Center for Responsible Lending
302 W. Main Street
Durham, NC 27701

August 28, 2008

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

Re: Regulation C: Docket No. R-1321

Dear Ms. Johnson:

The Center for Responsible Lending (CRL) appreciates the opportunity to comment on the proposed revisions to Regulation C. Our comments are based both on our extensive experience working with data collected and reported pursuant to the Home Mortgage Disclosure Act (HMDA) and on a specific analysis that we conducted to evaluate the proposed changes.

Overall, we believe that the proposed changes to the rate spread disclosure threshold will achieve the Board's stated objective of more consistently identifying subprime loans while excluding prime loans from reporting requirements. By aligning Regulation C with standards set forth in Regulation Z, we also believe the proposed change will increase compliance while reducing costs and improving the ability of policymakers, regulators, researchers, and community-based organizations to better understand the reach of Regulation Z's new protections. For these reasons, we commend the Federal Reserve Board (Board) for its thoughtful proposal.

In light of the recent collapse of the subprime market and the devastating impact it has had on the nation's neighborhoods, housing market and economy, however, we believe that Regulation C should require reporting additional information. A primary purpose of HMDA is to help public officials target their resources and determine if lenders are meeting the housing needs of their communities. While understanding which loans have relatively high APRs is very helpful in this respect, it is clearly insufficient. To meet this charge in today's market, HMDA must provide information on the incidence and distribution of loans that present unique challenges to borrowers. To address this concern, we believe additional information on loan structure should be provided. Equipped with such information, analysts working with HMDA data will be much better-positioned to identify and evaluate emerging trends before they evolve into potential crises.

Finally, we renew our long-standing request to add reporting requirements that would identify brokered loans, disclose the total points and fees associated with a loan, and identify applicants' ages.[1] All of this information is readily known to lenders and would add tremendous benefit while imposing minimal additional costs in the course of a revision that will require a change in systems.

Summary of comments

Below are summary comments in response to the seven specific requests made in the notice of proposed rulemaking:

(1) We support the Board's proposal to change the reporting benchmark from Treasury yields to average prime offer rates. By using mortgage rates as a baseline from which to evaluate the pricing of originated home loans, the Board will more fully achieve its goal of requiring reporting of pricing on subprime loans while exempting prime loans. Our analysis shows that these improvements will be particularly notable during periods of unusual market conditions.

(2) We support the Board's plan to use the Freddie Mac Primary Mortgage Market Survey (PMMS) to estimate average prime offer rates. We agree with the Board's assessment that the PMMS results track other measurements of the costs of prime mortgages with reasonable accuracy.

(3) We support the method the Board proposes to use to derive average prime offer rates from the PMMS data, including its methods for deriving start rates for hybrid ARM products not included in the PMMS. However, we suggest that the Board clarify its method for identifying "comparable transactions" in its final rule.

(4) Given the Board's objectives, we support the specific proposed APR thresholds. Had the proposed threshold been in place from 2005 through the end of 2007, our analysis shows that it would have had little effect on the proportion of first-lien subprime and prime loans required to report pricing information while simultaneously increasing the consistency of those measurements. At the same time, we are concerned that the limited pricing information (both as it exists and as proposed) fails to provide insight into the incidence and distribution of certain loans that do not exceed these thresholds, yet present unique challenges to borrowers. Consequently, we recommend a new reporting requirement that would identify loan features on all originated and purchased loans (indicators for negative amortization, interest-only, balloon payment, reverse mortgage, open-end structure, equity sharing; and disclosure of prepayment penalty period and hybrid ARM fixed-rate period).

(5) While the proposed timing for the rate spread determination (time of final rate lock) is rational, we are concerned that it will be difficult for borrowers, their advocates, and

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[1] *See e.g.*, March 9, 2001 CRL comment letter on Federal Reserve Regulation C Docket No. R-1001 (requesting loan channel and points and fees information) (available at http://www.responsiblelending.org/pdfs/comments.PDF).

others to verify that their loan has been properly characterized—either for Regulation C or Regulation Z purposes. The rate-lock date is frequently not evidenced in documents received by the borrower. Also, adding to potential confusion, a loan may have more than one rate-lock date. As an alternative, we recommend that the Board use the average prime offer rate that would result from using the most recent PMMS results as of the 15th day of the month prior to loan closing as the appropriate reference rate.

(6) We support the proposed effective date of these amendments and the proposed method for transitioning to the new system.

(7) Finally, while we believe that there are benefits to the proposed changes, we believe the Board is missing an opportunity to make significant improvements to HMDA. In particular, we believe recent events have once again illustrated the need and potential benefit that would flow from requiring lenders to report whether a loan was originated through a third-party such as a broker and the total points and fees paid on the loan. In addition, particularly in light of the critical importance of home equity to older Americans, we believe the addition of applicants' ages to HMDA is indicated.

Positive aspects of the proposed rule

Benchmark for rate-reporting

We support the Board's proposal to change the reporting benchmark from Treasury yields to average prime offer rates. By using mortgage rates as a baseline from which to evaluate the pricing of reported home loans, the Board will more fully achieve its goal of requiring reporting of pricing on subprime loans while exempting prime loans. Our analysis shows that these improvements will be particularly notable during periods of unusual market conditions. These results are discussed below in more detail (please see "Threshold for rate-reporting").

We support the Board's plan to use the Freddie Mac Primary Mortgage Market Survey (PMMS) to estimate average prime offer rates. We agree with the Board's assessment that the PMMS results track other measurements of the costs of prime mortgages with reasonable accuracy.

We support the method the Board proposes to use to derive average prime offer rates from the PMMS data, including its methods for deriving start rates for hybrid ARM products not included in the PMMS. However, we suggest that the Board clarify its method for identifying "comparable transactions" in its final rule. While the Board should provide a complete explanation of its approach, it would be particularly useful to do so for ARMs with introductory rates in place for less than a year. In this case, we suggest the Board consider designating the average prime offer rate results obtained for 1-year hybrid ARMs for all ARMs with no initial term or with initial terms of one-year or less as the comparable transaction.

Threshold for rate-reporting

Given the Board's objectives, we support the specific proposed APR thresholds. Had the proposed threshold been in place from 2005 through the end of 2007, our analysis shows that it would have had little effect on the proportion of first-lien subprime and prime loans required to report pricing information while simultaneously increasing the consistency of those measurements.

To analyze the impact of the proposed changes to the APR spread reporting threshold, we evaluated a sample of first-lien, owner-occupied loans from McDash Analytics.[2] Specifically, we estimated the APR at origination for subsets of prime and subprime loans originated between January 2005 and December 2007.[3] We then compared these APR estimates to both the existing and proposed HMDA rate-reporting thresholds. In general, we find that the proposed threshold is very consistent with the current threshold in terms of the proportions of each of our samples that would be included for rate reporting. However, the new standard has the added advantage that the measurements result in less variability in the proportion of the samples that would be required to report pricing information from month-to-month. This result is desirable in that the consistency will allow for better understanding of changes over time. Our specific findings for each sample are presented below.

Compared to the current threshold, the proposed threshold captures subprime loans over time in a more consistent way. The current and proposed threshold captured an average of 84 to 85 percent of our subset of subprime loans per month. However, the proposed threshold had less variability (standard deviation of observations of 8.1% compared to 11.6% under the current threshold).

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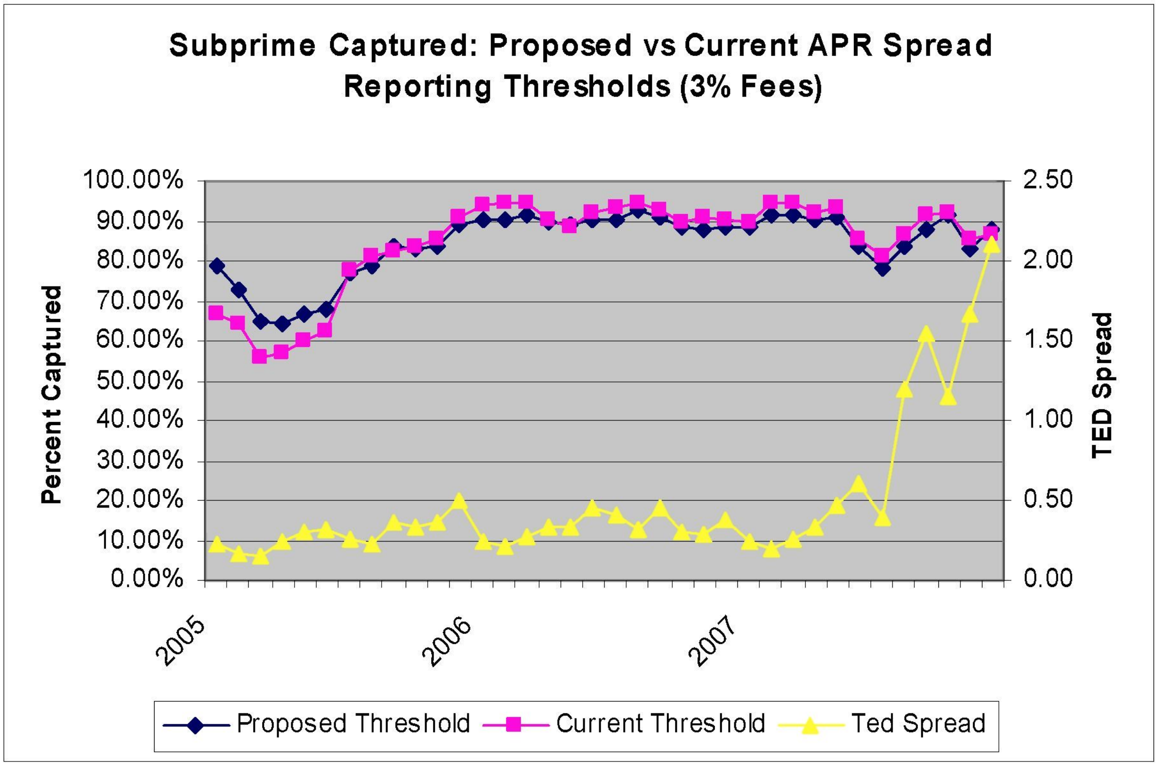
[2] McDash Analytics includes information on the note rate for fixed-rate mortgages, as well as the initial rate, adjustment periods, margin, index and caps for loans with adjustable rates. To estimate APRs for prime loans, we used the average points and fees from the PMMS for the month of origination. To estimate APRs for payment option ARMs and subprime loans, we assumed fees of 3 percent. However, we also conducted the analysis assuming fees for payment option ARMs and subprime loans of 5 percent. Though the findings outlined in this letter are based on the 3 percent fee assumptions, our basic findings hold true for 5 percent fees as well. Finally, since we do not know when borrowers locked-in their rates, we use the origination date to calculate APR for prime offer rates.

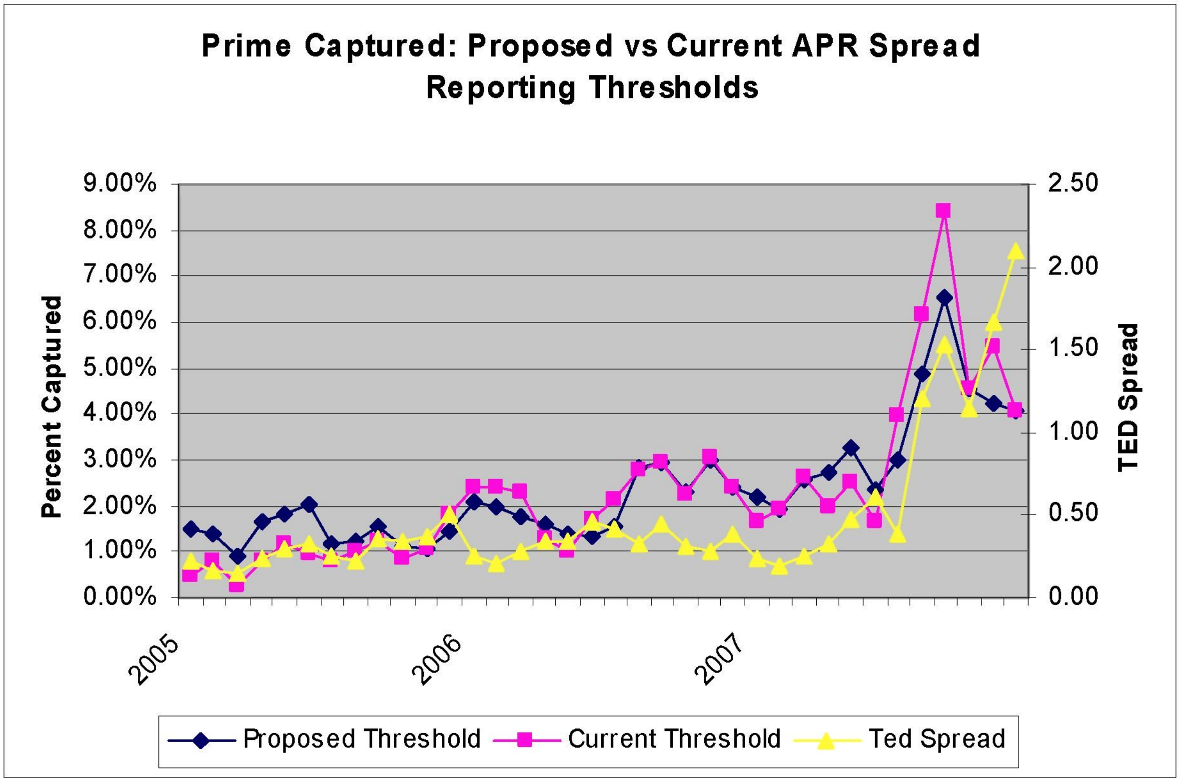
[3] McDash Analytics does not uniformly indicate whether loans are subprime or prime. Therefore, we categorized loans that were identified as first-lien "B&C" or which were fully-amortizing ARMs with margins greater than 300 basis points as subprime. We next selected a group of loans that had not been identified as subprime and which allowed for negative amortization to create a set of pay option ARMs. Finally, we selected loans that were not in our subprime or pay option ARM sets and which were listed as having Freddie Mae or Freddie Mac as the investor. To further insure this final sample reflected prime status, we removed loans that had loan-to-value ratios over 80 but did not have private mortgage insurance. Of course, while the selection criteria for prime loans will exclude jumbo loans from our analysis, we believe it provides a high degree of certainty that the sample avoids falsely characterizing mortgages as prime.



Compared to the current threshold, the proposed threshold captures roughly the same number of prime loans. Our analysis shows that both the old and the new threshold capture an average of 2.3 percent of prime loans in our sample each month. The proposed threshold has slightly less variability (standard deviation of observations of 1.2% versus 1.7% under existing threshold). Also, as can be observed directly on the figure below, the proposed threshold results in a notably smaller response to the rapidly increasing TED spread in the second half of 2007.[4] Interestingly, the results between thresholds do not markedly diverge during the latter half of 2006 and the first half of 2007, a period of time characterized by an inverted yield curve.[5]

[4] The TED spread used here is calculated as the percentage point difference between the yield on 3-month U.S. Treasury Securities and 3-month Eurodollar deposits as reported in Federal Reserve Statistical Release H.15. Increased TED spreads are typically interpreted as indicative of increased risk-aversion on the part of investors.

[5] We determined the slope of the yield curve using the percentage point differences in yields on 1-year and 10-year U.S. Treasury Securities as published in Federal Reserve Statistical Release H.15.



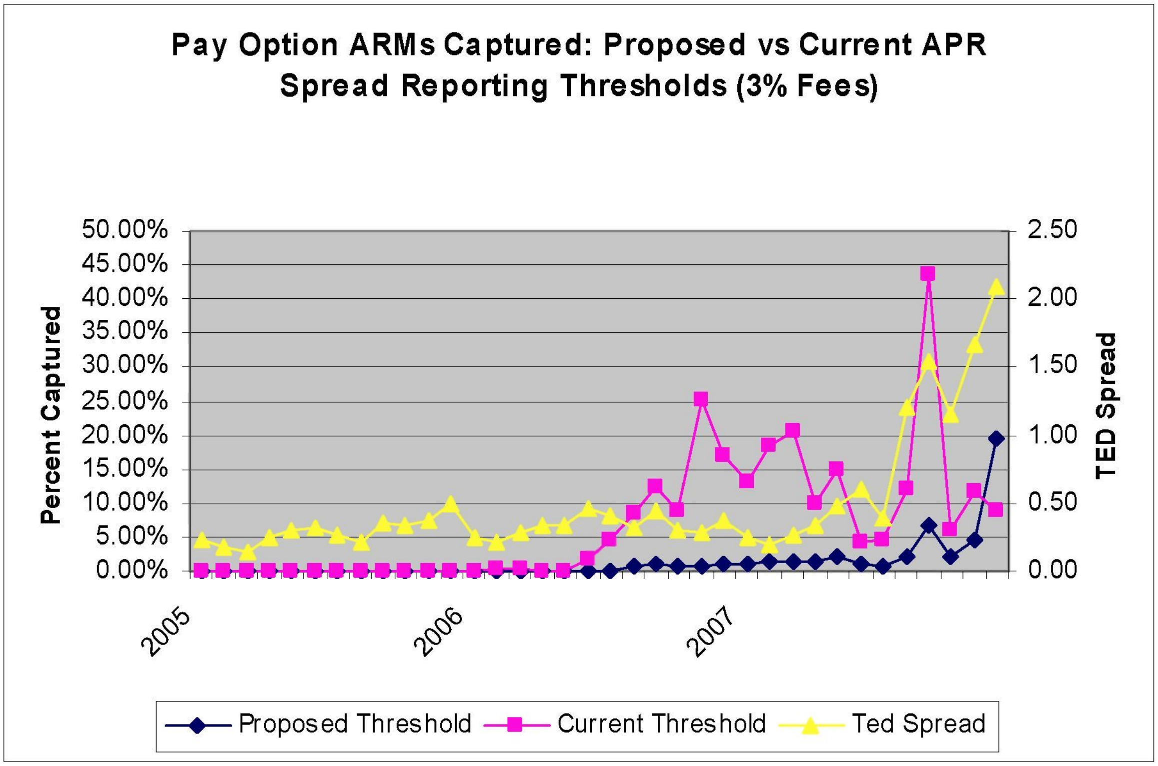
Suggestions to improve the proposed rule

Identify loan features

We are concerned that the pricing information collected in HMDA (both as it exists and as proposed) fails to provide insight into the incidence and distribution of certain loans that do not exceed these thresholds, yet present unique challenges to borrowers. Many of these loans are concentrated in the alt-A market segment. Perhaps most notably along these lines, pay option ARMs entail risks, which if not properly managed through prudent underwriting and other responsible practices, can result in significant challenges to borrowers.

Currently, lenders do not explicitly identify these loans in HMDA nor, as the analysis below demonstrates, are they included in the set of loans requiring rate-reporting in any great proportion under the current or proposed thresholds. Consequently, we recommend a multiple-position field that would identify certain loan features on all originated and purchased loans without regard to whether the loan is above or below the threshold for rate spread reporting. As envisioned the loan feature field would contain indicators for negative amortization, interest-only, balloon payment, reverse mortgage, open-end structure, equity sharing; and three digit disclosures of prepayment penalty period and hybrid ARM fixed-rate period.

Compared to the current threshold, the proposed threshold captures even fewer payment option ARMs. The proposed threshold captures even fewer payment option ARMs than the current threshold (monthly average of 1.4% versus 6.9%). Consistent with the results obtained for the prime and subprime sample, the percentage of the sample captured each month had less variability under the proposed threshold (standard deviation of observations of 3.4% versus 9.5% under the existing threshold).[6] The strong response of the existing standard in the high TED spread period in the latter half of 2007 is markedly different from the moderate response of the proposed standard.



Timing for threshold determination

While the proposed timing for the rate spread determination (time of rate lock) is rational, we are concerned that it will be difficult for borrowers, their advocates, and others to verify that their loan has been properly characterized—either for Regulation C or Regulation Z purposes. The rate-lock date is frequently not evidenced in documents received by the borrower. Also, adding to potential confusion, a loan may have more than one rate-lock date. As an alternative, we recommend that the Board use the most recent average prime offer rates obtained as of the 15th day of the month prior to loan closing as the appropriate reference rate. This choice would imply a rate lock period of 15-45 days. We believe that such an assumption is reasonable in light of the benefits that

[6] For all three sets of loans (i.e. subprime, prime and POARM), our analysis showed that the magnitude of the spread for loans above the threshold was slightly than for the existing threshold.

would be gained from certainty around the appropriate date to be used. Moreover, the standard would provide a minimum of two weeks from rate determination to loan closing, an adequate period of time for the lender to ensure compliance.

Additional benefits

Finally, while we believe that there are benefits to the proposed changes that clearly outweigh any one-time costs associated with reprogramming systems to adjust to the new standard, we believe the Board is missing an opportunity to make significant improvements to HMDA. In particular, we believe recent events have once again illustrated the need and potential benefit that would flow from requiring lenders to report whether a loan was originated through a third-party such as a broker and the total points and fees paid on the loan. In addition, particularly in light of the critical importance of home equity to older Americans, we believe the addition of applicants' ages to HMDA is indicated.

In closing, CRL once again thanks the Board for the opportunity to comment on the proposed revisions to Regulation C.

Sincerely,

Keith Ernst
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