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SPECIAL REPORT JULY 2, 2007

2007 Special Report: Banking Issues

Fed Pressured to Address Subprime ARMs

The woes in the subprime mortgage lending market have prompted lawmakers on Capitol Hill to pressure federal banking regulators to do something to address the issue. The Federal Reserve Board says it will do something – though the board's governors say they don't quite know what they'll do yet.

At a June 13 hearing of the House Financial Services Committee, Chairman Barney Frank, D-Mass., threatened to take away the Federal Reserve's authority to write consumer-protection rules, telling Fed governor Randall Kroszner the board must "use it or lose it."

"If the Fed doesn't start to use that authority to roll out the rules, then we'll give it to somebody who will," Frank told Kroszner.

A day later, at a public Fed hearing, Kroszner said the agency would "seriously consider" tougher lending rules, but that it also must make sure that any new guidance does not restrict legitimate access to credit.

"We must walk a fine line," Kroszner said. "We must determine how we can help to weed out abuses while also preserving incentives for responsible lenders. A robust and responsible subprime mortgage market benefits consumers by allowing borrowers with blemished or limited credit histories to become homeowners, access the equity in their homes, or have the flexibility to refinance their loans as needed."

Kroszner said the Fed would consider "regulations that restrict or prohibit practices that are unfair or deceptive" and seek information from state officials about their own laws and rules dealing with predatory lending.

The congressional pressure comes as the fallout from subprime borrowing continues to have effects, even after the country's largest subprime mortgage lender, New Century Financial Corp., went bankrupt and lenders have tightened their lending standards. The number of homeowners facing foreclosure

This report was written by Chris Grier, Washington correspondent.

Marriner S. Eccles Federal Reserve Board Building, Washington, D.C. Courtesy Federal Reserve Board

due to late mortgage payments hit a new record, the Mortgage Bankers Association said on June 14. Subprime loans entering foreclosure reached a five-year high of 2.43%, up from 2% in the previous quarter, while prime loan foreclosures hit a record 0.25%, up from 0.24% in the prior three months.

Frank, Senate Banking Chairman Chris Dodd, D-Conn., and others in Congress have been stepping up public pressure on the Fed over consumer-protection issues. Dodd said earlier this month he wants the Fed to write tougher regulations to curb abusive mortgage-lending practices, and that the Fed in fact has a duty to do so under the law.

At the same time, Rep. Carolyn Maloney, D-N.Y., also a member of the House Financial Services Committee, questioned whether there is still a "meaningful role…left for state regulators" in the wake of Watters vs. Wachovia, the U.S. Supreme Court decision that upheld federal pre-emption of state banking laws. At the Frank-chaired hearing on June 13, Maloney said the recent decision by the high court to side with the federal Office of the Comptroller of the Currency versus Michigan's Office of Insurance & Financial Services marked a watershed moment in the country's regulation of banking, which has been shared since 1863 between the states and the federal government.

"It may be correct, as the OCC says, that the Watters decision changed the law very little if at all," Maloney said. "But in legal history books, I believe, it will be seen as marking the end of one era and the beginning of the next. I hesitate to announce the impending death of the dual banking system, but I wonder what meaningful role is left for state regulators." Maloney said elected officials are often most responsive to consumer complaints, yet she acknowledged that "in today's global market, we may no longer be able to afford the luxury of having the most banking regulators in the world. Uniformity may be an advantage we can no longer afford to do without."

A.M. Best Co.

Special Report

July 2, 2007

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