Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Via email
VIA FACSIMILE

Re: *Docket No. R-1305: California Community Groups Comment on Proposed HOEPA Regulations*

Dear Ms. Johnson:

A year and a half ago, several community groups and consumers in California testified at the Federal Reserve Board (the "Board") HOEPA hearings held in San Francisco. At that hearing, and in subsequent comments to the Board, we highlighted a number of concerns with the mortgage market leading to widespread devastation for working families and their communities. At that time, we noted that 7 of the 10 metropolitan areas with the highest foreclosure rates in the country were in California.

A year and a half later, 7 of the 10 metro areas with highest foreclosure rates are still located in California, and foreclosures are increasing at a rapid pace, destroying entire neighborhoods. We commend the Board for taking certain steps to further regulate a widely unregulated marketplace, including through the proposed HOEPA and TILA regulations. But we are calling for bolder action on the part of the Board to prevent the further foreclosure of millions of family homes.

<u>Introduction</u>

The introduction to the proposed revisions to Regulation Z states that the goals of the amendments are to:

- protect consumers in the mortgage market from unfair, abusive, or deceptive lending and servicing practices while preserving responsible lending and sustainable homeownership;
- ensure that advertisements for mortgage loans provide accurate and balanced information and do not contain misleading or deceptive representations; and
- provide consumers transaction-specific disclosure early enough to use while shopping for a mortgage

In our roles as nonprofit legal service organizations, advocacy organizations, counseling agencies, community development corporations, advocacy organizations, housing providers, local government, private firms, research establishments, neighborhood community development initiatives and policy think tanks, naturally we embrace these goals. We believe that some of the Board's proposed revisions begin to address these stated goals, and we thank you for your efforts. However, we strongly encourage you to go further.

Through its utter failure to conduct subprime lending in a responsible manner, the industry has amply shown that its practices must be subjected to significantly more oversight. For example, the Board has proposed (commendably) that creditors be required to verify income and assets they rely upon in making loans, a practice that was once a routine (indeed, fundamental) aspect of underwriting. That the market has failed so badly that it has become necessary to impose a legal mandate on lenders to do so is indicative of the level of oversight that regulators must impose to begin to protect the public, our national economy, and even the industry itself from irresponsible actors. Accordingly, we urge you to broaden the scope of your proposed regulations.

Further, the proposed revisions in terms of lender due diligence, advertising requirements and other protections are so fundamental that we would recommend that such protections be extended to all loans, not just higher-priced mortgages. Perhaps there is a presumption that people who are receiving lower-priced, prime rate mortgages are somehow more sophisticated and knowledgeable, and thus able to identify and protect themselves from unscrupulous practices. However, there is no principled reason to deprive prime-rate borrowers of these very fundamental protections.

Lastly, **we urge the Board to clarify that the proposed regulations are not intended to preempt any state laws that speak to the same issues**. Rather, the Board should state that Regulation Z is a floor, not a ceiling, on consumer protection in the mortgage market.

Assumptions and Framework for Current TILA Revisions

While we agree with much of the analysis set forth in section II of the Supplementary Information to the proposed Reg. Z revisions ("Consumer Protection Concerns in the Subprime Market"), there are a couple of important items that are not accurate or not addressed.

Steering. The Board suggests that "subprime mortgage loans are made to borrowers who are perceived to have higher credit risk." While this is certainly true for many subprime loans, our experience has shown that, in fact, these loans have also been marketed heavily to vulnerable groups, **regardless of the prospective borrowers' perceived or actual credit risk**.

Subprime mortgage loans have been marketed heavily to people of color, as well as communities with a high incidence of limited English proficiency. They have been marketed heavily to residents of rural communities who have fewer choices in terms of where they can go for a loan. Subprime mortgages have also been marketed heavily to seniors, who, as a group, may be perceived to be easier to coerce into taking such a loan that is not in their best interest and who may also have more limited options in shopping for a loan. Discrimination in our credit markets is a reality that has to be acknowledged so that it can be addressed.

In fact, studies suggest that up to half of all borrowers with subprime loans could qualify for a lower-cost prime loan.[1] A Wall Street Journal analysis found that 61% of subprime borrowers in 2006 had credit scores that were high enough to qualify them for prime loans.[2] The Board has noted that much of the lending disparity by race and ethnicity can be explained by the fact that people of color are

[1] A poll of the 50 most active subprime lenders found that 50% of their clients could qualify for a conventional loan, according to Inside Mortgage Finance, a trade publication. (Paul D. Davies, *Beg, Borrow, Besieged,* Philadelphia Daily News, February 5, 2001.) A Freddie Mac publication cited the same poll, attributing it to Inside B&C Lending, and estimated based on its own findings that between 10% and 35% of subprime borrowers could qualify for prime loans (Freddie Mac, Automated Underwriting: Making Mortgage Lending Simpler and Fairer for America's Families, September 1996).

[2] Rick Brooks and Ruth Simon, "Subprime Debacle Traps Even Very Credit-Worthy," *Wall Street Journal*, December 3, 2007.

more likely to use a higher-cost subprime lender.[3] The Board has noted that the greater use of higher-cost lenders by people of color may reflect that lower-cost prime lenders are not serving these communities well, or that these borrowers are being improperly steered into higher-cost loan products.[4] Yet steering concerns are not limited to depository institutions. Ameriquest, one of the largest subprime lenders, recently came to terms with 49 state Attorneys General amid charges that it, amongst other allegations, sold loans to borrowers that were more expensive than their credit profiles warranted. Such practices are egregious, especially so if they have a disproportionate impact on certain borrowers and certain neighborhoods.

The Center for Responsible Lending, with access to enhanced loan-level data, released a report that found that for most subprime home loans, African American and Latino borrowers are at greater risk of receiving higher rate loans than white borrowers, even after controlling for legitimate risk factors. These disparities are large and statistically significant.[5]

As but one additional example, on December 5, 2006, the state of New York announced a settlement agreement with Countrywide Home Loans that culminated an investigation of lending disparities that began after a review of "federal Home Mortgage Disclosure Act ('HMDA') data showing that Countrywide's black and Latino customers were more likely than its white customers to receive high-priced loans in New York in 2004."[6] And analysis by the California Reinvestment Coalition showed that lending disparities in California for the entire industry as a whole in 2005 exceeded the disparities that produced this settlement agreement between Countrywide and the state of New York.

Industry fraud. Another significant issue to be noted is that fraud in the industry has been rampant. For example, brokers have falsified the income of borrowers (usually without their knowledge) to place them into large, unsuitable loans. Rampant greed on the part of brokers (and lenders) was a motivating force, as was the failure of state and federal regulators to provide oversight. Brokers were paid a commission on the total loan amount, and were commonly paid again, outside of closing, in the form of a Yield Spread Premium (YSP). Both payments were eventually borne by the borrower, either directly or through a higher interest rate. Brokers had incentives to push borrowers into loans with larger principal amounts than they could afford, because the bigger the loan amount, the bigger the YSP and commission; of course, these loans were also more expensive and burdensome on borrowers. Lenders may have been defrauded by these unscrupulous broker practices at times, but many of them failed to engage in due diligence to reduce the incidence of fraud, ignored widespread evidence of misuse of stated-income products, and provided payment incentives that encouraged the

---

[3] "Most of the reduction in the difference in the incidence of higher-priced lending across groups comes from adding the control for lender to the control for borrower-related factors." Robert B. Avery and Glenn B. Canner, "New Information Reported Under HMDA and Its Application in Fair Lending Enforcement," *Federal Reserve Bulletin*," Summer 2005, p. 379.

[4] Robert B. Avery and Glenn B. Canner, "New Information Reported under HMDA and Its Application in Fair Lending Enforcement," *Federal Reserve Bulletin*, Summer 2005, p. 381 ("Such a problem could arise in one or both of the following circumstances: (1) neighborhoods with high proportions of minority residents may be less well served by lenders offering prime products … or (2) some minority borrowers may be steered to lenders who typically charge higher prices than the credit characteristics of these borrowers warrant.").

[5] Debbie Gruenstein Bocian, Keith S. Ernst, and Wei Li, "Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages," Center for Responsible Lending, May 31, 2006.

[6] Office of the New York State Attorney General, "Countrywide Agrees to New Measures to Combat Racial and Ethnic Disparities in Mortgage Loan Pricing," press release December 5, 2006.

issuance of unsuitable loans. Lenders then passed along these bad loans to the public and other investors in securitized pools.

The following is but one example of the kind of abuse that occurs all too frequently in our communities:

Ms. V: San Jose brokers target and prey on Limited English Proficient homeowners

In a shocking case from San Jose, a Spanish-speaking couple of Latino origin systematically preyed on members of their own community by engaging in a series of unfair practices aimed specifically at people who did not speak English fluently. The couple—one a licensed broker and the other a salesperson (Ms. V)—lured homeowners into their offices with promises of lowering monthly payments, allowing them to tap tens of thousands of dollars of equity, and other attractive features—all at no cost to the borrower. All of these negotiations were in Spanish; in fact, Ms. V became irate with her staff if they referred English-speaking borrowers to her.

When these borrowers appeared at closing, they were confronted with large stacks of documents written in English with no Spanish translation. If they asked Ms. V any questions, she became very impatient and pushed them to simply sign where she indicated.

Some borrowers noticed major inconsistencies with what they had been promised despite the lack of translated documents. Ms. V would assure them that the terms were a mistake that she would "fix" later, or that she could secure a refinance for them shortly so the terms in question were nothing to worry about.

The terms of the loans in the binding English-language documents that these borrowers ended up with were far less attractive than what Ms. V had verbally promised them in Spanish. The loans featured huge fees to Ms. V, adjustable rates, balloon payments, and pre-payment penalties, and borrowers often received a fraction of the cash they were promised from the transaction.

Protections Covering Higher-Priced Mortgage Loans

Definition of Higher-Priced Mortgage. The Board's proposal to create a protected category of "higher-priced" mortgages with rate triggers set at 3 percentage points above comparable Treasury notes for first liens and 5 percentage points for subordinate liens represents an important step forward in Reg. Z's modernization. Inclusion of purchase-money liens in this definition is also a significant, necessary step forward in protecting consumers.

Include nontraditional loans. However, we believe the reasoning the Board applied in setting these triggers applies equally to non-traditional loan products, such as option ARMs and interest-only loans, and that the exclusion of such products from the proposed rules would effectively encourage their use. The Board should expand its definition of higher-priced mortgages under proposed rule 226.35 to include these non-traditional products.

Include HELOCs. Additionally, we encourage the Board to include HELOCs in the definition of higher-priced mortgages to reflect the fact that the industry is using HELOCs as a significant tool in the purchase and refinance of a consumer's home. HELOCs are sold frequently as "piggy-back" mortgages in combination with traditional first lien mortgages, functioning as a closed-end, subordinate mortgage. For example, in 2006, more than one-third of California home purchasers used piggy-back loans for that purchase.[7] Additionally, homeowners are induced to borrower against their equity through the use of HELOCs that function as closed end loans. Originators instruct borrowers to draw down the full amount of the line of credit in one lump sum creating, in effect, a simultaneous second closed-end purchase mortgage. The Board's proposed APR trigger should be applied to HELOCs used in this manner (versus being used as this product is intended, i.e., as an open-ended line of credit to access a home's equity post-purchase for such items as home repairs or emergency expenses). These industry practices have effectively created a HELOC loophole in Reg. Z coverage, a prime example of how the market has outpaced regulation.

Given the existence of this loophole, it is notable that African-Americans and Latinos in California were twice as likely to have received a subprime loan and to have received a piggy-back loan in 2006 as white borrowers.[8] Asian-Americans were more likely in some California metropolitan areas to have received piggyback loans.[9] The Board in its commentary indicated a preference for "applying protections based on loan characteristics rather than borrower characteristics"; however, when the industry pushes certain types of loan products on particular racial and ethnic groups, it must be acknowledged that the Board's decision whether or not to apply protections to those products will impact those racial and ethnic groups differently.

The Board's proposal to add regulations prohibiting a creditor from structuring a home-secured loan as an open-end plan to evade the requirements of the regulation is a sensible one. However, the reality is that too many HELOC's are closed-end loans in disguise. In California, the state's anti-predatory lending law, or covered loan law, already prohibits the restructuring of a loan as an open-end credit plan for the purpose of evading the statute's protections,[10] but this prohibition on loan restructuring has had little impact on industry practice. As one example, a Fresno homeowner with a disability and a fixed income was induced to take out a HELOC at 20% interest with extremely high fees that was in essence a closed-end loan likely designed to evade our state's covered loan law. The result is that Fresno now has one more homeless person with a disability.

The reality is that HELOCs are being increasingly sold by unscrupulous brokers and lenders to unsuspecting and unsophisticated borrowers, to the detriment of borrowers and their communities. We urge the Board to go from a long period of being under-inclusive in protecting borrowers with these loans, to ending the exemption for HELOCs outright.

Include reverse mortgages. We also urge the Board to reconsider its proposal to exclude reverse mortgages from HOEPA's protections. There is abuse in the reverse mortgage market, and many believe that reverse mortgages represent the next great wave of predatory lending practices. Extending HOEPA's reach to reverse mortgages will level the consumer protection playing field for our most vulnerable community members. Failing to cover reverse mortgages has a clear disproportionate impact on seniors, who are already disproportionately victimized by egregious practices. The National Community Reinvestment Coalition has shown that lending disparities by race and age of neighborhood persist even after accounting for neighborhood credit scoring data.[11] In another study,

---

[7] Fishbein, Allen, *Piggyback Loans at the Trough: California Subprime Home Purchase and Refinance Lending in 2006,* p.1, Consumer Federation of America (January 2008).
[8] *Id. at 2.*
[9] *Id. at 10.*
[10] Cal. Fin. Code §4973(m)(1)
[11] *The Broken Credit System,* National Community Reinvestment Coalition, 2003.

borrowers 65 years of age or older were found to be 3 times more likely to hold a subprime mortgage than borrowers less than 35 years of age.[12] As the reverse mortgage market explodes, federal regulatory protections must be in place to prevent abuses and to ensure that the Board is not again placed in the position of playing regulatory catch up, trying to regulate abuses that have run rampant and caused great harm.

Revisit exclusion of investor owners. The Board should refine its proposed exclusion of investment loans. Some of the "investors" who have gone into foreclosure over the past year—including some of our clients—are "mom and pop" single-family homeowners with no experience in real property or other investment. These are unsophisticated investors who owned only one home—sometimes for only a very short time—and were pushed by unscrupulous mortgage brokers (looking to line their own pockets with fees) to tap the equity in their primary residence to buy another property. We believe that a large percentage of the investors losing single-family homes as a result of abusive lending practices fall into this category. Many of them will lose or have already lost their primary residence as a result of the investment. In its commentary to the proposed revisions, the Board indicated that a loan to a consumer to purchase a second home would not be covered unless secured by the consumer's principal dwelling.[13] We ask the Board to take into account the actual practice that the industry has engaged in—encouraging homeowners to withdraw equity from their homes in the form of a HELOC and use it as a down payment for a second or third property.

Finally, inclusion of investor owners would have the effect of protecting perhaps the most innocent victims in the mortgage crisis – tenants living in investor-owned properties. While understandable, public policy that disfavors investor owners has the necessary effect of creating more displaced tenants. The Board cannot leave this issue to state and local government and pretend that is neutral with respect to tenant issues. Disfavoring investor-owned properties has the effect of harming tenants.

<u>Ensuring Repayment Ability</u>. We appreciate that the Board recognized the need to address loan originators' widespread practice of extending loans to borrowers without properly assessing their ability to afford them. Perhaps more than any other single issue, this practice is at the root of the current foreclosure crisis, since it traps borrowers in loans that they cannot afford, especially when combined with other problematic practices such as prepayment penalties, which prevent borrowers from being able to refinance out of or restructure these loans. We appreciate that the Board has also recognized that the ability of a borrower to repay a given loan must include a consideration of the borrower's total debt obligations and be based on the payments made at the fully amortized rate, rather than those made under a deceptively low initial rate.

However, we strongly object to the Board's proposed inclusion of language that would deny borrowers a remedy unless they can show that their unaffordable loan was part of a "pattern and practice of extending credit without regard to borrowers' ability to repay from sources other than the collateral itself."

This proposed restriction would severely undermine the critical affordability standard. First, we can see no good reason for a creditor to extend credit without regard to the borrowers' ability to repay from sources other than the collateral itself. Such a practice does not benefit the consumer and is highly risky for the lending industry, as we have seen from the closure of lenders in the past two years

---

[12] AARP Public Policy Institute, Data Digest Number 57, www.aarp.org.
[13] 73 Fed. Reg. 1682 (January 9, 2008).

whose repertoire included supporting that unsafe and unsound behavior and from the general collapse of the subprime mortgage lending industry. It will be a very rare situation indeed in which the borrower's interests are served by taking out an unaffordable loan. As such, the Board must tread carefully in trying to permit such exceptions or else risk the exception swallowing the rule. Similarly, we object to the notion of a safe harbor for lenders that can show that income and asset levels relied on were not materially greater than what the lender could have determined at loan consummation.

The Board's articulated concern that prohibiting lenders from making individual loans without regard to the borrower's ability to repay could result in tightening of mortgage credit is puzzling, since reducing these unsafe and unsound extensions of credit is exactly the point of expanding the regulation. The Board's concern that accidental violations not be punished could be addressed in another fashion that does not deny aggrieved consumers the protection of the law, perhaps through language that provides for a good faith defense under particular circumstances

The Board requests comment on whether the proposed rule should be narrowed, for example by distinguishing between cases where creditors or brokers were not complicit in applicants' inflating incomes. We believe that such a revision could potentially undermine the effectiveness of the broader attempt to prohibit brokers and lenders from routinely putting borrowers into unaffordable loans. As the Board notes throughout this proposal, consumers are relatively ill-informed regarding the mortgage process, and they reasonably rely on the expertise of brokers and lenders. These brokers and lenders should not be able to evade responsibility for making unaffordable loans by blaming the victims, as many will do if the Board permits the loophole to take hold.

The Board notes that it will test the effectiveness of current TILA mortgage disclosures and potential revisions by interviewing borrowers. If the Board does not eliminate the "pattern or practice" requirement, we urge the Board to, in the course of these borrower interviews, gather information with an eye to detecting whether lenders are engaging in patterns or practices of lending without regard for ability to repay, and to bring enforcement actions or refer the matter to other enforcement agencies, as appropriate.

Verification of income and assets. We commend the Board's proposal that creditors be required to verify borrowers' income and assets before making higher-priced mortgages. This revision would help address the problem of lenders and brokers placing consumers in loans that are completely unsuitable for them. The failure on the part of the mortgage industry to assure that borrowers had sufficient income to support the monthly payments associated with their home loans is one of the reasons that many borrowers have suffered the loss of their home, and our national economy has suffered a devastating blow. Had the Board taken this step years ago, when consumer advocates correctly pointed out that the lending industry was not undertaking proper due diligence in this regard, much of the current disaster could have been averted.

Prohibit prepayment penalties**.** The Board proposes to restrict the use of prepayment penalties, but we believe that prepayment penalties should be outright prohibited on higher-priced mortgage loans or, at a minimum, be further restricted to reflect current market realities. Prepayment penalties trap borrowers into unaffordable loans, are not bargained for or understood by many borrowers, and provide little to no borrower benefit. Prepayment penalties also frustrate one of the main justifications for subprime loans—helping borrowers get into a home with an eye to graduating to lower-cost prime products after they have accrued equity in the home and improved their credit score by making mortgage payments for a year or two. In California, prepayment penalties routinely cost borrowers thousands of dollars. Today, prepayment penalties are responsible for propelling many borrowers into foreclosure.

As the Board notes, "prepayment penalty clauses, which are found in a substantial majority of subprime loans, place an added demand on the limited equity or other resources available to many borrowers and make it harder still for them to refinance. Borrowers who cannot refinance will have to make sacrifices to stay in their homes or could lose their homes altogether."[14] Despite the fact that prepayment penalties are meant to provide borrowers with lower interest rates, countless borrowers were sold loans by brokers who earned extra fees in the form of Yield Spread Premiums for selling the borrower a loan with a **higher** interest rate and for slipping a prepayment penalty into the loan without the borrower's knowledge.

The Board proposes to restrict prepayment penalties for higher-price mortgage loans by limiting their duration to 5 years, and by requiring that they must end at least 60 days prior to first date of possible payment increase. The Board's proposal is disappointing in that most of the industry and state laws have already moved to shortening prepayment penalty duration to 3 years. In this sense, the current proposal is a step backwards. The Board itself notes that "with respect to fixed-rate loans, some financial institutions and industry trade groups stated that a three-year limit on term of a prepayment penalty would be appropriate."[15] Five years is an "exceedingly long period" in today's market, and prepayment penalties should not be permitted to extend that long.

The proposed 60-day window to allow for borrowers to refinance before payments increase is well intended but too short in duration to be effective. The proposal cites 2004-2006 HMDA data for the proposition that a sixty-day period would be enough time for a significant majority of subprime borrowers to shop for a new loan.[16] But today's market is unrecognizable from that of 2004-2006, and borrowers in today's credit-tightened environment have great difficulty in securing loans in a short timeframe. Borrowers must be given a meaningful opportunity to refinance out of their subprime loans before payments go up, without incurring the prepayment penalty. Most borrowers will need more than 2 months to finalize refinancing opportunities and will not be able to benefit from the proposal.

The Board suggests that "to the extent that penalties make the cash flow from investments backed by subprime mortgage predictable, the secondary market may become more liquid."[17] The investors are not worried about prepayment penalty provisions right now. Investors have been burned because the fundamentals of underwriting were thrown out the window over the last few years. There is a market for prime loans without prepayment penalties and in states that restrict prepayment penalties. The secondary market will recover and return when investors believe that reasonable regulations are in place so that investors, lenders and borrowers know that loans will only be made where there is an ability to repay the loan.

[14] *Id.* at 1674.
[15] *Id.* at 1693.
[16] *Id.* at 1695.
[17] *See id.* at 1693-1694.

We urge the Board to prohibit prepayment penalties on higher-price mortgage loans. In the alternative, we urge the Board to limit prepayment penalty periods to 3 years or 6 months prior to potential rate reset, and to require that a prepayment penalty in fact lower the borrower's interest rate. This could be accomplished by declaring a prepayment penalty illegal unless a lender or broker can demonstrate that, but for the prepayment penalty, the borrower's interest rate would have been higher.

Require escrow accounts. The Board is proposing to prohibit creditors from making a higher-priced loan secured by a first lien without establishing an escrow account for property taxes and insurance. However, under the proposed rule, creditors may allow a borrower to "opt out" of the escrow twelve months after loan consummation.

The Board's central rationale for escrow requirements is sound. By excluding escrows, loan originators deceptively market loans to consumers by advertising artificially low monthly payments that are substantially less than the consumers' actual obligation. Unsophisticated borrowers are therefore discouraged from loan products which may have a lower total monthly cost, but which contain set-asides for taxes and insurance, and originators are discouraged from offering escrows because it increases the advertised cost of the loans they are seeking to sell. This practice has caused enormous damage to consumers, who unknowingly enter into loans without realizing that they are responsible for significant additional monthly costs for taxes and insurance.

Don't permit opt out. A Rule allowing opt out after 12 months is bad for borrowers. The proposed rule is an improvement. However, because it allows for opt out after 12 months, it does not correct the "market failure" it intends to address. The limited consumer benefit derived from a provision that allows high cost loan borrowers to opt out of escrow is far outweighed by its potential risks and costs, which are virtually identical to the risks and costs that the escrow requirement intends to address. We believe that the only circumstance where a consumer should be permitted to opt out of escrow is when the borrower submits written proof of participation in a publicly subsidized property tax and insurance program.

Mortgage Broker Compensation- Yield Spread Premiums. The Board is proposing to prohibit creditors from paying a mortgage broker more than the consumer has agreed to in advance that the broker would receive. The Board indicates in its commentary that it envisions that creditors would show compliance by either complying with a state law providing for equivalent protection, or by otherwise showing that compensation was unrelated to the interest rate of the transaction.

Eliminate YSPs. While this proposal is a (long overdue) step in the right direction, **we think the time has come for the complete elimination of YSPs.** Such premiums have resulted in the rampant practice of lenders using brokers to sell consumers loans that are more expensive than what the consumer is qualified to receive; this is hardly surprising, since the entire purpose of YSPs is to reward brokers for, in the Board's words, "provid[ing] consumers loans with higher interest rates." (73 Fed. Reg. 1698.) Lenders also know that brokers are typically charging borrowers steep fees on top of the YSPs, which undermines any possible legitimate justification for the practice.[18] There is therefore no reason for an YSP other than to encourage brokers to find a way to sell consumers more expensive loans than the market would otherwise provide. It makes little sense to permit a practice,

[18] The Board itself could muster only a weak defense of YSPs in its discussion, stating on the grounds that "consumers potentially benefit from having an option to pay brokers for their services indirectly by accepting a higher interest rate." 73 Fed. Reg. 1698.

even with enhanced disclosures, that severely damages consumers and that serves precious little legitimate purpose.

As the Board has noted in its discussion of this proposed rule, many consumers believe that brokers are working for them.[19] In some states, the broker does, in fact, owe a fiduciary duty to the borrower. All too many brokers have not acquitted themselves in a manner, however, that measures up to that obligation, and most states do not have such a fiduciary requirement. Unscrupulous brokers lead the consumer to believe that they are working on the consumer's behalf. They advertise that they are available to help find the best loan for the consumer. They make all manner of promises to consumers that lead the consumer to justifiably rely on them and believe that they have the consumers' best interests in mind. Consumers do not even realize that the broker has received additional compensation from the lender until a housing counselor or other professional points it out to them, usually long after the transaction has been consummated.

The reality is that brokers serve two masters; they work for the lender as well as the borrower. As it is the lender who is paying significant compensation, from transaction to transaction; as an institutional player, it is by far the more powerful and influential of the two masters. YSPs encourage conflicting loyalties, and it is the consumer who suffers as a result. It is time for the Board to end this method of compensation that has lead to widespread abuse of consumers.

YSPs also present a collective action problem, as the Board noted in the context of escrow accounts. Lenders that do not pay YSPs (or that escrow taxes and insurance) may be at a competitive disadvantage in relation to their competitors, because fewer brokers will seek to do business with them; thus, the lenders are disincentivized to voluntarily adopt a more consumer-friendly position.

The Board notes that "disclosing that the creditor's payment may influence the broker not to serve the best interests of the consumer would help ensure that the consumers are on notice of the need to protect their own interests when dealing with a mortgage broker rather than assume that the broker would fully protect their interests."[20] But this is a strikingly weak form of consumer protection; why should the Board settle for disclosure to the borrower that the broker may not serve her best interests when it has an opportunity to follow several states' lead and meet consumer expectations by requiring brokers to act in borrowers' best interest?

Additionally, the Board should extend these obligations to loan officers working for lending companies. While the Board states that "it is not clear that . . . consumers expect [loan officers have] a legal or professional obligation to give disinterested advice and find the consumer the best loan available" (73 Fed. Reg. 1700), one need look no further than the *Ameriquest* litigation (mentioned on another point elsewhere in the Board's discussion [*see id.*at 1701]) for confirmation of that widespread consumer expectation. Ameriquest, one of the largest subprime lenders, came to terms with 49 state Attorneys' General amid charges that it, amongst other allegations, sold loans to borrowers that were more expensive than their credit profiles warranted. Just as with brokers, borrowers can reasonably believe that lenders will offer them to the best loan products for which they qualify.

---

[19] *Id.* at 1699.
[20] *Id.*

Earlier Disclosures to Consumers. We agree that earlier disclosures could help improve consumers' ability to shop for a loan. The Board proposes a requirement that transaction-specific mortgage loan disclosures be provided no later than three days after application and before the consumer pays any fee except for a credit check. We believe this proposal is a step in the right direction. Since we can easily imagine that some brokers or lenders could respond to this requirement by railroading consumers into an even higher-speed transaction in which the closing takes place very shortly after disclosures are provided, we recommend that language be included prohibiting closing of the loan sooner than 20 days after issuance of the disclosure.

Coercion of Appraisers. We commend the Board's proposal to prohibit coercion of appraisers by brokers and creditors. Over-valuation of properties created a false "bubble" in California, heightening the intensity of the subsequent collapse in home values. Consumers were lead to believe that they had a much higher amount of home equity than they actually did. The problem of overvaluation needs further focus and consideration by the Board, other policymakers, and advocates to create a system of checks and balances to protect consumers and our state and national economies. We suggest that the Board include stiff penalties for violation of this provision, such as a minimum fine of $25,000 per property, and/or the right of rescission on the part of the homebuyer upon discovery of violations of this provision. Without severe penalties, we believe that abuses will continue.

Servicing Abuses. We commend the Board for addressing the increasingly important issue of servicing abuse. We support the Board's proposals in this regard, but urge it to go further to address the more important issues of whether servicers are acting in good faith and consistent with any existing pooling and servicing agreements to modify loans to preserve homeownership for the millions of families who are at risk of losing their homes.

Much has been made of federal and state proposals to encourage loan servicers to voluntarily assist borrowers in distress to obtain loan modifications and other workouts. The Hope Now consortium and its monthly data releases purport to testify to the success of these efforts.

The reality is that there are no rules, no oversight and no consistent data reporting relating to the practices of loan servicers. As a result of these regulatory gaps, we have found that the outcomes achieved by California borrowers seeking to work out their distressed home loans are poor. A recent study by the California Reinvestment Coalition based on a survey of home loan counseling agencies suggested that 72% of counseling agencies reporting cited foreclosure as a very common outcome for their clients.[21]

We urge the Board to require loan servicers to report detailed data to the Board or FFIEC and to make this data publicly available. Just as HMDA data sheds light on industry practices, so too data on whether servicers are keeping their promises to work with borrowers should be available to the public. Additionally, the Board should clarify the obligations of loan servicers to work with borrowers to keep them in their homes, and enforce these obligations. We suggest that the Board require all loan servicers to follow the loss mitigation protocol utilized for FHA products.

Mortgage Advertising. It seems that higher-cost loans with onerous terms are marketed far more aggressively and visibly than moderately-priced loans. Not only are advertisements misleading in

[21] California Reinvestment Coalition, "The Growing Chasm Between Words and Deeds," March 2008.

form and content, but they are relentless and overwhelming in terms of sheer volume. Consumers are solicited daily for high-cost loans through written mailers, phone calls and other print media, as well as over the Internet and in person. Seniors and other more vulnerable groups may be more susceptible to this high-impact solicitation to the extent that they may be more isolated physically and socially. There are victims of predatory loans who never even met the perpetrator; they were called repeatedly by different brokers and, ultimately, capitulated to one of the barrage of solicitations. The final closing is carried out by a notary who comes to their home and is not trained, licensed or otherwise authorized to answer questions about the documents the consumer is being told to sign. With these pernicious practices poisoning the industry, the only effective response is for the Board to consider completely prohibiting phone solicitations for mortgages.

<u>Additional Protections Needed</u>

In order to fully meet the laudable goals of this rule-making effort, the Board must include key additional measures:

<u>Protect consumers against steering</u>. The Board notes prior testimony from consumer advocates regarding "aggressive marketing practices such as steering borrowers to higher-cost loans by emphasizing initial low monthly payments based on an introductory rate without adequately explaining that the consumer will owe considerably higher monthly payments after the introductory rate expires."[22] While steering is of course, an unfair and likely illegal business practice in and of itself, it can also implicate fair lending issues, as the Board notes in its discussion.[23] Several studies have shown that people of color are more likely to receive high-cost loans; that these disparities persist within bank and thrift holding companies where minorities are more likely to be steered into the subprime channel; and that the high costs borne by subprime loan borrowers often do not reflect their own creditworthiness.[24]

The Board believes that it sufficiently addresses steering through the provisions relating to Yield Spread Premiums and Ability to Repay.[25] But the proposed regulation concerning YSPs requires only disclosures, not significant protections, and applies only to brokered loans, not lenders. The Ability to Repay provision is limited in that it contains the unrealistic "pattern or practice" evidence discussed above; further, while steering results greater costs to the borrower than they should be incurring, it does not necessarily result in the borrower obtaining a loan he or she is unable to repay.

The Board must be more proactive in rooting out such practices by defining them as unfair and deceptive. Specifically, we urge the Board to prohibit lenders from offering borrowers a higher cost loan product than that for which the borrower qualifies with the lender or the lender's affiliated companies. The tie to a lender's affiliates can build off of similar language in the context of HOEPA loans and prepayment penalties.

Further, given the significant evidence of systemic fair lending problems related to steering discussed above, the Board, as regulator of Bank Holding Companies, must also vigorously enforce fair lending laws and investigate all pricing disparities evident from HMDA and other preliminary analysis. This

[22] 73 Fed. Reg. 1678.
[23] *See id.* at 1704.
[24] *See* discussion of steering on p. 2-3, above.
[25] *See* 73 Fed. Reg. 1704.

analysis should be heightened for lending companies that operate different lending channels which are vulnerable to differently impacting protected classes.

Promote pre-purchase counseling. Perhaps the best way to protect consumers against abusive practices is to require and promote pre-purchase home loan counseling for borrowers. We urge the Board to require such counseling for all borrowers seeking HOEPA and higher-priced mortgage loans, as defined in the proposed regulations. The Board should also use its authority and bully pulpit to push for increased congressional and industry funding for nonprofit home loan counseling agencies. Counseling agencies are often the only trusted and knowledgeable source for borrowers seeking assistance in our communities, but their capacity is currently being stretched to the breaking point by the explosion in foreclosures that germinated during the past few years of limited regulatory oversight.

Require that loan documents be in the language of the negotiation. California groups have for years called on industry, regulators and policymakers to require that when home loans are negotiated in a language other than English, key loan documents be translated into that language so the borrower has some possibility of understanding the terms of the loan. At the Board's HOEPA hearings in the summer of 2006, several panelists testified to the importance of this policy. More importantly, several consumers spoke during the public comment portion of the hearing to describe in their native languages how brokers from their ethnic or linguistic community preyed upon them by aggressively selling them loans in their non-English languages, but ultimately providing English-only documents with vastly inferior terms to what borrowers had been promised. These borrowers testified to being unable to pay their loans almost immediately, and represent the faces of the Early Payment Default loans that forced so many subprime lenders out of business and forced Wall Street to reevaluate its thirst for stated-income and other abusive products.

We were pleased to see the Board's proposal to address a piece of this concern by requiring disclosures to be in the same language as any non-English marketing materials used by lenders.[26] This is a positive step, but more needs to be done. Specifically:

- The Board should make it an unlawful and deceptive practice for originators to fail to provide translated copies of loan documents to a consumer where the negotiation of the home loan transaction was in a language other than English; and

- The Board should build upon California Civil Code §1632 and require that key loan documents (including, but not limited to, the promissory note, HUD-1, TILA, and GFE) are available in languages spoken in different markets, and that these documents be available through all retail and wholesale channels.

California Civil Code section 1632 is a very useful model. 1632 requires the party negotiating a mortgage in a language other than English to provide a translated version of the loan documents in the non-English language that loan was negotiated in. This translation is required for five most-spoken non-English languages in California; however, it seems clear that we are not the only state with these problems, so the Board should make these protections nationwide. Further, consumers in all high-

[26] *See id.* at 1715.

cost loans should at least be provided documents in a language they understand, whether those loans are brokered or not; lenders have argued that 1632 only applies to brokered loans.

In short, the Board should ensure that all borrowers—but especially those entering into high-cost HOEPA loans—are fully aware of the terms of the loan they are getting into. Otherwise, there is a basic failure of contract (i.e., both parties are not fully informed of the terms of the agreement) in a transaction that puts at risk what is almost certainly the largest asset a low- or middle-income family owns. In addition, we would recommend that those same requirements be implemented with regard to non-traditional loan products.

Lower HOEPA thresholds. HOEPA has been effective in driving costs below the APR and points and fees thresholds, as lenders do not wish to make HOEPA loans due to reputational and liability concerns. But the HOEPA thresholds have been too high and are unrealistic under current market conditions. We urge the Board to lower the thresholds to 5% of the total loan amount, and 5% above the rate for comparable Treasury securities; and to include YSPs and prepayment penalties in the points and fees calculation.[27] The creation of the higher-priced mortgage loan category is positive, but not all of HOEPA's protections extend to these loans. There is a role for the HOEPA thresholds to play, but they are too high to serve any meaningful purpose today.

Expand CRA. Board staff has noted that lending disparities were reduced within a bank's Community Reinvestment Act (CRA) assessment area. In other words, where banks had CRA responsibilities subject to regulatory oversight, their lending appeared to be more equally and fairly distributed. Yet at the same time, the bank regulators have allowed certain companies such as H&R Block Bank, Countrywide Bank, and Charles Schwab Bank to meet their CRA responsibilities by serving only a small fraction of the communities where they lend money. The Board should expand CRA requirements to promote fair lending. Specifically, the banking regulators should revise their outdated definitions of what constitutes a "branch" subject to CRA responsibility, by looking at where banking companies lend and where their depositors live. If the Board had so interpreted CRA over the last few years, it could have resulted in many more good loans crowding out the bad, and mitigated the growing impacts of our current crisis.

Conclusion

The situation in our communities is dire. Working families are losing their homes, tenants are being displaced, neighbors are losing property value and themselves being pulled to foreclosure, local governments are unable to collect taxes sufficient to provide for needed municipal services, and the larger economy is suffering. The federal government has directed nearly $400 billion to enhance liquidity on Wall Street.[28] So far it has failed to direct significant funds or energy to Main Street where they are most needed – to the homeowners who have been, or soon will be, foreclosed upon. If the Board can see fit to negotiate and guarantee nearly $30 billion to facilitate a takeover of Bear-Stearns to calm the financial markets, the very least it can do for Main Street is to put in place regulations to prevent homeowners from losing their primary source of wealth and from further destabilizing our communities.

Thank you very much for considering our views.

---

[27] The Board mentions, but does not analyze, the proposal regarding YSPs in its discussion. *See id.* at 1698.
[28] "Senate Housing Bill Fails to Deal With Magnitude of Crisis, *Continued Modest Steps Toward Real Resolution says NCRC.*" National Community Reinvestment Coalition press release, April 3, 2008.

Very Truly Yours,

Affordable Housing Services
Bay Area Legal Aid
California Alliance of Retired Americans
California Reinvestment Coalition
California Rural Legal Assistance
Center for California Homeowner Association Law
Community Housing Development Corporation of North Richmond
Consumer Action
Consumer Federation of California
East Bay Housing Organizations
East Oakland CDC
East Palo Alto Council of Tenants (EPACT) Education Fund
Fair Housing Council of the San Fernando Valley
Fair Housing of Marin
Fair Housing Law Project of the Law Foundation of Silicon Valley
Home Ownership Utilizing Supportive Education (H.O.U.S.E.)
Housing and Economic Rights Advocates
Inland Fair Housing
Law Center for Families
Legal Aid Foundation of Los Angeles
Local Alliance for Neighborhood Development & Integrated Services
Los Angeles Neighborhood Housing Services
Mission Economic Development Agency
Montebello Housing Development Corporation
Orange County Community Housing Corp.
Project Sentinel
Public Interest Law Firm of the Law Foundation of Silicon Valley
Rural Community Assistance Corporation
San Antonio Community Development Corporation
S.F. Consortium for Elder Abuse Prevention
Sierra Planning & Housing Alliance, Inc.
STAND Affordable Housing Program