HSBC

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VIA ELECTRONIC MAIL / FACSIMILE

August 15, 2007

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

regs.comments@federalreserve.gov

Re: Docket No.OP-1288

Dear Ms. Johnson:

In response to the Board of Governors of the Federal Reserve System (the "Board") hearing discussion and request for comment, HSBC Finance Corporation's ("HSBC Finance Corporation") retail lending branches, which operate under the Beneficial and HFC brands ("HSBC Consumer Lending"), Decision One Mortgage Company LLC ("Decision One"), and HSBC Mortgage Corporation (USA) ("HSBC Mortgage Corp"), an operating subsidiary of HSBC Bank USA, N.A. (collectively "HSBC") are pleased to offer remarks on the questions posed with regard to enhancing Home Ownership and Equity Protection Act ("HOEPA") coverage under section 129 (l)(2) of the Truth in Lending Act ("TILA"). As one of the nation's largest consumer finance companies, HSBC Consumer Lending has more than 1,300 branches in 46 states and 11 servicing facilities across the United States. HSBC Mortgage Corp offers prime and Alt A mortgage loans nationwide through retail loan production offices, telesales, and mortgage brokers. With such a broad and expansive customer base, HSBC is able to provide a wide perspective on the issues facing the Board.

As an initial matter, we note that many of the issues raised in the request for comment pose fundamental questions about whether new regulations should apply to all mortgage loan products or merely those considered "subprime". Defining "subprime", however, is a complex task, and many proposed definitions run the risk of being over inclusive and capturing loans that are not truly subprime. Moreover, "subprime" lending, in and of itself, does not equate to

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"predatory" or "abusive" lending but, instead, makes credit available to consumers whose credit qualifications are on the lower end of the credit spectrum. In contrast, predatory and abusive lending practices can occur throughout the credit spectrum, as these practices are generally tied to unscrupulous lenders and brokers and not the specific type of credit, i.e. prime or subprime. Thus, if the intent of additional regulation is to eliminate inappropriate lending practices, regulation of subprime lending alone will not achieve the desired result.

We agree that the issues identified by the Board, i.e. prepayment penalties, stated income and low doc loans, mandatory escrow, and affordability of loans, and the impact of these practices on consumers are very worthy of careful consideration. We question, however, whether these issues are appropriate to consider only in the subprime lending context or rather, are general mortgage lending issues.

HSBC is supportive of the Board's efforts in this area but would encourage the Board, in promulgating any new regulations, to consider using the broad authority provided by TILA rather than its rulemaking authority under Section 129(l) of TILA. Section 105 of TILA clearly authorizes the Board to promulgate regulations and disclosures to "effectuate the purposes of this title, to prevent circumvention or evasion thereof, or to facilitate compliance therewith." Section 129(l) does not provide a clear grant to authorize new disclosures; something clearly authorized by Section 105, but, instead, authorizes the Board to prohibit unfair or deceptive acts and practices.

The request for comment outlines specific information desired by the Board. HSBC appreciates the opportunity to respond to the Board's request for comment and hopes the following information proves useful to the Board in its consideration of any proposed rules.

A. Prepayment Penalties

HSBC supports limiting prepayment penalties to the initial fixed rate period. Such a limitation is already contained in the new Statement on Subprime Mortgage Lending ("Statement"), which also requires lenders to permit borrowers to refinance their loans without penalty for at least a sixty day period prior to the interest rate reset date. We believe this Statement, in combination with the Interagency Guidance on Nontraditional Mortgage Products ("Nontraditional Guidance"), sets forth consumer protection principles that, if made applicable to all lenders, will bring about a level playing field in the mortgage industry.

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While HSBC would be supportive of regulations that duplicate the principles contained in the Statement and the Nontraditional Guidance, for the reasons noted above, we caution the Board to give very careful consideration to any further restrictions on prepayment penalties beyond those already required by state law or contained in the Statement. Prepayment penalties are a frequently misconstrued aspect of borrower choice and loan pricing. A borrower who has the option to choose a prepayment penalty typically can reduce the interest rate on his/her loan by approximately a half of a percent. In practice, that can equal thousands of dollars in interest over a thirty year timeframe. Depending on the particular borrower's circumstances and objectives, the option to select a prepayment penalty can have tremendous value.

HSBC believes that consumers could benefit from improved disclosures that clearly communicate the presence of, and key details about, any prepayment penalty on their loan. Most lenders provide consumers with the option to choose a loan with or without a prepayment penalty. In order to be meaningful, we believe any new disclosure should include information about the availability of loans with and without prepayment penalties, how such penalties are calculated, the advantages and disadvantages of each option, and any rate differential between a loan with or without a prepayment penalty.

Ultimately, we believe that borrowers should have the right to determine what characteristics their loan should possess. One borrower may choose a higher interest rate in favor of no prepayment penalty; another may opt for the maximum prepayment penalty with a significantly lower rate. Maintaining options for borrowers benefits both consumers and lenders alike.

B. Escrow for taxes and insurance on subprime loans.

HSBC offers escrow for insurance and taxes in many of its business operations. The availability of escrow provides consumers with additional choices in connection with their mortgage loan. Many borrowers, especially first time homebuyers, choose escrow as a budgeting tool for their insurance and taxes. Other borrowers prefer to manage their insurance and tax payments outside of escrow, thereby retaining any interest earned on these amounts. HSBC agrees that escrow should be offered by lenders but believes that borrowers should generally be permitted to make their own informed choice. As such, we would recommend that any escrow requirement be coupled with the ability for a borrower to opt-out in appropriate mitigating circumstances. As the key to an informed choice is disclosure, HSBC supports a disclosure to consumers advising them whether escrow is available in connection with their loan transaction as well as the amount of their monthly debt obligation including insurance and taxes.

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If the Board ultimately decides that regulation in this area is appropriate, HSBC recommends any requirement for escrow be limited to first lien residential mortgage loans over 80% Loan to Value ("LTV"), and that these requirements (1) apply to all originators and servicers, including all state licensed entities, and (2) consumers are provided with the ability to opt-out of coverage in appropriate mitigating circumstances. HSBC also respectfully requests that the Board consider the need for systemic changes related to the implementation of such escrow provisions, and provide for an effective date of at least one year from the effective date of the regulation. HSBC Consumer Lending itself recently implemented an escrow process. The development effort, with dedicated technology, budgetary and other resources, took the better part of one year from initiation through implementation of escrow functionality to the branches and servicing centers.

C. **"Stated income" or "low doc" loans**

HSBC would be hesitant to support an absolute prohibition against "stated income" or "low doc" loan products as we believe that the availability of these products provides needed access to credit for a specific segment of the population today. For example, small business owners, self-employed consumers, new immigrants to the United States, consumers with seasonal or fluctuating income, and persons paid via commission often struggle to adequately document their income without the conventional W2 or other income verification documents provided by an employer.

As with any higher risk loan, mitigating circumstances should be considered during pricing and product development, especially when multiple layers of risk are present. Mitigating factors could include Debt to Income ("DTI") or LTV ratios, higher credit scores, or prior payment history with the same lender and no credit deterioration. Prudent lenders who offer these products perform analytics, use sophisticated modeling and pricing systems, and generally exercise higher standards when underwriting these loans. In addition, HSBC supports clear disclosure of the additional costs to the consumer associated with stated income and low doc loans, as provided currently in the Nontraditional Guidance and the Statement. This increased disclosure ensures that a borrower makes an informed choice when electing a stated income or low doc loan.

D. **Unaffordable loans**

A borrower's reasonable ability to pay should always be considered in the origination of a residential mortgage loan. HSBC is committed to complying with the principles of the Nontraditional Guidance and the Statement. We believe that

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prudent lending includes an analysis of the borrower's reasonable ability to repay and, for that reason; HSBC generally supports underwriting all loans at the fully indexed rate, assuming a fully amortizing repayment schedule. We would suggest excluding from this requirement, however, adjustable rate mortgages or other products with fixed rate periods equal to or greater than five years. Loan products with longer initial fixed terms allow substantial principal reduction and equity boost prior to reset and do not result in the sort of "payment shock" that the Nontraditional Guidance and Statement are intended to minimize.

HSBC does not recommend that the Board adopt any specific DTI ratio as we believe that use of an arbitrary ratio will reduce the opportunity for sound borrowers to access credit. We believe that DTI is only one indicator of affordability and does not take into account compensating factors such as disposable or residual income. For example, a consumer could have a DTI ratio of 60% but still have enough disposable income to repay the loan. We do not believe that reliance on DTI alone, without evaluating the overall consumer credit qualifications and characteristics, is the best predictor of the ability to repay.

As noted above, we believe that where lending practices merit further oversight, the specific practices or products should be addressed, rather than over broad, indefinable categories of loans such as "subprime". In effect, we believe that prescriptive standards are inappropriate for the ever evolving, complex, fact and circumstance based arena of underwriting, and that by defining "subprime", regulators risk coming perilously close to setting such standards. Regulators themselves struggled with defining subprime in the 2001 Expanded Guidance for Subprime Lending ("2001 Guidance"). Thus, the resulting definition is long and complex, and really focuses on safe and sound lending. Many of the "subprime" characteristics identified in the 2001 Guidance can also be present for prime borrowers. Crafting a regulation applicable to subprime loans requires a common definition of subprime that is widely accepted and that can withstand the passage of time and changing economic and social factors. However, such an exact definition simply does not exist at this time. While many in the industry have suggested a new threshold for subprime that is lower than HOEPA[1] but higher than the Home Mortgage Disclosure Act ("HMDA")[2], we believe that any threshold established runs the risk of being arbitrary and capricious. On its face, use of an existing HMDA threshold might seem like a reasonable alternative. However, the HMDA threshold is too susceptible to interest rate fluctuation and, because of flattening yield curves, where the distance between the threshold and the rate environment is exceptionally narrow, consumers who wouldn't "ordinarily" hit the threshold ended up doing so. As a result, HMDA thresholds, as they exist today, can be over inclusive. Additionally, because HMDA

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[1] See Regulation Z, 12 C.F.R. § 226.32(a)(1)(i)
[2] See Regulation C, 12 C.F.R. § 203.4(a)(12)

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thresholds are set at closing, administration of this standard at application would be extremely difficult.

Conclusion

HSBC strongly advocates a regulatory approach that applies equally to all mortgage lending participants, not just nonprime lenders and consumers, creates a level and competitive playing field, and leads to true consumer protection. If any proposed regulations are not applied equally and consistently, the result may be reduced credit availability, less competition and higher prices in the mortgage market. For this reason, HSBC supports appropriately tailored, bright line national standards for mortgage lending. We also support the creation of clear and simple disclosures, promulgated under the Board's general authority in section 105(a) of TILA. Improved disclosures will empower consumers to make informed choices that best meet their financial needs.

HSBC appreciates the opportunity to comment on the questions provided and supports the Board in its efforts to promote uniformity across the mortgage industry

If there are any questions concerning this letter, or the Board requires additional information, do not hesitate to contact me.

Very truly yours,

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