



National Association of Federal Credit Unions

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August 15, 2006

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

RE: Docket No. OP-1253

Dear Ms. Johnson:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents the interests of our nation's federal credit unions (FCUs), I am responding to the Board of Governors of the Federal Reserve System's (Board) request for written comment on the home equity lending market.

Section 158 of the Home Ownership and Equity Protection Act of 1994 (HOEPA) directs the Board to periodically hold public hearings on the issue of home equity lending and the adequacy of existing regulatory and legislative provisions in protecting the interests of consumers, especially low income consumers. Pursuant to this directive, over the past several months the Board held a series of hearings on the home equity lending market. Topics for the hearings included (1) predatory lending, including the impact of HOEPA rules and state and local predatory lending laws; (2) nontraditional mortgage products and reverse mortgages; and (3) informed consumer choice in the subprime market. The Board is also soliciting written comment from those who were unable to attend the hearings or otherwise wish to comment on the issues raised at the hearings.

NAFCU commends the Board's efforts to ascertain public views on these important issues. NAFCU appreciates the opportunity to share its views and would like to take the opportunity to submit the following comments.

Predatory Lending

The Board has solicited comment about predatory lending practices and whether access to credit has been reduced as a result of laws enacted to curtail abusive lending.

Recent reports indicate a growing trend of abusive lending practices in all aspects of consumer credit, including for example, credit cards, auto loans, mortgage and home

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equity lending, and short term installment debt. NAFCU is concerned about this increase in predatory lending, which exploits financially unsophisticated consumers.

For example, payday loans (i.e. short term installment loans, deferred advance loans, cash advance loans, check advance loans, post-dated check loans, etc.) are small cash, short-term loans based on borrowers' personal checks held for future deposit or on electronic access to the borrower's checking account and due in full on the borrower's next payday, typically in two weeks. These types of loans normally have very high fees and often cost triple-digit interest rates (e.g. 390% APR for a two-week loan with \$30 finance charge per \$100 borrowed). Payday loans are also rolled over frequently and result in a crippling cycle of debt for financially vulnerable consumers.

Federal credit unions are subject to regulatory limitations that do not apply to other financial institutions. These restrictions, coupled with credit unions' historical mission to serve the provident credit needs of its members, preclude federal credit unions from engaging in certain lending practices. Specifically, the Federal Credit Union Act and the NCUA Rules and Regulations limit the maximum interest rate federal credit unions can charge on loans and lines of credit. Currently, the maximum interest rate is set at 18 percent, inclusive of all finance charges. 12 U.S.C. §1757(5)(A)(vi); 12 C.F.R. § 701.21(c)(7). Federal credit unions are also prohibited from charging prepayment penalties 12 C.F.R. § 701.21(c)(6).

NAFCU believes that while consumers should be protected from predatory lending practices, access to legitimate subprime credit must be preserved to ensure that affordable credit is available to those underserved individuals who are most in need of financial services. In its review of Regulation Z and the HOEPA regulations, NAFCU urges the Board to be cognizant of the importance of providing underserved markets with access to credit, and to avoid any action which might adversely affect credit availability.

Nontraditional Mortgage Products

The Board is also soliciting comment on whether disclosures that are currently required under Regulation Z are sufficient or whether additional disclosures are needed to inform consumers of the risks associated with nontraditional mortgage products.

Nontraditional mortgage products have observed increased consumer demand and rapid secondary market appetite growth in recent years, particularly in high priced real estate markets. Nontraditional mortgage products include so-called "interest-only" and "payment option" adjustable rate mortgages (ARMs). Nontraditional mortgage loans offer payment flexibility and can be beneficial to some borrowers. However, these products carry greater risks due to the lack of principal amortization and potential accumulation of negative amortization. Data from NAFCU's *2005 Federal Reserve Report* indicates that only 24 percent of member credit unions offer interest-only loans.

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Regulation Z already requires creditors to provide comprehensive disclosures to consumers regarding all mortgage loans, including nontraditional mortgage loans. Additionally, in December 2005 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 jointly issued proposed guidance on nontraditional mortgages. Among other things, the joint guidance outlines recommended practices for communications with consumers to address the specific risks raised by nontraditional mortgage products.

NAFCU believes that the recommended practices in the proposed interagency guidance are appropriate and does not feel that further regulation is necessary at this time. Consumers are already provided with sufficient information under Regulation Z; the recommended practices will further ensure that information about the risks associated with nontraditional mortgages is presented in a noticeable, clear, and understandable format.

Additionally, NAFCU encourages the Board to minimize disclosure requirements to the greatest extent possible. NAFCU member credit unions have expressed concerns that the growing number of consumer protection disclosures is becoming overwhelming and consumers are not reading the disclosures that are provided to them. NAFCU believes that the benefits of disclosures are negated if consumers are not utilizing the information. Thus, we urge the Board to minimize disclosures such that the information provided will be useful in the consumer's decision-making process.

Informed Consumer Choice in the Subprime Market

Finally, the Board is requesting public comment on consumer choice in the subprime market.

Subprime lending programs, such as risk-based pricing, provide an important means by which financial institutions may more effectively meet the needs of consumers, particularly low income consumers, individuals with little credit history or bad credit, and first time borrowers. For example, risk-based lending utilizes a tiered pricing structure in which loan rates are based upon an individual borrower's credit risk. Although subprime borrowers may pay higher rates than borrowers with strong credit histories, these consumers are able to obtain legitimate loans without paying the exorbitant fees associated with predatory lenders.

NAFCU strongly believes that subprime lending can provide real benefits to underserved consumers by increasing loan availability for those who might not otherwise qualify for credit. NAFCU also feels it imperative that consumers be fully informed of their options so they are able to obtain loan products that best fit their individual needs. Accordingly, NAFCU supports an upfront risk-based notice requirement relative to Section 311 of The Fair and Accurate Credit Transactions Act (FACT Act). Section 311

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requires the issuance of a risk-based pricing notice during a transaction to inform consumers that their credit reports have an impact on credit decisions.

NAFCU believes that consumers would be best served if they could receive a risk-based pricing notice at the time of application because the consumer is focused on credit issues and is most likely to be receptive to the message of the notice at that time. Also, receiving a notice at the time of application permits consumers to have a more meaningful opportunity to then obtain their free annual credit report for review and take any appropriate action. Providing an upfront notice would also better enable institutions to offer risk-based pricing to consumers. Many credit unions would have difficulty basing the delivery time of a risk-based pricing notice on whether a member is offered credit that is materially less favorable than terms offered to other members. If asked to comply with such a standard, some smaller institutions with limited compliance resources could cease to offer risk-based pricing loan products.

Additionally, NAFCU encourages the Board to consult with Congress and other regulatory agencies in order to push for increased supervision of non-federally insured depository institutions. Federally insured institutions, including credit unions, are subject to strictly enforced regulatory requirements aimed at protecting consumers. Mortgage brokers, however, are not subject to the same level of oversight. Yet because mortgage brokers earn higher fees for larger loans, brokers are faced with an inherent conflict of interest. Thus, brokers should be appropriately supervised to ensure that consumers understand the role of mortgage brokers and are fully informed of their choices.

NAFCU would like to thank you for this opportunity to share its comments on the home equity lending market. Should you have any questions or require additional information please call me or Pamela Yu, NAFCU's Associate Director of Regulatory Affairs, at (703) 522-4770 or (800) 336-4644 ext. 218.

Sincerely,



Fred R. Becker, Jr.
President/CEO

FRB/pwy