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VIA E-MAIL – regcomments@ncua.gov

March 27, 2006

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

Re: Comments on Interagency Guidance on Nontraditional Loans

Dear Ms. Rupp:

The Credit Union National Association (CUNA) appreciates the opportunity to comment on the proposed guidance on nontraditional loans that NCUA and the other financial institution regulators have recently issued. CUNA represents approximately 88 percent of our nation's 8,900 state and federal credit unions, which serve nearly 87 million members.

Summary of CUNA's Comments

- The nontraditional loans covered under the guidance should only include first lien interest-only mortgages or mortgages with negative amortization features, such as those commonly referred to as "Option ARM" loans, and should not include other types of interest-only loans, such as bridge loans and home equity lines of credit.
- In most situations, lenders should underwrite these loans based on the borrower's ability to make more than just the minimum payments, especially for Option ARM loans in which negative amortization may result.
- Using reduced documentation for income for these types of loans would only be appropriate in certain situations, such as when the borrower clearly documents significant net worth.
- Future income growth should not be considered when making these types of loans as that would be too difficult to predict and is not consistent with current practices.
- CUNA would support separate disclosures that would provide more information about these types of loans in an effort to better educate consumers about the complex features of these loans and believes these should be developed by the financial institution regulators.

- We agree that including simultaneous second-lien loans with these types of nontraditional loans can result in reduced owner equity and higher credit risk and that interest-only and Option ARM loans are appropriate in these situations only if the borrower will continue to have substantial equity in the property.

Before providing specific comments on the proposed guidance, we first want to address the types of loans that will be covered. The guidance is intended to apply to “nontraditional” mortgage loans and then references “interest-only” mortgages in which the borrower has the option to pay no principal for a fixed period of time, as well as “payment option” adjustable-rate mortgages in which the borrower has flexible payment options, including the option to pay less than the interest owed, resulting in negative amortization.

We urge NCUA and the other financial institution regulators to clarify the scope of the guidance. We agree that “payment option” loans, also commonly referred to as “Option ARM” loans, should be subject to the guidance. However, we have a concern about including all types of interest-only loans. Although we understand the need to cover first lien interest-only mortgage loans, there are a number of other products, including other interest-only loans, that have been in existence for many years and, therefore, would not be considered “nontraditional” loans. These include bridge loans, that cover situations in which the borrower purchases a home shortly before selling his or her current home, home equity lines of credit, and situations in which lenders allow borrowers to defer payments on an occasional basis, such as what occurred on a wide spread basis in the aftermath of Hurricanes Katrina and Rita.

We do not believe that these types of interest-only loans should raise the same level of concerns as those that apply to the first lien mortgage products. It would also be impractical to apply the guidance in these situations since in many circumstances these types of interest-only loans are provided for only a short period of time, such as is the case with bridge loans, or to respond to emergency situations, as is the case when financial institutions offer payment deferrals on an ad hoc basis. Imposing the burdens outlined in the guidance in these specific situations would only serve to curtail these types of loans, which may result in borrowers not being able to purchase their next home if they are unable to sell their current home on a timely basis or losing their home as a result of a natural disaster or unexpected financial difficulties.

We are also concerned that the guidance will only apply to financial institutions and not to other types of financial service providers that are also involved in mortgage lending, such as finance companies and mortgage brokers. We believe these other providers should also be subject to guidance in this area as they have also been subject to criticism with regard to providing certain types of interest-only and Option ARM loans to borrowers who may not be qualified or may not understand the risks of these loans. It is also inequitable to apply the underwriting, risk management, and enhanced consumer protection burdens, as outlined in the guidance, on financial institutions but not on these other financial service providers.

The Fed has requested comment on a number of specific issues with regard to the proposed guidance on nontraditional loans. One issue is whether the lender should analyze each borrower's capacity to repay the loan under the assumption that the borrower only makes minimum payments.

We do not believe this would be an appropriate assumption in most situations. Interest-only payments cannot be made throughout the life of the loan and minimum payments under an Option ARM loan also cannot be made throughout the life of the loan. At some point, additional payments will need to be made to amortize the loan, unless the borrower refinances prior to that time. Higher loan payments will result, which will be exacerbated if rates rise significantly, and may be sharply higher for an Option ARM loan when the minimum payments lead to a higher loan balance. Assuming minimum payments from the borrower would only be appropriate if there are indications that the borrower will be able to handle the sharply high payments.

Instead of assuming minimum payments from the borrower, we believe lenders should underwrite these loans based on the borrower's ability to make more than just the minimum payments, although lenders should have flexibility when making these determinations. One method could be for the lender to underwrite based on the ability of the borrower to make the payments at the full indexed rate that applies at the time the loan is made. Another alternative would be to determine if the borrower could make the payments on a traditional 30-year fixed rate loan at the rate that applies at the time the loan is underwritten. Many lenders may choose this alternative not only because it is a simple approach, but also because it would ensure that these types of loans are made to borrowers who choose to minimize their payments for reasons other than because they could not otherwise afford the payments on traditional loans. There may be other alternatives as well, and the lender should have the flexibility to choose the appropriate option.

The Fed also requested comment as to when it would be appropriate to use the reduced documentation feature commonly referred to as "stated income" for these types of nontraditional loans. Although we generally believe that documenting income is prudent, especially for interest-only and Option ARM loans, there may be situations in which it would not be necessary, such as when the borrower clearly documents significant net worth. These are circumstances in which a well-qualified borrower may choose this type of loan in order to invest the funds that would otherwise be used to make the higher payments on a traditional loan. We believe lenders should have flexibility in these situations to determine whether income should be verified.

We believe the guidance appropriately addresses this issue by clearly stating that the use of reduced documentation should be governed by clear policy standards. We believe that clear policy is essential and, in fact, we would be comfortable if the guidance, or a subsequent rule, were to require this, as opposed to a suggestion that there be such a policy. Our only concern would to ensure that any such regulatory requirement is consistently applied and that it not specifically require the situations in which reduced documentation would or would not be appropriate, although we agree reduced documentation would be inappropriate for subprime borrowers, and we would not oppose a regulatory prohibition to that effect.

The Fed also raised the issue as to whether consideration of future income should be addressed in the guidance. We do not believe income growth should be considered when making these types of loans. Borrowers will often change jobs, or even careers, which would simply make it impossible to project how this would affect the household income. Borrowers may also lose their jobs for an extended period of time, or may have spouses entering or leaving the workforce at various times, which again makes household income projections next to impossible. It is our understanding that current secondary market guidelines for loan purchases assume that the borrower will have static income for the following three years, and we believe this is a preferable approach with regard to future income projections.

We also want to take this opportunity to comment on the consumer protection issues that are addressed in the guidance. The guidance suggests that lenders should provide clear and balanced information about the relative benefits and risks, including the risk and consequences of significantly higher payments and negative amortization. The guidance also provides suggestions on how the information for these types of loans can be presented in a clear manner, which includes focusing on the information important to the decision-making, highlighting key information, employing user-friendly and a readily navigable format, and using plain language with concrete and realistic examples.

We would support separate disclosures requirements for these types of loans that would incorporate the above suggestions. We believe this is essential, as these types of loans are very complex and it is necessary to inform consumers about their features in a manner they can understand so they will not be surprised by the possible significant fluctuations of the monthly payments. We believe the financial institution regulators are in the best position to develop additional model disclosures and other educational material for these types of loans, and we would welcome the opportunity to work with the regulators in developing these materials.

The agencies also suggest that this information could be provided when the consumer is shopping for and deciding on a mortgage, as opposed to the time the application is submitted. However, this may not be feasible as this would require having and providing this information for all consumers who are shopping for a loan, even if many or most of them are not seriously considering these types of nontraditional loans. Providing this information within three days of the application, as required for disclosures under the Truth in Lending Act, should prove helpful for consumers interested in these loans and give them sufficient time to seek alternatives if they then decide that these types of loans are inappropriate.

We also share the agencies' concerns when lenders combine these types of mortgage loans with other products or transactions, such as making second-lien mortgages simultaneously. We agree that simultaneous second-lien loans can result in reduced owner equity and higher credit risk and that interest-only and Option ARM loans are appropriate in these situations only if the borrower will continue to have substantial equity in the property.

Thank you for the opportunity to comment on the proposed guidance on nontraditional loans. If you or other Board staff have questions about our comments, please give Associate General Counsel Mary Dunn or me a call at (202) 638-5777.

Sincerely,

Jeffrey Bloch
Senior Assistant General Counsel