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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: Regulation Z, Docket No. R-1305

Dear Secretary Johnson:

Coastal Enterprises, Inc. (CEI) believes that the Federal Reserve Board has taken an important step in proposing changes to its Regulation Z that are intended to end unfair and deceptive practices on high-cost loans. The nation faces a foreclosure crisis, in large part, because risky lending was not constrained due to a lack of consumer protections and safety and soundness standards. Foreclosures are projected to be at least 2 million in the next couple of years.

CEI is a CDFI (community development finance institution) serving primarily Maine, as well as northern New England and upstate New York. Over the last few years we have seen an increase in housing counseling clients in foreclosure, particularly over the last year. Maine currently has the highest rate of first lien subprime loans in foreclosure (10.7%) in New England and exceeds the national average of 9.1%.[1] We frequently find both fraudulent lending practices as well as legal practices that permitted borrowers to get loans they could not afford, even at the initial rates, much less when these adjustable rate mortgages adjusted up. Because of these practices, CEI played a leadership role in passing Maine's anti-predatory lending law (An Act to Protect Homeowners from Predatory Lending) in June 2007. We are very concerned that any regulation that the Federal Reserve passes is at least as strong, if not better, than our law in Maine, and does not preempt what we already have in place.

While the Federal Reserve's proposal is critical and overdue, it has significant openings and exceptions in its major provisions dealing with unfair lending practices. The proposal has commendable aspects, but these open areas could significantly weaken important provisions of the proposed rule. We urge the Federal Reserve to address these areas and ensure that there are no opportunities to circumvent its major provisions.

[1] Data is Federal Reserve Board estimates based on data from First American Loan Performance, December, 2007. The First American Loan Performance data base covers 70% of securitized subprime loans; it does not cover loans securitized by Fannie Mae and Freddie Mac. The calculations of percentages are the author's using the Federal Reserve Board estimates based on data from First American Loan Performance, December 2007. .

Our comments on specific aspects of the proposal include the following:

Ability-to-Repay: We support the proposal's ability-to-repay standard. The proposed standards will curb the practice of qualifying borrowers on the initial, teaser rate – a practice that has contributed to "payment shock" and borrowers becoming delinquent after the loan's rate increases dramatically from the initial rate.

Unfortunately, other aspects of the proposed ability-to-repay standard have the potential to undermine protections against unfair and deceptive lending. For example, the proposal requires documentation of income but then contains an exception that essentially permits the practice of limited documented lending to continue. In addition, the proposed rule should require that a lender assure a borrower can repay during the entire term of the loan, not just the first seven years. Finally, and importantly, the ability-to-repay standard requires borrowers suing lenders to prove that the lenders exhibited a pattern and practice of making unaffordable loans. This is a very difficult standard for borrowers of limited resources to prove. The Federal Reserve should at least allow individual lawsuits under a standard that is not so difficult to prove.

Escrows Required: The proposal recognizes the importance of requiring escrows on high-cost and very-high cost loans. Yet, it permits a lender to allow a borrower to opt-out of escrow requirements after 12 months. Borrowers not familiar with the loan process can be swayed to opt-out of escrow requirements and then face unaffordable expenses. The proposal should not allow for the elimination of escrow requirements on high-cost and very-high cost loans.

Prepayment Penalties: The proposal to ban prepayment penalties after 5 years is too long a time period for high-cost and very-high cost loans. Some borrowers may need to refinance before that time to escape unaffordable loans. We urge the Federal Reserve to set a limit of between two to three years. The prepayment penalty should also be limited to a reasonable dollar amount so that the penalty does not pose a barrier preventing a refinance into a lower cost loan. In addition, we agree with the Federal Reserve that prepayment penalties must cease before the initial rate expires on an adjustable rate mortgage (ARM) loan. But we urge the Federal Reserve to require prepayment penalties to cease 90 days before the expiration of the initial rate, not 60 days as proposed.

Yield Spread Premiums: Yield spread premiums (YSPs) must be banned on high-cost and very-high cost loans instead of the proposed improvements in disclosures of YSPs. The subprime market is too complicated for borrowers unfamiliar with the loan process to be assisted in a meaningful way by enhanced disclosures of YSPs.

Protections for All Loans: We support the proposed protections against appraisal fraud, servicing abusive and deceptive advertising. We also support the proposed requirement that good faith estimates (GFE) of loan costs for refinance and other non-home purchase loans be supplied to borrowers before payment of application fees.

We urge the Federal Reserve to add protections in the area of servicing. For example, the Federal Reserve must require reasonable loss mitigation efforts before foreclosure proceedings are commenced. Protections against appraisal fraud must require a new appraisal and an adjusted loan amount in cases when the original appraisal was inflated.

Non-Traditional Prime Loans not Covered: The Federal Reserve has proposed protections regarding ability-to-repay, escrows, and prepayment penalties for high-cost loans only. It has not proposed these protections for exotic prime loans, such as option ARM loans, that have proven to be very problematic. The Federal Reserve must cover non-traditional prime loans as well.

Liability for Secondary Market: Aside for violations including very high-cost loans, the secondary market's liability is quite limited. Since most subprime loans are sold to investors, the limited liability for investors provides no effective redress for borrowers. At the very least, the Federal Reserve should broaden liability and allow individual borrowers to seek redress, if not class action lawsuits.

Conclusion

We urge the Federal Reserve to significantly strengthen and implement its proposal. Inadequate consumer protection regulation has significantly contributed to the foreclosure crisis and the current economic uncertainty. At the same time, Congress must pass a strong anti-predatory lending bill since even a strengthened Federal Reserve amendment of Regulation Z is unlikely to be as comprehensive and strong as needed in covering all parts of the lending industry.

Thank you for this opportunity to provide comments on this important matter.

Sincerely,

Ronald L. Phillips
President

cc: National Community Reinvestment Coalition