



ADVISORY BULLETIN 2005-AB-08

August 25, 2005

Federal Housing Finance Board Office of Supervision

To: Federal Home Loan Bank Chairs, Presidents, General Counsels, Community Investment Officers, and Internal Audit Directors, and Office of Finance Managing Director

From: Stephen M. Cross
Director
Office of Supervision

Subject: Guidance on Federal Home Loan Bank Anti-Predatory Lending Policies

Purpose:

The Federal Home Loan Bank Act (Bank Act) establishes that the primary duty of the Federal Housing Finance Board (Finance Board) is to ensure that the Federal Home Loan Banks (FHLBanks) operate in a financially safe and sound manner. Among other duties specified by the Bank Act, the Finance Board must ensure that the FHLBanks carry out their housing finance mission.¹

As Government Sponsored Enterprises (GSEs), the FHLBanks carry out their housing finance mission by serving as a source of liquidity for the nation's housing and community investment needs. Predatory lending practices that erode homeowners' equity in their homes or contribute to homeowners losing their homes are inconsistent with advancing homeownership and are incompatible with the FHLBanks' responsibility to carry out their housing finance mission in a safe and sound manner.

Each of the FHLBanks currently has anti-predatory lending guidelines or policies designed to avoid the purchase of mortgages with excessive interest rates or fees or that have illegal or predatory terms or conditions. A number of the FHLBanks also exclude predatory loans when calculating the level of advances that can be made to a member. The intent of this Advisory Bulletin is to provide uniform guidance to each of the FHLBanks concerning Finance Board assessment of FHLBank anti-predatory lending mortgage purchase and advance policies in furtherance of the FHLBanks' safe and sound operations and housing finance mission.

Background:

There is no single, comprehensive definition of predatory lending in federal, state, and local laws and regulations. Over the last several years, however, federal, state, and local jurisdictions have adopted anti-predatory lending measures to combat abusive practices in the subprime mortgage market.

In addition to these statutory responses, federal agencies have adopted restrictions aimed at curbing predatory mortgage practices by the entities that they regulate. For example, the Office of the Comptroller of the Currency (OCC) has recognized that making a residential mortgage loan without adequately considering a borrower's ability to repay represents an unsafe and unsound banking practice for a national bank and has proscribed such practice by regulation.² The OCC has also adopted guidelines raising concerns about certain potentially predatory practices that raise safety and soundness issues.³ The United States Department of Housing and Urban Development (HUD) has imposed similar restrictions on Fannie Mae and Freddie Mac by denying them credit toward their housing goals for certain high-cost loans and loans with certain terms and conditions.⁴

Federal banking regulators have stated that their monitoring and examination activities have uncovered little evidence of predatory lending in federally regulated depository institutions, which make up the majority of FHLBank members.⁵ Loans made by unregulated mortgage originators could affect the FHLBanks, however, in two ways. First, an FHLBank member may purchase mortgages from unregulated originators, and if the member has not performed adequate due diligence about the originator's operations, it could unwittingly obtain predatory loans that it later sells to an FHLBank or uses to obtain additional advances. Second, a member may obtain advances that are secured by mortgages held by an affiliate. If a member is part of a holding company structure that includes an unregulated mortgage originator, loans not subject to the scrutiny of a federal banking regulator could be used to obtain additional advances from an FHLBank.

Guidance:

Each FHLBank must have in place comprehensive anti-predatory lending policies to govern the FHLBank's purchasing of mortgages and calculating the level of advances that can be made to its members.

In developing those policies, the FHLBanks must review the predatory lending policies of other large financial institutions, including other GSEs. The FHLBanks must also review HUD's regulation on the types of loans that may be used in meeting the GSE housing goals, as well as any predatory lending guidance developed by other federal and state regulators, including their members' primary federal regulators.

To ensure that the FHLBanks do not support predatory practices, the FHLBanks' policies must preclude purchasing mortgages that violate applicable federal, state, or local predatory lending laws or including such loans when calculating the level of advances that can be made to a member. In addition, these policies must, at a minimum, address each of the following features:

- ▶ Mortgages subject to the Home Ownership and Equity Protection Act (HOEPA);⁶
- ▶ Prepaid Single-Premium Credit Life or Similar Insurance;
- ▶ Prepayment Penalties beyond the early years of the loan; and
- ▶ Mandatory Arbitration.

The Finance Board expects each FHLBank's board of directors to promptly begin a review of the FHLBank's anti-predatory lending policies and to formally adopt written anti-predatory lending mortgage purchase and advance policies that are consistent with the preceding guidance no later than December 31, 2005. Upon adoption of the policies by its board of directors, the FHLBank must provide a copy of the policies to the FHLBank's Examiner-in-Charge as well as distribute copies to each of its member institutions. The policies must also be made available to the public, such as through the FHLBank's Internet web site.

In addition, the FHLBank must require each member to certify that it is aware of the FHLBank's anti-predatory lending policies and will comply with those policies in the sale of mortgages to the FHLBank or when obtaining advances from the FHLBank. Each FHLBank must also develop written procedures and standards for verifying member compliance with its anti-predatory lending mortgage purchase and advance policies. Those procedures must pay particular attention to any loans that are otherwise not subject to review by a federal financial institution supervisory agency. Finally, each FHLBank must have agreements in place with its members to provide for replacement or indemnity for any loan or collateral that is found to be in noncompliance with the FHLBank's policies.

The Finance Board will review each FHLBank's anti-predatory lending mortgage purchase and advance policies, its member agreements, and its monitoring procedures and practices during annual examinations.

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¹ 12 U.S.C. § 1422a(a)(3).

² 12 C.F.R. § 34.3.

³ 70 Fed. Reg. 6329 (February 7, 2005) (*codified at* 12 C.F.R. part 30, Appendix C: OCC Guidelines Establishing Standards for Residential Mortgage Lending Practices). *See also* OCC Advisory Letter 2003-3 (Guidelines for Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans) (February 21, 2003); and OCC Advisory Letter 2003-2 (Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices) (February 21, 2003).

⁴ 24 C.F.R. § 81.16(c)(12), (13). HUD has also issued guidance on due diligence for purchasers of loans and loan pools. United States Department of Housing and Urban Development, *Mortgage Letter 2002-21 (Due Diligence in Acquiring Loans)* (September 26, 2002).

⁵ United States General Accounting Office: Consumer Protection: Federal and State Agencies Challenges in Combating Predatory Lending, GAO-04-280 at p.9 (January 30, 2004).

⁶ 15 U.S.C. §§ 1602(aa), 1639; 12 C.F.R. § 226.31-.34 (implementing regulations issued by the Board of Governors of the Federal Reserve System). HOEPA identifies a class of “high cost” mortgages and provides protections to consumers that obtain such loans. HOEPA applies only to refinanced mortgages and subordinated mortgages, excluding purchase money mortgages, reverse mortgages, and home equity lines of credit. HOEPA applies if, in the case of a first lien mortgage, the annual percentage rate (APR) exceeds a Treasury benchmark by more than eight percentage points and, in the case of a subordinated lien, the APR exceeds the Treasury benchmark by more than ten percentage points. HOEPA will also apply if the total points and fees payable by the consumer at or before closing exceed the larger of \$510 or eight percent of the total loan amount. (The \$510 figure is for 2005. This amount is adjusted annually by the Federal Reserve Board, based on changes in the Consumer Price Index).

An Advisory Bulletin is a staff document through which the Office of Supervision provides guidance to the Federal Home Loan Banks and the Office of Finance regarding particular supervisory issues. Although an Advisory Bulletin does not have the force of a regulation or an order, it does reflect the position of the Office of Supervision on the particular issue and as such will be followed by examination staff. If non-compliance with an Advisory Bulletin is cited as the basis for a supervisory determination, any such determination will be subject to review by the Board of Directors pursuant to the procedures of 12 C.F.R. § 907.9. Advisory Bulletins are effective upon issuance.