#2620

RECEIVED
2007 AUG 20 AM 7: 20
INDEPENDENT REGULATORY
REVIEW COMMISSION

August 16, 2007

Pennsylvania Department of Banking
Attn: Office of Chief Counsel
17 North Second Street • Suite 1300
Harrisburg, PA 17101

Dear Counsel:

This letter is a comment regarding the new mortgage regulations proposed by the Pennsylvania Department of Banking which are being considered by the Independent Regulatory Review Commission. Much of what this proposed regulation contains is common sense and laudable. My suggestions are not to meant attack the regulation but to point out where it is flawed.

As with most laws and regulations, the intentions are well-meaning but tend to be a knee-jerk reaction to a problem. In this case the problems being addressed are increased mortgage defaults and extreme hardship placed on borrowers to make payments in certain areas of the country. As a seasoned legislator once explained, "The unintended consequences of well-intentioned legislation can be worse than the problem they were designed to correct." The same is certainly true of regulations. The reasons for the current problems in the mortgage market are far from established. To eliminate certain loan products by state regulation too early may serve only to exacerbate matters.

If the proposed mortgage regulations are implemented unchanged, some borrowers will certainly suffer greatly, perhaps more than they have already. The market has concluded that offering mortgages to individuals with little likelihood of being able to repay has dire financial consequences. Over eighty major lenders are no longer in business since the beginning of 2007. The correction has been made and these products are either off the market or require substantial equity. On the positive side, nearly all borrowers who received no-income verification loans are still in their homes and making their payments. The pain was felt most by lenders who made bad decisions in the sub-prime market.

In an interview on PBS' Nightly Business Report, former Fed governor Alice Rivlin said, "Sub-prime lending has increased over the last few years enormously. It has helped a lot of people buy houses who wouldn't have been able to otherwise, a lot of them lower income and minorities. So, there's a lot of plus there. It just got a little out of control." Giving someone a loan who has no record of making timely payments with no downpayment and no regard for income are what got "out of control."

The proposed regulations will be aimed specifically at lower income individuals and minorities who tend to have lower credit scores. While those with higher incomes will find it easy to buy a home, the disadvantaged will be completely shut out. A market-driven economy quickly sorts out who is a good credit risk and who is not with little government intervention. It is novel that government leaders of every ilk pressed lenders to take more risks. Lenders did and housing ownership reached an all-time high.

However, one should not assume a loan not requiring absolute proof of income or adjustments is a sub-prime loan. The majority of loans requiring less rigid proofs of income are not sub-prime at all. Making loans to certain types of subprime borrowers who had shown unwillingness or inability to repay became common.

Regulators can make serious errors of judgment. Several years ago, Fed Chairman Greenspan, in a speech to the National Credit Union Administration, said:

"American consumers might benefit if lenders provided greater mortgage product alternatives to the traditional fixed-rate mortgage." It was said that the Chairman himself had a "payment option" ARM. Perhaps that was appropriate for him but that product was used by many individuals who did not understand how the program actually worked. As the Fed went on a series of 17 interest rate hikes in a row, taking the fed funds rate from 1% to 5.25%, interest rates on these loans soared, triggering the negative amortization caps. That caused extreme payment increases. Those with equity sold. Those with little or no equity were forced to default. Similar problems occurred under "2/28" programs that had sharp payment increases. This is a case for better disclosures, which are a very suitable part of the proposed regulations.

The great risk in implementing these regulations is that many low-income, minority and self-employed borrowers will be trapped in high-interest loans. By prohibiting these individuals from obtaining a new loan without traditional proofs of income, they are locked into an ever-increasing payment as rates escalate. If they have equity, they will be forced to sell. This serves to depress home prices causing further problems, loss of equity and an inability to sell for others. It would be a shame if homeowners would be forced to sell their home to utilize its equity. Risk and reward are part of the American economic system so long as both parties to the contract are sufficiently informed.

I am also concerned about qualification at the "amortizing, fully indexed rate." Loans with a short fixed period may require this. However, the market, including PMI insurers, has recognized that when the fixed-period is three years or greater and caps at adjustment are reasonable, the risk is very little different than a fixed-rate loan. These loans are often used by those whose job location is likely to change, such as those in the military, with great success. Currently, the indexes for ARMs are artificially high in relation to long-term instruments making fully-indexed qualification unrealistic. We have just experienced the greatest increase in the Fed Funds Rate since 1980. Perhaps the Fed should have thought about the carnage those massive increases would produce to mortgage holders who could have easily qualified at the fully indexed rate in 2005.

There are even more unintended consequences the new regulations could spawn for those who cannot fully prove income. There are no provisions for borrowers refinancing to a lower rate. This is especially troubling when borrowers who have FHA or VA loans can refinance to a lower rate with little or no documentation. Many FNMA and FHLMC loans would now require documentation standards that have proven to be unnecessary. It would seem prudent to provide a complete exemption for loans underwritten to FNMA, FHLMC, FHA and VA standards. Borrowers who had anticipated refinancing to an amortizing, fixed-rate loan could be forced to stay in a loan with high margins and caps or negative amortization. Ballooning loans could not be refinanced. At a time when so many loans with these features are in need of replacement, a large number of borrowers who currently have them will face untold hardship if they are unable to refinance. Homeowners could be forced to sell their houses, if they can, or face default, causing further decline in house values.

Regulators and even legislators must realize that we live in a capitalist society. Homeowners have used the equity in their homes to start businesses, send children to college or consolidate high-interest debt. Under the proposed regulation, borrowers could be forced into high-rate credit card debt that seldom requires proof of income. To extract equity, they would have to sell their homes. These are hardly laudable goals.

I also have a concern where the appraiser is influenced to "Ensure that an appraisal matches a requested or target value." Homeowners, buyers and sellers all make decisions based on what they believe the value of a home to be. To muzzle them does them a disservice. Borrowers should have a right to express their opinion and to be made aware immediately if their property value estimate is not accurate. Otherwise, the borrower can make financial decisions based on a faulty assumption. It is imperative that the appraiser be aware of the borrower's expectations of value or the purchase price of the property. Any appraiser who is familiar enough with a market to be appraising can tell very quickly if the borrower's expectations or the sales price are not realistic. The appraiser should immediately stop the appraisal process and perhaps charge a minimal fee rather than continue on with an appraisal that will not benefit the consumer or buyers and sellers. This does not give the appraiser or anyone else involved in the transaction the right to "pressure" the appraiser to create a false value. The proposed regulation does not recognize this balance sufficiently. The appraiser could operate with no accountability or with insufficient information if borrowers or a licensee are removed totally from the process.

While other factors may be in play, in 24 states, early 2007 foreclosures actually declined. Three states, Ohio, Michigan and Indiana accounted for 19.9% of all foreclosures nationwide in the first quarter of 2007. It should not be lost on Pennsylvania's regulators that Ohio was one of the first states to implement a ban on no income verification loans. Could it be that the ban forced more homes into foreclosure?

We do not have formal analysis yet for the 2nd quarter of 2007 and a GAO study is underway examining the causes of the current problems. Implementing these regulations prematurely before all facts are known may be unwise.

Finally, conversations with the leading regulatory attorneys in the area lead me to believe that the agency lacks the statutory authority to implement certain facets of this regulation. They feel that it is not consistent with the legislative intent of current state law. The regulation lacks specificity. Section e(3) is quite vague as to what constitutes adequate income or proof thereof. One must guess at what other information in addition to verified income would evidence a borrower's ability to repay. Many lenders have found that cash flow, especially for self-employed borrowers, is a good indicator of ability to repay. Other lenders and federal agencies have found that demonstrated ability to pay a higher payment in a timely manner is sufficient proof of ability to repay. This regulation lacks clarity on such determinations. Since there has been no significant demonstrated tie between proof of income and default in Pennsylvania, this part of the regulation seems unwarranted or lacking in justification.

Most of the requirements of the proposed regulation are reasonable and seek to regulate *how* business is conducted by licenses. It crosses the line when it attempts to regulate *what* business is conducted. It also attempts to limit the rights of consumers in several areas. I would hope that the Independent Regulatory Review Commission would require absolute proof that lack of rigid documentation of income is a significant indicator of loan default. The Commission should consider the types of loans in default and study the causes. Consumers and licensees should have the right to assert the borrower's expected value of a property and challenge mistakes of fact or judgment by appraisers. Of course, there should be no reprisal when an appraiser produces a quality product where reasonable people could differ. Finally, qualifying borrowers at the fully-indexed rate for mortgages with at least a three-year fixed period and caps at first adjustment of two percent or less contradicts risk findings by the GSEs and private mortgage insurers.

Thank you for considering these thoughts.

Sincerely,

John L. Councilman, CMC, CRMS
President
AMC Mortgage Corporation
Federal Housing Chair
National Association of Mortgage Brokers