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Via Email and U.S. Mail

April 3, 2008

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

Re: Docket No: R-1305
Reg. Z – 12 CFR Part 226 – Proposed Regulations
Our File No.: 980495

Dear Ms. Johnson and the Honorable Governors of the Federal Reserve System:

Our law firm represents the California Mortgage Association ("CMA") which is comprised of members who fund loans secured by residential and non-residential real property. Many of the loans are "consumer loans". CMA's members fund consumer loans through private investors, pools of private investors and, less frequently, with their own money for later resale to private investors. Many of the investors are retirees or working people attempting to obtain fixed income returns secured by real property in California. CMA members make or arrange loans, or intend to make or arrange loans, which will be covered by the proposed changes to Reg. Z (Docket No: R-1305). Literally all of CMA's members are subject to extensive state licensing and regulatory systems under the California Department of Real Estate ("DRE") or under the California Department of Corporations ("DOC"), or both. Some CMA members originate loans under a real estate broker's license and some under a California Finance Lender's (CFL) license subject to DOC regulation.

In making or arranging consumer loans held by multiple private investors/lenders, CMA's members rarely make nontraditional mortgage loans or those with the characteristics of those set forth in the various Guidances (defined in fn. 1) except for fixed rate, fixed payment, partially amortized loans.[1] CMA members generally service the loans they make or arrange for the life of the loan.

CMA has extensively reviewed the proposed changes to Reg. Z (Docket No: R-1305) and has the following comments based upon input from CMA's Legislative Chair, George Eckert, Esq, CMA's Legislative Committee and the undersigned, corporate counsel.

Comment on the Overall Proposed Regulation Changes.

While there are a number of good ideas in the proposed revisions to Regulation Z (truth in advertising, disclosure of a broker's entire compensation regardless of the source [***as a concept but not as proposed***], early warnings of interest rate changes, and banning coercion of appraisers to name a few), a number of sections, if adopted, will make it more difficult, if not impossible, for CMA members and for similar private lenders to continue to serve the needs of California's underserved borrowers, reducing the options such borrowers have in the market to satisfy their financing needs. While many of the proposals are directed to abuses by large, mostly institutional subprime lenders (many of whom are already out of business), few of the abuses relate to consumer loans made or arranged by CMA members and funded primarily by private lenders. CMA members, while making or arranging consumer loans secured by real property (many of the *borrowers* of which could be described as subprime *borrowers*), did not generally make loans characterized in the Guidances as nontraditional mortgages or as ARMs with the potential for payment shock.

CMA members have historically made or arranged private money, fixed rate, fixed payment loans that are either interest only or partially amortized loans (with balloon payments) or, less often, fully amortized. CMA member private money loans almost never contained introductory teaser rates, buy-downs, variable interest rates, variable payments, negative amortization and other features that would result in payment shock or with loan-to-value

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[1] "Guidance" refers to: (1) The Interagency Guidance on Nontraditional Mortgage Product Risks issued in September 2006 by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and the National Credit Union Administration; (2) The Statement on Subprime Mortgage Lending issued in June 2007 by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and the National Credit Union Administration; (3) The guidance on nontraditional mortgage product risks issued in November 2006 by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators; and, (4) The Statement on Subprime Mortgage Lending issued in July 2007 by the Conference of State Bank Supervisors, the American Association of Residential Mortgage Regulators, and the National Association of Consumer Credit Administrators. Guide (3) and (4) above apply to California licensed mortgage brokers, Consumer Finance Lenders and Residential Mortgage Lenders. (SB 385 -- 2007 stats. Ch. 301)

ratios in excess of 80%. While underwriting standards vary between brokers or lenders, many CMA members follow underwriting strictures that give substantial weight to the equity of the security, the ultimate loan-to-value ratio (generally 80% or less) and the borrower's ability to repay (although, ultimately, repayment may be from sale or refinance of the security as opposed to from income or other assets).

The types of loans made or arranged by CMA members do *not* have a default history typical of non-traditional mortgages described in the Guidances because they are generally limited to an 80% loan-to-value ratio secured by owner-occupied, single family residences and 75% loan-to-value ratio secured by non-owner-occupied, single family residences.[2] The nontraditional loans covered by the Guidances (not normally made by CMA members) frequently have very high loan-to-value ratios making the ability to pay from sources other than the collateral paramount.

CMA is concerned that certain sections of the proposed regulations to cure the disease, will kill the patient. That is, the proposed regulations may exacerbate the current real estate credit crisis and turn the equity of the most needy homeowners into an illiquid, inaccessible asset resulting in *increased* forced sales, foreclosures, and bankruptcies, not fewer. A number of the proposed Reg Z changes will effectively put out of business many CMA members who make or arrange consumer loans secured by real property, eliminating an important source of consumer financing in an already shrinking consumer credit marketplace. This unintended result will particularly hit hard underserved members of the community who will not be able to buy real property or access the equity in their property.

Higher Priced Mortgages (Secured by Consumer's Principal Dwelling) § 226.35

Definition of Higher Priced Mortgages. § 226.35(a).

The APR threshold for higher-priced mortgage loans is set far too low at 3% above comparable treasury security yields for 1st mortgages and 5% for subordinate liens. At that level, the new rules would cover far more than just subprime loans, including many A-Paper jumbo loans, and Alt-A loans, based on current market pricing for these products. With the relatively high price of homes in many California markets, our state could be disproportionately affected by the new provisions that would apply to higher-priced mortgages. In many California communities, even the new conforming loan rates will be exceeded by consumers purchasing or refinancing their personal residences, putting them in a higher rate and costs category.

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[2] Cal. Business & Professions Code § 10238(h)(1).

CMA recommends a more appropriate threshold to be 5% for 1st mortgages and perhaps 7 or 8% for junior liens. These higher thresholds would still include virtually all subprime loan products while excluding those offered to A-paper and Alt-A borrowers. Alternatively, many private money lenders and brokers will be driven out of business as it will be difficult, if not impossible, for them to comply with the provisions of § 226.35(b).

Also, consideration should be given to limiting application of these new rules to nontraditional mortgages as described in the Guidances that do not have a loan-to-value ratio of 80% or less.

Prepayment Penalty Limitations. § 226.35(b)(3).

CMA is not against reasonable limitations on prepayment penalties. Consumer loans secured by 1-4 unit residential real property in California are already subject to regulation that has proven to work for CMA members as well as for consumer borrowers.[3] However, the limitations in proposed § 266.35(b) on prepayment penalties and stated income loans for higher-priced mortgages could limit the availability of mortgage capital for California's Alt-A and Jumbo borrowers as well as borrowers wishing to access their equity for an array of important reasons.

Prohibiting prepayment penalties on higher-priced mortgages for borrowers whose debt ratios exceed 50% will negatively impact the availability of credit for such borrowers. Tight rate and fee limitations imposed by existing state and federal laws have significantly reduced the incentive for lenders to offer loans to higher risk borrowers. Many CMA members have already stopped making consumer loans because they can't achieve high enough yields to justify the risk. Removing the potential for a prepayment bonus could be the last nail in the coffin for mortgage loans to higher risk consumers.

Ability to Pay and Verification Requirements (No Stated Income or Low Document Loans) § 226.35(b).

With respect to the new higher cost mortgage restrictions, prohibiting brokers and private lenders from engaging "in a pattern or practice of extending credit . . . to consumers based on the value of consumers' collateral without regard to consumers' repayment ability as of consummation, including consumers' current and reasonably expected income, current and reasonably expected obligations, employment, and assets ***other than the collateral***", ignores the market realities and will turn consumers' equity, in many cases, into an illiquid, inaccessible asset that will be difficult to access even for the most serious needs. (§

[3] Cal. Business & Professions Code § 10242.6 [for broker made or arranged loans] and Cal. Civil Code § 2954.9 [for all others not subject to federal preemption or preemption by specific statutes relating to other types of lenders.)

226.35(b) and see § 226.34(a)(4).) While this may be appropriate for many of the types of nontraditional loans referenced in the Guidances, these standards should not be used for higher-priced mortgage loans with loan-to-value ratios of 80% or less as the risk is too great that otherwise qualified borrowers will be prevented from accessing their home equity.

Many of CMA's members make or arrange loans to people with hard to verify income or with income that is temporarily impaired but who are willing to put their home equity on the line for a chance to stay in their homes, to obtain necessary medical care, for college education or for many other legitimate and/or necessary purposes. Many times, for example, borrowers who may be in foreclosure because of job loss or unexpected medical expenses may need to access their equity to cure an existing foreclosure to give them time to recover, or to sell their property to salvage the remaining equity. Otherwise, the borrower's equity is lost. That does not mean the private lenders ignore the borrower's ability to repay. It just means that they are willing to consider non-traditional and unverifiable sources of income along with the equity in the property. As noted above, most loans made or arranged by CMA members are subject to state imposed loan-to-value ratios (not to exceed 80%) which prevent many of the abuses noted in the proposed regulations (i.e., dealing with loan-to-value ratios up to or exceeding 100%).

Many of the provisions of § 226.35 will disproportionately impact some of California's minority, elderly and immigrant communities where pooling of family resources to achieve and maintain home ownership is more common as compared to prime lending or Alt-A borrowers. It will also make it impossible for the elderly on fixed incomes and for borrowers whose income has been interrupted by illness, injury, or unemployment, to borrow on their equity to help them attempt to save their homes, pay their bills and otherwise bridge the gap until their income returns or, in the alternative, until they can sell their homes in a non-panic situation. The institutional lenders and large subprime lenders (many are not even in business today) will not help these borrowers. Because of the lack of institutional funding for this class of subprime borrower, many borrowers will look to private lenders who have traditionally been able to provide loans with less restrictive income and debt to income ratios (but lower loan-to-value ratios). CMA members will leave the market under the proposed regulations, leaving these borrowers underserved.

A perfect example of the adverse impact of similar regulation is California's high cost mortgage law that became effective in 2002. (Financial Code §§ 4970 et seq.) California's high cost mortgage law contains provisions similar (although not identical) to those provided for HOEPA, section 32 loans similar, as to the ability to pay provisions, to proposed regulation § 226.35. Shortly after the passage of California's high cost mortgage statute, most licensed brokers (for private lenders) and California Finance Lenders stopped making loans covered by the new law (i.e., "covered loans"). Similarly, because of the regulatory burdens and the increased risk of litigation, few of these brokers and private lenders offered Section 32 loans (§ 226.32). As a result, consumers in need of accessing their equity (even where the total loan-to-value ratios would be reasonable) were no longer able to get loans secured by their personal residences. In many instances, these borrowers had older, fixed rate, fixed payment loans secured by first deeds of trust. However, because small loans (less than $250,000, at first, and later less than $417,500) might be covered loans under California law, private lenders withdrew from that market.[4] Therefore, consumers not being able to borrower smaller amounts of their equity (e.g., $50,000 - $250,000) from a private lender were compelled to completely refinance their older, senior loans with favorable terms to obtain the cash they needed. Frequently, these refinances were with the very nontraditional mortgage or subprime mortgage products that have caused the current lending and foreclosure crisis. The law of unintended consequences exacerbated the crisis we face today. To extend such regulation to a much larger class of borrowers (i.e., borrowers of the proposed "higher cost mortgages") will have the same impact, freezing equity so that borrowers cannot access their equity (regardless of their loan-to-value ratio) and further reducing the availability of consumer credit in an already very tight credit market.

Subprime borrowers needing money for emergencies and necessities (e.g., to delay or stop a foreclosure until the home can be sold, a medical emergency, to remodel, for college expenses, etc.), will not be able to find loans because brokers and private lenders will be sued in almost every instance where the secured property goes into foreclosure (i.e., plaintiff's second guessing the underwriting decision). In addition, because such borrowers will tend to favor brokers funding with private lenders, it will be too easy to allege that brokers and private lenders have an alleged pattern and practice of extending credit without considering ability to repay. Unless the brokers and lenders (at least for loans with loan-to-value ratios under 80%), can consider sale or refinancing of the borrower's security, in addition to other factors evidencing ability to pay, private lenders will exit the market leaving borrowers in need of access to their equity with no one to turn to. Without access to their equity from legitimate, licensed or regulated, lenders or brokers, these borrowers will have two choices: (1) stop paying their existing lien, resulting in their substantial equity being foreclosed; or (2) deal with equity purchasers or loan sharks making loans with no regulation or totally disregarding any existing regulation.

Ability to Pay Safe Harbor Should Be Reduced to 5-Years. § 226.34(a)(4)(ii).

While CMA believes there should be loan-to-value exclusions from the provisions of §§ 226.34(a)(4) and 226.35(b), the safe harbor provision of § 226.34(a)(4)(ii) should be reduced

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[4] This author's informal survey of CMA members, while not scientific, found only one member willing to extend loans subject to California's high cost mortgage statute or subject to section 32.

to not to exceed 5 years (as opposed to 7 years). Historically, on the average, loans are refinanced every in less than 7 years.

Escrow (Impound) Accounts. § 226.35(b)(4).

Unless CMA's other suggestions are adopted (e.g., loan-to-value limitation etc.), the burden of creating and managing impound escrow accounts on "higher cost mortgages" will be costly and drive up the cost of consumer credit. Loans secured by the consumer's principal dwelling with loan-to-value ratios of 80% or less should be excluded from the impound or escrow account requirements, particularly with respect to fixed rate, fixed payment loans with balloon payments that do not become due in less than 5-years. Where there would be no impound requirement, CMA supports a clear disclosure to the borrower that the proposed loan payments do not include the payment of property taxes and insurance premiums and that the borrower will have to pay these property taxes and insurance premiums separately from the borrower's monthly loan payments.

Loan-to-Value Alternative.

As an alternative, CMA proposes loan-to-value limitations as a threshold issue as to whether the broker or lender is subject to the new restrictions relating to "higher cost mortgages." In general, this would protect consumers from high loan-to-value ratio loans with nontraditional loan features likely to result in payment shock. On the other hand, it would not prevent borrowers with substantial equity from accessing their equity. An 80% LTV (loan-to-value ratio), or less, should provide a sufficient equity cushion for all but the worst economic downturn. Stated income loans, by themselves, did not create the foreclosure crisis currently gripping our country. The combination of stated income, 100% financing and borrowers with less-than–perfect credit created the perfect storm in which we currently find ourselves. CMA members never made these kinds of loans because they sell their loans to their friends and neighbors rather than to Wall Street hedge funds, and because most of CMA members service the loans they make or arrange for the life of the loan. This forces most CMA members to use common sense when underwriting consumer loans rather than turning a blind eye to, or encouraging, bald-faced lies and the cyclical nature of the real estate market like many of the big subprime lenders who are no longer in business. Banning an entire industry from a pattern or practice of making loans to people who cannot prove their income or ability to pay separate from the collateral might cure the disease but also wind up killing the patient.

Prohibited Acts and Practices under § 226.36

Section 226.36(a), requiring that the broker enter into an agreement with the consumer before the consumer pays a fee to any person in connection with the mortgage transaction or before he/she submits a written application to the broker, whichever is earlier, is unworkable and will create an unfair competitive advantage for direct lenders over mortgage brokers. Borrowers will be reluctant to sign any contract with a broker before they have even made formal application for a loan. Only after another broker, or two or three, informs the borrower of the same requirement will the borrower realize that the first broker was only following the law. By that time, the first broker will have lost the deal. The second or third broker, or a finance company that is under no such requirement, will get the business. The unsophisticated borrower who does sign such an agreement will believe he is committed to the broker whose agreement he has signed and possibly miss the opportunity to shop around for a better price, the exact opposite of the result the Board is trying to achieve. Further, forcing brokers to price their services before they know the scope of the assignment is akin to forcing a life insurance company to set the insured's premium before knowing his/her age and health history.

Again, this proposal is likely to become subject to the law of unintended consequences. In California, brokers representing a borrower are fiduciaries to the borrower.[5] Direct lenders are not considered fiduciaries to the borrower in California.[6] The features of the proposed Reg Z changes discussed herein are likely to stimulate the trend of licensed brokers to migrate to licenses as direct lenders, raising funds through small mortgage pools. Another unintended consequence will be that brokers may tend to overprice their services just to be safe, or will be more likely to refuse to work with borrowers who present greater difficulty before obtaining the requested loan or any loan.

CMA believes providing a three-day window ***after receipt of an application***, but before accepting any fees other than for a credit report, or allowing for renegotiation of the broker's fee under certain circumstances would produce a better result for borrowers, while still allowing brokers to compete with direct lenders on a level playing field.

Servicing Practices § 226.36(d).

Late Charge and Anti-Pyramiding Provisions. § 226.36(d)(ii)

CMA supports most of the proposed regulations relating to "servicing practices". Many years ago, the California legislature adopted late charge provisions similar to those proposed in § 226.36(d)(ii) prohibiting the pyramiding of late charges for loans whether made or arranged by brokers or by other lenders.[7]

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[5] *Wyatt v. Union Mortgage Company* (1979) 24 Cal.3d 773.

[6] *Nymark v. Heart Federal Savings & Loan Association* (1991) 231 Cal. App. 3d 1089.

[7] Cal. Business & Professions Code § 10242.5 [for broker made or arranged loans] and Cal. Civil Code § 2954.4 [for loans not subject to federal preemption or preemption by specific statutes relating to other types of lenders.)

Providing a List of Servicing Charges upon Request of Borrower or Borrower's Representative. § 226.36(d)(ii)

CMA opposes § 226.36(d)(ii) which mandates that the servicer, upon request of the borrower or the borrowers representative, provide "a schedule of all specific fees and charges that the servicer may impose on the consumer in connection with servicing the consumer's account, including a dollar amount and an explanation of each such fee and the circumstances under which it is imposed". Many CMA members service the loans they make and arrange from origination to payoff. Without narrowing the definition of this proposed section, this requirement would create an unreasonable (and undefined) burden upon servicers both in terms of costs and in terms of performance. While it is possible to disclose such charges if purely limited to servicing activities (e.g., collecting payments, remitting payments to lenders and providing entitled persons to payoff demands or beneficiary statements)[8], this requirement becomes literally impossible to comply with if third party charges that may be incurred in enforcing the mortgage or lender charges expressly set forth in the note or deed of trust are included. In particular, charges relating to foreclosure or other legal actions would be almost impossible to disclose prior to the event causing these third party charges to be incurred. For example, California foreclosures may be accomplished either through a statutorily regulated nonjudicial process or, at the lender's option, through a judicial foreclosure.[9] Although foreclosure fees and costs under either process are regulated by statute,[10] a servicer would not know the amount or even the rate of many of the fees and costs until the third party is retained. Nonjudicial foreclosures, which constitute over 99% of the foreclosures in California, are conducted by trustees whose fees are capped by statute. But, the actual fees could be less than the statutory caps. Fees such as the cost of publication of the notice of trustee's sale will vary substantially depending upon the number of words contained in the publication (e.g., some containing long legal descriptions). The cost of trustee's sale guaranties or litigation guarantees used in foreclosures will vary depending upon the size of the loan and, in some instances, depending upon the rates of the title company[11] selected to provide these products. Similarly, the attorney's fees and costs in a judicial foreclosure would not be known until the court rules on the issue of fees and costs.[12] Even determining an hourly rate for services provided by attorneys can be difficult, as such rates vary widely in California between rural and small towns to large urban areas. This

[8] See, Cal. Civil Code § 2943.

[9] Cal. Civil Code §§ 2924 et seq; and Cal. Code of Civil Procedure §§ 725a et seq.

[10] Cal. Civ. Code §§ 2924c(c)&(d), Code Civ. Proc. §§ 580c and 726(a).

[11] Rates for title insurance products are subject to regulation by the California Department of Insurance.

[12] Cal. Code of Civil Procedure § 580c.

same problem would occur any time an attorney is used for a judicial foreclosure, for obtaining relief from a bankruptcy stay or for opposing borrowers' challenges such as applications for temporary restraining orders and preliminary injunctions.

Payoff demands. § 226.36(d)(iv).

Currently, in California, a lender or servicer may charge $30.00 for a payoff demand and is subject to penalties for failing to provide the borrower or its authorized representative with such statement as required by law.[13] Clarification of § 226.36(d)(iv) is required to make it clear that a reasonable fee may be charged not to exceed the amount permitted by state law or under the terms of the mortgage, whichever is less. CMA is sure that the Board understands the cyclical nature of the real estate and mortgage markets. As soon as the current downturn rectifies itself, as it will, one could expect another refinancing or purchasing boom. If there is no cost associated with request for payoff demands, borrowers, rather than shopping for the best loan, will apply with multiple originators and request numerous payoff demands in a short period of time. Servicers, like CMA members, get almost all of their compensation from their private lenders (not from the borrower) with the exception of reasonable payoff demand fees. Removing payoff demand fees, or failing to clarify what may be charged, will raise the cost of consumer credit.

The proposed commentary suggests that a "reasonable" time to provide a payoff demand is "three business days".[14] CMA believes that under normal market conditions this time period is extremely short. California now provides for a 21-day period.[15] CMA recommends the shortest period be 7 business days under normal market conditions and 14 business days where the servicer is experiencing an unusually high volume of refinancings. An exception for 3-business days could be carved out for the situation where the servicer is advised in writing that the property is subject to a documented foreclosure sale in less than 14 business days.

Conclusion.

As stated above, CMA believes that the Board's proposed revisions to Reg. Z have both good points and bad points. However, the elements discussed above have the potential to drive one of the last remaining sources of real estate capital for higher risk consumers out of the market for good. The mortgage credit crunch has hit California especially hard, and has the real potential to further prolong the current housing slowdown. As noted above, CMA

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[13] Cal. Civil Code § 2943.

[14] 73 FR 1703.

[15] Cal. Civil Code § 2943(c).

believes that revised proposed regulations limiting the application of some of the new proposals to loans with high loan-to-value ratios (over 80%) and/or with nontraditional loan mortgage features as defined in the Guidance is a better approach and will prevent consumers' equity from becoming an illiquid and non-useable asset.

Respectfully submitted,

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