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VIA EMAIL: regs.comments@federalreserve.gov

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

Re: Docket No. R-1305

Dear Ms. Johnson:

I write on behalf of the Empire Justice Center with the following comment regarding the Federal Reserve Board of Governor's proposed amendments to Regulation Z, which implements the Truth in Lending Act (TILA) and the Home Ownership and Equity Protection Act (HOEPA) regulations. Thank you for examining this critical federal regulation which governs home lending. We appreciate the opportunity to comment.

Empire Justice is a non-profit legal services organization in New York with offices in Albany, Rochester, White Plains and on Long Island. Empire Justice provides support and training to legal services offices statewide, undertakes policy research and analysis, and engages in legislative and administrative advocacy. We also represent low-income individuals, as well as classes of New Yorkers, in a range of poverty law areas including consumer law. Advocates in our Consumer, Housing and Community Development unit have been working on the subprime mortgage lending issue for over a decade including representing individual homeowners trapped in predatory loans, training and consulting with local housing counselors, working with lenders to provide good loan products in traditionally underserved areas and advocating for state and federal policy changes for better lending and homeownership.

On March 28th 2007, Empire Justice released a report entitled "Curbing the Mortgage Meltdown: The Impact of Foreclosures on New York's Economy and Upstate and Long Island Communities."[1] The report maps zip code level data drawn from reports by the Board of Governors of the Federal Reserve System and released in January by the Federal Reserve Bank in New York. The report provides a powerful snapshot of subprime loans that are already in foreclosure or in which households are already 30 or more days behind in making mortgage payments, as well as percentages of Adjustable Rate Mortgages (ARMs) that will have interest rates increase, or will "reset," between now and October 2009.

The subprime crisis has yet to peak in New York, and the potential wave of foreclosures could have a devastating impact on Long Island and in key upstate cities, towns and neighborhoods. As this report vividly demonstrates, many of our neighborhood have an unsustainable concentration of high cost loans. In cities like Rochester and Buffalo a decade of foreclosures has left neighborhoods with vacancy rates as high as 30 percent. These and other neighborhoods throughout the country cannot afford to lose one more home to foreclosure, yet bad loans continue to be made. We need the Board to take strong regulatory action immediately to stop the poison of predatory lending that is decimating our communities.

The proposed Regulation Z changes would give consumers important added protections. It is our position, however, that the proposals should be strengthened to make sure that consumers are adequately protected from the abuses that have led to the current crisis in the subprime mortgage lending industry and to ensure compliance.

A. *Proposals to Prevent Unfairness, Deception and Abuse*

1. Protections Covering Higher-Priced Mortgage Loans
   a. **The definition of covered loans should be broadened.**
   The definition under the current proposal excludes categories of non-traditional mortgages that, except for the disclosure requirements prescribed by TILA, would remain unregulated. Loans that would be exluded, include payment option ARMs, interest-only mortgages, and home equity lines of credit (HELOCs). These mortgages contain some of the worst abuses in the home lending industry. Expanding the definition of loans to be covered by the enhanced regulations would most certainly better satisfy the objectives of covering the subprime market while generally excluding the prime market.[2]

Client story: *Mrs. O is an 80 year old, disabled widow who has lived in her Rochester, NY home for over 44 years. In January of 2006, Mrs. O was aggressively solicited to refinance her mortgage and told that due to her exceptional credit rating of 710, she was eligible for a 1% to 1.5% fixed rate conventional loan that would change to whatever the prime rate was after a period of 5 years. What she actually received was an option ARM that had a 2% fixed rate for one day. Her first year's payments were based on that 2% rate, even though her actual rate changed the first month her payments started and every month thereafter, varying between 7.5% and 11% per month. This negatively amortizing loan has caused her principal balance to increase in excess of $600 per month; after one year, Mrs. O's principal balance increased to $186,741 from its initial $176,000. In addition to this loan, at the time of closing Ms. O was given a home equity line of credit for $22,000 which she was told had no balance and could be used for emergencies. In*

[1] Empire Justice Center website at http://www.empirejustice.org/content.asp?ContentId=3101 .
[2] We agree with the Board that investment properties, business loans, and loans secured by second homes should not be covered.

actuality, this loan was sold to her to pay approximately $17,000 in closing costs. The entire balance was used up at closing and is an interest only, ARM that has increased to 10.5%; the principal balance remains the same after 2 years of on-time monthly payments. The total of the two loan balances is now more than $70,000 of the market value of the house. In addition, Mrs. O has never been able to afford the fully amortizing payments of her first loan, especially coupled with the second loan payment. She will fall behind when her monthly payment increases in year two, putting her in severe risk of losing her home. Mrs. O's two loans would not be covered by the new proposed regulations.

b. **Lenders making higher-priced mortgages should <u>always</u> be prohibited from extending credit without regard to a borrowers' ability to repay.** The making of unaffordable loans is at the heart of the current subprime crisis and is an element found too abundantly in the mortgage cases we review. We strongly support requirements that lenders be required to verify ability to repay, including verifying income and assets. However, the "pattern and practice" language dilutes the regulation and puts into question whether the regulation will do much to prevent the abuse. Whether a creditor has engaged in a pattern and practice has not, in fact, depended on the totality of circumstances in individual HOEPA cases. Rather, consumers have generally been unable to meet the great burden of proof courts have demanded to produce significant evidence of vast lending patterns. Thus, despite this regulation, lenders continued to make large numbers of unaffordable HOEPA loans. Unless the "pattern and practice" language is removed, history indicates that lenders will continue to make high-priced mortgages without regard to ability to repay. Removing this element from the proposed regulation would provide lenders with a bright-line rule, add simplicity and ensure compliance.

Client story: *Ms. B. has been on a fixed income receiving Social Security Disability for the last 10 years. On her disability payment, she supports her teenage daughter. Ms. B received an ARM loan that was unaffordable from the inception. Although her loan officer properly listed the amount of Ms. B's income, the broker falsely claimed that she was self-employed as an antiques dealer for the last 5 years, implying that her income could support the fluctuating payment of an ARM. The lender failed to verify the stated income and extended credit to Ms. B that she clearly could not afford.*

c. **Ability to repay should not be based solely on the fully-indexed rate.** The fully-indexed rate as defined is a fictional number. Consideration should be given when adjustable rate mortgages are made in a market with an exceptionally low index rate. For example, the Current Index is expected to be exceptionally low now and into the near future as a result of the lowered interest rates by the Federal Reserve. This uncharacteristically low Current Index, which will likely last for only a short period of time, should not give lenders latitude to make loans to borrowers who could not afford the mortgages at the fully-indexed rate if the rate was determined at a time of more normalcy. We suggest that the definition of fully-indexed rate be expanded. One possibility would be to include a look-back period, taking an average index figure on which the fully-indexed rate will be calculated.

Interest rate increases should be realistically considered in underwriting to prevent the making of loans intended to be short-term and forcing borrowers to pay the costs for refinancing within a short period of time.

d. **We support requiring creditors to verify income and assets; however the safe harbor provision should be removed.**
Lenders have a wide range of documentation they can use to verify income and assets including pay statements, bank account information, tax returns, check receipts and an inventory of assets. Enhanced verification requirements will not affect self-employed and other borrowers who may traditionally have had difficulty in documenting income and assets from getting access to credit. The proposed amendment will prevent rogue lenders, especially those who rely on third parties to sell their loans, from giving loans to people who really can't afford them.

e. **Prepayment penalties should be banned or, in the alternative, prohibited after the first year.**
We fully support a limitation on prepayment penalties, but urge the Board to ban them altogether, or alternatively, limit prepayment penalties to the first year from the date of loan origination for HOEPA and higher-priced loans. New York State's one-year limitation on prepayment penalties never restricted lending (even before the law was preempted for nationally chartered banks by the 2004 OCC regulation). Limiting prepayment penalties to one year appropriately balances the potential benefits and potential costs of prepayment penalties to consumers who have higher-priced mortgage loans.

In addition, prepayment penalties should expire six months, rather than the proposed 60 days, before the first interest rate change date for adjustable rate mortgages to give borrowers a better chance of refinancing out of their impending unaffordable or burdensome loans.

Client story: *Mr. R, a 49 year old single Hispanic man lives in the city of Rochester and has worked as a custodian in a local school for 14 years. After owning his home for 13 years with only 6 years of payments remaining on his mortgage and having built a strong credit score, Mr. R researched options to pay off his principal balance even sooner. After 2 months of negotiating various mortgage terms with a mortgage broker, Mr. R decided that he was better off with his current loan terms (12% fixed rate and 15 year term with 6 years of payments remaining) rather than accept the offer of a 15 year fixed rate loan at 5.875%. He advised the broker that he no longer needed his services. Shortly thereafter, the broker contacted Mr. R and offered him a 30 year mortgage with a 2.75% interest rate fixed for the first 5 years. The rate would increase to 8.5% for the remaining 25 years. Mr. R agreed to these terms believing he could substantially pay down his mortgage principal during the first 5 years.*

On the day of closing, however, Mr. R discovered that the new loan did not offer a fixed 2.75% rate for the first 5 years. Instead the loan was a 30 year, 8.5% rate, fixed only for the first year. The loan was also an "option ARM" which means every month he must choose which payment to send. Under *pressure from the broke (more fully described below), Mr. R later learned the mortgage has a 3 year prepayment penalty, two years after his interest rate was scheduled to reset.*

f. **We support the requirement that creditors establish escrow accounts for taxes and insurance in first-lien mortgages.**
Mortgage brokers and loan officers for too long have taken advantage of subprime loan products that don't escrow for taxes and insurance. Borrowers have been deceptively refinanced into loans, led to believe that their new payment is lower than their current payment monthly, only to learn after the loan closing that their new payment does not include an escrow for taxes and insurance. In New York, where property taxes are particularly high, this deception has resulted in severe distress for homeowners who did not separately factor a tax payment into their housing budget. Borrowers should be informed about the escrow payment when they are first told what their monthly mortgage payment will be, and with every disclosure (oral and written) thereafter so that borrowers can efficiently shop for the best loan product and realistically determine whether a loan is in their best interest.

g. **The Board should additionally prohibit yield spread premiums.**
We have never seen a case in which a yield spread premium (YSP) made in the subprime mortgage lending market has benefited the borrower by lowering the fees paid, or otherwise. YSPs are counter-intuitive to borrowers who generally believe that a broker is required to be working in their best interest to get them the best interest rate and loan. YSPs are not transparent to borrowers, as noted, and they leave too much room for abuse. They are predatory and should be prohibited in all loans, **not just higher-priced and HOEPA loans**

At a minimum, yield spread premiums should be allowed only where the rate includes all closing costs, and regulations should be added to provide for the inclusion of YSP's in the HOEPA points and fees trigger calculation. YSP's are compensation paid to the broker as a direct result of the borrower's loan transaction, and by the borrower through their increased interest rate on the loan. It does not follow logic that the points and fees test include all broker compensation (Sec. 226.32(b)(1)(ii)), but yet YSPs have been determined to be excluded.

2. Protections Covering Closed-End Loans Secured by Consumer's Principal Dwelling

a. **Regulations should be added to establish a fiduciary duty between mortgage brokers and borrowers.**
If it is the intent of the Board to protect borrowers from unscrupulous broker practices, then it makes sense to demand that brokers work in the best interest of the borrower for whom they are working and by whom they are getting paid, either directly or indirectly. Borrowers generally believe that a broker is required to be working in their best interest. A regulation setting this forth explicitly would create clarity in the marketplace.

The regulation should demand mortgage broker compensation agreements with borrowers to be in writing, and should significantly limit, if not ban, the payment of yield spread premiums. The proposed compliance alternatives are inadequate to protect consumers and ensure compliance with this proposed regulation. In New York, mortgage broker agreements are not required in writing up front, at the initiation of the relationship. Thus, under the proposed amendment, it does not appear as though creditors would be required to demand agreements in writing from mortgage brokers. Borrowers should have in writing the amount for which they will be required to pay their broker. Secondly, allowing creditors to show that they pay brokers the same flat fee for all transactions allows lenders, not consumers, to set the fee amount.

Client story (continued from above): *Mr. R clearly explained his intention to his mortgage broker - that he wanted to refinance for the purpose of allowing him to pay off his existing loan balance in fewer years than the 6 remaining on his current loan, and ultimately, to pay less in interest. When he was presented with the new loan offer at the closing table, which differed significantly from the loan his broker had promised him prior to closing, Mr. R declined the new loan. His mortgage broker insisted that the documents were in error and that as long as Mr. R signed the papers, the broker could "fix" the loan terms before the first payment was due. Mr. R trusted his broker and believed the broker was working in his best interest and therefore, he signed the mortgage documents. Ultimately, the broker never submitted additional documentation to the lender to "fix" the loan as promised. The new loan increases the total amount Mr. R has to pay on his home by almost $100,000.*

What is important to understand about this case is that Mr. R was very specifically trying to lower his total mortgage costs over the life of the loan and engaging in relatively sophisticated financial planning to reach a point of paying off his mortgage in anticipation of an eventual reduction in income as he aged and could not work. He was trying to preserve his only asset, his home. Despite shopping around and being savvy, Mr. R was taken advantage of and ripped off.

b. We strongly support regulation of the appraisal process, and urge the Board to enhance the regulation to ensure compliance.

Upstate New York cities such as Rochester and Buffalo have particularly felt the devastating impact of inflated appraisals being used in the subprime mortgage lending industry. Many of our homeowners are "upside down" in their homes, unable to afford their current loans and unable to sell, or refinance, because the amount of the loan exceeds the value of the home. Foreclosures concentrated in certain neighborhoods of these cities are now jeopardizing the stability of these communities. It almost goes without saying that creditors and mortgage brokers should be prohibited from coercing, influencing, or otherwise encouraging an appraiser to provide a misstated appraisal. However, we are concerned that, as written, the proposed regulation will not adequately ensure compliance. We urge the Board to explicitly hold lenders responsible for appraisal misconduct. In addition, we ask that the Board consider including a set of policies in its final rule to ensure appraiser independence and accurate valuations. As a starting point, the Board could use the policies developed in the Ameriquest-AG settlement.

c. **Regulations governing mortgage servicing are long overdue and should be expanded to include the regulation of servicer fees, provision of payment histories and loss mitigation.**
We laud the Board for recognizing the need for regulation of the mortgage servicing industry. Though the proposed amendments would codify what should already be standard business practice amendments – including crediting payments when received, providing payoff statements and fee schedules within a reasonable time period and prohibiting the "pyramiding" of late fees – our extensive experience in working with borrowers is that these basic practices are too often not followed.

Regulation also is needed to limit the fees that servicers can charge, and to mandate that servicers provide borrowers clear and understandable payment histories with accurate accounting of suspense accounts.

Customer service and loss mitigation departments should also be regulated. In particular, the Board should state that failure to provide reasonable loss mitigation prior to foreclosure is an unfair practice. Borrowers are reluctant to turn to their lenders for assistance when they fall behind in their payments in great part because they are often met with unfriendly and confusing service and a paucity of workable options. Loss mitigation options have not kept up with changes in the economy and changes in the foreclosure crisis. More flexible and diverse options are needed so that homeowners can get relief directly through their lenders.

d. **Regulations should be added to prohibit negative amortization.**
The costs to borrowers, especially those being sold higher-priced loans, of loan terms that cause negative amortization are great. Not only does negative amortization counteract one of the main goals lauded by U.S. housing policy of homeownership – the building of wealth through one's home – but it also puts affordability into jeopardy when principal balances are recalculated and payments increase. Prohibiting negative amortization would alleviate some (but not all) of the concerns regarding the limited universe of loans covered as higher-priced loans. Proposed regulation Sec. 226.35(b)(1) does not adequately protect borrowers from negative amortization for reasons described above regarding the troubling "pattern and practice" language. In addition, the definition of fully-indexed rate does not ensure that borrowers would be able to pay their monthly payments once the principal balance is recalculated.

e. **Regulations should be added to prohibit the steering of borrowers into loans priced higher than the borrowers' risk profile warrants.**
Current law and regulations are not sufficient. The Equal Credit Opportunity Act (ECOA) protects limited groups of borrowers. In addition, it is difficult to prove that a borrower was steered into a higher priced loan as the result of the borrower's race, ethnicity, or other prohibited factor, especially when a

lender routinely steers borrowers into higher priced loans. The proposed regulations covering mortgage broker compensation (Sec. 226.36(a)) and prohibiting lenders from engaging in a pattern and practice of making unaffordable loans (Sec. 226.35(b)(1)) are inadequate for the reasons explained above. If it is the agreement of the Board that steering is inappropriate, then we urge the Board to explicitly prohibit the practice.

f. **Regulations should be added to provide for strong and effective remedies**. In particular, the Board should include in the final regulation clarification that assignee liability applies to substantive violations of the rule.

B. Proposals to Improve Mortgage Advertising

We generally support the proposed regulations that would require advertisements for both open-end and closed-end mortgage loans to provide accurate and balanced information in a clear and conspicuous manner. All prohibitions are needed. We particularly have seen problems in which lenders have given the false impression that they offer "government loan programs," or "government supported loans." To enhance the proposed regulations, we recommend the following:

a. **Prohibitions should be extended to cover telephone and door to door solicitations, as well as oral statements.**

b. **In addition to prohibiting foreign-language advertisements, the Board should consider mandating that disclosures be provided in the primary language in which the loan transaction was discussed, negotiated or sold.**

C. Proposals to Give Consumers Disclosures Early

a. **The disclosure should be enhanced and borrowers should be given a remedy if early and accurate disclosure is not made.**

We support the proposal to give loan applicants for all home-secured closed-end loans a disclosure no later than three days after application that would include transaction-specific mortgage loan information such as the APR and payment schedule. Moreover, we urge the Board to make these disclosures binding, not just estimates. Disclosures can never replace or equal the protections that prohibitions and strong regulation can provide for consumers. However, applicants should be empowered with the most accurate and current information possible to allow them to shop for the best product. After all, a free market economy optimally works if consumers are able to make fully informed decisions.

Borrowers also should be given information regarding other key loan features including the total amount of the loan, finance charges and whether there is a prepayment penalty. Good faith estimates have proven ineffective in providing borrowers with early information about their loans.

We also urge the Board to extend this disclosure requirement to HELOCs for loans secured by a principal dwelling. HELOCs are mortgages and can jeopardize homeownership if the borrower is unable to make their scheduled payments; they should not be excluded from this protection. Finally, creditor compliance will only occur if borrowers are given the right to rescission and other remedies when the regulation is violated.

Thank you again for your attention to these extremely critical regulations implementing the Truth in Lending Act and HOEPA, and for the opportunity to comment on the Board's proposal amendments.

Respectfully,

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