H.R. 1728, THE MORTGAGE REFORM AND ANTI–PREDATORY LENDING ACT OF 2009

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

APRIL 23, 2009

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H.R. 1728, THE MORTGAGE REFORM AND ANTI–PREDATORY LENDING ACT OF 2009

Thursday, April 23, 2009

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:04 a.m., in room 2128, Rayburn House Office Building, Hon. Melvin L. Watt presiding.

Members present: Representatives Frank, Kanjorski, Waters, Maloney, Gutierrez, Velazquez, Watt, Ackerman, Sherman, Meeks, Moore of Kansas, Capuano, Clay, McCarthy of New York, Baca, Lynch, Miller of North Carolina, Green, Cleaver, Bean, Moore of Wisconsin, Hodes, Ellison, Klein, Wilson, Perlmutter, Donnelly, Foster, Carson, Speier, Childers, Minnick, Adler, Kilroy, Driehaus, Kosmas, Grayson, Himes, Peters, Maffei; Bachus, Castle, Royce, Manzullo, Biggert, Miller of California, Capito, Hensarling, Garrett, Neugebauer, McHenry, Bachmann, Marchant, Posey, Lee, Paulsen, and Lance.

Mr. WATT. [presiding] Good morning, everybody. This hearing of the full Committee on Financial Services will come to order. Let me first extend the apologies of the chairman, Barney Frank, who had to be on the Senate side this morning to testify at a confirmation hearing and asked me to preside over today's activities until he returns. We have three panels, so it's going to be a fairly long day, and I should advise members that, as Barney would do if he were here, I will try to be pretty strict on the time. So if you have a question that you want an answer to, please ask it far enough in advance of the expiration of the time to allow for the witnesses to answer. Otherwise, we'll have to move on, because the committee is so big and we have three panels, and we want to cover all of the territory today, and a lot of people I think will be perhaps leaving to go back to their districts.

As is the rule, the opening statements will be divided into 10 minutes on each side, and without objection, all members' opening statements will be made a part of the record. So anyone who wants to submit a statement for the record is entitled to do that.

I will recognize myself for 2 minutes for an opening statement just to welcome the witnesses on this panel and subsequent panels to make it clear that today's hearing is about H.R. 1728, the Mortgage Reform and Anti-Predatory Lending Act, which Representative Miller of North Carolina, Representative Watt of North Carolina, Representative Frank, and a number of other members are cosponsors of; we are aware that the bill that has been introduced is out there and subject to comment, and we are aggressively listening to comments about various aspects of this bill and trying to take those comments into account to reach a product that protects consumers and the public, protects the economy from future meltdowns of the kind that we have experienced, and does not dry up credit in the process.

Those are our three primary objectives here, and sometimes those things may be in conflict with each other, and drawing language that walks that delicate balance and accomplishes all three of those objectives is inordinately difficult. So the testimony and assistance of people who will be testifying today we consider immensely important and want to give reasonable assurance that every piece of input will be taken into account.

My time has expired, and I will now recognize Mr. Hensarling for 2½ minutes.

Mr. HENSARLING. Thank you, Mr. Chairman. I appreciate this hearing being held. It is a very serious subject, but unfortunately, the bill is rather disappointing. Clearly, there were a number of causes of the economic turmoil that our Nation finds itself in today, but none loom larger than Federal regulation and Federal legislation surrounding Fannie Mae and Freddie Mac. Now the government gave them monopoly powers. The government enabled them to make monopoly profits. The government told them to finance loans to people who ultimately could not afford to pay them back. The dice were rolled and the American taxpayer lost.

Note the title of this bill is the Mortgage Reform and Anti-Predatory Lending Act. There can be no clear mortgage reform without reform of Fannie and Freddie. And for those who say that this has already been accomplished, well, when Fannie and Freddie have been effectively nationalized, when their market share for new mortgages has gone from roughly 50 percent to 90 percent, when the taxpayer is on the hook for hundreds of billions of dollars, I think not.

With respect to the second half of the title, Anti-Predatory Lending, well, the bill is almost completely silent as to predatory borrowing. We know that FINCEN has stated that mortgage fraud has increased over 1,400 percent in the last decade, and the majority of that fraud was tied to borrowers who lied about their income, their assets, their occupancy. Ninety-nine percent of this bill deals with the duties, responsibilities and liabilities of lenders. We do need to reform that. But it is almost silent as to the duties of the borrower. It essentially says if you're caught defrauding the lender, well, you can't sue him. That is the extent on dealing with predatory borrowing.

Also, I question, in the middle of a national credit crisis, not unlike what we did yesterday when people are struggling to refinance their homes, why, why would we want to make credit more expensive and less accessible? What is the national policy here?

And finally, I must admit after a lot of wailing and gnashing of teeth in yesterday's mark-up regarding a requested study by the Federal Reserve of the impact of that legislation, lo and behold, we find a commission, a study commission by the GAO to report to us on the impact of this bill on availability and affordability of credit. Now which is it?

With that, Mr. Chairman, I yield back the balance of my time.

Mr. WATT. The gentleman from Pennsylvania, Mr. Kanjorski, is recognized for 3 minutes.

Mr. KANJORSKI. Thank you, Mr. Chairman. Mr. Chairman, as we begin today's hearing, I want to discuss several issues concerning H.R. 1728, the Mortgage Reform and Anti-Predatory Lending Act, which I helped to write and to introduce.

First, I have heard suggestions from some that the skin in the game requirements found in the bill constitute a war on securitization. Such thinking is entirely wrong. At a hearing in September 2007, I cited the fact that few players had any real skin in the game helped to contribute to the implosion of our financial markets. If they had contained some risk in the game, I believe that they would have made better decisions. Since then, others have joined my thinking. So the skin in the game provisions of H.R. 1728 are about prudent underwriting, not about ending securitization, as some have maintained.

This issue, however, is a difficult one. Like Chairman Frank, I admit that the 5 percent retention requirement now in the bill needs some work. Rather than hearing more complaints about it, we need suggestions to perfect it. I hope that our witnesses will do just that.

Second, I have focused my attention in recent weeks on the bill's considerable mortgage servicing and appraisal provisions, which I wrote and added to the legislation during our debate on the Floor in November of 2007. Much has happened in these fields since then, including the adoption of new rules by the Federal Reserve on escrowing, credit payments and appraisal independence, as well as the appraisal reform agreements of New York Attorney General Andrew Cuomo with Fannie Mae and Freddie Mac. In moving forward, we should codify much of their good work, and we must also take bolder steps to provide greater protections for consumers and improve industry responsibility.

As such, I am preparing a comprehensive amendment that will, among other things, provide all subprime borrowers with access to a written appraisal, improve independent standards so appraisers can operate as honest referees, free of interference, and enhance confidence in the results produced by automated valuation models.

We must also further augment the powers of the appraisal subcommittee to monitor and assist State appraiser agencies. Moreover, we must establish oversight for appraisal management companies. They now touch 64 percent of written appraisals, but they are subject to little supervision.

Going forward, we cannot allow anyone to play in the dark corners of our markets. We must ensure that everyone who operates in our financial system is subject to appropriate oversight, whether they are a hedge fund, a credit rating agency or an appraisal management company.

Before closing, Mr. Chairman, I ask unanimous consent to submit into the record a letter from the Title Appraiser Vendor Management Association that makes some observations about the regulation of appraisal management companies.

Mr. WATT. Without objection, that will be admitted. And as the chairman indicated yesterday, virtually anything that anybody wants to put in the record will be admitted without objection. The gentleman yields back, and the gentlelady from West Virginia, Mrs. Capito, is recognized for 2½ minutes.

Mrs. CAPITO. Thank you, Mr. Chairman. I would like to thank you for calling this hearing today. Almost 2 years ago, I worked with Chairman Frank, Ranking Member Bachus, and many Members on both sides of the aisle on a bipartisan compromise to address the challenges posed in the housing market by subprime mortgages. At that time, many Americans were facing mortgage resets on adjustable rate mortgages, resulting in higher payments that would be beyond their abilities to pay.

The housing market continues to struggle, however. I do have concerns that this legislation before us could potentially do harm, do greater harm to a housing market that is already unstable. Any action this body takes should be to encourage positive growth and strength in the mortgage markets.

I do have some specific concerns. First, H.R. 1728 effectively relegates any home loan which is not a 30-year fixed-rate mortgage into the category of a subprime mortgage. Even loans backed by the FHA, Veterans Affairs, and the Rural Housing Service would be considered subprime and assumed to be predatory if they do not conform to the narrow definition of a qualified mortgage set forth in H.R. 1728.

While I believe we must take steps to regulate the nontraditional products like interest only or no income verification lending practices, there are a number of traditional lending products in addition to 30-year fixed-rate mortgages that belong in the safe haven because of their good safety record. I fear that excluding these standard, more traditional products other than this 30-year mortgages from the safe harbor will serve to place more stress on the housing markets and the overall economy's ability to recover.

Second, while there is general agreement for the need for originators to have skin in the game, it is important that we address this issue in a thoughtful and deliberate manner. I am concerned that the risk retention provision in H.R. 1728 has not been fully vetted and could have some unintended consequences.

Finally, as introduced, the bill permanently alters contract law by requiring participation in the Section 8 Program for all purchasers of foreclosed properties with Section 8 tenants. And the bill does not include important safeguards on the $140 million legal assistance grant fund. It is my hope the committee will proceed with caution with this legislation, as we do not want to inflict further harm on an already struggling market. Again, thank you for presenting this hearing, and I look forward to hearing the witnesses. Thank you.

Mr. WATT. I thank the gentlelady. And in an effort to kind of keep the time balanced, we will now yield 1 minute to the gentleman from Delaware, Mr. Castle.

Mr. CASTLE. Thank you very much, Mr. Chairman. I don't think any of us would question the need to reform predatory lending practices in the mortgage industry, and many of our colleagues, as has already been indicated, supported the previous iteration of this, the Mortgage Reform and Anti-Predatory Lending Act when it passed the House the last Congress. But I do think we need to approach this carefully. And I am aware—first I'm aware that this bill intends to increase accountability by requiring creditors to keep a 5 percent share of the credit risk on each loan they make, but how does that affect smaller lenders who typically do not hold onto a large amount of capital? Will this affect their ability to participate in mortgage lending and selling? And I don't even understand the mechanics of how you would do that. So we need to look at that carefully.

Additionally, I think it would be beneficial to consider that some other types of loans in the qualified safe harbor under Section 203 of H.R. 1728 aren't FHA and VA loans, which are guaranteed by the Federal Government, and aren't adequately regulated safe enough to qualify.

Those are just a couple of the questions which I have. We have a lot of witnesses today, and hopefully we're going to learn a lot more about what we could and should be doing. It's the right concept, but we need to get the details right. And I thank you, Mr. Chairman. I yield back the balance of my time.

Mr. WATT. The gentleman's time has expired. The gentleman from North Carolina, Mr. Miller, is recognized for 3 minutes.

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman. The finance industry's explanation of our financial crisis is that there was a weird, unpredictable combination of events, a perfect storm of macroeconomic forces. With benefit of hindsight perhaps they loaned not wisely but too well, but certainly none of their business practices were really blameworthy. I don't claim to have seen the collapse of the whole world's financial system coming, but I knew that the mortgages that have proven toxic for the finance industry were toxic for homeowners, and I thought that was reason enough to act.

Mr. Watt and I introduced legislation 6 years ago that would have forbidden the mortgage practices that have brought our Nation's economy to grief. We will hear the same arguments today—we already have—that we have heard for 6 years from an entirely unrepentant industry.

All the mortgage terms that may appear abusive or predatory to the unsophisticated were really based on risk, they argue. And without those practices, lenders would not be able to make credit available to people who needed it. We know you mean well, the industry said, but your legislation will just hurt the very people you're trying to help. And they said we needed to be careful we didn't pass well meaning but poorly crafted legislation that would have unintended consequences. It's hard to argue in favor of sloppy, careless legislation, but the Nation and the world would have been better off if Congress passed a bill that we drafted on a napkin.

During the subprime heyday from 2004 to 2006 when the toxic mortgages were made, profits in the finance industry metastasized to more than 40 percent of all corporate profits. That's after the vulgar compensation and all the perks that we've heard so much about in the last few months. Maybe the industry's margins were not really so tight after all. Maybe some of the mortgage terms that appeared predatory on their face really were.

This committee will soon consider legislation to address systemic risk in the financial industry, to protect the industry from getting itself into such trouble again, but we need to do more than just keep the masters of the universe from running with scissors again in the future. We need to reform consumer lending practices that have trapped millions of working and middle-class families hopelessly in debt, practices that have pushed millions of Americans out of the middle class and into poverty.

I yield back.

Mr. WATT. The gentleman yields back the balance of his time. The gentlelady from Illinois, Mrs. Biggert, is recognized for 1 minute.

Mrs. BIGGERT. Thank you, Mr. Chairman, and I'd like to thank Chairman Frank and Congressman Miller for their work on this bill, which at its core aims to tackle some of the unsound practices that got us into this housing mess. In particular, I'd like to thank the chairman for including my bill, H.R. 47, the Expand and Preserve Homeownership through Counseling Act. I think it elevates housing counseling within HUD by establishing an Office of Housing Counseling, expands the availability of HUD-approved housing, counseling services, offers grants to States and local agencies, and launches a national outreach campaign as well.

And I'd also like to commend the Fed for updating mortgage standards under HOEPA and TILA, which I think will enhance protections and transparency to benefit consumers and restore integrity to the mortgage process. The new appraisal rules are, I think, particularly important. On this note, I'd like to thank Congressman Kanjorski and Congresswoman Capito for working with me on Sections 5 and 6 of H.R. 1728. Some of these mirror the Fed's work and all are aimed at improving mortgage services and appraisal practices to benefit consumers.

I look forward to examining the viability of some of the new provisions in H.R. 1728 that weren't in last year's mortgage reform. With that, I yield back.

Mr. WATT. The gentlelady's time has expired. The gentleman from New Jersey, Mr. Garrett, is recognized for 1 minute.

Mr. GARRETT. I thank you, and I thank the chairman, and I thank Chairman Kanjorski as well for holding this hearing, and the members of the panel. I want to take a moment just to focus my remarks specifically on a section of the bill and I look forward to your comments. That's Section 213 of the bill, the Credit Risk Retention provision. As the chairman knows, based on my recent actions and attention on covered bonds, I am very supportive of lending institutions retaining some credit risk or skin in the game. And so I applaud the chairman and Congressman Miller for their attempt in the underlying bill to address this issue. However, I and many others have serious concerns of the way the provision is presently crafted.

I do believe that there are significant questions as to how this provision is actually going to work, how capital provisions and positions of struggling lending institutions would be affected, and how small lending institutions would be able to comply with this, and the negative market affairs that would occur. And so knowing of our common interest in this matter that Chairman Frank has indicated in the past, I would like to work with the chairman and Chairman Kanjorski as well to craft a more feasible alternative that can help facilitate sound mortgage underwriting while not reducing the much needed market liquidity.

And with that, I yield back.

Mr. WATT. The gentleman's time has expired. The gentleman from Idaho, Mr. Minnick, is recognized for 2 minutes.

Mr. MINNICK. Mr. Chairman, in order to prevent another subprime mortgage meltdown, loan originating companies should be required to keep a certain percentage of any loans they make and take the first loss on any contract that goes bad.

I want to thank Chairman Frank and Congressmen Miller and Watt for including my bill, the Credit Risk and Retention Act, into their broader mortgage reform bill. Credit risk retention is a way to avoid some of the worst problems which undercapitalized risky loans that have crippled the financial system.

The company making a loan has to keep some skin in the game and to take the first loss. It is important to put into the underwriting process an incentive that keeps institutions that write a loan or underwrite a mortgage-backed security from being able to shed all responsibility. This bill makes the originator retain at least 5 percent of any loan made.

I am open to ideas on how to implement and prudently enforce this concept in a way that protects consumers but also makes sense for banks and other loan originators. This is not meant to be punishment for a lending institution. Rather, it is a preventive measure to improve underwriting and avoid another financial meltdown.

I yield back the balance of my time.

Mr. WATT. The gentleman yields back the balance of his time. The ranking member of the full committee, Mr. Bachus, is recognized for 1 minute.

Mr. BACHUS. I thank the chairman. I have laryngitis, so I'm going to be brief. This bill, first let me point out, is different from the bill that we passed last year with broad Republican support. The goal ought to be to address problems in mortgage origination and in our subprime mortgage system, not create new problems. And I'm afraid this bill, unlike the bill last year, creates a lot of new standards. They're vague and they're narrow, and I think ultimately this bill would restrict access to credit and probably cause people to turn to payday lenders and other type of financing.

Let me just close by saying all of us have recognized that the originate to distribute model has problems, and so I will say that just like Mr. Garrett and just like Chairman Frank, I agree we ought to look at the credit risk retention requirement, and originators should have skin in the game. I don't think what we're doing here is the way to solve that.

Thank you.

Mr. WATT. I thank the gentleman. Everyone who has made an opening statement has addressed an issue that is of importance, and that's why we're having this hearing today. I just want to encourage on behalf of the chairman of the full committee, for those who have raised the issues related to risk retention, safe harbor, preemption, the whole—all of those issues are still being looked at very carefully, and it would be helpful in advance of next Tuesday's mark-up if we have constructive, concrete ideas about how to address the concerns that have been raised as opposed to just, we don't like what has been written. So—

Mr. BACHUS. Mr. Chairman?

Mr. WATT. The chairman wanted me to encourage that, because this is a work in progress, and not a finished product. Otherwise, we wouldn't need to have the hearing.

Mr. BACHUS. I very much appreciate that. In fact, my opening statement contains some of that, but I agree with you. If we're going to successfully resolve this, we need dialogue. We need deliberation, and we need to work with the regulators. Actually, the Federal Reserve and others have—they've made their own proposals and we'll hear some of that today on how to address these problems, but we will tell you that we would like to be partners in this effort.

Mr. WATT. All time for opening statements has expired. I will now introduce this panel of witnesses. The first witness for today is Ms. Sandra Braunstein, Director of the Division of Consumer and Community Affairs of the Board of Governors of the Federal Reserve, and the second witness is Mr. Steven L. Antonakes, Commissioner of Banks for the Commonwealth of Massachusetts, on behalf of the Conference of State Bank Supervisors. Each witness will be recognized for 5 minutes. Without objection, your written statements will be made a part of the record in their entirety.

And, Ms. Braunstein, you are recognized for your opening statement.

STATEMENT OF SANDRA F. BRAUNSTEIN, DIRECTOR, DIVISION OF CONSUMER AND COMMUNITY AFFAIRS, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Ms. BRAUNSTEIN. Thank you, Mr. Chairman, Ranking Member Bachus, and members of the committee. I appreciate this opportunity to discuss the important issue of mortgage reform, the Federal Reserve's actions in this regard, and potential legislation to address remaining challenges.

The Federal Reserve is committed to promoting sustainable homeownership through responsible mortgage lending. While the expansion of the subprime mortgage market over the past decade increased consumers' access to credit, many homeowners and communities are suffering today because of lax underwriting standards and unfair or deceptive practices that resulted in unsustainable loans.

Moving forward, it is important to achieve both clarity for the marketplace and strong consumer protection. We do not think those goals are mutually exclusive. In fact, those were our objectives last July when the Board issued final rules to establish new regulatory protections for consumers in the residential mortgage market.

The Board's rules contain four key protections for a newly defined category of higher priced mortgages. First, lenders are prohibited from making any higher priced mortgage loan without regard to the borrower's ability to repay the obligation from income and assets other than the home.

Second, lenders are prohibited from making stated income loans and are required to verify the income and assets they rely upon to determine the borrower's repayment ability.

Third, the final rules ban prepayment penalties in cases where borrowers face payment shock.

And fourth, creditors are required to establish escrow accounts for property taxes and homeowners insurance for all first lien mortgage loans.

Recently, the Mortgage Reform and Anti-Predatory Lending Act was modified and reintroduced in this committee. There have been many changes in the market since the original version of this bill was passed by the House in 2007. We commend the committee's work on the new iteration of the bill, which addresses some important issues for the mortgage markets. Although some of the details differ, both the pending bill and the Board's rules set minimum underwriting standards for higher priced loans.

A major addition to the new legislation is a provision to address the problem of misaligned incentives through credit risk retention. The lack of skin in the game has been widely recognized as one cause of the lax underwriting that was widespread in the subprime mortgage markets. However, this is a very complex issue, and risk retention could have unintended consequences of constraining credit. Therefore, we recommend that Congress consider additional discretion for rule writers in defining credit risk and other critical terms.

Board staff have worked closely with the committee staff to furnish both technical and substantive comments on this bill. We are available to continue that work as the legislation moves forward.

I would now like to offer a few additional comments. The Board's HOEPA rules take effect on October 1, 2009. Given the time required for the legislative process, the rule writing and comment period that will follow, it would be difficult to have new legislative provisions implemented by that date. We respectfully request that the committee clarify that the legislation does not alter the effective date of the Board's regulations. This would ensure that consumers will receive these important protections in the interim period from October 2009 until any new legislation takes effect.

I would also like to comment on the bill's delegation of rule writing. Many provisions of the bill would be implemented by regulations that are promulgated jointly by the Federal banking agencies. In our experience, interagency rulemakings may provide an opportunity for different perspectives, but the joint rulemaking process generally is a less efficient, more time consuming way to develop new regulations, and compromises often occur to bring rulemaking to closure. This can result in weaker consumer protections than would be achieved in a single agency.

The mortgage markets have undergone considerable change in the past few years. Current conditions are certainly not normal, and we cannot be certain how the markets will ultimately reset. Therefore, we recommend that Congress provide sufficient rule writing flexibility in the new legislation so that regulations can be adjusted over time to address new marketing conditions and new mortgage products.

We look forward to working with Congress to enhance consumer protections while promoting sustainable homeownership and access to responsible credit.

Thank you.

[The prepared statement of Ms. Braunstein can be found on page 166 of the appendix.]

Mr. WATT. We thank you for your testimony.

Mr. Antonakes is recognized for his opening statement.

STATEMENT OF STEVEN L. ANTONAKES, COMMISSIONER OF BANKS FOR THE COMMONWEALTH OF MASSACHUSETTS, ON BEHALF OF THE CONFERENCE OF STATE BANK SUPERVISORS

Mr. ANTONAKES. Good morning, Mr. Chairman, Ranking Member Bachus, and distinguished members of the committee. My name is Steven Antonakes and I serve as Commissioner of Banks for the Commonwealth of Massachusetts. It's my pleasure to testify today on behalf of the Conference of State Bank Supervisors in support of the objectives of H.R. 1728.

First, however, I would like to update the committee on what I believe is an important and complementary reform of the industry. The States have been working to develop a more coordinated system of oversight to enhance supervision of the residential mortgage market. The hallmarks of reform should be high minimum standards, robust regulation and strong enforcement. Moreover, the most effective system of supervision and consumer protection is not purely Federal. The better way is a coordinated system that draws on the responsiveness and innovation of State regulation and the ability of the Federal Government to set high minimum standards. These unique State and Federal strengths should be complementary. For the benefit of consumers, Congress must forge a more cooperative federalism.

The model for this cooperative federalism is the CSBS AAMR Nationwide Mortgage Licensing System and the S.A.F.E. Act. The States began developing NMLS back in 2003. It was successfully launched in January 2008, and by this January, 43 States, the District of Columbia and Puerto Rico will be on the system. This effort was recognized by Ranking Member Bachus, and this committee, as you enacted the S.A.F.E. Act, requiring all mortgage loan originators to be licensed or registered through the NMLS. Within weeks of the Act's passage, the States developed a model State law to implement its requirements. As of today, 20 States have passed legislation to become compliant with the S.A.F.E. Act, and an additional 29 States are in process.

The S.A.F.E. Act and NMLS are vital to protecting consumers in battling abusive lending practices. Combined, these initiatives establish a broader regulatory reach, enhance accountability of loan providers and give regulators powerful tools to bring enforcement actions against bad actors.

Relative to H.R. 1728, CSBS supports the establishment of a Federal predatory lending standard that allows the States to address abusive practices as they evolve. But the Federal standard should be a floor for all lenders and not stifle a State's ability to protect its citizens through State legislation or enforcement actions.

It is difficult to legislate when State law applies only to a minority of the loans.

State supervisors welcome coordination with our Federal counterparts to promote responsible lending. Because of congressional action, Federal regulators are working much more closely with the States through the FFIEC. The FFIEC can be an invaluable forum for State and Federal authorities to coordinate our efforts to provide seamless and comprehensive supervision of financial service providers. To harness the expertise of State regulators, CSBS recommends that H.R. 1728 require rulemaking to be coordinated through the FFIEC. While the largest banks may be federally chartered, the States supervise the majority of banks and also have responsibility for credit unions, mortgage banks and mortgage brokers. The Federal rulemaking process would benefit from the breadth of this perspective. And if we are to have broad application of Federal standards, there will need to be State enforcement.

CSBS also recommends the committee and Congress end regulatory preemption of State consumer protection laws. The States have been and continue to be the front line guardians of consumer protection and at the forefront in the battle against predatory lending. Congress should reinstate the ability of States to develop the sort of standards that have been the models for Federal law.

Finally, we believe that H.R. 1728 provides many important improvements in consumer protection. We do have some additional concerns and recommendations outlined in detail in my written testimony.

CSBS recognizes the challenges of balancing consumer protection and product innovation in your efforts to strike this balance in the liability and safe harbor provisions. We do, however, oppose the preemption of State law in this area and believe that if a safe harbor is to be established, that it must be very narrow.

Additionally, any Federal standard should be enforceable by State regulators and attorneys general. The mortgage industry has proven itself to be innovative and dynamic. A static solution will simply not be able to keep pace with the market without the involvement of State authorities. CSBS commends the work of this committee to protect consumers and the financial system. We urge you to develop legislation that builds upon and does not inhibit the efforts of State authorities.

Thank you for the opportunity to testify today. I look forward to answering your questions.

[The prepared statement of Mr. Antonakes can be found on page 112 of the appendix.]

Mr. WATT. I thank both witnesses for their testimony. We will now recognize members for questioning for 5 minutes each. Let me reemphasize the statement made at the outset of the hearing. We have three panels, and in accordance with the chairman's practice and instructions to me, we're going to be pretty tough on the 5 minutes. So if you have a question that you want an answer to as opposed to a written response, please ask it sufficiently in advance of the end of your 5 minutes to give the witnesses an opportunity to answer it, because we have three panels and a lot of members to get to. So, I'm not trying to be hard on anybody, I am just trying to move the hearing along.

Mr. Kanjorski is recognized for 5 minutes.

Mr. KANJORSKI. Thank you very much, Mr. Chairman. You may not want to be hard on us, but you put the fear of God in me.

Mr. Antonakes, appraisal management companies are largely unregulated now except in two or three States that have passed laws in recent weeks. Yet these companies touch 60 percent-plus of the loans, and their importance will grow with the Cuomo agreement being implemented.

We have previously provided for State regulation of appraisers. Can States undertake this responsibility if mandated, is 36 months a sufficient amount of time to do this?

Mr. ANTONAKES. Congressman I believe 36 months of time would be a sufficient period of time to do this. I draw upon our experience implementing the S.A.F.E. Act, which has been a heavy lift for State regulators. We have met on a weekly basis simply on implementation issues relative to the S.A.F.E. Act, and as described in my oral testimony, we now have 49 out of 50 States well on the way to pass implementing legislation by the July 1st timeframe. So I believe it can be accomplished, and we would welcome the opportunity, my colleagues and I, to work with you in this regard.

Mr. KANJORSKI. Very good. It seems like we are moving along, does it not?

Mr. ANTONAKES. I believe we are, Congressman.

Mr. KANJORSKI. That is very good. What other things would you suggest from the State level that are not included in this Act that would make it a better Act? You heard the invitation of the Chair. We are looking for perfecting the Act to be more responsive. Do you have any suggestions that you could give the committee?

Mr. ANTONAKES. The key takeaway that we would provide, Congressman, is to ensure that a Federal standard, which we do support, is a floor and not a ceiling, and that States continue to be able to innovate and address issues as they occur within their jurisdictions to enact more protective laws as need be. The Truth-in-Lending Act was passed by the Federal Government in 1968. It was passed in Massachusetts in 1966. It became the model for the Federal law. States have to be able to innovate.

Also, given the breadth of expertise that we do have, we're the only regulators that oversee the banks, the credit unions, the mortgage lenders, the mortgage brokers. I think States have to be involved in a rulemaking process and maintain their ability to enforce a Federal standard as well as State law.

Mr. KANJORSKI. Very good. May I pose a question to the Federal Reserve? Do you have any suggestions or perfections that could be made in your opinion to the legislation that would make it a better piece of legislation?

Ms. BRAUNSTEIN. We applaud a lot of what is in the legislation, and in fact a lot of it mirrors what we did with our HOEPA rules. We feel that there should be some rule writing discretion. One of the things we would keep in mind is that the markets currently are not in a normal state, and we are not really sure where they're going to reset and how they'll normalize in the future.

So it would be helpful to not be as prescriptive and to allow some discretion in the future to make modifications to deal with the new markets, and we know that the industry is very innovative and that there will be new mortgage products that are going to evolve once the markets open up again, and there needs to be the flexibility to deal with consumer protections for those products.

Mr. KANJORSKI. The question all of us were working, the skin in the game question, the 5 percent, you seemed to indicate that may have been a little harsh, and you would like some discretionary authority there. How would you structure that?

Ms. BRAUNSTEIN. Well, I don't have an exact answer for you on that. I mean, I think that's something we would have to look at closely. We do acknowledge the fact that there were misaligned incentives in the previous markets and that was a cause of some of the problems. I think that issue needs to be looked at closely in a way to make sure that people do have skin in the game. I don't have an exact answer for you as to how that would work, but I think that's something that we have suggested. Again, there would need to be some discretion in terms of working that out now and working that out in the future.

The current provision provides some issues for depositories in terms of capital retention against that 5 percent, and it's also unclear how that would work in nondepositories in terms of them having something put aside to deal with that 5 percent risk. There's a lack of clarity right now as to whether that is 5 percent in first position, you know, where does that fall in terms of risk? I think there's a lot of unanswered questions at this point about it.

Mr. KANJORSKI. Thank you very much. Mr. Chairman, I yield back my time.

Mr. WATT. The gentleman's time has expired. Mr. Castle from Delaware is recognized for 5 minutes.

Mr. CASTLE. Thank you, Mr. Chairman. Ms. Braunstein, just along the same lines, and I raised this in my opening statement, I really don't understand the 5 percent business at all, and I've tried to read it and that has not helped clarify it. But as you read the bill or at least your understanding of any discussions you've had about it, does the originator of the mortgage have to keep 5 percent of its total mortgage portfolio or 5 percent of each mortgage it originates? Can you explain that provision to me? I just—I'm having trouble grasping it.

Ms. BRAUNSTEIN. Well, I'm not sure I'm the expert to do that since we didn't craft it.

Mr. CASTLE. I realize you may not be.

Ms. BRAUNSTEIN. But my reading of it is that it's not the originator, it's the creditor. So it's whoever—which would differentiate the originators could be brokers, but that this applies to creditors. So this is who makes the initial loan, as opposed to being able to sell off the entire loan, there would have to be a 5 percent retention. And as I said before, it is not clear to us either as to whether that would be a first position, second position, how exactly that would work. I don't think that kind of clarity is in there right now.

Mr. CASTLE. Okay. The other thing that concerned me that I raised in the opening statement are the safe harbor provisions, which I think are quite narrow, perhaps too narrow. Should there be discretion to adjust the safe harbors to guarantee that credit remains available to creditworthy perspective home buyers, and do you have the necessary tools to expand or constrict the safe harbor?

Ms. BRAUNSTEIN. I think that's right, that there needs to be some discretion on that. We have provided some comments to the committee staff on this issue. There are some loans that would probably be safe prime loans, for instance, right now the way the safe harbor is written, an example is that the term would have to be 30 years. And we know that there are some people in the market who are getting 15-year loans that may be very safe, sound loans. That would not fall into that safe harbor right now, nor would for affordability's sake, some of the loan modifications that are being done, people are being taken to 40-year loans. Those would not be, even though they may be very affordable loans, safe loans. They would not fall into that safe harbor.

So, again, I think there is a need to retain some discretion to look at these criteria. And of course we don't know what new products are going to come on the market. So I agree that there probably needs to be some discretion.

Mr. CASTLE. In asking this next question, I'm not trying to scuttle this legislation, and I'd like to improve it and see it pass if possible, but I was wondering if you think that this legislation is necessary or are the new HOEPA rules sufficient to limit unfair predatory mortgage practices? Should we have the legislation or can you do without it?

Ms. BRAUNSTEIN. Well, one of the things that the legislation addresses are issues that we did not have the authority to address in HOEPA in regulations. For example, the legislation will increase remedies for consumers. It provides assignee liability, which is something that we are not able to do by regulation. So there definitely is a role for legislation.

Mr. CASTLE. Okay. Mr. Antonakes, in your testimony, you mention that the Federal law prohibiting predatory lending should not interfere with the States' efforts. What in your view is the best way to balance the State efforts, which are ongoing, as I understand, a number of States have done things, others are in the process of doing things. But what we're trying to do on a Federal level so that we keep a good balance.

Mr. ANTONAKES. Sure. Well, Congressman, I do believe it's important to have a Federal standard and a Federal predatory lending law I think is very important. I think again the key here is to ensure that whatever standards enacted by the Federal Government are not ceiling, allow States the flexibility locally to move beyond that standard if they so see fit to protect their individual consumers.

Also, if there is a Federal law, you have to provide the ability for State regulators to enforce that Federal standard as well. I think that would be again the key issues from the State regulator perspective.

Mr. CASTLE. In reading this legislation, do you feel that provision is there to afford the States the flexibility that they need?

Mr. ANTONAKES. I think we may need a little bit more in terms of ensuring that we have a role in enforcement and rulemaking as well.

Mr. CASTLE. Good. Thank you. I yield back, Mr. Chairman.

Mr. WATT. The gentlelady from California is recognized for 5 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman. I thank our witnesses for being here today. I'm concerned about the bill's preemption provisions. The bill would potentially be read to preempt claims regarding an assignee's own illegal actions as well as the more common claims in which liability is related to the assignee's standing in the shoes of the originator or creditor.

An example of such primary liability occurred in the First Alliance case, which I mentioned when this bill was marked-up in 2007. This case was brought by the attorney general of my home State of California, which has very strong laws in this regard. In this case, Lehman Brothers was an assignee but also actively participated in the illegal activity. The current preemption clause insulates assignees from liability for their own conduct if it is not under the rubric of fraud.

I'm concerned about how the bill will affect the ability of States with strong consumer protection laws to protect borrowers. In your opinion, how does the bill's preemption provisions affect States like California, Ms. Braunstein?

Ms. BRAUNSTEIN. Well, my understanding is that the current bill as drafted, and Mr. Antonakes could probably address this better than I can, does preempt State laws. I will add that when we wrote our HOEPA rules, purposely our HOEPA rules do not preempt the States from going further and protecting consumers.

Ms. WATERS. Would you like to add anything?

Mr. ANTONAKES. Congresswoman, I would agree with you that there are preemptive matters in this legislation that from the State perspective we would rather not see, because we do believe it would inhibit our ability to provide maximum protection for our consumers.

Ms. WATERS. Okay. Let me ask you, since I have a little bit more time, it appears that we do not eliminate all prepayment penalties in the bill. Is that your understanding?

Ms. BRAUNSTEIN. Yes. I think that's true. I think they're eliminated for mortgages that don't fall into the qualified mortgage bucket.

Ms. WATERS. I'm sorry. Would you say that again?

Ms. BRAUNSTEIN. They're eliminated for mortgages which do not fall into the safe harbor.

Ms. WATERS. Okay. And could you comment on the mortgage brokers and the yield spread premiums? What is your understanding about what happens in this bill? It appears that it is kind of business as usual, that there is no attempt to eliminate the kickbacks.

Ms. BRAUNSTEIN. My understanding of the bill is that there is an attempt to limit yield spread premiums in the sense that they cannot be given to originators for moving somebody to a higher priced loan in order to prevent the steering to higher priced mortgages.

I would also add that yield spread premiums have been a very difficult issue for us. When we proposed HOEPA rules, we issued some proposed rule around that, and a lot of it dealt with disclosure and increasing transparency. We did consumer testing and found that consumers did not understand these concepts at all, that it was not going to be effective, so we dropped that idea. And

I think the bill does have some disclosure elements to it that concern us because of that. We are currently looking at them, because we're rewriting closed-end rules and we are planning to address yield spread premiums in upcoming rules, and we are looking at things other than disclosure in order to address them.

Ms. WATERS. Thank you. And I would like very much to see your original attempt at addressing the issue. Do you have that in writing?

Ms. BRAUNSTEIN. Yes. We have a report from the testing company. It's up on our Web site. We can forward it to you.

Ms. WATERS. Would you make that available to my office?

Ms. BRAUNSTEIN. Yes.

Ms. WATERS. All right. Thank you, Mr. Chairman. I yield back the balance of my time.

Mr. WATT. I thank the gentlelady. The gentlelady, Mrs. Biggert, is recognized for 5 minutes.

Mrs. BIGGERT. Thank you, Mr. Chairman. Ms. Braunstein, in your testimony you mentioned your work under TILA and on mortgage disclosure forms and also HUD's work on RESPA. Do you think that HUD's new RESPA rule should be suspended until the Fed and HUD can work together to develop a single form that creditors could use to satisfy the requirements of both TILA and RESPA? As you stated in your testimony?

Ms. BRAUNSTEIN. Back in the 1990's, we made a recommendation that there should be a single form. We still do believe that. We have made some attempts to reach out to HUD to talk to them. We are still working on that and we hope that there is a way that we can work together.

Mrs. BIGGERT. Do you think that's possible if they go ahead with their form and then you haven't completed—

Ms. BRAUNSTEIN. I don't think anything is impossible and I am still hopeful.

Mrs. BIGGERT. Okay. Then, the bill that we're considering today has a provision that was not part of the Congress' mortgage reform bill in the past, in requiring the mortgage lenders to retain the percentage of credit risk for all non-qualified mortgages. And it also prevents institutes from hedging that retained risk. Does the Fed believe that the limitation on hedging is wise?

Ms. BRAUNSTEIN. We think that the limitation on hedging, for one thing, as it's currently written, is a bit unclear to us as to exactly how that would work. We know that hedging portfolios is something that is done to promote prudential, safe and sound lending within financial institutions. We think that provision would need to be looked at more closely.

Mrs. BIGGERT. Do you believe that such a provision against hedging would be enforceable?

Ms. BRAUNSTEIN. At this point, I am not sure how that would be done but, you know, we would have to explore that.

Mrs. BIGGERT. Well, it seems like the authors of the bill believe that hedging eliminates incentives to prudently underwrite loans. Do you agree with that?

Ms. BRAUNSTEIN. Well, it is caught up in the whole risk retention provisions and those are provisions that we need to look at very closely. I will say that in the past, there were financial institutions that were retaining even 100 percent of some loans on portfolio, even though they turned out not to be very safe and sound loans. So, I think that needs to be looked at, too, in terms of how effective it might be.

Mrs. BIGGERT. How would the accounting for this risk retention work?

Ms. BRAUNSTEIN. Well, in depositories, if there is risk retention, there would have to be some capital held for that. I am not sure how that accounting would work in non-depository institutions.

Mrs. BIGGERT. Okay. Well, then we don't know what the consequences for bank capital requirements would be.

Ms. BRAUNSTEIN. Not until there's more specificity on how this provision will work. It is not clear whether the 5 percent is in a first position.

Mrs. BIGGERT. Okay. And who would decide that?

Ms. BRAUNSTEIN. Well, it depends how the statute ends up being written, whether that decision would be left to the rule writers or whether that will be further defined in the statute itself.

Mrs. BIGGERT. Okay. Thank you, I yield back.

Mr. WATT. The gentlelady from New York, Ms. Velazquez, is recognized for 5 minutes.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Ms. Braunstein and Mr. Antonakes, there is a sector of the residential mortgage market that has been overlooked and that is multi-family housing. Cases of multi-family mortgages defaulting are occurring all over the country. New York City, Phoenix, Washington, D.C., San Francisco, and Philadelphia are just some of the places where renters are feeling the effect of this crisis. If responsible lending practices driven by the ability of banks to shed the risk exposure through the sale of inflated loans to Wall Street triggered this debacle, what in the writing standards should be applied to these multi-family mortgages to ensure that future loans do no carry the same reckless risks?

Ms. BRAUNSTEIN. Well, multi-family properties are obviously different, a little bit different in terms of underwriting. I would agree that these are issues, important issues, and I know that in our office, through our community affairs program, we have been having conversations with providers of multi-family housing to talk about these kinds of issues and try to get a better handle on what the risks are, what the issues are, and what can be done going forward.

Ms. VELAZQUEZ. So, are there any contingency plans in place in cases where these loans are going to default or foreclosure?

Ms. BRAUNSTEIN. I am not aware of any.

Ms. VELAZQUEZ. So, are you all confident that there is no threat to those loans?

Ms. BRAUNSTEIN. No, I'm not confident about that.

Ms. VELAZQUEZ. In New York City alone, we have identified over 80,000 units of affordable housing that have been purchased at inflated prices by speculative real estate investors. These units are occupied by working families who do not have the resources to find adequate housing if displaced. So, do you think that you're going to start assessing this potential risk? This is a looming crisis.

Ms. BRAUNSTEIN. As I said, we are having conversations with a number of experts in that field to try to get a better handle on what's going on in the multi-family housing markets.

Ms. VELAZQUEZ. Okay. Do you have anything to add to that, Mr. Antonakes?

Mr. ANTONAKES. No. I would agree with my colleague. It is a serious problem that we're concerned with and we're looking at and working on, at least in the Commonwealth, with our housing agencies as well as we try to determine solutions for what is going to become and is becoming a very difficult problem.

Ms. VELAZQUEZ. So, let me ask you, often overlooked are the tenants who are the real victims here. H.R. 1728 contains tenants' protections. Are there ways we can build on those to ensure that residents in multi-family buildings are also protected?

Ms. BRAUNSTEIN. I think that is something for the committee to decide, but I do think that those provisions that are in H.R. 1728 that deal with tenants are very important provisions and that we have been hearing for quite some time stories, even in single family homes, where tenants are unaware that their landlords are facing foreclosure. They've been paying their rent on time and they find themselves being evicted for basically no reason, no fault of their own and that is a very serious issue that needs to be addressed.

Ms. VELAZQUEZ. Okay, let me ask you another question. Do you think that multi-family mortgages should be part of TILA?

Ms. BRAUNSTEIN. I think that's a question for Congress to decide.

Ms. VELAZQUEZ. But you don't have any opinion?

Ms. BRAUNSTEIN. No.

Ms. VELAZQUEZ. Thank you. Thank you, Mr. Chairman.

Mr. WATT. Mr. Posey is recognized for 5 minutes.

Mr. POSEY. Thank you, Mr. Chairman. Same question for both of you. Shrinking the safe harbor is certain to increase mortgage originators' litigation risk and it would appear also to severely limit the origination of any loan other than a 30-year fixed-rate mortgage. Do you think that this bill, if enacted, would limit consumer choice? And do you think it would limit the origination of any loan other than a pure vanilla 30-year mortgage?

Ms. BRAUNSTEIN. I think that's one of the things we've been looking at and I do think that the bill, the way the structure is, it seems like it's somewhat intended to drive the market into 30-year fixed loans, not necessarily fixed, it doesn't specify fixed, but 30-year loans. That could have the consequence of very much limiting the kinds of products that become available when the markets reset. But some of that is very difficult to predict, because, as I said in my opening testimony, the markets are not in a normal state right now and we're not sure how they will normalize in the future.

Mr. ANTONAKES. Well, Congressman, we're generally in support of the concept of a safe harbor, but I think it has to be very carefully defined. I think the way it's written, we can see in some aspects, that it's too strict. Certainly 15-year rate fixed mortgages, 20-year fixed mortgages that the applicant demonstrates an ability to repay could receive consideration. There's also a traditional ARM products in which, at the fully indexed rate, the applicant the can demonstrate the ability to repay that could be considered.

By the same token, we have concern that it could be too broad. And that given the interest rate caps that exist right now, some subprime loans conceivably could get the protection of the safe harbor. So, there could be an impact on the availability of credit. I think it's hard, as my colleague indicated, it's hard to predict. We're generally supportive of the safe harbor, but I think it has to be very carefully crafted.

Mr. POSEY. Follow up, Mr. Chairman. The bill contains some pretty rigid criteria for qualifying people for mortgages, the ability to pay, employment. Right now, just as an analogy, there are 10 ways people can buy a home, when you reduce it down to 1 way, don't you this will hurt the housing recovery more than it would help it? Just by limiting the resources people have to stay in their homes or refinance their homes, or to buy a home?

Mr. ANTONAKES. Well, I think a lot of the bad underwriting at this, you know, that is intended to be cured here, doesn't exist right now, so again, I don't think we have a normal market and I think there is limited means of refinancing a home or purchasing a home at this point in time, right now. Again, I think, you know, there should be restrictions on some of the underwriting difficulties that we've experienced over the past several years. This is a means of doing it but it's going to have to be carefully crafted.

Mr. POSEY. Now, are you both confident that this is not over-reaching?

Ms. BRAUNSTEIN. I don't know that we can answer that. As I said, it's hard to judge in today's market. There isn't much available now—

Mr. POSEY. Your gut reaction. You're the experts and you're the ones that we rely on for guidance so if you don't have a clue, then we're going to feel awfully bad doing something if you think it might be over-reaching, if you're not sure whether it is or not.

Ms. BRAUNSTEIN. Well, what I can say is that when we crafted the HOEPA rules, we did not feel that what was contained in those was over-reaching. We felt that we were addressing the most egregious practices that we saw that caused a lot of the problems in the marketplace. And that those kinds of practices should not be allowed to come back into being even when the markets normalize. So, we do think that it's very consistent to have safe and sound lending.

There needs to be clarity for the industry as to what the rules are so that the industry can function. That's very important and that there needs to be a balance so that there's still can be credit available and people will have some options. But again, they need very strong consumer protections. And that is a balance that is sometimes difficult to achieve, but I think we need to strive for that.

And that's one of the reasons that I've asked for additional flexibilities in the rules, in the legislation, so that when the market does re-emerge there may be new products that we're not even thinking of today that will need to be addressed.

Mr. POSEY. You say, when the market re-emerges. Do you have any idea what decade that might be?

Ms. BRAUNSTEIN. I wish I could say that.

Mr. POSEY. Thank you, Mr. Chairman.

Mr. WATT. The gentleman's time has expired. The gentleman from Kansas, Mr. Moore, is recognized for 5 minutes.

Mr. MOORE OF KANSAS. Thank you, Mr. Chairman. I have concern with the product known as Adjustable Rate Mortgages or ARMs, which usually start with a lower monthly payment, but which may reset to a much higher monthly payment that homeowners can't afford. Instead of the typical 30-year fixed-rate mortgage that has the same monthly payment and is easier to understand, it seems that these different mortgage products were sold to individuals who, in many cases, did not understand what they were signing up for.

I want to ask the witnesses, what role do you think ARMs have played in the current housing crisis?

Ms. BRAUNSTEIN. Well, I think that ARMs, in particular the hybrid ARMs and the option ARMs, were very significant players in the current crisis and created a lot of problems. The ones that had the 2-year and the 3-year, the 2/28's, the 3/27's, as well as the option ARMs that ended up with negative amortization. Those were a real problem.

Mr. WATT. Do the witnesses have any comments?

Mr. ANTONAKES. I would agree with that, but I would also say that I think the traditional ARM products that have been around for a long time, the 5 and 1, 7 and 1, ARM products that had limitations on how much the interest rate could swing were not the primary problem here. It was the hybrid products, it was the newer, interest-only products that were the driver.

Ms. BRAUNSTEIN. I would agree.

Mr. WATT. All right.

Mr. MOORE OF KANSAS. Do you believe H.R. 1728 adequately addresses these concerns regarding the role ARMs and other complicated mortgage products played in creating this financial crisis? Does this proposed bill, does this proposed law, is it going to address the problem and solve the problem in your estimation?

Ms. BRAUNSTEIN. I know we submitted some technical comments along this line. I think there was some concern that the former iteration of this bill actually banned negative amortization as one of the provisions for the safe harbor. And that is no longer present in the safe harbor. I think that was a concern of ours and there were some other technical corrections that we did submit through staff.

Mr. MOORE OF KANSAS. Thank you. Any comment sir?

Mr. ANTONAKES. Well, I think the key provisions here are the safe harbor and the credit risk retention. And I think, again, we're generally supportive of both concepts, the safe harbor and the credit risk retention. The issue that has been discussed today at length has been the concept of skin in the game and certainly we can see that there should be, you retain greater risk for making higher risk loans. I think the only concern would be, was there were many companies, mortgage companies and banks that had considerable skin in the game, consider risk but failed anyway. It didn't prevent them, from in all cases, making bad underwriting decisions. So, I think that's going to have to be reconciled as well, as you continue to work through this process.

Mr. MOORE OF KANSAS. Thank you. This week, Congress received a quarterly report from the Special Inspector General for TARP. In the report, the SIG TARP states that one of the most common features of traditional mortgage fraud is that applicants falsely inflate their income and support those lies with fraudulent documentation and employment verification. To address this potential fraud, SIG TARP recommends Treasury require that verifiable third party information be obtained to confirm an applicant's income before any modification payments are made. Do you agree this is an important element of this? Should we pursue that?

Ms. BRAUNSTEIN. Absolutely. In fact, our HOEPA rules ban stated income loans. For high-cost loans, we require verification of income and assets and I think that is a very important aspect going forward.

Mr. MOORE OF KANSAS. Sir?

Mr. ANTONAKES. I agree, absolutely. We have issued hundreds of enforcement actions and the majority of the cease and desist orders and the referrals to law enforcement have involved fraud, unstated income loans. It's very easy to do and we routinely find it during our examination process. What is concerning to us is, it seemingly permeated every level of the origination through securitization process.

Mr. MOORE OF KANSAS. Thank you. Mr. Chairman, I'll just finish by stating that next Monday, Congressman Cleaver and I will be hosting an event in Kansas City with the State Attorneys General from Kansas, Missouri, and an FBI agent, encouraging our constituents to be vigilant and report any suspicious or illegal actions by fraudulent companies. I would encourage other Members of Congress to do the same and I yield back my time, sir.

Mr. WATT. The gentleman from Minnesota, Mr. Paulsen, is recognized for 5 minutes.

Mr. PAULSEN. Thank you, Mr. Chairman. I have some additional questions regarding the skin in the game provisions of the bill, in particular, Mr. Antonakes, if I could ask you, as a State regulator, are you at all concerned that the bill's provision requiring lenders to retain that 5 percent of the credit risk for non-qualified mortgages will put smaller, non-depository financial institutions completely out of business? Does it hamper them additionally? I mean, do you see this provision, in essence, leading to decreased competition, greater consolidation over time of larger depository institutions?

Mr. ANTONAKES. Congressman, that's certainly possible. The alternative would be for these lenders, if they didn't seek to have a 5 percent holdback to make traditional mortgage loans that fit within the safe harbor. So, that opportunity for small businesses would still be available, to make those traditional loans if they didn't want to maintain this increased risk or retention of the credit. You know, we have, in Massachusetts, a substantially increased net worth and bonding requirements for our non-bank lenders and brokers over the course of the last several years. So, there are other efforts as well, to ensure that, you know, adequate resources are on hand, as well as would be complimentary to that effort.

Mr. PAULSEN. And then, Ms. Braunstein, if I could ask you, if the lenders that the Federal Reserve regulates were required to retain also that 5 percent threshold of the risk of the non-qualified mortgages they originate, how much additional capital are they going to have to have on hand or keep in reserve? I mean, how is that going to affect the safety, the security and the soundness which is really, I think, primarily the focus we're all interested in having in the banking system, given the trouble we've had.

Ms. BRAUNSTEIN. That is one of the things that we're looking at and is of some concern to us in terms of moving forward with the 5 percent retention. I don't have specific answers for you because there's not enough clarity or detail yet around that 5 percent and what position it would be in. We do know that for depositories, if they're retaining 5 percent, there's going to have to be some capital held for that, but the details of that, we would need more information about how exactly that 5 percent would work, what position it would be in how that would work before we could be specific about capital.

Mr. PAULSEN. And also, do you anticipate or can you foresee then, would they, and these banks have to increase, essentially, interest rates to account for the additional risk that they're going to have to carry, potentially, having those capital requirements?

Ms. BRAUNSTEIN. Well, it is speculation going forward, as I have said before, I think that this bill would have the outcome of moving a lot of people into that safe harbor to avoid this, and for those who choose to still work in the space where the loans were not in the safe harbor, they would price them accordingly, so most likely they would be very high-cost loans.

Mr. ANTONAKES. Well, I'll just ask, in a little different take, but you know, the bill, H.R. 1728, dramatically expands the reach of HOEPA, however, because of the nature of HOEPA restrictions, my understanding is that few such loans are actually ever made, you know, is a better approach, one that's taken by the Federal Reserve, you know, in recent HOEPA rules in general. Is it better to offer great, in essence, protections to loans outside of HOEPA instead, rather than expanding HOEPA itself to cover more loans?

Ms. BRAUNSTEIN. When you're talking about the original HOEPA carve out, that is one of the reasons why we said that we think this will push people out of that space because, in fact, that is what happened in HOEPA. When we tightened those triggers up in 2000, we found that there were very few loans being made in that space and we started counting them. I know there was 1 year where there were just millions of mortgage loans and there were approximately 30,000 HOEPA loans in the whole country. So, there is not much going on. And now of course, there's not much going on anywhere but there was not much going on in that space. And that could happen again with loans that are outside this safe harbor.

Mr. PAULSEN. Okay. Thank you, Mr. Chairman. I yield back.

Mr. WATT. The gentleman from California, Mr. Baca.

Mr. BACA. Thank you very much, Mr. Chairman. Mr. Antonakes, in your testimony, you urge Congress to eliminate the Federal preemption of State consumer protection laws from the State because, as you put it, the States have and continue to be the front line guardian of consumer protection. That isn't always the case. But according to recent 2009 CRL reports, over 1.5 million homes have already been lost through subprime foreclosures and another 2 million families with subprime loans are currently delinquent and are in serious dangers of losing their home. And in my area, in the LN Empire, we have the third largest foreclosure in the United States. I don't think these 2 million families feel very protected. They don't feel very protected right now. How can you justify the continuance of the system that has led us to where we are now?

Mr. ANTONAKES. Well, Congressman, I would say, that the preemption of the OCC and the OTS blunted State efforts. We had predatory lending laws in certain States, North Carolina, dating back to 1999, that were gutted by Federal preemption. As a result of which, only certain lenders had to be compliant with those laws. And that the laws, even during the rule making process, assignee liability provisions that would have prevented many of the things we deal with today, were gutted, as well. We have done, I think, as well as we could with one hand tied behind our back over the last several years. I guess our point here today is, let's work together. Let's not eliminate State—

Mr. BACA. What are you going to do to correct it? What are you going to do for those people who have lost those homes right now? What kind of protection do we have as safeguards so we have in the future that we don't have the same things occurring right now, because we have these predators every day calling, we have these marketers calling individuals that are very gullible, very naive, and they're preying right into the subprime bodies or people that says, hey, you know what, I guarantee you, you can buy a home and get into a home.

Mr. ANTONAKES. I believe that, you know, that there is a legitimate role today for the Federal Government to pass a Federal law to enhance protections. States also have the opportunity to pass laws, as well. We have passed laws in Massachusetts dating back several years, most recently in 2007, which significantly increased protections for consumers facing foreclosure problems today, as well as with the areas in the future. States have an active role to play. Certainly some play it more actively than others. There's no denying that, but there is a real role today to work together, the States and the government, the Federal Government, not to be opposing each other, but to be working collaboratively to provide protections, meaningful protections for those people facing trouble today, right now, as well as provide protections in the future.

Mr. BACA. Yes, but how do you tell someone who is losing their home, I mean, you have to look someone in the face who says, you know what, I really don't have that kind of protection, I'm losing my home, what kind of guarantee do I have, I really don't trust the system anymore? And that's basically what's happening with a lot of the people who got into this kind of a situation. How do we tell them that they are about to become homeless?

Mr. ANTONAKES. Again, in Massachusetts, we've held forums throughout the State, foreclosure prevention forums. We have taken, similar to what the bill is "proprieted" today. We have granted several million dollars to nonprofit entities to establish regional foreclosure prevention centers across the Commonwealth. There are meaningful ways to help people in trouble right now. I'm not saying that there's going to be a solution for everyone. Unfortunately, there can't be. But, we cannot give up. We can provide assistance and hope for these folks, the people on the ground. The States are well-positioned to do that. And I think what we're asking today is to allow us to continue to do that, enhance our ability to do that and don't tie us up as we try to do that now and in the future.

Mr. BACA. Well, we'll only tie you up because we need accountability and oversight regulations. But let me ask either one of you, or both of you, since minority groups were unjustly targeted for subprime lending, they are now suffering disproportionately from foreclosures and mortgage delinquency rates. Do you think H.R. 1728 will prevent this racial targeting of subprime lending?

Ms. BRAUNSTEIN. I am not aware of any provisions that particularly address the issue that you raise other than the fact that it will help everybody in the mortgage market and that would include minorities because there are some provisions in there about steering and keeping people away from high-cost loans and from loans that could potentially be abusive and predatory.

Mr. BACA. What can be done to improve this area or do you have any suggestions, especially as we look at individuals who are targeted within our communities. And people know which of the individuals to target, which ones are naive, which ones don't have the knowledge and there's certain individuals out there. Do you have any suggestions?

Ms. BRAUNSTEIN. Well, one thing that we're trying to do is, we're working very hard to increase efforts on financial education for people. In addition to substantive protections and to make people aware, especially today, some of the people who are facing foreclosure, the people you talked about who are feeling somewhat hopeless at this point, have an even bigger problem facing them and that is the mortgage foreclosure scams that are operating. And we have been very visible in trying to get the word out to people as to how to avoid getting caught up in these foreclosure scams.

Mr. BACA. What is one—

Mr. WATT. The gentleman's time has expired. And we're operating a very tight 5 minutes here, as I announced earlier, before you arrived. The gentleman, the ranking member of the full committee.

Mr. BACHUS. Thank you.

When we were growing up, I think our fathers and mothers always told us if you can't afford it, don't buy it. And I think if we would all remember if you can't afford a house, don't buy it, we would all be better off. And part of this, and if you're a bank, don't loan to people who can't pay it back. But what we're getting into here, all of this, and I think there is a need for legislation, but you're substituting the government's for individual's decisions on whether they can afford it or for the bank's decision on whether and how to loan it. And I think when you do that, where do you stop? It's a real problem.

Mr. Antonakes, let me commend you and your organization, because there already have been some very important steps taken to prevent these subprime lending debacle that we've witnessed over the past few years and this national registration and licensing, which you all have proposed. The Congress passed that, and as you said, 20 States have instituted it; and you said 49 States are well on the way of betting it. What is the one State that isn't?

Mr. ANTONAKES. We don't have any information at this time, and where the State of Minnesota is with regard to implementing legislation, so we will continue to communicate with them.

Mr. BACHUS. And that was really a bipartisan effort of this Congress to institute, and that's not meant to substitute our opinion for home buyers or for banks. But it will go a long time. Had that been in place? A good percentage—you might want to comment on that—of these loans wouldn't have been made. But what is your view of how that's going to help?

Mr. ANTONAKES. I think it's going to help significantly, Congressman, and we greatly appreciate your leadership on this issue. The Safe Act and the Nationwide Mortgage Licensing System is a complete database that attracts everyone involved in the mortgage origination of the lending process. The key here is every individual from the originator to the brokers to the lender has a unique identifying number which follows them throughout their careers, even if they move from State to State or from company to company. It also provides a complete database of a disciplinary action as well.

So if a company gets into trouble in one State, they can't simply change their name and move to another jurisdiction as well. So that information follows them, also provides access to the States for very complete FBI criminal background check information as well. It is truly a very robust system, and in addition to being this uniform portal for licensing, in many ways it's also the foundation for coordinated supervision among the States.

And now with our Federal colleagues as well with the registration with loan originators that work for banks and for credit unions, you know, I've been in this business nearly 20 years and to me it is truly the most extraordinary and significant developed in the area of mortgage supervision during that point in time.

Mr. BACHUS. All right, and I don't think that in the press or the media that you have been given the credit in your organization for what you've done in this regard.

Mr. ANTONAKES. Thank you, Congressman.

Mr. BACHUS. I very much appreciate it.

Let me ask you this, Ms. Braunstein. Does the Federal legislation or does the Fed—I'm sorry—believe that the limitation on hedging is wise?

Ms. BRAUNSTEIN. Does it? I'm sorry?

Mr. BACHUS. The bill in just reading it that requires mortgage lenders to retain a percentage of credit risk for all non-qualifying mortgages, it also prevents institutions from hedging that retained risk. And do you believe the limitation on hedges is wise? The authors of the bill have stated that they believed hedging eliminates incentives to prudently underwriting loans. I mean, do you agree?

Ms. BRAUNSTEIN. Congressman, that entire section of risk retention is something that we have sent up some substantive comments and technical comments on. And we would like to get more detail. The current bill, the way it is worded, does not give a lot of clarity on that, so we are a bit concerned about the hedging part of it in terms of how exactly that would work. It's not clear to us, and we know that hedging in general with portfolios is something that is commonly accepted as a safe and sound way to deal with risk in an institution. So the prohibition, until we get more clarity on that, it's hard to comment specifically.

Mr. BACHUS. Or how you would enforce it?

Mr. WATT. The gentleman's time has expired.

The gentleman from North Carolina, Mr. Miller, the co-sponsor of the bill, is recognized for 5 minutes.

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman.

Since this is a 5-hour hearing, I hadn't really intended to ask questions of this panel, but I do have a question based on the earlier questions. Please try to hide your disappointment. The question earlier was whether this was the right time for this legislation, that credit is now constricted and that this legislation might constrict it further. So whatever the merits of the legislation, this is not the right time to do it.

A couple years ago, I recall industry argued that homeownership is going up and whatever our drawbacks may be for some subprime lending while homeownership is going up, this is not the time to restrict credit and restrict homeownership. Do you recall a time that the industry said was the right time to adopt consumer protection legislation? Ms. Braunstein?

Ms. BRAUNSTEIN. No. I don't know that I can say. I do think that this is definitely the right time to add consumer protections to the mortgage market considering what we saw in the past. We do believe that. We believe that very strongly, which is why we issued the HOEPA rules that we did.

Mr. MILLER OF NORTH CAROLINA. Mr. Antonakes, do you remember any time that they thought was the right time? Or do you think that the complaints about timing or not really their objections, they will oppose regulation until the end of days?

Mr. ANTONAKES. I believe that's generally true, Congressman. I believe the bill is overdue and recognize the reference and those of many others to pass it previously. The key I think is, you know, to recognize that the market can change and to the extent some flexibility can be provided in the rulemaking process will, I think, continue to ensure. It's as robust and protective as it needs to be.

Mr. MILLER OF NORTH CAROLINA. I yield back my time.

Mr. WATT. The gentleman from California, Mr. Miller, is recognized for 5 minutes.

Mr. MILLER OF CALIFORNIA. Thank you, Mr. Watt.

I appreciate the question regarding right time. I think had we defined subprime versus predatory 6 or 7 years ago, we might not be in the severe housing downturn we are in today, but when you have a very viable marketplace as the subprime and you allow predators out there to make loans to individuals who don't verify income. They don't even verify if the individual has a job, and they make that individual a loan knowing that when the trigger kicks in, they can't make the payment, that's a predatory loan. But the subprime market places a very, very viable marketplace. And I think when you do it, we kind of strengthen it. But I'm glad we're addressing the predatory concepts at least in this bill. But there's a bill's definition of qualified mortgage as is defined, limit the organization other than the fixed-rate 30-year loan; and, does the provision of the bill limit consumer choices?

Ms. BRAUNSTEIN. Well, I do think the way the safe harbor is designed that it will drive a lot of the market into that safe harbor. That is not necessarily always a bad thing, because a lot of the practices that we saw that were egregious and that caused a lot of the problems would not obviously fit into that.

Mr. MILLER OF CALIFORNIA. But there are some practices that might not fall into qualified mortgage or safe harbor that might not necessarily be egregious.

Ms. BRAUNSTEIN. Right, and that was the next thing I was going to say. But there are some things that it's important not to define such that you are eliminating the ability to get loans that otherwise would be safe and sound, and good loans for consumers, which is why we have recommended that there be some flexibility given to the rule writers in terms of being able to make adjustments to that safe harbor.

And in particular that is going to be important when the mortgage markets reemerge and redevelop themselves. We don't know what kinds of products will be developed in the future and we may need to adjust it either way. It's not just loosening it, but there may be things that aren't contained now that would need to be added to it to protect consumers.

Mr. MILLER OF CALIFORNIA. Are there any provisions in the bill that a loan that's made that doesn't qualify as a safe harbor, but yet was a good qualified loan, does any change in law occur within the bill that would put you in a situation different than you're in today as far as putting a lender at risk where he might not currently be today?

Ms. BRAUNSTEIN. I'm not sure that I totally understand your question.

Mr. MILLER OF CALIFORNIA. Well, let's say if you made a loan today that was very specific and defined that did not necessarily qualify for a safe harbor but was an up-front, viable loan based on mark of requirements at that point in time, is there anything in this bill that would put a lender in a more severe situation as far as litigation than he would currently face to day under current law?

Ms. BRAUNSTEIN. Well, there would be provisions they would have to comply with such as the risk retention. An example, that would be somebody making a 15-year mortgage today which might be a very good loan. It would not fit into the safe harbor as it is currently defined in the bill.

Mr. MILLER OF CALIFORNIA. But are they in a worse situation under the new laws than they would?

Ms. BRAUNSTEIN. It would mean they would be subject to potential liabilities. They would probably have to up-price that loan in order to cover potential liabilities.

Mr. MILLER OF CALIFORNIA. So they could face additional liability that they don't currently face?

Ms. BRAUNSTEIN. Correct.

Mr. MILLER OF CALIFORNIA. That's something I think we need to be very cautious of, because market conditions might require a lender to make a certain type of a loan that might be very popular amongst consumers that does not qualify for safe harbor, yet they're putting it in a situation where they could be sued very easily, whether they might not be.

I hope we would address that before we mark the bill up to make sure we don't have some unintended consequence that might apply against a good lender for making a loan that might be a good loan but not qualify for safe harbor. How do you reconcile your rule and the HBCC considering your real consumers regardless of who orders the appraisal and the HBCC does not?

Ms. BRAUNSTEIN. That I do not. I am not familiar with what you are—I know that there are appraisal restrictions that we put out in our rule in terms of not coercing appraisals. And my understanding was that the rule was very similar, that the legislation that's on the table is very similar to what our rule was.

Mr. MILLER OF CALIFORNIA. But we're not sure?

Ms. BRAUNSTEIN. I thought it was the same. You are pointing out something that I am not aware that there's a difference.

Mr. MILLER OF CALIFORNIA. Can you check into that for me?

Ms. BRAUNSTEIN. I will check into that, yes.

Mr. MILLER OF CALIFORNIA. I'm concerned about that, if there is a problem there I think we need to address. Maybe you could get back to me on that.

Ms. BRAUNSTEIN. Absolutely.

Mr. MILLER OF CALIFORNIA. Okay. Mr. Watt, I am glad we are finally addressing the difference between subprime and predatory, but I hope we are not being overly aggressive and not considering future market conditions. I would hate to have a viable loan made in the future by a lender that might be very popular among consumers that puts a lender in a very bad situation. We might be sued for doing something right.

Mr. WATT. The gentleman's time has expired. We will reiterate what I said at the outset before the gentleman arrived that this is an issue we are aggressively trying to work on and would welcome and value input between now and Tuesday.

Mr. MILLER OF CALIFORNIA. I just wanted to bring up my concern. Thank you.

Mr. WATT. Mr. Green from Texas is recognized for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman, and I thank the witnesses. And, again, welcome to the committee.

A series of questions if you will and I would like each of you to respond and I shall move as quickly as possible, because I have a number of questions. Was YSP, a/k/a yield spread premium, a real problem for us prior to—well, maybe it continues to be a problem at this time, because we haven't completely dealt with it. Do you agree that it was and is a problem?

Ms. BRAUNSTEIN. Yield spread premiums definitely were a problem, in particular because they were used to steer people into higher cost loans in order for the originator to make greater compensation. Now that there's not much going on in the market right this minute, there may not be the same kind of problem, but they need to be dealt with for the market to reemerge.

Mr. GREEN. Do you agree, sir?

Mr. ANTONAKES. Yes, I do.

Mr. GREEN. 3/27s, 2/28s; were they a problem?

Ms. BRAUNSTEIN. Absolutely.

Mr. ANTONAKES. Yes.

Mr. GREEN. Prepayment penalties that coincided with the teaser rates; were they a problem?

Ms. BRAUNSTEIN. Yes.

Mr. GREEN. Tenants with an excellent payment history who are being evicted because property was being foreclosed upon; was this a problem?

Ms. BRAUNSTEIN. Yes, it is a problem. Did you use past-tense?

Mr. GREEN. Is a problem?

Ms. BRAUNSTEIN. Yes.

Mr. GREEN. Does this bill seek to address what we clearly have as problems? Does it seek to address them?

Ms. BRAUNSTEIN. Yes.

Mr. GREEN. And more specifically with reference to the yield spread premium, do you agree that it is difficult to explain the yield spread premium to the average person who has not had an opportunity to study some of these issues as we have?

Ms. BRAUNSTEIN. It is extremely difficult. As I've said, we've tried that with consumer testing. We tried it several times and we were not successful. Disclosure was not successful.

Mr. GREEN. For edification purposes so that people can understand, the yield spread premium allows an originator to raise the interest rate that the person will receive in the loan qualifies for 5 percent. Give the person a loan at say, 8 percent, and not tell the person that he or she has been placed into a higher interest rate than he or she qualified for. Is this correct?

Ms. BRAUNSTEIN. It's similar. It's more something that's supposed to be added to allow people to finance the cost of their loan through their interest rate, but it also is used—it's compensation for the broker—and it is also used to put people with higher prices.

Mr. GREEN. I understand. Hold it just a moment if you would, please, ma'am. We'll get to the broker. That's called a kickback. But let's talk right now about how it functions. It functions by virtue of the interest rates moving a person into a higher interest rate than he or she qualified for. Is this true?

Ms. BRAUNSTEIN. Correct, to cover cost of the loans.

Mr. GREEN. Yes, okay. Well, for whatever reasons there were many people who were placed into loans that were higher than what they qualified for. Is this true?

Ms. BRAUNSTEIN. Yes, that's our understanding.

Mr. GREEN. Yes. Empirical evidence supports it and they were placing these higher loans. And as a result many people found themselves having to pay mortgages that they could not afford that they may have been able to afford. For example, some people went into subprime who were really qualified for prime. Is this true?

Ms. BRAUNSTEIN. Correct.

Mr. GREEN. Okay. Now, we can get to the second phase of this. The person who did this, the person who pushed into this high interest rate, this person received a lawful kickback. We are not going to demean the kickback by saying it was a crime, but we will say it was what it was. It was a kickback, true?

Ms. BRAUNSTEIN. It was compensation, yes.

Mr. GREEN. Would you not call by definition this act a kickback?

Ms. BRAUNSTEIN. Yes, I suppose you would.

Mr. GREEN. Okay, it was a kickback. You know, sometimes you have to call a thing what it is and this is one of those days. It was a kickback and it was a lawful kickback, but it was still invidious. It was harmful. It was hurtful. This bill attempts to deal with that type of invidious behavior. Do you agree?

Ms. BRAUNSTEIN. Yes.

Mr. GREEN. And finally my comment because my time is running out, my comment is this: Sometimes when all is said and done, more is said than done. We don't want to allow that to happen at a time when there is great need.

Thank you, Mr. Chairman. I yield back.

Mr. WATT. Ms. Bachmann is recognized for 5 minutes.

Mrs. BACHMANN. Thank you, Mr. Chairman, and thank you too to the panelists.

I've enjoyed listening to the discussion and to your remarks today. And as we are looking at this bill it really does impose harsh penalties on the lenders, and, so, I am wondering if they are being censured for violating vaguely the fine effects, some people might say undefined lending standards.

I was just wondering if you could explain criteria or how one would truly define the concept of net tangible benefit, what that means to the consumer, or what a reasonable ability to repay really means. Because I am thinking if I am a lender or if I am a consumer trying to make out that loan, it's difficult for anyone to make that determination of what does net tangible benefit mean. What does reasonable ability to pay mean, because it looks like this will be left up to the banking regulators to make that ultimate decision to determine. But how can they possibly define those terms when every person's financial situation is completely different? And in reality it seems like any definition will just open the door for a barrage of law suits, and it doesn't seem that we have any shortage of those.

So it seems like it would be an extraordinary waste of resources if that's what we do, create just one more cause of action that would ultimately result, I think, in restricting access to credit for a lot of families. So I understand we want to retain this balance to be able to offer secure loans, but at the same time we want to make sure that we have the free flow of credit.

Can you help me with both of those definitions? Who is going to be making that determination and how will we ensure what's fair without just opening up the flood gate for a brand new tide of litigation?

Ms. BRAUNSTEIN. Well, the way the statute is currently written, the rule writers would be further defining both of those terms and I think it would be very important to add as much clarity as possible, because the lenders will need to be able to do due diligence to know that they are not running sideways of the law, so that clarity will be important.

Mrs. BACHMANN. In reclaiming my time, one thing that I have seen in various areas of the law, when we leave writing that definition up to people who are tasked with that assignment is oftentimes that doesn't bring clarity either and that it remains a malleable definition. And usually the ones who make the definitions then are attorneys who take these suits to courts and then judges end up writing what the parameters are.

Oftentimes, when it's left to the bureaucracy, the definition is obfuscated, and so we are being asked as Members of Congress to vote for something that is obfuscated with no promise that clarity will be brought to the situation. Perhaps the only promise is that it will create new causes of action and tying up the legal system. How has anyone benefitted by that?

Ms. BRAUNSTEIN. Well, I think of the two terms, the one that will be most challenging is net tangible benefit. There are so many different kinds of loans with characteristics out there. There are so many different kinds of reasons why borrowers choose to take loans. It will be a challenge to narrow that down and put something very clear into regulations, but certainly we would attempt to do that because we do feel that it's important that credit keeps flowing and that there be as much clarity as possible.

Mrs. BACHMANN. And I would agree with you on that, but it seems that the bill does impose very stringent assignee or assignee liability on the assignees and the securitizers for any loans that would violate these big standards. So what I'm wondering is, does the pool of people who could face litigation maybe grow even larger because of that? It seems to me that it would and then it seems like that gift that this bill would be giving to trial lawyers would be even sweeter.

Mr. ANTONAKES. Well, I believe the rules can be written and defined very tightly. A lot of States have experimented and have pushed the ability to repay standards as well as net tangible benefit standards. It has to be tightly defined so that people can understand the bright line exists to provide banks, lenders, the ability to comply with those rules. I think it can be accomplished. It has to be done in a robust, meaningful process, whereby the regulators can get meaningful comment from all of the stakeholders involved.

Mrs. BACHMANN. But I am sure you understand this has happened before, many, many, many, many times. We have a lot of history to look to.

Mr. WATT. The gentlelady's time has expired.

Mrs. BACHMANN. If I could just end my sentence, and I will.

Mr. WATT. The gentlelady's time has expired, but she can end her sentence.

Mrs. BACHMANN. The example in previous times that the bright line test occurs in the courtroom and that's my concern.

Mr. WATT. The gentlelady's time has now expired on her second sentence.

The gentleman from Missouri, Mr. Cleaver, is recognized for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman.

I won't take 5 minutes. I have one question and it's a philosophical one. Ms. Braunstein, you are always one of the more frank and candid witnesses we have and I appreciate it, but this is not technical at all. It's philosophical for both of you. Do you think that the terms "survival of the fittest" and "capitalism" are synonymous?

Ms. BRAUNSTEIN. That is not a question that I can just answer on the fly.

Mr. ANTONAKES. No. I don't.

Mr. CLEAVER. No, you don't?

Mr. ANTONAKES. I don't believe they're the same.

Mr. CLEAVER. That is the argument with this legislation, that capitalism is survival of the fittest and if people are too dumb, too ignorant, too stupid to figure out what damage is being done to them in a mortgage then that's exactly what should happen to them. You've answered the question.

Thank you, Mr. Chairman. I yield back the balance of my time.

Mr. WATT. The gentleman from California, Mr. Royce, is recognized for 5 minutes.

Mr. ROYCE. Yes, I'll ask Ms. Braunstein a question here. What do you believe the effect will be on the secondary mortgage market if Congress passes legislation without adequately clarifying the terms by which players in the secondary mortgage market would be legally liable for failures at the origination level? Could you give me your view on that?

Ms. BRAUNSTEIN. Given the fact that the markets are not functioning well now, it's hard to predict accurately what the impact would be. But, certainly, the more clarity that is there, the better they will function when they come back. So again I would argue for great clarity in what the rules are so that they are able to do the due diligence they need to do before purchasing loans.

Mr. ROYCE. If capital fails to come back into the secondary mortgage market, what will that do to the availability of credit at the origination level in your view, if you could share that with us?

Ms. BRAUNSTEIN. That would be a severe outcome for the ability to have credit available in the market. I do not think though that having strong consumer protections in place necessarily means that there would not be capital flow. I don't think they're mutually exclusive.

Mr. ROYCE. Going to another question, should Congress fail to pass mortgage reform legislation, how willing do you believe investors will be to purchase mortgages from institutions with lax underwriting standards?

Ms. BRAUNSTEIN. I would hope that investors would not be willing at all to purchase homes from institutions that lack good underwriting standards. One would hope that that lesson has been learned, but that does not preclude the need for rules to make sure that happens going forward.

Mr. ROYCE. In your opinion, to what extent have private investors shied away from the secondary mortgage market in the United States since the housing downturn? Can you quantify that for us?

Ms. BRAUNSTEIN. No. I am not prepared to do that.

Mr. ROYCE. Pardon?

Ms. BRAUNSTEIN. No. I cannot do that. I don't have that kind of data with me.

Mr. ROYCE. What do you suspect has happened there? Or without the data, can you give us a kind of broad overview of what you think has happened?

Ms. BRAUNSTEIN. I really am not prepared to discuss that. It's not my area of expertise.

Mr. ROYCE. Well, I'll ask the other witness for his views on that.

Mr. ANTONAKES. Well, I think certainly the private investors have shied away from that market without strong evidence to demonstrate it other than what we see, just based on the uncertainty that's occurring at this point in time. But like my colleague before me, I also daresay that we heard these arguments before when assignee liability was discussed in the past, and I think the market would be in far better condition today if State provisions, relative assignee liability, had held up.

Mr. ROYCE. Yes, I think the secondary mortgage market outside of the reach of the Federal Government is all but evaporated from what I've seen; and so I didn't think it was too tough to come to that conclusion. And I think private investors in this market, many of whom originally endured significant losses when the housing bubble burst on us, I think what they're suffering here is a crisis of confidence.

And I think the actions that we are taking that we need to take are to re-instill that confidence. And to the extent that we make mistakes in terms of the policies that we push that create the blowback of even greater lack of confidence and the judgment either of Congress or the regulators that that compounds the problem going forward, would you agree with that assessment?

Ms. BRAUNSTEIN. I think that it would be important to re-instill confidence in the markets, that there be some kind of rules in place that will help re-instill that. I think that having rules rather than no rules would instill more confidence.

Mr. ROYCE. I agree with that, but I think we also though have to caution the members on this committee against moving legislation that would discourage the very essential private capital from coming off of the sidelines and back into the private market, because that's what we need right now.

Mr. WATT. The gentleman's time has expired.

Mr. ROYCE. Re-instill that confidence. Thank you.

Mr. WATT. The gentleman from Colorado, Mr. Perlmutter, is recognized for 5 minutes.

Mr. PERLMUTTER. Thank you, Mr. Chairman. Ms. Braunstein and Mr. Antonakes, thank you for your testimony today.

You two are knowledgeable in some very complicated areas. The products you know, change every day, seem to be more elaborate, more complex every day and not quite sure where they're going.

Which sort of brings me to my point number one. My point number one is we're trying to address a lot of products, a lot of issues, a lot of consumer—you know, can the customer really understand what it is that they're getting when it comes to the loan that's being made?

And the desire is to make sure that the buyer is aware. Buyer beware. Let's start with Caveat Emptor, Buyer Beware.

But we need to make sure, because these things are getting so complex. And you know, I had last year's version of this bill which pushed me pretty far. I come at it more from a creditor's standpoint than some of my colleagues on this side of the aisle.

But I do feel that customers have been bowled over by some of the terminology. So let's just get to "a bright line." And this is more of a theoretical question. But maybe we should just be saying: The companies can do anything they want, so long as it's under "X" interest rate. To get back to the old usuary laws that existed, whether it's for first mortgages, junior mortgages, credit cards.

Can I have your reaction to establishing just plain old bright-line usuary laws that everybody works within?

I stunned you, because I'm coming at from such a different direction—

Ms. BRAUNSTEIN. No. I think that while there may be some appeal to that, that would very much restrict choice in the markets, and restrict availability of credit to a number of people.

I do think that it should not be just Caveat Emptor. I don't believe in that. I think that these products have become very complex and that disclosure alone is not adequate to deal with many features on these products. And that's why there is a need for substantive regulation around products and features, but that the regulation should still allow some innovation in products to make credit widely available and to give customers some choice in the products they choose; but the customers should be protected at the same time, and I think both can happen.

Mr. PERLMUTTER. All right. Mr. Antonakes?

Mr. ANTONAKES. Well, I think this bill tries to do that in some respects by limiting the types of bills and the interest rates, which would be covered by the safe harbor.

So I think that is one of the goals of this legislation.

Yes, we've done something similar with a different approach in Massachusetts, in terms of subprime loans. We've required now a mandatory opt-out of a customer. They have to affirmatively opt out of a subprime loan, if it's not a fixed-rate product. And if they choose on their own volition to move into a subprime loan that's an adjustable rate mortgage, then mandatory in-person counseling kicks in to provide that type of education, so they can then make hopefully an educated decision as to whether or not this is the best product for them.

You know, a cap on interest rates would simplify matters, especially with the fixed-rate products, certainly. My guess is that that's, you know, part of the goal of these legislation. The more simplified loans, with, you know, market interest rates get the safe harbor. The more complex loans, they can still be made, but there's going to be greater restrictions and greater penalties for the companies, conceivably.

Mr. PERLMUTTER. Well, and I guess where I'm coming from is we've talking about bright lines a lot, and I have to agree with my colleagues on this side about the complexity of these loans and sometimes the borrower doesn't really know what they're getting until it's too late.

But I agree with some of my colleagues on the other side of the aisle that we're going to have some consequences from net tangible benefits and thing like that, that I'm not quite sure where we're going.

In Colorado—and it's before both of your times—but back in the early 1980's, we did have limits for first mortgage. We had limits for junior mortgages. We had limits for credit cards. And things seemed to work pretty well.

But then we had that huge spike in interest rates in the early 1980's, and Congress basically lifted the lid on all interest rates, as it applied to customers.

And I don't know whether we need to go back to those old days—and I'm just sort of speaking, you know, to two experts out loud, and I appreciate your responses.

A couple other points—

Ms. BRAUNSTEIN. Can I just say that—

Mr. PERLMUTTER. My time is up.

Ms. BRAUNSTEIN. Oh.

Mr. WATT. The gentleman's time has expired.

The gentleman from New Jersey, Mr. Lance, is recognized for 5 minutes.

Mr. LANCE. Thank you very much, Mr. Chairman. Good morning to you both, and thank you for being here. And I certainly rely on your expertise. I want you to know that.

Mr. Antonakes, many States have voluntarily passed SAFE implementation legislation, and some of those States' standards are higher than the standards that are contained in this bill.

And do you think that this bill should have been more restrictive, or was it written properly to give you at the State level enough participation in what you want to do across the United States?

Mr. ANTONAKES. Well, Congressman, thank you.

I believe that ideally, a Federal predatory lending law is a floor, not a ceiling, allows States to enact laws more protective to their customers, if they choose to do so. And also whereas the rules are going to be such an integral part of the implementation of this law, there as to be a mechanism for State involvement in the rule-making process and also a mechanism for State enforcement.

Mr. LANCE. Thank you. And when you were here before—and I certainly was very interested in your testimony before—you stated that regarding ARMs, that you didn't think necessarily that they were the problem, and that you'd hate to cut those products out of the marketplace.

Some critics of the legislation believe that the safe harbor provisions aren't so safe for prime ARMs. What is your view regarding that in this legislation?

Mr. ANTONAKES. Well, I think that safe harbor is a good concept. I think it has to be drafted very carefully. We've discussed that I believe there are fixed-rate products out there, beyond a 30-year rate product, which is a safe and sound loan if it's underwritten appropriately, and the customer understands it and they can afford it.

Likewise, a traditional ARM product, not the interest only loans, not the loans with the teaser rates; your traditional 7(1), 10(1) ARM products are sound products, and they are limited on how much the interest rate can swing, as well as the underwriting and the ability to repay is taken into account.

I believe, you know, we're fortunate to be in a low-interest rate environment now, but those are products that are more important as rates increase, and would hope that if it is truly understood product, a vanilla product, a well underwritten product, that it could conceivably fit within the safe harbor as well.

Mr. LANCE. Thank you.

And Ms. Braunstein, good morning to you. I also rely on your expertise and always enjoy your testimony.

Obviously, we don't want to throw the baby out with the bath water and this is a subtle matter. Generally speaking, do you believe that the legislation strikes the right balance? Not all the particulars, but just generally speaking. Obviously, we want as much available to the American public as possible, with the appropriate safeguards, so that the public is not being abused.

Just generally, do you believe that an appropriate balance is being struck here?

Ms. BRAUNSTEIN. Generally, I would say that is true. Our staff has worked closely with committee staff to submit a number of comments on it, and there are some pieces that I think still need further clarity for us to get a sense of.

But generally, a lot of it mirrors what we did with the HOEPA rules, and we think that those struck the right balance.

Mr. LANCE. Thank you very much. I yield back the balance of my time.

Mr. WATT. Mr. Minnick is recognized for 5 minutes.

Mr. MINNICK. My question is for Ms. Braunstein. Consistent with Chairman Watt's opening remarks that this is still a work in progress, and we all share the similar objective of, "Let's improve underwriting by having some risk retention as a principle."

And listening to Ranking Member Bachus and some of my Republican colleagues, concerns that the 5 percent retention when compounded, would simply chew up a lot of the capital and reduce the capacity to make loans, particularly for long-term loans over an extended period of time—concerns which frankly have been expressed by financial institutions in my State when I've discussed the concept with them.

What would you think if we were to pass a bill that allowed 100 percent alienation if you could sell the entire loan, but you retained a contingent liability for 5 percent of the exposure for the first loss, and then grant to your or other bank regulatory institutions the power to establish regulations that would decide how to value, that retained a contingent interest and set that up as the reserve against capital?

And of course, you'd have independent auditors, who would make their judgment with respect to financial statements. But as a way of basically not incurring more capital than was actually needed to retain the risk that in fact is retained, based on the underwriting of these institutions.

Ms. BRAUNSTEIN. I think as with all methods of doing this, the devil is always in the details for these things. But I would—

Mr. MINNICK. This is why I want to give the authority to you.

Ms. BRAUNSTEIN. Right. Well, and I think that that would be helpful, and I would want to have our capital experts back at the office take a look at what you're suggesting.

Mr. MINNICK. Thank you.

Mr. Antonakes, do you have any reaction to that conceptually?

Mr. ANTONAKES. No. I think it's an interesting concept, and I think it merits review and study. And it may, you know, conceivably could alleviate some of the concerns. We would have to take a look at it, but we would be happy to do so.

Mr. MINNICK. Thank you, Mr. Chairman. I yield back the balance of my time.

Mr. WATT. I yield myself 5 minutes. Oh, I'm sorry, Mr. Ellison has arrived. I thought I was going to be last. But Mr. Ellison is recognized for 5 minutes.

Mr. ELLISON. Thank you, Mr. Chairman.

I have had a busier morning than usual. This is a very, very important hearing for me. And I want to thank the panelists for being here.

Ms. Braunstein, could you indicate what you think the benefits would be of requiring mortgage originators to adhere to their fiduciary duties, including the basic one that they act in the best interests of the buyer?

Ms. BRAUNSTEIN. Well, I think that one of the problems that we have seen in the current crisis has been that customers often do not understand how mortgage brokers function, and that they're not necessarily in all cases looking out for the benefit of the customer, that they are looking to their own compensation, and that that is not something that consumers often understand.

So I think that having a duty of care might help to alleviate some of that. I think there may be some, again, the devil is in the details in terms of enforcement of that and how exactly that would work. But—

Mr. ELLISON. Well, on a common-sense level, I'm a 45-year-old person who bought a home back in 1991 with my wife. I have purchased a home exactly once. But if you're a mortgage originator, you can't survive if you're only doing one deal per morning. So you're doing them all the time.

There is clearly an asymmetry of information and experience, so that duty might be beneficial.

Do you agree with that, Mr. Antonakes? Or what do you think?

Mr. ANTONAKES. I agree conceivably that—yes. And I certainly agree that a lot of folks, regardless of whether they went to a broker or lender or even banks in some instances, were put in loan products that were not the best product for them.

Mr. ELLISON. Yes. And in my view it doesn't matter what your level of education is. If you don't do mortgage origination, you don't know it as well as somebody who does it every single day.

Ms. Braunstein, you expressed concern about the ability of investors to comply with the prohibition against making loans without a "net tangible benefit." Could you discuss your thoughts on this issue, and just kind of more clearly explain your views on this subject?

Ms. BRAUNSTEIN. Yes. The concern with that is really the definition of net tangible benefit. And I know that there have been States that have worked on this.

It is a very difficult term to define.

It would need to be clearly defined, on the one hand because the lenders and assignees, moving forward, or securitizers, would need to be able to do the due diligence necessary to decide whether or not they're buying a loan that was within the bounds of the law.

On the other hand, trying to narrow net tangible benefit, there are so many products and features of those products, and there are so many reasons why people take out mortgage loans, and refinance, that it would be difficult to narrow that down and not end up excluding circumstances where there is a loan that was in the best interest of that person, but didn't make the list.

So I just think it would be a challenge. I'm not saying it's impossible. But it would be a challenge to do that.

Mr. ELLISON. Thank you.

Mr. Antonakes, could you talk about your views on this subject? During the mortgage crisis, we've seen that States often can move quicker than the Federal Government can. In fact, we have yet to pass an anti-predatory lending bill, so that's evidence that can happen.

With that in mind, do you think that it's important that Federal legislation be a floor and not a ceiling for the benefit of customers, that we keep 50 pairs of attorneys' general eyes on the problem?

Can you talk about this idea?

Mr. ANTONAKES. I'd be happy to, Congressman. I believe it's vital that the law be a floor and not a ceiling, allow States the ability to continue to innovate, pass laws that are more consumer protective, if they so desire, keep the attorneys general and the banking departments that have examiners and investigators that can go into a place the day after an event has occurred, and keep them working.

In Massachusetts, we have a predatory lending law dating back to 2004. We had regs in place in 2001. We have State CRA for nonbank mortgage lenders now.

Mr. ELLISON. Can I just ask you all this question in my last remaining moments. I've heard some people in the industry say that well, "You know, the worst of the predatory loans is out, all the people making the bad predatory loans are out of the business now. So we don't need to legislate."

Can you respond to such an opinion? I don't hold that view. But what is your view? Do we still need anti-predatory lending—

Ms. BRAUNSTEIN. Well, right now we're not in normal markets and there's not much going on, predatory or otherwise.

But the markets will recover at some point, and I think it is important to put good protections in place for the future, which is why we wrote the HOEPA rules. And I do think that's an important piece.

Mr. WATT. Thank you. The gentleman's time has expired. I will recognize myself for 5 minutes, and then recognize the chairman of the Full Committee finally afterwards, since this is a continuation of where Mr. Ellison was going anyway, on this State preemption issue.

Our intention on writing the preemption provision was to preempt States only insofar as they had laws specifically relating to the ability to repay, or net tangible benefit. And we're still working on the language. The question I want to ask is: If we found the right language to do exactly that, is there anything else in this bill that would preempt you from doing the kinds of things that you've described to Mr. Ellison that you think States ought to be not preempted from?

Mr. ANTONAKES. Yes, Congressman. I believe some of the provisions relative to assignee liability are preempted. Also, I believe strongly that—

Mr. WATT. Preemptive but preemptive with respect to ability to repay and net tangible benefits, as I understand it. Do you understand it to be something beyond that?

Mr. ANTONAKES. Well, I understand that some of the penalties that exist in State law for violations in those areas would also be preemptive as well.

You know, I guess again what we're asking today is we support, and we have supported for a long time, a concept of a Federal law. We really believe it needs to be a floor, not a ceiling; allow States to continue to collaborate with our Federal colleagues, and insure maximum consumer protection throughout.

And I believe that also, if we're going to have a Federal standard, that we have to be involved in some fashion, be it consultation of whatever the case may be, in the rule-making process as well.

I believe we have—

Mr. WATT. That actually leads me to my second question, and that goes to Ms. Braunstein. Mr. Antonakes has made that comment in his testimony and repeatedly in answers to various questions. Can you react to the notion that States might be allowed to be part of the rule-making process?

Ms. BRAUNSTEIN. Well, as I've commented in my testimony and in my oral statement today, we think that when rule-making becomes inter-agency, it is not as efficient or timely as it is when done by a single agency.

However, we do think it's very important to get input and consultation from everybody who's involved in the issue, and that would include the other agencies and definitely the State regulators. That doesn't mean that they have to hold the pen.

Mr. WATT. All right. That actually leads me to the third question I had, which was your comments in your original testimony about it would be more efficient to have one rule-maker as opposed to multiple rule-makers as we formalized in this bill, because sometimes you have to compromise down to satisfy all of those parties.

How do you address the concern that we have that those parties might also make you compromise up? Whomever the ultimate rule-maker is.

Ms. BRAUNSTEIN. Well, that's certainly a possibility. I'm not precluding that. But I can tell you from our experience with inter-agency rule-makings, that is generally not the direction in which it goes.

Mr. WATT. Mr. Antonakes, finally, you mentioned State enforcement, and I actually asked the staff as you were saying that, what the status of that was in the bill. And they acknowledged that might be a concern.

So would you please, as quickly as possible, give us some language on what might be being proposed there, so we can look at it?

Mr. ANTONAKES. I'd be very pleased to do so.

Mr. WATT. Okay.

With that, I yield back the balance of my time, and recognize the chairman of the Full Committee, Mr. Frank.

The CHAIRMAN. Thank you, Mr. Chairman, and thanks to two of our very reliable witnesses.

I was at the Senate Banking Committee, being very noble. I was urging them to confirm as the new Assistant Secretary for Congressional Affairs my Chief of Staff, an idea which I hate, but could not think of a decent way to sabotage. And that's where I was.

But I did hear in the question from the gentleman, I know one of our most thoughtful members, a point which we may have—in the bill. As I understood it, the concern raised by some was—I'm talking now about the securitization and the risk retention that 5 percent at every level would accumulate pretty much.

And it was never my intention to go above the first level. That is, I think the importance here is with the originator. My own sense is that the problem is when the homes were originated—and I believe that—and maybe the language was ambiguous in what we drafted—I think it is important to do a 5 percent retention, or whatever we decide is appropriate, for the originator.

I don't think you need it after that. That is, it's the originator who makes the loan or doesn't make the loan, and my view is if there are too many bad loans, you have a problem.

So as to the problem of accumulating, yes, I think that would be a problem. I think the major public purpose if served by putting this on the originator, because it really is the originator who decides whether it's a good loan or not.

I would yield to my friend from Idaho.

Mr. MINNICK. Mr. Chairman, I had not intended it to accumulate either. But the accumulation issue was one mentioned by institutions—

The CHAIRMAN. No, I appreciate that. I'm glad the gentleman brought it our attention, because let me ask him, if we were to make it explicit that it was not an accumulating thing, but just that the originating level? Would that alleviate some of the concerns—

Mr. MINNICK. No, it would not, Mr. Chairman, because the concern was 5 percent on this loan accumulated with 5 percent on the next loan. After you make 20 loans, you've used up your lending capacity, or potentially if—or 100 loans. At some point, you would have all of your capital tied up in this cumulative—

The CHAIRMAN. Well—

Mr. MINNICK. Of loans that you have made over—

The CHAIRMAN. All right. I would respond—then the question is: Do we want people who are so thinly capitalized to be originating all these loans? That's the issue. I mean, you do get 95 percent of it right back. And you can, as people start to repay, get some money back.

I understand that. I thought it was going up the chain. Then the question is, if people are so thinly capitalized—I would also note that it is the case that there wasn't any securitization at all. That didn't stop people from lending.

But I appreciate that clarification.

I would yield to the gentleman.

Mr. MINNICK. Mr. Chairman, I might add that the concern was particularly expressed by mortgage brokers and others that do not have a deep pool of capital available for this purpose. And the thought was if they could retain on a contingent liability—

The CHAIRMAN. Well, I would look at that. But again, I want to say, the purpose of legislation is to create a system in which people can get mortgages. It's not to provide employment for any particular business that offers mortgages.

We often—in this committee, where we deal with the intermediation function, where the means becomes the ends in the minds of some people. And the purpose is to have a good, reliable system providing mortgages.

People are saying, "Well, you know what? I don't have that much money, so if you put in some of these rules, I may not be able to issue as many originations." Well, maybe that's not such a bad thing.

But I understand that, and if a contingent liability works, okay. But I mean, if the argument is: "You know what? We want to get in the business of lending money, but we don't have any, so would you please allow us to have a system in which we can make a lot of loans, given the fact that we don't have any money?"

I think that may be partly how we got into the problem. But I thank the gentleman for the clarification, and I would yield back.

Mr. WATT. I thank the Chair for his intervention. And just for the Chair's information, one other possibility that's being floated is perhaps the possibility of maybe either reducing or eliminating the retention requirement for safe harbor loans.

So I've asked the Chair to think about that as a concept. I'm not asking you for a—

The CHAIRMAN. No, I appreciate it. And the details have to be there.

But I did just wonder if the gentleman would give me back some time, is that the notion that if we do something that we think makes the system work better, some people won't be able to make a living out of it, I mean, the purpose of the system is to get well-run loans. And if there are other ways to deal with it, that would be reasonable. To the extent that that encouraged more of the kind of safe-harbor loans, that would be reasonable.

Mr. WATT. I think I want to express the committee's full thanks to these two witnesses. I think you've edified us, and gotten us off to a great start, and laid a foundation for further discussion.

Ms. BRAUNSTEIN. Thank you.

Mr. WATT. And you are excused.

I would invite the second panel to come forward, as I invite the Chair to come forward to assume leadership.

Can I encourage the transition to take place as rapidly and as quietly as possible?

Let me thank the next panel of witnesses for being here, and introduce them promptly and briefly without elaborating on all of their credentials, so that we can expedite getting to their testimony. Mr. John Taylor, president and chief executive officer of the National Community Reinvestment Coalition, Mr. Mike Calhoun, president of the Center for Responsible Lending, Ms. Margot Saunders, Of Counsel at the National Consumer Law Center, Mr. Eric Rodriguez, vice president of public policy of the National Council of La Raza, and Mr. Hilary O. Shelton, vice president for advocacy and director of the Washington bureau of the NAACP.

Each witness will be recognized for 5 minutes to provide testimony. Your full written statements and any materials you wish to submit with it will be made a part of the record in their entirety.

Mr. Taylor is recognized.

STATEMENT OF JOHN TAYLOR, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL COMMUNITY REINVESTMENT COALITION

Mr. TAYLOR. Good afternoon, Chairman Watt, Ranking Member Bachus, and other distinguished members of the committee. I am John Taylor, the president and CEO of the National Community Reinvestment Coalition. I am honored to testify today on behalf of NCRC on the topic of H.R. 1728. NCRC applauds the chairman's leadership on this issue, and supports H.R. 1728 as a necessary measure to address mortgage reform and the need for comprehensive anti-predatory lending legislation.

Predatory lending and other abusive practices have destabilized the markets, driven widespread unemployment, and brought the economy to its knees. This is not a new problem, and Congress must not let another session go by without passing anti-predatory lending legislation.

NCRC has zeroed in on new waves of predatory lending practices. Most recently, unscrupulous lenders have migrated to the Federal Housing Administration program, FHA, which is now experiencing a rapid increase in defaults.

In addition, the old predators are transforming themselves into new predators. NCRC's investigation into foreclosure scams shows that formerly abusive brokers are now reemerging as foreclosure mitigation consultants. These consultants exploit distressed families by charging exorbitant fees, and not engaging in any legitimate foreclosure prevention.

NCRC will be releasing a fair lending audit using mystery shopping of more than over 100 for-profit national foreclosure prevention service providers in May of 2009. If regulatory enforcement is not immediately tightened, the unsafe and reckless lending practices of the past will continue to recycle into new abuses against consumers, thereby prolonging the economic crisis and hampering the recovery.

In order to effectively purge predatory lending practices, an anti-predatory lending law must include comprehensive protections against abusive products. NCRC does believe that H.R. 1728 could be expanded to include consumer protection provisions. However, NCRC also acknowledges the fact that the current bill provides several protections banning and limiting a number of problematic practices.

We support the bill's ban on prepayment penalties for subprime loans and non-traditional loans, and its ban on mandatory arbitration for both closed end and open end loans. Like prepayment penalties, mandatory arbitration traps borrowers in abusive loans.

NCRC also supports the tenant protection provisions included in H.R. 1728. Tenant protections safeguard the interests of all parties, including the neighborhood—the lender and the tenant, by ensuring that a foreclosed home is occupied until it is sold.

We support the protections against abusive servicing in H.R. 1728, such as the prohibition against force placed insurance on borrowers by services. Likewise, we're pleased to see that H.R. 1728 will help deter appraisal fraud on high-cost loans. But while helpful, we believe that more comprehensive measures must be implemented to safeguard against the appraisal fraud.

This committee has diligently sought advice on strengthening the bill's provisions, and we are grateful to be part of that conversation. We operate a national foreclosure prevention program, directly interacting with individuals and communities that have been attacked by predatory lending.

Therefore, we would like to offer the following recommendations to strengthen the consumer protections contained in H.R. 1728. The safe harbor provision assumes that certain loans are not abusive. A presumption of compliance means that any consumer alleging a legal violation may prove that the loan violated—must prove that the loan violated H.R. 1728's provisions.

When loans do not quality for the safe harbor, a lender must prove that they are not affordable, or lacked a net tangible benefit. A consumer will have much more difficulty defending against an abusive loan that slipped through the safe harbor than a loan that did not qualify for the safe harbor.

NCRC therefore recommends the deletion of the safe harbor provision, and the use of strong consumer protections to all loans. If the committee retains the safe harbor, the legal standard for safe harbor loans should be altered to provide borrowers with adequate defenses against abusive loans.

Also, there is no requirement that a residual income analysis be used when determining if a borrower qualifies for a loan. This analysis ensures that low-income borrowers have enough income left over after paying on debts, in order to afford the basic living expenses.

Regarding tenant protections, NCRC recommends modification of H.R. 1728 to allow tenants without a lease the rights afforded to them under the State or Federal law, whichever is stronger in the better interest of the renter.

Under H.R. 1728, lender securitizers and assignees would have limited liability. NCRC recommends that the committee reevaluate the limited liability mechanisms, and develop a system that would more effectively assure compensation to wronged borrowers, while responding to the industry concerns about unlimited liability.

The bill's provision that lenders assume 5 percent of the credit risk is a good start to placing responsibility on all parties. However, NCRC recommends that the committee consider apportioning predictable portions of liability on services, securitizers, and investor institutions.

Mr. WATT. Mr. Taylor, I always hate to do this to witnesses, because I know we don't give them enough time, but I do have to ask you to wrap up.

Mr. TAYLOR. I'll do that. We ask you to reconsider the preemption portion of the bill, consider that the fair housing laws and CRA laws that apply to the States, and they are able to do things on—States on additional level that expand on those laws.

I have to say a word about the regulatory agencies, because, you know, you folks, you passed HOEPA, you passed the fair lending laws, you passed truth in lending, you passed CRA. If you don't have the sheriff, the regulatory agencies enforcing these laws, then you might as not waste everybody's time. Because that agency that just sat up here, and testified—

Mr. WATT. The gentleman's time has expired. I agree with you, but it doesn't relate to the bill, so I—

Mr. TAYLOR. Understood.

Mr. WATT. We are with you.

[The prepared statement of Mr. Taylor can be found on page 290 of the appendix.]

Mr. WATT. Mr. Calhoun, you are recognized for 5 minutes.

STATEMENT OF MICHAEL CALHOUN, PRESIDENT, CENTER FOR RESPONSIBLE LENDING

Mr. CALHOUN. Thank you, Mr. Chairman, and Ranking Member Bachus. Like the Center for Responsible Lending and its lending affiliate, Self-Help, I personally come at this issue with feet in both the lending and the consumer protection world. I've been responsible for legal compliance for a multi-State lender. I've sold and securitized home loans on the secondary market. I've been a primary drafter of the North Carolina and other State predatory lending laws. I've been a private residential real estate developer, closed home loans as an attorney, and represented borrowers facing foreclosure.

I would start with three critical numbers, 90, 60, and 50: 90 percent of subprime borrowers had a home before they got the subprime loan; 60 percent of them qualified based on credit scores for prime loans; and 50 percent of them will lose their homes, lose their homes, not go into default, but lose their homes in this crisis. And when you add in the fact that over about half of all African-American and Hispanic borrowers were getting subprime loans, the impact has been devastating.

I want to first praise this bill for several areas where it substantially improves over the previous bill, the coverage of all loans, not just subprime loans. About half of the foreclosures will be non-subprime foreclosures.

Second, the removal of the irrefutable presumption of compliance that was in the previous bill. The previous bill would have insulated from any legal claim all of the payment option ARMs that are bringing down so many financial institutions today, for example. And finally, for recognition of the effective lack of accountability. And with that, I'll segue into the areas where the bill, I believe, can be improved.

First, regarding the skin in the game provision which has been discussed. We support that, as we believe lack of accountability has been a problem. There are some inherent limitations, though, on how much the skin in the game can help. It essentially says, "If this loan goes bad, you share in the losses," but you run into capital problems and things like that, about how much of the loss.

I mean, 5 percent? Loans today are having 50 to 60 percent loss. You're not keeping much of the loss there with the originator, and I don't know if you can keep more.

We think the flip side of that is even more important, and that is, how do you make money off the loan, and that should be aligned with sustainability. Right now, and what we have seen over the last few years, most of the money was made by the origination of the loan, rather than the performance of the loan.

Two simple steps would dramatically change that, and would go to—Congressman Perlmutter, would be more akin to what—you and I both grew up with lending standards in the 1970's—and that is, to require that qualified mortgages have no prepayment penalty, and have fees of not more than 2 percent lender origination fees—is what that would do, would mean that for loans to be profitable, they have to perform. You're not getting the money for origination.

It also has the virtue of it's a bright line that people can easily comply with at all levels, from origination to the secondary market. And it would dramatically change the market, and do perhaps more than any other provision that's in this bill right now, so we strongly urge that as a protection.

Let me move next to some of the other areas. There have been questions today about the anti-steering provision. It currently has weak language and weak remedies, and we have urged in our written testimony specifics about how to improve that.

Second, regarding yield-spread premiums, in 2001, HUD gave yield-spread premiums the green light, and much of the damage that we have seen in recent years is a result of that. They need to be reigned in, and the bill needs to be strengthened to prohibit the double charging of broker fees that is still permitted under the bill, that is you can get front end and back end fees, and double charge the consumer.

Fourth, Wall Street needs to be required to look at the loans that it funds. This bill actually removed and deleted the due diligence provisions that you had in the prior bill, and I know Mr. Watt, that you worked to improve. They were removed from this version. We urge that they be put back, and improved in the way that you suggested in 2007.

Finally, you need to strengthen the remedies, while still protecting responsible lenders. If there were a crisis of speeding-related accidents, I don't think we would respond with a general prohibition against excessive speeding, a limited number of officers to enforce the law, and remedies that said if you're stopped, the penalty is that you're required to slow down for that specific trip.

The remedy provisions in this law, unfortunately, are much like that. If you violate the law, and I'll conclude quickly, they are generally on the general standards. If you violate them, the result is you correct that specific loan, and we believe that may not be enough to move the market in the direction that I think we all are trying to do.

[The prepared statement of Mr. Calhoun can be found on page 179 of the appendix.]

Mr. WATT. I thank the gentleman.

Ms. Saunders is recognized for 5 minutes.

STATEMENT OF MARGOT SAUNDERS, OF COUNSEL, NATIONAL CONSUMER LAW CENTER

Ms. SAUNDERS. Chairman Watt, Mr. Lance, Mrs. Capito, members of the committee, I am here today on behalf of a long list of national and State organizations that are listed on my testimony. We, and I speak on behalf of many of—all of these attorneys across the country representing low-income consumers fighting foreclosures. We respect your continued efforts to stop the abuses in the mortgage market. We are grateful for the proposed funding in the bill for legal services, which would supplement the work of many attorneys around the country, and avert thousands more foreclosures.

We appreciate the improvements to Title I and Title II, relating to yield-spread premiums, limiting qualified mortgages, the tenant protections, and the change presumptions, as well as many of the other positive provisions in the other titles.

But with regret, I am here today on behalf of these many low income—I mean, legal services and nonprofit attorneys, to say that in its current form, we oppose H.R. 1728. The bill is complex, convoluted, and will not accomplish its main goal, to fundamentally change the way mortgages are made in this country.

Our chief concern is that the bill will preempt State law claims against holders, which are regularly used to save homes from foreclosure. Section 208 preempts State law claims which are premised on an ability to pay or net tangible benefit issues.

These issues are integral to many of the common law and statutory claims that are brought to stop foreclosures or affirmatively. For example, proof of the failure to determine the ability to repay is a critical part of proof of an unconscionability claim, or a breach of good faith in fair dealing.

There are a variety of specific State law common law claims that are omitted from the list that's protected against holder preemption. The bill also—while preempting State law, the bill fails to provide meaningful remedies against holders for violating the prohibitions in the bill. Recisions against holders would be available only for loans in foreclosure, only after the holder has had 90 days to cure the violation, and failed to do so, and then only if the holder is not a securitization vehicle. This is complex and virtually impossible as a mechanism to solve the current problem.

We would ask that you look at the passage of the FTC holder rule in 1975. That rule applied full liability to assignees for all claims and defenses that could be brought against sellers for loans used to purchase consumer goods such as cars.

At the time, the retail and finance industries violently objected. They said the rule would cause credit to dry up, banks to stop purchasing consumer loans, the elimination of much of the consumer finance business altogether. The industry insisted that they should not bear the responsibility of policing sellers, that the rule would interfere with re-competition.

In my testimony, I have a graph from Federal Reserve Board information that shows not one of these nightmare scenarios materialized. There was no reduction in available credit. There was no indication that sellers were hurt. There was no discernible increase in defaults.

This should be a lesson heeded today. Capped and measurable assignee liability imposes a market based discipline on the industry. The industry will not cease to exist. It simply will find a way to operate within the new guidelines, which will at the same time protect homeowners and create incentives within the industry to comply with the rules. Thank you.

[The prepared statement of Ms. Saunders can be found on page 264 of the appendix.]

Mr. WATT. You probably heard the bells and whistles that are going off. Unfortunately, we have been called to a series of votes, seven to be exact, so—and that's the bad news. The good news is that these are the last votes of the day. So once we come back, we will be able to continue the hearing and proceed without being interrupted by Floor votes. So I'm—there is a motion to recommit. There are seven votes, so maybe we should just set a time by which everybody should be back, and that would give you an opportunity to go and maybe grab a bite to eat or something of the kind.

Let's see, 15, 20, 25, 30, plus 10 is 40, 15 more is 55, and final passage, 60, 65 minutes of votes, even without lag time. So let's shoot to reconvene at 2:00, and that's subject to our being able to get back. But plan—if the witnesses will plan to be back by 2:00, I think that would serve a very useful purpose, and that will allow us to hit the ground running as soon as we get back. I apologize, but doing it this way allows the final two witnesses on this panel to provide some continuity into the question and answer period.

The hearing will stand in recess until at least 2:00.

[recess]

Mr. WATT. The hearing will come to order. I thank all of your for being patient. Members will filter in as we continue this afternoon.

And unless somebody is able to represent to me that all of the differences have been worked out while the recess was in, and that everybody is in agreement, we'll proceed with the hearing. If we all have an agreement, then we can all go home.

Ms. SAUNDERS. Oh, but we—it's great, we'll be great.

Mr. WATT. Well, we had some.

[laughter]

Mr. WATT. I didn't get the unanimous consent. Let me ask unanimous consent that Mr. David Berenbaum replace John Taylor as the person who will answer questions in his place. Mr. Taylor had a plane to catch.

Now—we're missing somebody else.

Mr. SHELTON. Yes. I believe Ms. Aponte is going to be representing Eric Rodriguez. Thank you.

Mr. WATT. Is she invisible?

Mr. SHELTON. She was here a little while ago.

Mr. WATT. Okay. I ask unanimous consent that Ms. Aponte replace Mr. Rodriguez on the panel, because apparently Mr. Rodriguez had another commitment also.

Without objection, it is so ordered, and we will proceed.

Mr. Shelton is recognized for 5 minutes.

STATEMENT OF HILARY O. SHELTON, VICE PRESIDENT FOR ADVOCACY & DIRECTOR, WASHINGTON BUREAU, NAACP

Mr. SHELTON. Well, thank you, Chairman Watt, Chairman Frank, Ranking Member Bachus, and and all the members of the committee for your work on this issue, for this hearing, and for inviting me here today.

The NAACP is deeply appreciative of your interest in our views on predatory lending, as it is clearly a crucial civil rights issue for the 21st Century.

For many Americans, the issue of predatory lending has just come into focus within the last few years as a disparate number of foreclosures are currently rocking our Nation's economy due to subprime predatory loans. Sadly, predatory loans of all types are nothing new to the African-American community and other racial and ethnic minority Americans as well.

For decades, predatory lenders targeted Americans, borrowers of color, with their nefarious products. Studies from as early as 1996 clearly demonstrate that many people of color could qualify for more affordable loans then they are allowed to receive.

African Americans are 3 times more likely to receive a higher-cost subprime loan than our Caucasian counterparts. Latinos are 2.7 times more likely to receive a higher-rate loan than white borrowers.

For most types of subprime home loans, African Americans and Latino borrowers are more than 30 percent more likely to have higher rate loans than Caucasian borrowers, even after accounting for differences in risk.

Let me make it clear that the NAACP recognizes the legitimate role that the subprime market has played, and can continue to play for hundreds of thousands of qualified Americans with spotty credit, or in some cases a lack of traditional credit history to pursue the American dream of homeownership.

Unfortunately subprime markets have been abused by too many unscrupulous lenders who are willing to ruin people's lives, not to mention whole communities, for their own personal gain.

Predatory lending ruins not only individuals' lives and families. It's disastrous impact can be felt by whole communities. Sadly, these people and their communities are often those who can least afford to lose what little wealth and stability they hoped to gain through homeownership.

Given that homeownership is considered one of the most reliable ways for economically disadvantaged populations to close the wealth gap, one direct result of these unfair and immoral discriminatory predatory loans is that it is harder for African Americans and other racial and ethnic minorities to build wealth.

Predatory lending is a direct attack on our financial security and economic future, an attack that is targeted on individuals and communities in part because of the color of our skin.

Furthermore, given what we know about the impact that these predatory loans can have on families, communities, and our Nation, it should come as no surprise that once again, African Americans feel that we are the canary in the coal mine.

Financial institutions appear to be willing to see how much damage they can inflict on one sector of the population, and then we will know what the rest of the Nation can stand.

And so the NAACP has a strong interest in seeing predatory loans outlawed and predatory lenders put out of business permanently.

As such, there are several elements that the NAACP feels should be included in any effective comprehensive legislation, that will go a long way towards ending the scourge of predatory lending.

These elements include:

First, a band on compensation tied to the terms of the mortgage that often serves as an incentive for steering vulnerable borrowers into loans that are more expensive and riskier than those for which they may qualify;

Second, the establishment of a Duty of Care that requires originators to present borrowers with loan options which are appropriate for their financial circumstances.

Third, the establishment of a requirement that lenders and originators make loans that the borrower can afford to repay.

Fourth, a prohibition on prepayment penalties in a subprime market.

Fifth, an increase in protection available under the HOEPA for high-cost loans.

Sixth, States and municipalities should be able to do more to end predatory lending than what is in the Federal bill, especially given the regional nature of some types of predatory loans and the fact that predatory lenders have a history of coming up with new schemes that bilk homeowners and would-be homeowners out of their hard-earned capital, whenever the existing scheme is outlawed.

And finally, no legislation should in any way provide immunity for past acts of discrimination or violations of civil rights laws and regulation by lenders, mortgage brokers, or financial institutions.

In closing, Mr. Chairman, I'd like to highlight that the NAACP supports H.R. 1782, the Fairness for Homeowners Act of 2009, introduced by Congressman Keith Ellison of Minnesota. While some of the provisions in Congressman Ellison's bill are similarly addressed in H.R. 1728, H.R. 1782 has a very strong and detailed anti-steering provision.

The NAACP feels strongly that H.R. 1782 is a good start, based on proven anti-predatory lending practices that have worked very well in Minnesota.

And finally, a few words about H.R. 1728, the Mortgage Reform and Anti-Predatory Lending Act. As far as the NAACP is concerned, while this legislation has some definite strengths, there are also some areas where we look forward to working with the committee to make stronger.

However, it should be clearly stated that in no way do we believe that this legislation as it is now will result in more discriminatory lending to racial and ethnic minorities.

I'd like to again thank the chairman and the committee for your sustained longstanding and tireless efforts to address predatory lending. And as far as the NAACP is concerned, you were on the forefront, trying to end predatory lending abuses long before it was a hot topic. And we appreciate all that you've done and all that you continue to do.

I look forward to continue to work with you to ensure that predatory lenders are put out of business and that everyone is free to pursue the American dream of affordable, sustainable homeownership, regardless of his or her gender, age, race, or ethnic background.

Thank you so much.

[The prepared statement of Mr. Shelton can be found on page 286 of the appendix.]

Mr. WATT. I'll let the record show him to go beyond his 5 minutes, only because he was bragging about my history of being involved in the legislation.

[laughter]

Mr. WATT. Mr. Rodriguez' appearance has improved tremendously since we went into recess.

And so, we will recognize Ms. Aponte for 5 minutes.

STATEMENT OF GRACIELA APONTE, LEGISLATIVE ANALYST, ON BEHALF OF ERIC RODRIGUEZ, VICE PRESIDENT OF PUBLIC POLICY, NATIONAL COUNCIL OF LA RAZA

Ms. APONTE. Thank you. My name is Graciela Aponte. I handle NCLR's legislative and advocacy work on issues such as affordable homeownership and foreclosure prevention.

Prior to joining NCLR, I worked with constituents and community-based organizations on behalf of congressional representatives in Maryland and in New York City. And for 4 years, I worked as a bilingual housing counselor.

NCLR has been committed to improving the life opportunities of the Nation's 44 million Latinos for the last 4 decades.

I would like to thank Chairman Frank and Ranking Member Bachus for inviting me to share our recommendations for the Mortgage Reform and Anti-Predatory Lending Act of 2009.

This year, 400,000 Latino families will lose their homes to foreclosure. Rising unemployment has certainly had an impact; however, reckless and deceptive lending are the main culprits behind our foreclosure crisis.

We commend members of this committee for their efforts to bring forth a stronger anti-predatory lending bill. However, there is more work to be done.

Some have argued that predatory lending legislation is unnecessary at this point, that the banks have learned their lesson, and everyone will do a better job.

However, we can see that abuses are still occurring, even in a market with tight credit standards. We must make sure that this never happens again.

Here's a glimpse of how this is still occurring: A retired vet recently visited El Centro in Kansas City, one of our affiliates. He had received a VA loan. After months of trying to make payments, he could no longer keep up. The counselor discovered that the payments represented 60 percent of his monthly income.

His income had been marked up without his knowledge. He could have easily qualified for a mortgage based on his actual income. The brokers simply marked up his loan to earn higher fees.

As foreclosure rates rise, these stories continue to emerge. Oftentimes, the counselors find the borrowers could have qualified for a safe prime product. After helping more than 25,000 families purchase a home with a prime loan, we've seen that good products make all the difference.

Housing counselors instruct their clients to wait until the right moment to purchase their home, then they connect them with the home loan that will set them up for success.

The following provisions included in H.R. 1728 would have made a difference for so many families. We urge Congress to protect these provisions: Ability to repay standard; qualified mortgage; safe harbor; and tenant protections.

First, the ability to repay provision would ensure that borrowers receive loans they can afford to pay. This reinstates a common sense lending standard.

Through our housing counseling network and our lending partners, we've seen the power of good loans. It should be a primary goal of this legislation to create the space for sound lending products to compete for market share.

Second, the qualified mortgage standard shifts the incentives in the market. Right now, borrowers are steered away from practical and affordable home loans. Instead, they are directed towards expensive and risky products that earn originators high fees.

Together, these two provisions will help make room for positive innovations in the market. Over the past few years, we have seen good products, like the Bank of America Community Commitment loans, fall by the wayside in favor of risky products that pay a higher commission.

Third, tenants need the time to find a place to live if the house they are renting is foreclosed on. This bill provides protections for tenants who are trapped in this bad situation.

Having said that, three areas of the bill must be strengthened:

First, the anti-steering provision does not clearly prohibit certain deceptive practices. Legislation should explicitly prohibit lenders from steering consumers to loans more costly than they deserve.

Second, the Duty of Care provision does not go far enough to reign in mortgage brokers. Borrowers pay mortgage professionals to coach them through the largest financial transaction of their lives. Brokers should be obligated to give customers information they can trust.

Third, the liability and enforcement standards are not strong enough to deter creditors from violating the new law. The mortgage system must work, regardless of whether families complain.

We offer the following recommendations to further strengthen the legislation and to provide our full support: Any effective legislation must prohibit lenders from luring unsuspecting borrowers into unaffordable loans; must make mortgage brokers accountable for mortgages they give families; and must strengthen enforcement to make lenders obey the law.

Representative Ellison's bill, H.R. 1782, addresses some of these concerns. We are ready to work with the committee to strengthen H.R. 1728 and provide the protection our families need. I would be happy to answer any questions you have.

[The prepared statement of Ms. Aponte can be found on page 141 of the appendix.]

Mr. WATT. I thank each of these witnesses for their testimony, and I will now recognize Mr. Miller from North Carolina for 5 minutes.

Mr. MILLER OF NORTH CAROLINA. Mr. Chairman, since Mr. Green has started to ask the kind of questions that I've asked in the past, I'll pass on asking questions.

Mr. WATT. Okay.

Then, we will recognize Mr. Maffei while Mr. Green is getting organized.

Mr. MAFFEI. I could certainly defer back to Mr. Green, if he's ready. I don't want—

Mr. GREEN. Mr. Chairman, it seems that it is now my turn.

Mr. WATT. In that case—

Mr. GREEN. I will defer to seniority, but would like to be recognized—

Mr. WATT. If we have to recognize Mr. Green, we'll recognize him.

Mr. GREEN. Thank you. Rarely do I find myself having been yielded to by two members. It's a wonderful feeling. Thank you.

Thank you very much, friends, for being here today and giving us your testimony. You've heard some of the previous testimony, and I'm concerned about your reaction to some of the testimony that you've heard, because obviously we want to get the best bill possible.

So why don't I start on this end. Is it Ms. Aponte?

Ms. APONTE. Yes.

Mr. GREEN. My vision is bad, but it's not that bad. Okay? Yes, ma'am. With reference to previous testimony, is there something that you would like to respond to that will help us with this bill?

Ms. APONTE. Our key recommendations are the anti-steering provision, to strengthen the anti-steering provision, which legislation is included in 1782, Representative Ellison's bill, which gives explicit and clear direction to lenders to not steer consumers into high-cost loans.

And then also the fiduciary duty for mortgage brokers. Our families pay extra money to go to a mortgage broker to help them find the best loan product for them. And this is not included in 1728, which would obligate them.

Mr. GREEN. Is the bill clear enough with reference to whom it is the broker represents? I found that many of my constituents actually believe that the broker represents them. Is the bill clear enough on that point?

Ms. APONTE. No. We would like it to have an actual fiduciary duty, where brokers are obligated to give the clients information, the best information that they can trust and not giving them higher commissions, so an actual fiduciary duty.

Just like our families trust their doctors and their lawyers and folks like that, we want them to be able to trust their mortgage brokers.

Mr. GREEN. All right.

Mr. Shelton, if you would, please? Thank you, ma'am.

Mr. SHELTON. Thank you.

I would have to agree with everything that Ms. Aponte has said very well, and she raised the issue of making sure that consumers understand who is representing them.

As you know, that has been a tremendous problem. Our mortgage brokers go into our communities all the time, talk to less sophisticated customers about refinancing their homes, and before they know it, they find themselves taking out a $20,000 loan and owing $100,000 as a principal.

Indeed that means that they assume that the mortgage broker represents their interest. There are some helpful provisions in the bill that we think help move us in that direction. But you cannot do too much to make sure that customers understand this.

So certainly beyond the protections in the bill, it would be very important that we do a number of community education programs to provide that kind of assistance as well.

Mr. GREEN. Thank you.

Ms. Saunders?

Ms. SAUNDERS. Thank you.

Yes, I can clearly say there are a few things we'd like.

First of all, there should be no preemption of State laws, State remedies in this bill.

Second of all, there needs to be a simple, clear structure that applies to the entire market, with clear, meaningful remedies.

We have tried to propose repeatedly that you draft a simple bill that creates market-based incentives for enforcement rather than litigation opportunities, shall I say, which this bill is full of.

And for example, we think that if you required a 30-year, fixed-rate, full amortizing, no-point-and-fee, no prepayment penalty—just the rate goes up and down based on credit risk—to be offered to everybody applying for a home loan—just require that it be offered, and the homeowner could opt out and get another, more exotic loan and have access to good disclosure—

Mr. GREEN. I'm going to have to ask you to summarize quickly, because I'd like for Mr. Calhoun—

Ms. SAUNDERS. Okay. I'm just about finished. But if you required that, it would make everything transparent and clear.

Mr. GREEN. Okay. All right.

Mr. Calhoun?

Mr. CALHOUN. Something similar, but a little different that I touched on earlier. One of the key structures in this bill is the qualified mortgage safe harbor, because then you don't have to have the credit risk retention, which will be a disincentive for loans outside the safe harbor.

Loans inside the safe harbor should not be allowed to have prepayment penalties, and should not have fees above 2 percent, which accommodates almost all the lending that's done today.

If you put those protections in place, they will add market pressure to stop, for example, a lot of the steering, because the steering counts on being able to trap a borrower in loan and/or either take a lot of money out in fees.

Mr. GREEN. I'm going to have to—yes, sir—

Mr. BERENBAUM. Very quickly, I would build upon Congressman Kanjorski's remarks about home evaluation and appraisal practices. There are current abuses in the area of broker price opinions, and also with regard to the unregulated role that appraisal management copies are currently playing in the marketplace.

Mr. WATT. The gentleman's time has expired.

Mr. Maffei is recognized for 5 minutes.

Mr. MAFFEI. Thank you very much, Mr. Chairman. Thank you to the witnesses for being here.

I just want to ask a brief question about some of the appraisal processes. I know that many of you have had some real concerns about how the appraisal process affects consumers.

I share those concerns, and I wanted to ask specifically about "so called cost appraisals." In fact, I do have a letter here that's signed by both the National Consumers League and the National Community Reinvestment Coalition, which is represented here today by Mr. Berenbaum, among others, that speaks directly to the issue.

It states that, "We need to return to a system in which home appraisals are determined using multiple methods." And the letter suggests that the cost approach would help to stabilize the housing market.

Mr. Chairman, I ask unanimous consent that the letter be included in the record. I just want to put the letter in the record by unanimous consent.

Mr. WATT. Without objection, it is so ordered.

Mr. MAFFEI. Okay. Thank you.

I'll start with you, Mr. Berenbaum, and then ask if anyone else has a thought. But what are your thoughts on mandating that a qualified appraiser use the multiple valuation methods?

Mr. BERENBAUM. We actually fully support the use of a qualified valuation professional, an appraiser, in every loan situation.

Now in the marketplace, that is not the reality today. One of our areas of concerns frankly has been the pressure that has been historically in this marketplace, brought originally to push up numbers. Now it's the exact opposite in an environment of short sale and foreclosure, to in fact push down numbers.

We are also very troubled by the inappropriate use of inaccurate automated valuation systems, or AVMs, by many securitizers, originators, and other players in the marketplace right now.

They unfairly, and inaccurately in many cases, put valuations on property that injure communities, the tax base, and the consumer and homeowners alike.

With regard to cost appraisals, we do believe that they are a tool, but just one tool. We do have some concerns about their use in low- to moderate-income communities. But again, we are looking to have in play as many different practices as possible to ensure accurate appraisals.

Let me add one final point. We feel it would be very appropriate for the FFIEC Appraisal Subcommittee to play a role with this legislation, if we could augment the legislation as it has been presented to address problems with AVMs, to address problems with in fact the role of appraisal management companies.

Mr. MAFFEI. Thank you. That's a real constructive idea.

I do have a minute or two left. Anybody else have a thought on this topic? I'll open it up to the panel.

Mr. CALHOUN. I would just add that I think the appraisal situation is an example where it shows that generalized duties have little market impact, whereas bright lines requirements and bright lines standards are much more effective.

Virtually every State had a law that said it's illegal to coerce appraisers, but that was the rule of the day. We need to structure market incentives so people make money off performing loans, not off originating loans regardless of whether they perform.

Mr. BERENBAUM. And Congressman, if I could quickly build on that point. This proves the utility of having attorneys general have an active role in the marketplace. Andrew Cuomo and the New York State Attorney General's Office is to be applauded for their role in developing a code of conduct in the IVCC and build on a suggestion—community organizations that was very similar.

Mr. MAFFEI. As a New Yorker, I appreciate your compliment of my very able friend and Attorney General, Andrew Cuomo.

Thank you very much to the panel, and thank you, Mr. Chairman. I yield back.

Mr. WATT. The gentleman from—

Mr. POSEY. Florida—

Mr. WATT. —is recognized for 5 minutes. Sorry about that.

Mr. POSEY. Thank you, Mr. Chairman.

Mr. Calhoun, it has been said that the yield spread premium, or the YSP language from the last Congress' bill, that there would be no possibility of anyone getting higher compensation in return for putting someone in a higher-cost loan.

But your testimony here indicates that's a little bit different. And I just wondered if you might expound upon that for me a little bit.

Mr. CALHOUN. There are two sections in that provision. And the first has a general prohibition against bearing compensation. But then there's a rule of construction that essentially said you can put any fee into the rate, so long as it has been disclosed.

And so if I walk in for a loan, they can either charge me a $5,000 broker fee or a $10,000 broker fee, and put it all in the rate, and they're just going to get paid more by raising the interest rate.

So that rule of construction opens a loophole that allows I think one of the practices that there has been a lot of consensus should be prohibited.

Mr. POSEY. And so as a followup, you see that as a fallacy in last year's legislation. Do you see any correction in this year's legislation?

Mr. CALHOUN. That loophole was carried forward, is what we have suggested. And it follows on the testimony earlier this morning from Sandy Braunstein from the Fed, their studies have shown the customers lose almost every time when there's a mix of an up-front fee and a back-end lender-paid fee to the broker. They tend to be double fees, not a substitute for each other.

So we have said if you're going to allow yields for premiums, say no up-front fee in addition to that fee that's being paid by the lender. Studies show that customers at least have a chance under that system.

Mr. POSEY. Now that makes perfect sense. Would you be kind enough to give me language that would make a change like that? Get it to my staff in the next few days? Would that be a reasonable request?

Mr. CALHOUN. We can do that this week, yes.

Mr. POSEY. Okay.

And also for, let's see, Mr. Berenbaum, yes, there you are. The committee has been told—or at least I have understood—that Mr. Bernanke promulgated rules this year that will make it impossible to get those subprime loans. Why are the Fed's high-cost loan protections and its new HOEPA regulations insufficient, in your estimation?

Mr. BERENBAUM. Well, let me share a conversation I just had with a customer yesterday, who is facing an imminent foreclosure. They purchased their home from a major national home developer in a brand new development. The home was over-valued, after we did a forensic appraisal by the tune of $80,000.

On top of that, they had an income which did not qualify them for the purchase of that home, which was a half-a-million-dollar home. And they were given an option ARM as a first, and a second loan that was due in a period of 5 years.

They are now struggling to avoid a foreclosure, in fact, applying to the President's new initiative to try to stay in their home. But that issue, in and of itself right there, addresses so many of the loopholes that we are concerned about that existed in the marketplace, and why, in fact, regulatory recommendations are inadequate to solve the problem.

We need a transparent law that works from Main Street to Wall Street to prevent this from happening again.

Mr. POSEY. And how do you think we might best accomplish that? I think everybody really wants that. But it has been elusive. What would be your recommended treatment of the problem—

Mr. BERENBAUM. Well, I think some of the testimony in the first panel, particularly from the Commonwealth of Massachusetts, was very instructive.

In my mind, a strong national law that actually allows States to work in concert, in partnership with Federal officials, would be ideal. And in fact, that law would allow States to bring actions that are new, fresh, that are not covered by existing Federal law.

And so there are examples of that, in the Fair Housing Act, in the environmental movement, where in fact Federal and State regulators work hand-in-hand, and there is a clear bright line standard for all.

The challenge for you on this committee is to find that common ground to establish that standard.

Mr. POSEY. In reading the legislation, you know, throughout it's pretty clear that nothing is intended to interfere or usurp any of the legislation that's enacted by any States. Do you see that as being problematic?

Mr. BERENBAUM. I do think that there are inherent limitations in the bill, as introduced, and our written testimony speaks to that, as did many of my colleagues at the table.

Mr. POSEY. Well, thank you. I'm out of time. I'd like to have more time, but I understand the restraint, Mr. Chairman.

Mr. WATT. The gentleman's time has expired.

Mr. Miller from North Carolina, if you wish to ask questions? Or I'll go to Mr. Cleaver.

I guess it is me then.

I think I have been in conversation with virtually everybody at this table in one way or another about various aspects of what they are concerned about, so maybe I should not ask questions, and that will expedite moving along. I mean, I think various concerns have been raised by various people, and we have been in discussions trying to address those concerns. I'm not sure we will ever be able to address Ms. Saunders' concern that we not preempt anything, but at least I understand more thoroughly what her concern is today.

Mr. BERENBAUM. Mr. Chairman?

Mr. WATT. Mr. Berenbaum?

Mr. BERENBAUM. If I could just make one final thought raised earlier by Mr. Taylor, my CEO, and that is we strongly would recommend that H.R. 1231, Chairman Frank's and Congressperson Moore's bill, the Foreclosure Rescue Fraud Act, be considered at the same time as this legislation. As you have heard from many witnesses, as you have seen reported in the newspapers, consumer rescue scam fraud is endemic right now. Thousands of dollars in equity is being lost with little service given, and we applaud that legislation and hope you can incorporate it into this legislation.

Mr. WATT. I would just strongly encourage you to press that issue with the Chair. That is a decision that is probably above any of our pay grades as we sit here. But—

Mr. CALHOUN. Mr. Chairman, as a native Floridian, if I could follow up to Congressman Posey's question there on the preemption. There is, in addition to the preemption on remedies against assignees or just the holder who buys the loan, and most of these loans are sold—I think it is important to remember that this bill is still being enacted in the context of regulatory preemption by the Federal banking regulators who have said that the States cannot do anything, essentially, in terms of mortgage regulation against anybody—against creditors, against brokers, against assignees, securitizers, anyone. And just another one—

I think there are two lessons from that. One, for most loans, this bill will be the only standard, and so it needs to be strong and comprehensive. In most loans, particularly with the consolidation in the financial industry that we are seeing recently, they are going to be originated through federally preempted lenders, and so the States aren't going to be add on. So it is all the more reason to make sure this bill does the job and that that preemption by the regulatory agencies does not expand.

Mr. WATT. Ms. Saunders wants to fuss at me, I'm sure.

Ms. SAUNDERS. No, no. I would never fuss at you, Mr. Chairman.

I just wanted to add that regardless of preemption, setting that issue aside, which is hard for me to do, but for the moment, setting it aside, it is very important that the remedies in this bill be clear and achievable, and the remedies are very confusing. First of all, it will be very difficult for any homeowner or their local legal aid attorney to find the securitizer, so a remedy against a securitizer is not all that helpful.

Mr. WATT. I think we may be in the process of curing that problem.

Ms. SAUNDERS. Well, that brings me to the second issue, which is the right to cure throughout this bill. If you have a right to cure that imposes simply the requirement that you do what you should have done all along, it creates an incentive to the creditor to just violate the law because every once in a while when they are caught they just get to cure. There has to be a heavy penalty for violating the law, and the penalty needs to be applicable for the benefit of the homeowner as against anyone who owns the loan.

And if you want to clean up, you want to allow the creditor to be the one holding the bag, then make the securitizer or the holder sell the loan back to the creditor when a complaint is made. But the homeowner has to be able to go against whoever owns the loan. Otherwise, the remedy for that problem cannot be a loan modification or stopping of foreclosure.

Mr. WATT. My time has expired, even though I didn't even ask a question, I think. But Ms. Bean, do you wish to be recognized for 5 minutes to ask questions of this panel?

Ms. BEAN. If I could.

Mr. WATT. The gentlelady is recognized for 5 minutes.

Ms. BEAN. Thank you, Mr. Chairman.

I had a question for Mr. Calhoun. I recall when I closed on a home or even done a refinancing, the process is very confusing with all the documents. Right now, borrowers have a right to request and review a draft of the HUD-1 settlement statement, but many of them aren't aware of the fact that they can get those documents prior to a closing so they would be better informed and prepared. Do you believe it would be more helpful for borrowers if we required that they were to receive those documents in advance of a closing?

Mr. CALHOUN. I think that would be helpful because, in addition to the fact that most borrower's aren't aware of it, under current law there is no penalty, the borrower has no private right of action to take any recourse if they request it and the lender denies it. That provision of RESPA does not have any penalty.

At the same time, I think it is important what Ms. Braunstein said, that the Federal Reserve has concluded that in a number of areas of mortgage lending, the disclosure is helpful and should be made as clear as possible, but it is not a substitute for strong, clear, substantive protections. When you go in to buy a car, we don't say—they are going to tell you all of the engineering defects in the car and you figure out whether you want to buy it. We make them sell you a safe car, at least they are supposed to. And we need something similar in the mortgage context since that is most families' most important financial transaction.

Ms. BEAN. All right, I have another question to the group and whomever is interested in answering. The underlying bill has a title establishing an office of housing counseling in HUD, which I support. But in talking with mortgage servicers it is apparent that many borrowers have debt problems that extend well beyond their mortgage. Do you think it would be advantageous to create a certification process at HUD for total debt counseling?

Mr. BERENBAUM. The National Community Reinvestment Coalition is a national HUD counseling intermediary, and I think that there are several issues related to the housing counseling programs. First, one, they are underfunded, which is a major issue. Second, many of the counseling agencies, because of the structure of some of the various modification or forbearance programs now are not doing full file review, and that is a disservice to the consumers who they are trying to advocate for, as well as some of the servicers whom they are engaging with.

I think you can't possibly do informed housing counseling without looking at the entire budget situation of a consumer and recommending appropriate credit counseling or other assistance. It also means looking at if their legal rights have been violated and telling that consumer, don't sign a waiver of liability or lease of claims that many of the servicers are in fact requiring today in modifications. But ASA also does money counseling.

Ms. BEAN. Yes?

Ms. APONTE. We are also a HUD intermediary. We have 50 housing counseling agencies nationwide. This is something that our counselors have asked for many times. They do homeownership counseling, but we have been asking for financial counseling for low- to moderate-income families for many years, so that is something that we would support.

Ms. BEAN. Thank you.

And the last thing I wanted to mention, as a co-sponsor of H.R. 1728, I am supportive of the reforms that we are making in the lending process, but concerned that we might be overly restricting how we are defining legitimate, safe mortgages or qualified mortgages. And I would like your comments on whether you are supportive of including FHA, VA, rural housing loans, Fannie and Freddie confirming loans, and particularly fixed-rate loans that may be beyond a 30-year duration, either a 50- or 40-year. That is open to the panel, whomever would like to comment as well.

Ms. SAUNDERS. May I comment?

Ms. BEAN. Yes.

Ms. SAUNDERS. It makes a lot of sense to want to include government-sponsored loans like FHA and VA loans, but we should keep in mind that FHA loans have been the vehicle for a lot of very bad lending. So just because they are FHA loans or VA loans by themselves should not, I think, permit them to be included in this safe harbor.

Second of all, 40-year loans should be used very sparingly and carefully. The amount of interest that is added to a 40-year loan is dramatic, whereas the effect on the payment is fairly small.

Ms. BEAN. You are not really establishing the equity. At the same time, in what we have done to rework existing loans for many homeowners who have run into trouble, what we have done particularly through the FDIC programs—and I hope, Mr. Chairman, I can just finish this answer—is allow them to extend the term, and I think in some way to preclude someone in a similar income situation but doesn't have the past problem to get payments down to a level that is affordable and provide access to homeownership. I think it is at least worthy of consideration, recognizing it is not ideal.

Mr. WATT. The gentlelady's time has expired.

Ms. BEAN. Thank you, I yield back.

Mr. WATT. I want to express my thanks to this panel of witnesses for their input and encourage them to continue to stay engaged as we move toward mark-up next week.

And while this panel is changing to the next panel, I will recognize Mr. Posey for a unanimous consent request.

You all are excused. Thank you.

Mr. POSEY. Thank you very much, Mr. Chairman. I would like to ask unanimous consent to enter into the record two letters, one from the Consumer Mortgage Coalition and one from the United States Chamber of Commerce.

Mr. WATT. Without objection, it is so ordered.

And I had a unanimous consent request myself. I ask unanimous consent to submit for the record the statement of Chris Koster, attorney general of Missouri, a statement from the Credit Union National Association, a statement from the American Homeowners Grassroots Alliance, a March 17, 2009, letter from National Consumer League, NRCR, and the Teamsters. Without objection, these things will be submitted for the record.

And if I could encourage this transition to take place from the last panel to the final panel of the day as expeditiously and quietly as possible, I will proceed as people are being seated in the interest of time with the brief introductions just to identify the witnesses, not to do justice to all of their credentials:

Mr. G. Gary Berner, executive vice president, commercial real estate, First Niagara Bank, who is testifying on behalf of the American Bankers Association; the Honorable John H. Dalton, President, Housing Policy Council, on behalf of the Financial Services Roundtable; Mr. David G. Kittle, chairman, Mortgage Bankers Association; Mr. Michael S. Menzies, Sr., president and chief executive officer, Easton Bank and Trust Company. on behalf of the Independent Community Bankers of America; the Honorable Timothy Ryan Jr., President and Chief Executive Officer of the Securities Industry and Financial Markets Association; Ms. Denise M. Leonard, chairman, Government Affairs, National Association of Mortgage Brokers; Mr. Charles McMillan, president, National Association of Realtors; Mr. Jim Amorin, president of the Appraisal Institute; and finally, Mr. Jim Arbury, senior vice president, government affairs, on behalf of the National Multi Housing Council and the National Apartment Association.

Each of you will be recognized for 5 minutes for a summary of your testimony. Without objection, your entire written testimony and any attachments thereto will be made a part of the record.

Mr. Berner, you are recognized for 5 minutes.

STATEMENT OF G. GARY BERNER, EXECUTIVE VICE PRESIDENT, COMMERCIAL REAL ESTATE, FIRST NIAGARA BANK, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Mr. BERNER. Thank you. Chairman Watt and members of the committee, I am Gary Berner, executive vice president of First Niagara Bank, Lockport, New York, which is located just outside of Buffalo.

I am pleased to be here today on behalf of the American Bankers Association to testify on H.R. 1728. First Niagara Bank is one of many banks that has never varied from traditional underwriting standards. Our $2 billion residential loan portfolio remains strong with first quarter, 30 day and over day and over delinquencies of less than 1 percent and chargeoffs running at just 2 to 3 basis points, or almost zero.

The turmoil in the mortgage markets has been very troubling to the banking industry, an industry filled with institutions that have existed for decades, and in the case of my bank, for over 125 years. It has been primarily the actions of loosely regulated non-bank lenders who have steered applicants to inappropriate mortgage products that have caused tremendous damage for both consumers and the banking industry.

Banks are already a major part of the solution to our housing finance problems. At my bank, over the last 6-month time period, we have completed 27 repayment plans or modifications and have only had 3 re-defaults. I have just returned from chairing ABA's industry meetings on housing finance, and almost all banks reporting having similar successes with their workouts and modifications. As such, we are all the more focused today on reaching out to over-extended borrowers before they become past due.

As the committee considers new legislation, it is critical to recognize the significant changes that are already underway in the mortgage industry that will provide much greater protections to the consumers. Last July, the Federal Reserve amended Reg Z to address many issues that lead to the housing price bubble and the overextension of credit. The new regulations address the use of exotic or non-traditional mortgages, require traditional underwriting standards, and reduce complexity in mortgage products.

These new regulations are forcing many banks and non-banks to renew their mortgage lending operations, even those that have always followed sound underwriting principles. Among other things, the new regulations define a new category of loans based on its APR as a higher priced mortgage loan. While this change was targeted to subprime loans, the standards are so stringent that they will include some loans that were previously classified as prime. This will curtail banks' ability to serve many creditworthy borrowers.

Further changes, including some proposed in H.R. 1728, have the potential to impair economic recovery further and should be considered carefully. At a minimum, legislation must ensure that non-banks comply with the same duties of care as federally regulated banks. In fact, all lenders should follow the same conservative underwriting practices.

While H.R. 1728 does seek to close gaps that still exist in the mortgage lending market, ABA has a number of recommendations to improve the bill. First, ABA recommends a two tier safe harbor. Tier one would create an irrebuttable safe harbor which would apply only to fully amortizing fixed-rate loans of any duration made by ensured depository institutions. The loans would be required to be fully underwritten and documented and could not be higher priced loans under the Truth in Lending Act regs.

Tier two would create a rebuttable safe harbor for fully documented and fully underwritten loans with well-established and traditional characteristics. Garden variety traditional ARMs with reset and lifetime caps would fall into this tier, as would fixed-rate mortgages originated by non-bank institutions. It would not, however, include loans deemed non-traditional under Federal banking agency regulation or loans considered higher priced under the Truth in Lending Act.

Second, ABA recommends further modifications to the risk retention provisions to provide greater certainty in the securitization process. Alternatively, we would suggest directing the regulators to set standards to achieve this purpose.

Finally, we recommend that the language giving the States additional authority over unfair and deceptive acts and practices be deleted or synchronized with similar authority and other laws to ensure a consistency of approach and results.

Thank you Mr. Chairman. We hope these suggestions are helpful to the committee.

[The prepared statement of Mr. Berner can be found on page 156 of the appendix.]

Mr. WATT. Thank you for your testimony.

Mr. Dalton, you are recognized for 5 minutes.

STATEMENT OF THE HONORABLE JOHN H. DALTON, PRESIDENT, HOUSING POLICY COUNCIL, THE FINANCIAL SERVICES ROUNDTABLE

Mr. DALTON. Chairman Watt, members of the committee, I am John Dalton, president of the Housing Policy Council.

First, I want to acknowledge that many lenders and others in the mortgage business have made some serious misjudgments and mistakes in the last few years. On behalf of the Housing Policy Council, I apologize for those misjudgments and mistakes. We want to ensure that these mistakes are not repeated. We stand ready to work with this committee to ensure that appropriate legislative changes are enacted.

The challenge is to craft a bill that prevents inappropriate practices, yet preserves a vibrant system of mortgage finance. There are key provisions that must be revised to meet this goal. We urge the committee to consider the corrective actions that Federal regulators in the industry have already taken to address the practices that contributed to the current financial crisis.

Since 2007, the industry has tightened underwriting standards, recalibrated credit practices, and realigned incentives. Regulators have issued the 2008 HOEPA regulations which implement many of the underwriting reforms that were proposed by this committee in H.R. 3915 in 2007.

The Housing Policy Council supports many elements of H.R. 1728. For example, we believe new loans should be based on the borrower's verified ability to repay and that yield spread premiums should be prohibited.

Other provisions in H.R. 1728 have major flaws. I want to highlight three of these provisions: the definitions of qualified loans; the 5 percent risk retention requirement; and the need for uniform national standards.

The definition of qualified loans is too narrow. There are other mortgage products that are safe and should be included in the definition. These include VA, FHA, rural housing loans, and loans that meet the conforming loan standards for Fannie Mae and Freddie Mac. All of these loans must of course meet the new underwriting criteria in the bill and in the 2008 HOEPA regulations.

Good loans of a duration other than 30 years, and with adequate rates—adjustable rates, excuse me—should also qualify. A fully underwritten 15-year or 40-year fixed-rate loan or a traditional adjustable rate loan with caps can be as safe a loan as a 30-year loan. The presumption that qualified loans under this section are in the safe harbor should be irrebuttable.

We agree that lenders should keep some skin in the game. However, the 5 percent risk retention requirement will significantly reduce the volume of new mortgage loans, increase the cost of new loans, or both. FHA, VA, rural housing loans, and the loans sold to Fannie and Freddie should be included as qualified loans and thus exempted from this requirement. This would focus the risk retention agreement on the type of loans that have the greatest risk.

Regulators should be explicitly authorized to apply the 5 percent requirement on a pro rata basis. Under a pro rata approach, both the lender and the assignee would share proportionally in any loss. The risk retention requirement should be time limited. As drafted, a lender must retain an ever-increasing amount of capital against its mortgage loans.

An 18-month time limit would avoid this excessive build up, yet install appropriate underwriting incentives. The committee also should authorize the banking regulators to permit lenders to implement alternatives to the 5 percent requirement that achieve the same goal.

Finally, the standards created in this bill should be uniform national standards. H.R. 1728 is a strong bill with significant consumer safeguards. These safeguards should apply to all consumers regardless of where they live.

The Housing Policy Council supports legislation that will improve mortgage lending practices. With some modifications, we believe that H.R. 1728 can achieve this goal.

Thank you very much.

[The prepared statement of Mr. Dalton can be found on page 200 of the appendix.]

Mr. WATT. Thank you so much for your testimony, Mr. Dalton.

Mr. Kittle is recognized for 5 minutes.

STATEMENT OF DAVID G. KITTLE, CHAIRMAN, MORTGAGE BANKERS ASSOCIATION

Mr. KITTLE. Thank you, Mr. Chairman.

MBA shares this committee's commitment to improving mortgage regulation. Doing so is the best path to restoring investor and consumer confidence and assuring the availability and affordability of mortgage credit for years to come. At the same time, we caution that if regulatory solutions are not well-conceived, they risk worsening a credit crisis that trillions of public dollars have yet to resolve.

Since the last hearing on this subject, MBA was proud to offer the Mortgage Improvement and Regulation Act, a comprehensive proposal that would ensure Federal regulation for the entire mortgage industry and that would establish a strong national consumer protection standard. MIRA, as we call it, builds on H.R. 3915 from 2007 as well as the Federal Reserve's HOEPA rules. It represents our industry's commitment to fixing the problems in the market.

We know that the current crisis requires a bold response and we are proud that MIRA would achieve this while ensuring a vibrant credit market in the future.

Our proposal shares the same goals as H.R. 1728, though we differ in some critical respects. My written statement comprehensively discusses our concerns with the bill, but I would like to highlight the most important issues. First and foremost, H.R. 1728 does not establish a single strong consumer protection standard. By allowing additional State and local laws, the bill would perpetuate and expand an already uneven and confusing regulatory patchwork where the costs are ultimately borne by the consumers. A better approach would be to preempt State laws but still provide a pivotal role for State regulators. This is the approach we took in our MIRA proposal and we think it will better serve all stakeholders.

We are just as concerned about the bill's mandate that lenders retain at least 5 percent of the credit risk presented by non-qualified mortgages. Lenders already have skin in the game through their responsibilities to investors. When a loan fails as a result of bad origination practices, lenders are forced to repurchase it. This is an important and extremely effective check on bad underwriting.

The new additional requirement, however, would have far-reaching and damaging consequences, particularly to non-depository lenders and to banks that will have to further increase their capital at a time when taxpayers are the most likely source of that capital. Ultimately this idea will narrow choices and increase costs for many borrowers.

MBA believes the definition of a qualified mortgage is far too limited. H.R. 1728 as currently drafted would raise costs on broad categories of safe mortgage products. They include loans with adjustable rates, many jumbo loans, fixed 15-, 20-, 25-, and 40-year loans, FHA, VA, and rural housing loans, as well as some Fannie and Freddie mortgages. We urge the committee to provide more flexible standards that will still protect borrowers.

The regulators should have the authority to allow loans to be qualified unless they contain higher risk features such as negative amortization provisions or no documentation. This would ensure that sound credit options are available to the full range of borrowers.

The bill does not contain bright line safe harbors that would allow prudent behavior without costly and unnecessarily litigation. This will deter lenders and investors from being part of the market even for qualified mortgages.

We believe the prohibitions against steering are ambiguous. They could prohibit certain important and legitimate incentive based forms of compensation as well as payments to lenders from the secondary market.

Finally, HUD should withdraw its RESPA rule and join the Fed to make the mortgage process more transparent and work better for consumers. RESPA and TILA disclosures should work together to give the borrowers the information they need to make the best choices and to make life harder for predators. Over half of the House of Representatives echoed similar concerns in a letter last year.

Congress is facing a once-in-a-lifetime opportunity to improve the mortgage lending system. H.R. 1728 is an important first step in what we hope will continue to be a collaborative and ultimately fruitful process. We at MBA look forward to working with this entire committee to improve this bill and enact strong mortgage reform as soon as possible.

Thank you Mr. Chairman.

[The prepared statement of Mr. Kittle can be found on page 216 of the appendix.]

Mr. WATT. Mr. Menzies is recognized for 5 minutes.

STATEMENT OF R. MICHAEL S. MENZIES, Sr., PRESIDENT AND CHIEF EXECUTIVE OFFICER, EASTON BANK AND TRUST COMPANY, ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA

Mr. MENZIES. Thank you, Chairman Watt, and members of the committee. My name is Mike Menzies, and I am president of Easton Bank and Trust in Easton, Maryland. I am also honored to be the chairman of the Independent Community Bankers of America and it is my pleasure to speak on behalf of our 5,000 community bank members.

While we do have concerns with some of the approaches to reform taken in H.R. 1728, we commend you, Chairman Watt and Representative Miller and Chairman Frank, for initiating the process of achieving needed reforms for your work on comprehensive mortgage reform legislation. Congress and the regulators and the financial services industry working together must develop strong measures to avert any recurrence of this foreclosure crisis. Imprudent and abusive and unethical lending practices in the subprime mortgage market produced this situation. It is appropriate for Congress to consider legislation to improve the regulation of residential mortgages.

Despite the challenges of the credit market, I am pleased to report to you that community bank mortgage originations remained steady throughout 2008. We estimate community banks originated approximately 800,000 mortgage loans for more than $125 billion last year, and Easton Bank and Trust has experienced record mortgage volumes in the first quarter of this year.

Policymakers should avoid hindering the flexibility community banks use to meet customer needs at different stages in their lives. Let me tell you a story about just one of my customers. As chairman of our local hospice, I was approached 2 years ago by a woman who left her job to serve as the hospice nurse of her dying husband. She had depleted most of her savings, yet only had equity left in her home. I made a 1-year interest-only loan to her with the understanding that after her husband passed away, she would return to work. Her husband survived the pancreatic cancer for almost a year and then she returned to work, and re-established her income. We found it necessary to extend the loan for 6 months interest only. When her income was re-established, we placed her in the secondary market.

This is the type of flexibility community banks need for their customers. We do have skin in the game. A flexible yet sensible mortgage finance system serves the best interest of consumers in the long run. Most community banks are very conservative in their underwriting practices and a consumer's documented ability to pay is a central part of our underwriting standards. Nevertheless, the new lending standards articulated in this bill, along with the cause of action provided to enforce new standards, raises concerns for community banks.

H.R. 1728 creates more litigation risk than the bill adopted by the House in the last Congress by providing no truly clear presumption of compliance for any mortgage product. We suggest the legislation provide more certainty by adopting a clear presumption of compliance for mortgages meeting interest rate caps. Moreover, the presumption should apply to a broader range of safe mortgage products that are beneficial to consumers, not just 30-year fixed-rate mortgages. Without a wider safe harbor, the legislation could cause a rigidity that prevents lenders from responding to varying financial environments in local markets. We strongly urge the committee to remove the 30-year fixed-rate requirement from the qualified mortgage definition and to make other changes that preserve the choices enjoyed by consumers today, particularly in rural and small towns.

Community bankers believe that regulation of non-bank originators must be significantly strengthened. New anti-steering regulations must be focused on this part of the industry where regulation is most needed.

We are further concerned about Section 103's restriction on compensation. Our interpretation is that it would prevent a bank from offering a consumer the opportunity to lower their interest rate by paying points. The legislation should exempt this standard practice to offer consumers lower rates.

Mr. Chairman, thanks for this opportunity to testify on behalf of the Independent Community Bankers of America. I look forward to your questions.

[The prepared statement of Mr. Menzies can be found on page 245 of the appendix.]

Mr. WATT. Thank you, Mr. Menzies.

Mr. Ryan is recognized for 5 minutes.

STATEMENT OF THE HONORABLE T. TIMOTHY RYAN, Jr., PRESIDENT AND CHIEF EXECUTIVE OFFICER, SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION

Mr. RYAN. Thank you, Mr. Chairman. I am pleased to appear before the committee on behalf of the Securities Industry and Financial Markets Association and the American Securitization Forum. We appreciate the opportunity to highlight just a few concerns or considerations that we would like you to focus on in your deliberations.

We believe the 2007 bill that this committee worked on, H.R. 3915, struck a reasonable balance, and we are encouraged that the committee used that bill as a starting point for this year's H.R. 1728. We also understand that the mortgage market is vastly different than it was in the fall of 2007. The housing GSEs have been placed into government conservatorship, a number of major mortgage market participants have gone out of business, and the government has taken unprecedented steps to stabilize the financial system, minimize foreclosures, and encourage mortgage lending. Given these developments and the dormant state of the existing securitization and subprime mortgage market, we believe that every effort should be made to take bold action now to facilitate a functioning and fair mortgage market for the future.

We have three key suggestions for this year's bill. One, protect the prime market. We recommend the committee revise the current legislation to ensure the continued functioning of the prime mortgage market. As currently drafted, the bill would impose potential legal liability on secondary purchasers of all mortgage loans and provides only a rebuttable presumption against liability for qualified mortgages, a narrow subset of certain 30-year fixed-rate loans. There are a host of other prime loans that provide meaningful benefits to qualified borrowers depending on their individual situation and the existing interest rate environment. We hope the committee will expand and strengthen this safe harbor to help ensure the continued availability of a host of different prime loans. In particular, expand the definition of qualified mortgages to include other prime loans. They have been mentioned by other members on the panel, so I will not repeat.

Two, provide a meaningful safe harbor for secondary purchasers of these prime loans by limiting the rebuttable presumption to creditors. This language was included in the 2007 legislation so that secondary purchasers can continue to provide liquidity to the prime market and should be added back to H.R. 1728.

Number two, better align incentives in the subprime mortgage market. Clearly, there were problems in the subprime market that should be addressed legislatively to assure they do not happen again. Most bad actors are gone. Regulations have been implemented to facilitate stronger underwriting standards. Far fewer bad loans are still being made and fewer still are securitized. But thoughtful legislation can help prevent backsliding when markets turn around.

One addition included in H.R. 1728 is a minimum 5 percent risk retention requirement for creditors of non-qualified mortgages. We agree that requiring creditors to have some skin in the game may help better facilitate the traditional lender/borrower relationship. European regulators are far along in the process of developing legislation that would require originators to retain skin in the game. Their approach has been to include many complex specifics in a piece of pan-European legislation that would be relatively difficult to amend should they find change to be required once into law. We note that the European approach has been to focus on the retention of risk in securitization exposures, in other words, in securities as opposed to the approach in your bill which is focused on loan level risk retention.

A more effective approach would be for Congress to lay out the broad principles for what retention should encompass and to designate the relevant regulator to implement those principles and to monitor compliance. In addition, we appreciate the committees willingness to facilitate an open regulatory process by putting such a requirement in place. Accordingly, we recommend providing regulatory flexibility to consider, one, the duration of risk retention, the size and calculation of the retention and circumstances when hedging may be used that protects safety and soundness and ongoing business flexibility.

Last, we think there should be clear and national standards. That is key. So we would recommend establishing a clear, preemptive single national standard for secondary mortgage participants related to the ability to repay and net tangible benefit test established in H.R. 1728.

Thank you very much.

[The prepared statement of Mr. Ryan can be found on page 253 of the appendix.]

Mr. WATT. Thank you, Mr. Ryan.

Ms. Leonard, you are recognized for 5 minutes.

STATEMENT OF DENISE LEONARD, CHAIRMAN, GOVERNMENT AFFAIRS, NATIONAL ASSOCIATION OF MORTGAGE BROKERS

Ms. LEONARD. Thank you. Good afternoon, Mr. Chairman, and members of the committee. I am Denise Leonard, chairman of government affairs at the National Association of Mortgage Brokers. Thank you very much for the opportunity to be here today.

Like most of my fellow NAM members, I am a small business owner living in the same community in Massachusetts where I work. The mortgage industry is much different than it was when I first started in the business over 19 years ago. Today, we have a deconstructed market. Origination, funding, selling, servicing, and securitizing can occur separately or can all fall under one entity. That is why we are especially pleased by the all-originator approach taken in H.R. 1728 and its comprehensive inclusion of all aspects of the mortgage process. We commend this committee's leadership on realizing that consumer protections should relate to function rather than entity structure. We applaud your response to the current problems in our mortgage market and share a resolute commitment to protecting consumers throughout that process.

As you know, a great deal of change has been affected already through legislative and regulatory action. We commend the all-originator approach as it is paramount to ensuring true consumer protection.

There are many provisions contained in H.R. 3915 that NAM supported, most notably the section now called the Safe Act that became law as part of the Housing and Economic Recovery Act, requiring loan originator standards for licensing and registration. Like 3915, NAM is extremely supportive of the overall concepts and provisions embodied in Title 1 and Title 2 of H.R. 1728. However, we remain extremely concerned that specific provisions of Title 3 will further harm many consumers.

More stringent standards for all originators is something that NAM has consistently advocated for since 2002, and we again support the all originator approach to a Federal duty of care and believe its value lies in the uniformity of treatment of all competitors in the mortgage industry.

We support the intent of the language contained in Section 103, which prohibits originators from persuading consumers into products based solely on compensation. We believe that the anti-steering provision, coupled with the ability to repay provision, if interpreted correctly, should be an effective means of protecting consumers from being placed into loans solely for reasons of higher compensation without completely prohibiting consumer choice.

Fortunately, the global provisions of H.R. 1728 do not legislatively pick winners or losers or further disadvantage small business or harm consumers in the mortgage industry. However, it is important to note that issues remain that can and will negatively impact the benefits that the tenets of this bill stand to establish, the most notable of which are the Home Valuation Code of Conduct and RESPA.

The Home Valuation Code of Conduct, or HVCC, is an agreement that was forced on the government—the GSEs—by the New York Attorney General. We are supportive of the concepts included in this bill and the Federal Reserve Board's approach to appraisal standards as they are applied uniformly to all industry parties regardless of who orders the appraisal whereas the provisions in the HVCC do not. In addition, the HVCC create a de facto regulation that did not go through the public debate and open process as required by the Administrative Procedures Act and will cause serious harm to consumers, brokers and independent appraisers if it is allowed to stand. It is set to go into effect in one week, and we encourage you to urge the FHFA to withdraw it before its effective date.

In addition, a significant component of the RESPA rule directly conflicts with H.R. 1728 by imposing an asymmetrical disclosure provision that unfairly exacerbates the unequal treatment of mortgage transactions. We believe HUD should withdraw the RESPA rule to work with conjunction with the Federal Reserve Board and coordinate its activities.

NAM appreciates the opportunity to appear before you here today, and I am happy to answer any questions you may have.

[The prepared statement of Ms. Leonard can be found on page 224 of the appendix.]

Mr. WATT. Thank you, Ms. Leonard.

Mr. McMillan is recognized for 5 minutes.

STATEMENT OF CHARLES McMILLAN, PRESIDENT, NATIONAL ASSOCIATION OF REALTORS

Mr. MCMILLAN. Thank you, Chairman Watt, and distinguished members of the committee. Thank you for inviting me here to testify on behalf of H.R. 1728, the Mortgage Reform and Anti-Predatory Lending Act of 2009. I am Charles McMillan, 2009 president of the National Association of Realtors, a Realtor for more than 25 years, director of Realtor relations and broker of record for Caldwell Banker Residential Brokerage, Dallas/Fort Worth.

I testify here today on behalf of more than 1.2 million Realtors who are involved in all aspects of the real estate industry. Specific to H.R. 1728, mortgage lending reform is paramount to our economic stability and a critical step in the housing market recovery. We appreciate your tackling this very important issue.

Realtors believe H.R. 1728 is properly focused. However, there are some areas of the bill that could result in unintended consequences for real estate professionals and the consumers we serve. Let me highlight five areas of concern for your consideration:

First, we believe the definition of "mortgage originator," as outlined in Section 101 of the bill, is way too broad. Everyday, Realtors provide guidance to our clients on what information they need to be apply for a mortgage. We also may discuss prevailing mortgage rates and products and may even recommend a number of loan officers. In providing these services, Realtors would be considered originators and therefore subject to the requirements currently set forth in H.R. 1728. Likewise, home sellers, who provide financing to a buyer, would also be subject to the same requirements as lending institutions and mortgage brokers. We respectfully request that you explicitly exclude real estate professionals and consumers who provide seller financing from this definition.

Second, NAR supports requiring originators who refinance a mortgage to verify that the new loan provides a significant benefit to the borrower. However, we suggest adding specific language that requires the lender to weigh the borrower's circumstances, all terms of the new loan, the fees and other costs of refinancing, prepayment penalties, and the new interest rate compared to those of the original loan.

Third, Realtors believe that the safe harbor criteria in Section 203 are too narrow, and we have concerns that conditions for rescinding the loan are too broad. We recommend you offer more protection to mortgage originators in the rebuttal presumption and that you expand the safe harbor provision to encompass more than just 30-year fixed-rate mortgages. If the safe harbor provision is not expanded, we fear that the credit risk retention requirement in Section 213 could prompt lenders to stop offering products that are not covered under the safe harbor. In other words, the impact of the credit risk retention requirements depends heavily on what is included in the safe harbor.

Fourth, Realtors support efforts to include taxes, insurance, and other homeowner fees in escrow for subprime mortgage loans. However, we believe borrowers who make at least a 20 percent downpayment should have the option to budget for these payments independently.

And, finally, Realtors believe H.R. 1728 helps strengthen the accountability and oversight of appraisers while also creating new consumer protections such as allowing borrowers to obtain a copy of all appraisers prior to closing.

NRA applauds the committee's effort to craft comprehensive legislation that ensures safe and affordable mortgage lending. This bill is a major step in the right direction.

In conclusion, I would like to reiterate that you consider making the adjustments outlined today to ensure that the legislation does not cause unintended consequences and unduly restrict the marketplace.

Thank you for this opportunity to present our thoughts. As always, the National Association of Realtors stands ready to work with Congress and our industry partners to help facilitate a full economic recovery.

[The prepared statement of Mr. McMillan can be found on page 239 of the appendix.]

Mr. WATT. Thank you, Mr. McMillan, for your testimony.

Mr. Amorin is recognized for 5 minutes.

STATEMENT OF JIM AMORIN, PRESIDENT, APPRAISAL INSTITUTE

Mr. AMORIN. Thank you. I am honored to represent the Appraisal Institute and our industry partners, the American Society of Appraisers, the American Society of Farm Managers and Rural Appraisers, and the National Association of Independent Fee Appraisers.

Mr. Chairman, H.R. 1728 is a good bill. It builds on H.R. 3915 from the last Congress, refined in light of our tough learning experiences over the last several months. It is a back-to-basics approach to plugging many of the holes the current crisis revealed in our mortgage finance system.

We applaud the bill's recognition that greater due diligence is essential to extend protections for lenders and consumers. H.R. 1728 requires physical property visits for high-cost mortgages. We submit that the vast majority of transactions merit similar protections, including subprime, high loan-to-value loans, and conventional loans. Too often, so-called "drive-by appraisals" have proven inadequate. Indeed, while some lenders are moving away from this practice, many appraisals in recent years have been developed without even seeing the property. Corruption thrives in the dark. This bill protects consumers by bringing the true costs and risks of mortgage transactions into the open. Definitions of and regulations around new entities, like appraisal management companies and BPOs, will bring policy up-to-date with current realities.

America's professional appraisers are particularly pleased by this bill's realistic approach to combating the pressures we often experience from loan originators and others to skew our valuations for their convenience. Making it illegal for anyone to seek to improperly influence the outcome of our work goes far to close a disastrous loophole that figured in the current industry crisis. What good does it do to employ competent, trained, and credentialed appraisers, using the most sophisticated methodologies, if their conclusions must give way to a pre-determined number? To protect the appraiser is to protect the consumer.

H.R. 1728 caulks another gap in our system by giving the Federal Appraisal Subcommittee effective tools like rule-making authority and authority for interim sanctions to oversee and conduct enforcement activities over State appraisal boards. Here, the Appraisal Subcommittee gains alternatives to the nuclear option of de-certifying a State and halting transactions there. This bill also provides much needed resources for State and Federal enforcement.

We suggest that the Appraisal Subcommittee can be further improved by adding representatives from other relevant agencies, like the Department of Veterans Affairs, the Federal Housing Finance Agency, the SEC, and the Federal Trade Commission. As an advisory board of stakeholder consumers, professional appraisal and real estate finance organizations could also contribute to the ASC's effectiveness.

On a broader note, the single most effective action would be to close the glaring loopholes Federal agencies have progressively drilled to circumvent crucial appraisal requirements. Currently, there are 13 exemptions from the requirement for an appraisal, including the $250,000 di minimis threshold. This threshold can exempt nearly all homes in many communities.

This legislation can be strengthened by limiting broker price options and automated valuation models in mortgage origination or mortgage servicing, particularly where markets have materially changed, as all too many have lately. Delivered by those who lack experience or training in valuations, BPOs invite conflicts of interest. Yet, Federal banking agencies encourage the use of these cut-rate substitutes for competently developed appraisals.

Another step, a bare minimum, is the regulation of appraisal management companies. AMCs charge "appraisal management fees," the details of which are not fully disclosed to the consumer. Consumers unwittingly believe that this includes a quality appraisal when in fact it is typically a cut-rate substitute. Because AMCs and lenders cram into these fees other undisclosed management charges, consumers are short-changed by quick valuations by AMC contractors paid a fraction of the normal compensation. Since appraisal fees are artificially capped by current Federal policy, this guarantees that corners will be cut. To remedy this irrational cap, Congress should direct HUD to revisit Mortgage E-Letter 97–46 and require transparency and full disclosure of appraisal fees and any additional management related charges.

Mr. Chairman, this bill plugs many holes in our mortgage finance system, but if we do not plug them all, our economy will continue to sink. This is a moment of opportunity to get back to the basics.

Thank you.

[The prepared statement of Mr. Amorin can be found on page 103 of the appendix.]

Mr. WATT. Thank you, Mr. Amorin.

Mr. Arbury, you are recognized for 5 minutes.

STATEMENT OF JIM ARBURY, SENIOR VICE PRESIDENT, GOVERNMENT AFFAIRS, ON BEHALF OF THE NATIONAL MULTI HOUSING COUNCIL AND THE NATIONAL APARTMENT ASSOCIATION

Mr. ARBURY. Thank you, Mr. Chairman, and members of the committee. I would like to thank you on behalf of the National Multi Housing Council and the National Apartment Association for the opportunity to provide the committee with important information about the multi family apartment rental sector as you begin debate on H.R. 1728.

First, I would like to thank Lisa Blackwell, our VP of housing policy, who worked so tirelessly on these issues.

As you take action to address the foreclosure crisis and the problems that accompany it, we urge you to carefully consider the meaningful differences between the single family condo, multi-unit sector on the one hand, such as duplexes and four-plexes, and the apartment sector, which we define as properties with five or more units. Without a proper understanding of those differences, any actions taken to address the single family meltdown may cause unintended consequences for the apartment sector. Understanding the needs of the apartment sector is more important now than ever because America is relying increasingly on rental apartments to house our citizens.

The word “multi-unit” has been used to encompass not only duplex and four-plexes but also multi-family apartment rental communities with five or more units. So conveniently people who use the word “multi-unit” blur the distinction that is necessary between the big foreclosure problem that is out there, which is primarily single family, condos and maybe some duplexes and four-plexes, and apartment rental properties.

Nobody likes to see people evicted from their homes as we saw last year before various lenders announced a moratorium on evictions. Before the moratorium, many people who had purchased a single family or condominium home during the housing bubble could not make their mortgage payments. And since single family houses and condos are intended to be ownership housing, the lenders were eager to move that housing as quickly as they could. This resulted in evictions, but then the lenders found out that there were few buyers. Ownership housing is fundamentally different from multi-family apartment rental housing. We are not in the business of selling. We are in the business of renting homes to millions of Americans. In fact, there are over 15 million apartment homes in this country.

If a multi-family apartment rental community goes into foreclosure, residents are not evicted. Foreclosure does not mean eviction in the multi-family apartment rental sector. There is a much more orderly transition. The community continues to be managed as a rental community. We want to retain residents, not evict them.

One only has to look at the history of what happened during the recession of the late 1980’s and early 1990’s when a number of apartment communities that had been overleveraged went into foreclosure. There were no stories about evictions from those communities because of the foreclosure. Multi-family apartment rental communities, those with five or more units, are fundamentally different from where the huge national problem with foreclosure/eviction lies.

I also offer this perspective to help you understand why it is critical that any actions you take to address the foreclosure crisis not adversely affect the ability of the apartment sector to meet the great demand for affordable rental housing. We truly understand the committee’s desire to protect renters who face eviction because they are renting a foreclosed property, but the proposed tenant protections included in H.R. 1728 and the stand-alone bill, H.R. 1257, the Protecting Tenants and Foreclosure Act of 2009, could have many unintended consequences that could lead to less private investment in affordable multi-family rental apartment or housing.

Therefore, we strongly oppose provisions in these bills that would essentially mandate participation in the voluntary Section 8 voucher program. Specifically, the legislation requires the immediate successor and interest of a foreclosed property to be subject to any preexisting lease Housing Assistance Payments, HAP contracts, for Section 8 recipients.

Through changes in the language to the HAP contract, the legislation attempts to subject the new owner to the immediate successor and interest to the existing HAP contract that was agreed to by the previous owner. There are many problems with this provision. First, it is not clear how it would be applied considering that the new purchaser is not party to the existing HAP contract. Further, the HAP contract is not a recorded covenant or lien that passes with transfer of title to the property. Finally, it is not clear whether this new requirement subjects to the immediate successor and interest to the contract violations of the previous owner.

When Congress created the Section 8 Program, it explicitly made the program voluntary because it recognized that there are costs and burdens imposed on property owners who choose to participate. Now this legislation seeks to mandate that in the event of a foreclosure, the immediate successor and interest would subject to the HAP contract of the previous owner. In other words, Section 8 participation would be mandatory.

We fully support Section 8. It is a critical program for meeting the housing needs of millions of Americans and some firms willingly participate in the program. But historically the program has been troubled with inefficiencies and bureaucratic requirements that make it more expensive to rent to a Section 8 voucher holder than to a market rate renter. Instead of making participation mandatory, we need to reform the program.

And you should also understand that with a Section 8 voucher, when there is a foreclosure, the person does not lose their voucher.

Just in closing, in any economic cycle, good or bad, multi family foreclosures will occur for a variety of reasons. The new owners come and there is an orderly transition to better management of the property.

Thank you.

[The prepared statement of Mr. Arbury can be found on page 149 of the appendix.]

Mr. WATT. Thank you so much for your testimony. I thank the entire panel for their testimony. Mr. Miller from North Carolina is recognized for 5 minutes for questions.

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman. Mr. Kittle, Robert Couch testified before this committee on behalf of your organization on November 5, 2003. And he said that, "Through innovations in the mortgage finance industry, through various financing and risk-enhancing tools created for the specific purpose of extending credit to our more needy communities, credit-impaired individuals now have ample opportunity to obtain loans through this non-prime or subprime market." He said that, "A truly amazing mortgage structure, based upon an international secondary market, has given the American population the best, cheapest and most efficient mortgage capital system in the world." Mr. Kittle, is there any part of that that you will not back?

Mr. KITTLE. Well, Congressman Miller, I was not here when he made that testimony, and he spoke for the Association at that time in that environment, but I will say that the statistics are today that 7 out of 10 of those loans that were made are still paying on time, which means 7 out of 10 of every customers who got a subprime loan got into a home that they may not have been able to purchase before. That would be the only answer that I can give you. I did not have the facts in front of me that he gave that day and, again, I was not here when he made the testimony.

Mr. MILLER OF NORTH CAROLINA. Do you disagree with the statistics that I have heard frequently, that more 70 percent of subprime loans were actually made to people who already owned their homes, they were refinances?

Mr. KITTLE. I do not know how to respond to that. I do not agree or disagree with that because I have not seen the numbers on it.

Mr. MILLER OF NORTH CAROLINA. Okay. Mr. Dalton, I appreciate that you have acknowledged serious mistakes—serious misjudgments and mistakes and that you apologized for those misjudgments and mistakes. But looking more closely at the nature of what you appear to be apologizing for, you say, "In all candor, these actions were well-intentioned and were taken as part of an effort to expand housing opportunities for Americans." The fact that there were intellectual misjudgments seems to be beyond argument. The fact that underwriting was seriously flawed, the fact that the economic assumptions were entirely off seems to be beyond any possible dispute. But do you acknowledge that there was any failure not just of intellectual analysis but of moral compass?

Mr. DALTON. Mr. Miller, I think these mistakes were made in good faith, but they were mistakes. Our industry made mistakes, I represent I made mistakes, and those mistakes contributed to the economic crisis that we are currently experiencing. And for that, I offer a genuine apology, but let me say that by the same token, we want to move forward, and I think you have a proposal in this legislation that can be improved, and we think will improve the mortgage industry and we are in favor of doing that. And that is the reason I am here.

Mr. MILLER OF NORTH CAROLINA. And I have heard that, "let's look forward, not backwards" many times, in many circumstances but, again, "In all candor, these actions were well-intentioned and were taken as part of an effort to expand housing opportunities for Americans," was the pursuit of profits not your principal motivation, your industry's principal motivation in mortgage lending?

Mr. DALTON. Our companies are in business to make a profit, and I do not apologize for that.

Mr. MILLER OF NORTH CAROLINA. I am not asking you to apologize for that, but you attribute it to an effort to an expand housing opportunities. Well, you were not Fannie and Freddie, you did not have a dual mission, right? You just had a mission of making profits, isn't that correct?

Mr. DALTON. I would not agree with that, Mr. Miller. I think that the people who are in this business do think that there is importance to homeownership and do think that homeownership is an opportunity for the American people to create equity and live the American dream. But the fact is we do live in a capital system that I applaud, and I think it is good.

Mr. MILLER OF NORTH CAROLINA. My time is expiring. I have a question both for you, Mr. Dalton, and for you, Mr. Ryan: 8 to 10 million families will lose their homes to foreclosure in the next 4 years, according to economists' forecasts. During the period that those mortgages were made, this financial sector was making more than—the 2004 to 2006 period, was making more than 40 percent of all corporate profits. You do not think that there was any overreach, that there was any moral failing in any of your conduct?

Mr. WATT. The gentleman's time has expired. If the witness cares to answer, he can answer very briefly.

Mr. RYAN. I will answer it very quickly, because I will say what I have said here I think 4 times in the last 2 months. At least our members, and many of the groups here represent the same people, the large financial institutions in this country, ours are global. As I have said before, we, especially in some of the subprime products and the way they were structured and distributed, we pushed the financial engineering to a level of complexity that was unsustainable and that was a mistake. We all know that. You have heard that from the CEOs of these companies too, and we are trying to change it. So we applaud your effort to give some symmetry and some sensibility to a mortgage market going forward because we all need it. Thank you.

Mr. WATT. The gentleman's time has expired. Mr. Posey is recognized for 5 minutes.

Mr. POSEY. Thank you, Mr. Chairman. And I thank each and every one of you for your testimony today. We have maybe the greatest group of well-credentialed problem-solvers since I have been in some of these meetings, and I wish we could lock you all up in a retreat for a weekend, and let you put your thoughts together. How about let's strike, "lock up."

Mr. WATT. It may be better to lock them up with the last panel of witnesses.

[laughter]

Mr. POSEY. Yes, and I think you all could really help find a roadmap to a solution for the crisis that this country is now in. We have heard the Fed's game plan and it is basically five Hail Mary's. Operate on a crisis de jour, and I know in private business, for better or for worse, you all do not work like that, you had road maps and you have systematic plans. And so I wish I had time to ask each and every one of you questions, but I learned my first day on the job here, we only get 5 minutes, and most of the witnesses or panelists we had, if you asked them what time it is, they would spend 4 minutes and 59 seconds describing the clock, the color of the hands, and you would never get your answer, so what I have done before, and unless there is an objection, I will do today, is spend my remaining time asking some questions and requesting your response to the committee in writing. Typically, it is about 30 days, I think, before these are officially requested and it is expected you could get a response in 30 days.

From that, what I would like to do is request from each one of you that you provide a one-page summary of your personal observation of how you think we got in this financial crisis. And if you think there is some culpability on the part of Congress, I hope that you will be candid and say so. And rather than ask each and every one of you yes or no, could you just shake your head yes if you understand the question. Let the record show every head shook yes except Mr. Arbury. Mr. Arbury? Yes, and he shook yes. Thank you.

As I mentioned earlier, I think that you all could have some great input with what you bring to the table on a potential road map to recovery, so I would also request, and the first request and this request are a little bit different. I do not care if you discuss the second request among you, but I would like the first request to be done without collaboration if you would not mind, so it would be your honest opinion and nobody else's.

The second request if you could give us a 5-page summary, and you might go over that a little bit, but 5 pages ought to do it, of what you personally think should be the kind of road map we should look at for recovery, not money, more money, more and more money and more and more and more money, but what you think systematically, some of the suggestions Mr. Ryan pointed out, that would help give us some stability, some of the things that would not ruin the secondary market. They might give us some immediate satisfaction but would destroy the secondary market for the future. But just some of your varied thoughts from your professional backgrounds or your associations' backgrounds that maybe we could look at and get some good ideas for a plan. I think that is what America wants.

I do not think we are ever going to recover from this no matter how much money we throw at it until the people in this country believe in their hearts that there is a real plan for recovery, that is measurable, that they can see, that we can see and only then will the consumers have confidence to begin spending money again. Until we have a real plan instead of a crisis de jour operation, people are going to hang on to every dollar like it is their last dollar. I know I will and probably most of you are. But when we can come up with a plan that is measurable, where we are, where we want to go, that the public can see, and that we hopefully can keep on course without bankrupting the next 20 generations, if this country should last that long with what we are doing, I think it would give us the quickest jumpstart to a recovery that there is, just so people could know how to cope with it, the people you represent would know how to cope with it, the people you do not represent would know how to cope with it, the people you do not represent that others represent would know how to cope with it and the average guy in the street would have some level of comfort with an expectation of what lies ahead in the future.

And I may have run over, Mr. Chairman, if so, I want to thank you very much for your indulgence.

Mr. WATT. You have 21 seconds.

Mr. POSEY. I will yield back.

Mr. WATT. The gentleman yields back. What a wonderful American.

[laughter]

Mr. WATT. Mr. Green is recognized for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman. Mr. Chairman, I must say that I think this is one of the most diverse group of witnesses that we have had, although I must also say that, Ms. Leonard, I think you may be slightly outnumbered. But it may be that it takes eight men to offset what one woman is capable of doing, so I compliment you.

Ms. LEONARD. Thank you.

Mr. GREEN. All of you. Friends, I would like to, while, Greg, if you would pass out the information to each member, each witness, I will just make some comments while he is doing this. I think that even with this group, I think there are some things that you can all agree on, and I am going to take a real stab at asking a question that I think everybody can agree on. Do you all agree that some reform is necessary after the crisis that we currently find ourselves in? And the only way that I can be sure and not use up all of the time to have your answers, just ask you to raise your hand if you agree that some reform is necessary? You do not have to, just in your mind think of the reform is, and probably some is not necessary. But if you agree that some form is necessary, would you kindly raise a hand?

[The witnesses raise their hands.]

Mr. GREEN. Okay, everybody agrees, let the record reflect that everybody agrees. But I ask this because there are those who absolutely believe that we should do nothing and let the system sort of work it out. And with a group as diverse as this, I think, to have this consensus is meaningful.

Next question, which may be a little bit more difficult, has to do with the yield-spread premium. If you are familiar with the yield-spread premium, and I have to assume that you are, do you think that what we have in the bill is better than having nothing at all as it relates to the yield-spread premium or there may be some who are of the opinion that the way it worked previously is fine and that we should do nothing about it. Do you think that the bill is better than nothing at all as it relates to the yield-spread premium? And for those who may not know, the yield-spread premium is that fee that is accorded an originator for causing a person to go into a higher interest rate as opposed to one that the person qualified for. And as the law currently is constructed, there is no requirement that the borrower be informed that you are going into a higher premium. So if you think that what we have is better than—what we have in the bill is better than what we have now, which is why I have tried to articulate, let me see if you would agree that what we had in the bill is better. If so, raise your hands. I will for the record—you are not sure on the end? You are not impacted by it all?

Mr. ARBURY. We are not, no.

Mr. GREEN. Okay, all right, we will exclude you. Let's see the hands now.

Mr. RYAN. Congressman, what we seek is a clear understanding of the points only in that sometimes it makes a lot of sense for a borrower to reduce their payment by buying the mortgage down.

Mr. GREEN. I understand, but what I am getting at, I am trying to not just weigh. What we are attempting to do, is it better than leaving things as they are? Is it better than leaving things as they are? Is what we are attempting to do better than leaving things as they are? Currently, you get the benefit of the yield-spread premium and the borrower never gets to know that you actually have put him or her into a higher interest rate, literally that is lawful. That is one phase of it, there are other aspects of it too. So I just want you to in your mind to evaluate, and all I am going to do is call your name is say that you have agreed or have not agreed. One more question, okay, yes, sir?

Mr. DALTON. Mr. Green?

Mr. GREEN. My time is about up so I better act fast.

Mr. DALTON. Well, I agree that the yield-spread premium, I agree with what is in the bill regarding the yield-spread premium, but there are some other things—

Mr. GREEN. I have to come back, my time is almost up, I'm sorry. If you agree that what we are trying to do is better, raise your hand? Okay, I am just going to note hands up for a minute. Mr. Menzies' hand, Mr. Dalton and Mr., is it Berner? Okay.

Now, the final thing, I gave you some print that is darkened on this page and this deals with Realtors. I think that Realtors who happen to do just what they are supposed to do, they are Realtors or they are brokers, they are not engaged in lending, that they ought not come under the scrutiny of what depository institutions come under or originators. If you agree with this, would you raise your hand? Is there somebody who differs with this? You think a Realtor ought to be sanctioned? Okay, Mr. McMillan agrees. Anyone else? Anybody differ with the language? I am going to take it if you do not raise your hand that you differ. You do not agree with the language?

Mr. BERNER. No, I agree.

Mr. GREEN. You agree with it. Anybody differ with it?

Mr. DALTON. I would like the opportunity to read it.

Mr. GREEN. Okay, I am sorry, take the opportunity to read it.

Mr. DALTON. Congressman, the language needs to be improved, we agree.

Mr. GREEN. All right, if I can improve upon it, I will. But, Mr. Chairman, may I ask unanimous consent for just the answer to this question?

Mr. WATT. Yes, sir. Do you want to go down the line?

Mr. GREEN. Yes, sir, if I can. We already have Mr. Berner. Mr. Dalton, is that language acceptable to you?

Mr. DALTON. It appears to be.

Mr. GREEN. All right. Mr. Kittle?

Mr. KITTLE. We would say that we think the language needs to be improved.

Mr. GREEN. Okay.

Mr. KITTLE. If that is answering your question, then—

Mr. GREEN. All right, is it better than nothing?

Mr. WATT. Does the committee have a copy of what the gentleman is asking for comment on?

Mr. GREEN. Yes, sir, I can pass a copy to you, Mr. Chairman.

Mr. KITTLE. The term "servicer" needs to be taken out of here.

Mr. GREEN. Okay, you don't want servicers included, all right. Mr. Menzies?

Mr. MENZIES. Well, I almost could, but from what I have read in bullet, I am fine with that.

Mr. GREEN. Okay.

Mr. MENZIES. Bullet two,—

Mr. GREEN. The darkened bullet, the one that is darkened.

Mr. MENZIES. Four?

Mr. GREEN. Yes, read that one while I go to Mr. Ryan. Mr. Ryan?

Mr. RYAN. I do not have a view but we will get one to you.

Mr. GREEN. Okay. Ms. Leonard?

Ms. LEONARD. We would not want to exclude—

Mr. GREEN. Just the darkened.

Ms. LEONARD. But I would like to be able to review it and get back to you on it.

Mr. GREEN. Okay.

Mr. WATT. Mr. Green, it might be more practical to get a quick written response from all of them.

Mr. GREEN. All right. Mr. McMillan, is it all right with you?

Mr. MCMILLAN. No, sir, the language is not okay.

Mr. GREEN. Okay.

Mr. MCMILLAN. It needs further clarification, if I may.

Mr. GREEN. Okay, well, we will talk about it. Let me just get to the last person, yes, sir?

Mr. AMORIN. Mr. Green, this issue does not really impact appraisers but to the extent that—we would love to take the time to study this issue, we could get back to you in writing.

Mr. GREEN. All right, thank you very much.

Mr. WATT. The gentleman's time has long expired.

The gentleman from North Carolina, Mr. McHenry, is recognized for 5 minutes.

Mr. MCHENRY. I thank the chairman. I thank my colleague from North Carolina.

Mr. Kittle, after watching the financial system collapse, thanks in part to some shoddy mortgage practices and lending standards, obviously, and poor risk management—these are all sort of self evident at this point—but there are a lot of Americans who wonder why we would not just regulate the heck out of mortgage lending to an inch of its life.

Can you tell us what the consequences might be for homeownership if Congress did that?

Mr. KITTLE. It would increase the cost of capital, number one. What we really need here, Congressman, is better transparency when a customer goes to loan application.

In my opening oral statement, I asked for this committee to look and we request that HUD withdraw its RESPA proposal.

We have a truth in lending that the Fed is looking at re-doing. We have a RESPA law that is going to go into effect at the end of this year that is onerous, that added requirements and papers to the loan application.

We need better transparency. More regulation is not the key, although we have proposed the Mortgage Improvement and Regulation Act before a subcommittee of this committee just last month. I testified on this.

We are asking for more regulation on us but we are asking for the right regulation that does not restrict capital.

Mr. MCHENRY. Mr. Menzies, in terms of that, what has happened in the securitization market over the last year, and what would this legislation in terms of liability provisions do to securitization going forward?

Mr. MENZIES. Congressman, there is no question that over the past year, the underwriting standards have become significantly more strict. We see that across-the-board.

Most community banks are straightforward common sense lenders selling conforming product, Fannie, Freddie, Ginnie and the like.

Therefore, lots of this legislation simply increases our cost of doing business rather than helping us do a better job with our consumers.

In that regard, the additional expense ultimately will be, I guess, passed onto the consumer. That is who ends up paying for regulatory burden.

Those are my off-the-cuff thoughts.

Mr. MCHENRY. Mr. Ryan, if you want to touch on that, I do have a question for you as well.

Mr. RYAN. Ask your question and then I will give an answer.

Mr. MCHENRY. Go right ahead.

Mr. RYAN. Go ahead.

Mr. MCHENRY. I have limited time. In terms of lowering the triggers for what classifies as a HOEPA loan, which this legislation does, would it make it more likely the wider swath of lending just simply would not be done?

Mr. RYAN. That is entirely possible. Let me go back to the larger issue you raised to Mr. Menzies.

Mr. MCHENRY. Can you touch on this?

Mr. RYAN. Let me just put this in perspective. In 2007, we had about $2.8 trillion of securitization. We were tracking along in 2008, the first quarter, around that same number, and everything dropped off the shelf.

That business is basically outside of the conforming area dormant. I say “dormant” because I do not want to say “dead,” because hopefully it will come back. In fact, it has to come back because of credit availability.

This is true for not only this committee, but also we have been saying this to the Europeans, if you go too far in your legislative drafting and you push things to a complexity that will not afford the opportunity to securitize and distribute.

We need to find in this industry a massive amount of new capital to put into these financial institutions so that we can make loans to people so they can buy homes and buy cars.

Mr. MCHENRY. Thank you. My time is running short.

I want to see if Mr. Kittle and Ms. Leonard, if you all could touch on the HOEPA elements here. The fact is there are such restrictions within that classification of lending that it is simply done on a very, very limited basis nationally, and we are going to create a larger type of lending that is under those standards, and therefore, simply would not be done on any major scale basis.

Ms. LEONARD. Correct, and it will have an impact on loans, especially loan amounts that are less let’s say than $100,000.

Mr. MCHENRY. Thank you.

Mr. KITTLE. My answer is that HOEPA should not be expanded. For the non-prime loans is what it was there for. It has already set up the ability in escrow accounts and things like that. To stretch it into the prime market, no, absolutely not.

Mr. MCHENRY. Thank you.

Mr. WATT. The gentleman’s time has expired. The gentleman from Pennsylvania, Mr. Kanjorski, is recognized for 5 minutes.

Mr. KANJORSKI. Thank you very much, Mr. Chairman.

Mr. Amorin, recently there have been many rule changes that affect professional appraisers. The appraiser independent rules issued by the Federal Reserve, new requirements on the standardized appraisal forms, and the home valuation code of conduct developed by New York Attorney General Andrew Cuomo, to name a few.

Are professional appraisers concerned about how all of these changes might affect appraisal quality, and if so, what should the Congress do?

Mr. AMORIN. Congressman, we are absolutely concerned about it. Professional appraisers are used to rules and we are used to playing by the rules. The home valuation code of conduct did one great thing in identifying the need for appraisal independence.

Unfortunately, it has opened up the door to unregulated activity by AMCs. These appraisal management companies usually focus on two things, who can do it the quickest and who can do it the cheapest.

We believe corners will be cut as a result of that. At the end of the day, the consumers are going to be getting lesser quality appraisals than they should.

Mr. KANJORSKI. What should Congress do about it?

Mr. AMORIN. That is a great question. We think AMCs should be regulated. We believe there are some mechanisms in place today to do that, either through the State or the Federal level.

To the extent that we can have appraisal management companies and the rules focus on quality of the appraisal, I think that would be great first steps.

Mr. KANJORSKI. Very good. As you know, I am working on an amendment to the bill that would require the registration and supervision of appraisal management companies by the existing State appraisers certifying and licensing agencies with additional Federal oversight of the State system provided by the appraisal subcommittee.

This regime would build on the existing appraisal regulatory system. Alternatively, we could have a Federal registration and supervision requirement.

Which system do you prefer and why?

Mr. AMORIN. It is clearly the Wild West right now, and some AMC regulation is required. Currently, there is a mechanism in place at the State level to regulate appraisers, and we think with additional resources to allow the States to do good oversight of that, that the mechanism at the State level may be the appropriate way to go.

It is a continuing problem. We think it is going to be a continuing problem if Congress does not address it. To the extent that the Appraisal Institute has been active in this area, we have developed some model legislation for the States to use, and we are seeing some success in that area, but to the extent that you can help push that along, we would really appreciate it.

Mr. KANJORSKI. Thank you. Finally, the Congress established Federal appraisal requirements in 1989 with the intent of protecting the safety and soundness of financial institutions.

Have the regulations promulgated by the Federal agencies been effective in your opinion?

Mr. AMORIN. I do not believe that the regs have been effective, primarily due to the fact that there are 13 exemptions to the appraisal requirement that exists today.

Any additional oversight that we can give to the appraisal subcommittee to help in that regard would be very helpful. To the extent that we can limit the use of alternative valuation products such as AVMs, automated valuation models, and broker price opinions for mortgage origination, we think those are great steps in the right direction.

Mr. KANJORSKI. Do you have any thoughts on what we should do on consumer protection mandates or establishing quality controls for automated valuation models and limiting the use of broker price opinions?

Mr. AMORIN. We do believe that broker price opinions are a very useful tool in the market to help set the listing price for a home or for a property, but to use a broker price opinion or some other alternative valuation model to determine the value of collateral we think is misplaced.

Appraisers are licensed and certified in the States in which they operate. We have requirements to meet those license certification requirements. We have oversight by State appraisal boards. In most cases, automated valuation models operate outside of that, and in many States, it is against the law for a broker to provide a price opinion for any other purpose except to obtain a listing or set a listing price.

Mr. KANJORSKI. Thank you very much. Mr. Chairman, I yield back the balance of my time.

Mr. WATT. The gentleman yields back the balance of his time. Mr. Cleaver is recognized for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman.

No matter how many times we have expert testimony which declares without ambiguity that CRA did not cause the crisis, there are those who will just continue to say it, and you can probably turn on the television on a talk show tonight and hear it.

Do any of you think CRA caused this crisis? Just raise your hands if you do.

You will hear about it if you just turn on a talk show.

Mr. McMillan, what was wrong with plain vanilla 30-year fixed-rate mortgages? Were we having problems? What was wrong?

Mr. MCMILLAN. Congressman Cleaver, there is nothing wrong with plain vanilla 30-year mortgages. The issue is when you make that the limit, then that limits the choices of individuals.

We have the ability today to get mortgages originated for a term that is customized specific to the borrower. You hear mostly of 15- and 30-year loans, but there are 20-, 22-, and 25-year loans as well.

To put a range there would be more appropriate as opposed to just specifically addressing a choice and amortization.

Mr. CLEAVER. What we are trying to do is to prevent all of these exotic products that physicists and major league baseball players are developing. I am not even sure where all of this stuff comes from.

Do you not think we have to squeeze that out or do you believe we need to squeeze that out so that after the crisis has ebbed, we end up with folks coming back with a new group of exotic products?

Mr. McMILLAN. Congressman Cleaver, with respect to exotic products, I do not think they should be legislated out. They are appropriate for someone in certain circumstances. They have always existed for a young person out of medical school or law school whose income is expected to go forward; athletes, highly paid athletes.

The thing for the lender to be concerned with is to make sure that on the basis of objective criteria, they make the appropriate loan to the appropriate person.

Outlawing them would be disenfranchising those who would benefit and that particular product would operate appropriately.

Mr. CLEAVER. Mr. Berner?

Mr. BERNER. I think our feelings as in our written testimony is that there certainly should be an expansion of the terms within your definition of a 30-year fixed-rate mortgage to fall within a 25-year, a 20-year, or a 15-year mortgage. Obviously, it is the American dream to own their house free and clear, and clearly, a 15-year fixed-rate mortgage for those with a dual income who can afford to make the payments and are properly qualified should be an alternative within the safe harbor.

It is in our testimony we also believe traditional adjustable rate mortgages, such as 5-, 7-, or 10-year ARMs which have appropriate caps are extremely important a financial vehicle, especially in a normal interest rate yield curve.

Our portfolio of adjustable rates, five, seven and ten, has one half of one percent or a 50 basis point lower rate than our fixed rate, and for a first time home buyer and/or low/moderate income person, that 50 basis points could be the difference of them being able to afford a home or not afford a home.

Mr. CLEAVER. You do not think we will drift back into the same deal?

Mr. BERNER. No. Again, we certainly agree non-traditional and/or exotics are not the way to go, but garden type ARMs and fixed rates of shorter terms are beneficial.

Mr. CLEAVER. Thank you. My final question is whether or not you believe that the Federal legislation ought to be the floor, and we would give States the authority to move up not down, that this would not be the ceiling but the floor.

How many of you would support that kind of a move?

Mr. McMillan?

Mr. McMILLAN. Yes.

Mr. CLEAVER. Mr. Ryan?

Mr. RYAN. We think there should be a single Federal standard, not a floor or cap, just one standard.

Mr. CLEAVER. Why?

Mr. RYAN. I think part of the reason we are here testifying is that the mortgage market unraveled a bit, and part of the reason it unraveled was the State regulation.

I think a Federal standard is a better standard.

Mr. CLEAVER. Mr. Kittle?

Mr. KITTLE. I agree with what he just said. We have a patchwork of laws out there right now. I heard earlier testimony where one of the panelists gave an answer and said they want each attorney general to be able to look at their one State law.

If we have a ceiling with one national law for everybody, then that attorney general only has to look at one law. The more laws we have, it makes it easier for predatory lenders. It makes it easier for mortgage fraud. We need a ceiling. The States can participate. The attorneys general can still go in and do their audits. They should come to the table and help develop that law. Let them implement the policy. We need a ceiling and one law.

Mr. CLEAVER. I think my time has run out.

Mr. Dalton?

Mr. DALTON. Mr. Cleaver, just briefly, I agree completely with the last two statements and think this is a good bill, can be a good bill with the changes, and it is a tough bill, and I think it ought to be an uniform national standard. Everybody living by the same standard.

Mr. WATT. The gentleman's time has expired. Mr. Ellison, about whose bill, 1782 as opposed to 1728, has gotten a lot more praise from some corners in today's sharing. You missed all the praise from the last panel.

Mr. ELLISON. As you know, Mr. Chairman, I need all I can get.

Mr. WATT. The gentleman is recognized for 5 minutes. I am going to give him that much praise.

Mr. ELLISON. Thank you, Mr. Chairman. I want to thank the entire panel and your being here to help inform us on how to formulate this legislation late on a Thursday night. It is highly commendable. I want you to know I appreciate it.

Mr. Arbury, I wonder if I might inquire of you. The National Low Income Housing Council estimates that about 40 percent of the families who face eviction due to foreclosure are renters.

Meanwhile, a study conducted by the University of Minnesota indicated that about 61 percent of all foreclosures over the past 2 years in my hometown of Minneapolis have been renter-occupied residences, 61 percent renter-occupied.

That is why I and a few other members of the committee introduced a bill to provide protections to renters in properties foreclosed upon. I am very pleased that these protections are also provided in H.R. 1782.

Given that, I am very concerned about certain views that I think you have articulated. I certainly respect those views but I have some concerns because to not apply some of these basic protections to tenants receiving Section 8 assistance and particularly you suggested Section 8 voucher contracts cannot be applied to the purchaser of a foreclosed property.

Could you explain exactly why not?

Mr. ARBURY. Sure. Congressman Ellison, we have seen those studies. We have seen the studies by the National Low Income Housing Coalition and some of the other studies.

It is true that there are a number of properties out there where there are renters and those properties are being foreclosed. Overwhelming, those properties are single family homes and condominiums, and in some cases, duplexes, triplexes and fourplexes, not multi-family. There are some multi-family properties. Those are apartment properties with five or more units that get foreclosed on, in any economy, good or bad.

We are in the business of renting. People who own single family and condo's are in the business of ownership, so evictions occur there. Back in the late 1980's and early 1990's when there was a huge problem in multi-family because the number of multi-family properties went into foreclosure because they had been over leveraged, we didn't see any stories about evictions.

Foreclosures in multi-family do not mean evictions. Second of all—

Mr. ELLISON. Let us do one point at a time. With respect to your views, sir, could you please offer me some statistical support for your position? We are trying to make evidence-based legislation.

Mr. ARBURY. Sure. We, for example, went in to analyze what happened in Hannapen County, Minnesota, in 2008. There were over 7,300 foreclosures. 6,300 of those foreclosures were in single family either homestead—I am not sure how you define "homestead" there—and non-homestead single family homes.

There were another 600 in duplexes. There were 87—this number just jumped off the page at me—87 foreclosures in what they labeled as apartments. Almost all of those were either triplexes or fourplexes, not multi-family.

When we called the Multi-Housing Council of Minnesota to ask them about what was going on, they said they had not heard of any evictions.

I would be glad to give you the analysis we did.

Mr. ELLISON. Reclaiming my time, has this report you cite been published and peer reviewed?

Mr. ARBURY. I do not know. It is from the Hannapen County Sheriff Foreclosure Sales by Lien Type, that is on the Internet.

Mr. ELLISON. How many of those—you said there 7,300 foreclosures, 6,300 in single family. If my math is anywhere close to being right, that is about 1,000. Am I right about that?

Mr. ARBURY. You are right.

Mr. ELLISON. That is 1,000 beyond single family homes and your position is there is about 600 that are duplexes; is that right?

Mr. ARBURY. Right.

Mr. ELLISON. That would leave about another 400 which would be—

Mr. ARBURY. When we got down to the detailed numbers of even the 87 so-called apartments that were listed, we are saying five or more units is what we classify as an apartment, and then we are down to maybe six communities but no evictions.

Mr. ELLISON. How many residents live in these type of units?

Mr. ARBURY. I do not know. There were no evictions so we did not know.

Mr. ELLISON. You seem to be arguing that if my bill goes into place, that it is not going to hurt you because you do not have any evictions. It will be there as a protection for the 1 or 2 or 87 people who might be subject to it, but it will not hurt you because the people you represent do not pursue evictions.

If it does not hurt you, why are you against it?

Mr. ARBURY. What it will hurt is the Section 8 Program. It is hard to attract private investment into the Section 8 Program. The more you make it mandatory, the more restrictions you put on it, the more mandates you put on it, it makes it harder and harder to attract investment in affordable multi-family housing.

Mr. ELLISON. Could I ask for unanimous consent to just respond before my time is over?

Mr. WATT. Your time is out, you can ask unanimous consent for one additional minute, without objection.

Mr. ELLISON. I will simply say that I disagree with your position. The legislation, both H.R. 1728 and H.R. 1247 clearly and specifically allow for—this is not additional barriers and burdens. The legislation allows for specific assignment of lease and a Section 8 voucher contract to the immediate successor.

They do this through the force of law, and Congress has the authority to make the law.

The bottom line is that it will give protections to people who need it. It will make sure that we do not have foreclosed buildings in our neighborhoods. It will stop these big buildings from being an attractive nuisance, and it will prevent things like arson and crime and community blight.

I am willing to continue the dialogue with you, sir. I think I am open to your point of view. I am not persuaded. I just want to put that on the record.

Thank you for listening and thank you for responding.

Mr. WATT. The gentleman's time has expired. I know Mr. Arbury wants to respond but I would ask him to respond in writing, especially since this is a hearing not about that bill.

[laughter]

Mr. WATT. Mr. Manzullo is recognized for 5 minutes.

Mr. MANZULLO. Thank you, Mr. Chairman, and to the panel, I am sorry, I have been catching bits of your testimony on television and other bits of trying to take care of a full load, including an office full of constituents.

I have an observation and a couple of questions. The subprime Regulation Z by the Fed takes effect on October 1st. That means there is already a Federal regulator who has the authority to govern instruments and underwriting standards.

That person is already in existence. I know many of you have testified this is what you want for uniformity, etc. It will not take place until October 1st.

The first question is, do we need new legislation prior to that? The observation is, and I am not picking on anybody in particular, but if you take a look at the testimony of the Independent Community Bankers, Mr. Menzies, and also the testimony from the Mortgage Bankers Association, each one starts with the statement, well, you know, we herald the idea of something to get rid of patchwork but, and then every group has their own "but's."

Everybody wants to write exactly what is going to be in this bill and that is not going to happen.

Those of you who want this type of legislation have to be prepared for whatever goes in there. I closed probably 2,000 real estate transactions as an attorney. Some of the stuff I see in here is frightening.

Who is going to take a mortgage? Who is going to securitize the mortgage when you have contingent liability? Hello.

The secondary market is suffering as it is. This makes it even worse. The legislation that we will take up next week will have a cram down for residential. Who is going to give a mortgage if you know the bankruptcy judge is going to go in there and change the terms of the mortgage.

If you guys do not want Federal control, just say this thing stinks, we do not need it. We have enough Federal regulation on top. We just need the regulators to do what is proper.

Does anybody want to tackle the question on if subprime Reg Z takes effect on October 1st, do we actually need this legislation? Does anybody want to take a stab at that?

Mr. Menzies, you are from the Eastern Shore, are you not?

Mr. MENZIES. I was just going to share the observation that community banks did not create this train wreck.

Mr. MANZULLO. That is correct.

Mr. MENZIES. Community banks did not create shadow corporations on Wall Street to house the Alt-A payment option, no doc.

Mr. MANZULLO. 2/28s, 3/27s.

Mr. MENZIES. Community banks have stuck to their knitting for decades and decades and decades. We continue to stick to our knitting. We make loans to people we know. We make loans to relationships, not for transactions. The people we lend to we see at the YMCA, at Rotary, on our volunteer boards. We are in the relationship business.

Does this legislation benefit community banking? Only to the extent that it prevents the next train wreck. We did not create this train wreck.

Mr. MANZULLO. Mr. Ryan?

Mr. RYAN. My answer is a little bit different. I do not know if you were here when I commented to one of your Republican colleagues, but certain parts of this bill are also pending in legislation in the European Commission.

They will affect any securitized product that is distributed globally, and for that reason, we are supportive of legislation here. We have made specific recommendations on how this legislation could be modified, where we could be fully supportive.

I would urge you—there are really only three specific areas, one of which is kind of expanding the terminology used for the safe harbor for giving a regulator some flexibility in dealing with the retention requirement.

Mr. MANZULLO. Right, but that is three that you do not like. As you go down the line, you find this group—

Mr. RYAN. I am only answering for our association, not for anybody else here.

Mr. MANZULLO. Right. You made the point. There is something else that on April 2nd, the President signed the G–20, a document that essentially, if you read it carefully, turns over control of the financial institutions of this country to the Financial Stability Board, which is going to be controlled by the European Union, the FSB countries, the G–20, and Spain.

I don't know if you are aware of that document, if you go to G–20—

Mr. RYAN. I have read the document. We do not necessarily agree with what you just said.

Mr. MANZULLO. If you read the document, it is frightening. We are signatories to it. It states the common principles. It states that prosperity is indivisible. It states the corporate social order, whatever the word is, be imposed upon the countries that are party of that.

The reason I raise that is although you have read the document and I appreciate that, most people in this country are not even aware of what happened at the G–20.

Mr. Menzies, we had talked a couple of weeks ago when you were in here, and you were one of the guys who got caught way at the end on the third panel also. I wish they would put the good guys up front and let the bureaucrats wait.

We had talked earlier over the fact that it is true you did not cause the problem but you would be subjecting yourself to the jurisdiction of the Federal Government under these very broad and pervasive powers.

I just wanted to raise that and thank you for your participation, and thank you, Mr. Chairman.

Mr. WATT. The gentleman yields back. I think that leaves only me to ask questions and to thank the witnesses for being here.

Let me just raise a few questions. Let me talk about the preemption issue first, just to make it clear that we are preempting only in two areas, and we are leaving State law to apply in all other areas.

I take it Mr. Kittle, Mr. Menzies, and Mr. Ryan probably would prefer a totally preemptive framework so that it would be only a Federal framework, but if we were doing that, I can assure you that the standards would be so high that I think we could not do it only in the subject matter of this bill.

I think we have found what appears to be a reasonable middle ground here, unless you all are saying something different.

Mr. Kittle, Mr. Ryan in particular, do you have differences with that?

Mr. KITTLE. If you go back to it, Mr. Chairman, it is the patchwork of State laws that created the environment for predatory lending and for bad regulation, and for mortgage fraud.

Mr. WATT. I am not sure I accept that as a proposition.

Mr. KITTLE. What we are saying is we would like the States to have a seat at the table, the States to go ahead and implement any regulation that comes out. The State attorneys general to look at that one law that the other panelists earlier said they only need to look at one, we will give them one, one national standard.

Every time you have—my company, which it does, is approved to lend in all 50 States—

Mr. WATT. I understand there are substantial efficiencies to the industry.

Mr. KITTLE. I am worried about the cost to the consumer as you are. That cost gets passed onto the consumer and it continues to drive up the cost of mortgages. We are worried about the consumer also.

Mr. WATT. I think the cost of credit to consumers in mortgages is probably lower than the cost of credit to consumers in any other area of our life at this moment.

I grant you at some point that will change, and it may well be, but it is hard to convince me that—anyway, we have had this discussion.

I actually think that setting a floor as a minimum standard would ultimately drive all States to exactly where you are getting to. I have had this discussion with the industry for a long time.

If the States get substantially out of line, lenders will just either raise interest rates in that State or they will leave that State. They did that in Georgia. They had to adjust back.

There are substantial pressures for any lender in the mortgage area to gravitate to whatever the national standard is anyway.

Mr. KITTLE. You are right in your assessment, but look at what it did to the consumers in Georgia. They had no access to credit for several months.

Mr. WATT. I never have professed to be more brilliant than anybody in my State legislature. Those people make decisions. They make them in the interest of their States. You either believe in federalism or you do not believe in federalism.

On some issues, I think we should federalize and we have done that in our Constitution, but I do not think every issue ought to be federalized, and we ought not preempt everything that goes on at the State level. Otherwise, we would not need any States.

That is a long-term subject discussion. I have had this discussion with various people.

Let me just go to Mr. McMillan for a little bit. I am a little concerned that excluding Realtors from the definition of "originators" even when they do things that originators do is probably not a good idea; right? At least, that is my assessment.

Excluding all sellers who sell finance would ultimately attract a bunch of sellers, builders, others to become sellers because they then would not be held to the same standards that originators would.

I understand the concept that you are working with and in general, I do not think Realtors are considered originators, but when they do what originators do, they kind of quack like a duck and walk like a duck, they probably ought to be treated as a duck.

When sellers sell finance and they do what originators do, they probably ought to be treated like originators.

Would you agree with that?

Mr. MCMILLAN. No, sir. I would love with the privilege you afford me to address both of those issues, starting with the latter with respect to sellers.

Mr. WATT. Actually, I am over my time. Let me invite you to address that to me in writing. I do not want this becoming an academic discussion. That is not even my part of the bill. I did not draft it.

It seems to me that going too far in the direction that you advocated might create a set of problems, and I would like to hear your side. I have explained publicly what my concerns are.

Give me that in writing and I will not hold up the rest of the committee. I do note that members may have additional questions for the panel which they may wish to submit in writing in addition to those who have been here.

Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and all of the prior panels, and to place their responses in the record. That includes the ones that have been propounded that Mr. Posey requested, if you can get those answers to us in the next 30 days, that would be great.

This has been a wonderful hearing all day. It has added immensely to the landscape in which we are operating both from the regulator's perspective, from the industry's perspective, and from the consumer's perspective, all of which are valuable perspectives.

As I indicated earlier this morning when we started, we are trying to accomplish three things here. We are trying to protect consumers. We are trying not to burden anybody, and we are not trying to chase any capital out.

Those things kind of, at points, can come into conflict. We acknowledge that. That is why we have tried to walk down this road as carefully as we can, and we will continue to do that not only between now and Tuesday when we mark-up the bill, but even after that, we will try to make sure that we find the right balance until this process is completed.

I thank you all for your participation and your wonderful testimony, and declare the hearing adjourned.

[Whereupon, at 4:55 p.m., the hearing was adjourned.]

A P P E N D I X

April 23, 2009

Ranking Member Bachus Statement

Full Committee Hearing

Entitled "H.R. 1728: Mortgage Reform and Anti-Predatory Lending Act"

Mr. Chairman, thank you for calling today's hearing. The subject of today's hearing is H.R. 1728, the Mortgage Reform and Anti-Predatory Lending Act. Before I go in detail about my specific concerns with H.R. 1728 I would like to discuss how the bill before us differs from H.R. 3915, a comprehensive, bi-partisan mortgage reform bill which I supported in the 110^{th} Congress.

The goal of mortgage origination legislation is to protect consumers from predatory loans without constricting the ability of the lending industry to provide appropriate loan products to worthy borrowers or increasing the cost of mortgage credit for millions of Americans. H.R. 3915 achieved this goal by establishing a clear standard for mortgages which recognized loans with lower rates require less regulatory intervention than those with higher rates. Also in that bill we put in place an ability to repay standard for all loans and mandated income verification for higher cost loans. We developed a qualified safe harbor mortgage standard to limit costly law suits and to ensure that the mortgage market would continue to offer worthy borrowers a range of appropriate loan products. Unfortunately, H.R. 1728 fails to meet benchmarks for a successful mortgage origination law. Instead, H.R. 1728 creates new standards which are narrow, vague and will ultimately restrict access to and raise the cost of mortgages for years to come.

In my opinion H.R. 1728 effectively relegates any home loan which is not a 30-year fixed rate mortgage into the category of a subprime mortgage. Even loans backed by the Federal Housing Administration, Veterans Affairs Administration and Rural Housing Service would be considered subprime and assumed to be predatory if they do not conform to the narrow definition of a 'qualified mortgage' set forth in H.R. 1728. The narrow definition of a 'qualified mortgage' also limits safe harbor protections from litigation for lenders and securitizers and expands assignee liability. Lenders and secondary market participants will be discouraged from making non-'qualified' loans for fear of being sued. The mortgage market will ultimately pass the price of litigation to consumers.

There are many portions of this bill which set forth untested standards. Most notable is the credit risk retention requirement. Along with many commentators I agree that the 'originate to distribute' model led to tremendous excesses. Originators need to have 'skin in the game.' However, the requirement to retain a portion of an origination portfolio will impact the capital requirements of financial institutions and may limit the successful functioning of the secondary mortgage market. We do not want H.R. 1728 to create an unworkable standard like last year's Hope for Homeowners program. I urge my colleagues to carefully deliberate this issue and gauge the impact this provision will have on all the relevant stakeholders before we move forward.

Other aspects of H.R. 1728 that are deeply troubling include the authorization of $140 million for "legal assistance" grant funds to legal organizations. Key taxpayer protection provisions restricting eligible uses for legal assistance funds included in the Housing and Economic Recovery Act of 2008 have been stripped out of H.R. 1728. Instead this bill uses taxpayer funds to finance civil lawsuits from home owners and tenants. Groups engaged in federal election fraud like ACORN will be eligible for receiving legal assistance grants. However, the bill has no requirement that HUD-approved housing counseling organizations provide any oversight of the legal assistance grant program.

Finally, as introduced H.R. 1728 permanently alters contract law by requiring participation in the Section 8 program for all new owners of foreclosed properties with Section 8 tenants. By discouraging purchases this provision will disrupt the market for multi-family properties when foreclosure inventories are mounting. This provision may also discourage participation in the Section 8 program overall.

Mr. Chairman, as we move forward with debate I would like to remind the Committee of laws and regulations already in effect which address problems we agree plagued mortgage origination. In 2007 I saw the need for origination reform and I introduced legislation to create a national licensing and registration database for all mortgage originators which became law as a part of the Housing and Economic Recovery Act of 2008. The creation of a national licensing and registration system brings greater accountability and professionalism for mortgage originators. Fifteen states have already adopted this standard, and several dozen more are currently considering legislation.

Last July the Federal Reserve issued regulations under the Home Ownership Equity Protection Act (HOEPA), which implemented many of the provisions in the predatory lending legislation I supported last Congress. The Fed rules address predatory practices and products; strengthen underwriting standards, address prepayment penalties and escrowing of taxes and insurance. It is important to let these rules work before we begin to layer restrictions on all but the most traditional mortgages.

Mr. Chairman, this is the first hearing focused on the legislation. Even though several of the provisions lack details and have not been fully vetted by all relevant stake holders, the Committee will mark up the legislation early next week. The legislation constitutes significant changes to our financial markets. We must fully consider all the ramifications of this bill and its impact on both the mortgage market and the greater economic recovery before voting on a finished product.

OPENING STATEMENT OF CONGRESSMAN PAUL E. KANJORSKI

HOUSE COMMITTEE ON FINANCIAL SERVICES

HEARING ON H.R. 1728, THE MORTGAGE REFORM AND ANTI-PREDATORY LENDING ACT

THURSDAY, APRIL 23, 2009

Mr. Chairman, as we begin today's hearing I want to discuss several issues concerning H.R. 1728, the Mortgage Reform and Anti-Predatory Lending Act, which I helped to write and to introduce. First, I have heard suggestions from some that the skin-in-the-game requirements found in the bill constitute a war on securitization. Such thinking is entirely wrong.

At a hearing in September 2007, I cited the fact that few players had any real skin in the game helped to contribute to the implosion of our financial markets. If people had retained some risk, I believe that they would have made better decisions. Since then, others have joined my thinking. So, the skin-in-the-game provisions in H.R. 1728 are about prudent underwriting, not about ending securitization as some have maintained.

This issue, however, is a difficult one. Like Chairman Frank, I admit that the 5 percent retention requirement now in the bill needs some work. Rather than hearing more complaints about it, we need suggestions to perfect it. I hope that our witnesses will do just that.

Second, I have focused my attention in recent weeks on the bill's considerable mortgage servicing and appraisal provisions, which I wrote and added to the legislation during our debates on the House floor in November 2007. Much has happened in these fields since then, including the adoption of new rules by the Federal Reserve on escrowing, crediting payments, and appraisal independence, as well as the appraisal reform agreements of New York Attorney General Andrew Cuomo with Fannie Mae and Freddie Mac.

In moving forward, we should codify much of their good work, but we must also take bolder steps to provide greater protections for consumers and improve industry responsibility. As such, I am preparing a comprehensive amendment that will, among other things, provide all subprime borrowers with access to a written appraisal; improve independence standards so appraisers can operate as honest referees, free of interference; and enhance confidence in the results produced by automated valuation models. We must also further augment the powers of the Appraisal Subcommittee to monitor and assist State appraiser agencies.

Moreover, we must establish oversight for appraisal management companies. They now touch 64 percent of written appraisals, but they are subject to little supervision. Going forward, we cannot allow anyone to play in the dark corners of our markets. We must ensure that everyone who operates in our financial system is subject to appropriate oversight, whether they are a hedge fund, a credit rating agency, or an appraisal management company.

Before closing, Mr. Chairman, I ask unanimous consent to submit into the record a letter from the Title/Appraiser Vendor Management Association that makes some observations about the regulation of appraisal management companies. I look forward to a vibrant debate not only on that issue, but also on all of the other important matters that we will consider today.

Congressman Gregory W. Meeks
6th Congressional District-New York
House Committee on Financial Services
Hearing entitled "H.R. 1728: Mortgage Reform and Anti-Predatory Lending Act"
Statement

Chairman Frank, Ranking Member Bachus, colleagues and testifying witnesses, good morning.

Today, the House Committee on Financial Services will debate H.R. 1728, the Mortgage Reform and Anti-Predatory Lending Act of 2009, legislation which will redefine the manner in which mortgage financing is done in our Nation.

I want to applaud my friends and colleagues, Representatives Mel Watt and Brad Miller, along with Chairman Barney Frank for their leadership in crafting this important measure. The Mortgage Reform and Anti-Predatory Lending Act of 2009 is a stronger version of the measure that was offered in the 110th Congress, H.R. 3915 Mortgage Reform and Anti-Predatory Lending Act of 2007, which called for overhauling mortgage regulations in an effort to prevent another subprime mortgage crisis. I support that bill which passed the House in 2007 with bipartisan support, but was not considered in the Senate.

The Mortgage Reform and Anti-Predatory Lending Act of 2009 represents an important step toward preventing the predatory and questionable practices that took hold in the mortgage lending industry in the past several years and undoubtedly contributed to our current housing crisis. Mortgage lending reform is a vital piece of the Congressional effort to prevent a future financial services disaster of this scale and I believe that we must move forward in our efforts to ensure that a similar crisis does not occur in the future.

Mortgage delinquencies and foreclosures are at all time highs and my district, New York's 6th Congressional District, has the highest level of foreclosures in New York and is among the highest in the region. As you may know, 2.4 million Americans risk foreclosure in 2009. That number could rise to 8.1 million over the next 4 years. The foreclosure epidemic is being caused primarily by families borrowing against their homes to pay their bills when something has gone wrong, not because they are buying more house than they can afford. Families are borrowing against their homes because of unexpected job loss, serious & catastrophic illness, and other life crisis. A significant number of these foreclosure victims were preyed upon by unscrupulous lenders.

The Mortgage Reform and Anti-Predatory Lending Act of 2009 will help to address the issue of predatory lending and unfair practices. Among the practices this bill addresses includes strengthening restrictions on compensation paid to mortgage loan originators and brokers that is based on a loan's interest rate and terms, often called yield-spread premiums. Lenders sometimes pay brokers an extra fee for making loans at a higher interest rate than the borrower otherwise could have received.

H.R. 1728 also encourages the market to move towards making 30-year fixed-rate, fully documented loans the standard once again in mortgage lending. While, our the Congress should encourage responsible innovation in our financial markets, the growth of exotic, non-traditional mortgages was a major factor in the current housing and foreclosure crisis. These types of loans have ravaged the 6th Congressional District of New York and have impacted nearly every area of our country.

Additionally, the legislation prohibits lenders from underwriting loans that consumers do not have a reasonable ability to repay and prohibits practices that increase the risk of foreclosure for consumers. I applaud this provision and my office has first hand experience with the importance of conducting affordability analysis for homeowners. The Consortium for Worker Education has been helping my constituents who are in delinquency and/or are in foreclosure and conduct a comprehensive analysis of a homeowner before contacting their mortgage servicer to obtain either a work out or a soft landing rental. Had we had this provision in place before the housing boom, untold numbers of Americans may have been speared the nightmare of foreclosure.

Finally, the legislation also protects consumers from being steered into loans that aren't in their best interest, and if they refinance there must be a tangible net benefit to the consumer. The bill will also create greater transparency by ensuring lenders make full disclosure of the terms of the loan at the time of signing.

Again, I believe that H.R. 1728, the Mortgage Reform and Anti-Predatory Lending Act of 2009 is legislation that is greatly needed and will serve as a major component of our nations overall economic recovery. I look forward to debating this bill with my colleagues and to receiving the testimony of the assembled witnesses. I yield back.

Potential Questions:

PANEL ONE

QUESTION FOR STEVEN L. ANTONAKES-CONFERENCE OF STATE BANK SUPERIVISORS

1. I your testimony, you recommended the Act be amended to require all rule writing by the Federal Banking Agencies be coordinated through the Federal Financial Institutions Examination Council (FFIEC) which includes—as a voting member—the Chairman of the State Liaison Committee. The FFIEC was designed to facilitate consistent federal regulation and supervision and coordination with state regulators. As you are aware, many of our nations smaller community banks and credit unions have remained fairly healthy in the current fiscal environment.

   To what extent will having rulemaking coordinated through the FFIEC assure some consideration of state expertise and help our regulators to perhaps think outside of the box to address the unique nature of smaller institutions?

QUESTIONS FOR SAUNDRA BRAUSTEIN-FEDERAL RESERVE

1. In your testimony, you indicate that one of the goals of the Board's final rules was "to ensure that mortgage loan advertisements do not contain misleading or deceptive representations… and the rules also prohibit misrepresentations about government endorsement of the loan program and misleading claims of "debt elimination."

   I have personally received advertisements and seen television commercials that utilize the word Federal and am disturbed by the co-opting of government for what are likely nefarious endeavors. To what extent is your agency working with and/or coordinating efforts with the FBI and local authorities, once a deceptive firm is identified, to prosecute these entities?

2. Also in your testimony your stated that the FED supported the goals of Housing and Urban Development's (HUD)efforts to make the Real Estate Settlement Procedures Act (RESPA) disclosures more accurate and more useful, and we commend HUD for using consumer testing to develop the new RESPA forms, but that, the FED continues to believe that efforts should be made to develop a single form that creditors could use to satisfy the requirements of both Truth In Lending Act and RESPA. Has the FED had any conversations with the new Secretary of HUD Shaun Donovan and/or his staff to help address this issue?

PANEL TWO

QUESTION FOR JOHN TAYLOR-NCRC

1. In your testimony you stated that "an inadequately regulated marketplace financed large amounts of problematic subprime and non-traditional loans over the last several years, with no regard for the long-term implications for borrowers with unsustainable debt." Clearly, predatory lending utilized subprime and non-traditional loans to engage in criminal acts. However, such loan products have helped to provide a bridge to homeownership to untold numbers of Americans and helped them to fulfill the American Dream of Homeownership. Has your organization worked in concert with the lending institutions on developing an appropriate set of best practices to ensure that worthy segments of aspiring homeowners, who demonstrate ability to afford a home but may have had some past issues, are not shut out of homeownership altogether?

QUESTION FOR MARGARET SAUNDERS-NCLC

1. As you are aware, liability of holders provides a measure of accountability because, under current law, it creates an incentive for buyers of loans to review the loans for compliance with the laws and the standards of the industry governing mortgages. In your testimony, you stated "Assignees need *more* liability to sufficiently animate these incentives, albeit this potential liability should be capped, so that the risk should be measured and priced for." Further, you state that your organization has "repeatedly proposed that assignee liability for mortgage holders be similar to the liability of assignees of credit sale contracts, as is dictated by the FTC Holder Rule." Could you provide this committee with the any potential impact to mortgage liquidity and thus availability of mortgages to potential homebuyers? Would there be any adverse impact of such a proposal?

QUESTION FOR HILLARY SHELTON-NAACP

1. In your testimony you called for the establishment of a Duty of Care that requires originators to present borrowers with loan options which are appropriate to their financial circumstances. There appears to be a substantial amount of evidence that African-Americans and Latinos with comparable credit scores and down payment amounts were steered into a disproportionate share of expensive non-traditional loans. How much of an impact would your proposed provision address this issue and if lenders were found to be in violation what enforcement actions do you propose?

PANEL THREE

QUESTION FOR G. GARY BERNER-ABA

1. In your testimony you stated that the ABA was supportive of the Federal Reserve Board's expansion of Regulation Z and that "In recent changes to Regulation Z, the Federal Reserve emphasized the need for more prudent and traditional underwriting. ABA supports changes including regulations to strengthen the integrity of appraisals and prohibit deceptive advertising. ABA also supports requirements that mortgage lenders properly consider a borrower's ability to repay the mortgage, whether it is a fixed or adjustable rate loan."

   Ultimately, the use of these practices throughout the mortgage industry will help to ensure that future lending is done in a prudent and safe manner. You further stated that "The Federal Reserve's expansion of Regulation Z come with teeth – including limits on terms and conditions for credit and the possibility of expensive individual actions and penalties as well as class action litigation – all of which will have an impact on lending, and reducing available credit for less creditworthy borrowers. The changes also address subprime lending by establishing a new category of "higher-priced" loans. However, the definition is based on a relatively low APR threshold. As a result, this new category is likely to include many prime loans in certain markets, depending on market conditions. This will further dampen credit availability to some creditworthy borrowers."

   Is the industry aggressively working with the FED to address the concerns regarding subprime lending and what suggestions is the ABA offering to ensure that a responsible non-traditional loan market exists moving forward?

2. I'd like to hear your thoughts on the timeframe afforded non-bank originators to comply with the SAFE Mortgage Licensing Act. Given the level of non-bank originations during the boom in a relatively short period of time, is there any concern that such entities may migrate to FHA and continue unhealthy practices?

Testimony presented on behalf of the

Appraisal Institute
American Society of Appraisers
American Society of Farm Managers and Rural Appraisers
National Association of Independent Fee Appraisers

Before the House Financial Services Committee

On

H.R. 1728 The Mortgage Reform and Anti-Predatory Lending Act

Presented by

Jim Amorin, MAI, SRA
President
Appraisal Institute

April 23, 2009

Chairman Frank, Representative Bachus and members of the Committee, I am Jim Amorin, MAI, SRA, President of the Appraisal Institute and Vice President of Atrium Real Estate Services in Austin, Texas. Today, I am pleased to represent the Appraisal Institute, American Society of Appraisers, American Society of Farm Managers and Rural Appraisers, and the National Association of Independent Fee Appraisers, the four largest professional appraisal organizations in the United States, representing 30,000 real estate appraisers. I want to thank the other appraisal organizations for their work and support on this testimony. We particularly appreciate the special contributions of the American Society of Appraisers regarding our positions on the appraisal provisions of HR 1728 and on our recommendations for how a few changes to those provisions would further enhance the safety and soundness of mortgage lending and the considerable consumer protections that independent, professional appraisals provide home buyers and homeowners.

Thank you for the opportunity to testify on H.R. 1728 "The Mortgage Reform and Anti-Predatory Lending Act." The professional appraisal community applauds the work of this Committee and Representatives Miller and Watt on bringing this legislation forward. Mortgage fraud and predatory lending practices have contributed greatly to the near collapse of our mortgage finance system. As this Committee knows, professional real estate appraisers can assist Congress, the Administration and consumers with relevant information regarding the value of collateral and provide the analysis needed for lenders and consumers to make informed decisions regarding real estate investments. Armed with advanced methodologies, professional appraisers today provide real-time information on local real estate markets, which is vital in trying times.

Appraisers provide impartial professional services in mortgage transactions. Our fees are not contingent upon whether loans go through, nor are they based on loan amounts. Independent, competent and qualified appraisers provide crucial safeguards in the process. Their objectivity, experience and ethics help participants in residential and commercial transactions understand the risks inherent in collateral lending. Appraisers should be the trusted advisor in the transaction.

That is what is supposed to happen. We are here to work on restoring integrity to the process, which, too often, has been corrupted by mortgage fraud. The mortgage industry has long suffered structural problems. Much of it, including appraisal, has regulation in place, yet many regulatory gaps still exist today, which invites devious participants to skirt basic safety and soundness requirements. Further, government regulators have been asleep at the switch on matters of oversight and enforcement. Existing rules have not been enforced adequately. Underfunding cripples many government oversight agencies, and structural deficiencies and unwillingness to act contribute to their ineffectiveness. Structural reforms for regulatory regimes must emphasize and strengthen oversight.

It is imperative that we return to the fundamentals of mortgage lending with the focus being on the <u>capacity</u> to repay the loan, <u>credit</u> worthiness of the borrower and underlying <u>collateral</u> value. These are the basic tenents of sound lending practices. Today, inadequate attention is paid to the collateral held in support of a loan. This oversight combined with loose credit policies and poor underwriting produced economic disaster. We no longer can continue to ignore the basics.

Modeled after H.R. 3915 from the last Congress, H.R. 1728 goes further in the area of appraisal reforms and is in many ways a "Back to Basics" bill. We believe this bill will go a long way in restoring confidence in mortgage lending. I will comment primarily on the provisions found in Title VI.

- Interior Observations, broader coverage for appraisal requirements
- Conflicts of Interest, Consumer Protection
- Appraiser Independence
- Registration of Appraisal Management Companies
- Appraisal Subcommittee Amendments
- Technical Issues

Interior Observations of the Property
Title VI of the bill requires that a qualified appraiser conduct a "physical property visit of the interior of the mortgaged property." Such a requirement to most seems obvious, yet many loans have been made without such an observation and in some cases without even a "drive-by" to confirm that the property was still standing. We

strongly support the intent of this provision and applaud the bill sponsors for its inclusion. This provision, we believe, should be extended to include mortgages beyond the "high cost mortgages" mandated in the bill to all subprime and even conventional loans to provide consumers with information and protection on issues related to valuation.

In addition to an interior observation, the Committee should consider restrictions on alternative valuation methods such as Broker Price Opinions (BPOs) and Automated Valuation Models (computerized models used to calculate an estimate of value) for mortgage origination purposes. Such models may have a role in performing additional due diligence or data confirmation, but should not be the basis of a lending decision. BPOs have the additional complication of being delivered by realty agents who may not be licensed as appraisers, have minimal training and education in appraisal methodology, and also may have an interest in garnering future brokerage business from the BPO client. We believe there is an inherent conflict of interest as well, where an agent's primary role is to facilitate a sale of real property, not objectively develop an opinion of its value.

We note that Freddie Mac recently clarified their policy prohibiting the use of BPOs for mortgage lending purposes. We urge the Committee to do same with regard to all federally related transactions.

Closing Other Loopholes
Lenders are turning to BPOs and away from professional appraisals principally because they appear affordable and they are essentially unregulated. Surprisingly, the federal bank regulatory agencies (with the exception of the NCUA) permit regulated financial institutions to use them (as well as other alternative products) in transactions involving loans of $250,000 or less. This extremely high threshold results in most mortgage loans in the U.S., and virtually all loans in thousands of low to moderate income communities in America, to be potentially based upon alternative valuation products, often from unregulated persons. The banking agencies are mistaken to conclude that BPOs and other products are sufficient to ensure the soundness of the deposit insurance funds. They are playing a dangerous game of roulette with people's homes.

Appraisals – traditionally the "gold standard" for valuing collateral property – cost more than a BPO, but their cost is nominal relative to the advisory and qualitative services provided. This is especially true when compared to other real estate services such as title insurance, filing fees and other miscellaneous fees required to close a loan. Unlike the real estate agents who perform BPOs on a part-time basis, appraisals are performed by full-time valuation professionals who have extensive training and education in valuation (including continuing education). Appraisers have demonstrated their valuation competency by passing a national exam and adhere to generally-accepted uniform valuation standards (USPAP). Professional appraisers are required by federal and state laws and the Ethics Rule of USPAP to be fully independent and objective in reaching their opinions of value. They are regulated by appraiser licensing boards in the 55 jurisdictions that issue licenses and have the ability to revoke those licenses. By contrast, real estate agents providing BPOs have minimal education and training in valuation theory and practice; do not adhere to any uniform valuation standards and are not always independent of the transactions for which their BPOs are provided.

We fail to understand why the federal banking agencies, understanding the many weaknesses of BPOs and the potential conflicts-of-interest involved in their performance, have adopted policies which encourage their use. More shocking, perhaps, is that having made their policy decisions to permit lenders to rely on BPOs, they have taken no action to establish meaningful standards regarding the performance of BPOs.

If a taxpayer wanted to donate real property to a charity and used a real estate agent or broker BPO to establish the value of the donation, the IRS would likely deny the deduction on its face. If the administrator of a deceased's estate used a BPO to value real property estate assets in connection with filing an Estate tax return, that valuation likely would be rejected by the Service. Similarly, BPOs and other valuation products are unacceptable for use in FHA, VA and USDA home loan guaranty programs. This is not an accident or an oversight by these agencies. It is a well thought out, fundamentally sound practice.

Other appropriate actions to address shortcomings in financial regulation include:

- Lowering the threshold (*de mimimis*) above which an appraisal is required.

- Tying the requirement for a mandatory appraisal to the down payment percentage; but also give the mortgagor the option to have an appraisal even if the down payment is sufficient to avoid one.
- Requiring the banking agencies and the FTC to hold a public hearing and make a determination on the hearing record regarding the requirement established by section 603(a)(3) of H.R. 1728 that threshold levels must be determined to provide "Reasonable Protection For Consumers Who Purchase 1-4 Unit Single Family Residences." Section 603(a) (3) of H.R. 1728 establishes an important new consumer protection requirement relative to the establishment of a de minimis level under which an appraisal will not be required. While we are concerned that the banking agencies will view this consumer protection determination lightly, a requirement that the determination be made based on the record compiled at a public hearing, could change the calculus somewhat. The provision also should require that the hearing be held and the determination made, on a specific time-table. We recommend 270 days after enactment as a reasonable time frame given how consumers have been treated under the current system. Anything longer would perpetuate the status quo for too long. We believe adoption of such a change would be an improvement over current law and policy, and could help to move the banking agencies toward more defined and improved appraisal specific guidance.
- Establishing meaningful anti-conflict of interest mandates and accountability requirements for those performing BPOs.
- Establishing Consumer Protection and Safety and Soundness Standards for AVMs.

Conflicts of Interest, Consumer Protection in Changing Market Conditions
Consumers are facing foreclosure and in many cases bankruptcy, lenders are taking significant losses as neighborhood property values decline. The recent glut of foreclosures in the current market is hurting consumers, lenders, and communities, as housing inventories increase to levels that require severe reductions in price. All of these factors have a wide-ranging effect on decreasing equity, wealth, and delivery of social services.

There are two issues on which we want to raise awareness today – a) Consumer protection during the pre-foreclosure and foreclosure process, and b) Basic due diligence requirements to protect the safety and soundness of financial institutions.

With regard to consumer protection, our members are reporting that foreclosed properties are oftentimes being sold below market value or at firesale prices. There may be several reasons for this, including the fact that financial institutions are not in the property management business, and sales activity is slow and real estate agents are looking to sell properties quickly by listing properties to entice sales. Potential buyers (whether "investors" or new owner-occupants) are aware of the "forced sale" duress financial institutions face and simply wait for the fire sale pricing. Then those price declines prompt examination officers to mandate further non-performing loan asset write-downs by financial institutions, which force more supply into saturated markets, continuing the spiraling price decline. In part, the price decline spiral is exaggerated by the actions of the financial institutions and their examination offices.

It is important to remember that there are basic consumer protection responsibilities that all parties must respect. Lenders have a fiduciary responsibility to obtain the highest value possible on the property to retain whatever equity is left in the house or reduce whatever amount is owed by the consumer to the lender. With many consumers facing judgments by lenders today, this is a serious issue. Selling properties at a fire sale price, as opposed to its market value, exacerbates the financial condition of the consumer and places additional burdens on the banking industry for these potential deficiencies

We are deeply disturbed by conflicts of interest that exist in this space today – most notably, the use of BPOs as alternatives to appraisals in valuing properties in pre-foreclosure situations. While BPOs can legitimately serve the function of helping a seller provide a list price of the property, price is much different than value from the standpoint of economic theory. Further, when issues of value are in question, such as in deeds in lieu of foreclosure and pre-foreclosure analysis, it should be compulsory for lenders to rely on the services of independent, impartial, and highly trained valuation professionals. Instead, many lenders and loan servicers today are relying heavily on BPOs as a replacement for appraisals, even in states that prohibit this activity. According to recent analyses conducted by our organizations, as many as 23 states appear to require licensed or certified appraisers to prepare opinions of value if it's offered for compensation. States have enacted these laws for good reason –consumers deserve basic protections within the valuation process.

Second, many lenders today are facing severe financial conditions themselves as a result of significant losses in real estate-related financial assets. Bank failures are on the rise, and there is increasing concern about the capital position of many banks and financial institutions. Real estate appraisal regulations require lenders to monitor their portfolios to ensure safety and soundness, and this includes requirements regarding the valuation of these assets. Further, these valuations are important because the assets are reported to investors as part of financial reporting requirements. Appraisals are required in certain situations in accordance to FIRREA, but often exempted in other valuation scenarios. These exemptions should be openly reexamined to determine if the public trust is truly being served.

One of the exemptions that is receiving a lot of activity in recent months is the exemption that allows the use of so-called "evaluations" in refinancing and renewals. This exemption is permitted under current rules so long as there are no material changes in market conditions or no new monies conveyed. Recently, the Obama Administration released guidelines to conduct loan modification under the Home Affordable Modification program, and we were shocked to see heavy reliance on BPOs and Automated Valuation Models instead of appraisals in the guidelines. Our concern is that there are clearly material changes in market conditions in many parts of the country today and that basic transparency, safety and soundness, and investor protection deserve accurate information relating to the value of these assets. We strongly believe the best way to attain this protection is through the use of highly qualified real estate appraisers. Additionally, we are concerned that the bank regulatory agencies have not provided clear definition to what constitutes "material changes in market conditions." In our view, the circumstances in the market today constitute material changes in market conditions, yet we do not believe the federal bank regulators have defined this term to date in their regulations or guidelines and some, to our astonishment, may be claiming there are no material changes occurring today by allowing this exemption to go unchecked.

To address these problems, we recommend two additional actions be taken by this Committee: 1) Require federal bank regulators to provide definition to "material changes in market conditions" that would include several components, including increases in unemployment, higher vacancy rates, and other economic indicators clearly providing evidence of economic decline; and 2) Require that all loan renewals and refinancings be appraised where there have been material changes in market conditions.

Appraiser Independence

A recent report by the Mortgage Asset Research Institute states that "reported mortgage fraud is more prevalent now than in the heyday of the origination boom."[2] Unfortunately, this report cites "Appraisal/Valuation" issues as the third most prevalent type of mortgage fraud. Our organizations believe that a majority of the issues related to appraisal/valuation arise when a party who has a vested interest in seeing that a particular mortgage transaction closes is the same party that is managing the appraisal ordering process. In many cases, appraisers are ordered or severely pressured to doctor their reports and to convey a particular, higher value for a property, or else never see work from those parties again. This is a terrible conflict of interest. While our members are confronted with systemic coercion on a regular basis and reject it outright, too often state licensed and certified appraisers are forced into making a "Hobson's Choice."

Congress took a huge step forward on this issue in 2008 with the passage of H.R. 3221, the Housing and Economic Recovery Act of 2008 (HERA). Title V of HERA enacted the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act) which requires all states to enact new mortgage loan originator licensing requirements within two years. Based upon this requirement, the Conference of State Bank Supervisors (CSBS) developed excellent model state legislation, which includes a provision that prohibits mortgage loan originators from making any payment, threat, or promise to any person for the purposes of influencing the value that is reported in conjunction with an appraisal for a mortgage loan. To date, language similar to that included in the CSBS model has been enacted into law in 25 states[3]. Legislation that would enact similar requirements is

[2] Denise James, Jennifer Butts, Michelle Donahue, "

[3] AK, AR, AZ, CA, CO, CT, DC, ID, IN, IA, KS, KY, MI, MN, MS, MO, NM, NY, NC, ND, OH, SD, UT, WA, WV – More information, including links to the statutory language is available on the Appraisal Institute's website at http://www.appraisalinstitute.org/newsadvocacy/stateissues.aspx

currently pending in 24 additional states[4]. We strongly support these state laws and the pending legislation. In fact, we would like to see these appraiser independence laws expanded to prohibit any person, not just mortgage loan originators, from attempting to improperly influence an appraiser. Violators of state appraiser independence laws risk suspension or revocation of their license, as well as potential civil action, and in some states, criminal enforcement with the possibility of a prison sentence.

While these are all excellent state laws, they are only as good as their enforcement. Fortunately, Attorneys General in several states have taken action to ensure the independence of appraisers in the real estate valuation process. In June, 2007 former Ohio Attorney General Marc Dann initiated complaints against ten mortgage brokerage firms and lenders alleging inappropriate influence on appraisers[5]. Many of these complaints have been settled, and have resulted in license revocations, surrenders, lengthy suspensions, and hefty fines. But action by Congress can ensure even enforcement in all states and jurisdictions.

Further, New York's Attorney General conducted a broad investigation of mortgage fraud and acted on its findings. That investigation led to an agreement with Fannie Mae and Freddie Mac and a commitment to protect the independence of appraisers in the mortgage loan process. We encourage additional state attorneys general to take swift and certain action against any party that improperly influences an appraiser, with severe civil and criminal penalties.

We also applaud the Federal Reserve Board's adoption of a new version of Regulation Z that will make it a violation of the Truth in Lending Act for a creditor or mortgage broker to coerce, influence, or otherwise encourage an appraiser to misstate an appraisal in connection with a mortgage loan.

Lastly, we note that the federal bank regulatory agencies have proposed a new version of the Interagency Appraisal and Evaluation Guidelines which reemphasizes the importance of the independence of an institution's appraisal and evaluation program from influence by the loan production process or borrower. The new rules will become effective on October 1, 2009.

Our organizations strongly support Section 602 of H.R. 1728, as proposed, which will amend the Truth in Lending Act to make it an unfair and deceptive practice, with significant civil penalties, for any person to inappropriately influence the outcome of an appraisal in conjunction with a mortgage loan. We further support provisions that would grant authority to the Appraisal Subcommittee to audit state appraiser independence laws to ensure that they are being adequately enforced.

Registration of Appraisal Management Companies

Appraisal management companies (AMC) are business entities that administer networks of independent appraisers to procure real estate appraisal assignments on behalf of lenders. AMCs are third-party brokers of appraisal services that sit between banks and other mortgage originators and licensed or certified appraisers who perform real estate appraisals. The AMC recruits appraisers, reviews their qualifications, verifies licensure, negotiates fees and establishes service level expectations with a network of third-party appraisers. The AMC is also responsible for many tasks associated with the collateral valuation process, including appraisal review, quality control, market value dispute resolution, warranty administration, and record retention. However, many reviews conducted by AMCs are performed by individuals who are not professional appraisers and who do not hold state appraiser certifications and licenses. Upon the completion of an appraisal by the appraiser, the appraisal management company is responsible for forwarding the appraisal report to the lender.

While appraisal management companies have been in existence for many years, the industry has experienced rapid growth as a result of outsourcing by financial institutions and the perceived need for an independent third-party in the appraisal ordering process to ensure that an appraiser is not subject to outside coercion or influence. Further, the implementation of the Home Valuation Code of Conduct (HVCC) on May 1, 2009 could result in a much larger role for AMCs in the collateral valuation process, an unintended consequence that could have chilling effect on the independent appraisal process.

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[4] AL, CT, FL, HI, IL, IN, LA, ME, MA, MO, NE, NV, NH, NJ, NY, NC, OK, OR, RI, SC, TN, TX, VT, and WV

[5] http://www.ag.state.oh.us/press/07/06/070607/LIST_OF_TARGETS.pdf

The advent of the appraisal management industry has resulted in serious problems. The issue of biggest concern to appraisers is AMCs that take an exorbitant percentage of the fee paid to the lender by the borrower for the appraisal as an "appraisal management fee". The current business model used by many AMCs involves a "cramdown" of appraisal fees to boost profits. Compounding this problem is that the borrower often pays a full appraisal fee and expects (and deserves) to have a competent and qualified appraiser performing the valuation analysis. With the AMC keeping more the half the appraisal fee in most cases, the quality of the appraisal suffers as the inexperienced and less competent appraisers are the only ones who will work for fees that do not allow for ample time to develop a credible appraisal.

In addition, we are aware of at least three instances where appraisers who have lost their licenses to revocation have formed or are major operators in AMCs, outside the oversight of a state appraisal regulatory agency. These are just a few of the problems that independent appraisers are facing from appraisal management companies.

Our organizations have attempted to address this gap in regulation by developing a model bill state law to register AMCs with state appraisal boards late last year. To date, three states – Utah, Arkansas, and New Mexico – have enacted requirements for state registration based largely on this model bill, and many other states are considering similar legislation. We strongly support the inclusion of language in HR 1728 that would require that states adopt registration requirements for AMCs operating in their states within three years. Our organizations have jointly developed model legislation on this topic. As noted, to date, AMC registration laws have been in enacted in three states – Arkansas, New Mexico and Utah. Additional legislation is currently pending, or will be introduced in the near future, in thirteen additional states. But more can certainly be done to effect a positive change.

HUD Mortgagee Letter 97-46—AMCs

The disclosure of appraisal fees and AMCs has been the subject of HUD Mortgagee Letters, 97-22 and 97-46. The issue revolves around the disclosure of the appraisal fee and how much is allocated to the appraiser that completed the assignment and the fee apportioned to the AMC for the services rendered in ordering and delivering the appraisal. ML 97-22 directed that "lenders utilizing management firms that secure the appraisal on behalf of the lender may only charge the mortgagor the actual amount paid to and received by the appraiser…" This set the stage for a distinction between the fee an AMC would charge and collect and the fee that an appraiser would receive. Later however, HUD re-addressed this issue in ML 97-46 wherein it states "the Department [HUD/FHA] will allow the mortgagor to pay a fee for the appraisal which may encompass fees for services performed by an appraisal management firm as well as fees for the appraisal itself. However, the total of these fees is limited to the customary and reasonable fee for an appraisal in the market area where the appraisal is performed."

This directive necessarily and irresponsibly restricts the fee paid to the appraiser to a fee below, perhaps significantly below, the customary and reasonable fee for that market area. At a minimum, fairness and transparency would require that fees for different services (appraisal vs. management) be separated and reported. Because AMCs are capped and can only charge the customary and reasonable "appraisal fee" for that area, AMCs must compensate the appraiser with a less than customary amount if the AMC is to make any money at all.

We believe Congress should direct HUD to adjust or eliminate the cap on appraisal and service fees for mortgage transactions and correct the irrational characterization of appraisal fees. In addition, HUD should be directed to require proper disclosure and transparency in terms of notifying consumers and mortgagors of the fees charged in a mortgage transaction. Unfortunately, allowing HUD to continue their current policies increases risk because AMCs are reduced to using less qualified appraisers (those that are willing to perform assignments for a fraction of the normal fee) to complete appraisals.

Home Valuation Code of Conduct (HVCC)

Recently, New York Attorney General Andrew Cuomo entered into an agreement with Fannie Mae, Freddie Mac, and the Federal Housing Finance Agency to develop a lender code of conduct relative to appraiser independence in loans sold to Fannie Mae and Freddie Mac. Consistent with the agreement it is likely that AMCs will play a larger role in the delivery of appraisal services and thus the issue of fee disclosure has been raised by many across the country. The same unfortunate circumstance of an artificially adjusted appraisal fee results wherever

AMCs are involved. One remedy for this anomaly is to direct that appraisal fees are clearly disclosed to borrowers and differentiated from management or service fees on all relevant mortgage loan documents.

Appraisal Subcommittee Amendments
We support the provisions in H.R. 1728 that are intended to modernize the effectiveness of the appraiser regulatory structure, authorizing additional oversight authority to the Appraisal Subcommittee in its responsibilities to oversee state appraisal laws. We have long supported additional rule making authority for the ASC as well as authority to make grants and provide incentives to states to improve enforcement of appraisal requirement. Effective discipline is necessary if we are to have a meaningful state certification program for appraisers. We believe Congress should "up the ante" with the ASC and help create a robust and realistic set of regulatory expectations. Further, we believe the Appraisal Subcommittee should be held accountable for its responsibilities and be more transparent with its operations, specifically, by providing details of field audits of state appraiser regulatory agencies, deficiencies found, and actions that were taken to achieve compliance.

The savings and loan crisis of the 1980s inspired FIRREA in 1989, and its Title XI established the current appraisal regulatory structure. Specifically, Title XI created the federal Appraisal Subcommittee to oversee the activities of the state appraisal boards and commissions. Yet, the only real power the Subcommittee has over state appraisal boards is authority to "decertify" a state if it is found to be out of conformance with Title XI. This specific power is called by some the "atomic hammer," because if it were invoked, virtually all mortgage-related lending in that state would cease. Because of its severity, the Appraisal Subcommittee has never used this power, and it likely never will. This is why we support the concept contained in H.R. 1728 that would grant the Appraisal Subcommittee authority to impose interim sanctions and suspensions on the State appraiser certifying and licensing agencies. Such powers include the ability to write rules and regulations, powers currently not granted to the Appraisal Subcommittee.

Technical Issues
The following are a series of technical and methodological issues we would like to discuss with the committee:

- **Appraisal Reviews:** An important issue relative to the relationship between appraisers and Appraisal Management Companies (AMCs) speaks to the integrity of the appraisal reports ordered through AMCs. Oftentimes, AMCs allow individuals who are NOT state licensed or certified to review reports prepared by appraisers who do hold similar credentials. They are often located in another part of the country, therefore lacking any geographic competency about the market area. These non-credentialed individuals exercise or seek to exercise control over the appraiser's opinion or conclusion of value, as well as relevant property and market characteristics' information (such as property condition, supply/demand and trends, etc.).

  In connection with this provision, it is important that the term "appraisal review" be defined in a way which prevents AMCs from avoiding the requirement by labeling what is actually an "appraisal review" (relating to the appraiser's opinion of value), as something else – such as an administrative review or quality control review, acceptance review, or the like. The amendment language below attempts to do that by relying, essentially, on the definition of "Appraisal Review" and the language of Standard 3 found in the Uniform Standards of Professional Appraisal Practice (USPAP):

  Definition: "'Appraisal Review' means the act or process of developing and communicating an opinion about the quality, adequacy or reasonableness of the work of an appraiser (including the appraiser's opinions or conclusions developed in an appraisal assignment, such as value) that was performed as part of an appraisal, appraisal review or appraisal consulting assignment."

- **Multiple Approaches to Value:** The appraisal process traditionally includes three "approaches to value," the Income Approach, the Sales Comparison Approach, and the Cost Approach. USPAP requires consideration of each of the approaches in each assignment, and the approaches that are appropriate, relevant or necessary should be used.

For residential properties, the Sales Comparison Approach is most often used as the Income Approach is primarily for commercial or income producing properties. The Cost Approach is sometimes employed in residential properties as an additional method for developing a value indication.

We have observed a decline in the use of the Cost Approach in single family residential appraisal. This has blurred the notion that there are separate components for improvements and land. In the past, appraisers were required to explain the land value contribution when it exceeded 35 percent of the total value. In the housing bubble it became apparent that the relative improvement value to the overall value had diminished, but this was not observable in appraisals because of the diminished role of the cost approach. We believe this information would be beneficial in the underwriting process, and that consideration of the Cost Approach by the appraiser should be viewed as a "best practice" for appraisers.

- **Consideration of Professional Designations:** Our organizations believe H.R. 1728 should conform with current Fannie Mae competency requirements, which state:

  > *"Professional appraisal designations can be helpful in evaluating an appraiser's qualifications, particularly when the designation is from a nationally recognized organization that has formal experience, education, and ethics requirements that are strongly administered. If lenders consider appraisal designations in their evaluations, they should be familiar with the appraisal organization's specific requirements to ensure that the designation is evaluated appropriately.*
  >
  > *Before using an appraiser's services, lenders should be satisfied that the appraiser has demonstrated the ability to perform quality appraisals. When a new appraisal is required for a mortgage that a lender delivers to us, the lender warrants that the property has been appraised by a state-licensed or state-certified appraiser."*

- **Addition of Agencies to the Appraisal Subcommittee:** In addition to the increased authority for the ASC we commented on earlier, we are in favor of expanding the membership of the agency. Specifically, we suggest the addition of the Veterans Administration, as that department has an important housing program for veterans, and a representative from the Federal Trade Commission Office of Consumer Protection. Other agencies with housing authority or financial interests could include the Federal Housing Finance Agency or the Securities and Exchange Commission for their interest in mortgage backed securities. In addition, we believe the Appraisal Subcommittee and the public would be served well through the establishment of an advisory board consisting of stakeholder organizations (consumer groups, professional appraisal organizations, and real estate finance trade organizations) that could meet on a regular basis, keep apprised of the ASC's activities, and provide input, insight, and resources to resolve identified concerns.

- **GAO Study:** Our organizations support the language in this legislation calling for a GAO study on possible improvements in the appraisal process, the effectiveness of State compliance efforts and the examination of the effectiveness of the existing de minimis. Moreover, we ask the Committee to consider a review of <u>all</u> of the current appraisal exemptions, and that the study seek the assistance of individuals familiar with the appraisal process.

- **Copy of Appraisal:** We support, as a disclosure matter, providing the consumer a copy of the appraisal three days prior to closing and believe this provision could be strengthened by also including a copy of any appraisal, review appraisal, evaluation, or valuation related product used in making the decision to fund the loan.

Thank you for this opportunity to testify, I am pleased to respond to any questions you may have.

TESTIMONY OF

STEVEN L. ANTONAKES

MASSACHUSETTS COMMISSIONER OF BANKS

On behalf of the

CONFERENCE OF STATE BANK SUPERVISORS

On

H.R. 1728, THE MORTGAGE REFORM AND ANTI-PREDATORY LENDING ACT OF 2009

Before the

FINANCIAL SERVICES COMMITTEE

UNITED STATES HOUSE OF REPRESENTATIVES

April 23, 2009, 10:00 a.m.

Room 2128 Rayburn House Office Building

Introduction

Good morning, Chairman Frank, Ranking Member Bachus, and distinguished members of the Committee. My name is Steven L. Antonakes, and I serve as the Commissioner of Banks for the Commonwealth of Massachusetts. It is my pleasure to testify today on behalf of the Conference of State Bank Supervisors (CSBS).

CSBS is the professional association of state officials responsible for chartering, supervising, and regulating the nation's over 6,000 state-chartered commercial and savings banks. For more than a century, CSBS has given state banking supervisors a national forum to coordinate supervision of their regulated entities, develop regulatory policy, provide training to state officials, and represent state officials before Congress and the federal financial regulatory agencies.

In more recent years, as states responded to the growth of mortgage lending and origination outside of regulated banks, state banking regulators have assumed new responsibilities for nonbank mortgage supervision. To address the need for expanded and enhanced mortgage supervision, state regulators have engaged in unprecedented coordination. Through CSBS, working closely with the American Association of Residential Mortgage Regulators (AARMR)[1], a new network of mortgage originator and lender regulation has taken shape. Presently, the states are applying this new framework to a universe of 77,000 mortgage companies, 50,000 branches, and 410,000 loan officers.

The states, the federal financial regulatory agencies and the Obama administration are actively working to restore confidence in the mortgage market. I commend you, Chairman Frank, Representative Miller and Representative Watt for your legislative efforts

[1] AARMR is the organization of state officials responsible for the administration and regulation of residential mortgage lending, servicing, and brokering. http://www.aarmr.org/.

and dedication to protecting consumers and for promoting the principles of responsible lending.

Regulatory oversight of the residential mortgage market is undergoing significant reforms to address many of the shortcomings of the current system. Presently, we are making tremendous progress toward a more coordinated state/federal system of supervision to address the ongoing challenges presented by the evolving mortgage market and to ensure that no market participants fall through gaps in financial supervision. High minimum standards for the conduct of mortgage professionals and protection of consumers must be the hallmark of a reformed system. The most effective reform is not one of federalization, but a more coordinated system that draws on the strengths of state and federal supervision. A more coordinated network of state and federal regulation and state and federal law will be much more flexible, responsive and comprehensive in providing high standards and meaningful regulation. Congress can do much to create both a framework as well as incentives that will lead to a more coordinated regulatory framework.

Mr. Chairman, in my testimony I will discuss the progress already being made toward developing this coordinated network of supervision, led by the CSBS-AARMR Nationwide Mortgage Licensing System and the recently enacted S.A.F.E. Act. I will also offer the Committee suggestions for regulatory enhancements to strengthen our system of supervision. Finally, I will discuss H.R. 1728, the Mortgage Reform and Anti-Predatory Lending Act (referred to herein as H.R. 1728, or the Act). CSBS supports the principles of H.R. 1728, but we have some concerns with specific provisions of the bill.

Ultimately, the legislative response to our housing crisis must facilitate a new era of cooperative federalism and break down barriers to communication and cooperation that currently exist between state and federal regulators.

A New Era of Cooperative Federalism

The states have long been recognized as leaders in responding to consumer protection issues with innovative solutions. It is important to note the initiatives outlined in my testimony were either fully in practice or well under way prior to the most recent collapse of our markets. States have been leading the fight to reign in abusive lending through predatory lending laws, licensing and supervision of mortgage lenders and brokers, and through enforcement of consumer protection laws and standards of safety and soundness. Rather than thwarting or banning such protections, the Committee and Congress should incorporate the early warning signs and interventions that state laws and regulations provide in your legislation.

My fellow state supervisors and I welcome coordination with our federal counterparts to promote responsible lending across the residential mortgage industry, as well as the regulation of other types of financial institutions. Since Congress added full state representation to the Federal Financial Institutions Examination Council (FFIEC) in 2006, federal regulators are working more closely with state authorities to develop processes and guidelines to protect consumers and prohibit certain acts or practices that are either systemically unsafe or harmful to consumers. The FFIEC should also be a vital tool to improve state and federal cooperation and coordination and to promote more seamless and comprehensive supervision of the mortgage market.

<u>CSBS-AARMR Nationwide Mortgage Licensing System and the S.A.F.E. Act</u>

Undoubtedly, the model for cooperative federalism among state and federal authorities is the CSBS-AARMR Nationwide Mortgage Licensing System (NMLS) and the S.A.F.E. Act enacted last year. In 2003, CSBS and AARMR began a very bold initiative to identify and track mortgage entities and originators through a database of licensing and registration. States have been working diligently to develop and implement NMLS. For the past three years, as a member of the NMLS oversight board, I personally have participated in weekly meetings with fellow regulators to engage in the critical decisions needed to develop a robust and meaningful new regulatory framework. In January 2008, NMLS was successfully launched with seven inaugural participating states, including my home state of Massachusetts. Today, just 16 months after its launch, 24 states and Puerto Rico are using NMLS. By January 2010 CSBS expects 43 states, the District of Columbia, and Puerto Rico to be using NMLS. I have attached, as Exhibit A, a map indicating when states will begin using NMLS.

The hard work and dedication of the states was recognized by Congress as you enacted the Housing and Economic Recovery Act of 2008 (HERA). As you are well aware, a significant portion of last session's Mortgage Reform and Anti-Predatory Lending Act was eventually incorporated in HERA as the S.A.F.E. Act. Special recognition must go to Ranking Member Bachus, who first developed the S.A.F.E. Act and its state/federal model for regulation and supervision. The purposes of the S.A.F.E. Act are to increase loan originator professionalism and accountability, enhance consumer protection, and reduce fraud by requiring all mortgage loan originators to be licensed or registered through NMLS.

The law requires states to pass legislation to meet the minimum requirements established by the S.A.F.E. Act by July 31, 2009. While the implementation of the S.A.F.E. Act within the time period required is a monumental task, the states have risen to the challenge and have unified under a Model State Law of implementing language and procedures.

Within weeks after passage of the S.A.F.E. Act, a working group of state regulators developed a Model State Law to assist states in making legislative changes to comply with the Act. On January 5th, the U.S. Department of Housing and Urban Development (HUD) published an interpretive piece on their website indicating that the CSBS/AARMR Model State Law was compliant with the S.A.F.E. Act.

As of today, just three months into most state legislative sessions, 20 states have passed legislation to bring them into compliance with the S.A.F.E. Act. An additional 27 states have legislation introduced. To date, no state legislature has adjourned without passing S.A.F.E. legislation.

Moving forward, regulators and the public will eventually have the opportunity to benefit from the power of a vast data network designed to thoroughly screen mortgage companies and professionals. The system will:

1. Assist regulators in determining whether companies and individuals have the character and fitness to conduct business with consumers;
2. Establish a system of professional testing and continuing education;
3. Assign a unique identifier for truly nationwide accountability; and
4. Facilitate consumer complaints, regulatory violations, and regulatory enforcement actions.

I cannot stress how important both the S.A.F.E. Act and NMLS are to the protection of consumers and in the battle against harmful business practices. Combined, these two initiatives create a system of accountability, interconnectedness, control, and tracking that has long been absent in the supervision of the mortgage market. By registering every loan originator with a unique identifier and requiring that identifier to be incorporated with loan origination documents, we have created the ability to associate the loan documents and business practices with the individual and company that negotiated the transaction. Further, NMLS will be a central repository for enforcement actions against companies and individuals. This is a powerful tool to ensure that bad actors cannot hide from their past bad actions. When combined with the required registration of loan originators operating within insured financial institutions, we have created an almost seamless connection that begins with practices and products and culminates with any record of consumer harm.

I have included a comprehensive list of state and federal coordinated initiatives to enhance supervision of the residential mortgage market as Exhibit B in the Appendix.

H.R. 1728, the Mortgage Reform and Anti-Predatory Lending Act

CSBS supports the principles of H.R. 1728 and recognize the need to establish a federal standard. However, the problems in the residential mortgage market are constantly evolving and shifting. A static legislative solution will simply not be able to keep pace of the market. Therefore, we urge the Committee and Congress to ensure that any new federal legislation support and enhance existing state and federal efforts to improve supervision and enhance consumer protection by contributing to the development of a coordinated system of supervision.

CSBS continues to support the creation of a federal minimum predatory lending standard that allows the states to address these predatory practices as they evolve. Therefore, the federal standard must be a floor for all lenders that does not stifle a state's authority to protect its citizens through state legislation that builds upon the federal standard. States should also be clearly allowed to enforce—in cooperation with federal regulators—both state and federal predatory lending laws for institutions that act within their state.

There are several provisions in H.R. 1728 that are new from last session's proposed bill. While CSBS is still reviewing and developing policy on some of these provisions, I would like to express our thinking to date on these new provisions.

State Participation in Rule Writing Authority

Throughout H.R. 1728, the authority to write and prescribe regulations are granted to the "Federal Banking Agencies," meaning the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the Federal Deposit Insurance Corporation, and the National Credit Union Administration. These are all the members of the FFIEC, except the voting state representative.

As previously described, better state/federal coordination and effective lending standards—applicable to all lenders—is needed if we are to establish rules that are appropriately written to and applied to all mortgage market participants. While the biggest lenders are federally chartered and subject to federal bank regulation, the vast majority of financial institutions in the United States are chartered and supervised by the states, making the states essential to ensure effective implementation of federal legislation. Also, the states have a breadth of experience in regulating the entire mortgage industry, not just banks. Unlike my federal counterparts, my state supervisory colleagues and I oversee all financial service providers, which include banks, thrifts, credit unions, mortgage banks, and mortgage brokers.

Therefore, CSBS recommends the Act be amended to require all rule writing by the Federal Banking Agencies be coordinated through the FFIEC which includes—as a voting member—the Chairman of the State Liaison Committee. The FFIEC was designed to facilitate consistent federal regulation and supervision and coordination with state regulators. Having rulemaking coordinated through the FFIEC assure some consideration of state expertise.

Section 101. Definitions.

In an effort to clarify definitions provided by the S.A.F.E. Act and H.R. 1728, CSBS encourages the Committee to amend the definition of "mortgage originator" in H.R. 1728. As a minimum licensing standard, the S.A.F.E. Act definition of "mortgage originator" requires that an individual meet both tests of "taking an application" and "offer[ing] or negotiate[ing] terms," created a regulatory loophole and unraveled existing licensing standards. The states have fixed this problem in our Model State Law to adopt the S.A.F.E. Act and fortunately, H.R. 1728 attempts to correct this problematic definition by replacing "and" with "or." However, this definition as written may be broader than intended. The problem occurs in allowing "for direct or indirect compensation or gain" to modify only the phrase "offers or negotiates terms" rather than the entire definition.

CSBS suggests that the definition we developed for state adoption of the S.A.F.E. Act could serve as a model.

Further, the states have made considerable efforts over the last year to identify risks associated with reverse mortgage loans and to establish supervisory mechanisms to deal with these risks. The exclusion of reverse mortgage loans from the definition of "residential mortgage loan"—and thereby all of the associated protections within H.R. 1728—is detrimental to consumer protection. In addition, the definition excludes open-end credit plans, including those known to be used in practices found to be harmful by the states.

By defining differently a term previously defined in the S.A.F.E. Act, Congress may inadvertently confuse the definition of "residential mortgage loan" applied to the licensing of individuals. CSBS encourages Congress to reconsider the H.R. 1728 definition and any unintended consequences related to consumer protection and consistency with licensing laws.

Section 103. Prohibition on Steering Incentives.

We believe this section of the bill establishes appropriate minimum standards. In hindsight, we all recognize that the originate-to-distribute model of mortgage lending too often focused on finding the originator, lender, and secondary market the best return rather than finding the borrower the best product. There are countless stories of lender incentives paid for the delivery of what we now call nontraditional mortgage products. These loans were designed to give the initial appearance of affordability, but carried the short-term harm of equity absorption and the long-term harm of unaffordable payments.

Section 103 of the Act carries substantive prohibitions on steering incentives that will help change the landscape of loan sales from one in which borrowers consume what they are told to, to one in which they consume only what they need. This section considers ability to repay, net tangible benefit and abusive sales practices. The Act also contains a prohibition on appalling practices seen in so many of the large predatory lending cases brought by state authorities. For example, the predatory practice of steering a borrower who qualifies for a conventional loan into a nontraditional loan—the result of which only served to enrich the originator and the lender—would be prohibited by Section 103.

Section 105. Regulations. (e) Discretionary Regulatory Authority.

As previously mentioned, we suggest that states have input into the rulemaking process by using the FFIEC to facilitate rulemaking. Section 105(e) of the Act grants discretionary authority to the federal banking agencies to draft regulations dealing with terms, acts or practices that are abusive, unfair, deceptive, predatory, or inconsistent with reasonable underwriting standards. While H.R. 1728 was modeled after the North Carolina predatory lending law first enacted almost a decade ago in 1999, the majority of the Act excludes the states from contributing to development of the laws and regulations that will ultimately govern prohibited practice. The states have vast experience in investigating and remedying these troubling practices and have taken thousands of enforcement actions against mortgage providers. State examiners in the field identify and examine these practices and state authorities prosecute cases against those that would exploit borrowers.

Section 203. Safe Harbor and Rebuttable Presumption.

CSBS supports establishing assignee liability in H.R. 1728 and believes that it is reasonable to draw the line at the securitizer. As a result, it is understandable to try and establish a safe harbor for certain mortgage loans. So while CSBS supports safe harbor for certain loans, we are concerned about the scope of the safe harbor. One may assume a "qualified mortgage" in Section 203 would refer to a 30-year, fixed-rate mortgage. In our interpretation, however, we believe the safe harbor would be granted to a much broader set of mortgage loans. If Congress is to establish a safe harbor, federal and state regulators must have the ability to refine the safe harbor as unanticipated abuses may occur within the confines of the defined safe harbor. While we can not foresee all problems with the safe harbor as presently defined, we do see some areas that may be inconsistent with the intent of this section:

1. The allowance on annual percentage rates exceeding the average prime offer rate by 1.5% for first lien mortgages and 3.5% for subordinate lien mortgages seems excessive. For example, if the average prime offer rate calculated on a $100,000 first lien mortgage equals 5.5%, then a loan made with an APR only

1.5% above this rate could carry nearly $14,000 more in loan fees than the comparable average prime offer rate loan. Clearly, a $14,000 differential in loan fees, all other things being equal, would put subprime loans in the category of qualified mortgages allowing a safe harbor.

2. The limitation on loan repayment periods less than 30 years makes little sense to us. Provided that the borrower is able to afford the higher monthly payment amount, 15 year or 20 year mortgages offer the opportunity to save tens of thousands of dollars in interest and an accelerated growth in real equity.

CSBS would recommend qualified mortgage limits of .5% and 1.5% respectively for APRs exceeding the average prime offer rate and consideration of the consumer benefits possible with loan terms less than 30 years.

<u>Section 208. Effect on State Laws.</u>

In Section 208 of the Act, state law is specifically preempted. As the Act states, "the Truth in Lending Act (as added by section 204) shall supersede any State law or application thereof that provides additional remedies against any assignee, securitizer, or securitization vehicle, and the remedies described in such section shall constitute the sole remedies against any as signee, securitizer, or securitization vehicle, for a violation of subsection (a) or (b) of section 129C of such Act or any other State law the terms of which address the specific subject matter of subsection (a) (determination of ability to repay) or (b) (requirement of a net tangible benefit) of such section129C."

The states have been, and continue to be, the frontline guardians of consumer protection and at the forefront in the battle against predatory lending. In fact, many aspects of H.R. 1728 draw directly from a decade of state legislative, regulatory and enforcement experience. It is interesting to note that the Truth in Lending Act (TILA) was passed in the Commonwealth of Massachusetts two years before it was enacted at the federal level. TILA serves as one more example of states implementing legislation that is later used as a model for federal action.

Therefore, CSBS urges the Committee and Congress to eliminate federal preemption of state consumer protection laws. Because of our proximity to and knowledge of the communities we serve, state authorities are often best poised to identify emerging trends and practices that are harmful to consumers. Further, we are often able to react more swiftly and severely to impose enforcement actions upon those entities that engage in fraudulent or abusive practices.

We believe that liability can be an effective means of addressing abusive practices in lending. At the same time we understand the reasoning for placing limits on liability in order to encourage sound lending practices that have historically not been associated with consumer harms. While we generally support the concept of a safe harbor for qualified mortgages, we are concerned that too broad of a definition combined with limits on both the state's and the consumer's ability to utilize existing remedies against all parties to the transaction will create an environment void of the intended consumer protections. Once the limits of liability are drawn at the securitizer line, circumvention via the statutory definition is a likely consequence. In other words, if the bar for safe harbor is set too low and equitable remedies are simultaneously eliminated, consumers may once again find themselves in a situation where harmful practices are virtually irreversible.

Of course, looking back is always easier than looking forward and what appeared as healthy may ultimately be revealed as harmful. Section 208 unintentionally establishes a federal ceiling of regulation that exposes consumers to even greater potential risk than exists today.

CSBS has worked closely with AARMR in identifying and combating these risks. Attached as Exhibit C are suggestions developed by AARMR concerning the ability to repay and net tangible benefit standards established in H.R. 1728 and the potentially harmful limits imposed by Section 208. We encourage Congress to amend the federal preemptions in this section and empower the states to join the federal agencies in determining the appropriate mechanisms to avoid any evasion of the Act's intent.

Section 213. Credit Risk Retention.

Section 213 proposes regulations to require any creditor that makes a residential mortgage loan that is not a qualified mortgage to retain an economic interest in a material portion of the credit risk for any such loan that the creditor transfers, sells or conveys to a third party. As we have no experience with such a requirement, we do not know what the impact will be, but it is not unreasonable to imagine such a requirement could reshape the mortgage industry and have a significant impact upon credit availability.

In our experience, corporate risk alone may not alter our outcomes. Both bank and nonbank lenders who seemingly had "skin in the game" made risk decisions that resulted in their failure. And more would have failed if not for government intervention. It is possible that risk retention could have the opposite of the desired effect. It could result in an industry consolidation that creates more banks that are considered too big to fail that pose even greater and seemingly intractable risks to our financial system and economy. Additionally, from our state perspective it is not difficult to imagine an industry so consolidated and systemic that it is seemingly unaccountable to consumers.

If the goal of Congress is to reduce the future numbers of non-qualified mortgages, using credit risk retention may very well have this effect. However, if the goal is to encourage sound underwriting and good origination practices there may be better and more holistic ways to revision the current system of originations. One possible idea would be to limit an originator's upfront earnings potential by spreading a future income stream out over the life of the loan. Our belief is that the transparency provided by unique identifiers applicable to the entire industry of originators also provides important incentives and checks on poor lending standards and abusive practices.

<u>Section 216. Legal Assistance for Foreclosure-Related Issues.</u>

I am personally encouraged to see a provision for legal assistance to borrowers facing foreclosure-related issues and the allocation of $35 million a year to support this provision. In Massachusetts for example, the Division of Banks has provided $3 million in grants to fund regional foreclosure education centers, statewide foreclosure prevention efforts, and first-time homebuyer programs. All funding for this program comes from fees paid by licensed mortgage originators. We welcome the addition of legal assistance funding to these types of ongoing state efforts.

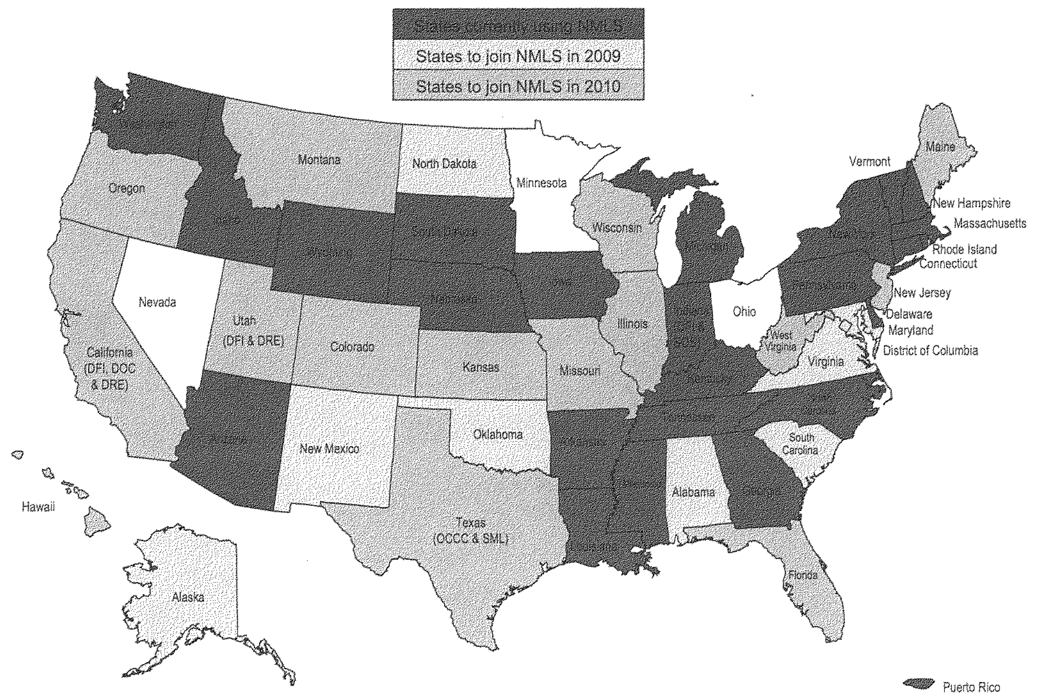
Conclusion

I commend the work of this Committee to protect consumers and the financial system. States have undertaken a number of initiatives to enhance supervision, protect consumers, and take action against predatory lenders. I urge you to develop legislation that builds upon—and does not inhibit—the work done by state and federal authorities toward this end.

Thank you for the opportunity to testify today. I look forward to answering any questions you may have.

Exhibit A: NMLS Implementation Map

CSBS/AARMR Nationwide Mortgage Licensing System



State Regulatory Registry LLC, February 2009

Exhibit B: State Initiatives to Enhance Supervision

Nationwide Cooperative Protocol and Agreement for Mortgage Supervision

In December 2007, CSBS and AARMR initiated the Nationwide Cooperative Protocol and Agreement for Mortgage Supervision to assist state mortgage regulators by outlining a basic framework to coordinate supervision of Multi-State Mortgage Entities (MMEs). The goals of this initiative are to protect consumers; ensure the safety and soundness of MMEs; identify and prevent mortgage fraud; supervise and examine in a seamless, flexible and risk-focused manner; minimize regulatory burden and expense; and foster consistency, coordination and communication among the state regulators.

To date, 48 states, the District of Columbia and Puerto Rico have signed the Protocol and Agreement. This month, the first multi-state examinations are scheduled to begin based upon examination procedures and methods redesigned to provide broader institution coverage, while focusing examiner resources where problems are most likely to reside.

Mortgage Examinations with Federal Agencies

Beginning in late 2007, the states, in partnership with the Federal Reserve System (Fed), the Federal Trade Commission (FTC), and the Office of Thrift Supervision (OTS) engaged in a pilot program to examine the mortgage industry. Under this program, state examiners worked with examiners from the Fed and OTS to examine mortgage businesses over which both state and federal agencies had regulatory jurisdiction. The FTC also participated in its capacity as a law enforcement agency. In addition, the states separately examined a mortgage business over which only the states had jurisdiction.

State Examination Programs

Beyond investigations and enforcement actions, states regularly exercise our authority to investigate or examine mortgage companies for compliance not only with state law, but with federal law as well. Unheralded in their everyday routine, examinations identify weaknesses that, if undetected, might be devastating to the company and its customers. State examinations act as a check on financial problems and sales practices gone astray. Examinations also stop a supervised entity from engaging in misleading, predatory, or fraudulent practices. In addition, examinations often result in the early detection of emerging harmful practices or trends.

State financial institution examiners conduct thousands of on-site examinations each year of depository institutions, mortgage companies, consumer finance companies, payday lenders and other financial services providers. Taken as a whole, this system of state regulators is one of the largest financial regulatory bodies in the United States. This supervision mirrors the diffused industry it oversees. States are working in the same spirit that governs NMLS—a cooperative system that leverages local expertise and authority through joint examinations within the state system and with our federal regulatory counterparts.

To ensure state examiners are well-prepared, examiner training is an integral part of the state regulatory system. States have made a significant commitment in examiner skill sets that is continually broadened and improved to match the complexities of today's financial markets. For example, in 2007 state banking departments alone spent nearly $8 million on training for its examination staff.

Since 1984, CSBS has maintained a state banking department accreditation program to enhance the professionalism of departments and their personnel, making 2009 its 25th year in operation. In 2008, CSBS established the mortgage accreditation program to encourage state mortgage regulatory agencies to enhance their capability to promote excellence in mortgage supervision.

Proactive Regulatory Guidance and Requirements

Proximity to our supervised entities, examinations, and consumer complaints all help the states identify emerging threats, risks and troubling products or practices. Our network of supervision must build upon this early-detection system and facilitate the development of supervisory tools that are proactive. State/federal coordination on regulatory policy has not always been successful. An example of this disconnect is the development of the 2006 *Guidance on Nontraditional Mortgage Product Risks*. State officials were barred from contributing to the development of these guidelines, but then publicly chided for failing to have similar guidelines in place. The states did quickly develop parallel guidelines, and also developed AARMR/CSBS Model Examination Guidelines (MEGs) to facilitate implementation of the guidance. The process did improve when Congress gave the states a voting seat on the FFIEC. This allowed us to participate in the development of the 2007 *Statement on Subprime Mortgage Lending*.

In an effort to stay ahead of market practices and innovation, and to ensure we are providing comprehensive consumer protection, state and federal authorities must strive toward developing coordinated guidelines, examination procedures, and regulations. Through our involvement with the FFIEC, coordination between the states and our federal counterparts has greatly improved in the last two years and continues to do so.

In early 2008, state regulators identified the reverse mortgage lending market as one of future concern and potential problems—not only to consumers, but to the safety and soundness of financial institutions as well. Despite the relatively small size of the market for reverse mortgage lending today, the states believe it holds the potential, much like subprime lending, for explosive growth in coming years, particularly as the "Baby Boomer" generation retires with depleted retirement accounts as a result of today's recession. Therefore, CSBS and AARMR held the first ever regulatory training school on reverse mortgages. By the end of 2008 we had developed and released a comprehensive set of Reverse Mortgage Examination Guidelines (RMEGs) at least two years prior to our projections of growth in the market.

The clarity provided by the MEGs and the RMEGs will greatly enhance industry compliance with regulatory guidelines. By providing the industry with clear expectations, regulators will be able to hold institutions accountable for compliance failures and monitor more precisely any unsound practices.

Regulatory Reporting

Another CSBS/AARMR initiative underway prior to the passage of the S.A.F.E. Act is a system of mortgage data reporting similar to the Call Reports for depository institutions. Inadequate data means inadequate supervision. This is one more area where I would like to thank this Committee for having the insight to help us bring this initiative to the level of a national standard. In time, we will be collecting data and developing a much better understanding of the shape of the mortgage market as it returns to healthy and viable levels of business.

Technology and New Examination Methods

Beginning in 2007, the states—through CSBS—began a year-long process of investigating available technology and in 2008 entered a public/private venture to bring the best of the available technologies to the examination process.

By extracting loan file data electronically for every loan originated or funded by the institution and running the data through specialized software built upon regulations and guidelines, we are able to conduct a pre-examination offsite review before the examiner ever leaves his or her desk. The idea is to identify apparent violations and problems before the examination begins, and then direct the examination resources exactly where they are needed the most. The use of technology eliminates the previous reliance upon random sampling and educated guessing and replaces these with skilled resources focused where the problems are most likely to be found.

State Predatory Lending Laws

Currently, 35 states—including Massachusetts—and the District of Columbia have enacted subprime and predatory mortgage lending laws.[1] The innovative actions taken by state legislatures have prompted significant changes in industry practices, as the largest multi-state lenders were forced to adjust their practices to comply with the strongest state laws. All too often, however, states are frustrated in our efforts to protect consumers by the federal preemption of state consumer protection laws. Preemption should not be used as a method to circumvent stringent consumer protection requirements.

As mentioned above, CSBS supported the Mortgage Reform and Anti-Predatory Lending Act in the last Congress, and we continue to support the creation of a federal minimum predatory lending standard that allows the states to address these predatory practices as they evolve. However, we would once again like to stress the federal standard must be a floor for all lenders that does not stifle a state's authority to protect its citizens through state legislation that builds on the federal standard. States should also be clearly allowed to enforce—in cooperation with federal regulators—both state and federal predatory lending laws over institutions that act within their state.

State Enforcement of Consumer Protection Laws

[1] Source: National Conference of State Legislatures. http://www.ncsl.org/.

State attorneys general and state regulators have cooperatively pursued unfair and deceptive practices in the mortgage market. Through several settlements, state regulators have returned nearly one billion dollars to consumers. In 2002, the settlement with Household resulted in $484 million paid in restitution; a settlement with Ameriquest four years later resulted in $295 million paid in restitution; and a settlement with First Alliance Mortgage Company resulted in $60 million paid in restitution. These landmark settlements included significant injunctive relief and monitoring programs setting new standards for fairness and further contributing to changes in industry lending practices.

While these cases have received most of the recognition, success is sometimes better measured by those actions that never receive media attention. Attached as Exhibit D is a chart of enforcement actions taken by state regulatory agencies against mortgage providers. In 2007 alone, states took almost 6,000 enforcement actions against mortgage lenders and brokers. But these cases do not include the unrecorded investigations and referrals for criminally punishable fraud and other crimes. To keep pace, state agency investments in resources combating serious crimes are a significant and growing portion of state agency budgets.

<u>State-Specific Initiatives</u>

Like many states, Massachusetts has taken a proactive approach to dealing with the foreclosure crisis and the devastating effect foreclosures have on our local communities. Below are some of the initiatives undertaken in Massachusetts—including passage of a comprehensive foreclosure prevention law signed by Governor Deval Patrick in November 2007—to address these issues and to prevent their recurrence:

- *Extending Community Reinvestment Act-like obligations to non-bank mortgage lenders.* Under a new law in Massachusetts, licensed mortgage lenders making

50 or more loans in a year in the state will be subject to requirements that are substantially similar to both the state and federal Community Reinvestment Act (CRA). After issuing proposed regulations and holding a public hearing last summer, the new regulations became final on September 5, 2008. These "Mortgage Lender Community Investment" regulations include a Lending Test and a Service Test. Unlike the federal CRA for banks, these mortgage lender regulations include a review of the availability of mortgage products that are suitable for low- and moderate-income individuals. They also consider loans and services to assist delinquent borrowers to remain in their homes, including loan modifications. The Massachusetts Division of Banks posted the first schedule of examinations to be conducted on mortgage lenders under the new regulations, and are currently underway.

- *Requiring mandatory counseling for first time homebuyers who choose to take out a subprime adjustable rate-mortgage.* Massachusetts law now prohibits a lender from making a subprime adjustable-rate loan to a first-time homebuyer unless they affirmatively opt-out of a fixed rate or prime loan product and receive counseling from an approved counselor.
- *Providing grant funds.* The Division of Banks has provided $3 million in grants to fund regional foreclosure education centers, statewide foreclosure prevention efforts, and first-time homebuyer programs. $2 million in grants was provided in fiscal year 2008 and $1 million has been provided thus far in 2009 to fund non-profit organizations providing assistance to areas hardest hit by foreclosures. All funding for this program comes from fees paid by licensed mortgage originators.
- *Database of foreclosure notices.* Launching a web-based database of foreclosure notices will allow my office to study trends and better focus examination efforts. In addition, we have also built in functionality to track the entities responsible for maintaining vacant foreclosed properties. The Division has partnered with local health and public safety officials to ensure that vacant properties do not become a threat to the neighborhood.

- *Seeking voluntary foreclosure stays.* For homeowners facing imminent foreclosure, at the Governor's direction we have worked to secure voluntary 30 to 60 day stays in the foreclosure process from mortgage loan servicing companies. Our goal is to provide a short amount of time for homeowners to connect with reputable homeownership counseling firms and encourage mortgage lenders to work with homeowners who are unable to make their mortgage payments to see if a solution short of foreclosure is attainable. Since 2007, the Division has been able to obtain nearly 1,100 voluntary stays for homeowners who were facing foreclosure in Massachusetts.
- *Establish a 90 day Right to Cure.* Homeowners are now entitled to a 90 day "Right to Cure" before a mortgage holder can initiate foreclosure proceedings. As part of this requirement, the lender or servicer must allow the homeowner 90 days to cure the default and must provide an accounting of how much must be paid during that time to bring the mortgage current. During that period, the mortgage holder can not charge legal or other fees other than principal and interest under the mortgage.
- *Stabilizing neighborhoods.* To combat foreclosure trends in some of the hardest hit communities in Massachusetts, the state Department of Housing and Community Development (DHCD) launched neighborhood stabilization pilot programs in Lawrence, Boston, Brockton, New Bedford, Springfield and Worcester neighborhoods. DHCD has partnered with lenders and non-profits to reclaim pre-foreclosure and foreclosed properties in these communities. The properties will be sold to qualified first-time homebuyers with the goal of returning them to fully-occupied status as quickly as possible.

Around the nation, states are engaging in an array of efforts and initiatives to prevent foreclosure and protect consumers. The National Governors Association has developed a report that provides a comprehensive overview of state efforts in this area. The report is available online at http://www.nga.org/Files/pdf/0902FORECLOSUREREPORT.PDF.

Exhibit C: AARMR Suggestions

American Association of
AARMR Residential Mortgage Regulators

AARMR SUGGESTIONS
ON
THE ABILITY TO REPAY AND NET TANGIBLE BENEFIT STANDARDS
IN
H.R. 1728

April 22, 2009

H.R. 1728 proposes federal "ability to repay" (ATR) and "net tangible benefit" (NTB) standards that build on more than ten years of state laws and regulations in dealing with consumer protection in mortgage lending. The American Association of Residential Mortgage Regulators (AARMR), representing state mortgage regulators, supports this effort to implement a federal minimum standard in these areas to supplement existing state law protections. While this standard clearly improves federal law, AARMR has the following suggestions for consideration:

1. **Congress should include State regulators in developing rules to implement HR 1728 through FFIEC and through consultation with AARMR.** Several states have implemented ATR and NTB standards. AARMR has recently issued guidance to state regulators and our licensees on ATR. State experience in fine-tuning and enforcing these standards offers an important perspective that would augment federal regulatory expertise. State regulators have worked cooperatively with our federal counterparts on non-traditional mortgage loan guidance and the subprime lending statement, and should be included in any rule-making. For example, ATR/NTB rulemaking will need to consider issues such as:
    - application of debt-to-income ratios to borrowers with different levels of debt and income;
    - application of ATR standards for loans with balloon payments;
    - items included in definition of "total monthly debt";
    - when expectation of future income should be considered in ATR;
    - exceptions for certain types of mortgage loan products, such as reverse mortgage loans, if certain conditions are met.

   Therefore, H.R. 1728 should be amended to specifically require federal regulators to consult with state regulators through AARMR and CSBS when developing applicable regulations.

2. **Congress should not preempt state laws or create safe harbors for creditors or holders of residential mortgage laws**. In some states, homeowners may have common law or statutory claims they may be able to assert against holders for the conduct of creditors. AARMR is concerned that the preemptive language in H.R. 1728 would eliminate these types of consumer defenses and make it more difficult to avoid foreclosure on securitized loans. State lawmakers and regulators have responded to the evolution of the "originate to distribute" model of mortgage lending by extending regulatory oversight and application of state laws to activities beyond mortgage origination. Similarly, AARMR is concerned that H.R. 1728 may preempt state ATR laws that provide greater consumer protection than the ATR regulations promulgated under the current proposal. Providing a

Exhibit C: AARMR Suggestions

new preemptive safe harbor creates an unnecessary federal barrier to state and private enforcement of state law claims. H.R. 1728 should be amended to include language that explicitly protects from preemption all state laws used by consumers as defenses against foreclosure and state regulators to police the mortgage industry including ATR laws. In addition, H.R. 1728 should be amended to authorize state mortgage regulators to enforce H.R. 1728.

3. **Congress should explicitly apply ATR and NTB standards to mortgage brokers.** Mortgage brokers frequently have primary contact with borrowers and may have the best understanding of the borrower's financial situation. Mortgage brokers should not avoid responsibility for selling products that do not consider a borrower's ability to repay or that do not have a net tangible benefit to the borrower.

4. **Congress should ensure homeowners have an adequate remedy for violations of ATR and NTB requirements.** Current proposed language in H.R. 1728 does not adequately ensure compliance with ATR or NTB as creditors can avoid any liability simply by "curing" the violation after notice by the borrower. To effectively deter improper conduct, Congress should give the borrower the option of rescission or requiring a creditor to cure the violation.

Exhibit D: State Enforcement Actions Against Mortgage Providers

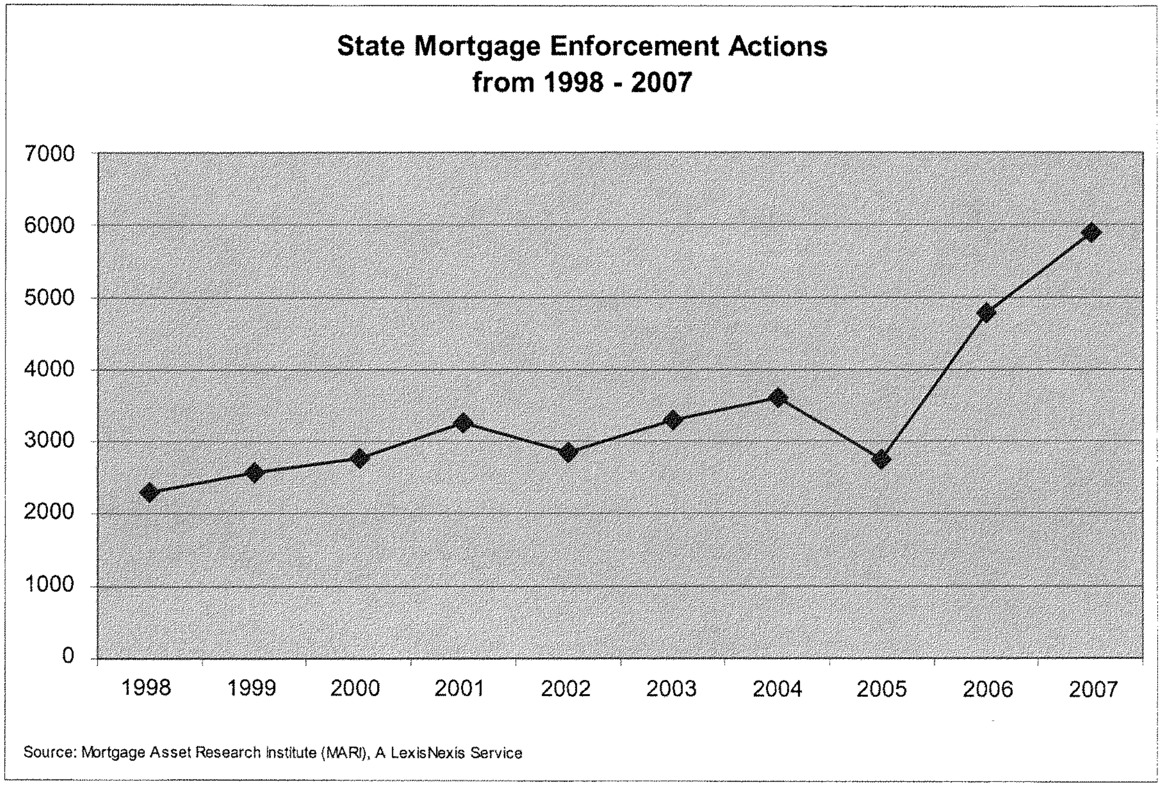


Exhibit D: State Enforcement Actions Against Mortgage Providers

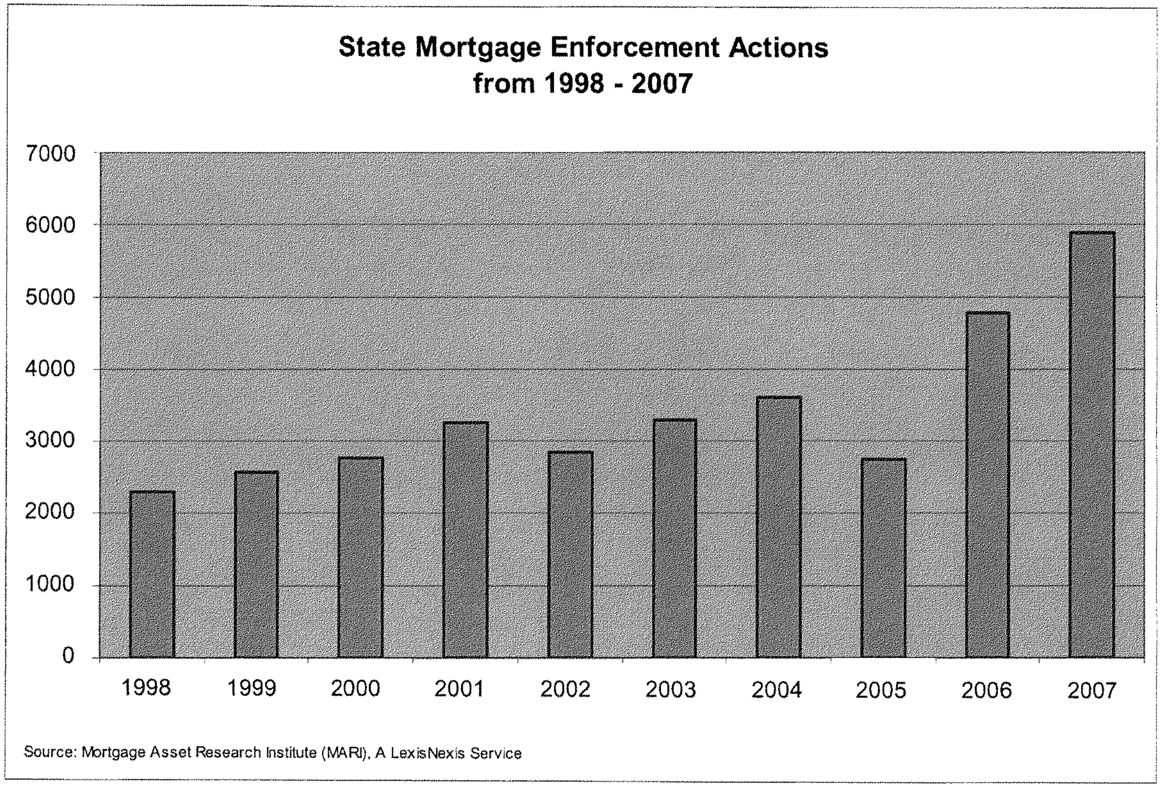
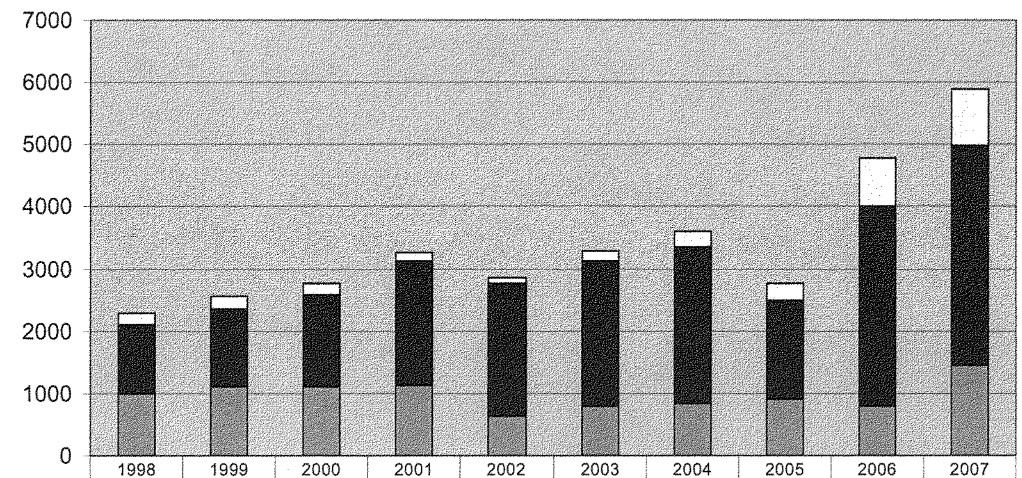


Exhibit D: State Enforcement Actions Against Mortgage Providers

State Mortgage Enforcement Actions from 1998 - 2007



	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Disciplinary / Fines	185	212	180	133	93	171	249	260	761	912
Cease & Desist	1121	1242	1480	2002	2117	2343	2534	1595	3227	3527
Criminal / Revocation	992	1116	1106	1126	638	782	829	904	788	1457

Source: Mortgage Asset Research Institute (MARI), A LexisNexis Service

NCLR

Putting an End to Predatory Lending in Minority and Latino Communities

Presented at:

Hearing on the "Mortgage Reform and Anti-Predatory Lending Act of 2009"
(H.R. 1728)

Before:

Committee on Financial Services
U.S. House of Representatives

April 23, 2009

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My name is Graciela Aponte, and I am a legislative analyst at the National Council of La Raza (NCLR) the largest national Hispanic[1] civil rights and advocacy organization in the United States. NCLR has been committed to improving opportunities for the nation's more than 45 million Latinos since 1968. To this end, NCLR conducts research, policy analysis, and advocacy on a variety of financial services issues that impact the ability of Latinos to build and maintain assets and wealth. I would like to thank Chairman Frank and Ranking Member Bachus for inviting me to share our recommendations for the "Mortgage Reform and Anti-Predatory Lending Act of 2009" (H.R. 1728). NCLR has supported earlier versions of this legislation while also calling for improvements.[2] We applaud the Committee for strengthening sections in H.R. 1728 that are essential to protecting vulnerable borrowers from unfair lending. However, there is more work to be done. Our community has been hit hard by predatory lending, record-high foreclosure rates, and erosions of hard-earned home equity. NCLR stands ready to work with the Committee to strengthen this bill and ensure that all homebuyers are protected from deceptive lending practices.

For more than two decades, NCLR has actively engaged in relevant public policy issues such as preserving and strengthening the Community Reinvestment Act (CRA) and the Home Ownership and Equity Protection Act (HOEPA), supporting strong fair housing and fair lending laws, increasing access to financial services for low-income people, and promoting homeownership in the Latino community. For the last ten years, NCLR has been helping Latino families become homeowners by supporting local housing counseling agencies. The NCLR Homeownership Network (NHN), a network of 50 community-based counseling providers, works with more than 37,000 families annually and produced more than 25,000 first-time homebuyers in its first decade. Recently, our focus has shifted to helping families keep their homes. NHN members counseled more than 7,500 homeowners facing foreclosure last year alone. Our subsidiary, the Raza Development Fund (RDF), is the nation's largest Hispanic community development financial institution (CDFI). Since 1999, RDF has provided $400 million in financing to locally based development projects throughout the country. This work has substantively increased NCLR's institutional knowledge of how Latinos interact with the mortgage market, their credit and capital needs, and the impact of government regulation of financial services markets.

For years, NCLR and the civil rights community have urged Congress to put an end to predatory lending.[3] The lack of strong laws, regulations, and enforcement has severely damaged Latino and other minority communities' ability to securely enter the ranks of the middle class. Reckless and deceptive lending practices will likely result in the disappearance of a generation of wealth and financial security. While this Committee has actively fostered dialogue and debate on the issue, and even passed legislation in the previous Congress, a new law has yet to be signed. We are disappointed that it has taken a foreclosure and economic crisis in order for Congress and regulators to seriously address predatory and deceptive lending practices.

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[1] The terms "Hispanic" and "Latino" are used interchangeably by the U.S. Census Bureau and throughout this document to identify persons of Mexican, Puerto Rican, Cuban, Central and South American, Dominican, and Spanish descent; they may be of any race.
[2] Letter from NCLR and NAACP to Barney Frank, Chairman, House Financial Services Committee, and Spencer Bachus, Ranking Member, House Financial Services Committee, November 6, 2007.
[3] Janis Bowdler, *Jeopardizing Hispanic Homeownership: Predatory Practices in the Mortgage Market* (Washington, DC: National Council of La Raza, 2005).

We commend members of this Committee for their efforts to bring forth a stronger anti-predatory lending bill to protect future homeowners. In my testimony today, I will discuss protections included in H.R. 1728 that are paramount to guarding Latino families and other underserved communities. I will also discuss sections that need to be strengthened to ensure that lenders are effectively deterred from steering borrowers into high-cost, deceptive, and unaffordable mortgages. Finally, I will close with a series of recommendations.

Background

For decades stakeholders have worked together to increase homeownership rates in Latino and other underserved communities. Like most American families, Latino families purchased their homes to build wealth and long-term financial security. In fact, the home is often the primary asset for communities of color, representing more than three-quarters of their net worth. Home equity can help families save for retirement or a college education for their children, start a small business, and provide a safety net for financial emergencies. Unfortunately, neither the prime nor the subprime markets have served the Latino and immigrant communities well. Hispanic and immigrant borrowers often have unique profiles that make them unattractive to lenders who rely heavily on automated underwriting. For example, 22% of Latinos have a thin credit file or no credit history, which usually results in a credit score of zero, compared to only 4% of Whites.[4] However, the fact that these individuals do not have a credit score does not mean that they are not creditworthy borrowers. For example, many of these individuals pay for items in full with cash, do not have a credit card, pay their rent and bills on time, and live within their means.

Despite the fact that there exist sound prime products that accommodate nontraditional credit, including proof of on-time rent and bill payments, there was a strong disincentive to market these products. To lenders relying on automation, making such loans seemed too time-consuming and burdensome to bother with. Instead, prime lenders referred hard-to-serve borrowers to their subprime affiliates or simply did not market themselves to such borrowers. This left a vacuum that subprime and predatory lenders quickly filled. Meanwhile, subprime products and loan characteristics earned higher fees for loan originators. Originators with a wide range of products at their disposal often steered borrowers, especially those considered "hard-to-serve," toward products that earned higher commissions rather than products that were a good fit for the consumer. Research shows that Latinos are 30% more likely than Whites to receive a high-cost loan when purchasing their home.[5] Other research shows Latinos were more likely to receive loans with interest-only or negative amortization features, prepayment penalties, and high yield spread premiums. When forced on the wrong borrower, these products and features leave borrowers vulnerable to foreclosure. Now, as many as 400,000 Latinos may lose their homes to foreclosure this year alone.[6]

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[4] Michael Stegman et al., "Automated Underwriting: Getting to 'Yes' for More Low-Income Applicants," (presentation, 2001 Conference on Housing Opportunity, Chapel Hill, University of North Carolina, 2001).
[5] Debbie Gruenstein Bocian, Keith S. Ernst, and Wei Li, *Unfair Lending: The Effect of Race and Ethnicity on Price of Subprime Mortgages* (Durham, NC: Center for Responsible Lending, 2006).
[6] *Projected Foreclosures to Latinos by State* (Durham, NC: Center for Responsible Lending, 2009).

Through NHN, NCLR has served more than 150,000 low- and moderate-income families seeking to become homeowners. Each year, we help more than 3,000 families purchase their first home with a prime mortgage product. Moreover, NCLR moved quickly to respond to the foreclosure crisis by providing funding and training to more than 40 community-based housing counseling agencies throughout the country. This year, NCLR launched a campaign with the National Urban League (NUL) and the National Coalition for Asian Pacific American Community Development (National CAPACD) to expand efforts to help community-based organizations address the rising rates of foreclosures. In addition, NCLR has conducted research and analysis on homeownership and foreclosure issues in the Latino community.

We understand the credit needs of low-income families. When paired with a safe and affordable loan product, families are much less likely to default, even when facing tough economic times.[7] Unfortunately, matching creditworthy families with positive lending models has not been the dominant practice in the mortgage market for some time. During the subprime boom years, negative and reckless lending practices crowded out positive lending innovations in both the prime and subprime markets. New legislation and regulations should seek to promote positive innovation while keeping deceptive and harmful developments in the market at bay.

Protecting Borrowers and Tenants

The "Mortgage Reform and Anti-Predatory Lending Act of 2009" includes several vital protections for borrowers and tenants. As the Committee continues to debate this bill, we urge you to protect three provisions in particular:

- **Ability-to-repay standard.** The ability-to-repay standard would require lenders to present borrowers with "appropriate mortgage loans." The lender must determine that the borrower has a reasonable ability to repay the loan, present a net tangible benefit to homeowners seeking to refinance, and ensure that the loan cannot have any predatory characteristics such as equity stripping, excessive fees, or abusive terms. The standard makes it clear that the borrower's financial circumstances, including credit history, income, debt-to-income ratio, property taxes, insurance, and other related costs, are factored into the determination of eligibility for a home loan. Many NHN clients seeking foreclosure assistance are in trouble because they received mortgages they could never afford to repay. By reinstating this commonsense lending standard, we will ensure that borrowers receive affordable and sustainable mortgage loans.

- **Safe harbor for qualified mortgages.** By providing a safe harbor for traditional 30-year fixed rate loans, H.R. 1728 will help shift the incentives away from exotic mortgages to those that are as safe and sound for families as they are for the economy. We challenge the idea that this will stifle innovation. The innovative models established by credit unions, Community Reinvestment Act programs, community banks, CDFIs, and others demonstrate the ability of the lending institutions to provide mortgages that meet the safe

[7] Roberto Quercia and Janneke Ratcliff, "The Preventable Foreclosure Crisis," *Housing Policy Debate* 19 (2008): 775–785.

harbor standard without sacrificing innovation, sound lending principles, or profit.[8] For example, the Community Commitment suite of products by Bank of America was widely successful among NHN clients. The mortgage product allowed the use of nontraditional credit, offered low down payments, and required counseling. Except for those affected by unemployment, NHN counselors see very few Community Commitment borrowers return to their shops. The Committee should provide further direction to bank regulators, using this as an opportunity to develop cutting-edge lending models that truly meet the needs of all borrowers.

- **Tenant protections.** All too often we hear from tenants on the verge of homelessness because their landlord did not pay their mortgage. Tenants who have been paying their rent on time become innocent victims. Many are forced into an unaffordable rental market and an unstable housing situation. They need time to find an affordable home to rent, save for their security deposit and the move itself, and make other arrangements for their family. This bill gives tenants the right to remain in their homes until the end of their lease. If they do not have a lease or if the property is purchased, then tenants must be given 90-day notice to vacate.

In addition, NCLR also applauds the Committee for its continued support of community-based counseling and legal assistance programs. The bill elevates the U.S. Department of Housing and Urban Development (HUD) Housing Counseling Program by creating an Office of Housing Counseling and expands funding opportunities for free and low-cost legal services programs. These programs often serve as a lifeline for communities cut off from the financial mainstream.

Strengthening H.R. 1728

While this legislation includes vital provisions to protect consumers, several areas must be strengthened to prevent abuse and make way for constructive developments in the market. Although some have argued that lenders have "learned their lesson" and will implement better lending practices moving forward, current events suggest otherwise. As credit markets have tightened, we have seen abusive practices creep into the Federal Housing Administration (FHA) and Veterans Administration (VA) markets.

Take the case of a retired veteran who came to El Centro, Inc., based in Kansas City, Kansas. The veteran came to the agency when his VA loan was no longer affordable. After reviewing his case, the counselor discovered that a mortgage broker from a popular local firm had inflated the borrower's income and the borrower was dedicating 60% of his pension to his home. He had struggled to keep up with the payments, but they proved to be too much. Now the veteran is in default and counselors at El Centro are working to secure a loan modification.

In Los Angeles, counselors from East Los Angeles Community Corporation met Ricardo S. when his loan adjusted and he couldn't keep up with the payments. Upon further investigation, they discovered that he had been sold two loans (popularly called an "80/20"). His first

[8] See Subcommittee on Financial Institutions and Consumer Credit, *Mortgage Lending Reform: A Comprehensive Review of the American Mortgage System,* 111th Cong., 1st sess., 2009.

mortgage had five built-in adjustments, with a balloon payment due at the end of the 30-year term that would have represented 70% of the principal. In other words, had this loan not been discovered by the counselors, the borrower would have spent 30 years paying the mortgage only to have repaid 30% of the principal balance.
As struggling borrowers flood the doors of NHN agencies, similar cases are appearing throughout the country. Some are quick to blame the borrower for getting a loan that they cannot afford. However, the reality is that most of our families could have qualified for 30-year fixed rate mortgages but were unknowingly steered into unaffordable, high-cost loans. We know that it is possible to get our families into prime loan products, even with nontraditional credit barriers. NHN counselors have helped more than 25,000 families purchase homes with prime mortgage products.

Mrs. Romero, a single mother working at the local YWCA, is one of our success stories. She sought out the help of El Centro when she decided to move her four children out of their apartment and into a house. Her housing counselor helped her create a budget and savings plan. They enrolled her in their individual development account (IDA) program, which allowed her to open a matched-savings account and receive financial counseling. She recently applied her savings to her down payment after qualifying for an FHA mortgage.

Housing counselors instruct their clients to wait until the right moment to purchase their home and connect them with financial products that will guarantee success. We urge the Committee to bolster three provisions critical to protecting Latino and other communities of color and ensuring that truly positive lending models emerge:

- **Section 103: Anti-steering provision.** Many originators are paid premiums for adding prepayment penalties, increasing interest rates, including onerous and unnecessary terms, or shifting borrowers to limited documentation loans, even when borrowers can document their income and credit history. These premiums create an incentive for steering unsuspecting borrowers, including many Latino and immigrant borrowers, toward risky and expensive products. The result is that many Hispanic homeowners waste hard-earned income paying unnecessary fees and higher-than-reasonable interest when they should be paying off principal and building equity and wealth. As a result, as interest rates reset on adjustable rate mortgages and Option ARMs, Latinos are at risk of experiencing a record number of foreclosures. Section 103 is a step in the right direction. It aims to curb the practice of steering, but it is ambiguous and does not clearly prohibit certain deceptive practices.

- **Section 102(b): Duty of care.** Most borrowers pay mortgage professionals to coach them through what is likely the largest financial transaction they will make in their lifetime. Similar to the way they rely on the advice of other professionals such as doctors, lawyers, and accountants—all of whom have legal and ethical responsibilities to their clients—borrowers believe mortgage brokers are obligated to work on their behalf. Unfortunately, this is not the case. Despite the efforts of some to implement best practices, brokers are under no legal or professional ethical responsibility to work on behalf of the borrower. H.R. 1728 includes a duty of care for all originators, and while this is a step in the right direction, more is needed. Mortgage brokers must be held accountable for the role they play in helping consumers shop for their mortgage.

- **Liability and enforcement.** H.R. 1728 outlines liability standards for originators, lenders, and Wall Street. However, in many cases the liability may not be strong enough to deter those covered by the legislation from violating the new law. Instead, the bill shifts the responsibility on the borrower to discover that the law has been violated and fight the industry for a correction. As it is, Latinos and immigrants are often the least likely to file formal complaints. While there are many reasons for this, one is that filing a complaint does little to resolve one's immediate situation. We need a mortgage system that works regardless of whether victims file a complaint, pursue legal action, or default on their mortgage. The liability and enforcement provisions included in H.R. 1728 must be strengthened to effectively discourage creditors from breaking the law.

Recommendations

We offer the following recommendations to further strengthen the legislation. Addressing these points would earn our full support of the bill.

- **Prohibit lenders from luring unsuspecting borrowers into unaffordable loans.** Stronger anti-steering provisions are necessary to protect Latino and other communities of color from reckless and discriminatory lending. The "Fairness for Homeowners Act of 2009" (H.R. 1782) includes strong provisions that explicitly prohibit steering consumers toward loans that are more costly than those for which they qualify and mischaracterizing the consumer's information, property value, and home loan. We are prepared to work with the Committee and other consumer groups to incorporate these strong provisions into H.R. 1728 to provide further protections for consumers.

- **Make mortgage brokers accountable for the mortgages they sell to families.** We urge Congress to establish a fiduciary duty for mortgage brokers. The "Fairness for Homeowners Act of 2009" would impose a fiduciary responsibility on brokers and other mortgage originators, prohibiting undisclosed compensation and requiring brokers to find the most beneficial deal for borrowers and act in the consumer's best interest.

- **Ensure lenders obey the law.** We urge Congress to include stronger remedies to deter creditors from violating the statute. H.R. 1728 allows creditors to provide a cure in cases where the statute has been violated, along with other nominal damages. However, this consequence is unlikely to change the business practices of at least some mortgage originators. Thus, we believe that stronger penalties may be required for knowingly committed, pattern and practice violations.

While the focus of this hearing is on mortgage reform and anti-predatory lending legislation, additional measures will be required to create a robust and cutting-edge mortgage market and regulatory infrastructure. NCLR supports a strengthened regulatory system, efforts to modernize CRA, and increased funding for community-based housing and financial counseling. We also support proposals to invest in affordable rental and homeownership opportunities, revitalize neighborhoods, and build wealth in minority communities. Finally, we have endorsed the "Foreclosure Prevention and Sound Mortgage Servicing Act of 2008" (H.R. 5679, 110th Congress), which seeks to reform the mortgage servicing industry as a means of helping families save their homes from foreclosure. We look forward to working with this Committee, Congress, and the new administration to enact these proposals in the coming months.

NMHC National Multi Housing Council
Apartments: Smart Communities, Smarter Living

National Apartment Association

TESTIMONY OF JIM ARBURY

ON BEHALF OF THE

NATIONAL MULTI HOUSING COUNCIL

AND

NATIONAL APARTMENT ASSOCIATION

BEFORE THE

HOUSE COMMITTEE ON FINANCIAL SERVICES

ON

H.R. 1728, THE "MORTGAGE REFORM AND ANTI-PREDATORY LENDING ACT"

APRIL 23, 2009

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As the Financial Services Committee begins debate on H.R. 1728, the "Mortgage Reform and Anti-Predatory Lending Act," the National Multi Housing Council (NMHC) and the National Apartment Association (NAA) would like to take this opportunity to provide the Committee with key information on the apartment sector as well as how this legislation will impact the multifamily sector.

NMHC and NAA represent the nation's leading firms participating in the multifamily rental housing industry. Our combined memberships are engaged in all aspects of the apartment industry, including ownership, development, management and finance.

The National Multi Housing Council represents the principal officers of the apartment industry's largest and most prominent firms. The National Apartment Association is the largest national federation of state and local apartment associations. NAA is comprised of nearly 200 affiliates and represents over 51,000 professionals who own and manage more than 6 million apartments. Nearly one-third of Americans rent their housing, and more than 14 percent of all U.S. households live in an apartment community.

As you and your fellow lawmakers take action to address the foreclosure crisis and the concomitant problems that now accompany it, we urge you to carefully consider the meaningful differences between the single-family/multi-unit sector and the apartment sector, which we define as properties with five or more units.

Without a proper understanding of those differences, any actions you take to address the single-family meltdown may cause unintended consequences for our industry. Understanding the needs of the apartment sector is more important than ever because America will increasingly rely on rental apartments to house our citizens.

Unlike most industrial nations, the U.S. population is growing. In fact, our population is expected to increase 33 percent by 2030 to 376 million. That's 94 million more people than there were in 2000. To accommodate that growth, we will need 60 million new housing units by 2030.

But we don't just need more housing, we need different housing. The U.S. is on the cusp of fundamental change in our housing dynamics as changing demographics and housing preferences drive more people away from the typical suburban house and toward rental housing.

Rental housing is clearly important for the 73 million Echo Boomers who are getting ready to enter the housing market, typically first as renters. It's also critical for the estimated 13 million immigrants who will come to this country in the next 10 years.

But the bigger force at work here is a dramatic change in what constitutes the "typical" American household. For generations, married couples with children dominated our housing markets and caused the suburbs to grow explosively. But today these families are less than 25 percent of American households.

In their place are a growing number of nontraditional households who are more likely to choose renting—single parents, couples without children and empty nesters. By 2020, singles and unrelated individuals living together will comprise one out of every three households. That's a profound change.

The takeaway from all of this is that our housing demand is rising, our housing preferences have changed dramatically and rental housing is an increasingly important component of our housing system. These changes were underway before the foreclosure crisis, but with this new development, rental housing has taken on even more prominence.

According to Professor Arthur C. Nelson, Presidential Professor and Director of Metropolitan Research at the University of Utah's College of Architecture and Planning, to meet emerging housing demands, half of all new residential construction between now and 2020 will have to be rental units.

To meet that need, however, federal lawmakers need to take action on four key issues:

(1) Enacting a More Balanced Housing Policy;
(2) Continuing the Ban on Seller-Financed Downpayment Programs;
(3) Retaining and Expanding the Supply of Affordable Rental Housing and Rejecting New Mandates on Multifamily Owners; and
(4) Preserving the Apartment Industry's Access to Capital.

ENACT A MORE BALANCED HOUSING POLICY

For decades, the federal government has pursued a "homeownership at any cost" housing policy, ignoring the growing disconnect between the country's housing needs and its housing policy. In the process, many people were enticed into houses they could not afford, which in turn helped fuel a housing bubble that ultimately burst and caused a global economic crisis.

The nation is now paying the price for that misguided policy and learning firsthand that there is such a thing as too much homeownership; that aggressively pushing homeownership was not only disastrous for the hardworking families lured into unsustainable homeownership, but also for our local communities and our national economy.

If there is a silver lining in this situation, it is the opportunity we now have to learn from our mistakes and rethink our housing policy. Housing our diverse nation means having a vibrant rental market along with a functioning ownership market. It's time we adopt a balanced housing policy that doesn't measure success solely by how much homeownership there is.

For many of America's most pressing challenges, from suburban sprawl to affordable housing, apartments are a much better solution. Apartments help create stronger and healthier communities by offering enough housing for the workers that businesses need, by reducing the cost of providing public services like water, sewer and roads and by creating vibrant live/work/play neighborhoods.

They will help us house our booming population without giving up all our green space and adding to pollution and traffic congestion. And they will help us reduce our greenhouse gas emissions by creating more compact communities that enable us to spend less time in our cars.

Elements of a Balanced Housing Policy

NMHC and NAA have joined together to advocate for a more balanced housing policy, one that respects the rights of individuals to choose housing that best meets their financial and lifestyle needs. We urge decision makers at all levels of government to work with the apartment industry to craft a smarter housing policy that:

- Assures that everyone has access to decent and affordable housing, regardless of his or her housing choice;

- Respects the rights of individuals to choose the housing that best meets their financial and lifestyle needs without disadvantaging, financially or otherwise, those who choose apartment living;
- Promotes healthy and livable communities by encouraging responsible land use and promoting the production of all types of housing;
- Recognizes that all decent housing, including apartments, and all citizens, including renters, make positive economic, political and social contributions to their communities; and
- Balances the expected benefits of regulations with their costs to minimize the impact on housing affordability.

CONTINUE THE BAN ON SELLER-FINANCED DOWNPAYMENT PROGRAMS

One key element of a more balanced housing policy is to oppose policies that would reinflate the housing bubble. One such program is proposed legislation that would reinstate seller-financed downpayment programs.

Under these programs, builders and other house sellers contribute funds to an organization–AmeriDream, Inc. and Nehemiah Corporation of America are among the most prominent–and the organization, in turn, provides those funds to a prospective house buyer to use as the downpayment.

In 2006, the IRS stripped these organizations of their tax-exempt status, ruling that the sellers often merely raise the property's selling price in order to offer the funding, and therefore the program may not result in a net benefit to the buyer.

The primary beneficiaries of these programs are builders and house sellers, not first-time homebuyers. In fact, in many cases, these programs push more families into unsustainable homeownership by increasing the number of owners with no equity in their properties in a marketplace characterized by falling house values.

Reinstating these programs could create more foreclosures and push homeownership out of reach of many families by artificially inflating house prices. They also threaten the viability of the Federal Housing Administration, which reports that loans issued with seller-financed downpayments are three times as likely to default.

We urge lawmakers to resist calls to return to the failed policies of zero-down mortgages by maintaining the ban on seller-financed downpayments.

RETAIN AND EXPAND THE SUPPLY OF AFFORDABLE RENTAL HOUSING; REJECT NEW MANDATES ON MULTIFAMILY OWNERS

The 2002 Millennial Housing Commission report identified affordability as the "single greatest housing challenge facing the nation." According to Harvard University, 35 million households spend 30 percent or more of their annual income on housing, a common definition of affordability. The causes of the affordability problem are not hard to establish. It is, primarily, an income problem. The fastest-growing industries in the U.S. economy are those with lower-paying jobs such as retail workers, customer service representatives, office clerks and home health aides.

Nationally, in 2006, a family would have to earn $33,925 a year to be reasonably assured of finding an affordable two-bedroom apartment. Yet, roughly 42 million households earned less than that last year.

This shortage existed before our current housing crisis, but the explosion in foreclosures has aggravated it, creating more demand for affordable shelter and causing more people to choose to remain in rental housing. Rental housing has to become a higher priority if we are going to solve the affordable housing shortage.

The federal government's primary involvement in the provision of affordable housing is through two programs, the Low-Income Housing Tax Credit program and the Section 8 Housing Voucher program.

Low-Income Housing Tax Credit Program: Federal Action Needed to Sustain the Program

The LIHTC program is the only federal program that actually subsidizes the construction of affordable housing, but it has become a collateral victim of the banking and mortgage crisis. We urge you to support proposals that will enable current investors to continue and to increase their investment activity, including proposals that will permit the carryback of LIHTCs for up to five years and proposals providing for a temporary acceleration of LIHTCs.

We also support proposals to continue to encourage new investors for the LIHTC market, such as proposals for a temporary modification of the passive loss rules for the limited purposes of the LITHC. In addition, we encourage the Committee to urge HUD to make changes to the formulas used to calculate LIHTC rents applicable to currently occupied properties. These changes are necessary to ensure the continued viability of existing LIHTC properties, which have thin operating margins that are being squeezed by increased expenses and limited revenues.

Maintain the Existing Affordable Housing Stock: A Modest Tax Proposal

In addition to expanding our supply of affordable housing via the LIHTC, Congress also needs to enact exit tax relief to help preserve our existing supply of affordable rental housing. The nation has a serious problem where long-time owners of many affordable apartment properties would now face an enormous tax bill if they sold the property – in some cases the tax bill would exceed the sales value.

This discourages the current owners from making additional capital investments or from selling them to someone who would. Instead, current tax law encourages them to simply hold them until they die and can transfer them to their heirs with no tax implications.

A modest change in the tax rules that would waive the depreciation recapture liability when investors sell their property to new owners who agree to invest new capital in the property and to preserve the property as affordable housing for another 30 years would preserve the stock of federally assisted affordable housing at minimal revenue cost to the federal government. NMHC/NAA are grateful to Representative Artur Davis (D-AL) for his past support of this proposal.

Section 8 Program: Oppose Mandates on Property Owners

NMHC strongly supports the Section 8 Voucher program. Housing Choice Vouchers enable nearly two million households of low- and very low-income families and the elderly to achieve decent, safe and affordable housing. For decades, Section 8 vouchers have provided housing assistance to struggling families, but the program has been troubled with inefficiencies and onerous bureaucratic requirements that can discourage private owners from accepting vouchers. We need to reform the program so it is more "transparent" so it doesn't cost a property owner more to rent to a voucher holder.

NMHC/NAA supported the "Section 8 Voucher Reform Act of 2007" (H.R. 1851, S. 2684) that passed the House of Representatives in the 110th Congress. The bill would have overhauled the program's burdensome and duplicative inspection standards—a priority for NMHC/NAA—and permanently fixed the flawed voucher renewal funding formula. It also streamlined the process for calculating income and rent and implemented changes that would make the program more consistent with the Low-Income Housing Tax Credit (LIHTC) program so the two could have been used together more effectively. While the legislation was not enacted, we are hopeful that the new Congress will work toward the goals highlighted in H.R. 1851/S. 2684.

Given the current limitations of the program, however, we strongly oppose legislation that has been introduced in the House (H.R. 1247, "Protecting Tenants at Foreclosure Act of 2009," and H.R. 1728, the "Mortgage Reform and Anti-Predatory Lending Act") that, in an effort to protect renters living in foreclosed properties by imposing a set of notice requirements, essentially mandates participation in the voluntary Section 8 voucher program.

Specifically, the legislation requires the "immediate successor in interest" of a foreclosed property to provide the tenant with at least 90 days notice before requiring the tenant to vacate the property. In addition to the 90-day notice, the bills require that the tenant may stay beyond the 90-day notice period to the end of the lease term. Notice is clearly important to the tenant, it is also important to the multifamily housing sector that flexibility remain.

The legislation also requires that the "immediate successor in interest" of a foreclosed property be subject to the pre-existing lease and Housing Assistance Payment (HAP) contracts for Section 8 recipients. Through changes in the language to the HAP contract, the legislation attempts to subject a new owner, who is the "immediate successor in interest," to the existing HAP contract that was agreed to by the previous owner.

There are many problems with this provision. First, it is not clear how this provision would be applied considering that the new purchaser is not party to the existing HAP contract. Further, the HAP contract is not a recorded covenant or lien that passes with the transfer of title to the property. In addition, it is not clear whether this new requirement subjects the "immediate successor in interest" to the contract violations of the previous owner.

When Congress created the Section 8 program, it explicitly made it voluntary because it recognized that there are costs and burdens imposed on property owners who choose to participate. Now, this legislation seeks to mandate that in the event of a foreclosure the "immediate successor in interest" would be subject to the HAP contract of the previous owner. In other words, Section 8 participation would be mandatory.

It is important to note that Section 8 voucher renters do NOT lose their subsidy as a result of a foreclosure. For this reason, it is unclear why Congress would want to provide additional protections to voucher renters while infringing on the rights of the potential purchaser or the "immediate successor in interest." This provision will have the unintended consequence of making it more difficult to encourage the resale of all foreclosed properties. It will also greatly diminish private investment in affordable housing at a time when demand for affordable rental housing is higher than ever. We understand the appeal of such mandates, but ultimately they are self-defeating.

We fully support Section 8 as a critical program for meeting the housing needs of millions of Americans, and many members willingly participate in the program. But we oppose the provisions in both H.R. 1247 and H.R. 1728 subjecting an "immediate successor in interest" to the Section 8 HAP contract of the previous property owner.

As for the other provisions of the renter protection legislation, it is important to note that the bill's provisions apply to every residential unit, from a single-family house or condo to the nation's large apartment properties. Yet there is little data to suggest that nationwide foreclosures are occurring at any significant rate in multifamily rental buildings with more than five units.

We understand the need to protect renters living in single-family houses and individually owned condominiums, but such protections are unnecessary for renters in apartment properties with five or more units. When a multifamily rental apartment community is foreclosed on, renters with a valid lease and who are paying their rent are not evicted.

PRESERVE THE APARTMENT INDUSTRY'S ACCESS TO CAPITAL

In order for the apartment sector to meet the nation's growing housing needs, it is vital for the industry to retain access to capital. During the past year, when just about all sources of mortgage capital left the market, Fannie Mae and Freddie Mac continued to meet the industry's needs. In 2008, they provided an estimated 85 to 90 percent of the mortgage capital to the rental housing industry. Fortunately, prudent underwriting by the Government Sponsored Enterprises (GSEs) has resulted in extremely low delinquent and default rates.

This capital has been critical to ensuring stable property operations. It is at risk, however. With greater dependence on mortgage securitization due to limitations in the marketplace, it is critical to ensure an active investor market. We call upon the Federal Reserve to include multifamily mortgages in its enterprise mortgage security purchases. This market has seen expanded growth since the beginning of the year, but it is still volatile, and the Federal Reserve's participation would add confidence and help expand it.

The level of actual purchase activity would not need to exceed $25 billion over the next year of the planned $500 billion, just five percent of the Federal Reserve's allocation to support the agencies' mortgage programs. Additionally, investments into longer-term obligations of Fannie Mae and Freddie Mac would also improve mortgage liquidity to the rental housing sector due to the longer-term nature of the mortgages, which are prohibited from pre-payment, unlike single-family mortgages.

Congress should urge the Federal Reserve to take these actions to ensure that rental housing continues to meet the mortgage needs. These actions, along with the actions by the Treasury and Federal Reserve to include commercial and multifamily mortgages as part of the Term Asset-Backed Loan Facility (TALF) and to create the Public-Private Investment Program to respond to troubled assets, will ensure that the rental housing sector continues to serve the housing needs of millions of American families.

Thank you for the opportunity to express our views. We look forward to working with the Committee to address these important issues.

April 23, 2009

Testimony of

G. Gary Berner

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Committee on Financial Services

United States House of Representatives

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Chairman Frank, Ranking Member Bachus, and members of the Committee, my name is G. Gary Berner. I am Executive Vice President of First Niagara Bank, Lockport, New York. First Niagara Bank is a federally chartered savings bank, with approximately $9.6 billion in assets. We hold $2 billion in single family residential loans and service approximately $616 million in residential single family loans for investors. I am pleased to be here today on behalf of the American Bankers Association (ABA). ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.9 trillion in assets and employ over 2 million men and women.

We appreciate the opportunity to testify on H.R. 1728, which aims to improve mortgage lending standards. I wish to make it clear from the outset that the First Niagara Bank is one of many banks that never varied from traditional, portfolio lender underwriting standards. Our $2 billion residential loan portfolio is strong, with quarter-end delinquency rate of less than one percent and first quarter charge-offs running at an annualized pace of less than one basis point. We also have a "High Satisfactory" lending rating for Community Reinvestment Act (CRA) purposes, and our FA/VA portfolio is in excess of $50 million.

The fallout of the mortgage markets has been very troubling to the banking industry – an industry filled with institutions that have existed for decades, and in the case of my bank, for over 125 years. It has been primarily the actions of loosely-regulated non-bank lenders, and their sometimes fly-by-night operations, that have caused tremendous damage for consumers and for the lending industry, including banks like mine. Many of the non-bank firms have already gone out of business, while others have begun restructuring their businesses. As bankers, we intend to be in our communities for the next 100 years and beyond. Therefore, we know that we must be part of the solution, and we are very pleased to work with you, Mr. Chairman, and with the members of this Committee, on finding ways to bring mortgage lending practices back into balance.

Indeed, we are already a major part of the solution. At First Niagara Bank over the last six months, we have done 27 repayment plans or modifications and have had only three defaults. I have just returned from the ABA's industry meetings on housing and mortgage finance, and almost all banks there reported having similar success with workouts and modifications.

This should not be surprising. As you well know, the vast majority of banks in this country never made a toxic, subprime loan. Rather, we have followed underwriting practices that serve both our customers and our bank. Unlike many state licensed, unsupervised mortgage originators, most banks in this country have served our respective communities for decades. Since we retain loans in our portfolio as well as use the secondary market, we have a vested interest in lending to people who have a well-documented ability to pay us back.

Any regulation or legislation should promote a return to universal and conservative underwriting practices like those maintained at most banks. Conservative practices must be codified and promoted for ***all*** lenders at the same time. At a minimum, legislation must ensure that the prudently managed, federally-regulated banks are not subject to greater burdens than their less regulated, non-bank competitors. Additionally, care must be taken to ensure that the outcome of any legislation does not restrict housing credit. Such unintended consequences will prolong the recession and limit the potential for a strong recovery.

In July of last year, the Federal Reserve issued amendments to Regulation Z that addressed many issues that led to the housing price bubble and the ensuing overextension of credit. These are important and major changes, which in most aspects reflect the sound underwriting principles that have formed the foundation of traditional bank mortgage lending. The new regulations address the use of exotic or nontraditional mortgages; the loosening of underwriting standards, especially among non-depository financial institutions; and the increase of mortgage product complexity. The amendments to Regulation Z fundamentally change the protections offered to consumers, and the changes are forcing many banks and non-bank originators to rework their mortgage lending operations, even those that have never made a problem loan.

Among other things, the recent regulatory changes define a new category of loan based on its Annual Percentage Rate (APR) as a "higher-priced mortgage loan." The standards are so stringent that this category will include some loans that previously were classified as prime. That definition and pricing will certainly force many lenders to stop making loans that carry the stigma of "higher cost" label. The extent of the Regulation Z changes are sufficiently far reaching that our members report an expectation that it will curtail their ability to serve many creditworthy borrowers that may have less-than-perfect credit.

In considering any new legislation, it is critical to recognize the significant changes that are already underway in the mortgage industry that will provide much greater protections to consumers. Further changes, including some proposed in H.R. 1728, have the potential to impair economic recovery further and should be considered carefully.

In my statement, I would like to focus on these three points:

- The changes required in recent regulation constitute major reforms to the mortgage industry;
- The recent regulatory reforms reflect the sound underwriting principles that have formed the foundation of traditional bank mortgage lending; and
- H.R. 1728 should be amended to better recognize the conservative tendencies of banks and the protections afforded by supervisory processes, and provide safe harbors for bank products that fill important market needs; further, it should not overly restrict quality credit being made available to creditworthy borrowers.

I will discuss each of these in turn.

I. The changes required in recent regulations constitute major reforms to the mortgage industry

In recent changes to Regulation Z, the Federal Reserve emphasized the need for more prudent and traditional underwriting. ABA supports changes including regulations to strengthen the integrity of appraisals and prohibit deceptive advertising. ABA also supports requirements that mortgage lenders properly consider a borrower's ability to repay the mortgage, whether it is a fixed or adjustable rate loan. Some of the elements of these new rules codify the underwriting practices of many of our members. The use of these practices throughout the mortgage industry will help to ensure that future lending is done in a prudent and safe manner.

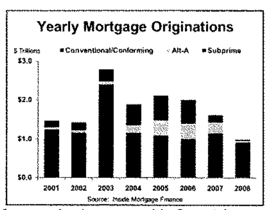
The standards set by the Federal Reserve in its amendments to Regulation Z are stringent. We believe that the subprime excesses would not have occurred had these regulations been in place and enforced earlier. Had the secondary market provided for some degree of "skin in the game" for all market participants, there would also have been far less abuse and fewer bad loans made.

The Federal Reserve's expansion of Regulation Z come with teeth – including limits on terms and conditions for credit and the possibility of expensive individual actions and penalties as well as class action litigation – all of which will have an impact on lending, and reducing available credit for less creditworthy borrowers. The changes also address subprime lending by establishing a new category of "higher-priced" loans. However, the definition is based on a relatively low APR threshold. As a result, this new category is likely to include many prime loans in certain markets, depending on market conditions. This will further dampen credit availability to some creditworthy borrowers.

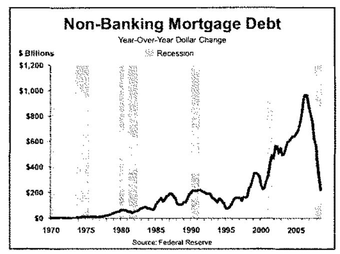
The challenge will be to apply the rules in a targeted manner that prevents recurrence of the subprime problem without unnecessarily restricting credit. ABA has embraced the Federal Reserve's approach, and we will continue to work with the Federal Reserve and other regulators to help ensure that only the intended results are achieved. Congress may choose to go beyond these changes, but we feel it is important to understand the cumulative effect of the recent regulatory changes and changes in the marketplace before enacting further restrictions.

II. Recent reforms reflect the sound underwriting principles that have formed the foundation of traditional bank mortgage lending

The return to traditional underwriting is already visible. This chart shows a comparison of traditional, Alt-A, and subprime loan originations. The trend away from subprime and Alt-A products is clear, and we can expect that numbers for 2009 will continue this trend.



The vast majority of banks have long followed traditional, prudent underwriting models. By doing so, they have avoided troubled loans and prevented borrowers from getting into untenable financial situations. We agree with Chairman Frank when he said: "Reasonable regulation of mortgages by the bank and credit union regulators allowed [that] market to function in an efficient and constructive way, while mortgages made and sold in the unregulated sector led to the crisis."[1] It has been the actions of loosely-regulated non-bank lenders, with low market entrance hurdles and little or no stake in the subsequent performance of the loans that have caused much of the damage for consumers and for the industry. In fact, many bankers tried to warn consumers against subprime loans and deals that were too good to be true, only to watch those consumers succumb to the pitches of non-regulated originators. Now we are helping to clean up the mess that the less regulated industry has left behind. We are effectively addressing problem loans that are the result of economic recession and our own mistakes, and we are extending new credits wherever possible to creditworthy borrowers.



This conservative approach has led the market to turn back to banks as the lenders of choice. In fact, in some cases, banks are the only lenders available. In fact, banks increased lending during 2008. According to the Federal Reserve, commercial bank loan balances have grown from $6.8 trillion as of December 2007 when the recession began, to $7.2 trillion by the end of 2008. Although this number has decreased slightly to $7.1 trillion as of the end of the first quarter, lending is still above first quarter 2008 levels of $6.94 trillion. Almost all banks are reporting an increase in mortgage lending market share.

Even with this increase, banks are unlikely to make up for all the gaps created in the non-bank lending market. Non-bank funding has dominated credit markets, particularly over the last several years. The financial turmoil of the last 18 months has changed this balance. Suddenly, investors have become completely risk-averse, and much of the funding normally coming from the non-GSE secondary market ceased. As a result, banks were forced to find other sources of short-term funds to meet their loan obligations. Fortunately, the Federal Home Loan Banks were able to meet many of these needs. Without this source of funding, the severe lack of liquidity would have been magnified many times over.

Further complicating the current situation, bank regulators continue to caution banks about adding risk to their lending portfolios in this environment. Current economic conditions and declining home values have also contributed to a decline in both commercial and consumer demand for loans.

[1] *Boston Globe*, September 14, 2007.

This means that loan volume will likely decline. The more conservative approach typical of banks and the regulator oversight that emphasizes prudent underwriting based on ability to repay is precisely what permitted the volume of non-bank originations to increase so dramatically. Homebuyers were anxious to tap home equity, speculative investors were eager to ride the rapidly-rising home values, and Wall Street firms had an insatiable hunger to sell high interest-rate securities backed by subprime loans.

In contrast, banks that stuck to traditional underwriting and lent within their own footprint have successfully avoided many of the problems of the current market situation.

III. H.R. 1728 should be amended to better recognize the conservative tendencies of banks and the protections afforded by supervisory processes, and provide safe harbors for bank products that fill important market needs; further, it should not overly restrict quality credit being made available to creditworthy borrowers

Given the magnitude of the problems in the mortgage market, we understand the impulse for Congress to act against abusive lending. ABA appreciates and supports the general thrust of the legislation to require ***all mortgage lenders*** to abide by the strict underwriting standards and other requirements adhered to by insured depository institutions. Gaps still exist. I note with concern that, despite the passage last year of the SAFE Mortgage Licensing Act, non-bank originators still have more than a year to comply with licensing requirements, and lack of supervision for this lending segment remains a concern. A recent article in the Washington Post headlined the fact that the FHA insured 9,200 loans that defaulted after making less than one payment. Much of this lending was done ***by non-bank originators over a period of just 14 months***. This reveals there are still gaps in the system.

At its core, H.R. 1728, the Mortgage Reform and Anti-Predatory Lending Act, seeks to eliminate these gaps. However, this legislation can be modified to ensure that the prudent, federally-regulated survivors are not subject to greater burdens than their less-regulated competitors. H.R. 1728 should enable banks to continue to lend in the same conservative fashion in which they have always lent, utilizing products that are usual and customary for particular needs in the mortgage market. As noted above, this lending is critical to guaranteeing the continued availability of credit in the mortgage market.

ABA is particularly concerned about the safe harbor provisions in the bill, which we believe are far too limited. We have been pleased to work with committee members and staff, and we suggest the following improvements:

1) ***The safe harbor should be expanded to include all types of fixed-rate mortgages.***

The safe harbor as envisioned in H.R. 1728 is currently limited to 30-year fixed-rate mortgages. However, there are fixed-rate mortgages in durations other than 30 years that meet specific financial needs. All fixed-rate, fully-amortizing loans of any duration made by insured depositories should be included in the safe harbor, including 30, 15, 20, 40 year loans and other fixed-rate loans. At First Niagara Bank, of the $1.6 billion of fixed-rate, fully-amortizing loans we currently hold in portfolio, a full 66 percent were originated with original terms of 10-25 years.

2) ***The safe harbor should be expanded to include adjustable rate mortgages.***

ABA's Real Estate Lending Survey shows that even after the housing economy collapsed and long-term interest rates reached historic lows, lenders were making a significant number of "garden variety" adjustable rate mortgages (ARMs). Given the remaining popularity of ARMs, even in a low interest rate environment, they should not be overly restricted. Interest rates will rise as the economy improves. And, in a rising interest rate environment and traditional steep yield curve, ARMs will be an increasingly necessary tool to help people finance home purchases.

3) ***The safe harbor should be irrebuttable for insured depository institutions making the safest loans.***

Because insured depositories have constant regulation and examination, the safe harbor for insured depositories making fully-amortizing and fully-documented fixed-rate mortgages should be irrebuttable.

4) ***A rebuttable safe harbor should be available for all lenders.***

There should be a rebuttable safe harbor for all lenders (not just insured depositories) which would include fully amortizing, fixed-rate loans of any duration, as well as ARMs which are not classified as "non-traditional" by the bank regulatory agencies or "higher-priced" loans under the Truth in Lending Act regulations.

These safe harbor changes would, in effect, create a two-tier safe harbor:

- **Tier one** would apply only to fully-amortizing, fixed-rate loans (of any duration) made by insured depository institutions. As in H.R. 1728, the loans would be required to be fully underwritten and fully documented and could not be higher-priced loans under the Truth in Lending Act (TILA) regulations. A full safe harbor is necessary for these loans because fully-amortizing fixed rate loans are among the least risky, most well-understood products in the marketplace, and insured depositories are the most regulated and examined participants in the marketplace. The combination of product stability and heavily regulated lenders should allow for certainty that these loans, made by these lenders are fully compliant with the duty of care requirement established by the bill.

- **Tier two** would include fully-documented and fully-underwritten loans with well-established and traditional characteristics. To be eligible to be in this tier, loans could not be deemed "non-traditional" loans under federal banking agency regulations or guidance and must not be higher-priced under TILA. ARMs would fall into this tier in addition to fixed-rate mortgages not originated by an insured depository institution. The rationale for the rebuttable safe harbor remains much the same as in H.R. 1728 in its current form; however, garden variety ARMs, which continue to account for a significant percentage of the mainstream mortgage lending market, would also be allowed. These loans provide borrowers with affordable loans which often are better suited to their borrowing needs than longer term loans.

ABA has the following further concerns with H.R. 1728:

- **Risk retention provision:** ABA supports the concept of prudential lending standards reinforced through risk exposure, but has concerns about the provisions in H.R. 1728. If implemented as currently drafted, it will have many repercussions across the industry, which would require the restructuring of much of the securitization market and likely would also require significant accounting changes. In addition, the provision could significantly curtail the availability of credit by requiring significant increases in capital requirements in the loan origination process, even when mortgages are ultimately held by non-leveraged investors.

  The provisions in the bill set out the barest of frameworks for risk retention. Much more detail and discussion is needed across the spectrum of participants in the industry. Originators, securitizers, and investors must be involved in setting the structure of a revised set of requirements.

- **Delegation of discretionary authority:** ABA is confused about the new delegation of discretionary authority to issue regulations about unfair and deceptive acts and practices, among other abusive lending topics. There are currently a number of statutes in which there is delegation of discretionary authority, including new FTC authority granted in the recent appropriations bills. Each delegation of authority is slightly different, including providing for different remedies. Given the specific acts and practices that H.R 1728 is designed to address, we suggest that this general language be deleted or synchronized with all of the similar authority contained in other laws to ensure a consistency of approach and results.
- **Liability provision:** Section 204, Liability should be clarified to clearly state that trustees are not included in the term assignee or securitizer. We would be pleased to provide a specific proposal to the Committee on how to better address issues involving trustees.

Conclusion

Significant changes are underway in the mortgage industry that will provide significant protections to consumers. Further dramatic changes have the potential to impair economic recovery further and should be considered carefully. ABA appreciates the opportunity to testify today and we stand ready to work with this Committee to improve legislation that would make the mortgage markets a safer place for all consumers.

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Statement of

Sandra F. Braunstein

Director, Division of Consumer and Community Affairs

Board of Governors of the Federal Reserve System

before the

Committee on Financial Services

U.S. House of Representatives

April 23, 2009

Chairman Frank, Ranking Member Bachus, and members of the Committee, I appreciate the opportunity to appear here today to discuss recent problems in the subprime mortgage market, regulatory actions taken by the Federal Reserve to address these problems, and potential legislative responses.

The Federal Reserve is committed to promoting sustainable homeownership through responsible mortgage lending. While the expansion of the subprime mortgage market over the past decade increased consumers' access to credit, too many homeowners and communities are suffering today because of lax underwriting standards and other unfair or deceptive practices that resulted in unsustainable loans. In addition to obvious consumer benefits, protecting borrowers with responsible underwriting standards can provide a broader benefit of enhancing the integrity, consistency, and proper functioning of the mortgage market by increasing investor confidence. The Federal Reserve's goal has been to craft clear rules that deter abuses while preserving responsible lenders' ability to meet the needs of traditionally underserved borrowers and communities.

In my testimony today, I will first outline the final rules for mortgage loans that the Federal Reserve issued in July 2008, under the Truth in Lending Act (TILA) and the Home Ownership and Equity Protection Act (HOEPA). I will then briefly discuss the Board's pending efforts to improve the usefulness of consumer disclosures in mortgage transactions, because well-informed consumers are in a better position to make decisions that are consistent with their own needs and financial goals. And finally, I will offer some thoughts about possible legislative reforms.

The Board's Rules under TILA and HOEPA

The Federal Reserve has primary rulewriting responsibility for many consumer protection laws, including the Truth in Lending Act and the Home Ownership and Equity Protection Act, which amended TILA. TILA and HOEPA are implemented by the Board's Regulation Z. Following a series of hearings in 2006 and 2007, the Board last July used its authority under TILA and HOEPA to revise Regulation Z by issuing final rules to establish sweeping new regulatory protections for consumers in the residential mortgage market. Importantly, the Board's new rules apply to all mortgage lenders, not just depository institutions supervised by the federal banking and thrift agencies.

In response to specific problems we saw in the subprime market, some restrictions in the final rules apply only to higher-priced mortgage loans. Other provisions, however, apply to all mortgage loans secured by a consumer's principal dwelling. In addition to rules that protect consumers from unfair or abusive lending and mortgage servicing practices, the Board also adopted rules governing mortgage advertisements to ensure they provide accurate and balanced information and do not contain misleading or deceptive representations. A third component of the final rules ensures that for all types of mortgage loans, consumers receive transaction-specific cost disclosures early enough to use while shopping for credit.

It is important to note that the Board's final rules resulted from an interactive process that involved extensive research and outreach to consumer groups, industry representatives, and other government agencies at the state and federal levels. The Board held a series of public hearings on consumer protection in the mortgage market in four cities across the country during the summer of 2006. In light of the information received at the 2006 hearings and the rise in defaults that began soon after, the Board held an additional hearing in June 2007, to explore how it could use its authority under HOEPA to prevent abusive lending practices without unduly constricting credit. At the 2007 hearing, and in hearing-related public comments, the Board received input from individual consumers, lenders, mortgage brokers, state government officials, and academicians. The Board's rulemaking was also informed by the comments received in connection with the development of interagency supervisory guidance on nontraditional mortgage products issued in September 2006 and interagency guidance on subprime lending that was issued in June 2007.

In response to the proposed rules that were issued under HOEPA in December 2007, the Board received and considered approximately 4,700 comment letters that represented a broad spectrum of views. The Board also used consumer testing by conducting several dozen one-on-one interviews with a diverse group of consumers to test the effectiveness of proposed disclosures related to mortgage broker compensation. The testing results were the basis for making significant changes to the final rule. In sum, listening carefully to the commenters, collecting and analyzing data, and undertaking consumer testing, led to more effective and improved final rules.

Rules for Higher-Priced Loans

The Board's HOEPA rules add four key protections for a newly defined category of "higher-priced mortgage loans." These are defined as consumer-purpose loans secured by a consumer's principal dwelling and having an annual percentage rate (APR) that exceeds the average prime offer rate for comparable transactions published by the Board by at least 1.5 percentage points for first-lien loans, or 3.5 percentage points for subordinate lien loans. For the foreseeable future, the Board will obtain or derive average prime offer rates from Freddie Mac's Primary Mortgage Market Survey, and will publish these rates on at least a weekly basis.

Based on the available data, the thresholds adopted by the Board would cover all, or virtually all, of the subprime market and a portion of the alt-A market.

Concerning the four key protections for higher-priced mortgage loans:

First, lenders are prohibited from making any higher-priced mortgage loan without regard to the borrower's ability to repay the obligation from income and assets other than the home. The rule requires the lender to take into account future, predictable changes in payments in determining repayment ability. Lenders comply, in part, by assessing repayment ability using the highest scheduled payment in the first seven years of the loan, rather than the consumer's initial monthly payment. For example, for an adjustable rate mortgage (ARM) with a discounted initial interest rate that is fixed for five years, the lender determines repayment ability using the scheduled payment in the sixth and seventh years, which is based on the fully indexed rate.

Second, lenders are prohibited from making "stated income" loans and are required in each case to verify the income and assets they rely upon to determine borrowers' repayment ability. Lenders must also verify and consider the borrower's other debt obligations, such as by using a credit report. The rule is intended to ensure that creditors do not assess repayment ability using overstated incomes or understated payment obligations. The rule is sufficiently flexible to allow lenders to adapt their underwriting process to accommodate a borrower's particular circumstances, such as when the borrower is self-employed.

Third, the final rules restrict the use of prepayment penalties. Prepayment penalties can prevent borrowers from refinancing their loans to avoid monthly payment increases or if there are other reasons that their loan becomes unaffordable. Under the Board's rule, prepayment penalties are prohibited when the monthly payment can change during the initial four years after consummation. For other higher-priced loans, a prepayment penalty cannot last for more than two years.

Fourth, creditors are required to establish an escrow account for property taxes and homeowner's insurance for all first-lien mortgage loans. This addresses the concern that the lack of escrows in the subprime market increases the risk that consumers' borrowing decisions will be based on misleading low payment quotes that do not reflect the true cost of their homeownership obligations. The rule preserves some consumer choice by permitting creditors to allow consumers to opt-out of the escrow account after 12 months.

Protections for All Loans Secured by Consumers' Principal Dwelling

In addition to the rules for higher-cost loans, the Board adopted other protections that apply to all mortgage loans secured by a consumer's principal dwelling, regardless of cost. The rules prohibit lenders or brokers from coercing, influencing, or otherwise encouraging an appraiser to misstate or misrepresent the value of the property. The Board also prohibited loan servicers from engaging in certain unfair billing practices. Servicers are prohibited from failing to credit a payment to a consumer's account as of the date received. Second, the rule prohibits the "pyramiding" of late fees by prohibiting servicers from imposing a late fee on a consumer when the consumer's payment was timely and made in full but for any previously assessed late fee. In addition, the rules prohibit loan servicers from failing to provide a loan payoff statement on a timely basis after receiving a request from the consumer or any person acting on the consumer's behalf.

Based on the results of consumer testing, the Board did not adopt a proposed rule that would have prohibited a creditor from paying a mortgage broker more in compensation than the consumer agreed in advance the broker would receive. Under the proposal, brokers would have to disclose to consumers their total compensation, including any portion paid directly by a creditor as a "yield spread premium" before obtaining the consumer's written agreement. Brokers would also have to disclose that a creditor payment to the broker could influence the broker to offer the consumer loan terms that would not be in the consumer's interest or the most favorable terms the consumer could obtain.

The proposed rule was intended to limit the potential for unfairness, deception, and abuse while preserving the ability of consumers to cover their payments to brokers through rate increases. The Board also anticipated that the proposal would increase transparency and increase competition in the market for brokerage services. The withdrawal of this portion of the proposal was based on the results of the Board's one-on-one interviews with several dozen consumers which demonstrated that the proposed agreement and disclosures would confuse consumers and undermine their decisionmaking rather than improve it. The Board is continuing to explore options for addressing potential unfairness associated with originator compensation arrangements such as yield spread premiums.

Advertising Rules

Another goal of the Board's final rules is to ensure that mortgage loan advertisements do not contain misleading or deceptive representations. Thus, the Board's rules require that advertisements for both closed-end loans and home-equity lines of credit (HELOCs) provide accurate and balanced information about rates, monthly payments, and other features in a clear and conspicuous manner. In addition, the Board used its authority under HOEPA to prohibit seven deceptive or misleading advertising practices. For example, an advertisement for a variable rate loan may not use the word "fixed" in referring to the interest rate or payment unless there is an equally prominent statement of the time period for which the rate or payment is fixed.

The rules also prohibit misrepresentations about government endorsement of the loan program and misleading claims of "debt elimination."

Requiring Earlier Cost Disclosures

With the increased complexity of today's mortgage products, consumers need to be well-informed shoppers. To assist consumers further, the Board amended Regulation Z to require that lenders provide consumers transaction-specific cost disclosures earlier in the application process, so that they can be used by consumers while shopping for a mortgage loan. Under the revised rules, creditors must provide a good faith estimate of the loan costs, including a payment schedule, within three days after the creditor receives the consumer's application. To ensure that consumers are able to use the information to shop, consumers cannot be charged any fee until after they receive the early disclosures, except a reasonable fee for obtaining the consumer's credit history. The rule applies to any home-secured loan, including home refinance loans and home-equity loans. Currently, early cost estimates are only required for home-purchase loans.

Last July, the Congress enacted the Housing and Economic Recovery Act of 2008, which codified the Board's new requirements for providing earlier TILA disclosures and also added some additional requirements, including a requirement that the estimated cost disclosures be provided at least seven days before the loan closing. This will enable consumers to review the transaction-specific disclosures when they have more time and are not confronted by a large number of other loan documents. In December 2008, the Board issued proposed rules to implement these additional changes and, with the recent close of the comment period, we expect the final rules to be issued in early spring.

The Board's Current Efforts to Improve Mortgage Disclosures

The Board recognizes the need to update TILA's cost disclosures for mortgage loans, to better reflect today's more complex products. Last year, we began using one-on-one interviews with consumers to test the current disclosures and potential revisions. We are well aware that consumers receive an overwhelming amount of information at the time they close a mortgage loan. The Truth in Lending disclosure, however, is a single-page form, and we are hopeful that the new requirements for providing this form earlier in the application process will distinguish the TILA disclosure from the many legal documents presented at loan closing as part of the credit contract or to satisfy state or local laws. However, the effectiveness of a disclosure is best judged through the results of consumer testing and not by the length of the disclosures alone.

Our goal is to improve the content and format of disclosures for both closed-end loans and home equity lines of credit in order to make mortgage disclosures more useful. The challenge is to strike a proper balance between providing information that is accurate and complete but not so complex as to create information overload. Testing model disclosures with real consumers is critical to the success of this effort.

In addition to our consumer testing, we are engaged in extensive outreach to obtain the views and suggestions of consumer advocates, industry representatives, and others. One concern that has been expressed over many years is the fact that consumers must receive separate disclosures under TILA and the Real Estate Settlement Procedures Act (RESPA), which is implemented by the Department of Housing and Urban Development (HUD). This issue is not unfamiliar to us. In 1998, the Board and HUD submitted a joint report to the Congress containing recommendations for legislative reforms, including a requirement that a single model form be developed that creditors could use to comply with both TILA and RESPA. The joint report included a sample model form showing one approach to combining the disclosures.

Several years ago, HUD initiated efforts to revise the RESPA disclosures and the forms creditors use to provide a Good Faith Estimate (GFE) of settlement charges. Creditors must provide the GFE within three days after receiving a mortgage loan application, which is also the timing requirement for providing loan cost disclosures under TILA. HUD's efforts over the past several years have included testing its proposed disclosure forms with consumers and consulting with the Board's staff. We support the goals of HUD's efforts to make RESPA disclosures more accurate and more useful, and we commend HUD for using consumer testing to develop the new RESPA forms. However, we continue to believe that efforts should be made to develop a single form that creditors could use to satisfy the requirements of both TILA and RESPA.

In November 2008, HUD finalized its revised RESPA rules and mandated the use of a new three-page GFE form developed by HUD. As the Board moves forward in revising TILA's mortgage disclosures, we will continue to coordinate with HUD to avoid potential inconsistencies in the two disclosure schemes. We also remain ready to work with HUD in developing a combined disclosure form if HUD is willing to pursue this approach.

Legislative Responses

On November 15, 2007, the House of Representatives passed H.R. 3915, the Mortgage Reform and Anti-Predatory Lending Act of 2007, which takes a comprehensive approach to addressing mortgage lending problems while appropriately focusing on the practices that took place in the subprime mortgage market. We commend Congress' work on H.R. 3915, which informed the Board's rulemaking and represents a significant contribution to the public debate about these issues. The Board shares Congress' concerns with these practices, many of which are also addressed in the Board's recently adopted rules under HOEPA. As with regulations, it is important that any new laws carefully target abuses without unduly restraining responsible credit. Maintaining this balance is particularly important as many borrowers may need to refinance subprime loans into more affordable loans.

At this time, I will share briefly some observations about the bill. It should be noted that members of the Board's staff have previously discussed technical issues concerning the bill with congressional staff. We would be pleased to continue these discussions going forward if the Congress considers additional amendments to the bill.

As I stated earlier, H.R. 3915 would address many of the same concerns addressed in the Board's HOEPA rules. Although some of the details regarding implementation differ, H.R. 3915 and the Board's HOEPA rules both set minimum underwriting standards that are designed to ensure creditors verify and document borrowers' ability to repay higher-priced loans. H.R. 3915 would also provide consumer remedies for violations of the bill's minimum standards and consumers would be able to seek these remedies against creditors, assignees, and securitizers. As a general matter, the issue of appropriate remedies is one that is best left to the Congress. We note, however, that in order for assignee liability to create more market discipline, the laws must be clear about what acts or practices are prohibited so that assignees can perform due diligence and detect violations before purchasing the loans. Assignees may have difficulty in determining a creditor's compliance with a broad prohibition against making loans that do not provide a "net tangible benefit" unless that term is capable of being clearly defined in law or regulation.

H.R. 3915 also seeks to establish a federal duty of care that would apply to all mortgage originators, although the bill would not create a fiduciary relationship between the originator and the consumer. Loan originators would be required to present a range of loan products for which the consumer is likely to qualify, and which are appropriate for the consumer's current circumstances. The mortgage products presented to a consumer must be consistent with the consumer's ability to pay and provide a net tangible benefit. Because these standards are broad and originators would be liable for violations, we believe that the establishment of clearly defined safe harbors may be appropriate in implementing the law and that the statute should clarify that the rulewriting agency has sufficient flexibility for this purpose.

I would also like to say a few words about the bill's delegation of rulewriting responsibility. Since enactment of the Truth in Lending Act in 1968, the Federal Reserve has been the sole agency responsible for issuing rules to implement that Act. Several provisions of H.R. 3915 would amend TILA and would be implemented by regulations that are promulgated jointly by the federal banking agencies. On the one hand, interagency rulemakings ensure that different perspectives are considered in developing a rule and that all agencies have a say in the outcome. On the other hand, the interagency rulemaking process generally is a less efficient way to develop new regulations. Frequently, it can be challenging to achieve a consensus among the different agencies involved in an interagency rulemaking. As a result, interagency rulemakings can take considerably longer to complete than rulemakings that are assigned to a single agency.

Conclusion

The Federal Reserve is continuing its efforts to enhance consumer protection in the residential mortgage market. As we develop more useful consumer disclosures for both closed-end loans and home-equity lines, we are mindful that improved disclosure may not always be sufficient to address abuses. Accordingly, we will carefully consider whether additional substantive protections are needed to prevent unfair or deceptive practices. We look forward to working with the Congress to enhance consumer protections while promoting sustainable homeownership and access to responsible credit.

Testimony of Michael Calhoun, Center for Responsible Lending
Before the U.S. House of Representatives Committee on Financial Services

"H.R. 1728, the Mortgage Reform and Anti-Predatory Lending Act of 2009"

April 23, 2009

Good afternoon Chairman Frank, Ranking Member Bachus, and members of the Committee. Thank you for inviting us to testify about H.R. 1728, the Mortgage Reform and Anti-Predatory Lending Act of 2009.

I serve as President of the Center for Responsible Lending (CRL), a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, a nonprofit community development financial institution that consists of a credit union and a non-profit loan fund. For close to thirty years, Self-Help has focused on creating ownership opportunities for low-wealth families, primarily through financing home loans to low-income and minority families who otherwise might not have been able to get affordable home loans. Self-Help's lending record includes a secondary market program that encourages other lenders to make sustainable loans to borrowers with weak credit. In total, Self-Help has provided over $5.6 billion of financing to 62,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across America.

A year and a half ago, this chamber passed legislation designed to make the subprime mortgage market safer for consumers. Today, the market that legislation targeted has virtually disappeared, and the entire mortgage finance system has imploded. The long-standing bulwarks of that system, Fannie Mae and Freddie Mac, have failed, and are now under the care of the government and receiving taxpayer aid. The private investment banking system that operated and built up the non-conforming secondary market has vanished, and the values of mortgage-backed assets once thought to be risk-free are now in free fall.

In light of what has happened, it is more essential than ever that Congress pass strong, sensible lending rules that will permit the mortgage market to resume its full functioning yet will prevent abusive, unsustainable lending in the future that could return us to the current crisis. *The key to reform is to realign the incentives of the market with as many bright-line rules as possible, yet also with adequate remedies to ensure that no one will fall through the cracks.*

We know that addressing this issue requires courage and resolve. Many industry interests have already begun to present objections to any limits on lending, threatening that they won't make loans if the rules are too strong from their perspective. Yet it is the *absence* of substantive and effective regulation that has managed to lock down the flow of credit beyond anyone's wildest dreams. For years, mortgage bankers told Congress that their subprime and exotic mortgages were not dangerous and regulators like the Federal

Reserve and the Office of Thrift Supervision believed the ideology that we should not restrain the "free flow of credit" at any cost. Then, after the mortgages started to go bad, lenders swore the damage would be easily contained.[1] As the global economy lies in tatters today with credit choked off, any new request to operate without basic rules of the road is more than indefensible; it's appalling.

The central question before us today is whether H.R. 1728 does what is necessary to prevent future abuses in the mortgage market. While we applaud many of the steps that this bill takes, we fear that on balance, the current language of the bill is insufficient for the task it undertakes. On the positive side, HR 1728 includes important protections that are similar to those in the Federal Reserve's rules on underwriting earlier this year: requiring underwriting with regard to ability to repay, requiring documentation of income, and limiting egregious prepayment penalties on certain categories of loans. The bill also expands the scope of the Federal Reserve guidance, putting in place critical protections with regard to "nontraditional" mortgages. And it includes a prohibition against abusive refinancing loans that do not provide a benefit to the borrower, but instead strip equity from the home to provide more income to the lender.

Some of these standards reflect significant improvements over earlier versions of similar bills, such as H.R. 3915 in the 110th Congress. HR 1728 does not include the earlier bill's "irrebuttable presumption" section, which gave some lenders a free pass to make unsustainable loans with no recourse at all available to the wronged homebuyer. It also makes crucial changes that strengthen the definition of "qualified mortgages," and adds a credit risk retention requirement for nonqualified mortgages. The strong tenant protection rules in this bill will greatly assist those innocent victims of the crisis, and the addition of legal aid funding will help wronged homeowners obtain redress.

There are still several important deficiencies in the bill, however, that will prevent the bill from achieving its stated goals:

- ***The bill does not eliminate the perverse incentives that led originators to push risky loan terms and products.*** While the bill imposes some duties on mortgage originators, prohibits steering, and restricts yield spread premiums, most of these provisions are relatively weak and the remedies are extremely limited. The bill needs stronger broker duties, a more powerful anti-steering prohibition, and a tighter ban on yield spread premiums, as well as stronger remedies for these violations, to end the reckless and discriminatory lending that has devastated many neighborhoods of color. As many states have already realized, one of the most effective steps the bill could take to realign incentives would be to ban prepayment penalties entirely throughout the market, thereby enabling any consumer to refinance immediately if they discover they can get a better mortgage elsewhere.

- ***While the bill establishes an "ability to pay" requirement and a requirement that refinancing loans provide a "net tangible benefit" to the homeowner, the consequences faced by wrongdoers are so minimal that there will be little incentive to comply with the law.*** Even with strong standards, there are no serious consequences to lenders for violating these standards. All a lender (or assignee) needs to do when a homeowner discovers wrongdoing is to "cure" the mortgage, giving the homeowner the loan that should have been provided at the outset. The cost of curing is minimal, meaning that lenders can simply factor a small number of cures into the cost of doing business. This remedy is unlikely to change business practices or provide useful remedies to homeowners. While the bill does include an innovative credit risk retention mechanism to discourage risky lending, the risk retention requirement alone – as useful as it may be – cannot substitute for providing consumers with a way to hold lenders accountable. In fact, most lenders already retained some risk on existing loans through recourse arrangements and buy-back requirements, yet the system still failed.

- ***The bill does little to realign incentives and reduce Wall Street's appetite for risky loans.*** The bill continues to protect the secondary mortgage market from the consequences of ignoring basic underwriting standards by eliminating any due diligence requirement, completely banning all class actions no matter what kind of conduct was involved, and prohibiting homeowners from obtaining recourse against the owners of their loans unless foreclosure has already been filed. Direct and meaningful accountability for those who fund, facilitate and encourage inappropriate loans is the only way to make victims whole and discourage risky lender or broker behavior. Furthermore, for protections to be meaningful, homeowners must be able to communicate with the people who own the note or those who can act on behalf of holders to provide the wronged borrower with a remedy. During economic hard times, making consumers default on their mortgages in order to vindicate their rights does no one any good – not homeowners, not their neighbors, not the lenders, and not the economy as a whole.

  The bill would threaten the use of the most important tools being used at the state level to fight predatory lending abuses. The preemption provision in the bill removes the strongest existing claims that homeowners are using now to save their homes, particularly those state laws that are currently used to reach secondary market participants. It limits homeowners victimized by unfair, deceptive and unconscionable acts to the weak remedies described above. In this significant respect, it would be a step backward for consumer protection.

In this testimony, we highlight the strengths and weaknesses of HR 1728, and we suggest specific ways in which the bill could be strengthened. Specific legislative language to carry out our suggestions has been provided to the Committee staff, and is available upon request.

I. Background

A. Today's mortgage market

While statistics seem almost unnecessary to illustrate what everyone here knows, every part of the mortgage origination system is in deep trouble. Overall mortgage activity has plummeted. For 2008, residential loan production cratered: $1.61 trillion compared to $2.65 trillion in 2007.[2]

Furthermore, originations of subprime, Alt A, and other non-prime mortgages all but stopped in 2008. Only an estimated $64.0 billion in such mortgages was originated last year, according to an analysis by Inside B&C Lending.[3] At its high point in 2006, nonprime lending constituted 33.6% of all mortgage production. By the fourth quarter of 2008, it had fallen to 2.8%.[4] These loans are not being originated in large part due to the collapse of the secondary market for these mortgages, which was driving the demand and facilitating the production, and analysts predict that 2009 will see "little or no non-agency securitization."[5]

Meanwhile, tens of thousands of mortgage brokers have lost their jobs, and more are positioned to lose their jobs as lenders stop using independent brokers; mortgage insurers are placing additional restrictions on loans originated by brokers; and banks are increasing net worth requirements on third-party lenders.[6]

On the demand side as well, every major indicator is down. Between 2006 and 2008, existing home sales dropped 24 percent,[7] while new home sales and new construction starts plummeted by 54 and 58 percent, respectively.[8] In February, mortgage applications for the purchase of homes hit their lowest levels since April 1998.[9]

While this hearing focuses on mortgage origination rather than on foreclosure prevention, the devastation of the foreclosure crisis is yet another factor that should guide our thinking as we craft lending legislation. Our most recent report on subprime mortgages shows that over 1.5 million homes have already been lost to foreclosure, and another two million families with subprime loans are currently delinquent and in danger of losing their homes in the near future.[10] New projections of foreclosures on all types of mortgages during the next five years estimate 13 million defaults from 2008Q4 until 2014.[11] Right now, more than one in ten homeowners is facing mortgage trouble.[12] Nearly one in five homes is underwater.[13]

The spillover costs of the foreclosure crisis are massive. Tens of millions of homes – households where, for the most part, the owners have paid their mortgages on time every month – are suffering a decrease in their property values that amounts to hundreds of billions of dollars in losses.[14] These losses, in turn, cost states and localities enormous sums of money in lost tax revenue and increased costs for fire, police, and other services. As property values decline further, the cycle of reduced demand and reduced mortgage origination continues to spiral downward.

B. A brief explanation of the recent meltdown.

Buying or refinancing a home is the biggest investment that most families ever make. For the vast majority of Americans, this transaction is often decisive in determining a family's future financial security. For this reason alone, prospective homeowners cannot be treated with a hands-off, caveat-emptor approach. But recent events have shown us the macroeconomic importance of affordable mortgages for homeowners. Rules of the road for mortgage lending are not just for the benefit of individual families, but for the benefit of the entire housing market and national economy.

A misalignment of incentives lies at the heart of today's mortgage meltdown.[15] Back in the days when families went to their local savings and loan to get a mortgage and the thrift held that loan among its own investments, the interests of borrowers and lenders were aligned: if the borrower did not pay the mortgage, the lender did not make money. But the proliferation of independent brokers and the growth of the secondary market upset that core alignment of interests between lender and borrower by creating a system where each actor was compensated early in the loan transaction, often within the first month of the loan term, thereby reducing or even eliminating the incentive to worry about how the borrower would fare later on.[16]

At the height of the housing bubble, independent mortgage brokers originated the vast majority of subprime loans, receiving their compensation from lenders immediately upon brokering the loan. Those lenders then sold the loan into the secondary market within weeks, where it was bundled together with other mortgages and sliced and diced into mortgage-backed securities (MBS). The facilitators of this process – the investment bankers, lawyers, and ratings agencies involved – were all paid their fees regardless of the performance of the MBS. Those securities were then sold to investors. At the same time, even more derivative products were layered on top of them, with credit default swaps at the top of the pyramid – what Warren Buffet identified as early as six years ago as "financial weapons of mass destruction."[17]

Now, the entire economy is paying the price of this untenable structure, as lenders have gone out of business, and those remaining are limiting their lending. The investors that sliced and diced the loans can't put them back together again to help prevent massive foreclosures that are a direct result of their original facilitation of bad acts in the marketplace. To prevent this situation from happening again in the future, a legislative effort to help create a safer, more sustainable mortgage market should have the guiding principle of realigning both the market incentives and the legal incentives all the way up the chain, from brokers through investors.

II. Eliminate the perverse incentives that lead originators to push risky loan terms and products.

A. Ban yield spread premiums.

One of the most significant drivers of the subprime mortgage crisis was the institution of yield spread premiums (YSPs), through which mortgages brokers were able to obtain additional compensation from lenders in return for selling consumers a higher rate loan than they qualified for. YSPs create a perverse incentive for mortgage brokers to steer borrowers into loans that are more costly and dangerous even though they could qualify for a more affordable product. Lenders then provide additional compensation to brokers to lock borrowers into those higher-rate loans with a prepayment penalty to provide an income stream to pay off that upfront YSP payment.

In the prime market, the YSP was originally used as a trade-off for up-front mortgage origination fees. In those cases, the consumer essentially financed their upfront costs by agreeing to a higher rate loan; the lender then paid the broker a sum of money rather than the consumer paying the broker directly. The reality, however, is that – especially in the subprime and nontraditional mortgage markets – this trade-off rarely, if ever, occurs.[18] The fact is, most consumers have a great deal of trouble understanding the concept of paying through the rate.[19] Because YSPs are so confusing, brokers have been able to charge customers up-front for discount points and other fees while also placing them into a higher interest rate loan than that for which they qualified and thereby earning a YSP – essentially being paid for the same loan by both the customer and the lender.

We applaud H.R. 1728 for banning YSPs that vary with the terms of the loan. We believe this ban will significantly reduce incentives for brokers to upsell borrowers into more expensive and riskier loans than those for which they qualify.[20] However, there is still a large loophole in the ban that needs to be closed. Although Section 103 bans yield spread premiums that vary with the term of the loan, it still permits consumers to finance fees, costs and compensations through a higher interest rate on their loan than that for which they qualify. We agree that financing through the rate can be a useful tool for some borrowers, but only if it is done in a very careful way and consumers are adequately protected. Thus, we strongly recommend permitting financing through the rate only for qualified mortgages only if all fees and costs are paid through the rate.

B. All mortgage originators should have a duty of good faith and fair dealing, and independent mortgage brokers should have a fiduciary duty to their customers.

While H.R. 1728 does establish a duty of care for originators, we believe these duties need to be stronger to ensure that originators uphold the highest standards when selling mortgage loans to consumers. For all mortgage originators, any legislation should establish a duty of good faith and fair dealing for all mortgage originators, requiring an originator to make reasonable efforts to secure a home mortgage loan that is appropriately advantageous to the consumer. The originator would have to sell a product that was appropriate with respect to product type, rates, charges, and repayment terms of the loan.

Independent mortgage brokers, however, should be held to an even higher standard than retail lenders. Experts on mortgage financing have long raised concerns about problems inherent in a market dominated by broker originations. For example, the chairman of the Federal Reserve Board, Ben S. Bernanke, noted that placing significant pricing discretion in the hands of financially motivated mortgage brokers in the sales of mortgage products can be a prescription for trouble, as it can lead to behavior not in compliance with fair lending laws.[21] Similarly, a report issued by Harvard University's Joint Center for Housing Studies, stated, "Having no long term interest in the performance of the loan, a broker's incentive is to close the loan while charging the highest combination of fees and mortgage interest rates the market will bear."[22]

For the foregoing reasons, independent brokers should have a fiduciary duty to their customers, just as stockbrokers do. Unlike retail lenders, who are obviously in business to sell loans to consumers, brokers hold themselves out to consumers as trusted advisers for navigating the complex mortgage market. Like stockbrokers, that is the value-added service they sell, and it is the service consumers assume they are buying. Yet most mortgage brokers and their trade associations deny that they have any legal or ethical responsibility to refrain from selling inappropriate, unaffordable loans, or to avoid benefiting personally at the expense of their borrowers. Moreover, because of the way they are compensated, brokers have strong incentives to sell excessively expensive loans to their customers, even when those customers qualify for better loans.

C. Ban discriminatory steering of borrowers into more expensive loans than those for which they qualify.

Mortgage lending legislation should absolutely prohibit racially discriminatory steering. While an efficient financial market theoretically would provide equally qualified borrowers with equally competitive prices on subprime home loans, both quantitative research and anecdotal evidence show that some borrowers, particularly African-American and Latino families, pay more than necessary for their mortgages.

In May 2006, CRL analyzed data submitted by mortgage lenders for loans made in 2004 to assess the effects of race and ethnicity on pricing in the subprime market while controlling for the major risk factors used to determine loan prices. Our findings showed that, for most types of subprime home loans, African-American and Latino families were at greater risk of receiving higher-rate loans than white borrowers, even after controlling for legitimate risk factors.[23] In other words, if two families received subprime loans, one African American and one white, and they had the same credit score and were similarly qualified in every other way, the African-American family has a significant chance of receiving a higher-cost loan.

We are pleased to see that H.R. 1728 contains an anti-steering provision. However, this provision needs to be stronger. It currently prohibits "abusive or unfair lending practices," but does not explicitly preclude steering consumers to loans more costly than those for which they qualify or prohibit certain types of mischaracterizations of information.

D. Combine Title I and Title II of the bill to improve clarity and remedies.

We strongly recommend moving the substantive lending standards in Title I (all of Sec. 123) to Title II for two reasons: (1) to improve clarity by including all lending standards in the same Title; and (2) to ensure that remedies are both consistent and adequate for violations of all lending standards. This change would place anti-steering protections, YSP limitations, and broker underwriting duties on the same level with the other standards in the bill. Consumers should receive the same protections and remedies for all of the bill's standards.

III. Require that all loans are affordable and provide the customer with a benefit and ensure that the consequences for failing to meet these standards are sufficient to change behavior.

A. Mortgage originators should be required to evaluate the ability of the consumer to pay the loan and provide the consumer with a net tangible benefit when refinancing a loan.

Perhaps one of the most astonishing aspects of the recent reckless lending spree was that the market utterly ignored whether a borrower could actually afford the mortgage. This core underwriting principle – a basic, common-sense business principle that would be understood by virtually anyone – was not only ignored, it was affirmatively shunned. The mortgages that sparked the market meltdown were "designed to terminate" specifically to ensure a continuing stream of new originations.[24] Given that business model, sustainability was at best irrelevant and at worst affirmatively undesirable.

Not considering a borrower's ability to repay was especially dangerous in the case of adjustable rate mortgages (ARMs) that incorporated an element of payment shock to the borrower. Payment shocks are created by a variety of dangerous loan structures: loans made without documenting incomes because the families simply did not afford the payment; subprime exploding ARMs where the payment increases by 30% - 40% after the second year, even if rates in the economy stay constant; interest-only loans where the payment can increase by 50% when the loan starts amortizing over a shorter remaining life; and payment option ARMs where the payment can double when it recasts at the fifth year, for lenders who require recasting at that time rather than ten years out. If these loans were not carefully underwritten at the fully indexed, fully amortizing payment when made, as many lenders failed to do, they set the borrowers up for almost certain failure. In fact, at times of very low interest rates, such as the current time, it may be prudent to underwrite to a higher payment, such as the maximum payment under the loan, because when interest rates rise, homeowners face payment shock from any type of adjustable rate loans.

Most loan originators understood that they were putting borrowers into loans that were unsustainable and that would need to be refinanced prior to reset. In 2004, the General Counsel of New Century, then the nation's second-largest subprime lender, referred to its 2/28 interest-only product and stated that "we should not be making loans to borrowers with the expectation that the borrower will be able to refi in a couple years."[25] His warning was ignored.

What's more, during the recent heyday of reckless lending, loan originators – particularly independent mortgage brokers – encouraged borrowers to take out so-called "no doc" or stated-income loans even when those borrowers had easy access to their W-2s. Without adequate income verification, a lender's approval of a loan is meaningless. Borrowers often do not understand that they are paying a higher interest rate not to document their income, even though their W-2s are readily available. They also often do not realize that the broker has inflated their income on the loan application. A review of a sample of stated-income loans disclosed that 90 percent had inflated incomes compared to IRS documents and almost 60 percent of the stated amounts were exaggerated by more than 50 percent.[26] Overstated incomes leads to overestimated repayment ability and then to foreclosures.

In July of last year, the Federal Reserve Board finally exercised its authority under HOEPA to prohibit unfair and deceptive practices.[27] Its rule addresses some of the most destructive practices leading to this crisis, although only for subprime loans. It requires lenders to evaluate a borrower's ability to repay; reduces abusive prepayment penalties on short-term subprime ARMs; and requires escrowing for taxes and insurance.

Unfortunately, the Federal Reserve Board did not extend these common-sense protections far enough. To help prevent further abusive lending, these common sense protections must apply to the entire mortgage market. As we have seen from the crisis we are now in, no segment of the mortgage market is immune from dangerous lending practices. Such legislation would simply codify what responsible lenders are already doing.

Federal legislation also should mirror successful state laws requiring a net tangible benefit for mortgage refinances. Loan flipping has, since the beginning of the subprime market, been a prime tool for stripping the equity from homeowners. These laws prevent the serial refinancing by unscrupulous originators and have been shown not to reduce access to legitimate credit.[28]

For the reasons above, we are very pleased to see that H.R.1728 applies the ability to repay and net tangible benefit requirements to all loans. By establishing a special category of "qualified" mortgages, the legislation provides mortgage industry participants with the protection that if loans fall within these parameters, they will benefit from the presumption of the ability to repay. On the other hand, by making that presumption rebuttable, the law protects those homeowners who may fall through the cracks and receive loans that are clearly unsustainable. Similarly, the net tangible benefit requirement provides lenders with similar protections for refinancing activity.

B. Tweak definition of qualified mortgage to limit excessive fees and consider residual income.

In defining "qualified mortgage," H.R. 1728 properly identifies many of the best indicators regarding the sustainability of a loan. It requires full documentation of income; underwriting to a fully-indexed, fully-amortizing rate; and consideration of a consumer's debt-to-income ratio. It also appropriate excludes nontraditional mortgages, such as interest-only or negatively amortizing "option ARM" loans. All of these requirements make good business sense; indeed, much of the American public has been mystified to discover that these basic rules had not regularly been followed by the mortgage industry.

Two additional requirements are needed for this category. The first protection, and one that has long been at the forefront of preventing predatory lending, is limiting excessive fees.[29] Historically, mortgage loans primarily generated income and profits through the performance of the loans and the payment of interest. In recent years, this model was abandoned for quick payments generated at closing that were divorced from the long-term sustainability of the loan. Longstanding and widespread state limitations on upfront mortgage fees were swept aside by federal preemption, and mortgage lending turned its focus from performance-tied returns to fees extracted at closing. The result has been the loss of home equity for families and an unstable and unsustainable mortgage system that has badly wounded our overall economy.

Legislation should provide transparent limits on up-front fees. Originator fees should be limited to 2%, with additional costs and profits recovered through the interest rate. This provides pricing transparency, which is essential for competition to work, and it rewards lenders who provide sustainable loans instead of lenders who extract the greatest amount of equity at closing. To the extent loans are permitted that exceed these limits, there should be additional safeguards and lender responsibilities to ensure that homeowners benefit from any additional charges. This limitation on fees should include all direct and indirect fees and charges other than bona fide filing fees and escrow amounts.[30]

Finally, while we agree that debt-to-income ratios are an important tool in ensuring the customer's ability to repay a loan, it is also crucial to consider residual income when evaluating ability to repay. This is especially true for lower-income consumers. In §226.34 of the new HOEPA regulations released last summer, the Federal Reserve Board described residual income as "the income the consumer will have after paying debt obligations." We believe that consideration of residual income as defined this way should be added as a factor to be considered in evaluating ability to repay for all mortgages or, at the least, for qualified mortgages. Further definition should be left to the regulators.

C. Ban prepayment penalties for all loans.

Prepayment penalties were a pervasive and insidiously harmful feature of the now-collapsed subprime market. During the current crisis, many families that might have escaped their mortgage by refinancing before housing values became prohibitively low found themselves trapped by a prepayment penalty. Commonplace in the subprime market, a prepayment penalty on a $250,000 loan could be expected to be in the range of $8,000-$10,000—enough to prevent or discourage refinancing. Independent research has fixed the increased risk of default on subprime mortgages with prepayment penalties from 16-20% over already high baseline rates.[31]

Costly prepayment penalties and high front-end fees rewarded originators by paying them handsomely regardless of the long-term sustainability of the loan. Prepayment penalties were also highly valued by Wall Street because they protected the income stream to investors. We now know that the harm caused by trapping borrowers in bad loans and stripping equity caused far more harm to those investors in the long run. In short, prepayment penalties are an anticompetitive practice and the direct and indirect costs of this market-distorting practice far outweighs the benefits.

Contrary to some industry claims, empirical analysis of the effects of anti-predatory lending laws, including those with limitations on prepayment penalties, shows that banning prepayment penalties and other predatory practices does <u>not</u> cause a restriction in access to credit.[32] Instead, it only causes a decrease in targeted abuses. In fact, in states that have limited prepayment penalties as part of their approach to curbing predatory lending, interest rates have stayed the same or even been lowered, compared with control states where such protections are absent.[33] In other words, rather than reducing access to legitimate credit, regulation has countered a market that had previously been governed by Gresham's Law (bad loans tended to drive out good loans). Careful regulation is a thereby an aid to competition as well as to consumers.

For these reasons, we are pleased that H.R. 1728 bans prepayment penalties for nonqualified mortgages. However, especially given the rarity with which these penalties are used in the prime market, we support a full ban on prepayment penalties for all mortgages. These provisions are extremely rare in the current origination environment, which provides the perfect opportunity to ban them from the marketplace entirely without causing any significant repercussions. (Ironically, yesterday's Wall Street Journal reported the banking industry is aggressively lobbying the Treasury Department to make it less costly for financial institutions to get out of the Troubled Asset Relief Program. The banks told the Journal that they object to being charged prepayment penalties.)[34]

D. Credit risk retention is a creative innovation that could enhance market discipline, but it is not a substitute for bright line origination rules or appropriate legal accountability.

One of H.R. 1728's most interesting innovations is its requirement that lenders retain the credit risk for a certain percentage of its loans. The goal of this requirement is to realign lender incentives for making loans that will perform over time.

While we understand and agree with the goal of this requirement, we have several concerns. First, while structural changes to the market that encourage self-policing are important, they are not a substitute for legal accountability. Even in a market where all the incentives are lined up perfectly, laws and rules will from time to time be violated, and it is crucial that the victims of such wrongdoing have individual recourse to be made whole.

Second, we are not certain that a 5% credit risk retention requirement for nonqualified loans will make a significant difference in the market. At present, most securitized loans features various representations and warranties up and down the chain of ownership that provide essentially full legal risk retention, yet that system did not function to discourage the origination of many abusive and highly risky loans.

Third, this requirement may generate some problems of its own. From our discussions with regulators and industry participants, we hear that it will have a disproportionately negative impact on smaller lenders and non-depository institutions because of enhanced capital requirements, and that the prohibition on hedging may cause significant problems for regulated institutions.

On balance, we suggest considering whether a mortgage reform bill with strong bright line rules, such as a ban on yield spread premiums and prepayment penalties and a cap on fees, plus clear accountability up the chain of ownership, would provide strong enough protections in the market so that this additional provision would be unnecessary.

IV. Realign incentives in order to reduce Wall Street's appetite for risky loans.

Although all parts of the mortgage origination chain bear some responsibility for the foreclosure crisis, perhaps nothing exacerbated the crisis as much as Wall Street's demand for predatory loans. As the subprime market grew, investment bankers sought more and more of these loans offering higher-risk investments with the potential for higher returns.

In response to the Wall Street demand, lenders created new, dangerous loan products that appeared deceptively affordable to borrowers, and brokers pushed these products to earn high fees. After filing for bankruptcy, the CEO of one mortgage lender explained it this way to the *New York Times*, "The market is paying me to do a no-income-verification loan more than it is paying me to do the full documentation loans," he said. "What would you do?" Similarly, Alan Greenspan recently told *Newsweek*, "The big demand was not so much on the part of the borrowers as it was on the part of the suppliers who were giving loans which really most people couldn't afford. We created something which was unsustainable. And it eventually broke. If it weren't for securitization, the subprime-loan market would have been very significantly less than it is in size."[35]

Wall Street rating agencies also turned a blind eye to the increasingly high volume of poorly underwritten, extremely dangerous loans included in mortgage investments. Paid by the securitizers to rate the tranches, the agencies overlooked loans that any experienced underwriter would have known were headed for foreclosure, giving AAA ratings to the majority of the tranches created.[36]

The best way to prevent a reoccurrence of Wall-Street-fueled bad lending is for the secondary market to fear adverse consequences for purchasing – and thereby fueling the demand for – abusive or unsustainable mortgages. If investors want the high returns that come with purchasing risky loans, they should agree to bear some of the risk of the loans that they buy. Accountability must follow the loan all the way through the chain. We do not have to choose between a system that feeds irresponsible debt bubbles with too little accountability and a system that is too restrictive. Carefully crafted legislation can find the appropriate balance to ensure that consumers have adequate redress and that all players in the market have the necessary accountability without unduly restricting responsible and affordable credit.[37]

While both the homeowner and the ultimate note holder may, in most situations, be without specific culpability, the holder is in a far better position than the homeowner to bear the risk of a bad mortgage for three reasons. First, the holder can conduct stringent due diligence to ensure that it is not unwittingly purchasing bad mortgages. Second, the holder can choose from whom to buy their loans and can therefore choose reputable originators who are likely to make quality mortgages and who are strong enough to purchase the loans back if they violate the representations and warranties that the secondary market purchaser imposes. Third, in the rare instances where a holder cannot put losses back on the original lender, the holder can spread its loss across thousands of other loans, while the homeowner has but one home.

Unfortunately, as drafted, H.R. 1728 does not establish an effective level of accountability, and the minimal accountability scheme that it does create is unworkable under current law. Below, we lay out our suggestions for improvement.

A. **Require Wall Street firms to scrutinize the loans they buy.**

After the events of the past year, it should be axiomatic that Wall Street firms should b required to review the loans they purchase by performing some form of due diligence, yet there is no due diligence requirement in the bill at all. Moreover, permitting secondary market actors to escape all liability through a cure will likely remove or significantly reduce any existing incentive to review loans prior to purchasing and securitizing them. If the only remedy in the small percentage of cases in which rescission is sought is to do what should have been done in the first place, there is very little deterrence to noncompliance. In today's climate, it seems unacceptable to enable Wall Street to continue to purchase loans with no need to be concerned about their terms.

We suggest two possible ways to reintroduce the concept of due diligence into the bill. First, it could be added to the cure provision, so that assignees could escape liability only if they provide a cure to the wronged homeowner *and* if they had conducted due diligence on the loans that they purchased. Alternatively, the ban on class actions could be conditioned on the performance of due diligence.

Finally, because whether appropriate due diligence has been performed can be a grey area that leads to unnecessary litigation costs, we suggest that the bill provide authority to a regulator to provide a clear definition of acceptable practices.

B. Give homeowners a chance to save their homes without having to go into foreclosure first.

H.R. 1728 gives homeowners a right to bring a lawsuit against assignees for violations of the bill's substantive provisions – a right that is consistent with other Truth in Lending provisions – and to receive the main remedy of the bill, which is rescission. Through rescission, an owner of a loan essentially undoes the entire loan transaction, putting wronged homeowners in the position they would have been in before buying the mortgage. Importantly, the only party that can provide rescission is the owner of the loan.

Yet H.R. 1728 artificially insulates trusts (also known as special purpose vehicles, or SPV's) that hold pools of loans from liability. Consequently, if a homeowner's loan is held in the secondary market as a whole loan, the homeowner may bring an action against the owner of the loan; yet if that loan has been securitized, the homeowner may no longer reach the owner. Instead, the homeowner has to sue the "securitizer." But the securitizer is not in the chain of ownership, so as a matter of law, the securitizer cannot provide the rescission remedy.

One justification put forward for this structure is the goal that an SPV not have to go to court. Yet SPVs go to court all the time – most notably, to file foreclosure actions against homeowners in default. In addition, SPVs are sued all the time under TILA, under the holder-in-due-course provisions of the UCC, or under other state laws – and even under H.R. 1728, the homeowner can counterclaim against the SPV if a foreclosure is pending. These lawsuits are handled by a trustee (or, most typically, handled by a servicer hired by the trustee) and the contracts among the SPV and the other market participants (the securitizer, the loan originator, the trustee, etc) generally provide indemnification up and down the chain.

Another justification is the desire to hold harmless the investors in securities backed by pools of mortgages. This concern is unwarranted, because under existing law, investors are not liable for any illegal actions of the trust or previous assignees or originators, just as shareholders in a company are not liable for violations of the company they've invested in. However, to the extent that it is desired, H.R. 1728 can explicitly provide that investors are not liable. It is not necessary to exempt the SPVs themselves from liability to do so.

The fact is, as a practical matter, it is hard enough for homeowners (or as we have seen in many recent cases, even courts) to learn who the real owner of the loan is, much less what firm packaged, sold and underwrote an MBS issuance. Moreover, it is unclear how such a structure would interact with the claims against the SPV that already are part of the law. The homeowner might have to sue different parties for different claims, perhaps even in different courts.

The only way to solve this problem is to permit all homeowners to be able to bring claims against the owner of their loan. If desired, the bill could also explicitly provide for the securitizer to indemnify the SPV, although that is currently the industry practice and would certainly be an even more common practice if H.R. 1728 is passed.

V. Preserve the most important tools being used at the state level to fight predatory lending abuses.

For nearly a decade, we have heard demands for federal preemption in the name of uniformity. Industry argues that the "patchwork quilt" of laws is a drag on the efficiency of the mortgage machine. In response, the federal bank regulatory agencies have pursued a sweeping preemption agenda in the name of uniformity.[38]

The existing crisis vividly demonstrates why federal law must not prevent the states' ability to deal with the problems that they typically see first. It is rare that a problem impacts all states equally and simultaneously. The states are far more nimble than Congress and their role as laboratories is a literal one. States' laws give us a track record for Congress to examine when lobbyists -- from all sides – make claims about the likely impact of proposed laws.[39]

Congressional discussions around mortgage reform in 2005 were still focused on the kinds of abuses that the states had begun targeting for legislative reform in 1999, but by then, the market had moved on. And while the federal banking regulators were denying that "their" institutions were engaging in these particular subprime origination practices, they failed to come to grips with the practices their institutions <u>were</u> engaging in – both in buying up the results of those practices, and in their own problem originations in the nontraditional market.[40] As we now know beyond a reasonable doubt, the incredible appetite for originations led to new kinds of abuses: the abandonment of underwriting, and the market pushing inherently risky products for the reasons we have described.

But on the ground, the states recognized that the market was infecting their cities with a new virus. And, to the extent permitted by preemption, they took action. Ohio enacted the first of this "second generation" of anti-predatory mortgage lending laws as early as May 2006.[41] That legislation, among other things, addressed the ability to pay for all home loans and required a duty of good faith and fair dealing by non-preempted originators. It was followed by Minnesota and approximately ten other "second generation" mortgage reform laws.[42] As for Congress, we are here today – nearly three eventful years later – to talk about addressing those problems at the national level, despite the fact that the market self-destructed in the meantime.

We understand that this Committee is attempting to balance the interests of state law enforcement against the interests of industry's desire for a 50-state standard by putting some preemption into the bill, but limiting it to preemption of assignee liability. While we strongly prefer no preemption at all, at a minimum, any preemption clause that must not make consumers worse off than they are now regarding these claims.

However, as written, H.R. 1728's preemption language would override many important existing consumer remedies. As a result, consumers in many states would be put in a worse position than they are now, notwithstanding the strong substantive protections of the bill. Concerns about the current clause include the following:

- The bill as written does not accommodate current state and federal UDAP and UCC law on holders in due course. UDAP claims should not be preempted, especially for abuses grounded in unfairness. Moreover, the protection of the preemption should be limited to holders in due course.

- For claims arising out of state law claims that specifically address ability to repay or net tangible benefit, H.R. 1728 exempts assignees from all liability under these laws. We think it would be more consistent with the intention of the preemption clause compromise to preempt only state law liability that is *greater than* the limited liability set out in the bill.

- The provision needs to be extremely clear that it does not preempt claims regarding the assignee's own illegal actions. An example of such primary liability occurred in the First Alliance case that Rep. Waters raised at the markup in 2007, in which Lehman Brothers was an assignee but also actively participated in the illegal activity. The current preemption clause actually insulates assignees from liability for their *own* conduct if it is not under the rubric of fraud or deception.

VI. Mortgage servicers should attempt to keep homeowners in their homes before filing foreclosure.

Mortgage loan servicing is the least-regulated part of the entire mortgage market. Yet at the same time, servicing is not an industry subject to typical economic incentives. Homeowners "cannot choose the servicer that handles their loan and cannot change servicers if they are dissatisfied."[43] Instead, servicers are driven by the desire to maximize their own profits and to maximize returns to the investors who now stand in the shoes of the original lender.[44]

Over the past year, we have witnessed the spectacular failure of the servicing industry. In the face of millions of defaulting loans, the current servicing model responded with a weak and ineffective loss mitigation effort. The servicers began by focusing on short-term workouts that were not at all effective to solve the current problems, and to the extent loan modifications were made, most were unsustainable. Unbelievably, servicers routinely wrote modifications that *increased* monthly payments on customers who already could not afford their mortgages.[45]

While the servicing provisions of H.R. 1728 are helpful in many ways, loan servicers should be required to engage in loss mitigation prior to foreclosure. Such a requirement – already in existence for FHA and VA mortgage loan servicers – would make clear that alternatives to foreclosure should always be explored. As part of this requirement, homeowners should always be able to reach a live person with decision-making authority, and they should not need to sign away their legal rights just to get the modification. Perhaps most important, any agreement reached through loss mitigation should be affordable by the homeowner. Careful consideration of the borrower's income as well as any expenses, including debt and residual income left over for other living expenses, is critical in determining the affordability of any solution intended to keep homeowners in their home. Legislation should also impose reporting requirements so that policymakers and stakeholders have an accurate understanding of the kinds of loss mitigation being provided. The progress that has been made by the Treasury Department in defining a sustainable loan modification will enable similar legislation to provide more certainty for servicers, homeowners, and investors alike.

Conclusion

Today, as our nation struggles in the ruins of a broken mortgage market, it is important to remember that the benefits of homeownership have not changed. Long-term homeownership remains one of the best and most reliable ways that families can build a better economic future, and all of us have a strong national interest in ensuring that the mortgage market works to build our economy, not tear it down. In an effective home lending market, lenders and borrowers will enter transactions with the same fundamental measure of success – that is, a commitment to a mortgage that represents a solid investment both short-term and long-term. We urge Congress to strengthen H.R. 1728 so that it can help ensure competent risk management, profitable mortgage-backed investments, and sustainable homeownership.

[1] For example, in September 2006, Robert Broeksmit of the Mortgage Bankers Association told Congress, "Our simple message is that the mortgage market works and the data demonstrate that fact," and "I strongly believe that the market's success in making these "nontraditional" products available is a positive development, not cause for alarm." Statement of Robert D. Broeksmit, CMB Chairman, Residential Board of Governors, Mortgage Bankers Association, Before a Joint Hearing of the Subcommittee on Housing and Transportation and the Subcommittee on Economic Policy, U.S. Senate Committee on Banking, Housing and Urban Affairs, Calculated Risk: Assessing Non-Traditional Mortgage Products, *available at* http://banking.senate.gov/public/_files/broeksmit.pdf./. In May 2007, John Robbins of the Mortgage Bankers Association said, "As we can clearly see, this is not a macro-economic event. No seismic financial occurrence is about to overwhelm the U.S. economy. And we're not the only ones who think so." John M. Robbins, CMB, Chairman of the Mortgage Bankers Association at the National Press Club's Newsmakers Lunch – Washington, D.C. , *available at* http://www.mortgagebankers.org/files/News/InternalResource/54451_NewsRelease.doc.

[2] *National Mortgage News* (March 9, 2009).

[3] *Inside B&C Lending* (February 27, 2009).

[4] Id.

[5] *Inside Mortgage Finance MBS Database.*

[6] *National Mortgage News* (March 9, 2009).

[7] National Association of Realtors, http://www.realtor.org/research/research/ehsdata.

[8] US Census Bureau, http://www.census.gov/const/quarterly_sales.pdf and http://www.census.gov/const/www/quarterly_starts_completions.pdf.

[9] Based on the Mortgage Bankers Association's Weekly Mortgage Applications Survey for the week ending February 27, 2009. The four-week moving average for the seasonally adjusted Purchase Index reached its lowest level since April 1998. *See* www.mortgagebankers.org/NewsandMedia/PressCenter/67976.htm.

[10] Center for Responsible Lending, *Continued Decay and Shaky Repairs: The State of Subprime Loans Today*, p.2 (Jan. 8, 2009) [hereinafter "*Continued Decay*"], *available at* http://www.responsiblelending.org/issues/mortgage/research/continued-decay-and-shaky-repairs-the-state-of-subprime-loans-today.html.

[11] Goldman Sachs Global ECS Research, Home Prices and Credit Losses: Projections and Policy Options (Jan. 13, 2009), p. 16; *see also* Credit Suisse Fixed Income Research, Foreclosure Update: Over 8 Million Foreclosures Expected, p.1 (Dec. 4, 2008).

[12] Mortgage Bankers Association National Delinquency Study (March 5, 2009).

[13] First American Core Logic (March 4, 2009).

[14] *Continued Decay*, p. 3.

[15] For a much longer discussion of the roots of today's crisis, see Testimony of Eric Stein, Center for Responsible Lending, before the Senate Committee on Banking (Oct. 16, 2008), *available at* http://www.responsiblelending.org/pdfs/senate-testimony-10-16-08-hearing-stein-final.pdf.

[16] Chairman Bernanke makes this point in a recent presentation: "Housing, Housing Finance, and Monetary Policy," remarks by Ben Bernanke, Chairman, Board of Governors of the Federal Reserve System at the

Federal Reserve Bank of Kansas City's Economic Symposium – Jackson, Hole, Wyoming (August 31, 2007), pp. 16 – 17.

[17] Berkshire Hathaway Annual Report (2002).

[18] HUD, in the regulatory review accompanying the issuance of their recently-enacted proposed rule in March 2008, cited extensive evidence to the fact that even in the prime market, borrowers with YSPs pay in the aggregate more in fees, interest, and other closing costs than borrowers who do not pay YSPs. *See* Susan Woodward, *A Study of Closing Costs for FHA Mortgages,* HUD Office of Policy Development and Research (May 2008); *see also* Howell E. Jackson and Laurie Burlingame, Kickbacks or Compensation: The Case of Yield-Spread Premiums, 12 Stan. J. L, Bus & Fin. 289, 353 (2007).

[19] See 73 Fed. Reg. 44563-65 (consumers do not understand yield spread premium disclosures).

[20] Last year, we released a study that showed broker-originated mortgages cost more for subprime loans but less for some classes of prime loans. Keith Ernst, Debbie Bocian and Wei Lei, Center for Responsible Lending, *Steered Wrong: Brokers, Borrowers and Subprime Loans* (Apr. 8, 2008), *available at* http://www.responsiblelending.org/issues/mortgage/research/steered-wrong-brokers-borrowers-and-subprime-l-oans.html.

[21] Remarks by Federal Reserve Board Chairman Ben S. Bernanke at the Opportunity Finance Network's Annual Conference, Washington, D.C. (November 1, 2006).

[22] Joint Center for Housing Studies, "Credit, Capital and Communities: The Implications of the Changing Mortgage Banking Industry for Community-Based Organizations," Harvard University, pp.4-5. Moreover, broker-originated loans "are also more likely to default than loans originated through a retail channel, even after controlling for credit and ability-to-pay factors." *Id.* at 42 (citing Alexander 2003).

[23] Debbie Gruenstein Bocian, Keith S. Ernst and Wei Li, *Unfair Lending: The Effect of Race and Ethnicity on the Effect of Subprime Mortgages*, Center for Responsible Lending (May 2006), *available at* http://www.responsiblelending.org/pdfs/rr011-Unfair_Lending-0506.pdf.

[24] Souphala Chomsisengphet, Timothy Murphy and Anthony Pennington-Cross, *Product Innovation and Mortgage Selection in the Subprime Era*, presented at The Subprime Housing Crisis: Interdisciplinary Policy Perspectives, Univ. of Iowa, October 10-11, 2008 (referring to loans "designed to terminate.") A former broker confirmed to CRL that applicants were steered to 2/28s to generate repeat business.

[25] Debra Cassens Weiss, *New Century GC Sounded Early Warning About Subprime Exposure*, ABA Journal (March 31, 2008).

[26] Mortgage Asset Research Institute, Inc., *Eighth Periodic Mortgage Fraud Case Report to Mortgage Bankers Association*, p. 12, *available at* http://www.mari-inc.com/pdfs/mba/MBA8thCaseRpt.pdf (April 2006); *see also* 2007 Global Structured Finance Outlook: Economic and Sector-by Sector-analysis, FITCH RATINGS CREDIT POLICY (New York, N.Y), December 11, 2006, at 21 (commenting that the use of subprime hybrid arms "poses a significant challenge to subprime collateral performance in 2007").

[27] The Federal Reserve Board was given the authority to regulate mortgages under the HOEPA law passed in 1994, but they did not exercise that authority until the summer of 2008.

[28] The practices of IndyMac, one of the largest originators of Alt A loans until it went defunct, demonstrate that perverse incentives drove abuse even outside of the subprime market. IndyMac routinely avoided including income information on their loans or pushed through loans with inflated income data, even from retirees. As recently as the first quarter of 2007, only 21% of IndyMac's total loan production involved "full-doc" mortgages.

[29] When widespread abusive lending practices in the subprime market initially emerged during the late 1990s, the primary problems involved equity stripping—that is, charging homeowners exorbitant fees or selling unnecessary products on refinanced mortgages, such as single-premium credit insurance. By financing these charges as part of the new loan, unscrupulous lenders were able to disguise excessive costs. To make matters worse, these loans typically came with costly and abusive prepayment penalties, meaning that when homeowners realized they qualified for a better mortgage, they had to pay thousands of dollars before getting out of the abusive loan. *See, e.g.*, Eric Stein, *Quantifying the Economic Costs of Predatory Lending*, Center for Responsible Lending (2001), *available at* http://www.responsiblelending.org/pdfs/Quant10-01.pdf.

[30] Before the current crisis, a strong housing market and largely favorable interest rates allowed borrowers with subprime loans to refinance when their payments rose. In this scenario, with each refinance, the borrowers lost significant equity as they incurred a whole new set of lender fees, broker fees, and third-party closing fees with each loan. In turn, this loss of equity meant that borrowers lost their single largest source of wealth and ended up trapped in a cycle of subprime loan after subprime loan, spiraling towards foreclosure. Breaking this cycle of equity stripping is a critical first step in the new era.

[31] Roberto G. Quercia, Michael A. Stegman & Walter R. Davis, The Impact of Predatory Loan Terms on Subprime Foreclosures: The Special Case of Prepayment Penalties and Balloon Payments (vol. 18, issue 2, 2007), *available at* http://www.mi.vt.edu/data/files/hpd%2018.2/5.hpd_quercia_web.pdf.

[32] Wei Li and Keith S. Ernst, *The Best Value in the Subprime Market: State Predatory Lending Reforms*, pp. 2-3, 13-17, Center for Responsible Lending (February 23, 2006).

[33] *Id.* The study ranked states as to four substantive protections, prepayment penalties among them, as well as the scope of coverage to which the protections applied and the remedies available. The lowered interest rates likely result from the perverse relationship between yield spread premiums and prepayment penalties in the subprime market, as we discuss above. We also note that at least thirty-five states regulate prepayment penalties, including eleven states that have prepayment penalty bans on broad categories of mortgage loans. There is no evidence that consumers feel deprived of "choice" in those states. **Alabama** (unless approved mortgagee under National Housing Act or where creditor is exempt from licensing, per ALA. CODE § 5-19-31) (ALA. CODE § 5-19-4(c)); **Alaska** (except federally insured loans requiring prepayment penalty) (ALASKA STAT. ANN. § 45.45.010(g)); **Indiana** (prepayment penalty banned for a consumer loan (key requirement: secured by an interest in land or by personal property that is the borrower's principal dwelling) that is not "*primarily* secured by an interest in land" (i.e., that is not a first lien mortgage) as well as for a refinancing or consolidation (junior lien)) (IND. CODE ANN. § 24-4.5-3-209 (limitation on penalty); § 24-4.5-3-104 (definition of "consumer loan"); § 24-4.5-3-105 (explanation of "primarily secured by land")); **Iowa** (purchase money or refinance of purchase money loan secured by 1- or 2-family dwelling or by agricultural land)(IOWA CODE ANN. § 535.9.2); (reverse annuity or graduated payment mortgage loans) (IOWA CODE ANN. § 528.4); **Minnesota** (prohibited in residential mortgages under Fannie Mae conforming limit) (Minn. Stat. §58.137(2)(c); **New Jersey** (for loans with interest rates exceeding 6%) (N.J. STAT. ANN. § 46:10B-1, B-2); **New Mexico** (N.M. STAT. ANN. § 56-8-30); **North Carolina** (banned on first mortgage loans below $150,000) (N.C. GEN. STAT. § 24-1.1A(b)(1)); **Ohio** (prohibited in residential mortgage under $75,000) (Ohio Rev. Code §1343.011(2)(a); **South Carolina** (banned on loans below $150,000) (S.C. CODE ANN. § 37-23-80, 37-10-103);**Vermont** (Vermont Stat. Ann. tit. 8 § 2232a, tit. 9 § 45).

[34] "Financial Firms Lobby to Cut Costs of TARP Exit," *Wall Street Journal Online* (April 22, 2009) http://online.wsj.com/article/SB124035639380840961.html.

[35] "The Oracle Reveals All," *Newsweek* (Sept. 24, 2007) pp. 32, 33.

[36] *See, e.g.* Allan Sloan, "An Unsavory Slice of Subprime," *Washington Post* (October 16, 2007) ("Even though individual loans ... looked like financial toxic waste," 68% of the issue was rated AAA.)

[37] *See* Raphael Bostic, Kathleen C. Engle, Patricia A. McCoy, Anthony Pennington-Cross & Susan Wachter, *State and Local Anti-Predatory Lending Laws: The Effect of Legal Enforcement Mechanisms*, 60 J. Econ. & Bus. 47-66 (2008), full working paper version *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1005423, p. 18 (finding that stronger private enforcement regimes, including private right of action and assignee liability, did not constrict subprime originations in 2004 and had an elevated probability of originations in 2005).

[38] *See, e.g.* 69 Fed. Reg. 1904, 1908 (January 13, 2004) (supplementary information to OCC Preemption rule).

[39] *See, e.g.*Wei Li and Keith Ernst, *Do State Predatory Lending Laws Work? A Panel Analysis of Market Reforms*, Housing Policy Debate 18:2, p. 347 (2007); Raphael Bostic, Kathleen C. Engle, Patricia A. McCoy, Anthony Pennington-Cross & Susan Wachter, *State and Local Anti-Predatory Lending Laws: The Effect of Legal Enforcement Mechanisms*, 60 J. Econ. & Bus. 47-66 (2008), full working paper version available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1005423 (includes literature review).

[40] *See, e.g.*, Testimony of Patricia A. McCoy Before the U.S. Senate Committee on Banking, Housing and Urban Affairs, *Consumer Protection in Financial Services: Past Problems, Future Solutions* (March 3, 2009).

[41] S.B. 185 (May, 2006), http://www.legislature.state.oh.us/BillText126/126_SB_185_EN_N.pdf.

[42] In addition to Ohio, Minnesota, North Carolina, Maine, Illinois, Kentucky and Colorado have enacted laws taking aim at at least some of these practices since May 2006. This wave of state laws continued in 2008, with New York, Maryland, Connecticut and Washington passing substantive legislation and the Massachusetts Attorney General's rules going into effect as well.

[43] Testimony of Tara Twomey, National Consumer Law Center, Before the U.S. House of Representatives Subcommittee on Housing and Community Opportunity, p. 8 (April 16, 2007).

[44] *Id.* at 7 (cutting costs is one reason for heavy reliance on often frustrating voicemail and touch tone menu options, as well as for the lack of adequate staff to handle requests for negotiation or information).

[45] Alan White, *Deleveraging American Homeowners: December 18, 2008 Update to August 2008 Report*, Valparaiso University School of Law (Dec. 2008), p.2 (finding that of more than 3.5 million subprime and Alt A mortgages (all securitized) reviewed in November 2008, only 35% of modifications reduced monthly payments below the initial payment, while 20% left the payment the same and 45% increased the monthly payment).

HOUSING POLICY COUNCIL
THE FINANCIAL SERVICES ROUNDTABLE

Statement of

John H. Dalton

President, Housing Policy Council

before the

Committee on Financial Services

United States House of Representatives

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Hearing on

"H.R. 1728:

Mortgage Reform and Anti-Predatory Lending Act"

2128 Rayburn House Office Building

Introduction

Chairman Frank, Ranking Member Bachus, and Members of the Committee, I am John Dalton, President of the Housing Policy Council ("HPC") of The Financial Services Roundtable.[1] Thank you for the opportunity to present the views of the Housing Policy Council on H.R. 1728, "The Mortgage Reform and Anti-Predatory Lending Act." My testimony today will focus on what has happened in the mortgage lending industry over the past few years, discuss the key elements of H.R. 1728 that we support, and identify areas of the bill we think need improvement.

Mistakes Made

Over the last few years, lenders and other participants in the mortgage industry made some serious misjudgments and mistakes. Heading that list was the assumption that housing prices would continue to rise and support increasing loan volumes. That mistaken assumption helped contribute to a relaxation in underwriting standards, including the use of "no document" loans, 100% financing, and the over-promotion of certain mortgage products, such as hybrid and option ARMs. The originate-to-distribute loan origination model was misused by some instead of being used wisely to generate appropriate funding for secure and reliable residential mortgage loans.

On behalf of the Housing Policy Council, I apologize for these mistakes and misjudgments.

[1] The Housing Policy Council, established in 2003, is part of The Financial Services Roundtable. The Housing Policy Council is devoted to mortgage finance issues of significance to consumers, the economy, and the members of the Roundtable. Today, the Housing Policy Council consists of twenty-six of the nation's leading mortgage lenders, representing 65% of mortgages originated, and 76% of mortgages serviced in the US.

In all candor, these actions were well intentioned and were taken as part of an effort to expand housing opportunities for Americans. Homeownership became a reality for many Americans and products were available for borrowers in a variety of positions. The majority of these borrowers were successful. Nevertheless, mistakes were made that contributed to the current crisis.

Like every member of this Committee, the members of the Housing Policy Council want to ensure that these mistakes are not repeated and that mortgage credit is available to American consumers in a responsible and well-regulated environment. We stand ready to work with this Committee to ensure that reforms take place. We are fortunate in that reforms have already been started by self-policing in the industry, regulations promulgated by federal regulators, and the rejection of some of the worst of the practices by the market itself. We are prepared to work with this Committee as it tries to ensure that mortgage lending reforms are thorough and cover the weaknesses revealed by the recent housing downturn.

We support legislation that will strengthen mortgage lending and securitization practices. H.R. 1728 contains provisions which would implement changes in the system and we support those which we believe strengthen the system and benefit consumers. The challenge the Committee faces is crafting a bill that creates protections against inappropriate practices, yet preserves a vibrant system of mortgage finance. Several of the provisions in H.R. 1728, such as the definition of "qualified" mortgage, the duty of care, and the 5% credit risk retention requirement can be crafted in a slightly different way and still address the intended goals of the legislation. As presently drafted, we believe these provisions would cause a significant contraction in mortgage lending. While the current crisis is the result of inadequate and uneven standards and safeguards in providing mortgage credit, we urge the Committee to seek a balance between new regulation and keeping mortgage credit available for Americans who need it and can qualify for it.

Changes in the Industry

Since 2007, the industry and its regulators have taken a number of actions to address the practices that contributed to the current financial crisis. Underwriting standards have been revised and strengthened, both voluntarily and through regulation. Low and no-document loans are no longer being made, and many of the alternative mortgage products offered in the last few years are no longer available. I would like to give a brief overview of some of the most significant changes that have taken place during the past couple of years.

Many Originators have been Eliminated

Many originators have gone out of business. The business model they used which became more aggressive with weaker underwriting led to their failures. They no longer are a part of the industry.

Distribution has Changed

Broker originations have dropped considerably as a percentage of all new loans. While this decline is largely due to a drop in loan applications, it also is due to greater oversight and regulation of brokers. The Office of the Comptroller of the Currency ("OCC") now requires national banks and their subsidiaries to have their brokers sign a broker fee agreement with each borrower. In addition, broker licensing will be required in every state this year as mandated under the SAFE Mortgage Licensing Act, an Act generated by this Committee. A loan originator registry which will track bad actors throughout the country is also in place. The SAFE Act will provide better licensing and oversight of brokers

Loan Products Have Changed

Loan products have been revised in response to a failure of the market to support them and to actions taken by the federal banking agencies. In 2006, the federal banking agencies issued the Joint Guidance on Nontraditional Mortgage Product Risks ("Guidance"). That Guidance was designed to set standards for interest-only and payment option ARMs. Under the terms of the Guidance, borrowers qualify for these loans only if it can be shown that they can pay the full debt at maturity under the fully indexed rate, and without excessive reliance on credit scores for qualification or dependency upon collateral for repayment. This Guidance applies only to federally regulated banks and their subsidiaries, but most states adopted comparable regulations for state chartered banks.

In June 2007, the federal banking agencies issued the Statement on Subprime Mortgage Lending, which focused on hybrid ARMs. The Statement required prudent qualifying standards for these loans to avoid unsupportable "payment shock." In the Statement, the banking agencies also required documentation and verification of income for subprime borrowers. This Statement also applied only to federally regulated institutions, but most states adopted similar regulations for state chartered institutions.

In July 2008, the Federal Reserve issued amendments to its Home Ownership and Equity Protection Act (HOEPA) regulation which applied to all lenders whether state or federally regulated. Those amendments implement many of the underwriting reforms that were proposed in H.R. 3915, legislation which was generated by this Committee and passed by the House in 2007. Those amendments will take effect on October 1, 2009.

The Secondary Market

On Wall Street, the business of private-label securitization has essentially stopped. Over the long-term we should strive to bring private-label securitizations back to the market with proper safeguards. Securitization is a powerful tool that allows for the free flow of capital throughout the economy. We must build a regulatory model that properly addresses the risks inherent in a sophisticated system while keeping intact the benefits of a system that allocates capital quickly and efficiently from investor to borrower and back.

To this end, we have a great deal of work to do. Today, the Federal Reserve essentially finances the American housing market. The Federal Reserve's credit easing plan, which includes the purchase of up to $1.25 trillion in Agency mortgage-backed securities, is essentially the lone support of the US housing market right now. We greatly support the actions taken by the Federal Reserve in this regard. The actions of the central bank have helped push mortgage rates to historic lows and have created a refinancing market.

But we also worry that over the long-term a properly functioning housing finance system requires the return of private capital to the secondary trading market. It can not and should not be the role of the central bank to serve as the primary source for housing finance in our country. Private capital must return to the market.

According to data compiled by the Department of the Treasury, foreign investors have either reduced or held steady their monthly holdings of US Agency and mortgage bonds since this crisis peaked in late September 2008. Since that time, global institutions have sold a net

$125 billion of American mortgage bonds, initially driving up interest rates sharply and forcing the Federal Reserve to stand-in as buyer of last resort. Billions of dollars in capital are now idle, waiting for clarity on where the United States mortgage market goes from here. The decisions we make now will have long lasting effects on the American and global economy for years to come. The eyes of investors across the world are now focused squarely on Washington, as they watch to see what we do to help re-build a more sustainable secondary market system. We must get this right.

Administration's Making Home Affordable Program

The Housing Policy Council supports the Administration's efforts to help at-risk homeowners through the Making Home Affordable Program ("Program"). We support the Program and believe the Administration is on the right track by focusing on making loans affordable for at-risk homeowners. We are working with representatives from Treasury, the Department of Housing and Urban Development, Fannie Mae and Freddie Mac to understand and implement this important program and will do our best to make it a success. All servicers of Fannie and Freddie loans will participate in the Program for GSE-owned loans. Servicers for private label securities are examining their ability to apply the Program to loans in private mortgage-backed securities. On April 16, Treasury announced the participation in the loan modification Program by a number of major servicers who are Housing Policy Council members. We appreciate the Administration's willingness to work with servicers in the implementation of this Program.

HPC member companies continue to work to keep as many people in their homes as possible, and the vast majority of our members are also members of the HOPE NOW Alliance.

The HOPE NOW Alliance and the Homeowner's HOPE Hotline, 888-995-HOPE, are reaching and assisting homeowners struggling with their mortgage payments by providing opportunities for at-risk homeowners to contact and talk to their servicer or a trained non-profit counselor for free. HOPE NOW servicers are now modifying 100,000 or more loans a month, and reached a record high of 134,000 loan modifications in February 2009, the most recent month for which we have data. That number does not include the Administration's Program which is still in its beginning stages. In addition, HOPE NOW is educating borrowers on the Administration's Program through the HOPE Hotline and homeownership preservation events. In the past 12 months, HOPE NOW has held over thirty-five in-person events across the country where more than 25,000 homeowners met directly with their servicer or a non-profit counselor. Most recently, HOPE NOW assisted more than 3,300 homeowners in Atlanta on April 15 and 16. HOPE NOW incorporated the Administration's Program and some borrowers in attendance received this new modification solution. We plan a total of thirty outreach events for 2009. The Homeowner's HOPE Hotline is receiving thousands of calls per day from homeowners and the members of the Alliance have mailed over 4.1 million letters, averaging 200,000 per month, to at-risk homeowners offering assistance and urging them to call their servicer or the HOPE hotline.

Provisions in H.R. 1728 Supported by HPC

The Housing Policy Council believes there are many elements of H.R. 1728 that will lead to a better mortgage market and we support those provisions. For example, we believe that no originator should originate a mortgage if it does not believe that the borrower has a reasonable ability to repay the loan, including all applicable taxes and insurance payments, based upon information available at the time the loan is made. The lender should base its belief upon reasonable considerations, and those should include the borrower's income, ratio of debts to income, credit history, employment, and financial resources. Those elements are included in the bill and we believe they are appropriate.

If the loan is a variable rate loan, the lender should determine the ability to repay the loan based upon a fully indexed amortizing schedule of payments. Appropriate criteria should be verified and documented. We support those provisions. We also support full disclosure to borrowers in advance, and have in the past supported even broader changes that would permit borrowers to shop with better understanding of the products and prices.

We also believe that yield spread premiums should be prohibited. We oppose paying brokers compensation based on charging a borrower higher prices than that for which he or she qualifies. We oppose steering borrowers to higher priced loans, and we support escrow requirements for taxes and insurance payments.

In other words, there are many provisions in this bill that we have supported in the past and continue to support. We hope they become law and believe that their passage will lead to a sounder mortgage market in which those who can qualify for mortgage loans will receive them at a fair price that they can repay. That should not be interpreted to mean that we believe that the bill should be supported without change.

Provisions in H.R. 1728 that Need Modification

We believe there are some important provisions that have major flaws and would urge the Committee to either delete or modify those provisions before moving the bill. Absent those changes, we fear that the bill would create an environment that would lead to a drop in the percentage of homeowners in the country and an increase in costs for those who manage to get mortgage loans.

Here are those provisions which we believe compromise the effectiveness and desirability of H.R. 1728; listed in the order in which they appear in the bill.

Duty of Care

The Duty of Care provisions in sec. 102 of the bill create a duty which the creditors are simply not able to meet. Originators can make a judgment that borrowers do or do not have the financial ability to repay a loan. They have the expertise and the ability to do that, providing that borrowers do not deceive them.

Originators do not, however, have the ability to determine what loan is "appropriate" for a borrower, nor are they able to discern what is meant by predatory "effects" in sec. 103, a definition that will probably only be known after a number of lawsuits are decided. The terms "predatory characteristics or effects" are undefined, provide no guidance, and will put originators at risk of litigation. These terms are not necessary since the bill and present law prohibit abusive or unfair lending practices and require that the originators determine that the borrower has the ability to repay the loan. If "appropriate" is limited to "ability to repay the loan," and predatory characteristics and effect are carefully spelled out so that originators have a clear direction to follow, we can support the provision.

We urge that Congress limit duties it plans to impose upon originators to those duties which they have the ability to meet, not ones that are vague and beyond their ability to meet.

Applicability of Steering Prohibition

While we fully support the concept that originators should not be compensated for charging a borrower prices higher than those for which the borrower qualifies, we are concerned that the provision as written in sec. 103 may have unintended negative consequences. We support the general concept that the compensation to a mortgage originator should not vary based on the terms of the loan, and that a borrower should always be offered a qualified loan if the borrower meets the requirements for that loan. Certain loan products, however, may take more of an employee's time and effort to process than other loans. For example, FHA, VA and CRA loans often take longer to process and many are for a smaller principal amount than a conventional 30-year fixed rate loan. As the bill is currently drafted, creditors could not give their employees sufficient incentive pay to process such loans as the incentive must be based on the same incentive plan for conventional 30-year fixed rate loans. Employees will not want to work on such products because their total compensation will be less than if they process easier loans with higher principal amounts. We believe this is not the intended purpose of this section and want to work with the Committee to try to correct it.

Definition of Qualified Loans

The definitions of qualified loans in sec. 203, and the effect of those definitions, also warrant change. We suggest that VA, FHA, and rural housing loans, as well as loans sold to Fannie Mae and Freddie Mac be added to the standards. VA, FHA, and rural housing loans that are made or guaranteed by the applicable governmental departments are governed by an extensive array of conditions that are at least equal to the standards established in this section and thus, should be included within the definition of qualified loans. Similarly, Congress and

FHFA have the authority to carefully regulate the quality of conforming loans that can be purchased by Fannie Mae and Freddie Mac, and the federal government fully guarantees the MBS issued by the enterprises. Loans meeting those standards should be included within the definitions of qualified loans.

We urge that more precise directions be given to the agencies to permit loans of durations other than 30 years and with adjustable rates to qualify. The present language of the bill requires that all loans within the definition of qualified loans must be of precisely 30 years duration, and while it is silent on rate, we understand the intention is that the rate be fixed, and not adjustable. Adjustable rate loans and loans with other durations than 30 years, provided that they meet all the other standards within the section and pass regulatory muster should be included as qualified loans. Many highly qualified borrowers would prefer to have rates that adjust or repay their loans more rapidly than 30 years. Those borrowers should not be penalized under an assumption that a 30-year fixed rate loan is the only appropriate loan; other fully underwritten fixed rate and adjustable rate loans are also safe. It also should be noted that modifications under the Administration's Making Home Affordable Program ("Program") may not meet the definition of a qualified loan. Under the Program's guidelines, the term of the new loan can be up to 40 years.

We also believe that the presumption should be irrebuttable. If the loans meet those standards, making the presumption irrebuttable will provide some certainty to lenders and avoid a string of lawsuits created by imaginative plaintiffs who want to avoid their own responsibilities. Creditors must have guidance that provides certainty that practices they are following will comply with statutory requirements. This can only be achieved if the standards are fully articulated, and compliance with the standards is deemed to satisfy the statutory tests.

Risk Retention

The risk retention provisions in H.R. 1728 are designed to assure that the original lender retains some risk in the performance of a mortgage loan. We support the general concept of originators retaining some credit risk. Too many originators failed to pay sufficient attention to risk during the past few years, and such a requirement would instill greater attention to underwriting standards. However, a requirement to retain 5% of the credit risk for every loan sold could reduce banks' incentives to make mortgage loans, or lead banks to increase the costs of mortgage borrowing, or both. Thus, unless carefully drafted, one unintended effect of the risk retention requirement will be to reduce levels of homeownership.

Even small changes in capital requirements can have a disproportionate impact on a lender's behavior. Mortgage originators operate with narrow spreads between expenses and profits. Therefore, any additional capital costs associated with making a mortgage loan will require a lender to evaluate whether the loan is yielding a sufficient return to justify the capital allocation required. If not, a lender will have to consider either increasing the return on the loan by raising interest rates and other charges, or if that is not practical, reducing the amount of capital allocated to the loan by limiting the production of new mortgage loans. The extent to which this will be felt by the public depends on the significance of the higher capital charge.

The impact of the risk retention provision in H.R. 1728 will vary based upon the manner in which it is implemented by federal banking regulators. If a lender's risk retention position is intended to absorb all of the losses on a loan until the amount of retention if exhausted (i.e., a first loss position), then a lender will be required to treat all of the loans in a securitization as if they were never sold. On a pool of $100 million in mortgage loans this would equate to a capital charge of $5 million.

We have a number of ideas for refining the risk retention requirement in the bill to promote greater attention to underwriting standards without creating such damage to the market.

First, we recommend the scope of loans subject to the requirement be more targeted. As drafted, the requirement applies only to loans that are not "qualified" loans. As noted above, we believe that the definition of "qualified loan" is too narrow; it fails include many loans that are safe and sound, including FHA, VA, rural housing, and loans sold to Fannie Mae and Freddie Mac. The risk retention requirement would be better focused if these loans were deemed to be qualified loans. This would focus the risk retention requirement on the type of loans that were the source of the problem, namely risk loans. It would achieve the goal of mandating more intense scrutiny for higher risk loans without curtailing the availability of mortgage credit for better borrowers.

Second, we recommend that the regulators be explicitly authorized to apply the 5% credit risk requirement on a pro-rata basis with the assignee. As noted above, the existing requirement could be read to require a lender to hold a 5% first loss position against a pool of mortgages, and this would impose a sizable cost that would substantially curtail mortgage lending activities. Under a pro-rata approach, however, the lender would have a 5% interest in the loan proceeds that is equal in priority to the assignee's interest. In other words, both the lender and the assignee would share proportionally in any loss. For example, if the 5% risk retention requirement is applied on a pro rata basis and there is a $100 loss, the lender would incur a $5 loss, and the assignee would incur a $95 loss. This ensures that a lender will continue to have some "skin in the game", without having the unintended consequence of significantly reducing mortgage availability. Furthermore, applying the risk retention requirement on a pro-rating basis is similar to the approach that the European Union (EU) is considering. The EU, however, would apply the risk retention to securitizers, not originators.

Third, we recommend that the risk retention requirement be time limited. As drafted, a lender must retain an ever increasing amount of capital against its mortgage loans. For example, if a lender makes $100 in mortgage loans in year 1, the lender would be required to have $5 risk retention position against those loans. In year 2, if the lender makes another $100 in mortgage loans, its risk retention positions would include not only the original $5, but another $5 for a total of $10. Under the bill, this process would go on indefinitely. To avoid this excessive build-up of capital depleting positions, we recommend that the retention requirement be subject to an 18 month time limit. Given the enhanced underwriting standards otherwise mandated by the bill, we would expect the time period in which a loan becomes a nonperforming, early default loan to be reduced to around 12 to 18 months. Therefore, it would seem reasonable to set the outer limit of the retention requirement at 18 months.

Finally, we recommend that the Committee authorize the banking regulators to permit lenders to implement alternatives to the 5% requirement that may achieve the same goal as the 5% requirement. For example, the regulators could permit a lender who sells a loan to receive from the buyer only 95% of the sales price when the sale is consummated, and receive the full sales price only after certain performance benchmarks are reached.

This is a complex issue. We would like to work with the Committee on this issue going forward.

Uniform National Standard

We believe that all of the matters covered in this bill should set the standard for loans nationwide. In other words, this federal law should be a national standard. The mortgage industry is a national industry. Mortgage rates are set by national markets, and many of the basic terms and conditions in loans are set by Fannie Mae and Freddie Mac. The protections afforded consumers should also be national in scope and application. Indeed, gaps in consumer protection regulation contributed to the recent crisis in our financial markets.

These national standards should not be a floor for additional regulation by individual States. Additional, and different, state regulations will add compliance costs for lenders and increase the cost of mortgages for consumers. Strong and uniform national standards are the best protection for consumers.

Conclusion

The Housing Policy Council supports reforming the mortgage industry to ensure that the mistakes made over the past several years do not happen again. We want to continue to work with this Committee to ensure that these reforms curtail bad practices while maintaining a strong system of mortgage finance.

MORTGAGE BANKERS ASSOCIATION
Investing in communities

Statement of David G. Kittle, CMB

Chairman

Mortgage Bankers Association

Before the

Committee on Financial Services

United States House of Representatives

Hearing on

"H. R. 1728, the Mortgage Reform and Anti-Predatory Lending Act of 2009"

April 23, 2009

Chairman Frank, Ranking Member Bachus and Members of the Committee, good afternoon. As Chairman of the Mortgage Bankers Association,[1] I greatly appreciate the opportunity to testify before you today on proposals for mortgage lending reform.

Although we have some differences in approach, which I will discuss today, we share your commitment to improving mortgage regulation. Our nation faces a once-in-a-generation opportunity to improve the mortgage lending process and MBA welcomes the opportunity to participate in this important effort. If carefully crafted, improved regulation is the best path to restoring investor and consumer confidence in the nation's lending and financial markets and assuring the availability and affordability of sustainable mortgage credit for years to come. At the same time, if regulatory solutions are not well conceived, they risk exacerbating a credit crisis that trillions of public dollars have still not resolved.

To achieve reform, MBA and its members have been working on a parallel track to that of the committee to develop sensible approaches. Just last month, as a result of this work, we were able to submit to Congress the Mortgage Improvement and Regulation Act (MIRA), which I am attaching to this statement. MIRA would establish uniform lending standards and change the regulatory structure to make the market more transparent and better protect consumers.

MBA's proposal acknowledges the vast changes to the financial and regulatory landscape that have taken place in just the past two years. Since H.R. 3915 passed the House at the end of 2007, the Board of Governors of the Federal Reserve (the Board) undertook a careful review of abuses in the mortgage process that included public comment and open hearings. Following these deliberations, the Board finalized new comprehensive rules under the Home Ownership and Equity Protection Act (HOEPA) addressing the central issues raised by H.R. 3915. These include greater protections for subprime borrowers with new requirements for ability to repay determinations, documentation, escrows and prepayment penalties. The rules also include requirements for all mortgage loans to stem appraiser coercion, servicing and advertising abuses.

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

In establishing new lending standards, MIRA seeks to judiciously build on the Board's rules. It also includes legislative proposals that were developed by this committee as part of H.R. 3915, new transparency provisions to conform the Real Estate Settlement Procedures Act (RESPA) and the Truth in Lending Act (TILA) disclosures, and MBA's own initiatives, such as proposals for a duty of care for loan originators – all with an eye to assuring consumer protection and returning liquidity to the market.

Taken together, we believe our proposed reforms comprise rigorous and workable standards that would include clear requirements for lenders and investors and equally clear protections for consumers, nationwide. Changes to the regulatory structure, among other things, would involve the establishment of a new federal regulatory agency that would implement the new standards and would also be charged with regulating independent non-depository mortgage bankers and mortgage brokers. The agency would also assume responsibility for national counseling and financial literacy programs.

While the new standards would be preemptive of state lending laws, the standards would be both consistent and dynamic, and would require a very high level of federal and state partnership in their development and enforcement. To achieve this, MIRA would establish a council of state and federal regulators to revisit and update the standards regularly to address current abuses and concerns. At the same time, state and federal regulators would work together in reviewing and examining mortgage bankers and brokers and in enforcing the new standards.

H.R. 1728, the Mortgage Reform and Anti-Predatory Lending Act

While we applaud the comprehensive nature of H.R. 1728 and believe legislation in this area is needed, we have several concerns that we will discuss in this testimony. On each of these issues, we believe our MIRA proposal presents an alternative and better approach.

Lack of national standards

First and foremost, H.R.1728 does not establish a national standard for mortgage lending that replaces the uneven patchwork of state mortgage lending laws.[2]

By making the new law a "floor" and not a "ceiling" for additional state and local laws – no matter how laudable their objectives – the bill will perpetuate and expand an already uneven and confusing regulatory patchwork of lending laws where the costs are ultimately borne by consumers. To illustrate this problem, with my testimony I am submitting a map of the patchwork of state anti-predatory lending laws that exist today. Some states have highest cost loan laws that track federal law, some have their

[2] Only the assignee liability provisions provide a narrow preemption.

own highest cost loan laws, some have both their own highest cost and higher-cost laws and some do not have highest cost or higher-cost loans at all.

MBA's MIRA proposal takes the opposite approach from H.R.1728 and preempts state laws, while still providing a pivotal role for state regulators. In a world that is seeking international and national solutions to the current crisis, MBA sees no reason to perpetuate separate federal and state lending requirements.

Lender retention of risk

We are just as concerned about the bill's provision requiring lenders to retain at least five percent of the credit risk presented by non-qualified mortgages. Lenders already have "skin in the game" by virtue of their representations and responsibilities to assignees and investors. At a time when policymakers are focusing so much of their efforts on injecting capital into the financial services sector, this provision would force an inefficient use of capital across all types of institutions, and would threaten to further impair their ability to lend at all.

The approach laid out in the bill would make it impossible for many lenders to operate, including smaller non-depositories who employ warehouse lines of credit. It will also necessitate that larger lenders markedly increase their capital. Both results will narrow choices, lessen credit and significantly increase costs for many borrowers, if credit is available at all.

Considering the potential national and even international effects of this provision, we recommend that, at minimum, this approach should be carefully studied along with workable alternatives before it is implemented. Moreover, because of its implications on secondary market financing, MBA believes this proposal would be more appropriately considered in the context of pending changes to secondary market regulation. The results of a comprehensive study would inform that debate.

Our MIRA proposal empowers the regulator to increase net worth and bonding requirements. MBA believes that such requirements offer a far more desirable alternative that would help align originators' interests with those of borrowers and at the same time provide borrowers a means of recompense in the event of failure.

Defining "qualified mortgages"

MBA believes the definition of "qualified mortgage" is far too limited and will result in the unavailability of sound credit options to many borrowers and the denial of credit to far too many others. Under H.R. 1728, only qualified mortgages will be excluded from the new rules requiring lenders to retain five percent of the credit risk and only qualified mortgages will be subject to the presumption that the ability to repay and net tangible benefit standards have been met. Consequently, loans outside this set will be made at substantially higher costs, if at all.

We urge the committee to redefine the term "qualified mortgage" to provide more flexible standards that will still protect borrowers. Specifically, the regulator should be provided authority to identify products as "qualified mortgages" and the interest rate triggers (1.5 percent over the prime rate for first lien loans and 3.5 percent over the prime rate for subordinate lien loans) should be removed. Doing so would permit both subprime and prime loans to be "qualified" unless they contain nontraditional features that might be regarded as higher risk such as teaser rates, negative amortization provisions, or no documentation requirements. Such a reconfiguration would ensure that sound credit options can be made available to borrowers across the credit spectrum and that jumbo loans, which could easily exceed the trigger, would continue to be available to borrowers in high-cost areas.

Furthermore, any fixed-term loan of 15 to 40 years, government-backed loans, including FHA, VA, Rural Housing, as well as Fannie Mae and Freddie Mac mortgages, should all be regarded as "qualified mortgages" to assure their continued availability to borrowers. MBA notes that an earlier draft of H.R. 1728 permitted mortgages with a fixed payment for a minimum of five years and limited adjustment features to be regarded as "qualified." Other adjustable loan products, including yearly adjustable mortgages without risky features, can be beneficial for borrowers and should be regarded as "qualified" under specified circumstances as well.

Steering

MBA believes the prohibitions against steering are unclear, overly broad and would unnecessarily prohibit incentive-based compensation to loan officers for mortgage lenders and mortgage brokers, notwithstanding their far different roles. The restriction may also cover payments from the secondary market to mortgage lenders. There also is a lack of clarity surrounding what is meant by the prohibition against payment based on "loan terms."

MBA has consistently reminded policymakers that lenders and their employees offer products that borrowers shop for and compare, whereas mortgage brokers act as intermediaries between lenders and the borrowers who employ brokers to shop for them. Consequently, considering the differing functions of mortgage brokers and lenders, whether or not lender loan officers' employees are paid on commission, they do not present the same steering concerns as mortgage brokers or their employees.

Payments from the secondary market to lender companies based on the terms of loans should not be restricted by anti-steering provisions. Such compensation represents efficient, market-driven means of valuing loans and servicing through which liquidity is provided to the primary market. It differs from, and need not affect, originator compensation. MIRA addresses steering judiciously by requiring a much greater level of disclosure by loan officers. Mortgage brokers would be required to disclose whether they are acting as the borrower's agent and the sources of their compensation; at the same time lender loan officers would disclose if they are paid on commission.

Safe harbor

We are concerned that the bill's presumptions do not result in bright line safe harbors. As such, they will discourage lenders and investors from entering the market even for qualified mortgages, no matter how promising the borrower. MIRA, on the other hand, would establish bright line safe harbors so that if creditors act properly, they will not be dogged by litigation that increases borrower costs.

Assignee liability

The assignee liability provisions in H.R. 1728, as in MIRA, should include provisions from H.R. 3915 that allow assignees to satisfy their obligations through due diligence and other specified standards. The absence of these provisions, which are contained in MIRA, will discourage investors and hamper the return of sustainable credit to nonprime borrowers.

Other Concerns

MBA has several other concerns that we would be pleased to discuss in greater detail. These include that the definition of a "mortgage originator" may cover mortgage servicers – inadvertently impeding the committee's, the administration's and the industry's efforts to assist troubled borrowers. While MIRA would require the new regulator to implement servicing standards, our proposal does not contain this confusing definition.

The bill's provisions empowering the federal banking agencies to establish net tangible benefit rules for refinancings should require that these standards comprise bright-line tests such as a specific percentage decrease in loan payment or percentage increase in loan amount. If these standards remain subjective, credit will be far more costly, if it is available at all.

While the duty of care is similar to MBA's MIRA proposal, H.R. 1728 should provide that forms be developed for borrowers to provide such information as income, net worth and risk profile so lenders can determine which loans are appropriate based on borrower information.

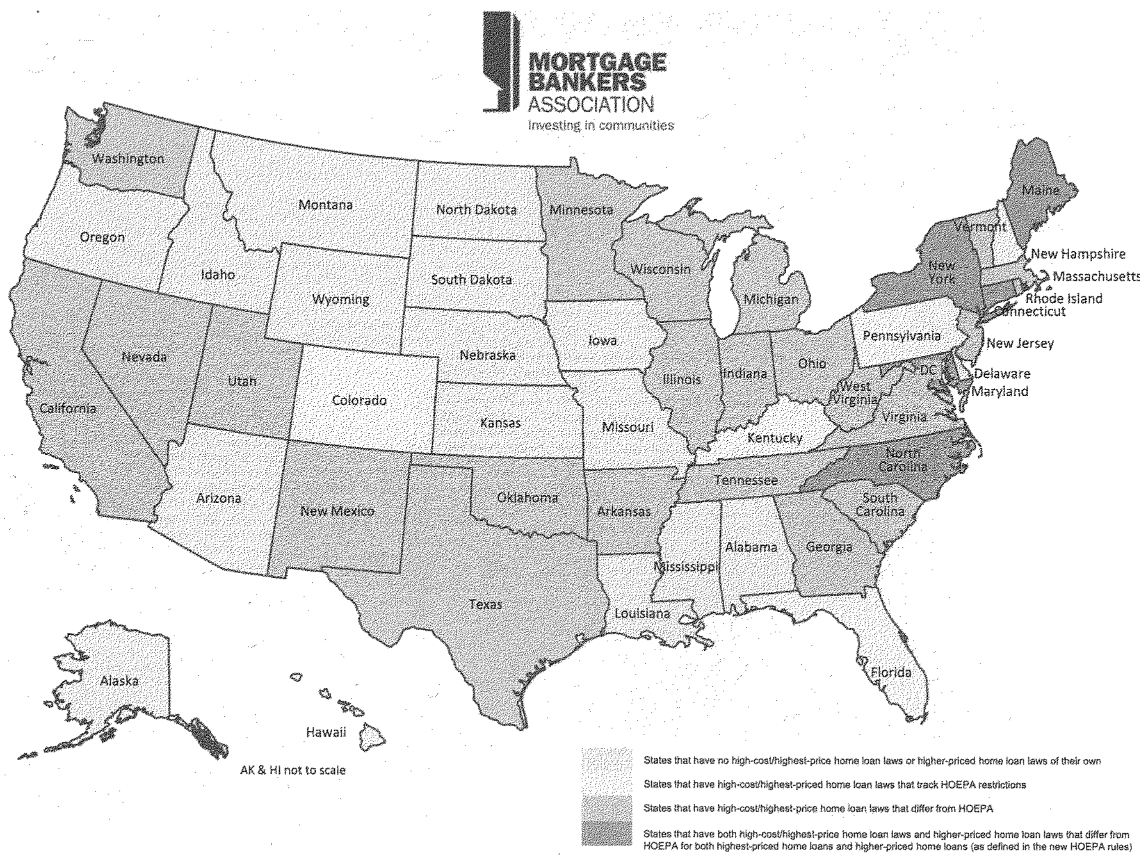
The bill's provision that tenants in foreclosed properties can stay until the end of the existing lease is well meaning, but will unnecessarily increase financing costs for rental properties. While MIRA establishes clear standards for reasonable notice to tenants, it would not impair the value and costs of financing rental properties to the same extent as H.R. 1728.

H.R. 1728 would make several changes to the existing requirements for very high-cost (HOEPA) loans, resulting in far more loans being categorized as high-cost loans. Because of the nature of HOEPA's restrictions, however, few HOEPA loans are ever made. Like the Board, MIRA would focus protections on loans below the HOEPA thresholds rather than expanding HOEPA's high-cost requirements and shutting off credit.

Finally, at a time when the mortgage process needs to be made more understandable for consumers, H.R. 1728 does little to achieve this result. The bill should call upon the Department of Housing and Urban Development to withdraw its RESPA rule and join with the Federal Reserve to truly simplify mortgage disclosures. MBA has worked with industry experts to develop forms that would satisfy RESPA and TILA requirements. These forms, which we would be happy to share with the committee, can serve as a basis for a new, much more comprehensive reform effort.

Conclusion

Congress is facing a historic opportunity to improve mortgage lending for years to come. While we strongly favor comprehensive legislation in this area and commend the committee for the priority it has placed on addressing this issue, we feel that H.R. 1728 does not yet strike a proper balance between protecting consumers and maintaining the availability of credit that has helped so many Americans realize the dream of homeownership. MBA looks forward to working with Congress on legislation that will replace our patchwork quilt of regulations with a strong uniform lending standard that works for the entire nation.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New York
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Maine
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Rhode Island
Connecticut
New Jersey
DC
Delaware
Maryland
Alaska
Hawaii
AK & HI not to scale
States that have no high-cost/highest-price home loan laws or higher-priced home loan laws of their own
States that have high-cost/highest-priced home loan laws that track HOEPA restrictions
States that have high-cost/highest-price home loan laws that differ from HOEPA
States that have both high-cost/highest-price home loan laws and higher-priced home loan laws that differ from HOEPA for both highest-priced home loans and higher-priced home loans (as defined in the new HOEPA rules)

National Association of Mortgage Brokers

Prepared Testimony of

Denise Leonard

Chairman, Government Affairs

National Association of Mortgage Brokers

On

"H.R. 1728,

The Mortgage Reform and Anti-Predatory Lending Act of 2009"

Before the

Committee on Financial Services

United States House of Representatives

Thursday, April 23, 2009

Good morning Chairman Frank, Ranking Member Bachus, and Members of the Committee. I am Denise Leonard, Chairman of the Government Affairs Committee of the National Association of Mortgage Brokers ("NAMB"). Thank you for inviting NAMB to testify today on "H.R. 1728, the Mortgage Reform and Anti-Predatory Lending Act of 2009." We appreciate the opportunity to discuss this critical piece of legislation that is of vital importance to our members, to consumers, and to the future of our industry.

NAMB is the only national trade association that represents the mortgage broker industry. NAMB represents the interests of more than 70,000 mortgage broker professionals located in all 50 states and the District of Columbia. NAMB also works with 49 state affiliate associations nationwide. Additionally, NAMB represents the interests of homebuyers, and advocates for public policies that serve the mortgage consumer by promoting competition, facilitating homeownership, and ensuring quality service.

NAMB is committed to promoting the highest degree of professionalism and ethical standards for its members. NAMB requires that its members adhere to a professional code of ethics and best lending practices that fosters integrity, professionalism, and confidentiality when working with consumers. In 2002, NAMB and the nation's mortgage brokers were the first to introduce uniform licensing and testing of all originators, and we are proud that through the actions of this Committee, that concept was adopted and enacted into law as the S.A.F.E. Mortgage Licensing Act of 2008 ("SAFE Act") which encompasses the role of the mortgage originator and enhances consumer protection throughout the mortgage process.

NAMB provides its members with access to professional education opportunities and offers rigorous certification programs to recognize members with the highest levels of professional knowledge and education. NAMB also serves the public directly by sponsoring consumer education programs for current and aspiring homebuyers seeking mortgage loans.

Mortgage brokers work with consumers to help them through the complex mortgage origination process. Mortgage brokers add value to the process for both consumers and lenders by serving areas that are typically underserved by banks and other lending institutions. Mortgage brokers also add value by providing goods, facilities, and services with quantifiable value, including a customer base and goodwill.

I. Introduction

NAMB shares this Committee's ongoing concern over the abusive lending practices that once existed, and in some cases may still exist throughout our mortgage lending system. We believe many of the reforms set-forth in this bill will lay a strong foundation for the recovery and future prosperity of our mortgage lending system. We applaud the uniform approach taken in H.R. 1728, but will suggest minor improvements to the legislation in order to carry out its consumer protections without undue industry confusion.

NAMB will focus this testimony most specifically to the areas we were directed by the Chairman to address today and will subsequently present the broader and more rudimentary characteristics of our elements of concern to this Committee for review.

As we continue to reevaluate the current state of the American mortgage lending system and contemplate reform, NAMB believes it is important to thoroughly explore the true origins of our current market problems and take into consideration the many recent legislative, regulatory, and market changes that have already taken place.

We are confident that a comprehensive and constructive bill addressing the most pressing issues facing industry participants, consumers, and the mortgage market itself can be passed, and NAMB looks forward to working with the members of this committee and others in the House and Senate to effect beneficial and lasting changes where they are needed.

II. Origins of the Current Market Problems

At the very beginning of our current market crisis, it was not uncommon to believe that all of our problems were the result of reckless subprime mortgage lending and aggressive speculation in risky housing markets. However, after witnessing the collapse, or near-collapse, of many of our nation's largest financial institutions, we have come to realize that subprime lending was only one part of a far more extensive problem.

Recent developments in our financial markets have brought to light the sobering reality that the policies, practices, and behaviors which caused this crisis were not isolated in a particular geographic region or a single segment of the industry. Rather, it was a multitude of factors that led us to where we are today.

First, financial innovation reached unprecedented levels over the past decade. Lenders, borrowers, investors, and regulators became increasingly overconfident in the security and effectiveness of new and sometimes exotic financial products that promised to bring wealth and prosperity while allegedly minimizing risk.

At the same time, underwriting standards for mortgage loans were significantly relaxed and greater emphasis was placed on home valuation as opposed to other factors traditionally used to determine a borrower's likelihood of repaying a loan. With home prices steadily rising, borrowers seized upon this opportunity to take out increasingly larger mortgages with little to no down payment required and less stringent qualifying documentation requirements. As a result, millions of Americans obtained loans that many would subsequently be unable to afford due to rate increases, job loss, unexpected additional expenses, and other factors.

Lenders, investors, regulators, and homeowners all took comfort in the belief, however misguided, that property values would continue to rise. Unfortunately, however, that was not the case and the projected perpetual prosperity created a hazardously indulgent environment that quickly came to an end.

Builders and real estate agents were clamoring to sell properties as home values skyrocketed. At the same time, banks and lenders, who were effectively assuming the role of middle-men, further relaxed underwriting standards to maintain and increase production The lenders would then quickly absolve themselves of responsibility for by passing them off to Wall Street investors.

For its part, Wall Street was buying millions of mortgage loans, good and bad, from lenders all across the country and chopping them up in order to repackage them as complex investment securities. Wall Street would then turn around and offer these securities for sale to banks, pension funds, and countless other investors worldwide. Despite the fact that virtually no one understood what these security instruments were made up of or how they were going to behave, rating agencies proceeded to certify them as "AAA," although we do acknowledge the fact that the agencies may not have been given all pertinent information from the lenders in order to properly rate these securities.

As was noted in a New York Times Editorial last month, "the unfolding evidence makes clear that this was a systemic problem, driven by Wall Street's insatiable appetite for mortgage backed securities."[1] Many experts agree, and identify these security instruments, which were created by Wall Street, propped-up by rating agencies, and gobbled-up by investors as being at the heart of our current financial crisis.[2]

Compounding the problem further, Wall Street also began peddling arcane investment vehicles known as "credit default swaps." Credit default swaps are private, largely undisclosed and completely unregulated "insurance" contracts that mortgage investors could enter into in order to protect themselves against losses if their initial investments failed. The additional investment in credit default swaps was aggressively marketed to investors as an essential risk-saving device for anyone nervous about purchasing mortgage-backed securities. This "perceived" safety net eliminated the need for Wall Street and investors to implement their own quality control measures on the mortgages within the risky mortgage-backed securities because they believed they were guaranteed to come out ahead, regardless of performance.

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[1] *Editorial: Common Sense in Lending*, NY Times, March 8, 2009.

[2] *60 Minutes: A Look at Wall Street's Shadow Market* (CBS News television broadcast, October 5, 2008).

Had housing prices continued to rise, we may never have fully realized the risk presented by all of this unchecked financial innovation. However, when the housing bubble finally burst, it set into motion a chain reaction of events that brought our financial system to its knees. Homeowners began defaulting on their mortgages when their interest rates adjusted upward or their overall financial circumstances changed, and the value of their home was no longer sufficient to cover the cost of refinancing. This led to a rise in foreclosures and a glut of homes on the market, which served to further depress housing prices, and in turn led to even more defaults and foreclosures.

The rapidly increasing number of mortgage defaults and foreclosures naturally led to the failure of the high-risk mortgage-backed securities sold on Wall Street, which prompted many investors to try to cover their losses by calling-in credit default swaps they had purchased to protect themselves from precisely this occurrence. However, the large investment banks responsible for creating the mortgage-backed securities and peddling the credit default swaps had never set aside sufficient capital to cover their obligations should those "insurance policies" be called-in. As a result, it became increasingly impossible for these institutions to extend credit to borrowers or shield their tremendous financial losses from regulators and investors.

With depleted cash reserves and assets that had lost tremendous value, financial institutions became unable to make new loans at the pace needed to keep our economy running, and virtually overnight, the problem of insufficient capital at some institutions became a crisis of illiquidity throughout our entire economic system.

Now we are faced with the extremely challenging task of working to improve our mortgage lending system and ensure its future strength and stability, in an environment where overcorrection in some areas has already made the situation worse, and additional overcorrection may serve to further exacerbate and prolong the hardships being felt by consumers across the country and in every segment of the market.

III. Recent Legislative, Regulatory & Market Changes

In addition to the ongoing turmoil in our mortgage and financial markets, a great deal of change has been affected through legislative and regulatory action. Some of this change has been thoughtfully considered and will undoubtedly strengthen and stabilize the mortgage industry for years to come. However, other changes have been more hastily initiated and threaten permanent negative long-term consequences for consumers and market participants if they are not corrected.

(A) S.A.F.E. Mortgage Licensing Act of 2008 ("SAFE Act")

The SAFE Act was signed into law in July 2008 as part of the Housing and Economic Recovery Act of 2008, which also included much needed changes to the government sponsored enterprises. The SAFE Act is comprised of key provisions from H.R. 3915, the Mortgage Reform & Anti-Predatory Lending Act of 2007, and establishes a nationwide licensing and registration system for loan originators. Under this system, all loan originators, regardless of whether they work for depository or non-depository institutions, are required to submit fingerprints to the FBI, and any other governmental agency or entity authorized to receive such information for a state and national criminal background check, and must obtain a unique identifier through the Nationwide Mortgage Licensing System and Registry administered by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators ("CSBS/AARMR"). Additionally, all state-licensed loan originators are required to meet minimum education and testing standards.

The SAFE Act represents a critical step toward achieving uniformity and a higher level of professionalism throughout the mortgage lending industry. NAMB has advocated for such uniformity for many years now and led the nation in urging its passage, over the objections of others. We are pleased to see the advances now being made in that regard. Education and testing of every state-licensed loan originator helps to ensure that consumers will receive accurate and consistent product information, which will allow them to make an informed decision about different loan financing options available in the market. Additionally, mandatory continuing education and professional ethics training helps to ensure that state-licensed originators remain knowledgeable and competent with regard to addressing consumer concerns. State and federal criminal background checks will also prevent unqualified individuals from entering, remaining, or moving within the industry. We continue to advocate that all loan originators, even those at the Federal level, should be covered by these requirements.

Although the SAFE Act represents much needed changes for loan originator licensing standards, we understand that some state legislators are still confused with regard to the implementation of the SAFE Act, particularly as it relates to currently licensed and registered loan originators. We look forward to working with Congress in an effort to address these implementation issues.

(B) Home Ownership & Equity Protection Act Amendments ("HOEPA Rules")

Also in July 2008, the Federal Reserve Board approved amendments to Regulation Z, under the Home Ownership and Equity Protection Act ("HOEPA"), to better protect consumers and facilitate responsible lending. The new HOEPA Rules prohibit unfair, abusive or deceptive home mortgage lending practices and restrict certain other mortgage practices. The rules also establish advertising standards and require certain mortgage disclosures to be given to consumers earlier in the transaction. According to the Federal Reserve Board, the HOEPA Rules are intended to protect consumers from unfair or deceptive acts and practices in mortgage lending, while keeping credit available to qualified borrowers and supporting sustainable homeownership. These new HOEPA Rules are applicable to all mortgage lenders, not just those supervised and examined by the Federal Reserve.

The new Rules promote clarity and professionalism throughout the mortgage industry and help protect consumers by requiring accuracy and balance in advertisements as well as the establishment of escrow accounts for the payment of property taxes and homeowners' insurance on all first-lien loans.

The Rules also set forth an anti-coercion appraisal standard which, much like H.R. 1728, applies equally to all originators. The Rules prohibit all mortgage brokers, mortgage lenders and their affiliates "from coercing, influencing or otherwise encouraging appraisers to misstate or misrepresent the value of a consumer's principal dwelling."

During consideration of the appraisal standards set forth in the Regulation Z final rule, the Board addressed the issue of who orders appraisals and declined to find that "any particular procedure for ordering an appraisal necessarily promotes" fraudulent appraisals. Rather, the Board found that "coercion of appraisers" whether by lenders or brokers "is an unfair practice," and determined that the appraisal provisions in Regulation Z should apply equally to lenders and brokers alike. The Federal Reserve's appraisal standard implementation date is October, 2009. NAMB supports this uniform approach to protecting consumers which is consistent with the appraisal provisions contained in H.R. 1728.

We will work constructively with the Federal Reserve Board to finalize the much needed revisions to the Truth In Lending Act ("TILA") and recommend that the U.S. Department of Housing and Urban Development ("HUD") withdraw its final rule in order to comport to the changes the Federal Reserve Board regulations establish as well as any changes to be passed as part of H.R. 1728.

(C) Real Estate Settlement Procedures Act Revisions ("RESPA Rule")

HUD released its long-awaited RESPA Rule in November 2008. As part of that Rule, HUD is requiring loan originators to provide consumers with a standard Good Faith Estimate ("GFE") that the agency believes clearly discloses key loan terms and closing costs.

The RESPA Rule requires only mortgage brokers, but no other mortgage provider, to make detailed disclosures regarding their direct and indirect compensation. This asymmetrical disclosure of originator compensation places mortgage brokers at a significant and permanent competitive disadvantage, which impedes competition in the mortgage market and threatens to increase costs for consumers. Moreover, this type of disclosure has been shown through multiple studies to cause consumer confusion and prompt consumers to choose more expensive loan products than they might otherwise select. Lastly, HUD adopted this RESPA Rule in direct contravention of its own stated policy that all loan originators – regardless of the type of financial institution they work for, should be required to make the same types of disclosures.

HUD proposes to make bold changes in the marketplace through implementation of this rule. However, in light of the current market situation – rising home foreclosures, the credit crunch, the day-to-day changes to the marketplace, and rapid Congressional and regulator response, among other factors – NAMB questions the appropriateness of the timing and implementation of the rule and fears the grave unintended consequences it will inflict on the already fragile economy.

Today's mortgage market is significantly strained and continues to experience turmoil and change. The market has lost over 250 lenders, underwriting standards have tightened, minimum credit scores have significantly increased beyond the national average, and new rules continue to be announced and implemented by both state and federal agencies. In addition, Congress continues to consider sweeping changes to how loans are originated in the United States. Before implementing sweeping changes to the settlement process, a thorough analysis should be undertaken to ensure any changes made to RESPA are done so with a positive impact on consumers.

Additionally, Congress enacted the Mortgage Disclosure Improvement Act last year as part of the Housing and Economic Recovery Act of 2008 amending the timing requirements for TILA disclosures which, in part, will go into effect in July 2009. As the regulators continue to require additional or enhanced disclosures, we stress the importance of providing both uniformity and coordination of approach by both the Federal Reserve Board and HUD so that consumers receive the maximum benefit of any disclosures.

At this time, NAMB believes HUD's efforts, and the mortgage market in general, may be better served by focusing on the many issues facing homeowners today and providing support for those consumers currently at risk of losing their home to foreclosure. NAMB believes HUD should withdraw the RESPA rule to work in conjunction with the Federal Reserve Board and coordinate its activities. At the very least, HUD should withdraw the portion of the rule that unfairly exacerbates the unequal treatment of mortgage transactions. The all originator construct needs to remain the same, especially in light of the passage of the SAFE Act and the appropriate uniformity of treatment contained therein. As regulators, Congress, and industry focus on the issues at-hand, we must be cautious and ensure that the market has an opportunity to stabilize, accommodate changes, and provide the necessary assistance to borrowers facing foreclosure and in need of help from various refinancing programs administered by HUD.

(D) Home Valuation Code of Conduct ("HVCC")

On March 3, 2008, the Federal Housing Finance Agency ("FHFA") announced that it had entered into agreements with the NY Attorney General and Fannie Mae and Freddie Mac ("Agreements") regarding certain home appraisal requirements. Among other things, the Agreements required the GSEs to adopt a new policy regarding home appraisals, called the "Home Valuation Code of Conduct" ("HVCC").

The HVCC is a substantive rule that amounts to de facto regulation of the entire mortgage industry, and is in direct conflict with existing regulations, policies, and guidelines regarding home appraisal standards. Additionally, the rule was promulgated by the FHFA in violation of the Administrative Procedures Act. The HVCC resulted from an investigation by the NY Attorney General into appraisal fraud between a lending institution and an appraisal management company ("AMC"). However, the HVCC targets industry participants and practices which are entirely unrelated to the investigation that precipitated its enactment. It narrowly targets mortgage brokers and independent appraisers, and forces consumers to rely exclusively on lenders and their AMCs for home appraisals. Consequently, the HVCC places small-business mortgage professionals and independent appraisers at a significant and permanent competitive disadvantage, which will impede competition in the mortgage lending marketplace and inevitably produce higher costs and other negative consequences for consumers. The investigation that started with fraudulent appraisals between a Federal financial institution and Fannie Mae and Freddie Mac has created a new revenue stream for financial institutions and produced a competitive advantage over others in the marketplace; two results that directly harm consumers.

In February 2009, NAMB filed suit against FHFA to block implementation of the HVCC which will inhibit competition among mortgage originators and increase the cost of mortgages to consumers. NAMB's suit asserted that the HVCC constituted a "de facto" rulemaking that did not comply with the requirements of the Administrative Procedures Act (APA), which sets out the procedures a federal agency must follow when issuing a regulation.

In May 2008, the Office of the Comptroller of the Currency ("OCC") stated in a letter to the Director of Office of Federal Housing Enterprise Oversight ("OFHEO"), (now the FHFA) "The OCC has substantial concerns about the unintended adverse consequences of the Agreements and Code...for the cost of mortgage credit to consumers." OCC further stated, "In our opinion, this de facto regulation...will lead to the following unintended and adverse consequences." "We agree with points made in comment letters recently sent to the GSEs that the Agreements and the Code together constitute a 'rule' establishing binding norms of wide applicability, adopted contrary to the rulemaking requirements of the Administrative Procedures Act (APA)."[3]

In April 2008, a joint letter from the American Bankers Association ("ABA"); American Financial Services Association ("AFSA"); Consumer Bankers Association ("CBA"); Consumer Mortgage Coalition ("CMC"); Housing Policy Council, The Financial Services Roundtable; Independent Community Bankers of America ("ICBA"), Mortgage Bankers Association ("MBA") and Real Estate Services Providers Council, Inc. ("RESPRO") was sent to OFHEO asserting that "The Agreement Violates the Administrative Procedure Act". "The Agreement entered into by OFHEO is an agency statement of general applicability and future effect designed to implement, interpret, or prescribe law or policy. The fact that it takes the form of an 'agreement' does not change the need for the agency to conform to statutory requirements." "Because the adoption of the Agreement has grave procedural defects, is inconsistent with the interest of the housing market and other aspects of sound public policy, we urge

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[3] Letter: May 27, 2008 from the Office of the Comptroller of the Currency to Director of Office of Federal Housing Enterprise Oversight.

OFHEO to withdraw its assent to the Agreement, to not permit the GSEs to implement the Agreement, and take steps to assure that this type of rulemaking by settlement does not occur in the future."[4]

NAMB has withdrawn its lawsuit against the FHFA, without prejudice. NAMB invoked this strategic maneuver to assess means by which it can refute the FHFA's claim that no court may review their decisions while the GSEs are in conservatorship. NAMB believes the FHFA's claim that there are no legal limits on the arbitrary and unilateral use of their conservatorship power is unprecedented and will prove detrimental to consumers.

NAMB strongly opposes FHFA's position that it does not need to comply with the APA and other laws. NAMB continues to assess various means to challenge FHFA's extraordinary claim. Those options include filing suit again with revised and expanded arguments directed at FHFA's new claim. NAMB believes the findings of this closed investigation by the NY Attorney General of a financial institution and an AMC should be made public and placed into the record by holding hearings on this investigation. Specifically, who had knowledge of the faulty appraisals from an AMC and who had knowledge of these facts before mortgages associated with those appraisals were packaged into securities and sold to investors on Wall Street.

Nevertheless, NAMB remains supportive of legislative efforts to provide for appraisal independence standards like the ones included in H.R. 1728. Unlike the HVCC, these appraisal standards have already been, and continue to be vetted through the legislative process, are the subject of open and public debate, and will ultimately need the approval of a majority of the members of Congress before they may take effect.

(E) Imposition of Increased GSE Loan Fees

In 2007, the Government Sponsored Enterprises ("GSEs") announced that they would be imposing adverse market fee delivery charges on all loans the companies purchase. These charges are purportedly based on the overall credit risk of a loan (*i.e.,* consumer credit score, property demographic, LTV, etc.). In August 2008, the FHFA doubled the adverse market fee on all loans purchased by Fannie Mae and Freddie Mac. At a time when our housing market is being hit hardest and consumers are experiencing a severe credit crunch, efforts should be made to drive down mortgage costs for consumers, not increase them.

With the GSEs under federal government conservatorship since last September, what we are essentially seeing is the federal government charging these exorbitant fees to consumers, which are costing consumers thousands of dollars. To date, the FHFA has not provided any reasonable justification for charging such fees to consumers, nor has the FHFA explained the wide range of fees being charged based on consumers' credit scores. Moreover, it remains unclear as to where all the money being collected is going, how it is being used, and what happens if a consumer does not pose the risk the FHFA presumes to exist.

Now, consumers who want to take advantage of lower interest rates and tax credits being offered to first time homebuyers, as well as current homeowners who are facing adjustable-rate mortgage resets or want to take advantage of the same low rates to refinance and decrease their monthly payments (and lessen the

[4] Letter: April 30, 2008 from the American Bankers Association; American Financial Services Association; Consumer Bankers Association; Consumer Mortgage Coalition; Housing Policy Council, The Financial Services Roundtable; Independent Community Bankers of America; Mortgage Bankers Association; and Real Estate Services Providers Council, Inc. to Office of Federal Housing Enterprise Oversight.

likelihood of default), will find it harder or even impossible to get a mortgage, while those who are able to get a mortgage will be hit with even higher rates and fees.

These policies and practices imposed on consumers by the GSEs are not what our mortgage market needs in these turbulent times, and they fly in the face of so many other efforts to help consumers and facilitate an economic recovery. Congress should explicitly call for the reduction of adverse market fees for a defined period of time from enactment and require the GSEs to open up their credit decision engines (automated underwriting systems) to determine whether these increased fees are justified by being based on actual credit risk issues or whether they are being imposed to recover revenue losses from operations.

IV. Title I – Residential Mortgage Loan Origination Standards

NAMB shares this Committee's concerns about responsible lending and, in particular, the need to implement uniform minimum standards applicable to all residential mortgage loan originations. We applaud the uniform approach taken in H.R. 1728 and offer suggestions contained herein.

(A) Federal Duty of Care

Since 2002, NAMB has consistently advocated for more stringent standards for all mortgage originators to protect consumers and curb abusive lending practices throughout industry. We feel strongly that a federal standard of care should be imposed by statute and must be applicable to all originators if it is to have the desired effect. We support the all originator approach taken in H.R. 1728 and we believe the value of such an approach lies in the uniformity of treatment of all competitors in the mortgage industry.

The acts of originating, funding, selling, servicing, and securitizing loans today may all be conducted separately and independently, or may be engaged in collectively under one corporate structure or through affiliated business arrangements. This is why we believe it is important for consumer protections to relate to the function, as opposed to the structure of any entity.

The federal standard of care should properly apply whenever an individual is acting as a loan originator under the definition in the SAFE Act. In the end, consumers deserve the same level of protection regardless of who they choose to work with when obtaining a mortgage loan.

The duty of care in H.R. 1728 requires mortgage originators to include their unique identifier provided by the National Mortgage Licensing System ("NMLS") on all loan documents. While we support the disclosure of originators' NMLS identifier to consumers and the inclusion of the identifier in the consumer's loan documents, we fear that requiring that the identifier be placed on *all* loan documents is unnecessarily onerous and likely to produce a tremendous number of unintentional and mistaken violations of H.R. 1728. NAMB believes that the requirement to include a mortgage originator's unique identifier on consumer loan documents should be clarified and limited to specific documents in the consumer's loan package so that it produces its desired effect and benefit consumers.

(B) Complimentary & Non-Duplicative Disclosures

NAMB believes that consumers who understand the mortgage process are better able to make informed decisions about loan products, features, and pricing options. We also believe that improved and mandatory disclosures will help expose the activities of unscrupulous mortgage originators who try to shield themselves from detection by keeping consumers uninformed.

We appreciate the inclusion of language in H.R. 1728 that directs the federal banking agencies, in conjunction with the Federal Trade Commission ("FTC") and the Department of Housing & Urban

Development ("HUD"), to ensure that required consumer disclosures are complementary and non-duplicative with other disclosures. However, we encourage this Committee to further strengthen the disclosure provision in H.R. 1728 by requiring the aforementioned agencies to jointly develop and prescribe a Standard Universal Residential Mortgage Loan Disclosure form and Good Faith Estimate ("GFE") that supersedes the current GFE and any other current disclosures that would be duplicative if provided in conjunction with the new form.

NAMB believes that a universal residential mortgage loan disclosure form is critical to enhancing consumer understanding of the mortgage process, the role of the mortgage originator in that process, and the features of any loan products being considered by the consumer. We also believe it is imperative that any disclosure be comprehensively consumer-tested and proven effective before being introduced into the marketplace. Finally, we feel a truly uniform and universal disclosure must contain the same information regarding consumer settlement costs regardless of the mortgage originator making the disclosure.

The Standard Universal Residential Mortgage Loan Disclosure form and GFE we are advocating for today must contain the critical information that is most important to consumers without adding superfluous information that is likely to confuse consumers or distract them from the essential elements of the form. The critical information that must be provided on such a form should include: (1) the loan amount, (2) whether the loan is fixed or adjustable-rate, (3) the loan term, (4) the estimated interest rate, (5) the estimated monthly payment (6) the rate lock period, (7) the existence of a balloon payment, (8) the existence of a prepayment penalty, (9) the total estimated settlement charges, and (10) the total estimated cash required at closing.

We urge this committee to further strengthen the consumer protections in H.R. 1728 by expanding the disclosure provision in Title I, Section 102 to require the joint agency development of a new and comprehensive mortgage disclosure form to be used in all residential mortgage transactions.

(C) Prohibition on Steering Incentives

NAMB supports the intent of the language contained in Section 103 which prohibits all mortgage originators from persuading consumers into products based solely on compensation (*i.e.,* steering). The anti-steering provision in H.R. 1728, if interpreted by the regulators correctly, should be an effective means of protecting consumers from being placed into loans solely for reasons of higher compensation without completely prohibiting consumer choice.

We appreciate in particular the all originator approach taken in this section of the bill as it contemplates that consumers must be protected from steering regardless of which loan origination channel they use to purchase a loan as steering can take place throughout the entire process of the loan. We believe that it is important to prohibit loan originators from being incentivized to push specific loan products based solely upon the compensation they are likely to receive. We also strongly believe that any anti-steering provision will only be effective if its reach does not limit or remove financing choices from borrowers. We are hopeful that consumers will not be harmed by any unintended consequences of the anti-steering provision.

An area of concern under Title I, Section 103 of H.R. 1728 states that mortgage originators are prohibited from steering consumers from a "qualified mortgage," as defined in Title II, Section 203 of H.R. 1728, to any loan that is not classified as a "qualified mortgage." Under that definition, any loan other than a 30-year fixed rate loan would not be classified as a "qualified mortgage", and as such, the "steering" provision could be interpreted to mean that a consumer who qualifies for a 30-year fixed rate loan is prohibited from choosing any other product option that is not deemed a "qualified mortgage," regardless of the consumer's goals, circumstances and most importantly, their choice.

We do not believe it is the intention to legislatively restrict consumer choice or direct qualified borrowers into particular loan products or programs that may or may not meet their individual financial needs or objectives. Therefore, we believe the prohibition on steering in Section 103 could be further clarified in order to help preserve and protect consumer choice with regard to loan product options for qualified borrowers.

We also believe that the discretionary regulatory authority of the federal banking agencies must be used cautiously when crafting rules to address troublesome and abusive mortgage terms and practices that may arise in the future so they do not unintentionally restrict the market and expose consumers to greater risk of being arbitrarily rejected for credit or restrict an informed consumer from being able to choose a loan product that fits his/her needs.

V. Title II – Minimum Standards for Mortgages

NAMB believes it is important for creditors and underwriters to make a reasonable assessment of a borrower's ability to repay a mortgage loan at the time such loan is consummated, and we are generally supportive of the ability to repay and net tangible benefit requirements in H.R. 1728. We also support the additional standards and requirements set forth in Title II, Section 206 that prohibit certain prepayment penalties and single-premium credit insurance, and require creditors who offer loan products with prepayment penalties to also offer consumers an option that does not include a prepayment penalty.

NAMB supports the overall intent of Section 206 (l) with regard to tenant protections in the event of foreclosure with the exception of subsection (1)(A) whereby it permits the tenant to occupy the premises "until the remaining term of the lease" without any reasonable limitation on the "remaining term". For example, a borrower (upon notice of intent to foreclose) could sign a lease for a protracted period of time that could effectively sabotage the foreclosure process. In such a case, prospective buyers would be discouraged from purchasing the foreclosed property.

NAMB supports the proposed provisions of Section 216 relating to legal assistance for foreclosure-related issues.

Strong objective parameters must be established when the regulators issue rules to implement this Title, because consumers cannot and will not be served by any standard that allows for a wide range of subjectivity on the part of creditors.

(A) *Safe Harbor & Rebuttable Presumption*

Under Title II, Section 203 of H.R. 1728, a "qualified mortgage" is defined as a loan that, among other things, has an annual-percentage rate ("APR") – for 1st liens – that does not exceed the Average Prime Offer Rate by 1.5 or more percentage points, *and* is a 30 year fixed rate loan. When read in conjunction with the anti-steering provision in Title I, Section 103, this definition poses a potentially significant problem for both consumers and mortgage originators. If a borrower qualifies for a loan that is deemed a "qualified mortgage" under this definition, then Title I, Section 103 would seem to prohibit that borrower from being able to choose another product that is not deemed to be a "qualified mortgage" (*i.e.*, essentially any variable-rate mortgage).

As a result, we believe that the word "and" at the end of Title II, Section 203(c)(2)(A)(iv) should be changed to "or," thus defining "qualified mortgage as any loan meeting the parameters set forth in Section 203(c)(A)(i – iv), or any 30 year fixed-rate loan. In the absence of such a change, everything other than a 30 year fixed-rate mortgage loan will be deemed to be "non-qualified."

(B) Creditor & Assignee Liability

Title II, Section 204 of H.R. 1728 significantly expands creditors' liability and enhances a number of consumer rights with regard to violations of this Act. This section imposes liability on assignees with regard to the ability to repay and net tangible benefit requirements of the Act. Although a safe harbor exists for "qualified mortgages," we are concerned about the effect that this assignee liability may have on the market's recovery. Because the threshold is so low – 1.5% – and captures many jumbo, FHA and GSE mortgages, it seems fair to presume that most investors will only buy "qualified mortgages" in order to take advantage of the safe harbor and limit their liability, thus further diminishing property values and shutting many qualified buyers out of the market.

Additionally, because of the expansive definition of the term "residential mortgage loan" in Title I of H.R. 1728, there is a significant increase in a creditor's exposure to liability for rescission under this legislation. Virtually every consumer credit transaction secured by residential real property is captured in the definition of a residential mortgage loan. NAMB is concerned about the effect on the affordability of consumer credit if TILA is expanded to allow non-owner occupiers to exercise a right of rescission against creditors. We believe the definition of residential mortgage loan in H.R. 1728 requires clarification to reduce the potential unintended consequences that could result from expanded creditor and assignee liability.

(C) Credit Risk Retention

Section 213 of Title II requires the federal banking agencies to promulgate regulations requiring creditors to retain an economic interest in a material portion – 5% – of the credit risk for loans the creditor transfers, sells, or conveys to a third party. The 5% credit risk retention only applies to loans other than qualified loans so it is somewhat limited in its application. We are supportive of the concept of credit risk retention by the creditor but have some concerns with 5% risk retention number. While the idea of creditors retaining a financial interest in the credit risk presented by a loan seems initially appealing, in practice such a requirement should weigh other alternatives that protect all investor participants and provide for some flexibility.

The federal banking agencies are in a position to create systemic risk rules that would accomplish these goals without hard-wiring risk retention rules in statute.

VI. Title III – High-Cost Mortgages

While NAMB is largely supportive of the provision in Title I and II of H.R. 1728, particularly the all-originator approach taken throughout the bill, we remain extremely concerned that specific provisions in Title III will further harm many consumers who are currently in the most need of available and affordable credit. Respectfully, NAMB supports significant changes to Title III or its removal in its entirety.

Last year, the Federal Reserve Board promulgated new rules amending Regulation Z, which implements both TILA and the Home Ownership and Equity Protection Act ("HOEPA"). These rules were designed to protect consumers in the mortgage market from unfair, abusive, or deceptive lending and servicing practices while preserving responsible lending and promoting sustainable homeownership.

NAMB strongly supports the Federal Reserve Board's 2008 TILA and HOEPA amendments. We believe they represent a clear victory for consumers and a definitive step toward increased professionalism and accountability in the mortgage lending industry. Moreover, we feel that these rules adequately address many of issues dealt with in Title III of H.R. 1728.

These Federal Reserve Board rules apply new consumer protections to a class of mortgages defined as "higher-priced mortgage loans." "Higher-priced mortgage loans" are specifically defined as any first-lien mortgages that have an annual percentage rate of 1.5 percentage points or more above the "average prime offer rate" index established by the Federal Reserve Board (or 3.5 percentage points above for subordinate-lien mortgages). This definition is designed to capture virtually all loans in the subprime market, but generally exclude loans originated in the prime market. The Federal Reserve Board will publish the "average prime offer rate," index based on a survey currently published by Freddie Mac.

The HOEPA Rules apply four specific consumer protections to the category of "higher-priced mortgage loans."

(1) Lenders are prohibited from making a loan without regard to the borrower's ability to repay the loan from income and assets other than the home's value.

(2) Creditors are required to verify the income and assets they rely upon to determine repayment ability.

(3) Prepayment penalties are banned if the loan payment can change in the first four years of the loan. For other higher-priced loans, prepayment penalty periods cannot extend beyond two years.

(4) Creditors are required to establish escrow accounts for property taxes and homeowner's insurance for all first-lien mortgage loans.

Even more important than the specific content of these rules is the fact that the new rules apply to all mortgage lenders, not just those supervised and examined by the Federal Reserve. In addition to offering broader protection for consumers, this uniform set of rules serves to level the playing field for industry participants and increase competition in the mortgage market, to the ultimate benefit of consumers.

NAMB strongly supports diligently reviewing and analyzing consumer protection efforts to ensure borrowers are being afforded the highest levels of protection. However, given the current state of our mortgage market, we feel it is imperative that the market be given an opportunity to adjust to the changes already effected by the Federal Reserve Board's TILA and HOEPA Rules, which are set to take effect October 1, 2009.

The Federal Reserve Board carefully considered information obtained from testimony, public hearings, consumer testing, and over 4,500 comment letters before promulgating its final rule. We believe the amendments to TILA and HOEPA are positive and are significant regulatory changes that will ultimately yield benefits to consumers and strengthen and stabilize the mortgage industry.

VII. Title VI – Appraisal Activities

Title VI of H.R. 1728 establishes certain property appraisal requirements designed to improve appraisal quality and promote appraiser independence. NAMB has long-supported policy initiatives that seek to ban coercion of appraisers, and NAMB is very supportive of the appraisal reforms contained in H.R. 1728. However, in light of the 2008 FHFA agreement with the New York Attorney General's Office, Fannie Mae and Freddie Mac, we believe H.R. 1728 needs to be amended to specifically address the numerous deficiencies that exist in the FHFA rule that is the product of this agreement – namely, the Home Valuation Code of Conduct ("HVCC").

The HVCC is a *de facto* rule promulgated by the FHFA and the New York Attorney General's Office, which attempts to regulate the entire residential mortgage lending and home appraisal industry nationwide. This rule is set to take effect May 1, 2009, and it overwhelmingly favors Appraisal Management Companies ("AMC") and lenders of which an investigation thereof caused the creation of the HVCC. Despite being the product of an investigation into appraisal fraud at a lending institution and an AMC, the HVCC specifically targets mortgage brokers and independent appraisers, and forces consumers to rely exclusively on lenders and their AMCs for home appraisals.

In direct contravention to the all-originator approach to regulation taken in H.R. 1728, the HVCC prohibits mortgage brokers from ordering appraisals, but imposes no similar restrictions on lenders, their employees, or their affiliates. This prohibition on broker-ordered appraisals means that mortgage brokers will no longer be able to submit complete loan application packages to lenders, which effectively precludes mortgage brokers from providing their customers with an efficient and cost-effective means of obtaining a mortgage. It also limits the portability of an appraisal thereby increasing the cost every time a consumer or broker works with a new lender.

NAMB believes that there should be increased standards for all mortgage originators when working with appraisers, and that no person or entity should be permitted to coerce or otherwise unduly influence an appraiser to provide a misstated valuation.

Appraisal independence is essential to protecting consumers from fraud and from unscrupulous actors in the real estate, home mortgage, and appraisal industries. To that end, NAMB strongly supports Title VI of H.R. 1728. At the same time, NAMB respectfully urges this Committee to amend the bill and direct the FHFA to either withdraw the HVCC or prohibit its implementation for 12 months in order to ensure that the rule complies with the Administrative Procedures Act process.

In addition, as stated earlier, the Board of Governors of the Federal Reserve System (FRB) on July 14, 2008, amended Regulation Z of the Truth in Lending Act (TILA) adopted under the Home Ownership and Equity Protection Act (HOEPA) which prohibits all mortgage brokers, mortgage lenders and their affiliates "from coercing, influencing or otherwise encouraging appraisers to misstate or misrepresent the value of a consumer's principal dwelling." The implementation of this Rule, which NAMB fully supports, will take place this October. This Rule, which went through the Administrative Procedures Act and the Regulatory Flexibility Act, provides uniformity and protection to consumers regardless of where they get their appraisal.

NAMB would also like to take this opportunity to commend and note our appreciation for the efforts of Representatives Kanjorski and Biggert in continuing to work towards reforming and strengthening the oversight of our appraisal system. We look forward to continuing to work closely with members of this Committee, as well as others in the House and Senate, to improve all aspects of our residential mortgage and home valuation processes.

VIII. Conclusion

NAMB greatly appreciates this opportunity to discuss H.R. 1728, the Mortgage Reform & Anti-Predatory Lending Act. Everyday our members live and go to work in their communities alongside consumers who continually express their desire to simply obtain a mortgage they can afford and will be able to keep.

We strongly believe that consumers need and deserve equal protection no matter where or with whom they choose to get their mortgage. Therefore, NAMB is extremely supportive of many of the overall concepts embodied in H.R. 1728 (with exception to Title III).

NAMB looks forward to continuing to work with this Committee to enhance consumer protection and elevate the standards and professionalism of our industry, while maintaining the availability of affordable credit and preserving a competitive environment for small business owners across the country.

Thank you again for this opportunity to appear before the Committee today and discuss this critical piece of legislation.

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TESTIMONY OF

CHARLES McMILLAN, CIPS, GRI

2009 PRESIDENT OF THE

NATIONAL ASSOCIATION OF REALTORS®

BEFORE THE

U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES

HEARING REGARDING

"H.R. 1728: THE MORTGAGE REFORM AND ANTI-PREDATORY LENDING ACT OF 2009"

APRIL 23, 2009

Introduction

Chairman Frank, Ranking Member Bachus, and Members of the Committee, thank you for inviting me to testify today regarding H.R. 1728: the "Mortgage Reform and Anti-Predatory Lending Act of 2009."

My name is Charles McMillan, and I am the 2009 President of the National Association of REALTORS® (NAR). I have been a REALTOR® for more than 20 years, and am Director of Realty Relations and Broker of Record for Coldwell Banker Residential Brokerage, Dallas-Fort Worth. Along with being a REALTOR®, I have been active in my community, serving as past chairman of the Community Development Council of Fort Worth, the Tarrant County Affordable Housing Task Force, the Housing Subcommittee of Fort Worth, and a past director of the United Way of Tarrant County and of the Fort Worth Chamber of Commerce.

I am here to testify on behalf of more than 1.2 million REALTORS® who are involved in residential and commercial real estate as brokers, sales people, property managers, appraisers, counselors, and others engaged in all aspects of the real estate industry. Members belong to one or more of some 1,400 local associations/boards and 54 state and territory associations of REALTORS®.

We thank the House Financial Services Committee for holding this hearing on an issue that is paramount to restoring confidence in the U.S. housing market.

REALTORS® Support Mortgage Lending Reform

At its core, H.R. 1728, the "Mortgage Reform and Anti-Predatory Lending Act of 2009", exhibits the principals that REALTORS® across the nation believe are required to restore consumer confidence in the housing industry. Historically low mortgage interest rates and a significant tax credit for first-time homebuyers have begun to entice consumers to get back into the housing market; however, wholesale reform of the mortgage lending sector to give consumers the protections they need, will, we believe, remove the last impediment preventing a housing recovery.

Congress' efforts to reform mortgage lending are paramount not only to the housing recovery, but to the recovery of the national economy. As I, and many of my REALTOR® colleagues, have mentioned in prior testimony to this and other Congressional committees, housing has always led our economy out of downturns, and it will again -- once the appropriate measures are put in place to prevent recurrence of the past irresponsible and abusive lending practices, which are largely responsible for causing the problems we are experiencing today.

However, as Congress moves towards putting these protections in place, REALTORS® respectfully remind you that an appropriate balance must be struck between safeguarding the consumer and making sure consumers have access to mortgages at a reasonable cost. Undue regulation of the mortgage market that makes the sector unattractive for business participants will be as harmful to the consumer as the lack of regulation that allowed for the level of irresponsibility and abuse we have just experienced.

Items Requiring Additional Clarification for REALTORS®

REALTORS® believe that the intention of H.R. 1728 is properly focused; however, there are some areas that must be addressed or they may yield unintended consequences for real estate professionals and the housing consumers.

Section 101 (5): Definition of Mortgage Originator

NAR is concerned by the broad definition of mortgage originator as detailed in section 101of the bill. According to the bill's definition, mortgage originator includes "any person who—...(iii) assists a consumer in obtaining or applying to obtain a residential mortgage loan." This assistance is defined to include "advising on residential mortgage loan terms (including rates, fees, and other costs), preparing residential loan packages, or collecting information on behalf of the consumer with regard to a residential mortgage loan".

In their daily business activity, REALTORS® prepare consumers for the mortgage origination process by giving them insight into the information that they will likely need in order to apply for a mortgage. Moreover, they may discuss with the consumer prevailing rates that they see in the market place, or products that past clients may have utilized. Finally, some REALTORS® may recommend a number of loan officers for the consumer to contact so that they may begin the mortgage origination process in earnest.

By virtue of our members providing this normal level of service to the housing consumer, they would become subject to the requirements set forth in H.R. 1728 although they do not originate mortgages. For this reason, we respectfully request that language be considered to explicitly exclude real estate professionals from this definition when they provide advice and counsel to their clients as part of their normal real estate activities."

In addition, NAR has concerns about the impact of mortgage reform legislation on those sellers who provide direct financing to consumers. Especially in a housing downturn, seller-financing becomes more popular. In some cases, the only way a property owner can sell his home, or small business property is by providing the financing directly. Legislation that requires individuals who provide financing for a single transaction to register or meet licensing requirements certainly seems beyond the intent of Congress. We would hope the Committee would consider an exception for seller-financing, so owners who need to sell their properties don't have to meet burdensome requirements intended for lending institutions or mortgage brokers.

Section 202: Net Tangible Benefit for Refinancing of Residential Mortgage Loans

NAR supports an anti-mortgage-flipping rule requiring mortgage originators making or arranging for a loan that refinances an existing residential mortgage to verify that the new loan provides a significant benefit to the borrower (one test often proposed, and that is included in H.R. 1728, is that the loan must provide a "reasonable net tangible benefit" to the borrower). REALTORS® support requiring the lender to consider the circumstances of the borrower, all terms of the new loan including taxes and insurance, the fees and other costs of refinancing, prepayment penalties, and the new interest rate compared to that of the refinanced loan.

Section 203: Safe Harbor and Rebuttable Presumption

NAR supports strong underwriting standards that require all mortgage originators to verify the borrower's ability to repay the loan based on all its terms, including taxes and insurance. REALTORS® believe that lenders should consider all relevant facts, including the borrower's income, credit history, future income potential, and other life circumstances.

Although we appreciate the intention of section 203: Safe Harbor and Rebuttable Presumption, NAR believes that the safe harbor criteria are too narrow in scope, and the ability of rescission of the loan by the consumer is potentially extremely broad. It is our recommendation that the rebuttable presumption be strengthened to offer more protection to the mortgage originator, as well as expand the safe harbor to encompass more than just 30-year fixed rate mortgages. Should neither be done, the legislation risks encouraging sound lenders to leave the marketplace, as well as forcing the remaining lenders to reduce their product offerings (i.e. shelve their 25-, 20-, and 15-year fixed rate products, and their traditional 5/1 and 7/1 ARMs). Both actions would prove detrimental to consumers and the housing market.

Section 213: Credit Risk Retention

Over the last several months, many involved in the mortgage reform debate have discussed the need for additional "skin" to be in the game to make loans safer for both consumers and creditors. Section 213 attempts to accomplish this by requiring that lenders originating loans, other than loans that qualify for the safe harbor, retain a portion of the risk on their books so that they have incentive to underwrite carefully to ensure that the product will perform. REALTORS® are generally supportive of providing incentives that result in safer lending.

However, REALTORS® do caution that in this instance, the credit risk retention requirement could be detrimental to the consumer if products that are not covered by the safe harbor (i.e. 15- to 25-year fixed rate mortgages) are no longer offered, thus substantially reducing the amount of mortgage capital available to consumers. REALTORS® are not bankers; therefore, we cannot determine the amount of risk that lenders should hold for "risky" lending products. But we do have a strong interest in what is considered a "risky" lending product. And, as mentioned in our suggestions on expanding products that should be included in the safe harbor provision, 30-year fixed rate mortgages are not the only mortgage products that should be included in the safe harbor.

Title V: Mortgage Services - Escrow or Impound Accounts and Assignee Liability

NAR supports regulations that require lenders that make subprime mortgage loans to generally require that the monthly payment include an amount to be held by the mortgage servicer in an escrow account for the payment of the borrower's periodic payments, such as taxes, insurance, and homeowner/condo fees. However, REALTORS® believe that similar to the exception for prime loans in some jurisdictions, borrowers that make at least a 20 percent down payment should have the option to budget for these payments independently.

Title VI: Appraisal Activities

Finally, NAR believes a strong and independent appraisal industry is vital to restoring faith in the mortgage origination process. The "Mortgage Reform and Anti-Predatory Lending Act of 2008" is an attempt to prohibit undue influence on home appraisers. H.R. 1728 strikes an appropriate balance by strengthening the accountability and oversight of appraisers while also creating new consumer protections. Recent studies indicated that up to 90 percent of appraisers have been asked to hit a targeted value, while 70 percent of appraisers feared that if they did not meet that target, their business would be harmed. This bill strengthens the independence of the appraisal process by ensuring appraisers serve as an unbiased arbiter of a property's value for the buyer, seller, lender, investor and other market participants.

NAR's Responsible Lending Policy recommends the following measures to strengthen the appraisal process:

- Require lenders to inform each borrower of the method used to value the property in connection with the mortgage application, and give the borrower the right to receive a copy of each appraisal.

- Establish enhanced penalties against those who improperly influence the appraisal process. Those with an interest in the outcome of an appraisal should only request the appraiser to (1) consider additional information about the property; (2) provide further detail, substantiation, or explanation for the appraisal; and (3) correct errors.

- Provide federal assistance to states to strengthen regulatory and enforcement activities related to appraisals.

- Support enhanced education and qualifications for appraisers.

H.R. 1728 addresses some of these concerns in Title VI, Appraisal Activities. We are pleased the legislation requires lenders to inform the borrower of the method used to value the property by requiring a written appraisal of any property where credit is extended in the form of a mortgage and creditors are required to provide a free copy of the appraisal to the borrower. The legislation also includes fines and penalties for those who willfully fail to obtain an appraisal as required and for those who attempt to influence appraiser independence.

Conclusion

NAR applauds the Committee's effort to craft comprehensive legislation to reform mortgage lending. This bill is a major step in the right direction; however, we strongly recommend some adjustments to ensure that the legislation exempts real estate professionals who are not acting as lenders, and does not harm consumers by unintentionally removing some traditional and prudent mortgage products (i.e. 15- to 25-year fixed rate mortgages and standard 5/1 and 7/1 adjustable rate mortgages) from the market place.

REALTORS® help families achieve the dream of homeownership. The National Association of REALTORS® supports lending reform that protects the consumer but ensures them reasonable access to mortgage capital so that they may attain the American Dream – homeownership.

I thank you for this opportunity to present our thoughts on H.R. 1728 reform. The National Association of REALTORS® is at the call of Congress, and our industry partners, to reform the mortgage market and help facilitate a housing recovery.

ICBA
INDEPENDENT COMMUNITY
BANKERS of AMERICA

Testimony of
R. Michael S. Menzies, Sr.
President and CEO, Easton Bank and Trust Company

On behalf of the
Independent Community Bankers of America

Before the

Congress of the United States
House of Representatives
Committee on Financial Services

Hearing on

"H.R. 1728, the Mortgage Reform and Anti-Predatory Lending Act of 2009"

April 23, 2009
Washington, DC

Chairman Frank, Ranking Member Bachus, Members of the Committee, my name is Michael Menzies, and I am the President and CEO of Easton Bank and Trust Company, Easton, MD, and the Chairman of the Independent Community Bankers of America[1]. Easton Bank is a state-chartered community bank with $150 million in assets. I am pleased to represent community bankers and ICBA's 5,000 members at this important hearing on "H.R. 1728, the Mortgage Reform and Anti-Predatory Lending Act of 2009."

Introduction

Community banks are strong, commonsense lenders that largely did not engage in the practices that led to the current crisis. As a result of this commonsense approach to banking, the community banking industry, in general, is well-capitalized and has fewer problem assets than other segments of the financial services industry.

That is not to suggest community banks are unaffected by the recent financial collapse. Indeed, the squeeze on interbank lending has raised liquidity issues in some areas, the collapse in the value of the preferred stock of government-sponsored enterprises Fannie Mae and Freddie Mac under the Treasury/Federal Housing Finance Agency conservatorship has affected the bottom lines of some community banks, and the general decline in the economy has caused many consumers to tighten their belts and reduce their demand for credit. And, many bank examiners are overreacting, sending a message that contradicts recommendations from Washington to banks that they maintain and increase lending. That is why it is essential that the government continue its efforts to stabilize the financial sector.

And, just as important, Congress, regulators and the financial services industry working together must put in place strong measures to prevent a reoccurrence of the current crisis. Imprudent and predatory lending practices in the subprime mortgage market instigated the current financial crisis. It is appropriate that Congress consider legislation to improve regulation of residential mortgage lending. Community banks are truly invested in long-term relationships with their customers and their communities. Community banks put consumers into mortgages they can repay. We do not want our customers to default because it

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[1] *The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.*

With nearly 5,000 members, representing more than 18,000 locations nationwide and employing over 268,000 Americans, ICBA members hold more than $1 trillion in assets, $800 billion in deposits, and more than $700 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

is not only bad for the bank and the customer, it also has a negative impact on the community. If all mortgage lenders had used the common-sense lending practices of community banks, we would not be here today to discuss mortgage reform legislation.

Principles for Mortgage Reform

While we have concerns with some of the approaches to reform taken in, H.R. 1728, which we discuss later in the testimony, we commend Chairman Frank and Representatives Watt and Miller for initiating the process of achieving needed reform and for their work on comprehensive mortgage reform legislation. Before addressing the specific provisions of H.R. 1728, we would like to set forth some principles that we believe should be observed in reforming mortgage regulation.

- Maintain Community Banks' Role

Community banks continue to play an important role in our mortgage finance system. Community bank mortgage originations have remained steady throughout 2008. We estimate community banks have originated approximately 800,000 mortgage loans for an aggregate principal amount of approximately $125 billion for 2008. Reform should not inadvertently diminish the ability of community banks to participate in the mortgage finance market.

- Concentrate on Problem Lenders

Congress and the regulators should concentrate their efforts on those parts of the market that overextended and overheated mortgage lending, particularly the less regulated mortgage brokers and non-bank mortgage lenders, and should avoid unnecessary additional regulation of community banks that did not engage in the abusive subprime lending practices at the heart of the current crisis.

- Maintain Flexibility for Homebuyers

Policymakers should also avoid hindering the flexibility community banks use to meet consumers' needs at different stages in their lives and in changing interest rate and lending environments. A flexible, yet sensible, mortgage finance system serves the best interest of consumers in the long run.

Summary of Comments and Recommendations

<u>New Standards under TILA</u>

- Community banks base their credit decisions on a customer's documented ability to pay, and they do not engage in robbing their customers of equity in pursuit of fees. Nevertheless, the new lending standards as articulated in the bill, along with the cause of action to enforce the new standards, raise concerns for community banks.
- H.R. 1728 creates more litigation risk than the bill adopted by the House in the last Congress, H.R. 3915, by providing no clear presumption of compliance for any mortgage product. We suggest that the legislation

provide more certainty by adopting a clear presumption of compliance for mortgages meeting interest rate caps.

- Moreover, whether it is a clear presumption of compliance or the rebuttable presumption provided in H.R. 1728, the presumption should apply to a broader range of safe mortgage products that are beneficial to consumers, not just 30-year fixed rate mortgages.

- Without a more certain safe harbor covering a broader range of safe mortgage products, the legislation would instill in the mortgage finance system a rigidity that prevents lenders from responding to changing lending environments and local markets.

Anti Steering Provisions

- It is appropriate for Congress to consider legislation to prevent a mortgage originator from steering a consumer to a subprime product, when the consumer qualifies for a prime loan, or promoting a mortgage product with predatory characteristics. Unless the regulation of non-bank originators – the main perpetrators of this practice - is significantly strengthened, new mortgage origination regulations will not be focused on the part of the industry where regulation is most needed.

- Paying points to adjust the interest rate on a mortgage provides a tremendous benefit to consumers. The legislation should not restrict a consumers' ability to vary his or her interest rate by paying points. We suggest that the legislation clearly exempt this standard practice from the bill's originator compensation restrictions.

Risk Retention Requirement

- If the secondary market had required that all market participants have some skin in the game, the current crisis would not be as severe. We need to be careful, however, that we address the problems that created the subprime crisis without unnecessarily burdening mortgage credit.

Changes to HOEPA

- We are concerned the proposed trigger based on fees could capture some low-dollar prime mortgages. The concern is that fixed-cost items, like credit reports and appraisals, could put prime mortgages with small dollar principals above the threshold. We suggest the Federal Reserve be given discretion to exempt fixed-cost items from the definition of fees with respect to smaller loans.

New TILA Standards Applicable to All Residential Mortgages
H.R. 1728 would amend the Truth-In-Lending Act (TILA) to create two new standards applicable to all residential mortgages. The first would require the creditor to make a reasonable and good faith determination that the consumer, at the time the loan was made, had a reasonable ability to repay the loan, taxes and assessments. The determination would have to be made on verified, documented information. The second would require a creditor to make a reasonable good faith determination that a refinanced mortgage provides a net tangible benefit to the consumer. The legislation would leave to the Federal banking agencies the responsibility of defining "net tangible benefit," but would provide that no net tangible benefit is provided by a loan where the costs associated with the loan exceed the amount of any newly advanced principal without any other changes that are advantageous to the consumer.

The legislation would provide a new cause of action for rescission and costs against a lender, assignee and securitizer for violations of the new standards. Lenders would also be liable for attorneys' fees. A consumer would have three years from the date of consummation of a fixed-rate mortgage to bring an action. For an adjustable rate mortgage, the statute of limitations is the earlier of one year after the reset or six years from the date of consummation. A claim under the new provisions could be asserted as a defense to foreclosure during the statute of limitations period, and even after the statute of limitation period expired, a consumer could bring an action for damages, cost and attorneys' fees in defense of a foreclosure.

A lender, assignee or securitizer could avoid liability under the new provisions by providing a cure to the violation. The legislation would define cure for a violation of the ability to repay or net tangible benefit requirements as a modification or refinancing of the loan at no cost to the consumer on terms that would have satisfied the ability to repay and net tangible benefit requirements, plus additional costs of the borrower and a reasonable attorney's fee.

The legislation would permit a creditor and any assignee or securitizer of a residential mortgage loan to presume that the loan has met the ability to repay and net tangible benefit requirements if the loan is a "qualified mortgage." However, presumption is rebuttable.

The bill would define "qualified mortgage" as a mortgage:

1. that meets the bill's interest rate restrictions: any first lien residential mortgage must have a rate that does not exceed the "average prime offer rate" (to be published by the Federal Reserve) by 1.5 or more percentage points and any subordinate lien residential mortgage must have a rate that does not exceed 3.5 or more percentage points;
2. for which the income and financial resources of the consumer are verified and documented;

3. for which the underwriting is based on the fully-indexed rate, and takes into account all applicable taxes, insurance and assessments;
4. that does not cause the consumer's monthly debt to exceed a percentage of gross monthly income or other percentage of such income as may be prescribed;
5. for which the term of the loan is fixed for a period of not less than or more than 30 years.

New Cause of Action Raises Concerns

Most community banks are very conservative in their underwriting practices, and a consumer's documented ability to pay is a central part of underwriting their loan. Moreover, community banks do not engage in robbing their customers of home equity in the pursuit of fees on mortgages that do not benefit the customers. Nevertheless, the new lending standards articulated in the bill, along with the cause of action provided to enforce the new standards, raise concerns for community banks. We address these concerns in the sections that follow, along with suggestions to address these concerns in some cases.

The Safe Harbor Should Provide More Certainty and Cover a Broad Range of Safe Mortgage Products

H.R. 1728 creates more litigation risk than the bill adopted by the House in the last Congress, H.R. 3915, by providing no clear presumption of compliance for any mortgage product. As a result, every mortgage product, even the ones that meet the stringent standards of "qualified mortgage" under the bill, carries with it litigation risk that it does not have today. Moreover, because a consumer would always have a claim for damages as a defense to a foreclosure action, the litigation risk never goes away. While it is hard to say what the premium associated with the additional litigation risk would be, the risk would affect the pricing of all residential mortgages. We suggest that the legislation provide more certainty by adopting a clear presumption of compliance for mortgages meeting interest rate caps.

Moreover, whether it is a clear presumption of compliance or the rebuttable presumption provided in H.R. 1728, the presumption should apply to a broader range of safe mortgage products that are beneficial to consumers, not just 30-year fixed rate mortgages. The underlying premise of H.R. 1728 is that only 30-year fixed rate mortgages are beneficial for consumers. Currently, there is a very favorable interest rate environment for 30-year fixed rate loans, but that will not always be the case. Adjustable rate mortgages have benefited millions of consumers in times when long-term interest rates were significantly higher than short-term rates.

Additionally, consumers in many rural areas and small towns need alternatives to 30-year fixed rate products. In those rural areas, the secondary market for 30-year fixed rate mortgages may be very weak or non-existent because the loans from these areas cannot meet secondary market requirements, such as collateral valuation requirements based on comparable properties or because the amount of the loans are relatively small. Often first-time homebuyers will need a parent's guarantee to qualify for a mortgage. Such loans do not meet secondary market standards. Community banks making loans to these consumers must hold the loans in portfolio. In order to make these loans in a safe and sound and economically feasible manner, the community bank has to fund the loans from short-term deposits. As a result, the community bank cannot offer a 30-year fixed rate product under these circumstances.

Without a more certain safe harbor covering a broader range of safe mortgage products, the legislation would instill in the mortgage finance system a rigidity that prevents lenders from responding to changing lending environments and local markets and to customer needs. We strongly urge the Committee to remove the 30-year fixed rate requirement from the "qualified mortgage" definition and to make other changes that preserve the choices enjoyed by consumers today, particularly rural consumers.

Anti-Steering Provisions

It is appropriate for Congress to consider legislation to prevent a mortgage originator from steering a consumer to a subprime product, when the consumer qualifies for a prime loan, or promoting a mortgage product with predatory characteristics. As a general matter, community banks do not steer customers to inappropriate predatory products. However, community banks are concerned that any new origination requirements will not be enforced evenly across the mortgage finance industry.

The regulatory regime for non-bank originators is not nearly as rigorous as the one that regulates banks. Non-bank originators are not subject to onsite compliance examinations. The new SAFE Act's licensing requirements for mortgage brokers are minimal and easily met. The predatory steering practices of non-bank originators were a principal cause of the subprime mortgage crisis. Unless the regulation of non-bank originators is significantly strengthened, new mortgage origination regulations will not be focused on the part of the industry where regulation is most needed. Instead, new requirements will add to the regulatory burden of community banks, which did not engage in these steering practices, without any significant benefit to consumers.

Section 103 of the legislation provides that the amount of direct and indirect compensation permitted to a mortgage originator may not vary based on the terms of the loan (other than the amount of the principal). Under the definition of mortgage originator, the term includes a bank originating a loan, both those held in portfolio or sold to the secondary market. We are concerned that Section 103's restriction on compensation would prevent a bank from offering a consumer the opportunity to lower the interest rate on their mortgage through the payment of points. Paying points to adjust the interest rate on a mortgage provides a tremendous benefit to consumers. The legislation should not restrict a consumer's ability to vary his or her interest rate by paying points. We suggest that the legislation clearly exempt this standard practice from these compensations restrictions.

Risk Retention Requirement

The bill would require the Federal banking agencies to jointly prescribe rules to require any creditor making a non-qualified mortgage to retain an economic interest in a material portion (at least five percent) of the credit risk for each such loan the creditor transfers, sells or conveys. If the secondary market had required that all market participants have some skin in the game, the current crisis would not be as severe. We need to be careful, however, that we address the problems that created the subprime crisis without unnecessarily burdening mortgage credit.

While the accounting treatment of the proposal is not entirely clear, it is clear that an originator will have to hold capital against its retained interest for the life of the loan. Over time, the retention requirement will limit an institution's capacity to originate loans. The impact would be greatest on banks that are heavy users of the secondary market for ARMs and other non-qualified mortgages.

Changes to HOEPA

The legislation would lower the triggers that define "high-cost mortgage" under Home Ownership Equity Protection Act (HOEPA). We are concerned the proposed trigger based on fees could capture some low-dollar prime_mortgages. The concern is that fixed-cost items, like credit reports and appraisals, could put prime mortgages with small dollar principals above the threshold. We suggest the Federal Reserve be given discretion to exempt fixed-cost items from the definition of fees with respect to smaller loans.

Conclusion

Thank you for this opportunity to testify. We look forward to working with the Congress to create a regulatory regime that prevents abusive mortgages, while providing the mortgage finance industry flexibility to meet consumers' needs. I would be happy to answer the Committee's questions.

American Securitization Forum

SIFMA
Securities Industry and Financial Markets Association

TESTIMONY OF

T. TIMOTHY RYAN, JR.
PRESIDENT AND CEO
SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

HEARING ON

H.R. 1728, THE MORTGAGE REFORM AND ANTI-PREDATORY LENDING ACT OF 2009

APRIL 23, 2009

Chairman Frank, Ranking Member Bachus, thank you for permitting me to testify here today on behalf of the Securities Industry Financial Markets Association[1] and the American Securitization Forum[2] regarding mortgage finance reform and in particular certain mortgage origination practices that contributed to the housing crisis affecting the nation today. We are pleased to have worked on this issue constructively with the Committee as it moved toward passage of H.R. 3915, the "Mortgage Reform and Anti-Predatory Lending Act of 2007" last Congress. We appreciate the opportunity to highlight the key considerations that have guided our involvement and identify our concerns about the provisions contained in H.R. 1728, the "Mortgage Reform and Anti-Predatory Lending Act of 2009."

We believe the 2007 bill struck a reasonable balance and are encouraged that the Committee used that bill as a starting point for H.R. 1728. We also understand that the mortgage market is vastly different than it was in the fall of 2007. The housing GSEs have been placed into government conservatorship, a number of major mortgage market participants have gone out of business and the government has taken unprecedented steps to stabilize the financial system, minimize foreclosures and encourage mortgage lending. Given these developments, and the lack of an existing securitization and subprime mortgage market, we believe every effort should be made to take bold action now to facilitate a functioning and fair mortgage market for the future. We offer three key suggestions for improving H.R. 1728:

- Protect the Prime Market. We recommend that the Committee revise the current legislation to ensure the continued functioning of the prime mortgage market. As currently drafted, the bill could impose potential legal liability on secondary purchasers of all mortgage loans -- and provides only a rebuttable presumption against liability for "qualified mortgages" (a narrow subset of certain 30 year fixed rate loans). There are a host of other prime loans that provide meaningful benefits to qualified borrowers depending on their individual situation and the existing interest rate environment. We hope the Committee will expand and strengthen this safe harbor to help ensure the continued availability of a host of different prime loans. In particular:
    - ***Expand the definition of "qualified mortgage" to include other prime loans.*** (Although there will always be disagreements over where to best draw the line, at a minimum this should include loans where the federal government establishes underwriting criteria (e.g., FHA, VA and GSE), 7 and 15 year and longer fixed

[1] The Securities Industry and Financial Markets Association brings together the shared interests of more than 600 securities firms, banks and asset managers locally and globally through offices in New York, Washington, D.C., and London. Its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong. SIFMA's mission is to champion policies and practices that benefit investors and issuers, expand and perfect global capital markets, and foster the development of new products and services. Fundamental to achieving this mission is earning, inspiring and upholding the public's trust in the industry and the markets. (More information about SIFMA is available at http://www.sifma.org.)

[2] The American Securitization Forum ("ASF") is a broadly-based professional forum of participants in the U.S. securitization market. Among other roles, ASF members act as issuers, underwriters, dealers, investors, servicers and professional advisers working on securitization transactions. More information about ASF and its involvement in financial accounting matters may be found at www.americansecuritization.com. ASF is an adjunct forum of SIFMA.

rate loans and adjustable rate loans with APRs that fall within a narrow band of "prime");

- ***Provide a meaningful safe harbor for secondary purchasers of these prime loans*** (i.e., "qualified mortgages") by limiting the "rebuttable presumption" to *creditors* (those who actually made the loans). This language was included in the 2007 legislation so that secondary purchasers can continue to provide liquidity to the prime market and should be added back to H.R. 1728.

- Better Align Incentives in the Subprime Mortgage Market. Clearly there were problems in the subprime market that should be addressed legislatively to ensure that they do not happen again. Most bad actors are gone; regulations have been implemented to facilitate stronger underwriting standards; far fewer bad loans are still being made and fewer still securitized; but thoughtful legislation can help prevent backsliding when markets turn around. H.R. 1728 contains a number of important provisions for ensuring those protections: it offers a host of strong originator obligations; important ability to repay and net tangible benefit protections and liability up and down the mortgage chain including the securitizer. One addition included in this regard is a minimum five percent risk retention requirement for creditors of non-qualified mortgages. We agree that requiring creditors to have some "skin in the game" may help better facilitate the traditional lender-borrower relationship. In addition, we appreciate the Committee's willingness to facilitate an open regulatory process for putting such a requirement in place. Our members have expressed some concern that (1) an overly burdensome standard could substantially reduce the ability of non-bank mortgage lenders to provide liquidity for this market; and (2) creditors who do provide needed mortgage credit may find their inability to hedge or shed these risks limit their competitiveness and lending capacity. Balancing these conflicting interests is difficult. We hope Congress and the regulators will be careful to focus clearly on the ultimate goal of aligning borrower and creditor incentives and not unintentionally restrict credit or undermine safety and soundness, which is obviously not in anyone's interest. Accordingly we recommend:

    - ***Providing regulatory flexibility to consider (1) the duration of the risk retention; (2) the size and calculation of the retention; and (3) circumstances when hedging might be used in a way that protects safety and soundness and ongoing business flexibility without undermining the needed alignment of borrower-lender interests. We also recommend that federal regulators work with their foreign counterparts to facilitate a coordinated global approach.***

- Clear Rules are Key. Over the last year we have been reminded that consumer protection and safety and soundness are interrelated; and the same rules should apply to all entities engaged in the same activity. Otherwise some market participants will find ways to exploit differences to bypass standards. This is particularly true in large liquid markets like those that existed for mortgages and mortgage-backed securities. The 2007 bill recognized this by setting strong underwriting and secondary market standards and making clear that the remedy was the sole remedy available for claims against secondary purchasers. H.R. 1728, however, revises those provisions and creates uncertainty about when and whether states may impose other obligations on secondary market participants for ability to repay and net tangible benefit tests. The liquidity needed to fund a functioning U.S. mortgage market requires that these assets be sold to longer-term investors (freeing up capital for new loans). While creditors should be held to account for the loans they make, the sale and resale requires legal certainty and commoditization for subsequent buyers. We believe H.R. 3915 better achieved this balance. To help facilitate their continuing participation, the Committee should make clear that these investors will not need to monitor fifty plus different standards before providing liquidity by:

- ***Establishing a single clear standard for secondary market participants related to the ability to repay and net tangible benefit tests established by H.R. 1728.***

We believe these are modest changes that go directly to protecting the availability of good prime credit to current and future American homeowners, without undercutting this Committee's interest in regulating subprime and predatory mortgage lending practices.

Detailed Discussion

Because H.R. 1728 is so similar to last Congress' H.R. 3915, it may be helpful to provide some context by briefly discussing the 2007 bill before moving to the differences with H.R. 1728. We believe the House wisely sought to limit the majority of H.R. 3915's provisions to subprime loans by focusing on the core practices that it believed contributed to the credit crisis. The underlying premise was that every segment of the market – from borrower and broker through to the investor – bore some responsibility for the breakdown, but that loans to borrowers who may not meet traditional agency standards could be made in a responsible way, and that there was a desire to see industry continue to support this segment of the mortgage market. As such, the committee worked to make the new requirements relatively understandable and the penalties for violations maintained a sense of proportionality.

Since then the availability of subprime credit has evaporated. This market has not returned. The prime market is functioning but fragile, and the private mortgage securitization market remains dormant. Congress and the Administration have taken numerous initiatives to address the current foreclosure and housing crisis. The Federal Reserve Board has addressed a number of underwriting concerns when it enacted its final regulations to the Home Ownership Equity Protection Act in July 2008. As a result, it appears that any new legislative initiative will be prospective in nature in anticipation of the eventual return of a private lending and securitization market, and one of the key questions going forward is the extent to which policymakers wish to encourage the return of private investment in housing finance, particularly for borrowers who may not meet agency standards.

During its deliberations of last Congress' bill, the House sought to balance the legitimate interests of borrowers, lenders and assignees in addressing five basic issues: (i) who should be subject to the law's requirements, (ii) what types of residential mortgage loans should be subject to the law's requirements, (iii) what does the law require, (iv) what are the remedies for violations of the laws, and (v) what is the relationship of the new federal law with state laws addressing similar issues. We believed then, and we still believe today, that there are certain principles that guide the ability and willingness of the industry to participate in the primary and secondary mortgage markets. First, lenders, assignees and securitizers need legal certainty before being subjected to potential legal liability. Second, borrowers and market participants are looking primarily for a system that works: one that protects both the legitimate interests of innocent consumers from inappropriate lending products and practices and provides incentives for investors to invest the funds needed to help get that borrower a home. Although we had some concerns, we felt that many of the provisions of H.R. 3915 provided a fair balance and appreciate that most were included unchanged in H.R. 1728.

I. BACKGROUND ON H.R. 1728

A. Substantive Requirements

Substantially all of the provisions in H.R. 3915 are contained in the new H.R. 1728 or have been enacted in subsequent legislation such as the Housing and Economic Recovery Act. Like last Congress' bill, H.R. 1728 essentially imposes four substantive obligations, two on mortgage lenders (defined as "creditors") and two on mortgage originators (which would include both independent mortgage brokers and employee loan officers of mortgage lenders). First, it would prohibit a creditor from making a residential mortgage loan unless the creditor makes a reasonable and good faith determination, based on verified and documented information, that at the time the loan is consummated, the consumer has a reasonable ability to repay the loan according to its terms (or to make the combined payments on all loans on the same dwelling about which the creditor knows or has reason to know), and all applicable taxes, insurance, and assessments. Second, H.R. 1728 would provide that no creditor may extend credit in connection with any residential mortgage loan that involves a refinancing of a prior existing residential mortgage loan unless the creditor reasonably and in good faith determines, at the time the loan is consummated and on the basis of information known by or obtained in good faith by the creditor, that the refinanced loan will provide a net tangible benefit to the consumer.

While last Congress' ability to repay and net tangible benefits standards technically applied to all "residential mortgage loans," its presumptions protected large portions of the prime market and secondary purchasers. This permitted secondary purchasers to continue to provide liquidity to the prime market, while holding creditors responsible for the particular lending decisions (even for safe harbor loans). H.R. 1728 significantly reduces the size of the safe harbor and eliminates the protection for secondary purchasers (i.e. even safe harbor loans can be rebutted against secondary purchasers). These changes mean that secondary purchasers of loans could risk legal liability for prime loans made by others (even 30 year fixed rate loans) within the "qualified mortgage safe harbor." This risks a substantial reduction in investor participation in the mortgage markets.

Third, the 2007 bill required that mortgage originators "diligently work to present the consumer with a range of residential mortgage loan products for which the consumer likely qualifies and which are appropriate to the consumer's existing circumstances." Furthermore, the duty would mandate that originators make complete and timely disclosures to a borrower of the comparative costs and benefits of each product offered, the nature of the originator's relationship to the borrower, and any relevant conflicts of interest. This duty would apply to both prime and subprime, consumer purpose, residential mortgage loans. These provisions are largely unchanged. Fourth, H.R. 1728 clarifies and expands to all loans, last Congress' language prohibiting mortgage originators from receiving additional compensation based on the terms of a loan (other than principal amount).

B. Remedies for Violations

The remedies for violations of these provisions differ depending on the violations. The standard civil liability provisions of the Truth in Lending Act would apply to violations of the H.R. 1728's provisions. H.R. 1728 would increase the type and amount of monetary damages that would be available for violations.

TILA currently imposes liability primarily on lenders who fund loans in their name; it applies to "creditors," but not mortgage brokers. H.R. 1728 would extend TILA civil liability to include mortgage originators. A mortgage originator that violates the duty of care and anti-steering provisions would be liable for actual and statutory damages but not enhanced damages. However, those monetary damages would be capped at the greater of three times the total amount of direct and indirect compensation or gain accruing to the mortgage originator in connection with the mortgage loan, plus costs and attorney's fees, and actual damages; H.R. 3915 would have limited the damages to the multiple of compensation or gain.

H.R. 1728 also would materially expand rescission as an available remedy. Rescission, which extinguishes the loan and requires the creditor or assignee to return to the borrower all amounts he or she previously paid, is an extraordinary remedy under current law but limited in its application from a time standpoint. Under TILA currently, a borrower has a right to rescind a refinancing mortgage loan transaction for three days after closing or until the delivery of certain material disclosures, whichever is later. If the creditor fails to provide those disclosures altogether, or fails to provide accurate material disclosures, the right to rescind extends to three years. This three-year term is considered the "extended" right to rescind, compared to the "general" rescission right that is limited to three days following closing.

H.R.1728 would provide an extended right to rescind for certain of its new loan origination provisions. Rescission would be available to consumers as a remedy for violations by creditors of the proposed underwriting requirements. If the creditor could not provide, or a consumer could not obtain, rescission because the loan was held by somebody else, the liability would have to be satisfied by providing the financial equivalent of a rescission, plus costs and reasonable attorney's fees. Further, a creditor would not be liable for this new rescission remedy if the creditor cures the violation within 90 days after the consumer notifies the creditor of the violation. H.R. 1728 creates an exemption from liability and rescission in the context of borrower fraud or deception.

As with H.R. 3915, H.R. 1728 would impose limited assignee liability for violations by creditors of its underwriting requirements but not for violations by mortgage originators, although it does not define the term "assignee." Liability would extend to assignees and "securitizers." A "securitizer" is defined as any person that assigns residential mortgage loans, to any securitization vehicle. It also exempts "securitization vehicles" from assignee liability, which meant that trusts or other entities that issue securities backed by the loans and that also hold those loans, as well as the purchasers or repackagers of the securities, would not be liable for others' violations. This is a vital protection that helps facilitate investor participation in the mortgage markets.

An assignee or securitizer that acts in good faith would be liable in an individual action for rescission, costs and attorney's fees, but not for money damages. It could avoid rescission as a remedy in one circumstance. It could cure a violation within 90 days by modifying or refinancing the loan, at no cost, to provide terms that would comply with TILA (as amended) at time of origination, plus refund costs and pay reasonable attorney's fees.

H.R. 1728, however, deletes an important protection for secondary purchasers of loans contained in last Congress' bill. An assignee or securitizer would not have been subject to liability under the previous bill if the assignee or securitizer had followed rules promulgated by federal banking and securities regulators; established a policy to only buy "safe harbor" mortgages *and* required the seller to represent and warrant in the loan sale agreement that all of the loans met the safe harbor requirements.

H.R. 1728 expressly states that these are the exclusive liabilities that could be imposed on an assignee for violation of the proposed underwriting requirements. H.R. 1728 provides a limited preemption of state laws that would apply additional rules and penalties to secondary market participants with regard to the construct in H.R. 1728. Specifically, H.R. 1728's liability provision would expressly supersede any state law or application of state law that provides additional remedies against any assignee, securitizer, or securitization vehicle. The remedies described in the new liability provision would constitute the sole remedies against an assignee, securitizer, or securitization vehicle for a violation of the ability to repay or net tangible benefit standard or any other state law addressing that specific subject matter. However, H.R. 1728 expressly would ***not*** preempt the applicability of state laws against creditors, nor would it preempt the availability of state law remedies for fraud, misrepresentation, deceptive acts and practices, false advertising, or civil rights laws against an assignee, securitizer, or securitization vehicle for its own conduct in connection with the making of a loan, or the sale or purchase of residential mortgage loans or securities.

C. Revisions to the High Cost Loan Requirements of HOEPA

While the bulk of H.R. 1728 is the creation of a new regulatory regime for higher cost, subprime loans that did not rise to the level of high cost loans under HOEPA, it also would increase the universe of loans that would be subject to HOEPA and the substantive restrictions that would apply to such loans.

II. POSITIVE ELEMENTS OF H.R. 1728

H.R. 1728 contains a number of valuable provisions. It properly differentiates between the new legal responsibilities of mortgage brokers and mortgage lenders, recognizing the inherent differences in the roles of the two types of originators and the related expectations of consumers. It seeks to limit the applicability of its provisions to residential mortgage loans not meeting the criteria for the exception, recognizing that the lending abuses that afflicted the subprime market were generally absent in the prime market. It qualifies the responsibilities of creditors to lessen the likelihood of successful claims for errors in judgments made in good faith. While it increases the monetary damages that would be available for violations, it limits the availability of "enhanced" or penalty damages to ensure some level of proportionality between the violation and the remedy. While it increases the availability of the extraordinary remedy of rescission, it offers a creditor the ability to avoid rescission by curing the violation.

The bill also properly balances its treatment of assignees, although the term remains undefined. There are major limitations on assignee liability that are worth noting. First, no assignee would be responsible for violations by mortgage originators, recognizing that it would be virtually impossible for an assignee to diligence a mortgage broker's activities. Second, it excludes from any assignee liability the securitization trusts and their certificate holders, instead focusing on the assignees in the chain up until a securitization is issued. Third, it limits the types of remedies that could be asserted against assignees to individual claims for rescission, thereby eliminating claims asserted on a class basis or for money damages. Fourth, it permits assignees, like creditors, to cure the violation in lieu of providing the remedy of rescission. Unfortunately, H.R. 1728 deleted the provision contained in H.R. 3915 that protected secondary purchasers that took strong steps to completely avoid loans that were not in the safe harbors.

III. CONCERNS WITH H.R. 1728

Although we continue to have concerns about several issues from H.R. 1728, we appreciate the committee's balanced approach and beginning the discussion with the final version of H.R. 3915.

We would like to highlight a few concerns:

Scope of the "Qualified Mortgage" Safe Harbor. The definition of qualified mortgages is too narrow and creates the risk that legitimate forms of responsible lending will be impaired by their non-qualified status. The definition of qualified mortgages should be revised to include FHA-insured, VA guaranteed and, loans eligible for purchase by Fannie Mae or Freddie Mac (particularly because they are under government control). The federal government already is deeply involved on a real time basis in developing eligibility criteria and overseeing the performance of the loans originated under those criteria. It makes little sense to have the federal banking agencies developing the eligibility criteria for loans administered under the auspices of other federal agencies and opening the door to confusing inconsistencies between and among federal agencies.

We believe qualified mortgages should not be limited to fixed rate loans or loans with terms of only thirty years. Responsible adjustable rate mortgage loans have been originated for many years before the subprime crisis. The problem that emerged with hybrid ARMS pertained to the frequency and size of the adjustments and lack of underwriting to the likely increases on the loans. These features can be regulated without effectively banning adjustable rate mortgage loans. Similarly, it is ironic that a qualified mortgage would exclude 40 year mortgage loans at the very time that the Administration's loan modification programs emphasize such loan terms to promote long term affordability. Moreover, fifteen year loans rarely if ever have been associated with abusive lending and long have been a valuable tool for borrowers to accumulate equity in their homes.

"Strength" of Qualified Mortgage Safe Harbor. We believe creditors and assignees will need greater certainty whether or not the loans they are making and purchasing will be subject to legal liability. The new "rebuttable presumption" means that no one knows at the time a loan is made (or purchased) what standards apply, who is responsible for violations and what remedies apply. This uncertainty will impair the willingness of some to participate in the mortgage market. We recommend a stronger, more certain safe harbor. If the safe harbor may be "rebutted" it should be rebuttable only against the creditor (the entity that actually made the loan), not subsequent purchasers. This problem is exacerbated by the deletion of H.R. 3915's "policies and procedures" language (discussed above) and the elimination of language contained in H.R. 3915 stating that loans outside the safe harbor cannot be inferred to violate the law. Eliminating this last provision strongly implies that loans that are outside the safe harbor *do* violate the ability to repay/net tangible benefit test and will greatly reduce their availability. This is particularly troubling given the size of the safe harbor.

Conflicting Legal Standards. We are concerned that Congress may be inadvertently establishing a number of conflicting standards for unfair and deceptive acts or practices among other abusive lending topics. H.R. 1728 contains a new provision (Section 105(a)) that provides broad discretion for regulators to promulgate rules to address lending practices including "unfair and deceptive acts and practices." Section 208 (the preemption provision) attempts to provide a single secondary market standard for violations of ability to repay and net tangible benefit, but provides that nothing in this act "limits [state laws] regarding the availability of remedies based upon...deceptive acts or practices" and adds a new definition for when "acts or practices are deceptive" for purposes of this provision (and therefore, for purposes of 50 different state laws). Finally – and separately – there is (1) the delegation of authority in HOEPA on which the Federal Reserve Board relied in issuing its regulations last year and (2) new FTC authority granted in recent appropriations legislation which also seems to attempt to address this issue. There is a real risk that each of these similar standards will be interpreted differently creating a host of conflicting legal standards that will reduce the desire of investors to participate in the mortgage market. Although we understand that the Committee is not at this time reviewing all the conflicting definitions of unfair or deceptive nationwide, at a minimum we ask that the Committee reestablish a single standard for secondary market participants with respect to the specific obligations imposed under this act.

Possible Contraction in Mortgage Credit. The combination of new HOEPA triggers (contained in H.R. 3915), the new smaller and weaker safe harbor, and conflicting legal standards risks a contraction in mortgage credit, particularly for borrowers who do not meet agency criteria. This could erode further the availability of credit, particularly in higher interest-rate environments where adjustable rate mortgages may be more attractive to borrowers than long-term fixed rate mortgages.

Risk Retention Requirement. Finally, we support policy steps to achieve a more effective alignment of incentives between mortgage originators and investors, to ensure that mortgage originators have a direct economic interest in the underwriting quality and credit performance of loans that are funded via the secondary market. However, we have some concerns about whether the specific risk retention provisions of H.R. 1728 are the best way to achieve this objective and believe an open regulatory process for risk retention requirement may help facilitate a balanced approach that provides the right "skin in the game" while minimizing unintended consequences, such as:

- *A reduction in mortgage market liquidity.* The current language could adversely affect financial institutions--and on the capacity of the broader financial market to fund mortgage credit for new home purchase and refinancing transactions. Non-depository institutions could encounter severe constraints on their ability to raise and retain capital sufficient to satisfy these recourse obligations. These institutions provided important capital and competition to the mortgage markets. Depository institutions, which may already be capital constrained, would be required to hold capital on their books that could otherwise be deployed to support additional consumer and business lending.

- *An unintended increase in longer-term risk.* Requiring that creditor retain a minimum *five percent credit risk and not hedge that risk directly or indirectly* could pose problems if markets change and management, foreseeing a possible credit issue (or hoping to avoid one), is prohibited by law from taking steps to minimize that risk to the institution. This may also raise longer-term, safety and soundness concerns – particularly if this risk retention extends for a significant period.

  Similarly it could limit some of the flexibility needed to manage mortgage lending businesses and adapt to changing markets (for example, if an institution wants to sell-off its mortgage assets *in toto* and exit the mortgage business or whether the provision as drafted would apply a risk retention requirement to standard financing transactions, such as repurchase arrangements, which many mortgage originators use to finance their loan portfolios). Could a company just sell the all the mortgage assets *and the retained risk*, or must it retain the risk even after it has exited the business?

To facilitate a reasonable balance between the possible unintended consequences and the desire to better align incentives, the Committee may want to consider providing regulatory flexibility to consider (1) the duration of the risk retention; (2) the size and calculation of the retention; and (3) circumstances when hedging might be used in a way that protects safety and soundness and ongoing business flexibility without undermining the needed alignment of borrower-lender interests. We also recommend that federal regulators work with their foreign counterparts to facilitate a coordinated global approach.

European regulators are far along in the process of developing legislation that would also require originators to retain skin in the game. Their approach has been to include many specifics in a piece of pan-European legislation that will be relatively difficult to amend once passed into law. A more effective approach would be for Congress to lay out the broad principles of what retention should encompass, and to designate the relevant regulator to implement those principles and to monitor compliance.

A proposal that this committee should consider in order to achieve two of the important goals of this legislation is the construction of a statutory covered bond market. Covered bonds show the promise of improving liquidity to the mortgage markets by providing a complementary source of financing while financial institutions retain these loans on their portfolios. In the U.S. we have suffered from statutory uncertainty as to the treatment of covered bonds – while regulators have sought to provide some comfort in this area, without legislative clarity, investors will be reluctant enter this market. Once established however, a covered bond market would allow investors to invest with confidence in pools of mortgages. This will drive funds into this important sector, fostering solid underwriting and funding mortgages held on balance sheets.

Thank you very much for the opportunity to raise these issues. We look forward to working with the Committee to craft legislation that protects homeowners while ensuring a vigorous home finance market.

HR 1728: Mortgage Reform and Anti-Predatory Lending Act
House Financial Services Committee
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AFL-CIO
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Consumer Action
Low-income clients of the **National Consumer Law Center**
National Association of Consumer Advocates
National Fair Housing Alliance
Public Citizen
U.S. Public Interest Research Group
Woodstock Institute

and the following state and local legal services and public interest organizations:

Center for California Homeowner Association Law of Oakland, California
Public Counsel of Los Angeles, California
Connecticut Fair Housing Center of Hartford, Connecticut
Jacksonville Area Legal Aid, Inc. of Jacksonville, Florida
Housing Action Illinois of Chicago, Illinois
Civil Justice, Inc. of Baltimore, Maryland
Massachusetts Law Reform Institute of Boston, Massachusetts
WilmerHale Legal Services Center of Harvard Law School of Jamaica Plain, Massachusetts
Capitol Services/Michigan Advocacy Project of Lansing, Michigan
Mid Minnesota Legal Assistance of Minneapolis, Minnesota
Beyond Housing of St. Louis, Missouri
Gateway Legal Services, Inc. of St. Louis, Missouri
Metropolitan St. Louis Equal Housing Opportunity Council of Saint Louis, Missouri
Legal Services of New Jersey of Edison, New Jersey
Better Neighborhoods, Inc. (BNI) of Schenectady, New York
Capital District Women's Bar Association Legal Project, Inc./The Legal Project of Albany, New York
Empire Justice Center of Rochester, New York
Fair Housing Council of Central New York, Inc. Syracuse, New York
MFY Legal Services, Inc./Foreclosure Prevention Project of New York, New York
Neighborhood Economic Development Advocacy Project (NEDAP) of New York, New York
The Legal Aid Society in the City of NY/Law Reform Unit of New York, New York
Western New York Law Center of Buffalo, New York
Financial Protection Law Center of Wilmington, North Carolina
Legal Services of Southern Piedmont of Charlotte, North Carolina
North Carolina Justice Center of Raleigh, North Carolina
Advocates for Basic Legal Equality of Dayton, Ohio – on behalf of Edgemont Neighborhood Coalition
Northeast Ohio Legal Services of Youngstown, Ohio
ACTION Housing, Inc. of Pittsburgh, Pennsylvania
Greater Philadelphia Urban Affairs Coalition/Campaign for Working Families of Philadelphia, PA
Community Action2 Committee of the Lehigh Valley of Bethlehem, Pennsylvania
Community Legal Services of Philadelphia, Pennsylvania
Consumer Credit Counseling Service of Delaware Valley of Philadelphia, Pennsylvania
Philadelphia Unemployment Project of Philadelphia, Pennsylvania
Philadelphia VIP of Philadelphia, Pennsylvania
South Carolina Appleseed Legal Justice Center of Columbia, South Carolina
Virginia Poverty Law Center of Richmond, Virginia
Columbia Legal Services of Olympia, Washington
Mountain State Justice, Inc. of Charleston, West Virginia
Legal Aid Society of Milwaukee, Inc. of Milwaukee, Wisconsin
Wisconsin Consumers League of Milwaukee, Wisconsin

HR 1728: Reform of the Residential Mortgage System

Chairman Frank, Ranking Member Bachus, Members of the Committee, I very much appreciate the opportunity you have provided me to testify on HR 1728. I am here today on behalf of the low income clients of the **National Consumer Law Center,**[1] the **National Association of Consumer Advocates,**[2] **AFL-CIO,** the **Communications Workers of America, Consumer Action,** the **National Fair Housing Alliance, Public Citizen, U.S. Public Interest Research Group,** the **Woodstock Institute,** as well as the low-income clients of the **thirty-nine legal services** and public interest organizations from across the nation listed on the title page of this testimony (contact information for each of these organizations is provided in Appendix 1).

First, we want to underscore how much we appreciate the continued efforts of Mr. Watt and Mr. Frank, as well as other members of this Committee, to pass legislation designed to stop the abuses in the mortgage market. We have seen how diligently you have been working in these complex trenches to craft a solution to the difficult, delicate and vexing problems that deregulation of mortgage regulations has spawned. We also are very grateful for the proposed funding for legal services work included in this bill. This funding would significantly supplement the work that our advocates around the country already are doing and allow additional attorneys to assist potentially thousands of homeowners to save their homes from foreclosure. We also appreciate the strengthening of the yield spread premium provision.

Titles I and II of H.R. 1728 (the core mortgage reform standards) provide some important and beneficial improvements over those titles in H.R. 3915. The elimination of the irrebuttable presumption and the strengthened definition of "qualified mortgages" entitled to the safe harbor presumption is a crucial change.

However, unhappily, and with tremendous regret, our primary message today is that in the current form, we have to oppose HR 1728. The bill is complex, convoluted and simply will not accomplish its main goal - to fundamentally change the way mortgages are made in this country. More importantly, in its current form, the bill will do affirmative harm:

1. Section 208 of HR 1728 will preempt the state law claims against holders of loans which are currently the primary tools used for saving homes from foreclosure. These claims must remain viable in both defensive and affirmative claims against the holders of the loans to protect homeowners from predatory mortgages.

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[1]The **National Consumer Law Center, Inc. (NCLC)** is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on mortgage and other consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of sixteen practice treatises and annual supplements on consumer credit laws, including *Truth In Lending*, (6th ed. 2007), *Cost of Credit: Regulation, Preemption, and Industry Abuses* (3d ed. 2005) and *Foreclosures* (1st ed. 2005), as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low-income people, conducted training for thousands of legal services and private attorneys on the law and litigation strategies to address predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. NCLC's attorneys have been closely involved with the enactment of the all federal laws affecting consumer credit since the 1970s, and regularly provide extensive comments to the federal agencies on the regulations under these laws. This testimony was written by Alys Cohen and Margot Saunders.

[2]The **National Association of Consumer Advocates (NACA)** is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

2. Just as state law remedies against holders are preempted, the bill also fails to provide meaningful remedies against these holders for violations of the prohibitions in the bill. The bill would allow rescission against holders *only* for loans in foreclosure, *only* after the holder has had 90 days to cure the violation and failed to do so, and *then only* if the holder is not a securitization vehicle. We do not believe these limited, complex mechanisms would protect homeowners. To provide meaningful relief and to stop predatory lending - especially when replacing viable, valuable state law remedies against these holders - the new rules must be clear and enforceable against all holders of the loans and must provide incentives to encourage compliance. This bill unfortunately lacks both.

If the purpose of this bill is to preserve home ownership, holders of home mortgages must be responsible for the origination violations of this federal law. The bill contemplates a complex set of transactions through which a homeowner could assert rights against a party with whom the homeowner has no pre-existing relationship and the identity of which may be hard to identify, and then relies on presumed actions by various intermediate parties to the transaction to provide relief to a homeowner struggling to make mortgage payments. Speaking on behalf of the public interest lawyers who are litigating these claims, we need to tell you: *the plan proposed in HR 1728 will not work.*

Direct relief must be available both as defensive actions to stop foreclosures, and as affirmative actions to protect those homeowners who - through great difficulty and perseverance - have avoided default but who are making their payments on predatory mortgages.

Below we provide a detailed analysis of how the current version of HR 1728 needs to be changed to accomplish its goal of preventing bad mortgages from being made in the future and to protect homeowners when the new rules are broken. While there have been some improvements in the language between HR 3915 (passed by the House in November, 2007), these improvements, unfortunately, do not mitigate the serious problems still extant in HR 1728.

Moreover, as we articulated in the April 7 letter to the Chairman signed by dozens of national groups regarding this bill, the basic criterion for any proposal for reform of the mortgage system at this point must be whether, if this law had been in place five years ago, the current mortgage crisis would have been avoided. Unfortunately, it appears that this bill will not repair the misalignment of incentives running through the entire mortgage origination and securitization chain. While Titles I and II have been improved since they were first passed in HR 3915, there are still significant problems with them. Moreover, Titles III is based on an antiquated mechanism for regulating mortgages – HOEPA – which has proven to be completely inadequate. The result is a bill which will provide benefits for only sector of the economy – for-profit lawyers. This bill is so confusing that, if passed in its current form, there will be extensive litigation just to work through what the various provisions actually mean.

In the balance of this testimony, we will discuss the following subjects:

I. The Preemption Provision Erases Key State Law Protections
II. Answers to Questions Regarding the Impact on Predatory Lending of Specific Provisions of Title II
III. Our Recommendations for Reform: Simple, Clear Rules Applicable to the Entire Mortgage Market

I. The Preemption Provision Erases Key State Law Protections

The debate about whether preemption of state regulation of mortgage lending is appropriate has been waging for well over a decade. Proponents of preemption always point to the difficulties faced by an industry marketing products throughout the nation complying with the multiplicity of state laws and regulations. They argue that the costs of ensuring compliance with 50 different state laws are ultimately borne by consumers, and that consumers will have access to less expensive credit – and thus more opportunities for home ownership – if compliance costs were reduced by having one national standard.

The key assumption in this argument for preemption of state laws is that the national standard must fulfill the dual goals of a) establishing strong *incentives* for industry players to make fair, affordable and sustainable mortgages, and b) ensuring that homeowners who have been harmed have access to meaningful redress. Unfortunately, as currently framed, HR 1728 does not provide either incentives for compliance or meaningful redress to homeowners who have been harmed. This is one reason why we are so alarmed that passage of this bill would preempt the viable state law remedies currently used for redress.

Section 208 of HR 1728 would preempt many of the primary tools currently used by homeowners to save their homes from predatory loans while minimizing Wall Street's liability for core market abuses fueled by securitization money and the specifications of the secondary market. The state law claims preempted by Section 208[3] are an essential tool for saving homes from foreclosure and must remain available to address the problem loans held by this part of the mortgage industry.

A. Broad Preemption of Core Claims

Section 208 first preempts claims against holders and assignees for any claims related to ability to repay (subsection (a) of new Section 129B of the Truth in Lending Act) and net tangible

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[3]SEC. 208. EFFECT ON STATE LAWS.

(a) In General- Section 129C(d) of the Truth in Lending Act (as added by section 204) shall supersede any State law or application thereof that provides additional remedies against any assignee, securitizer, or securitization vehicle, and the remedies described in such section shall constitute the sole remedies against any assignee, securitizer, or securitization vehicle, for a violation of subsection (a) or (b) of section 129C of such Act or any other State law the terms of which address the specific subject matter of subsection (a) (determination of ability to repay) or (b) (requirement of a net tangible benefit) of such section 129C.

(b) Rules of Construction- No provision of this section shall be construed as limiting--

(1) the application of any State law against a creditor for a particular residential mortgage loan regardless of whether such creditor also acts as assignee, securitizer, or securitization vehicle for such mortgage; or

(2) availability of remedies based upon fraud, misrepresentation, deceptive acts or practices, false advertising, or civil rights laws--

(A) against any assignee, securitizer, or securitization vehicle for its own conduct relating to the making of a residential mortgage loan to a consumer; or

(B) against any assignee, securitizer, or securitization vehicle in the sale or purchase of residential mortgage loans or securities.

(c) Definition- For purposes of subsection (b)(2), acts or practices are deceptive if--

(1) there is a representation, omission, or practice that misleads or is likely to mislead a consumer;

(2) from the consumer's perspective, the interpretation of the representation, omission, or practice is reasonable under the circumstances; and

(3) the representation, omission or practice is material so that it is likely to affect the consumer's conduct or decision with regard to a product or service.

benefit (subsection (b) of new Section 129B):

> SEC. 208. EFFECT ON STATE LAWS.
> (a) In General- Section 129C(d) of the Truth in Lending Act (as added by section 204) shall supersede any State law or application thereof that provides additional remedies against any assignee, securitizer, or securitization vehicle, and the remedies described in such section shall constitute the sole remedies against any assignee, securitizer, or securitization vehicle, for a violation of subsection (a) or (b) of section 129C of such Act or any other State law the terms of which address the specific subject matter of subsection (a) (determination of ability to repay) or (b) (requirement of a net tangible benefit) of such section 129C.

This language appears to require that any claim brought against the holder challenging the terms of the loan or the circumstances surrounding the origination of the loan, which might be construed to address "the specific subject matter" of the federal requirement for the originator to ensure an ability to repay and a net tangible benefit, will be preempted because of Section 208. This broad language seeks to preempt any case with facts relating to the borrower's ability to pay the loan or the borrower's benefit from the loan, whether or not the claim itself uses such language directly.

In a landmark case, the Massachusetts Attorney General sought and obtained an injunction prohibiting a servicer – Fremont Investment & Loan – from foreclosing on mortgages it is servicing without the permission of the Attorney General based on the unfair nature of unaffordable mortgage loans. The abuses were comprised of "unsatisfactory lending practices" with regard to the origination of adjustable rate mortgages, including: qualifying borrowers based only on the ability to pay the initial pre-reset payments; failure to verify income; substantial prepayment penalties and product features likely to require frequent refinancings. Fremont had voluntarily entered into an agreement for the Attorney General to review foreclosures and then terminated the agreement when objections were raised. The Attorney General sought an injunction based on the unfairness of the loans following termination of the voluntary agreement. The Superior Court allowed the injunction and the Massachusetts Supreme Judicial Court affirmed the injunction.[4]

This ruling – as well as subsequent actions like it against other originators and servicers holding home loans in Massachusetts – has substantially assisted thousands of homeowners in that state from losing their home to foreclosure.[5] The crux of the claims brought by the Massachusetts Attorney General against Fremont was that the loans were *unfair* because they were not affordable and that Fremont should have known that. Because Fremont securitized many of its loans, the loans in question appear to mostly be held by investors. As this case was not brought against the holders of the loans, it might not be affected by the preemption in Section 208. On the other hand, it is questionable whether the agents of the holders – the servicers – would be reachable by state law if the holders themselves were exempt. More importantly, the case typifies the kinds of claims being used daily on an individual basis against holders of mortgage loans to challenge overreaching mortgage loans.

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[4]Com. v. Fremont Investment & Loan, 452 Mass. 733, 897 N.E.2d 548 at 556 (Mass.,2008).

[5]Over a three year period, Fremont originated over 14,000 mortgages for owner-occupiers in Massachusetts alone; 3,000 were outstanding at the time the injunction was sought, and 2,500 were serviced by Fremont.

There are many, many cases brought all over the nation against holders of loans under claims of unfairness, unconscionability, or other violation of state common or statutory law.[6] We have gathered examples of many of these cases in our report – HR 3915: *Key Home-Saving Measures at Risk: The Threat of H.R. 3915's Preemption Rule.*[7]

The Fremont case in Massachusetts is illustrative of the many cases alleging unfairness and similar claims, which are based on the "specific subject matter"of the federal requirement for the originator to ensure an ability to repay. These claims must be applicable to the holders of the loans,

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[6] *See, e.g.* Associates Home Equity Services, Inc. v. Troup, 778 A.2d 529 (N.J.Super.A.D. 2001) (Assignee of note and mortgage brought foreclosure action, and homeowners filed counterclaim alleging violations of the Consumer Fraud Act (CFA), the Law Against Discrimination (LAD), the Fair Housing Act (FHA), the Civil Rights Act (CRA), and the Truth-In-Lending Act (TILA) by original lender and assignee. Dismissal of unconscionability claim reversed where allegations revealed that the higher interest rates and points charged to the borrowers may not have been warranted (net tangible benefit type of analysis).); Beneficial Mtg. Co. of Ohio v. Leach, 2002 WL 926759 (Ohio App. May 9, 2002). (Defense to foreclosure brought by assignee was permitted to continue to trial when borrower alleged unconscionability of loan as a defense.); Cazares v.Pacific Shore Funding, 2006 WL 149106, (C.D.Cal. January 3, 2006). (Court finds that in class action alleging excessive fees charged on home mortgages (similar to a "net tangible benefit" analysis), assignees can be liable under California statute prohibiting unfair practices for origination problems with loans, based on both derivative and direct liability.); Cooper v. First Government Mortg. & Investors Corp., 206 F.Supp.2d 33 (D.D.C.2002). (Motion to dismiss denied in case brought by homeowner against mortgage brokers, assignees, and settlement agents challenging excessive fees, and other costs, and onerous and unfair terms of mortgage loan (claims that could be otherwise construed to challenge the "net tangible benefit" of the loan.); Gilbert v. Security Finance Corp. of Oklahoma, Inc., 152 P.3d 165 (Okla.2006). (Borrower's guardian brought action against lenders and non-resident parent corporations and holding companies to recover for fraud, breach of fiduciary duty, and breach of the duty of good faith and fair dealing for consistent overcharging and flipping home equity mortgage (a "net tangible benefit" type analysis). The Oklahoma Supreme Court held that one corporation may be held liable for the acts of another under the theory of alter-ego liability if (1) the separate existence is a design or scheme to perpetuate a fraud, or (2) one corporation is merely an instrumentality or agent of the other. Evidence created jury question on parent corporation's liability for lenders' acts under alter-ego theory.); Hays v. Bankers Trust Co. of California, 46 F.Supp.2d 490 (S.D.W.Va.1999). (Borrower sued lenders and assignees of her loans, alleging that overcharges and other problems with the mortgage violated state statutory and common law prohibitions against unconscionability. The federal district court held, *inter alia,* assignee was a "holder" of borrower's note under West Virginia law; civil conspiracy claim applicable to assignee.); Herrod v. First Republic Mortg. Corp., Inc. 625 S.E.2d 373 (W.Va.2005). (The home mortgagors alleged that lenders made mortgage loan without regard to their ability to pay the loan, and charged excessive fees (a "net tangible benefit" type claim). The claims against the assignee of the original mortgagee included violations of Consumer Credit and Protection Act, fraud, unfair or deceptive practices, and unconscionability. The West Virginia Supreme Court held that a genuine issue of material fact precluded summary judgment as to assignee's liability under theories of joint venture, agency, or conspiracy.); In re Maxwell, 281 B.R. 101 (Bkrtcy.D.Mass.2002). Bankruptcy court held as against the holder of the loan that a mortgage refinancing agreement was unconscionable because the sum total of the contract's provisions drives too hard a bargain for court of conscience to assist it (same analysis as a "net tangible benefit" analysis).); Johnson v. Long Beach Mortgage Loan Trust 2001-4, 451 F.Supp.2d 16 (D.D.C.2006). (In case in which homeowner alleged that the contract was unconscionable (and other claims) on the basis of excessive fees (a claim similar to a "net tangible benefit analysis), the court allowed claim to proceed against mortgage assignee on the basis of agency.); M & T Mortgage Corp. v. Miller, 323 F.Supp.2d 405 (E.D.N.Y.2004). (Purchaser of mortgage settled foreclosure case, and claims were allowed to proceed against originators and others relating to unconscionability and fraud in sale of unaffordable homes to plaintiffs.); Short v. Wells Fargo Bank Minnesota, NA, 401 F.Supp. 2d 549 (S.D.W.V. 2005). (When the low-income homeowner went to Delta Funding to borrow $2000 to $4000 to pay off some bills, he was provided a loan which refinanced his first mortgage loan and charged over 19% in up-front fees. The federal court held that both the assignee and the servicer of the loan, Wells Fargo Bank and Countrywide, could be found to be parties to a "joint venture" based on the existence of a Pooling and Servicing agreement between them, and thus responsible for both the origination problems (no net tangible benefit) and servicing problems (as well as other claims) brought by the homeowner. The homeowners' claims included unconscionability and breach of contract.); Williams v. First Government Mortg. and Investors Corp., 225 F.3d 738 (D.C. Cir. 2000). (Unconscionability claim allowed against assignee in mortgage based on net tangible benefit and ability to pay type claims.).

[7] http://www.consumerlaw.org/issues/predatory_mortgage/content/HR_3915_Preemption_Analysis.pdf

else the relief – modifying the loans and/or stopping the foreclosures – will not be available. Section 208(a) would preempt the application of these state laws to holders of the loans. The Rule of Construction in subsection (b) – which exempts certain types of state law claims from exemption stated in subsection (a) – does not help because unfairness, as well as other, well used, claims are not in the list.

B. Holder Liability at Stake.

Liability of holders *under current law* provides some accountability because it creates an incentive for buyers of loans to review the loans for compliance with the laws and the standards of the industry governing mortgages. That liability is essential – not only to allow individual homeowners to preserve their homes from foreclosure and preserve their home equity – but perhaps more importantly, to create the incentive for market participants – those infusing liquidity into the system – to police the market. Indeed the failure of assignees to ensure that adequate underwriting took place has been repeatedly criticized by industry experts as one of the reasons for the recent melt-down in the mortgage industry.[8]

Assignees need *more* liability to sufficiently animate these incentives, albeit this potential liability should be capped, so that the risk should be measured and priced for. We have repeatedly proposed that assignee liability for mortgage holders be similar to the liability of assignees of credit sale contracts, as is dictated by the FTC Holder Rule.[9] This cap would limit holder liability to the total of payments on the loan.

Under current state and federal law, a holder can be liable for claims against the originator under any one of a number of theories, largely determined by a combination of factors including state law, the terms of the particular transaction, and the behavior and knowledge of the holder before and during the transfer of the note and mortgage to the holder. The liability of the holder comes in two basic forms: liability stemming from the actions of the mortgage originator (derivative liability) or liability for the assignee's own actions (direct liability).[10] A holder's derivative liability is based simply on the fact that the holder is considered an assignee of the note and mortgage, and may be liable for all claims that could be made against the originator.

An assignee generally can avoid derivative liability if it can show that it is a holder in due course. This is an affirmative defense, which, while often available, is not an automatic status conferred on every holder of every mortgage note, especially in today's mortgage market of

[8]See, e.g., M. Diane Pendley, Glenn Costello & Mary Kelsch, Fitch Ratings, The Impact of Poor Underwriting Practices and Fraud in Subprime RMBS Performance (Nov. 28, 2007), available at www.fitchratings.com/corporate/reports/report_frame.cfm?rpt_id=356624 (noting the absence of adequate underwriting contributed significantly to the elevated default rates in 2007); *See* Susan E. Barnes, Patrice Jordan, Victoria Wagner & David Wyss, Standard & Poor's, Standard & Poor's Weighs in on the U.S. Subprime Mortgage Market 12 (Apr. 5, 2007) (increase in early payment defaults within four months of origination, particularly for loans with low documentation and a piggyback loan), available at www2.standardandpoors.com/spf/pdf/media/TranscriptSubprime_040507.pdf.

[9]16 C.F.R. 433. *See* discussion of the history and the impact of this rule in subsection E, *infra.*

[10]*See generally* National Consumer Law Center, *Cost of Credit* (3rd ed.2005), § 12.12.

adjustable rate loans with well-known defects.[11] In addition, federal claims, such as those made under the Truth in Lending Act, subject holders to derivative liability in some circumstances, notwithstanding their holder in due course status.

Even if the assignee is a holder in due course, and can avoid derivative liability, courts have held assignees liable for origination claims based on the holder's own conduct. For example, state common law and statutory claims may be available to hold the assignee liable based on theories of agency, joint venture, conspiracy, and aiding and abetting.

C. Preserved Claims Leave Out Key Protections

Subsection 208(b)(1) appears to specify that holders will be continue to be liable when they also were original creditor. Section 208(b)(2)(A) appears to preserve holders' liability for their own actions when the claims against them are for fraud, misrepresentation and deception, civil rights laws, and false advertising. Subsection 208(b)(2)(B) appears to extend this preservation of actions against holders for these claims regardless of whether the holders are considered to be directly liable or liable based on their status as an assignee.

There are still many critical state claims that are not preserved, and thus may be preempted because of subsection (a). For example, the following state statutory or common law claims could be preempted against holders when they involve facts challenging the net tangible benefit or ability to pay of a home loan:

- common law unconscionability of contract;
- statutory unconscionability;
- breach of good faith and fair dealing;
- breach of fiduciary duty;
- unfair trade practice;
- breach of contract; and
- state consumer protection statute prohibiting specific activities, such as making loans with no net tangible benefit or without ascertaining the borrower's ability to repay the loan.

D. Preempted Claims Save Homes

Homeowners who have been victimized by predatory mortgages routinely bring actions against the holders of their loans under common law and statutory theories of unfairness, unconscionability, and breach of duty of good faith and fair dealing. These claims generally are used to challenge the overall damaging nature of the loan, sometimes known as a "net tangible benefit" claim, or to challenge the lender's failure to determine the homeowner's ability to pay the loan. Courts regularly allow these claims to go forward, and they are used to save homes around the nation. They are often the main claim used to protect against foreclosure—both because they encapsulate the predominant market abuses of today – unaffordable loans and loans grossly mismatched with the borrower's circumstances – and because, unlike fraud claims, they do not require proof of a series of specific elements. Such challenges are couched in different terms,

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[11]An assignee is a holder in due course only if it can show that a) the mortgage is a negotiable instrument as defined by Article 3 of the Uniform Commercial Code, b) the note was properly endorsed to the holder, c) the holder paid value for the mortgage, and d) the holder purchased it without notice that it is overdue and without notice that there is a defense about any nonpayment. *See* National Consumer Law Center, *Cost of Credit* (3rd ed. 2005), § 10.6.

determined by the rules and requirements of state law and by the facts of the individual cases. They boil down to the same problems: bad loans made with no real analysis of the homeowners' ability to repay or with no material benefit to the borrower.

Claims against the holder that challenge loans based on theories related in any way to these claims appear to be preempted under Section 208, regardless of whether the claims specifically include the words "ability to repay" or "net tangible benefit." The preemption applies whether the claims were made for the assignee's own conduct or for the conduct of the originator for which the assignee is liable as an assignee of the loan.

This preemption of essential claims against assignees would eradicate the ability of homeowners to use legal claims as leverage to stop foreclosures, to void bad loans, or even to modify their loans, when the basis for their claim against the originator is grounded in an analysis similar to "net tangible benefit" or failure to determine the borrower's ability to repay the terms of the loan. Including the holder in the case is critical for the relief needed to address the problem: only the holder has the power to modify or cancel the loan.

Lawyers who represent homeowners in most states—both defensively against foreclosures[12] and affirmatively—routinely use non-fraud consumer claims to challenge the predatory nature of the loans. There are dozens and dozens of examples of these types of cases. Just a few of these examples are gathered together in our report referenced above on the same provision in last year's bill, **HR 3915: *Key Home-Saving Measures at Risk: The Threat of H.R. 3915's Preemption Rule.*[13]** Included in this report are numerous reported cases, as well as explanations of other cases, pleadings and orders saving homes from the following states:

- California
- Florida
- Georgia
- Illinois
- Massachusetts
- New Jersey
- New York
- North Carolina
- Ohio
- Pennsylvania
- South Carolina
- Washington
- West Virginia

[12]In judicial foreclosure states, these claims can be raised as a defense against the foreclosure. In a nonjudicial foreclosure state, it often is necessary to file bankruptcy to have these claims heard, because to stop a foreclosure in a non-judicial foreclosure state requires the filing of an independent, affirmative action, and the issuance of an injunction. In many of these states the bond requirements are prohibitively expensive, so that the only way to stop a foreclosure is to file a bankruptcy.

[13]http://www.consumerlaw.org/issues/predatory_mortgage/content/HR_3915_Preemption_Analysis.pdf

E. History is Instructive: Making Holders of Bad Loans Responsible Does Not Reduce Credit Availability

All players involved in a bad mortgage loan must be part of the solution, just as they are now part of the problem. Wall Street's investment in subprime lending transformed the industry from a modest player into a significant portion of the market. The securitization process also resulted in product development aimed at secondary market sales, rather than at homeowners. Moreover, homeowners facing default and foreclosure must contend with rules set by the trusts holding pools of securitized loans.[14] Assignee liability is the only mechanism that will align market incentives of the holder with those of the homeowners.

Opponents of assignee liability claim that a series of terrible events will befall the mortgage industry if full assignee liability is applied. This "sky is falling" list includes: a dramatic decrease in the availability of credit, particularly affecting minorities; ruinous effects on small businesses; unfair burden on the secondary market to police loans, as the process is so routinized and involves so many loans at any one time that a careful review of each loan would be nearly impossible and would dramatically increase the cost of credit.

A key perspective in analyzing these concerns is to look at what happened after the Federal Trade Commission passed the Preservation of Consumers Claims and Defenses Rule (commonly referred to as the "Holder Rule") in 1975.[15]

The Holder Rule applies liability for *all claims and defenses that could be brought against the seller* to assignees of loans used to purchase goods and services.[16] The rule reallocates the cost of seller misconduct from the consumer to the creditor,[17] by abrogating the Holder in Due Course doctrine so that a consumer who has been harmed may obtain a remedy.

When the rule was proposed, the automobile dealers and other sellers of goods argued that, if the rule passed, the cost of credit would increase, credit would be more difficult to obtain, retail merchants would be hurt, financial institutions would stop purchasing consumer loans altogether, businesses would suffer, and many would be forced out of business altogether.[18] The finance companies and the banks insisted that they should not bear the responsibility of policing sellers, the credit finance industry would not survive with the additional red tape, many consumers would stop paying on the loans without cause, and the rule would interfere with free competition.[19]

Not one of these nightmare scenarios materialized. There was no reduction in available consumer credit; there were no indications that sellers were hurt in any way; there was no discernable increase in defaults.

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[14] These rules are set out in Pooling and Servicing Agreements.

[15] 16 C.F.R. 433, 40 Fed Reg. 53506 (November 18, 1975).

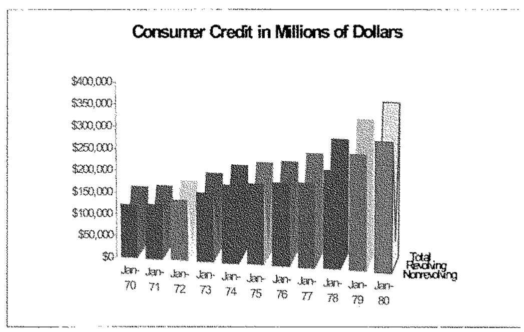
[16] The transaction must involve a consumer credit contract and the seller must be in the business of selling goods or services to consumers. The assignee's liability is limited to the amounts paid by the consumer.

[17] Maberry v. Said, 911 F. Supp. 1393 , 1402 (D. Kan. 1995).

[18] 40 Fed. Reg. 53506 (November 18, 1975) at 53517.

[19] *Id.* at 53518.

The primary argument addressed by the FTC was that the proposed rule would increase the cost of credit or make it very difficult to obtain.[20] Here is a chart showing the level of credit in the United States from 1970 through 1980.



The level of "non-revolving credit" is indicated in the front column and includes auto loans, loans for mobile homes, education, boats, trailers and vacations but excludes all credit card loans. In 1970, total non-revolving credit in the US was approximately $124 billion; growth continued steadily through the 1970s, with not even a blip in 1975 and 1976 when the FTC rule was announced. By December 1980, total non-revolving credit in the United States was approximately $297 billion. In the space of ten years, consumer credit – notwithstanding the announcement and final promulgation of the holder rule[21] halfway through that decade – had more than doubled. The amount of outstanding consumer credit has continued to climb unabated since then: the outstanding amount of non-revolving debt increased over 500% during the seventeen years from January 1980 to December 2007.[22] In the area of auto loans, this FTC rule has not interfered with the securitization of auto credit.[23] Auto ABS volume for

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[20] *Id.*

[21] Federal Reserve Statistical Release G.19, 1970 to 1980.

[22]The amount of non-revolving debt (in millions of dollars) was $295,524.23 in 1980 and grew to $1,580,039.43 (in millions of dollars) by December 2007. Federal Reserve Statistical Release G.19, 1980 & 2007, available at http://www.federalreserve.gov/Releases/g19/hist/cc_hist_nr.html.

[23]Letter from Vernon H.C. Wright, Chairman, American Securitization Forum, to Financial Accounting Standards Board (May 10, 2004), available at http://www.americansecuritization.com/uploadedFiles/FAS_140_Setoff_Isolation_letter_51004.pdf. The letter in part describes the FTC Holder Rule and its importance and describes the assessment used in the regular course of business to incorporate such liability into deals. It also states that buyers are willing to assume such risks and purchase such assets.

> For decades, a rule of the Federal Trade Commission (the "FTC Rule") has required every consumer credit contract (for instance, retail automobile installment loans) to include a legend to the effect that any purchaser of the contract is subject to all claims and defenses which the debtor could assert against the seller of the goods financed under the contract. This is to assure that consumers are not deprived of important defenses relating to payments owed on defective goods merely because their initial creditor sells the contract.
> The Uniform Commercial Code (the "UCC") provides that a buyer of many common types of receivables (for instance, credit card receivables, short term trade receivables and lease receivables) may be subject to all defenses or claims of the debtor against the seller... .
>
> Notwithstanding these risks, buyers are willing to purchase these types of assets. For instance, most retail auto installment paper is originated by auto dealers, who assign the paper to a finance company or bank. The finance company or bank may in turn transfer the paper into a securitization. The FTC and UCC rules about setoff are the same for both the initial purchase from the auto dealer and any subsequent transfer into a securitization.

2005 for prime and subprime loans combined exceeded $75 billion.

II. Answers to Questions Regarding the Impact on Predatory Lending of Specific Provisions of Title II

1. Scope and Potential Effects of New Section 213.

Section 213 of HR 1728 requires the Federal banking agencies to promulgate regulations requiring creditors of mortgage loans which do not meet the qualified mortgage definition to retain a material portion of the credit risk in the mortgages that they originate. The definition of a qualified mortgage, set out in section 102 of the Bill, would be codified in new section 129B of the Truth in Lending Act.

We are not sure of the potential effects of such a requirement. We appreciate capital requirements if they have the effect of imposing market discipline and creating dynamics for the market to police itself. Unfortunately, we are not convinced that this proposal will have the needed salutary effect on the mortgage market, as it appears to us it would not be significantly different from the current practice to require in the sale of most mortgage loans that the originator promise to purchase loans back from the holder if the loans go bad. While the current practice is a contractual promise to re-purchase the entire loan, and the proposed rule would require the originator to retain an ownership interest (at least 5%) in the loan itself, we are not sure that the industry would translate this requirement as imposing more discipline to ensure compliance with state and federal laws.

Clearly, credit retention requirements would significantly increase the capital requirements of the originators, as they could only sell 95% of the loans, rather than 100%. But, if the contractual promise to repurchase 100% of the problem loans back from the holder has not imposed any market discipline on originators, why would requiring an ownership stake in only 5% of the risky loans make a difference?

We understand that it was the retention of the contractual credit risk in the sale of bad loans that has been the primary cause of the bankruptcy or failure of so many predatory creditors – both mortgage companies and financial institutions. Yet, it did not change the originators' behavior when making the loans. The mortgage industry claims that this credit risk retention requirement will either eradicate non-qualified mortgages or cause very high prices. This claim is unsupported by history. Market players have always found ways to adjust to new federal rules and to profit substantially within them.

Moreover, retention of credit risk is clearly something that *can* be priced into the mortgage. The actual cost of that retention of credit risk is obviously a question of some dispute, and not one we are qualified to address. The *fact* that credit risk retention can be priced into the mortgage is an indication that it is likely to be – at best – an imperfect protection against bad mortgages. This is because retention of credit risk does not actually provide any protections to the homeowner/borrower. There are no additional rights of redress to the borrower who has had the misfortune to be provided a high cost loan for which the originator retained credit risk. So there will be no new ways that homeowners will be able to protect themselves against predatory mortgages made by originators who retained credit risk. In addition, homeowners are paying for the increased risk – but it is not clear that originators would be. And it is not clear that the risk retention itself

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Banks and finance companies that buy this paper analyze potential setoff risks as analogous to other ordinary course seller risks that a buyer of any asset takes.

would change the market so as to remove any need for consumer redress. Redress has shown itself to be the primary means for market discipline.

If non-qualified loans will continue to be made – and because the safe harbor for Qualified Mortgages is narrow, it appears such loans will be made – there must be clear, unambiguous rules applicable to those mortgages, which are enforceable against the *holders* of those mortgages. There must be strong incentives to the originators of the mortgages to comply with these rules, and equally strong incentives to the buyers of these mortgages to ensure that they are not purchasing loans which do not comply with the rules. There are no such incentives in the HR 1728 as currently written.

Under the current construct of HR 1728, even with the credit risk retention requirement, there will be few meaningful consequences to an originator who makes a loan in violation of the new requirement to ascertain the borrower's ability to repay the loan. Let us assume a particular originator makes a practice of making loans without properly determining the borrower's ability to repay the loan – as was the case among too many lenders until a few months ago. Presumably this originator would do what so many have done in the past: essentially guard against losses based on the possibility of refinancing the loan when the payments become unaffordable to the borrower. Available equity to fund a refinancing might be found in the difference between the loan amount and either the true value of the house or – as has been done so often in this decade – an inflated value of the house.

What would happen under this bill if a homeowner needed redress for this originator's violations of this new law? Little. First, if the originator still owned the loan, the originator would be given the opportunity to "cure" the violation before any real penalties would be owed. This is per new section 129(d), in section 204 of the bill. So, the originator is caught, a lawsuit is threatened, all of the originator's fees might have to be refunded unless the originator makes the loan comply with the law. Depending on how far off the loan is from being affordable, this could mean a significant or an incremental adjustment in the interest rate.

The originator could now alter the terms of the loan to bring the payments within the affordability requirements. So perhaps the interest rate might be changed from 9% to 8.5% (or the change could be more significant if that were required to make the loan affordable to the homeowner's means at the time of the origination.) But regardless of the change required – whether small or significant – the change is clearly only a cost of doing business. There is no penalty for *not* doing what was required at the outset. The originator does not have to disgorge all of its fees. The originator does not have to pay a penalty for failing to follow the law to begin with. *There is no incentive whatsoever for the originator to comply with the law, because there is no penalty for non-compliance.* In this way, the routine violation of the law is actually economically smart if it is profitable, because the only consequence for violating the law is to comply in the very few instances in which there is a threatened law suit.

As there are few real penalties in this bill for originators who violate the law, the primary financial risk to originators and holders is from a loss resulting from the non-payment on the mortgage. But under current practice, the originators are required to buy back 100% of these bad loans, and in the proposal the originators would risk losing only 5% of their investment. How does this new rule change the dynamics of the marketplace to impose market discipline?

Moreover, requiring credit risk retention does not appear to add any protection whatsoever to the homeowner. It does not encourage the making of the legal, sustainable and affordable loans.

Unfortunately, because of the limited liability of holders and the persistent right to cure without penalty applicable to both originators and holders, credit risk retention likely will make little difference in the market place. Much more needs to be done in order to effectuate real change in the mortgage market.

Moreover, given the preemption in the bill of existing state laws that are routinely and successfully used to hold accountable both originators and holders of loans which were made without a determination of the ability to repay or without a net tangible benefit – the mortgage industry will find it easier to make bad loans if HR 1728 were to pass than they can under current law.

2. Scope and Effects of Standards and Safe Harbor for *Qualified Mortgages.*

If there were adequate liability in the bill for violating the ability to repay standards and the requirement for mortgages to have a net tangible benefit, *then* providing a conditional safe harbor for certain, specific, generally safe mortgages would be a fine idea. Without clear penalties for violating the rules, it matters little what those rules are.

However, *assuming* that the right to cure in this bill is eradicated and holders were to remain liable for violations of the law, the standards and safe harbor for qualified mortgages are a good start. We do think that there should be clear statutory incentives for good mortgage products, as is provided in Section 203, while it is also a necessity to ensure that even these products can be challenged as improperly made.

We applaud the sponsors of HR 1728 both for narrowing the types of mortgage loans that fall within the parameters of a Qualified Mortgage, and for allowing the presumption of compliance to be rebuttable, rather than irrebuttable. These are both important and positive changes to this proposal, as compared to HR 3915.

A Qualified Mortgage should be simple and transparent. A 30 year mortgage with an interest rate within range of the prevailing rate for conforming mortgages is a very good start. However, a Qualified Mortgage should include the following factors:

- Fully amortizing,
- 30 year loan,
- with a *fixed rate,*
- with no lender or broker points or fees,
- and no prepayment penalties.

These loans are relatively simple for most homeowners to understand. They provide few traps for the unwary, and thus are more transparent. If, in fact, the rates that can be charged for them are also limited – as is currently included in the bill – they also would force originators to be much more cautious about the underwriting. If profits from high interest rates are limited, that forces lenders to be more cautious that all loans will be repaid – as the excess profits from the borrowers that pay the high rates will not be available to cover the losses caused by those borrowers who cannot afford the payments.

We also applaud the change from HR 3915 relating to the presumption of compliance – from irrebuttable to rebuttable. There must always be a way to challenge the legality of a loan. Without that, there will always be some scoundrels in the marketplace who will find the loopholes in the law to take advantage. The latest scams on loan modifications make that clear.

As we explain in Section III of this testimony, we believe that a Qualified Mortgage which includes all of these criteria should be required to be offered to all homeowners applying for a home loan. If the homeowner has credit challenges, the interest rate on the loan can be higher, but all other required components should be included. In this way, every homeowner applying for a home loan would always have the opportunity to obtain a transparent, understandable and safe loan. Requiring the *offer* of the Qualified Mortgage would not preclude the offer of other, more exotic mortgages – but the costs and risks of these other products would be contrasted to the Qualified Mortgage based on uniform method of comparison. Moreover, homeowners should be required to affirmatively opt-out of the Qualified Mortgage, as some have suggested.[24]

3. Scope and Effect of Other Provisions in Section 103.

A. Prohibitions on steering. We applaud the sponsors of the bill for including in the bill prohibitions prohibiting racially discriminatory steering. While an efficient financial market theoretically would provide equally qualified borrowers with equally competitive prices on home loans, both quantitative research and anecdotal evidence show that some borrowers, particularly African-American and Latino families, have been steered into worse or more costly mortgages than those for which they qualify.

However, the current provision to prohibit steering prohibits "abusive or unfair lending practices," but does not explicitly preclude steering consumers to loans more costly than those for which they qualify or prohibit certain types of mischaracterizations of information. We concur in the suggestion made to you by the Center for Responsible Lending to add stronger language, as is included in their testimony today.

B. Yield Spread Premiums. Again, we concur with the recommendations of the Center for Responsible Lending. Although Sec. 103 does ban yield spread premiums that vary with the term of the loan, it still permits consumers to finance fees, costs and compensations through a higher interest rate on their loan than that for which they qualify. However, financing compensation or other fees through the rate is very confusing for most consumers. Consumer testing by both HUD and the Federal Reserve Board shows that consumers have a great deal of trouble comparing deals that involve financing some portion of costs/fees through the rate. In the subprime market, many consumers ended up paying some costs and fees through a higher rate while at the same time paying additional costs and fees up front, as well as paying discount points and prepayment penalties that were purportedly in there to buy a lower rate - and the prepayment penalties served to locked them into the higher rate.

We strongly recommend banning the ability to finance points and fees through the rate for any mortgage *unless all* fees and costs are paid through the rate.

C. Expanding Rulemaking Authority on Predatory Terms to All Banking Agencies. We do think it is a good idea to make it simpler for more agencies to identify and counter predatory lending. However, it seems overly cumbersome to require all of the banking agencies to have to agree on the rules, and such a requirement is likely to result in rules which are least protective of consumers. We recommend that a single federal agency be assigned the role as the protector of consumers and be provided with the capacity to promulgate appropriate rules and regulations.

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[24] *See,* Mullainathan, Sendhil; Barr, Michael S.; Shafir, Eldar, *A One-Size-Fits-All Solution*, Publisher: New York Times, December 2007. http://www.wcfia.harvard.edu/node/2396.

D. Revised tenant protections. We very much appreciate the enhanced protections for tenants against foreclosures. The proposed protections will go a long way toward helping innocent victims of this mortgage crisis stay in their homes.

E. Establishing Framework for Additional Legal Assistance to Consumers Facing Foreclosures. As is evident from the strong support for this provision from the National Legal Aid and Defender Association ("NLADA") and many legal services organization across the country, there is a huge unmet need for legal services to deal with foreclosures. All of the state and local signatories to this testimony struggle daily to deal with the scores of homeowners coming to their doors seeking assistance to stop foreclosures. Non-profit attorneys in every state are stretched thin – with huge caseloads – defending foreclosures. Even with the wonderful promise of additional funding in HR 1728, which would go far to help meet this terrible need, these attorneys recognize that additional funding for legal services coupled with preemption of the basic laws they are using to defend those foreclosures is not a win for their clients or their programs. As a result, many of them are reluctantly joining in this testimony to oppose this bill, despite this desperately needed new funding.

III. Our Recommendations for Reform – Simple, Clear Rules Applicable to the Entire Mortgage Market

At a hearing before the Subcommittee on Financial Institutions and Consumer Credit on March 11, 2009, we provided a set of recommendations to reform the mortgage market which we think are simple, inexpensive and would be very successful.[25] Below these recommendations are summarized.

We propose a different orientation to the mortgage regulation conundrum: rather than creating a complex set of rules which are enforceable some of the time by some of the players against some of those involved in the process, create a system which creates *incentives* to accomplish sustainable and secure credit.

We propose to you an approach which carries the following three key characteristics:

1. **Simplicity** – The rules should be fairly easy for most people to understand. Multiple categories of creditors, borrowers, and types of loans result in confusion, without establishing a clear structure designed to facilitate fair, affordable, and safe mortgage lending.

2. **Transparency** – The contracts and obligations of the parties should be simple. The rules governing the transaction should not only be clearly disclosed, but also be easy to understand. The disclosures governing today's mortgages have become increasingly complex and technical because they are attempting to describe unbelievably complicated transactions. The disclosures must be correct – but if it is too difficult to describe the transaction, perhaps the transaction is too complex to be permitted?

3. **Appropriate Incentives** – The current system rewards originators for making bad loans – because the originators are paid regardless of whether the loan is unfair,

[25] *See,* http://www.house.gov/apps/list/hearing/financialsvcs_dem/saunders031109.pdf.

fraudulent, or unaffordable. Similarly, mortgage servicers are rewarded for servicing practices which do not sustain homeownership or home-equity. Both the origination and the servicing systems should be re-tooled so that the originators, the lenders, the investors and the servicers *all profit only from practices which promote sustainable, affordable and safe home mortgages.*

Outline of New Mortgage Regulatory Structure

1. **Realigning Incentives – Pay Originators from Mortgage Payment Stream Only.** Insurance brokers are paid their commissions entirely from the stream of payments made by the consumer for the insurance product. If the consumer can no longer afford the product and the payments stop being made, the broker does not receive payment – so the insurance broker has every incentive to ensure that the consumer is sold a product that is affordable. The insurance company also has an incentive to ensure that the consumer can afford the insurance product: as soon as the commissions are paid, the amount of the premiums that the company receives increases.

The insurance model of compensating brokers should be used for the mortgage industry: require that both originators and lenders receive all of their costs associated with originating, making and servicing the loan from the *payment stream.* A homeowner making payments on the mortgage is the sign of an affordable, sustainable mortgage – the continued affordability of those payments should be incentivized by the mortgage regulatory structure.

Currently, the origination process itself is the major source of profit. In fact, it is the only source of profit for the mortgage broker and a not-insignificant source of profit for the mortgage lender: both parties generally receive substantial up-front fees (almost always paid for from the consumer's home equity) at the origination of the mortgage. The lender, which then generally sells the loan into a security, also receives compensation at that point. Neither party depends on the payment stream to recover either their costs associated with making the loan, or for their profit. The current system encourages loan churning – making new loans to homeowners over and over – because the *making of the loan* is what generates the business and the profits in this market. This is the incentive that needs to be changed.

If instead the originator received a percentage of each payment for the first – say two – years – of the loan, that originator would have a strong business incentive to ensure that the homeowner would both be able to make the first two years' payments, and that the homeowner would *want to* continue making the first two years's payments.

Even if the loan were affordable, if the homeowner refinanced it after the first few months – say to obtain a lower interest rate – the originator would lose that part of the commission left unpaid. To avoid this refinancing, at the time loan was first made, both the originator and the lender would want to ensure that the loan were the best possible loan available at the time for the homeowner.

This proposal would be structurally simple to implement: simply pass a federal law which requires that all compensation to the mortgage broker, the originating lender, and the holder, be recovered entirely through the regularly scheduled payment stream of the loan. Third party fees necessarily incurred to close the loan would still be paid by the consumer at closing.

2. **Making Simple, Fair Mortgages the Default Mortgage – Mandating the Offer of a *Uniform Mortgage*.** Originators should be required to offer every homeowner applicant for a

mortgage loan a Uniform Mortgage product. The Uniform Mortgage would be defined as a fixed rate, fully amortizing 30 year mortgage at a rate set by the lender in response to the perceived credit risk of the borrower, with no prepayment penalties.

Alternatives to the uniform loan can also be provided by the mortgage originator – but the costs, risks and benefits would always have to be compared to the uniform mortgage that would be offered. These comparisons – to be provided contemporaneously with the offer of the alternative product would have to be provided at the same time as the alternatives are offered, and would be provided via a simple format developed by the federal agency – presumably the Federal Reserve Board – charged with developing the details of the new disclosure and transparency regulations.

These two changes – requiring that all profits from the origination process be paid through the payment stream, plus requiring that homeowners always be offered the uniform fixed rate, fully amortizing 30 year mortgage, with no prepayment penalty – would be relatively simple to mandate, simple to implement, simple to comply with, and simple for consumers to understand.

There would essentially be just one variable in the uniform mortgage that would change in response to the homeowner's particular circumstances – the fixed rate applicable for the full term. These changes would make the process of obtaining a mortgage, as well as the mortgage itself, transparent.

3. Common Sense Rules Should Be Required. Deregulation of the mortgage origination and servicing process has produced some strikingly absurd situations: lenders making loans without determining the borrowers' ability to make the scheduled mortgage payments, who then find that those homeowners cannot in fact afford the increasing payments; foreclosures on homes when the investors, the communities, as well as the homeowners would benefit from loan modifications instead.

Common sense rules for sustainable long-term home ownership help not only homeowners but also investors. Federal law should require that those making the decisions about the origination and foreclosure of home mortgages must include some basic, common-sense requirements. For example, the following rules should be applicable to all home mortgages made in the future:

- **Mandate that Originators Find that the Homeowners Can Afford All Payments Due on Loan.** Originators must be required to determine that the homeowners' income will be sufficient to afford all of the payments due on the loan. This includes separate components:
    - All scheduled payments due under the terms of the loan, including any potential increases in the interest rate or principal, must be found to be affordable.
    - All other housing debt, as well as monthly contribution requirements for property insurance and taxes, must be included in the sum of housing debt.
    - All income must be verified through independent means, either using wage statements, bank account and deposit records, or tax information.

- **Mortgage Loans Above Value of Home Should be Prohibited.** Originators should be prohibited from making a mortgage loan for more than the home is worth at the time the loan is made. Similarly, the terms of the mortgage loan should not contemplate that the principal of the loan will climb to an amount over the value of the home. In the current marketplace lenders have made hundreds of thousands of

Payment Option Arm Loans (see next section for more discussion about the dangers of these loans) which included basic loan terms contemplating that the principal of the loans would climb above the home's value at origination. This is a recipe for foreclosure – which is exactly what we are seeing. Similarly, inflated appraisals have become commonplace in states which did not experience the steep increases in real estate values – and homeowners and investors are both suffering. To counter these inflated appraisals, originators should be held fully responsible.

- **No Foreclosures Permitted without Modification of Loans.** Federal law should impose one critical requirement before lenders are permitted to foreclose on a primary residence: the servicer must evaluate the homeowner's situation and offer an affordable loan modification where it will produce more income for the investor than a foreclosure. Currently servicers make more money from a foreclosure than a loan modification. Moreover, the income structure for servicer fees encourages them to pad loans with high servicer fees, pushing more homeowners into foreclosure. The servicer fee structure also needs to be changed.

4. Full Enforcement Should be Incentivized – While relying on enforcement of the rules through government administrative action or private litigation is not a sufficient means of making the market successful, public and private enforcement are essential back-ups which serve two essential purposes: 1) they ensure compliance with the rules, and 2) they allow the individuals actually harmed by the violations of the rules to use those rules to protect themselves.

All rules should be enforceable by federal regulators and state attorneys general, as well as by private lawyers. Attorneys' fees and costs should be recoverable by prevailing homeowners. Additionally there should be a general prohibition against unfair, unconscionable or deceptive acts and practices applicable to all involved in the loan origination, servicing and holding. Statutory damages, along with actual damages should be awardable for violation of these rules, up to the value of the combination of the amount remaining due on the loan, plus what has been paid.

5. Full Responsibility – No one involved in the creation, the funding of, or the enforcement of a mortgage loan which violates the rules should be permitted to profit from a loan made in violation of the established rules. Here, again, the complexity and negative incentives in the current mortgage marketplace have allowed too many entities to make money from activities which support fraudulent practices, faulty underwriting, and anti-homeowner practices. This needs to be changed, so that everyone in the process profits from practices which sustain homeownership and home equity.

6. No preemption – In the current mortgage debacle, it has become clear that the state laws protecting consumers are the last bastion of redress for those homeowners who are fortunate enough to find an attorney able to protect them from foreclosure. State laws on fraud, unfair trade practices, unconscionability, foreclosure defenses, good faith and fair dealing, conspiracy, joint venture, as well as other torts and contract defenses, have been the primary way many individual homes have been saved. The rich and textured common law in the states has been particularly useful to the courts as they craft appropriate responses to the new and complex set of problems that have arisen in recent years.

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STATEMENT OF HILARY O. SHELTON
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BEFORE THE HOUSE FINANCIAL SERVICES COMMITTEE

"H.R. 1728: MORTGAGE REFORM AND ANTI-PREDATORY LENDING ACT"

April 23, 2009

Thank you, Chairman Frank, Ranking Member Bachus and all the members of the committee for your work on this issue, for this hearing and for inviting me here today. The NAACP deeply appreciates your interest in our views on predatory lending as it is clearly a crucial civil rights issue for the twenty-first century.

For many Americans, the issue of predatory lending has just come into focus within the last few years as a disparate number of the foreclosures that are currently rocking our nation's economy are due to sub-prime, predatory loans. Sadly, predatory loans of all types are nothing new to African Americans and other racial and ethnic minority Americans: for decades predatory lenders targeted American borrowers of color with their nefarious products.

As early as 1996, a study by Fannie Mae and Freddie Mac reported that as many as a third of the families who receive subprime loans actually qualified for prime loans[1]. A 2000 study by the U.S. Department of Housing and Urban Development clearly demonstrated that many people of color could qualify for more affordable loans than they were allowed to receive[2].

More recently, in 2005 a study released by the Federal Reserve showed that African Americans were 3.2 times more likely to receive a higher cost, subprime loan than our Caucasian counterparts; Latinos were 2.7 times more likely to receive a higher rate loan than white borrowers[3]. A 2006 study by the Center for

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[1] Freddie Mac. September 1996. *Automated Underwriting: Making Mortgages Lending Simpler and Fairer for America's Families. Washington DC*

[2] U.S. Department of Housing and Urban Development and U.S. Treasury Department. 2000. *Curbing Predatory Home Mortgage Lending.* Washington, DC: U.S. Department of Housing and Urban Development.

[3] Robert B. Avery, Kenneth P. Brevoort and Glen B. Canner, "*Higher Priced Home Lending and the 2005 HMDA Data,*" Federal Reserve Bulletin, amended September 18, 2006.

Responsible Lending demonstrated that for most types of subprime home loans, African American and Latino borrowers are more than 30% more likely to have higher rate loans than Caucasian borrowers, even after accounting for differences in risk[4]. Moreover, another study showed that high-income African American and Latino borrowers in the Boston were six to seven times more likely to have an expensive mortgage than Caucasians in the same income bracket in 2005[5].

Let me say at this juncture that the NAACP recognizes the legitimate role the subprime market has played and can continue to play for hundreds of thousands of qualified Americans with spotty credit, or in some cases a lack of a traditional credit history, to pursue the American dream of homeownership. Unfortunately, the subprime market has been abused by too many unscrupulous lenders who are willing to ruin people's lives, not to mention whole communities, for their own personal gain.

Predatory lending ruins not only individual lives and families: its disastrous impact can be felt by whole communities. Sadly, these people and their communities are often those that can least afford to lose what little wealth and stability they had hoped to amass through homeownership.

According to the US Census Bureau, just over 68% of Americans owned their own homes in 2007. Among white Americans, the average was slightly higher; 72% owned their own homes. In that same year, however, only 47.2% of African Americans and 49.7% of Hispanic Americans owned their own homes.

Given that homeownership is considered one of the most reliable ways for economically disadvantaged populations to close the wealth gap, one direct result of these unfair and immoral discriminatory predatory lending practices is that it is harder for African Americans and other racial and ethnic minorities to build wealth as they prepare for their futures or pass any material possessions on to their heirs. Predatory lending is a direct attack on our financial security and economic future; an attack that is targeted at individuals and communities because of the color of our skin.

Furthermore, given what we now know is the impact these predatory loans can have on families, communities, and our Nation it should come as no surprise that once again, African Americans feel that they are the "canary in the coal mine"; financial institutions appear to be willing to see how much damage they can inflict

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[4] Center for Responsible Lending. May 31, 2006. "*Unfair Lending: The effect of Race and Ethnicity on the Price of Subprime Mortgages*" Debbie Gruenstein Bocian, Keith Ernst and Wei Li.
[5] Massachusetts Community and Banking Council. January 2007. "*Borrowing Trouble VII: Higher Cost Mortgage-Lending in Boston, Greater Boston, and Massachusetts in 2005*" Jim Campben

on one sector of the population and then we will know what the rest of the Nation can stand.

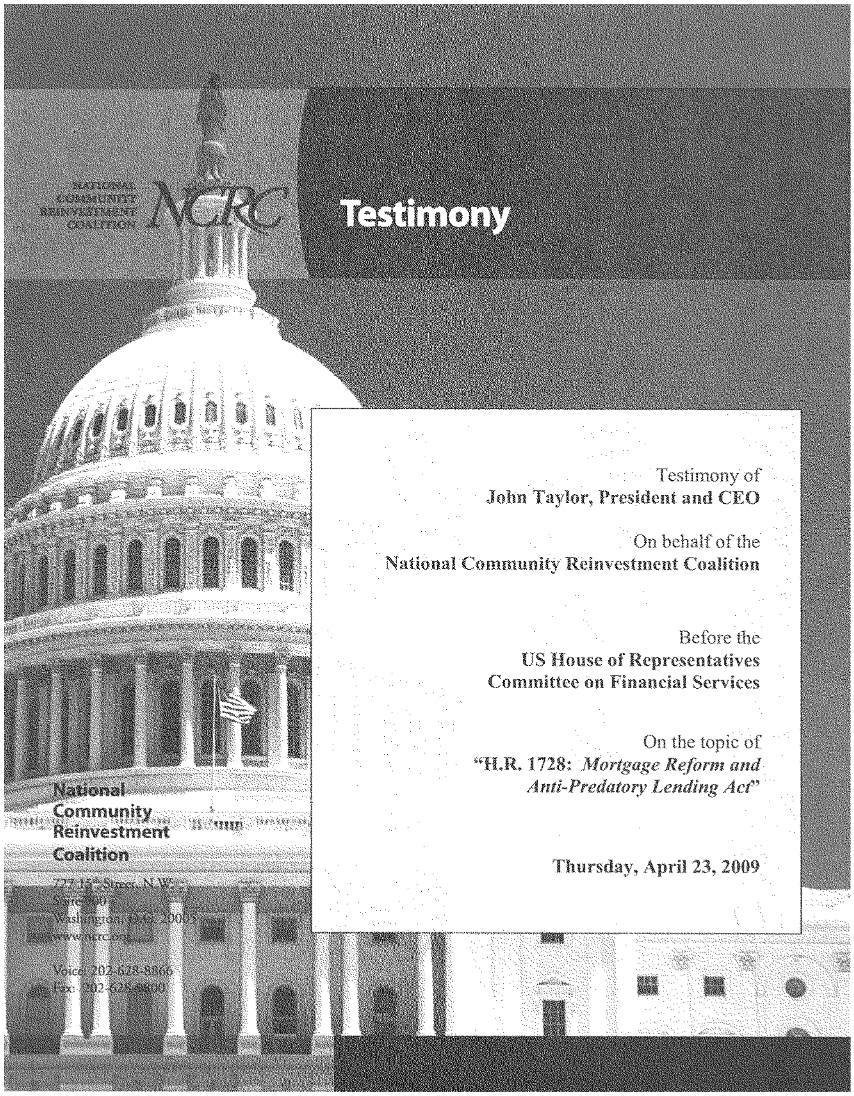
And so the NAACP has a strong interest in seeing predatory loans outlawed and predatory lenders put out of business permanently. And while I suspect not everyone in this room would agree with everyone else on just what an "ideal" bill is, I will say there are several elements that the NAACP feels should be included in any effective, comprehensive legislation that will go a long way toward ending the scourge of predatory lending. These elements include:

- A ban on compensation tied to the terms of the mortgage that often serves as an incentive for steering vulnerable borrowers into loans that are more expensive and risky than they qualify.
- The establishment of a Duty of Care that requires originators to present borrowers with loan options which are appropriate to their financial circumstances;
- The establishment of a requirement that lenders and originators make loans that the borrower can afford to repay;
- A prohibition on prepayment penalties in the subprime market;
- An increase in protections available under the Home Owner Equity Protection Act (HOEPA) for high cost loans;
- The federal legislation should clearly be a floor rather than a ceiling; states and municipalities should be able to do more to end predatory lending than what is in the federal bill, especially given the regional nature of some types of predatory loans and the fact that predatory lenders have a history of coming up with new schemes to bilk homeowners and would-be homeowners of their hard-earned capital whenever their existing scheme is outlawed; and
- No legislation should in any way provide immunity for past acts of discrimination or violations of civil rights laws and regulations by lenders, mortgage brokers or financial institutions.

While, as I said earlier in my statement I suspect it would be rather difficult to draft legislation that would please everyone in this room, let alone on this panel, I would also like to highlight the NAACP's support for H.R. 1782, the "*Fairness for Homeowners Act of 2009*" introduced by Congressman Keith Ellison of Minnesota. While some of the provisions in Congressman Ellison's bill are similarly addressed in H.R. 1728, H.R. 1782 also has very strong and detailed anti-steering provisions. The NAACP feels strongly that H.R. 1782 is a good start based on proven anti-predatory lending practices that have worked well in Minnesota.

Finally, please allow me to say a few words about the legislation that has been introduced by Congressman Miller of North Carolina and co-sponsored by Chairman Frank, H.R. 1728, the *Mortgage Reform and Anti-Predatory Lending Act*. As far as the NAACP is concerned, while this legislation has some definite strengths there are also some areas where we look forward to working with the committee to make stronger. However, it should be clearly stated that in no way do we believe that this legislation as it is now will result in more discriminatory lending to racial or ethnic minorities.

I would like to again thank the Chairman and the committee for your sustained, long-standing and tireless efforts to address predatory lending. As far as the NAACP is concerned, you were on the forefront of trying to end predatory lending abuses long before it was a hot topic, and we appreciate all that you have done and all that you continue to do. I look forward to continuing to work with you to ensure that predatory lenders are put out of business and that everyone is free to pursue the American dream of affordable, sustainable homeownership regardless of his or her gender, age, race or ethnic background.



Testimony of
John Taylor, President and CEO

On behalf of the
National Community Reinvestment Coalition

Before the
US House of Representatives
Committee on Financial Services

On the topic of
"H.R. 1728: *Mortgage Reform and Anti-Predatory Lending Act*"

Thursday, April 23, 2009

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I. Introduction

Good afternoon, Chairman Frank, ranking member Bachus, and other distinguished members of the Committee. I am John Taylor, President and CEO of the National Community Reinvestment Coalition (NCRC). I am honored to testify today on behalf of NCRC on the topic of "H.R. 1728: *Mortgage Reform and Anti-Predatory Lending Act.*" NCRC supports the enactment of H.R. 1728 to address the crisis in the housing and credits markets and the need for comprehensive anti-predatory lending legislation.

NCRC is an association of more than 600 community-based organizations that promotes access to basic banking services, including credit and savings, to create and sustain affordable housing, job development, and vibrant communities for America's working families.

II. Reform the Mortgage Market by Strengthening Laws and Regulatory Oversight

The sharp economic decline resulting from the foreclosure crisis can be traced to out-dated consumer protection laws and failed regulatory oversight. Loopholes in the law and inadequate regulatory enforcement allowed abusive and problematic lending to flourish. The foreclosures that arose from predatory lending have not only severely undermined the financial stability of working families and communities but also are now weakening the credit markets and diminishing overall economic activity and performance. Credit Suisse forecasts an additional 8 to 10 million foreclosures over the next five years given an 8 percent unemployment rate.[1] With the nationwide unemployment rate now at an unsettling 8.5 percent—the highest rate in more than 25 years—unemployment-driven foreclosures are further undermining the strength of the national economy. This past March alone, more than 650,000 jobs were lost, contributing to the more than 4.4 million total loss of jobs since the recession began in December 2007.

[1] Credit Suisse. "*Foreclosure Update: over 8 million foreclosures expected.*" December 4, 2008. For unemployment figures, see Michael A. Fletcher, *Administration Officials Showcase Package's Impact* in the *Washington Post*, Saturday, March 7, 2009.

Loose underwriting combined with a rise in unemployment has contributed to 803,489 foreclosure filings during the first quarter of 2009, a 24 percent increase from the first quarter of 2008 according to RealtyTrac.2 On an annual basis, the first quarter filings would equal an astounding 3.2 million foreclosure filings for 2009. This past March alone saw an additional 290,000 homes fall into foreclosure.

The foreclosure crisis has destroyed significant amounts of national and family wealth. Since the onset of the crisis, home prices have declined by at least 25 percent, with approximately 10 percent more in declines projected in the next few years.[3] According to the Federal Reserve Board, families have lost more than $13 trillion in total household wealth since mid-2007.[4] While the crisis is becoming widespread, it has not been an equal opportunity crisis. During the boom years of subprime lending, subprime lending was disproportionately targeted to minority communities. An NCRC report found that of all the conventional loans made to African Americans in 2005, 54.5 percent were high-cost. In contrast, of all the conventional loans issued to whites, only 23.3 percent were high-cost.[5] Subsequent research has shown that foreclosures, arising from the subprime lending, have also been concentrated in minority communities.[6] The situation is so dire within the African-American community that United for a Fair Economy, a

[2] "Foreclosure Activity Increases 9 Percent in First Quarter," April 16, 2009, RealtyTrac, via http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=6180&accnt=64847.

[3] S&P / Case-Shiller Composite -20 Home Price Index (as of December 2008).

[4] Presentation to the Forecasters Club of New York, New York, NY, by Janet L. Yellen, President and CEO, Federal Reserve Bank of San Francisco, March 25, 2009, http://www.frbsf.org/news/speeches/2009/0325.html

[5] National Community Reinvestment Coalition, the 2005 Fair Lending Disparities: Stubborn and Persistent, May 2006. Also, see Robert B. Avery, Kenneth Brevort, and Glenn Canner, *Higher-Priced Home Lending and the 2005 HMDA Data*, Federal Reserve Bulletin, September 2006, via http://www.federalreserve.gov/pubs/bulletin/2006/hmda/bull06hmda.pdf.

[6] Kristopher S. Gerardi and Paul S. Willen, *Subprime Mortgages, Foreclosures, and Urban Neighborhoods, Public Discussion Papers*, Federal Reserve Bank of Boston, December 22, 2008 and Lisa Nelson, *Foreclosure Filings in Cuyahoga County* in A Look Behind the Numbers, Fall 2008, published by the Federal Reserve Bank of Cleveland, via
http://www.clevelandfed.org/Our_Region/Community_Development/Publications/Behind_the_Numbers/2008/0908/BTN_20080929.cfm.

Boston-based policy group, estimates that African Americans could experience the greatest loss of wealth since Reconstruction.

An inadequately regulated marketplace financed large amounts of problematic subprime and non-traditional loans over the last several years, with no regard for the long-term implications for borrowers with unsustainable debt. More recently, unscrupulous lenders have migrated to the Federal Housing Administration (FHA) program, which is now experiencing a rapid increase in defaults. In addition, the old predators are transforming themselves into new predators. NCRC's investigation into foreclosure scams shows that formerly abusive brokers are now reemerging as foreclosure mitigation consultants. These consultants exploit distressed families by charging exorbitant fees and not engaging in any legitimate foreclosure prevention. NCRC will be releasing a Fair Lending Audit using mystery shopping of more than 75 for-profit national foreclosure prevention service providers in May 2009. If regulatory enforcement is not immediately tightened, the unsafe and reckless lending practices of the past will continue to recycle into new abuses against consumers, thereby prolonging the economic crisis and hampering recovery.

Eugene Ludwig, former Comptroller of the Currency, and Eric Stein, senior vice president at the Center for Responsible Lending, assert that insatiable demand from Wall Street prompted lending institutions to dramatically increase risky lending. Ludwig states, "Investors' appetite for subprime mortgage securitizations was huge, and Wall Street responded by providing more of the products, greatly increasing the demand for originations of subprime loans."[7] Both Ludwig and Stein document that fees and profits associated with subprime lending was higher than those for prime lending for institutions across the financial industry, ranging from brokers earning yield spread premiums, to lending institutions, and to Wall Street investment banks.[8]

[7] Eugene A. Ludwig, James Kamihachi, and Laura Toh, *The CRA: Past Successes and Future Opportunities in Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act*, A Joint Publication of the Federal Reserve Banks of Boston and San Francisco, p. 96, via http://www.frbsf.org/publications/community/cra/index.html.

[8] Testimony of Eric Stein, Center for Responsible Lending, Before the U.S. Senate Committee on Banking, Housing and Urban Affairs, "Turmoil in the U.S. Credit Markets: The Genesis of the Current Economic Crisis," October 16, 2008, pp. 17-18. and also see p. 97 of Ludwig, et al.

Credit rating agencies also had incentives to deal in mortgage-backed securities (MBS), since credit rating agencies were paid by the issuers of these securities. Credit rating agencies inflated ratings and facilitated the sale of hundreds of billions of dollars of MBS containing problematic loans that defaulted in large numbers.

Ludwig suggests that the final breaking point occurred when investment bankers used MBS to create highly leveraged bets in the form of complex credit derivatives. Credit derivatives were not subject to margin requirements, meaning that investors could pay for these securities with short-term loans. As a result of massive amounts of trading and speculating with inadequately capitalized loss reserves, Wall Street firms and investors could not absorb the losses that came from massive defaults of risky loans and sudden declines in home prices.[9]

The heightened pace of financing problematic lending occurred because institutions escaped penalties for making and financing abusive and risky loans. Economic theory suggests that too much of a good or service will be developed when a producer does not internalize (through penalties, fines, or losses of profit) the harmful aspects of the product. In this case, brokers and lending institutions sold problematic loans to Wall Street banks and investors; and investors did not require brokers or lending institutions to bear any significant amount of future losses should the loans become delinquent or default. Investors, likewise, calculated that the new financial instruments including credit derivatives and MBS with finely-tuned tranches sufficiently diversified risk so that no one investor would suffer unsustainable losses. The difficulty was that the financial industry did not anticipate the bursting of the housing bubble in the form of large-scale home value declines, which resulted in widespread foreclosures and devalued assets.

Federal Reserve Chairman Ben Bernanke stated in Congressional testimony, "The originate-to-distribute model (selling loans to the secondary market instead of holding them in portfolio) seems to have contributed to a loosening of underwriting standards in 2005 and 2006."[10] Federal Reserve statistics reveal that the portion of subprime adjustable rate mortgage (ARM) loans with

[9] Ludwig et al., p. 97.

[10] Ben S. Bernanke, "Subprime Mortgage Lending and Mitigating Foreclosures," Testimony before the Committee of Financial Services, U.S. House of Representatives, Washington DC, September 20, 2007.

low or no documentation of borrower income rose from 20 percent to 40 percent in 2006. The Congressional Oversight Panel, in a recent report, also documents an increasing market share of subprime and ARM products with related increasing delinquencies, particularly between 2004 and 2007.[11] The great majority of reckless lending was originated by independent mortgage companies that were not covered by the *Community Reinvestment Act* (CRA) and other fair lending and safety and soundness regulations. According to the Federal Reserve Board, only 6 percent of the subprime loans issued in 2006 were made by CRA-covered banks to low- and moderate-income borrowers/neighborhoods and considered on CRA exams.[12]

Since a wide variety of financial institutions were involved in the financing of problematic loans, a mortgage reform law and its accompanying regulations must be comprehensive, vigorous, and cover the entire financial services industry. Coverage must not only extend to the entities commonly discussed (e.g., brokers, lending institutions, appraisers, and servicers) but also must include Wall Street investment banks and the so-called "shadow market," including hedge funds and credit derivatives. The current lack of financial penalties for excessively risky activities must end. Congress must create comprehensive protections and establish a fiduciary responsibility for brokers and lending institutions for adhering to the comprehensive protections. In addition, Congress must also apply assignee liability to investors and other secondary market firms. Assignee liability requires investors and other firms to adequately compensate borrowers for violations of prohibitions against unfair and deceptive lending. Future crises of a similar scale and magnitude will occur in the near future unless Congress enacts aggressive mortgage reform legislation that includes enhanced consumer protections and penalties for financial institutions that violate consumer protections.

[11] Congressional Oversight Panel, the Foreclosure Crisis: Working Towards a Solution, March 6, 2009, pp. 18-22, via http://cop.senate.gov/documents/cop-030609-report.pdf.

[12] Governor Elizabeth A. Duke At the Revisiting the CRA Policy Discussion, Washington, D.C., February 24, 2009, CRA: A Framework for the Future, http://www.federalreserve.gov/newsevents/speech/duke20090224a.htm and Federal Reserve Staff Analysis of the Relationship between the CRA and the Subprime Crisis http://www.federalreserve.gov/newsevents/speech/duke20090224a.htm.

II. Enact a Comprehensive Anti-Predatory Law

In order to be effective, an anti-predatory law must include several protections against abusive products and practices. H.R. 1728 provides rigorous protections banning and/or limiting a number of problematic practices. In addition, it extends important protections for tenants, which are particularly needed in this economic climate. Finally, H.R. 1728 provides resources for borrowers to pursue housing counseling and legal aid.

Important Protections in H.R. 1728 that Must be Preserved

Prepayment Penalties: NCRC strongly supports the bill's ban on prepayment penalties for subprime loans and nontraditional loans. Prepayment penalties have trapped borrowers in unaffordable and/or abusive loans. Prepayment penalties, which can total thousands of dollars, must be paid by borrowers before they are able to refinance with another lender. H.R. 1728 prohibits prepayment penalties for subprime loans and other loans that do not qualify for safe harbor (loans that qualify for safe harbor are automatically assumed to meet prudent underwriting standards, such as borrower ability to repay). Loans that qualify for safe harbor in H.R. 1728 can contain prepayment penalties, but the penalties must phase out over three years and must be a decreasing percentage of the loan amount during each of the three years. Our understanding is that variable rate prime loans are excluded from the safe harbor provision, though the current language in H.R. 1728 is not clear.

Ban on Single Premium Credit Insurance: H.R. 1728 bans single premium credit insurance, which has been an abusive product that significantly increases loan costs when it is financed as part of the loan. The bill also bans single premium credit insurance on open-end mortgage loans. H.R. 1728 exempts credit unemployment insurance from the ban, but NCRC recommends that this provision be deleted.

Ban on Mandatory Arbitration: H.R. 1728 bans mandatory arbitration for both closed-end and open-end loans. Mandatory arbitration often trapped borrowers who needed legal recourse to get out of abusive loans.

Tenant Protections: Tenant protections safeguard the interests of all parties, including the neighborhood, lender, and tenant, by ensuring that a foreclosed home is occupied until it is sold. When a house becomes vacant, surrounding property values plummet because of decay and vandalism of the vacant home. To avoid this, NCRC supports H.R. 1728's provision that after foreclosure proceedings, a tenant has the right to remain in the property until the end of the lease, or for at least 90 days for tenants without a lease. If the new owner of a foreclosed property plans to occupy the property as a homeowner, the current tenant will have 90 days to vacate the property. Also, NCRC supports H.R. 1728's requirement that pre-existing lease and housing assistance payment contracts for Section 8 recipients be honored in the case of foreclosed properties. NCRC recommends that tenants without a lease should have all of the rights afforded them under federal or state law, whichever is stronger and in the better interests of the renter.

High-Cost Protections: H.R. 1728 establishes additional protections for high-cost loans (defined as first-lien loans with annual percentage rates (APRs) that are greater than 8 percentage points above Treasury rates for comparable maturities, or total points and fees are more than 5 percent of the loan amount). NCRC supports the enhanced protections for high-cost loans, since abuses resulting in unaffordable loan payments are more likely on high-cost loans. Balloon payments are banned on high-cost loans. Pre-loan counseling is required for high-cost loans, and loan flipping is prohibited. In addition, prepayment penalties are banned on high-cost loans when the loan amount is below FHA loan limits (this provision contradicts the previous prepayment ban for subprime and other loans that do not qualify for safe harbor, but NCRC expects that this will most likely be reconciled in mark-up). The provision prohibiting prepayment penalties on subprime and other non-safe harbor loans must remain because it is broader than the prepayment provision in the high-cost loan section of the bill.

NCRC recommends a revision to the ability-to-repay standard for high-cost loans. H.R. 1728's pattern-and-practice standard of violating the ability-to-repay provision for high-cost loans is too high a legal standard to meaningfully assist struggling borrowers. A borrower would have great difficulty gathering evidence to document that the institution's lending as a whole exhibited a tendency to ignore the borrower's ability to repay. Recognizing this, the Federal Reserve Board dropped a pattern-and-practice standard in its final *Homeownership and Equity Protection Act* (HOEPA) rules last summer.

Protections against Servicer Abuses: H.R. 1728 requires escrows for subprime loans, on loans in which the debt-to-income ratio exceeds 50 percent, and on high loan-to-value loans of 90 percent or more. The bill requires escrows on these loans for five years. Escrows are funds that lenders and servicers establish to pay for homeowners insurance and taxes. A lack of escrows has confronted borrowers of subprime and non-traditional prime loans with unexpected fees and expenses. In addition, H.R. 1728 establishes a prohibition against force-placed insurance on borrowers by servicers. The bill also requires that servicers promptly credit borrower payments.

Appraisal Protections: NCRC believes that the appraisal protections in H.R. 1728 will help deter appraisal fraud on high-cost loans. While helpful, NCRC believes that more comprehensive measures be implemented to safeguard against appraisal fraud and adequately address overall appraisal practices. H.R. 1728 requires on-site appraisals by qualified appraisers for high-cost loans. A second appraisal must also be conducted if a property is sold within 180 days of a previous sale and the sale is financed by a high-cost loan. The second appraisal helps safeguard against property flipping schemes that have greatly inflated prices and victimized unsuspecting borrowers. NCRC recommends that the second appraisal be required for all loan transactions (not just high-cost loan transactions) since two successive sales within 180 days are not normal and thus warrant extra protection. Further, NCRC recommends full walk-through appraisals for non-traditional loans in addition to the bill's proposed language for high-cost loans. NCRC supports the bill's provision requiring a regulatory rulemaking process to further develop protections against intimidation and coercion of appraisers since market practices, including problematic practices, are likely to continue to evolve.

NCRC founded the Center for Responsible Appraisals and Valuations (The Center) after receiving a significant number of complaints from borrowers about overvalued appraisals. The Center encourages mortgage finance professionals to adopt a code of conduct pledging to ensure fair and accurate appraisals for borrowers; informs the public about those who have taken the code of conduct so that borrowers can make more informed choices about mortgage finance professionals; and mediates differences between professionals about valuations, as well as files complaints on behalf of appraisers when they report pressure by lenders, brokers, and others to inflate housing values.

Lenders to Assume Risk: NCRC supports H.R. 1728's requirement that lenders assume a portion of the risk for selling a loan. If a lender sells a loan to the secondary market, the lender must maintain at least 5 percent of any credit risk for a loan that does not qualify under safe harbor. A regulatory rulemaking process can increase the percentage of risk that must be maintained by the creditor. The regulatory rulemaking process is beneficial in that future developments in the marketplace may require greater risk retention in order to provide a deterrent against reckless and abusive lending. This provision will provide an incentive for lenders to offer prudent loans, but the provision should apply to all loans lenders sell and not exempt safe harbor loans. Safe harbor loans should not be exempt because the risk exposure is known to the lender and is in response to industry concerns about legislating potentially unknown costs to lenders.

Legal Assistance: H.R. 1728 provides grants for legal aid organizations that provide defense against foreclosures for low- and moderate-income owners and tenants. The US Department of Housing and Urban Development (HUD) would establish a competitive bidding process for $35 million in grants each year from 2009 through 2012. Sufficient funding for legal aid is especially critical in the light of the foreclosure crisis. Should H.R. 1728, or a similar bill, become law, this Committee should review legal aid funding levels at least annually to determine whether households facing foreclosure are obtaining adequate legal representation. If legal aid organizations are in short supply, NCRC recommends that this Committee allocate more funding to support these organizations and their work to assist struggling homeowners.

Office of Housing Counseling: H.R. 1728 establishes an Office of Housing Counseling at HUD and provides $45 million each year from 2009 through 2012 for operational use and for grants to entities, including non-profit organizations for housing counseling. Just as with legal aid organizations, NCRC recommends that this Committee determine whether housing counseling organizations are adequately funded; if they are not, NCRC recommends that this Committee allocate more funding to support these organizations and their work to assist struggling homeowners.

Provisions in H.R. 1728 that Should be Strengthened

While NCRC applauds the Committee for developing a series of comprehensive consumer protections in H.R. 1728, we urge the Committee to address certain weaknesses in the enforcement and liability sections of the bill.

Safe Harbor Assuming Certain Loans Not Abusive: H.R. 1728 includes a safe harbor provision that presumes that certain loans automatically comply with the bill's ability-to-repay and net tangible benefit standards. A presumption of compliance means that any consumer alleging a legal violation must prove that the loan violated H.R. 1728's provisions. This is a much more difficult standard for a consumer than in the case of loans that do not qualify for safe harbor. When loans do not qualify for safe harbor, a lender must prove that they were not unaffordable or lacked a net tangible benefit.

The safe harbor provision is intended to cover only fixed-rate prime loans.[13] NCRC recommends that the safe harbor provision be removed, and that equal protections be applied to all loans since safe harbor coverage creates a difficult legal standard for consumers to prove that a loan was illegal and unaffordable. This difficult legal standard for consumers creates an incentive for lenders to develop risky and abusive products that qualify for safe harbor, but are nonetheless harmful to consumers. If the Committee wishes to retain the safe harbor provision, it should be very narrow and not made any broader. NCRC recommends that safe harbor only apply to fixed-rate prime non FHA loans. NCRC's also appreciates the authority created in H.R. 1728 for the regulatory agencies to further amend safe harbor so that the regulatory agencies can address abusive features in any new loan products that should disqualify the new products from safe harbor.

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[13] The bill has a drafting error which makes it appear that prime option ARM loans are also covered by the safe harbor. We expect and advocate for a manager's amendment to be introduced during the House Committee on Financial Services mark-up that will clarify that the safe harbor only applies to fixed-rate prime loans.

NCRC also believes that FHA loans should not automatically qualify for safe harbor. Prime-rate loans are the great majority of FHA loans and would therefore qualify for safe harbor. Recently, FHA lending has been plagued with high rates of default and risky practices. Since FHA lending is likely to replace subprime lending in the foreseeable future, it will probably comprise 20 to 30 percent of the loan market. In order to ensure that FHA lending does not become as problematic as subprime lending, NCRC urges the Committee to remove FHA loans from safe harbor. At the very least, if FHA loans continue to automatically qualify for safe harbor, a regulatory rulemaking mandated by H.R. 1728 must clarify the characteristics of FHA loans that would qualify them for safe harbor.

Limited Liability: H.R. 1728 provides that lenders, securitizers, and assignees would have limited liability. They would not be required to compensate borrowers (in most cases) for any loss if the loans complied with the ability-to-repay standard and the net tangible benefit standard. (In order to receive compensation in the form of rescission of the loan and attorney costs, a borrower would have to overcome the "presumption" in the case of safe harbor loans, which, as noted above, is a difficult legal standard to overcome.) In this instance, it is unlikely that a borrower will be able to successfully defend himself or herself against abusive prime or FHA lending.

Securitizers, investment banks, and investment institutions in pools of loans have no liability, which may make it more difficult for borrowers to receive compensation. The only case in which securitizers, investment banks, and investment institutions or "holders" of the mortgage may be liable for compensating the borrower is when the borrower is defending herself or himself against foreclosure. It would be more equitable to the borrower and more efficient for all stakeholders involved if the securitizers, investment banks, and investment institutions were involved in compensating the borrower for an illegal loan earlier in the process rather than a loan at the brink of foreclosure. Moreover, class action lawsuits against securitizers and assignees are prohibited, even if the securitizers and assignees have not developed due diligence procedures against unaffordable loans or loans that do not provide a net tangible benefit.

NCRC recommends that this Committee reevaluate the limited liability provisions in H.R. 1728 and develop a system that adequately compensates borrowers, while responding to industry concerns regarding unlimited liability. First, safe harbor should either be eliminated or the legal standard of presumption of compliance should be revised to make it easier for consumers to seek legal recourse and defend themselves against abusive loans. Second, this Committee should consider the provision in Senator Dodd's S. 2452 (introduced in the 110th Congress) which holds investors liable in all cases to individual borrowers, and liable in class action lawsuits when investors have not established due diligence mechanisms that disqualify abusive loans from MBS and other investment vehicles. The protection against class action lawsuits when due diligence mechanisms are employed motivates investors and secondary market institutions to monitor lending activity and finance only those loans that pass a responsible lending screen.

NCRC recommends that the Committee also establish through legislation or a required regulatory rulemaking process a fair method for distributing liability among all parties involved in financing a lending transaction. H.R. 1728's provision that lenders retain 5 percent of the credit risk is a start towards developing a fair method for distributing liability. Further development of distributed liability provisions would assign percentages of liability to securitizers, assignees, servicers, and investors. These provisions would also consider situations when the lending institution is both the originator and the servicer of the loan. Distributing liability among all parties would ensure that all parties are motivated by potential financial penalties to lend responsibly. In addition, liability can be carefully limited so that the parties involved in the transaction know in advance what their potential liability is.

H.R. 1728 has a sensible provision of requiring rescission of the loan (or its financial equivalent) and the coverage of costs, such as attorney fees, that a borrower has incurred in seeking recourse for an illegal loan. This provision makes a borrower whole, while limiting liability for the financial services industry.

Concerns about unduly burdening passive investors (e.g., pension funds) most likely prompted the carve-out on investor liability. While it is probably desirable to protect passive investors from exposure to unlimited liability, it is far worse to expose a borrower to total loss of wealth resulting from foreclosure (for many Americans, their home is their only form of wealth) when the borrower is preempted from seeking redress for abusive loans by an unduly restrictive liability provision. Moreover, NCRC recommends that provisions be created to ensure that passive investors and other stakeholders share liability, which also limits their liability exposure to manageable levels. Finally, requiring all financial entities to share the costs of compensating borrowers creates a powerful mechanism to encourage responsible lending. A lack of financial penalties and liabilities for all entities, including credit rating agencies and Wall Street investment banks, was a major enabler of irresponsible lending that fueled the current economic crisis.

Preemption: H.R. 1728 preempts state law that provides additional remedies from assignees or securitizers to borrowers. The bill specifies that preemption does not apply to creditors who also act as assignees or securitizers. It does not preempt state law that prohibits fraud and deception, nor does it preempt state law against assignees or securitizers for their own actions. If H.R. 1728 were strong on secondary market liability then preemption would not be an issue. Yet, though H.R. 1728's secondary market liability limitations and safe harbor provisions should be stronger, it will still preempt more vigorous state law. Also, H.R. 1728 does not preempt anti-fraud and deception laws, but it would preempt laws that hold secondary market institutions accountable for unfair practices, which include lending beyond a borrower's ability to repay.

NCRC appreciates that the Committee is sensitive to issues associated with enforcement and preemption (as evidenced by the Committee's providing specific exemptions from preemption, such as no preemption for the actions of the assignee or securitizer while preempting state laws that establish liability for the assigner or securizer based on the actions of the lender). Yet, the selective preemption from state law undermines stronger state law by encouraging activities to migrate to financial institutions exempt from liability in the weaker federal law. NCRC urges the Committee to reconsider preemption and consider following other federal laws, such as the *Fair Housing Act* and the *Community Reinvestment Act*, which do not preempt stronger state laws.

Incomplete Coverage: Protections in H.R. 1728 generally do not apply to open-end credit plans or reverse mortgages, except in certain provisions of the bill when open-end plans are included.

NCRC recommends that this structure be reversed, and that protections generally apply to all loans.

Absence of Fiduciary Duty: The bill states that its duty of care provisions (requiring that borrowers receive appropriate loan products) do not involve a fiduciary duty. A fiduciary duty is important because financial penalties for deceptive and unfair practices are needed to prevent brokers and/or lenders from placing borrowers into unaffordable loans.

No Limits on Yield Spread Premiums: YSPs encourage brokers to steer minorities and other protected classes to higher-cost loans when they qualify for lower-cost loans. H.R. 1728 does not prohibit or limit yield spread premiums (YSPs or payments to brokers through higher interest rates), except to specify that YSPs cannot be used to steer borrowers to high-cost loans when they qualify for lower cost loans. In contrast, Senator Dodd's bill (S. 2452) outlawed YSPs on subprime and non-traditional loans. Also, H.R. 1782, introduced by Rep. Ellison, prohibits any fees or closing costs if a broker receives a YSP.

H.R. 1728 has an anti-steering provision that prohibits "abusive or unfair lending practices that promote disparities among consumers of equal credit worthiness but of different race, ethnicity and gender, or age." The bill's flexibility toward YSPs has the potential to undermine its anti-steering provision. As described in NCRC's previous testimony before the Financial Institution's Subcommittee of the House Committee on Financial Services, YSPs have been abused repeatedly in subprime and non-traditional lending. Our previous testimony contained examples from NCRC's foreclosure prevention program (the National Homeownership Sustainability Fund) of brokers charging exorbitant YSPs, while the loans still contained usurious origination and other fees. Based upon our experience, we are not convinced that YSPs can be effectively constrained in subprime and non-traditional lending. Also, our experience suggests that unscrupulous lenders will circumvent H.R. 1728's ban on using YSPs for steering borrowers to high-cost loans. At the very least, the regulatory rulemaking process established in H.R. 1728 regarding steering should explicitly include the power to limit and/or outlaw YSPs if YSP abuses continue to occur.

Ability-to-Repay Provision is Incomplete: The ability to repay provision is incomplete in H.R. 1728. For variable rate loans, it requires an analysis at a fully-indexed rate, which is helpful but does not require an analysis at the maximum rate that can be charged under the loan contract. The maximum rate is often higher than the fully-indexed rate. In contrast, H.R. 1782 requires lenders to add 200 basis points to the fully-indexed rate in the ability-to-repay analysis. The approach in H.R. 1782 comes closer to assessing ability to repay at the maximum rate that can be charged.

H.R. 1728 does not require a residual income analysis. This analysis ensures that low-income borrowers have enough income left over after paying on debts in order to afford basic living expenses. NCRC believes that a residual income analysis would also be important to ensure that FHA loans are affordable for borrowers with limited incomes.

III. Address Emerging Trends and Other Issues Not Included in H.R. 1728

NCRC recommends that the Committee update H.R. 1728 to account for new and dramatic trends in the financial marketplace, such as new developments in FHA lending, misconduct among credit ratings agencies, scams related to foreclosures, and the need to broaden foreclosure mitigation efforts and loan modification programs.

Rise in Defaults in the FHA Program

NCRC calls for an immediate Congressional investigation and subsequent hearing regarding the rise in defaults in the FHA program. NCRC also asks the Committee to reconsider the safe harbor provision in H.R. 1728 for FHA loans (as previously discussed). Recently, the *Washington Post* reported on the spike in defaults of FHA loans, and on the difficulties HUD is experiencing monitoring lenders using FHA.[14] More than 9,200 FHA loans during the past year have entered into default after no, or only one, borrower payment (which is triple the rate of

[14] Dina Elboghdady and Dan Keating, *The Next Hit: Quick Defaults – More FHA-Backed Mortgages Go Bad Without a Single Payment* in The Washington Post, Sunday, March 8, 2009.

previous years'). HUD's inspector general is quoted in the article that immediate defaults suggest "impropriety and fraudulent activity."

One cause of the sudden defaults appears to be a rapid increase in FHA activity—as the FHA program has increased its share from 2 percent to 33 percent of all loans in the marketplace. The number of FHA-approved brokers has likewise surged from 16,000 in 2007 to 36,000 currently, while the number of FHA lenders has increased more than five-fold since 2006 to 3,000. HUD's inspector general recently testified that some of the unscrupulous subprime lenders are now operating as FHA lenders.[15] The *Washington Post* article reports that HUD dismantled an FHA fraud unit in 2003, and that an office responsible for overseeing FHA lenders had not increased staff despite the rapid increase in FHA brokers and lenders. As a result, there has been inadequate monitoring by HUD, and the article suggests that "the same flawed lending practices that contributed to the mortgage crisis are now eroding one of the main federal agencies charged with addressing it." These practices include increasing loan volume by brokers and small lenders for the purpose of increasing fees and commissions, with little regard for whether loans could be repaid.

HUD acknowledges that the FHA guarantee may encourage loose underwriting practices by lenders. In a recent Mortgagee Letter 09-12, HUD states that "The Department expects each mortgagee to exercise the same level of care in originating, underwriting and servicing an FHA-insured mortgage as it would for a loan in which the mortgagee would be entirely dependent on the property as security to protect its investment."[16] This letter exhorts lenders to exercise as much care in making and servicing an FHA-guaranteed loan as a loan without a loan guarantee. Given the problems with FHA lending, NCRC recommends that H.R. 1728 include additional consumer protections for FHA loans, and that the Committee exclude FHA loans from the safe harbor provision and/or establish a regulatory rulemaking process to enact additional consumer protections for FHA loans.

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[15] Inside Regulatory Strategies, Vol. 20, No. 8, April 13, 2009, "Legislative Fix for H4H Could Open Door to Mortgage Fraud," pp. 6-7.

[16] See Mortgagee Letter 09-12 issued April 2, via http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09-12ml.doc.

Credit Ratings Agencies

Credit rating agencies reaped millions of dollars in fees for providing inflated ratings to residential MBS and collateralized debt obligations. These practices contributed to the funding of hundreds of billions of dollars of loans that were not underwritten for long-term sustainable homeownership. The President's Working Group on Financial Markets in March 2008 cited "the erosion of market discipline" by credit ratings agencies and "flaws in credit rating agencies' assessments" as being among the underlying cause of financial market collapse. More recently, the Congressional Oversight Panel asserted that credit rating agencies perhaps played the "decisive" role in endangering the financial system.[17]
NCRC has filed complaints against Fitch, Inc., Moody's Investors Service, and Standard and Poor's with HUD. NCRC alleges that these agencies substantially contributed to the housing and foreclosure crisis in African-American and Latino communities by making public misrepresentations about the soundness and reliability of subprime securities' ratings. The rating agencies fueled imprudent, high-cost mortgage lending disproportionately targeted to minority communities, which contributed to high default and foreclosure rates in violation of the federal *Fair Housing Act*.

In order to prevent credit rating agencies from enabling reckless lending in the future, NCRC recommends that Congress pass legislation that changes the method by which ratings agencies are compensated. At the very least, Congress should require that ratings agencies clearly disclose how they are compensated. Currently, ratings agencies have a strong incentive to inflate ratings because they receive fees from sellers of MBS. The Congressional Oversight Panel recommends that, instead, ratings agencies could be compensated by creating pools financed by fees of all issuers so that an agency is not paid directly by an issuer for rating a security. The Congressional Oversight Panel also recommends that Congress provide clearer and stronger

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[17] Congressional Oversight Panel, Special Report on Regulatory Reform: Modernizing the American Financial Regulatory System – Recommendations for Improving Oversight, Protecting Consumers, and Ensuring Stability, January 2009, p. 40. http://cop.senate.gov/documents/cop-012909-report-regulatoryreform.pdf.

oversight of ratings agencies by creating a Credit Rating Review Board that would oversee ratings and generally monitor the ratings agencies.[18]

The *Washington Post* highlights an intriguing proposal from British financial analyst George Cooper that would require credit rating agencies to rate MBS on a curve.[19] Rating on a curve could reduce ratings inflation since MBS are judged against one another, meaning that only the highest quality MBS–as judged against other MBS–would earn ratings in the top 10th percentile. Rating on a curve, however, would not solve the ratings inflation problem if the overall ratings methodology remains opaque and subjective. In order to ensure rigorous ratings, NCRC recommends that compensation reform be accompanied by more vigorous regulatory oversight that demands accountability and transparency in ratings methodology.

Foreclosure Scams

Economic distress caused by national mortgage delinquency rates and job loss has been compounded by the proliferation of abusive foreclosure rescue scams that target financially distressed homeowners. Foreclosure rescue scams include the "Phantom Help Scam," in which victims pays thousands of dollars in fees, receive few or no services, and ultimately lose their homes. Other foreclosure scams involve homeowners unknowingly signing over the title of their homes or power of attorney to the scammer, who then either evicts the homeowners, sells the house to a third party, or may even file for bankruptcy in the homeowner's name. NCRC is currently engaged in an investigative project that is revealing a multitude of exploitative practices directed towards distressed and financially vulnerable homeowners. We expect to release a report in May 2009 that details how former mortgage brokers and other predators are migrating to this unregulated business scheme.

This regulatory loophole that allows foreclosure scam artists to multiply must be eliminated. NCRC supports the passage of the *Foreclosure Rescue Fraud Act of 2009* (S. 117), introduced

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[18] Congressional Oversight Panel Report of January 2009, see pages 43-44.

[19] "Curve Cure," Editorial in the Washington Post, Sunday April 19, 2009, p. A18.

by Senator Herbert Kohl (D-WI) on January 6, 2009, and introduced as H.R. 1231 by Representative Gwen Moore (D-WI) and Representative Barney Frank (D-Mass) on February 26, 2009 in the House. This legislation requires that all contracts between a foreclosure consultant and a homeowner be in writing and fully disclose the nature of the services rendered and the exact cost. In addition, this bill prohibits up-front fees from being collected, and prohibits a foreclosure consultant from obtaining the power of attorney from a homeowner. This legislation also includes a preemption clause that allows states and federal agencies to work together to combat these abuses. States have been proactive in addressing foreclosure rescue scams, and at least nine states have already enacted legislation.[20] Most of the laws require foreclosure rescue consultants to disclose a customer's right to cancel the agreement, cap fees, and rescind or ban the transfer of property to the consultant.

NCRC encourages the regulatory approaches supported by the FBI that include creating a provision that requires the mortgage industry to report fraudulent activity, and establishing safe harbor provisions that protect the mortgage industry through mandatory reporting.[21]

Replace Broker Price Opinions with Appraisals

NCRC recommends that H.R. 1728 amend its appraisal section to require that independent and professional appraisers estimate the values of Real Estate Owned (REO) properties and that Broker Price Opinions (BPOs) be outlawed.

Owners of REOs are eager to dispose of REOs because REOs are costly to maintain and attract vandalism and crime. These REO owners have enlisted real estate brokers to issue BPOs of the value of the REOs. The real estate brokers, acting as agents of the REO owners, develop hasty and inaccurate BPOs that underestimate the values of the REOs. Undervaluation is often destructive to local markets and depresses the value and equity of neighbors of REO properties.

[20] Colorado, Connecticut, Florida, Illinois, Iowa, Maryland, Massachusetts, New York, and Texas.

[21] See n1.

NCRC recommends that the Committee require that Appraisal Management Companies (AMC) be required to register with appropriate state oversight agencies, and be appropriately regulated by these authorities to ensure accurate valuations. NCRC also recommends that the Appraisal Subcommittee of Federal Financial Institutions Examination Council be charged with developing oversight standards for AMCs that ensure the integrity of the valuation process and the objectivity and independence of valuation professionals. The Subcommittee would also be responsible for proposing new guidance and quality control checks relative to the use of Automated Valuations Systems and BPOs.

As noted, NCRC's Center for Responsible Appraisals and Valuations endorses valuation best-practices for all industry participants. Therefore, NCRC recommends that this Committee consider adopting specific provisions from the Home Valuation Code of Conduct negotiated among New York Attorney General Andrew Cuomo, the Government Sponsored Enterprises (GSEs), and the GSE's regulator (first OFHEO and then FHFA). These provisions provide additional clarity regarding no intimidation and coercion of appraisers and also establish procedures for ensuring that appraisals are conducted impartially when the lending institution owns an affiliate that conducts appraisals.[22]

Loan Modification Programs and Foreclosure Mitigation Efforts

A strengthened H.R. 1728 will prevent future foreclosure crises similar in scale and magnitude as the one the US is currently experiencing. To address the current crisis, the Administration has implemented a Home Affordable Modification Program (HAMP). HAMP is a voluntary program that provides monetary incentives to lenders, servicers, and borrowers to encourage financial institutions to modify mortgages and make them affordable to borrowers who experience difficulties paying their mortgages. HAMP is the most comprehensive approach to-date to stem the rising tide of foreclosures, as it commits up to $75 billion to assist 3-4 million homeowners faced with foreclosures. But, as several lenders have ended their voluntary moratoria on foreclosure proceedings, lenders estimate that only a small percentage of distressed

[22] http://www.orea.ca.gov/pdf/HVCCFinalCODE122308.pdf

borrowers will qualify for HAMP. GMAC, for example, estimates that only 10 percent of their borrowers threatened with foreclosure would qualify for HAMP.[23] If these initial estimates prove to be accurate, lenders are likely to move the great majority of their distressed borrowers to foreclosure. Therefore, NCRC recommends that this Committee consider our HELP Now proposal, in which the government would purchase troubled mortgages at a significant discount using its power of eminent domain (or other strategies) to enable affordable and sustainable loan modification. After an initial outlay of up to $50 billion, the government would finance a HELP Now program by selling the modified loans to the private sector using a reverse auction approach. Unlike the voluntary efforts of the government-sponsored programs that are proving unsuccessful, HELP Now mandates that financial institutions participate in the discounted purchase of troubled assets to accomplish broad-scale loan modification.

The rapidly increasing unemployment rate is now driving foreclosures. In order to keep pace with rising unemployment, Congress and the Administration should consider implementing a program like Pennsylvania's Home Emergency Mortgage Assistance Program (HEMAP). When a homeowner becomes unemployed involuntarily, the state's housing finance agency will arrange for a two-year loan of up to $60,000 to enable the homeowner to continue making payments until the borrower's income recovers.[24] Since the program's inception in 1983, HEMAP has assisted more than 40,000 homeowners. The program is cost-effective, in that it received an initial state appropriation with subsequent funding that came from borrower loan repayments. A federal program like HEMAP would most likely require a significant initial capital outlay, but could be sustainable through self-financing. If the national unemployment rate continues to climb, Congress and the Administration should immediately implement a program like HEMAP in order to stave off a second foreclosure crisis.

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[23] Ruth Simon, "Banks Ramp Up Foreclosures Increase Poses Threat to Home Prices; Delinquent Borrowers Face New Scrutiny," in the *Wall Street Journal*, April 15, 2009.

[24] See http://www.phfa.org/consumers/homeowners/hemap.aspx and http://www.phfa.org/forms/brochures/foreclosure_prevention/HEMAP_2008.pdf.

In a number of situations, the unemployed may be unable to find new jobs within a time period specified by a HEMAP-like program, or may have an income level that cannot sustain homeownership. In these circumstances, instead of immediate foreclosure, the unemployed should be allowed to remain in their homes as renters, using, for example, some portion of their unemployment insurance (and/or income from an employed spouse/partner when applicable) as monthly rent. The tenant protections in H.R. 1728 are essential in this context and should be complemented by crafting a provision that allows unemployed homeowners and renters to remain in their homes.

Conclusion

While a comprehensive anti-predatory lending bill will provide needed protections, NCRC recommends that Congress reform the regulatory structure so that all entities in the financial services industry, including credit ratings agencies, investment banks, and other secondary market institutions, be required to adhere to legislative mandates that increase consumer protection and eliminates predatory lending practices. The regulatory agencies responsible for enforcing fair lending and fair housing law repeatedly failed to heed warnings from community groups about the reckless lending practices that have now destabilized the national economy and driven widespread unemployment. NCRC believes that Congress must require that regulatory agencies review regulations biannually to determine the extent to which these regulations promote access to responsible credit, investments, and banking products for consumers. The agencies must also be required to have public comment periods to determine the need to amend any regulations. After this process, the agencies would be required to report to Congress on their public deliberations and whether those deliberations led to enhanced consumer protections. Until the agencies prove that they are capable of monitoring and enforcing fair housing and fair lending laws, Congress should appoint an independent reviewing body to oversee enforcement activities and Congress should also hold annual oversight hearings.

NCRC supports Elizabeth Warren's proposal to form a Financial Product Safety Commission (FPSC), which would be dedicated to enhancing consumer protections and ensuring that consumer protection laws and regulations be applied to all segments of the financial services industry. FPSC would also create standards for disclosure and transparency, eliminate unfair and deceptive practices, and promote the responsible provision of credit. The FPSC could also assume the federal banking agencies' CRA responsibilities of conducting CRA exams and enforcing CRA through the merger and applications process. Though the existing agencies have mostly succeeded in adopting a uniform approach to enforcing CRA during its three decades, the agencies did splinter recently in a potentially destructive race towards dismantling CRA. In order to prevent future regulatory arbitrage of CRA and to ease its implementation, it is time to consider enforcement of CRA by a single agency.

NCRC believes that updating and modernizing CRA must be part of any regulatory restructuring. CRA requires that community credit needs be met consistent with safety and soundness. A law that establishes an affirmative and continuing obligation to meet credit needs responsibly is an integral part of preventing abusive lending. It is likely that a foreclosure crisis would not have occurred had CRA been extended to cover broad segments of the financial services industry (e.g., banks, credit unions, mortgage companies, investment banks, insurance companies, securities firms, and other financial institutions).

NCRC applauds the Chairman for planning to hold hearings on CRA modernization. NCRC recommends that this Committee consider the *Community Reinvestment Modernization Act of 2009*. If passed, this legislation would meaningfully expand access to credit and capital for affordable housing, small business creation, and community development for working neighborhoods and communities.

NCRC recommends that this Committee craft H.R. 1728 into a comprehensive anti-predatory law that covers all entities in the financial services industry, and imposes financial penalties and liabilities for predatory and abusive lending practices. Had such legislation been in place several years ago, the current foreclosure crisis would be smaller in scale and magnitude; in fact, a comprehensive anti-predatory law might have averted the crisis altogether and saved the national economy trillions of dollars in lost assets. This Committee should also amend H.R. 1728 to incorporate consumer protections for emerging trends such as foreclosure scams, risky FHA lending, and BPOs. Additional foreclosure prevention efforts to assist struggling homeowners, the unemployed, and renters should be included in H.R. 1728 (or into other legislation Congress is currently considering).

NCRC supports H.R. 1728 as a necessary measure to address mortgage reform and the need for comprehensive anti-predatory lending legislation. We believe that our recommendations are critical to enhancing consumer protections and would substantially strengthen the provisions outlined in this legislation.

April 21, 2009

TO THE MEMBERS OF THE UNITED STATES CONGRESS:

The undersigned organizations strongly oppose the numerous anti-arbitration bills and legislative provisions currently under consideration in the 111th Congress. Arbitration has been used to amicably resolve disputes for more than 80 years and is a fair, efficient, and less expensive means of resolving disputes for consumers, employees, investors, franchisees, and businesses. Opponents, however, are trying again to effectively abolish the use of arbitration in consumer, employee, or franchise contracts.

In a recent study of arbitration claims before the non-profit American Arbitration Association, America's largest arbitration service provider, the Searle Civil Justice Institute found that consumers paid an average of $96 per case with claims seeking less that $10,000 and won relief in more than 53 percent of the cases they filed. A study by the California Dispute Resolution Institute bolsters this finding, concluding that consumers prevailed more than 70 percent of the time in arbitration in the cases it examined. Moreover, their disputes were resolved in an average of 100 days, significantly shorter than the lengthy litigation process which takes, on average, two years.

The American public also recognizes that the attacks on arbitration are bad policy. For example, a bipartisan poll conducted for the U.S. Chamber of Commerce's Institute for Legal Reform found that 82 percent of consumers prefer arbitration to litigation as a means to settle disputes, and 71 percent of likely voters oppose efforts by Congress to remove arbitration agreements from consumer contracts. Despite public opposition to Congressional action against arbitration, opponents continue to attack arbitration broadly with bills such as H.R. 1020, the "Arbitration Fairness Act" and its soon to be reintroduced Senate companion, as well as advocating for narrower, industry-specific anti-arbitration bills and provisions. Examples of these industry-specific bills and provisions include:

Mortgage Reform and Anti-Predatory Lending Act (H.R. 1728) contains a provision which would require that "no residential mortgage loan and no extension of credit under an open end consumer credit plan secured by the principal dwelling of the consumer, other than a reverse mortgage, may include terms which require arbitration;"

Consumer Fairness Act (H.R. 991) which would treat many arbitration clauses as an unfair and deceptive trade practice and prohibits their use in consumer transactions;

Fairness in Nursing Home Arbitration Act (H.R. 1237/S. 512) which would prohibit the use of arbitration in disputes between nursing homes and their clients/patients;

Payday Loan Reform Act of 2009 (H.R. 1214) which contains a provision that would make it unlawful for payday lenders to include mandatory arbitration clauses in payday loans under many circumstances; and

Servicemembers Access to Justice Act of 2009 (S. 263) which would prohibit the enforcement of arbitration clauses between an employer and an employee in disputes under the Uniformed Services Employment and Reemployment Rights Act of 1994.

If successful, these bills would retroactively invalidate potentially millions of arbitration agreements and will actually *limit* the realistic opportunity for average consumers, employees, or investors to obtain a remedy if a dispute arises. Studies show that plaintiffs' lawyers are reluctant to take cases involving relatively small claims because they seek larger potential attorneys' fees than would likely result from these cases.

According to one survey, plaintiffs' employment lawyers said they would not take a case unless it was worth at least $60,000, on average. Therefore, without the option of arbitration, consumers and employees would be faced with two choices—trying to navigate the legal system on their own, or abandoning their claim. The only real beneficiaries would be class action plaintiffs' lawyers, who would benefit from both the rare blockbuster claim and the possibility of bringing more class action lawsuits.

These various anti-arbitration bills and provisions are unnecessary and would undermine a system that has benefited consumers, employees, and businesses for decades, and on which many of them now rely. Accordingly, the undersigned organizations strongly urge you to oppose the Arbitration Fairness Act as well as the various industry-specific anti-arbitration bills and provisions currently under consideration in Congress.

Sincerely,

American Bankers Association
American Financial Services Association
American Health Care Association
American Insurance Association
American Seniors Housing Association
American Tort Reform Association
Assisted Living Federation of America
Auto Alliance
Business Roundtable
Consumer Bankers Association
National Association of Home Builders
National Association of Manufacturers
National Center for Assisted Living
National Retail Federation
Property Casualty Insurers Association of America

Securities Industry and Financial Markets Association
The Council for Employment Law Equity
The Financial Services Roundtable
The Institute for a Drug-Free Workplace
U.S. Chamber of Commerce
U.S. Chamber Institute for Legal Reform

CONSUMER MORTGAGE COALITION

April 23, 2009

The Honorable Barney Frank
Chairman
Committee on Financial Services
United States House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Spencer Bachus
Ranking Member
Committee on Financial Services
United States House of Representatives
22129 Rayburn Building
Washington, D.C. 20515

Dear Chairman Frank and Ranking Member Bachus:

You are holding an important hearing today on the need for mortgage market reforms, and on the proposed Mortgage Reform and Anti-Predatory Lending Act, H.R. 1728, in the House of Representatives' Committee on Financial Services. We are pleased to see that your Committee is giving serious consideration to the pressing problems in the mortgage industry.

We have experienced, and are still facing, a financial crisis that in many respects was fueled by breakdowns in our industry – breakdowns that have left whole markets frozen, businesses wiped out or incurring extreme losses, and, most devastating, millions of American families suffering the loss of their homes in foreclosure. We fully support the Committee's efforts to thoroughly investigate the root causes of this breakdown, and pass thoughtful legislation to ensure that it never happens again.

As this crisis continues to unfold, the loan products and underwriting practices that have most widely criticized and scrutinized have ceased. They no longer exist. Now the industry is focused on efforts to keep as many families in their homes as possible through sustainable workouts, loan modifications or refinances. But it also time to step back and reflect on what changes should be made to our home mortgage system. Clearly it is out of alignment. It is also too complex. We would like share our thinking on these issues with you.

H.R. 1728 would add another layer of restrictions and liabilities on the current mortgage process. We have included comments on its provisions below, but we suggest that now is the time to re-

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examine the current process altogether. We believe the current crisis reflects, and results from, structural imbalances in the industry. The crisis calls for a comprehensive and reasoned analysis that identifies not merely what went wrong but why. Consumers' inability to repay their loans is certainly a dire problem, but it is a symptom of deeper, more basic flaws in the way the industry is organized. Unless and until we remove the structural causes of the current crisis, we cannot eradicate the problems.

Thus, we urge the Committee to re-examine the organizational failures of our current system and consider an alternative structure to the current process that makes use of our government-backed institutions as well as private capital to inject standardization and transparency into the mortgage market – a "mortgages in the sunshine" approach. We need to reform the system to align risks and incentives appropriately, restore confidence to the secondary market, and ensure affordable loans to American consumers. The market has a short memory. Without significant structural changes to our mortgage finance system, we cannot be assured that this crisis will not recur.

This letter addresses three things. First, we discuss the principal causes for the mortgage crisis, and outline a proposal for a new structure that we believe appropriately mitigates those causes, including a new role for Fannie Mae and Freddie Mac. This proposal is a preliminary sketch for consideration, with many gaps needed to be filled in, but we believe it is necessary to begin the dialogue for changing our mortgage finance system. Second, we outline some specific comments on H.R. 1728, with the strong note that many of the changes in the bill are about to be addressed by the Federal Reserve Board's Truth in Lending Act regulation on higher priced mortgage loans, due to become effective October 1, 2009. Those comments are contained in Attachment A. Third, because we believe that the current mortgage disclosure process is unduly complex, extremely burdensome, confusing, and getting worse, we also note problems with new regulations implementing the Real Estate Settlement Procedures Act (RESPA) that will be harmful to consumers unless redrawn. Those comments are included in Attachment B.

The Underlying Causes of the Mortgage Crisis

While the causes of the financial crisis will be written about and analyzed for decades, it appears clear that the secondary market, and particularly the securitization market, played a large part in fueling the appetite for higher and higher yielding mortgage products, which in turn fueled more aggressive sales practices by loan brokers and originators, who bore little to no risk on the loans, and more aggressive underwriting practices by mortgage bankers (including little or no verification of income on the loans). The securitization sponsors and investors, however, did not effectively perform due diligence on or "police" the creditworthiness of the loans, relying rather on continued home price appreciation or rating agency ratings both of which proved unrealistic or unreliable. When the housing bubble burst, and many loans turned out to be highly risky, defaults ensued, particularly on nontraditional products, such as option ARMs and hybrid ARMS, which involve sometime stark increases in the interest rate. Securitization investors began suffering significant losses on their securities, and soon lost confidence in the system. In short, the parties originating the loans had incentives to originate as many as possible but no incentive to care about the risk, while the investors who had the risk either didn't fully understand or ignored the underlying creditworthiness of the loans.

To put this in context and to flesh out the active participants in this breakdown, some history is instructive. For much of the last century, savings and loan associations, or "thrifts," provided the bulk of the mortgage loans in this country. In the traditional lending model, the thrift raised money from deposits from its customers and then lent that money to finance home purchases. When a borrower was unable to make its mortgage payments, the thrift suffered the consequences directly. The advent of deposit insurance protected depositors, so loan defaults only risked the capital of the institution. With limited risk management capability and limited ability to raise deposits outside of their home markets, thrifts were subject to a boom and bust cycle that meant that capital flows for mortgage lending were uneven.

The secondary market for mortgages was developed to separate the process of creating loans from the capital required to fund the loans. The secondary market transfers the risk of borrower default to investors. Investors for the most part, however, were unwilling to take on the risk of borrowers whose credit characteristics were unknown to them. To facilitate the availability of capital, Congress created Ginnie Mae, Fannie Mae and Freddie Mac. These agencies take on the credit risk of borrowers and allow other financial market participants to provide funding for mortgages.

These agencies, as well as the mortgage insurance companies, bore the primary risk of default. To protect themselves, they established underwriting criteria for the types of loans they would own or guarantee. While they do not originate loans, the agencies are actively involved in monitoring the process of loan origination.

To further insure the performance of purchased loans, the mortgage market developed the practice of requiring representations and warranties on purchased loans. These representations and warranties are designed to insure that the loans sold meet the purchasers' guidelines. This is necessary because mortgage market participants have long recognized that there is substantial risk in acquiring loans that someone else originated. Representations and warranties are only valuable, however, if their providers have sufficient capital to back up their obligations to repurchase loans subsequently determined to be inconsistent with the representations and warranties. Also, in early 2006, many of the repurchase contracts under which loans that defaulted in the first several months were put back to mortgage bankers were eliminated. This opened the floodgates to many low-doc/no-doc, FICO-based, non-fixed rate loans that have been found to be fraudulent.

In the modern secondary mortgage market, investors have no direct contact with borrowers. While this process allows consumers to access capital from global investors, the crisis has shown that the secondary market does not today ensure a sound mortgage origination process. The market lacks a mechanism to ensure that loans are made appropriately, sold, and priced correctly.

In the secondary market, mortgage transactions are generally structured so that the lender or initial purchaser would take the first slice of credit risk and thus ensure proper loan origination. In some cases, it was possible to originate loans and sell them at such a high price that, even if the mortgage banker or aggregator were to retain a first loss piece (or residual), the transaction could be profitable even if the loans did not perform well. Furthermore, the terms of the residuals sometimes let the residual owners receive a substantial portion of their cash flows before the full extent of losses was known.

The key risk-takers in the market, the mortgage investors, were far from the origination process. At the origination phase, without the discipline of a skeptical buyer, abuses grew. Relying on ratings and limited data, investors chased yields. They did not conduct independent due diligence. They did not limit their investments to appropriately underwritten loans, or price appropriately for the riskiness of the investments they were making.

Fannie Mae and Freddie Mac were also chasing yield and fees. Between the two firms, they funded up to 36% of the subprime loans in the years prior to the bubble bursting. Given their market presence, their decision to participate in these loans gave false comfort to other investors who should have been doing more due diligence.

An unintended consequence of the readily available credit extended largely by the less well-capitalized mortgage market participants was that many borrowers were able to buy homes that they otherwise could not afford. The vast majority of these loans were made with little or no documentation from the borrowers with relatively high FICO scores, but who were not truthful on their loan applications. This served to further inflate home prices. Once home prices stopped rising and began falling, the inadequacy of the loan underwriting standards of many loans has become clear to all.

As losses began to be incurred and credit standards tightened, the adverse consequences of the subprime mortgage boom became exacerbated. As noted, many borrowers who have been current on their loan payments are facing a steep increase in payments as they approach reset. With tighter credit standards and the decline in home values, it is much more difficult for them to refinance, increasing the risk of default. The decline in home prices also reduced the opportunity for borrowers to sell their homes to avoid a default and foreclosure. While loan modification and refinance programs are being activity pursued to assist borrowers in distress, defaults and foreclosures remain at record levels. These developments have now affected even those who maintained disciplined lending practices.

In summary, the economy is undergoing a significant and painful de-leveraging process. The crisis, and indeed the broader worldwide financial crisis, was caused by a massive over-leveraging by all parties, including borrowers as well as lenders, securitizers, and investors.

Proposal for Consideration

We believe a new mortgage finance structure should be considered which centers on a transparent, standardized securitization process that will restore confidence in the market. Securitizations were the principal driver of the demand for mortgage loans that today are not able to be repaid. Securitizations, therefore, must be the focus of reform. This proposal attempts to reinsert discipline and foster more conservative, well-informed investment decisions, which will influence initial mortgage credit decisions that are sounder. Under this proposal, the secondary market door will be closed for many of the loans that should not have been made in the last few years. Any new structure must be flexible so as not to stifle innovation, but at this point a return to basics is what we believe is required.

While our recommendations are continuing to be developed, the following are our suggestions for reengineering the mortgage finance system at this time:

Mortgage Clearinghouse – Public/Private Joint Venture

An at-cost cooperative entity (a "Mortgage Clearinghouse") would be established to standardize, centralize and enhance the residential mortgage securitization process. (This would be an analog to the Depository Trust & Clearing Corporation (DTCC), which provides an efficient and safe way for buyers and sellers of securities to make their exchange, and thus "clear and settle" transactions.) The purpose of the Mortgage Clearinghouse would be to act as a "gateway" for securitized mortgage product so as to restore liquidity to the securitization market now and maintain the integrity of the market in the future. It would accomplish this purpose by establishing basic underwriting rules, requiring data transparency, and provide reinsurance coverage, backed by appropriate levels of capital, on the securitizations.

Underwriting Standards

The Mortgage Clearinghouse would ensure all loans being put into a securitization meet basic underwriting and eligibility standards, established by its board of directors ("Board"), such as full documentation of income and financial resources, no negative amortization, acceptable loan-to-value ratios, etc. All investors would be assured that the loans were subject to and met these standards.

Transparent Loan Data

To enhance the transparency of the loans going into securitizations, the Mortgage Clearinghouse would make available to all investors data on all loans being put into a securitization, on both the creditworthiness of the borrower and the value and features of the property (subject to appropriate constraints). This ready availability of credit information is critical. Part of the problem that led to the crisis was the over-reliance on rating agencies. While we believe rating agencies should be better regulated, we also feel that investors and securitizers should themselves take the responsibility for ensuring the soundness of the mortgages underlying a securitization. This can only be accomplished by more effective due diligence, facilitated by easy access to accurate data on the loan pools. The Mortgage Clearinghouse can enhance this process also by providing standardization to this data.

Ownership Structure

We suggest that the Mortgage Clearinghouse would be owned 50% by well-capitalized private lenders and financial services companies and 50% by a government entity, with members of the Board appointed from both sides. We recommend that the government entity be a single Government Sponsored Enterprise (GSE), resulting from the merger of Fannie Mae and Freddie Mac.

To prevent a recurrence of their need for massive amounts of federal backing, the role of Fannie Mae and Freddie Mac must change. And it is changing. Fannie Mae and Freddie Mac are in conservatorship, and operated by the federal government. They are dependent of federal funding to survive. Since September 2008, the federal government has infused over $400 billion into Fannie Mae and Freddie Mac, and that number is climbing. Further, the Department of the Treasury is using the GSEs to administer and monitor compliance, by private lenders, with the Homeowner Affordability and Stability Plan. As part of this effort, the federal government will permit the GSEs to refinance certain mortgage loans into new loans without complying with the GSE charter act requirements for mortgage insurance and for prior regulatory approval of new products. The GSEs are no longer functioning as private corporations. It is time to rethink and redesign their role. The GSEs future role should be one of a public utility that adds value, but that does not displace available private sector capital and resources.

Reinsurance backed by Capital

Another large part of the problem causing the crisis relates to a lack of capital by some key players in the mortgage market. Loan originators and sellers today may be theoretically liable for a faulty loan in a securitization, but recovery from the at-fault originator is not possible if that originator has no capital to absorb its future liability. The ability to avoid liability for making inappropriate loans by the simple expedient of not holding capital is a bad design, affecting all loan types and loan products, and one in need of Congressional attention. This is particularly a problem for sales into the secondary market. Unlike today, a new system must eliminate the incentive loan originators have to push through any loan type that can possibly be pushed through to the secondary market, even (or especially) if the borrower does not know what the loan entails. Originators who sell their loans must have some responsibility, and liability, for the future performance of their lending decisions, even if the liability does not arise until well after loan origination.

Thus, the Mortgage Clearinghouse would also provide a means whereby the lenders or aggregators who submit a pool of loans for securitization would assume some level of risk on such securitization, backed by adequate capital. This would apply to loans across the mortgage spectrum. To effectuate this assumption of risk, the Clearinghouse would provide a reinsurance "wrap" on the securitizations that it processes. The lenders that participate in the ownership of the Mortgage Clearinghouse would have their ownership capital at risk under this reinsurance for the securitizations they sponsor. Thus, these private lenders will have a financial stake to act as gatekeepers to the secondary mortgage market, accepting liability, backed by capital, for loans that go into the securitizations and later default. [That responsibility could be shared mutually or could be individual.]

Portfolio Loans Have Built-In Safeguards

The reason why we focus our proposal on securitizations is that lenders that hold the loans they make in their own portfolio have much greater incentive to be concerned about loan performance than some lenders that sell their loans into the secondary market. For loans not sold in the secondary market, the consequence of making inappropriate loans is simple and is self-enforcing – if the borrower does not repay, the lender loses. Thus, loans not sold in the secondary market already have a built-in safeguard against abusive or inappropriate loans.

There is a need, however, for Congress and federal regulators to re-examine the capital requirements that favor putting loans into a securitization over holding them in portfolio. While we understand aligning risk with capital requirements, we need to ensure that capital requirements do not present an undue obstacle to holding loans in portfolio – i.e., that there is a level playing field.

Align Mortgage Broker Compensation with Loan Performance

Experience has shown that loans originated by mortgage brokers have higher default rates than loans made directly by a mortgage lender. We believe that part of the reason for this is that the mortgage broker works for a fee or commission, earned as soon as a loan closes, without regard to the future loan performance. While some lenders required a "hold back" of a small percentage of the broker fee, based on a repurchase from the secondary market, this was not by any means the rule. Thus, the broker's interest in receiving upfront compensation on a closed loan was not in alignment with the borrower's, lender's or investor's interest in ensuring that the loan can be repaid. Even if the broker made representations and warranties to the lender, brokers generally have very little capital with which to repurchase a loan or indemnify a lender's losses on a defaulted loan. This situation has given rise to greater incidences of fraud or other breaches of representations in the origination process.

We recommend that this be changed. Much like insurance agents, who receive their sales commissions over time, mortgage brokers should receive their compensation over a period of time. We are not recommending that mortgage brokers take credit risk on the loan beyond responsibility for breach of representations and warranties. But an early payment default often is the result of problems in the origination process. A broker, who knows that his or her compensation is conditioned on a loan performing for one or two years, is much less likely to engage in fraud or questionable practices that could result in an unaffordable loan.

We recommend that this structural change be made for all residential mortgage loans, not just those put into a securitization, because portfolio lenders share the same need as the secondary market to be assured that no fraud has occurred on their loans. The goal here is to create the right incentives and organizational structure that will yield affordable, sustainable mortgage loans for consumers, in contrast to the current system which, as shown above, led to the crisis we are all facing. We firmly believe that a structural approach to the problem is better than Congress simply banning certain types of loans or loan terms. Restricting certain types of loans or loan terms will not address the underlying problem of misaligned incentives. It would merely require those with inappropriate incentives to design another type of loan that someone, somewhere, will make or buy.

E-Mortgage Study

Finally, we recommend that Congress order a study be made of the use of electronic mortgages. We believe there are great cost savings and other advantages (including significant potential fraud reduction) to be realized from greater use of E-mortgage processes, from origination to closing to servicing as well as in the secondary market investing. While strides have been made, a study should be undertaken of why electronic mortgages do not represent a more significant part of the mortgage market. We should understand what obstacles exist that are preventing E-mortgages from being more prevalent.

We appreciate the opportunity to present these views for your consideration. We look forward to working with the Committee as it further examines these issues that are critical to our industry and the consumers we serve.

Sincerely,

Anne Canfield
Executive Director

Attachment A – Comments on H.R. 1728

We have the following comments on the provisions of H.R. 1728 (the "Bill"). Overall we note that many provisions in the Bill reflect requirements are already addressed by the Truth In Lending Act final rule adopted last summer, most of whose provisions go into effect October 1, 2009. The industry is hard at work implementing those significant changes. We recommend allowing those provisions to go into effect before layering on an additional set of restrictions.

Definition of mortgage originator (Sec. 101). This definition could include many loan servicers who advise borrowers on loan terms, or who work on or "offer" loan modifications. They should be excluded. We recommend the definition of "mortgage originator" mirror the definition of "loan originator" in the SAFE Act (but substituting the term "person" for the term "individual").

Duty of Care Provisions (Sec. 102). This section requires mortgage originators (including mortgage broker entities and individual loan officers) to disclose to the consumer the nature of their relationship to the consumer. This requirement makes sense for mortgage brokers because the relationship of the broker to the consumer is not always clear and any conflicts of interest the broker may have in serving the consumer's interests should be identified to the borrower. If the broker is acting as the consumer's agent, the broker has a duty to fully and fairly represent the interests of the consumer in obtaining a home loan. A broker that does not act as the consumer's agent should disclose both the broker's lack of a duty to the consumer—that the broker is neither representing the interests of the consumer nor legally responsible for getting the consumer the best rate or product for their home loan—and that the consumer should shop around. However, it does not make sense to require loan officers employed by lenders to be required to make such disclosures to consumers, as it is clear to the consumer that they work on behalf of the lender.

This section requires mortgage originators to disclose to the consumer any relevant conflicts of interest. Again, this requirement makes sense for mortgage brokers because their relationship to the consumer is not always clear. However, all lender-employed loan officers have an inherent conflict of interest with borrowers because they represent their company and presumably its shareholders, not the borrower, and this conflict of interest should be readily apparent to the consumer because the loan officer works for the lender.

The section requires a mortgage originator to certify to the creditor that the mortgage originator has fulfilled all requirements applicable to the originator. Brokers should be required to certify to lenders that they have complied with the requirements that apply to the broker. However, under the Truth in Lending Act, a lender is a creditor. Thus, this provision would require originators that are employed by lenders to make individual certifications within the company that the law has been complied with. Again, this should not be required. This provision also does not explain whether and to what extent the creditor is entitled to rely on the mortgage originator's certification. Arguably, this provision could be interpreted as providing a lender with a cause of action against a broker if the requirements of the section are not satisfied. However, the provision does not provide any clarification on this issue.

The section provides that the federal banking agencies will promulgate regulations to further define the duty of care established under the section. There are many undefined terms in this section, such an "appropriate" loan, or loans with "predatory characteristics or effects (such as equity stripping and excessive fees and abusive terms)," "reasonable ability to repay," and "net tangible benefit." Greater guidance should be provided as to the role of the federal banking agencies in defining these terms. At a minimum, the federal banking agencies should be instructed to develop forms and bright-line tests that are easy to understand, for purposes of certainty of compliance.

The section provides that the relevant agencies must endeavor to make the required disclosures to consumers under this subsection complementary and nonduplicative with other disclosures for mortgage consumers to the extent such efforts (i) are practicable; and (ii) do not reduce the value of any such disclosure to the recipients of such disclosures. The current disclosure regime is a complicated quagmire that is being made even worse by the extraordinarily burdensome and confusing requirements of the new RESPA reform rule. As noted on Attachment B, we urge Congress to have HUD withdraw the RESPA rule and require the Federal Reserve Board and HUD develop a single, standard mortgage disclosure that is easy to use and understand.

Anti-Steering Provisions (Sec. 103). This section's prohibition on varying incentive compensation to an originator based on the terms of the loan should be clarified. It should not apply to the amount of any purchase premiums or service release premiums paid in connection with any transfer of loans in the secondary market.

The section calls on the federal banking agencies to promulgate regulations to prohibit abusive or unfair lending practices that promote disparities among consumers of equal credit worthiness but of different race, ethnicity, gender, or age. This language appears to create a disparate impact standard. The Equal Credit Opportunity Act and Fair Housing Act already seek to prohibit discrimination in lending. Before a provision such as this should be enacted into law, clarification is needed as to how it would fit into the existing legal regimes.

Liability For Violations (Sec. 104). This section would amend Section 129A of the Truth in Lending Act by inserting a subsection on liability for violations of a provision of the bill or any regulations subsequently promulgated pursuant to it. These remedies would be up to three times the total amount of direct or indirect compensation *or gain* accruing to the mortgage originator in connection with the residential mortgage loan involved in the violation, plus the costs to the consumer of the action, including a reasonable attorney's fee. It is unclear why this provision creates another remedy structure in TILA. TILA already contains a remedy provision in Section 130. It is unclear how this new remedy provision would interact with the current structure of Section 130.

UDAP Regulations (Sec. 105). This section gives broad authority to prescribe regulations addressing unfair, deceptive, predatory, or other acts and practices not in the interest of the borrower. This authority should be coordinated with existing regulations under Section 129 of TILA so as not to adopt conflicting standards.

Safe Harbor and Presumption (Sec. 203). This section allows a creditor and an assignee or a securitizer to presume that a loan meets the Bill's requirements for reasonable ability to repay and net tangible benefit requirements if the loan is a "qualified mortgage," but the presumption is rebuttable. We are concerned that the definition of "qualified mortgages," which are limited to only "low risk" prime or very near prime, 30-year loans, is far too narrowly defined. It is important to understand that many creditworthy consumers would not meet the bill's "low risk" standard. The bill would effectively prohibit all loans but those priced as low-risk loans, meaning those made to the most creditworthy and highest-income borrowers. People with comparatively higher LTV or debt-to-income ratios, low credit scores, income that is difficult to verify, or income that fluctuates, would likely be left out of the mortgage market entirely. And there is no reason that 15 year or 40 year loans would not be qualified loans. We recommend the regulators be given the authority to identify products that may be "qualified mortgages", which would allow both prime and nonprime loans to be "qualified" unless they contain high risk features, such as negative amortization.

Liability (Sec. 204). Section 204 adds a new Section 129B(d) to TILA creating a civil action for rescission. As noted below, this rescission appears to differ significantly from the current rescission mechanism in Section 125 of TILA (which does not provide for a "civil action"). Significantly, the creditor or the assignee may cure the violation giving rise to the rescission claim. The structure of Section 204 is complex.

Section 204 is a significant departure from the long-standing right of rescission under TILA.

- *What is rescission under TILA?* Rescission has properly been described as the most "draconian" remedy under TILA. Under Section 125 of TILA, when a borrower exercises its right of rescission, the borrower must repay the principal amount of the loan and the creditor must return all "finance charges".

- *How much does a creditor pay in rescission?* All "finance charges," including interest and other fees and charges. Because of how mortgage loans amortize, the initial monthly payments on a mortgage are almost all payments toward interest, and gradually the payments are paid less toward interest and more toward principal, this is tantamount to returning nearly all mortgage payments as well as other fees and closing costs. If a borrower rescinded after two years, the creditor would have to return an amount nearly equal to two-years' worth of mortgage payments. The longer the time period between loan closing and rescission, the greater the amount of the cost. (Six years' worth of mortgage payments would amount to tens of thousands of dollars in rescission, even for loans secured by lower-cost houses.) Some courts have even held that a loan that has been paid off in its entirety can be rescinded after the fact.

This remedy is especially concerning when one considers it is triggered by violations of subjective concepts like "reasonable ability to repay" and "net tangible benefit."

- It is unclear whether Section 204 of the bill is the same as rescission under Section 125 of TILA?

- The bill differs significantly from TILA § 125 in how rescissions can happen. Under § 125, a borrower provides notice of rescission to the creditor or raises rescission as a defense in foreclosure. In contrast, the bill creates a new civil action for rescission. It is unclear how this new remedy provision would interact with the current structure of Section 125.

  Under TILA, rescission is intended to return the borrower and creditor to the status quo (i.e., to how things were before their pre-loan positions). Section 204, however, turns rescission into a significant monetary damages provision. More clarity is needed on the meaning and effect of this new rescission right.

By prohibiting Section 204 rescission class actions only against assignees and securitizers, the bill appears to permit Section 204 rescission class actions against creditors. A rescission class action could expose the mortgage lending industry to hundreds of billions of dollars in potential litigation liability. Courts are in disagreement as to whether TILA § 125 permits rescission class actions. Arguably, Section 204's class action provision could tip the scale and expose lenders to rescission class actions under § 125—again, exposing lenders to potentially hundreds of billions of dollars of liability.

Defense to Foreclosure (Sec. 205). Section 205 provides that a borrower with a right to bring a Section 204 rescission action can assert that right as a defense in foreclosure. If the foreclosure proceeding begins after the right to bring a Section 204 rescission action expires, the borrower can seek "actual damages" incurred by the violation. Section 205 also provides that a holder or anyone acting on behalf of a holder may sell a loan to a creditor, etc. to effect a rescission or cure.

- The bill provides no indication as to what "actual damages" would be in the "reasonable ability to repay" or "net tangible benefit" contexts. There is some risk that a court could interpret this as being the financial equivalent, or close to the equivalent, of rescission. If so, this would effectively extend indefinitely the financial consequences of a Section 204 rescission action. If not, it might be the difference to a loan that the borrower could repay, or one that would have met the benefit test.

Tenant Protections (Sec. 206). Section 206's requirement that a foreclosure be subject to "any bona fide lease" will have a chilling effect on lenders making loans. Lenders (and servicers, etc.) do not want to be in the property management business. Foreclosures n substantial losses for the entity foreclosing—even when the foreclosed property is sold quickly—and foreclosures are a last resort to try to limit losses. If foreclosing properties must be subject to existing leases, lenders and investors will have less appetite for properties that might be rented unless the cost of the loan compensates them for the risk. The net effect of this requirement likely will be to make mortgage credit more expensive and less available to many consumers.

Rule of Construction and Effect on State Laws (Secs. 207, 208). Section 207 provides that Section 129A and 129B of TILA (as added by Title I, Subtitle A, and Title II) do not affect any other state or federal laws. Section 208 provides only that Section 129A(d) (as added by Section 204 and dealing with rescission) supersedes similar state laws applicable to assignees or securitizers. The bill's lack of meaningful preemption is highly problematic. Without preemption, the bill would be little more than another major overlay in the already confusing and inefficient patchwork of state laws. We urge Congress, if it decides that standards and requirements are mandatory, to make those standards the universal rule. Otherwise, the cost of lenders' compliance with various and inconsistent state laws will be passed along to consumers, raising the cost of credit.

Credit Risk Retention (Sec. 213). While we appreciate the goal of requiring creditors of non-"qualified mortgages" to align their economic interests with borrowers and investors by retaining a 5 percent interest in loans sold, we recommend that this proposal be further studied. It will have significant and potentially adverse implications for capital-starved financial institutions, as well as for non-depositories that will have difficulty raising capital to support the recourse. We refer to our suggested mortgage system restructuring proposal above. We clearly believe that adequate capital should stand behind reinsurance obligations of aggregators and loans sellers who are putting their pools of loans into securitizations.

Additional Disclosures (Sec. 214). Requiring a disclosure of the "approximate amount of the wholesale rate of funds" in connection with the loan is unclear and potentially highly problematic. If the intent is to disclose the wholesale rate that a lender provides to a mortgage broker so that the borrower understands how the rate may be increased to allow the financing of costs (including the broker's compensation) through the rate or decreased by paying higher points on the loan, such a disclosure may assist the borrower's understanding of his or her options for paying the costs of the loan. Even here, however, it may be overly confusing, intrusive, and burdensome, as a lender's wholesale rate is subject to frequent change, and is often based on a large number of factors, including loan amount, loan type, FICO score, and a host of factors measuring the quality of broker originations. But to the extent this section could be interpreted to require any disclosure of the purchase premium or servicing release premium that a lender may receive when selling a closed loan to an investor after closing is unacceptable. Borrowers should understand the rate and costs of a loan that a lender charges, and should understand the amount of the mortgage broker's compensation and the ways in which it may be paid (in addition to the role the broker is playing in the transaction). But once the loan is made, the economic impact on the lender of its choice either to keep the loan in portfolio and earn the interest paid by the borrower over time, or sell the loan into the secondary market for a purchase or servicing release premium (in effect, monetizing the interest stream) is not relevant to the borrower and should not be subject to disclosure.

HOEPA Changes (Title III). Title III would substantially amend the existing provisions of the Home Ownership and Equity Protection Act of 1994 ("HOEPA") to cover more types of loans, to lower the "thresholds" so that loans with lower interest rates and lower points and fees will be subject to the various requirements, to add additional charges to the "points and fees" calculation used for the threshold, and to impose numerous additional obligations on covered loans. The net effect of these changes is to broaden the number of loans that, if made, would be covered by HOEPA. The net result of this is these loans will not be made. Because of the assignee liability provisions and higher penalties, the secondary market has no appetite for HOEPA loans. Thus consumers will have less financing options available to them. For practical purposes, the HOEPA thresholds function like usury ceilings. Lowering the thresholds likely will simply lower this usury ceiling.

Escrow Provisions (Sec. 501). This section would amend the Truth in Lending Act to add a new Section 129D that would create new escrow or impound account requirements on certain mortgage loans. In particular, the section would require an escrow or impound account for first-lien mortgages (excluding HELOCs and reverse mortgages) in certain circumstances. Among other concerns, it is unclear whether the section eliminates federal preemption of state escrow law for federally-chartered entities, and expose these entities for the first time to the varying requirements of the various states. The bill should clearly provide that federal preemption continues to apply.

RESPA Amendments (Sec. 503). This section makes other amendments to the current provisions of RESPA with respect to force-placed insurance (insurance placed on a property when the borrower fails to maintain hazard insurance), payment crediting, etc. We recommend that, to prevent abuse, the section clarify that the "qualified written request" (QWR) can only be used to obtain specific information directly related to the borrower's loan, and cannot be used by plaintiffs' lawyers as a substitute for discovery or a means to engage in fishing expeditions.

The new timing requirements for QWRs are much faster than is reasonably possible. As information requested often is need to be obtained from a prior servicer, we are concerned that they are unrealistic. For many subprime borrowers, the prior servicer is in bankruptcy or no longer exists.

The new force-placed insurance requirements in RESPA Section 6(l), as amended, would create a 45-day letter cycle (30 and then 15 prior to placing force-placed insurance). In practice, this requirement likely would lead to all non-escrowed loans receiving a letter to ensure the timing of this requirement can be maintained. Instead of this problematic cycle, we request that a servicer coordinate with force-placed insurance carriers as to when the insurers know or suspect the borrower has no insurance. We also recommend that the Bill permit other forms of communication than first-class mail, particularly electronic communication, which borrowers often prefer.

Escrows Included in Repayment Analysis (Sec. 505). Section 505 would amend TILA to require the inclusion of escrow payments into the TILA repayment schedule disclosure. We are very concerned about this new requirement. Escrow payments change each year (as taxes, insurance premiums, etc. fluctuate from year to year). However, the TILA monthly payment disclosure does not provide for such fluctuations. The monthly payment disclosure has been based on the payments required by the note. TILA permits NO tolerance for the disclosure. If escrow payments are added to the repayment schedule, the result will be that all payments will be estimates (and all will be inaccurate to some unknown degree). As lenders will not be able to comply with TILA's strict requirements as they now exist—a wide tolerance must be established.

Appraisal Requirements (Sec. 601). We continue to urge that appraisers be made subject to significant insurance requirements to back up their valuations. This would provide an economic incentive for appraisers to be accurate in their appraisals and resist their urge to inflate values.

We share the Committee's concern about fraudulent or abusive appraisals. However, we are concerned that very high penalties are inappropriate given the broad and vague nature of the term "unfair and deceptive practices or acts." In addition, prohibitions on appraiser pressure are appropriate, but the requirements should be a two-way street. Lenders should be held liable for pressuring appraisers, and appraisers likewise should be held accountable for succumbing to pressure (overt or imagined) and inflating appraisals. Additionally, appraisers should be required to report contemporaneously any instances of an attempt to improperly influence the appraisal, both so that such attempts will be eradicated and so that appraisers are not able to hide behind ex post facto claims of pressure that may be very difficult for lenders to rebut. If an appraiser does not report an attempt to improperly influence an appraisal, the appraiser—not the lender—should be liable for any inflated valuation. If appraisers do not stand behind their valuations, there is little value in preferring them in transactions over AVMs.

Attachment B – Recent Changes to RESPA Rules

One of the problems in the mortgage market today is that consumers did not always understand loans that they were obtaining and the documents they were signing. Certainly this needs to be fixed, and efforts have been underway for some time to improve consumer mortgage disclosures. Congress last July enacted the Mortgage Disclosure Improvement Act (MDIA), which amends the Truth in Lending Act (TILA). The Board of Governors of the Federal Reserve System is actively implementing the MDIA through consumer testing and through rulemakings.

As you know, over the objections of over 250 Members of Congress, the Department of Housing and Urban Development (HUD) recently issued regulations implementing the Real Estate Settlement Procedures Act (RESPA) that become effective January 1, 2010[1] (the "New Rule"). The New Rule has created untold problems for lenders seeking to implement systems to implement it. There are literally dozens of critical questions, both legal and operational, unanswered under the New Rule, and no guidance form HUD has been forthcoming.

We urge Congress again to encourage HUD in the strongest possible terms to withdraw the RESPA Rule. The problems are legion.

The underlying purpose of RESPA and its implementing Regulation X is to help consumers understand the terms of and the settlement costs of residential mortgage loans. Recent amendments to Regulation X, for which compliance is required by January 1, 2010, would in many instances have the opposite effect.

- The revised Regulation X needs to be coordinated with similar disclosures under the Truth in Lending Act (TILA) because the two are closely related.

- There are several areas where RESPA and TILA disclosures need to be coordinated, but the most prominent is the difference between an interest rate and an annual percentage rate (APR), as described below. The interest rate and APR are of paramount importance to consumers, yet the difference between them is complicated. Under the new Regulation X, consumers may often not see an important part of their loan before they close.

- Regulation X seems to prohibit lenders from providing consumers with binding loan commitments until after a consumer has selected a home to purchase. This is unfortunate because consumers are normally better advised to find out how much they can afford to spend before they select a new home.

[1] 72 Fed. Reg. 68204 (November 17, 2008), implementing the Real Estate Settlement Procedures Act.

- Regulation X will require binding good faith estimates (GFEs) of settlement costs, to be provided either by a lender or a mortgage broker. But the regulation does not address the possibility that a broker may provide a GFE with disclosures that differ from the lender's disclosures. Consumer confusion will result.

- Although it is not final, the new definition of "required use" clearly needs revision, and HUD appears willing to revisit that issue. As drafted, lenders would be required to ensure that consumers do *not* receive any type of discount from settlement service providers that the lender identifies on a GFE.

Additionally, Regulation X has a number of gaps in its instructions as to how to make certain disclosures and where the disclosures must appear on a form. Lenders and settlement service providers are "driving blind" as they try to determine what the regulation requires in a number of areas. Sometimes, over disclosing can solve problems of unclear disclosure requirements. But RESPA's GFE and HUD-1 Settlement Statement do not permit this because they add up the required disclosures to arrive at total costs. Here, the potential solution of over disclosing can result in inaccurate totals.

The following identifies with some specificity the major concerns and unanswered questions we have with the new rule.

I. Coordination with TILA

RESPA and TILA both have the purpose of informing consumers about their loans. The two laws are similar in that they both require disclosures informing consumers about their mortgage loan terms. RESPA and TILA require disclosures that overlap in several areas. These disclosures can be effective only if they complement each other. The most recent amendments to Regulation X will require lenders to make consumer mortgage disclosures that, with TILA disclosures, will confuse consumers.

A. Confusing Interest Rate with APR

One of the most unfortunate, and preventable, problems with the revised Regulation X concerns the difference between an interest rate and an annual percentage rate (APR). Regulation X will require lenders to disclose a loan's interest rate on a good faith estimate (GFE), but the GFE may not include the APR. TILA requires lenders to disclose a loan's APR. That is, consumers will receive two separate pieces of paper, one disclosing the interest rate and another disclosing the APR.

Some consumers will read the first disclosure they receive about the loan rate, whether it is the interest rate or the APR, and then stop reading because they will believe they have received the information they need. Unless they happen to understand the difference between the interest rate and the APR, they may not have received the correct information if they do not pay careful attention. This is simply unfair to consumers.

An interest rate and an APR are not the same. They differ in their inclusion of points, which is particularly important in mortgage lending because points can make a significant difference in the cost of mortgage credit.

- The interest rate does not include points.
- The APR includes the interest on a loan, plus any points on the loan, divided by the principal amount.

As the Federal Reserve Bank of New York explains:

> Some lenders charge lower interest rates but more points than other lenders. The APR therefore provides a useful gauge for comparing the total cost of mortgage loans.
>
> For example, a 30-year mortgage with an interest rate of 8.0% and four points would have an APR of 8.44%, while a mortgage with an interest rate of 8.25% and one point would have an APR of 8.36%.[2]

It is quite unreasonable to expect consumers to be aware of the difference between an interest rate and an APR, let alone to be able to calculate it. Regulators should resolve the required disclosures "behind the scenes" so that consumers do not need to discover by themselves the complexities of APR calculations. Requiring lenders to disclose the interest rate on one paper while disclosing the APR on a different piece of paper will obviously confuse consumers.

B. "Our Origination Charge" vs. "Itemization of Amount Financed"

Another area of confusion between the two sets of rules concerns the new definition of "our origination charge" under RESPA and the disclosure of "amount financed" under Regulation Z.

- The Revised Regulation X will require GFEs to disclose as a lump sum "our origination charge" that must include "all charges that all loan originators involved in this transaction will receive, except for any charge for the specific interest rate chosen (points)."[3]

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[2] *Interest Rates: An Introduction, Definition*, available at http://www.ny.frb.org/education/define.html#aps.
[3] Regulation X Appendix C at 73 Fed. Reg. 68204, 68253 (November 17, 2008).

- Regulation Z permits lenders to substitute a GFE for the Regulation Z disclosure of a "written itemization of the amount financed[.]"[4]

Because the new GFE will use a lump sum for origination charges, it may not make clear to consumers what is included in their "amount financed." Lenders can create an additional disclosure to explain this to consumers. If each lender must create its own consumer disclosures, the disclosures may not be uniform. This will confuse consumers unnecessarily.

Again, this is an area where regulators need to decide "behind the scenes" what information lenders should disclose and in what form. All RESPA and TILA disclosures should be created together and integrated so they will be seamless to consumers. Which regulation requires a disclosure is not relevant to consumers.

C. Multiplicity of Frequent Disclosures Can Confuse Consumers

If a lender will collect charges related to a change in circumstances, Regulation X will require an amended GFE if certain settlement costs change, may require a new GFE if loan terms change, will require an amended GFE if the consumer locks an interest rate, and will require an amended GFE if the earlier GFE expires. Regulation Z will require "corrected disclosures" if an APR changes, which can happen for a number of reasons. The result is that consumers will receive disclosures more frequently than they do today. A large number of disclosures are especially unhelpful if the disclosures themselves are uncoordinated and confusing. State regulations may require yet more disclosures. The benefit of inundating consumers with a large number of complicated disclosures is not apparent. The far better approach would be to require clear disclosures only when they are meaningful.

D. Definition of Business Day

Both RESPA and TILA rules require delivery of disclosures within three business days of a loan application. Both sets of rules define "business day" consistently for this purpose. However, the definition can be ambiguous, and it can vary by lender. We believe both rules should use a clear, consistent definition.

Under both RESPA and TILA, the three-day disclosure requirements use a definition of "business day" that depends on which day an entity is open to the public for carrying on substantially all of its business functions.

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[4] 12 C.F.R. § 226.18(c), note 40.

Regulation Z uses, for other purposes, a more precise definition of business day – all calendar days except Sundays and Federal holidays.[5] This more precise definition does not depend on a determination of which days a lender is "open."

- A definition based on which days a lender is "open" is ambiguous in the information age. Many lenders are open for most purposes around the clock every day, through websites and automated teller machines, as well as through live telephone call centers and automated telephone response systems. Using a definition that turns on when a lender is open for substantially all business can make it difficult to know which day is a business day.

- Even if we could clearly determine which day a lender is "open" for business, the distinction is likely meaningless to consumers. The purpose of the three-day disclosure requirement is to ensure consumers receive their disclosures quickly. Consumers do not know which days a lender is "open" under federal regulations, and for purposes of receiving timely disclosures during the information age, may not believe it is relevant.

- Further, a definition based on when a lender is "open" will vary by lender. For example, lenders in Maine and Massachusetts may close their offices the third Monday in April when those states observe Patriots' Day, while lenders in other states probably have staffed branch offices that day. There does not appear to be any justification for assigning consumers differing disclosure rights based on their lender's geographic area or varied holiday schedules.

- A variable definition of business day can present a problem for brokered loans. Regulation X permits either the lender or a mortgage broker to deliver the initial GFE, within three business days after a broker receives a loan application. This can be construed to permit GFE delivery within three of the lender's business days, or three of the broker's business days, after the broker receives the loan application. With a variable definition, there are two measures of the same time period for the same loan.

While the more precise definition is the better definition because it does not depend on the vague issue of when an entity is "open," the *most important issue* is that consumers receive their first disclosures as close in time as is reasonably possible. Especially given the importance to consumers of the APR disclosure, and given the fact that APR may not be included in a GFE, it is important that the two initial disclosures be close in time.

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[5] 12 C.F.R. § 226.2(a)(6).

Rather than retaining the vague definition in Regulation Z just to be consistent with Regulation X, it would be better to include the better definition in both regulations. This would satisfy the important goal of getting disclosures to consumers close in time and quickly, while using the same definition for all lenders regardless of when they are "open." Both regulations should use the more precise definition.

II. Loan Commitments and Preliminary Loan Determinations

Regulation X requires disclosures after a lender receives a loan application. The revised Regulation X definition of "application" does not seem to permit the very common practice of a consumer receiving a binding loan commitment from a lender before deciding which house to buy. It also does not seem to contemplate the practice of prequalifying consumers to give them a preliminary loan determination rather than a binding commitment. Both binding commitments and preliminary determinations are helpful to consumers as they shop for mortgage loans and for homes. There does not appear to be any reason to deprive consumers of these tools.

- The problem arises from the revised Regulation X definition of "application," which must include six items. One of the required items is a property address. Before a customer selects a home to purchase, there is no property address and therefore no "application." Without an "application," a lender is prohibited from requiring the consumer to submit income verification information. Lenders cannot make binding loan commitments without income verification. That is, binding loan commitments will be prohibited before a consumer has selected a home. This will force consumers to shop for a house before they shop for a mortgage, even though the opposite is the safer practice.

- Similarly, under the revised regulation, making a preliminary determination appears to be the same as taking a full loan application. There does not appear to be any consumer benefit from preventing lenders from offering preliminary loan decisions so consumers have some idea of the loan they qualify for before they decide whether to continue with the process. Because the regulation does not make this distinction, it appears lenders may be prohibited from offering preliminary determinations.

III. Loans Submitted through Brokers

Regulation X will require lenders or brokers to deliver GFEs to consumers, and much of the information disclosed in the GFE is then binding. A broker may deliver a GFE to a borrower before the lender receives any loan inquiry. The revised regulation is rather unclear about which GFE prevails.

- Is it the GFE the broker delivers to the consumer without the lender's knowledge? Or must the lender deliver a new GFE that supersedes the broker's GFE? If it is the latter, is the lender bound by any part of the broker's GFE?

- Is a broker's submission of an application to a lender a changed circumstance permitting either the lender or the broker to revise the GFE?

- Or perhaps the broker is bound by its GFE while the lender is bound by a differing GFE on the same loan. If the lender and broker disclose conflicting terms, which prevail?

- Or perhaps the regulation requires lenders and brokers to agree ahead of time what the GFE will contain. Exactly how, when, and how often such pre-application coordination should happen is unclear.

How any of this will benefit consumers is not apparent.

IV. Required Use

The definition of "required use" in Regulation X was amended (although HUD is revisiting the revision due to pending litigation). HUD amended the definition to prevent inappropriate steering of settlement services business to builders' affiliates. However, as drafted the amendment would do more. It would prohibit lenders from passing discounts on settlement services through to borrowers.

- Section 8 of RESPA prohibits receiving any "thing of value" for referrals of settlement services business. Regulation X defines a "referral" to include a required use. The new definition of required use includes giving a consumer access to a discounted price on a settlement service from an identified provider, even if the lender does not require the consumer to use that provider, and even if the provider is not affiliated with the lender. As a result, lenders would be required to ensure that consumers do *not* receive any type of discount from settlement service providers that the lender identifies on a GFE.

- The new definition of required use would also overrule long-standing exceptions to the anti-tying rules applicable to depository institutions. These rules permit, in some circumstances, a depository institution to provide a discount for a service for customers who obtain a loan from an affiliate of the depository institution. Under the new definition of required use, a bank could not offer a reduced cost checking account for customers who obtain a mortgage loan from a bank affiliate. Those very same customers could get reduced cost checking accounts for obtaining any *non*-mortgage loan from a bank affiliate. This distinction between mortgage and nonmortgage loans seems without purpose.

V. Gaps in Disclosure Requirements

A. Origination charges

The revised Regulation X requires a number of disclosures about origination charges, in specified places, but has contradictory or absent disclosure requirements.

The new GFE will require lenders to disclose in "our origination charge" all of the lender's charges (other than the loan rate) for the loan. Separate disclosures are required for settlement services for which the lender selects the provider, and for settlement services for which the borrower selects the provider. But the regulation does not specify where to disclose the costs if the lender provides those services.

The lender's origination charge and the loan rate are separate disclosures, but some costs do not fit in either category. For example, if a lender offers a lengthened rate lock period for a fee, is that an origination charge or part of the loan rate?

Must origination charges vary depending on whether a loan closes in a lender's name or a broker's name? For example, a lender may charges a $600 processing fee, pays a broker a $2,000 yield spread premium, and the broker receives no direct compensation from the consumer.

- If the loan were to close in the lender's name, the origination charge would be $2,600, there would be a $2,000 credit for the rate, and the adjusted origination charge would be $600.
- If the same loan were to close in the broker's name, would the disclosure be the same? Or would the disclosure be an origination charge of $2,000, a $1,400 credit for the rate, and a $600 adjusted origination charge?

If a loan is not a "no cost" loan and the lender will absorb certain third party charges, may the lender:

- Omit the item?
- Show a charge but reduce the origination charge?
- Show a charge but also show a credit?

B. Required Services That "We Select" or That "You Can Shop For"

- Regulation X requires settlement charges to be within limited tolerances of the amounts disclosed in a GFE. The tolerance provisions in the regulation refer to "lender-required" settlement services and the HUD-1 and its instructions similarly refer to the "lender." However, the GFE instructions refer to services required by the "loan originator" (including a broker) and further state that the loan originator must provide a list identifying providers of services for which the borrower may shop. If a mortgage broker but not lender requires the service of a third party provider, do tolerances apply to that service?

- A GFE must disclose title services charges, and must separately disclose a list of providers of required services for which the borrower may shop. In which place should lenders disclose required title services for which the borrower may shop?

- If a seller-paid fee is underestimated on the GFE and the borrower rather than the seller pays the difference, is the lender required to include the fee in the 10% tolerance if the services were provided by a service provider required or recommended by the loan originator?

C. Average Charges

- Revised Regulation X permits the use of average charges in some circumstances, including that the same charge is used in all transactions within a class.
  - Does this prohibit waiving or reducing the amount charged on an exception basis?
  - May the service provider use the same average charge as the maximum amount that could be charged on every transaction in the class, but have some variation in the amounts charged on individual transactions?

- Average charges are not permitted for costs that are based on the property value. Appraisal charges today may be loosely based on property value. May an average charge be used for appraisals?

D. Rate Locks

The new GFE will require many disclosures about interest rates, including rates that are not yet locked. The specific requirements are very much in question.

The revised regulation is unclear about the following:

- Whether there is a minimum time a rate must remain available.
- If a loan does not offer a rate lock, how a lender must disclose the date through which a rate is available.
- A GFE must disclose how long after a rate-lock before a loan must close, and how long before settlement before a rate must lock, but it is not clear whether a loan can be required to close within a certain period from loan application.
- The new GFE does not seem to accommodate disclosures about a rate that can float down but not up after loan application.
- Some states do not permit brokers to issue rate locks, but if the broker's GFE indicated in the "Important Dates" section that the initial rate would be available for any period of time that could be construed as offering to issue a rate lock. May the date be left blank?

E. Seller-Paid Fees

The new GFE does not contemplate fees that a property seller pays. This will cause the GFE to overstate the lender's settlement charges, plainly misinforming consumers. Lenders can create yet another disclosure to explain the amount of cash the consumer will need at closing, taking into account the charges the seller will pay. The better approach would be for the GFE to accommodate seller-paid fees.

F. Revised GFEs

- GFE changes are permitted only due to limited reasons. If an interest rate expires due to applicant inaction, it is unclear whether the lender can revise the GFE if the applicant were to renew an interest in getting a loan.
- Whether and how a lender may revise "Important Dates" in a revised GFE is unclear.
- A lender may revise a GFE due to changed circumstances, although the disclosures for some charges may not increase in the revised GFE. If one of those charges has in fact increased but is still within the permitted tolerance, it is not clear how the lender must reflect this change, either in the GFE or in the comparison of the GFE to the HUD-1.
- The regulation does not clarify whether changes in the loan principal after application but before closing are a change in loan terms that require a revised GFE. Especially with refinances, this is a normal event and needs to be addressed in the regulation.

G. HUD-1 Title Charges

The instructions for the new HUD-1 Settlement Statement require clarification in several areas.

- A HUD-1 must disclose "title services and lender's title insurance," and must include a separate disclosure for the "settlement or closing fee." The definition of "title services" includes conducting a settlement. In which category is the cost of conducting a settlement to be disclosed?
- Do "title services" include preparing loan documentation, or is any part of this to be disclosed separately?
- "Title charges' include "preparing title work." Does this include title examination and search? What attorney's fees are included in "title charges?"
- The regulation defines title services to include the service of conducting a settlement. The HUD-1 distinguishes between title services and settlement fees. This leaves confusion about how to disclose administrative and processing services of conducting the settlement.
- Do title services include charges for notary services? Does it depend on which documents are notarized?
- Do title services include attorneys' fees regardless of which party the attorney represents?
- The instructions for Lines 1101 through 1108 specify whether the charges are to be listed in or outside the columns, except for Lines 1102 and Line 1104. The reason for the difference is unclear. Are amounts on Lines 1102 and 1104 to be shown outside the columns?

- Line 1107 lists the Agent's portion of the total title insurance premium. Is this amount determined by what the applicable state law defines as the premium? Does it include administrative or processing charges?
- Similarly, Line 1108 lists the Underwriter's portion of the total title insurance premium. Is this amount determined by what the applicable state law defines as the premium? Does it include administrative or processing charges?
- The Instructions to the HUD-1 state that title services should not be itemized except as provided in the Instructions. They further state, "[d]isbursements to third parties must be broken out in the appropriate lines or in the blank lines in the series and amounts paid to these third parties must be shown outside of the columns if included in Line 1101. Charges not included in Line 1101 must be listed in the columns." Are any of the following "other third parties" whose charges must be broken out on separate lines:
    - Attorney
    - Closing or settlement agent
    - Title company
    - Title insurance agent, or
    - Insurance underwriter?
- If a lender does not independently require a property survey, but only requires a survey to the extent necessary for a title insurer to issue a title policy with no survey exceptions:
    - Should the cost of the survey be included in the Line 1101 total? Should it be included in a blank line in the 1100 series?
    - Should the cost of the survey be shown in the 800 series or the 1300 series? Does the answer depend on whether the borrower may shop for a surveyor?
- When the settlement agent performs services that are not included in the definition of Title Services and that are not required by the lender, where are these services to be disclosed?

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Testimony

of the

The American Homeowners Grassroots Alliance

Submitted to the

House Financial Services Committee

Hearing on

Mortgage Reform

April 23, 2009

The American Homeowners Grassroots Alliance (AHGA) is a national consumer advocacy organization which focuses on policy issues that have a significant economic impact on homeowners and home ownership. Our members are individual homeowners from across the economic spectrum. AHGA and its sister education and research organization, the American Homeowners Foundation, have been serving the nation's 70+ million homeowners since 1984.

AHGA commends the House Financial Services Committee for holding this hearing on mortgage reform, and specifically, on the Mortgage Reform and Anti-Predatory Lending Act of 2009. We strongly support this measure and commend House Financial Services Committee Chairman Barney Frank, Representative Brad Miller, and Representative Mel Watt for sponsoring H.R. 1728. We believe that this legislation will help curb future predatory lending, which has been a major factor in the highest home foreclosure rate in the nation in 25 years.

While lower income and less educated homeowners have tended to be the most frequent direct victims of predatory lending, the foreclosure crisis that has resulted has had terrible consequences for all American homeowners. Even though the majority of homeowners have never had anything other than a 30 year fixed rate mortgage, virtually all homeowners have lost substantial equity in their homes as a result of the economic downturn, which was precipitated by predatory mortgage lending practices. For most homeowners the equity in their home is their single largest source of savings and contributor to their net worth.

Many homeowners hold securities in mortgage lending institutions, either directly or as components of their mutual funds, in their investment accounts and/or IRA's, 401Ks, or other retirement savings vehicles. Those homeowners had expected that the CEO's of those lending institutions would be using prudent financial management practices consistent with the protection of their assets. Instead, American homeowners learned that those companies essentially abandoned sound underwriting principles. They qualified borrowers based only on their ability to pay initial "teaser" interest rates which only two or three years later were almost certain to rise substantially based on the their reset formulations. They lent out their stockholders' money without verifying the borrower's income. As a result of this gross mismanagement, millions of American homeowners will have to defer their retirement, and many of them will never be able to afford to retire.

It is critical to take steps that will prevent a recurrence of predatory lending. We believe that all the provisions in H.R. 1728 will contribute to that goal. A number of the provisions of the bill are particularly important. Among them are the creation of a federal duty of care that requires licensing and registration, as applicable, under state or federal law, presenting consumers with appropriate mortgage loans (i.e., loans that a consumer has a reasonable ability to repay and for which (s)he receives a net tangible benefit and that do not have predatory characteristics, making full disclosures to consumers, and assuring that lenders comply with mortgage origination requirements.

The legislation should establish minimum professional standards for entrance into the mortgage origination profession, strong sanctions for violation of the duty of care, and independent determination of fault. We had made that recommendation in our April 17, 2007 testimony to this committee, and we are delighted that some of those recommendations have been addressed. Because real estate agents and real estate brokers have also, in many cases, been accomplices to the predatory lending process this title should be expanded to create a parallel minimum professional standard for entrance into the real estate services profession, strong sanctions for violation of the fiduciary duty of real estate brokers and agents, and independent determination of fault. Currently, minimum professional standards in that sector are too low, fiduciary duty to their clients is often ignored or undermined by industry rules, and regulatory capture usually characterizes the rulemaking and standards enforcement in that field.

Requiring that the creditor must make a reasonable, good faith determination that the consumer has a reasonable ability to repay the loan at a fully indexed, fully amortizing rate is simply a requirement that sound underwriting principles be used in all cases. This is what lenders normally do and are supposed to do, and it thus imposes no new or unreasonable requirements on prudent lenders or their business partners. The net tangible benefit standard should prevent refinancings that increase consumer costs without providing any discernable benefit. The use of the potential proceeds from a cash-out refinancings should be taken into consideration in judging benefits, however. For example, cash outs can be used for meritorious purposes, such as home remodeling/additions or children's education, which could not otherwise be financed as inexpensively.

The establishment of a "safe harbor" for qualified mortgages (which should include FHA, VA, rural housing and mortgages purchased by Fannie Mae and Freddie Mac) serves the useful purpose of providing lenders guidelines they can rely on without fear of being second guessed. AHGA supports the stronger protections for tenants with leases and housing assistance payment contracts for Section 8 recipients. We also support additional standards and requirements designed to protect consumers, including mandating the availability of mortgages without prepayment penalties, advance notice of alternatives for holders of adjustable rate mortgages, prohibiting mandatory arbitration, requiring specific disclosures for loans that include negative amortization features, and prohibiting the creditor from directly or indirectly financing single-premium credit insurance in connection with a consumer mortgage loan.

This legislation should help trim the expense of high-cost loans under HOEPA through such practices as lowering the APR trigger from 10% to 8% over comparable Treasuries, lowering the points and fee trigger from 8% to 5%, prohibiting the financing of points and fees, prohibiting excessive fees for payoff information, modifications, or late payments, prohibiting practices that increase the risk of foreclosure, such as balloon payments, and requiring pre-loan counseling.

Also important are the provisions to improve the independence of appraisers. Part of the problem with predatory lending is the potential for unhealthy collaboration between different players who influence home buyers – real estate agents, mortgage originators, and appraisers. Those in all three fields who are willing to put their selfish interests ahead of their clients generally know who their unethical counterparts are in the other fields, and have no remorse for threatening to withhold future referrals to others in those fields whose ethical concerns can make it difficult to "grease" the transaction. Anything that can be done to assist home buyers in identifying the most qualified professionals for each of the required services they will need, as well as reduce the ability of unethical service professionals to exert a coercive influence over other professional involved in the transaction, will be a great step forward.

We also applaud the provision of additional disclosures of important financial information, and the creation of additional consumer counseling services. One of the lessons learned from the predatory mortgage lending experience is that many borrowers are financially naïve. While most nonprofit foreclosure counseling agencies are doing an excellent job under extenuating circumstances, many have become hopelessly overloaded by the foreclosure crisis. It is important to prevent these problems in the future through better advance consumer counseling.

We understand that many organizations in the mortgage finance sector have difficulty with some of the provisions in this legislation. Although we disagree with them on many points, we urge you to give their constructive suggestions careful consideration for several reasons. We know that supporters of this legislation do not intend that it limit reasonable options for responsible homeowners or undermine the objective of enabling beleaguered homeowners to refinance their homes. Some of the provisions create tradeoffs in that regard. For example, while a 5% credit risk retention requirement will encourage more responsible lending practices, it may also somewhat limit the availability of mortgage loans for qualified borrowers and thereby slow the housing market's economic recovery. To the greatest degree possible, members of this committee should try to avoid unintended consequences from happening, and give regulators the ability to adapt regulations toward that goal while maintaining the protections against future outbreaks of predatory lending.

Additional steps will be needed to address the many problems in mortgage lending and other areas related to financial and real estate services. Some, like the bankruptcy reform bill, are clearly "shovel ready", thanks to the good work already done by the House of Representatives. Members of this body have made all the compromises necessary with mortgage lenders on that bill – and probably more than were really necessary - to assure that the legislation helps rather than hurts mortgage lenders.

In many cases both the Administration and Congress may have to respond quickly to new information in the future. Thoughtful development of legislation under difficult circumstances will be critical, and that is a challenge in a fluid and high pressure environment. For example, financial services firms correctly pointed out that legislation to limit the bonuses of highly compensated financial services executives could have the undesirable potential for driving away talented executives who had nothing to do with determining the policies that have hurt homeowners and the firms' investors alike. From our perspective the legislation also didn't address the core problem which could easily recur in the future– terribly bad business decisions made under the incompetent leadership of those firm's CEOs. In our opinion a better approach would be to require that any financial services firm that receives any federal funding as a result of its corporate mismanagement must agree to the orderly replacement of the incumbent CEO during the period the mismanagement occurred. There are many highly competent senior financial services professionals who had nothing to do with the problems caused by some companies, who can ably serve as the incumbent CEO's successor, and they should be given the latitude and flexibility to use the federal funds in a constructive manner to benefit the company's stockholders and the economy.

Earlier this week, Columbia University Professor and 2001 Nobel Prize recipient Joseph Stiglitz, testified before the Joint Economic Committee. He recommended that the government break the behemoth financial firms into smaller, more transparent companies. At the same hearing, Massachusetts Institute of Technology Professor Simon Johnson urged that our antitrust laws be overhauled to prevent the development of financial firms that are too large in the future. Professor Johnson also urged that the existing very large financial services companies be broken up. Our organization also believes that the biggest financial service organizations may well have gotten so large that they are at the point that any benefits of their economies of scale are more than offset by their bureaucratic inefficiencies and the potential drastic impact of their failure on the U.S. and the world economy. For that reason, the professors' suggestions may have some merit, and we urge further study of these recommendations.

The Obama Administration and Congress are doing their best to address the housing crisis and the major challenges facing our economy. The challenges of addressing them in real time and while they are in a state of flux are enormous. No doubt additional adjustments will have to be made by Congress and the Administration under the best of circumstances. The American Homeowners Grassroots Alliance promises our support for this committee's worthy efforts at this critical time in American history.

CUNA
Credit Union National Association
cuna.org
Daniel A. Mica
President & CEO

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April 23, 2009

The Honorable Barney Frank
Chairman
Committee on Financial Services
United States House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Spencer Bachus
Ranking Member
Committee on Financial Services
United States House of Representatives
2246 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Frank and Ranking Member Bachus:

On behalf of the Credit Union National Association (CUNA), I am writing regarding H.R. 1728, the Mortgage Reform and Anti-Predatory Lending Act, and request that my letter be made part of the full committee hearing record on this bill. CUNA represents more than 90% of America's 8,000 credit unions and 92 million credit union members.

Given that credit unions are member-owned, not-for-profit organizations, it is not surprising that CUNA supports efforts to eliminate predatory mortgage lending practices. H.R. 1728 is similar to many of the provisions of H.R. 3915, introduced in the 110th Congress. Since then, the federal financial regulators have been moving forward with key regulatory revisions that will impact mortgage lending practices – by restricting questionable practices and by providing better disclosures to borrowers. Therefore, we urge you to continue to work closely with the regulators regarding the implementation and enforcement of mortgage lending laws, rather than pressing for the enactment of additional laws before everyone – legislators, regulators, financial institutions and consumers – can assess the effectiveness of the regulations being implemented.

Since the end of 2007, the following regulatory actions are underway to address mortgage lending problems and concerns:

- The Department of Housing and Urban Development has finalized extensive changes to the regulations implementing the Real Estate Settlement Procedures Act (RESPA). Notable revisions to the good faith estimate requirements and the HUD-1 settlement statement information are effective January 1, 2010.

- The federal financial regulators are currently designing rules to implement the mortgage registration requirements of the S.A.F.E. Mortgage Licensing Act (Title V of the Housing and Economic Recovery Act of 2008), and states are addressing the licensing requirements for mortgage brokers. We are advising credit unions that they should expect to have to register their staff in the second half of 2009. Mortgage licensing provisions first appeared in H.R. 3915.

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- The Federal Reserve Board finalized amendments to Regulation Z that will establish new protections for consumers from unfair or deceptive home mortgage lending and advertising practices under its authority in the Home Ownership Equity Protection Act (HOEPA). For a new category of "higher-priced mortgages," which should include nearly all subprime loans, the regulations will require lenders to consider the borrower's ability to repay the loan, require verification of income and assets, impose limits on prepayment penalties, and require escrow accounts for taxes and insurance. Most of these new regulatory requirements become effective October 1, 2009. The Board was certainly encouraged by members of Congress – rather than directed by the enactment of any legislation -- to use its HOEPA authority to develop these regulations.

- The Federal Reserve Board is currently reviewing its closed-end lending rules and its home equity lending rules under Regulation Z, which implements the Truth in Lending Act. This is a major undertaking, and we anticipate a proposed regulation to be publicly circulated later in 2009. The Board's action follows its review of the open-end Regulation Z rules, which were finalized at the end of 2008 and which were certainly shaped by concerns expressed by members of Congress, especially comments about unfair and deceptive credit card practices.

- The Treasury Department issued guidelines on March 4, 2009 to implement the Administration's "Home Affordable Modification Program," although many details still need to be addressed.

All these requirements, which are in various stages of development and implementation, will have major impact on financial institutions' mortgage lending programs and require tremendous investments in data processing reprogramming, new forms and disclosures and staff training. As the Committee proceeds with consideration of H.R. 1728, CUNA urges consideration of only those statutory changes which are absolutely essential.

With respect to the legislation that is under consideration at today's hearing, most of the provisions were included in H.R. 3915 (110th Congress). However, there is one provision of H.R. 1728 and not in H.R. 3915 which is garnering a lot of attention: Section 213 on "credit risk retention." Section 213 would apply to any residential mortgage loan that is not a "qualified mortgage." When a lender makes a mortgage loan that does not meet the definition of a "qualified mortgage," it would have to retain at least 5% of the mortgage balance – so the lender would retain a 5% investment and assumedly be less willing to originate poorly underwritten mortgage loans.

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A qualified mortgage would be defined as a residential mortgage loan:

- with an APR that does not exceed the limits set for higher-priced loans under Regulation Z (1.5% or more for a first lien loan and 3.5% or more for a subordinate lien loan);
- where the income and financial resources of the borrower are verified and documented;
- where the underwriting process is based on the fully indexed rate and takes into account escrow items;
- does not cause the borrower's debts to exceed a currently undefined ratio or limit (to be determined by regulation); and
- is for a 30-year term.

In our limited discussion with credit unions on this new provision, we believe that it would not have a major impact on their operations, since they are depository institutions. However, this is not to suggest that this provision will have no impact on credit union mortgage lending. While we assume that the secondary market would adapt to this provision, were it law, we also expect that refinancing would become more complicated, and there undoubtedly would be some unintended consequences of the proposal, such as standardizing mortgages to a 30-year term and, to a small degree, limiting the ability of mortgage lenders to make more mortgages, since they would be retaining 5% of their originations on their books.

We do have a number of practical questions or concerns with the bill as introduced. For example:

- In Section 209 and in other sections, the effective dates are just not workable, factoring in the compliance involved. We would encourage the Committee to consider an effective date of at least 12 months after issuance of a final rule or 24 months after the date of enactment.
- In Section 304 which addresses the correction of errors to avoid liability, the time period is far too short; it is very unlikely that a lender would even discover any noncompliance within 30 days after a loan closing. We would encourage the Committee to give lenders no less than 180 days after loan closing to discover any failure to comply.
- In Section 503 on proposed RESPA amendments, the lender is to send two notices and wait at least 45 days before imposing forced-placed hazard insurance. We are concerned that the lender's security could be destroyed during this period.
- We note that a number of provisions in the bill already seem to be required by regulation. For instance, Section 605, which would amend the Equal Credit Opportunity Act to require that the applicant gets a copy of the appraisal, is already required by the Federal Reserve Board's implementing rules, Regulation B.

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Finally, we have a major concern involving the new standards the legislation proposes. The Truth in Lending Act has been the subject of innumerable lawsuits over the last 40 years, so lenders are understandably concerned about the establishment of some new standards in the bill which would trigger many new lawsuits, such as a "duty of care" in Section 102, the "reasonable and good faith determination" of the applicant's ability to repay in Section 201, the "net tangible benefit" in Section 202, and the "rebuttable presumption" in Section 203. The new HOEPA regulations that go into effect this fall hopefully will address many of the concerns of the sponsors of this legislation.

On behalf of America's credit unions, thank you for considering our views on H.R. 1728. We look forward to continuing to work with the Committee to eliminate predatory mortgage lending practices.

Sincerely,

Daniel A Mica

Daniel A. Mica
President and CEO

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April 22, 2009

The Honorable Barney Frank
Chairman
House Committee on Financial Services
United States House of Representatives
2252 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Frank:

I write to comment on proposed H.R. 1728, and to request this bill not be passed as written.

My Office supports the testimony submitted by the National Consumer Law Center in opposition to this bill. In particular, this bill's proposed expansion of preemption would greatly reduce the protections available to consumers to seek redress for the predatory practices that have contributed to our economic distress.

Expansion of preemption is unwise and unwarranted. State laws and state enforcement authorities need to have vigorous enforcement power. Please do not make it more difficult for consumers to vindicate their rights. We urge you to not pass the bill as written.

Sincerely,

Chris Koster
Attorney General of Missouri