



The Subprime Lending Crisis: A New Era in Consumer Protection

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Federal Agencies' Existing Responses to Subprime Mortgage Issues

- Principles-based guidance issued through Interagency Policy Statements
- Guidance involved both Safety and Soundness and Consumer Protection issues
- Pending response will be issued through new and revision consumer regulations but will involve lending restrictions as well



Role of the FR Board in Consumer Protection

Congressional mandate to FRB

- Primary rule-writing authority for many consumer protection laws

Two fundamental approaches

- Require pertinent and accurate information
- Develop/enforce substantive rules against abusive and unfair practices



Consumer Protection in Financial Services

- 1970's – 1980's: Significant consumer protection statutes passed to address lending issues (ECOA, TILA, CRA)
- 2007: New/revised regulations may result in significant Consumer Protection changes



Existing Guidance on Subprime Lending

- Interagency Guidance on Nontraditional Mortgage Product Risks (2006)
- Statement on Subprime Mortgage Lending (2007)
- Interagency Statement on Unfair and Deceptive Trade Practices and Acts (2004, 2007)
- Interagency Statement on Working with Mortgage Borrowers (2007)



Nontraditional Mortgage Products

Applicable Guidance:

2006 Interagency Statement on Nontraditional Mortgage Products

Applicability:

All banks and their subsidiaries

All BHC's and their nonbank subsidiaries



Coverage

Principles-based guidance relating to the offering of “nontraditional” or “exotic” mortgage loans

Characteristics of such loans

- Interest-only mortgages
- Payment-option ARMs
- Hybrid mortgages (e.g., 2/28, 3/27 programs)
- Reverse mortgages



Subprime Mortgage Lending

Applicable Guidance:

2007 Interagency Statement on Subprime Mortgage Lending

Applicability:

All banks and their subsidiaries

All BHC's and their nonbank subsidiaries



Coverage

“Principles based guidance” relating to Adjustable Rate Mortgages (“ARMs”)

- Targeted to subprime borrowers
- Principles also apply to ARM products offered to non-subprime borrowers



Prudent underwriting standards

- Underwrite based on ability to repay at maturity, assuming fully indexed rate/amortizing payment
- Include total monthly housing related payments (taxes and insurance) in DTI ratio
- Verify and document income
- Document risk mitigants for stated income or low documentation loans
- Develop strong control systems



Prudent Underwriting Standards (cont'd)

- Risk layering requires demonstration of risk mitigating factors
- Exercise caution with low introductory interest rates
- Monitor such loans to subprime borrowers for UDAP compliance



Consumer Protection Issues

Important Disclosures

- Payment shock
- Prepayment penalties
- Taxes and insurance
- Negative amortization
- Others



Unfair or Deceptive Acts or Practices (UDAPs)

Applicable law: Section 5 of the Federal Trade Commission Act (“FTC Act”)

Guidance:

Interagency Guidance concerning Unfair or Deceptive Practices by State-Chartered Banks

Broad Coverage

Applies to all acts or practices of a bank, *not just lending!*



Applicability

Federal Reserve Board

- All banks and their subsidiaries
- All BHC's and their nonbank subsidiaries

Federal Trade Commission

- All entities engaged in commerce



Unfair Acts or Practices Defined

- Cause or likely to cause substantial injury to consumers
- Cannot reasonably be avoided by customers
- Is not outweighed by countervailing benefits to consumers or competitors



Deceptive Acts or Practices Defined

- Requires a representation, omission or practice that misleads the customer (or is likely to do so)
- Representation, omission or practice must be material



Practices and Acts with Greatest Risk

- Advertising and solicitations
- Disclosures and agreements
- Servicing and collections
- Management and monitoring of third-party service providers



Interagency Guidance

- Outlines strategies for banks to minimize risks and protect customers
- Includes “Best Practices” for avoiding claims of UDAPs



Interagency Statement on Working with Mortgage Borrowers (2007)

Encourages financial institutions to engage in loss mitigation strategies with troubled borrowers



FRB Rulemaking Proposals

Truth-in Lending Act (TILA)

Revisions to Disclosure Requirements

- Early disclosures will be required for all real-estate secured loans, not just purchase money transactions
- Additional clarity will be required
- Changes may also be required related to advertisements and solicitations



FRB Rulemaking Proposals

HOEPA Changes (12/07)

Issues under review:

- Prepayment penalties
- Escrow accounts
- “Stated Income” or “Low Doc” loans
- Borrowers ability to repay
- Yield spread premiums



FRB Rulemaking Proposals

HOEPA Changes (12/07)

- Applicability: All subprime loans, not just high-cost loans currently covered under Section 32 of HOEPA
- Changes will be significant
- Expected effective date
 - Issued for comment: 12/7
 - Effective date: Possibly 1/8 or shortly thereafter



Legislative Initiatives

Overriding themes

- Regulation of non-federally regulated entities
- Borrower qualification and underwriting mandates
- Prepayment penalties
- Assignee liability
- Suitability standards
- Mortgage broker regulation and liability
- Foreclosure prevention programs



Pending Congressional Acton

“Mortgage Reform and Anti-Predatory Lending Act of 2007” (H.R. 3915)

- Requires licensing/registration of mortgage originators, brokers and bank loan officers
- Sets a minimum standard for mortgages that borrowers must have a reasonable ability to repay



Pending Congressional Acton cont'd

Mortgage Reform and Anti-Predatory Lending Act of 2007” (H.R. 3915)

- Attaches limited liability to secondary market securitizers who package and sell interest in home mortgage loans outside of these standards
- Expands consumer protections for “high-cost loans” under HOEPA



Outlook

- More legislative attention on the mortgage industry
- Focus on the supervision of non-federally regulated entities
- Continued refinancing concerns
- Retrenchment of investors and lower liquidity
- Return of discipline in underwriting and pricing
- Reduction in available products



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- QUESTIONS OR COMMENTS?



