



August 3, 2007

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

Re: Request for Comments: Docket No. OP-128

I. INTRODUCTION

The Securities Industry and Financial Markets Association (SIFMA)¹ and the American Securitization Forum (ASF)² appreciate the opportunity to provide comments to the Board of Governors of the Federal Reserve System (the Board) regarding the Board's authority to address certain abusive or unfair lending practices. Due to the importance of mortgage-backed investment vehicles in the securitization markets, SIFMA and ASF have been studying and discussing with their members initiatives of federal and state policymakers to address the challenges in the subprime mortgage industry. We fully support the Board's efforts to explore ways to curb abuses without restricting the availability of legitimate affordable mortgage credit. In addition to the testimony offered at your June 14, 2007 public hearing by Michael Decker, SIFMA's Senior Managing Director for Research and Public Policy, we respectfully request that the Board consider the following comments in deciding whether to issue proposed regulations, and if so what the substance of those regulations should be.

In submitting these comments, we recognize that many of our members would not be directly subject to the substantive restrictions or prohibitions of the Board's regulations under the Home

¹ SIFMA brings together the shared interests of more than 650 securities firms, banks, and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services, and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington, D.C., and London. Its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

² ASF is a broad-based professional forum of over 370 organizations that are active participants in the U.S. securitization market. Among other roles, ASF members act as issuers, investors, financial intermediaries, and professional advisers working on securitization transactions. ASF's mission includes building consensus, pursuing advocacy and delivering education on behalf of the securitization markets and their participants. This letter was developed principally in consultation with ASF's Subprime Mortgage Finance Task Force, with input from other ASF members and committees. Additional information about the ASF, its members and activities may be found at ASF's internet website, located at www.americansecuritization.com. ASF is an adjunct forum of SIFMA.

Ownership Equity Protection Act (HOEPA). While many of our members do not directly act as mortgage creditors or interact directly with consumers, our members recognize that the nation's well-functioning and efficient mortgage securities markets, which ensure American homeowners (and future homeowners) have access to affordable mortgage loans, will depend upon and be deeply affected by the government's response to subprime challenges. Thus, we believe that the consideration of our members' comments in your deliberations is critical.

II. GENERAL COMMENTS

In Section 129 of HOEPA, Congress imposed disclosure requirements and substantive restrictions on the terms and features of certain higher cost home mortgage loans. That section of HOEPA also charged the Board with issuing regulations or orders to prohibit acts or practices it found to be "unfair, deceptive, or designed to evade" HOEPA, or that (in connection with refinancings) are abusive or are not in the borrower's interest. To examine whether and how to use that authority, on May 31, 2007 the Board announced that it would hold a public hearing on the home equity lending market, and also invited the public to submit comments. Wisely, the Board stated that it is seeking information to evaluate whether it can address predatory lending issues in a way that preserves incentives for responsible lenders to provide credit to borrowers, particularly subprime borrowers. In seeking that information, the Board asked broad-ranging questions about the impact of certain potential regulatory prohibitions through the use of its authority to address "unfair and deceptive" acts or practices, or acts or practices designed to evade HOEPA. In response, SIFMA and ASF members have several overarching principles for the Board's consideration, followed in the next section by comments on the Board's specific questions. We also discuss below the congressional intent behind the Section 129 rulemaking authority and the resulting narrow scope of that authority.

A. Recent Measures Already Working

First, the Board, other regulatory agencies, and participants in the mortgage financing markets have, in the last year, taken numerous steps in an attempt to address the problems perceived as harmful to subprime borrowers and the mortgage market.

- In October 2006, the Board and the other federal banking regulators issued the Interagency Guidance on Nontraditional Mortgage Product Risks (Nontraditional Guidance), addressing topics similar to those in the Board's request, such as determining the ability to repay nontraditional mortgage loans and stated income/reduced documentation underwriting.
- The Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR) quickly adopted the Nontraditional Guidance and distributed substantially similar guidance to state agencies that regulate residential mortgage brokers and mortgage companies. Upon that pronouncement, many states immediately began adopting, through various processes, the CSBS/AARMR master nontraditional mortgage guidance without modification.
- Fannie Mae and Freddie Mac announced they are implementing changes to their underwriting requirements and policies consistent with the Nontraditional Guidance, and that beginning this fall, they will not purchase loans that do not comply with that Guidance, regardless of whether the particular lender is otherwise directly subject to the Guidance on either the federal or state level. (Fannie Mae also announced it intends to take the same steps in accordance with the Subprime Statement, described below.)
- In late June of this year, the Board and other federal agencies adopted their Statement on Subprime Mortgage Lending (Subprime Statement), in even greater alignment with the Board's current request for comments, addressing standards for the borrower's ability to repay, the use of stated income/reduced documentation underwriting, prepayment penalties, and the option of escrowing for taxes and insurance.

- On July 17, 2007, the CSBS, the AARMR, and the National Association of Consumer Credit Administrators issued a Statement on Subprime Lending to state agencies that regulate residential mortgage brokers and companies, which statement is substantially similar to the federal Subprime Statement. Those organizations report that 26 mortgage regulators stand ready to expedite implementation of that Statement.
- On July 18, 2007, the Board, the Office of Thrift Supervision, and the Federal Trade Commission, along with the CSBS and the AARMR announced that they will cooperate in an innovative pilot project to conduct targeted consumer-protection compliance reviews of selected non-depository lenders with significant subprime mortgage operations. The agencies will evaluate the companies' underwriting standards and compliance with state and federal consumer protection laws and regulations.
- Significant changes have taken place within the industry in response to the challenges presented by the current economic environment, including the material losses actually realized and to be realized by holders of subprime securities. Subprime mortgage underwriting, due diligence, and loan purchase and securitization criteria have tightened considerably. Many subprime lenders have exited the subprime business entirely, have been acquired, or have become insolvent. Those that remain have modified their lending standards and programs, with some having announced recently that they will no longer offer certain hybrid adjustable rate loan products. Institutional investors have curtailed their involvement in some segments of the subprime mortgage market altogether, and have raised the risk premiums they require in order to remain involved in others. As a result of those market forces, the availability of subprime credit to borrowers seeking to purchase or refinance their homes and the liquidity supplied to the subprime mortgage finance sector via the debt capital markets have already diminished considerably.

The Nontraditional Guidance and the Subprime Statement mentioned above address many issues related to mortgage lending, including the issues for which the Board has requested comment. Importantly, the federal banking agencies recognized the need for flexibility in providing and underwriting mortgage credit. The agencies issued guidance documents, rather than strict regulations, taking a nuanced approach based on a layering of risk factors and a search for mitigating factors. Those guidance documents (and the actions by states and the government-sponsored enterprises in tandem with those documents) have already changed and will continue to change the behavior of both state and federally regulated lenders, yet they preserve the flexibility of those institutions to meet the needs of deserving borrowers. SIFMA and ASF urge the Board to review the impact of those changes before proposing additional regulations, and to target its efforts instead on proposing improved uniform disclosures to assist borrowers, as addressed further below.

B. Mortgage Products/Features Not “Unfair” or “Deceptive”

Second, we appreciate and further encourage the Board's recognition of the important distinction between the abuses relating to sales and marketing of mortgage loans (with issues such as faulty or misleading disclosures, fraud, or steering) – which the government properly should address through its “unfair and deceptive” authority (as well as through penal/criminal enforcement authority) – and mortgage loan product types and features (such as prepayment fees or underwriting documentation requirements) that are not inherently unfair but in fact may benefit certain borrowers. In our view, the Board should focus its efforts on preventing unfair and deceptive lending practices in connection with HOEPA loans through creating improved uniform mortgage disclosures for borrowers, and not prohibiting certain products or features that are not inherently unfair or deceptive. In the dynamic and ever-changing mortgage market, we believe it is absolutely critical to empower the mortgage finance industry to innovate and provide flexible approaches to meet the credit needs of consumers, and to empower borrowers by giving them clear and balanced information, without prohibiting often beneficial loan terms or features.

C. Importance of Uniformity

Third, the Board also recognizes that the states have been very active in their attempts to address abusive lending practices and to protect their resident mortgage consumers from unfair marketing or origination practices. For over a decade, states have been enacting anti-predatory lending standards and imposing various substantive requirements, many of which vary from HOEPA's standards and requirements. These local laws have forced regional and national lenders to reconcile an overwhelming variety of standards and disclosure requirements. Similarly, the national mortgage-backed securities markets, which work effectively only through uniformity and certainty, have had to contend with often vague or subjective standards of compliance and even unbounded assignee liability. Apart from assignee liability, the substantive regulation and supervision of entities having the same functional involvement in the mortgage origination process varies widely, depending upon whether those entities are regulated at a federal or state level.

The recent avalanche of new federal and state requirements addressing similar concerns in different ways creates a compliance nightmare that already is impairing the efficient conduct of business. The mortgage industry faces significant challenges in dealing with requirements under each of the laws, regulations, and guidance, and determining how to rationalize or synchronize the inconsistent legal requirements. The likely result most certainly will be higher mortgage costs and confusion for consumers. The prospect of another layer of regulations and guidance addressing similar issues as those already addressed by the Board will exacerbate the problem.

For those reasons, SIFMA and ASF members stress the importance of uniform, clear, and consistent regulatory standards—a “level playing field” that will promote both lender compliance and the efficient operation of the secondary mortgage market. Any new regulations issued under HOEPA should explicitly provide that compliance with the regulations constitutes compliance with the federal and state Nontraditional Guidance and Subprime Statement, and that the regulations preempt inconsistent state laws even if they are deemed to be more restrictive than the new federal regulations. We think such an approach is consistent with the intent of Congress to delegate rulemaking authority to the Board in lieu of enacting new national legislation.

D. Improved Model Mortgage Disclosures

We support efforts like the agencies' recently released Downloadable Consumer Illustrations of Information on Nontraditional Mortgage Products, which give borrowers important information about their loan, and more importantly provide interest rate scenarios for borrowers so they can better understand the risks of taking out an adjustable rate mortgage. However, the agencies have yet to accomplish a comprehensive overhaul of uniform federal mortgage disclosures. Chairman Bernanke testified before Congress in July that the Board is testing proposed disclosures, but that it may take “some time” before the Board is ready to propose new uniform disclosures. Although the Board and other federal agencies have done much in approaching subprime mortgage problems, SIFMA and ASF members believe that uniform and meaningful model disclosures will assist borrowers in making informed choices and promote market efficiency.

The Board has broad rulemaking authority outside of HOEPA (under Section 105 of the Truth in Lending Act (TILA)) to publish model disclosures forms (applicable generally to all creditors and mortgage loans) to facilitate compliance with the Act and aid the borrower in understanding the transaction. That section also provides that a creditor using such a model form “shall be deemed to be in compliance with the disclosure provisions” of the Act. We urge the Board to focus its attention there in the hopes of speeding that process. Using Section 105 to provide clear information in a uniform disclosure to the borrower is the best way of addressing unfairness or deceptiveness in the subprime mortgage market.

E. Concerns Regarding Expanding HOEPA Remedies

Finally, if the Board considers expanding the substantive restrictions of HOEPA beyond high cost loans, we respectfully request that the Board remember the relationship between the substantive

requirements of HOEPA, including any new restrictions that might arise by virtue of this rulemaking process, and the extraordinary remedies that are available to aggrieved mortgagors under HOEPA. As you know, in addition to actual and statutory damages, HOEPA provides for rescission and enhanced damages. It also provides for assignee liability, which extends to violations by the creditor of any laws, not just those that arise under HOEPA, yet there are limited cure rights under HOEPA for a creditor or an assignee. There is virtually no primary or secondary market for loans subject to HOEPA because of the profound financial risks faced by both creditors and assignees, without regard to actual harm suffered by the mortgagor, or the assignee's knowledge of or participation in the creditor's origination violation. If those remedies were available to mortgagors under home loans that are not high cost loans, there could be a significant disruption in the marketplace. As a result, any proposed rulemaking should be extremely limited, objective, and clear in its application so as not to unduly restrict the availability of credit. Further, any rulemaking should address only those matters that cannot be adequately addressed through enhanced disclosure practices, and that rise to the level of unfair or deceptive acts. Even then, the Board must consider proposing less drastic remedies and enhanced cure rights. Otherwise, if the enhanced remedies for loans covered by Section 129 extend to home loans without regard to the cost of the loan, the Board faces the real risk that such home loans, like high cost loans under today's HOEPA, will become largely unmarketable.

At a minimum, we request that, in any proposed and final regulations under Section 129, the Board explicitly confirm that violations of new substantive regulations may not be asserted against an assignee (unless the related loan also is a high cost loan). Section 131(d) of TILA imposes assignee liability on "any person who purchases or is otherwise assigned a mortgage referred to in Section 103(aa)." The referenced section (103(aa)) is the definition of a high cost loan based on the loan's annual percentage rate or total points and fees. Section 129(j) makes any mortgage that contains a provision prohibited by that section subject to TILA's right of rescission under Section 125. In order to avoid the type of market disruption described above, any proposed and final regulations the Board decides to promulgate under Section 129 must state explicitly that violations of those new regulations do not create assignee liability under Section 131(d) nor a right of rescission against an assignee under Sections 125 and 129(j).

III. COMMENTS ON BOARD'S QUESTIONS

A. Prepayment Penalties

The Board asks whether it should direct its rulemaking authority at loans requiring a borrower to pay a fee to repay a mortgage loan before it is due. Specifically, the issue has arisen most frequently in the context of adjustable rate mortgage loans (ARMs) with an initial fixed-rate period, and whether prepayment fees should be prohibited if they apply to a borrower's repayment of the loan beyond the first rate or payment adjustment. The Board also asks whether enhanced disclosure of prepayment fee terms would address concerns about abuses. Finally, the Board requests comments on the extent to which a prepayment fee prohibition or restriction would affect consumers and the type and terms of credit offered.

HOEPA and the Board's regulations already address prepayment fees for applicable high cost mortgage loans, allowing them only under certain circumstances (only for the first five years, for consumers with a debt-to-income (DTI) ratio of 50% or less based on certain verified financial information, and so long as the repayment funds are not from the creditor or its affiliate). In addition, the new Subprime Statement provides that applicable institutions should not contract for prepayment penalties that exceed the initial reset period, and that borrowers should be provided a reasonable period of time (typically at least 60 days prior to the reset date) to refinance without penalty. The Subprime Statement also states that information to borrowers should clearly explain the ramifications of prepayment penalties, including the existence of a prepayment penalty, how it will be calculated, and when it may be imposed. As mentioned above, the states, with the encouragement of CSBS and AARMR, will likely, as promised, follow along and adopt similar standards in the coming months.

SIFMA and ASF members appreciate that the Board and the other banking agencies recognize the legitimate purpose prepayment penalties may serve, and have not seen fit to ban them (even in loans

subject to HOEPA's strict requirements). As many in the industry have already commented, prepayment penalties generally represent an economic trade-off, through which a borrower receives a lower interest rate over the life of the loan, or lower up-front fees, in return for the lender's additional security that the loan will not refinance for a set period of time (or that the lender will be compensated under those circumstances). As the Board notes, prepayment penalties in loans help to ensure a baseline return for lenders and investors in securities backed by those loans.

As such, prepayment penalties are not inherently unfair, deceptive, or detrimental to a borrower's interest, so long as the penalties and their terms are clearly disclosed. SIFMA and ASF members agree that improved disclosure of prepayment penalties may help reduce perceived abuses. Borrowers deserve to receive a clear, concise schedule of all costs and fees associated with a loan, including the presence of a prepayment penalty, its terms, and its expiration date. However, fully disclosed prepayment fees are not, in themselves, "unfair, deceptive, or designed to evade" HOEPA, nor are they abusive or contrary to the borrower's interest. Thus, SIFMA and ASF urge the Board not to consider using its "unfair or deceptive" authority in Section 129 of HOEPA to enact further regulatory restrictions on prepayment fees on any type of mortgage loan products (beyond those already reflected in HOEPA and the Subprime Statement), and instead to pursue, on a fast track using Section 105 of TILA, an enhanced and improved disclosure regime that will provide useful information to borrowers about the terms and costs of their mortgage loan.

B. Escrow for Taxes and Insurance on Subprime Loans

The Board also asserts that, unlike prime mortgage loans, loans to subprime borrowers typically do not include escrowing by the servicer for homeowner's expenses such as property taxes or insurance. Borrowers may not be aware of their responsibility to budget for and pay those expenses. The Board asks whether it should require escrowing for taxes and insurance for subprime mortgage loans, and if so, whether consumers should be permitted to "opt out" of that service. The Board also asks about appropriate disclosures regarding the presence or absence of escrows and estimated costs for taxes and insurance. Finally, the Board asks how escrow requirements would affect consumers and the type and terms of credit offered.

As a preliminary matter, the issue of forcing mortgagors to escrow funds for future payments has been a consumer protection issue at the state and federal levels for several years. Consumers have complained that it is inherently unfair to be required by a lender to escrow funds up front for future tax and insurance obligations to third parties. This has led some states to prohibit lenders from requiring borrowers to escrow funds unless the loan to value ratio exceeds a specified percentage.³ Congress also has specifically regulated the maintenance of escrows in Section 10 of the Real Estate Settlement Procedures Act (RESPA) to address consumers' concerns that no more than the amount reasonably anticipated to be disbursed over the next year be held in escrow accounts on residential mortgage loans.⁴ The Board proposal would mark a significant shift in public policy by obligating mortgagors to provide funds to the lender to pay future obligations.

The Board and the other federal banking agencies addressed escrowing in subprime mortgage loans in their recent Subprime Statement. The agencies suggest that applicable institutions can address escrowing concerns simply by requiring borrowers to escrow funds for taxes and insurance.⁵ However,

³ See, e.g., Cal. Civ. Code § 2954(a) (prohibiting the requirement of impound accounts except (among other circumstances) where the original principal amount of such a loan is 90% or more of the appraised value of the property securing the loan).

⁴ 12 U.S.C. § 2609.

⁵ In this regard, please be aware that the Fannie Mae/Freddie Mac uniform security instrument requires mortgagors to post escrows:

the agencies obviously recognized that the option of not escrowing is an appropriate choice for the borrower and the lender, and that while encouraging the practice may be appropriate, a regulatory mandate is not. The Subprime Statement also provides that information to borrowers should clearly explain, if applicable, a lack of escrow for taxes and insurance, including the requirement to make payments for real estate taxes and insurance in addition to their loan payments, and the fact that taxes and insurance costs can be substantial.

SIFMA and ASF members believe that the consideration of estimated taxes and insurance amounts is an essential part of a prudent underwriting process, and that lenders should consider the borrower's ability to afford those homeownership expenses when underwriting a loan. However, once again, there is nothing inherently unfair or deceptive about a loan that does not have escrows for taxes and insurance, which perhaps explains why Congress specifically legislated the amount of escrow funds that a lender could require a mortgagor to provide but not the right or requirement of a lender to demand that borrowers post escrows for future obligations.

In fact, as mentioned above, borrowers should have the informed option of budgeting for those expenses themselves, as they do all of their other periodic household expenses. There are legitimate reasons why a borrower may want to opt out of escrowing, such as the desire to manage his or her own cash flow. As with other issues regarding the borrower's best interests, SIFMA and ASF members believe that borrowers, not lenders (or the government), are in the best position to judge what is in their best interest.

With that, however, SIFMA and ASF members agree with the benefits of encouraging borrowers to opt in – to escrow funds for taxes and insurance on a monthly basis. If borrowers choose to opt out, our members support a requirement that they be given a clear good faith estimate of tax and insurance payments (although lenders certainly do not set those rates or premiums, so they cannot guarantee or be held responsible for those estimates). Borrowers are able to make their own informed choices, appropriate to their unique circumstances, when they are given clear information. Thus, while SIFMA and ASF members support clear and full information regarding escrowing, and urge the Board to propose model disclosures under TILA Section 105 as its top priority, they strongly object to removing legitimate options for borrowers in structuring their mortgage and homeownership finances.

C. “Stated Income” or “Low Doc” Loans

The Board recognizes lenders' comments that stated income or low documentation (low doc) loans are appropriate and beneficial for many borrowers. However, the Board has heard from consumer advocates that lenders sometimes charge higher rates for such loans, and that stated income and low doc loans may be vehicles for fraud by lenders, brokers, or borrowers. The Board asks whether it should promulgate regulations prohibiting the acceptance of stated income or low documentation for certain loans, such as loans to subprime borrowers or loans with high loan-to-value ratios. The Board also asks

3. Funds for Escrow Items. Borrower shall pay to Lender on the day Periodic Payments are due under the Note, until the Note is paid in full, a sum (the “Funds”) to provide for payment of amounts due for: (a) taxes and assessments and other items which can attain priority over this Security Instrument as a lien or encumbrance on the Property; (b) leasehold payments or ground rents on the Property, if any; (c) premiums for any and all insurance required by Lender under Section 5; and (d) Mortgage Insurance premiums, if any, or any sums payable by Borrower to Lender in lieu of the payment of Mortgage Insurance premiums in accordance with the provisions of Section 10. These items are called “Escrow Items” (emphasis added).

Some lenders already use a similar clause in nonconforming conventional loans; some lenders modify the clause reserving the right of the lender to impose such a restriction in the event of a borrower's delinquency.

about framing disclosures to emphasize that the borrower has the option of providing documentation. Once again, the Board asks how a restriction on stated income or low doc loans would affect consumers and the type and terms of credit offered.

The federal banking agencies' Subprime Statement provides that applicable institutions may accept reduced documentation loans if there are "mitigating factors that clearly minimize the need for verification of repayment capacity." SIFMA and ASF are pleased that the banking agencies, including the Board, have recognized that reduced documentation underwriting has a place in the American mortgage market, and we urge the Board to rely on the Subprime Statement (and the likelihood that it will be adopted by states, as well as other institutions), rather than deeming stated income or low doc loans to be "unfair" or "deceptive."

SIFMA and ASF members understand that mortgage fraud, by unscrupulous brokers and even by borrowers, is particularly problematic in the stated income/reduced documentation segment of the mortgage industry. If a broker or lender inflates or fabricates, or encourages a borrower to inflate or fabricate, the source or amount of a potential borrower's income, that act clearly is unfair or deceptive, and may even constitute a criminal act. We strongly support vigorous enforcement of laws prohibiting fraud by any person in connection with a mortgage transaction. However, electing not to verify a prospective borrower's claims is quite different. Loans with particular underwriting features are not inherently unfair or deceptive, and SIFMA and ASF members strongly oppose outright bans or limitations on the types of mortgage products and features that lenders may offer to consumers, subprime or otherwise. Consumers are best served by having a variety of mortgage options from which to choose.

It is undisputed that borrowers should be fully informed of the terms and features of contracts they are considering, and SIFMA and ASF members believe that information should include whether a lower-rate loan may be available if the borrower fully documents his or her income. We believe, however, that restrictions or prohibitions on providing stated income or low doc loans will cut some deserving borrowers off from the credit they need. Some borrowers will be able to obtain a full documentation loan – but others will not. Those borrowers likely would have been able to repay a reduced documentation loan consistent with its terms – however they would not have the chance to prove that if policymakers prohibit that practice. Thus, we believe the Board should rely upon the standards set in its Subprime Statement, and continue allowing stated income or low documentation underwriting practices, with mitigating factors for subprime loans as described above, along with clear and balanced (and uniform) disclosures to promote borrower choice.

D. Unaffordable Loans

The last issue the Board specifically addressed in its invitation for comments is loan affordability, and underwriting practices that seek to predict the borrower's ability to repay a loan based on its terms. Once again, the Board and the other federal banking agencies have explored this issue at length, both in the context of nontraditional mortgage loans and subprime mortgage loans, requiring institutions to underwrite those loans based on the fully indexed rate with fully amortizing payments. The Board is now asking whether it should require lenders to underwrite all loans based on the fully indexed rate and fully amortizing payments; whether it should establish a rebuttable presumption that a loan is "unaffordable" if the borrower's DTI ratio exceeds 50% at loan origination; and whether consumer disclosures would address concerns about unaffordable loans. The Board also asks how those restrictions or presumptions would affect consumers and the type and terms of credit offered.

SIFMA and ASF believe that the consideration of a borrower's ability to repay is an important aspect of the underwriting process. We assert that there may be instances in which it is appropriate for a lender to underwrite a loan based on a rate other than the "fully indexed rate" (such as a recent college graduate who expects significant increases in earnings, or someone who does not plan to remain in a property/mortgage loan for a long period of time, such as an employee with a one or two year contract). Nonetheless, SIFMA and ASF members acknowledge the Board's policy of requiring institutions to qualify subprime borrowers at the "fully indexed rate" for nontraditional or subprime mortgage loans.

SIFMA and ASF members also believe that clear disclosures are essential for borrowers to make smart choices. Borrowers deserve to be given good-faith estimates of the total cost of a loan they are considering, including all fees paid to the lender and/or broker, monthly payments on the loan, and estimates of tax and insurance amounts if the borrower chooses not to escrow. For example, as mentioned above, we support efforts like the agencies' recently released Downloadable Consumer Illustrations of Information on Nontraditional Mortgage Products, which give borrowers important information about their loan.

However, underwriting a loan is a very complex task that requires a lender to assign weights to a variety of factors. Individual institutions should have the freedom to weigh all those factors, and to use their own expertise and judgment in determining whether a particular borrower will be able to repay a particular loan. Furthermore, borrowers have a variety of intentions when seeking a mortgage loan – they may plan to stay in their house forever; they may plan to move in a short time (for example, if they have a temporary employment contract); or they may be purchasing the property as an investment. Different loan products may be more appropriate for each of those situations. The lender and the borrower are in the best position to understand the borrower's intentions and the appropriate means of financing those intentions.

No prudent lender will make a loan unless it believes the borrower will repay that loan. Delinquencies and foreclosures do not benefit anyone – borrowers, lenders, secondary market participants, or investors in mortgage-backed securities. However, no hard standard or grouping of quantified underwriting criteria can successfully avoid all bad loans and equally ensure that all worthy loan applications are funded. A regulatory ability to repay standard applicable to all loans or a 50% DTI presumption will be a straitjacket that will prevent experienced underwriters from making appropriate credit decisions.

Specifically, issuing a regulation that establishes a rebuttable presumption of unaffordability for DTIs over 50% is particularly troublesome. Of course, the regulation would have to provide explicit and clear definitions of "debt" and "income," and even that first step raises a multitude of questions of what types of income and debts or expenses must be included, and whether and how those amounts must be documented or verified. Since measuring DTI alone is an incomplete assessment of a borrower's ability to repay, the regulation also would have to address the types of mitigating factors that would be sufficient to overcome the presumption, such as high credit scores, substantial assets, or other strong indicia of repayment capacity or credit worthiness. Further, although a 50% DTI underwriting standard is commonly mentioned, there is no magic number that will ensure affordability for all borrowers.

Moreover, this issue represents the dangers of expanding Section 129 and the related remedies to home loans beyond those that qualify as HOEPA loans. While lenders need flexibility to innovate, assignees need objective, "bright line" tests of compliance, particularly to avoid the purchase of loans subject to extended rescission rights or for which they may have assignee liability, without regard to whether they knew or could have known of the alleged violation. If lenders are unable to figure out in advance whether they are in compliance because of the regulations' reliance on presumptions, balancing tests, and mitigating factors, how can an assignee possibly know? And, if the consequence of getting it wrong is the risk of rescission and enhanced damages, how likely is it that assignees will buy these loans?

While imposing an ability to repay standard (using a fully indexed rate and fully amortizing payments) arguably is acceptable in particular segments of the mortgage market (such as nontraditional loans or loans to subprime borrowers), SIFMA and ASF members strongly believe that regulators should not, in the furtherance of consumer protection, generally restrict an underwriter's flexibility to consider all of a borrower's circumstances and rely on his or her own expertise in predicting whether the borrower can repay a mortgage loan. Artificial restrictions are, we believe, unnecessary and inappropriate, and will lead to a decrease in the availability of mortgage credit for borrowers that may not fit the standard mold. Further, as described below, we believe the Board's rulemaking authority under Section 129(i) is generally narrow and was not intended to put all home loans at risk of rescission or assignee liability based on the codification of national underwriting standards. We suggest that the Board consider

whether there may be an objective proxy for the concerns articulated by the Board that might apply to only a small subset of home loans, recognizing that any such carve-out likely will affect the marketability of those loans because of the risk of enhanced damages and rescission. Even more worrisome, unless the Board affirmatively clarifies through explicit regulations that those carved-out home loans are not subject to HOEPA's assignee liability, confusion on that issue will lead to a conservative reaction making those loans fully unmarketable (even if that reaction is not necessarily mandated by a careful reading of the statute).

IV. SCOPE OF AUTHORITY

In the Board's announcement of the June 14th hearing and its request for comments, it asks how it might use its rulemaking authority under Section 129(l)(2) of HOEPA to address concerns about abusive lending practices in the mortgage market, including the subprime mortgage market. Congress enacted HOEPA/Section 129 in 1994, and in the ensuing 13 years the Board has never relied on the delegation of authority contained in Section 129(l) to implement HOEPA's provisions, so we recognize the importance of this regulatory initiative. HOEPA explicitly enumerates a range of restrictions on a limited class of residential mortgage loans, the so-called "high cost" loans. If the Board were to promulgate regulations reflecting the questions it asked in its request for comments, it essentially would add new substantive restrictions that HOEPA does not impose presently with respect to high cost loans (e.g., escrow for taxes and insurance), materially revise an existing substantive restriction that Congress previously enacted (e.g., prepayment penalties), expand the applicability of an existing substantive restriction well beyond the narrow class of loan transactions to which Congress chose to subject the law (e.g., ability to repay), and expose a broad class of loan transactions to HOEPA's draconian penalties. In other words, by wielding its Section 129(l) authority to promulgate the contemplated regulations, the Board would move beyond HOEPA's express provisions (and those of the numerous other consumer credit laws like RESPA, which already addresses escrows for taxes and insurance).

However, the clear intentions of Congress in enacting Section 129(l)(2) compel a reasonably narrow interpretation of the delegation of authority granted to the Board. Specifically, the Board asks whether it should prohibit or restrict certain terms or practices for all mortgage loans, only for loans offered to subprime borrowers, or other subsets of loans, such as loans to first-time homebuyers, home purchase loans, refinancings, home equity loans, adjustable rate loans, and/or nontraditional loans. Based on the legislative history of the Board's rulemaking authority under HOEPA/Section 129, the Board's actions in using that authority to address unfair or deceptive practices beyond high cost loans should be restricted to a clearly defined subset of loans that have objectively determinable features, and should not apply broadly to all residential mortgage loans, if and to the extent any new regulations drag along the extraordinary remedies available to mortgagors with respect to HOEPA loans.

HOEPA's Conference Report, filed just weeks before it was passed and commenting on the final version of HOEPA (among other provisions of the legislation), provides that the underlying need for HOEPA was to address "reverse redlining" (the practice of targeting residents of certain communities for credit on unfair terms with high rates and high fees) and to protect borrowers from creditors who peddle high-rate, high-fee mortgage loans to low-income homeowners.⁶ The Conference Report specifically addresses the scope of the Board's authority, warning that with HOEPA's enactment, new products and practices may be developed that result in reverse redlining or that otherwise evade HOEPA's restrictions. Prior statements in March 1994 by one of the Senate's co-sponsors of the HOEPA amendments (former Senator D'Amato, R-NY) also appear to clarify that the Board must use its authority to prohibit any act or practice in connection with HOEPA mortgages that it finds to be unfair, deceptive, or designed to evade the Act.⁷ Thus, Congress believed the Board should have rulemaking authority to further curb any act or practice that facilitates that which HOEPA attempts to regulate and restrict—specifically and by definition limited to HOEPA loans. Thus, HOEPA's legislative history indicates that Congress did not intend to

⁶ H.R. Rep. No. 103-652 (to accompany H.R. 3437), at 161-62 (1994).

⁷ 140 Cong. Rec. S3037 (daily ed. March 16, 1994).

delegate broad authority to the Board to prohibit unfair and deceptive mortgage lending practices across the board. Rather, that history indicates that Congress meant to target the Board's authority toward those abusive practices specifically concerning HOEPA loans.

The question, accordingly, is what should be considered a HOEPA loan other than high cost loans? We are not prepared to resolve that issue today, but we do believe firmly that HOEPA must apply to a delineated subset of loans that are perceived to have a materially higher risk of default based on objective criteria. Congress intended HOEPA loans to be an exception to most residential mortgage loans based on the perception that the borrowers with those high cost loans suffered a higher risk of default and deserved more expansive remedies to protect their rights. The exception should not swallow the rule.

V. CONCLUSION

SIFMA and ASF members strongly believe that consumers should be provided clear disclosures allowing them to understand material terms, costs, and risks of loan products to help them select products and choose among payment options. For that reason, SIFMA and ASF support enhanced borrower education and information, and urge the Board to use its rulemaking authority under Section 105 of TILA and its considerable expertise to that end, by developing and proposing improved uniform mortgage disclosures that will combat the risk that consumers will be unfairly targeted or deceived.

As we mentioned above, mortgage loan products (even loans underwritten based upon reduced borrower documentation) are not categorically unfair or inappropriate under all circumstances, and lawmakers and regulators certainly should not impose outright prohibitions on those products or features (or restrictions that effectively prohibit those products or features). We believe those actions will adversely affect the availability of legitimate mortgage credit in fairly quick order.

We understand there is a great deal of political pressure on all fronts to address the subprime mortgage markets, to protect innocent consumers from fraudulent or unfair practices by brokers or lenders, and to ensure that homeowners and their communities are not devastated by arguably preventable foreclosures. However, the Board and other regulators (as well as Fannie Mae and Freddie Mac) have done substantial work in issuing guidelines to address perceived problems in the subprime mortgage market. Similarly, the mortgage lending and capital markets have been quickly reacting to the recent challenges. Investors are adjusting their demand and the prices they are willing to pay for securities backed by certain mortgages, and lenders are of their own accord tightening their underwriting standards. We anticipate and hope, too, that enforcement officials will pursue any person using fraudulent or deceptive practices in the marketing or origination of mortgage loans. However, issuing regulations based upon certain products or terms and subject to burdensome penalties with limited opportunity to cure violations does not ensure protection for vulnerable borrowers or ensure against defaults, even in the face of solid underwriting. That protection can come only by providing borrowers with clear and understandable information through one uniform set of federal disclosures, with a safe harbor for compliance.

In addition to testimony provided at the June 14th hearing, SIFMA and ASF appreciate this opportunity to provide comments for the Board's consideration, and urge caution and deliberation in taking unprecedented incursions into the underwriting process, considering the adverse impact that may have on the availability of mortgage credit to borrowers who may not qualify for the lowest-cost traditional loan products.

Sincerely,

Handwritten signatures of Randolph C. Snook and George P. Miller. The signature of Randolph C. Snook is on the left, and the signature of George P. Miller is on the right.

Randolph C. Snook
Senior Managing Director
and Executive Vice President
Securities Industry and
Financial Markets Association

George P. Miller
Executive Director
American Securitization Forum