CORE
Metadata, citation and similar papers at core.ac.uk
Provided by Research Papers in Economics

Nontraditional Mortgage Guidance

By John Olson

On September 29, 2006, the federal financial institution regulators (the "Agencies") issued the Interagency Guidance on Nontraditional Mortgage Product Risks.[1] The guidance was developed to clarify how institutions can offer nontraditional mortgage products in a safe and sound manner, and in a way that clearly discloses the risks that borrowers may assume. This article provides a brief summary of the guidance, but financial institutions should refer to the guidance itself for more information, and should work closely with their regulator in developing or changing systems, policies, and procedures in response to the guidance. Consumers and homeownership counseling organizations may find this summary useful in understanding bank mortgage products as well as consumer rights and responsibilities.

Background

The need for guidance on nontraditional mortgage products arose from the increasing popularity of mortgage products that allow borrowers to defer payment of principal and, in some cases, interest. These products include interest-only loans and payment option adjustable rate mortgages (ARMs) and contain the potential for substantial payment shock when the loans begin to fully amortize. Nontraditional mortgage products have been available for many years, but these products are now offered to a wider spectrum of borrowers by a much greater number of institutions.

The growth of these loans raises a series of pressing questions for regulators, lenders, and consumers: Do these loans pose special risks to lenders, and how are those risks best managed? Do consumers have enough information to make informed decisions about these products? Are consumers prepared for payment shocks when loans re-set, and do lenders appropriately account for payment shocks? Do these loans help certain segments of the population become homeowners, and would increased regulation inappropriately restrict access to credit? Alternatively, are these loans dangerous for some consumers, putting their dream of homeownership at risk, suggesting the need for more regulation?

Overview

In response to these questions and concerns, the Agencies issued guidance to financial institutions to emphasize the importance of developing sound underwriting standards and portfolio risk management practices, and to recommend practices for consumer disclosure to ensure that borrowers are informed about both the risks and the benefits associated with these products.

The guidance applies, in general, to "all residential mortgage loan products that allow borrowers to defer payment of principal or interest," including interest-only mortgages and payment option adjustable-rate mortgages. The guidance asserts that financial institution management should:

- Ensure that loan terms and underwriting standards are consistent with prudent lending practices, including consideration of a borrower's repayment capacity;
- Recognize that many nontraditional mortgage loans, particularly when they have risk-layering features, are untested in a stressed environment; and
- Ensure that consumers have sufficient information to clearly understand loan terms and associated risks prior to making product choice.

The guidance is divided into three sections: Loan Terms and Underwriting Standards, Portfolio and Risk Management Practices, and Consumer Protection Issues, as detailed below.

Loan Terms and Underwriting Standards

Qualifying borrowers: An institution's qualifying standards should recognize the potential impact of payment shock, especially for borrowers with high loan-to-value ratios, high debt-to-income ratios, and low credit scores. The criteria should be based upon prudent and appropriate underwriting standards, considering both the borrower's characteristics and the product's attributes. For all nontraditional mortgage products, an institution's analysis of a borrower's repayment capacity should include an evaluation of their ability to repay the debt by final maturity and the fully indexed rate.

Underwriting standards: Nontraditional mortgages can be an effective financial management tool for some borrowers, but may not be appropriate for all borrowers. When qualifying borrowers for nontraditional mortgages, banks need to make sure the borrower is able to repay the loan. The guidance states that loans should be underwritten at the fully indexed rate, assuming a fully amortizing payment, including the additional payment burden from any negative amortization that can accrue.

Collateral-dependent loans: Institutions should avoid the use of loan terms and underwriting practices that may

heighten the need for a borrower to rely on the sale or refinancing of the property once amortization begins. Loans to individuals who do not demonstrate capacity to repay, as structured, from sources other than the collateral pledged are generally considered unsafe and unsound.

Risk layering: Risk layering features such as limited documentation and simultaneous second liens should be accompanied by mitigating factors. Mitigating factors can include lower LTV and DTI ratios, higher credit scores, sufficient liquid assets or other credit enhancements.

Reduced documentation: Reduced documentation practices should be used with caution. As the level of credit risk increases, the Agencies expect an institution to more diligently verify and document a borrower's income and payment capacity.

Simultaneous second-lien loans: Loans with minimal or no owner equity should not have a payment structure that allows for delayed or negative amortization without other significant risk mitigating factors.

Introductory interest rates: When developing nontraditional mortgage product terms, an institution should consider the spread between the introductory rate and the fully indexed rate. Because a wide initial spread means that borrowers are more likely to experience payment shock, institutions should minimize the likelihood of payment shock when setting introductory rates.

Lending to subprime borrowers: Mortgage programs that target subprime borrowers should follow the applicable interagency guidance on subprime lending.[2] Institutions should recognize that risk-layering features in loans to subprime borrowers may significantly increase risks for both the institution and the borrower.

Portfolio and Risk Management Practices

Institutions should ensure that risk management practices keep pace with the growth and changing risk profile of their nontraditional mortgage loan portfolios and changes in the market. Active management of these risks is especially important to institutions that have experienced, or project, significant growth or concentration levels. To meet the Agencies' expectations that institutions that originate or invest in nontraditional mortgages adopt more robust risk management practices, institutions should:

- Develop written policies that specify acceptable product attributes, production and portfolio limits, sales and securitization practices, and risk management expectations;
- Design enhanced performance measures and management reporting that provide early warning for increased risk;
- Establish appropriate Allowance for Loan and Lease Losses (ALLL) levels that consider the credit quality of the portfolio and conditions that affect collectibility;
- Maintain capital levels that reflect portfolio characteristics and the effect of stressed economic conditions on collectibility; and,
- Conduct stress tests on key performance drivers such as interest rates, employment levels and housing value fluctuations. Stress testing results should provide direct input in determining underwriting standards, product terms, concentration levels and capital levels.

Consumer Protection Issues

While nontraditional mortgage loans provide flexibility for consumers, the Agencies are concerned that consumers may enter into these transactions without fully understanding the product terms. Institutions should provide consumers with clear, balanced, and timely information concerning the risks of nontraditional mortgage products, including the risks of payment shock and negative amortization. Clear information should be provided at critical decision times, such as when selecting a loan product or when choosing a monthly mortgage payment option–not just upon submission of an application.

Institutions that offer nontraditional mortgage products must ensure that they do so in a manner that complies with all applicable laws and regulations. Applicable laws and regulations include the Truth in Lending Act (Regulation Z), which governs disclosures that institutions must provide, and Section 5 of the Federal Trade Commission Act, which prohibits unfair and deceptive acts or practices. Other laws, including the fair lending laws and the Real Estate Settlement Procedures Act, also apply.

Communications with consumers: Institutions should provide consumers with information that is designed to help them make informed decisions when selecting and using these products. Institutions should alert consumers to potential increases in payments for nontraditional mortgages, such as when an introductory rate expires or because of a cap on negative amortization. Negative amortization and its impact on the consumer's loan balance and home equity should also be highlighted. If an institution offers loans with prepayment penalties or reduced documentation loans, the institution should highlight those features, including the premium for a reduced documentation loan. If the institution may impose a prepayment penalty, consumers should be alerted to this fact and to the need to ask the lender about the amount of any such penalty.

Monthly statements on payment option ARMs: Statements should enable consumers to make informed choices about their payment options, explaining the impact of each choice on the loan balance.

Practices to avoid: Institutions should avoid practices that obscure significant risks to the consumer. For example, if an institution emphasizes the comparatively lower initial payments, it should also provide clear and comparably prominent information alerting the consumer to the risks.

Institutions should avoid promoting payment patterns that are unlikely to occur. Institutions should also avoid making one-sided representations about the cash savings or expanded buying power to be realized from nontraditional mortgage products, suggesting that initial minimum payments will cover accrued interest charges, and making misleading claims that interest rates or payment obligations for these products are "fixed."

Control systems: Institutions should put systems in place to ensure that their practices are consistent with the guidance. Among other things, institutions should not use compensation programs that improperly encourage lending personnel to direct consumers to particular products. Institutions that make, purchase, or service loans through third parties should take appropriate steps to mitigate risks relating to consumer protection discussed in the guidance. These

Comments on Interagency Guidance on Nontraditional Mortgages

Box 4.1

On December 20, 2005, the Agencies issued for comment proposed guidance on nontraditional mortgage products. The comment period ended on March 29, 2006, and the final guidance was issued on September 29, 2006. Over 60 comments were received by the Agencies, and comments letters are publicly available on the Federal Reserve's website.[1] Comment letters from several prominent organizations are highlighted below.

American Bankers Association (ABA)

While the ABA also pointed out that the consumer protections in the guidance would apply only to regulated financial institutions, it listed a number of its own concerns about the guidance. The ABA asserted that the proposed guidance "overstates the risks of these mortgage products," would be overly prescriptive, and would inappropriately combine safety and soundness guidance with consumer protection guidance. The ABA also expressed concern that the guidance would result in compliance problems by creating an additional layer of disclosure on top of what is required by Regulation Z and RESPA; it suggested that "the Agencies agree on a generic consumer brochure explaining the risks of both interest-only and option ARMs…and specify a practical time when a lender should give the consumer the standard disclosure brochure."

California Reinvestment Coalition (CRC)

While generally supporting the proposed guidance, CRC's comment letter raised several areas of concern about the guidance and about the market for nontraditional loans. "CRC would argue against combining stated income loans or loans with reduced income documentation with *any* nontraditional mortgages and/or subprime mortgages" (emphasis in original). CRC also asked that the Agencies give greater guidance to secondary market participants because it "believes that much of the clamor for these products comes not from borrowers but from investors." CRC also advocated for a closer link between the guidance and the CRA, citing a Federal Reserve analysis of HMDA data that showed that lending within banks' CRA assessment areas showed significantly smaller race disparities than lending outside the assessment areas.

Mortgage Bankers Association (MBA)

The MBA expressed concern that the proposed guidance would be overly prescriptive, would introduce an inappropriate third-party oversight standard for depository institutions, and that the guidance does not sufficiently use the authority of the Federal Reserve to improve consumer disclosure. The MBA stated that it is "concerned that these deficiencies will stifle mortgage product innovation and hurt consumers' access to homeownership financing." While agreeing with the Agencies' recommendation that borrowers should not be underwritten at a teaser rate, the MBA asserted that "the proposed guidance goes too far in detailing underwriting standards," and will "force lenders to apply credit policies inconsistent with risk." The MBA also expressed concerns in the consumer protection area, stating that guidance would create "an even more duplicative and fragmented system than the current one and will arguably add confusion rather than clarity."

National Consumer Law Center (NCLC)

NCLC called the proposed guidance a "good beginning for what should be a major effort by the federal financial regulators to evaluate what changes need to be made in the regulation of the mortgage marketplace." The organization urged the Agencies to focus on the risk to consumers inherent in these products, rather than the risk to lenders. The deficiencies in the guidance alleged by NCLC included the fact that the guidance would not be enforceable by consumers seeking relief from a lender that had not conformed to the guidance; that the guidance would not apply to lenders that are not depository institutions; that the guidance would provide inadequate consumer protections; and that the guidance would fail to require meaningful underwriting (by not requiring "fully indexed" underwriting). While NCLC applauded the Agencies focus on the need for appropriate underwriting, it found the proposed guidance to be "inherently limited in its reach and strength."

steps would include, for example, monitoring third parties' compliance with agreements and bank policy, and taking corrective action if the third party does not comply.

Guidance for Non-bank Entities

As noted in several comments to the Agencies on the proposed guidance (See Box 4.1), while nontraditional mortgages are offered by a range of institutions, including many non-bank lenders, the Agencies' guidance applies only to insured depository institutions. Since the issuance of the guidance, however, several other regulatory and supervisory entities have issued similar guidance for other participants in the nontraditional mortgage market.

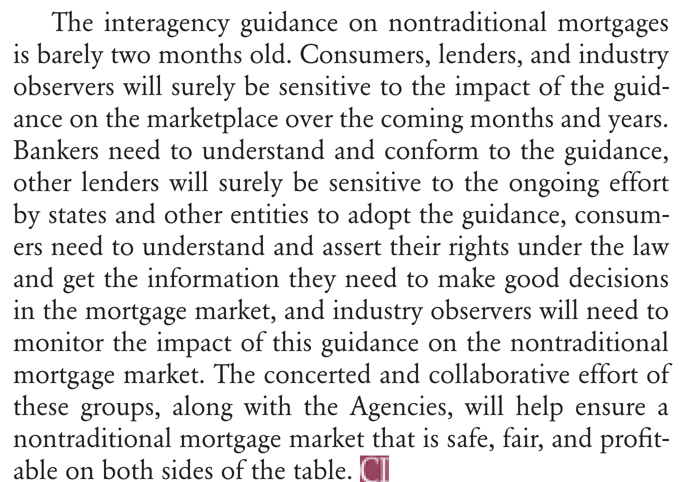
State Supervisors

In a comment letter responding to draft guidance, Neil Milner, President and CEO of the Conference of State Bank Supervisors (CSBS), wrote: "As the Interagency Guidance is directed towards insured financial institutions and their subsidiaries and their affiliates, it appears that nonbank lenders, most of which are licensed and regulated by state authorities and control a large share of the mortgage origination market, may not be subject to this proposal. CSBS will encourage its members to determine the best course of action for distributing this Guidance, or guidance that is similar in nature and scope, to the financial service providers under their supervision."[3] Indeed, the CSBS and the American Association of Residential Mortgage Regulators jointly distributed guidance to their state agency members that "substantially mirrors" the federal guidance.[4]

Fannie Mae and Freddie Mac

On December 13, 2006, the Office of Federal Housing Enterprise Oversight (OFHEO) "directed Fannie Mae and Freddie Mac to immediately take action to support practices outlined in an interagency guidance on nontraditional mortgage product risks."[5] Director James B. Lockhart stated that Fannie and Freddie adopting the principles of the guidance into their risk management and business practices will enhance industry underwriting standards, risk management, and consumer protection. Fannie and Freddie are expected to report progress on developing policies in line with the guidance by February 27, 2007.

Conclusion



The interagency guidance on nontraditional mortgages is barely two months old. Consumers, lenders, and industry observers will surely be sensitive to the impact of the guidance on the marketplace over the coming months and years. Bankers need to understand and conform to the guidance, other lenders will surely be sensitive to the ongoing effort by states and other entities to adopt the guidance, consumers need to understand and assert their rights under the law and get the information they need to make good decisions in the mortgage market, and industry observers will need to monitor the impact of this guidance on the nontraditional mortgage market. The concerted and collaborative effort of these groups, along with the Agencies, will help ensure a nontraditional mortgage market that is safe, fair, and profitable on both sides of the table. CI

Homeownership at High Cost: Recent Trends in the Mortgage Lending Industry

1 Joint Center for Housing Studies of Harvard University (2006). "State of the Nation's Housing 2006."

2 Belsky, Eric and Mark Duda (2002). "Anatomy on the Low-Income Homeownership Boom in the 1990s." In *Low-Income Homeownership: Examining the Unexamined Goal,* Nicolas Retsinas and Eric Belsky, eds. The Brookings Institution.

3 Doms, Mark and Meryl Motica (2006). "The Rise in Homeownership." *FRBSF Economic Letter,* Number 2006-30.

4 U.S. Government Accountability Office (2006). "Alternative Mortgage Products: Impact of Defaults Remains Unclear, but Disclosure of Risks to Borrowers Could be Improved."

5 Joint Center for Housing Studies of Harvard University (2006). "State of the Nation's Housing 2006." and Avery, Robert, Kenneth Brevoort and Glenn Canner (2006). "Higher-Priced Home Lending and the 2005 HMDA Data." *Federal Reserve Bulletin.* Federal Reserve Board.

6 Joint Center for Housing Studies of Harvard University (2006). "State of the Nation's Housing 2006."

7 Immergluck, Daniel and Marti Wiles (1999). "Two Steps Back: The Dual Mortgage Market, Predatory Lending, and the Undoing of Community Development." Woodstock Institute.

8 "Non-prime" includes Alt-A low- and no-documentation loans

9 Board of Governors of the Federal Reserve System (2006). "Interest–Only Mortgage Payments and Payment Option ARMS—Are they for you?" http://www.federalreserve.gov/pubs/mortgage_interestonly/#comparison

10 Herbert, Christopher and Eric S. Belsky (2006). "The Homeownership Experience of Low-Income and Minority Families: A Review and Synthesis of the Literature." U.S. Department of Housing and Urban Development, Office of Policy Development and Research.

11 Johnson, Hans and Amanda Bailey (2005). "California's Newest Homeowners: Affording the Unaffordable," Public Policy Institute of California.

12 Because many of the AMP loans originated in recent years have not yet reset, it is not yet clear how much of an impact these types of payment shocks are having on delinquencies and foreclosure rates.

13 Apgar, William and Mark Duda (2005). *Collateral Damage: The Municipal Impact of Today's Mortgage Foreclosure Boom.* Report prepared for the Homeownership Preservation Foundation. Available: http://www.hpfonline.org/PDF/Apgar-Duda_Study_Final.pdf

14 Immergluck, Daniel and Geoff Smith (2005). "There Goes the Neighborhood: The Effect of Single-Family Mortgage Foreclosures on Property Values." Chicago: Woodstock Institute. Available at: http://www.woodstockinst.org/publications/research_reports

15 Immergluck, Daniel and Geoff Smith (2005). "The Impact of Single-Family Mortgage Foreclosures on Neighborhood Crime." Paper presented at the Federal Reserve System National Community Affairs Research Conference, Washington, D.C.

16 Mortgage Bankers Association. National Delinquency Survey, Second Quarter 2006.

17 Herbert, Christopher and Eric S. Belsky (2006). "The Homeownership Experience of Low-Income and Minority Families: A Review and Synthesis of the Literature." U.S. Department of Housing and Urban Development, Office of Policy Development and Research., and Carr, James and Lopa Kolluri. (2001) "Predatory Lending: An Overview" http://www.knowledgeplex.org/kp/text_document_summary/article/relfiles/hot_topics/Carr-Kolluri.pdf

18 Loans are identified as "high cost" in the Home Mortgage Disclosure Act (HMDA) dataset if the spread between the interest rate on the loan and the prime rate exceeded a specified amount (i.e. 3% for first-lien loans and 5% for second-lien loans).

19 Avery, Robert, Kenneth Brevoort and Glenn Canner (2006). "Higher-Priced Home Lending and the 2005 HMDA Data." *Federal Reserve Bulletin.* Federal Reserve Board.

20 Carr, James and Lopa Kolluri. (2001) "Predatory Lending: An Overview" http://www.knowledgeplex.org/kp/text_document_summary/article/relfiles/hot_topics/Carr-Kolluri.pdf

21 Courchane, Marsha, Brian Surette and Peter Zorn (2004). "Subprime Borrowers: Mortgage Transitions and Outcomes," *Journal of Real Estate Finance and Economics,* 29:4, 365-392, 2004.

22 Bocian, Debbie, Keith Ernst and Wei Li (2006). Unfair Lending: *The Effect of Race and Ethnicity on the Price of Subprime Mortgages.* Center for Responsible Lending., and U.S. Government Accountability Office (2006).

12th District Trends in Mortgage Lending – Box 1.1

1 "Nightmare Mortagages." (9/11/2006) *BusinessWeek,* online at http://www.businessweek.com/magazine/content/06_37/b4000001.htm

2 *FDIC Outlook Summer 2006–Breaking New Ground in U.S. Mortgage Lending.* Federal Deposit Insurance Corporation (2006). http://www.fdic.gov/bank/analytical/regional/ro20062q/na/2006_summer04.html

3 *Ibid.*

Predatory Lending – Box 1.2

1 "Loan flipping" refers to lenders who encourage borrowers to rapidly refinance loans; loan flipping may result in equity-stripping because refinancing costs money and often these charges are refinanced into the amount of the loan.

Foreclosure Risk in California – Box 1.3

1 This research focuses on a subset of the subprime market—loans that are "high cost." For the first time in 2004, loans are identified as "high cost" in the Home Mortgage Disclosure Act (HMDA) dataset if the spread between the interest rate and the prime rate exceeded a specified amount (i.e. 3 percent for first-lien loans and 5 percent for second-lien loans).

2 According to a recent study by the Public Policy Institute of California, forty percent of households with mortgages in the state, and 52 percent of recent homebuyers pay more than the HUD recommended guideline of spending 30 percent of their income on housing costs. Twenty percent spend more than half of their income on their housing costs. Among low-income households, the percentages of those spending the majority of their income on housing costs is even higher. Baldassare, M. "Statewide Survey November 2004: Special Survey on Californians and Their Housing," Public Policy Institute of California. Available at: http://www.ppic.org/content/pubs/survey/S_1104MBS.pdf

3 Notices of Default are not a perfect indicator of foreclosure risk because many households that have home loans they cannot afford do not ever get to the point where they receive a notice of default. Some homeowners are able to refinance or sell their home before receiving this official warning. Here, the term "foreclosure risk" is used as shorthand to describe areas in which households have received notices of default. Areas are described as having a "higher level of foreclosure risk" if they have a higher rate of notices of default.

Preventing Foreclosure: Initiatives to Sustain Homeownership

1 Mortgage Banker's Association (2005). *National Delinquency Survey, First Quarter 2005 – Fourth Quarter 2005.*

2 Cutts, A C. & Green, R. K.. (2005). Innovative Servicing Technology: Smart Enough to Keep People in Their Houses?. in *Building Assets, Building Credit: Creating Wealth In Low-Income Communities,* Retsinas, N. & E. Belsky, eds. Brookings Press. 348-377.

3 Apgar W.C. & Duda M. (2005). *Collateral Damage: The Municipal Impact of Today's Mortgage Foreclosure Boom.* Homeownership Preservation Foundation Minneapolis, Minnesota from www.hpfonline.org.

4 Immergluck, D. & Smith, G.. (2005). *The Impact of Single-Family Mortgage Foreclosures on Neighborhood Crime.* Federal Reserve Community Development Conference, Washington, DC from www.chicagofed.org/cedric/files/ 2005_conf_paper_session1_immergluck.pdf

5 Apgar W.C. and Fishbein A.J. (2005). "Changing Industrial Organization of Housing Finance and Changing Role of Community-Based Organizations," in *Building Assets, Building Credit: Creating Wealth In Low-Income Communities,* Retsinas, N. & E. Belsky, eds. Brookings Press. P. 107-137.

6 Courchane, M., Surette B., and Zorn, P. (2004). "Subprime Borrowers: Mortgage Transitions and Outcomes," *Journal of Real Estate Finance and Economics* 29 (4): 365-92.

7 Apgar W. C. and Fishbein, A.J. (2005). Hilgert, M.A., Hogarth J.M., & Beverly S.. (2003). "Household Financial Management: The Connection between Knowledge and Behavior." *Federal Reserve Bulletin,* 89 (7) 309–322. M. Wiranowski, 2002, *Sustaining Home Ownership Through Education and Counseling.* Joint Center for Housing Studies, Harvard University.

8 Hilgert, M.A., Hogarth J.M., & Beverly S. (2003).

9 Hirad, A. and Zorn, P. (2001). *A Little Knowledge is a Good Thing: Empirical Evidence of the Effectiveness of Pre-Purchase Homeownership Counseling.* Hartarska, V., Gonzalez-Vega, C., and Dobos, D. (2002). *Credit Counseling and the Incidence of Default on Housing Loans by Low-Income Households.*

10 For a list of organizations and agencies that provide HUD certified homeownership counseling in your state, visit http://www.hud.gov/offices/hsg/sfh/hcc/hcs.cfm.

11 Emerging markets are defined as households of color, non-English speaking households, and households in which English is a second language.

12 Todd, R. and Grover, M. (2005). "A Case for Post-Purchase Support Programs as Part of Minnesota's Emerging Markets Homeownership Initiative," *Federal Reserve Bank of Minneapolis Community Affairs Report No. 2005-1.*

13 For more information on EMHI's goals and participating organizations, see the EMHI Business Plan at www.mhfa.state.mn.us/about/EMHI_Business_Plan.pdf.

14 W. Pitcoff (2006), "Homeownership Rescue," *Shelterforce Online* Issue Number 147. National Housing Institute.

15 Neighborhood Housing Services of Chicago (2006). *Home Ownership Preservation Initiative: Partnership Lessons & Results, Three Year Final Report.*

16 For more information on ACORN's HFC Foreclosure Avoidance Program, please visit http://acornhousing.org/TEXT/fap.php.

17 D. Sheline (2006). "Sustaining Homeownership and Communities," *Community Developments Online,* Spring 2006. Office of the Comptroller of the Currency.

18 Silver J. and Williams M. (2006), *Asset Preservation: Trends and Interventions in Asset Stripping Services and Products,* National Community Reinvestment Coalition and The Woodstock Institute.

19 Barr, M.S. (2005). "Modes of Credit Market Regulation," in *Building Assets, Building Credit: Creating Wealth In Low-Income Communities,* Retsinas, N. & E. Belsky, eds. Brookings Press. P. 206-236.

20 Barr, M.S. (2005).

21 Engel, K.C. and. McCoy, P.A. (2001). *A Tale Of Three Markets: The Law And Economics Of Predatory Lending.* Cleveland-Marshall College of Law, Cleveland State University.

22 Engel, K.C. and. McCoy, P.A. (2001).

23 United States Government Accountability Office (2006). *Alternative Mortgage Products: Impact on Defaults Remains Unclear, but Disclosure of Risks to Borrowers Could be Improved.* GAO-06-1021.

24 S.F. Braunstein (2006). *Nontraditional mortgage products.* Testimony before the Subcommittee on Housing and Transportation and the Subcommittee on Economic Policy, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, September 20, 2006.

25 For an analysis of the differences between HR 1182, Prohibit Predatory Lending Act (Miller-Watt-Frank) and HR 1295, Responsible Lending Act (Ney-Kanjorski), the two pieces of legislation introduced during the 109th Legislative Session, visit http://www.responsiblelending.org/issues/mortgage/policy/page.jsp?itemID=29837365

26 Quercia, R.G., Stegman, M.A., and Davis, W.R. (2004). "Assessing the Impact of North Carolina's Predatory Lending Law," *Housing Policy Debate* 15(3): 573-601.

27 Other states with predatory lending laws include Arkansas, Colorado, Connecticut, the District of Columbia, Florida, Georgia, Illinois, Indiana, Kentucky, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New Mexico, New York, North Carolina, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Tennessee, Texas, and Wisconsin.

28 Information relating to state and local laws and their provisions is from a database maintained by Butera & Andrews, A Washington, D.C., law firm that tracks predatory lending legislation, and is current as of September 8, 2006.

29 Elliehausen, G. and Staten, (2002) *Regulation of Subprime Mortgage Products: An Analysis of North Carolina's Predatory Lending Law,* Credit Research Center, Georgetown University.

30 For a review of these studies, see Quercia, R.G., Stegman, M.A., and Davis, W.R. (2004).

31 Quercia, R.G., Stegman, M.A., and Davis, W.R. (2004).

The Consumer Rescue Fund – Box 2.1

1 For a more detailed description and analysis of the Consumer Rescue Fund, see Josh Silver and Marva Williams (2006), Asset Preservation: Trends and Interventions in Asset Stripping Services and Products, National Community Reinvestment Coalition and The Woodstock Institute.

2 The name of the consumer has been fictionalized for privacy reasons.

3 Alabama, Arizona, California, Florida, Georgia, Illinois, Indiana, Maryland, Massachusetts, Nevada, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, Texas, and Wisconsin.

Calculated Risk: Assessing Nontraditional Mortgage Products

1. This article was adapted from testimony that was given in September 2006 before the Senate Committee on Banking Housing and Urban Affairs. The full text is available at: http://www.responsiblelending.org/policy/testimony/page.jsp?itemID=30380832
2. Inside B&C Lending, 9/1/2006; See also Inside Mortgage Finance MBS Database, 2006.
3. 54.7 percent of African-Americans who purchased homes in 2005 received higher-rate loans. 49.3 percent received such loans to refinance their homes.
4. 46.1 percent of Latino white borrowers received higher-rate purchase loans. 33.8 percent received higher-rate refinance loans. For the purpose of this comment, "Latino" refers to borrowers who were identified as racially white and of Latino ethnicity.
5. Hudson, Mike and E. Scott Reckard, "More Homeowners with Good Credit Getting Stuck in Higher-Rate Loans," *L.A. Times,* p. A-1 (October 24, 2005).
6. *Ibid.*
7. In 2nd quarter of 2006, 80.7 percent of subprime loans were adjustable rate loans. This figure based on Mortgage Backed Securities through the 2nd quarter of 2006, see Inside Mortgage Finance MBS Database, 2006.
8. *Ibid.*
9. Laing, Jonathan R. "Coming Home to Roost," *Barron's* (New York, NY), Feb. 13, 2006, at 26.
10. For example, a recent prospectus shows that a large subprime lender, Option One underwrites to the lesser of the fully indexed rate or one percentage point over the start rate. For a loan with a typical 2/28 structure, the latter would always apply. See Option One Prospectus, Option One Mtg Ln Tr Asset Bk Ser 2005 2 424B5 May 3 2005, S.E.C. Filing 05794712 at S-50.
11. See, eg., Chase Home Finance Subprime Lending marketing flier, "Attractive Underwriting Niches," at www.chaseb2b.com (available 9/18/2006) stating "Taxes and Insurance Escrows are NOT required at any LTV, and there's NO rate add!" (suggesting that failing to escrow taxes is an "underwriting highlight" that is beneficial to the borrower).
12. See, eg.," B&C Escrow Rate Called Low" (February 23, 2005) *Mortgage Servicing News Bulletin,* July 23, 2005 "Servicers of subprime mortgage loans face a perplexing conundrum: only about a quarter of the loans include escrow accounts to ensure payment of insurance premiums and property taxes, yet subprime borrowers are the least likely to save money to make such payments….Nigel Brazier, senior vice president for business development and strategic initiatives at Select Portfolio Servicing, said only about 25 percent of the loans in his company's subprime portfolio have escrow accounts. He said that is typical for the subprime industry."
13. 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).
14. Figure based on Mortgage Backed Securities through the 2nd quarter of 2006, see Inside Mortgage Finance MBS Database, 2006.
15. See "Steep Increase in California Foreclosure Activity," *DataQuick News,* October 18, 2006, http://www.dqnews.com/RRFor1006.shtm and "National Foreclosures Increase 17 Percent In Third Quarter" Press Release from RealtyTrac, November 1, 2006, http://www.realtytrac.com/ContentManagement/PressRelease.aspx?ItemID=1362.
16. Quercia, Roberto, Michael Stegman and Walter Davis, *The Impact of Predatory Loan Terms on Subprime Foreclosures: The Special Case of Prepayment Penalties and Balloon Payments,* Center for Community Capitalism, University of North Carolina at Chapel Hill (January 25, 2005) at 30 and 24.
17. CRL conducted an OLS regression of state-level changes in housing prices and foreclosure rates among subprime loans originated in 2000 (based on performance through May 2005), which shows a highly significant relationship ($p < 0.01$) with an adjusted r-squared of 0.57 and coefficient of -0.92. In other words, for every percentage point decrease in appreciation rates, the model predicts a 0.92 percentage point increase in foreclosure rates. Mean foreclosure rate=13.57 percent, N=51.
18. Knox, Noelle and Barbara Hansen, "More Fall Behind on Mortgages," *USA Today* at B1 (September 14, 2006). The *USA Today* figures refer to total delinquency figures (30 days + delinquent through foreclosure).
19. See MBA survey cited in Noelle Knox and Barbara Hansen, More Fall Behind on Mortgages, *USA Today* at B1 (September 14, 2006).
20. Income verification could include nontraditional methods including bank accounts, records of consistent bill paying that are not recorded by standard credit agencies or other methods that will reasonably verify income to meet mortgage requirements.

Nontraditional Mortgage Guidance

1. The guidance was issued by the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the National Credit Union Administration. The guidance is available online at http://www.federalreserve.gov/boarddocs/press/bcreg/2006/20060929/attachment1.pdf.
2. Interagency Guidance on Subprime Lending, March 1999. http://www.federalreserve.gov/boarddocs/srLETTERS/1999/sr9906a1.pdf
3. February 14, 2006 letter to the Agencies. http://www.federalreserve.gov/SECRS/2006/February/20060224/OP-1246/OP-1246_10_1.pdf
4. See http://www.csbs.org/AM/Template.cfm?Section=Press_Releases&Template=/CM/ContentDisplay.cfm&ContentID=9010.

Comments on Interagency Guidance on Nontraditional Mortgages – Box 4.1

1. See http://www.federalreserve.gov/generalinfo/foia/index.cfm?doc_id=OP%2D1246&doc_ver=1&ShowAll=Yes.

Glossary

1, 2, 6, 7, 19: "Consumer Handbook on Adjustable Rate Mortgages" (2005). Board of Governors of the Federal Reserve System: http://www.federalreserve.gov/pubs/arms/glossary_english.htm.

13, 29: Board of Governors of the Federal Reserve System: http://www.federalreserve.gov/events/publichearings/hoepa/2006/default.htm

12: "Frequently Asked Questions about the New HMDA Data" (2006). Board of Governors of the Federal Reserve System: www.federalreserve.gov/boarddocs/press/bcreg/2006/20060403/attachment.pdf

3, 4, 5, 11, 16, 23, 25, 27, 30-33: Center for Responsible Lending: http://www.responsiblelending.org/glossary.html

8, 9, 10, 15, 18, 24: Fannie Mae: http://www.fanniemae.com/tools/glossary.jhtml

14, 21, 22, 28: "Overview of Nonprime Mortgage Lending and Nontraditional Mortgage Product Terms". In FDIC Outlook Summer 2006—Breaking New Ground in U.S. Mortgage Lending. Federal Deposit Insurance Corporation: http://www.fdic.gov/bank/analytical/regional/ro20062q/na/2006_summer04.html

17, 20, 27: U.S. Department of Housing and Urban Development: http://www.hud.gov/offices/hsg/sfh/buying/glossary.cfm