair and deceptive trade practice, and vigorously enforce fair lending laws and investigate all pricing disparities evident from HMDA and other preliminary analysis. Additionally, the FRB should expand Home Mortgage Disclosure Act reporting requirements, so more data are available to better detect areas of discrimination.

4. Expand CRA.
The Board has found that banks which had CRA responsibilities subject to regulatory oversight appeared to distribute their lending more equally and fairly. Yet at the same time, the bank regulators have allowed certain companies such as H&R Block Bank, Countrywide Bank, and Charles Schwab Bank to minimize their CRA responsibilities to a small fraction of the communities in which they lend money. The FRB should expand CRA requirements to promote fair lending. This is the time to enhance CRA responsibilities and to promote cooperative efforts by advocates, community organizations and lenders to address the needs of local communities.

5. Enhance transparency and support home loan counseling and review.
We support the Statement's concern for adequately informing borrowers about key loan terms and features, including payment shock, prepayment penalties, balloons, the cost of reduced document loans, and the failure to escrow tax and insurance payments.

Clearly, borrowers are uncertain, and in all too many cases misled, about key features of their loans. In California, a significant problem exists with regard to brokers who discuss loan terms in a borrower's native, non-English language, but provide only English-language documents, in many cases with different terms than those discussed. We urge the Board to require, promote, and support funding of both pre-purchase and post-purchase home loan. The agencies should also require that brokers and lenders provide translations of key loan documents in the non-English language in which the negotiation was conducted. In California, and increasingly in other jurisdictions, it is essential that these documents be available in Spanish and in other primary non English languages. In this very lucrative industry, there is no justification for a failure to provide accurate translations of key disclosures and key loan documents, which after all, are essentially boilerplate forms.

6. Bring Wall Street in.

The secondary market has facilitated the growth of abusive lending. Three-quarters of all subprime securitized loans were 2:28 or 3:27 loans. The agencies must impose an obligation on Wall Street firms not to fund or securitize predatory loans, in effect turning off the spigot of predatory finance.

7. Impose a moratorium on foreclosures.

In light of cascading defaults and great uncertainty and anxiety, we urgently call for the regulators to impose and support, <u>at a minimum</u>, a six-month moratorium on foreclosures to allow time to untangle complicated issues, promote loss mitigation, and prevent homeowners from losing their homes as a result of abusive lending practices.

The mortgage market is currently broken. Consumers need help. LAFLA joins other consumer advocates and homeowners in urging you to take effective and immediate action to stop abusive loan practices and to help keep borrowers in their homes. Thank you for your consideration of these comments.

Very Truly Yours,

Dorothy Herrera Settlage

Legal Aid Foundation of Los Angeles
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Senior Attorney

Cc: California Reinvestment Coalition