

## Community Investments

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# Editor's

NOTEBOOK by Joy Hoffmann Molloy

On September 7th, 2000, the Federal Reserve Bank of San Francisco held a public hearing on the HOEPA, capping a series of public hearings sponsored by the Federal Reserve Board at branches across the country. The hearings provided an opportunity to gather information and hear perspectives about predatory lending from financial institutions, consumer groups, community advocates and researchers. Public testimony helps personalize the issues and provides concrete examples of consumers' experiences. These hearings were intended to help regulators better understand what regulatory changes might be most effective in ending predatory lending, and how these changes might impact the availability and cost of credit.

While subprime lending can be credited with greatly improving access to credit for marginal borrowers, it also has fueled the predatory lending practices that have victimized homeowners and raised a red flag for community advocates, the Fed and financial institutions alike. The Fed's Community Affairs unit is particularly concerned about "predatory" lending practices because of their disproportionate effect on low-income persons and economically marginalized communities. The question is whether the regulatory tools at our disposal are sufficient to halt predatory lending without curtailing the availability of credit for those who already have limited options.

The Home Ownership and Equity Protection Act (HOEPA) of 1994 is one tool the Fed can use to protect consumers from unfair lending practices. HOEPA doesn't inhibit loans from being made, rather, it expands the Truth in Lending Act (TILA) by requiring additional disclosures and restricting certain alternative loan terms (e.g., pre-payment penalties, higher default interest rates) on "high-cost" loans. These disclosures are triggered by loans with closing fees that exceed eight percent of the loan amount or an APR ten points above prevailing Treasury rates for securities with comparable maturities. The most significant deterrent under HOEPA is the three-year period in which a loan that violates any HOEPA provision can be rescinded.

Currently, only 0.7% of subprime loans trigger HOEPA disclosure requirements. Lowering the trigger to eight percent would increase that number to 3.9%. Given the increased reporting burden, financial institutions contend that lowering the trigger would make subprime lending unattractive thereby shrinking the credit opportunities for low-and-moderate income borrowers. Balanced public testimony is an important part of determining whether this increased reporting burden will have a decisive impact on ending predatory lending and can be justified as a benefit to consumers.

Another tool—and in my opinion the more effective one—is financial education. The issue of predatory lending is broader than any regulation can address. While predatory lending is universally acknowledged as an egregious practice, a clear-cut solution isn't readily apparent. However, self-empowerment through financial literacy would better prepare consumers to face the barrage of product and service offers, and equip them with the knowledge necessary to make sound financial decisions. As stories surface nationwide of "equity rich but cash poor" consumers entering into questionable loan agreements, it is clear that regardless of their age, income or race, one characteristic common to almost all victims of predatory lending is their vulnerability due to limited financial savvy. The Fed plays an important role in both educating consumers and regulating financial institutions on fair lending practices. In its unique role as educator and overseer, the Fed can play an urgent and important role in limiting the havoc of predatory lending. The public hearing on September 7th was an important step towards this goal.

