Rethinking Banking Regulations for the 21st Century

By Tim Schofer, Principal

Many of today's banking regulations came into being since the 1970's. During this time, they've been patched and bandaged but it's not enough. What we really need to do is start over again, from scratch. If we were building a banking system today, what would some of our consumer regulations look like?

Regulatory Agencies

Prior to deregulation of the financial industry in the 1970s and 1980s, there was some justification for separate supervision of banks, thrifts, and credit unions. But in the 21st century, do we still need five separate Federal agencies, which together have now developed another hierarchy, the FFIEC?

Let's start by streamlining the redundancy in the agencies that supervise our banking system. Currently, we have the OCC, FDIC, FRB, OTS, and NCUA overseeing an industry that has become almost homogenous in the past 30 years. Bankers (and taxpayers) would be better serviced by one consolidated agency.

Regulation C – Home Mortgage Disclosure Act (HMDA)

HMDA should be repealed in its entirety and not replaced. The only remaining purpose for this regulation is to have thousands of lenders spend countless hours compiling and recording *only certain data* for *only certain types of loans*, transmit this data to the Banking regulator, who in turn summarizes this data and sorts it into 26 different formats, then sends it back to the institution where it needs to be placed in a specific file, just in case anyone ever asks for it. Ask ANY banker how many requests they've had for this data, and you'll understand the futility of this exercise.

For any examiners or community groups still willing to argue the value of HMDA, just answer the question why the regulation is only concerned with home mortgage loan data and not other types of lending.

Regulation Z – Truth-in-Lending Act

The purpose of the Truth-in-Lending Act is to promote the informed use of consumer credit by requiring disclosures about its terms and cost. But is this, in fact, what the law currently promotes? With its multiple amendments, the law today only serves to make borrowing more confusing to consumers and compliance more difficult for bankers. Not to mention the inconsistencies; for example, that interest rates need not be disclosed on closed-end loans.

Wholesale reform would begin by eliminating the concepts of "residential mortgage transaction," "APR," and "finance charge." The fact that lenders can impose certain non-finance charge fees to avoid affecting the APR illustrates how useless the APR really is in measuring the true cost of credit for the consumer.

Instead of the current right of rescission process, consumers could be given notice at the time of application that they have three calendar days from the date of application to change their minds and cancel the application. Rescission after settlement would no longer apply.

Section 32 (HOEPA) should be eliminated. Most of the problems addressed by this section apply to the mortgage banking industry and not

© 2007 S.R. Snodgrass, A.C.

to regulated banks. Moreover, the disclosures have not been effective in protecting consumers from the risks addressed. Predatory lenders can be dealt with in more effective ways without imposing burdens on the vast majority of lenders that don't do this type of lending.

Other recommended changes:

- Negative amortization will not be permitted.
- Allowable interest calculation methods could only be an actual/actual or 30/360 method.
- Streamline disclosure language, as outlined below. This would provide consumers with all the information they need and permit them to easily compare terms from one lender to another.

SAMPLE DISCLOSURE LANGUAGE

You are borrowing **$100,00**0 at an interest rate of **7.55%**, to be repaid in 180 monthly installments of **$929.86** beginning June 1, 2007. You will be required to pay certain fees totaling **$1,344.00** in connection with this loan as itemized on the attached schedule.

You selected a loan with a variable interest rate; the interest rate may change annually by no more than 2.00 percentage points, and will never increase by more than 5.00 percentage points. Annual increases are based on the XYZ index, to which we add a 1.25% margin. At the first adjustment your payment could increase to **$988.12**; at the maximum rate your payment would be **$1,091.04**.

You may prepay this loan at any time without penalty. Your loan cannot be assumed by anyone else without our consent.

Regulation B – Equal Credit Opportunity Act
The purpose of this regulation is to promote the availability of credit to all creditworthy applicants without regard to race, color, religion, national origin, sex, marital status, or age. The regulation also requires creditors to collect information about the applicant's race and other personal characteristics in applications for certain dwelling-related loans. While well-meaning, the regulation imposes enormous record-keeping burdens on lenders. These burdens are inconsistent and apply only to certain loan types.

We should either eliminate the requirement altogether, or we should be consistent and require the same data-gathering for every loan made by every bank. If examiners need to review this lending data, then it should include data on *all* loans made by the bank.

Regulation X – Real Estate Settlement Procedures Act (RESPA)
A prime candidate for reform should be the disclosure requirements of RESPA. These regulations were aimed at the mortgage banking industry, which is only lightly regulated. But somehow the heavily regulated banking industry got caught up in HUD's effort to police the abuses of a few.

Requirements for disclosing the Good Faith Estimate, HUD-1, Required Providers of Settlement Services, should be re-examined with a focus on producing concise and meaningful disclosures. At a recent real estate loan settlement, the borrower left with over 200 pages of information and disclosures. It is doubtful that most consumers read or value the required settlement disclosures provided.
We should also revisit Section 8 prohibitions against kickbacks and unearned fees and also

Affiliated Business Arrangements. Many banks are forming lending subsidiaries and title insurance affiliates. These regulations make doing so more difficult. Again, these restrictions were designed to address abuses in the mortgage banking industry and should be eased for regulated banks. ♦

About the Author

Tim Schofer is a Principal at S.R. Snodgrass, A.C., an expert auditing and financial consulting firm in Pennsylviania. The certified professionals at Snodgrass provide a diverse menu of financial services primarily structured along five distinct business lines: Auditing; Consulting; Internal Audit and Regulatory Compliance; Tax Preparation and Planning; and Technology Services.

© 2007 S.R. Snodgrass, A.C.