

TO: Walter E. Fauntroy  
FROM: John M. Balder, Jr.  
DATE: October 24, 1988

RE: Speech on Home Equity Lending

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The Home Equity Loan Consumer Protection Act of 1988 passed the Senate at 2 A.M. on Saturday morning. According to sources, the Senate acceded to the House language. I have redrafted the speech to indicate that indeed the bill has passed.

There are several additional points which might prove useful to you in the question and answer period.

First, should someone ask how the bill passed the Senate, you might respond that the bill was packaged by the Senate with the Management Interlocks Act and the Insider Trading Act, all of which were approved at the end of the session.

Second, should someone ask what the differences were between the House and Senate bills, you might respond that the House language does not exclude credit unions from the provisions of the bill--the Senate language did. In addition, the House bill requires less of the home equity lending industry in terms of disclosures than did the Senate bill.

And, finally, if someone should state that they would have preferred no bill at all, you might respond that had the House and Senate not managed to reach some sort of agreement, the Federal Reserve Board would have addressed the issue in much the same way as does the House bill.

STATEMENT OF THE HONORABLE  
WALTER E. FAUNTROY  
CONGRESSMAN FROM THE DISTRICT OF COLUMBIA  
AND MEMBER OF THE HOUSE BANKING COMMITTEE

at the

NATIONAL COUNCIL OF SAVINGS INSTITUTIONS  
1988 HOME EQUITY LENDING SEMINAR

Good afternoon, ladies and gentlemen. I appreciate being offered the opportunity to speak before you today concerning H.R. 3011, the Home Equity Loan Consumer Protection Act of 1988. As you all must know, the Act was first introduced by my colleague, Congressman David Price of North Carolina. The House of Representatives passed H.R. 3011 in June of this year, though action by the Senate awaited the end of the session last week.

Senate passage of H.R. 3011 did not occur until the end of the session. In fact, the Senate agreed to accept the House language at 2 A.M. on Saturday, October 22nd, about one hour before the end of the 100th Congress. The bill is expected to be signed into law by the President.

A BRIEF HISTORY

Today, I would like to discuss with you why I believe the benefits this legislation will provide to consumers far outweigh the additional compliance that will be required of lenders.

Home equity lines of credit have become one of the most attractive financial products of this decade -- for both lenders and consumers. In fact, home equity lending has become a \$100 billion business and is still growing.

The news media has given home equity loans a lot of attention since the passage of the 1986 Tax Reform Act. This tax law phases out interest deductibility for all unsecured consumer credit, though it did not eliminate the deduction on interest incurred on debt secured by a taxpayer's home. This has been a tremendous benefit for the home equity lending industry, as I think all will agree.

Thus, the restrictions of the tax act are encouraging consumers to finance purchases with the equity built up in their homes. Home equity lines have a lot of benefits for consumers. They allow borrowers to consolidate debt, receive lower interest rates than with unsecured debt, and provide easy access to funds through the use of checks or credit cards.

At the same time, these products also have their pitfalls. Some home equity loans have balloon payments that require a borrower to pay off all of the outstanding balance at the end of the loan period. Some loans have low promotional rates that soar after a short period. A borrower who is not familiar with these features could be in for an unpleasant surprise.

Adding to Congress's concerns about these loans is the overly aggressive advertising and sometimes less than scrupulous lending practices we have all seen. In order to guide and protect consumers through this confusion, the Congress considered and has now passed the "Home Equity Loan Consumer Protection Act of 1988."



H.R. 3011

It is important to note that this legislation received bipartisan support both within the Banking Committee and within the House of Representatives. Consumer advocacy groups and the financial industry groups worked together to achieve a fair balance. This legislation represents a compromise between various interests.

Before I try to persuade you to see my point of view, let's take a brief look at what the legislation attempts to accomplish. Essentially, the bill is comprised of three parts.

First, it requires DISCLOSURE of all the essential features of a particular home equity loan product upon application by a consumer.

Second, the bill assures that home equity advertisements do NOT MISLEAD when they promote key features.

Third, the bill attempts to STOP ABUSIVE LENDING PRACTICES.

Today's consumers are more sophisticated in their knowledge of financial products than ever before. They understand the mechanics of adjustable rate first mortgages, credit cards, and revolving lines of credit.

However, many consumers lack knowledge about home equity loans. These products are new to the majority of the public. They are unstandardized and complex -- a combination that can confuse a typical consumer.



The purchase of a home is the most important investment made by most people. For this reason, any loan agreement that might jeopardize the ownership of one's home should be thoroughly understood and assessed by the consumer.

The best way to ensure that the consumer makes an educated financial decision is to provide the decisionmaker with good educational tools. The legislation introduced by the Banking Committee provides the best tools -- clear and understandable disclosures.

Most importantly, the disclosures inform the consumer that the home serves as security for the loan and that in the event of default the consumer could risk losing it.

This legislation also shows borrowers how their interest rates are calculated. It describes when borrowers can draw down funds and when repayment of principal must occur.

In the case of interest only loans, it will alert a borrower whether the principal amount can be amortized at the end of the draw-down period, or whether a balloon payment will be required.

Lenders will disclose an estimate or range of fees charged by the lender to open or maintain the account.

Timing is equally crucial to ensure consumer awareness. For this reason, the legislation requires that a lender disclose the key features of the home equity loan when he or she applies.

Advance disclosures give consumers a chance to evaluate whether they can afford the home equity product before a non-refundable fee is paid. This new timing also permits consumers to shop for features best suited to their individual needs.

Because the large majority of home equity loans have variable rates, Congress included three particular disclosures designed to alleviate "payment shock" during periods when interest rates rise.

First, the lender must state whether there is an annual cap and also state what the lifetime cap is.

Second, to help illustrate the effects of changing interest rates on the minimum monthly payments, the legislation calls for an example based on a hypothetical home equity loan with \$10,000 outstanding. The example uses a history of index values based on the past 15 years. This table shows how the index movement caused interest rates to rise or fall and how minimum monthly payments were affected by these fluctuations.

Third, the 15-year historical example would also show how minimum monthly payments would change should the bank refuse to advance additional funds.

We have all seen advertisements which are overly self-promotional. They tote very low teaser rates or use terms such as "free money." Although advertisements are meant to entice, they should not mislead. For this reason, Congress has added provisions to ensure that advertisements give consumers a complete picture.

With this legislation, an advertisement cannot only promote low introductory interest rates. It must give equal prominence to the interest rate that would have been charged if the promotional rate was not offered. This gives consumers a better idea of what the interest rate would be like after the teaser rate offer expires.

I can understand that you, as lenders, might have your misgivings about legislation that requires additional compliance burdens and imposes restrictions on certain contractual practices. I share your concern for maintaining adequate rights to guarantee your security interest.

But I can assure you that this legislation reflects your needs as well as those of the consumers.

Let me point out some substantive provisions of the legislation that I am sure will be of particular interest to you. The provisions are aimed at stopping abusive lender practices without damaging the lender's ability to protect his security interest.

One provision prohibits lenders from unilaterally changing the terms and conditions of the loan. By contrast, under current law, home equity contracts are permitted to contain clauses that give lenders the right to change one or all of the terms of a home equity loan. Even key terms can be changed, such as the index used to calculate the interest rate or the repayment terms.



Congress recognizes the potential for abuse and wants to ensure that these practices do not continue. But, I understand that you as lenders need to protect your security interest. For this reason, we've included some exceptions to the "no change in terms" provision.

For instance, if the value of the securing property declines, a lender can freeze the funds or reduce the credit line.

Likewise, a lender can prohibit additional extensions of credit or reduce the credit line if the borrower's credit standing changes or if the borrower is in default.

Finally, lenders do not have to make funds available if government action jeopardizes the lender's lien priority or precludes the lender from imposing the maximum lifetime cap stated in the contract.

Another substantive provision of this legislation sets ground rules for calling a loan due before the loan period expires. Only cases of fraud, delinquency, and threat to the lender's security interest are considered acceptable reasons for accelerating repayment.

This provision was borne out of concern that financial institutions would find it attractive to accelerate repayment of the outstanding balance if the interest rate exceeds the loan's lifetime cap.

One more major provision prohibits a lender from using an index that an institution generates internally. Although studies indicate that most lenders use the prime rate as their index, there are some lenders who make interest rate adjustments based on the discretion of their board.

Congress's intention is not to penalize all home equity lenders, but to curb the abuses that have occurred in the marketplace.

Congress believes that home equity loans are useful consumer products. We certainly do not want our actions to cause home equity loans to vanish. Congress did not agree, for example, to cap interest rates on these loans, and the House version of the bill slims down the amount of disclosures required of institutions making these loans. We do not want to impose rules so restrictive as to make them unattractive to consumers and inflexible for lenders.

We simply believe that a balance should be struck. In the long run, I am sure this legislation will benefit everyone.