Revise Home Ownership Equity Protection Act

The *Home Ownership and Equity Protection Act of 1994* restricts certain terms of high cost home loans (where the interest rate or fees are above a specified level) to protect consumers. While providing a good starting point, HOEPA's rate and fee thresholds are much too high and, even if the thresholds are met, its protections are insufficient. We recommend changes to:

1. Prohibit financing of fees for high cost loans: HOEPA should prohibit the financing of points and fees in high cost mortgage loans to protect unsophisticated homeowners from the equity-stripping effects of anti-competitive, excessive up-front fees. HOEPA provides a generous fee authorization to cover the costs a lender incurs in originating a loan. Financing fees higher than HOEPA limits either strips equity from a homeowner if they are successful in refinancing at lower rates, since these fees are due in full to the original lender upon closing the new loan, or keeps the borrower from getting out of a bad loan at any price. Lenders should price for risk in the interest rate of the loan, not through financing excessive fees. If lenders did so, borrowers could safely escape high-rate loans through refinancing with a reputable lender without losing their equity, which may have been built up over a lifetime.
2. Prohibit balloon payments: HOEPA should prohibit balloon payments for high-cost mortgage loans. Most high-cost borrowers are unsophisticated and do not clearly understand that their monthly payments in a balloon loan are not fully amortizing their mortgage loan.
3. Homeownership counseling: Recent studies suggest 30% to 50% of the sub-prime borrowers could qualify for lower-cost conventional mortgages, providing evidence that unsophisticated borrowers do not fully understand their opportunities to secure mortgage credit on favorable terms. HOEPA should therefore require homeownership counseling for high-cost mortgages.
4. Include all potential fees and charges in calculation of HOEPA trigger: HOEPA should count all prepayment penalties authorized in the loan documents to prevent unscrupulous lenders from shifting origination and other up-front fees into a back-end prepayment penalty. In addition, HOEPA should include any yield-spread premium (or service-release premium) paid by the lender to a mortgage broker. A yield-spread premium should be included since it constitutes a cost to the borrower in the form of higher interest payments than the borrower need otherwise pay.
5. No fees for refinancing: When the same lender (or an affiliate) refinances a high-cost mortgage loan with a borrower, the lender should not collect points, fees, or finance charges on the portion of the loan that was refinanced. As an example, a lender's fees should apply just to the $10,000 of new money advanced to a borrower with an existing $50,000 loan to the same lender that is refinanced into a $60,000 loan. This provision will remove the incentive to continuously "flip" borrowers into larger and larger loans.
6. Lower the fee threshold to 5%: The fee threshold should be 3%, plus two legitimate discount points (for a total of 5%) used to reduce the interest rate of the loan. Mortgage origination costs are declining throughout the industry due to technological changes and most middle-class borrowers are paying between one

and three percent fees. Lenders should price for credit risk in the interest rate, not in the up-front fees to the borrower.

7. Lower the interest rate threshold to 8% over the one-year Treasury rate: Anchoring HOEPA to a particular rate eliminates the ambiguity in determining the "comparable periods of maturity" currently in effect. For instance, the average life of a 30-year mortgage is less than ten years. It is unclear whether the comparable Treasury index is the 30-year or the 10-year index.

8. Include open-end credit transactions: With tighter HOEPA provisions, unscrupulous lenders will likely structure loans as open-end credit to take advantage of the current loophole in HOEPA.

9. Clearly authorize state regulation of predatory lending: HOEPA should state that DIDMCA[1[1]] and AMPTA[2[2]] do not pre-empt state authority to establish limitations on interest, fees, finance charges, and terms refinanced home loans. Federal law should not prevent states from protecting consumers from unscrupulous lenders.

10. No mandatory arbitration clauses in high-cost mortgages: While arbitration is a cost- and time-saving mechanism for resolving disputes, mandatory arbitration clauses are unfair in high-cost mortgage transactions given the lack of sophistication and resources of the borrower compared with the lender. These clauses often require the borrower to pay high costs to arbitrate a claim, including traveling to an out of the way location.

11. Eliminate "pattern or practice" requirement to establish HOEPA violation: The requirement that a borrower establish a "pattern or practice" of abuse unduly deters enforcement of HOEPA for borrowers who receive loans that exceed their repayment ability.

12. Increase penalties for HOEPA violations: With the significant profits available to abusive lenders, the HOEPA remedy (rescission plus $2,000) is not sufficient to deter abusive practices.

[1[1]] Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 164, Title V (March 31, 1980).

[2[2]] Alternate Mortgage Transaction Parity Act, part of Depository Institutions Act of 192, Title VIII, 12 U.S.C. §3800, Pub. L. 97-320, 96 Stat. 1469 (Oct. 15, 1982).