MMBA
MASSACHUSETTS MORTGAGE BANKERS ASSOCIATION

October 17, 2022

Ms. Mary Gallagher
Commissioner of Banks
The Commonwealth of Massachusetts
1000 Washington Street, 10th Floor
Boston, Massachusetts 02118

RE: Regulatory Bulletin 1.3-104 Counseling And Opt-In Requirements For Subprime Adjustable Rate Mortgage Loans Made To First Time Home Loan Borrowers

Dear Commissioner Gallagher,

On behalf of the Massachusetts Mortgage Bankers Association (MMBA), we are requesting guidance, clarification and potential revisions to the above referenced bulletin which implemented M.G.L. Chapter 184, Section 17B ½. The MMBA represents 200 lending institutions made up of equal representation between depository institutions (banks and credit unions) and non-depository institutions (mortgage banker/lender companies, mortgage brokers and all ancillary companies) which facilitate mortgage transactions throughout the Commonwealth.

<u>Background:</u>
As a result of the subprime crisis many federal and state laws and regulations were implemented to protect consumers. Among these many initiatives, M.G.L. Chapter 184, Section 17B ½ and the implementing above referenced bulletin specifically gave protections to first-time home loan borrowers obtaining a variable or adjustable -loan.

At the time when the law and regulation was implemented, most adjustable-rate mortgages (ARM) used a treasury index also known as a Constant Maturity Treasury (CMT) as the public index to calculate interest rates. Adjustable-rate mortgages with treasury indexes are still traded on the secondary market and have always been the prevailing index for smaller banks and credit unions.

As a brief index history, HUD didn't add the London Inter-Bank Offered Rate (LIBOR) as an acceptable index along with CMT until 2007. Presently the LIBOR is being discontinued as of June 2023 and the new prevailing index used (along with the CMT) is the SOFR - Secured Overnight Financing Rate.

In 2021, Freddie Mac and Fannie Mae updated their guidelines regarding adjustable-rate mortgages. Effective Oct. 1, 2021, both Fannie Mae and Freddie Mac ceased purchasing any CMT-indexed ARMs, regardless of the Application Received Date or Note Date.

Determination of Subprime Mortgage Loans per Regulatory Bulletin 1.3-104:

Per Regulatory Bulletin 1.3-104, the first test to exclude an adjustable or variable rate mortgage made to a first-time home loan borrower is:

- The loan amount does not exceed the conforming loan limits set for the Federal National Mortgage Association ("FNMA") or the Federal Home Loan Mortgage Corporation ("FHLMC") and is eligible for purchase by FNMA or FHLMC.

As of October 1, 2021, any loan using a treasury index is not eligible for sale to Fannie Mae or Freddie Mac, and so no longer meets the key criteria for exclusion in determining if an ARM meets the subprime definition in Bulletin 1.3-104.

Regulatory Bulletin 1.3-104 provides two other calculations to determine if adjustable-rate mortgages meet the subprime definition for first time home loan borrowers:

1. The loan amount does not exceed the conforming loan limits set for FNMA or FHLMC and the fully indexed rate is greater than **three (3.0)** percentage points above the yield on United States Treasury securities having comparable periods of maturity, as of the 15 th day of the month immediately preceding the month in which the application for the extension of credit is received by the creditor; or

2. The loan amount exceeds the conforming loan limits set for FNMA or FHLMC and the fully indexed rate is greater than **four (4.0)** percentage points above the yield on United States Treasury securities having comparable periods of maturity, as of the 15th day of the month immediately preceding the month in which the application for the extension of credit is received by the creditor.

The consequence of the above calculations, especially in a rising interest rate environment, means that most treasury adjustable-rate mortgages will fall into a subprime loan category when they are not in fact subprime mortgages.

Subprime Loan Calculations under Regulatory Bulletin 1.3-104:

One of our depository members provided the MMBA with a recent example of an adjustable-rate mortgage that would be deemed subprime under the bulletin.

A First Time Home Loan Buyer Applied for a loan on September 13, 2022, in Boston.

- The **30-year fixed rate option for the borrower was 6.625%.** Principal & Interest on a $400,000 loan amount was $2,561
- The **10/1 treasury ARM rate option for the borrower was 5.25% with a margin of 2.75.** Principal & Interest on a $400,000 loan amount was $2,209 (a difference of $352 per month)

Subprime loan determination calculations:

- The 30-year treasury index on the 15th of the month preceding the application was 3.10% (8/15). The 1-year CMT (index) on 9/13 was 3.43%. This is higher because of rising rates and the inversion of the yield curve.

- Under the subprime test calculations, the fully indexed rate (Index plus Margin) needs to be no higher than **6.10%** (3.10% + 3.00%).

- Using the 1-Year CMT, the 10/1 ARM fully indexed rate with a standard 2.75 margin was **6.18%** (3.43% + 2.75) making this product a subprime loan under Regulatory Bulletin 1.3-104.

Consumer Harm Impact under Regulatory Bulletin 1.3-104:
Using the above adjustable-rate mortgage as an example, would any legislator, regulator, depository, or first-time home loan borrower think that a 10/1 adjustable-rate mortgage is subprime? Unless the Division amends Regulatory Bulletin 1.3-104**, lenders will be forced to limit and withhold affordable and safe lending mortgage product options from first time home loan buyers.**

Using the example from above, a first-time home loan buyer that selected the 10/1 adjustable-rate mortgage:

- Would not experience an interest rate increase until year 11. The average loan is refinanced within the first 5-7 years.
- Over 10 years at a lower interest rate, the first-time home loan borrower would save $42,240 compared with the fixed rate mortgage option.

Suggested Revision of Bulletin 1.3-104
Since M.G.L. Chapter 184, Section 17B1/2 allowed the Division to issue guidelines or regulations, and the implementation of this law was by Regulatory Bulletin and not Regulations under 209 CMR, we would ask the Division to make the following updates/changes to Regulatory Bulletin 1.3-104:

3. **Determination of Subprime Mortgage Loans**

   For the purposes of General Laws chapter 184, section 17B½, the determination of whether an extension of credit with an adjustable or variable rate of interest made to a first-time home loan borrower will be deemed to be a subprime mortgage loan shall be made in accordance with the following:

   a. **First Lien Mortgage Loans**

      I. A first lien mortgage loan shall not be deemed to be subprime if the loan amount does not exceed the conforming loan limits set for the Federal National Mortgage Association ("FNMA") or the Federal Home Loan Mortgage Corporation ("FHLMC") and is eligible for purchase by FNMA or FHLMC **with the exception for the use of a treasury-based index**.

      II. Otherwise, a first lien mortgage loan shall be deemed to be a subprime mortgage loan if either of the following apply:

1. The loan amount does not exceed the conforming loan limits set for FNMA or FHLMC and the fully indexed rate is greater than **three (3.0)** percentage **points above the fully indexed interest rate as of the date of application;** or
2. The loan amount exceeds the conforming loan limits set for FNMA or FHLMC and the fully indexed rate is greater than **four (4.0)** percentage points **above the fully indexed interest rate as of the date of application.**

III. A first lien mortgage shall not be deemed as subprime if the initial period until adjustment is at least 60 months and there is no prepayment penalty.

In a rising rate environment, using the previous month's index instead of the current month could have the unintended consequence of categorizing these ARM products as subprime.

Thank you for your consideration of this revision to Bulletin 1.3-104. Please let me know if you have any questions or would like any additional information.

Sincerely,

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Executive Director

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