

Federal Advisory Council comments on HOEPA

September 7, 2007

Docket No. OP-1288

At a meeting with the Board on September 7, 2007, James C. Smith, Chairman and CEO of Webster Bank, N.A. and Webster Financial Corporation, Waterbury, Connecticut, presented the views of the Federal Advisory Council on how the Board might use its rulemaking authority under the Home Ownership and Equity Protection Act (HOEPA) to curb abusive lending practices in the home mortgage market.

How best could the Federal Reserve use its regulatory authority under the Home Ownership and Equity Protection Act to curb abusive mortgage lending practices?

- Members believe that the Federal Reserve Board has the regulatory authority needed to effect meaningful change in mortgage lending practices under existing HOEPA regulations. We urge the Board to move swiftly to promulgate regulations which prohibit unfair or abusive practices in the origination of subprime mortgages.
- Members believe that had existing regulations covered all mortgage originators, including brokers, there would not have been a subprime crisis. Regulated lenders have been making subprime loans responsibly for many years. Therefore, members urge the Board to tailor its regulatory response to address specifically and narrowly the problem of subprime loans in which there are abusive practices. The response should not extend to all mortgage loans, nor should it create new burdens for responsible bank lenders.
- Section 129(l) of the 1994 HOEPA amendments to TILA grants the Board power to “prohibit acts or practices in connection with mortgage loans that the Board finds to be unfair, deceptive or designed to evade the provisions of this section.” The same holds true for refinances of mortgage loans “that the board finds to be associated with abusive lending practices, or that are otherwise not in the interest of the borrower.” While this subsection deals with prohibitions rather than prescriptive or recommended practices and disclosures, its broad application makes HOEPA the best vehicle for implementing targeted regulation with the least disruption. Expanding HOEPA via Section 129(l) would improve regulatory oversight of the mortgage market and improve its long term functioning. Expanding HOEPA reporting to purchase mortgages and home equity lines of credit would increase consumer knowledge and awareness.
- Members strongly support regulations that will bring a greater level of supervision and enforcement to mortgage brokers who, while not creditors, are the source of a significant portion of loan originations, and the source of much of the abuse we are discussing here. Federal regulations on subprime loans should create a national standard that overrides conflicting or additional state requirements and the weak and inconsistent application of existing state standards. Changes should uniformly impact all lenders (and brokers) and contain safe harbors, and, where appropriate, cure provisions. Members recommend uniformity of licensing, supervision and examination of mortgage brokers by state and federal regulatory entities, and requirements that brokers disclose the nature of their relationship to the borrower,

including how and by whom they are compensated for their services and whether or not they represent the borrower. While most states have defined mortgage broker licensing requirements, brokers are still not subject to the level of regulatory examination scrutiny applied to regulated financial institutions. Minimum net worth requirements and/or expanded bonding or insurance requirements should be considered for mortgage brokers along with rules regarding bankruptcy and reentry constraints.

- Members believe that the mortgage market would benefit from the creation of a uniform national standard for subprime loans that targets the elimination of abusive and deceptive lending practices. Such a standard must strike a careful balance that provides enhanced consumer protections without unintentionally limiting the availability of loans to creditworthy borrowers, and should preempt state and local lending restrictions.
- Members believe the Board should use its rulemaking authority under HOEPA to apply the same regulatory standards to all mortgage originators that currently apply through guidance to the banking industry, especially as regards non traditional mortgage disclosures (see item 4B from February 2007 FAC agenda). In particular, the Board brochure regarding non traditional mortgage products and the corresponding risk to the consumer should be a required distribution at the time of application for subprime loans. The objective should be to provide a consistent level of consumer information and protection regarding mortgage products offered by lenders. While financial institutions subject to federal regulatory oversight have generally engaged in responsible advertising and lending practices based on sound underwriting and credit review including an analysis of the ability to repay, lax oversight and accountability for non-banking lenders (and brokers) have contributed significantly to abusive lending practices.
- Members support the 2007 Interagency Statement on Subprime Lending. We suggest that HOEPA/Reg Z could be used to establish an improved, universal definition of “subprime” as a consumer protection tool. Today’s definition of subprime is a safety and soundness definition which is broad, vague and creates confusion over what truly constitutes a subprime loan. Members favor a clear, narrow definition based on the type and terms of loans commonly seen in the subprime market. Disclosure and accountability requirements for this loan category could be extended to all HOEPA loans by including HOEPA loans in the definition of subprime. Any advertising for subprime loans should clearly disclose the nature of the loan and that the borrower may qualify for other products.
- Members support a requirement to underwrite subprime loans, including HOEPA loans to the fully indexed rate over the fully amortizing term of the loan, while allowing lenders flexibility to exercise judgment regarding each borrower’s circumstances and ability to repay. Complete and clear disclosure of terms and conditions will help ensure that borrowers make an informed choice.
- Further lowering APR triggers for HOEPA reporting would extend existing HOEPA disclosure reporting requirements to a broader population of borrowers thereby ensuring better customer awareness of the higher cost loan implications and discouraging abusive lending practices which may be occurring below the current reporting thresholds. There is some risk to lowering the APR triggers because

many banks simply don't make HOEPA loans in order to avoid a perceived stigma associated with making these loans, which could have the unintended effect of curtailing funding for some borrowers.

- In general regarding required disclosures, members believe that Reg Z/ECOA/Reg B disclosures be combined where possible using simplified, compatible terminology and calculations, and where possible moved forward in the application process ahead of the collection of a non-refundable application fee to ensure actionable information for consumers. Fewer disclosures would be a boon to the application and closing process. Consideration should be given to requiring consumer initials at the payment schedule portion of the loan document thus encouraging loan officers/counselors/brokers to provide complete explanation of the loan programs.
- Members also believe that changes should be made to the advertising requirements of Reg Z to better define the trigger terms and disclosure requirements regarding the benefits and risks of mortgage products. For example, in all cases where an advertised monthly payment does not reduce the principal balance, the creditors should be required to explicitly and clearly disclose this fact and its implications.
- Members support clear disclosure of prepayment penalties and related charges along with the need for paying taxes and insurance on any property purchase, though most members do not support a requirement for escrow accounts.
- Members believe that consumer education with respect to high cost mortgages would be useful in enhancing consumer awareness and knowledge of attendant costs, risk and implications.
- Members support a federal requirement for consistency in disclosures provided to consumers by national banks, mortgage bankers, and state licensed lenders and brokers.
- Members ask the Board to carefully delineate which penalties under Reg Z might apply under the new rule making. Members caution that severe penalties could reduce banks' inclination to offer covered products which could negatively impact low and moderate income borrowers.
- Members ask the Board to be clear that its determination that a practice is unfair, deceptive or abusive be prospective only and not retroactively applied in a manner that could create unintended significant exposure to class action and lender liability suits.

More generally, are any legislative actions needed in response to the subprime mortgage problems (e.g. banning some practices or requiring others)?

- Members strongly believe that subprime lending abuse can be best and fully addressed through regulatory action. It is a narrow issue well suited for resolution through regulations which can be adapted to the fluid, fast changing mortgage market.
- Legislation, while likely, is not needed and would surely be more burdensome than curative to responsible lenders.
- Swift, decisive regulatory action by the Board could reduce the perceived need for legislation.