

QuestSoft

March 11, 2002

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

RE: Docket No. R-1120, Regulation C (Home Mortgage Disclosure Act)

Dear Ms. Johnson and Board:

This letter is in response to your request for comment on proposed rule changes to the Home Mortgage Disclosure Act (Regulation C). Our comments specifically address the three areas requested by the Board of Governors (Board) along with some additional comments on our concerns as software developers over technical implementation issues that we would like to see addressed by the Board over the next several months.

QuestSoft is a compliance services firm that specializes in HMDA compliance and geocoding services. Our main product, HMDA RELIEF™, is used to process and submit a substantial number of the total transactions received by the Federal Reserve annually. We are responsible for the successful geocoding of about 2 million HMDA records annually. We work with over 40 loan origination software firms regarding HMDA issues and are committed to a very strong educational program this summer to ensure that the new regulations proposed are implemented as accurately as possible on January 1, 2003. Essentially, the Board through its software, QuestSoft and PCi Services will probably account for about 90-95% of all submissions that will be made next year.

I have often found that things that one would think are simple in programming are often difficult. Conversely, the reverse that things that seem difficult are often very easy to program. Therefore, since our company ultimately must conform our software designs to your rules, we are going attempt to concentrate more on these technical issues and focus a little less on the political issues that usually surround decisions.

REQUESTED AREAS OF COMMENT

The Board specifically requested comment on the following areas:

1. Thresholds for Reporting Loan Pricing Data

Contrary to what you may receive from others, we actually believe that the Board came to a fairly reasonable compromise for reporting pricing data. We have always been against the reporting of all APR's because what is to say that a 12% APR at the end of 2003 wouldn't be a good A+ loan even if 7% is an A+ loan today? APR's are relative and in general often misrepresent the actual scenario of the loan, especially on ARM loans in times where indexes are relatively low as is the current case.

However, we also know that the FRB has insisted for the last several years that APR be included. The field is also required for fair lending examinations so its inclusion at this time is not the technical challenge it was last year when a number of loan origination systems had not begun to save that data in their borrower records.

Our main comment here would be to plead above all for the use of a single index for triggers for any regulatory event surrounded with special disclosures. This will make programming and updates of information far easier. We note that the Board has proposed using the Treasury Securities index. If this will be used with HOEPA, Reg Z, Reg C, TILA, etc. then loan origination software products will be able to more easily program and maintain their software.

Whether the Board should consider higher thresholds we will generally leave to other commenters. From personal experience with the lending industry, I do feel that the thresholds of 3% and 5% are low and are probably going to create some sort of litmus test for subprime lending. This may result in the unintended consequences of lowering access to credit by borrowers with less desirable credit histories. Essentially, the Board as of today is probably limiting first trust deeds to about 8.25% APR and seconds to 10.25% APR at current rates. Given the change in FRB monetary policy this month, suddenly mortgage rates are rising and I am now hearing rates of 8% with no points advertised as “A paper” loans.

This sudden minor change in the market in itself suggests that the Board may have set these thresholds too low. It just seems reasonable to us that lenders that provide funds to borrowers with special credit needs and especially second trust deed lenders will be hard pressed to justify these threshold rates and their reporting may automatically classify them by the watchdog groups as “predatory lenders”.

In terms of price thresholds for determining the loans for which institutions must report loan pricing data, any established threshold would have to take into consideration the difference between first and subordinate liens to order to allow for proper interpretation of loan pricing data. Notwithstanding the need for this loan pricing and lien status information, examiners and enforcement agencies will still need to closely review other relevant information (e.g., loan amount, fixed or variable interest rate, loan-to-value, credit score, debt-to-income, etc.) pertaining to each loan originated with a spread that exceeds an established threshold. Failure to review other relevant information would not result in a fair and accurate description of an institution’s lending pattern. To this extent, we agree with the general concerns that the MBA has voiced.

QuestSoft sees no problems in the technical implementation of this new requirement for either us or for loan origination software products. Many of these products still calculate APR’s yet do not save them. However, they have known about this issue for some time and with changes to the URLA and new codes for race and other fields, we would expect them to code features to save APR’s at the same time. We intend to advise these vendors on ways they can make implementation of this rule easy for their customers.

2. Reporting of Lien Status

The reporting of Lien Status **MUST BE INCLUDED** or there will be no way to implement automated methods of complying with the Loan Pricing provision. In addition, as you have pointed out on Page 11 of your final rule, home improvement lending data will be more useful with knowing the lien status.

The Board commented on page 18 of the final rule that it felt that pricing data would be “more useful” with the reporting of lien status. We are here to state emphatically that unless lien status is included, there will be no way to accurately calculate some of the new requirements of your proposed rule changes.

The Board also questioned whether to require lien status on purchased loans. From a purely technical view, it is always better to program systems if the rule is consistent across the board. Therefore, what you consider as an additional burden may actually be more of a burden to exclude. Our recommendation would be to include lien status here also.

3. Requesting Applicant Information in Telephone Applications

I believe that the reason that the rise from 8% to 28% in the number of loan applications with missing race/sex data is the result of many factors. In talking with my customers, many fear reprisals from their regulators and community organizations if they actively seek this data. Some lenders have taken the position that if they don’t ask, they can’t be accused of making or denying loans on a racially biased basis. Others just simply feel it gets in the way of the goal of the conversation, which is securing a loan for the borrower.

I also feel there is a potential for increased legal activity to the lender by simply asking the question. In addition, there may be added suspicion on behalf of the borrower if they are denied a loan. Inquiries about an individual’s ethnicity and multi-race categories may be met with some resistance and confusion over the telephone. After all, if you ask for a name, address, social security number, and race and then deny the loan, how much of the credit decision do you think the minority borrower is going to place on the fact that their credit score was a 610 and the lender required 620 or higher? It is more likely that they will accuse the lender of race discrimination. Therefore, the question becomes how far will the FRB and the U.S. Government go to protect legitimate lenders from the legal ramifications of asking the question? I doubt if much protection will be given.

Therefore, though technically speaking this is not a problem, we are not in favor of conforming the telephone application rule to the rule applicable to mail and internet applications. It may be more confusing to applicants to respond to questions concerning multiple race designations over the telephone as part of the loan application process without first referring to a document that lists the multi-race designations and the government monitoring disclosure statement.

OTHER AREAS OF COMMENT

In addition to the Board’s requests, we would like to comment on some areas we feel the Board should consider in this and future implementations.

A. GSE Coordination Regarding Required Reg C Form Changes

The substantial changes in the race and sex code provisions to conform to new OMB guidelines will mandate changes to the Universal Residential Loan Application (URLA – FNMA Form 1003). Since form changes are normally provided six months prior to their required implementation to accommodate form vendors, this means that changes will need to be provided to vendors no later than July 1. This leaves two months for the Board to coordinate with FannieMae and FreddieMac regarding the first major form change in several years.

B. An Official FRB/FFIEC Interpretation on Transition Procedures

There is **substantial concern** in the loan origination software community regarding implementation of these new changes. There are many new codes along with changes in the current codes. Of primary concern is how to handle loans originated in 2002 with the current race, sex and other codes yet finalized in 2003. In general, I assume that respondents will use the codes in place as of the action date rather than application date. However, a written clarification of the transition procedures is needed immediately.

The FRB or FFIEC also need to provide guidance on how to handle issues dealing with "Other" race (eliminated under the new rules) along with the fact that we are transitioning from one race to a potential of 5 race codes per borrower. Again, these transition period clarifications need to be provided by early July to ensure they are coded into loan origination systems accurately. If other is used under current codes, what should it be coded as under the new rules?

Finally, we are concerned with ramifications of the elimination of "other" as a race code. Some guidance would be helpful on how to code people of Middle Eastern cultures who disdain in many cases being labeled "white". We also feel this may result in more instances where the borrower refuses to make a selection.

C. Increased Fairness in Application of HMDA Regulations

In Year 2000, 381 lenders submitted HMDA reports with a total record count of 10 or less loans. A total of 2,871 lenders submitted reports of 100 records or less. This is at the same time that mortgage companies with 10,000 predatory loans totally avoid any HMDA reporting because the loans are used for second trust deed lending without any home improvement purposes and not used to replace an existing loan.

The result is that Congress in its infinite wisdom then dumps on HUD who says they can't track these lenders. This infuriates Congress and then gets the AARP lobbying for laws that force good lenders to again spend inordinate amounts of time complying with new state laws. In an attempt to quickly identify these "bad lenders" auditors get special priced fair lending analysis software so they can ask lenders to provide 14 more fields of information for fair lending. Good lenders comply and the problem still perpetuates.

I believe there are a significant number of HMDA submitters out there that feel the system is inherently unfair. Their animosity toward the regulation has grown as they have continued to see inequities in enforcement of non-depository lenders. Your proposal to eliminate the loophole by including a new \$25 million test is a definite step in the right direction.

HUD must be provided with more regulatory authority than just to have field auditors that merely check to see if there is the first and last page of a HMDA report. HUD has made attempts by announcing bold proposals to fine companies \$1 million or more for non-compliance but it is probably unenforceable, would be tied up in years of legal action, and has yet to be used. For the most part, States have decided to use their banking commissioners and corporations departments to provide better enforcement. This has resulted in the proliferation of predatory lender laws in cities. Why? Because HUD has no real authority aside from stripping a lender of its FHA lending authority. Big Deal! Predatory Lenders don't use FHA as their funding source so there is nothing to take away. There is no real penalty for non-compliance for the worst of the worst.

CitiFinancial just announced that it was removing over 70% of the approved brokers of the former Associates housing division. Brokers now account for over 80% of the originations and control to a great extent how the lending game is played. Doesn't this even begin to give regulators and Congress a hint of where possible discrimination and usury practices might exist today?

We and the vast majority of lending institutions all desire for the good guys to win and for credit to be available to all classes of borrowers in accordance to reasonable risk. We also desire for the regulatory burden necessary for regulators to sort out the "wheat from the chaff" be significantly reduced so that lenders can efficiently compete, earn an honorable profit for their shareholders and ultimately reduce the cost of loans to borrowers. I also believe that the industry is becoming very tired of seeing the good lenders constantly being asked to pay the price of increased regulation while watching primarily non-depository companies that refuse to play by the rules go unpunished.

We would propose that FRB and Congress consider the elimination of the reporting requirements for small volume lenders (100 loans or less) and free up its resources to concentrate on requiring the reporting of loan types that more accurately represent the market today rather than the way it was years ago when HMDA was first enacted. Maybe states wouldn't be passing all of these confusing laws if HUD had the authority and acted on it five years ago when the issue first arose.

D. Eliminate the HMDA "Bait and Hide".

We have seen a new popular practice emerge in the non-depository side with companies that act as both lenders and brokers simultaneously. Under the scenario, a lender will report a loan as HMDA if it is an A paper loan that they fund. However, on any loans that they probably would deny, they broker the loan to a third party and receive a denial. The result is that they appear to be a shining example of a community based lender having 100% funding rates. Again, we believe this creates increased animosity among banks and credit unions. We hope that in future years, the Board will consider comment on how to address the issue in this changed lending environment.

Thank you for consideration of our comments.

Sincerely,

Leonard Ryan
President
QuestSoft