United States Senate
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, DC 20510–6075

May 17, 2007

Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th and Constitution Avenue, NW
Washington, DC 20551

Sheila C. Bair
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

John C. Dugan
Comptroller of the Currency
Office of the Comptroller of the Currency
250 E Street, SW
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John M. Reich
Director
Office of Thrift Supervision
700 G Street, NW
Washington, DC 20552

JoAnn Johnson
Chairman
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Dear Chairman Bernanke, Chairman Bair, Comptroller Dugan, Director Reich, and Chairwoman Johnson:

We appreciate your efforts to extend to subprime borrowers, through the March 2, 2007 Subprime Mortgage Lending Statement, the same protections and common-sense underwriting requirements established by the Nontraditional Mortgage Guidance. In our view, this is an important step forward, for which we commend you. We want to urge you to finalize the Subprime Guidance as quickly as possible, retaining all the protections proposed.

In particular, we commend the Guidance's emphasis on the prudent requirement that each lender qualify its borrowers, taking into account the payment shock that results from subprime adjustable rate mortgages (ARMs), by analyzing a borrowers' ability to repay the mortgage at the fully indexed rate by the maturity date, assuming a fully amortizing repayment schedule. This is extremely important both to ensure the safety and soundness of the lender, and the financial well-being of the borrower.

The Senate Committee on Banking, Housing, and Urban Affairs has held three hearings this year, and two at the end of last year, to consider problems in the mortgage markets. These hearings outlined in considerable detail the difficulties that borrowers experience when their subprime ARMs reset. Testimony indicated that many borrowers face payment shocks of 30 to 40 percent or more, even though the borrowers' debt-to-income (DTI) ratios based on the teaser rates alone were typically close to 50 percent. Lenders testified that post-reset DTIs would be as much as 70 percent, a level that is clearly unaffordable. Faced with this severe financial burden, borrowers will be forced into the terrible choice of refinancing their loans at great cost, defaulting on their loans, or selling their homes in order to discharge their financial obligations. This raises significant concerns about the safety and soundness of such lending practices, and certainly raises concerns about reputation risk for the lenders. Lending that forces so many borrowers into these kinds of desperate choices should be discouraged. By requiring a lender to determine a borrower's ability to repay a loan by underwriting to the fully indexed rate, we would expect that the number of these kind of unaffordable loans would be greatly reduced, and replaced with mortgages that borrowers can afford over the life of the loan.

We understand that one objection to the Subprime Guidance is the concern that borrowers facing resets would not be able to qualify for loans other than another subprime ARM underwritten to the teaser rate only, such as a 2-28 mortgage; a borrower in this circumstance might face foreclosure. Frankly, we view this objection as an admission that the original subprime ARM was inappropriate. It stretches credulity to argue that the path out of one poorly underwritten loan is another unaffordable loan underwritten on the same faulty basis.

In fact, we note that the Mortgage Bankers Association, as well as a number of the largest subprime servicers, including Countrywide, Wells Fargo, Litton Loan Servicing, and others, recently adopted a set of servicing principles in which they agreed to pursue loan modifications for borrowers who cannot afford to pay the reset rates on subprime ARMs, including, for example, permanent extensions of teaser rates. These kinds of modifications offer a real alternative to foreclosure for borrowers, and we urge you to encourage servicers to pursue this course of action.

Again, we thank you for the proposal, and ask that you move expeditiously to finalize these important new guidelines.

Sincerely,

Chris Dodd

Senator Christopher J. Dodd

Wayne Allard

Senator Wayne Allard

Jack Reed

Senator Jack Reed

Jim Bunning

Senator Jim Bunning

Chuck Schumer

Senator Charles E. Schumer