# The Federal Reserve Board's Proposed New Consumer Protection Rules for Mortgages

April 1, 2008

Kathleen C. Ryan
Federal Reserve Board

# Challenges

- Limits on consumers' ability to protect themselves from abuse; limits of disclosure
- Misaligned incentives of originators and consumers (and investors)
- Fragmented origination market

# Goals

- Protect consumers from abusive, unfair, or deceptive acts or practices
- Preserve consumers' choice and their access to responsible credit

# Statutory (HOEPA) Authority

- Board shall prohibit acts or practices in connection with
  - Mortgage loans that are unfair or deceptive, or designed to evade HOEPA
  - Refinancings of mortgage loans that are associated with abusive lending practices or not in the interest of the borrower

# Overview

- Stricter regulation of underwriting practices and loan terms on higher-priced loans
- Protections for most mortgage loans in brokerage services, appraisals, and servicing
- Advertising requirements and restrictions
- Earlier disclosure of loan terms

# Higher-Priced Loans

- Assessment of repayment ability
- Verification of income or assets relied on
- Escrows for taxes and insurance
- Prepayment penalty restrictions

# Higher-Priced Loans
## *Definition*

- APR exceeds comparable Treasury security by 3 or more percentage points (or 5 points if subordinate-lien)
  - Timing
- Expected to cover all subprime loans and some alt-A
- A few exceptions, e.g., HELOCs

# Higher-Priced Loans
## *Repayment ability*

- Prohibits pattern or practice of lending based on collateral without regard to ability to pay from income or assets
- Does not prescribe UW standards
- But creates presumptions for failing to follow certain basic UW practices

# Higher-Priced Loans
## *Income verification*

- Creditors must verify income or assets they rely on
- Must be a third-party document that provides reasonably reliable evidence
- Non-traditional documentation allowed if it meets this standard
- Limited safe harbor

# Higher-Priced Loans
# *Escrows*

- Mandates escrows on first-lien loans
- Creditor decides whether to permit opt-out
- But opt-out prohibited in first 12 months

# Higher-Priced Loans
## *Prepayment penalties*

- Targeted approach forbids penalties where risks to consumers are higher
- Higher repayment burden:
  - Verified DTI > 50% (prohibition)
  - Payment increase (expire 60 days before)
- Potential for “flipping”: same lender

# Restrictions on Most Loans

- Prohibits lender or broker from coercing appraiser
- Prohibits servicers from imposing certain unwarranted charges; requires fee disclosure
- Prohibits lender from paying broker more than consumer agreed broker would receive

# Disclosure

- Requires advertisements to be accurate and complete; prohibits certain deceptive practices
- Requires loan terms be disclosed three days after application, or before charging a fee (except a fee for credit review)

# More on Broker Proposal

- Brokers improve competition
- But competition does not work as it should if consumers believe brokers will get them the best deal, yet
  - Brokers have no such obligation, and
  - Brokers have incentives to do otherwise (increased payment from lender)
- Because then consumers won't shop or negotiate as they otherwise would

# More on Broker Proposal

- The proposal would prohibit lender from paying broker more than consumer had agreed broker would receive.  Agreement must be executed before fee paid or application made.
- Plus two disclosures:
  - Consumer pays, directly or indirectly
  - Lender payments may create conflict of interest

# More on Broker Proposal

- Compliance alternatives
  - Disconnect payment from interest rate
  - State law providing similar protection
- Requests for comment
  - Apply to lenders' employees?
  - Apply only to subprime?
  - Permit fee agreement to be modified?
- We are testing proposed disclosures

# Conclusion

- Comments due April 8, 2008
- We value and will consider all opinions
- We value <u>specific</u> information, anecdotal as well as quantitative
- We will move expeditiously to finalize