Mortgage Insurance Companies of America

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April 8, 2008

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Docket No. R-1305

Dear Ms. Johnson:

The Mortgage Insurance Companies of America (MICA) is pleased to comment on the proposal by the Federal Reserve Board (FRB) to revise the standards that determine predatory and abusive mortgage loans pursuant to the Home Ownership and Equity Protection Act (HOEPA, codified at 15 USC 1639). We shall provide detailed comments on the notice of proposed rulemaking (NPR) as published [71 FR 1672]. All of our comments are based on one fundamental observation: mortgage loans are by definition intended to be secured ones founded on adequate collateral. If loan structures do not in fact ensure that collateral exists at origination and throughout the duration of a mortgage, then the loan is an unsecured one that should be priced accordingly, backed by considerably higher capital and reserves and otherwise structured to recognize this critical difference. MICA believes that perhaps the most serious problem in the current mortgage market is the fact that far too many loans were originated or refinanced without adequate assessment of a borrower's ability to meet their payment obligations and without assurance of adequate collateral except under house-price appreciation scenarios used solely to justify the new loan structures.

In finalizing these rules, the Federal Reserve must ensure that all mortgages – not just "higher-priced" ones – meet this fundamental criterion of appropriate underwriting and reliance on actual home values. Absent it, the loan should not qualify as a mortgage for purposes of all applicable bank regulatory requirements. This fundamental principle will protect borrowers, lenders and investors going forward and it should be the basis on which the FRB considers not only the HOEPA rules, but also the other actions now under way to stabilize the nation's credit markets.

With specific regard to the NPR, MICA supports the Federal Reserve's intent to enhance the protections afforded borrowers against dangerous

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loans secured by a primary residence. As the proposal rightly notes, no other asset is as important to individuals and the neighborhoods in which they live. Further, abusive mortgages can create significant credit risk with profoundly adverse market and solvency implications now all too evident. However, we believe the rule should be revised in numerous important respects, most importantly by applying the new protections against abusive mortgages to all mortgage loans, not just those that may be subprime ones as determined by the proposed arbitrary price thresholds. As discussed in more detail below, we believe the proposed thresholds which attempt to differentiate subprime loans from prime loans will create perverse incentives for originators to structure problematic loans based on indices or with features (e.g., pre-payment penalties) that put borrowers at risk. As is all too painfully evident from current foreclosure data, prime borrowers and those using non-traditional mortgage features (e.g., simultaneous second liens) are experiencing high delinquency and foreclosure rates, demonstrating that problems are not confined to the subprime sector. Further, first-time homebuyers – among the most vulnerable borrowers – cannot be differentiated by credit score or the other factors typically associated with subprime loans. If these borrowers are excluded from needed protections against patently inappropriate loans – which the Board's approach would do – then the Federal Reserve's laudable goal of enhancing borrower protection from such lending would be seriously undermined.

As discussed below, MICA also believes that the proposed limits on abusive underwriting and loan features are too weak and will not achieve the Board's goal of consumer protection and prudential mortgage lending. We strongly urge that abusive practices – e.g., making loans without regard to ability to repay and/or doing so without reliance on verified documentation – apply to all loans, not just to a "pattern or practice" of predatory activity. Establishing prohibitions based on "pattern and practice" standards will create a major loophole through which lenders could make many problematic and predatory loans without triggering supervisory action. As discussed below, we also urge that the exceptions to prohibited practices be significantly tightened to restore underwriting standards to those which predominated in the market just a few short years ago. These prudential standards led to record home ownership and served new borrowers without creating the significant foreclosure problems now gripping neighborhoods and financial markets.

Key points MICA respectfully brings to the attention of the Federal Reserve include:

- All mortgages for primary residences – not just higher-priced and high-cost ones – must meet accepted, proven prudential standards. We would note that HOEPA requires the Board to address predatory and abusive practices without limiting its purview in any respect to subprime loans. Thus, to ensure true market reform that does not create opportunities for evasion and ongoing abuse, the Board's rule should cover all home mortgages, providing discretion for the limited number of qualified, sophisticated borrowers who may be able to handle high-risk features through rebuttable-presumption exceptions as needed.

- The proposed interest-rate differentiation for "higher-priced" mortgages does not reflect current market conditions and will lead to regulatory arbitrage-focused pricing as some banks price mortgages at 299 basis points above comparable Treasury obligations, use other interest-rate thresholds (e.g., LIBOR) or convert spread-based profit incentives into those resulting from other product features (e.g., pre-payment penalties) not captured by the proposed price differential. Mortgage insurance premiums now count towards the annual percentage rate (APR) triggers used in the proposed price distinctions, and retaining the definitions thus would also create a disincentive to the use of both private and Federal Housing Administration (FHA) mortgage insurance with adverse implications for home ownership and borrower protection. Chairman Bernanke and other members of the Board have rightly pointed to the critical role the FHA can and must play in foreclosure prevention and the HOEPA rule should advance, not undermine, this goal.

- The FRB has identified some problematic mortgage features – i.e., no-documentation – but left one critical risk – simultaneous second liens – unaddressed. Chairman Bernanke highlighted this issue in his March 4 speech and FRB rules should reflect this insight. Mortgages with simultaneous second liens (also known as "piggyback" mortgages) not only significantly increase credit risk, but also complicate loan modification (again as Chairman Bernanke notes). The FRB should thus ban use of home-equity loans and home-equity lines of credit (HELOCs) as alternatives to mortgage down payments. We acknowledge that the NPR proposes to cover closed-end subordinate liens in its protections, but believe that the application of these protections only to higher-priced loans and numerous exceptions provided for them will not result in meaningful borrower protection. Despite regulatory efforts in 2005 to rein in abusive home-equity and HELOC practices[1], the mortgage market only worsened thereafter, validating the need for more substantive and specific regulatory sanctions when these loans are used as down payment substitutes.

- Restrictions on loans with simultaneous second liens – as with all others related to risky practices – should be applied to all residential mortgages, with rebuttable presumptions permitting lenders to vary terms and conditions as needed to meet specific borrower needs if these presumptions are not so broad as to permit continued predatory lending. If a lender relies on any of these rebuttable presumptions, then it should be required to keep documentation on this and subject all such loans to pre-approval scrutiny by internal audit personnel independent of the business unit making the underwriting decision or by third parties compensated according to accurate risk determinations, not by volume or similar criteria. This would ensure disciplined underwriting to prevent the FRB's proposed flexibility from providing significant loopholes for a renewal of abusive mortgage lending by individuals whose compensation incentives may not comport with safety and soundness and borrower protection criteria.

- All loans for a primary residence should be subject to a meaningful ability-to-repay test to ensure they are in fact adequately collateralized loans suitable for consideration under the mortgage rules. The proposal would apply an ability-to-repay test based on observable "patterns and practices" only to higher-priced mortgages and leave considerable room for exceptions, but the extent of market turmoil and loss demonstrate the urgent need that this test be binding and apply to all loans. In fact, the bank regulators have mandated this with regard to non-traditional mortgages regardless of price [71 FR 58609] and the FRB's HOEPA rule should be consistent with this principal. Further, the ability-to-repay test should be clarified to expressly bar consideration of house-price appreciation.

[1] Interagency Credit Risk Management Guidance for Home Equity Lending, May 16, 2005. Federal Reserve Board, Supervision and Regulation letter 05-11.

- The FRB should also introduce controls over cash-out refinancings (refis) at high loan-to-value (LTV) ratios, as these expose borrowers to significant risk. The cost of foreclosure in home-price depreciation scenarios can be seemingly more advantageous to borrowers than repayment, leading to downward market spirals. Rebuttable presumptions to limit use of cash-out refis to low-LTV mortgages should be required.

- The proposed treatment of escrows is an improvement over current practice, but insufficient. Escrows should be required for all loans without adequate collateral (e.g., 80% LTV) and maintained for the duration of the mortgage. Rebuttable presumptions can be used to ease this requirement when doing so does not endanger long-term home ownership.

MICA's specific comments follow. We would be pleased to provide any additional data or assistance to further the Board's efforts to finalize the NPR as quickly as possible in a firm, forward-looking rule that will prevent a recurrence of the current mortgage-market debacle.

I. Protection Against Abusive, Unsound Loan Features Should Extend to All Primary-Residence Mortgages

In numerous areas in the NPR, the Board has requested comment on whether the protections proposed for higher-priced loans (as defined) should also cover all mortgage loans secured by a primary residence. As noted, MICA urges the FRB in fact to expand its coverage to cover all primary-residence loans, noting that rebuttable presumptions will provide ongoing underwriting flexibility to meet specific needs for qualified, sophisticated borrowers. As should be clear by now from the pace of foreclosures for mortgages that do not meet the higher-priced criteria in the NPR, many borrowers are losing their homes due to abusive loan features and underwriting based solely on home value and assumptions as to house-price appreciation, not long-term ability to repay. Providing needed protections only to a limited segment of the mortgage market will leave many borrowers unprotected and their homes and neighborhoods at grave risk.

We would note that Congress intended the protections under HOEPA to apply without limitation other than the specific provisions for "high-cost" mortgages defined in law. For example, the conference report on HOEPA states:

> ...[T]he Board is required to prohibit acts and practices that it finds to be unfair, deceptive, or designed to evade the section

> and with regard to refinancings that it finds to be associated with abusive lending practices or otherwise not in the interests of the borrower. The Conferees recognize that new products and practices may be developed to facilitate reverse redlining or to evade the restrictions of this legislation. Since consumers are unlikely to complain directly to the Board, the Board should consult with its Consumer Advisory Council, consumer representatives, lenders, state attorneys general, and the Federal Trade Commission, which has jurisdiction over many of the entities making the mortgages covered by this legislation. In making any determination, the Board should look to the standards employed for interpreting state unfair and deceptive trade practices acts and the Federal Unfair and Deceptive Practices Act (15 USC 45(a)(1)).[2]

This provision does not require or even urge the Board to limit these protections to subprime mortgages, those for low- or moderate-income individuals or in any other fashion, instead dictating that the Board protect borrowers from abusive practices like those rightly identified in the NPR as posing this risk. Further, the statute is in no way limited in its application to groups of borrowers based on the price of products offered to them. Thus, the limited nature of the NPR's protections is at variance with the express statutory direction to the Federal Reserve related to borrower protection.

Moreover, there are policy as well as legal reasons for the Board to apply its protections to all at-risk borrowers. The banking agencies wisely recognized the need for protecting all borrowers – not just certain ones -- in the above-mentioned guidance on non-traditional mortgages (NTMs). That guidance rightly requires a demonstrated ability to repay and numerous other safeguards for these loans reflecting the fact that certain NTM features on their own – let alone those in conjunction with additional risk layers such as simultaneous second liens – put borrowers at significant risk. For example, loans with a nominally low rate that would not meet the proposed price criteria can have short-term balloon features, payment shock, pre-payment penalties and other provisions that put borrowers at risk of foreclosure. An incentive for use of these features would be created if the Board confines its consumer protections only to loans meeting arbitrary interest-rate triggers. Further, the regulators rightly included in the standards covering hybrid-adjustable rate mortgages for

[2] House Conf. Rep. No. 103-652, page 162.

subprime borrowers requirements that the protections cover all at-risk borrowers, not just subprime ones.[3]

The Board suggests that covering only high-priced loans is appropriate because guidance such as the NTM standards are already in place at insured depositories and their holding companies. However, as has become all too clear, significant segments of the market are outside the purview of the banking agencies – indeed, the Board has recently joined with state regulators in an effort to enhance supervision and enforcement in recognition of this problem. The President's Working Group on Financial Markets has also recognized the critical importance of uniform national lending standards to ensure borrower and financial-market protection, and the proposed limits in the NPR violate this essential principle.[4] Given that it is clear in numerous respects that loan standards cannot be limited only to federally regulated institutions if they are to have effect, the Board should build on this painful lesson and ensure that new protections against abusive loans reach all mortgage loans, not just arbitrarily defined segments of the market.

The Board also suggests that "prime" loans need none of the NPR's protections because the government-sponsored enterprises (GSEs) ensure that only prudent loans are securitized in this segment. We note that it is not correct to assume that all prime loans are securitized, and thus subject to GSE oversight. Moreover, recent data make it clear that Fannie Mae and Freddie Mac purchased mortgages with high-risk features such as simultaneous second liens and limited or no documentation. It is also clear that the GSEs are critical to only a limited segment of the securitization market. While private-label mortgage-backed securities are experiencing problems at present, the market may well rebound with vigor. It is essential for all needed protections to apply to all home mortgages so that unregulated pockets in the market do not again proliferate with serious adverse consequences to borrowers, neighborhoods and financial markets as a whole.

Finally, we would note that interest-rate triggers, even without taking fees into account as proposed, have ceased to be a meaningful distinction between subprime and conventional mortgages. As the Federal Reserve knows all too well, recent credit-market problems have

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[3] "While the Statement has retained its focus on subprime borrowers, the Agencies note that institutions generally should look to the principles of this Statement when such ARM products are offered to non-subprime borrowers." 72 FR 37570.
[4] The President's Working Group on Financial Markets, *Policy Statement on Financial Market Developments*, March 2008.

significantly widened mortgage spreads for even the safest loans above comparable Treasury rates, resulting in potential coverage as "higher-priced" loans for many otherwise conventional conforming mortgages. Fannie Mae and Freddie Mac have also recently added an array of steep "delivery fees" for even the safest mortgages, again significantly complicating distinctions between higher-priced loans and other mortgages. Subprime mortgages are almost exclusively now priced according to the London Inter-Bank Offering Rate (LIBOR), not the comparable Treasury rate on which the Board would base its determination of subprime loans.

We would also note that these price triggers include the cost of mortgage insurance provided by private mortgage insurers and the FHA since premiums (private and FHA) are included in the APR calculation. As noted, this is contrary to the current Federal Reserve objective of expanded reliance on the FHA to avert foreclosures. It also creates a serious disincentive for the use of sound, proven credit-risk-mitigation that provides essential borrower and market protections.

To avoid significant consumer-protection and market disruptions based on temporary pricing or interest-rate factors, MICA recommends that the Board determine which underwriting features are essential for consumer protection and apply them to all mortgages, using rebuttable presumptions to provide lenders with sufficient flexibility to meet exceptional borrower needs.

II. The NPR Must Include Simultaneous Second Liens as a High-Risk Factor

On March 4, Chairman Bernanke noted that:

> The recent surge in delinquencies in subprime ARMs is closely linked to the fact that many of these borrowers have little or no equity in their homes. For example, data collected under the Home Mortgage Disclosure Act suggest that nearly 40 percent of higher-priced home-purchase loans in 2006 involved a second mortgage (or "piggyback") loan. Other data show that more than 40 percent of the subprime loans in the 2006 vintage had combined loan-to-value ratios in excess of 90 percent, a considerably higher share than earlier in the decade.

Because first lien mortgages with simultaneous second liens are often underwritten as if they were below 80 percent loan to value ratio loans, such structures are problematic for all borrowers, not just subprime ones. Analysis by SMR Research has shown that piggyback mortgages grew rapidly in 2005 and

2006 so that, by the fourth quarter of 2006, 39% of all homes sold with financing were comprised of piggyback loans and fully 50% of the dollar amount of home purchase mortgages in that quarter were piggyback transactions.[5] Additionally, SMR Research has recently found that, at the end of 2006, there were 4 million borrowers with piggyback mortgages outstanding compared to 9.3 million borrowers with freestanding home equity liens. However, for the first eight months of 2007, the foreclosure rate on piggyback mortgages was seven fold the rate of foreclosures on free-standing home equity liens.[6] Many of these piggyback loans – to prime borrowers – were layered with additional risk factors such as hybrid interest-rate structures with "teaser" initial rates, lack of documentation and similar practices. As a result, borrowers whose ability to repay a loan was already compromised by poor underwriting had no protection against losing their homes because they have little or no equity on which to draw to prevent foreclosure, and did not benefit from the proven history of effective loss mitigation programs that mortgage insurers have offered to borrowers.

As Chairman Bernanke rightly went on to say, piggyback mortgages are seriously problematic not only because of the sharp increases in foreclosures that occurs when borrowers have little or no equity, but also because they make it far more difficult to modify a loan and prevent foreclosure. Numerous proposals are now being considered to address this problem, with the difficulty of finalizing any of them making clear how serious an impediment second liens have proven in the loan-modification and foreclosure-prevention effort. When a second lien substitutes for a downpayment or mortgage insurance, a servicer must deal with two obligations – not just one – and find a way either to subordinate a second lien or write it down before foreclosure on the first lien can be prevented. This is proving extremely difficult because servicers and investors are unclear about the legal risk involved in such actions in light of the difficulty differentiating different types of second liens and the prospects for eventual repayment, and because the interests of the first lien holder and second lien holder are not always consistent. In contrast, insured mortgages have a significant advantage to the consumer in that the economic interests of the insurer are generally aligned with those of the borrower. Also from a consumer perspective, the insured loan provides the borrower with the benefit of mortgage insurance cancellation when the

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[5] SMR Research, *Key Findings for the Fourth Quarter of 2006, The Home Purchase Market Quarterly,* pp.2-3. Available at www.smrresearch.com.

[6] SMR Research, *Foreclosure Forecast 2008*, p.22-24.

borrower achieves a sufficient level of equity, as well as avoiding the complexity of two simultaneous mortgages with two origination fees, two loan payments, two sets of disclosures, and other costs. Finally, it almost always benefits the mortgage insurer to attempt to restructure a loan and avoid foreclosure, and the mortgage insurance industry has a long record of effective loss mitigation that serves the interests of both the borrower and the insurer.

Indeed, even when a borrower has enough equity in the home to refinance both a first and second lien into a new first lien at a more advantageous rate, the existence of the second lien is proving seriously problematic. For example, Fannie Mae has indicated that it will not provide new jumbo loans that refinance a mortgage with a second lien unless the second-lien holder resubordinates its interest to the new first lien, thus, making it very difficult for borrowers to restructure their mortgages and avoid predatory features in their initial piggyback mortgages that now threaten foreclosure.

We would note that barring second liens from serving as downpayments will have no adverse impact on home ownership, including that for first-time homebuyers. Indeed, it will, we believe, significantly increase the prospects for long-term home ownership based on proven ability to repay. There is ample capacity to provide mortgage insurance in lieu of second liens through both providers of private mortgage insurance and the FHA. Recent legislation [Pub. L. No. 110-185] has made both private and FHA mortgage-insurance premiums tax deductible for low- and moderate-income individuals, reducing the already low cost of these premiums which are often far more cost-effective for borrowers when compared to the interest and fee expenses required for a simultaneous second liens. Unlike second liens, federal law requires that mortgage insurance is automatically cancelled when a borrower accumulates sufficient equity. In addition, there is only one loan with mortgage insurance – not two loans with high fees that can benefit the broker or other parties in the origination process at the expense of the borrower.

Further, when private mortgage insurance provides this coverage, a second underwriting is required to review borrower credit risk – a critical additional discipline in the underwriting process that significantly enhances borrower protection. Importantly, the incentives of the mortgage insurer are directly aligned with those of the borrower in avoiding foreclosure – in sharp contrast, of course, to originators and securitizers who may stand at no long-term credit risk when imprudent mortgages that put borrowers at risk are made.

To prevent second liens from exacerbating the risk of foreclosure and creating the impediment to loan modification now all too evident, MICA recommends that the NPR be revised to make simultaneous second liens a prohibited practice for all mortgage loans for a primary residence, with a rebuttable presumption that would permit them when it can be demonstrated that the borrower has ample resources with which to honor both mortgage obligations over at least three years without consideration of any possible house-price appreciation. Although the NPR does not, we believe, appropriately address second liens, it would at least cover subordinate closed-end home-equity loans within its protections. This is an improvement over current standards, but the proposed exception for HELOCs creates a significant loophole. The Board in part justifies exempting HELOCs on the grounds that current inter-agency guidance has mandated borrower protection. However, as noted, MICA believes that the condition of the current market and the sharp increase in foreclosures associated with second liens supports the need for tougher standards in this critical area.

The NPR suggests that HELOCs are not used in conjunction with mortgage originations, but rather used to finance other purchases subsequent to closing a first lien. In fact, HELOCs became a significant component of piggyback lending as short-term interest rates fell. We note that the concern with HELOCs as part of piggyback structures has been highlighted by consumer groups for several years.[7] Accordingly, MICA urges the Board at the very least to include HELOCs in its protections when these lines of credit are originated as a substitute for a down payment in conjunction with a first lien, although as noted we believe it essential for the rule to go further and bar use of any form of second lien as a replacement for a downpayment.

III. The Proposed Restrictions Should Not Apply Only to "Pattern-and-Practice" Violations and Be Tightened to Protect Borrowers

As noted, MICA recommends that all of the NPR's proposed protections apply to all mortgages for a primary residence, not just higher-priced ones for the reasons detailed above. Further, we urge the Board to outlaw abusive practices for all mortgages, not just intercede if a "pattern or practice" of abusive lending is found. In our view, one

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[7] See Comments of the Center for Responsible Lending, Regulation Z, Subpart B: Open-End Credit, Implementation of the Bankruptcy Amendments of 2005, December 16, 2005, Federal Reserve Board Docket No. R-1217, p.10, ff.19 referencing HELOC piggyback consumers unaware of balloon features.

borrower in a predatory loan is one too many and the FRB's rules should not create inadvertent incentives for originators to target borrowers by race, income or other criteria for abusive loans as long as the originators believe they would not make so many such loans as to trigger a "pattern or practice" finding. We support the concept of rebuttable presumptions to specified prohibited practices to allow some flexibility. However, we fear that the rebuttable presumptions proposed in the NPR are so broadly written as to create the potential for significant loopholes and, thus, abusive and predatory lending.

We note specific recommendations for improving "pattern and practice" exceptions and the rebuttable presumptions below. In general, MICA recommends that the final rule clarify that lenders must ensure that use of rebuttable presumptions does not lead to significant exceptions that put borrowers, neighborhoods or financial institutions at risk. Typically, such requirements are imposed through mandatory, detailed documentation of extensive policies and practices, which can often be burdensome and, worse, sometimes establish formal procedures that are then abandoned in practice. To avoid undue burden and ensure ongoing compliance with the intent of the Board's rule, MICA recommends that the final rule require agreement by internal audit personnel that any loan originated with reliance on any of the Board's rebuttable presumptions is in fact in full compliance with these standards. Alternatively, lenders could make use of third-party underwriters who validate these findings – a less costly option for small originators – as long as these third parties are truly independent and receive compensation tied to accurate risk determination, not volume or other inappropriate incentives.

With specific regard to the proposed origination standards, MICA's comments are as follows:

A. Ability to Repay Test

The ability-to-repay test should be clarified as noted to prohibit consideration of house-price appreciation during the first three years after closing. The test should apply to all loans instead of being applied solely through observable patterns and practices, as basing this test only on large numbers of mortgages will leave originators considerable scope to make loans to individual borrowers or even groups of them without regard to long-term ability to repay. This clearly undermines the Board's goals, leading to continued potential mortgage abuse. MICA supports the proposed comment to the rule that would require all originators providing simultaneous second liens independently to verify borrower data to assess ability to repay, although, as noted, we also urge that the NPR be clarified expressly to ban use of second liens as an alternative to a downpayment on a purchased mortgage or refinancing for a principal dwelling.

B. Stated-Income Loans

The proposed prohibition against a pattern or practice of failing to verify information on which the ability-to-repay determination is made should be replaced by an express prohibition on originating loans without verification, providing a rebuttable presumption that permits ongoing reliance on information such as borrower assets (other than home collateral) that the originator can verify without documentation from the borrower. As with setting the ability-to-repay test solely on "pattern and practice" determinations, doing so for documentation would create loopholes through which many loans are again originated with reliance on no or limited documentation. As is all too clear, this has led to significant mortgage fraud that has put borrowers, neighborhoods and the financial system at risk.

MICA also recommends that the NPR be tightened to require that, if any loan is originated without full documentation, the borrower be provided with a disclosure detailing the income and asset assumptions on which the ability-to-repay determination is based, with the borrower required to sign the statement to indicate agreement with these assumptions. This disclosure would not only better inform borrowers, but also ensure that any borrowers considering fraudulent misrepresentation of income or assets are required to make a formal statement that will either deter such fraud or provide clear grounds for subsequent prosecution.

C. Additional Protections

The Board should tighten the proposed debt-to-income (DTI) requirements first to clarify a maximum DTI of 45 percent, which may be exceeded if rebuttable presumptions that show ready access to liquid assets or similar sound underwriting reasons for an exception exist. We further recommend that the standard be revised to require not only a stated DTI ratio, but also clear evidence of at least two months of reserves (i.e., a savings account or similar funds) to ensure that the borrower has ready access to additional funds for unanticipated circumstances. This, like a DTI of 28-33% – was standard mortgage underwriting practice only five years ago and it should be reinstated as part of the Board's overall effort to prevent abusive and predatory lending. We note that the Board argues against a specific DTI in part based on the value of high credit scores and downpayments. However, neither of these now characterizes mortgage lending, with credit scores showing themselves as particularly poor predictors of long-term ability to repay under house-price depreciation conditions.

In addition, cash-out refinances increase borrower combined LTV and thus heighten the risk of default. With a current LTV at or above 90%, most borrowers would realize more cash from a cash-out refi than they would realize from a sale of the property, which makes this a high-risk feature, especially during times of house-price depreciations such as the cycle now gripping the national housing market. As a result, MICA urges the Board to detail in the final rule that cash-out refis are expressly authorized only when the resulting loan-to-value ratio of the new loan is no greater than 80 percent. If the cash-out refi results in a higher-LTV loan without a downpayment or mortgage insurance, then the refinance loan in essence puts the borrower into the same position as a borrower with a simultaneous second lien – exposing him or her to significant risk following any adverse life event and/or during periods of house-price depreciation. Such loans put borrowers at undue risk of losing their homes and do not meet the fundamental test for a mortgage loan outlined at the beginning of this comment letter.

Finally, MICA urges the Board to tighten the proposed requirements associated with escrow accounts. As noted, the NPR is an improvement from current law, but still provides considerable flexibility and would apply only to higher-priced loans. The market and pricing forces detailed above make clear that the higher-priced threshold included in the NPR is a poor and possibly dangerous way to attempt to identify loans at long-term risk of foreclosure. As a result, MICA recommends that the Board use the NPR's rebuttable-presumption approach and require escrows for all loans secured by a primary residence with LTVs above 80% that are not backed by private or federal mortgage insurance. The rebuttable presumption associated with this general requirement would specify that the escrow requirement need not apply if the borrower's DTI ratio is low (i.e., 25%) and accompanied by at least six months of reserves held in liquid form.

MICA also recommends that the Board require that any home mortgage loans without an escrow requirement be accompanied by advance written disclosures which borrowers must sign making clear that the lack of an escrow account may leave the borrower vulnerable to risk from non-payment of taxes and insurance. This disclosure must also provide the borrower with a good-faith estimate of these payments and advise the borrower of the percentage of income these payments would represent in conjunction with a fully-amortized, fully-indexed payment of principal and interest on all mortgage loans (including any second liens in place or associated with the loan at origination). MICA opposes the proposed termination of escrow accounts after twelve months, as this leaves borrowers exposed to payment challenges from life events (e.g., unemployment) that frequently arise well after the end of the first twelve months from loan origination.

IV. Conclusion

MICA would like again to thank the Federal Reserve Board for the extensive research and public outreach that led to the NPR. This hard work is a clear testament to the Board's strong commitment to ensuring that borrowers are protected and financial markets stabilized by urgently-needed improvements to mortgage-lending practices. We also appreciate the Board's commitment to a federal standard defining predatory and abusive loans, although we believe that the proposed limitation of many crucial protections only to "higher-priced" loans seriously undermines this objective. Further, as noted, we do not believe that HOEPA in fact provides the Board with statutory authority to confine protections only to a limited group of mortgages, with the proposed threshold based on certain interest-rate spreads likely to lead to significant pricing arbitrage, use of predatory loan features and other evasions that will expose borrowers of nominally lower-priced loans to serious risk of foreclosure.

MICA also appreciates the Board's effort to define problematic mortgage features. As noted, we believe these should be barred for all mortgages, as well as apply on a per-borrower, not "pattern or practice" basis. However, we believe a critical problem – use of simultaneous second liens instead of downpayments – is omitted. We strongly urge the Board to bar use of all types of second liens (HELOCs as well as closed-end seconds) as an alternative to downpayment or mortgage insurance. As noted above, private and government mortgage insurance can be considerably more cost-effective for borrowers while providing consumer protections and an additional level of prudential underwriting for mortgage holders with capital at risk.

We would be pleased to provide any additional information that would be of assistance to the Board as this rule is finalized. We urge final action on a comprehensive, tough rule as quickly as possible to promote a rapid return to a stable national housing market that ensures long-term homeownership in support of macroeconomic prosperity.

Sincerely,

Suzanne C. Hutchinson