August 13, 2007

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

Re: Docket Number OP-1288

Dear Ms. Johnson:

Thank you for the opportunity to share our opinion regarding whether the Federal Reserve Board should use its rulemaking authority under Section 129 (1) (2) of HOEPA to address abusive lending practices. We are glad that the Federal Reserve is considering this, and we urge you to use this opportunity and issue the strongest possible regulations to protect families from the predatory practices that have been too common in the subprime market.

I am submitting these comments on behalf of the more than 350,000 ACORN member families in over 100 cities across the country. ACORN, the Association of Community Organizations for Reform Now, is the nation's largest grassroots community organization. ACORN members have been engaged in a major effort since 1999 to protect our neighborhoods from predatory lending. The campaign has included working to shine a spotlight on and reform the practices of individual lenders, playing a leading role in passing city and state legislation to restrict predatory lending, and conducting outreach and education to the communities that are most effected.

Our sister organization ACORN Housing is one of the leading foreclosure prevention agencies in the country. Last year alone they helped over 4,800 families work out repayment or forbearance plans, loan modifications, refinances and partial claims, which allowed these families to keep the equity they built in their homes.

ACORN Housing also provides one-on-one mortgage counseling and first-time homebuyer classes and has directly helped over 50,000 families obtain affordable mortgages to achieve their dream and buy a home.

This experience has given us a deep understanding of predatory mortgage lending and the current foreclosure crisis. We believe that the Federal Reserve can and must take action to address these pressing problems in a way that protects consumers from abusive lending practices, while not restricting access to credit on fair terms.

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Prepayment Penalties

There is no legitimate purpose for prepayment penalties on subprime loans, and they should be prohibited. The inclusion of prepayment penalties on any subprime loan, not just those with adjustable rates, is an abusive practice. They serve solely to benefit the investors while stripping homeowners of their equity or keeping them locked into an unnecessarily high rate.

The large majority of subprime loans contain prepayment penalties, compared to just a small fraction of prime loans that do, because prime borrowers would not accept prepayment penalties unless there was a real benefit. The cost of prepayment penalties in the prime market is also much smaller than in the subprime market.

The evolution of prepayment penalties over the last five years demonstrates the true nature of the product. Until the OTS changed its rules, subprime lenders regularly exploited the loophole in AMTPA in order to avoid state laws and include prepayment penalties that were in effect for the first five years of the loan and were for six months interest. These were regularly used in conjunction with 2/28 and 3/27 ARMs.

There was no pretense that borrowers had been given a choice about the prepayment penalty, and although lenders maintained that prepayment penalties gave borrowers lower interest rates, there was no evidence to support this.

Now that lenders can no longer use the AMTPA loophole and must comply with the growing number of state laws that limit prepayment penalties, there has been a reduction both in the length of time and the amount of the typical prepayment penalty, and there has not been a corresponding increase in cost to the borrower.

Lenders created forms to make it appear that borrowers were being given a choice between loans with or without prepayment penalties, but we have found through our interviews with thousands of borrowers that in the subprime market borrowers do not choose any of their loan terms. They are simply given the loan that the broker or loan officer wants to give them and at best the broker or loan officer explains the loan terms and will point out things such as that they have a prepayment penalty.

We have heard from countless borrowers that they didn't know they had a prepayment penalty until they went to refinance or we reviewed their loan documents with them. We feel strongly that new or different disclosures will not adequately stem predatory practices such as prepayment penalties. Borrowers will always rely on what the broker or loan officer tells them about their loan.

Escrow accounts for taxes and insurance on subprime loans

Lenders should be required to escrow taxes and insurance for subprime mortgages. Our experience has shown us that this is something that borrowers want and expect with their mortgage, and when there is no escrow it's due to the broker or lender.

While it is the norm in the prime market to include taxes and insurance in the monthly payment, this is the case in less than half of all subprime loans. There is no credible explanation for why lenders expect that subprime borrowers, who are charged higher rates because they are perceived to be a greater credit risk, will be able to pay the thousands of dollars in lump sum payments for taxes and insurance.

The borrowers themselves know that they will have trouble coming up with the money for lump sum payments, which is why they want to have their taxes and insurance included. When the taxes and insurance are not included in the payments, it can have devastating effects on homeowners.

If the homeowner does not have an insurance policy in place, the lender will impose force-placed insurance which is more costly and provides less protection to the homeowner than a standard policy. While the lender didn't escrow for taxes and insurance before, now the lender will require the borrower to pay the cost of the force-placed insurance as part of the monthly payment. If the homeowner can't afford the higher payment, they will end up in foreclosure.

When the homeowner becomes delinquent on the property taxes, it leads to loan flipping because the homeowner has to refinance just to pay the taxes.

There is regularly fraudulent and deceptive practices regarding tax and insurance escrows. Many borrowers are led to believe that the monthly payment quoted to them included taxes and insurance, but find out later that their monthly payment with taxes and insurance is actually much higher. In other cases, they don't find out that the monthly payment does not have an escrow until their tax or insurance payment is due.

"Stated income" or "low doc" loans

We are glad that the Federal Reserve is considering issuing regulations regarding the problem of stated income loans. This product has been overused and abused, accounting for almost half of the mortgages of subprime lenders.

We have been extremely concerned with the proliferation of loans that were being made with no verification of the borrower's ability to pay the loan.

We saw numerous cases of brokers and loan officers submitting applications for a supposed self-employed borrower, who was actually a wage-earner or even social security recipient and whose income was much less than on the application.

We have been shocked by the lack of any effort to substantiate that a borrower was indeed self-employed, such as at least reviewing a borrower's tax return to see if they filed a Schedule-C or phoning the borrower.

The introduction of a new category, "stated wage earner", was a disturbing development in this area. Brokers or loan officers no longer had to lie about a borrower's source of income, only the amount of their income.

In all of the cases we have seen, the borrower provided the required income verification – paystubs and tax returns – but the broker or loan officer submitted the application as a stated income loan without the borrower's knowledge.

We believe that this was done not only to get loans through that otherwise would not have been made, but also because the resulting loan had a higher rate, a particularly abusive practice. In the majority of cases we have seen, borrowers were not aware that they had received a stated income loan, much less that they were charged a higher interest rate. In almost all of these cases, the borrowers did not even know what information was included in their application. The application had been filled out by the lender or broker, and the borrower had not been given an opportunity to review it until at closing when it was placed in front of the borrower in a stack with all the other closing documents and the borrower was simply instructed to "sign here."

Subprime lenders were aware of the abuses of the product, but made a conscious decision not to tighten their underwriting guidelines. ACORN members have sat across the table from the CEO's of some of the largest subprime lenders and brought specific cases of abuse to their attention and urged them to make changes, but the lenders did not want to lose business from brokers by restricting loans.

It appears that some of the changes that have been made recently in the underwriting of these loans has only been done to protect the lender and investor, but not the homeowner. For instance, lenders have begun to require a lower loan-to-value for stated income loans, which protects their investment, but does not make a difference to the homeowner if the payment is unaffordable.

We believe that lenders should be required to verify the borrower's ability to repay the loan, which is not always the same as verifying income. We believe that the lender should verify whatever information is used in making the underwriting decision. For instance, if the loan is made based on the borrower's financial assets, other than the subject property, than those assets should be verified.

Underwriting Adjustable Rate Mortgages

Adjustable Rate Mortgages have become the default product originated by subprime lenders. While ARMs represent about a quarter of all home loans nationwide, they made up three-quarters of all subprime loans originated in 2005 – a huge increase from 1999 when half of all subprime mortgages were ARMs.

Abuses are prevalent in the origination of subprime ARMs. We have interviewed hundreds of subprime ARM borrowers, and none of them were given a choice about whether they wanted a fixed or adjustable rate. For lenders who insist their customers are choosing adjustable rates, we would ask these lenders how their customers could make a choice since we have never seen any forms that a broker or loan officer might use to help a borrower decide.

We asked borrowers about when they learned they would be getting an adjustable rate and how it was explained to them. Their answers can be grouped into the following categories:

- Some customers were told that an ARM was the only or best way to go.
- Some customers were told they didn't qualify for a fixed rate, but weren't told why
- Some customers expressed concern when they learned they were getting an ARM, but were told not to worry because they could refinance in a year or two.
- Some customers did not learn until closing that they were getting an ARM
- Some customers did not know they had an ARM until an ACORN representative reviewed their loan documents.
- Some customers didn't find out they had an ARM until their payment went up.

In addition, none of the borrowers received an accurate explanation of how their LIBOR-based, teaser-rate ARM worked. The most common type of subprime ARM is one in which the borrower's initial rate will increase after two years even if rates stay the same or decrease, but in no case will it go below the starting rate. Typically, the rate can increase up to a maximum of 700 basis points above the starting rate.

However, the borrowers we interviewed were not given any explanation or were told incorrectly that :

- the rate may just go up a little
- the rate may go up or down
- the payments will only go up as shown on the TIL statement
- the lender will refinance them before the rate changes

While we believe that there are many ways that the existing disclosures can be improved, it is clear that improved disclosures alone will not adequately stem the predatory practices that are pervasive in the origination of subprime ARMs. Disclosures may work in a market where there is discussion and deliberation in the decision-making process – practices which do not exist in the subprime world.

In the subprime market, lenders typically will allow borrowers to have a larger debt-to-income ratio than in the prime market. It is common for subprime lenders to qualify a borrower with a 50% or 55% debt ratio, using a monthly payment based on a teaser-starting rate that is almost guaranteed to increase in two years. It is clearly unsound for both borrower and lender when loans are underwritten with no consideration beyond the first two years of the loan. Instead, subprime ARM lenders are relying on the likelihood that these borrowers will be forced to refinance before their payments become unaffordable.

Underwriting adjustable rate loans to ensure affordability based on the fully-indexed rate will help address this problem, but it will not solve it, especially during periods when the index rate that is used is very low, such as in 2004 with the LIBOR rate. 2/28 ARMs that were made that year often had starting interest rates and a floor <u>above</u> the fully-indexed rate.

As in the case of this borrower from San Antonio, Texas, who closed on her loan in June 2003.

The LIBOR rate at that time was about 1.2%.
The margin on her loan was 7.0%.
The fully-indexed rate was 8.12%.
The starting rate on her loan was 8.69%.
The minimum rate on her loan was 8.69%.

Underwriting her loan at the fully-indexed rate would not have prevented the affordability problems that she experienced when her rate increased in July 2005 and again six months later.

Conclusion

We urge the Federal Reserve Board to use its rulemaking authority to protect homeowners from abusive lending practices by:

1) Prohibiting prepayment penalties on subprime loans
2) Requiring that lenders include taxes and insurance in the payment on subprime loans
3) Requiring lenders to verify a borrower's ability to repay the loan
4) Requiring lenders to underwrite loans at the fully-indexed rate and fully-amortizing term

The Federal Reserve's last revision of HOEPA in 2002 had the effect of eliminating single premium credit insurance, the most predatory practice at that time. The Federal Reserve has a similar opportunity now. We urge the Federal Reserve to act on this opportunity and to protect homeowners from abusive lending practices that lead to increased foreclosures, harming individual families and entire communities.

Sincerely,

Maude Hurd
ACORN National President