

**BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM**

Open Meeting Agenda

Wednesday, December 12, 2001

I. Discussion Item:

Amendments to Regulation Z addressing concerns related to abusive lending practices in mortgage lending.

Since the mid-1990s, the subprime mortgage market has grown substantially, providing access to credit to borrowers with less-than-perfect credit histories and to borrowers who are not served by prime lenders. The increase in subprime lending has led to an increase in reports of abusive lending practices, which generally involve fraud, deception, or unfairness.

In 1994, in response to anecdotal evidence about abusive practices involving home-secured loans with high rates or high fees, the Congress enacted the Home Ownership and Equity Protection Act (HOEPA). HOEPA amended the Truth in Lending Act and applies to closed-end home-equity loans (excluding home-purchase loans) bearing rates or fees above a specified percentage or amount. For covered transactions, HOEPA imposes substantive limitations, such as restrictions on short-term balloon notes and prepayment penalties, and additional disclosure requirements. A loan is covered by HOEPA if, at the time of consummation, the annual percentage rate (APR) exceeds by more than 10 percentage points the yield on Treasury securities having a comparable maturity or if the total points and fees exceed 8 percent of the loan amount or \$400, whichever is greater.

HOEPA authorizes the Board to adjust both price triggers. The Board may adjust the APR trigger by up to 2 percentage points if it determines that the increase or decrease is consistent with the consumer protections in HOEPA and is warranted by the need for credit. The Board may adjust the fee-based trigger by including additional fees, not by adjusting the percentage.

In the December 2000, after hearings in four cities on how the Board might use its authority under HOEPA to deter abusive lending practices, the Board published for

comment a proposal to amend Regulation Z. The proposed amendments would (1) extend the protections of HOEPA to more loans; (2) prohibit certain acts or practices; (3) strengthen HOEPA's prohibition on loans based solely on homeowners' equity without regard to repayment ability; and (4) enhance HOEPA disclosures to be given to consumers before closing.

The Board received more than 1,300 comments, including 1,100 identical e-mail messages. Most creditors and other industry commenters opposed making more loans subject to HOEPA. In their view, the coverage of more loans would reduce competition and the availability of credit in the range of rates affected because certain lenders will not make HOEPA loans. For the other parts of the proposal, creditors wanted more guidance on flexibility and compliance. Representatives of consumer and community development organizations generally supported the proposal as a minimal first step toward addressing the problem of predatory lending but believed additional consumer protections were needed.

After analyzing the comments received, the staff recommends that the Board publish a final rule amending Regulation Z, as set forth below. The final rule is substantially similar to the proposed rule, with two exceptions. The staff recommends lowering the APR trigger only for first-lien mortgage loans. The staff also recommends dropping the proposal to restrict the refinancing of subsidized low-rate loans into high-rate loans, because the benefit to borrowers protected by such a rule appears to be far outweighed by the potential compliance burden for refinancings generally. In summary, the final rule would do the following:

1. **Extend HOEPA's protections to more loans**

- Adjust the APR trigger for first-lien mortgage loans from 10 percentage points to 8 percentage points above the rate for Treasury securities having a comparable maturity. The APR trigger for subordinate-lien loans would remain at 10 percentage points.
- Adjust the fee-based trigger to include amounts paid at closing for optional credit life, accident, health, or loss-of-income insurance and other debt-protection products.

2. **Prohibit specific acts or practices**

- Address "loan flipping" in the first 12 months of a HOEPA loan. A creditor that has made a HOEPA loan to a borrower in the preceding 12 months would generally be prohibited from refinancing another HOEPA loan to the same borrower. A creditor would be permitted to make such a loan if it is in the borrower's interest. Assignees holding or servicing a HOEPA loan would be covered by this rule as if they were the original creditors.

- Prevent evasion of HOEPA, which covers only closed-end loans, by prohibiting a creditor from wrongfully documenting loans as open-end credit.
 - To ensure that lenders do not accelerate the payment of HOEPA loans without cause, prohibit a creditor from exercising “due-on-demand” or “call” provisions in a HOEPA loan, unless the clause is exercised in connection with the consumer’s default. A similar rule applies to home-secured lines of credit.
3. **Strengthen enforcement of HOEPA’s prohibition on unaffordable lending**
- Create a presumption that a creditor has violated the statutory prohibition on making HOEPA loans without regard to repayment ability if the creditor generally does not verify and document consumers’ repayment ability.
4. **Enhance disclosures**
- Revise the HOEPA disclosure given three days before loan closing in refinancings to alert consumers to the total amount borrowed, which may be substantially higher than the loan amount requested by the borrower due to the financing of insurance, points, and fees. To enhance consumer awareness, the HOEPA disclosure would have to specify whether the total amount borrowed includes the cost of optional insurance.

Note: Staff’s memoranda relating to today’s agenda are available in limited quantity outside the Board Room. Additional copies of the memoranda may be obtained from the Freedom of Information Office (FOI), Room M-P-500, or are available electronically at <http://www.federalreserve.gov> on the Board’s Web site. Cassette recordings of the meeting may also be obtained from FOI.