April 5, 2007

Thrift Institutions Advisory Council
Regulatory Guidance and Residential Mortgage Lending
Statement on Subprime Mortgage Lending (Docket No. OP-1278)

At the meeting of the Thrift Institutions Advisory Council with the Board of Governors on March 16, 2007, Kenneth Koranda, President, Mid America Bank, Downers Grove, Illinois, and Kerry Killinger, Chairman and Chief Executive Officer, Washington Mutual, Inc., Seattle, Washington, presented the Council's views on regulatory guidance and residential mortgage lending.

The Council believes that both the Non-Traditional Mortgage Guidance and the proposed Subprime Statement promote sound underwriting principles intended to curb abusive, as well as certain unsafe and unsound lending practices that have proliferated in the past several years. However, the Council believes that banking regulators, by themselves, cannot solve these problems. Wall Street investors will purchase risky non-traditional and subprime mortgages as long as these loans are profitable and available. Mortgage brokers and mortgage bankers probably will originate these products as long as there are investors to purchase them. Therefore, any effective approach must tie in the mortgage brokers, mortgage bankers, and Wall Street. The Conference of State Bank Supervisors outreach to the states is admirable but falls far short of guaranteeing enforcement and compliance at the state level.

The Council sees no need to expand the Guidance to a wider range of mortgage products. Hybrid ARM products such as 3/1s, 5/1s, 7/1s and 10/1s, as well as other products, have been used successfully in the marketplace for decades without causing payment shock or any increased incidence of delinquencies. Therefore, the expansion of guidance to these products is unnecessary and may have unintended effects that diminish credit without achieving any purpose.

The Council believes that the Non-Traditional and Subprime Guidance effectively establishes a de facto set of "best practices" for federally regulated lenders. Although the Council agrees with the regulators' "principle-based" approach, the Council believes further guidance is unwarranted. By reaffirming the 1993 Interagency Guidelines for Real Estate Lending and subsequent related guidance, the agencies effectively clarified best practices for mortgage underwriting that have served the industry well for over a decade, and they have done so in a manner that both clarifies these principals in an evolving market and avoids much of the risk of unintended consequences that a more proscriptive statement might create. The Council believes that many market innovations have served consumer credit needs well. In particular, non-traditional mortgages and subprime mortgages have served a useful public purpose and have extended homeownership opportunities to borrowers who otherwise could not have purchased a home, build equity and move up on the socio-economic ladder.

Most Council members will not be directly affected by the Guidance because they are not engaged in subprime lending. However, all Council members believe that the Guidance will create transitional needs. One of the problems that borrowers, lenders and the agencies will face is that some borrowers who had 2/28 or 3/27 loans will be unable to qualify for another mortgage at the fully indexed rate when their interest rate resets. Some of these borrowers will be able to refinance into a fixed-rate mortgage or other product, but others will not. There are no easy answers to this already existing problem. The guidance should help to mitigate these situations in the future, but the agencies should consider accommodations to the extent possible, particularly regarding the difficult problem of investor-owned subprime mortgage-backed securities.

The Council believes that lending practices in the subprime arena have changed dramatically in the past year due to recognition by lenders of the impact of imprudent practices, self correction in the market place, and regulatory guidance. However, the Council is seriously concerned that unintended consequences and credit curtailments could result if regulatory guidance or mandates go too far in prescribing lending practices.

Finally, the Council also believes that lenders must retain the flexibility to make mortgages to creditworthy borrowers. For example, a lender should be able to use mitigating factors in underwriting (for example, low loan-to-value ratios, high credit scores, long-term relationships with customers, etc.) to offset other risk factors.

Council members responded to Board members' inquiries about the disaggregation of the mortgage process into a chain of many participants, the effect on contractual and legal obligations, the situation facing subprime borrowers, and the response of regulatory agencies and the Congress.

Council members noted the challenge to the industry of working through a period of rising delinquencies. They suggested adoption of a consumer bill of rights including principles of consumer protection, recourse, and remediation. They also urged that forbearance be shown toward borrowers who can be helped to work through current difficulties and remain creditworthy customers.