

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DIVISION OF CONSUMER AND COMMUNITY AFFAIRS

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DATE: July 9, 2010  
TO: Public Dockets R-1366; R-1367  
FROM: DCCA Staff  
SUBJECT: Meeting with NCLC and CRL Representatives

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On February 4, 2010, representatives with the National Consumer Law Center and the Center for Responsible Lending met with Board staff. The representatives were: Margot Saunders, Diane Thompson, and Andrew Pizor, NCLC; and Kathleen Keest, CRL. The representatives discussed their views regarding the Board's August 2009 proposed rules for closed-end mortgages and HELOCs. They also offered views on the Board's review of the rules regarding the consumer's right to rescind. Their views are summarized in the attached agenda they prepared for the meeting with Board staff.

**AGENDA**  
**Federal Reserve Board - February 4, 2010**

1. Introductions
2. Extend Substantive Protections to All Loans (both Alt-A & HELOCs) (20 min)
  - All of the justifications for regulating subprime loans in 2008 apply to both Alt A and HELOCs
  - Regulate HELOCs Like Closed-End Mortgages
    - Both in disclosures and substance, the divergence of protections is a problem
    - The foreseeable result will be that abuses and lapses will migrate (to the extent they have not already). The greater the differences in protections, the greater the incentive for industry to move to the least regulated product.
    - Especially in 80/20s, lack of complete information to consumers on the obligation; no GFE or early TIL required for HELOCs; no advance notice requirement; no "all-in price tag. Result: equally positioned consumers get treated unequally.
3. Ban Payment Terms That Allow Long-Term Negative Amortization (10 min.)
  - Contract terms are too complex for most homeowners to understand
  - The risk of loss far outweighs any benefit
  - Long-term negative amortization hurts sustainable homeownership
  - A ban will not harm the market now and will protect everyone when memories fade
4. The Right of Rescission—Clarification Particularly Important Since Refinancing Is Now Difficult (25 min.)
  - Underline necessity of strict compliance
  - Further clarify who must receive notice: notice to servicer must be good notice as to holder
  - Clarify damages, particularly when assignees are involved
  - Extend the definition of material disclosures
  - Address tender issues
    - Add explicit examples for tender: cash now, cash at some point in future, sale, loan modification
    - Tender must not be a condition precedent to getting in the court house doors
  - Allow class actions for rescission
5. No Foreclosure Without Loan Modification Evaluation (10 min.)
  - Creditors should be required to offer sustainable and affordable loan modifications to delinquent borrowers before referring the account to foreclosure
  - Use of an NPV test will protect investors and will promote market stability
  - Requirement would comport with the generally recognized legal duty to mitigate damages.
6. Reverse Mortgages (5 min.)
  - Reverse mortgages are of growing importance—600% increase in Ginnie Mae HECM MBS in 2009
  - NCLC study shows unaddressed problems

## Payment Option ARMs: Current Status and Conclusions

### RECOMMENDATION:

**Prohibit long-term negative amortization.** We urge the Board to prohibit mortgages secured by homeowners' principal residences where the note allows long-term negative amortization. This form of credit—predominantly POARMs—is not only asset-based but depends on the asset appreciating significantly in value. POARMs are unsustainable unless the economic stars are perfectly aligned to create an environment in which rates remain low, property values climb, or borrowers win the lottery. From an asset-building perspective, a POARM is worse than renting.

### ANALYSIS:

#### **POARMs are dangerous for investors.**

Moodys anticipates POARM RMBS to sustain cumulative losses of:<sup>1</sup>

- 20% on 2005 RMBS
- 41% on 2006 RMBS
- 51% on 2007 RMBS

#### **POARMs have proven highly detrimental to homeownership.**

Serious delinquencies on POARMs:<sup>2</sup>

- 40.4% for 2005 loans
- 47.3% for 2006 loans
- 41.3% for 2007 loans

Compared to 8.85% of all loans (MBA 3rd Q. 2009)

#### **The 2006 interagency guidance on non-traditional loans<sup>3</sup> was inadequate.**

The high losses and default rates on post-2006 loans shows either:

- lenders ignored the guidance because it was voluntary, or
- the guidance was not strong enough

Either explanation shows the Board needs to take clear, strong action against residential mortgages that allow the accumulation of negative amortization.

#### **By creating negative equity, POARMs increase the risk of default.**

- Over 80% of borrowers make the minimum payment.<sup>4</sup>
- Negative equity "lowers homeowners' mobility because they can't sell, even if they want to move to get a new job." Borrowers who owe more than 120% of their home's value . . . [are] more likely to default."

—Mark Fleming, chief economist of First American Core Logic<sup>5</sup>

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<sup>1</sup> Diana Golobay, *Option ARMs Surpass Subprime Mortgages in Loss Severity*, Housing Wire, Jan. 29, 2010, available at [www.housingwire.com/2010/01/29/option-arms-surpass-subprimemortgages-in-loss-severity/](http://www.housingwire.com/2010/01/29/option-arms-surpass-subprimemortgages-in-loss-severity/).

<sup>2</sup> *Id.*

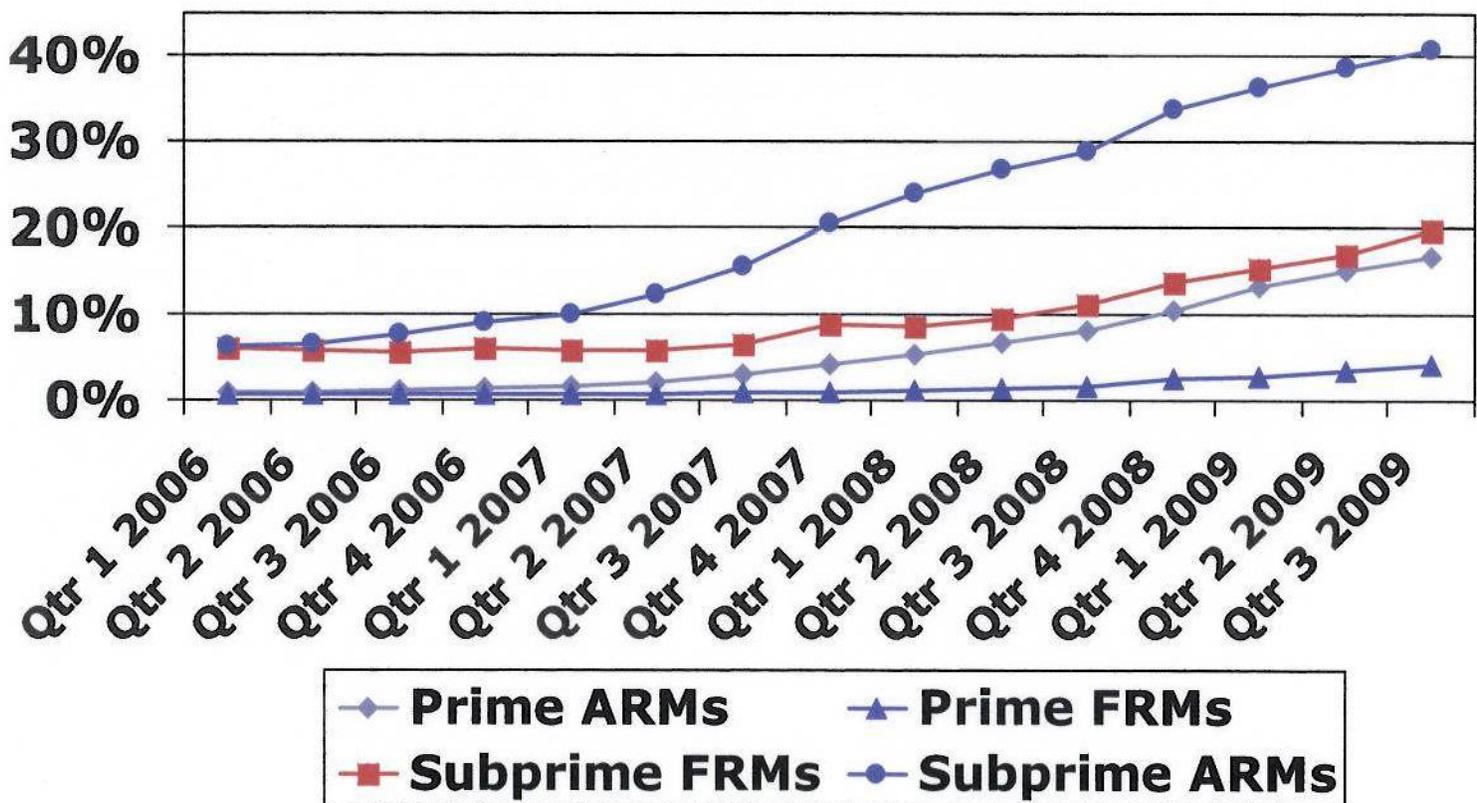
<sup>3</sup> Interagency Guidance on Nontraditional Mortgage Product Risks, 71 Fed. Reg. 58,609 (Oct. 4, 2006).

<sup>4</sup> Joint Ctr. for Hous. Studies, *State of the Nation's Housing 2007*, at 17

<sup>5</sup> Ruth Simon and James R. Hagerty, *One in Four Borrowers is Underwater*, Nov. 24, 2009, available at <http://online.wsj.com/article/SB125903489722661849.html>. See also Fernando Ferreira, et al., *Housing Busts and Household Mobility*, NBER Working Paper No. 14310 (Abstract, Sept. 2008) (finding negative equity reduces homeowner mobility by almost 50%).

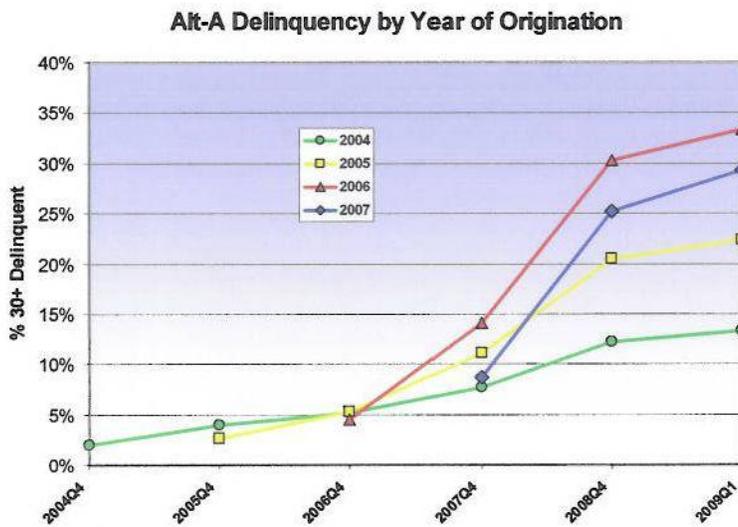
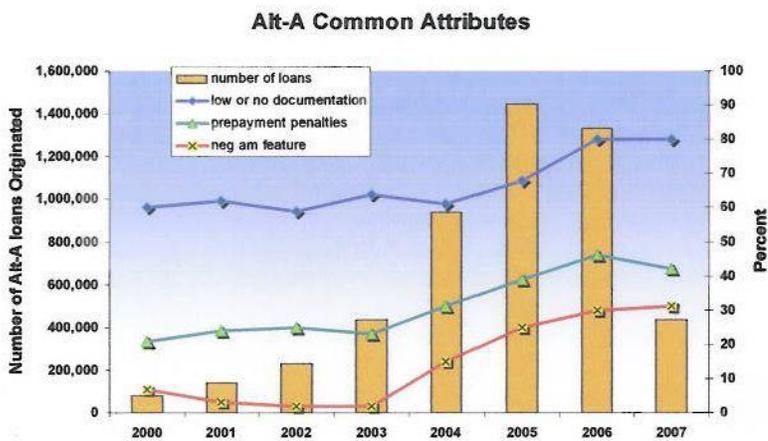
# ARMS "SERIOUSLY" DELINQUENT (90+ DAYS)

Source: MBA Delinquency Survey, 2006-2009

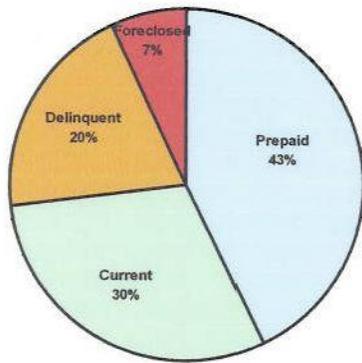


Excerpts from Presentation –

Sam Rogers, Sonia Garrison, Pete Smith, Center for Responsible Lending: *The State of Alt-A, Interpreting the GAO report on the Characteristics and Performance of Non-prime Mortgages* (from July 29, 2009).



**Performance Status Payment Option ARMS Originated  
2004-2007**



**Current Status Outstanding Payment Option Arms  
Originated 2004-2007**

