California Credit Union League
NEVADA Credit Union League

April 8, 2008

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

Re: Docket No. R–1305—Proposed Rule to Amend the Home Mortgage Provisions of Regulation Z

Dear Ms. Johnson:

On behalf of the California and Nevada Credit Union Leagues, I appreciate the opportunity to comment on the Federal Reserve Board's (Board's) proposed changes to Regulation Z regarding new protections for consumers from unfair and deceptive home mortgage lending and advertising practices. By way of background, the California and Nevada Credit Union Leagues (the Leagues) are the largest state trade associations for credit unions in the United States, representing the interests of more than 400 credit unions and their 9 million members.

The Leagues recognize that this proposal is intended to address issues associated with the current subprime mortgage lending crises, an issue that is also being addressed by Congress and many state legislatures. We are supportive of meaningful legislation—on the state and federal level—that will curtail further subprime mortgage lending problems without placing unnecessary burdens on credit unions (which have not been the source of these problems), or creating undue obstacles for qualified borrowers seeking to obtain a mortgage loan. We also appreciate the significant amount of time and deliberation the Board has invested in developing these revisions, including the HOEPA hearings, which examined a number of home equity lending issues and the adequacy of existing regulatory and legislative provisions in protecting the interests of consumers.

The Leagues support the goals and general approach of the proposal, as well as many of the specific provisions as proposed. The provisions we support in their current form are:

- Prepayment penalties—we support the prepayment penalty provisions as proposed for "higher-priced mortgage loans," and would be supportive of more stringent restrictions, such as limiting the time period in which they can be imposed to two years, rather than the five-year period contained in the proposal.

- Yield spread premiums—we support the proposal's enhanced disclosures for yield spread premiums on all mortgage loans, and agree that a broker should not be permitted to keep the yield spread payment without providing a benefit to the borrower.
- Appraisal provisions—we agree with the provisions in the proposal in which lenders and mortgage brokers will be prohibited—on all mortgage loans—from pressuring an appraiser to misrepresent the value of the home. This is consistent with current requirements in which credit unions and other financial institutions are already required to ensure that appraisers are independent and not subject to undue influence, and we support expanding these provisions to mortgage brokers.
- Servicing abuses—we support the provisions that address servicing abuses on all mortgage loans.
- Advertising rules— we approve of the proposed advertising restrictions and enhanced disclosures for home-secured loans.

***Our Concerns***
However, we do have concerns about some of the remaining provisions, in particular the proposed threshold for determining whether a mortgage loan is a "higher-priced" mortgage loan, subject to specific restrictions or prohibited practices. We will discuss this concern and others in the balance of our letter.

*Higher- Priced Mortgage Loan Threshold*

Although the Leagues generally support the proposal's approach regarding "higher-priced mortgage loans," we are concerned about the proposed threshold for making this determination, which would be loans with APRs that exceed the yield on Treasury securities of comparable maturity by at least three percentage points for first-lien loans, or five percentage points for subordinate-lien loans. Our concern is that this will cover significantly more than subprime loans (the fulcrum of the current mortgage crisis), to include a significant number of alt-A loans and almost all jumbo mortgages.

A review of current pricing conditions may help to illustrate our concern. On April 3, 2008, the average 30-year fixed rate mortgage as reported by Freddie Mac was 5.88 percent. The comparable 10-year Treasury yield was 3.61 percent, resulting in a 227 basis point spread. While this is currently below the 300 basis point spread which would trigger the "higher-priced" classification, it is important to look at historical spreads to understand and appreciate the variability in them. From 1971 through January 2008, the average spread between the 30-year conforming Freddie Mac commitment rate and the 10-year treasury was 168 basis points. More importantly, the standard deviation of the spread over that period is 57 basis points, indicating significant variability in the mortgage to treasury spread.

This problem may be even more significant in that the pricing of Treasury securities can be quite volatile, and can increase precipitously based on reactions to political, economic, or other events. This may result in even more loans exceeding the higher-priced mortgage loan threshold. Also, these political and economic events may be temporary, and the pricing of Treasury securities may then move quickly in the opposite direction. The result would mean that a loan at a specific rate may or may not be a higher-priced mortgage loan, depending on whether the loan is made at a time when the Treasury market is moving significantly in a certain direction.

Beyond conforming secondary market rates, it is not atypical to find "A" quality jumbo mortgages in the current market priced 300-350 basis points over the curve. Further, jumbo mortgage spreads are higher in general and are currently at approximately 100 to 150 basis points higher than conforming spreads. As a result, it is apparent that nearly all jumbo mortgages would be classified as "high- priced mortgages." In light of this information, the Leagues respectfully recommend that if the Board must define subprime loans in this fashion, that a spread of 400-450 basis points for first liens would be more appropriate.

Regarding the timing requirements for recording the comparative Treasury rate to the mortgage rate for purposes of determining if a loan is a higher-priced mortgage loan, the proposal requires lenders to use the Treasury security yield as of the 15th of the month preceding the month in which the application is received. We oppose the use of this timing requirement, as it differs from the Home Mortgage Disclosure Act (HMDA)— which refers to the month before the rate is locked—and overlooks the fluidity of typical pricing benchmarks (e.g., Freddie Mac, Fannie Mae, Treasury rates, etc.) experienced by most mortgage market participants. The means for making the determinations under the HMDA requirements are already well developed, and would not require significant and unnecessary programming changes by lenders. Therefore, the Leagues recommend that the timing requirement mirror the HMDA requirement (i.e., the 15th of the month before the rate is locked).

*Borrowers' Ability to Repay*

We agree with the Board that lenders should consider the borrower's ability to repay the loan and understand that these provisions are targeted to the proliferation of stated income, no documentation loans in recent years in which lenders provided mortgage loans based on statements made by borrowers, without further inquiry as to whether they were affordable. We agree that these types of loans are generally inappropriate. However, for all other types of loans in which there is some level of documentation, we believe lenders should have significant flexibility in determining if the borrower has the ability to repay the loan, and believe some aspects of the proposal will unnecessarily limit this flexibility.

For example, the proposal will require lenders to consider whether the borrower will have sufficient "residual" income, which is the income that may be used to pay for ordinary living expenses after the mortgage loan and other obligations are paid. We do not believe this is necessary if lenders are using other legitimate and commonly used methods for determining the borrower's ability to repay the loan, such as the borrower's debt to income ratio.

The proposal will also require lenders to consider the borrower's repayment ability for the first seven years of the loan. This would appear to require lenders to consider possible changes in the borrower's financial situation, which may include possible changes in property taxes, homeowners' association dues, and insurance premiums. We believe that such speculation is impractical, inaccurate, and unacceptably subjective. It is extremely difficult for a lender to attempt to foresee the extent to which a borrower's expenses and income may change over time. Therefore, the Leagues recommend that repayment ability should be based on current income and expenses, which would also include consideration of the fully-indexed rate for variable loans, based on the current margin and index that would apply at the time the loan is made.

*Verification of Income and Assets*

The proposal will require lenders to verify the income and assets they rely on with reliable third-party documents, such as the IRS W-2 form, tax returns, payroll receipts, financial institution records, or other documents. We understand that the purpose is to eliminate the problem of lenders providing stated income, no documentation mortgage loans that were provided to borrowers who were ultimately not able to repay these loans.

However, we believe that this practice should not be completely prohibited, as it may be appropriate in some borrowers' situations. For example, self-employed borrowers may not be able to provide tax or payroll information but may have an unblemished credit history. We believe providing a mortgage loan would be appropriate in these situations under certain circumstances, such as if the loan-to-value ratio is less than eighty percent.

We understand that focusing on collateral has also been associated with providing borrowers with inappropriate loans. However, credit unions are by nature very conservative with high lending standards, as demonstrated during the recent subprime mortgage crisis that has affected other lenders, and they should be permitted to make these types of loans if there are other favorable factors, such as a reasonable loan-to-value ratio and an outstanding credit history. We believe this is one example in which the proposal is attempting to target inappropriate lending that unfortunately may have the unintended consequence of limiting loans for certain borrowers who are very well-qualified.

*Requirements for Escrow Accounts*

Under the proposal, escrow accounts will be mandatory for first-lien, higher-priced mortgage loans. In addition, lenders may —but are not required to—offer borrowers an option to cancel escrow accounts twelve months after consummation of the loan. The Board has requested comment on this requirement and the lender's option to cancel the account, as well as whether the borrower should have the right to cancel the escrow account after twelve months.

The Leagues believe that sound underwriting of mortgage loans requires consideration of the borrower's ability to pay the taxes and insurance. An escrow account for these payments is the best approach for ensuring that they are made on a timely basis, and we agree that escrow accounts are essential for subprime loans, especially those in which the loan-to-value ratios are high and the mortgage payments represent a relatively large percentage of income. We also note that both Fannie Mae and Freddie Mac require escrows for the mortgages they purchase that have loan-to-value ratios that exceed 80%.

Without escrow accounts, borrowers with unexpected expenses may decide or be forced to use funds that would otherwise be used to pay their tax and insurance payments. This is especially true for subprime borrowers who may have lower incomes than prime borrowers. Overall, loans with escrow accounts are likely to perform better than loans without these accounts. Both the lender and the borrower benefit if the loan performs and the borrower can make the payments and remain in the home.

For this reason, we support escrow accounts for subprime loans. However, we believe that, if offered, a borrower should not be able to cancel the escrow account after only twelve months. Doing so would tend to subvert the purpose of setting up such an account (i.e., the borrower is higher risk, and typically has a large percentage of income committed to their mortgage payment), and would be burdensome to lenders, especially smaller lenders. We suggest a longer period—36 to 60 months, perhaps—possibly in conjunction with a decrease in the loan-to-value ratio.

In closing, the California and Nevada Credit Union Leagues would like to thank the Board for the opportunity to comment on these proposed changes to Regulation Z. We appreciate your consideration of our suggested changes to the proposal, and support the Board's efforts to protect consumers from unfair or deceptive home mortgage lending and advertising practices.

Sincerely,

Bill Cheney
President/CEO
California and Nevada Credit Union Leagues