HSBC

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April 8, 2008

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. R-1305

Dear Ms. Johnson:

In response to the Board of Governors of the Federal Reserve System (the "Board") request for comment, HSBC Finance Corporation's ("HSBC Finance Corporation") retail lending branches, which operate under the Beneficial and HFC brands ("HSBC Consumer Lending") 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 proposed revisions to Regulation Z, which implements the Truth in Lending Act ("TILA") and the Home Ownership and Equity Protection Act ("HOEPA"). As one of the nation's largest consumer finance companies, HSBC Consumer Lending has approximately 950 branches in 46 states and 8 servicing facilities across the United States. HSBC Mortgage Corp offers prime and Alt A mortgage loans and home equity loans nationwide through retail loan production offices, bank branches, telesales, correspondents and mortgage brokers. With such a broad and expansive customer base, HSBC is able to provide a wide perspective on the revisions being proposed by the Board.[1]

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 the proposed rules. We are supportive of the Board's goals in proposing amendments intended to protect consumers in the mortgage market from unfair, abusive or deceptive lending and servicing practices while preserving responsible lending and sustainable home ownership; ensure that advertisements for mortgage loans provide accurate and balanced information and do not contain misleading or deceptive misrepresentations; and provide consumers with transaction-specific disclosure early enough to use while

[1] Home equity loans are not offered through mortgage brokers.

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shopping for a mortgage. However, HSBC would encourage the Board to reconsider use of its rulemaking authority under Section 129(l) of TILA to promulgate these regulations and, instead, use the broad authority provided by Section 105 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. We believe that the degree of liability exposure under Section 129(l) is inconsistent with Congress' intent in enacting and amending TILA and HOEPA, and would likely have significant adverse consequences to the availability of credit in the market. Most of the proposed regulations are more closely aligned with the statutory purpose that underlies regulatory action under Section 105(a), i.e. the informed use of credit. As such, we believe that the penalties for violations of the proposed regulations should be consistent with the other provisions of TILA and Regulation Z that were enacted to serve the same purpose of informed use of credit. Enacting the proposed regulations under Section 129(l)'s unfair and deceptive acts or practices authority could subject lenders to additional and substantial liability under state unfair and deceptive acts and practices laws. As noted earlier, increased risks for lenders may have the unintended consequence of adversely impacting both the cost and the availability of credit.

I. <u>Proposed Rules for Higher Priced Mortgage Loans</u>

As an initial matter, we question whether creation of a new category of loans subject to additional regulation will have the intended benefits contemplated by the Board. We believe that an even playing field is necessary for the continued existence of national and state lenders. Creating a separate category of loans that only covers a portion of the credit spectrum and applying separate rules to these, makes it more difficult for consumers to compare offers from multiple lenders. We believe that the proposed definition of "Higher Priced Mortgage Loans", while providing a bright line test, is likely to be over-inclusive. These Higher Priced Mortgage Loans are subject to additional restrictions, some of which are subjective and, as such, subject to interpretation and thus, increased risk. In its Summary of Proposal, the Board mentioned that consumer advocates and some state officials noted that few loans are made with rates or fees at or above the HOEPA triggers. Many lenders price their mortgage loans under the HOEPA thresholds to avoid being identified or perceived as a high cost lender because of concerns about reputation risk. These same lenders are unlikely to make Higher Priced Mortgage Loans because of these same reputation risk concerns. The unintended consequence will be the shrinking of available credit to consumer's whose credit history would necessitate a higher priced loan.

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a. Higher Priced Mortgage Loan Thresholds

We commend the Board's attempt at a bright line test for identifying Higher Priced Mortgage Loans. For the reasons noted earlier, we are generally not supportive of the increased regulation of only one segment of the lending arena – subprime lending. However, to the extent that the Board is determined to further regulate subprime loans, we believe that the threshold in the proposed regulation §226.35(a) -- an APR that is more than three percentage points in excess of the comparative Treasury security for first liens and five percentage points for subordinate liens – is too low and will capture many near prime loans, especially alt-A loans. For example, HSBC Mortgage Corp, a prime lender, believes that about 10% of its current loan originations would fall into the "higher priced" category. If the Board ultimately decides that a Higher Priced Mortgage Loan category is warranted, we would recommend that the proposed thresholds be modified to four and six percentage points, respectively, for first and subordinate lien loans. Even at the increased thresholds, approximately two percent of HSBC Mortgage Corp. loan originations will continue to be covered.

b. Timing

HSBC urges the Board to adopt the same timing requirements for Higher Priced Mortgage Loans as are currently in place for HOEPA loan thresholds. Under HOEPA, the APR threshold is based on the Treasury yield as of the 15th day of the month immediately preceding the month in which the application is received.[2] The proposed Higher Priced Mortgage Loan threshold is based on the yield on Treasury securities as of the 15th day of the preceding month if the creditor receives the application between the 1st and the 14th day of the month and as of the 15th day of the current month if the creditor receives the application on or after the 15th day.[3] The use of two different timing requirements will create significant operational and compliance burdens, increasing operational costs and, potentially, consumer costs.

c. Repayment Ability – Proposed § 226.35(b)(1)

HSBC believes that a consumer's reasonable ability to pay should always be considered in the origination of a residential mortgage loan. For this reason, HSBC generally supports underwriting all loans at the fully indexed rate, assuming a fully amortizing repayment schedule. We believe that underwriting guidelines should be prudent but flexible and are concerned that the proposed approach is overly restrictive and interferes with prudent underwriting practices. HSBC also believes that the proposed regulation and its accompanying proposed commentary, as currently written,

[2] 12 C.F.R. § 226.32(a)(1)
[3] Proposed § 226.35(a)(4)

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create areas of ambiguity and, thus, risk for lenders. The proposed amendments to existing Section 226.34(a)(4) require lenders to consider not only current income and obligations but also reasonably expected income and obligations. It is unclear, nor does the proposed Commentary provide any guidance on, how a lender is expected to determine a consumer's reasonably expected obligations. The ramifications for failing to accurately make this future obligations assessment are significant given what appears to be a presumption of liability in proposed Section 226.34(a)(4)(ii) and no safe harbor for lenders. As drafted, the proposed regulation appears to have a bias toward liability, which perception appears to be supported by the proposed Commentary to this section that only excludes from a presumptive violation those consumer defaults arising from a serious illness or job loss. This language does not take into account that default frequently occurs for other reasons, such as divorce or other family disruption, disability, and general financial mismanagement. We also believe that, while well intentioned, this language will create significant incremental risk to lenders, providing a basis for the plaintiffs' bar to argue, and Courts to uphold, that a loan should be void on the basis that a consumer lacked the ability to repay as a result of subsequent events. It should also be noted that this requirement could conflict with fair lending laws. In order to assume expected obligations (such as upcoming college expenses) or anticipated reduction in income (such as retirement), a lender would be required to violate fair lending laws, inquiring into the protected classes of age, familial status, protected income sources and others. Many lenders are likely to avoid making Higher Priced Mortgage Loans to insulate against this risk resulting in even less credit being available to consumers in an ever tightening credit environment

d. <u>Verification of Income and Assets</u> – Proposed § 226.35(b)(2)

The proposed regulation requires creditors to either verify the consumer's income, including expected income, and assets through the consumer's W-2, tax returns, payroll receipts, financial institution records, or other third party documents that provide reasonably reliable evidence of the consumer's income or assets. We believe that this is a sound rule, however, we would recommend that the Board incorporate in its regulation the mitigation concept from the Statement on Subprime Mortgage Lending ("Statement"). The Statement would permit stated income and low-documentation loans if there are mitigating factors that clearly minimize the need for direct verification of repayment capacity. Consumers with a demonstrated favorable payment performance and no deterioration of their financial condition, who are seeking to refinance an existing loan with a new loan of similar size and terms, should not be barred from doing so without requiring lenders to re-verify their income or assets. HSBC believes that the Board's proposal could conflict with the Equal Credit Opportunity Act ("ECOA"), which prohibits discrimination against older consumers, particularly if older consumers are required to disclose Social Security payments and retirement savings and/or plans, and would ask the Board to add clarity around this area to enable lenders to comply with both ECOA and the proposed rules.

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e. Prepayment Penalties – Proposed § 226.35(b)(3)

HSBC cautions the Board in adopting further restrictions on prepayment penalties beyond those already required by state law or contained in the Statement on Subprime Mortgage Lending ("Statement"). As HSBC has noted in previous comment letters, prepayment penalties are a frequently misconstrued aspect of consumer choice and loan pricing. A consumer who has an 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 consumer'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 continue to believe that consumers should have the right to determine what characteristics their loan should possess. One consumer 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 consumers benefits both consumers and lenders alike.

f. Mandatory Escrow for Property Taxes and Insurance – Proposed § 226.35(b)(4)

Under the new proposed regulations, escrow for property taxes and insurance is required on all first lien Higher Priced Mortgage Loans. HSBC offers (and in some instances, requires) 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 consumers, especially first time homebuyers, choose escrow as a budgeting tool for their insurance and taxes. Other consumers prefer to manage their insurance and tax payments outside of escrow, thereby retaining any interest earned on these amounts. HSBC Consumer Lending provides to its customers the option of an escrow in connection with its portfolio loan products. In March 2008, approximately 50% of portfolio loan product customers elected escrow. HSBC agrees that escrow should be offered by lenders but believes that consumers should generally

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be permitted to make their own informed choice. As such, we would recommend that any escrow requirement be coupled with the ability for a consumer to opt-out in appropriate mitigating circumstances as early as at or before closing. 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.

If the Board ultimately decides that regulation in this area is appropriate, HSBC recommends that 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, 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.

II. Proposed Rules for Mortgage Loans

a. Mortgage Broker Provisions/Early Fee Disclosures

We believe that the Board, working with HUD, which has just released proposed regulations that would change the GFE and HUD-1 documents, should adopt a new set of uniform mortgage disclosures that will condense the existing and any newly required disclosures. This will better allow comparison shopping by consumers, particularly with respect to mortgage broker compensation.

HSBC supports the development of a single form, as stated above, that would be accepted as a safe harbor for compliance with both RESPA and TILA. HSBC notes that other commenters may be submitting sample forms, and we urge the Board to review these and select one, or create one, that satisfies these concerns.

HSBC Mortgage Corp. is regulated by the OCC, which currently requires its lenders to ensure that mortgage brokers disclose all fees (including total compensation) to the consumer before services are performed. The consumer is also required to request the broker's services and accept the fees in writing. If a rule is adopted that has similar requirements, HSBC requests that the rule be uniform, cover all existing regulatory requirements, and pre-empt state laws covering the topic. It would be helpful if certain things are clarified, such as tolerances for fee increases between application and closing, and what would constitute acceptable explanations for same.

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The timing requirement of the proposed broker agreement raises a few issues. First, it will be difficult for a lender to really know when the agreement is executed. It may come to the lender undated, or if dated, there is no way to know whether the date was before services were rendered. There should be some safe harbor for lender compliance regarding the date of the agreement. Also, if a lender receives a loan package from a broker without the disclosure agreement in the package, or with the disclosure agreement but imperfectly or untimely completed, the lender might have to decline the loan (and for what reason?), or maybe the Board intends that the broker not be paid any fee. In either instance, this will have a deleterious effect on lending. In such event, the broker would have no incentive to continue working on the loan and could leave a consumer without a loan.

The proposed rule also requires disclosure of the total broker compensation as a flat dollar amount. Flat dollar fees are not appropriate, as they may have the effect of shutting out consumers in lower priced markets. The fee might be too high for consumers to bear. A percentage fee is fairer to the consumer, and much easier for the lender to administer, as the final fee will depend upon the final loan amount (which often changes between application and closing, at the consumer's request or due to appraisal results).

Finally, we reiterate that the Board's rules should preempt all state laws that require alternative disclosures or limits on broker compensation. An even playing field is necessary for the continued existence of national and state lenders.

b. Misrepresentation of Value of Consumers Dwelling/Coercion of Appraisers – Proposed § 226.36(b)

HSBC understands the Board's concerns about fraudulent appraisals and the harm these cause to both lenders and consumers alike. However, we believe that the proposed rules contain too many vague terms which will create incremental risk for lenders. If an appraisal were later deemed to be fraudulent or inflated, a lender would need to prove that any contacts made in the ordinary course of business, whether direct or indirect, were not attempts to "influence" the appraiser. HSBC Consumer Lending, for example, undertakes back-end appraisal reviews to audit both the quality and value confidence of an appraisal. Appraisers with unacceptable quality, which could include value confidence, are placed on various stages of corrective action. Any appraiser with a trend of issues is placed on an ineligible list, which is communicated to our unaffiliated appraisal management company. While the intent of these proposed regulations is not to discourage lenders from instituting appraisal review procedures, this could be an inadvertent result. We are also concerned that the language "reason to know" is so vague that lenders will not be able to adequately counter allegations that they should have known appraisals were inflated or fraudulent, even where a lender has had no

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direct or indirect contact with an appraiser, or where a lender has significant controls around valuation processes.

c. Servicing Practices – Proposed § 226.36(d)

HSBC supports prohibiting the pyramiding of late fees but believes this prohibition is adequately covered under the credit practices rule of Regulation AA, 12 CFR 227.15 and does not need to be included in these proposed changes.

HSBC is concerned that requiring lenders to provide a schedule of fees and charges presents a significant compliance burden for lenders without a demonstrable benefit to consumers. The proposed regulation uses very broad language to describe the nature of fees that must be included in the fee schedule, i.e. "fees and charges….the servicer may impose…in connection with servicing the consumer's account", and also requires lenders to include the specific dollar amount of each fee, an explanation of each fee and the circumstances under which it may be imposed. Many fees and charges that a lender could pass on to a consumer can change frequently and vary by county, locality or state. For example, the hourly rate for a collection attorney may change at any given time and also will vary by firm and state. Some fees may only be triggered by a very specific set of circumstances not applicable to most consumers. HSBC would recommend that the Board eliminate this requirement from the proposed regulations.

HSBC concurs with the Board that consumers should receive responses to payoff requests within a reasonable time-frame but recommends that the Board consider extending the time-frame from three (3) business days to five (5) business days. This will enable servicers to comply with payoff requests in high volume periods such as when interest rates are decreased.

In addition, HSBC is concerned with the requirement that payments be credited the same day as they are received. There are two concerns with this requirement. One is that there needs to be a cut-off time in the definition of "day" to allow payments to be processed. Second, except for home equity lines of credit, most mortgages do not require any additional payment of interest, nor add on any fees, provided that payment is made within the contractual grace period. Therefore, the lender should not be penalized if the payment is credited on a date subsequent to receipt, so long as there is no additional charge or negative effect to the consumer.

III. Advertising

HSBC is supportive of the Board's goal of strengthening the clear and conspicuous standard for closed-end and open-end advertising disclosures, including the regulation of disclosed rates and payments as these relate to low introductory or teaser rates. In undertaking these goals, the Board must weigh the benefits of providing

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consumers with additional, clearer information that can be used by them to weigh and compare credit offers from different lenders against the potential risk that this additional information will result in more detailed and complex disclosures that will create consumer confusion. An additional factor to be considered is that, to the extent that the new disclosures require lenders to prepare extremely complex disclosures, because of space limitations or concern about clarity, many lenders may discontinue providing any specific product information in their advertising. Thus, instead of supplementing the existing disclosures provided to consumers under existing advertising regulations, the proposed changes could result in less information being available to consumers.

Proposed § 226.24(f)(1) requires lenders who advertise real estate secured loans with a simple annual rate of interest, where more than one simple annual rate of interest will apply over the life of the loan, to provide, in a clear and conspicuous manner, additional rate and payment stream disclosures. We believe, as noted earlier, that this requirement will lead many lenders to avoid disclosing product specific information in their advertising. However, if the Board decides to enact this regulation as proposed, HSBC would request that either the regulation itself or the related Commentary to this section provide express clarification that this section is intended to apply only to those loans products whose simple annual rates of interest and payments have the potential to increase over the life of the loan.

We do not believe the intent of proposed § 226.24(f)(1) is to capture loans whose simple annual rates of interest and payments can only decrease over the life of the loan. For example, Fannie Mae's Expanded Approval's Timely Payment Rewards® feature encourages consumers to improve their creditworthiness by making on-time payments for a consecutive 24-month period, thus qualifying them for a one-time rate reduction. HSBC Consumer Lending's Pay Right Rewards product allows consumers to earn up to a maximum of ten or twelve reductions in their initial contract interest rates as a reward for their 12 consecutive on-time monthly payments. Once earned, each rate reduction is permanent so any subsequent failure to make an on time payment will not result in a rate increase. Even after a payment default the customer may again earn a rate reduction after another 12 consecutive months of on time payments. Requiring lenders, who offer these products with strong consumer benefits, to provide the increased interest and payment stream disclosures might result in lenders not advertising these products to consumers due to the complexity of the disclosures. This would surely not be in the best interest of consumers.

IV. 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. Because of the scope and complexity of some of the proposed regulations, however, HSBC reiterates the

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need for the Board to allow sufficient time for lenders to comply with the proposed regulations. It could take lenders who do not currently offer escrow at least a year to provide this service. Many of the rules requiring new disclosures would also take a significant time to implement. We would ask that that mandatory compliance with the new regulations be required no sooner than eighteen months after issuance of the final rules.

HSBC appreciates the opportunity to comment on the proposed regulations 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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