Reining in bad lenders

by The Milwaukee Journal Sentinel

The Federal Reserve took unprecedented action Tuesday to curb predatory lending in the subprime mortgage market as a coming wave of foreclosures threatens the nation's economy. The action was an important first step toward cleaning up the excesses of the past two years.

Congressional Democrats immediately criticized the proposals as too little, too late. And they have a point. But moving tougher regulation through Congress may be a tall order in the coming months. It's important to act now.

The Fed would require lenders to consider the ability of borrowers to repay loans and to verify borrowers' income or assets. Borrowers would be required to maintain an escrow account for taxes and insurance for at least a year. The rules do not ban "yield-spread premiums" - fees lenders pay to brokers - but those fees would be limited and harder to hide. Borrowers would have to approve all fees in writing.

The Fed should get tougher in several areas. For one thing, prepayment penalties should be banned for all subprime loans. Under the Fed proposal, prepayment penalties would still be allowed until 60 days before a loan resets to a higher rate. The proposed rules also give lenders too much wiggle room in determining income. There should be no such loopholes. And the Fed should require a one-page summary of loan terms in plain English.

Some bankers worry that the rules might elbow credit-worthy borrowers out of the market. Perhaps. But a pullback in lending was inevitable once the subprime bubble burst. The sad part is that low-income borrowers, including many minorities, may be shut out of the housing market for years. But lenders do no favors when they loan money to people who cannot repay it. Common sense was a casualty of the loose lending standards fueled by mortgage-backed securities.

The Fed actions are overdue. Former Fed Chairman Alan Greenspan always claimed his hands were tied, but he had the power to step in and should have. His successor, Ben Bernanke, should have reacted sooner once it became clear that the subprime market was melting down. Consumer protection for homeowners should be consolidated under one federal agency, and that probably shouldn't be the Fed. But the Fed's new rules do represent a solid middle ground that may be difficult to stake out in the bitterly divided halls of Congress. It's a start.

Reprinted from The Milwaukee Journal Sentinel â€“ CNS.

Reining in bad lenders by The Milwaukee Journal Sentinel