

FEDERAL RESERVE SYSTEM

[Docket No. OP-1253]

AGENCY: Board of Governors of the Federal Reserve System

ACTION: Public Hearings; Request for Comment

SUMMARY: Section 158 of the Home Ownership and Equity Protection Act of 1994 (HOEPA)¹ directs the Board to hold public hearings periodically on the home equity lending market and the adequacy of existing regulatory and legislative provisions (including HOEPA) in protecting the interests of consumers. Consequently, the Board will hold hearings on the home equity lending market and invites the public to attend and to comment on the issues that will be the focus of the hearings. Additional information about the hearings will be posted to the Board's website at <http://www.federalreserve.gov>.

DATES: The dates of the hearings are:

1. June 7, 2006, 8:30 a.m. to 4:00 p.m., Chicago, IL.
2. June 9, 2006, 8:30 a.m. to 4:00 p.m., Philadelphia, PA.
3. June 16, 2006, 8:30 a.m. to 4:00 p.m., San Francisco, CA.
4. July 11, 2006, 8:30 a.m. to 4:00 p.m., Atlanta, GA.

Comments. Comments from persons unable to attend the hearings or otherwise wishing to submit written views on the issues raised in this notice must be received by August 15, 2006.

ADDRESSES: The locations of the hearings are:

1. Chicago – The Federal Reserve Bank of Chicago, 230 South LaSalle Street, Chicago, IL 60604.
2. Philadelphia – The Federal Reserve Bank of Philadelphia, 10 Independence Mall, Philadelphia, PA 19106.
3. San Francisco – The Federal Reserve Bank of San Francisco, 101 Market Street, San Francisco, CA 94105.
4. Atlanta – The Federal Reserve Bank of Atlanta, 1000 Peachtree Street, NE, Atlanta, GA 30309.

You may submit comments, identified by Docket No. OP-1253, by any of the following methods:

¹ Pub. L. 103-325, 108 Stat. 2160.

- Agency Web Site: <http://www.federalreserve.gov>. Follow the instructions for submitting comments at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm>.
- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- E-mail: regs.comments@federalreserve.gov. Include the docket number in the subject line of the message.
- Fax: (202) 452-3819 or (202) 452-3102.
- Mail: Address to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, DC 20551.

All public comments will be made available on the Board's web site at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm> as submitted, unless modified for technical reasons. Accordingly, comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room MP-500 of the Board's Martin Building (20th and C Streets, N.W.) between 9:00 a.m. and 5:00 p.m. on weekdays.

FOR FURTHER INFORMATION CONTACT: Kathleen C. Ryan, Counsel, Minh-Duc T. Le, Senior Attorney, or Ellen A. Merry, Economist, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, DC 20551, at (202) 452-2412 or (202) 452-3667. For users of Telecommunications Device for the Deaf (TDD) only, contact (202) 263-4869.

SUPPLEMENTARY INFORMATION:

I. Background

In 1994, Congress enacted the Home Ownership and Equity Protection Act (HOEPA) as an amendment to the Truth in Lending Act (TILA), in response to testimony before Congress of predatory home equity lending practices in underserved markets, where some lenders were making high-rate, high-fee home equity loans to cash-poor homeowners. HOEPA identifies a class of high-cost mortgage loans through criteria keyed to the loans' rates and fees and requires creditors to provide enhanced disclosures of, and to comply with substantive restrictions on, the terms of those loans. Section 158 of HOEPA also directs the Board to hold public hearings periodically on the home equity lending market and the adequacy of existing regulatory and legislative provisions for protecting the interests of consumers, particularly low income consumers.

The Board last held hearings under HOEPA in 2000, at a time when heightened concerns were being expressed about predatory lending. The 2000 hearings focused on

the Board's ability to use its regulatory authority under HOEPA to address abusive lending practices. Following those hearings and the receipt of public comment, the Board amended the provisions of Regulation Z that implement HOEPA. The revisions took effect in October 2002.

II. Information About and Goals of the Hearings

The 2006 hearings are open to the public to attend. Seating will be limited, however. Further information about the hearings, as it becomes available, will be posted on the Board's web site at <http://www.federalreserve.gov>.

The Board will invite persons to participate in panel discussions on the topics discussed below. In addition to the panel discussions, the Board intends to reserve about one hour at the end of each hearing to permit interested parties other than those on the panels to make brief statements. To allow as many persons as possible to offer their views during this period, oral statements will be limited to five minutes or less; written statements of any length may be submitted for the record. Interested parties who wish to participate during this "open-mike" period may contact the Board in advance of the hearing date at the telephone numbers provided in this notice, to facilitate planning for this portion of the hearings.

The Board's hearings will examine developments in the home equity lending market, with a focus on four objectives. First, the Board wishes to gather views on the effectiveness of the 2002 revisions to the HOEPA rules in protecting consumers and on the rules' impact on the availability of credit in the higher-cost portion of the subprime market. Second, the Board would like to gather information that will assist its review of Regulation Z, which implements TILA and HOEPA. In particular, the Board anticipates that the hearings will provide information that would help in its review of the rules governing home mortgage loans under Regulation Z. Third, the hearings may help identify matters for which the Board or other entities can develop educational materials to help consumers make informed choices about mortgage loans. Fourth, the Board anticipates that the hearings may help identify matters for which additional research about the mortgage lending market would be beneficial.

III. Hearing Topics

The Board consulted with its Consumer Advisory Council (CAC), lenders and their trade associations, consumer advocacy groups, secondary market participants, and other federal agencies to identify issues the Board might address at the hearings. The following three topics will be discussed at the hearings.

Topic 1: Predatory Lending: The Impact of HOEPA Rules and State and Local Predatory Lending Laws

For loans covered by HOEPA, creditors must provide enhanced disclosures to consumers three days before consummation of the transaction, in addition to the

disclosures required by TILA for all home mortgage loans. HOEPA also prohibits lenders from including certain terms in their loan agreements with borrowers and bars certain acts or practices in connection with HOEPA-covered loans.

One of the goals of the hearings is to help the Board assess the impact of the HOEPA rules on improving consumers' understanding of their mortgage loan terms, and on curbing abusive practices, while preserving access to subprime credit. The Board is also interested in gathering information about any new practices that have developed since the 2000 hearings that may be abusive, and other practices in the subprime market that continue to raise concerns, such as the amount and prevalence of prepayment penalties, as well as whether creditors make loans with appropriate evaluation of each borrower's repayment ability.

In addition, the Board wishes to gather information about how state and local laws that address predatory lending have affected abusive lending practices and access to credit. Since the 2000 hearings, numerous state and local governments have enacted laws to address predatory lending practices, some of which are modeled on HOEPA, but with stricter terms. Consumer advocates generally assert that these laws are effective in protecting consumers from abusive lending, while lenders, mortgage brokers, and investors have expressed concerns that these laws have adversely affected consumers' access to legitimate subprime loans. Available research is not definitive regarding whether these laws have been effective in eliminating abusive practices and whether they have reduced the availability of legitimate high-cost credit.

The Board invites comment on the following questions related to HOEPA and predatory lending practices:

1. Have the revisions to the HOEPA regulations (12 CFR § 226.32 *et seq.*) been effective in curtailing predatory lending practices? What has been the impact of these changes on the availability of subprime credit? Have other abusive practices emerged since the 2002 revisions? If so, what are they?
2. What has been the impact of state and local anti-predatory lending laws on curbing abusive practices? Have these laws adversely affected consumers' access to legitimate subprime lending? Have certain provisions been particularly effective, or particularly likely to negatively affect credit availability?
3. Since the 2002 revisions to HOEPA, what efforts to educate consumers about predatory lending have been successful? What is needed to help such efforts succeed?
4. Should the existing HOEPA disclosures in Regulation Z be changed to improve consumers' understanding of high-cost loan products? If so, in what way?

Topic 2: Nontraditional Mortgage Products and Reverse Mortgages

Interest Only Loans and Payment Option Adjustable Rate Mortgages. In recent years, rising home prices and marketing activities have led to growing consumer demand for mortgage products designed to minimize initial monthly mortgage payments. As a result, nontraditional mortgage products have become more prevalent in the market, including interest only mortgage loans, for which a borrower pays no principal for the first few years of the loan, and “payment option” adjustable rate mortgages, for which a borrower has flexible payment options, including a payment choice that results in negative amortization. Some institutions also increasingly combine these nontraditional mortgages with other practices, such as making simultaneous second-lien mortgages and allowing reduced documentation in evaluating an applicant’s creditworthiness.²

Nontraditional mortgage products can enable a broader segment of consumers to achieve home ownership or access to home equity. However, concerns have been raised that such loans may expose marginally qualified, highly leveraged borrowers to a greater risk of default than other products, such as a traditional thirty-year, fixed rate mortgage, in the event of widespread or regional cooling in housing prices or when rates adjust upward. These products and practices are being offered to a wider spectrum of borrowers, including subprime borrowers and others who may not otherwise qualify for more traditional mortgage loans or who may not fully understand the risks of nontraditional mortgages. Nontraditional mortgage products are more complex than traditional fixed rate products and adjustable rate products and also can present greater risks of payment shock and negative amortization.

While the Board’s Regulation Z requires creditors to provide disclosures to consumers in connection with mortgages, including nontraditional mortgages, consumer groups and others have stated that additional disclosures are needed.

The Board seeks public comment on the following questions regarding nontraditional mortgage products:

1. Do consumers have sufficient information (from disclosures and from advertisements) about nontraditional mortgage products to understand the risks (such as payment increases and negative amortization) associated with them?
2. Should any disclosures required under Regulation Z be eliminated or modified because they are confusing to consumers, unduly burdensome to creditors, or are simply not relevant to nontraditional mortgage products? Do the required

² Concerns about nontraditional mortgage products led the Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and the National Credit Union Administration to jointly propose Guidance on Nontraditional Mortgages on December 20, 2005. The proposed Guidance addresses loan terms and underwriting standards; portfolio and risk management practices; and consumer protection issues.

disclosures present information about nontraditional mortgage products in an understandable manner?

3. Are there some Regulation Z disclosures that should be provided earlier in the mortgage shopping and application process to aid consumers' understanding of key credit terms and costs for these products?

Reverse Mortgages. Reverse mortgages have increased in popularity in the last 5 years. For example, according to the National Reverse Mortgage Lenders Association, the number of reverse mortgages insured by the Department of Housing and Urban Development (HUD) (representing 90 percent of reverse mortgages) grew from about 8,000 originations in 2001 to about 43,000 originations in 2005. Reverse mortgages allow borrowers to convert equity in their homes to a loan, which need not be repaid until the borrower dies or sells the home.

Reverse mortgages can have relatively high up front fees (e.g., for insurance and origination costs) and are complicated transactions. Although Regulation Z requires lenders to provide special disclosures for reverse mortgage transactions (12 CFR § 226.33), some concerns have been raised that consumers may not understand the terms of these products. In the HUD-insured reverse mortgage program, borrowers must receive pre-application counseling from a counselor approved by HUD.

The Board seeks comments on the following questions related to reverse mortgages:

1. Are current Regulation Z disclosures adequate to inform consumers about the costs of reverse mortgages and to ensure that they understand the terms of the product?
2. Has counseling (under the HUD program) been effective in educating consumers about reverse mortgages and in preventing abuses from occurring?
3. In reverse mortgages that are not insured by HUD, is counseling offered to applicants? Do borrowers of these loans have difficulty understanding their loan terms or encounter other difficulties? Do these lenders employ alternate disclosure approaches that have proven to be effective?

Topic 3: Informed Consumer Choice in the Subprime Market

The growth of the subprime market over the last several years has expanded access to credit, helping to increase homeownership and opportunities for consumers to use the equity in their homes. However, the growth of the subprime market has also raised public policy concerns. Among the concerns is whether consumers who obtain higher-priced loans are sufficiently informed about mortgage products, their options, how to effectively shop for the best rates and terms, and ultimately how to obtain the best available mortgage for their needs.

In addition, the variation in prices paid by some borrowers has led to concerns that price disparities may reflect illegal discrimination rather than legitimate cost and risk-related factors. Home loan price data disclosed in 2005 for the first time under the Home Mortgage Disclosure Act show that African-American and Hispanic borrowers obtain higher-priced mortgage loans more frequently than do white and Asian borrowers, and obtain loans from lenders that specialize in higher-priced loans more frequently than do other groups.³ These differences may reflect legitimate distinctions among the credit characteristics of borrowers, or may be the result of other factors. The Board would like to use the hearings to gather information about borrowers' knowledge and shopping behavior in the subprime market that may stimulate additional research in this area.

The growth of the subprime market has also raised concerns about consumers' understanding of the role of mortgage brokers. Some consumer advocates have asserted that because brokers' fees are based on the amount of a loan, brokers may encourage consumers to obtain mortgage products that enable consumers to obtain larger loans without providing information about the risks for those products or other mortgage products that might better meet the consumer's needs. The hearings will be used to gather information about the role of brokers, to assist the Board in identifying new consumer education strategies, and to enable the Board to provide informed consultation with Congress and other agencies on possible legislative and non-legislative measures that might improve consumer understanding and protection in this area.

The Board solicits comment on the following questions regarding consumers in the subprime loan market:

1. How do consumers who get higher-priced loans shop for those loans? How do they select a particular lender?
2. What do consumers understand about the role of mortgage brokers in offering mortgage products? Has their understanding been furthered by state-required mortgage broker disclosures?
3. What strategies have been helpful in educating consumers about their options in the mortgage market? What efforts are needed to help educate consumers about the mortgage credit process and how to shop and compare loan terms and fees?
4. What are some of the "best practices" that lenders, mortgage brokers, consumer advocates and community development groups have employed to help consumers understand the mortgage market and their loan choices?

³ In the case of conventional first-lien home-purchase loans extended in 2004, 32.4 percent of African-Americans and 20.3 percent of Hispanic whites obtained higher priced-loans, compared to 8.7 percent of non-Hispanic whites and 5.9 percent of Asians. More information about these findings and the HMDA data in general, is available on the Board's website at http://www.federalreserve.gov/pubs/bulletin/2005/summer05_hmda.pdf, and <http://www.federalreserve.gov/boarddocs/press/bcreg/2005/20050331/default.htm>.

5. What explains the differences in borrowing patterns among racial and ethnic groups? How much are the patterns attributable to differences in credit history and other underwriting factors such as loan-to-value? What other factors may explain these patterns?

By order of the Board of Governors of the Federal Reserve System, May 1, 2006.

Jennifer J. Johnson (signed)

Jennifer J. Johnson
Secretary of the Board