

Ms. Jennifer J. Johnson  
Secretary  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue NW  
Washington, DC 20551

RE: DOCKET R-1305

April 2, 2008

Dear Ms. Johnson:

Opportunity Finance Network (OFN)<sup>1</sup> appreciates the chance to comment on the Federal Reserve Board's (the Board) efforts to address emerging issues and questions relating to certain subprime mortgage lending practices and its proposed amendments the provisions in Regulation Z, implementing the Truth in Lending Act.

We commend the Board for its continued effort to combat predatory lending practices and ensure a responsible mortgage system. We support strong legislative and regulatory solutions that facilitate affordable, responsible credit for all Americans and help to make the American dream of homeownership a reality.

We also support strong lending solutions. To provide responsible alternatives, OFN has developed the Opportunity Mortgage Network platform, offering fair and competitive mortgage products to borrowers with limited credit histories or who are rebuilding their credit histories.<sup>2</sup> We know that efforts to combat abusive lending must be combined with responsible lending in practice.

In OFN's view, the Board's current proposal falls significantly short of its goals to correct the dysfunctions and imbalances in the subprime mortgage market. In particular, the proposed rules fail to fill three main gaps in a fair and responsible mortgage market:

- **Prepayment Penalties.** The Board's proposal does not ban this "exit tax" on subprime loans that traps families in bad loans. It must. Though the proposed regulation limits prepayment penalties slightly for adjustable-rate mortgages, it leaves the majority of

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<sup>1</sup> Opportunity Finance Network, the national network of more than 160 financial institutions creates growth that is good for communities, investors, individuals, and the economy. Its members include Community Development Financial Institutions (CDFIs) and other opportunity finance institutions that work just outside the margins of conventional finance to bring those markets into the economic mainstream and to help the economic mainstream flow into those markets. CDFI financing has resulted in significant numbers of new jobs, jobs preserved, quality, affordable housing units, and new commercial and community facility space in all 50 states. Over the past 30 years, the Opportunity Finance industry has provided more than \$23 billion in financing that would not otherwise have happened in markets that conventional finance would not otherwise reach.

<sup>2</sup> In the Opportunity Mortgage Network platform, community development financial institutions (CDFIs) originate and broker the products into a specially designed centralized processing, fulfillment, closing, financial literacy, and servicing infrastructure. Each of the CDFIs and nonprofits under the platform must complete training, agree to firm lending standards and have ongoing transactions reviewed in order to be certified to originate under the platform. For more information on the Opportunity Mortgage Network and its products, see [http://www.opportunityfinance.net/financing/finance\\_main.aspx?id=52](http://www.opportunityfinance.net/financing/finance_main.aspx?id=52)



subprime borrowers subject to this penalty, which can prevent them from refinancing out of a bad loan and taking advantage of an improved credit record. The Board should ban all prepayment penalties.

- **Yield-Spread Premiums.** Subprime borrowers are far more vulnerable than prime borrowers to abuses of yield-spread premiums—compensation to brokers for securing loans at a higher interest rate than the borrower qualifies. The Board’s proposal enhances disclosure of yield-spread premiums, but this disclosure is insufficient to protect subprime borrowers. Unscrupulous brokers could easily “bury” the disclosure statement in unfamiliar paperwork. Instead, the Board should ban yield-spread premiums in subprime loans.
- **Ability to repay.** Lenders extending credit without regard for the borrower’s ability to repay have been a significant cause of the current housing finance crisis. While the Board’s proposal recognizes that this irresponsible extension of credit is a problem, it fails to protect individual borrowers. By requiring proof of a “pattern or practice” of making loans without regard to homeowners’ income and repayment ability,” The Federal Reserve is permitting significant harm to individual homeowners in lieu of a pattern or practice that can withstand prolonged legal proceedings. This burden makes the provision virtually unenforceable. The Board should strengthen these rules.

In two other areas, the Board took significant steps forward in the fight against abusive lending, but missed opportunities to provide maximum protection:

- **Verification of income.** The rules address the lack of documentation of income that has caused significant payment problems on subprime loans, but the Board failed to extend this rule to non-traditional mortgages, even when a borrower could easily provide a W-2 form or other proof of income. This loophole defies common sense.
- **Escrow of taxes and insurance.** Deceptive lenders or brokers commonly market loans with an artificially low monthly payment by excluding mandatory tax and insurance costs. While we applaud the Board’s proposal to require the escrow of taxes and insurance for subprime loans, we are concerned that this sensible rule would not also apply to non-traditional mortgages, such as payment option adjustable-rate mortgages, and the fact that there is a one-year opt-out will reduce its effectiveness.

## Background

The current trouble in the housing market has gained national media and policymaker attention as a once highly profitable mortgage business begins to weaken dramatically. The recent housing boom fueled by rising housing prices, high demand for commercial and residential real estate, and easy credit precipitated a climate in which unscrupulous lenders could profit from entrapping borrowers into exotic, nontraditional mortgages of the type addressed in the Board’s proposal, including adjustable rate mortgage (ARM) products that borrowers could not afford. Unscrupulous lenders, enticed by massive profits reaped during the boon, loosened underwriting standards in order to secure more mortgages for increasingly expensive homes. These adjustable rate mortgages, often equipped with below market-rate initial “teaser” rates and sometimes not including tax and insurance payments, result in lower than normal introductory payments during the beginning of the loan period.

The introductory period is now ending for millions of borrowers, and they are seeing their mortgage loans reset at much higher-interest rates, with their mortgage payments increasing sharply. As a result, many borrowers will be—in fact, many already are—in a predicament in



which they cannot afford their payments, and may become seriously delinquent and possibly have their homes enter foreclosure.

Today, the rate of homes in foreclosure is the highest it has been in the history of tracking such a statistic. Even though subprime mortgages are only 13 percent of all mortgages, they account for 50 percent of foreclosure starts. Adjustable rate subprime mortgages account for only six percent of mortgages, but 40 percent of foreclosures.<sup>3</sup> Because the subprime binge continued late into 2006, the peak of the problem is yet to come. It is estimated that 2.2 million families will lose or have lost their homes to foreclosure due to reckless subprime lending, including one out of every five subprime mortgages made in 2005 and 2006.<sup>4</sup>

The recent turmoil in credit markets has been exacerbated in large part by these rising default rates of mortgage loans in the subprime market that are resulting primarily from irresponsible lending. This has created a tsunami effect on the economy, reverberating from the subprime mortgage market into the overall credit markets. Lenders made loans to borrowers with undocumented sources of income and questionable credit histories. Thus, flaws in the subprime mortgage market have overflowed into the larger credit markets, and are impacting consumer wealth and confidence amid declining housing prices, large loan payments, and rising interest rates.

### **Conclusion**

To preserve homeownership for American families, we need real, systemic change in policies that protect homeownership. The explosion of the largely unregulated subprime lending industry has contributed to an increase in abusive lending practices that threaten to undo many of the community reinvestment gains of the last decade and changed the face of the financial services industry. Predatory lending, in all its forms, strips billions of dollars from consumers and communities in the United States. A rigorous predatory lending standard will protect new homeowners created by the Administration's initiatives to increase minority and low-income homeowners, as these populations are among those most vulnerable to predatory lending.

OFN urges the Board to build on these proposed rules and strengthen the protections it begins to offer subprime borrowers with this proposal. The Board has an opportunity to level the playing field for people with limited experience in the mainstream financial system. It should not miss that opportunity.

Thank you for the opportunity to comment. Please do not hesitate to contact me at 215.320.4304 or [mpinsky@opportunityfinance.net](mailto:mpinsky@opportunityfinance.net) if you have questions or need additional clarification.

Sincerely,

Mark Pinsky  
President and CEO

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<sup>3</sup> Treasury Secretary Henry M. Paulson, Jr., Remarks before the U.S. Chamber of Commerce, (March 26, 2008): <http://www.treas.gov/press/releases/hp887.htm>.

<sup>4</sup> Eric Stein, "Straightening Out the Mortgage Mess: How Can We Protect Home Ownership and Provide Relief to Consumers in Financial Distress," Testimony Before the U.S. House Judiciary Committee Subcommittee on Commercial and Administrative Law, (September 25, 2007): <http://www.responsiblelending.org/pdfs/stein-testimony-on-subprime.pdf>.