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INDEPENDENT REGULATORY REVIEW COMMISSION

ACORN

Association of Community Organizations for Reform Now

August 20, 2007

Department of Banking
Office of Chief Counsel
Attention: Public Comment on Regulation 3-43
17 N. Second Street, Suite 1300
Harrisburg, PA 17101-2290

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DEPARTMENT OF BANKING
LEGAL SECTION

Thank you for the opportunity to share our opinion regarding the Department's proposed regulations, 37 Pa.B.3416, released on July 21, 2007.

We are submitting these comments on behalf of the more than 25,500 ACORN member families in Pennsylvania. 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 Department should implement the proposed regulations to protect consumers from abusive lending practices, and that this will not restrict access to credit on fair terms.

We strongly support the Department's goals of putting an end to the predatory practices that have been too common in the subprime market, and also of ensuring that lenders provide borrowers with the information needed to make decisions about their loan. We believe that the proposed regulations are a step towards accomplishing these goals.

DISCLOSURES

Since ACORN began its campaign against predatory lending eight years ago, we have talked with thousands of families in Pennsylvania and nationally who have been ripped off by predatory lenders. One of the things

Philadelphia: 846 North Broad Street, Philadelphia, PA 19130 - (215) 765-0042
Pittsburgh: 5907 Penn Avenue, Suite 300, Pittsburgh, PA 15206 – (412) 441-6551
Allentown: 602 East Hamilton Street, Suite 202, Allentown, PA 18101 – (610) 433-3313
Harrisburg: 14 South 13th Street, Harrisburg, PA 17140 – (717) 233-0133
Erie: 2413 Peach Street, Erie, PA 16502 – (814) 871-6370
www.acorn.org

we hear from almost every family after we have reviewed and explained their loan documents is "If I had known what was really in this loan, there's no way I would have taken it!"

The only way that predatory lenders are able to sell their loans is through deceit and lies because if they were truthful about the terms of the loan, their customers would walk out the door.

We support the added disclosure that has to be given to the borrower early in the process, not just at the closing, but right after the application is submitted. This disclosure will tell the borrower if their taxes and insurance will be included in their payment, if the loan has a prepayment penalty, if there will be negative amortization, and if they have an adjustable interest rate. These are the exact things that loan officers and brokers lie to their clients about, and that people don't find about until closing, or in some cases even after closing.

We would also suggest that the disclosure include the borrower's monthly payment, and details about any adjustable rate feature, such as when it will change and what the maximum rate is.

A part of the regulations proposed last year (36 Pa.B. 4010) that is not in the current version was the requirement that lenders orally explain the terms and conditions of the loan. We believe that this was an important provision since many borrowers, due to native language or reading ability will have to rely on what the broker or loan officer tells them.

ABILITY TO PAY: VERIFICATION OF INCOME

We also strongly support the provision that lenders should not make loans if the borrower does not have the ability to repay the loan. So-called stated-income loans have 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 were 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 – pay stubs and tax returns – but the broker or loan officer submitted the application as a stated income loan without the borrower's knowledge. In the majority of cases we have seen, borrowers were not aware that they had received a stated income loan. 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."

The only change that we would suggest would be that the lender should determine that the borrower will be reasonably expected to not just pay the loan, but also the property taxes and insurance.

ABILITY TO PAY: ADJUSTABLE RATES

We also support the provision under the ability to pay section that the ability to pay should be determined based on the fully-indexed interest rate and with a fully amortized payment schedule.

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.

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

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 above the fully-indexed rate.

As in the case of this New Century borrower 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.

However, requiring lenders to determine a borrower's ability to pay based on the fully-indexed rate and a fully amortizing payment schedule will make state regulations consistent with the federal guidelines that cover nationally chartered banks and credit unions.

ADDITIONAL PROVISIONS

There are several other important issues which we believe should be covered in the regulations.

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.

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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. 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 are 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.

<u>Steering.</u> Too many prime borrowers, especially African-American and Latino, are being charged subprime rates and fees. Regulations should explicitly prohibit lenders from giving a borrower a worse loan than they qualify for.

<u>Future Predatory Practices.</u> Regulations should not only address current predatory practices, but also must be broad enough to cover practices that emerge in the future. The best way to accomplish this is to require that loan officers have a duty of "good faith and fair dealing" to require them to treat their customers honestly and fairly and that brokers have a duty to act in the best interest of the borrower.

ENFORCEMENT

Even the strongest consumer protections will accomplish nothing if they are not enforced. We urge the Department to aggressively enforce the regulations after they have been enacted to ensure maximum compliance by lenders and brokers.

Thank you,

Jordan Ash
Director
ACORN Financial Justice Center

Ian Phillips
Legislative Director
PA ACORN

Philadelphia: 846 North Broad Street, Philadelphia, PA 19130 - (215) 765-0042
Pittsburgh: 5907 Penn Avenue, Suite 300, Pittsburgh, PA 15206 – (412) 441-6651
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