February 21, 2007

John M. Reich
Director
Office of Thrift Supervision
700 G Street, NW
Washington, DC 20552

Sheila C. Bair
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Ben S. Bernanke
Chairman
Board of Governors of the
Federal Reserve System
20th and Constitution Avenue, NW
Washington, DC 20551

John C. Dugan
Comptroller of the Currency
Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

JoAnn Johnson
Chairman
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Neil Milner
President and CEO Conference of State Bank Supervisors
1155 Connecticut Ave., 5th Floor
Washington, DC 20036-4306

Dear Director Reich, Chairwoman Bair, Chairman Bernanke, Comptroller Dugan, Chairwoman Johnson, and Mr. Milner:

We commend you for issuing the Guidance on Nontraditional Mortgage Product Risk this past fall. We are hopeful that the guidance will curb some of the abuses associated with high risk, non-traditional loan products. However, despite your recent efforts, we remain concerned that millions of high-risk, unaffordable loans are not covered by the guidance and that massive payment shocks built into these loans could cause a foreclosure crisis that eclipses the displacement caused by Hurricane Katrina.[1] Specifically, subprime hybrid 2-28 and 3-27 adjustable rate mortgages (ARMs) pose the risk of the very severe payment shock that the guidance is intended to prevent.

We therefore call upon you to help protect American families by issuing supplementary guidance to clarify that subprime hybrid ARMs are subject to the same underwriting standards as non-traditional mortgages, particularly the requirement of underwriting at the fully-indexed rate.

It is as important for subprime borrowers as for prime interest-only or negative amortization borrowers that "an institution's analysis of a borrower's repayment capacity should include an evaluation of their ability to repay the debt by final maturity at the fully indexed rate. "[2] The severity of the current problem demonstrates that simply reiterating past guidance is not sufficient. We also are asking that the Conference of State Bank Supervisors take similar action for state-regulated entities.

Subprime lenders generally make hybrid ARMs without considering whether the borrower can afford the loan past the initial teaser rate, making the loan in effect a two-year balloon. The resulting acute subprime payment shock is significant, because 18% of all loan originations last year were subprime hybrid ARMs.[3] A mid-year 2006 analysis from Fitch Ratings reported that 2-28 subprime ARMs carried an average built-in payment shock of 29% even if interest rates remained unchanged, [4] and since the London Interbank Offered Rate (LIBOR) increased 1.09% by year-end, the Fitch analysis suggests current payment shock of 48%.

Subprime borrowers are particularly ill-suited to bear high payment shock because they are financially stretched already – loans are commonly underwritten to 50% to 55% debt-to-income ratios. In addition, this nominal payment shock understates the real shock subprime borrowers face for two reasons: (1) in half of the cases, lenders use stated rather than documented income,[5] and stated income has been shown to be exaggerated 90% of

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[1] Hurricane Katrina caused more than one million people to be displaced in Louisiana and up to several hundred thousand in Mississippi; see "Many Displaced By Katrina Turn to Relatives for Shelter," by Blaine Harden and Shankar Vedantam, *Washington Post*, 9/8/05, p. A1, available at http://www.washingtonpost.com/wp-dyn/content/article/2005/09/07/AR2005090702415_pf.html. A recent study by the Center for Responsible Lending estimates that 2.2 million subprime loans made in recent years have ended or will end in foreclosure (at a rate of 19%). See *Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners* available at, http://www.responsiblelending.org/pdfs/CRL-foreclosure-rprt-1-8.pdf.

[2] Interagency Guidance on Nontraditional Mortgage Product Risks at 20.

[3] *Subprime Mortgage Origination Indicators*, Inside B&C Lending (November 10, 2006).

[4] *Structured Finance: U.S. RMBS Criteria for Subprime Interest-Only ARMs*, Fitch Ratings Credit Policy (Oct. 4, 2006).

[5] *Structured Finance: U.S. Subprime RMBS in Structured Finance CDOs*, FITCH RATINGS CREDIT POLICY (August 21, 2006), at 4.

the time;[6] and (2) lenders fail to put in escrow borrowers' property taxes and hazard insurance,[7] lump sums that subprime borrowers must find a way to pay .[8] It is no wonder that, according to the MBA National Delinquency Survey, subprime loans constitute just 13% of outstanding mortgages but over 60% of foreclosures.[9]

A majority of home loans made in 2005 to African-American families were subprime loans, and the overwhelming majority were 2-28s and 3-27s. Forty percent of loans to Latinos were also in this category.[10] By contrast, approximately 80% of home loans made during this time period to white families were prime loans, the market sector in which products covered by the guidance are more common. Unless the underwriting standards from the guidance are clarified to also cover 2-28s and 3-27s, the guidance will afford limited protection in the market sector that disproportionately serves minority borrowers.

It is also troubling when older homeowners, often reliant on fixed incomes, are marketed loan products that include terms such as substantial monthly payment increases within 2-to-3 years of closing. These loans are backed not by a projected jump in income, but by the equity in the home -- equity that often represents a lifetime of hard-earned savings. Clarifying the guidance is an important step in the process of protecting all these vulnerable homeowners from current market abuses.

We look forward to working with you on this important matter. Thank you for your consideration.

Sincerely,

AARP
Leadership Conference on Civil Rights
National Association for the Advancement of Colored People
Rainbow/Push
ACORN
AFL-CIO
Center For Responsible Lending
Coalition of Community Development Financial Institutions
Consumer Action
Consumer Federation of America
Consumers Union
National Association of Consumer Advocates

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[6] Mortgage Asset Research Institute, Inc., *Eighth Periodic Mortgage Fraud Case Report to Mortgage Bankers Association*, p. 12, available at http://www.mari-inc.com/pdfs/mba/MBA8thCaseRpt.pdf (April 2006).

[7] *See, e.g.* "B&C Escrow Rate Called Low," *Mortgage Servicing News Bulletin* (February 23, 2005).

[8] *Partnership Lessons and Results: Three Year Final Report*, p. 31 Home Ownership Preservation Initiative, (July 17, 2006) at www.nhschicago.org/downloads/82HOPI3YearReport_Jul17-06.pdf.

[9] Mortgage Bankers Association, *National Delinquency Survey – Third Quarter 2006.*

[10] Based on 2005 data submitted under the Home Mortgage Disclosure Act.

National Consumer Law Center (On behalf of its low-income clients)
National Community Reinvestment Coalition
National Fair Housing Alliance
National Lawyers' Committee for Civil Rights Under Law
National NeighborWorks Association
Opportunity Finance Network
U.S. PIRG
African American Caucus of the NC Democratic Party
Arkansans Against Abusive Payday Lending
Appalachian Community Enterprises
Boston Community Capital
Capital District Community Loan Fund
CASA of Oregon
Cascadia Revolving Fund
California Reinvestment Coalition
Capital Alliance.
Chautauqua Home Rehabilitation and Improvement Corporation
Clearinghouse CDFI
Coalition on Homelessness & Housing in Ohio
Coastal Enterprises, Inc.
Colorado Enterprise Fund
Community Action Committee of the Lehigh Valley
Community Legal Services in East Palo Alto
Community Development Venture
Community Enterprise Investments, Inc. (FL)
Covenant Community Capital, Houston TX
Dayton Community Reinvestment Coalition
Delaware Community Reinvestment Action Council, Inc. (DE)
Double Eleven Credit Union
Economic Opportunities Fund
Edgemont Neighborhood Coalition Inc
Enterprise Corporation of the Delta
FAHE Inc., KY
Federation of Appalachian Housing Enterprises, Inc.
Funding Partners for Housing Solutions
Greenlining Institute
Housing Committee of the NC Conference of the NAACP
Jewish Community Action
Lenders for Community Development
Leviticus 25:23 Alternative Fund
Long Island Housing Services, Inc.
Low Income Investment Fund
MaineStream Finance
Maui Economic Opportunity Business Development Corporation
The Native American Lending Group, Inc.
National Association of Human Rights Workers -

National Community Investment Fund
North Carolina Fair Housing Center -
New Jersey Citizen Action (NJ)
New York Association for New Americans
Neighborhood Economic Development Advocacy Project (NEDAP), NY
North Carolina Community Development Initiative
Northeast Entrepreneur Fund
Northeast South Dakota Community Action Program (NESDCAP)
Northeast South Dakota Economic Corporation
Northland Foundation
Oregon Community Credit Union
Partners for the Common Good
Pittsburgh Community Reinvestment Group
PPEP MicroBusiness and Housing Development Corporation
RNA Community Builders
The Reinvestment Fund
SC Appleseed Legal Justice Center.
Scott County Housing Council (IA)
Southern Financial Partners
United Neighborhood Centers
Virginia Partnership to Encourage Responsible Lending (VaPERL)

Ed Gramlich,*The Urban Institute

Patricia A. McCoy ,George J. & Helen M. England Professor of Law,*University of Connecticut School of Law

*- organization listed for identification purposes only

Northwest Indiana Community Reinvestment Alliance (IN)