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Pat V. Combs, ABR, CRS, GRI, PMN
President

May 7, 2007

The Honorable John C. Dugan
Comptroller of the Currency
250 E Street, SW
Washington, DC 20219
[Transmitted by e-mail to:
regs.comments@occ.treas.gov]

RE: OCC, Docket Number OCC-2007-0005, Proposed Statement on Subprime Mortgage Lending

Dear Comptroller Dugan:

On behalf of more than 1.3 million members of the National Association of REALTORS® (NAR), I am pleased to provide comments to the federal banking agencies and the National Credit Union Administration (Agencies) on the Proposed Statement on Subprime Mortgage Lending (Statement) published in the Federal Register on March 8, 2007.[1]

The National Association of REALTORS®, "The Voice for Real Estate," is America's largest trade association, including NAR's five commercial real estate institutes and its societies and councils. REALTORS® are involved in all aspects of the residential and commercial real estate industries and belong to one or more of some 1,500 local associations or boards, and 54 state and territory associations of REALTORS®. The proposed Guidance will have an impact on the availability of financing homeownership and, therefore, is of vital concern to REALTORS®.

The Statement is the Agencies' response to the serious problems in the subprime mortgage market that affect both current homeowners and future home buyers. NAR recently released its April 12, 2007, Enhanced Subprime Lending Policy that builds on our 2005 Subprime Lending Policy. The 2005 policy promotes stronger anti-predatory lending legislation and regulations, primarily in the context of HOEPA, and consumer education. The Enhanced Policy proposes solutions to avoid repeating the mistakes that led to the current problems and to help homeowners who face the risk of default and foreclosure as the interest rates on their mortgages reset in 2007 and 2008.

[1] 72 Federal Register 10533 (March 8, 2007).

NAR strongly supports the continued work of the Agencies to fight abusive lending practices and promote consumer education. The Statement and NAR's Policy are, to a very high degree, consistent. In some cases, we recommend you adopt even higher standards, and in others, we recommend that you give lenders more flexibility in determining whether applicants can afford to meet their obligations under their loans. We share with you the goal of preventing abusive lending practices without creating a credit crunch.

Introduction to Proposed Statement

NAR agrees with the Agencies that many subprime borrowers do not understand the risks of subprime adjustable rate mortgages(ARMs), such as 2/28s and 3/27s, often referred to as hybrid ARMs. The Statement explains that products with the following features are of particular concern:

- "Teaser rates" for an initial period that then jump based on an index plus margin.
- Low- or no-documentation underwriting ("stated income" underwriting).
- High or no limits on interest rate adjustments, contributing to "payment shock."
- Features that are likely to require the borrower to refinance the mortgage.
- Large prepayment penalties or prepayment penalties that apply beyond the initial interest rate adjustment period.
- Inadequate disclosure to the borrower about the features and risks of the loans, including absence of an escrow for taxes and insurance.

While this is a good list, NAR has several suggestions for its improvement:

- The "teaser rate" feature is not only a problem when it applies only for a "short initial period." A payment shock at the end of the fifth year of the mortgage could still result in a family losing its home through foreclosure or forced sale. NAR recommends you revise this sentence or give an example so lenders don't interpret "short" to mean 12 months or less.
- Footnote 4 explains "payment shock" as the significant increase that "occurs when the interest rate adjusts to a fully indexed basis." The borrower can experience "payment shock" as soon as the payments start to adjust, even if that is before reaching the fully indexed rate. If the initial "teaser rate" payment results in a high debt-to-income ratio (such as 50%), any additional adjustment is likely to result in a "payment shock" to most borrowers. NAR recommends that the Agencies revise the footnote to broaden the definition.

The Statement explains that features such as those listed above may result in the following consequences:

- Inability to pay the mortgage when the interest rate adjusts because of "payment shock."
- Difficulty in paying real estate taxes and homeowners insurance when there is no escrow for this purpose.

- High refinancing fees and prepayment penalties.
- Foreclosure, forced sale, or assignment of the title to the lender.

Inability to pay the mortgage is not only a problem when the interest rate resets. Footnote 10 is a perfect example of a mortgage where affordability is a problem from the first month. Based on the $36,000 borrower income, the debt-to-income ratio is 44%, just for principal and interest of $1,331. If you assume $200 a month for taxes and insurance, the initial debt-to-income ratio jumps to 51%. This leaves the family with $1,469 for all of its other expenses, including food, utilities, clothing, transportation, and other necessities. This may be sufficient in some circumstances (moderate climate, small family, no car, and an extremely modest lifestyle), but it is much more likely to illustrate the problem of making a loan without considering the residual income available to the family. NAR recommends that the example of "payment shock" posit a mortgage that is not likely to be unaffordable from its very first month.

Risk Management Practices

Predatory Lending Considerations. The Statement explains that lenders should avoid making predatory loans, which typically include one or more of the following:

- Underwriting based on the value of the property instead of the ability of the borrower to repay the loan.
- Inducing borrowers to refinance mortgages repeatedly with high points and fees stripping equity from the family each time the loan is refinanced.
- Fraud or deception of the risks of the loan and related products.

There are other features typical of predatory loans that we recommend you consider including:

- Inflated appraisals that allow excessive fees to be included in the loan and result in the borrower owing more than the home is worth.
- Imposing interest rates and fees that do not reflect the creditworthiness of the borrower. Some borrowers that qualify for prime interest rates and reasonable fees unfairly receive loans with subprime interest rates and high fees instead.
- Fraud and deception that force borrowers into high-cost loans through:
    - "bait and switch" tactics;
    - delaying closings so borrowers lose commitments for reasonably-prices loans; and
    - unethical document management, such as having applicants sign blank documents that are then filled in with fabricated income, employment, asset, and other information about the borrower.

Underwriting Standards. NAR policy is largely consistent with the proposed Statement on underwriting standards. The one main area where we have some concern, as we did (to no avail) in our comment on the Agencies' Nontraditional Mortgage Guidelines, relates to the need for lenders to be able to take the totality of the circumstances of the applicant into consideration in determining whether to make the loan. In some unique circumstances, underwriting based on the fully indexed, fully amortizing payment amount may be too strict. We understand that today's mortgage lending industry is heavily dependent on automated underwriting. But when an applicant is turned down by "the computer," lenders should have the flexibility to review the file and consider all the borrower's circumstances to determine whether to make the loan. Otherwise, NAR is concerned that the new standards that we and many others welcome as crucial reforms may unnecessarily prevent or at least delay homeownership or access to credit through refinancing for some families.

NAR supports the general principle that all mortgage originators should act in "good faith and with fair dealings" in each transaction and treat all parties honestly. NAR's Code of Ethics already imposes a similar requirement on REALTORS®, who are required to treat everyone in the transaction honestly. This general principle has guided us in developing the policies described in this letter, and we are recommending it to the Agencies for the same purpose. NAR recommends inclusion of the following key underwriting principles in the Statement:

- **Ability to Repay.** NAR supports strong underwriting standards that require all mortgage originators to verify the borrower's ability to repay the loan based on all its terms, including taxes and insurance, without having to refinance or sell the home.[2] Lenders should consider all relevant facts, including the borrower's income, credit history, future income potential, and other life circumstances. Lenders should not makes loans to borrowers that make loss of the home through sale or foreclosure likely if the borrower is unable to refinance the mortgage or sell.

- **Underwriting Subprime Loans with "Teaser Rates."** Some subprime loans are structured with a significant jump in monthly payments often resulting in "payment shock" for the borrower. While these mortgages may be a reasonable choice for subprime borrowers who can afford them, a majority of subprime borrowers do not understand the unique terms and conditions of these risky mortgage products that can result in a significant "payment shock." Therefore, lenders (including mortgage brokers) should exercise more caution when underwriting such loans to subprime borrowers to make sure the borrower is able to afford the mortgage. Examples of these risky mortgage products include loans with a short-term interest "teaser rate" for the first two or three years (known as 2/28s and 3/27s), loans with an initial interest-only period, and mortgages that negatively amortize, such as payment option ARMs.[3]

  NAR believes it is abusive to underwrite subprime loans that include potential "payment shock" based solely on the initial payment amount under the loan.

- **Reasonable Debt-to-Income Ratio.** NAR supports requiring lenders to make subprime loans that have a reasonable debt-to-income ratio. Borrowers should have

[2] The limited exceptions to this general principle would include prime borrowers with sufficient verifiable assets to handle a balloon mortgage or a significant jump in mortgage payment.
[3] Negative amortization ordinarily results if the mortgage permits a borrower to pay less than the interest on the mortgage for a limited time, in which case the difference is added to the total amount of the loan the borrower must repay.

enough residual income after making their monthly mortgage payment, including taxes and insurance, to meet their needs for food, utilities, clothing, transportation, work-related expenses, and other essentials. Requiring underwriting at a fully amortizing, fully indexed rate is meaningless if the lender uses such high debt-to-income ratios that the family doesn't have enough income remaining to pay for other necessities.

- **Escrow for Payment of Taxes and Insurance.** Lenders that make subprime mortgage loans should generally require that the monthly payment include an amount to be held by the mortgage servicer in an escrow (sometimes called a reserve or impound) account for the payment of the borrower's periodic payments, such as taxes and insurance. Similar to the exception for prime loans in some jurisdictions, borrowers that make at least a 20 percent downpayment should have the option to budget for these payments on their own.

- **Limit Stated Income/Stated Assets Underwriting.** Because mortgages underwritten based on "stated income" and/or "stated assets" (also known as "no income verification" or "no doc" loans) typically have higher rates, lenders making subprime loans should, as a general rule, underwrite loans based on verified income and assets. The main exception should be for borrowers whose incomes derive from genuinely hard-to-verify sources (such as self-employed borrowers and borrowers in the "cash economy").

- **Flexibility for Life Circumstances.** As noted above, NAR believes that a standard for determining a borrower's ability to repay must be flexible to accommodate borrowers with unique circumstances, such as:
    - Borrowers who have demonstrated the ability to make monthly payments, over a long term, that are higher than underwriting standards would otherwise allow. Lenders should consider, for example, the borrower's history of making rent and student loan payments.
    - Borrowers with high assets but low income who, for cash management or other financial planning reasons, elect a mortgage with a monthly payment that their current income is not sufficient to cover.
    - Borrowers who anticipate a jump in income or assets due to life events such as graduation, completion of professional training, completion of payment obligations for student or car loans, another member of the household entering the work force when young children start school, or an inheritance.

- **Anti-Mortgage Flipping Policy.** NAR supports an anti-mortgage-flipping rule requiring mortgage originators making or arranging for a loan that refinances an existing residential mortgage to verify that the new loan provides a significant benefit to the borrower (one test often proposed is the loan must provide a "reasonable net tangible benefit" to the borrower). The lender should consider the circumstances of the borrower, all terms of the new loan including taxes and insurance, the fees and other costs of refinancing, prepayment penalties, the remaining term of the mortgage being refinanced, and the new interest rate compared to that of the refinanced loan.

- **Bar Prepayment Penalties.** Since adoption of our 2005 policy, NAR has opposed prepayment penalties for all mortgages. Prepayment penalties often work to trap borrowers in loans they cannot afford by making it too expensive to refinance. If complete prohibition of prepayment penalties is not feasible, NAR supports permitting prepayment penalties for the shortest time and the lowest amount possible. For example, a borrower in a 2/28 mortgage should be able to refinance at the end of the initial two-year "teaser rate" period without having to pay a prepayment penalty.

- **Mortgage Choice for Borrowers.** NAR supports requiring mortgage originators to offer borrowers one or more mortgages with interest rates and other fees that appropriately reflect the borrower's credit risk. It remains the responsibility of borrowers to decide which is the best mortgage for their needs and circumstances, but they may only do so if they understand all the facts so they can make an informed decision. The following are suggested principles for consideration of the regulators:
  - For originators who offer nontraditional mortgage products, the originator should:
    - offer all borrowers a choice of several significantly different mortgage options;
    - include at least one traditional loan product as one of the options for the borrower to consider, if the borrower qualifies for such a product offered by the originator; and
    - before application acceptance, disclose information about the maximum potential payment over the life of the loan and the date the initial payment will increase to a fully amortizing, fully indexed payment amount.
  - For subprime borrowers, originators that offer FHA-insured mortgages or VA home loan guaranty mortgages should consider whether these types of mortgages should be offered as an appropriate option.
  - If the originator does not offer mortgages with rates and fees appropriate for the borrower's credit risk, the originator should inform the borrower a lower interest rate may be available from another originator or that the borrower may wish to seek housing counseling, to allow the borrower an opportunity to shop elsewhere or receive counseling before proceeding. For example, a prime borrower that applies for a loan to a lender that only makes subprime loans should be advised that other options may be available.
  - For loans originated by a mortgage broker, the broker should offer mortgage options that are among the lowest-cost products appropriate for the borrower.

Consumer Protection Principles. The Statement describes consumer protection principles, including underwriting based on ability to repay (covered above) and consumer education.

NAR has long been on record in favor of consumer education and disclosure. The disparity in knowledge and power between the lender and the borrower suggests that lenders should be subject to very high standards to assure that consumers understand the terms of their loan. We have heard lenders explain that they never expected borrowers with 2/28 mortgages to still be in their loans when they reset. Rather, the lenders expected borrowers to use the initial interest rate (two- or three-year) period as an opportunity to improve their credit score and to refinance before the reset period. This approach has several problems that should be of particular concern to the Agencies:

- It is unrealistic to adopt a lending business plan that assumes that house prices will only go up in value. If house prices are stable or decreasing in a market, which is now not unusual, refinancing is unlikely for families without significant savings.
- Making a loan with the goal of refinancing it within two or three years means the family will lose significant equity in its home due to the closing costs (fees and points) for the new loan.
- Some lenders impose significant prepayment penalties beyond the "teaser rate" period. This is a good example of an unfair practice that is completely inappropriate when there is such a disparity in negotiating power.

Control Systems and Supervisory Review. NAR applauds the policy urging banks to adopt strong control systems. We are hearing too many anecdotal problems where banks with strong anti-predatory lending policies rely on third-party originators (for example, mortgage brokers) for compliance and fail to independently underwrite the mortgages they purchase. The recent Supreme Court decision in Watters v. Wachovia Bank makes the OCC and OTS responsibilities for overseeing bank and thrift practices all the more important. All lenders should carefully monitor mortgages referred by third-parties to assure they are consistent with their underwriting standards and anti-predatory lending policies.

Request for Comment on Four Questions

You have asked for comment on four questions, in particular.

1. The proposed qualification standards are likely to result in fewer borrowers qualifying for the type of subprime loans addressed in this Statement, with no guarantee that such borrowers will qualify for alternative loans in the same amount. Do such loans always present inappropriate risks to lenders or borrowers that should be discouraged, or alternatively, when and under what circumstances are they appropriate?

> While NAR is sure that some lender could design a mortgage product that we believe would not be appropriate for any borrower, we think most of the products currently available are reasonable choices for at least some borrowers. The current abuses can be greatly mitigated by adoption of strong underwriting requirements. Sustainable homeownership is the key, and REALTORS® understand that in some cases that means that a home buyer may not qualify for as large a mortgage today as they could six months ago before lenders began to tighten underwriting on their own, or will have to delay homeownership. No one benefits from borrowers being placed in mortgages that result in foreclosure, distressed sale, or assignment of the title to the lender in lieu of foreclosure—not the borrower, not the lender, not the community, and not the REALTOR®.

2. Will the proposed Statement unduly restrict the ability of existing subprime borrowers to refinance their loans and avoid payment shock? The Agencies also are specifically interested in the availability of mortgage products that would not present the risk of payment shock.

> As discussed earlier, NAR supports most aspects of the Statement, as necessary to prevent abuses in the subprime lending mortgage market. However, we believe that lenders should have the flexibility to take into account all the circumstances of the borrower[4] and to approve a loan, even if the borrower doesn't qualify based on the fully indexed rate. NAR recommends that the Agencies give lenders some flexibility under the Statement when considering whether to refinance an abusive mortgage, if the rate and fees on the new mortgage are reasonable and are not simply another round of equity stripping.

3. Should the principles of this proposed Statement be applied beyond the subprime ARM market?

> NAR believes that federal standards should address problems in the market and be careful to avoid imposing "red tape" on the prime market to the extent it is functioning well. NAR does, however, support requiring all lenders to:
> - Verify each borrower's ability to repay the loan based on all its terms, including taxes and insurance, without having to refinance or sell the home, taking into account the borrower's circumstances.
> - Verify that a loan being used to refinance an existing loan provides a significant benefit to the borrower, to avoid equity stripping.
> - Drop prepayment penalties or impose them for the shortest time and lowest amount possible.

4. We seek comment on the practice of institutions that limit prepayment penalties to the initial fixed rate period. Additionally, we seek comment on how this practice, if adopted, would assist consumers and impact institutions, by providing borrowers with a timely opportunity to determine appropriate actions relating to their mortgages. We also seek comment on whether an institution's limiting of the expiration of prepayment penalties such that they occur within the final 90 days of the fixed rate period is a practice that would help meet borrower needs.

> As noted already, NAR opposes prepayment penalties for all mortgages, but if complete prohibition is not feasible, prepayment penalties should be for the shortest time and lowest amount possible. To the extent lenders do impose prepayment penalties, we commend those who impose penalty periods no longer than initial fixed rate periods, and even shorter would be better to allow borrowers to refinance as soon as possible. Lenders should also consider waiving prepayment penalties where the borrower is refinancing with the same lender.

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[4] Including, but not limited to borrower's income, credit history, future income potential, and other life circumstances.

Conclusion

Finally, NAR urges the Agencies to work closely with responsible lenders, especially those who have extensive experience in the subprime mortgage market, to make sure that borrowers with the financial capacity will continue to have access to fair and affordable mortgage loans so they can achieve homeownership.

Thank you for the opportunity to provide comments on the proposed Statement. Please call Jeff Lischer, Manager, Financial Services (202.383.1117) if you have any questions about our comments.

Sincerely yours,

Pat V. Combs

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