BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

BEN S. BERNANKE
CHAIRMAN

May 18, 2007

The Honorable Christopher J. Dodd
Chairman
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you for your letter dated April 23, 2007, regarding problems in the subprime mortgage market. Specifically, your letter raises concerns about deteriorating credit standards and lending practices that may be considered abusive, deceptive, or unfair. You urge the Board to issue regulations to address these problems under authority granted in the Home Ownership and Equity Protection Act (HOEPA).

HOEPA amended the Truth in Lending Act in 1994 to provide additional protections for certain home-secured loans. HOEPA imposes disclosure requirements and restricts terms for loans exceeding specified price triggers. In 1995, the Board implemented HOEPA by amending Regulation Z.

As you note, HOEPA also states that the Board shall prohibit acts or practices in connection with mortgage loans that the Board finds to be unfair or deceptive, and also prohibit practices in connection with home refinance loans that the Board finds to be associated with abusive lending or otherwise not in the interest of the borrower. These provisions are contained in Section 129(l) of HOEPA under the heading "Discretionary Regulatory Authority" of the Board.

In 2001, the Board revised its HOEPA rules to adjust the price triggers and address abusive lending practices. At that time, the Board used its rulemaking authority under section 129(l) to prohibit certain practices that were deemed to be unfair, abusive, or not in the borrower's interest. Specifically, the Board addressed the issue of "loan flipping" by prohibiting creditors (or their assignees) from refinancing a HOEPA loan in the first 12 months with another high-cost HOEPA loan. The Board prohibited the use of "due on demand" clauses or "call" provisions in HOEPA loans because the Board found it is unfair for creditors to terminate a loan without cause and subject borrowers to unnecessary refinancing costs and possible higher rates. The Board also prohibited creditors from evading HOEPA's requirements for closed-end loans by documenting the transaction as an "open-end" line of credit when it does not qualify, because there is no expectation of repeat transactions under a reusable line.

The Board addressed other abusive practices in the 2001 revisions as well. The revisions address the practice of "packing" HOEPA loans with fees and credit insurance premiums without borrowers' knowledge or consent, by requiring additional disclosures at least three days before the loan is closed. The rules also create a presumption that creditors violate HOEPA if they engage in a pattern or practice of making HOEPA loans without verifying and documenting borrowers' income and repayment ability.

With respect to the recent problems in the subprime mortgage market, the Board plans to consider how it might further use its rulemaking authority, including the authority in section 129(l) of HOEPA, to address particular lending practices. We are mindful, however, that loan terms that may be harmful to some borrowers may provide benefits in other transactions. Accordingly, any rules should be tailored to avoid the unintended and undesirable consequence of limiting credit availability in legitimate transactions. Because borrowers can file private lawsuits to obtain remedies for violations of HOEPA rules, any new rules should also be crafted in a manner that avoids creating uncertainty regarding lender compliance.

The Board plans to hold a public hearing addressing these issues in Washington, D.C., on June 14, 2007. Through the hearing and other outreach efforts, the Board will seek the views of interested parties on how it might use its rulemaking authority to address concerns about predatory lending without discouraging responsible subprime lending.

We appreciate receiving your views on these important issues. We will give careful consideration to your concerns.

Sincerely,