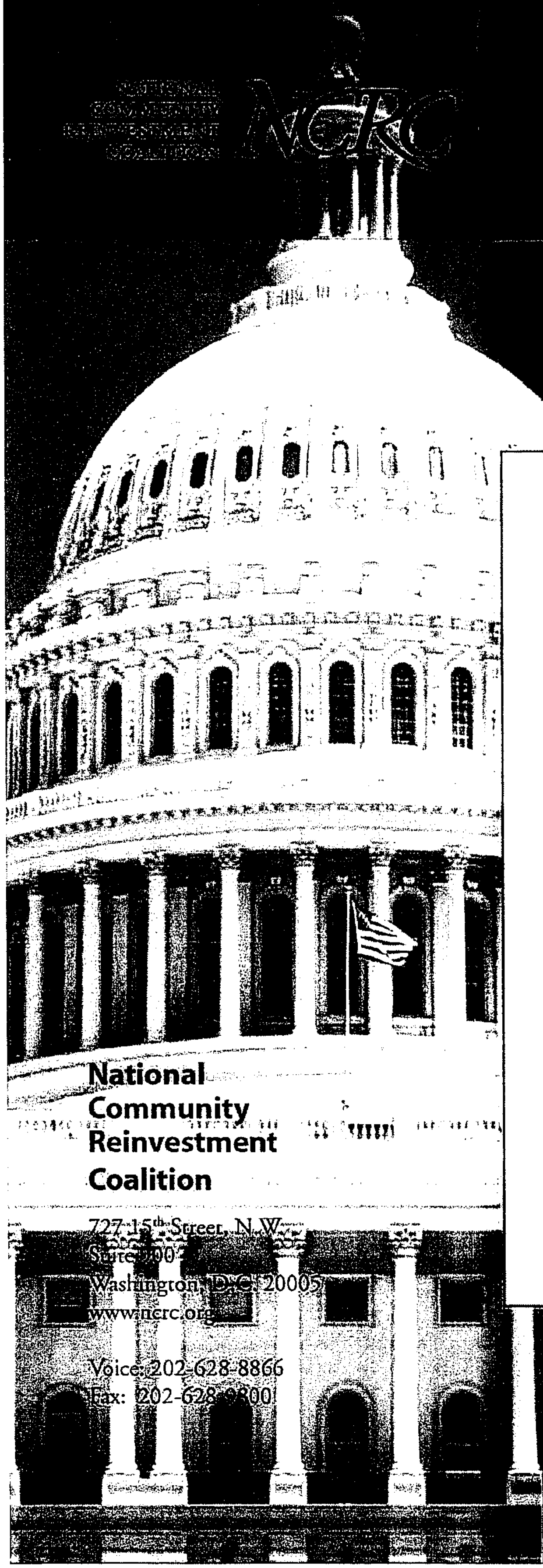
Testimony



Testimony of
David Berenbaum, Executive Vice President

On behalf of the
National Community Reinvestment Coalition

Before the US House of Representatives Subcommittee on Financial Institutions and Consumer Credit

On the topic of
"Mortgage Lending Reform: A Comprehensive Review of the American Mortgage System"

Wednesday, March 11, 2009

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I. Introduction

Good afternoon, Chairman Gutierrez, ranking member Hensarling, and other distinguished members of the Subcommittee. I am David Berenbaum, Executive Vice President of the National Community Reinvestment Coalition (NCRC). I am honored to testify today on behalf of NCRC on the topic of "Mortgage Lending Reform: A Comprehensive Review of the American Mortgage System."

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 and distress in the mortgage market 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. Massive foreclosures are spurring a self-reinforcing cycle of defaults, declines in home values, and rising unemployment. Widespread unemployment is accelerating the economic crisis, as evidenced in a recent report published by Credit Suisse. The study projects 9 million foreclosures over the next four years, assuming an eight percent unemployment rate. The federal government reported late last week that nationwide unemployment is now 8.1 percent, the highest rate in more than 25 years. In addition, the nation lost 651,000 jobs last month, the 14th consecutive month of job losses.[1] Loose underwriting combined with a rise in unemployment has contributed to new record rate of 11 percent of loans in foreclosure, or

[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.

at least one payment past due according to a Mortgage Bankers Association report released last week.[2]

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] Home price declines destabilize credit markets, diminish family wealth, decrease consumer confidence, and further drive unemployment.[4] In 2008, $3.3 trillion in home equity was erased.[5]

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. If regulatory enforcement is not immediately tightened, the unsafe and reckless lending practices of the past will recycle into different loan products, prolonging the crisis and hampering recovery. Following this weekend's news-breaking article in the *Washington Post*, NCRC calls for an immediate investigation into mitigating the spike of defaults in the FHA program.

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

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[2] Mortgage Bankers Association, Delinquencies Continue to Climb in Latest MBA National Delinquency Survey, March 5, 2009, http://www.mortgagebankers.org/NewsandMedia/PressCenter/68008.htm.

[3] S&P / Case-Shiller Composite -20 Home Price Index (as of December 2008)

[4] Christie, Les, Foreclosures dominate home sales CNNMoney.com February 3, 2009

[5] S&P Case-Shiller Home Price National Index

originations of subprime loans."[6] 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.[7] Credit rating agencies also had incentives to deal in mortgage-backed securities (MBS), as credit rating agencies were paid by the issuers of these securities. The credit rating agencies inflated ratings and facilitated the sale of hundreds of billions of MBS containing problematic loans that defaulted in large numbers.

Ludwig suggests that the final breaking point creating a highly leveraged Wall Street 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.[8]

The heightened pace of financing problematic lending occurred because institutions escaped penalties for making and financing abusive and risky loans. Research 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

[6] 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

[7] 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.

[8] Ludwig et al., p. 97.

one investor would suffer unsustainable losses. The difficulty was that the financial industry did not anticipate large-scale home value declines, which resulted in significant defaults and foreclosures of problematic loans. Instead, the financial industry was operating on the assumption that home values would continue to rise, making it possible for borrowers to refinance out of unsustainable loans.

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."[9] Industry statistics suggest a loosening of underwriting standards over time. For example, the Mortgage Bankers Association reports that 39 percent of loans were interest-only or option Adjustable Rate Mortgage (ARM) in 2006, while only 2 percent of the loans issued in 2000 exhibited these risky features.[10] In addition, Federal Reserve statistics reveal that the portion of subprime ARM loans with low or no documentation of borrower income rose from 20 percent to 40 percent in 2006. In recent years, more than 75 percent of the loans in subprime MBS pools were particularly high-risk ARM loans of the 2/28 or 3/27 variety (the first number being the number of years in which the loan has a fixed rate and second number indicating the number of years in which the loan rate adjusts).

According to the Federal Reserve, as of December 2008 only 61 percent of subprime ARM loans had full documentation of borrower income, 74 percent had prepayment penalties, and the borrowers' average debt-to-income ratio was 41 percent.[11] Only 40 percent of subprime ARM loans are current, 22 percent are 60 days or more delinquent, 16 percent are in foreclosure, and 10 percent are in Real Estate Owned (REO) status. Similarly, only 67 percent of ALT A ARM loans are current. The Congressional

[9] 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.

[10] Interest only loans permit the borrower to pay only the monthly amount due for interest during a specified time period. For an option ARM loan, the borrower has various payment options. For example, the borrower can pay the entire monthly payment due for interest and principal or can elect to not even pay the amount due to cover monthly interest. Many borrowers opted to pay the lowest amount each month, not suspecting that this would result in large increases in future payments.

[11] http://www.newyorkfed.org/regional/US_December.xls

Oversight Panel, in a report issued last week, also documents an increasing market share of subprime and ARM products with related increasing delinquencies, particularly between 2004 and 2007.[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 industry. Coverage must not only extend to the entities commonly discussed such as brokers, lending institutions, appraisers, and servicers but must also 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.

NCRC supports the Obama Administration's efforts to stem the foreclosure crisis by crafting the most far-reaching foreclosure prevention plan to date. Key members of the House Committee on Financial Services have played vital roles in supporting this effort (such as seeking to enact bankruptcy reform and improvements to the Hope for Homeowners program). However, future crises of a similar magnitude will occur in the near future unless Congress enacts aggressive mortgage reform legislation that includes strong consumer protections and financial penalties for financial institutions that violate consumer protections.

Address Emerging Trends and Other Issues Not Included in H.R. 3915

NCRC recommends that the Committee update H.R. 3915 to account for new and dramatic trends in the financial marketplace, such as new developments in FHA lending, misconduct among credit ratings agencies, and scams related to foreclosures.

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[12] 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

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. This past weekend, the *Washington Post* reported on the spike in defaults of FHA loans, and on the difficulties the US Department of Housing and Urban Development (HUD) is experiencing policing lenders using FHA.[13] 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 previous years). HUD's inspector general is quoted in the article as stating 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 market share from 2 percent to 33 percent of all loans in the marketplace. The article reports that HUD dismantled an FHA fraud unit in 2003 and that an office overseeing FHA lenders has not expanded staff despite a doubling of FHA-approved lenders to 2,300 in the past two years. 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 can be repaid.

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

[13] 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.

Oversight Panel asserted that credit rating agencies perhaps played the "decisive" role in endangering the financial system.[14]

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 oversight of ratings agencies by creating a Credit Rating Review Board that would oversee ratings and generally monitor the ratings agencies.[15]

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

[14] 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

[15] Congressional Oversight Panel Report of January 2009, see pages 43-44.

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.

Foreclosure rescue consultants are unregulated entities. This regulatory loophole must be eliminated in an effort to steady the U.S. housing and financial markets. NCRC supports the passage of the *Foreclosure Rescue Fraud Act of 2009* (S. 117), introduced by Senator Herbert Kohl [D-WI] on January 6, 2009, and introduced in the House (H.R. 1231) by Representative Gwen Moore [D-WI] and Representative Barney Frank [D-Mass] on February 26, 2009. This legislation requires that all contracts between a foreclosure consultant and a homeowner be in writing and fully disclose the nature of the services 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.[16] Most of the laws require foreclosure rescue consultants to disclose a customer's right to cancel the agreement, cap fees, and rescind or ban transfer of property to the consultant.

NCRC encourages the regulatory approaches supported by the FBI that include creating a mechanism that requires the mortgage industry to report fraudulent activity, and establishing safe harbor provisions that protect the mortgage industry under a mandatory reporting mechanism.[17] Comprehensive regulatory reform must aggressively address the dramatic increase of mortgage fraud.

II. Enact Comprehensive Anti-Predatory Lending Legislation

This Committee has chosen the right moment to take a fresh look at H.R. 3915, consider improvements, and pass a comprehensive anti-predatory lending law. H.R.

[16] Colorado, Connecticut, Florida, Illinois, Iowa, Maryland, Massachusetts, New York, Texas

[17] See n1.

3915 is the most comprehensive bill to date that limits, and in some cases prohibits, several problematic practices of originators, brokers, servicers, and appraisers.

NCRC recommends that the Committee consider the profound changes in the mortgage market, which suggest the need to extend more of H.R. 3915 protections to a much larger pool of loans. When subprime and non-traditional prime lending were prevalent, anti-predatory lending bills (including H.R. 3915) typically divided loans into three categories: prime, subprime, and high-cost subprime loans. The bills would apply relatively few protections to prime loans, more protections to subprime loans, and the most stringent protections to subprime high-cost loans. The rationale for extending more protections to subprime and subprime high-cost loans was that these loans were the riskiest loans.

The future of subprime lending is quite uncertain, suggesting that the subprime and subprime high-cost loan categories may contain few loans. The trade publication *Inside B&C Lending* estimates that only $64 billion of subprime, Alt A, and other non-prime loans were originated in 2008 (the lowest level since 1991 and in sharp contrast to the $1 trillion issued in each 2005 and 2006).[18] The riskiest forms of lending in future years may consist of non-traditional prime and near prime loans, which include option ARM loans and ARM loans. And, the FHA market is likely to rebound, thereby enticing a variety of lenders (including unscrupulous ones) to offer FHA loans. Therefore, NCRC recommends that H.R. 3915 extend comprehensive protections to all loans, and dispense with the loan classification system. Should this Committee choose to retain the loan classification system, NCRC recommends increased consumer protections for each of the loan categories.

Protections Applied to Originators

Prohibition Against Steering by Originators

H.R. 3915, the Mortgage Reform and Anti-Predatory Lending Act of 2007, and S. 2452, the Homeownership Preservation and Protection Act of 2007, both contain comprehensive protections applied to a broad segment of the financial industry, but differ

[18] Inside B&C Lending, Volume 14, Issue 5, February 27, 2009

in the assignee liability applied to institutions in the secondary market. H.R. 3915 contains a prohibition against steering borrowers into higher-cost loans when borrowers qualify for lower-cost loans. The bill contains a prohibition against "abusive or unfair lending practices that promote disparities among consumers of equal credit worthiness but of different race, ethnicity, gender, or age." S. 2452 adds an important clause "that a mortgage originator may not steer a consumer to a loan with rates, charges, principal amount, or prepayment terms that are more clostly for which the consumer qualifies." In other words, the prohibition does not include only a higher interest rate than is justified based on a borrower's creditworthiness, but also higher charges, principal amounts, or prepayment terms. NCRC recommends that this Committee consider the prohibitions on steering in both H.R. 3915 and S. 2452 and use this language to craft the strongest and most inclusive mandates against steering.

Steering has been widespread and has resulted in significant amounts of lost wealth in minority communities and neighborhoods with large concentrations of elderly residents. In the "Broken Credit System" study released in early 2004, NCRC selected ten large metropolitan areas for analysis: Atlanta, Baltimore, Cleveland, Detroit, Houston, Los Angeles, Milwaukee, New York, St. Louis, and Washington, DC. NCRC obtained creditworthiness data on a one-time basis from a large credit bureau. As expected, the number of subprime loans increased as the amount of neighborhood residents in higher credit risk categories increased. After controlling for risk and housing market conditions, however, the race and age composition of the neighborhood had an independent and strong effect, increasing the amount of high-cost subprime lending. In particular:

- The level of refinance subprime lending increased as the portion of African Americans in a neighborhood increased in nine of the ten metropolitan areas. For home purchase subprime lending, the African-American composition of a neighborhood boosted lending in six metropolitan areas.
- The impact of the age of borrowers was strong in refinance lending. In seven metropolitan areas, the portion of subprime refinance lending increased solely when the number of residents over the age of 65 increased in a neighborhood.

NCRC also observed that racial differences in lending increased as income levels increased. In the 2008 study "Income is No Shield Against Racial Difference in Lending" we found that middle- and upper-income (MUI) minorities were more likely, relative to their MUI white counterparts, to receive high-cost loans than low- and moderate-income (LMI) minorities are, relative to LMI whites. MUI African Americans were twice or more likely as MUI whites to receive high-cost loans in 71.4 percent of the metropolitan areas examined in this report, while LMI African Americans were twice or more likely as LMI whites to receive high-cost loans in just 47.3 percent of the metropolitan areas examined. Lending disparities that correlate with higher income levels can also be observed when comparing Hispanics with whites and minority to non-minority census tracts.[19]

Lending discrimination in the form of steering high-cost loans to borrowers qualified for market rate loans results in equity stripping and has contributed to inequalities in wealth.[20] For example, suppose 15 percent (or 300 families) in a

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[19] NCRC's findings are consistent with a wide variety of research on subprime lending. Paul Calem of the Federal Reserve, and Kevin Gillen and Susan Wachter of the Wharton School also use credit scoring data to conduct econometric analysis scrutinizing the influence of credit scores, demographic characteristics, and economic conditions on the level of subprime lending. Their study found that after controlling for creditworthiness and housing market conditions, the level of subprime refinance and home purchase loans increased in a statistically significant fashion as the portion of African-Americans increased on a census tract level in Philadelphia and Chicago. The Center for Responsible Lending (CRL) also used the 2004 HMDA data with pricing information to reach the same troubling conclusions that racial disparities remain after controlling for creditworthiness. A more recent CRL study suggests that brokers are particularly likely to steer borrowers into subprime loans. See Paul S. Calem, Kevin Gillen, and Susan Wachter, *The Neighborhood Distribution of Subprime Mortgage Lending,* October 30, 2002. Available via pcalem@frb.gov. also Paul S. Calem, Jonathan E. Hershaff, and Susan M. Wachter, *Neighborhood Patterns of Subprime Lending: Evidence from Disparate Cities,* in Fannie Mae Foundation's Housing Policy Debate, Volume 15, Issue 3, 2004 pp. 603-622. Also, Center for Responsible Lending, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages,* see http://www.responsiblelending.org/issues/mortgage/reports/page.jsp?itemID=29371010. Also see Steered Wrong: Brokers, Borrowers, and Subprime Loans, April 2008, http://www.responsiblelending.org/pdfs/steered-wrong-brokers-borrowers-and-subprime-loans.pdf.

[20] Using a mortgage calculator from Bankrate.com, a $140,000 30-year mortgage with a prime rate of 6.25% costs about $862 a month or about $310,320 over the life of the loan. In contrast, a 30-year subprime loan with an interest rate of 8.25% costs $1,052 a month or approximately $378,637 over the life of the loan. The difference in total costs between the 6.25% and 8.25% loan is $68,317. Finally, a 30-year subprime loan at 9.25% costs $1,152 per month and $414,630 over the life of the loan. The difference in total costs between a 6.25% and 9.25% loan is $104,310. For a family that is creditworthy for a prime loan but receives a subprime loan, the total loss in equity can easily be between $50,000 and $100,000. This amount represents resources that could have been used to send children to college or start a small business.

predominantly minority census tract with 2,000 households receive subprime loans although they were creditworthy for prime loans (15 percent of families that are inappropriately steered into subprime loans is a realistic figure based on existing research). Further, assume that these families pay $50,000 more over the life of the loan than they should (the $50,000 figure is conservative, see footnote 21). In total, the 300 families in the minority census tract have paid lenders $15 million more than they would have if they had received prime loans for which they could have qualified. The $15 million in purchasing power could have supported stores in the neighborhood, economic development in the neighborhood, or other wealth building endeavors for the families and neighborhood. For even one neighborhood, the magnitude of wealth loss due to pricing disparities and/or discrimination is stark. Across the country, the wealth loss is staggering.

Strong prohibitions against steering are justified to prevent dramatic equity loss in minority neighborhoods. Another motivation is preventing the spread of abusive lending that harms communities and financial institutions. The present crisis started with predatory lending targeted in minority neighborhoods. If the regulatory agencies had acted swiftly and aggressively against this abusive lending, using the anti-discrimination laws, it is possible that abusive lending could have been substantially curtailed before it wrecked havoc in minority communities and then spread to predominantly white areas.

Protections Regarding Ability to Repay

H.R. 3915 requires a lender to consider principal, interest, taxes, and insurance when assessing whether a borrower has the ability to repay the loan. For variable rate loans, the bill requires lenders to consider the full amortizing rate. S. 2452 also has a similar provision but requires that the lender consider the maximum monthly payment during the first seven years of the loan when determining a borrower's ability to repay. In addition, S. 2452 requires a residual income analysis. Both H.R. 3915 and S. 2452 establish a total debt-to-income screen, but S. 2452 establishes a specific threshold that debt shall not exceed 45 percent of income.

The ability to repay provision must take into account the maximum interest rate that can be charged during the first seven years of the loan, particularly in the case of adjustable rate mortgage loans. Basing a borrower's ability to repay on the fully-indexed rate (as in H.R. 3915) runs the risk of basing ability to repay on an artificially low rate when the LIBOR or other commonly used benchmark rates are low. Should this Committee prefer the fully-indexed rate, NCRC recommends the addition of a margin such as 200 basis points above the fully-indexed rate, which is the underwriting procedure mandated by Rep. Ellison's bill, H.R. 3081, introduced during the 110th Congress.

The ability to repay provision should be further strengthened by adding residual income into the analysis required by H.R. 3915. It is possible for low-income borrowers to meet required debt-to-income ratios but lack sufficient funds to cover other basic necessities. Therefore, a residual income analysis would consider borrower income levels after monthly loan payments are made in order to ensure that borrowers can afford basic necessities in addition to their mortgage payment.

H.R. 3915's provisions related to underwriting for negative amortization are important, but the underwriting in this bill should be based on the full effect of negative amortization and failure to make principal payments. Finally, the provisions in both H.R. 3915 and S. 2452 that require verification of income in their ability-to-repay standard are important because of the widespread prevalence of no or limited income documentation loans that created high volumes of unaffordable loans, which subsequently defaulted after short time periods.

NCRC operates a foreclosure prevention program, the National Homeownership Sustainability Fund (NHSF), whose clients have been placed in loans beyond their ability to repay. A sample of 69 NHSF cases revealed that the median debt-to-income ratio was about 50 percent. Since the median ratio was 50 percent for the consumers seeking assistance from NCRC's NHSF program, it is likely that a 50 percent debt-to-income ratio represents a breaking point in terms of making a loan unaffordable. Therefore, we ask this Committee to consider a slightly lower threshold ratio of 45 percent as contained in S. 2452.

The following case study from the NHSF program illustrates how unaffordable loans are often accompanied by other abuses:

NHSF Case Study

An elderly man refinanced his home in the summer of 2007 in order to pay for existing medical bills and minor unsecured debt. He retired in 1983 and lives on a fixed income of $2,831 per month. His 700 credit score along with $100,000 of home equity made him a prime "target" for this predatory Option Arm loan product. The broker assured him his payments would be low and affordable. Fixed income borrowers should never be steered toward an Option Arm loan product.

The borrower's current payment of $1,637 (PITI) is 58% of his monthly income. He can only afford to make the minimum payment of the Option ARM. Therefore, his principal balance increases each month. The fully amortized payment option is more than he actually makes monthly. His balance has increased from $386,000 to $402,000 ($16,000) in only nineteen months. The broker stated that the borrower's income as $6,102 per month to make the deal work. The broker was paid a "kickback" or yield-spread premium of $7,720 and a broker fee of $2,831. To complete the deal he added a three year pre-payment penalty. The borrower is starting to borrow from credit cards in order to pay the mortgage and pay for his basic needs. The lender has refused to modify the loan because the borrower is current and they do not feel there is enough of a hardship situation.

Protections Regarding Net Tangible Benefit

H.R. 3915 stipulates that a loan that refinances a prior loan shall not be considered to provide a net tangible benefit to the consumer if the costs of the refinanced loan, including points, fees, and other charges, exceed the amount of any newly advanced principal without any corresponding changes in the terms of the refinanced loan that are advantageous to the consumer. This provision is intended to prevent flipping (or the repeated refinancing of loans), which drains borrower equity and makes it more difficult for borrowers to afford loan payments.

H.R. 3915 requires that the costs of the refinanced loan do not exceed the amount of the new principal loan amount. An important provision to add to H.R. 3915's net tangible benefit standard is that a refinance loan must legitimately lower costs for a borrower. The lower interest rate must also be low enough so that the savings achieved from the lower rate pays off the fees associated with the new loan within a specified time period (e.g., four years).

Protections Regarding Prepayment Penalties

H.R. 3915 bans prepayment penalties on very high-cost loans and on certain subprime loans. For prime loans with variable rates, prepayment penalties must end 90 days before the first interest rate adjustment upward. S. 2452 bans prepayment penalties for high-cost subprime loans, subprime loans, and non-traditional loans.

NCRC recommends that this Committee adopt a wider ban on prepayment penalties in S. 2452. Also, this Committee should also ban prepayment penalties on non-traditional loans including prime variable rate loans as S. 2452 does. Alternatively, H.R. 3915's restriction on prepayment penalties for prime variable rate loans should be extended from 90 to 120 days. Prepayment penalties too often serve as traps for borrowers not familiar with the lending process. These borrowers either do not know what the prepayment penalties are even after the loan officer or broker disclosed them and/or do not have the resources to pay them and refinance into other loans. The Federal Reserve, in its final rule implementing the *Home Ownership and Equity Protection Act* (HOEPA), also recognized the harm of prepayment penalties unless they are significantly constrained.

Protections Applied to Yield Spread Premiums and Overages

H.R. 3915 permits yield spread premiums (YSPs) if the YSP was properly disclosed and do not vary based on the terms of the loan or the consumer's decision to finance such fees or costs. S. 2452 prohibits YSPs on high-cost subprime, subprime, and non-traditional loans. S. 2452 permits YSPs for traditional prime loans provided that the mortgage broker receives no other compensation, the loan does not include discount points or origination points, the loan does not have a prepayment penalty, and there are no other closing costs associated with the loan, except for fees to government agencies or amounts to fund escrows.

NCRC prefers the approach in S. 2452 given the rampant abuse of YSPs. YSPs, if permitted at all, should only be permitted for prime loans and then only in very carefully prescribed circumstances. In her comment letter on the Federal Reserve's proposed HOEPA rule, FDIC Chairman Sheila Bair recommends discontinuing YSPs to compensate mortgage brokers.[21]

YSPs encourage mortgage brokers to steer borrowers into costly loans with abusive features, because the higher the cost of loans, the higher YSPs become. The Congressional Oversight Panel, in a report published last week, documents that broker commissions were higher for subprime and option ARMs than prime loans.22

Instead of receiving YSPs and overages, brokers and loan officers should receive fees for their services. A substantial portion of their fees should be based on loan performance and should be paid in increments only over the course of the loan (as long as the loan does not become delinquent over a specified time period).

NCRC's NHSF program has worked with many borrowers who experienced predatory lending and were charged thousands of dollars for loans with exorbitant rates and steep prepayment penalties. One such case involved a Hispanic borrower in Virginia who experienced additional abuses aside from YSPs.

[21] http://www.fdic.gov/news/news/speeches/archives/2008/chairman/spjun0508.html

[22] Congressional Oversight Panel, Foreclosure Crisis: Working Towards a Solution, March 6, 2009, p. 25, see http://cop.senate.gov/documents/cop-030609-report.pdf.

NHSF Case Study

In the summer of 2007, a Hispanic female refinanced her home with Mortgage Link, Inc. She refinanced her first and second mortgages of $426,000 and $105,000, respectively. The borrower states that her loan officer promised that the transaction would reduce her payments from $4,100 to $2,600 (interest only). After closing, the borrower was then informed by the bank that her payments were actually $4,800 (interest only). Moreover, she would have to pay $6,000 per month to cover her mortgages' principal and interest.

The borrower received no cash benefit from her new loan. However, her broker received a yield-spread premium of over $19,000 along with a loan origination fee of $7,500. The borrower's settlement statement shows additional equity stripping with the charge of $16,300 as her total settlement cost. Her loan also came with an expensive three year prepayment penalty. Because of her inability to read English well, the borrower had no idea that she received a 5-year fixed adjustable rate note, with language that spelled out that her note allowed for negative amortization. Her loan's principal balance could go up by 110% or $604,010 of the original amount borrowed. Her note also allows for a balloon payment due at maturity.

Protections Regarding Escrows

H.R. 3915 would require escrows for subprime loans for the first five years. S. 2452 would require escrows for subprime and non-traditional loans. NCRC favors the approach in S. 2452 and recommends requiring escrows on all loans.

Protections Regarding Financing Points and Fees

Both H.R. 3915 and S. 2452 prohibit financing points and fees for high-cost subprime loans. NCRC recommends that this prohibition cover all subprime, non-traditional loans, and prime loans. At the very least, a limit of financing points and fees should be applied (e.g., no financing points and fees beyond 3 percent of the loan amount). A common industry standard is that prime loans generally do not have fees and points beyond 1 percent of the loan amount. A limitation of 3 percent of the loan amount allows for fees that are three times the industry standard. Therefore, it is arguable that financing fees higher than 3 percent of the loan amount is abusive and in great excess of industry standards.

Duty of Care and Fiduciary Relationship to Borrower

H.R. 3915 and S. 2452 impose a duty of care upon originators to offer loans that borrowers likely qualify for and are appropriate (H.R. 3915) and appropriately advantageous to borrowers (S. 2452). In addition, S. 2452 imposes a fiduciary duty on a broker in the best interests of the borrower. Because the current crisis demonstrates a lack of explicit fiduciary duty from brokers and loan officers, NCRC recommends that a duty of care and fiduciary relationship be extended to all originators.

Additional Protections for Originators

H.R. 3915 prohibits single premium credit insurance and mandatory arbitration on all loans. NCRC supports H.R. 3915's blanket prohibition of mandatory arbitration, credit insurance, and similar products on all loans, which were reforms that significant companies in the financial services industry voluntarily agreed to over the years. Therefore, codifying these reforms into law will ensure that these abusive products and terms will not reenter the marketplace. Moreover, NCRC recommends H.R. 3915's prohibition against balloon loans to be cast over a broader pool of loans to include (at least) all subprime and non-traditional loans.

Protections Applied to Appraisers

Maintain Appraisal Independence

H.R. 3915 and S. 2452 promotes independence in providing professional appraisals by prohibiting intimidation, coercion, and collusion with appraisers. S. 2452 also requires a loan to be recast if a retrospective appraisal determines that the original appraisal inflated home values by 10 percent or more. 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.[23]

Protections against appraisal fraud should be part of a comprehensive anti-predatory bill. It is necessary to return to an objective system in which home appraisals are determined using multiple methods by licensed appraisal professionals, including market comparables and the Cost Approach method. Both methods are needed and they can be reconciled, but there must be objectivity related to the replacement value of a home returned to the system. Automated Valuation Models (AVMs) are only useful as compliance tools.

Replace Broker Price Opinions with Appraisals

NCRC recommends that H.R. 3915 amend its appraisal section to require that independent and professional appraisers estimate values of Real Estate Owned (REO) properties and that Broker Price Opinions (BPOs) be outlawed.

Owners of REOs are anxious to dispose of REOs because they 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.

Protections Applied to Servicers

H.R. 3915 requires servicers to promptly credit borrower loan payments, establish protections against forced placement of insurance, and ensure prompt provision of payoff amounts. S. 2452 establishes these same protections and also provides that a servicer must wait 90 days during a dispute with a consumer before reporting any negative information to a credit bureau regarding that consumer. S. 2452 also establishes a loss-

[23] http://www.orea.ca.gov/pdf/HVCCFinalCODE122308.pdf

mitigation requirement to exhaustively pursue feasible strategies prior to foreclosure, including loan modification or short sales. S. 2452 requires servicers and lenders to publicly report data on loan medication efforts. Another bill, H.R. 5679, provides more specificity regarding Congressional expectations regarding loss mitigation, such as stipulating that loan modifications and similar strategies must be pursued first before short-sales and other non-foreclosure mechanisms that involve a borrower surrendering the home.

The requirements in S. 2452 and H.R. 5679 to pursue feasible loss-mitigation strategies would be vital complements to the recently announced foreclosure prevention program offered by the Obama Administration. It is unclear whether voluntary actions to pursue foreclosure prevention will be sufficient to address the large-scale nature of this current crisis. Therefore, NCRC recommends that Congress compel servicers and financial institutions to make good faith efforts to pursue reasonable loss-mitigation strategies. Publicly available data on loss-mitigation efforts is also essential to holding servicers accountable for pursuing loss mitigation. The data should be available on the race, income, age, and gender of the borrowers receiving loss-mitigation services in an effort to ensure that Congress and the public at-large can determine whether the nation's fair housing and fair lending laws are being followed by servicers.

The forced placing of property and flood insurance on borrowers has also led to widespread abuses in the servicing industry. Many homeowners are in default, with foreclosure looming, because of these practices. Therefore, NCRC appreciates that H.R. 3915 includes protections against forced placement of insurance for borrowers. Another common servicer abuse addressed by H.R. 3915 is not crediting the borrower with making loan payments, which often results in loan delinquencies.
NCRC also recommends that this Committee add S. 2452's provision that requires servicers to wait 90 days to resolve a dispute before reporting negative information to a credit reporting bureau.

The following NHSF case study illustrates the needless harm of refusal to modify can inflict on borrowers.

NHSF Case Study

A female purchased her home in the fall of 2007 for $193,000. The loan is in her name only. The interest rate was 6.5% fixed for thirty years. Her credit score at the time of settlement was 644. She paid an origination fee, loan discount fee, and funding fee totaling 3.63% or $7,057.77. The purchase was financed at 100% LTV with no pre-payment penalty. The parameters of this loan seem reasonable and sustainable until examining her actual income. She makes $2,674 gross monthly. This created a total PITI housing payment ratio of 54%. She was able to make loan payments because her husband worked. His income was not used to qualify for the home purchase. But then the husband became ill and was unable to work for weeks at a time without pay. He did not have disability insurance or medical leave. The company then reduced his status to part-time. The entire loan responsibility fell on the wife. The high housing ratio made it impossible for her to make payments and she soon fell behind on the mortgage.

Her servicer refused to assist her with a loan modification or any sustainable workout options. She was told to seek help through the Hope Line and other non-profit organizations. Her only option from the lender was a repayment plan she could not afford. The borrower felt abused and humiliated by the representative assigned to her file. The NCRC counselor working with the borrower verified the servicer's resistance to meaningful help, recalling that a servicing specialist simply believed that the borrower "cannot afford the home and she needs to sell it." At this point, NCRC staff reached out to the loan's investor, who was absolutely willing to assist with a modification. Various times throughout the process the servicer was verbally abusive. Without NCRC's assistance, this homeowner would be homeless.

Protections Applied to Secondary Market Investors and Securitizers

H.R. 3915 exempts assignees and securitizers from liability if loans meet various safe harbor tests that are designed to ensure that the loans were issued in a safe and sound manner. In contrast, S. 2452 allows a private right of action for individual borrowers in all cases and allows for class action lawsuits if the assignees and investors did not have due diligence procedures that prevent purchases of loans that violated the protections in the bill.

The foreclosure crisis underscores the need to establish assignee liability for all loans. Therefore, NCRC recommends that this Committee dispense with distinctions in the level of liability based on classifications of loans into prime and subprime categories. The only classification that should be created is establishing liability for class action lawsuits when no due diligence mechanisms were present, which would allow for individual right of action in all cases. When certain loans are subject to individual right of action, Congress should ensure that this right of action is realistic, in that borrowers can afford quality counsel. After Congress enacts such a law as H.R. 3915 or S. 2452, the Financial Services and Banking Committees should hold annual hearings regarding the effectiveness of these laws and whether assignee liability mechanisms are effective in deterring illegal and unsafe lending practices.

Renters' Rights

H.R. 3915 requires investors of foreclosed properties to assume the commitments in leases with renters and requires vacate notices to provide 90 days for tenants who do not have leases to move out. As homeowners and investors default on their mortgages, their tenants face eviction, and communities face the possibility of speculators buying properties and then renting them out at higher rates without proper upkeep. This cycle of eviction and lack of investment is devastating for communities, and as such, NCRC recommends the enactment of strong protections for renters who are in properties that are in foreclosure to ensure that renters can either maintain their existing housing or have adequate time to relocate.

Preemption of State Law

Since a root cause of the current economic crisis is a lack of regulation, greater enforcement must be encouraged at coordinated levels of government. HOEPA and its implementing Regulation Z has long established a regime of consistent state law coexisting and complementing federal law and regulation. Substantial equivalence is an analogous example of the coexistence of federal fair housing law and complementary state law. Environmental law likewise supports federal and state law complementing each other. Therefore, NCRC recommends that this Committee amend H.R. 3915 to affirm that anti-predatory lending legislation at the state level is consistent with federal law and not preempted.

III. Support Comprehensive Regulatory Restructuring

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 are required to adhere to legislation that increases consumer protection and eliminates predatory lending practices. Congress could require that 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 could 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 strengthened consumer protections.

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 (e.g., the *Community Reinvestment Act*).

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 needs responsibly is an integral part of preventing abusive lending and promoting responsible lending to ensure the long-term sustainability of communities. It is likely that a foreclosure crisis would not have occurred had CRA been extended to cover broad segments (e.g., banks, credit unions, mortgage companies, investment banks, insurance companies, securities firms, and other financial institutions) of the financial services industry.

Conclusion

NCRC recommends that this Committee craft H.R. 3915 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 economy trillions of dollars in lost assets. NCRC also recommends that this Committee consider the soon-to-be introduced *CRA Modernization Act of 2009*. If passed, this bill would meaningfully expand access to credit and capital for affordable housing, small business creation, and community development for working communities.