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August 15, 2006

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Docket No. OP-1253 – Home Equity Lending Hearings

Dear Ms. Johnson:

The Credit Union National Association (CUNA) appreciates the opportunity to comment on the public hearings that the Federal Reserve Board (Fed) recently held regarding home equity lending and the adequacy of existing regulatory and legislative provisions in protecting the interests of consumers. CUNA represents approximately 90 percent of our nation's 8,800 state and federal credit unions.

Summary of CUNA's Comments

- Although unscrupulous lenders are aware that their practices are now being scrutinized, abuses are continuing and have now been associated with nontraditional loans, such as interest-only and payment option adjustable rate mortgages with negative amortization features, commonly referred to as "Option ARM" loans. Increased enforcement of current laws and rules should help address these concerns, and CUNA could support additional federal regulatory changes, especially those changes that would improve the consumers' understanding of high-cost loans and those that would specifically target predatory lenders.
- State and local predatory lending laws, if targeted directly at predatory lenders, can curb abusive lending practices without affecting access to legitimate subprime loans.
- CUNA believes that providing financial education to consumers is a very effective means in which to protect consumers from predatory lending. CUNA has been involved in programs to provide education in the school system, and

credit unions continuously provide education and counseling to their members to help them choose financial products and services that meet their needs.

- CUNA would support regulatory changes that would provide additional information to consumers about nontraditional loans. This should include information that outlines how the payments on these loans can escalate sharply in the future.
- For all types of mortgage loans, consumers should have three days to review the disclosures they receive before they incur any nonrefundable fees, similar to what is now required for home equity lines of credit under Regulation Z, the Truth in Lending Act.
- Consumers should be clearly informed about the role of the mortgage broker and that the broker is not the lender.

In connection with these hearings, the public was invited to submit written comments on the issues that were addressed, which include the following:

- Predatory lending and the impact of the Home Ownership and Equity Protection Act (HOEPA), as well as state and local predatory lending laws, on the subprime mortgage market.
- Nontraditional mortgage products and reverse mortgages.
- Consumer choice in the subprime market.

As part of this process, the Fed requested comments on specific questions within these broad categories. Below are CUNA's responses to these questions

Predatory Lending: The Impact of HOEPA and State and Local Predatory Lending Laws

<u>Question 1</u> - Have the 2002 revisions to the HOEPA rules been effective in curtailing predatory lending practices? What has been the impact of the changes on the availability of subprime credit? What other, if any, abusive practices have emerged since these revisions were enacted?

<u>CUNA's Response</u> – Credit unions strongly oppose the practice of predatory lending and generally supported the 2002 changes to the HOEPA provisions of Regulation Z, the Truth in Lending Act, which are intended to combat abusive predatory lending practices through a targeted approach directed primarily at high-priced mortgage loans. Although the 2002 revisions to the HOEPA rules have not been completely effective in curbing predatory lending practices, it appears that unscrupulous lenders are more aware than ever that their practices have come under and will continue to be under close scrutiny. Hopefully, this has and will continue to curb to some extent the unethical behavior of these types of lenders, which will benefit both consumers and legitimate subprime lenders.

Since the 2002 HOEPA revisions became effective, abusive practices appear to have increased in connection with nontraditional mortgage loans, which include interest-only and "Option ARM" loans, as these loans have become more popular as a result of rapidly rising home prices, particularly on the East and West Coasts. CUNA's concerns and comments on these issues are outlined in more detail below in response to the Fed's questions regarding these types of loans.

We also believe an effective means to ensure that these revisions are successful in curbing this problem is to increase the enforcement of these and all other laws and regulations that address predatory lending. These enforcement efforts should be directed at all the parties involved in these unscrupulous practices, including mortgage brokers. As part of this process, we are hopeful that the current data regarding high cost loans being generated as a result of the recent changes to the Home Mortgage Disclosure Act rules will provide useful information regarding those predatory lenders who are unfairly targeting minority borrowers.

In an effort to steer consumers away from predatory lenders, CUNA last year initiated the creation of a billion-dollar mortgage lending initiative for credit unions. Under this initiative, called the Home Loan Payment Relief (HLPR) program, participating credit unions offer a three-year adjustable rate mortgage at one percentage point below the national average for such loans to qualifying borrowers. The rate will be fixed for the first three years. After three years, it will adjust annually to market rates, with rate adjustments capped at one percent per year, and five percent over the life of the loan.

To qualify, a borrower's household income must be 100% or less of the area median income, except for certain "high-cost" areas. The program lowers mortgage costs and helps credit union members qualify for suitable mortgage loans. This program demonstrates credit unions' commitment to serve all their members, including those of modest means, and will help ensure that they do not need to turn to predatory lenders for their mortgage finance needs.

Question 2 - What has been the impact of state and local predatory lending laws on curbing abusive practices? Have they adversely affected access to legitimate subprime lending?

CUNA's Response – We believe state and local predatory lending laws, if targeted directly at predatory lenders, as opposed to including legitimate subprime lenders, can curb abusive lending practices without affecting access to legitimate subprime loans. The Center for Responsible Lending, the North Carolina advocacy group dedicated to eliminating predatory lending practices, which is affiliated with Self-Help Credit Union, has recently published a comprehensive study on this very issue, titled *The Best Value in the Subprime Market – State Predatory Lending Reforms.* This study analyzes how these state and local laws have benefited consumers without adversely affecting access to legitimate subprime lending, and is available on the Center's website at www.responsiblelending.org.

Question 3 - Since the 2002 HOEPA revisions, what efforts to educate consumers about predatory lending have been successful? What is needed to help such efforts succeed?

CUNA's Response – CUNA believes that providing financial education to consumers is a very effective means in which to protect consumers from predatory lending. Consumers who lack financial education and money skills will always be prey to unscrupulous lenders. Because they lack these skills, they are unable to effectively shop for mortgage loans or other financial services. As a result, they are forced to or select credit at unfavorable rates and terms and because of these poor money skills, they are often unable to qualify for lower rates even if they knew such options existed. Under these conditions, consumers will likely accept credit from any lender willing to provide it, regardless of the rates and terms.

Financial education should begin in the school system, and CUNA strongly supports such efforts. CUNA works with the National Endowment for Financial Education to provide instruction and materials for our school systems and also serves on the Board of Directors of the JumpStart Coalition, which is a leading organization that provides financial education and materials. CUNA also has a wide variety of financial education materials for consumers on its website, www.cuna.org, and recently announced it will hold a National Financial Education Summit on September 26, 2006, in Washington, DC. This Summit will provide all credit unions with an opportunity to share and develop opportunities to provide financial education to their members.

Question 4 - How should the HOEPA disclosures required under Regulation Z be changed to improve consumers' understanding of high-cost loans?

CUNA's Response – CUNA was supportive of many of the 2002 HOEPA changes and could support additional changes, especially those changes that would improve the consumers' understanding of high-cost loans, as well as other, substantive changes that would specifically target predatory lenders.

Topic 2 – Nontraditional Mortgage Loans and Reverse Mortgages

Question 1 - Do consumers have sufficient information about nontraditional mortgage loans to understand the risks?

CUNA's Response – Although consumers are provided information about nontraditional loans, the complexities of these loans are such that this information is extremely difficult for most consumers to understand. This is especially true with regard to "Option ARM" loans, in which the borrower has flexible payment options, including the option to pay less than the interest owed, resulting in negative amortization.

Stories in the media are now beginning to surface about how homeowners with "Option ARM" loans are unprepared for the substantial increases in the loan payments that have or will occur in the near future. This often results from the feature of these loans that allow for negative amortization, which allows consumers to make relatively small payments, but results in an increase in the loan balance. At regular intervals, usually after every five years, the loan is readjusted to ensure the loan fully amortizes within the agreed time frame, usually thirty years. This results in very significant increases in the monthly payments, which is compounded when the interest rates on these loans increase.

In many of these cases, the borrower clearly did not understand the extent to which these payments could increase, both as a result of negative amortization and the increase in the interest rate of the loan. It is clear that improved disclosures are necessary to ensure that borrowers understand these risks and to help them shop from among these types of loans, as well as to compare these loans to other types of mortgage loans that may be more suitable.

However, changes in these disclosures should not necessarily apply to all types of interest-only loans. Although we understand the need to include "Option ARM" and first lien interest-only mortgage loans, there are a number of other products 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.

<u>Question 2</u> - Should any current disclosures required under Regulation Z be eliminated or changed because they are confusing to consumers, unduly burdensome to creditors, or are not relevant to nontraditional mortgage loans?

<u>CUNA's Response</u> - Based on our response to Question 1 above, it is clear that the borrower should receive specific information as to how the loan payments may increase over time. For example, if the borrower is receiving a reduced interest rate for a period of time at the beginning of the loan term, the borrower should be provided with the amount that the payment would be if it were based on the fully indexed rate at the time the application is submitted. The borrower should also be provided with the amount the payment would be under the worst case scenario, in which the borrower only pays the minimum amount, leading to the maximum amount of negative amortization under a situation in which the interest rate rises to the maximum level as allowed under the loan terms. This should reduce the shock that these borrowers would otherwise experience if they were not made aware of these worst case scenarios.

In addition to these examples, there could also be changes to the language of the current Regulation Z disclosures that would convey similar information. For loans with negative amortization features, such as "Option ARM" loans, there could be a simple, but prominent statement about the potential for increased payments, such as:

"Your loan has a deferred interest feature, which means you have the option of deferring a portion of the interest payments. Deferring interest will result in an increase in the loan balance and significantly higher monthly payments will likely be necessary to ensure repayment of the loan with the time specified in the loan agreement."

For interest only loans without a negative amortization feature, a similar statement should also be included, such as:

"Your loan has an interest-only feature, in which you have the option of paying only the interest on the loan for a period of time. When that time period ends, your monthly payments will likely increase significantly, due to the requirement to pay principal on the loan, in combination with the reduced time period in which those principal payments must be made."

<u>Question 3</u> - Are there Regulation Z disclosures that should be provided earlier in the mortgage shopping and application process to help consumers understand the cost and terms of these types of loans?

<u>CUNA's Response</u> – Under the provisions in Regulation Z for home equity lines of credit (12 CFR § 226.5b), creditors are not permitted to impose nonrefundable fees until at least three days after the consumer receives the required disclosures and booklets. Although other types of variable mortgage loans have similar provisions in that consumers are entitled to receive certain disclosures before paying nonrefundable fees, we believe consumers for all types of mortgage loans should be allowed three days to review their disclosures before being required to pay a nonrefundable fee, similar to the provisions that apply to home equity lines of credit. This should especially include nontraditional mortgage loans, such as interest-only and "Option ARM" loans, since these loans are especially complex and consumers would benefit by having a period of time to review these disclosures.

<u>Question 4</u> - Are the current Regulation Z disclosures adequate to inform consumers about the costs and terms of reverse mortgages?

<u>CUNA's Response</u> – Credit unions are not at this time very active in providing reverse mortgages, although it appears that the disclosures for these types of loans are fairly comprehensive. We also recognize that the fees for these types of loans are very high. Although they appear to be disclosed to the consumer, CUNA would support additional efforts to provide information and disclosures to

ensure that consumers thoroughly understand these fees and how these loans operate.

Question 5 - Has counseling, as required for reverse mortgages insured by the Department of Housing and Urban Development, been effective in educating consumers about reverse mortgages and preventing abuse?

CUNA's Response – We believe counseling is an effective tool to help consumers understand reverse mortgages. We also believe counseling would be effective in helping consumers understand other types of mortgage loans, especially nontraditional loans, which are very complex.

Topic 3 – Informed Consumer Choice in the Subprime Market

Question 1 - How do consumers who obtain higher priced loans shop for these loans and how do they select a particular lender?

CUNA's Response – Consumers who accept high priced mortgage loans are often forced to accept such loans because of prior financial problems that have made them ineligible for lower interest rate mortgages or because they lack the knowledge that there are lower priced options available to them. In fact, these two reasons are often intertwined, in that the lack of financial knowledge in general may often be the source of the problems that have resulted in low credit scores or other situations that have made these consumers ineligible for lower rate mortgages. Consumers in these situations simply do not have an array of mortgage options available to them and for this reason they are often forced to accept the loan from the first lender who approves their application, regardless of the interest rate or terms. Under these situations, consumers often do not have the option or ability to shop from among competing offers from lenders. Even with competing offers from lenders, consumers generally do not have the ability to review the terms of these loans to determine which loan offers the best combination of interest rate and fees.

Question 2 - What do consumers understand about the role of mortgage brokers? Has this understanding been furthered by state-required mortgage broker disclosures?

CUNA's Response – We believe consumers generally do not distinguish between mortgage brokers and mortgage lenders. They often consider the broker the lender, especially since the broker is the one with whom the consumer works with throughout the loan process. Also, the required mortgage loan disclosures are very long and complicated and for this reason the consumer often relies on what the broker says, rather than what is written in the disclosures or other documents.

Relying on the broker for information can often result in misunderstandings, such as when the broker provides information that, although possibly not wrong, could be considered misleading. For example, a broker may tell the consumer who selects a variable interest rate loan that he or she can always refinance into a fixed rate loan. Although this may be true, the broker may then neglect to tell the consumer that a fixed rate loan in the future may be at a higher interest rate and the consumer may not qualify for the future loan if, for example, he or she has inadequate income or other credit problems.

For these reasons, consumers should clearly be informed that the broker is not the lender. Brokers should also provide contact information for all relevant regulators so the consumer will know to whom to direct complaints if problems arise during the loan process.

Question 3 - What strategies have been helpful in educating consumers about their options in the mortgage market? What efforts are needed to educate consumers about the mortgage credit process and how to shop and compare terms and fees?

CUNA's Response – As mentioned above in our response to the third question on predatory lending, we believe financial education is the primary means in which to help consumers understand the mortgage process. These efforts should begin with general financial education at the public schools at the earliest age possible and then focus on specific issues, such as mortgages, at the higher grade levels. This education should also provide information about brokers to address the confusion between the roles of brokers and lenders, as discussed in our response to the previous question above. Credit unions also provide direct education to their members as the need arises, and this has proven to be very effective.

Thank you for the opportunity to comment on these issues regarding home equity lending. If you have questions about our comments, please contact Senior Vice President and Deputy General Counsel Mary Dunn or me at (202) 638-5777.

Sincerely,

Jeffrey Bloch
Senior Assistant General Counsel