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American Financial Serivces Association Letter to Federal Regulators

Robert McKew

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919 18th Street, NW
Suite 300
Washington, DC 20006

March 28, 2006

By Electronic Mail

Office of the Comptroller of the Currency
250 E Street, SW
Public Reference Room
Mail Stop 1-5
Washington, DC 20219
Attn.: Docket No. 05-21

Regulation Comments
Currency Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attn.: Docket No. 2005-56

Jennifer Johnson
Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Ave., NW
Washington, DC 20551
Attn.: Docket No. OP-1246

Robert E. Feldman
Executive Secretary
Attn: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

Re: Proposed Guidance—Interagency Guidance on Nontraditional Mortgage Products, 70 Fed. Reg. 77249 (December 29, 2005)

Ladies and Gentlemen:

The American Financial Services Association ("AFSA") hereby submits this comment letter in regard to the proposed Interagency Guidance on Nontraditional Mortgage Products (the "Guidance") issued for public comment on December 29, 2005, by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and the Office of the Comptroller of the Currency (collectively, the "Agencies").

AFSA is the trade association for a wide variety of market-funded providers of financial services to consumers and small businesses. AFSA members are important sources of credit to the American consumer, providing approximately over 20 percent of all consumer credit. AFSA

member companies offer or are assigned many types of credit products, including mortgage loans.

Although most of its members will not be directly subject to the Guidance, AFSA is interested in the Guidance for a number of reasons. First, while the exact effect that the Guidance will have on the secondary market is not something that can be predicted with certainty, we think it is likely that the Guidance will influence how the secondary market treats nontraditional mortgage products, and that this could result in the Guidance becoming de facto industry standards. The Guidance might also serve as a template for similar guidelines developed by our members' regulators and the foundation for claims by class action plaintiffs and state attorneys general.

The institutions that make up the secondary mortgage market—as purchasers, aggregators, MBS underwriters, etc.—include many financial institutions that will be subject to the Guidance. Since the Guidance applies to all aspects of a financial institution's involvement with nontraditional mortgage products, these secondary market participants will be required to implement policies and practices that conform to the principles laid down in the Guidance and which address the concerns of the Agencies expressed in the Guidance. Because the secondary mortgage market is so integrated, the policies and practices that these financial institutions adopt have the potential to affect the practices of the rest of the market, and ultimately the entire mortgage industry. Even if it is not directly subject to the Guidance, a company that might want to sell loans to or purchase loans from a financial institution subject to the Guidance—or, by extension, anyone who might want to sell loans to or purchase loans from that company—must be cognizant of the Guidance and consider whether its own practices and policies are consistent with the Guidance's principles and directives in order to ensure the broadest possible market for nontraditional mortgage loans they originate or purchase. This could result in a "ripple effect" beyond the financial institutions directly subject to the Guidance, and even beyond other institutions supervised by regulators that use the Guidance as a model for their own regulatory standards.

While the Guidance is certain to have *some* impact on the market, no one can be sure how profound it will be. Indeed, it might turn out to be more muted than in the scenario described above. Our point is not to offer precise predictions about how dramatically the Guidance will affect the industry, but to frame the perspective from which many of our comments below are made. Although, as explained above, most of AFSA's membership will not be directly subject to the Guidance, AFSA's members do look to the capital markets as a major source of funding for their mortgage originations. Therefore, in reviewing the Guidance, our focus was on how the Guidance might affect the secondary market for nontraditional mortgage products, and how this might affect AFSA's members. We also considered how the state and federal agencies that supervise our members might interpret and apply the Guidance if they look to it as a source of "persuasive authority" on standards for nontraditional mortgage loans.

I. General Comments

A. Scope of Guidance

In order to avoid any confusion or uncertainty about the scope of the Guidance, we ask that the Agencies precisely define the term "nontraditional mortgage loan." Although the Guidance is directed toward interest only mortgage loans and payment option ARMs—and both those terms are defined in the Appendix to the Guidance—it suggests that the term "nontraditional mortgage loan" includes any "residential mortgage loan products that allow borrowers to defer repayment of principal and, sometimes, interest."[1] If read literally, this definition would encompass most reverse mortgage products, for example, although we suspect that this is not what the Agencies intended. Other types of products not intended to be covered by the Guidance might also fall within its scope.

One approach that the Agencies could take would be to carve out certain types of loans – such as reverse mortgages – from the scope of the Guidance. However, we recommend that, instead, the Agencies limit the scope of the Guidance to interest only mortgages and payment option ARMs, as those terms are defined in the Appendix to the Guidance. The Guidance was drafted with those types of loan products in mind, so limiting its scope to those products would ensure that it is not misapplied in a context where it was not intended to apply. The terms "interest only mortgage loan" and "Payment Option ARM" are broadly defined, so limiting the Guidance to those types of loans would not materially narrow its scope. Moreover, if a mortgage product emerges in the future that the Agencies believe should be subject to the Guidance, it would not be difficult for the Agencies to so declare. On balance, we believe that limiting the scope of the Guidance in this manner will not frustrate its purpose, and will give the industry predictability about how it will be applied.

B. Importance of Flexibility

AFSA asks that the Agencies clarify that the Guidance is intended to be a statement of general principles that should govern analysis of safety and soundness and consumer protection issues that arise in connection with interest only and payment option mortgages, not a set of rigid proscriptions. While we believe that this is what the Agencies intended, there are several reasons that we believe it is important that the Agencies leave no question about this.

Although there is no private cause of action for "violating" the Guidance, plaintiffs' attorneys have in the past argued that state UDAP laws can create (or augment) liability for noncompliance with a standard expressed in some other law or policy. Plaintiffs' attorneys using UDAP laws to create or augment liability for violating standards under some other law or policy have had mixed results, and we certainly do not intend to suggest that such a claim would be legitimate even in connection with the Guidance as presently written. However, we ask that the

[1] *See Interagency Guidance on Nontraditional Mortgage Products*¸ 70 Fed. Reg. 77249, 77251-52 (December 29, 2005).

Agencies are careful to ensure that the Guidance is not used as a "roadmap" for UDAP claims in connection with nontraditional mortgage products. (This is especially a concern with the portions of the Guidance that expressly address "consumer protection" concerns that the Agencies have, although it is possible that a court might incorporate a standard of conduct in the safety and soundness discussion into a state UDAP law.)

Clarifying that the Guidance is intended to contain flexible principles, not "rules," will reduce the risk that a court will conclude that an act or practice that technically violates an absolute statement in the Guidance is presumptively (or even *per se*) unfair or deceptive. The Agencies might consider, for example, adding the following paragraph to the end of the introductory statements (immediately before the heading "Loan Terms and Underwriting Standards"):

> When using this guidance, institutions and examiners should understand that the Agencies do not intend to establish rigid rules or suggest that specific practices are presumptively inappropriate, unsafe, unsound, unfair, or deceptive. The Agencies recognize the inherent subjectivity and uniqueness of each mortgage transaction. The Agencies' goal in issuing this guidance is to assist institutions and examiners in making these determinations in particular circumstances by identifying areas of concern and articulating broad principles that should be evaluated and considered. Even when not written in qualified language, the statements in this guidance are not intended to be interpreted and applied as proscriptive rules.

Statements like this will help minimize the risk that a court later determines that technical noncompliance with a provision in the Guidance is an unfair or deceptive practice giving rise to liability under a state UDAP law.

We also ask that the Agencies consider revising certain specific directives to reflect the fact that they are not intended to be statements of absolute rules. Even when the language of a statement is tempered to clarify that it is not intended to be an absolute, there is still a concern that a court or regulator applying the Guidance as the standard of conduct under a UDAP or similar state law will not read it so flexibly. Some examples:

- In the "Recommended Practices" section of the "Consumer Protection" discussion, the Guidance identifies a number of facts to which consumers should be "alerted" or "apprised" (such as the potential for payment shock, negative amortization, prepayment fees, and costs incurred by using a reduced documentation option).[2] This might be read as imposing a specific disclosure requirement on lenders, not just a statement of information that must be conveyed in some reasonable manner.

- The monthly statements discussion contains a specific discussion of what the monthly statement must look like. We ask that the Agencies revise this to explain what

[2] *See id.* § 77256.

information needs to be gleaned from the monthly statement, and give institutions greater flexibility to decide how to accomplish that.

- Near the end of the "Consumer Protection" discussion, the Guidance identifies several practices that should be avoided: (1) making unwarranted assurances or predictions about the future direction of interest rates; (2) inappropriate representations about "cash savings" to be realized from nontraditional mortgage products in comparison with amortizing products; and (3) misleading claims that the interest rates or payment obligations for these products are "fixed."[3] By including the phrases "unwarranted," "inappropriate," and "misleading," the Agencies appear to be making clear that the practices identified would not be *per se* impressible absent these qualifications. However, we are concerned that given the specificity with which the practices are described, courts might conclude—expressly or by application of the standards in actual cases—that the practices identified are presumptively "unwarranted," "inappropriate," and "misleading." If they did, then many acceptable statements would be covered by the Guidance. For example, it is factually correct that during the initial term of a nontraditional mortgage, the borrower will have more cash available than if he or she took out a traditional, fully-amortizing mortgage. We do not think it would be inappropriate to point out the fact of lower initial payments to the consumer—indeed, since it is the defining benefit to the borrower of a nontraditional mortgage product vis-à-vis a fully amortizing one, it seems impossible to advertise or even discuss such products without making this observation—provided that the downsides of nontraditional products are also discussed, and the consumer is not misled into thinking that the initial cash savings means that the nontraditional product is the less expensive product in the long run. However, we are very much concerned that courts or regulators would read the Guidance as discouraging even appropriate and factually accurate comments about how nontraditional mortgage products operate.

- Another practice that the Guidance says should be avoided is making "statements suggesting that initial minimum payments in a payment option ARM will cover accrued interest (or principal and interest) charges."[4] A statement that the minimum monthly payment will cover accrued interest would be false in connection with most of the payment option ARM products being originated today. However, the definition of "Payment Option ARM" in the Appendix to the Guidance would cover any product where the borrower is given payment option amounts, including one where the minimum payment covers accrued interest. Although we do not know whether there are a significant number of such products today, it is possible that more will be offered in the future.

These are just a few examples where a literal reading of the Guidance could lead a court or regulator to conclude that acceptable conduct is in violation of the standards set by the

[3] *Id.* at 77256-77257.

[4] *Id.* at 77257.

Guidance. Given the possibility that the Guidance's statements could be morphed into normative statements about what kinds of conduct are "unfair" or "deceptive" under state UDAP laws, the risk of misunderstanding from literal reading like this is a significant concern. We ask that the Agencies not only make express that nothing in the Guidance should be read so rigidly, but also ensure that the language of individual directives is not prone to such an interpretation notwithstanding the inclusion of qualifying statements.

II. Safety and Soundness

A. Repayment Ability

AFSA wholeheartedly agrees with the Agencies that it is inappropriate to make a loan to a borrower without making a reasonable evaluation as to whether the borrower will be able to repay it.[5] AFSA also agrees that the determination of repayment ability generally should include an evaluation of whether the borrower will be able to handle the increase in payment amounts that will occur after the introductory period.

However, we do note one situation where it might not be necessary to evaluate whether the borrower is able to handle the monthly payments after the introductory period. Some interest only loans have interest only periods of ten years or longer. Although there are relatively few of these products right now, there might be more in the future. We think that as a general rule it is less important that lenders consider repayment ability after the interest-only period in connection with these types of loans.

Lenders are not generally going to be able to predict the borrower's income level ten years or more in the future, so a lender making a repayment determination would generally have to consider the borrower's current income. This will result in the disqualification of many borrowers who could benefit from these products, and to whom a loan could be made consistent with prudent lending standards. Even though a lender could not predict what the financial situation of the borrower will be in a decade or more, a prudent lender could become comfortable that the risk of the borrower defaulting in ten or more years when the loan begins to amortize is reasonably low. Over ten or more years, many things can happen:

- There is a reasonable probability that the borrower's income will, in fact, increase;
- Although property values can decline in value, as a general rule property values will increase over the long term, which means that a lender could reasonably conclude that there will be a net appreciation in the value of the property during the long introductory period (which would allow the borrower to refinance or sell the property if his or her financial situation at the end of the introductory period is such that he or she will not be able to manage the higher monthly payments), notwithstanding periodic fluctuations in value;

[5] *See id* at 77252-77253.

- The borrower might refinance;
- The borrower might sell the property.

While the likelihood that any one of these individual events (or others) will occur is too speculative to be determined with certainty, a lender still might reasonably be able to conclude that the confluence of these factors makes it unlikely that the borrower will actually have to start making the higher monthly payments and be unable to do so. Accordingly, we ask that the Agencies allow lenders some flexibility in making assessments about repayment ability in connection with interest only loans with long interest only periods.

B. Assumptions When Assessing Repayment Ability

1. Interest Rate

The Guidance says that financial institutions should assess repayment ability by using the "fully-indexed rate, assuming a fully amortizing repayment schedule."[6] The Guidance defines "fully-indexed rate" as "the index rate prevailing at origination plus the margin that will apply after the expiration of an introductory interest rate." We agree that it may be imprudent to determine repayment ability solely using a teaser rate or an introductory rate that is significantly below the fully-indexed rate. However, in some instances using a "fully-indexed rate, assuming a fully amortizing repayment schedule" would distort the explanation of the risk associated with the product. For example, using a fully-indexed rate would mean that a borrower would be less likely to qualify for a 10/1 hybrid ARM with a 20-year amortization beginning in year ten than a 2/28 product – even though generally the 10/1 hybrid ARM would be considered a less risky loan.

2. Payments During Introductory Period

The Agencies asked commenters to address whether financial institutions should be required to assume that the borrower will pay only the minimum payment amount during the introductory period on a payment option ARM when assessing the borrower's repayment ability once the loan begins to amortize. Our view is that such a requirement would be unnecessarily stringent, and could significantly reduce the number of people who would qualify for nontraditional mortgages.

Lending money always entails some risk – the challenge for lenders is to develop underwriting standards that will allow them to measure the risk in connection with a given loan to a reasonable degree of certainty. This means developing models to predict consumer behavior in connection with a loan based on empirical data. By and large, the lending industry has been successful in developing models to predict consumer behavior in connection with loans, and there is no reason to suppose that they could not develop ways (to the extent they have not

[6] *Id.* at 77252.

already) to predict to a reasonable degree of certainty what consumer payment patterns will be during the early years of a nontraditional mortgage. Requiring lenders to assume that every borrower will make only the minimum payment each month, even when this assumption is empirically denied, is unnecessarily conservative.

The Guidance sets forth a clear principle—a lender should not make a nontraditional mortgage loan to a borrower unless it is reasonably confident that the borrower is likely to be able to handle the higher monthly payments once the loan begins to amortize. The Agencies should give financial institutions flexibility in deciding exactly how to do this. Using established methods of risk assessment, financial institutions should be able to develop methods of making reasonable predictions about borrower payment patterns. While a healthy dose of conservatism may be appropriate when making these predictions, there is no reason to require lenders to assume facts that are unlikely to occur.

3. Future Income of Borrower

The Agencies also asked commenters to address whether the assessment of repayment ability after the introductory period should be made based on the borrower's income at the time of application, or whether financial institutions may take into account the possibility that the borrower's income might rise at some point in the future.

As with the question of whether lenders should assume that borrowers will only make minimum payments, our view here is that establishing a rigid rule that requires lenders to assume the worst case scenario would be unnecessarily conservative. Of course, the income of some borrowers will not increase appreciably over time. Lenders are aware of this possibility and endeavor to predict the probability of this realistic, but relatively uncommon occurrence among all borrowers. However, lenders should have the flexibility to use sound underwriting techniques and empirical data to consider the likelihood and implications of this.

C. Reduced Documentation Application Processes

When a "stated income" or other reduced documentation application procedure is offered to the borrower, it is because the lender has determined that other positive factors allow the lender to make an informed credit decision. So, for example, a "stated income" application process would be appropriate where the credit factors other than income – the borrower's credit history, loan-to-value ratio, etc. – are sufficiently strong to compensate for any increased risk that might result from not verifying the borrower's income. In addition, in many cases, a "stated income" loan does not mean that the lender does not consider income; rather, the lender often will compare the stated income with industry benchmarks for the type of job in the geographic area in question to determine whether the stated amount is within the range of reasonableness.

The basic method of determining whether "stated income" or another reduced documentation application process is appropriate is no different for a nonprime borrower than for a prime borrower. In either instance, the lender must identify and consider what compensating factors exist that might balance out the increased risk associated with the use of the reduced

documentation process. The borrower's credit profile is one of the factors that must be considered, and the less creditworthy the borrower, the more important it will be that there be other factors that reduce the risk. Since the nonprime borrower's credit profile is, by definition, not as strong as a prime borrower's, the other risk mitigators will be especially important when deciding whether to offer the nonprime borrower the option of a reduced documentation application process.

D. Monitoring of Third-Party Originators

1. Scope of Monitoring Obligation

AFSA asks that the Agencies clarify some points relating to the obligation of financial institutions to monitor compliance with standards and guidelines by their third-party loan originators. This portion of the Guidance is of particular interest to AFSA because many of our members would be third-party originators within the meaning of these comments, so the way in which these comments are interpreted and applied by financial institutions will have a direct effect on AFSA.

We ask that the Agencies make clear that the Guidance does not change the basic standards for monitoring of third-party originators established by previous general guidance issued by the Agencies. As presently written, the proposed Guidance only mentions previous issuances by the Agencies on this subject in a passing reference in a footnote.[7] We ask the Agencies to clarify that the Guidance is not intended to supplant the general guidelines set forth in prior issuances by the Agencies on the subject of managing third-party risk, but rather to be a discussion of how the general principles set forth in prior issuances might apply with particularity in connection with nontraditional mortgage products. This would ensure that financial institutions recognize that the Guidance does not represent a fundamental change in the expectations that the Agencies have in connection with third-party monitoring.

Additionally, we are concerned that when certain portions of the Guidance are read in conjunction with the discussion about managing third-party risk, financial institutions might conclude that it is impossible to rely on third-party originators for nontraditional mortgage products. According to the Guidance, the "[c]ontrols over third parties should be designed to ensure that loans made through these channels reflect the standards and practices used by an institution in its direct lending activities."[8] The Guidance also says that the financial institution's monitoring should have a "particular emphasis on marketing and borrower disclosure practices."[9]

These statements about third-party monitoring seem to suggest that financial institutions have an obligation to ensure that their third-party originators conduct their own activities in

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[7] *See id.* at 77254 n. 8.

[8] *Id.* at 77254.

[9] *Id.*

accordance with the standards set forth in the Guidance. That financial institutions should have this expectation of their third-party originators and should take steps to make sure that the originators take it seriously is unobjectionable. However, we are concerned that the Guidance could be interpreted as directing financial institutions to verify adherence to these standards to an unreasonably high degree of certainty and in connection with individual transactions. This would not be an especially significant problem when verifying compliance with, say, the financial institution's policy on providing written disclosures to consumers on the risk of payment shock, or the financial institution's underwriting standards. Compliance with policies like these can be verified by the financial institution to a reasonable degree of certainty through loan file reviews. However, the originator's adherence to many of the standards of conduct set forth in the Guidance will not be so easily verifiable.

Take, for example, the statement in the Guidance that all communications with consumers, including advertising and initial communications, should provide "clear and balanced" information about the risks and benefits of the products being offered. These requirements appear to be among those referred to when the Guidance says that monitoring by financial institutions of third-party originators must place "particular emphasis on marketing and borrower disclosure practices." However, there would be no practical way for a financial institution to verify compliance with these requirements and standards on a loan level to the degree of certainty that compliance with written disclosure or understanding standards can be verified. There is no way for purchasers to meaningfully review every representation made or omitted in advertising or, especially, in discussions between borrowers and brokers or loan officers to ensure that they comply with these requirements and standards. If financial institutions were to conclude that their monitoring practices could not satisfy the standards established by the Guidance, then they might simply conclude that it is not possible to originate nontraditional mortgage products through third-party originators.

We of course are not asking the Agencies to say that financial institutions may abdicate responsibility for monitoring the activities of third-party originators based on a proposition that it might be burdensome. What we do ask the Agencies to do is to clarify that the nature of the monitoring will vary depending on the context. Financial institutions have developed many ways to ensure that their third-party originators comply with applicable laws and the institutions' own policies, even when direct loan-level verification is impossible. Periodic compliance reviews of correspondents—which might include reviews of written and unwritten policies and procedures, interviews with individuals responsible for compliance, etc.—are one way to ensure that third-party originators can be relied on to adhere to the institution's standards. Institutions also have developed ways to identify "warning signs" that a third-party originator's compliance system might not be strong enough. In short, there are many ways that financial institutions can discharge their responsibility to monitor their third-party originators—and these monitoring practices have been found acceptable by the Agencies' examiners (or, at least, the ones still in use have been found acceptable). We ask that the Agencies expressly recognize that these approaches should be presumed to be suitable in connection with nontraditional mortgage loans in the absence of other compelling and concurrently detectable evidence of a systematic pattern of underwriting abuse by a third-party originator.

2. Liability for Actions of Third-Party Originators

We also ask the Agencies to state expressly that the Guidance is not intended to expand the liability of financial institutions for the actions of third parties beyond existing law. Even though the Guidance does not purport to establish a new and independent basis for imposing liability against financial institutions for the actions of third-party originators, it might be interpreted to impose monitoring obligations that are more expansive than and fundamentally different from the obligations that exist under current law. The failure to satisfy these monitoring obligations might lead to assignee liability claims, and we want to make sure that the Guidance cannot be interpreted in this way.

E. Portfolio Monitoring

The industry practice is to monitor and control for retail credit risk on a portfolio basis--not on a loan-by-loan basis. For example, lenders engage in stress testing and monitor risk concentrations by looking at segments of their portfolios—not by assessing individual borrowers and their future. Although the Guidance never says expressly that loan-level monitoring is required, we ask the Agencies to confirm that the industry's portfolio-level focus is appropriate.

F. Secondary Market Activity

The Guidance's comments under the subheading "Secondary Market Activity" downplay the ability of lenders to manage credit risk by selling loans on the secondary market. The Guidance argues that in addition to the contractual recourse obligations, a seller might have "implied recourse" obligations that would require it to repurchase nonperforming loans even in the absence of a contractual obligation to do so.[10] The reason the institution might do this, the Guidance argues, is "to protect its reputation in the market." The Guidance is vague about how this should be interpreted by institutions, and moreover provides little, if any, basis as to why this situation needs to be addressed in the guidance at all.

We ask the Agencies to remove, or at least substantially revise, this "implied recourse" discussion. Sellers rarely repurchase nonperforming loans when not contractually obligated to do so, and then only in extraordinary circumstances. To suggest that such repurchases are routine, even in connection with nontraditional mortgage loans, is not accurate. Certainly, it does not occur with such frequency that sellers should be required to account for "implied recourse" obligations when determining their risk-based capital requirements.

We also do not see how the Agencies could suggest that the "implied recourse" obligation exists for nontraditional mortgage loans, but not for any other type of loan sold into the secondary market. Every loan carries a risk of underperformance. If the risk that a loan might underperform means that a seller has to consider its "implied recourse" obligations when determining risk-based capital requirements, then the ability of lenders to rely on secondary market sales to manage credit risk and diversify their portfolios would be hampered substantially.

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[10] *Id.*

III. Consumer Protection

A. Obligation of Originator to Determine Whether the Loan is Suitable for the Consumer

The consumer protection discussion in the Guidance appropriately focuses on ensuring that lenders provide accurate and complete information to consumers so that consumers have the information they need to make informed decisions. We ask, however, that the Agencies make clear that they do not intend to impose an obligation on lenders to make a subjective assessment as to whether a particular product is "suitable" for a customer. While the Agencies never actually say that such an obligation exists, requirements such as these are unfortunately becoming so common at the state level that we think it is important that the Agencies disclaim that they intend to imply such an obligation. Most loan officers and mortgage brokers are not financial planners, and do not have the training or information to make decisions for consumers about whether a particular product is a "good deal" for them.

The better policy, AFSA believes, is to ensure that consumers receive complete and accurate information that will allow them to decide among different products themselves. This is the approach that the Guidance appears to favor, but we still ask that the Agencies unequivocally disavow any intent to force lenders to go down the inherently subjective and perilous path of injecting some kind of a "suitability" test for every borrower. It is not difficult to make the logical leap that every mortgage loan that results in a foreclosure is, by definition, is a loan that should not have been made. Most lenders would rush to embrace a system that could identify in advance the loans that will ultimately fail. Unfortunately, such a system does not exist, and we do not see one on the horizon. A "suitability" test is definitely not the solution.

Therefore, AFSA believes that the Guidance should expressly disavow an intent to establish such a test. This might be accomplished by adding the following paragraph after the first paragraph under the "Consumer Protection Issues" heading:

> Generally, loan officers and brokers are not trained as financial planners, and moreover would often not have all the information they would need about an individual consumer's financial situation to assess whether a particular nontraditional mortgage product is the best choice for the consumer. The Agencies are of the view that the decision of whether or not to take out a particular loan is best made by the individual consumer, perhaps in consultation with a financial planner if the consumer so desires. Unless other law provides otherwise, the Agencies believe that the obligation of the lender or mortgage broker in the decision-making process should be to provide complete and accurate information to the consumer about available loan products, not to decide whether any particular loan product is a "good deal" for the consumer. To this end, the recommendations below all focus on the provision of information to consumers, and intentionally do not suggest (and are not meant to imply) that lenders or mortgage brokers have an obligation to determine whether a particular loan is advisable for a particular consumer.

B. Desirability of Sample "Safe Harbor" Documentation

The Guidance appropriately does not purport to require specific disclosures to be provided to borrowers in connection with nontraditional mortgage products. However, in order to ensure that nontraditional mortgage products are freely transferable, it is important that there be a degree of consensus among originators, purchasers, and other secondary market participants about the minimum standards established by the Guidance for communications with consumers and "disclosure" of pertinent information. While the secondary mortgage market has demonstrated again and again a remarkable ability to reach consensus on compliance and "best practices" issues like the ones posed by the Guidance—and we have no doubt that it would do so with the Guidance as well—this consensus can still take time to develop. The Agencies could help hasten the establishment of common standards by providing sample disclosures that provide examples of acceptable language. (Of course, we ask that the Agencies make very clear that these are samples only, and not required.)

Another way to ensure that consumers receive accurate information about loan characteristics at an early stage in the application process would be for the Federal Reserve to revise the CHARM booklet to discuss nontraditional mortgage products.

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AFSA appreciates this opportunity to provide its views to the Agencies in connection with the important topics addressed in the Guidance. If it would be helpful to the Agencies, we would be happy to make AFSA staff and member firm personnel available to meet and discuss any of the points raised in this letter. Please address any questions or requests for additional information to the undersigned at (202) 466-8606.

Robert McKew
Senior Vice President and General Counsel
American Financial Services Association