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April 8, 2008

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

Re: Docket No. R-1305

Dear Ms. Johnson:

Thank you for the opportunity to comment on the Federal Reserve Board of Governor's proposed amendments to Regulation Z, which implements the Truth in Lending Act (TILA) and the Home Ownership and Equity Protection Act (HOEPA) regulations.

For years, New York City neighborhoods, particularly low- and moderate- income communities of color, have been destabilized by abusive subprime lending, which has stripped equity and led to high rates of foreclosures. As it has throughout the country, abusive, unaffordable lending has reached epic proportions in New York City, where foreclosure filings last year more than doubled since 2005, to nearly 14,000. Experience has clearly shown that the subprime industry needs significantly more oversight and regulation. If the Board had acted decisively years ago to regulate the subprime industry, the foreclosure crisis facing this nation could have been avoided.

While we commend the Board for now taking significant steps to regulate subprime abuses by strengthening HOEPA, we believe that more forceful action is needed to prevent millions more from losing their homes in the future. Accordingly, we urge the Board to broaden the scope of its proposed regulation.

The Neighborhood Economic Development Advocacy Project (NEDAP) is a resource and advocacy center that provides legal, technical, and information support to community groups and individuals in low and moderate income neighborhoods and communities of color in New York City and State. Founded in 1995, NEDAP's mission is to promote community economic justice, and to eliminate discriminatory economic practices that harm communities and perpetuate inequality and poverty. Through community education, legal and public policy advocacy, corporate accountability, and research and documentation, NEDAP works with grassroots organizations to ensure that communities have access to fair and affordable credit and financial services, necessary for equitable community development and financial security.

For the past decade, NEDAP has been at the forefront of anti-predatory lending and foreclosure prevention efforts in New York City and State. NEDAP founded and chairs New Yorkers for Responsible Lending, a coalition of 139 community financial institutions, community-based organizations, affordable housing and first time homebuyer groups, advocates for seniors, legal services organizations, community reinvestment, fair lending, and consumer advocacy groups in New York State who are committed to fighting predatory practices in the financial services industry. NEDAP also convenes the New York City Anti-Predatory Lending Task Force. NEDAP's founder and co-director, Sarah Ludwig, serves on the Federal Reserve Board's Consumer Advisory Council.

The Foreclosure Prevention Project at South Brooklyn Legal Services (SBLS) is an integrated education, outreach, and legal service delivery program for homeowners facing foreclosure, with a specific focus on abusive lending practices by subprime mortgage companies. The Project is a leader in New York City and State in fighting predatory lending practices. Since its inception in 1998, SBLS has provided counsel and advice, referral services, or legal representation to more than 3,000 homeowners in all five boroughs of New York City. As a result, SBLS has detailed knowledge of the array of abusive practices used by predatory lenders, and their devastating effect on low- and moderate income communities of color.

We call on the Board to consider the following specific changes to its proposed regulations.

Ability to Pay Standard

The single most pervasive abusive practice in the subprime market is the making of unaffordable loans, based on the equity in the property rather than the borrower's ability to pay. For years, this practice has been the central underpinning of predatory lending. Advocates throughout New York City and State have represented and counseled countless borrowers who were induced by unscrupulous lenders and brokers into unaffordable loans that they had no chance of paying. The Board itself recognizes that "there does not appear to be any benefit to consumers from loans that are clearly unaffordable at origination." Any effective regulation must contain strong prohibitions against collateral-based lending.

While we commend the Board for expanding protections against collateral-based lending to a wider pool of loans, the Board undermines the effectiveness of the proposed regulations in several critical ways.

The Board Must Remove the "Pattern and Practice" Element from the Prohibition Against Making Higher-Priced Mortgage Loans Without Regard to Borrowers' Ability to Repay.

The Board's continued inclusion of the "pattern and practice" element in the regulations severely weakens the protections against collateral-based lending. The Board specifically states that it "is not proposing to prohibit making an individual loan without regard to repayment ability", but rather will only prohibit lenders from engaging in a pattern and practice of such lending.

The "pattern and practice" requirement greatly reduces the deterrent effect on lenders, since the Board is essentially saying that it is acceptable to make an individual loan without regard to repayment ability, as long as the lender does not get caught in a pattern and practice. Unfortunately, as the Board well knows, a "pattern and practice" is extremely difficult for an individual borrower to establish. This considerable loophole in the regulation will result in many homeowners losing their homes in foreclosure because they were unable to rely on the protection of the rule to defend themselves. A recent case brought by SBLS in federal court on behalf of Ms. O provides an illustrative example:

> Ms. O is an elderly, African-American, disabled widow who has owned her own home in Brooklyn for 25 years. In mid-2005, Ameriquest induced her through misrepresentation into a completely unaffordable mortgage with monthly payments of three times her fixed income. Ameriquest falsified financial documents to make it appear that she could afford the loan, including fake tax returns, a fake employment letter, a fake 401(k), and fake bank statements. To establish its claim under HOEPA, SBLS had to prove that Ameriquest engaged in a pattern and practice of making unaffordable loans, and thus requested loan files for a subset of Ameriquest borrowers in New York.
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> After Ameriquest refused to turn over the documents, a lengthy discovery battle ensued in court, after which Ameriquest was ordered to turn over approximately 50,000 pages of documents. This proved to be a tremendous drain on SBLS' limited resources, and prevented SBLS from representing other homeowners in need. The case was eventually settled. Even though Ameriquest had so clearly violated the law, the "pattern and practice" requirement made it nearly impossible for Ms. O to prove her case.

The Board states in its commentary to the proposed rules that "the 'pattern and practice' element is intended to balance potential costs and benefits of the rule." It is puzzling why the Board is so concerned with "balancing" on such a critical rule. It is in no one's interest to make unaffordable loans, and lenders should not be permitted to make them. The Board professes concern that "creating civil liability for an originator that fails to assess repayment ability on any individual loan" could cause a reduction in the availability of credit. For advocates who have pressed for stricter lending rules for years, however, the threat of dried up credit is a familiar refrain, used by the industry to ward off effective regulation.

Given the rampant abuses by lenders that failed to assess repayment ability on individual loans, and given the dire consequences that this failure has caused for millions of borrowers and for the American economy, it defies logic why the Board is concerned about creating civil liability for a lender that violates the law. Without such civil liability on individual loans, there is little to deter lenders from continuing with such practices.

The Fully Indexed Rate Must be Defined so that Affordability is Assessed for Subsequent Re-sets, and not Just the Initial Re-Set

Most of the ARMs that New York groups have seen re-set multiple times, at considerably higher payment amounts. This leads to high rates of foreclosure, when borrowers who were barely able to afford the initial payment face increasing monthly payments. Assessing affordability based solely on the initial re-set fails to protect consumers from subsequent rises in the underlying index (usually, the LIBOR), which inevitably happens.

To ensure sound underwriting and prevent foreclosures, the Board should require lenders to underwrite loans based on the highest monthly payment that the borrower could pay under the terms of the loan. Notwithstanding industry expectation that borrowers will refinance when rates reset, it would be harmful for the Board to base public policy regarding mortgage affordability and sustainability on the possibility of future refinancing by borrowers. We urge the Board to define "fully indexed rate" as the highest interest rate that could apply under the terms of the loan documents. Another approach would be for the Board to require lenders to underwrite ARMs at the first reset rate plus additional basis points, which will provide a cushion against subsequent resets.

Lenders Should be Required to Verify Income Information on all Mortgages, and Should Not be Given a Safe Harbor from Verification

While the Board's proposed regulations regarding income verification are a step in the right direction, the Board undermines its proposal by creating a safe harbor for creditors who fail to verify income and assets, when they can show that the borrower's actual income is not materially less than the stated income on the loan. In the communities that we serve, "stated income" loans are continually used in an abusive fashion, and we are particularly concerned that the safe harbor will allow stated income lending to continue unimpeded to the detriment of consumers. The Board should enact a clear, unambiguous rule requiring verification of income and assets, in order to deter fraud and abuse, and remove incentives for lenders to blur the lines and hope they can get away with it.

Lenders Should be Required to use the "Best and Most Appropriate" Form of Income Verification Available

We commend the Board for recommending rigorous income verification requirements, but urge the Board to require that lenders use the "best and most appropriate" form of income verification available. The proposed regulations contain a possible loophole for unscrupulous lenders by allowing them to use "any other third party documents that provide reasonably reliable evidence of the borrower's income and assets." The Board's examples of acceptable documents include a written statement from the borrower's employer.

We have seen numerous examples of lenders and brokers falsifying income documentation by providing, for example, false employer letters. Requiring lenders and brokers to use more reliable income verification, such as W-2s and paystubs, *if such information is available,* would reduce the ability of unscrupulous actors to falsify income information to qualify borrowers for unaffordable loans. Given the rampant abuse by lenders and brokers that falsify income to close on loans, there is no reason why the best and most appropriate form of income verification should not be required for underwriting purposes, across the board.

A requirement that lenders and brokers use the best and most appropriate documentation available will not preclude lenders from relying on non-conventional income documentation, such as a merchant's inventory or other income and expense verification, for loan applicants for whom conventional documentation is unavailable.

The Board Should Ban Prepayment Penalties for Higher-Priced Mortgages

The Board should adopt a rule that unequivocally bans prepayment penalties. Prepayment penalties harm borrowers, trapping them into unaffordable loans by making the cost of refinance prohibitive, and stripping equity when borrowers do refinance. This is particularly problematic, as our groups have often found, where borrowers are induced into unaffordable financing with promises that they will be able to refinance in a short period of time if they make their payments, or where exploding adjustable rates will force borrowers either to refinance or lose their home. By locking borrowers into unaffordable loans, prepayment penalties greatly increase the risk of foreclosure.

Prepayment penalties are imposed disproportionately on subprime borrowers: whereas upwards of 80% of subprime loans have prepayment penalties, only 2% of prime loans have them. There is ample evidence that brokers and lenders steer subprime borrowers into higher cost loans than they should otherwise have qualified for, even where a prepayment penalty is attached. In fact, in numerous cases, brokers received yield spread premiums, and borrowers thus received a higher interest rate, despite the fact that the loan contained a prepayment penalty. The case of SBLS' client Mr. J, an 82 year-old retired municipal worker from Brooklyn on a fixed income, provides an example:

> Mr. J, who had excellent credit, agreed to refinance his home of 25 years when a mortgage broker offered him a loan fixed at 1% for 5 years, telling him he could refinance in five years when the teaser period ended. It was only after the loan closed and he received his first statement from Countrywide, that Mr. J learned that he had been duped into a Payment Option ARM loan, due to reset to a floating rate after only a month. The lender paid the broker a yield spread premium of $11,747. The loan contains a 3-year prepayment penalty of six months interest, or more than $12,500.

The vast majority of abusive, unaffordable subprime loans contain prepayment penalties. There is little evidence that prepayment penalties drive down the cost of credit for subprime borrowers, as the industry asserts.

An outright ban on prepayment penalties must apply for higher-priced loans to restore equity to the market. Many subprime borrowers with debt-to-income ratios below 50% are stuck in loans that are unaffordable or barely affordable due to exorbitant prepayment penalties. Furthermore, the Board's proposed restriction on prepayment penalties after 5 years does very little to address the problem, as the majority of borrowers stuck in unaffordable loans need to refinance far in advance of 5 years.

At the very least, if the Board does not ban prepayment penalties, it should prohibit them after the first year. Our state's ban on prepayment penalties after the first year has proven a vital consumer protection, with no adverse impact on the industry. Finally, if prepayment penalties are not banned, the Board must give borrowers a meaningful opportunity to refinance prior to a rate re-set, without incurring a prepayment penalty. The 60-day cushion proposed by the Board does not give a borrower adequate time to explore and close on alternative financing, particularly in the current credit markets; a period of up to six months would be more appropriate.

The Board Should Impose an Outright Ban on Yield Spread Premiums for Higher-Priced Loans

While the Board's proposal governing yield spread premiums is a step in the right direction, particularly for the prime market, the proposal does not go nearly far enough for the subprime market. We urge the Board to ban yield spread premiums for higher-priced loans.

Like prepayment penalties, yield spread premiums have been widely used in the subprime market to gouge consumers. For years, brokers in New York City have induced borrowers of subprime loans into higher cost loans than they otherwise should have qualified for, and have garnered exorbitant fees from lenders in return. Because there is little accountability as to where unscrupulous lenders allegedly set their par rates for a given borrower, the yield spread premium in the subprime market typically amounts to little more than a kickback from a lender to a broker for steering the borrower into a more expensive loan than the market would otherwise have provided. As a result, yield spread premiums have provided an incentive for brokers to market higher cost products to borrowers.

Very often, we have seen borrowers gouged twice, where yield spread premiums are paid out in conjunction with thousands of dollars in financed brokers' fees. People of color in New York City have been disproportionately targeted with loans that contain such exorbitant fees. As the case of Mr. J above illustrates, yield spread premiums fail to facilitate more equitable financing for borrowers, or fair fees for brokers.

The case of Mr. F, a SBLS client and 86-year old Brooklyn homeowner with dementia, provides another particularly egregious example:

> Despite his obvious mental disability, a broker induced Mr. F from a low-interest, fixed rate loan into a completely unaffordable, stated income, Payment Option ARM with Indymac. The broker received a yield spread premium payment from Indymac of $14,463. In addition, the broker received a financed brokers' fee of $6,875, for a total combined broker compensation of $21,338. Mr. F is now facing foreclosure.

Mere disclosure to borrowers has not provided any transparency and has proven wholly ineffective in curbing yield spread premium abuses in the subprime market. While we have counseled and represented hundreds of borrowers with yield spread premiums, *we have yet to* *identify a single homeowner who understood what a yield spread premium entailed—or even knew that they had one on their loan.* Many, if not the majority, of these borrowers also paid a financed broker fee in their transaction.

Since borrowers rarely, if ever, understand or detect them, yield spread premiums are a favored tool of unscrupulous brokers who take advantage of less sophisticated borrowers. The Board's proposal to require brokers to state their total fees up front so a borrower can comparison shop assumes a fair marketplace in which borrowers are informed, brokers fully disclose pertinent information, and transactions are negotiated at arm's length. Unfortunately, this imaginary subprime marketplace could not be further from reality. If the Board were to go further and create a fiduciary duty from brokers to borrowers, so that brokers are required by law to act in the borrower's best interest, it might obviate the need to ban yield spread premiums for higher-priced loans. In lieu of a fiduciary duty, however, yield spread premiums should be banned because they add no value to the market, and because they are widely used to deceive and gouge borrowers.

<u>Coverage</u>

We applaud the Board for its proposal to expand consumer protections by creating a new protected category of "higher-priced" mortgages, with rate triggers at 3 % over comparable Treasury securities for first liens, and 5% over Treasury securities for second liens. While this threshold will help to capture a wider number of potentially abusive loans, it does not go far enough to effectively regulate the abuses in the subprime marketplace.

Non-Traditional Loans Should be Included in the Definition of "Higher-Priced" Mortgages

Advocates around New York City have found that many of the worst abuses in the subprime market have occurred with "non-traditional" mortgages, such as Payment Option ARMs and Interest Only mortgages. Some abusive lenders underwrite payment option ARMs in an inappropriate fashion, particularly to elderly and other borrowers who can ill afford the full monthly payments, and who do not understand the complicated terms. These borrowers have often reported that they were led to believe that the initial minimum payment option represented the cost of the monthly payment over the term of the loan, only to find out later after payment shock hit that they could not afford their loan. Ms. D, an SBLS client and home heath aide from the Bronx, provides an example:

> When Ms. D needed additional money for her husband's health care costs in 2006, she refinanced her loan with a Payment Option ARM from Countrywide. Not understanding that the payments of $1,100 represented the monthly minimum, and that her payments would go up drastically, Ms. D thought she could afford the monthly payments on the refinance loan with the approximately $3,300 she received from Social Security, employment, and rental income. It was not until she showed her complicated statement to a social worker at her senior citizen center that she discovered that her monthly payments would soon be completely unaffordable. Ms. D is now at risk of losing the home that she has owned for 37 years.

The thresholds in the proposed Board regulations would leave out many non-traditional mortgages, creating a partial void of regulation over a set of loan products that contains some of the most abusive loans. In fact, the specific exclusion of many non-traditional loans from the regulation could encourage their increased use. It is critical that the Board expand the definition of higher-priced mortgages to include the definition of non-traditional mortgages, as defined in the Interagency Guidance on Nontraditional Mortgage Product Risks.

The Ability to Pay Standard Should Apply to All Mortgages

The ability to pay standard incorporated in the proposed regulations should apply to all mortgages, not just "higher-priced" mortgages. There is no reason why lenders in the prime and subprime markets should follow a different set of rules for sound underwriting. For many years, unscrupulous lenders have violated the spirit, if not the letter, of HOEPA by making unaffordable loans just under the high-cost thresholds. The Board must crack down on unaffordable lending throughout the industry. In order to restore confidence in the marketplace, and to prevent continued abuse, it is essential to ensure sound and honest underwriting for all types of loans, including loans in the prime or Alt-A markets.

HELOCs Should be Included in the Definition of "Higher-Priced" Mortgages

We urge the Board to include Home Equity Lines of Credit ("HELOCs") within the definition of higher-priced mortgages. Exempting HELOCs from the proposed rules would provide an incentive for unscrupulous lenders to disguise what is in effect a closed-end loan as a HELOC in order to sidestep regulation governing higher-priced loans. There is ample evidence that some lenders have engaged in this practice for years to avoid regulation under HOEPA.

For example, HELOCs are often used as "piggy-back" loans, behind a first lien home purchase mortgage, where the full amount of the line of credit is used in the home purchase, and the piggy-back HELOC functions in the same way as a closed-end second mortgage. Many of these piggy-back loans have been used to induce first-time homebuyers into unaffordable home purchase deals. These piggy-back loans, and other closed-end loans disguised as HELOCs, will be exempt from the ability to pay rules and other regulation if the Board exempts HELOCs from the proposed regulations. In order to adequately protect consumers and curb additional unsustainable lending in the marketplace, the Board must close the HELOC loophole.

The Regulations Should Cover Subordinate Lien Loans

The Board has requested comment on whether the proposed rule should cover subordinate lien loans. Subordinate lien loans such as piggy-back mortgages have been widely used by subprime lenders to qualify borrowers for financing that they cannot afford. We have seen numerous borrowers, many of them first-time homebuyers, sold homes at over-appraised values, who could not afford the payment on the second, piggyback mortgage. Further, the piggyback mortgages themselves often contain onerous terms. Exempting piggyback mortgages from the rules would create the opportunity for further abuse. There is no reason why subordinate lien loans should not be subject to the same rules on ability to pay and other protections as first lien loans.

The Board Should Impose Stronger Penalties for Appraiser Abuse

We commend the Board for proposing to prohibit creditors and mortgage brokers from coercing appraisers to misrepresent the value of a consumer□s principal dwelling; and to prohibit creditors from extending credit when they know or have reason to know that an appraiser has misstated a dwelling's value. We urge the Board, however, to impose far stricter penalties to ensure that this regulation is effective.

Neighborhoods of color in New York City have been decimated by appraisal fraud, particularly in "property flipping" schemes, where first-time homebuyers are sold fraudulently over-valued properties in poor condition by unscrupulous speculators. These schemes lead to high rates of foreclosure, but are highly profitable for the brokers and lenders who facilitate the financing by working in concert with speculators, appraisers, and attorneys. Appraisal abuse has been rampant throughout the country for years, with very little incentive for brokers and lenders to ensure that appraisals are sound.

The proposal provides little in the way of teeth to enforce the rule. Instead, the Board passes the buck to the states by claiming that the proposed appraisal rule would give state enforcement agencies a strong enforcement tool against appraisal abuse. In order to create an effective disincentive for lenders to close on loans for which they know that the appraisal is fraudulent, the Board should strengthen the rule by proposing a strict penalty like rescission.

The Board Should Propose Additional Protections Against Servicer Abuses

For years, servicers have operated in a regulatory vacuum, with virtually no oversight or reporting requirements. The borrowers we work with widely report difficult experiences working with servicers, including lack of responsiveness; harassment; overcharging of fees; misapplication of payments; complete lack of transparency as to both fees and to the process in general; and refusal to engage in loss mitigation in good faith.

We commend the Board for proposing to regulate mortgage servicing abuses. We also strongly support the Board's proposed rules to regulate servicers. We urge the Board, however, to impose additional regulations in three key areas.

First, the Board should provide for an enforcement mechanism with penalties, to give servicers an incentive to comply with the regulations. Penalizing the holder of the loan for the actions of the servicer would force abusive servicers out of business, and uniformly raise the standards in the servicing industry. Second, the Board should require a servicer to pursue loss mitigation in good faith before the servicer can bring a foreclosure action against a borrower. Similar rules are already in place for FHA loans, requiring servicers of FHA loans to evaluate a borrower's options, including consideration of the homeowner's ability to afford a viable modification, before proceeding to foreclosure. There is no reason why this simple rule should not apply to all loans. Finally, the Board should require mortgage loan servicers to provide detailed data on servicing outcomes to the Federal Reserve, so that the outcomes of their servicing can be made available to the public.

The Board Should Provide for Strong Assignee Liability Where Violations of the Substantive Protections in Regulation Z Occur

Assignee liability is critical to ensuring accountability in the secondary market, and to preserving protections for borrowers in foreclosure. The securitization process in particular has stripped many borrowers of the ability to raise defenses in a foreclosure action. When the holder of the loan asserts the "holder in due course" doctrine, borrowers are left defenseless—their only legal recourse is against the originators who no longer hold the loan and have no ability to stop the foreclosure. Many of these originators have gone bankrupt. Depriving borrowers of the right to defend against foreclosure is wrong as a matter of fairness and public policy. It is thus critical that the Board strengthen the principle of assignee liability where substantive violations of Regulation Z have occurred.

We strongly urge the Board to follow the recommendation of the National Consumer Law Center, that it state in the Supplementary Information accompanying the proposed rules that "apparent on the face of the disclosure" in the context of the substantive protections of Regulation Z means the entire loan file, including the loan application.

The Board Should Prohibiting Steering in its Proposed Rule

There is ample evidence that lenders and brokers intentionally steer many subprime borrowers into mortgage products that are more expensive than the borrower otherwise would qualify for. There is even more alarming evidence that people of color are being specifically steered toward higher cost loans than warranted. This ensures that a far higher proportion of subprime loans are concentrated in communities of color than the credit characteristics of those communities would indicate. The attached map shows the alarming fair lending implications of racial steering on New York City neighborhoods, and the resultant toll on those communities in foreclosures.

Steering by lenders and brokers, whether racially targeted or not, has helped exacerbate the foreclosure crisis by pushing more and more Americans into unaffordable or barely affordable financing. If the Board is serious about regulating abusive practices, it must address steering in the proposed rule. The Board should use its authority under TILA to define steering as an unfair and deceptive practice, and to regulate it as such.

Conclusion

Abusive subprime lending has taken a huge toll on borrowers and communities in New York City, and around the country. The Board has an unprecedented opportunity to issue strong and effective regulations that will protect American borrowers, prevent future foreclosures, and restore confidence in the mortgage markets. These regulations must be a floor rather than a ceiling, in terms of protections for American borrowers. We urge the Board to consider our comments and suggestions for strengthening the proposed rules.

Sincerely,

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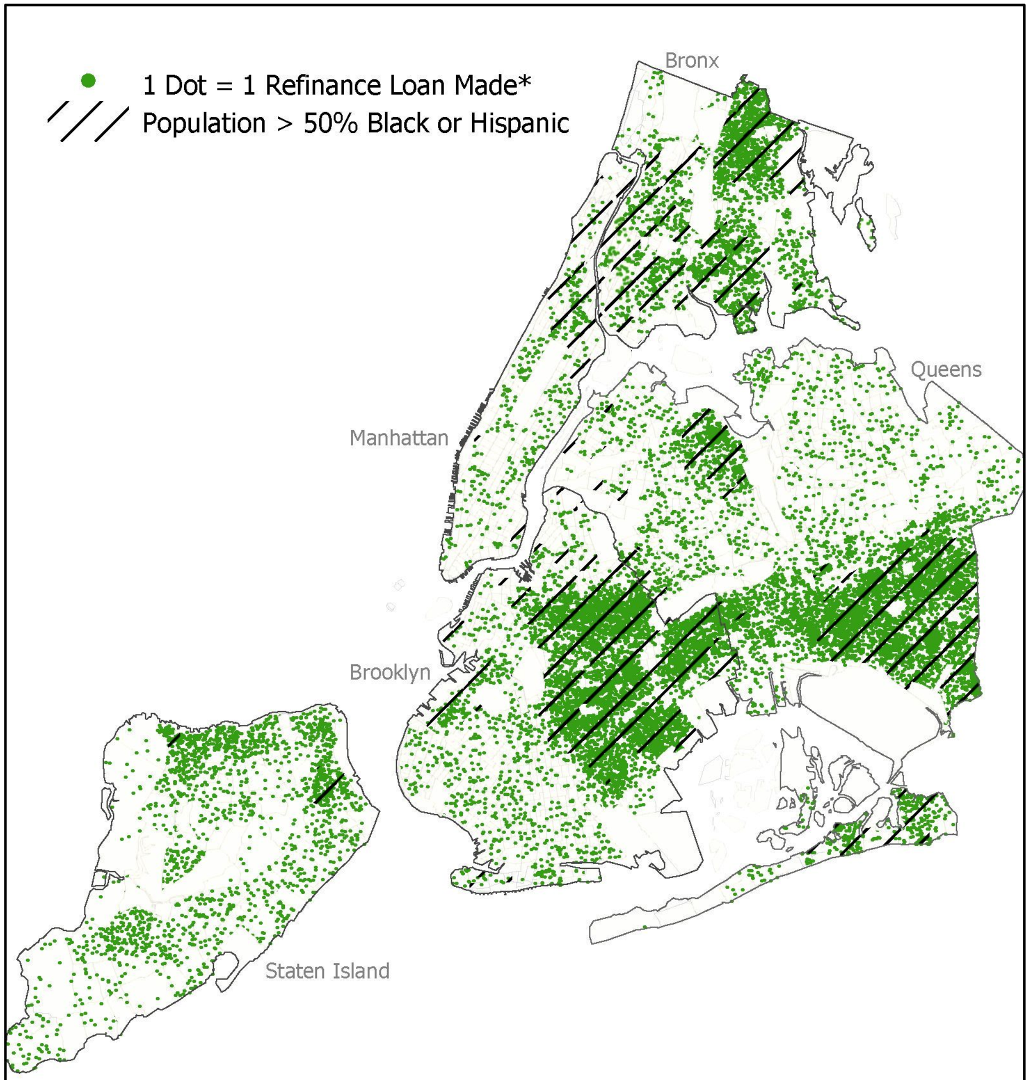
NEW YORK CITY

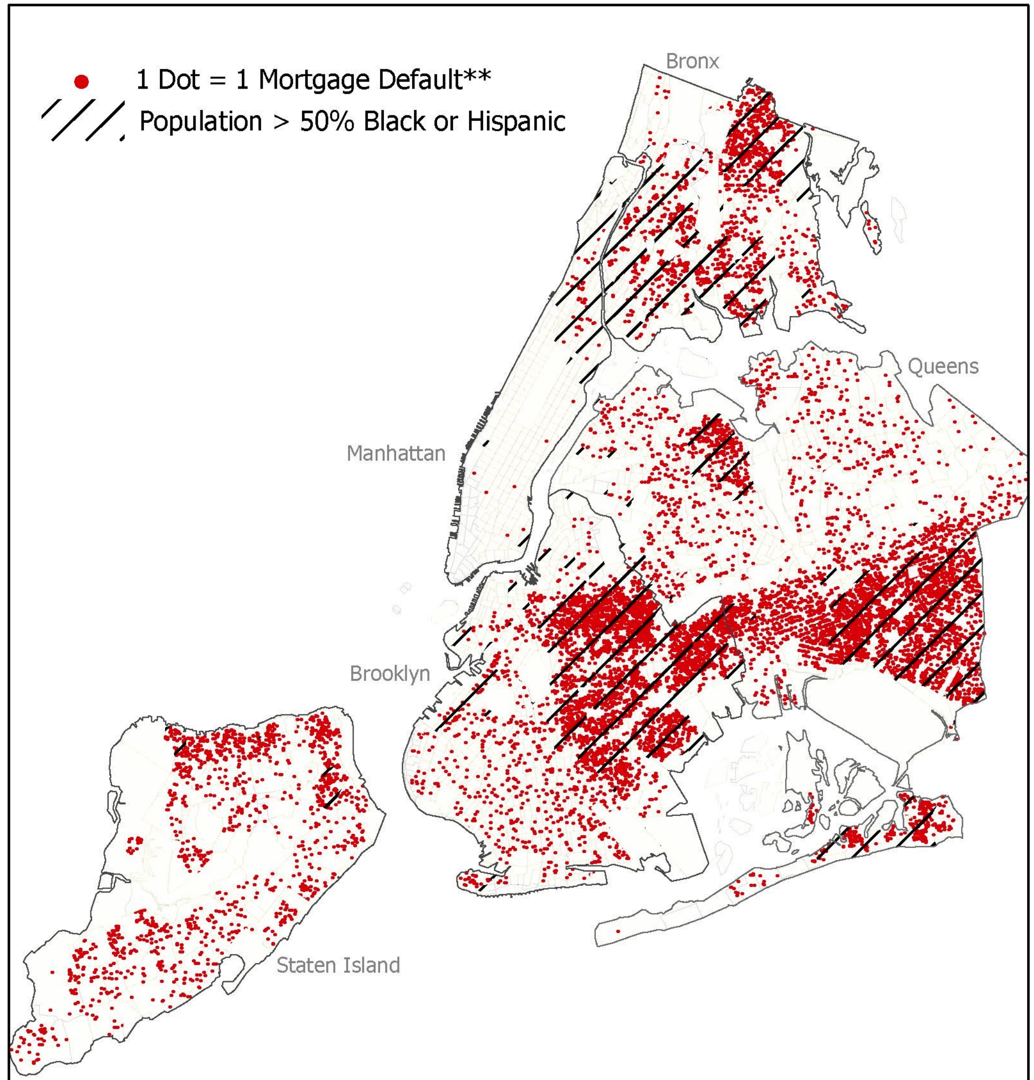
HIGH-COST REFINANCE LOANS MADE - 2006



*first-lien loans with annual percentage rates of 3% above Treasury securities of comparable maturity

16,590 high cost refinance loans were made in NYC in 2006

FORECLOSURE PATTERNS - 2007



**13,831 lis pendens of mortgage default filings were filed in NYC 1-4 family homes in 2007.

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Sources: HMDA (2006); Profiles Publications; U.S. Census (2000)