MORTGAGE LENDING REFORM: A COMPREHENSIVE REVIEW OF THE AMERICAN MORTGAGE SYSTEM

HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

U.S. HOUSE OF REPRESENTATIVES

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MORTGAGE LENDING REFORM: A COMPREHENSIVE REVIEW OF THE AMERICAN MORTGAGE SYSTEM

Wednesday, March 11, 2009

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:33 p.m., in room 2128, Rayburn House Office Building, Hon. Luis V. Gutierrez [chairman of the subcommittee] presiding.

Members present: Representatives Gutierrez, Maloney, Watt, Sherman, Moore of Kansas, Waters, McCarthy of New York, Green, Clay, Miller of North Carolina, Scott, Cleaver, Ellison, Wilson, Foster, Minnick; Hensarling, Castle, Capito, Neugebauer, McHenry, Marchant, Lee, Paulsen, and Lance.

Also present: Representative Donnelly.

Chairman GUTIERREZ. This hearing of the Subcommittee on Financial Institutions and Consumer Credit will come to order. Good afternoon, and thanks to all of the witnesses for agreeing to appear before the subcommittee today.

Today's hearing will examine the current state of the U.S. mortgage system with an eye toward comprehensive mortgage lending reform legislation that the Financial Services Committee is expected to take up later this month.

The subcommittee has asked our witnesses to recommend changes to H.R. 3915, the Mortgage Reform and Anti-Predatory Lending Act of 2007, from the 110th Congress. H.R. 3915, which was passed by the Financial Services Committee and approved by the House of Representatives in November 2007 will be used as the starting point for today, for this year's mortgage lending reform.

We will be limiting opening statements to 10 minutes per side, but, without objection, all members' opening statements will be made a part of the record.

I yield myself 5 minutes.

The last time this committee addressed legislation to restrict predatory mortgage lending was in November 2007. The world has changed dramatically since then. Mortgage delinquencies and foreclosures are now at record levels.

Since late 2007, my home City of Chicago has seen a 37 percent increase in new foreclosures, and in 2000 alone, Chicago saw

20,000 new foreclosure filings. Some of the areas in Chicago have seen more than a 300 percent increase in foreclosures since 2006.

Not unrelated, our communities are suffering from the highest unemployment rate since 1982, and those who do have jobs are experiencing falling real wages. Tumbling home prices have destroyed much of the wealth stored in what is often a family's only real investment, their home.

How did we get here? Some have tried to pin the housing crisis on fair lending laws and regulations, but such arguments downplay or even ignore the role that derivative instruments played in the current crisis by exponentially compounding the mortgage losses.

We do know that, in many cases, greedy, unscrupulous, and sometimes illegal subprime mortgage lending practices significantly contributed to the problem. These lending practices, combined with microeconomic/macroeconomic factors that only exacerbated this greed, have combined to create the perfect economic storm that now threatens our communities and our economy as a whole.

Cheap credit, derived from overseas foreign currency reserves, encouraged many in the banking and finance industry to disregard their normally prudent lending standards and finance poorly underwritten and often predatory mortgages. These subprime mortgages were then securitized into mortgage-backed securities and the corresponding credit default swaps that have caused the crisis that our world economy has been dealing with since last March.

While changes in the system and other aspects of the mortgage finance process must and will be addressed, this hearing will focus primarily on how to create fair and prudent mortgage origination standards to prevent this tragic cycle from ever happening again.

I have called the subcommittee hearing today to return our attention to comprehensive mortgage lending reform. In the 110th Congress, this committee and the House passed H.R. 3915. This bill was not signed into law, denying many of our most vulnerable communities the protection they needed from predatory mortgage lending. Now the fight has turned into one of keeping working families in their homes and out of foreclosure or bankruptcy court.

But it is important that we act with a sense of urgency to pass comprehensive mortgage lending reform that will keep us from repeating the mistakes of the housing boom and bust of the last few years.

I look forward to hearing from our witnesses, and to a spirited debate on these issues.

I yield the ranking member, Mr. Hensarling, 5 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman, and thank you for calling this important hearing. I mean, clearly, we still have many of our fellow citizens who are suffering in this economy, who are struggling to pay their mortgages, struggling to fill up their gas tanks, struggling to send their kids to college, and have a high level of anxiety about the future of their jobs.

So, number one, it is a very topical issue for us to discuss. It's one, as we well know, in which this subcommittee and this committee have been quite active.

I recall some words that our President shared with us during the State of the Union address, and were somewhat reflected in the chairman's statement.

Our President said, "It is only by understanding how we arrived at this moment that we will be able to lift ourselves out of this predicament." And I agree with our President.

As we're looking down the road to future and further mortgage market reforms, we must understand how we entered into this economic turmoil in the first place. I believe there are a number of causes.

I think with the hindsight of 20/20, the easy money policies of the Federal Reserve exacerbated a housing bubble that otherwise could not exist without them.

Mortgage fraud ran rampant for a decade, on the lenders' side and on the borrowers' side as well.

But we also have to take a clear look at government policies, no matter how noble the intent, that ultimately attempted to incent, cajole, or mandate financial institutions to lend money to people to buy homes who ultimately could not afford to keep those homes. Again, I know the intent was noble, but the effect has been devastating.

One need only look at the Community Reinvestment Act. Again, very noble in intent, designed to deal with a very serious problem of red-lining at the time, but ultimately, it helped put the Federal Government seal of approval not so much on helping raise the economic opportunities of the borrower, but instead, bringing down the lending standards of the lender.

We certainly know the infamous role that was played in the government-sanctioned duopoly of Fannie Mae and Freddie Mac. For years and years and years, Chairman Greenspan, the former Chairman of the Federal Reserve, came before this committee and said that there was huge systemic risk, and unfortunately, this committee did not act; previous Congresses did not act.

And again, they were given an affordable housing mission, I'm sure a most noble intent, but it led to essentially having an off-budget HUD where people were incented to lower their lending standards, Fannie and Freddie securitized this, and what might have been a localized problem in one segment of the economy was spread throughout, not only the national economy, but the global economy, as well, and we have to take a very serious look at those particular policies.

So as we embark upon this quest again, to look at successful mortgage lending reform, I believe I have several ideas of what successful mortgage lending reform ought to look like.

Number one, we ought to let competitive markets work. We want to ensure that the consumer has effective disclosure, not necessarily voluminous disclosure. We need transparency, and we need to make sure that we're working to make markets more competitive, not less competitive, as was done in the case of Fannie and Freddie.

Again, we do not need laws to incent, mandate, or cajole financial institutions to loan money to people who otherwise may not be able to afford it. We need to ensure that we do not deny an informed consumer's choices that they may need to realize their American dream. With full disclosure, let the consumer choose, not the all-enlightened Congress.

And then there is the issue of fairness. We should never forget that 95 percent of America rents, owns their home outright, or are current in their mortgage.

Now, there are many people worthy of financial assistance who are having mortgage problems, and there are many who aren't. We know that mortgage fraud ran rampant, speculation ran rampant, many used their homes as an ATM, many lived beyond their means. And when families are struggling to pay their mortgage, they shouldn't be forced to pay their neighbor's, as well.

So, Mr. Chairman, I appreciate you calling this hearing. I look forward to the testimony of all of our witnesses on three different panels, and with that, I yield back the balance of my time.

Chairman GUTIERREZ. Two minutes for Mr. Castle.

Mr. CASTLE. I thank the ranking member and the chairman very much for this important hearing.

And I think there is unanimity in this room and in the United States at this point that the subprime lending issues and the foreclosures that have arisen from that have contributed to the economic downturn we currently face.

In this body we have obviously considered proposals to help those facing foreclosures, and to restore the housing market, but many of us here are equally concerned with looking more precisely at this problem, to prevent it from reoccurring.

To what extent did lenders convince unknowing borrowers to enter into mortgage agreements they couldn't afford; how did borrowers lie or tweak their income to qualify for high-cost loans; how prevalent were these practices? These questions may need to be answered before we can craft effective legislative solutions.

I welcome hearing the testimony of our witnesses, and I'm particularly interested in hearing from Ms. Braunstein, not only because she is from Delaware, but also because she's an expert on consumer financial services issues.

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

Chairman GUTIERREZ. I thank the gentleman.

We'll introduce the panel. Our first panel is—yes? The gentleman from Minnesota for 2 minutes.

Mr. PAULSEN. Thank you, Mr. Chairman, for holding this very important hearing today.

You know, both in this Congress and last year in Congress, this committee, I know, has been trying to address some of the many problems in the mortgage system that have created great pain now for many of our constituents. While I think we need to remedy the problems caused by the bad actors, we also need to acknowledge the fragile condition of our current credit markets and make sure we do no harm with future legislation.

You know, many certainly can argue and say that the legislation that was passed in Congress here over the past few years has helped put us into this crisis by pushing the concept of homeownership onto those who financially and inevitably could not sustain that concept of homeownership themselves, and so I think we need to get ultimately back to the principles of common sense in terms of lending principles, so that we have requirements for reasonable downpayments, so that the borrowers actually have skin in the game themselves, and that we also have traditional gross income

to payment percentages that can help alleviate some of those changes and problems.

So I thank the witnesses for being here today and I thank you, Mr. Chairman, for holding this hearing.

Chairman GUTIERREZ. I thank the gentleman.

Our first panel consists of Sandra F. Braunstein, the Director of the Division of Consumer and Community Affairs at the Board of Governors of the Federal Reserve System; and Steven Antonakes, the Commissioner of Banks for the Commonwealth of Massachusetts, who is speaking on behalf of the Conference of State Bank Supervisors.

Please, you're each recognized for 5 minutes.

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

Ms. BRAUNSTEIN. Chairman Gutierrez, Ranking Member Hensarling, and members of the subcommittee, I appreciate this opportunity to discuss the Federal Reserve's regulatory actions to address mortgage problems and potential legislative responses to these issues.

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 unfair or deceptive practices that resulted in unsustainable loans.

Last July, the Board issued final rules to establish sweeping new regulatory protections for consumers in the residential mortgage market. The new rules apply to all mortgage lenders, not just depository institutions.

The Board's rules contain four key protections for a newly defined category of 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.

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 the borrower faces payment shock.

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

In addition to the rules for higher cost loans, the Board adopted other protections that apply to all mortgages.

Currently, the Board is engaged in robust consumer testing to improve the content and comprehension of cost disclosures for mortgage loans and home equity lines of credit.

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 new requirements for providing this form earlier in the application proc-

ess will distinguish the disclosure from the many legal documents presented at loan closing.

However, it is important to note that the effectiveness of a disclosure is best judged through the results of consumer testing and not by the length of the disclosure alone.

In 2007, the House of Representatives passed the Mortgage Reform and Anti-Predatory Lending Act. We commend Congress' work on the bill, which represents a significant contribution to the public debate about these issues. Although some of the details regarding implementation differ, both the House bill and the Board's rules set minimum underwriting standards for higher priced loans.

The bill would also provide consumer remedies for violations of the bill's standards and consumers would be able to seek remedies against creditors, assignees, and securitizers.

In order for assignee liability to increase market discipline, the law must be clear about what acts or practices are prohibited so that assignees can detect violations before purchasing 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 clearly defined in either law or regulation.

The bill also seeks to establish the Federal duty of care that would require loan originators to present a range of loan products for which the consumer is likely to qualify and which are appropriate for the consumer's circumstances.

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 the statute should clarify that.

I would also like to comment on the bill's delegation of rule writing. Several provisions of the bill would be implemented by regulations that are promulgated jointly by the Federal banking agencies. In our experience, inter-agency 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.

In closing, 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 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 149 of the appendix.]

Chairman GUTIERREZ. Thank you.

Ms. Antonakes.

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

Mr. ANTONAKES. Good afternoon, Chairman Gutierrez, Ranking Member Hensarling, and distinguished members of the subcommittee. My name is Steven 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 to discuss Federal predatory lending legislation, and more broadly, reform of our system of mortgage regulation and supervision.

My written statement provides you with a detailed discussion of dramatic regulatory reforms occurring at the State level and suggestions for Federal reforms. In my oral presentation, I would like to highlight two key points: First, an explanation of why federalism matters. And second, how a system of cooperative federalism can work and why it is in the best interests of the public, the industry, and our economy.

For the past decade, it has been clear to the States that our system of mortgage finance and mortgage regulation was flawed and that a destructive and widening chasm had formed between the interests of borrowers and of lenders. Over that decade, through GAO reports and congressional testimony, one can observe an ever-increasing level of State concern over this growing chasm and its impact on the State and Federal regulatory relationship.

Chairman Gutierrez, you are clearly one of the leading voices in Washington who saw how destructive this break between consumer, industry, State, and Federal interests was becoming.

I would like the committee to consider how the world would look today had the OCC and the rating agencies not intervened and the ASNI liability and predatory lending provisions of the Georgia Fair Lending Act had been applicable to all financial institutions.

I would suggest we would have far fewer foreclosures and would have avoided the need to bail out our largest financial institutions.

It is worth noting that the institutions whose names were attached to the OCC's preemption—National City, First Franklin, and Wachovia—were all brought down by the mortgage crisis.

Regulatory reform must foster a system that incorporates the early warning signs that State laws and regulations provide, rather than eliminating them. I'm not suggesting a status quo solution or a return to a balkanized system of regulation. Instead, Congress needs to forge a regulatory system of high standards that more successfully coordinates among State and Federal regulators.

A centralized, top-down, or consolidated system will set us up for future catastrophic boom or bust cycles similar to the ones that we're currently experiencing. The wisdom of our forefathers in recognizing the necessity of checks and balances and grassroots innovation is timeless, and should be heeded.

The model for this regulatory system is already in development. Thanks to the leadership of Ranking Member Bachus, who first introduced legislation, and to Chairman Frank, and Senators Feinstein and Martinez, who embraced it and helped it become law, a coordinated nationwide mortgage regulatory system is taking shape.

With the passage of a SAFE Act: nearly every State is now in the process of raising mortgage originator licensing standards; a centralized system of record and enforcement tools is up and running; and unprecedented State and Federal cooperation is beginning to evolve.

The work that began at the State level in 2003 to create the nationwide mortgage licensing system was empowered and enhanced by Federal law in 2008 and has compelled significant State to State and State to Federal cooperation. This is how the regulatory system should work.

We believe that H.R. 3915 also provides an example of how our system of federalism can work. The Miller-Watt-Frank-Bachus bill drew from the State laws and refined them. It does what only Congress can, which is ultimately make uniform applicable minimum standards.

We suggest Congress confirm that H.R. 3915 serves as a minimum standard for all institutions and that it allow for State enforcement of State and Federal law.

I'm not suggesting a regulatory free-for-all, but rather, a more coordinated and cooperative system of applicable law and enforcement.

I must also recognize and thank my fellow witness, Sandy Braunstein of the Federal Reserve Board, for the Board's leadership in creating a model of cooperative supervision through our joint pilot project to examine non-bank mortgage lenders. This project is an example of cooperative federalism.

CSBS looks forward to continuing to work with this committee and our Federal counterparts to reform our system of mortgage regulation.

Thank you for the opportunity to testify, and I would be glad to answer any questions the committee may have. Thank you.

[The prepared statement of Mr. Antonakes can be found on page 85 of the appendix.]

Chairman GUTIERREZ. Thank you, Mr. Antonakes.

Let me begin with you, Mr. Antonakes. I want to first applaud you for recommending in your testimony that we attend the National Bank Act to make it clear that State consumer protection laws can apply to national banks. As you alluded to, I have been fighting for years, and I appreciate you bringing it to the forefront today.

In your testimony, you also advocate for a bifurcated supervision system, one for the large systemic institutions, and one for community banks. This is intriguing, and this issue is front and center, as we're dealing with the fallout from the FDIC's premium increases that apply to all banks of all sizes, and as we consider a systemic risk regulator.

Could you expand a little bit on your proposal? For example, where would the cutoff be between a systemic bank and a regular bank, and how would you make that determination?

Mr. ANTONAKES. Well, thank you, Mr. Chairman.

The point I think we're trying to make here is that the diversity of our banking system has always been a strength in this country, a system which allows community banks, credit unions, also to compete with large money center banks.

The community bank system has been, and continues to be, a strength in the system today, very important, providing credit to local communities, to consumers, and small businesses. To the extent that they can be allowed to effectively compete with these largest institutions that pose systemic risk to the system, I believe is no longer a certainty.

Moreover, I think the concern is, if regulatory reform is more beneficial to our largest institutions, then I think continued consolidation of our industry will be harmful for our consumers ultimately, as well as for our businesses and for our local communities.

The opportunity here I believe is to ensure that we have a diverse banking system and one in which our smaller institutions that are very heavily invested in the communities within which they operate are allowed to effectively compete with behemoth institutions that pose less risk.

That being said, while I don't propose to have all the answers for this, or where the direct cutoff can be, I think we can determine which institutions pose the greatest risk to our country's financial system, those that do not, and determine whether or not separate rules in separate areas can be applied.

Chairman GUTIERREZ. Thank you.

Ms. Braunstein, how long have you been at the Federal Reserve system?

Ms. BRAUNSTEIN. Twenty-one years.

Chairman GUTIERREZ. Twenty-one years. Good. I just wanted to make sure it was during the last 8 years, and put that into the record.

So one of the arguments is that the government said everyone should own a home, and so everyone said, "Since that's what the government wants me to do, since the government is encouraging me to do it"—and no one ever has come to me and said, "I bought my house because the government encouraged me to buy a house." They said, "I wanted a home," for a lot of other reasons. But that's one of the arguments, and so, therefore, part of the reason we're in the current situation.

And so if that's true, what policies during, I don't know, from, let me see, 2001 to 2008, during the last 8 years, has the Federal Government forced on the American people so they could buy a home that has caused this problem? Is there such an entity that has caused this, such as the Community Reinvestment Act?

Ms. BRAUNSTEIN. There are obviously a lot of reasons as to why we're in the economic crisis we are in. It's a very complex situation. But I can state very definitively that from the research we have done, the Community Reinvestment Act is not one of the causes of the current crisis.

We have run data on CRA lending, and where loans are located, and we found that only 6 percent of all higher-cost loans were made by CRA-covered institutions in neighborhoods targeted—which would be low- and moderate-income neighborhoods—by CRA. So I can tell you, if that's where you're going, CRA was not the cause of the subprime crisis.

Chairman GUTIERREZ. But it is somewhat because, as I remember my stay here, my short stay during the last 17 years here in Congress and on this committee, we have attempted to expand

homeownership to the American public, but every time I evaluate the loans that have been given to communities of color, African-American and Latino and emerging immigrant communities, it hasn't been the CRA-covered institutions. Actually, it has been the subprime lending industry bringing about those loans.

I mean, if they were CRA, they might have gotten 5½ and 6 percent regular mortgages, but that is not what happened in those communities.

So I look forward—because I want Mr. Hensarling to be able to have his 5 minutes, I'm just going to end by saying, look, I would like especially Ms. Braunstein to—when we look at underwriting, let's set so that we could also go back to some sanity in the way we do this.

When I first bought my home in 1981, it was at 14½ percent. I had to come up with a 20 percent downpayment. I had to show my last 2 years of income taxes. I mean, there were requirements. I had a stake. Had the home diminished in value, I still would have had a stake in it, and I looked at it as a home.

So maybe we could look at some of those underwriting rules, so that the purchaser has something there, given that the government is many times the guarantor.

I thank you both.

Ms. BRAUNSTEIN. Congressman, just one quick statement to that.

That is what we have attempted to do with our HOEPA rules—

Chairman GUTIERREZ. Well, good.

Ms. BRAUNSTEIN. —is to afford those protections to homeowners.

Chairman GUTIERREZ. And now, Mr. Hensarling, my colleague, is recognized for 5 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman.

In assessing the various contributing and "but for" causes of our economic turmoil, I understand your opinion on CRA. I assume you haven't drawn the same conclusions with respect to the GSEs, or do you differ from former Chairman Greenspan in that respect?

Ms. BRAUNSTEIN. Well, I think that the Federal Reserve recognized that there were issues around the GSEs and their portfolios. I can't really comment on the impact of what—I think what you're talking about were the goals they were given for homeownership, and that, I cannot comment on whether that was a contributing cause or not.

Mr. HENSARLING. Let me ask you to comment on this.

In your testimony, you said, we are well aware that consumers receive an overwhelming amount of information at the time they close a mortgage loan.

And in trying to, again, provide the consumer with more effective disclosure, I understand, and I believe in your testimony you talk about more results from consumer testing being needed. Just exactly where is the Federal Reserve in this process?

Ms. BRAUNSTEIN. We actually initiated the consumer testing of mortgage disclosures last year. We are currently testing. We are redesigning disclosures, and we plan to have a proposal out with recommended new disclosures sometime this summer.

Mr. HENSARLING. This has been an ongoing process for a number of years; has it not?

Ms. BRAUNSTEIN. Well, TILA, the Truth in Lending Act, has been an ongoing process, but we first, as I think you know, we issued recently comprehensive rules on open-end credit, which is credit cards, and that was the first chunk that we tackled, and then we went into the HOEPA rules, which we finalized in July, and during that process, we also initiated the look at the closed-end lending or mortgage loans and home equity lines, and that's what we're trying to complete now.

Mr. HENSARLING. On page 10 of your testimony, you speak of assignee liability with respect to the earlier version of H.R. 3915.

I believe you say that laws must be clear about what acts or practices are prohibited, so the 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.

Given the problems we have had in the meltdown of our secondary mortgage market, given how many people are struggling to refinance their homes now, if we went forward with a fairly indefinite standard such as "net tangible benefit," do you have an observation or impression on what that impact may be on the secondary mortgage market?

Ms. BRAUNSTEIN. Well, I think that it could be problematic, because if the markets cannot determine what would be an allowable loan and what loan they would have, especially when they're carrying liability for those loans, I think they would be very hesitant to participate in the markets.

So we're saying that it's important to make sure that there are some bright lines drawn, that there is a clear definition, and whether that's done through statute or regulation, there needs to be some way of determining when you're evaluating what you're going to buy whether or not you're going to get in trouble for those loans.

Mr. HENSARLING. In mentioning the market, what has the Federal Reserve observed as far as the lending standards of lenders today?

My point would be this, in speaking your testimony, about there having to be a balance in some of the prescriptive acts that may come out of Congress or the Federal Reserve, but everything I read, see, and hear anecdotally is that already the market is adjusting to the excesses of the past, and I observe that those who may be accused of being the worst players and taking the greatest risk, for example, Countrywide, or New Century, they received the ultimate punishment of the marketplace; they no longer exist.

So is the market responding to the excesses of the past?

Ms. BRAUNSTEIN. Well, I think it's true that the kinds of excesses we saw in the past we're not seeing today, but also, we're not seeing, frankly, a whole lot of lending today. So this is not what we would call a normal marketplace.

Our concern in writing the HOEPA rules was that we wanted to make sure, because we know the markets will revive at some point, and when they do, that there are responsible loans being made.

And so, it is important to put a structure in place that will take care of the market when it does revive.

Chairman GUTIERREZ. Thank you. We should be back in about—we have one 15-minute vote, of which we have 5 minutes left, and two 5-minute votes, so we will be back in about 20 or 25 minutes. We will be back as quickly as we can, so we would ask the witnesses to stay for questions from other members.

Thank you so much.

[recess]

Chairman GUTIERREZ. Thank you very much for that short recess, and we're going to go to Mr. Moore for 5 minutes.

Mr. Moore, you are recognized.

Mr. MOORE. Thank you, Mr. Chairman, and I guess Mr. Hensarling is not here, but I thank him, too, and I want to thank the witnesses for their testimony.

We all know, and we have talked about this, nobody needs to tell you our economy faces some of the biggest challenges we have had since the early 1930's, and the crisis in our housing sector is certainly part of this problem.

I'm glad our subcommittee is taking a broad view of the U.S. mortgage system, so we can discuss how Congress might improve it and curb abusively predatory lending practices.

The last time the housing market was this bad, Congress set up the FHA, or Federal Housing Authority, to insure mortgages that lenders wouldn't otherwise make.

This past decade, however, Americans were drawn to aggressive lenders, were seduced by easy credit and loans with no upfront costs and a few basic underwriting requirements, such as verifying income, but the subprime mortgage market has crashed and borrowers are flocking back to the FHA, which has become the only option for those who lack large downpayments or good credit scores.

The FHA's historic role in backing mortgages is more crucial now than at any time since its founding. With all the new FHA-insured loans, we are seeing a sharp increase in quick defaults where some borrowers are failing to make more than a single payment before defaulting.

In response to this, HUD's Inspector General, Kenneth Donohue, said, "If a loan is going into default immediately, it clearly suggests impropriety and fraudulent activity." That's a quote.

What are your thoughts on this matter? Should Congress be increasing funding in the Inspector General's office as well as the FHA to keep up with demand and ensure that basic FHA lending requirements are being met?

In a Washington Post article, the reporter indicates Wells Fargo and Bank of America are increasing their requirements on certain FHA loans to ensure homeowners can afford the mortgage.

Should Congress consider tightening the FHA's standards to minimize defaults?

Either witness. Yes, ma'am?

Ms. BRAUNSTEIN. I would just say that I think FHA has a very important role to play in the mortgage markets, and maybe more so than ever now, given the crisis.

So, whatever needs to be done in order to make sure that credit flows, that it's available to people, and that people are getting safe and sound loans, I think it would be important to do.

Mr. MOORE. All right. Second question. Second and last question. I have concerns with adjustable-rate mortgages, or ARMs, as they're called, that start with a low monthly payment that rises over time. Personally, I don't have a problem with that, but I think some people get into those not understanding exactly how they work.

What role have adjustable-rate mortgages played in the current housing crisis? Is there a legitimate purpose for allowing these kinds of mortgage products to exist? Should we put any kind of controls or limitations or regulations on adjustable-rate mortgages?

Ms. BRAUNSTEIN. We have done that through the HOEPA rules that the Fed issued in July. Adjustable-rate mortgages were a big problem in the marketplace. A lot of people did not understand the terms, did not understand the payment shock, and that their loan would reset, and there was a huge difference, oftentimes, between the initial rate and the reset rate.

A couple of things that we did for the loans we define as higher-cost loans, include—the HOEPA rules will require that they be underwritten at the ability to repay, which means that you look at the highest payment that would be made within the first 7 years of the mortgage, whereas we heard before that loans were often being underwritten at those teaser rates, and people couldn't afford the resets.

We also put a lot of restrictions on prepayment penalties, and basically any loan that resets in the first 4 years is banned from having a prepayment penalty attached, which would allow people to get out of loans much easier, not having a prepayment penalty.

Mr. MOORE. Right. Sir, do you have any comments?

Mr. ANTONAKES. Yes, Congressman. I would add that I don't think traditional ARM products were the focus of the problem, and I would hate to cut those products out of the marketplace: 3/1 ARMs; and 5/1 ARMs.

As my colleague indicated, it was the option ARM products, no-interest loans, that caused the problems and created tremendous payment shocks that weren't properly underwritten.

In Massachusetts, we actually passed a law as part of a foreclosure prevention bill signed by Governor Patrick in 2007 that, for subprime ARMs, it requires a consumer to actually opt out of a subprime fixed-rate product, and then there's mandatory counseling if they want to proceed with a subprime ARM, to ensure that they truly do understand the terms and conditions of that credit.

Mr. MOORE. Thank you. Thank you, Mr. Chairman.

Chairman GUTIERREZ. And we have the gentleman from Delaware for 5 minutes, Mr. Castle.

Mr. CASTLE. Thank you, Mr. Chairman.

Mr. Antonakes, you heard Ms. Braunstein talk about the rules that the Fed has issued, which I guess will go into effect in October, or something of that nature. We have passed legislation, I think it was 3195, here in the House, that was not acted on in the Senate, I don't believe.

Obviously, you have indicated in your testimony otherwise; the States have done a few things.

Can you either, by the use of data or anecdotally, tell us if the lending, mortgage lending habits of our banks have changed as a result of that? Obviously, they have changed somewhat. But is there any clear evidence that there have been very substantial changes in terms of some of both the subprime, ALT-A, and other mortgage problems that have existed?

Mr. ANTONAKES. I think lending habits have changed dramatically, primarily because of the collapse of the mortgage market. I think there has been a mortgage correction, and many loans aren't being written anymore, be they subprime loans, ALT-A loans. But that's not to say they won't be written again once the market returns and once housing values improve.

So I think the real opportunity here, you know, we were supportive—I testified in support of the Federal Reserve Board's HOEPA regulations. I do think there's a historic opportunity here for the Congress to act on predatory lending legislation, action that has been taken in 35 States to date, plus the District of Columbia, but been blunted by Federal preemption. We haven't had the opportunity for those laws to apply uniformly across the spectrum.

I think the opportunity here is that Congress can act to set a minimum floor and allow States to continue to experiment and create laws that further protect the consumers if they so desire, as long as they do in fact apply to all entities within the jurisdiction of that State.

Mr. CASTLE. Okay. Thank you.

Ms. Braunstein, you said earlier, and we just heard Mr. Antonakes say, that mortgage lending is obviously way down at this point.

Is there any evidence that mortgage lending is beginning to recover at all, even talking about the last 2 weeks or 4 weeks, or whatever? I mean, I was amazed to see, I think it was CitiGroup actually had a profit in the last couple of months, or something of that nature. I don't know if that came from anything dealing with real estate.

But my question is, is there any—are you tracking that? Is the Fed tracking that? Is there any way of judging that it's beginning to actually recover?

Ms. BRAUNSTEIN. I'm sure that there are people at the Federal Reserve who are watching the markets very closely, but actually, I'm not prepared to comment on that.

Mr. CASTLE. That's okay.

Another question to you. You testified in your testimony, you spelled out the rules that the Fed is looking at for adoption in the fall of this year.

If we were to pass legislation here with some similarities to it—you're familiar, I think, with some of the legislation that we have dealt with in the past, in 3195, and some of the propositions for that—would this complement the Fed rule or would it be helpful or harmful, as far as you can ascertain?

Ms. BRAUNSTEIN. Some of the provisions in the legislation that was dropped in November last year actually mirror what's in our HOEPA rules. There are other things that go further and other

things that are different. And certainly, if you pass legislation, we would have to look at what we already have done in the HOEPA rules, and we'll have to reconcile that in some form or another.

But the HOEPA rules are scheduled to go into effect in October of 2009, so we're hoping that will move forward.

Mr. CASTLE. All right.

Mr. Antonakes, I wasn't going to ask this, but I will. Do you, in your position, have any thoughts or anything that we should be looking at or considering that we are not doing here at the Federal level, either in direct legislation, the kind of things that we do in Congress, beyond anything you may have testified to?

Mr. ANTONAKES. Congressman, I don't believe so. Again, I think the most important thing from my perspective is to ensure we truly have a level playing field in terms of what the rules are, that all entities, be they State licensed, State chartered, or federally chartered, are abiding by those rules, and that there's universal enforcement.

Mr. CASTLE. Very good. Thank you.

Ms. Braunstein, we are concerned about the need to strengthen loan underwriting criteria and standards, but also to ensure that borrowers can afford their homes. We would like to get the real estate market moving again, to some degree.

Are these two items completely, at this point, counterproductive, or do you feel that we can blend it together so that we can have good lending practices, but we can have the markets open up again?

Ms. BRAUNSTEIN. Yes, I do think that both are possible. I do not think that they're mutually exclusive at all.

In fact, I think the markets will work even better if there is responsible lending in the markets and people are able to afford their loans and keep their homes.

Mr. CASTLE. Thank you.

I yield back, Mr. Chairman.

Chairman GUTIERREZ. Thank you very much.

Just for the institutional memory of everyone, the HOEPA rules are the same ones that came about as a result of the 1994 legislation that we passed here in Congress.

Ms. BRAUNSTEIN. Correct.

Chairman GUTIERREZ. Okay. I just want everybody to know it took quite a while; I got here in 1994, and the rules finally have come about.

Mr. Sherman, you are recognized for 5 minutes.

Mr. SHERMAN. Thank you, Mr. Chairman, and Mr.—author of the 1994 bill. What was the name of that bill again, Mr. Chairman?

[laughter]

Mr. SHERMAN. Can you see any reason not to simply ban stated income, low doc, and no doc loans?

Ms. BRAUNSTEIN. We—the HOEPA rules that we issued in July do ban these products for higher-cost mortgages. Are you talking about across the entire spectrum?

Mr. SHERMAN. Across the board.

Ms. BRAUNSTEIN. I think we would have to look at that and see if there were unintended consequences

Mr. SHERMAN. Is it an important national priority to make sure that people can cheat on their taxes and still get good home loan financing?

Ms. BRAUNSTEIN. No, I don't think it is. I think that stated income, my understanding of stated income loans is that they were used in a small segment of the market for a number of years without any problem. However—

Mr. SHERMAN. Except for the fact that people could cheat on their taxes and get good home financing, which the home financiers didn't regard as a problem.

Ms. BRAUNSTEIN. Well, and that the problems in the markets, though, the mortgage markets, ensued when they became widespread.

Mr. SHERMAN. Until then, we just had the problem I—can you think of any reason why we shouldn't ban what I call teaser rate ARMs? That is to say, where the adjustable-rate mortgage's initial payments are below what they would be if the—at today's index and today's spread?

Ms. BRAUNSTEIN. As with many products, I guess there could be a case where these could be helpful to somebody, but if you're going to keep these products, there need to be protections around them, which we have done with the HOEPA rules.

You need to prevent prepayment penalties, which lock people in and make it much more difficult for them to get out of the loan before—

Mr. SHERMAN. If something has lots of harms, and whether it ever serves a good purpose at all is simply conjectural, as a matter of fact. We can't even figure out what benefit it would have, why wouldn't we ban it?

Ms. BRAUNSTEIN. Well, I guess, you can always draft a case where somebody actually knows that they have a lower income right now, but their income is going to rise in the next couple years, and it allows them to buy a home that they ordinarily would not be able to buy.

Mr. SHERMAN. I think that—

Ms. BRAUNSTEIN. So you could always construct that argument.

Mr. SHERMAN. —an awful lot of people are getting foreclosed now because they were sure they were going to get—

Ms. BRAUNSTEIN. I agree.

Mr. SHERMAN. —a couple of promotions, and I think that we ought to qualify people based on their current income, not based on, "Well, I'm going to graduate from school, unless I flunk out, and I'm going to get a high-paid job, unless there's a recession when I graduate."

The chairman of the full committee has suggested that we prohibit loan originators, that first lender, from being able to fully sell without recourse the loan into the secondary market. He has proposed, if I got this right, that they retain at least 15 percent ownership of the mortgage or 15 percent, the first 15 percent of the risk.

I would like both witnesses to comment on this. Do we want to abolish the business plan where a financial institution with limited capital is able to lend money and then sell the entire loan—lend money, sell the entire loan, and in that way, with limited capital, be able to originate a lot of loans?

Do we want, instead, only to have a business model where a portion of your capital is used up as you originate and sell off loans?

I would like both witnesses to respond.

Ms. BRAUNSTEIN. As business models are developed for the mortgage market going forward, I think it's going to be extremely important to look at the incentive structures, and certainly some of the problems that we are seeing in the current markets or that we saw in the markets are due to the fact that there was not an incentive on the part of brokers and others to take due diligence and do good underwriting because there was no skin in the game, so to—

Mr. SHERMAN. So you are saying not only should the loan originator have skin in the game, but the independent mortgage broker—

Ms. BRAUNSTEIN. Possibly. There needs to be incentives.

Mr. SHERMAN. —would have skin in the game? These are small businesses. Remember, they have to get audited financial statements to prove they have $75,000 in capital.

Are we basically then going to ban the small mortgage broker—

Ms. BRAUNSTEIN. Well, I'm not saying it would be easy to figure out how to structure it, but certainly the incentive structure is going to be important going forward, to make sure that people are making responsible decisions.

Chairman GUTIERREZ. The time of the gentleman has expired.

The gentleman from Texas for 5 minutes.

Mr. MARCHANT. Ms. Braunstein, my concern is the lender who has 100 percent of the skin in the game, and that is a person who sells their home and takes the note back, and is the lender, and keeps the note, and does not try to securitize it.

Do the rules sweep this whole class of people who make that kind of loan into a regulation scheme that puts them at risk of being drawn into court?

Does it contemplate that a lot of the loans that are made in America are made by the sellers, and the loan is—of the property, and the loan is actually retained by them and is not a conforming loan, and has, you know, the underwriting criteria used was the person that sold it found the person that bought it to be creditworthy?

And are we putting a lot—and I think across America, there are a lot of transactions like this that take place. Are we putting that lender in the same category as a mortgage broker at a mortgage company?

Ms. BRAUNSTEIN. Well—are you talking about your—the legislation that was introduced in the House—

Mr. MARCHANT. Yes, the rules or the legislation. I mean—

Ms. BRAUNSTEIN. The HOEPA rules do not deal with that issue, the new HOEPA rules that we introduced. The legislation that was introduced in 2007 by the House deals with assignee liability, and in particular, that was to try to close a gap and put some responsibility for the products onto the securitizers and assignees.

Mr. MARCHANT. So as long as a person has no contemplation to securitize, then they need not worry about this legislation?

Ms. BRAUNSTEIN. Well, if they're holding the note, they're holding—they have plenty of skin in the game.

Mr. MARCHANT. Yes. My next question has to do with that group of—can you make a loan that specifically on its face is prohibited by law to be securitized, so that a life insurance company that intends to originate mortgages for their own portfolio, which used to happen, and banks for their own portfolio, can know that, when they originated that loan, that it's specifically prohibited being put into a pool and securitized and sold in the secondary market, and if that happens, are banks and lenders going to be prohibited from making loans that they might make just for a business reason, for wanting to have a portfolio loan?

Ms. BRAUNSTEIN. I have to admit, I'm not sure I understand the scenario.

Mr. MARCHANT. Well, if you securitize—maybe Mr.—

Ms. BRAUNSTEIN. I don't think he does.

Mr. MARCHANT. Okay, I'm sorry. Do you have an answer for that? No. Okay. I'm not explaining myself properly.

What I'm concerned about is the small lender that makes loans for their own portfolio, and I'm afraid that these small lenders will get captured in some of these rules and in future legislation, that will basically curtail a great part of real estate business out there that never enters into the banking scheme and commercial banking. That's my biggest concern.

Ms. BRAUNSTEIN. If lenders are doing responsible lending, then there should not be a problem. They should not be prohibited. There should be nothing in the rules or—either our rules or legislation, that would prohibit that.

I think it is always important to look at any potential regulation or statutes to make sure that there are not unintended consequences that would inhibit responsible lending.

Mr. MARCHANT. And that would be my word of caution, because in many instances, the—I have had people call my office and say, "Can I do—under these new rules, will I be able to owner finance, under these rules, will I be able to make loans on a property that I sell?"

And I've said, "I don't think you will be affected." But it has had kind of had a chilling effect on some of the owner-sellers.

Thank you, sir.

Chairman GUTIERREZ. The gentlelady from New York, Ms. Maloney, is recognized for 5 minutes.

Mrs. MALONEY. I thank the gentleman for yielding and for organizing this hearing, and I welcome both panelists.

Beyond working on mortgage reform, this committee is working on regulatory reform, including a discussion of creating a systemic risk regulator, and I would like to ask each of the witnesses, could you discuss how you see these mortgage reforms working in concert with regulatory reforms? How do you see a systemic risk regulator overseeing parts of the mortgage market?

Mr. ANTONAKES. I believe that a systemic risk regulator would be complementary to regulatory reform and structure on the mortgage side where the States are most closely focussed. You know, we are working through a number of initiatives, including the nationwide mortgage licensing system, to increase transparency and effectiveness for consumers, and increase and improve upon a partnership with Federal regulators.

However, what we're doing is more focused, I believe, on the model of institutions that we're supervising. Certainly, I believe there are institutions that have either been largely Wall Street institutions, that have been largely unregulated, and that pose tremendous risk to our financial system, and there should be a regulatory structure in place which better captures that risk, and is frankly more stringent, given the risk to the financial system.

So I think the system has to be tailored very carefully to ensure that the greatest degree of oversight exists for our highest-risk institutions, and that there continues to be collaborative State and Federal action on those institutions, as well as those that frankly pose less risk to the system. And the model hopefully is flexible enough to ensure that those institutions that have less risk can continue to exist and compete well in the marketplace.

Mrs. MALONEY. So you see the systemic risk regulator overseeing a level of regulatory relief, say, across the board, or regulation, even-playing-field regulation that would protect them before getting to systemic risk?

Mr. ANTONAKES. I think they would have to work in a complementary fashion. I don't think you could remove all the risk in an entity and just have it solely based within the systemic risk regulatory. I think there would have to be coordination between the different agencies to ensure proper oversight, and I think that is achievable.

Mrs. MALONEY. And Ms. Braunstein? Nice to see you again.

Ms. BRAUNSTEIN. Nice to see you, too.

I also think a systemic risk regulator would have to be cognizant of all the risks in an organization, and that would include consumer protection risks.

As we have certainly seen in the current situation, consumer protection was actually somewhat like the canary in the coal mine in terms of other things going on, so it would be very important that that be a strong component of whatever is developed going forward.

Mrs. MALONEY. Some say that maybe we should have a separate regulator for consumer, separate from the systemic risk. Do you think it should be all together, or do you think it should be separate?

Ms. BRAUNSTEIN. Well, I don't have an answer to that question. I think that, obviously, these are issues that we're going to be exploring, all of us, in the agencies and on the Hill, going forward.

I think while there is a certain appeal to having a separate agency, I would say that I also think that there is a lot to be gained in terms of crafting rules that do not have unintended consequences and interrupt the flow of credit; there is a lot to be gained from the research analysis and the supervision that is done in the banking agencies.

Mrs. MALONEY. A number of States, including my home State of New York, have really been at the forefront of State-level mortgage reform.

Which States would you suggest the committee look towards for best practices and what advice would you give the committee as we discuss enacting nationwide reforms vis-a-vis existing State laws?

Mr. ANTONAKES. I think there are a number of States you could look to for those initiatives. I think certainly New York is one.

North Carolina is another. I believe my State of Massachusetts has been very progressive in this area, as well as the Commonwealth of Pennsylvania, and several other States, and we would be happy to provide a more exhaustive list, as well as a list of initiatives from those States to the committee, as well.

Chairman GUTIERREZ. I'm sorry. I can't see. It is getting to be that time of life.

Mr. Lance, for 5 minutes, is recognized.

Mr. LANCE. Thank you, Mr. Chairman.

Good afternoon to you both.

Regarding the issue of the systemic regulator, to follow up on the questions of the gentlelady from New York, it would seem to me that I would favor one shop in this regard, and then perhaps have within that area several different agencies underneath it, and I would ask you to follow up further on that.

Do you have an opinion as to whether it just should be one overall, as opposed to having a separate place for consumers in our society?

Ms. BRAUNSTEIN. As I say, I don't have a specific recommendation at this time. I mean, these are issues that we are certainly discussing, at the Federal Reserve, you know, were certainly being discussed in many venues.

I would say that there are a number of things that need to be looked at, in the benefits of where that is, and there are, you know, pros and cons on both sides of the argument.

Mr. LANCE. And from your experience at the State level in Massachusetts—and I come from a State legislature in New Jersey, where I served for 18 years, and I have great respect to what States are doing in this regard—do you have an opinion based upon your experience in Massachusetts?

Mr. ANTONAKES. Yes, I do, Congressman.

I don't believe you can divorce the safety and soundness and compliance risk. I think they have to be housed in the same entity.

Mr. LANCE. That would be my thought process, as well.

Mr. ANTONAKES. But also, I believe checks and balances are incredibly important, and I would think that one single Federal regulator, while perhaps eliminating some redundancy, would have enormous power, and that would create risks in its own right.

Mr. LANCE. I suppose, but I would not want to see a system where we didn't know where to go, and a confusing system, and an overlapping system, and from my experience in the State capitol, sometimes you don't know where to go, and certainly this is an area where there has to be continuity across the board, given the fact of what has occurred over the last year.

Mr. ANTONAKES. I don't disagree with you. Each agency has to have a charge that is well understood by the public, certainly, and by consumers.

I mean specifically that it should be a cooperative effort between the State and Federal agencies that share supervision, as opposed to just one simple Federal agency that makes the final call on all decisions.

Mr. LANCE. And from your perspective, given your expertise at the State level, are you concerned regarding a Federal system where, if there is not technically preemption, there is the view that

all is wise that comes from Washington and not from the various State capitals?

Mr. ANTONAKES. Well, I certainly do have concerns in that area. I believe that the advantage of a local regulatory is that I am closest to my consumers. If there's an issue somewhere in my State, I can have examiners at that facility within hours.

And I think while we have great working relationships, generally, with our Federal counterparts, I think an issue that occurs in my State probably gets my attention quicker than it's going to from a Federal agency in Washington.

Mr. LANCE. Thank you. And of course, because our banking system is, to some extent, State regulated and Federal regulated, so long as that continues, it seems to me there has to be some sort of recognition of your responsibilities and the responsibilities of your counterparts across the country.

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

Chairman GUTIERREZ. The gentleman yields back.

The gentleman from Charlotte, North Carolina, Mr. Watt, for 5 minutes.

Mr. WATT. Thank you, Mr. Chairman.

I will start by complimenting Mr. Lance. I thought we had lost all of our States' rights advocates, and I'll be looking forward to adding him to my States' rights caucus, as one of the people who has been trying to convince multiple members on your side that we should not set a Federal preemptive standard, but set a Federal floor standard that continues to allow State attorneys general and State regulators to be involved in regulating these loans. So it's wonderful to know that I have an ally on that side on that issue.

I was going to ask about that, but he did a magnificent job of fleshing that issue out for me, and so I will let your answer, Mr. Antonakes, stand on that point. It's probably better made to him than it would have been made to me.

Ms. Braunstein, there has been a relative sea change in this whole area of regulation of mortgage lending since my colleague, Brad Miller from North Carolina, and I started this discussion about—how many years ago was it, Brad?—6 years ago, and we finally got the regulators, after the horse was out of the barn, to issue some regulations that move in the direction of regulating the players in this industry.

The one question I want to be clear on is whether you all have an opinion as to whether those regulations ought to preempt any additional legislation that is being contemplated by Congress. Do you think you have exhausted the whole field, or is there more to be done, in your estimation?

Ms. BRAUNSTEIN. Well, I think that we should constantly be vigilant and look for opportunities to improve any law or regulation that's out there, so I think that there may be some additional things.

As I said in my testimony, we applaud a number of the things you have done in the bill. A lot of it overlaps with things that we have done. And we are just saying that if you intend to move forward with this, there are some areas of clarification that would be needed.

Mr. WATT. And have we gotten the benefit of your written comments about those areas of clarification, rather than just a general statement that there are some issues?

Ms. BRAUNSTEIN. I know that when the bill was introduced back in 2007, we had Fed staff working closely with your staff on the Hill, and we are happy to do that again as you move forward on reintroducing it.

Mr. WATT. And there are some things, I take it, that you cannot do in a regulatory fashion, such as determining what the private rights of action and the penalties and the—

Ms. BRAUNSTEIN. —liabilities.

Mr. WATT. —things of that kind. We have to do that at the legislative level; don't we?

Ms. BRAUNSTEIN. Yes.

Mr. WATT. Okay. All right.

I think that's what I wanted to establish. I didn't want to proceed with the assumption that we were doing something that was good, that—when other folks were saying we have done enough, so we will keep moving, or trying to move in the direction of tightening up these regulations, and I would welcome, I'm sure, the chairman of the full committee and the chairman of the subcommittee and Mr. Miller and I in particular, since we have been at this for a long time, would welcome those clarifications to which you made reference.

Thank you. I yield back.

Chairman GUTIERREZ. The gentleman yields back.

Mr. Neugebauer, please, for 5 minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

Ms. Braunstein, recently HUD has gotten a revised disclosure statement out. In House Bill 3195, I introduced an amendment that basically would bring forward a universal disclosure box.

My opinion is that we don't need longer disclosures, we need better disclosures, and somehow somebody got the message that a long disclosure was a better disclosure for the borrowers.

And, you know, the other piece of it is, it would help, I think, everybody if HUD and the Fed maybe had coffee together and sat down and maybe tried to figure out, have a universal consumer disclosure so that there's more clarity.

And what needs to be on the front of that form, you can—if the lawyers want to lawyer up, let them lawyer up the back, but what we need to do is, while the lawyers are at coffee, we need to sit down and let people that are actually in the business, get consumers and lenders together, and talk about what are really the important things.

And there are 10 or 12 things that a consumer needs to know about, you know, the contract that they're about to sign, and it needs to be in big letters, and, you know, what's the actual interest rate, what's the payment, you know, some of those things, the highest interest rate during this contract can be X, if it goes to that, you would not qualify for this—I mean, sitting down.

Why do we need two disclosure statements, and why can't we look at thinking outside of the box with a new box?

Ms. BRAUNSTEIN. Well, we issued a mortgage reform report back in the 1990's that also recommended one joint disclosure, so we

have been an advocate of that. We have made overtures to HUD over the last few years. We have offered to work with them on their RESPA reform. And I can just say that we stand ready to do so.

Another comment I would like to make, in terms of us moving forward on our TILA disclosure, which we're doing now, another important part, I agree with you that more disclosure is not necessarily better.

It is our strong opinion, based on our experiences in working on mortgage disclosures, as well as previously working on credit card disclosures, that consumer testing is a very important part of developing disclosures, because you can't really know if consumers are going to understand these and get the information they need until you go out and test them, and that's what we're doing now.

The new disclosure we plan to bring forward mid-year is going to be consumer tested—will have been consumer tested—and we will continue to do that with disclosures.

It's not the length of the disclosure that's as important as making sure it's well tested.

Mr. NEUGEBAUER. Well, then, I would say that what would make sense to me is, let's test the disclosure, let's sit down with the consumers, let's ask them what is the information that they think they need to know in order to make an informed decision.

Ms. BRAUNSTEIN. That is the first part of the testing process, is we do interviews with consumers to ask them, "When you are going to buy a mortgage, or when you are going to get a credit card, what are you looking for, what is important to you?"

And from that information is how we then design disclosures that we then go in and test again, and make sure the consumers are actually getting that information.

Mr. NEUGEBAUER. And so you said you have made overtures to HUD in the past, and you have not gotten a positive response, evidently?

Ms. BRAUNSTEIN. Well, I think they were on track to get RESPA done by the end of last year, and they were moving on that track to do so.

Mr. NEUGEBAUER. Well, this is the change age, and maybe what we need to do, Mr. Chairman, is look at seeing if we can get some of these agencies to sit down together, because I think, you know, a uniform, universal disclosure for consumer credit, it almost makes too much sense, and also being able to get the people at the table who are borrowing money to find out, you know, the things that they need. On the front, you know, then you have these 10 boxes or however many boxes that is, and then if you need to let the lawyers cover themselves on the next 25 or 30 pages, well, let them do that.

But the borrower doesn't really have a good way to shop consumer credit, because these disclosures are so convoluted, so long, that you're trying to compare 3 pages of a good faith estimate to 3 pages of another lender's good faith estimate, really, where if we had the hull of that in a consolidated way on the front page, at least, I think it makes sense.

So I look forward to working with—the chairman left me—look forward to working with the other side to do that.

Mr. CLAY. [presiding]. I thank the gentleman from Texas.

I recognize the gentleman from Texas, Mr. Green, for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman.

And I would like to continue where my colleague from Texas left off, because Representative McHenry and I introduced an amendment that passed by voice vote out of this committee to have a one-page disclosure. It was a part of H.R. 3915.

H.R. 3915 passed the House of Representatives on November 15, 2007, but did not pass the Senate.

So I would look forward to continuing the effort that we have put forth to get that one-page disclosure that Representative McHenry and I introduced and that passed out of committee, was in fact a part of a bill.

Moving on from disclosure to originator compensation, you did not prohibit certain originator compensations, one known as the yield spread premium. What you did was move to disclosure of originator compensation.

And in so doing, I am moved to ask, what happens when the disclosure requirement is not met?

Ms. BRAUNSTEIN. Well, actually, what we did is we proposed, when we put out proposed HOEPA rules, in December of 2007, we had in there a disclosure provision for the yield spread premium for broker compensation.

We then, between then and when we finalized our rules in July of 2008, we consumer tested that idea, and frankly, it did not work well, because that is a very complex concept, and we found that not only did consumers not understand what a yield spread premium was, it not only confused them, it actually could hamper them in decision making, so we—

Mr. GREEN. Permit me to intercede—

Ms. BRAUNSTEIN. Well, I just want to say we withdrew that from the final rule, so we did not mandate disclosure of yield spread premiums. We are working—

Mr. GREEN. Let me do this, if I may, because I'm going to lose my time in just a moment.

Ms. BRAUNSTEIN. Okay.

Mr. GREEN. What I would like to know is this. If you move to disclosure, what is the penalty for failure to disclose, if there is a penalty?

Ms. BRAUNSTEIN. Well, I'm not sure we are moving towards disclosure. I mean, that's what I'm saying. We are working on that issue now. We are considering other options—

Mr. GREEN. What other options are you considering?

Ms. BRAUNSTEIN. —including restrictions about having—

Mr. GREEN. What other options would you consider, other than disclosure or elimination?

Ms. BRAUNSTEIN. Restrictions—

Mr. GREEN. Say again?

Ms. BRAUNSTEIN. Restrictions on yield spread premiums, potentially bans on yield spread premiums. We are looking at all possibilities—everything is on the table.

Mr. GREEN. So right now, it's safe to say that you have not come to a conclusion as to how yield spread premiums—

Ms. BRAUNSTEIN. No.

Mr. GREEN. —should be addressed?

Ms. BRAUNSTEIN. That will be addressed in the rules that will be coming out this summer.

Mr. GREEN. All right. Thank you.

Let's move next to a provision for people who can pay a monthly payment, and who don't have traditional credit.

We have some people who can afford a mortgage payment, but they don't have traditional credit.

We have had the circumstance wherein persons didn't have to reveal what their income was, and they were able to get some loans, no doc loans, but we do have a class of people who can actually make a monthly payment, but they don't have traditional credit.

Has anything been done to address this class of people?

Ms. BRAUNSTEIN. Well, in our HOEPA rules that we just issued, in terms of people documenting income, we allow flexibility in there that—

Mr. GREEN. No, no, no. Excuse me. I need to intercede. And I don't want to be rude, crude, and unrefined, but I have to use the time efficaciously.

I'm talking now about people where you can clearly document that they can afford the loan, they can make the payment, but they don't have traditional credit. They pay light bills, gas bills, water bills, and phone bills, but they don't have a car note, they don't have a house note, and some other things.

Ms. BRAUNSTEIN. And that's what I'm saying. There's flexibility in the current HOEPA rules to look at alternative means of documentation of credit.

Mr. GREEN. So alternative credit scoring is something that you're looking at?

Ms. BRAUNSTEIN. It is definitely not prohibited. It can be looked at by lenders to make their decisions.

Mr. GREEN. Okay. And my final comment would be, as you embrace yield spread premium, if you move to the concept of disclosure, ask yourself what is the penalty for failure to disclose. I think that's going to be important, because my suspicion is that we'll get a certain amount of failure to disclose.

And I would like for your fellow witness to testify, if you would like to give a commentary.

Mr. ANTONAKES. Congressman, I would only add that, in our examinations, if a disclosure is not provided, then it has been the consistent position of our agency that any fee collected has to be reimbursed to the consumer in full.

Mr. CLAY. The gentleman from Texas' time has expired, and I recognize the gentleman from North Carolina, Mr. Miller, for 5 minutes.

Mr. MILLER. Thank you.

Ms. Braunstein, if you—I strongly discourage using disclosure as the remedy for yield spread premiums. The borrower relies upon the broker to tell them what it is they're signing, and I do not think disclosure, having them sign a form, is going to work.

I know after the proposed rules in December, there were many commenters who said roughly that. I was one of them. Do not remedy the problem with disclosure. It is not going to work.

If you allow a payment at all, at closing, because the borrower is paying a higher interest rate than the interest rate, the par in-

terest rate, what they qualified for, it should be a payment made directly to the borrower and not to anybody else.

You mentioned that the CRA was not the cause of our current financial problems. I think there has been a study by the Federal Reserve Board that 6 percent of subprime loans in the period were by institutions subject to the CRA, the depository institutions, banks and thrifts with federally insured deposits, in neighborhoods or to borrowers that the CRA encouraged lending to.

Ms. BRAUNSTEIN. Yes.

Mr. MILLER. Is that correct?

Ms. BRAUNSTEIN. That is correct.

Mr. MILLER. Six percent. And how has been the default or foreclosure rate among that 6 percent, as opposed to other subprime loans?

Ms. BRAUNSTEIN. I think that we have found that the foreclosure, the delinquency rates in those areas are no different or no worse than those that you find in higher-income areas that are not CRA targeted areas.

Mr. MILLER. Okay. On assignee liability, I have been generally sympathetic with the argument that someone buying a loan can't know everything that happened at closing, can't know ever oral representation, every discussion between the borrower and the lender, and that not all the sins of the originator should necessarily be attributed to an assignee.

But looking at the loans made in 2004 to 2006, there's a theory at law of constructive knowledge: if you didn't actually know something, you had other facts that should have let you know something was going on.

Ninety percent of the loans made, subprime loans, which jumped from 8 percent of all loans to 28 percent, 90 percent of them had a reset, a quick adjustment after 2 or 3 years, that went up 30 to 50 percent in monthly payments; 43 to 50 percent did not have full income documentation; 70 percent had a prepayment penalty.

Do you think the assignees—the people buying those mortgages—didn't know something was up at the retail level?

Ms. BRAUNSTEIN. Well, obviously, it is hard to speak for them, but it is hard to imagine that if due diligence was done, that you wouldn't see something amiss.

Mr. MILLER. Thank you. I have no further questions.

Mr. CLAY. The gentleman yields back. I recognize the gentleman from Georgia, Mr. Scott, for 5 minutes.

Mr. SCOTT. Well, I have a, kind of like a two-pronged question that I would like for you to respond to, if you would.

I'm concerned about this just sort of reviewing this issue about the spread and increase of predatory lending practices, and I understand that subprime mortgages have allowed for a large number of families to purchase homes that they would not otherwise have been able to do, which conceivably is a good thing.

However, I'm concerned about the nature and the targets of these loans and lending practices. There has been an inordinate percentage of minority families who have been tied up in what we can affectionately call a mess, and the facts are disturbing, at best, as black and Hispanic and individuals have been disproportionately borrowing in the higher-cost subprime market.

That has been because there have been certain incentives in place that steer people to these subprime lending markets, and I think in all of this area, this is sort of the meanest part of this predatory lending that, you know, I don't think we're really addressing enough; and that is, you have people here who don't need to be steered into subprime lending, but are steered into subprime lending.

And I'd like—you know, families with perfectly good credit, in some instances, have been swindled, they have been blindsided into these less than sound mortgage deals, and I want to know what steps are being taken towards stopping this, and what your thoughts are on having a mandatory standard for mortgage companies, having an increased number of people available to help people, and to be able to stop this purposeful effort of targeting Hispanic and black families and people, and short-circuiting them, and steering them into an area where they ought not be.

I mean, this is a terrible thing to do, and I would like to get your thoughts on that, and maybe a mandatory standard would work, or just how you feel about that. Are we doing enough about it?

Ms. BRAUNSTEIN. The HOEPA rules that we issued in July of 2008 will hopefully address a lot of these problems, because the features of these products that people were steered into will no longer be allowed to occur in these markets, in the higher-cost markets, and the markets where people were steered, and that does serve as a floor. It is not a ceiling, so there is also room for the States to improvise and to experiment and to go further with those rules.

Mr. ANTONAKES. Congressman, I would add that, and agree, that responsible subprime lending was advantageous to the market, but what has occurred over the past few years is hardly responsible lending, and yes, folks have been targeted by unfair and deceptive acts and practices.

We continue to examine lenders and brokers now on an only surprise basis to try to ferret out fraud. We have taken numerous enforcement actions and have numerous criminal actions pending with law enforcement agencies.

Also, I reject the notion that CRA caused this problem. Quite to the contrary, in Massachusetts, Governor Patrick signed legislation to extend our State CRA law, which already exists, and applies to banks and credit unions for the first time to non-bank mortgage lenders, so that they do have a responsibility to lend on appropriate terms throughout the communities within which they do business, including low- or moderate-income communities.

We're starting our CRA exams of non-bank mortgage lenders next month.

Mr. SCOTT. Okay. Just finally, I know my time is winding down, but do you think that as we move to get some reform to the mortgage system, that in a way, as we move to correct some of these things and address some of these issues, by bringing forth some of the reforms that were in our previous legislation that did pass the House, did not pass the Senate, Mr. Frank provided leadership on that last year—which I thought was needed—so that in tightening up in these areas, making people more responsible, making sure people can pay back the loan, putting these kinds of restraints to

prevent the abuses, would that in fact, in your mind, lessen the credit availability to some of the very people that we're protecting?

In other words, would we come out of this thing having responded by over-responding, and then drying up the credit, and then the very people that we're trying to get homes, we've tightened it up so that a lender is not going to lend now, because they think it's risky, and we—

Mr. CLAY. The gentleman from Georgia's time has expired.

Mr. SCOTT. Would you answer that for me—

Mr. CLAY. And I recognize—no—I recognize the gentleman from Missouri. We have to respect his time, too. Mr. Cleaver is recognized for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman.

Exhaustingly, I have been running from Homeland Security. I apologize for not being here.

I only have one question, maybe two parts to it, which is, as we are contemplating legislation, should we consider some part of this legislation as a regulatory mandate on brokers and appraisers? Should they be regulated?

Yes?

Mr. ANTONAKES. The mortgage broker industry is regulated, on a State basis, and we have taken numerous actions to improve standards within the mortgage broker business.

In addition, I would submit that there's something called third-party risk, and that is that the lenders or the banks that choose to outsource their origination to mortgage brokers have a duty to oversee those brokers, and to the extent that bad acts or practices are allowed to exist, then I believe supervision of those entities doing business should also be brought to task, as well.

Mr. CLEAVER. In Missouri, we have a real estate board, but I guess the question is, do you believe we need to have a national, uniform regulation of mortgage brokers?

Mr. ANTONAKES. Well, the SAFE Act, which was part of 3915, is what was enacted, creating this uniform platform for licensing and supervision of all mortgage originators throughout the country.

We now believe that 40 States will be on the system by the end of next year, and I believe the standards are in place and the oversight will be in place, as well, to ensure higher standards from the mortgage origination side. I think there still needs to be work on the funding side, as well as the securitization side.

Mr. CLEAVER. What about appraisers?

Mr. ANTONAKES. Appraisers, there are a lot of folks who were involved in the bad practices that existed, and I wouldn't limit it to mortgage brokers or to appraisers. Certainly, there were bad acts that existed there, but I would suggest closing attorneys, real estate brokers, Wall Street investment firms, securitization, and the rating agencies were involved, as well.

Ms. BRAUNSTEIN. I would also add, on appraisers, that we did, when we enacted the HOEPA rules, we also enacted a general prohibition for all mortgages on the coercion of appraisers or in any way trying to influence the value that they come to.

Mr. CLEAVER. Is there a penalty provision? I mean, how do we—

Ms. BRAUNSTEIN. Well, anything under TILA is subject to truth in lending penalties, and we would certainly, when we're out exam-

ining financial institutions, we'll be looking at those kinds of issues.

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

Mr. CLAY. The gentleman from Missouri yields back his time.

Let me thank the two witnesses for your testimony, as well as your responses. This panel is dismissed and now we will take a slight break to set up for the second panel.

[recess]

Mr. CLAY. The committee will come to order.

On our second panel today, we have David Berenbaum, who is the executive vice president for the National Community Reinvestment Coalition. Thank you for being here today.

Julia Gordon is the senior policy counsel for the Center for Responsible Lending. So good to see you.

Margot Saunders is counsel of the National Consumer Law Center, and is testifying on behalf of both the National Consumer Law Center and the National Association of Consumer Advocates. And welcome today.

Stephanie Jones is the executive director of the National Urban League Policy Institute. Welcome to the committee.

And Gracia Aponte—did I say that right? Okay. "Graciela," I'm sorry, Aponte is an analyst at the National Council of La Raza. Welcome to the committee.

And our final witness is Donald C. Lampe, who is a partner with the firm of Womble Carlyle Sandridge & Rice, PLLC, in Charlotte, North Carolina.

Thank you all for being here today, and we will start with Mr. Berenbaum. You may begin. You have 5 minutes.

STATEMENT OF DAVID BERENBAUM, EXECUTIVE VICE PRESIDENT, NATIONAL COMMUNITY REINVESTMENT COALITION

Mr. BERENBAUM. Thank you, Mr. Chairman, Ranking Member Hensarling, and members of the committee. I'm honored to testify today on behalf of the members of the National Community Reinvestment Coalition on the subject of mortgage lending reform, a comprehensive review of the American mortgage system.

Yesterday, Federal Reserve Chairman Ben Bernanke, in his remarks before the Council on Foreign Relations, stated that the financial system must be regulated, to quote him, "as a whole, in a holistic way," and acknowledged that the current financial crisis has, "revealed some shocking gaps in our regulatory oversight."

To speak candidly, the sharp economic decline and distress in the mortgage market resulting from the foreclosure crisis can be traced both to out-of-date 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 activity and performance.

Massive foreclosures are spurring a self-reinforcing cycle of defaults, now compounded by rising unemployment. Multiple studies

by Credit Suisse and others have documented the impact of, in fact, this reality. Over 600,000 jobs were lost last month, and in fact now unemployment is at 8.1 percent, the 14th consecutive month of job losses in our Nation.

The foreclosure crisis has destroyed significant amounts of national and family wealth, and, since the onset of the crisis, home prices have declined by at least 25 percent nationwide.

We request that you consider four emerging issues at this time:

First, we call for an investigation with regard to spikes in foreclosure within the FHA loan program. It is completely unacceptable at this time that a number of consumers who are simply 1 month into their FHA loan program payments are now defaulting. That documents widespread fraud, ongoing fraud, regardless of loan product in our system today, and the need for anti-predatory lending ordinances.

Second, since 3915 was originally enacted, there is substantial evidence that the rating agencies played a crucial role in the entire crisis. NCRC has filed letters of grievance to the SEC and three discrimination complaints to the United States Department of Housing and Urban Development, documenting the impact, the foreclosure impact, in minority, predominantly African-American, low- to moderate-income, and Latino communities.

Third, the widespread availability of foreclosure "scams" represented to be foreclosure assistance programs to consumers. Consumers again and again today are going to these for-profit con artists and having tens and tens of thousands of dollars in communities across the country stolen from them.

And then the abusive use of broker price opinions. It's a race to the bottom right now. In fact, real estate professionals are playing a role in managing REO, and also selling that property, a clear conflict of interest, compounding appraisal valuation issues, originally pushing to increase value, now in fact lowering the tax base around the Nation.

We believe that 3915, when it passed the House, was a significant step forward. However, we would like you to take a serious look at, in fact, the companion bill that, in the Senate, though it did not move, was, in fact introduced, that looks at some very difficult issues, such as assignee liability, looking at servicing, and other areas. We believe that that review would be extremely positive, in fact, moving a bill ahead.

I would like to address the issue of the Community Reinvestment Act, which also emerged in the first panel. There are any number of solutions to where we are in the current mortgage crisis.

CRA was not, I say again not, a factor in the current crisis. Multiple studies, not solely out of the Fed, have documented that CRA played a positive role in sustainable mortgage loans, and in fact, NCRC strongly argues for what Massachusetts has done, on a national level, to expand the Community Reinvestment Act to reach many in the marketplace: investment bankers; large credit unions; financial service corporations; Wall Street; and others.

Last, we also recognize that there's a need for a national financial product safety commission to really take a look at what is in a consumer's interest. I respectfully submit to you, with my 10 sec-

onds of remaining time, that what is in a consumer's interest is in corporate America's interest. Responsible lending benefits all.

Thank you.

[The prepared statement of Mr. Berenbaum can be found on page 124 of the appendix.]

Chairman GUTIERREZ. Ms. Gordon.

STATEMENT OF JULIA GORDON, SENIOR POLICY COUNSEL, CENTER FOR RESPONSIBLE LENDING

Ms. GORDON. Thank you, Mr. Chairman, Ranking Member Hensarling, and members of the committee. Thank you so much for inviting me to speak about mortgage lending reform.

I am senior policy counsel at the Center for Responsible Lending, a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth.

We're an affiliate of Self-Help, which makes responsible home mortgage loans to people who have not been able to access mainstream credit.

Our lending record amply demonstrates that carefully underwritten mortgages, with fixed rates and full payments, can create sustainable homeownership. Even in the current economic climate, our mortgages are still performing far better than the dangerous subprime or non-traditional mortgage products.

I need not belabor the point, but the mortgage market looks vastly different today than it looked when this body passed H.R. 3915 in November of 2007. That's why we think we need to start from scratch, in crafting smart, sensible rules of the road for the mortgage market.

There are several important principles that should underlie any new legislation:

First, the law must be simple and straightforward. Last year's law had a structure not unlike one of those Russian nesting dolls. Although it established some important protections, we feared that it would have been hard for consumers to understand, tricky for industry to follow, and all but impossible for regulators to enforce.

Where possible, bright lines and clear rules will benefit all market participants, from the consumer through the investor.

Second, the law should ensure that mortgage originators serve the best interests of their customers by putting them into appropriate products with sound terms and conditions. No loans should be made on the basis of stated income. We should ban prepayment penalties and yield spread premiums. These fees reward lenders and brokers for locking families into loans that are bad for them and bad for the economy. And for heaven's sake, originators should have to check whether the customer can afford a mortgage before giving it to them.

Third, the secondary market should share responsibility for the terms of the loan. A lesson from the recent meltdown is that every player in the mortgage chain needs to have skin in the game. When Wall Street purchases high-risk mortgages and receives the corresponding financial benefits, it also needs to accept responsibility for the risk placed on consumers and what its purchases will encourage at the origination level. In that way, the market can accurately price risk and police itself.

Fourth, the law should require mortgage servicers to attempt to save a family's home before foreclosing. Had this requirement been in place 2 years ago, it could have saved hundreds of thousands of homes. FHA and VA already require this of their servicers, and with the streamlined loan modification templates developed recently by the Treasury Department, there's no reason why all servicers cannot easily comply with such a requirement.

Fifth, consumers need to be able to assert their rights in a timely and meaningful way. While public enforcement is both powerful and necessary, there will never be enough public resources to take effective action against the whole universe of players in the mortgage system.

Finally, States should be able to protect their residents quickly and effectively. While Congress was still discussing whether to pass a so-called first generation anti-predatory lending law, the market had already moved on to new risky practices, which the States quickly recognized.

Ohio enacted its second generation law in 2006, soon followed by Minnesota and approximately 10 other States. As for Congress, we are still here 3 years later discussing whether to pass a second generation law, despite the fact that the market self-destructed in the meantime and the former subprime lenders are now moving to trying to push new products and services.

Despite the current state of the economy, we believe that long-term homeownership remains one of the best and most reliable ways that families can build a better economic future. We urge Congress to strengthen the mortgage system, not by creating impediments to sensible home loans, but by focussing on market-based solutions that result in profitable mortgage-backed investments and sustainable homeownership.

Thank you, and I look forward to your questions.

[The prepared statement of Ms. Gordon can be found on page 162 of the appendix.]

Chairman GUTIERREZ. Thank you.

Ms. Saunders, please, for 5 minutes.

STATEMENT OF MARGOT SAUNDERS, COUNSEL, NATIONAL CONSUMER LAW CENTER

Ms. SAUNDERS. Thank you, Chairman Gutierrez, and members of the subcommittee. Thank you for inviting me to testify today on behalf of the low-income clients of the National Consumer Law Center and the National Association of Consumer Advocates.

We are the attorneys who are representing the homeowners in foreclosure proceedings and trying to help maintain homes.

You asked first that we comment on H.R. 3915. This was an aggressive bill, for its time. This bill essentially maintained the current complex structure of regulation of mortgage origination, while tweaking—sometimes significantly—the law to enhance the obligations of the parties. Stronger consumer protections, however, were limited by the fear that too much regulation would limit access to credit.

We propose to you today a new approach, with three key criteria.

One, simplicity. The rules should be easy for everybody to understand. Multiple categories of creditors, borrowers, and types of

loans result in confusion, without establishing a clear structure designed to facilitate affordable and safe mortgage lending.

Two, transparency. The rules governing the transaction should be clearly disclosed and easy to understand.

Most importantly, appropriate incentives. The current system rewards originators for making bad loans, because originators are paid, regardless of whether the loan is unfair or unaffordable.

This is how we would do this:

One, realign the incentives. Pay the originators from the payment stream only. Insurance brokers are paid their commissions entirely from the stream of payments made by the consumer for the insurance product in the first few years. The insurance model should be the model for the mortgage industry.

Require that originators recover their costs associated with originating the loan only from the monthly payment stream. The homeowner's regular monthly payments are the sign of a sustainable mortgage.

The origination process is the only source of profit for the mortgage broker, and this current system encourages loan churning. Making new loans is the only way originators make money. If instead, the originator received a percentage of each payment for the first several years of the loan, the originator would have a very strong incentive to make sure that homeowner would make the first several years of payments.

Two, mandate a uniform mortgage offer. Originators should be required to offer every homeowner applicant a uniform mortgage, which is a 30-year, fully amortizing, fixed rate, no prepayment penalty mortgage. Alternatives could be offered as well, but they would always have to be compared to this 30-year uniform mortgage.

The mortgage would thus be simple for consumers to understand, and the only variable would be the change in rate which was based on the consumer's credit risk.

Three, common-sense rules should be required. Homeowners must be underwritten for their ability to repay all payments that can be due on the loan. No loan should be made for more than the home is worth. Foreclosures should only be permitted when the investor makes more money from the foreclosure than an affordable loan modification.

Public and private enforcement is essential. Government administrators enforcing the laws simply do not protect consumers. If you have private enforcement, it enhances compliance. It also allows the individual consumer who has been harmed to use those rules to protect themselves.

Fifth, full responsibility. The rules should be simple. There should be no enforcement of a loan made in violation of these rules.

And most importantly, preemption. Please do not preempt the State laws. We have seen in the last few years that it's the State laws that have been used to protect consumers from foreclosure, repeatedly. One of the most serious problems with 3915 was that it did preempt a series of State laws as they were applied to holders, and I would point you to a report that we did that detailed how 3915 actually would have cut back significantly on consumer protections.

Thank you. I would be happy to answer any questions.

[The prepared statement of Ms. Saunders can be found on page 228 of the appendix.]

Chairman GUTIERREZ. Thank you.

Ms. Jones, please, for 5 minutes.

STATEMENT OF STEPHANIE JONES, EXECUTIVE DIRECTOR, NATIONAL URBAN LEAGUE POLICY INSTITUTE

Ms. JONES. Thank you, Mr. Chairman, and Ranking Member Hensarling. I appreciate the opportunity to testify before you today on this critical issue of mortgage lending reform.

My name is Stephanie Jones. I am an executive director of the National Urban League Policy Institute, which is the research and policy arm of the National Urban League based here in Washington.

Through our front-line housing counseling services in Urban League programs throughout the country, the National Urban League received first-hand insight into the brewing mortgage housing crisis long before many in the country saw it coming. Our findings led the National Urban League president, Marc Morial, to release our Home Buyers' Bill of Rights in March of 2007. I have attached a copy of the Home Buyers' Bill of Rights to my testimony for inclusion in the hearing record. At that time, unfortunately, policymakers and government officials were reluctant to support greater regulation.

But today, I will focus my testimony on three of the six rights in the Home Buyers' Bill of Rights that address problems in the lending process and their impact on low- and moderate-income homeowners and mortgage applicants: One, the right to be free from predatory lending; two, the right to fairness in lending; and three, the right to fair treatment in case of default.

The National Urban League has long called for the elimination of incentives for lenders to make predatory loans, a fair competitive market that responsibly provides credit to consumers, access to justice for families caught in abusive loans, and the preservation of essential Federal and State consumer safeguards.

The National Urban League supports legislation that promotes these objectives and that works to better protect the consumers, such as the Mortgage Reform and Anti-Predatory Lending Act of 2007, H.R. 3915, that was passed by the House in 2007.

In fact, we in the nonprofit counseling industry strongly feel that we have a fiduciary responsibility to our clients to see that this bill is enacted into law.

We support the measure strongly, but believe that it can and should be improved, and so we would like to offer some suggestions on how we believe that it can be improved.

First, we believe that it should protect those States that have stronger anti-predatory lending laws. It should hold Wall Street accountable for buying abusive loans. And it should provide effective remedies for homeowners when brokers and lenders break the law.

Bottom line is, we really do need to get some of these bad eggs out of the business, when it comes to lending and mortgage brokers, and we find that broker licensing doesn't necessarily need to be nationwide, but it should be stricter.

Currently, as Sy Richardson, the National Urban League's vice president for housing, says, in most States, if you can fog a mirror, you can get a broker's license.

But education, qualification, and testing should be tougher. Individual mortgage brokers and loan officers must be licensed and registered and required to act in the best interest of the consumer, under guidelines comparable to those that financial advisors are subject to.

Penalties for bad behavior need to be strong enough to have a deterrent effect, and H.R. 3915 should increase enforcement capabilities even further.

The bill should also have stronger compensation disclosure requirements.

And we see that the current housing crisis that is threatening our entire economy is proof positive that these measures are absolutely necessary.

In addition, policymakers should pay particular attention to communities that have traditionally been underserved or at a disadvantage when obtaining credit, including communities of color and the elderly, to ensure that they have full access to the most appropriate loan products that can help them build and maintain wealth.

Those who are shown to have taken advantage of vulnerable populations, by offering inappropriate products or charging unjustified fees, should be held fully accountable for their actions.

The National Urban League believes there must be strict limits to prepayment penalties.

We also assert that steering borrowers qualified for prime loans into subprime loans is an unfair and deceptive practice. Numerous studies have documented that middle- and upper-income minorities are significantly more likely than middle- and upper-income whites to receive subprime loans, and that a significant number of minorities who were steered into subprime loans actually qualified for conventional mortgages.

Lenders must be held liable for deceptive and fraudulent practices committed by brokers with whom they do business.

We're generally pleased that many lenders, as well as the big mortgage gatekeepers, such as Freddie Mac, FHA, and the VA, have amended their approach to managing delinquencies, having fully realized that it's usually more cost-effective to help a borrower to stay in his or her home than to pursue foreclosure.

But in the case of default, the National Urban League believes that we must afford some protection to home buyers, including the opportunity to restructure the loan if the loan is determined to be onerous, and an opportunity, or access to the holder of the loan for development of reasonable workout plans, where the objective is preservation.

Chairman GUTIERREZ. The time of the gentlelady has expired.

Ms. JONES. Okay. Thank you.

Chairman GUTIERREZ. You are welcome.

Ms. Aponte, for 5 minutes.

STATEMENT OF GRACIELA APONTE, LEGISLATIVE ANALYST, WEALTH-BUILDING POLICY PROJECT, NATIONAL COUNCIL OF LA RAZA (NCLR)

Ms. APONTE. Thank you. Good afternoon.

My name is Graciela Aponte. I handle NCLR's legislative and advocacy work on issues such as affordable housing and foreclosure prevention.

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

I would like to thank Chairman Gutierrez and Ranking Member Hensarling for inviting NCLR to testify on this important issue.

Forecasters are predicting that 400,000 Latino families will be losing their homes in 2009, at the height of the crisis for the Latino families during 2009 and 2010 when more loans are scheduled to be reset.

NCLR provides funding to more than 50 housing counseling agencies across the country. Despite the counselors' skills and the clients' best efforts, many are still losing their homes and financial security.

We are pleased Congress is beginning to turn their attention to mortgage reform. However, this effort will have limited success unless Congress and the Administration follow through on their plans to reduce foreclosures.

In my brief time today, I will share with you three principles on which to organize strategy, a strategy to reform and revitalize our mortgage markets: Number one, reforming our loan servicing system; number two, reforming the mortgage market; and number three, the role of nonprofits.

Let's start with changes needed to our loan servicing system.

Last week, we gathered the heads of our housing counseling agencies and they shared stories about loan modifications that are being denied, even when a family can afford to make payments, loan modifications that are being approved days after the home has gone to foreclosure auction, borrowers that are given unaffordable loan modifications that leave them even worse off.

Housing counseling agencies are overburdened and underfunded, and foreclosure scam artists have stepped up their marketing efforts.

President Obama's foreclosure plan takes several steps to address these issues. However, parts of the plan must be strengthened to keep borrowers from falling through the cracks.

We also need legislation to raise the level of service provided to all borrowers.

Second, I will turn to reforming the mortgage market.

By now, it's clear that borrower protections are closely linked to safety and soundness. Latino families were routinely targeted by predatory lenders. They were steered toward expensive and risky products, even when they had good credit.

Take the case of the Rodriguez family, who went to our housing counseling agency in Stockton, California. They worked with a mortgage broker to help them purchase their first home. The broker told them that they qualified for a fixed-rate loan.

Four years later, their mortgage bills increased, and they realized that their broker had sold them an option ARM. Worse, even though the Rodriguez family could document all their income, the broker used Wite-Out to write in a higher income. They had paid a premium to be in a stated income loan, even though they had all their documentation.

We have seen this story repeated across the country. Brokers were paid more for risky loans, so it's no surprise that they steered families toward these products.

A reformed market must connect borrowers to products they can afford. One step would be to increase accountability measures throughout the process.

And finally, I want to discuss the role of nonprofits.

Credit unions, CDFIs, and community lenders have been providing safe and affordable mortgages to underserved communities for years. Housing counselors prepare families for homeownership and match them to good loans.

Another one of our counseling clients is a great example. Maria Martinez is a single mother from West Humboldt Park, Chicago. Maria came to the Spanish Coalition for Housing 4 years ago. She was displaced and facing homelessness.

The counselor was able to find her an apartment. She also put her on a plan to build her credit and savings. After years of working together, a door opened for Maria when a community land trust program offered an affordable homeownership opportunity. She went to closing 2 weeks ago.

The nonprofit lenders and organizations understand how to lend to underserved communities. Their work should serve as a model of what is possible when considering reform.

Ultimately, any effective response to our current crisis must include reforming the servicing system so that homeowners who are struggling to keep up with their mortgage payments can secure affordable and sustainable mortgages, reforming the mortgage system to protect future home buyers and keeping safe and affordable lending products available to underserved and vulnerable communities.

In my written testimony, I provide specific recommendations, with special attention to reforming the loan servicing system, restoring balance to the mortgage market, and promoting positive lending models.

I will be happy to answer any questions you may have. Thank you.

[The prepared statement of Ms. Aponte can be found on page 117 of the appendix.]

Chairman GUTIERREZ. Thank you, Ms. Aponte.

Mr. Lampe, for 5 minutes.

STATEMENT OF DONALD C. LAMPE, PARTNER, WOMBLE CARLYLE SANDRIDGE & RICE, PLLC

Mr. LAMPE. Mr. Chairman, Ranking Member Hensarling, and members of the subcommittee, thank you for the opportunity to appear today.

My name is Don Lampe, and I am a partner in the Charlotte, North Carolina, office of Womble Carlyle Sandridge & Rice. I have

been practicing consumer credit law for 25 years, and I have been involved on behalf of trade organizations, mortgage lenders, and others in the enactment of many significant State and local mortgage lending laws and regulations, over the past 10 years.

Because the legislation that the committee is reconsidering today, H.R. 3915, is based on residential mortgage lending laws from various States, I hope to be able to respond to the committee's questions regarding our experience with similar State laws.

Obviously, any assertion today that Congress should not act to reform the regulation of consumer mortgage lending is untenable, but then, what should Congress do to accomplish two things: protect consumers now; and make sure that we never have to endure this kind of a crisis again?

In the brief time that I have, I want to make three points. These points are built around a central theme.

First and foremost, it is critically important, as other panelists have said, that any legislation provide strong and effective consumer protection. That is the beginning point. We also must be mindful of preserving access for consumers, future consumers, for fairly priced, non-discriminatory, lawful, and appropriate mortgage credit.

The three points are as follows:

First, the Federal Reserve Board. There have been superseding events since the passage of 3915 by the House. One of the significant superseding events, which you heard about earlier, was the Fed exercised the powers that had been granted in 1994, and Chairman Bernanke was praised for that, to enact comprehensive unfair and deceptive trade practice laws.

It's important for Congress to give due regard to these groundbreaking rules, to consider carefully whether these rules already address fundamental consumer protections, and likewise, consider whether the rules should serve as a basis and/or complementary to additional consumer protection legislation.

Second, reform of consumer mortgage lending laws should be real reform, and not just the adding of additional layers of conduct requirements, disclosures, and liability to existing laws.

There is a real opportunity now, more than ever, for Congress to overhaul what many describe as a broken system of mortgage regulation, of loan origination.

Third, and very importantly, it is widely believed that too much credit created, if not outright caused, the current housing crisis. It's all too easy for all of us to believe right now that all you have to do is ban certain products and certain features, and make less credit available, and we won't have these problems in the future.

But I urge the subcommittee to give serious, thoughtful, and heartfelt consideration to the needs of current homeowners who wish to refinance, often out of unfair and potentially predatory loans, and also to new homeowners looking for loans.

Let's not forget that fair lending and anti-discrimination is based on credit being available to all Americans on fair terms.

In the moment that I have left, the most resonant point I could make has already been touched on by this panel. The disclosures now required by Federal law are virtually incomprehensible, and this is the case across-the-board. Subprime, FHA, confirming,

jumbo—what the disclosures have brought to mortgage lending is more information, but much less understanding.

It's very difficult, in my mind, to justify more disclosures and additional liabilities related to disclosure violations. At this time, Congress has an enormously unique opportunity to reconsider the overly complex system, where you have disclosures that are inconsistent between Federal agencies, even.

If consumers understand a transaction that is put before them, are capable of determining that the loan is fair and is affordable, and that they can afford to pay it back, if that is understood from the beginning, that outcome is the best way for us not to repeat the mistakes of the past.

In short, as has been said many times, sometimes seriously, sometimes tongue-in-cheek, that a crisis is a terrible thing to waste.

Thank you.

[The prepared statement of Mr. Lampe can be found on page 186 of the appendix.]

Chairman GUTIERREZ. Thank you very much, Mr. Lampe.

HOEPA was passed in 1994. This is my 9th term, so that was my first term in Congress. And let me say, there are 38 Members I have here—no, 39 Members on my side of the aisle—Frank, Kanjorski, Waters, Maloney, Gutierrez, Velazquez, and Watt—those are the only survivors of this panel, of this committee, when we passed—all of us voted to pass that law. Now, we have 32 new Members.

In other words, there is no institutional memory, because the Federal Reserve, you spoke very eloquently, Mr. Lampe, about how great the regulations were that the Federal Reserve—it took them 14 years.

Now, if they are so great today, and everybody likes them so much, can you imagine what would have happened if we actually had that regulation on the books, as they should have done?

But here is what the Chairman of the Fed consistently said to us: "It's ideological." Sometimes he was even berated by members of this committee on this side of the aisle, asking him to please promulgate the rules, the same rules that today we thank Mr. Bernanke for. A little late, though.

So it wasn't as though people didn't see things that could come about in a bad fashion for the consumer and for the mortgage industry. The fact is that it's very hard, and there are some very powerful interests out there that stop us from promulgating the rules, until it is actually too late.

I don't know how many members on the minority side were here, but not many. I think that's a very shameful action of the way government works.

So I know that people always complain that government does too much, that we should have smaller, less government. But in this case, it seems that everybody says, where was the government in this certain area, in not promulgating those rules?

Having said that, we have called this hearing so that we could hear from people about how it is we take on our anti-predatory lending bill, which we're going to mark-up from the last Congress.

We're going to use it as our base bill to see how we can improve it.

We're not simply going to—I hope the ultimate product isn't simply the Z regulations. I don't think they go far enough. I would like to see other kinds of rules and regulations put into place.

And I won't take my complete 5 minutes, but I do want to thank all of the panelists, especially those engaged in helping consumers go through the mire. It's overwhelming in congressional district offices across this country, people losing their homes and filing for bankruptcy, and the dire situations that they find themselves in.

And I know that there are those who want to blame the victims, that is, those who took out the mortgages, but I think there is a lot greater blame.

And there are those who want to blame government, and specifically the Community Reinvestment Act. And I'm almost—maybe make an amendment that says to anybody who provides a mortgage that not only does the recipient of the mortgage have to sign, but those issuing the mortgage: "The government didn't make me do it. I hereby sign that the government didn't make me do it," so that from here forward, this issue would never come up again. And the consumer would sign somewhere on these documents, "The government didn't ask me to take this loan, and the mortgager never told me the government made me do it."

Because I, in my 17 years in Congress and 8 years on the Chicago City Council, have never called a financial institution and asked them to make a mortgage for any one specific individual. We have implored, we have cajoled, begged, used every possible manner, to ask them to please make mortgages, and they have resisted.

So given all of that resistance, I just find it a little mind-boggling that those who did get a mortgage, all of a sudden, it was the government that made them do it.

I'm going to ask the next panel, which is the industry, I'm going to ask them if the government ever made them issue a mortgage. I want to know about that mortgage and I want to know who called them, because I want an investigation into that official who made them issue that mortgage.

I thank all of the panelists and I yield 5 minutes to the ranking member, Mr. Hensarling.

Mr. HENSARLING. Thank you, Mr. Chairman. Thank you for yielding me 5 minutes.

In 1997, Wall Street firms, the GSEs, and the CRA converged in a landmark event, the first securitization of CRA loans, a $384 million offering guaranteed by Freddie Mac, which de facto encouraged lenders and underwriters to relax their traditional underwriting practices, as did later the GSEs.

We have heard from the Federal Reserve. In 1993, they issued guidelines entitled, "Closing the Gap, a Guide to Equal Opportunity Lending," that says, in part, "Lack of credit history should not be seen as a negative factor."

Furthermore, in May of 1998, Bear Stearns—and we know what happened to Bear Stearns—published an article on guidance of why and how lenders should package CRA loans into mortgage-backed securities.

The document advised lenders that, "Traditional rating agencies view loan to value ratios as the single most determinant of default. It is more important at the time of origination and less so after the third year." "Explaining the credit quality of a portfolio to a rating agency or GSE, it is essential to go beyond credit scores."

My point is again, regardless of how noble the intent may have been in CRA—it has a very proud legacy, I have no doubt—the question is, has it served us well today?

Maybe there are different options. One is to try to bring down the lending standards of the lender. Another option is to attempt to improve the economic opportunities of the borrower.

Now, clearly, CRA, as far as volume of loans, was low. As far as putting the imprimatur, or, if you will, the Good Housekeeping Seal of Approval of Uncle Sam, on bringing down traditional lending standards, I believe that its impact was critical, and did play a role in where we find ourselves today, and I'm sure that the chairman and I will have ample opportunity to continue this discussion in further hearings.

Ms. Gordon, I have a question for you. In your testimony, on page 5, you state, "bright lines, such as bans on prepayment penalties and yield spread premiums and a requirement of income verification and escrow will redound to everyone's benefit."

Let me ask you specifically about prepayment penalties, prepayment fees. And one, it underscores a broader question.

I have seen a number of studies that have convinced me—maybe you have seen similar studies, maybe you are unconvinced—that the right to prepay, that those who want that feature in their mortgage end up paying a higher rate of interest than they otherwise would.

So one, have you seen studies, and if so, do you believe that to be true?

Ms. GORDON. There was a time—there are a number of features in the, you know, historic prime market, that you could put into a loan to buy down your rate. What we have seen happen, though, as the market moved over the past decade or so, was that prepayment penalties became almost exclusively a tool of the subprime market. Only about 2 percent of prime market loans have prepayment penalties.

And what happened in the subprime market was, they were misused. You had subprime borrowers not understanding the terms of the mortgages, and they were buying—

Mr. HENSARLING. I'm sorry, I think my time is running out, but let me just ask you this one question. If a borrower understood the terms of the mortgage product, and if he was convinced that he could receive a lower interest rate by agreeing to prepayment penalties, would you have Federal law preempt his or her decision?

Ms. GORDON. Now I would, because—

Mr. HENSARLING. Okay. Well, that's—

Ms. GORDON. —we know that—

Mr. HENSARLING. —that's all—

Ms. GORDON. —there are anti-competitive practices—

Mr. HENSARLING. I'm about to run out of time.

Mr. Lampe, real quick, can you state any similarities you see in H.R. 3915 to the provisions in North Carolina and Georgia?

Mr. LAMPE. The way I have said it concisely is, the similarities are the similarities between a zebra and a horse. They look very much alike, but they are different animals. And I can provide more information on that.

But the original Miller-Watt proposal, of course, which has been on the table for quite some time, is based on North Carolina, but not literally North Carolina, and it differs in important features, such as the size of loans covered, remedies, and the types of loans that are covered.

So the similarities, again, the analogy I draw is the similarity between a zebra and a horse. They are different—

Mr. HENSARLING. I see I am out of time, so perhaps we can get those answers in writing at a later time.

Thank you, Mr. Chairman.

Chairman GUTIERREZ. Thank you, Mr. Hensarling.

The gentleman from Charlotte, North Carolina, Mr. Watt, for 5 minutes.

Mr. WATT. I will actually do Mr. Hensarling a favor, because one of the questions I had on my list of questions was, how did the North Carolina law fail?

I mean, we have massive foreclosures and the need for modifications taking place in North Carolina, too, so maybe that's the answer he was trying to get to. I hope that was the answer he was trying to get to.

Mr. LAMPE. Yes, sir. I think I can answer that question.

Number one is, North Carolina does not have one of the nation's highest foreclosure rates, and there's not—none of the 34 top counties are in North Carolina.

The genius of regulation in North Carolina was the Mortgage Lending Act, which required licensing of all mortgage brokers, all loan officers, and anyone who had contact with a borrower in connecting with making a loan.

You cannot consider the North Carolina experience without the whole portfolio of consumer protections, and I think our banking commissioner and Martin Eakes of the Center for Responsible Lending have said that the Mortgage Lending Act did more to clean up the market in North Carolina than the substantive regulations of credit terms.

Mr. WATT. So really, what you are saying is North Carolina, if we would have had a similar regime at the Federal level as we had in North Carolina, not only a predatory lending law but the whole regime, we would be a lot better off today than we were. Is that what I hear you saying, bottom line?

Mr. LAMPE. I can't say a lot better off, but better off, and this Congress did pass a step with the National Mortgage Registry and Licensing System that very much emulates North Carolina.

Mr. WATT. All right. Let me get to a couple of other questions.

I hear both Ms. Gordon, Ms. Saunders, and Mr. Lampe actually, to some extent, saying that we need a massive overhaul, and suggesting possibly that the predatory lending bill that we passed before out of this committee may not even be an appropriate starting point.

I'm a little concerned about that, because I know how difficult it was to get to that point, and I'm not suggesting that the final prod-

uct was where we ought to end up going forward, but to scuttle the whole process and start over again, I think, could possibly be counterproductive, if that's what you're saying.

So clarify for me whether that's what you're saying, or what are you saying?

Yes, Ms. Saunders, go first.

Ms. SAUNDERS. It is what we're saying, for this reason, that it was a great bill, for that time, but North Carolina, if the North Carolina bill had been passed nationally, we still would have had payment option ARM loans, unfortunately. We still would have had a lot of the subprime loans.

What we can't do, what we believe is not possible to do at any time, is to capture a certain type of loan and apply regulation to that type of loan. That's what HOEPA did in 1994, over my—I was there in 1994. I vigorously objected to that. And then we tried to—

Mr. WATT. So basically, what you're saying is we need a regime that covers all loans, regardless of the category—

Ms. SAUNDERS. That's what we all—

Mr. WATT. —and a set of rules for the road that govern all loans, whether they are subprime, prime, whatever?

Ms. SAUNDERS. Yes, sir. And one other point.

Mr. WATT. Okay, go ahead.

Ms. SAUNDERS. Rather than—we, of course, need specific rules, "You shall do this, you shall not do this." But we should take a moment to think about the incentives. What about the marketplace is actually making originators make the bad loans? And let's try to address that.

Mr. WATT. We're going to run out of time, and I do want to hear from Ms. Gordon, and I want to at least put one more question out there, if I can.

Ms. GORDON. I'll just make two additional points.

One is, with respect to 3915, in addition to needing to extend protections to all loans, the actual structure of 3915 was very complex, it was—you know, there was a safe harbor and a qualified safe harbor, and a rebuttable presumption, and an irrebuttable presumption. And it was so complex that literally, if you asked everybody in this room how they understood it, I think you would get different answers.

Structure-wise, we might—not talking about content—structure-wise, you might look at the bill that was introduced in the Senate by Chairman Dodd, which was—again, it may not be the same substantive place we want to get to, but it was clearer in its structure.

You know, the other substantive thing I'll say about 3915, and this is true of the recently promulgated HOEPA rules, as well, that the chairman has noted were 14 years late in coming, is both of them ignore the market that contains the payment option ARMs, and in fact, 3915 substantively last year would have determined, as an irrebuttable presumption, that those loans were affordable.

So that's why we need an approach that's more incentive-based, rather than picking specific things and saying, "This is good today and this is bad today."

Mr. WATT. Can I just ask, Mr. Lampe, not today, but at some point, you mentioned that we need to do something different with disclosures, and I agree with you. I just don't know what we should

be doing. So if you can submit some more information to us on what you're proposing subsequent to today's hearing.

I yield back.

Chairman GUTIERREZ. Thank you very much. That would be useful to all of us.

Without objection, I would like to enter into the record a statement from the Attorney General of New York, Andrew Cuomo, which describes the cooperation between the State of New York and Fannie and Freddie to preserve appraiser independence during the home appraisal process.

Without objection, it is so ordered.

I would also like to enter into the record, without objection, a letter from the Chairman of the Federal Reserve to Senator Bob Menendez, stating that the Federal Reserve found no evidence that the Community Reinvestment Act caused high levels of default in the subprime mortgage market.

Without objection, it is so ordered.

And the gentleman, Mr. Cleaver, is recognized for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman.

I'm curious. The chairman—actually, I was ready to second his proposed legislation, but—because I do think that he made a point that many of us have been struggling with, which is that somehow we have done contortions to come up with the blame being laid out over the people who have been wounded.

I guess what I would like to—Ms. Jones, in your experience with the Urban League, are you finding, have you found that there are people coming to you to complain that somehow they were pushed into signing mortgages, that they actually were misrepresented as they sought to make the most significant purchase in their financial lives?

Ms. JONES. Thank you for that question, Mr. Cleaver. That is something we definitely have seen on the ground across the country.

One of the things we have found is that a significant number of borrowers who actually qualify for conventional loans are being steered into and have been steered into subprime loans.

This is something that often isn't talked about, as we hear the blame being passed around, and blame put on, particularly, low-income and minority borrowers, or blame being placed on the Community Reinvestment Act, which was designed to expand homeownership opportunities to those borrowers.

What we found in looking at this is that a substantial majority of the subprime loans were made by non-CRA compliant companies and lenders, so the—most of this activity was done outside of the regulatory scheme, and so it can't be blamed on CRA. We took a very close look at it. In fact, we report on it in our upcoming State of Black America Report, which will be out in a couple of weeks.

And we have also seen that, even though some of the standards were relaxed in order to make it easier for creditworthy borrowers to participate in the conventional market, we're seeing a lot of blame being passed over onto the borrowers and the CRA.

But to go back to your question, we are seeing a significant number of people who are just doing the best they can, who have saved their money, who qualify for conventional loans, being pushed into

loans that they can't afford or loans that Marc Morial refers to "Jack-in-the-Box" loans, that start off okay, and they're told, "No problem, you can pay this," and then, later on, the interest rate jumps up.

Another thing we're seeing also is that people, a large number of people qualify for loans, for conventional loans they can afford, they can afford those payments, but other things intervene, such as loss of a job or health care costs that result in their being unable to pay.

So there are a number of factors that feed into this, but—and we're very concerned about the blame, the blame game, which is something that, again, Marc Morial refers to the "weapons of mass deception."

And we have called on Congress, we have called on public officials and commentators to help defuse that, because it is problematic.

Mr. CLEAVER. Janet Murguia brought before this committee several months back actual cases of Ms. Aponte where this had happened, but nothing will stop, it seems, people from saying—I want this to go on the record. There was a story written on the front page of my hometown newspaper last Friday, I believe, with me dealing with this issue, and I'm not going to read the whole story, I don't have the time.

But it's from a Sidney Willens, an attorney in Kansas City, and he tells a story of a Sherrita Richardson, a 37-year-old African American mother of 4, who has been a bus driver for 9 years, and she lives, of course, in my district, and she is making just an inch above minimum wage, and in this letter, he outlines the fact that she went into a house that was appraised at $93,000, requiring a 10 percent downpayment.

I will quote here, "A Kansas broker"—I'm from Missouri—"A Kansas mortgage broker purchased a $9,300 cashier's check payable to the seller, made a copy to show that 10 percent downpayment was made, then redeemed the $9,300 check 24 hours later." And he goes on to talk about what the woman's condition is. I would like this to go into the record, Mr. Chairman. It's a letter that—

Chairman GUTIERREZ. Without objection, it is so ordered.

Mr. CLEAVER. —that points very clearly to the point you made earlier, and the comments of Ms. Jones. Thank you.

Chairman GUTIERREZ. Without objection, the letter will be made a part of the record.

We're going to just want to note a change. In the past, the order was always the regulator, the consumer groups, and then the industry, so today we changed it a little bit. We had the regulator, the consumer groups, and then the industry.

But I just want to see how this best works, so the next time we're not necessarily going to have the regulators first. Maybe we'll have the community groups come first, and see how we become much more knowledgeable, because many times, by the time you guys get here, the room is empty. We want to make sure that people had a dialogue and listened to one another.

I thank you so much for your testimony this afternoon.

We will now hear from the third panel:

Mr. Michael Middleton is the president and CEO of Community Bank of Tri-County and is testifying on behalf of the American Bankers Association. Mr. David G. Kittle is the chairman of the Mortgage Bankers Association. Mr. Marc S. Savitt is the president of the National Association of Mortgage Brokers. Mr. Charles McMillan is the president of the National Association of Realtors. Mr. Jim Amorin is the president of the Appraisal Institute. Mr. Joe R. Robson is the chairman of the board of the National Association of Home Builders. And last but not least, Mr. Laurence Platt is a partner at K&L Gates, who is testifying on behalf of the Securities Industry and the Financial Markets Association.

Welcome to you all, gentlemen, and Mr. Middleton, please proceed for 5 minutes.

STATEMENT OF MICHAEL MIDDLETON, PRESIDENT AND CEO, COMMUNITY BANK OF TRI-COUNTY, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Mr. MIDDLETON. Thank you, Mr. Chairman, Ranking Member Hensarling, and members of the subcommittee.

I'm honored to be here today on behalf of the American Bankers Association to testify on possible initiatives to improve mortgage lending standards, particularly related to subprime mortgages.

I wish to make it clear from the outset that the Community Bank of Tri-County is one of the many banks that has never varied from traditional lending standards. We offer both prime and affordable-based, affordable housing loan products.

Our residential owned portfolio is strong, with very low delinquencies, especially among our affordable housing portfolio. We have a high satisfactory rating for lending for CRA purposes. We have a zero default rate on our affordable housing portfolio.

Like other community banks, we work closely with the Federal Home Loan banks to acquire grants and affordable housing funding.

Many forces combined to create the problems we face today. The greatest was the migration of household sector assets from FDIC-insured institutions to Wall Street. This flow of funds to the uninsured sector was driven in part by pressure to seek ever-increasing returns.

The scope of the migration was extraordinary. Money market mutual funds accounts grew by some $16 trillion from 1990 to 2008, while FDIC-insured deposits only grew by $2 trillion.

Much of that money was then directed to the housing sector, where securitized credit helped to fuel a boom in home prices. The vehicle of choice for this allocation of funds was largely State-licensed, non-bank mortgage originators.

The frenzy that ensued—in the frenzy, sound underwriting practices were sacrificed, for the most part, by non-bank originators. Because the standards were relaxed, there was no regulator to examine them. The result was catastrophic.

To address the problems in the mortgage markets, the Federal Reserve has issued amendments to Regulation Z. The ABA supports many of these changes, including regulations to strengthen the integrity of appraisals and prohibit deceptive advertising, in addition to requirements that mortgage lenders properly consider

a borrower's ability to repay the mortgage, whether it is a fixed or adjustable-rate loan.

In fact, we believe some of the elements in these 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. However, the new standards are so stringent that some loans that were previously classified as prime will now be part of a new category called "higher-priced mortgage loans."

This definition in pricing may force State housing authorities to change pricing to meet the new standards, which could curtail their operations, and further limit the supply of credit.

In the wake of these changes, conservative local banks like Community Bank of Tri-County are reevaluating their lending policies to assure that we are in compliance, and to consider whether or not to exit the residential mortgage product line.

Because new legislation or regulation could have the unintended effect of decreasing credit availability, the ABA has formulated principles to keep in mind when considering further legislative action on mortgages:

All new standards should be national standards, preempting the myriad of State laws and regulations.

Terms should be specific and well-defined, limiting the potential for unnecessary litigation.

Any new mortgage standards should give enough guidance to regulators to ensure that the standard is both meaningful, as well as measurable.

Prime loans should be given a safe harbor from additional requirements, recognizing that the new amendments to Regulation Z restrict the definition of prime to a well-defined loan unlikely to be problematic for qualified borrowers.

Basic underwriting standards should be an important element of the loan origination process, and at the time in the process where the lender would reasonably expect to exercise judgment and adhere to the standards.

While the SAFE Act has embraced the essential components of H.R. 3915, we remain concerned that the Act's compliance hurdle for non-bank originators is minimal and easily met.

Thank you, Mr. Chairman. I hope these suggestions will be helpful.

[The prepared statement of Mr. Middleton can be found on page 203 of the appendix.]

Chairman GUTIERREZ. Thank you, Mr. Middleton.

Mr. Kittle, please, you are recognized for 5 minutes.

STATEMENT OF DAVID G. KITTLE, CHAIRMAN, MORTGAGE BANKERS ASSOCIATION (MBA)

Mr. KITTLE. Thank you, Mr. Chairman.

I appreciate the opportunity to testify before you today on proposals to reform mortgage lending.

After all that has transpired since the House passed H.R. 3915, we believe a fundamental reform of mortgage regulation is needed. That reform should take into account not only the many problems

exposed since the end of 2007, but also the many legal and regulatory changes that have occurred since then.

In July of 2008, the Federal Reserve Board undertook a review of the mortgage process. The Board then finalized comprehensive rules addressing the central issues in H.R. 3915.

These rules, which go into effect on October 1st, include greater protections for subprime borrowers with new requirements for underwriting, escrows, and prepayment penalties. The rules also address appraiser coercion and abuses in mortgage servicing and advertising.

MBA believes that the Board's rules, coupled with other important requirements, should serve as the basis for a single consumer protection standard that applies to everyone, regardless of where they live.

As you know, many domestic regulatory agencies, as well as the G–20 nations, have been working on regulatory reform proposals. MBA has been studying and learning from these proposals, and we believe that a comprehensive national package would be most effective.

At the same time, we have been developing our own approach to mortgage reform. While the mortgage industry is not the sole cause of today's difficulties, we believe that our industry must be central to solutions that restore faith in the market and protect future borrowers.

We know that these proposals will constrain some in our industry, but they will also help members and their customers in the long run.

MBA is working to complete our comprehensive reform proposal, and we plan to announce it shortly. In the meantime, we want to share the principles embodied in that proposal.

Reform proposals directed to the mortgage lending industry should be considered in a comprehensive, not piecemeal, manner.

While consumer protection, systemic risk, and safety and soundness all deserve attention, MBA believes that assuring sustainable homeownership demands that we pay special attention to mortgage lending.

Reform legislation should provide a rigorous new regulatory standard to protect consumers, regardless of where they live. Just as emergency efforts to return credit to the market have been national in scope, long-term solutions to mortgage lending challenges must also be national, with an important role for the States.

A new standard should build on the Fed's HOEPA rules, H.R. 3915, as well as MBA's initiatives.

A single set of consumer protection rules should be dynamic, and able to quickly respond to new concerns. Federal and State officials should work together to revise the national standard to address new abuses and concerns.

Standards, including assignee liability restrictions, must be clearly defined to facilitate the flow of affordable capital into the mortgage market.

MBA favors effective regulation and enforcement, and believes that regulated entities should pay reasonable costs to assure sufficient funding.

All players in the mortgage industry should be subject to consistent Federal regulation, including rigorous licensing, education, net worth, bonding requirements, as well as regular review and examination.

Regulatory reform must improve transparency for borrowers, including harmonizing the RESPA and TILA disclosures.

And finally, regulatory reform should assure better resources for counseling, financial literacy, and fighting mortgage fraud. Should adequate resources become available, MBA will even support mandatory counseling for some mortgage products.

We look forward to providing the details of our proposals to you shortly, and working with you to achieve efficient and effective regulatory reform.

Thank you.

[The prepared statement of Mr. Kittle can be found on page 183 of the appendix.]

Chairman GUTIERREZ. Thank you very much.

Mr. Savitt, please.

STATEMENT OF MARC S. SAVITT, PRESIDENT, NATIONAL ASSOCIATION OF MORTGAGE BROKERS (NAMB)

Mr. SAVITT. Good afternoon, Chairman Gutierrez, Ranking Member Hensarling, and members of the committee. I am Marc Savitt, president of the National Association of Mortgage Brokers.

In addition to serving as NAMB president, I am also a licensed mortgage broker in two States, and like most of my fellow NAMB members, I am also a small business owner.

Thank you for the opportunity to testify today on comprehensive review of the American mortgage system.

NAMB applauds this committee's response to the current problems in our mortgage market. NAMB shares resolute commitment to protecting consumers throughout the mortgage process.

I must first address the false allegations targeted at mortgage brokers for the past several years.

Mortgage brokers do not create or develop loan products. Brokers do not arrange or control the automated underwriting system used to qualify borrowers. Brokers to not underwrite loans, brokers do not approve the borrowers, brokers do not fund loans.

NAMB commends this committee for its work on H.R. 3915 in the 110th Congress, in particular, on the all originator approach it incorporated.

Now, turning to some of the significant legislative and regulatory changes that were enacted in 2008.

There are many provisions contained in H.R. 3915 that NAMB supported, as they provided consumers with needed protections.

NAMB is very pleased that a major section of 3915 became law last year as part of the Housing and Economic Recovery Act requiring loan originator standards for licensing and registration.

Under the SAFE Act, all originators will submit to a background check and be placed in a national registry.

In addition, the Act created a floor for pre-licensing and continuing education requirements for all State-chartered mortgage originators.

This all originator approach is one that NAMB has advocated since 2001, and we applaud Chairman Frank and Ranking Member Bachus for their leadership on this issue.

There have been some implementation issues with regard to the Act. Therefore, we recommend that HUD issue regulations needed for implementing the Act. With July 31st fast approaching, we believe each State should have the right to exercise independent judgment in interpreting silent or ambiguous provisions of the SAFE Act.

Turning now to RESPA and HOEPA rules.

A significant component of the RESPA proposal addresses broker compensation, YSP. Since 1992, brokers have been required to disclose YSP, or yield spread premium, on the good faith estimate in the HUD-1 settlement statement. The proposal, however, reclassifies this compensation as a credit to the borrower.

Many studies—two, incidentally, from the FTC—have shown HUD's method of disclosure is very confusing to consumers, causing them to choose higher-cost loans and put brokers at a competitive disadvantage by imposing unequal disclosure obligations among originators who receive comparable equal compensation.

YSP or its equivalent is present in every origination channel, regardless of whether a broker is involved in the transaction or not.

In fact, with the originate to distribute model, most bank and lender originators are brokering loans, yet fail to address the converging roles of the mortgage originators in its proposal.

NAMB encourages HUD to work with the Federal Reserve Board to product an alternative disclosure proposal. The RESPA rule should be withdrawn to allow both agencies to work together to harmonize provisions.

We also urge this committee to examine and pass a Federal standard of care based on good faith and fair dealing for all originators, as articulated in H.R. 3915. We believe such a standard would greatly enhance consumer protections.

On the issue of appraisals, NAMB commends and appreciates the work of Representatives Kanjorski and Biggert for their tireless effort to reform and strengthen oversight of our appraisal system.

NAMB supports independent appraisal standards as contained in 3915.

NAMB is not supportive of the Home Valuation Code of Conduct, or the HVCC, which created a de facto regulation in 2008 by the New York attorney general and the GSEs' regulator, which prohibits mortgage brokers and real estate agents from ordering appraisals and communicating at all with appraisers.

Finally, NAMB is deeply concerned over recent fee increases by the GSEs that are more than doubling consumer costs, based on alleged credit risks of credit scoring, property demographic, and/or loan to values.

At a time when consumers are experiencing a severe credit crunch, efforts should be made to drive down mortgage costs, not increase them.

These fees imposed on consumers 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.

We urge you to explore this troubling issue and consider appropriate action when contemplating legislative reform.

NAMB appreciates the opportunity to appear before you today, and we look forward to continuing to work with you to craft solutions that are effective in helping consumers, but not disruptive to the mortgage market or competition.

Thank you, and I'm happy to answer any questions.

[The prepared statement of Mr. Savitt can be found on page 246 of the appendix.]

Chairman GUTIERREZ. Mr. McMillan, for 5 minutes.

STATEMENT OF CHARLES McMILLAN, PRESIDENT, NATIONAL ASSOCIATION OF REALTORS (NAR)

Mr. MCMILLAN. Thank you, Chairman Gutierrez, Ranking Member Hensarling, and members of the subcommittee. Thank you so much for the opportunity to be invited here today to testify on the need for mortgage lending reform.

I am Charles McMillan, 2009 president of the National Association of Realtors, and I am also a practicing Realtor. I am here to share the views of more than 1.2 million Realtors who are involved in all aspects of the real estate industry every day.

On behalf of all Realtors, I thank the subcommittee for holding this hearing on an issue that is paramount to the success of the housing market, and indeed, the U.S. economy. Realtors have a tremendous stake in protecting consumers from unfair lending practices.

As we have seen recently, abusive lending erodes confidence in the Nation's housing system, strips equity from homeowners, and damages our local and national economies.

In May of 2005, NAR adopted a set of responsible lending principles. They include steps to ensure affordability, limited stated income and assets underwriting, provide flexibility for life circumstances, eliminate mortgage flipping, bar prepayment penalties, improve the way lenders assess creditworthiness, provide mortgage choice, strengthen enforcement, and promote appraiser independence.

My written testimony includes specific details on each of those principles, but my oral testimony today will focus on just one of those, appraiser independence. Realtors believe that a strong and independent appraisal industry is vital to restoring faith in the mortgage origination process.

In November of 2007, the House passed a bill that we believe would have struck an appropriate balance of oversight and consumer protection. That bill, H.R. 3915, referenced here several times today, would have strengthened the independence of the appraisal process by ensuring appraisers serve as an unbiased arbiter of a property's value.

More recently, Fannie Mae and Freddie Mac signed an agreement with New York Attorney General Andrew Cuomo that provides for a home valuation code of conduct, and like H.R. 3915, this code also attempts to strengthen appraiser independence. However, it does have significant flaws.

We believe primarily that implementing the code on May 1, 2009, could lead to an over-reliance on automated valuation models. Such

models do not consider qualitative factors as well as professional licensed and certified appraisers.

Additionally, the code also fails to address the cost of the real estate transaction.

H.R. 3915 and the code also fail to address regulation of appraisal management companies. It's an important issue that must be addressed to assure that appraisals are based on sound and fair appraisal principles and that they are accurate.

With that in mind, we recommend the following measures:

First, lenders should be required to inform each borrower of the method used to value the property in connection with the mortgage application, give the borrower the right to receive a copy of each appraisal, and at no additional cost.

Second, the Federal Government also should provide assistance to States to help strengthen regulatory and enforcement activities related to the appraisals.

And third, we support enhanced education and qualifications for appraisers.

Like all our responsible lending principles, we believe appraisal independence is absolutely vital to the future success of the housing market. However, Realtors also recognize the need for the Federal Government to address the current operational issues that are impeding the delivery of mortgage credit.

Specifically, we ask that you encourage lenders and private mortgage insurers to remove unnecessarily strict underwriting standards, and urge consumer reporting agencies to move quickly to correct errors in credit reports.

Realtors are proud to encourage responsible lending, and we stand ready to work with you to ensure that the nightmare of foreclosure does not overshadow the American dream of homeownership.

I thank you for this opportunity to share our thoughts, Mr. Chairman, and I welcome any questions from the subcommittee.

[The prepared statement of Mr. McMillan can be found on page 193 of the appendix.]

Chairman GUTIERREZ. Mr. Amorin, please.

STATEMENT OF JIM AMORIN, PRESIDENT, APPRAISAL INSTITUTE

Mr. AMORIN. Thank you.

A few years ago, the Appraisal Institute appeared before this committee and warned that the lack of oversight and enforcement in the mortgage lending industry was a ticking time bomb threatening our economy. That was 2005.

Now that the bomb has exploded, with aftershocks heard 'round the world, what now?

Four measures can help us work our way back to the basics and restore confidence in America's system of mortgage finance.

First, refine and reintroduce the concepts of H.R. 3915, which emerged from this committee in the last Congress, and was passed in the House.

A revised bill, with enhanced consumer protection, is needed to provide additional resources for aggressive oversight and enforcement.

Regrettably, too often, mortgage originators, who are only paid if the transaction goes forward, have been in charge of ordering appraisals. Such a system is ill-equipped to avoid bias and manipulation to the detriment of the consumer, and ultimately, the taxpayer.

As you are aware, the home valuation code of conduct, prompted by Attorney General Cuomo, elevated the issue of appraiser coercion to the national stage. This heightened awareness is further evidence that a system-wide approach to mortgage reform is needed.

Congress needs to look closely at the participation of appraisal management companies under the code, as they are unregulated entities and must be brought under control and fully engrossed in the regulatory process.

Congress must also ensure that any insertion of middlemen in the appraisal process does not come at the expense of obtaining competent appraisals.

Ultimately, this comprehensive legislation is central to curing a mortgage industry in distress.

Second, Congress should empower the oversight agencies for appraisal regulation, the Appraisal Subcommittee, to act more effectively in performing its functions. Legislation in response to our last financial crisis, the savings and loan disaster, created a system of licensing and certification for appraisers, but the current regulatory structure can only be described as feeble.

We can strengthen oversight by funding improvements for State appraisal licensing boards and giving the Federal oversight body the necessary authority to issue rules and effective guidelines.

Currently, this oversight agency only has one tool at its disposal to compel States to act. It can only decertify a State.

We believe it should have additional and more realistic enforcement authorities. Further, State appraisal boards must be given additional resources to strengthen enforcement activities.

Third, as indicated in our written testimony, the Administration's recently announced loan modification plan allows for home values to be determined by broker price opinions and automated valuation models. Frankly, we are shocked.

Once again, we are not treating the valuation process seriously. Congress must immediately review this policy and ensure it is consistent with longstanding bank regulations that require or encourage the use of appraisals.

Our last recommendation is to create an independent authority to oversee appraisal issues and keep them from getting lost in the shuffle of industry restructuring. This should be a high-level, senior position in an agency, such as the Treasury Department, where the Office of Chief Appraiser can effectively guide valuation policy and criteria across agency lines, and ensure consistency in application and oversight.

Members of this committee, just a week ago, the Treasury Inspector General released a devastating analysis of what went wrong in the Indy Mac mortgage meltdown. That lender shopped for appraisers, and ordered multiple appraisals, until it found a valuation that hit its desired numbers.

This is a systematic avoidance of the requirements, much in the same way the now-infamous peanut supplier shopped for laboratories and lab results until it found one willing to endorse its tainted product.

In one case, Indy Mac picked a $1.5 million valuation, more than double the lowest it was given, while regulators were asleep at the switch.

Unfortunately, such an abuse of the system has been repeated over and over again throughout the mortgage finance industry.

The corruption of mortgage lending practices helped doom Indy Mac to fail, ruining many innocent borrowers as it collapsed. Sadly, Indy Mac typifies the abuses in the mortgage industry, and ineffectual action by regulators before it was too late.

We need to start today to close the loopholes, to refine the regulations, and to empower enforcement that will return the industry to solid fundamentals of safe and sound underwriting with adequate oversight.

Thank you for your time today.

[The prepared statement of Mr. Amorin can be found on page 70 of the appendix.]

Chairman GUTIERREZ. Mr. Robson, for 5 minutes.

STATEMENT OF JOE R. ROBSON, CHAIRMAN OF THE BOARD, NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. ROBSON. Chairman Gutierrez, Ranking Member Hensarling, and members of the subcommittee, I thank you for the opportunity to testify today.

I'm a builder and developer from Tulsa, Oklahoma, and the 2009 chairman of the board of the National Association of Home Builders.

The housing market, the financial system, and the economy's performance continue to reel from the excesses earlier in the decade. Soaring mortgage foreclosures and declining home prices are interacting in an adverse feedback cycle that shows no signs of diminishing.

While the Nation will continue to suffer these consequences in the months ahead, the mortgage system itself has already undergone radical changes.

Federal and State bank regulators have taken significant steps to curb risky mortgage lending, strengthening underwriting and loan management policies, and improved consumer information and safeguards.

Congress has taken action to improve mortgage lending standards and oversight.

In addition, the private label securities market, which was a primary vehicle for exotic mortgages, has shut down, and mainstream lenders have become extremely cautious.

The pendulum, in fact, has swung back well past center, so that mortgage credit is currently available primarily to those with unblemished credit histories and the resources to make a significant downpayment on their home.

NAHB's members have supported steps to ensure that mortgage lending occurs in a manner consistent with sound underwriting,

prudent risk management, and appropriate consumer safeguards and disclosure.

Home builders and their customers, however, have been significantly impacted by the upheaval in the financial marketplace, and are highly focussed on what might lie ahead. There is a great deal of uncertainty with regard to how the mortgage lending system will function when the housing and financial markets finally stabilize, and there is a deep concern that additional market dislocations will increase the depth and length of the current downturn.

Single family appraisal problems are also an area of concern for home builders, and are contributing to the current housing and credit crisis.

Appraisers have often used sales of homes and foreclosures or other distressed properties as comparables of new homes, without having made the appropriate value adjustments.

NAHB believes that many appraisers lack the training and skills to perform the type of complex appraisals that are called for during this economic crisis. NAHB is working with the Appraisal Institute to raise the bar of appraiser education and performance.

As Congress considers additional actions to avoid future mortgage lending problems, NAHB urges careful evaluation of steps already taken, the ongoing market impairments and structural shifts in the housing finance system and the immediate and longer-term impacts on the cost and availability of mortgage credit for qualified borrowers.

As this subcommittee works to build upon legislation passed in Congress in 2007, we offer two specific policy recommendations:

First, NAHB urges Congress to implement a clear national framework for mortgage origination standards to replace the current—

Chairman GUTIERREZ. Excuse me, Mr. Robson. Could we please table the conversation—the gentlemen on the right? Just a little competition between our witnesses and the staff. I apologize, Mr. Robson. We will give you more time.

Mr. ROBSON. No, that's fine. Thank you.

—patchwork of State and local laws, which often lead to unnecessary restrictions on mortgage credit.

Specifically, Congress should establish a Federal preemption statute creating central uniformity in the mortgage market.

And second, as H.R. 3915 would have excluded the use of arbitration as a means to resolve disputes, NAHB urges the committee to refrain from limiting the use of alternative dispute resolution techniques, including binding arbitration, which we believe is the most rapid, fair, and cost-effective means to resolving disputes.

NAHB opposes any attempt to prohibit the use of pre-dispute arbitration in contracts.

Thank you again for this opportunity to testify, and NAHB looks forward to working with Congress and the committee to address these issues.

[The prepared statement of Mr. Robson can be found on page 218 of the appendix.]

Chairman GUTIERREZ. Thank you, Mr. Robson.

Mr. Platt, for 5 minutes.

STATEMENT OF LAURENCE E. PLATT, PARTNER, K&L GATES, ON BEHALF OF THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION AND THE AMERICAN SECURITIZATION FORUM

Mr. PLATT. Chairman Gutierrez, Ranking Member Hensarling, and members of the subcommittee, thank you for the privilege of testifying here today on behalf of the Securities Industry and Financial Markets Association and the American Securitization Forum regarding reform of mortgage finance, and in particular, certain mortgage origination practices that contributed to the housing crisis affecting the Nation today.

We were pleased to have worked on this issue constructively with the committee, as it moved toward the November 2007 passage of H.R. 3915, the Mortgage Reform and Anti-Predatory Lending Act.

We appreciate the opportunity to highlight the key considerations that guided the involvement of SIFMA and ASF in the earlier legislative initiative, and that remain important to SIFMA and ASF today.

And let me state the obvious: The market is very different today than it was in the fall of 2007. We believe the House at that time wisely sought to limit the majority of the bill's provisions to subprime loans by focusing on the core practices that it believed contributed to the subprime 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 subprime borrowers could be made in a responsible way, and that the industry could continue to support this segment of the mortgage market.

As such, the committee worked to make the new requirements relatively understandable and provide penalties for violations that maintained a sense of proportionality.

Since then, of course, the availability of subprime credit has evaporated. This market has not returned. The conforming prime market is functioning, but fragile.

Congress and the Administration have made several attempts to address the foreclosure and housing crisis. When the Federal Reserve Board adopted its final regulations to the Home Ownership Equity Protection Act, it sought to address certain of the major underwriting concerns that H.R. 3915 had covered.

As a result, it appears that this legislative initiative will be largely an 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.

Underlying the debate over H.R. 3915 back in 2007 was one basic question. Would the private market make buyers securitize subprime loans that were subject to those new restrictions, given its reluctance to purchase high-cost loans under HOEPA?

We believed then, and we still believe today, that there are certain principles that guide the willingness of the industry to participate in the primary and secondary markets.

First, lenders, assignees, and securitizers need legal certainty before being subject to potential legal liability.

Second, borrowers and market participants are looking primarily for a system that works. That is, one that both protects the legitimate interests of innocent consumers from inappropriate lending products, and provides incentives for investors to invest the funds needed to help get that borrower a loan.

Although we had some concerns, we felt that many of the provisions of H.R. 3915 provided a fair balance, and we hope that any newly proposed legislation will do the same.

For the secondary market, H.R. 3915 basically attempted to do two things:

First, it lowered the financial triggers that cause a loan to be classified as a high-cost loan. In other words, certain subprime loans that previously would not have qualified as high-cost loans under HOEPA would so qualify under 3915.

Second, it created a whole new set of restrictions for loans that cost more than prime loans but less than high-cost loans. The House used cost as a proxy for borrowers who it was perceived needed greater protection.

Please know that the final version of H.R. 3915 had many provisions that we considered extremely helpful.

It properly differentiated between the new legal responsibilities of mortgage brokers and mortgage lenders, recognizing the inherent differences in the roles of those two types of originators, and the related expectations of consumers.

It limited its applicability, generally, to subprime loans, recognizing that the lending abuses that afflicted the subprime market were generally absent in the prime market.

It qualified the responsibilities of creditors to determine a borrower's ability to repay and the presence of a net tangible benefit in order to lessen the likelihood of successful claims for errors in judgment made in good faith by lenders.

And while it increased the monetary damages that would have been available for violations, it limited the availability of penalty damages to ensure some level of proportionality between the violation and the remedy.

While it increased the availability of the extraordinary remedy of recision, at least the bill offered a creditor the ability to avoid recision by curing the violation, and the bill also properly balanced the interests of assignees.

Underlying these positive measures was the belief that consumers with troubled credit histories may have required greater protection—

Chairman GUTIERREZ. Your time has expired.

Mr. PLATT. Thank you.

[The prepared statement of Mr. Platt can be found on page 212 of the appendix.]

Chairman GUTIERREZ. That's quite all right.

I want to thank all of you, and just to go back to Mr. Savitt from the National Association of Mortgage Brokers, and just in general to respond to all of you, I personally can't think of any one of your industries I haven't dealt with over my last 30 years since I have owned a home, and paid for many a year of college for the members of the Realtors Association. You have done the best, as I look at

the books. So I have had wonderful experience dealing with members of your association through the years.

That is not to say that there aren't issues within each one of your groupings, whether it's bankers, whether it's appraisers, whether it's—so I don't want anybody to think that is the purpose of this.

We just want to get your information and want to tell you that you're welcome to continue to address the members of this committee and the chairmanship, as we go forward on this vote, but we will go forward on this vote, and from what I have heard from all of you, you think it's a good idea that we move, that there are many moving parts of this legislation that are very good, and so we're going to take that into consideration and move forward with that.

I have just one question of Mr. Kittle and Mr. Platt, so I'll ask both of you to answer just this one question.

There have been some extensive discussions in this committee about the mortgage securitization process, and I believe some valid concerns have been raised. Among those concerns is the fact that, in the entire loan securitized, the risk for the loan is passed on to the buyer, along with the profit, leaving little incentive for the originator to make a responsible loan.

Would you be in favor of a rule that requires part of the securitized loan to be maintained on the books of the originator in order to help keep them with what is called some "skin in the game?"

So why don't you just both respond to that question in general? Mr. Kittle first.

Mr. KITTLE. Thank you, Mr. Chairman.

Well, our members, with the Mortgage Bankers Association, most of our members are lenders, and we already have skin in the game, so we underwrite the loan, we have to have warehouse lines of credit, we have to have substantial net worth, minimum net worth at HUD, but many of our lenders are required to have a million-plus net worth. So the skin in the game is already there.

We have buyback agreements with the investors. Fannie and Freddie are sending loans back to our members right and left, right now, for repurchase.

So the skin in the game for our members, Mr. Chairman, is already there.

Chairman GUTIERREZ. Mr. Platt.

Mr. PLATT. Thank you. I would like to really second what Mr. Kittle said. There is risk retained already.

Non-depository institutions simply won't have the capital, I think, to be able to retain that kind of risk, and there are many securitization, asset-backed securitizations that presently don't have that kind of risk retention feature and work just fine.

SIFMA is looking at this issue, though, because it has been raised more recently, and so I think there's not a formal position yet of SIFMA on this.

Chairman GUTIERREZ. Thank you. I'm not going to pursue the question. I'm going to yield back the time, and yield 5 minutes to Mr. Hensarling.

Mr. HENSARLING. Thank you, Mr. Chairman.

I actually share a number of the concerns that you articulated. Clearly, there were a number of problems and shortcomings in the mortgage finance system that helped lead to this economic crisis. I'm somewhat fearful, though, that we may go from one extreme to the other, as is often the case in public policy.

My fear is particularly, as I looked at the original version of H.R. 3915, I'm having a hard time concluding at the end of the day that it's not going to make credit more expensive and less available precisely at a time when a number of people are trying to desperately refinance their homes and stay there.

I'm particularly concerned—I think, Mr. Middleton, you used the phrase that you were concerned about unnecessary litigation. And I know that you, under the provisions of 3915, would be held liable for, "net tangible benefit."

Can you tell me what a net tangible benefit is, to the borrower?

Mr. MIDDLETON. I was struggling with that definition myself.

Mr. HENSARLING. Well, I'm concerned, and I know that we have a process to work through, but for example, in retrospect, there were a number of borrowers who originally were renters, and opted to buy a home, ended up they couldn't afford the home that they bought, and I suppose one could make the case that they didn't have a net tangible benefit, they had a net tangible detriment.

Some people may be financially better off to rent, but it could be that they want to have their part of the American dream and own a home.

Might some very creative attorney decide that somebody came to you, they want to buy a home, they want to move from rental status, and you have to crunch a bunch of numbers and say, "You know what? I've decided that you will not receive a net tangible benefit from becoming a homeowner, therefore, I have to legally deny you credit"?

I mean, is this off the wall, or might this have—

Mr. MIDDLETON. No, sir. If you look at the Fair Credit Act, the Fair Lending Act, you almost have that condition now.

If John Doe applies for a fixed-rate mortgage, you must run that through and decline and counter-offer. So that's a rule we've been living with for all the years, ever since that bill has been in effect.

So the detail of the definition is what bothers me the most, because it becomes very subjective, and it really doesn't look at the four "C's" of credit that one always follows in a traditional lending, you know: capacity; character; collateral; and credit.

It just seems to be inconsistent with prudent underwriting. Prudent underwriting answers that, when you get into judgments about, "Is this really going to fit your tangible net benefit, Mrs. Jones?" I don't think that's something that we would like to see in this bill.

Mr. HENSARLING. Well, again, I think that sometimes we see public policy excesses, and I think we've gone from an atmosphere where a lot of you people would be brought before this committee and publicly slapped around for not making credit available to low-income people, and now to some extent, you're being slapped around for providing financing to low-income people.

I'm also concerned, besides the net tangible benefit—let me ask you this question, Mr. Middleton, since I started with you. How

many of the loans that your bank makes are HOEPA loans? Do you have a rough percentage?

Mr. MIDDLETON. We have never—

Mr. HENSARLING. Never?

Mr. MIDDLETON. Never, ever.

Mr. HENSARLING. Well, under H.R. 3915, as I understand it, we're going to essentially expand the scope of definition of HOEPA, and so a much greater universe of loans will now be HOEPA loans.

Representing your organization, should I conclude from that that there will be a whole new universe of loans that will not be made at a time when many borrowers again are trying to refinance?

Mr. MIDDLETON. At our institution, we would not approach that level of pricing, so the HOEPA loan criteria would not negatively affect us, because that is not our business model. We're not doing high interest rate loans, irrespective of the reason.

Mr. HENSARLING. Do you have an approximation of, representing your organization, how many of the loans are made by your member organizations that might be HOEPA loans?

Mr. MIDDLETON. By my organization, none.

Mr. HENSARLING. I'm sorry. Referring to the ABA.

Mr. MIDDLETON. Oh, I'm sorry.

Mr. HENSARLING. Not your individual bank. I'm sorry if I was not clear.

Mr. MIDDLETON. The reputational risk of being a HOEPA loan lender would not be in the business model or the interest of the member of the ABA. There's so much risk with that.

Additionally, we live with every loan. Every year, we have an examiner onsite going through the entire alphabet of compliance laws and safety and soundness laws, so we have no interest—and I think I speak for many of the community bank members and a large majority of members—we have no interest in being known as a HOEPA loan provider.

Mr. HENSARLING. I see I'm out of time. Thank you.

Mr. ELLISON. [presiding] The gentleman from North Carolina.

Mr. WATT. Thank you, Mr. Chairman. You look great over there in that chair.

Mr. ELLISON. Thank you, sir.

Mr. WATT. I didn't want to pass up this opportunity to compliment you on that.

We're kind of getting down to serious brass tacks. Brad Miller and I have been working on this for years now.

And while I don't normally do this, I know that you all have severe time constraints, and 5 minutes really won't allow me to get to all the issues that I would like to raise with you.

So what I think I will do, and this is unusual for me, is ask you all to, if you don't mind, give me some written responses to some things that are on my mind.

Mr. Middleton, you say at the bottom of page 6 and the top of page 7 of your testimony, "We also believe that had the secondary market provided for some degree of skin in the game for all market participants, there would have been far less abuse and fewer bad loans."

So obviously, Mr. Kittle says he has skin in the game; Mr. Platt said everybody has skin in the game.

Skin in the game, as I understand it, is kind of like a proposal that, if you make a loan, whoever makes that loan, got to retain 5, 10, 15 percent of it on their books, rather than selling it off into a secondary market, so that—so my question to you is, and if you can just give me something in writing on this, how do you do that, how do you require people to have skin in the game without increasing interest rates? Because I think that probably will have some impact on interest rates. And how do you do it without it just becoming a cost of doing business, which I think a lot of credit card companies assume that there will be some loss on—so, I mean, you know, they just factor it into what they're doing.

Give me a comment on that in writing.

Second, you say at the bottom of page 8 of your testimony that there should be terms that should be specific and well-defined, limiting the potential for unnecessary litigation.

And I know what unnecessary litigation—that's litigation that—against whomever—you know.

So I hope you're not suggesting there not be some means, either through attorneys general, regulators, or private participants to enforce whatever these specific and well-defined terms are, and if you are saying that, or if you're not saying that, tell me what those enforcement mechanisms should be, and if you can, give me something on that in writing, and how you both write a safe harbor provision, and not make that a hiding place for people to be irresponsible.

Mr. Savitt, please tell me your reaction in writing to the proposal that was made on the last panel for spreading yield spread premium or broker fees over a period of time, rather than paying them up front, as a means of making brokers more responsible in the process.

If you can tell me your reaction to, and if you are against it, tell me why, and what detriment there would be. I would like that.

The reason I'm doing this is because I mean, I think we're down—I could sit here and talk to you for 5 minutes about some of these issues, but we're down to the end of the road now, and I need you all to be constructive with me.

I'm particularly appreciative for the tone of Mr. Platt's testimony, but I hope he will continue to give us some way of making the securitization market have some responsibility for assuring that lenders don't make irresponsible loans and just sell them over and over and over into secondary, tertiary, 100th markets.

I know my time has expired, and that is why I did it this way, because I knew nobody was going to have time to respond.

Thank you, sir. Thank you, Mr. Chairman.

I thought if I called him "Mr. Chairman," he would give me more time, but it didn't work.

Mr. ELLISON. You got a little extra.

The gentleman from New York.

Mr. LEE. Thank you. Good evening, gentlemen. Thank you for coming.

I don't want to pick on Mr. Savitt, but whether you like it or not, I believe the mortgage broker industry is taking probably some of the brunt of this, and I'm always for not looking backward, I'm for looking forward and finding ways that, going forward, we can find

a better solution that protects taxpayers and keeps a system that gets people back into their homes, so I appreciate your comments as we go forward.

I know you're here representing the brokers, and there have been some very good actors, but there have also been some bad actors in the industry.

I would be very curious to hear your ideas and thoughts, outside of a registration process that has been put in place. What else should we be legislating or initiating to help eliminate some of these individuals who really shouldn't have been representing the industry.

Mr. SAVITT. Well, first of all, when you say registration, you're talking about the SAFE Act?

Mr. LEE. Yes.

Mr. SAVITT. Okay. Mortgage brokers would not be registered under the SAFE Act. They would be licensed under the SAFE Act.

They would go through, as many States now require them to do, they would have to pass a test, they would have 20 years of pre-education, they would have continuing education, background investigations, fingerprinting, both State and Federal.

They would have to have either a surety bond, a net worth requirement, or pay into a recovery fund. And mortgage brokers are the only ones that would be licensed that extensively under the SAFE Act.

Many of us now do have those very similar requirements in the States. I'm licensed in the State of West Virginia and also in the State of Maryland, and I went through those very same procedures that I just cited to you.

I think one of the things that we can do that can really help this industry is we have to regulate the practice, not regulate the license. We have to treat all originators, regardless of how they're licensed, the same, I mean, as far as disclosure.

In other words, on a good faith estimate, mortgage brokers have taken quite a hit, as you know, for the yield spread premium that they receive. It's an indirect compensation.

All originators, regardless of how they're licensed, receive some type of indirect compensation. The only difference is, with mortgage brokers, is that mortgage brokers have been required, under HUD regulation, since 1992, to disclose that to consumers. It's very confusing. The FTC has come out and said it's confusing.

And I think what we need to do to give a level playing field to the consumer, all originators should have to disclose all of their indirect compensation.

All originators should disclose, in the exact same manner, on the exact forms, because when you don't—you know, a consumer comes to shop, and they do shop. It doesn't matter if they're at a broker's office or a bank or a lender. They don't understand the difference. What they understand is they're applying for a mortgage loan. So we have to level the playing field for the consumer.

Mr. LEE. If I can continue on for one more point.

You also, I believe, in your testimony, mentioned there were some problems with the SAFE Act, and I'd like you to expound upon those and where you see that there is a problem.

Mr. SAVITT. Well, as far as the implementation, also the SAFE Act is silent as far as things like grandfathering.

I have been a mortgage broker for a little over 28 years, and I would be required to take a test for something that I have been doing for 28 years, and have 20 hours of pre-education, when I have gone through 7 hours of continuing education each year for, I think, 10 years.

I think there needs to be a certain provision spelled out, even though it is silent, and my understanding is that it was left silent to leave it up to the States, but the States have a different interpretation based upon what they have been told by CSBS, that there is no provision for grandfathering, and if Congress wanted grandfathering, they would have spelled it out.

I think the stronger argument is, since there is nothing spelled out, that again, it's being left up to the States.

It's—there needs to be a delay in the implementation, I believe—first of all, let me just say this. The SAFE Act was something that we have been supporting, or what's now the SAFE Act, we have been supporting since 2001.

The brokers were the first ones that came up with the idea for a registry. We backed off on that in the beginning, because it was only going to be for brokers, it wasn't going to be for all originators, which it now is, even federally chartered banks, their originators are in the registry.

Our model State statute from 2002 is almost a mirror image of what is in the SAFE Act, so we had a lot of input as to what goes into that, but HUD has not even written their regulations yet.

HUD told us it will take them 18 months to write their regulations, because they don't have the funds for it right now, so I think what we need to do is not rush into this. It should be a slow implementation, give the States a chance to get a handle on this, and make sure that, you know, if they do change their laws in the States, they don't have to go back and do it again because the HUD regulations say something different.

Mr. LEE. I'm not sure how much time I have left.

Mr. ELLISON. You're out, but make it quick.

Mr. LEE. I will make it really quick, because I appreciate that.

The gentleman who just left, from North Carolina, had talked about the yield spread premium and the fact of the skin in the game concept. You didn't have a chance to reply. But I did think that was an idea of trying to spread that.

I came from the business world, have been in Congress now for 2 months, but I worked in the private sector exclusively, and our sales people were compensated, but they're always compensated.

Typically, a bonus was paid at the end of the year, so there was time to actually evaluate and ensure that the products were sold and we were paid, and I like the concept of trying to do some form of a holdback or something.

I would like your comments on what kind of a system would work effectively.

Mr. SAVITT. I don't think that would work, for several reasons.

First of all, those who receive their compensation over a period of time right now also receive additional fees, servicing fees, over the period of time.

The other thing is that mortgage brokers have absolutely no control—let me back up even further. The loans are not our products. We have no say in the guidelines of those loans. We do not underwrite or approve those loans. That comes from the GSEs and also from the lenders. We have no control or say in the approval of products.

So that would be asking us to take a risk on something that we have no control or no say over.

Mr. LEE. My biggest concern was just ensuring that we get accurate data that's passed along so that, through an entire system, that, at the end of the day, we have qualified loans that will be paid.

Mr. ELLISON. The gentleman's time is up.

Mr. Robson, I was intrigued by your idea of a preemption statute that might add uniformity to mortgage law, and I think that does have the advantage of lending uniformity, but I wonder what your views are about a floor, a basic law that could leave room for States to apply their own local standards, and also, in order to have, you know, 50 attorneys general regulators to keep their eyes on fraud, waste, abuse, and things like that.

Mr. ROBSON. I think a lot of it has to do with the transparency of securities and that sort of thing, as much as anything, not necessarily oversight on abuses, but how do you analyze a loan from one various State under certain rules and regulations versus another, and have some sort of uniformity throughout the country.

So certainly you could have, I guess, every State attorney general kind of watching out after that, but I mean, some uniformity I think would go a long way in correcting some of the problems.

Mr. ELLISON. Also, I like the idea of alternative dispute resolution as well, but my problem is that I've received reports that in some cases, where there are binding arbitration clauses, there are companies that do arbitration, and that's their business, and they're paid by the person with the greater market power in the transaction, and things always seem to go their way.

I mean, do you see any opening or any flexibility in how, between the consumer and the lender, that we might arrive at an alternative resolution method that might be amenable to both sides?

Do you have any ideas on how we can make that more flexible?

Mr. ROBSON. The whole idea of arbitration is having a fair game.

Mr. ELLISON. Yes, it is.

Mr. ROBSON. And so if there is some need to tweak the arbitration rules so that everybody is playing fair, that's fine.

But it's certainly a lot quicker and easier and less expensive, if you want expense and that sort of thing to enter into it, to go to court.

Mr. ELLISON. Thank you, sir.

Mr. McMillan, could you share with me whatever ideas you may have about initiatives that you could recommend to help low-income families rehabilitate their credit score so that they don't have to be susceptible to predatory lending in the future?

Mr. MCMILLAN. Certainly, Mr. Chairman.

A number of those things have been addressed here, but one of the things that studies have shown is that most renters, which most low-income persons are, pay substantially more proportionate

toward rent than someone owning a home; therefore, the flexibility in underwriting guidelines and being able to consider someone who has paid their rent on time for years, while that may be 40 percent of their income, to receive a conventional type loan and therefore improve their credit by having credit in the normal marketplace.

With your permission, I would like to opine as well, if you don't mind, on the arbitration issue, because many of us in States have included arbitration provisions which bind the parties to arbitration should there be a dispute or any number of alternative dispute resolution procedures—

Mr. ELLISON. Reclaiming my time. But, Mr. McMillan, maybe in that case, the parties could somehow jointly pick an arbitrator. I get concerned when, you know, the lender, the person with the greater market power and the more access to more information, gets to sort of designate who that person is.

Any response?

Mr. MCMILLAN. Absolutely correct, sir.

What normally happens when someone purchases a home using the builder's contract, with the bias that you've just addressed, is that they supersede any State-mandated contracts and the borrower has those provisions as a take it or leave it type of process.

Mr. ELLISON. Reclaiming my time. Thank you, Mr. McMillan.

Mr. Savitt, could you offer your views on what powers a systemic risk regulator might have with respect to mortgage and consumer protections, particularly given that the current crisis was in many ways fueled in part by weak standards in that regard?

Mr. SAVITT. You are talking about an overall regulator? I think an overall regulator is a good idea, but something that I heard in the second panel I would agree with, also, is that there needs to be checks and balances.

So you may have an overall regulator who supervises other regulators, and I think that would be a very appropriate idea.

Mr. ELLISON. Thank you. My time has expired.

The gentleman from Minnesota.

Mr. PAULSEN. Thank you, Mr. Chairman.

You know, this committee has heard from the oversight authorities as well as representatives of the communities that are affected by lending rules, and I'm just wondering, for the bankers, you know, Mr. Middleton and Mr. Kittle, can you tell us the current lending conditions right now that you are facing, given the challenges right now that the markets are facing?

Mr. MIDDLETON. The economic conditions?

Mr. PAULSEN. Correct.

Mr. MIDDLETON. The borrower, the prospective borrower?

We're seeing what we would consider a prime-A credit that has sufficient downpayment, good credit history, are the ones that are venturing back into the market, so that I think we're seeing jumbo conforming, but they all have the same underwriting criteria, meet the same traditional underwriting criteria that we've always had.

So it's a fairly competent borrower who has the means to support the purchase.

Mr. PAULSEN. So in general, are homes being purchased and sold and under what conditions in general?

Mr. MIDDLETON. In southern Maryland, I can tell you that it is gradually moving—we feel a bottom has occurred in the pricing, and we're getting more seekers. I'm hearing good reports about traffic over the weekend, significantly higher visits to houses in the southern Maryland region. So that's good news.

Did I answer your question, sir?

Mr. PAULSEN. You did. Please, Mr. Kittle.

Mr. KITTLE. Well, we're finding that lending right now is more robust. We're coming into springtime. I agree with what Mr. Middleton just said. I mean, our business is cyclic, even though it's been tough over the last couple of years.

The biggest problem our members are facing right now is warehouse lines of credit. There are major banks that have decided to get out of the space. Chase. The rumor is, the announcement since the merger of PNC buying National City, that they will exit that space. National City is a huge warehouse lender.

So the small lenders, the independent mortgage bankers who take the risk, who have the skin in the game, are not able to get lines of credit.

We have a brand new housing program that the President just initiated on the modifications and to help with refinancing. There's not going to be the capacity out there to fund these loans.

And the problem is, if I may take just one more moment, that when you fund a loan on a warehouse line of credit, it's treated as a commercial loan, and it has certain cash requirements by that bank that must be set aside for that loan, and those cash requirements are restrictive.

So MBA, we took a group of our lenders to Treasury last week, to ask Treasury to help maybe the GSEs to get into possibly a participation with them. Fannie and Freddie will most likely end up with these loans, anyway. And if they could come in and do a participation on those lines of credit, it would free that cash up.

But clearly, our biggest problem facing us right now, other than the cramdown legislation, is warehouse lending.

Mr. PAULSEN. Well, that kind of leads into my question; have the underwriting rules changed since the credit crisis?

Mr. KITTLE. Well, we're making the best loans we have made in 15 years. We have tightened the underwriting. And now, there is even some criticism that we're too tight. So the pendulum has swung back. We're making good loans, and now we're in some cases being criticized because we're not loose enough.

Mr. MIDDLETON. To respond to that question, as well, we had not changed our underwriting criteria when things were loose. We're just consistent with the way we always did it. So there was really no tightening or loosening of any criteria.

Mr. PAULSEN. And just one more question.

How are the regulatory requirements of CRA, the Community Reinvestment Act, affecting the way that you do business in this economic environment right now?

Mr. MIDDLETON. Like I mentioned, we're a satisfactory CRA lender. We really find the CRA as a tool, not an obstacle.

And I mentioned also that all of our affordable housing loans are current, none of them are in default. We work with CDCs, and of particular interest to meet the CRA requirements, we work with

our community development corporations to be a partner in the layering of funds with other sectors, HUD and various grant folks, and we are finding that to be a very effective partnership with a highly productive outcome

Mr. PAULSEN. No other questions, Mr. Chairman. I yield back.

Mr. ELLISON. Thank you. The gentleman yields back.

I would like to enter into the record written testimony by Terry Clemmons, executive director of the National Credit Reporting Association.

Without objection, it is so ordered.

I want to thank the witnesses and the members for their participation in this hearing. The Chair notes that some members may have additional questions for the witnesses, which they may wish to submit in writing.

Therefore, without objection, the hearing record will remain open for 30 days for members to submit written questions to the witnesses and to place their responses in the record.

This subcommittee hearing is now adjourned.

[Whereupon, at 6:48 p.m., the hearing was adjourned.]

A P P E N D I X

March 11, 2009

Testimony presented on behalf of the

Appraisal Institute

Before the

House Committee on Financial Services'
Subcommittee on Financial Institutions and Consumer Credit

On

Mortgage Lending Reform: A Comprehensive Review of the American Mortgage System

Presented by

Jim Amorin, MAI, SRA
President
Appraisal Institute

March 11, 2009

Chairman Gutierrez, Ranking Member Hensarling and members of the Subcommittee, 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 here on behalf of the Appraisal Institute the largest professional appraisal organization in the United States, representing 25,000 real estate appraisers.

Thank you for the opportunity to testify on "Mortgage Lending Reform: A Comprehensive Review of the American Mortgage System." The professional appraisal community stands ready to assist the Congress, the Administration, consumers and investors in addressing critical issues confronting the real estate market and the economy. Armed with high ethics and advanced methodologies, professional appraisers today provide real-time information on local real estate markets, vital in trying times—as well as in periods of prosperity. This critical link has been missing in the latest crisis, as "collateral" was rarely considered.

Today I will discuss five major issues confronting us, including:

1. Lack of Consistent Oversight and Enforcement
2. Appraiser Coercion and Appraisal Independence
3. Mortgage Fraud
4. Inconsistent Bank Regulation
5. Abandoning Long-Standing Safety and Soundness Policies

First, please allow me to describe the function of appraisers. Independent, competent and qualified professional appraisers provide crucial safeguards in the mortgage process. Our fees are not contingent upon whether loans go through, nor are they based on loan amounts. Our objectivity, experience and ethics help participants in residential and commercial transactions to know property values and to understand the risks inherent in collateral lending.

That is what is supposed to happen. Unfortunately, the mortgage industry has long suffered structural problems. While much of it, including appraisal, is regulated effectively, more or less. Yet, all too often, government regulators have been asleep at the switch on matters of oversight and

enforcement. In particular, existing rules have not been enforced adequately, and regulatory loopholes have invited devious participants to skirt basic safety and soundness requirements. Underfunding is the primary cause for inadequate oversight, but structural deficiencies and the unwillingness to act also contribute to their ineffectiveness. Structural reforms for regulatory entities must occur to strengthen enforcement.

We must return to the fundamentals of mortgage lending: capacity to repay, credit history soundness and collateral. Today, even in the midst of our current economic crisis, inadequate attention is paid to the collateral held in support of a loan. This oversight, combined with loose credit policies and a lack of universal and enforceable underwriting guidelines, produced economic disaster. We no longer can continue to ignore these fundamental basics.

Too often, appraisal has been relegated into a formality in mortgage lending, a gimmick to push a deal, rather than a risk-management essential. It is and must continue to be a serious component if we are to promote transparency in the primary and secondary markets, and rebuild our residential mortgage securitization market.

However, we can correct these disorders of the mortgage market if we act decisively. America's professional appraisers stand ready to support that effort.

Lack of Consistent Oversight and Enforcement

Appraisal and valuation-related issues must be addressed in any efforts to improve the overall mortgage financing system. The lack of effective regulation and enforcement is a central problem that also must be addressed. Real estate appraisers are licensed and certified by state boards, which are reviewed by a federal agency, the Appraisal Subcommittee, for compliance with Title XI of the Financial Institutions Reform Recovery and Enforcement Act (FIRREA). Unfortunately, that oversight is not effective in ensuring an independent appraisal process. Title XI was designed to accomplish three purposes: 1) protect the safety and soundness of collateralized real estate lending; 2) raised the professional qualifications of those providing appraisal services; and 3) provide consumers with independent reliable opinions of the market value of residential properties they are financing. We believe that Title XI has succeeded somewhat in accomplishing those purposes, but on some occasions it has fallen short. State and federal oversight is feeble. State appraisal boards often

lack the resources necessary to enforce violations of standards. Few have the authority to intervene effectively against pressure placed on appraisers to produce false reports. That is why we also believe that Title XI can and must be improved by modernizing some of its provisions and by providing additional resources to state appraiser licensing agencies so they can better enforce Title XI's professional appraisal requirements.

This Committee is aware that various federal agencies regulating the nation's financial institutions have responsibility for real estate appraisal standards in certain federally related financial transactions. FIRREA requires these agencies to adhere to appraisal standards, yet numerous loopholes have emerged, allowing financial institutions to avoid getting appraisals.

I could cite numerous good laws crippled by insidious amendments or by ineffective application. For instance, the recently enacted "SAFE Act" requiring the licensing of mortgage originators was a good step, although it was taken 10 years after it should have been. And, in one state (Alabama), the appraisal independence provisions were recently struck from the implementing legislation.

Oversight of Licensed Appraisers

The savings and loan crisis of the 1980s inspired FIRREA. Its Title XI established the current appraisal regulatory structure. While created with the best of intentions, binding federal and state regulators to the private sector to oversee appraisers in the U.S has left us, 18 years later, with a configuration that is, without question, extremely convoluted and possibly a contributing factor in the current crisis.

Title XI created the *federal* Appraisal Subcommittee to oversee the activities of the *state* appraisal boards and commissions. Yet, the Subcommittee's only real power over state boards is the authority to "decertify" a state found to be out of conformance with Title XI. This penalty is nicknamed the "atomic hammer," because if invoked, it would stop virtually all mortgage-related lending in that state. 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. 3915, *The Mortgage Reform and Anti-Predatory Lending Act*, which would grant the Appraisal Subcommittee the authority to impose

interim sanctions and suspensions on State appraiser certifying and licensing agencies. Such powers include the necessary ability to write rules and regulations.

State Appraisal Board Underfunding Allows Abuses

Many state appraisal boards have acute difficulties maintaining effective regulatory systems. According to the 2006 Annual Report of the Appraisal Subcommittee, 60 percent of the state appraisal regulatory agencies failed to uphold their enforcement responsibilities. Most states try to keep up with the demanding workload, but they simply don't have the resources to perform effectively.

This lack of resources allows unscrupulous and unqualified appraisers to continue practicing with virtual impunity. Some bad appraisers have been linked to mortgage fraud schemes throughout the country. For example, a notorious real estate appraiser in New York was convicted of a felony for grossly inflating appraisals. His state license was revoked and he served a year in prison. Upon his release, he challenged the state appellate court to reinstate his license. The court did so, reasoning that he had served his time and he must return to becoming a "beneficial member of society." Amazingly, this fraudulent appraiser charged with participating in numerous land-scam schemes is now a practicing, sanctioned appraiser in New York.

Here's another example. In June 2003, a Maryland appraiser pleading guilty to fraud admitted that the government lost between $500,000 and $800,000 due to his actions. In the fall of 2003, he applied to renew his license. On the online application, he answered "no" to whether or not he had ever been convicted of a felony. His attorney argued that he answered the question honestly because in the federal system, one is not convicted until sentenced, and the appraiser was not sentenced until February 2004. Thus, the Maryland Commission of Real Estate Appraisers and Home Inspectors renewed his license last October for another three years. A spokesperson for the Maryland Commission told the *Baltimore Sun*, "All we have to go by is the honesty of the licensee. We are not required to perform background checks; moreover, the financial and personnel resources are not available at this time."

The Government Accountability Office conducted a lengthy investigation on the appraiser regulatory structure, and determined that underfunding of state appraisal board activities was a major

hindrance to enforcement. A GAO survey of state boards identified resource limitations as the primary impediment in doing their jobs. Of the 54 states and territories responding, 26 (48 percent) reported that the current number of investigators was insufficient for meeting their regulatory responsibilities, 37 (69 percent) cited a need for increasing investigative staff , and 22 (41 percent) cited a need for more resources to support litigation.

The survey continued, saying that the average state appraisal board had approximately three staff members responsible for overseeing almost 2,000 appraisers. Many agencies had to share resources—administrative staff, office space, investigators or all three—with other state agencies. Most states sharing resources also shared investigators, often with no real estate appraisal experience. The survey results indicated that investigations of complaints about problem appraisers suffered most from these shortages. GAO recommended that the Appraisal Subcommittee explore options for funding or otherwise assisting states in carrying out their Title XI activities, particularly investigating complaints against appraisers. While the Subcommittee has helped to develop state investigator training programs, funding mechanisms for enforcement have not been established.

The Appraisal Subcommittee is funded exclusively by license fees on individual state certified and licensed appraisers, which are collected by state appraisal boards. Individual appraisers are assessed an annual fee that is passed through to the Appraisal Subcommittee, which has resulted in a sizable reserve fund held by the Appraisal Subcommittee with no identified purpose. The Appraisal Subcommittee claims to lack legal authority to use these funds for grants to state appraisal boards.

We disagree and suggest a few options that are available to Congress in this area:

1. Grant the Appraisal Subcommittee authority to establish and manage a grant program to state appraisal boards to support enforcement activities.
2. Require state appraiser licensing fees to be used for state appraiser licensing and enforcement. Commonly, these fees are diverted into a state's general fund, forcing the appraisal board to compete with other state programs for funding. Self-funded Boards have significantly more enforcement capability.

Require the Appraisal Subcommittee to add "funding" as one criterion considered in monitoring a state program. We encourage this Committee to explore these options to help with the current state appraisal board funding crisis.

Problem appraisals are being allowed by a regulatory structure that is underfunded and allows lax enforcement and ineffective oversight. H.R. 3915 provided the Appraisal Subcommittee with a more robust oversight system, including a full range of supervisory sanctioning powers over state regulators. This modification, if implemented fairly and through an open and public process by the Appraisal Subcommittee, will encourage state appraisal boards to act against unethical and fraudulent appraisers.

Promoting Professionalism

The best advice Americans may obtain for the biggest financial transaction in their lives is an accurate real estate appraisal. Computer-generated analyses cannot approach the worth of appraisals prepared locally, by hands-on appraisers who are experts in their communities. In appraisal, all wisdom is local.

The use of knowledgeable appraisers is thwarted by misinterpretation of the ironically titled "Anti-Discrimination" clause (Section 1122 (d)) of FIRREA, which discriminates against highly trained and credentialed appraisers in favor of those with the most minimal qualifications. Intended to prevent the arbitrary exclusion of minimally licensed appraisers, it has been warped to favor them over more accomplished colleagues. Congress should fix this.

In a recent Appraisal Institute poll of significant users of appraisal services, 50 percent responded that the quality of appraisal services and appraisal reporting has declined, whereas only 28 percent said appraisal services and reporting have improved. Yet many of these users perceive the possession of a license to be the only necessary qualification on which to base whether or not an appraiser is "qualified" to perform an assignment, not fully considering the issue of competency for a particular appraisal.

While minimum qualifications are a good place to start, limiting clients to only those who are minimally qualified makes no sense. Currently, a third of the approximately 100,000 licensed and certified appraisers in the United States belong to professional appraisal organizations, evidence that

greater professionalism is still valued, but not as strongly pursued as it should be. H.R. 3915 made certain that professional designations can be considered by clients to help determine an appraiser's proficiency. This would not exclude anyone without a designation from receiving an assignment, but rather promote professionalism and place an emphasis back on quality.

Any legislation curbing predatory lending and mortgage fraud must address current weaknesses in the appraiser regulatory structure. H.R. 3915 addressed these concerns by prohibiting inappropriate pressure of appraisers, providing greater accountability of federal and state appraiser regulators, and promoting professionalism among appraisers.

In the 110th Congress, this Committee issued, and the House passed, H.R. 3915, *The Mortgage Reform and Anti-Predatory Lending Act*, which contained provisions to protect consumers and financial institutions from mortgage fraud by addressing shortcomings in the appraisal regulatory structure. These provisions originally were found in H.R. 3837, the Escrow, Appraisal, and Mortgage Servicing Bill, co-authored by Representatives Paul Kanjorski, Barney Frank, Paul Hodes and Charlie Wilson. We appreciate the work of the bill sponsors because mortgage fraud still demands the attention of Congress. It requires a holistic solution, since it involves many aspects of the real estate and mortgage finance industry, including real estate appraisals. It specifically addressed appraisal-related concerns by modifying *Title XI of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA),* which created the current state appraiser regulatory structure with federal oversight. We continue to support these provisions, and we urge that they be enacted immediately.

Appraiser Coercion and Appraisal Independence

In recent years, many financial institutions have lost touch with fundamental risk management practices, including the separation between loan production and risk management. Unfortunately, parties with a vested interest in a transaction are often the same people managing the appraisal process within many financial institutions: a flagrant conflict of interest. Appraisers are ordered to doctor their reports or else never receive work from those parties again. This was evident in a recent case involving nearly all state Attorneys General against Ameriquest, which resulted in an out-of-court settlement imposing new standards to prevent unfair and deceptive practices. Specifically,

Ameriquest had to overhaul its appraisal practices by removing branch offices and sales personnel from the appraiser selection process through the following means: instituting an automated system to select appraisers from panels created in each state; limiting the company's ability to get second opinions on appraisals; and, prohibiting its employees from influencing appraisals.

Acts of appraiser coercion may be blatant or subtle. Subtle tactics may fall short of outright coercion, but the implication is the same. It is common for clients to ask appraisers to remove details about the material condition of property, in order to avoid problems in qualifying certain types of mortgage. However, this omission amounts to a violation of appraiser ethical requirements. Such direct threats typically occur informally over the phone making it very difficult to document such pressure.

Another coercion tactic is the threat of being placed on a "blacklist" (aka "exclusionary appraiser list"), commonly used to blackball appraisers. It is one thing to maintain a list of reputable businesses to work with, or to maintain a list of firms to avoid as a result of poor performance. However, is another to place an appraiser on a blacklist for refusal to hit a predetermined value. Worse, we have heard reports of these blacklists circulating secretly among lenders, where the blacklisted appraiser has no notice of being on such lists, nor any chance to defend his or her reputation.

That such tactics fly in the face of regulation makes no difference where enforcement is feeble. Where rules prohibiting coercion exist, they are not always well enforced. Only a few diligent regulators and observant legislators have fought for appraisal independence. Appraisers themselves have made some gains lately in the states. Specifically, our organization has fought for amendments to the Truth in Lending Act (Regulation Z) to prohibit the coercion of appraisers by mortgage lenders and mortgage brokers, while advancing state appraiser independence requirements now enacted in some 16 states.

The recent agreement between the Attorney General of New York, Fannie Mae, Freddie Mac and the Federal Housing Finance Agency also highlights the issue of appraiser independence. Lenders selling loans to Fannie Mae and Freddie Mac must abide by a "Home Valuation Code of Conduct" starting May 1, 2009, which requires separation between loan production and risk/appraisal

management. Further, it prohibits mortgage brokers from ordering appraisals on loans sold to Fannie Mae and Freddie Mac.

The intentions of the Home Valuation Code of Conduct are consistent with our support for promoting appraiser independence. However, the insertion of third party "appraisal management companies (AMCs)" into the mortgage financing process may lead to actual declines in appraisal quality. With many AMCs taking as much as 60 percent of the fee as their "management" cost, many highly qualified appraisers are reluctant to perform mortgage appraisals for such entities. This flight of highly qualified appraisers is the last thing an already ailing mortgage market needs. Further, our members report that AMCs are just as likely to pressure appraisers into providing predetermined values. We note that AMCs are unregulated. As such we are concerned that the appraiser independence problem simply may be diverted from one formerly unregulated entity (mortgage brokers) to a new one (AMCs).

To address this concern, our organization has developed a model state bill to register appraisal management companies with state appraisal boards. The model bill is under review in several states at this time.

Mortgage Fraud

For years, appraisers have been warning Congress about perennial schemes perpetrated on consumers and the financial markets by real-estate rogues, including some mortgage brokers, mortgage lenders, realty agents and investors set on "flipping" properties for a quick buck. Professional appraisers help fight such scams. Through educational and ethical initiatives, the profession works to ensure that appraisers are both competent and accountable. We have been leading the fight to protect the public and shield our members from the intense pressure they receive from participants who only get paid if the deal goes forward. Such coercion to rubberstamp a predetermined value undermines the integrity of the process. Appraisers with integrity have found themselves frozen out of the market, while new or inexperienced appraisers become the minions of some lenders.

Mortgage fraud contributed heavily to our current situation. Fraud continues to cost consumers, lenders and taxpayers more than $1 billion annually and suspicious activity reports have

increased by an astounding 1,411 percent since 1997, according to the FBI and Department of the Treasury, respectively.

We are angry and disgusted that mortgage fraud can be perpetrated because of faulty appraisals. Law enforcement agencies must be given additional resources for enforcement. Furthermore, there must be coordination between law enforcement and licensing agencies in order to thwart such activity while it is being perpetrated.

Inconsistent Bank Regulation

The present crisis grew from several factors, many long simmering beneath the surface, including the following:

- Imprudent mortgage lending,
- Inconsistent and lax regulation,
- A housing bubble,
- Global imbalances,
- Breakdowns in the securitization model,
- Lack of transparency and accountability,
- Risky banking and financial activity,
- Failure of risk management systems, and
- Excessive leveraging[1].

Inconsistent bank examinations have been highlighted as a significant factor in the housing crisis. The Treasury Department's Office of the Inspector General recently shed light on this issue, claiming the Office of Thrift Supervision was too slow to react to the high-risk lending practices of IndyMac Bank and did not take aggressive enough actions to stop such practices from continuing to proliferate. The report presented a review of the failure of IndyMac Bank and the supervision of the institution by the Office of Thrift Supervision (OTS).

According to the audit report's findings, the OTS viewed growth and profitability as evidence that IndyMac management was capable of success, while failing to recognize the unsafe and unsound manner in which the thrift was operated.

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In addition, included in the Inspector General's report were the findings that IndyMac relied too heavily on appraisals that were often supported by weak underlying collateral. According to the audit report, the Inspector General identified several instances in which a borrower's qualifications were not properly reviewed; where IndyMac officials accepted appraisals that were not in compliance with USPAP; and where the borrower was allowed to select the appraiser.

The Inspector General's material loss review of IndyMac is the second such review the Treasury Department has performed of an OTS-regulated financial institution during the current financial crisis. In its first material loss review – of NetBank – the Treasury Department was critical of the Office of Thrift Supervision for not taking stronger action when problems noted by examiners remained uncorrected through several examination cycles. There also were several problems noted by examiners with regard to the business practices of IndyMac, however, these too went mostly uncorrected.

Wall Street and the secondary markets also played by its own set of rules, absent sufficient oversight from government regulators. Investment banks operated under different regulations than federally regulated institutions. Further, loan pools were not subject to consistent securitization due diligence standards, which would have facilitated a critical assessment of the value of the underlying assets making up the loan pool. Moving forward, greater transparency in the securitization market -- including greater awareness and understanding of the underlying assets that make up the loan pools -- is essential to help restore investor confidence. Specifically, Wall Street investors must understand that valuation services have varying degrees of risk. While appraisals prepared by licensed or certified appraisers are widely considered to be the "gold standard" in the industry, lesser services such as automated valuation models and broker price opinions are often used as a cost-cutting method in these situations. Investors deserve greater due diligence.

Abandoning Long-Standing Safety and Soundness Policies

Last week, the Obama Administration released guidelines outlining policies for the Home Affordable Modification program, which intends to help between three and four million at-risk homeowners avoid foreclosure by reducing monthly mortgage payments.

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[1] Jickling, M. (2009, January 29). *Causes of the Financial Crisis*. Congressional Research Service.

Participating lenders will be required to consider refinancing through FHA's Hope for Homeowners program and then conduct a standard "waterfall" test with regard to the loan modification. Part of this process involves a cost-benefit analysis on whether to foreclose or modify the loan. As part of this test, the current property value is a factor, and because no new monies are being conveyed, the agencies are apparently applying an exemption to Title XI of FIRREA that allows for the use of evaluations or appraisals to establish value.

According to the Guidelines, the servicer may use, at its discretion, either one of the government-sponsored enterprises automated valuation models (AVMs) – provided that the AVM renders a reliable confidence score – or a broker price opinion. As an alternative, the servicer may rely on the AVM it uses internally provided that (i) the servicer is subject to supervision by a federal regulatory agency, (ii) the servicer's primary federal regulatory agency has reviewed the model and/or its validation, and (iii) the AVM renders a reliable confidence score.

If the GSE or servicer AVM is unable to render a value with a reliable confidence score, the servicer must obtain an assessment of the property value utilizing a property valuation method acceptable to the servicer's federal regulatory agency.

Our organization is concerned by the Administration's decision to rely heavily on unregulated valuation services in the loan modification program, when streamlined appraisal services are readily available in the marketplace. The Interagency Appraisal and Evaluation Guidelines have consistently encouraged lenders to obtain appraisals where there have been material changes in market conditions, even in cases of loan modifications when no new monies have been conveyed. The Administration's plan rolls the dice on every homeowner's equity as it retreats from meaningful bank regulations in favor of unregulated and exotic valuation services.

Professional real estate appraisers deliver a diverse menu of valuation services, with many specifically designed to address distressed properties and others that may be used for most non-complex transactions. Examples of the types of services that appraisers can deliver for loan modification or distressed asset purchases include:

- Appraisal updates and reviews, or updates to existing appraisals.
- Drive-by appraisals, or appraisals of the exterior-of-the-property desktop appraisals.

- Appraisals performed from the appraiser's desktop without any exterior or interior inspection.

Today's technology and current methodology allow real estate appraisers to deliver necessary services quickly and securely. Given the advances in technology, these services are very cost-effective and affordable with delivery from the thousands of designated, certified and licensed appraisers in every community in the country.

Treasury should do everything in its power to encourage the use of services prepared by regulated individuals, in accordance with industry standards, that have the force of law, particularly where there have been material changes in market conditions, as we see in many parts of the country today.

Recommendations

Our organization recommends that a series of steps be taken to address the weaknesses and problems identified above, as follows:

1. Introduce and pass mortgage reform legislation similar to H.R. 3915, addressing the inappropriate pressure of appraisers, providing greater accountability of federal and state appraiser regulators, and promoting professionalism among appraisers. In addition to the appraisal provisions found in H.R. 3915, we offer the following improvements:
    - Require the regulation of Appraisal Management Companies within 24 months of enactment;
    - Require secondary market due diligence requirements/standards for appraisals;
    - Include a consumer protection mechanism, such as encouraging the formation of state "recovery funds" funded by real estate practitioners/licenses in the states. This, as opposed to requiring a surety bond for appraisers (which unnecessarily raises costs for borrowers) would be a preferred approach;
    - Require review of all exemptions to the use of appraisers for federally regulated transactions;

- Elevate the oversight and structure of the Appraisal Subcommittee board to a position reporting directly to the Secretary of the Department of the Treasury.

2. Establish a high-level position for collateral valuation review. As Congress moves forward with broader reform of the financial regulatory industry, the appraisal and valuation issues need to be addressed. We support a departmental level "Chief Appraiser" who oversees all appraisals and valuation issues across the financial spectrum, including the mortgage and secondary markets and all financial, mortgage and real estate-related financial instruments.
3. Conduct an immediate review of the new loan modification guidelines (Home Affordable Modification) released by Treasury last week, in order to ensure that consumers and neighborhoods are being protected and proper valuation is being utilized, including questioning the allowances of Broker Price Opinions being used in lieu of appraisals.

We are eager to work with Congress, consumer groups and banking interests to ensure that these provisions are included in any mortgage reform legislation in the 111th Congress.

Thank you for giving me this opportunity to address you today.

TESTIMONY OF

STEVEN L. ANTONAKES

MASSACHUSETTS COMMISSIONER OF BANKS

On behalf of the

CONFERENCE OF STATE BANK SUPERVISORS

On

"MORTGAGE LENDING REFORM:

A COMPREHENSIVE REVIEW OF THE AMERICAN MORTGAGE SYSTEM"

Before the

FINANCIAL SERVICES COMMITTEE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

UNITED STATES HOUSE OF REPRESENTATIVES

March 11, 2009, 2:30 p.m.

Room 2128 Rayburn House Office Building

Introduction

Good afternoon, Chairman Gutierrez, Ranking Member Hensarling, and distinguished members of the Subcommittee. 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 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 addition to regulating banks, most state banking departments also supervise the residential mortgage industry. As the mortgage industry has evolved over the past two decades, CSBS has expanded its mission beyond traditional commercial bank supervision and has been working closely with the American Association of Residential Mortgage Regulators (AARMR)[1] to enhance supervision of the mortgage industry. States currently have regulatory oversight of over 77,000 mortgage company licenses, 50,000 branch licenses, and 410,000 loan officer licenses.

The states, the federal financial regulatory agencies, the Obama Administration, and Congress have all been very active in trying to restore confidence in the mortgage market. I commend you, Chairman Gutierrez and members of the Subcommittee, for your

[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/.

dedication to protecting consumers and for promoting the principles of responsible lending.

The residential mortgage market is undergoing significant reforms to prevent a similar collapse in the future. Presently, we are working 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 mortgage professionals and consumer protection must be the hallmark of a reformed system. In other words, there should be nowhere to hide from high lending standards or enforcement of those standards. Let me be clear: federalization of regulation and applicable law is not the best option available to us. A coordinated network of state and federal regulation and state and federal law will be much more nimble, responsive and comprehensive in providing high standards and meaningful regulation.

Mr. Chairman, in my testimony I will discuss the Mortgage Reform and Anti-Predatory Lending Act that passed the House last Congress and which CSBS supported. I will also address the evolution of the mortgage market and the actions taken by state officials to enhance supervision of the mortgage industry. Finally, I will offer the Subcommittee suggestions for regulatory changes that should be considered as Congress debates reform of financial regulation, including offering our support for the Congressional Oversight Panel's recommendation to eliminate federal preemption of state consumer protection laws. Ultimately, the solution to our economic crisis must be to support the actions taken by state and federal regulators as we work to develop a new era of cooperative federalism and break down barriers to cooperation that currently exist. Specifically, I'd like to highlight the pilot initiative led by the Federal Reserve on

coordinated state-federal supervision of non-banks. This is a model for how cooperative federalism can work.

Mortgage Reform and Anti-Predatory Lending Act/NMLS as Model of Federalism

Another model for cooperative federalism is the CSBS-AARMR Nationwide Mortgage Licensing System (NMLS) and the S.A.F.E. Act enacted last year. The states first recognized the need for a tool to license mortgage originators several years ago. Since then, states have dedicated tremendous monetary and staff resources to develop and enact NMLS.

The hard work and dedication of the states was ultimately recognized by Congress as they enacted the Housing and Economic Recovery Act of 2008 (HERA). I commend Chairman Frank, Ranking Member Bachus and Representatives Watt and Miller for introducing and passing through the House the Mortgage Reform and Anti-Predatory Lending Act in the 110th Congress. The bill acknowledged and built upon the work that had been done in the states to protect consumers and restore the public trust in our mortgage finance and lending industries. 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. 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.

A significant portion of the Mortgage Reform and Anti-Predatory Lending Act was eventually incorporated in HERA as the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (the S.A.F.E. Act). Special recognition must go to Representative

Bachus, who developed the S.A.F.E. and its state-federal model for regulation and supervision. The purposes of the S.A.F.E. Act are to increase uniformity, reduce regulatory burden, enhance consumer protection, and reduce fraud by requiring all mortgage loan originators to be licensed or registered through NMLS.

First proposed among state regulators in late 2003, NMLS launched on time and on budget on January 2, 2008. The Nationwide Mortgage Licensing System is more than a database. It serves as the foundation of modern mortgage supervision by providing dramatically improved transparency for regulators, the industry, investors, and consumers. Seven inaugural participating states, including Massachusetts, began using the system on January 2, 2008. Only 15 months later, 23 states are using NMLS and by January 2010—just two years after its launch—CSBS expects 40 states to be using NMLS. Passage of the S.A.F.E. Act requires all states to comply with minimum testing, education, professional integrity and other standards by July 31, 2010. I have attached, as Exhibit A, a map indicating when states will begin using NMLS.

NMLS currently maintains a single record for every state-licensed mortgage company, branch, and individual that is shared by all participating states. This single record allows companies and individuals to be definitively tracked across state lines and over time as entities migrate among companies, industries, and federal and state jurisdictions. Additionally, this year consumers and industry will be able to check on the license status and history of the companies and individuals with which they wish to do business.

NMLS provides profound benefits to consumers, state supervisory agencies, and the mortgage industry. Each state regulatory agency retains its authority to license and supervise, but NMLS shares information across state lines in real-time, eliminates any

duplication and inconsistencies, and provides more robust information to state regulatory agencies. Consumers will have access to a central repository of licensing and publicly adjudicated enforcement actions. Honest mortgage lenders and brokers will benefit from the removal of fraudulent and incompetent operators, and from having one central point of contact for submitting and updating license applications.

In addition to loan originator licensing and mandatory use of NMLS, the S.A.F.E. Act requires the states to do the following:

1. Eliminate exemptions from mortgage loan originator licensing that currently exist in state law;
2. Screen and deny mortgage loan originator licenses for felonies of any kind within seven years and certain financially-related felonies permanently;
3. Screen and deny licenses to individuals who have ever had a loan originator license revoked;
4. Require loan originators to submit personal history information and authorize background checks to determine the applicant's financial responsibility, character, and general fitness;
5. Require mortgage loan originators to take 20 hours of pre-licensure education in order to enter the state system of licensure;
6. Require mortgage loan originators to pass a national mortgage loan originator test developed by NMLS;
7. Establish either a bonding or net worth requirement for companies employing mortgage loan originators or a recovery fund paid into by mortgage loan originators or their employing company in order to protect consumers;

8. Require companies licensed or registered through NMLS to submit a Mortgage Call Report on at least an annual basis;
9. Adopt specific confidentiality and information sharing provisions; and
10. Establish effective authority to investigate, examine, and conduct enforcement of licensees.

Taken together, these background checks, testing, and education requirements will promote a higher level of professionalism and encourage best practices and responsible behavior among all mortgage loan originators. Under the legislative guidance provided by Congress, the states drafted the Model State Law for uniform implementation of the S.A.F.E. Act. The Model State Law not only achieves the minimum licensing requirements under the federal law, but also accomplishes Congress' ten objectives addressing uniformity and consumer protection.

The Model State Law, as implementing legislation at the state level, assures Congress that a framework of localized regulatory controls are in place at least as stringent as those pre-dating the S.A.F.E. Act, while setting new uniform standards aimed at responsible behavior, compliance verification and protecting consumers. The Model State Law enhances the S.A.F.E. Act by providing significant examination and enforcement authorities and establishing prohibitions on specific types of harmful behavior and practices.

The Model State Law has been formally approved by the Secretary of Housing and Urban Development and endorsed by the National Conference of State Legislatures and the National Conference of Insurance Legislators. The Model State Law is well on its way to approval in almost all state legislatures, despite some unfortunate efforts by industry

associations to frustrate, weaken or delay the passage of this important Congressional mandate.

The S.A.F.E. Act acknowledges the work of the states and its extensive requirements appropriately create a minimum standard nationwide while demanding immediate and broad action by the states.

My fellow state regulators and I have expressed our ability and willingness to face the challenges posed by the mortgage market by enhancing supervision of the industry. Our efforts, however, must be supported by the efforts of the federal regulatory agencies. State and federal regulators are in the early stages of developing a more coordinated system of supervision to provide comprehensive regulation of the entire financial system. This should be strongly encouraged by Congress.

Evolution of the Mortgage Industry in the United States

The residential mortgage industry has changed dramatically over the past two decades. Twenty years ago, federal- and state-regulated savings and loans originated the majority of residential mortgages. Federal government-sponsored enterprises such as Fannie Mae, Freddie Mac, and Ginnie Mae held a significant percentage of the secondary market share and effectively set standards for the industry. At the time, the "standard" mortgage was a fixed-rate 15- or 30-year mortgage.

By 2000, the mortgage markets had dramatically changed. Savings and loans, traditional depository institutions, Fannie Mae, Freddie Mac, and Ginnie Mae no longer dominated the market. Product choices for consumers exploded. Mortgage loans were available in practically any combination of fixed, adjustable, or hybrid adjustable rate and amortizing, non-amortizing, or negatively amortizing mortgages, with terms ranging anywhere from two years to 50 years. Loan documentation requirements and underwriting

standards also became less stringent. In addition to these changes, risk-based pricing allowed more consumers than ever to qualify for home financing by trading a lower credit score or down payment for a higher rate. The industry changed dramatically in a relatively short period of time. Lending is still local, but financing is now global, and loan servicing has been consolidated into a few dominant companies associated with banks.

The volume of loan originations also increased dramatically over this time period from $500 billion in the early 1990s to a peak $3.8 trillion in 2003.[2] This increase in loan volume was facilitated in part by advances in technology such as automated underwriting systems, the increase of mortgage products available to the consumer, the development of the subprime market, and an expansion of the secondary market for mortgage securities to include international investors, hedge funds, and private equity funds.

More than ever before, homebuyers considered their home as a financial asset that would rarely, if ever, decline in value. In addition to providing protection from the elements, homes were seen as a source of financial security for the future. Homeownership was widely promoted by financial institutions, consumer advocates, politicians, the secondary mortgage market, and the media. Mortgage lenders and the Wall Street developed a number of products that offered homebuyers a wide variety of choices to manage this financial asset. Many of these products were quite complex, providing both opportunities and perils for consumers. Greater consumer confusion and commission-based compensation schemes also created greater opportunities and incentive for fraudulent or deceptive sales and lending practices. The sophisticated nature of these mortgage products requires an elevation of professionalism in mortgage originators and more robust oversight of the companies and individuals offering such products.

[2] Source: Mortgage Bankers Association. http://www.mba.org.

The mortgage revolution brought with it a number of benefits: a vast flow of liquidity into the mortgage market, increased availability of mortgage credit, and higher rates of homeownership. But it also brought moral hazard, as the allocation of risk of a mortgage loan default became dispersed through complex contractual arrangements that frequently began with the local mortgage broker, and ultimately ended with Wall Street investors. This dispersal of risk created opportunities and incentives for some actors to engage in lax underwriting and fraudulent practices.

Controls and market discipline that were in place to govern the market were overwhelmed by a Wall Street driven and funded securitization machine built for quantity, not quality. Years of stellar performance and low market interest rates created a demand for high yielding subprime mortgage securities, and the mortgage origination system responded to supply that demand.

As the mortgage industry has evolved, the states are increasingly playing a more active role in supervising the companies and professionals that originate and fund loans. All 50 states and the District of Columbia currently regulate mortgage companies and/or professionals. This is a dramatic change since 1993, when only 18 state agencies regulated the mortgage industry.[3]

States are 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. State regulators are working collaboratively and effectively on many fronts with each other and our federal counterparts. My fellow state supervisors and I welcome coordination with our federal counterparts to promote responsible lending across the residential mortgage industry. In many instances, federal regulators are working

[3] Source: Mortgage Asset Research Institute (MARI), A LexisNexis Service. http://www.marisolutions.com/.

closely with state authorities through the Federal Financial Institutions Examination Council to develop processes and guidelines to protect consumers and prohibit certain acts or practices that are either systemically unsafe or harmful to consumers.

State Initiatives to Enhance Supervision of the Mortgage Industry

As the residential mortgage industry has rapidly evolved, the states are playing a more active role in its regulation and supervision. It is worth noting that the residential mortgage industry as we know it is relatively young. Therefore, state supervision of the industry is also relatively new. Conversely, state bank supervision in the United States has been in existence since the late 18th century. The first bank in my home state, the Bank of Massachusetts, was chartered in 1784. The charter was signed by Governor John Hancock and Senate President Sam Adams. Obviously, state bank supervision has had centuries to evolve and improve. State mortgage supervision grows and improves each day.

My fellow state regulators and I have long recognized the need for changes to the residential mortgage system. As a result, CSBS and AARMR are working diligently to improve cooperation and coordination among state regulators and between state and federal authorities. Much progress has been made towards enhancing supervision of the residential mortgage industry as federal and state regulators have engaged in an unprecedented number of cooperative initiatives and agreements to ensure comprehensive supervision of the industry. State and federal financial regulators have developed—and continue to develop—guidelines, best practices, and regulations to prevent abusive lending practices in the mortgage industry. Congress and state legislatures have passed or are debating legislative initiatives designed to change industry standards and protect consumers.

State Predatory Lending Laws

Currently, 35 states plus the District of Columbia have enacted subprime and predatory mortgage lending laws.[4] Attached as Exhibit B is a chart of state predatory mortgage lending statutory provisions. These state laws supplement the federal protections of the Home Ownership and Equity Protection Act of 1994. The innovative actions taken by state legislatures have prompted significant changes in industry practices, as the largest multi-state lenders have adjusted 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 a tool for charter enhancement or used as a circumvention of more stringent consumer protection requirements.

State Enforcement of Consumer Protection Laws

State attorneys general and state regulators are also cooperatively pursuing unfair and deceptive practices in the mortgage market. Through several settlements, state regulators have returned nearly one billion dollars to consumers. For example, a settlement with Household Financial resulted in $484 million paid in restitution; a settlement with Ameriquest Mortgage Company 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 further contributed to changes in industry lending practices.

Success, however, is sometimes better measured by those actions that never receive media attention. States regularly exercise our authority to routinely examine mortgage companies for compliance not only with state law, but with federal law as well.

[4] Source: National Conference of State Legislatures. http://www.ncsl.org/.

Unheralded in their everyday routine, examinations or investigations 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. Also, examinations or investigations often result in the early detection of emerging harmful practices or trends. Attached as Exhibit C is a chart of enforcement actions taken by state regulatory agencies against mortgage providers. As an example, in 2007 alone, states took 5,896 enforcement actions against mortgage lenders and brokers.

Beyond statutory solutions and enforcement actions, states are undertaking numerous initiatives to enhance mortgage supervision. The examples detailed below provide a good model of financial regulation in a federalist system of government.

Nationwide Cooperative Protocol and Agreement for Mortgage Supervision

In December 2007, CSBS and AARMR launched the Nationwide Cooperative Protocol and Agreement for Mortgage Supervision to assist state mortgage regulators by outlining a basic framework for the coordination and supervision of Multi-State Mortgage Entities (those institutions conducing business in two or more states). The goals of this initiative are to protect consumers; ensure the safety and soundness of institutions; identify and prevent mortgage fraud; supervise in a seamless, flexible, and risk-focused manner; minimize regulatory burden and expense; and foster consistency, coordination, and communication among state regulators. Currently, 48 states plus the District of Columbia and Puerto Rico have signed the Protocol and Agreement.

The states have established risk profiling procedures to determine which institutions are in the greatest need of a multi-state presence and we are scheduled to begin

the first multi-state examinations next month. Perhaps the most exciting feature of this initiative is the planned use of robust software programs to screen the institutions portfolios for risk, compliance, and consumer protection issues. With this software, the examination team will be able to review 100% of the institution's loan portfolio, thereby replacing the "random sample" approach that left questions about just what may have been missed during traditional examinations.

CSBS-AARMR Reverse Mortgage Initiatives

In early 2007, the states identified reverse mortgage lending as one of the emerging threats facing consumers, financial institutions, and supervisory oversight. In response, the states, through CSBS and AARMR, formed the Reverse Mortgage Regulatory Council and began work on several initiatives:

- *Reverse Mortgage Examination Guidelines (RMEGs).* In December 2008, CSBS and AARMR released the RMEGs to establish uniform standards for regulators in the examination of institutions originating and funding reverse mortgage loans. The states also encourage industry participants to adopt these standards as part of an institution's ongoing internal review process.
- *Education materials.* The Reverse Mortgage Regulatory Council is also developing outreach and education materials to assist consumers in understanding these complex products before the loan is made.

CSBS-AARMR Guidance on Nontraditional Mortgage Product Risks

In October 2006, the federal financial agencies issued the *Interagency Guidance on Nontraditional Mortgage Product Risks* which applies to insured depository institutions. Recognizing that the interagency guidance does not apply to those mortgage providers not

affiliated with a bank holding company or an insured financial institution, CSBS and AARMR developed parallel guidance in November 2006 to apply to state-supervised residential mortgage brokers and lenders, thereby ensuring all residential mortgage originators were subject to the guidance.

CSBS-AARMR-NACCA Statement on Subprime Mortgage Lending

The federal financial agencies also issued the *Interagency Statement on Subprime Mortgage Lending*. Like the *Interagency Guidance on Nontraditional Mortgage Product Risks*, the Subprime Statement applies only to mortgage providers associated with an insured depository institution. Therefore, CSBS, AARMR, and the National Association of Consumer Credit Administrators (NACCA)[5] again developed a parallel statement that is applicable to all mortgage providers. The Nontraditional Mortgage Guidance and the Subprime Statement strike a fair balance between encouraging growth and free market innovation and draconian restrictions that will protect consumers and foster fair transactions.

AARMR-CSBS Model Examination Guidelines

Further, to promote consistency, CSBS and AARMR developed state Model Examination Guidelines (MEGs) for field implementation of the *Guidance on Nontraditional Mortgage Product Risks* and the *Statement on Subprime Mortgage Lending*.

Released on July 31, 2007, the MEGs enhance consumer protection by providing state regulators with a uniform set of examination tools for conducting examinations of

[5] The National Association of Consumer Credit Administrators represents the officials of the states and territories of the United States of America and of the Dominion of Canada, or their associates, who, by law, are vested with authority and duty to administer laws which require regulation or supervision of consumer credit agencies in the United States of America and the Domain of Canada. http://www.naccaonline.org/.

subprime lenders and mortgage brokers. Also, the MEGs were designed to provide consistent and uniform guidelines for use by lender and broker compliance and audit departments to enable market participants to conduct their own review of their subprime lending practices. These enhanced regulatory guidelines represent a new and evolving approach to mortgage supervision.

Mortgage Examinations with Federal Regulatory Agencies

Late in 2007, CSBS, 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. This pilot is truly the model for coordinated state-federal supervision.

State-Specific Initiatives

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. These examinations will begin in the second quarter of 2009.

- *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.

Suggested Congressional Action

CSBS and the states are working to enhance the regulatory regime for the residential mortgage industry to ensure legitimate lending practices, provide adequate consumer protection, and to once again instill both consumer and investor confidence in the housing market and the economy as a whole. Many mortgage brokers and lenders are honest, law-abiding loan providers. Many of the problems we are experiencing are both the result of "bad actors" and bad assumptions by the architects of our modern mortgage finance system. Enhanced supervision and improved industry practices can successfully weed out the bad actors and address the bad assumptions. If regulators and the industry do

not address both causes of our current crisis, we will have only the veneer of reform and will eventually repeat our mistakes. Some lessons learned from this crisis must be to prevent the following: the over-leveraging that was allowed to occur in the nation's largest institutions; outsourcing of loan origination with no controls in place; and industry consolidation to allow institutions to become so large and complex that they become systemically vital and effectively too big to effectively supervise or fail.

While much is being done to enhance supervision of the mortgage market, more progress must be made towards the development of a coordinated and cooperative system of state-federal supervision.

Preserve and Enhance Checks and Balances/Forge a New Era of Federalism

The state system of chartering and regulating has always been a key check on the concentration of financial power, as well as a mechanism to ensure that our banking system remains responsive to local economies' needs and accountable to the public. The state system has fostered a diversity of institutions that has been a source of stability and strength for our country, particularly locally-owned and controlled community banks. To promote a strong and diverse system of banking—one that can survive the inevitable economic cycles and absorb failures—preservation of state-chartered banking should be a high priority for Congress. The United States boasts one of the most powerful and dynamic economies in the world because of those checks and balances, not despite them.

Consolidation of the industry and supervision and preemption of applicable state law does not address the cause of this crisis, and has in fact exacerbated the problem. The flurry of state predatory lending laws and new state regulatory structures for lenders and mortgage brokers were indicators that conditions and practices were deteriorating in our mortgage lending industry. It would be incongruous to eliminate the early warning signs

that the states provide. Just as checks and balances are a vital part of our democratic government, they serve an equally important role in our financial regulatory structure.

Most importantly, it serves the consumer interest that the states continue to have a role in financial regulation. While CSBS recognizes the mortgage market is a nationwide industry that has international implications, local economies and individual homeowners are most drastically affected by mortgage market fluctuations. State regulators must remain active participants in mortgage supervision because of our knowledge of local economies and our ability to react quickly and decisively to protect consumers.

Therefore, CSBS urges Congress to implement a recommendation made by the Congressional Oversight Panel in their "Special Report on Regulatory Reform" to eliminate federal preemption of the application of state consumer protection laws to national banks. In its report, the Panel recommends Congress "amend the National Banking Act to provide clearly that state consumer protection laws can apply to national banks and to reverse the holding that the usury laws of a national bank's state of incorporation govern that bank's operation through the nation."[6] We believe the same policy should apply to the Office of Thrift Supervision. To preserve a responsive system, states must be able to continue to produce innovative solutions and regulations to provide consumer protection.

The federal government would better serve our economy and our consumers by advancing a new era of cooperative federalism. The S.A.F.E. Act enacted by Congress requiring licensure and registration of mortgage loan originators through NMLS provides a

[6] The Congressional Oversight Panel's "Special Report on Regulatory Reform" can be viewed at http://cop.senate.gov/documents/cop-012909-report-regulatoryreform.pdf.

model for achieving systemic goals of high regulatory standards and a nationwide regulatory roadmap, while preserving state authority for innovation and enforcement.

Systemic Supervision/Capital Requirements

As Congress evaluates our regulatory structure, I urge you to examine the linkages between the capital markets, the traditional banking sector, and other financial services providers. Our top priority for reform must be a better understanding of systemic risks. The federal government must facilitate the transparency of financial markets to create a financial system in which stakeholders can understand and manage their risks. Congress should establish clear expectations about which regulatory authority or authorities are responsible for assessing risk and for using the necessary regulatory tools to address and mitigate risk.

Congress, the administration, and federal regulators must also consider how the federal government itself may inadvertently contribute to systemic risk—either by promoting greater industry consolidation or through policies that increase risk to the system. Perhaps we should contemplate that there are some institutions whose size and complexity make their risks too large to effectively manage or regulate. Congress should aggressively address the sources of systemic risk to our financial system.

My fellow state supervisors and I have long believed capital and leverage ratios are essential tools for managing risk. For example, during the debate surrounding the advanced approach under Basel II, CSBS supported FDIC Chairman Sheila Bair in her call to institute a leverage ratio for participating institutions. Federal regulation needs to prevent capital arbitrage among institutions that pose systemic risks, and should require systemic risk institutions to hold more capital to offset the grave risks their collapse would pose to our financial system.

Perhaps most importantly, Congress must strive to prevent unintended consequences from doing irreparable harm to the community banking system in the United States. Federal policy to preserve the collapse of those institutions considered too big to fail should ultimately strengthen our system, not exacerbate the weaknesses of the system. Throughout the current recession, community banks have largely remained healthy and continued to provide much needed capital in the communities where they operate. The largest banks have received amazing sums of capital to remain solvent, while the community banks have continued to lend in this difficult environment with the added challenge of having to compete with federally subsidized entities.

Congress should consider creating a bifurcated system of supervision that is tailored to the size, scope, and complexity of financial institutions. The largest, most systemic institutions should be subject to much more stringent oversight that is comprehensive enough to account for the complexity of the institution. Community banks, which operate in a much smaller market than the money center banks, should be subject to regulations that are tailored to the size and sophistication of the institutions. In financial supervision, one size should no longer fit all.

Facilitate Orderly Failures of Institutions that Pose Systemic Risks

The FDIC, in the case of insured depositories, and the Federal Reserve, for non-depository systemic risk institutions, must have the authority and resources to manage the failure of these institutions in an orderly manner. Since the creation of the FDIC in 1933, the states and the federal government have been able to address failures in a manner that both preserves market discipline and consumer confidence. This standard must be preserved and must apply equally to all institutions.

Roadmap for Unwinding Federal Liquidity Assistance and Systemic Responses

The Treasury Department and the Federal Reserve should be required to provide a plan for how to unwind the various programs established to provide liquidity and prevent systemic failure. Unfortunately, the attempts to avert crisis through liquidity programs have focused predominantly upon the needs of the nation's largest institutions, without consideration for the unintended consequences for our diverse financial industry as a whole, particularly community banks. Put simply, the government is now in the business of picking winners and losers. In the extreme, these decisions determine survival, but they also affect the overall competitive landscape and relative health and profitability of institutions. The federal government should develop a plan that promotes fair and equal competition, rather than sacrificing the diversity of our financial industry to save those deemed too big to fail.

Conclusion

A downward turn always reveals bad practices and structural flaws of both institutions and supervision. As regulators we must—with an unbiased eye—collectively and collaboratively acknowledge and address the weaknesses that a downturn in the economy identifies. Our highly diverse financial system has been the envy of the world, allowing our markets to be flexible and responsive, and has survived booms and busts. Thanks to our decentralized regulatory system, our financial institutions are competitive internationally and locally. However regulators and legislators address the current market failings, it should be in a way that preserves the diversity of financial institutions and supervision that has made our economy nimble, resilient, and dynamic.

There is a need for improved coordination and cooperation among functional regulators. CSBS has been actively engaged in efforts to enhance coordination as we work

to develop a federalist system of supervision that ensures safety, soundness, and consumer protection, but still provides economic growth and innovation.

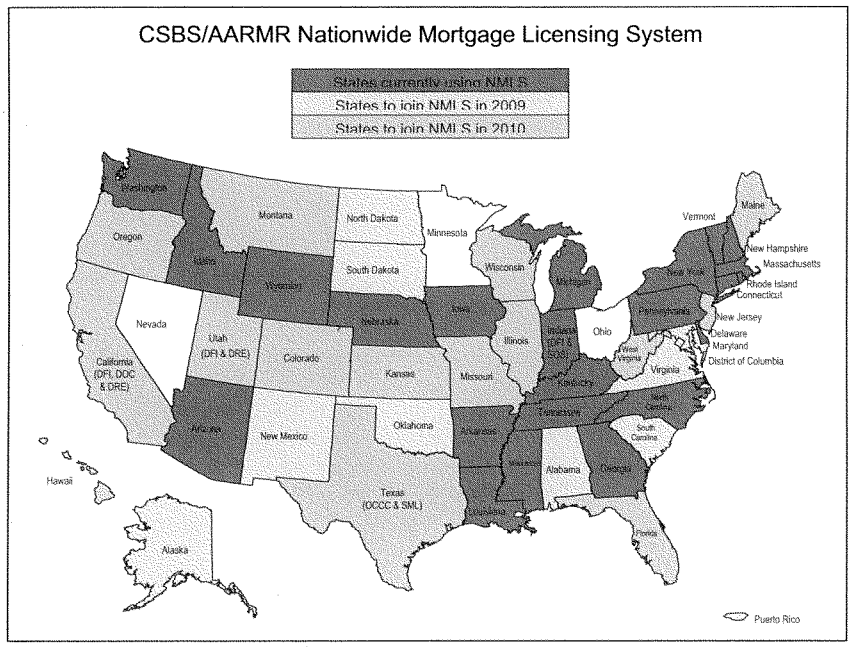
As Congress reviews proposals to restructure our financial regulatory system, there are several principles that must be adhered to. Ultimately, CSBS believes the structure of the regulatory system should:

1. Usher in a new era of cooperative federalism, recognizing the rights of states to protect consumers and reaffirming the state role in chartering and supervising financial institutions.
2. Foster supervision that is tailored to the size, scope and complexity of the institution and the risk they pose to the financial system.
3. Assure the promulgation and enforcement of consumer protection standards that are applicable to both state and nationally chartered financial institutions and are enforceable by locally responsive state officials against all such institutions.
4. Encourage a diverse universe of financial institutions as a method of reducing risk to the system, encouraging competition, furthering innovation, ensuring access to financial markets and promoting efficient allocation of credit.
5. Support community and regional banks, which provide relationship lending and fuel local economic development.
6. Require financial institutions that are recipients of governmental assistance or pose systemic risk to be subject to enhanced safety and soundness and consumer protection oversight.

CSBS looks forward to continuing to work with the federal regulators and Congress to address the needs and regulatory demands of an ever-evolving mortgage marketplace in an environment that fosters the strongest economy possible while protecting consumers and ensuring access to the broadest range of financial opportunity.

Appendix Items

Exhibit A: NMLS Implementation Map



State Regulatory Registry LLC, February 2009

Exhibit B: State Predatory Mortgage Lending Laws

Subprime and Predatory Mortgage Lending

This page addresses fraudulent or abusive lending practices in the mortgage market, commonly referred to as predatory lending. The most prevalent categories of abusive practices include:

Loan flipping-repeatedly refinancing loans, charging high fees each time.

Excessive fees and "packing"-adding fees far exceeding those justified on economic grounds, often through loan terms, such as the financing of points, fees and pre-payment penalties, single-premium insurance (to cover the balance of the loan should a borrower die, paid in one sum and added to the amount financed) and balloon payments (those due at the end of a loan that are significantly higher than monthly payments).
Asset-based lending-lending based on a borrower's overall assets, rather than income and ability to repay.
Outright fraud and abuse.

Legislation regarding foreclosures is covered on the Foreclosures page. Legislation regarding the specific crime of mortgage fraud is covered on the Mortgage Fraud page.

NCSL Information

Legislation Last Updated: June 12, 2008

Current State Laws

State:	Statutory Citation	Flipping Banned	Negative Amortization Banned	Prepayment Penalties Banned	Financing Credit Insurance Banned	Consumer Credit Counseling Provision	High Debt to Income Ratio Provision (Ability to repay loan)
Arkansas	Ark. Stat. Ann. §23-53-101 *et seq.*	X	X		X	3rd party required	Give due regard
California	Cal. Financial Code §4970 *et seq.* and §4973 *et seq.*	X	X			Disclosure	Presumption at 55%

Colorado	Colo. Rev. Stat. §5-3.5-101 *et seq.* and §38-40-105	X	X			Notification	Give due regard
Connecticut	Conn. Gen. Stat. §36a-746 *et seq.* and §36a-521		X			Notification	Presumption at 50%
D.C.	D.C. Code Ann. §26-1114. and §26-1151.01 *et seq.*		X	X			Give due regard
Florida	Fla. Stat. §494.0078 *et seq.*	X	X			Notification	Give due regard
Georgia	Ga. Code §7-6A-1 *et seq.*	X	X		X	3rd party required	Presumption at 50%
Illinois	Ill. Rev. Stat. ch. 815, 137/1 *et seq.* and ch. 765, 77/70	X	X		X	Notification	Presumption at 50%
Indiana	Ind. Code 4-6-12 and 24-9-1 *et seq.*		X		X	3rd party required	Give due regard
Kentucky	Ky. Rev. Stat. §294.010 *et seq.* and §360.100	X	X		X	Notification	Presumption at 50%
Louisiana	La. Rev. Stat. Ann. 6:1096(G) and 9:3572.6(C)						
Maine	Me. Rev. Stat. Ann. tit. 9-A, §2-509, tit. 9-B, §429; tit. 9-A, §8-103, §8-206-A, tit. 9-A, §10-102 and tit. 33, §506, 2007 Chapter 273, 2008 Chapter 471	X	X	X	X	3rd party required	Give due regard

Maryland	Md. Commercial Law Code §12-127, 12-311, 12-409.1 and 12-1029	X	X		X	3rd party required	Presumption at 45%
Massachusetts	Mass. Gen. Laws Ann. ch.183C, 1 *et seq.*		X	X		3rd party required	Presumption at 50%
Michigan	Mich. Comp. Laws §445.1631 *et seq.*		X		X	Notification	
Minnesota	2007 Chapter 18 Minn. Stat. §58.137	X				Notification	Requires vertification
Missouri	Mo. Rev. Stat. 375.937						
Montana	Mont. Code Ann. §32-5-306						
Nebraska	Neb. Rev. Stat. §45-702, 45-704 and 45-705				X		
Nevada	Nev. Rev. Stat. §598D.010 *et seq.*			X	X		Give due regard
New Jersey	N.J. Rev. Stat. 46:10B-22 *et seq.*		X		X	3rd party required	
New Mexico	N.M. Stat. Ann. §58-21A-1 *et seq.*	X	X	X	X	3rd party required	Give due regard
New York	N.Y. Banking Law 6-l	X	X		X	Notification	Give due regard
North Carolina	N.C. Gen. Stat. §24-1.1E, §24-1.1F, §24-10.2 and §53-243.01 *et seq.*	X	X			3rd party required	Presumption at 50%

Ohio	Ohio Rev. Code Ann. §1322.062, §1322.07, §1322.08, §1345.01 *et seq.* and §1349.25 *et seq.*	X	X		X		Give due regard/ Presumption at 50%
Oklahoma	Okla. Stat. tit. 14A, §3-204 and tit. 59, §2081 *et seq.*	X					Give due regard
Pennsylvania	Pa. Cons. Stat. 63, §456.101 *et seq.*					Notification	Presumption at 50%
Rhode Island	R.I. Gen. Laws §34-23-5 R.I. Gen. Laws §34-25.2-1 *et seq.*	X	X		X	3rd party required	Presumption at 50%
South Carolina	S.C. Code Ann. §37-23-10 *et seq.*	X	X		X	3rd party required	Presumption at 50%
Tennessee	Tenn. Code Ann. §45-20-101 *et seq.*	X	X				Presumption at 50%
Texas	Tex. Finance Code §343.001 *et seq.* and Tex. Gov. Code §2306.001 *et seq.*		X	X			Give due regard
Utah	Utah Code Ann. §61-2d-101 *et seq.*		X		X	Notification	
Virginia	Va. Code §6.1-422.1 and §6.1-422	X					
Washington	Wash. Rev. Code §31.04 *et*	-					

	seq.						
West Virginia	W. Va. Code §31-17-1 *et seq.*			X			
Wisconsin	Wis. Stat. Ann. §428.202 *et seq.*	X	X		X	Notification	Give due regard

Definitions of provisions:

Flipping: refinancing an existing mortgage loan with no benefit to the consumer; also referred to as churning.

Negative amortization: payment terms under which the outstanding principal balance will increase at any time over the course of the loan because the regular periodic payments do not cover the full amount of interest due or terms under which the aggregate amount of the regular periodic payments would not fully amortize the outstanding principal balance.

NCLR

Principles for Reforming the Mortgage Market to Promote Sustainable Mortgages for Latino Families

Presented at:

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

Submitted to:

**U.S. House Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit**

Submitted by:

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My name is Graciela Aponte, Legislative Analyst for the Wealth-Building Policy Project for the National Council of La Raza (NCLR), the largest national Hispanic[1] civil rights and advocacy organization in the U.S. which is dedicated to improving opportunities for Hispanic Americans. I conduct legislative analysis and advocacy on affordable homeownership, foreclosure prevention, and credit scoring. I have been working on issues that have an impact on low-income families for more than six years, providing assistance to constituents and nonprofit community-based organizations on behalf of their congressional representatives in Maryland and New York City. Prior to my joining NCLR, I worked as a bilingual housing counselor for a HUD-certified housing counseling agency in Prince George's County, Maryland. I was honored by the U.S. Department of Housing and Urban Development for outstanding assistance and having a direct impact on the Latino community, making homeownership a reality for many. Today's hearing is timely, and we applaud the Committee for proactively addressing the need for reform in the mortgage market.

For more than two decades, NCLR has engaged in public policy issues that focus on supporting strong fair housing and fair lending laws, increased access to financial services for low-income people, and promoting homeownership in the Latino community. Moreover, ten years ago, NCLR created the NCLR Homeownership Network (NHN), now a network of nearly 50 community-based housing counseling providers working with more than 30,000 families annually. Despite producing more than 25,000 first-time homebuyers in its first decade, our counselors' focus has shifted to foreclosure prevention; NHN members have counseled more than 7,000 homeowners facing foreclosure. In addition, NCLR's subsidiary, the Raza Development Fund (RDF), is the nation's largest Hispanic Community Development Financial Institution (CDFI). Since 1999, RDF has provided $500 million in financing to locally-based development projects throughout the country, building the capacity of local nonprofits and creating opportunities for Latino communities. Our research, programs, and market investments have increased NCLR's institutional knowledge of how Latinos interact with the mortgage and financial markets and the impact on their communities.

I would like to thank Chairman Gutierrez and Ranking Member Hensarling for inviting NCLR to testify on an issue that has had such far-reaching consequences for families nationwide. For years we have been pointing to the ways in which the mortgage market has failed to serve Latino and other minority communities well. As a result of flaws in the system, unethical and deceptive practices have replaced sound lending strategies, and the wealth built in our communities through homeownership is quickly deteriorating. We need a financial system that will level the playing field for borrowers, promote sound and innovative lending, and make wealth-draining foreclosures far less common.

In my testimony today I will describe the flaws in the mortgage servicing industry which make it difficult for families to save their homes from foreclosure, the unique barriers that Latino families face which make achieving homeownership difficult, and how we can learn from innovative programs offered by the nonprofit sector to build and sustain homeownership.

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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.

Background

For decades stakeholders have worked together to increase homeownership rates in Latino and other underserved communities. Like most Americans, Latino families build their family wealth, and therefore their financial security, through the equity in their home. Home equity can help families save for retirement or a college education for their children, be leveraged to start a small business, and provide a financial safety net for emergencies. Unfortunately, the conventional mortgage market has not served Latino and immigrant communities well. Latinos and immigrants often have unique borrower profiles that make them unattractive to many 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 "0" credit score, compared to only 4% of Whites.[2] Multiple wage earners, additional co-borrowers, and cash income are also common among Latino borrowers.

Since mainstream and prime lenders have relied heavily on automated underwriting, there has been little incentive to work with "hard-to-serve borrowers," such as Latinos, immigrants, and other underserved populations. In some cases, lenders refer borrowers to their subprime affiliates. Others simply do not reach out to such borrowers, leaving a vacuum that subprime and predatory lenders are quick to fill. As a result, many Latino homeowners have been steered into subprime, risky, and expensive mortgages, even when they have good credit. Research shows that Latinos are 30% more like than Whites to receive a high-cost loan when purchasing their home. Other research shows that nontraditional mortgage products such as Option Adjustable Rate Mortgages (Option ARMs) and interest-only mortgages are disproportionately concentrated among minority borrowers; Latinos are more than twice as likely as Whites to receive an Option ARM.

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 is launching 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 for decades. 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.

Principles for Reforming the Mortgage Market

Now more than ever it is clear that stronger oversight and consumer protections are vital for ensuring the safety and soundness of our financial markets as well as the long-term financial stability of American homeowners. It is also clear that we will not be able to move forward without resolving our current crisis. Forecasters are predicting eight million foreclosures in the

[2] Michael Stegman et al., "Automated Underwriting: Getting to 'Yes' for More Low-Income Applicants," Presented before the 2001 Conference on Housing Opportunity, Research Institute for Housing America Center for Community Capitalism (Chapel Hill: University of North Carolina, April 2001).

next four years,[3] and the height of the crisis for Latinos will likely come in 2009 and 2010 when their Option ARMs are scheduled to adjust. In our testimony today, NCLR offers three principles on which to organize a strategy to reform and revitalize our mortgage markets.

Reform the Loan Servicing System
To ensure the success of mortgage market reform, Congress must start by restoring stability in the current housing market. However, despite several attempts to resuscitate the market, several barriers still exist. Willing borrowers who are able to make reasonable mortgage payments are being turned down for loan modifications. Others are receiving their approved modifications mere days after their home is sold in a foreclosure auction. The voluntary efforts of mortgage servicers and investors have not kept pace with market demand. Poor quality modifications are leaving some borrowers worse off than when they started, and housing counseling agencies are overburdened and underfunded.

In the meantime, fraudsters have stepped up their marketing efforts. As borrowers grow increasingly frustrated with their servicers and more desperate to keep hold of their homes, they are more likely to turn to predatory foreclosure rescue scams for help, unaware of the dangers. In some communities, companies charge as much as $8,000 or more for processing a loan modification. In absence of strong servicing standards and accountability, many borrowers are not getting service.

The administration's "Making Home Affordable" plan takes several steps to address a number of these issues. The plan includes a formula for modifying at-risk mortgages based on the Federal Deposit Insurance Corporation's (FDIC) "Loan Mod in a Box" program and a series of incentives designed to encourage maximum participation. However, the components of the plan need to be strengthened to prevent eligible borrowers from getting left behind. We are concerned, for example, that despite Financial Stability Program participants being required to participate, there is no consequence for allowing an eligible borrower to go to foreclosure. Given the significant investment of taxpayer funds, there must be appropriate enforcement and oversight mechanisms to ensure that borrowers do not fall through the cracks of a strained servicing system.

Recent experience also shows that many at-risk borrowers, especially those with limited education or language barriers, do not have the necessary information or easy access to sources of culturally competent help. Thus, this program needs to be accompanied by significant support—in the President's budget and from the private sector—for housing counselors and other trusted sources of information.

Promote Sustainable Homeownership
For most Americans, their home is their primary source of wealth. Rather than viewing real estate as a get-rich-quick scheme like some unscrupulous lenders and investors, homeowners are purchasing an asset that will provide long-term financial security. However, the mortgage industry has strayed far from this once common goal.

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[3] Rod Dubitsky, Larry Yang, et al., *Foreclosure Update: Over Eight Million Foreclosures Expected* (New York, New York: Credit Suisse, December 4, 2008).

As described in the background section, many minority homebuyers are set on a path with limited mortgage options from the very beginning. Subprime lenders rushed in to fill the void left by prime and mainstream retailers. In addition, most compensation incentives were based on short-term goals rather than long-term success. Commission-based loan officers and mortgage brokers were paid more for expensive and risky loan features or characteristics. For example, a review of the rate sheets of subprime lenders, many of whom are now out of business, reveals that lenders paid extra for loans that were stated-income, had interest-only features, or had higher interest rates. Since borrowers tend to trust their brokers and lenders, the lack of transparency and accountability, as well as the increasing complexity of mortgage products, makes it difficult for even the most diligent borrower to shop effectively.

Take the case of Luis and Sara Rodriguez in Stockton, California. Luis and Sara bought their first house four years ago. They watched the home prices in their hometown going up quickly and decided to buy before the market got too unaffordable. The couple worked with a mortgage broker and realtor who had been suggested by a co-worker. However, a few months ago they received a notice that their mortgage was about to adjust. Confused, they reached out to Visionary Home Builders, an NHN housing counseling organization, for help. Their counselor reviewed their mortgage paperwork and had to explain to the Rodriguez family that the broker had saddled them with a stated-income, Option ARM loan and had used white-out to overwrite their income, making it appear as though they earned double their actual salaries.

Unfortunately, NHN housing counselors are finding that similar stories have become all too common throughout the country. Weak oversight and protections, coupled with misguided incentives, are leaving many innocent borrowers on the verge of foreclosure. A reformed mortgage market must hold all players accountable, from origination to the sale of the loan and servicing. Borrowers who play by the rules should be able to trust the deal they get from their mortgage professional.

Learn from the Nonprofit Sector

As Congress considers reforming the mortgage market, it must also examine the positive lending examples set by the nonprofit sector, as well as many community banks. While mainstream financial institutions have been servicing the easiest to process and non-bank institutions have been offering high-risk products, credit unions, CDFIs, and community lenders using Community Reinvestment Act (CRA) products were making loans to modest-income families and underserved communities. Housing counselors also played a critical role by preparing consumers for homeownership and then matching them with the appropriate loans.

A recent comparison of loans made by Self-Help Credit Union to subprime loans made to consumers with similar borrower profiles showed that when paired with a properly underwritten and priced loan, borrowers are far less likely to default.[4] Moreover, many community-based lenders have demonstrated that innovation does not have to suffer in the name of profitability or fairness.

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[4] Lei Ding, Roberto G. Quercia, Wei Li, and Janneke Ratcliffe, *Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Score Models* (Chapel Hill: University of North Carolina, September 2008).

The story of Maria Martinez, a single mother living in West Humboldt Park in Chicago, is an excellent example of how a consumer can be matched with an affordable and sustainable mortgage product. Maria came to the Spanish Coalition for Housing, an NHN housing counseling agency, four years ago for assistance in finding affordable rental housing. She was displaced and facing homelessness. The counselor was able to assist her in finding rental housing and set her on a path of building up her credit and saving money. After several years of working together, a door opened for Maria when the first community land trust program in Chicago offered affordable homeownership opportunities for low- to moderate-income families. She went to closing two weeks ago.

Responsible lenders and nonprofits 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 Congress to review the positive lending models that nonprofits and community banks use to serve those of modest means. Their models can serve as a blueprint for reform.

Recommendations

For decades the financial system has not worked well for Latino and other underserved communities. NCLR has supported a number of policies, best practices, and legislative proposals aimed at reforming the financial system to promote sustainable homeownership and wealth-building opportunities.[5] NCLR offers the following recommendations to ensure that families have the opportunity to enter the homeownership market and to help those who are facing foreclosure:

- **Restore balance to the mortgage market.** Latino families face significant barriers and abuse in the homeownership market. Congress needs to create new tools to help Latino families enter the mortgage market safely by strengthening enforcement and consumer remedies, improving accountability standards throughout the entire mortgage process, and reining in unscrupulous compensation schemes. Congress should also invest in homeownership and foreclosure prevention counseling for first-time homebuyers and other vulnerable populations.

- **Reform the loan servicing system.** Borrowers in danger of foreclosure face many challenges when trying to work with their loan servicer, especially as foreclosure rates continue to rise. Servicers should be required to provide loss mitigation services to struggling borrowers, offer loan modifications that are sustainable over the long term, disclose the investor upon request, and prohibit foreclosure during loss mitigation.

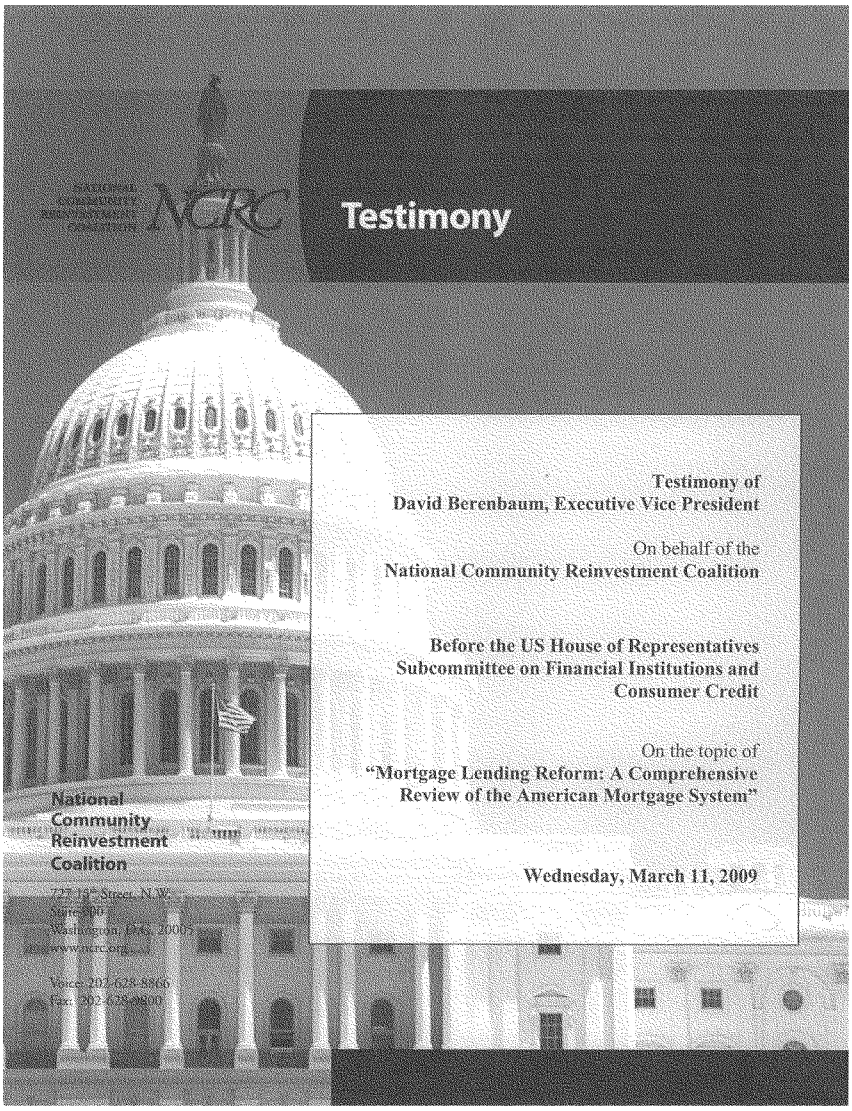
- **Promote positive lending models.** Innovative and safe lending models have been effective in matching consumers with appropriate loan products in which borrowers are

[5] NCLR has published several reports, public statements, and testimony on each of these issues. Reports are available at www.nclr.org. Key publications include: Janet Murguía, *Rethinking TARP Implementation: Strategies to Reduce Latino Foreclosures* (Washington, DC: National Council of La Raza, 2009); Janis Bowdler, *Improving Loan Servicing to Prevent Latino Foreclosures* (Washington, DC: National Council of La Raza, 2008); and Janis Bowdler, *Challenges to Building Sustainable Homeownership in Latino Communities* (Washington, DC: National Council of La Raza, 2007).

less likely to default. Congress should use credit unions, CDFIs, and community lenders using CRA as models on which to base reform.

Furthermore, NCLR calls on Congress and the administration to act swiftly to address the foreclosure crisis and reform the financial system to promote safe and innovative lending, giving Latino families and families of other underserved communities the opportunity to build wealth and financial security.

I will be happy to answer any questions you may have. Thank you.



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

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

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[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

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[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

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[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.

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[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.

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[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.

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Statement of

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Board of Governors of the Federal Reserve System

before the

Subcommittee on Financial Institutions and Consumer Credit

of the

Committee on Financial Services

U.S. House of Representatives

March 11, 2009

Chairman Gutierrez, Ranking Member Hensarling, and members of the Subcommittee, 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 Julia Gordon, Center for Responsible Lending
Before the U.S. House of Representatives Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

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

March 11, 2009

Good afternoon Chairman Gutierrez, Ranking Member Hensarling, and members of the Subcommittee. Thank you for inviting us to testify about ways to reform mortgage lending so that we can prevent a repetition in the future of the foreclosure crisis that has brought today's economy to its knees.

I serve as Senior Policy Counsel at 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.

Sixteen months 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 created and operated 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.

Under these circumstances, it is imperative that we rethink the way we regulate the mortgage market. The lending legislation that passed the House last session, H.R. 3915, was a narrowly focused effort to improve the subprime market, which at that time was still the epicenter of the foreclosure crisis. In that way, it resembles the HOEPA legislation passed in 1994, which was also a narrowly tailored law responding to the products and business products causing trouble at that time. Yet just as the relief provided by HOEPA did not prevent a whole new set of abusive and irresponsible practices from arising just a few years later, so we believe H.R. 3915's focus on subprime mortgages will prove inadequate to prevent the next wave of predatory practices.

In addition, H.R. 3915 was a highly complex piece of legislation due to Congress's effort to eliminate some particularly dangerous practices while satisfying industry demands for protecting various practices and products. For example, as a result of a last-minute change during the drafting of the legislation, H.R. 3915 created an irrebuttable presumption that all non-subprime loans were properly evaluated for a borrower's ability to repay – a presumption that in hindsight is clearly not warranted, given the performance of Alt-A and payment option ARM loans. Just as damaging, H.R. 3915 would have stripped homeowners' claims of unfair and deceptive practices against secondary market mortgage holders even as a defense against foreclosure. Now we know all too well that secondary market mortgage holders are the parties that hold the most control over whether homeowners in trouble have any hope of retaining their homes.

Therefore, we suggest a broader, simpler framework that addresses the entire mortgage market and that focuses on the underlying incentives in that market. The legislation should establish a bright-line ban on dangerous loan features such as prepayment penalties and "no-doc" loans as well as on market-distorting incentives such as yield-spread premiums. All mortgage origination should be subject to rules that discourage originators from placing people in mortgages that are more expensive than those for which they qualify or that they cannot afford to sustain. Most important, all participants in the mortgage origination and purchase chain must have "skin in the game" with real consequences for violating the law.

Such an approach provides several significant benefits. First, it allows the market to price for risk accurately, something the market did not do in recent years and that underlies its spectacular failure. Second, by harnessing the market's own power, there is a greater chance that this legislation will prevent similar problems in the future caused by products that have not yet been contemplated. Third, it can provide a much simpler, more administrable, and more easily enforceable piece of legislation than the complex system envisioned under H.R. 3915.

There are those who will once again reflexively object to a broader, simpler, incentive-based approach, claiming that they don't want to stop the "free flow of credit." Yet the ideology that lending should not be restrained at any cost – which was blindly followed by the country's banking oversight agencies, particularly the Federal Reserve under Chairman Greenspan – is exactly what 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. Then, after the mortgages started to go bad, they swore the damage would be easily contained.[1] As the global economy lies in tatters around them, any new request to operate without basic rules of the road is more than indefensible; it's appalling.

In this testimony, we discuss six important principles that this year's mortgage lending reform legislation should incorporate:

- Mortgage lending legislation should be simple and straightforward, which will benefit all market participants from the consumer through the investor.

- Mortgage originators should serve the best interests of their customers by putting them into appropriate products with sound terms and conditions that do not have prepayment penalties or yield spread premiums.

- The secondary market should have "skin in the game" by sharing responsibility for the terms of the loan.

- For homeowners in trouble, mortgage servicers must attempt to save the home before filing foreclosure.

- Consumers should be able to assert their rights in a timely, meaningful and comprehensible way.

- States and localities should be able to protect their residents quickly and effectively.

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, and industry projections suggest that 2009 production will total just $1.09 trillion.[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] 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 place additional restrictions on loans originated by brokers, and banks increase 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]

In addition, 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 perfectly 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]

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. Mortgage lending legislation should be simple and straightforward, which will benefit all market participants from the consumer through the investor.

The simpler and more straightforward this law is, the more easily the participants in the mortgage market can follow the rules and the more easily consumers can understand what the rules are supposed to be. While it is true that there are many principles articulated in this testimony that will require case-by-case analysis, bright lines such as bans on prepayment penalties and yield-spread premiums and a requirement of income verification and escrow will redound to everyone's benefit.

In addition to providing adequate and timely methods for consumers to enforce their own rights, the mechanisms by which they can be enforced must be simple and straightforward. The remedies available in H.R. 3915 for the two core protections – the ability to pay and the net tangible benefit protections – were available only after the consumer jumped a series of hurdles of unnecessary complexity. In prior testimony, we described the multiple gates that must be "unlocked" before relief can be obtained, and even then, it was not clear that it could be obtained against the holder of the note.[18] The complexity of the system alone would add to litigation costs, deter consumers from even trying to assert their rights, and confuse everybody. To provide necessary accountability, and to make the rights granted by the statute meaningful, the law's provisions must be adequate to provide meaningful and timely relief and be clear and comprehensible.

III. Mortgage originators should serve the best interests of their customers by placing them into appropriate products with sound terms and conditions.

A. 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.

To change the incentives for mortgage originators, any legislation should establish a duty of good faith and fair dealing for all mortgage originators. Among other things, this requirement would require 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 – among other things – 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: they 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.

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.[19] 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."[20]

B. Mortgage brokers must carry adequate bonding.

Another important way to align incentives for mortgage brokers is to require brokers to be bonded at a level sufficient so that consumers who receive illegal loans have some chance of obtaining redress from the broker who sold them those loans. While public enforcement – both civil and criminal – is a crucial part of this legislation and is discussed more below, the fact is that the best deterrent to illegal action is a private right of action for consumers. However, many brokers have been so thinly capitalized that even in the few cases where consumers are able to bring legal action against them, they are judgment-proof. For those brokers, the possibility of a lawsuit does not serve as a deterrent to illegal action.

C. Ban yield spread premiums.

In addition to imposing a clear fiduciary duty on brokers, Congress should also address the issue of how brokers are compensated by lenders. Right now, most brokers receive a yield spread premium (YSP) in return for making a loan on behalf of a lender. In theory, consumers can use YSPs to buy down upfront origination costs. The reality is that, especially in the subprime and nontraditional mortgage markets, this trade-off rarely (if ever) occurs. HUD, in the regulatory review accompanying the issuance of their recently-enacted proposed rule in March 2008, cited extensive evidence 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.[21]

Abusive 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. Banning YSPs would significantly reduce incentives for brokers to upsell borrowers into more expensive and riskier loans than those for which they qualify. [22]

Alternatively, YSPs should be banned for subprime and nontraditional loans and permitted in the prime market only when they are a true trade-off, i.e., when (1) the borrower pays *no* origination costs, either out of pocket or from the loan proceeds (except for fees paid to government officials or amounts to fund escrow accounts for taxes and insurance); and (2) the loan does not contain a prepayment penalty. If that approach is taken, any payment of such a premium by a lender should be recognized as a *per se* acknowledgment of agency between the broker and originating lender, with liability for the broker's acts and omissions irrebuttably attaching to the originating lender and subsequent holders of the note.

D. Ban prepayment penalties.

Previously, we have called for a ban on subprime and nontraditional prepayment penalties, and now we believe that ban should be extended to all mortgage loans. Since prepayment penalties are extremely rare in the current origination environment, we have the perfect opportunity to ban them without causing any repercussions for lenders.

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.[23]

Lengthy prepayment penalties and high loan 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.[24] 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.[25] 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.

E. Discriminatory steering of borrowers into worse loans should be banned.

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 subprime 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. 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.

F. Limit equity-stripping excessive fees.

Eliminating prepayment penalties and yield spread premiums would be major steps forward in protecting consumers and returning fairness to the market for responsible lenders. Another key protection, and one that has long been at the forefront of preventing predatory lending, is limiting excessive fees.[26]

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. It is critical to have these equity-stripping protections in place as we move forward to ensure that as borrowers refinance into sustainable loans and as new homeowners enter the market, they can preserve and build

on the core of their investment, maintaining and increasing their share of ownership and preserving a safety net for any future financial demands.[27]

G. Mortgage originators should 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.[28] 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.

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."[29] 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.[30] 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.[31] 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; reins in 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, Congress should expand the ability to repay and income verification requirements to include all mortgages. 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.

An analysis of a borrower's ability to repay, the fundamental tenet of sustainable mortgage lending, should take the following into account:

- **Debt-to-income ratio.** This ratio must be at a reasonable level and should take into account all debt payments, including principal, interest, taxes and insurance, any other mortgages, and other household debt.

- **Residual income.** Lenders must ensure that there are adequate resources available to cover family living expenses after deducting all debt service requirements from monthly income.

- **Documentation of income.** Lenders should verify income through written materials, such as W-2 and 1099 forms if available, or if not, through, tax records, bank records, and/or other reasonable third-party documents.

Finally, federal legislation 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.[32]

H. Lenders should require escrow for taxes and insurance.

The failure to escrow directly contributes to high rates of foreclosure. By creating artificially low monthly payment figures, it deceives consumers about the actual cost of these mortgages relative to those offered by competitors that do escrow and lures them into refinancing into less advantageous loans. The failure to escrow for taxes and insurance also often puts those homeowners already in the tightest financial situations in the position of facing an unexpected tax bill, and brokers later target these borrowers for new high-cost refinancing.

Moreover, homeowners who do not escrow are much more likely to be subjected to the unnecessarily high cost of force-placed insurance. Because lenders can generate significant fees from force-placing insurance, the lack of an escrow requirement provides an opportunity for them to increase their revenue. Fannie Mae has expressed concern over this practice, warning lenders who might "make a practice of rarely or never establishing escrows for blemished credit borrowers with the intent of understating the true cost of financing and generating fees out of activities like lender-placed insurance."[33]

Mandatory escrow will benefit both consumers and lenders. Requiring escrows will increase the transparency of the mortgage transaction and make sure that the borrower is fully aware of the true costs associated with the mortgage. It will also place all lenders on equal footing: responsible lenders that already escrow would not be unfairly undercut by more reckless lenders. Lenders will no longer be able to use the absence of escrows to mask the true costs of the loan, and borrowers will be less vulnerable to the threat of having to refinance to cover unanticipated tax payments. Mandatory escrows will also make it easier for borrowers to accurately compare the true monthly costs of the loans they are offered.

The Federal Reserve Board's HOEPA rule imposing a one-year mandatory escrow requirement for subprime loans is inadequate in both scope and duration. As the foreclosure crisis spreads ever further beyond the confines of the subprime market, it is clear that anticompetitive practices need to be removed from the entire market.[34] In our view, a mandatory escrow requirement should both cover the entire mortgage market and last for at least five to seven years before there is any opt-out option.

IV. The secondary market should have "skin in the game" by sharing responsibility for the terms of the loan.

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 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 Congress to require the secondary market, too, to have skin in the game. What that means is that risk associated with the origination of a loan needs to travel with the loan, rather than be stripped from the loan when the loan is securitized. In that way, when Wall Street purchases high-risk mortgages and any corresponding financial benefits, it also accepts responsibility for what its purchases will encourage at the origination level. The holder of the loan – meaning the individual or entity that is entitled to foreclose on the loan if the homeowner defaults – should maintain some level of ultimate responsibility for the terms of the loan. The result of meaningful secondary market liability is that the market can accurately price risk and thereby police itself.

While both the borrower 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 spread this loss across thousands of other loans, while the borrower has but one home. 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, the holder can conduct stringent due diligence to ensure that it is not unwittingly purchasing bad mortgages.

Last session's mortgage lending legislation did not change the incentives for Wall Street sufficiently to change behavior. This year's legislation must do so. If the substantive provisions of this bill are to be enforced, it will be done because wronged homeowners are able to seek redress from the holder of their loan, just as they would have been able to do when lenders held the mortgage for the life of the loan.

V. 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."[37] 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.[38]

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.[39]

The time has come to require loan servicers 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 continued homeownership is the highest goal of all servicers. 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.

Last year, Congresswoman Maxine Waters introduced H.R 5679, the Foreclosure Prevention and Sound Mortgage Servicing Act of 2008. Legislation along these lines would provide servicers with a mechanism for maximizing returns to the investors as a whole, while reducing harm to homeowners and communities. Many of the bill's requirements – that the servicers contact borrowers, provide direct access to loss mitigation personnel, and refer delinquent borrowers to HUD-certified housing counselors – are measures that industry representatives have committed to undertake already. 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. H.R. 5679 also addresses many other servicing issues that we believe are important.

VI. Consumers should be able to assert their rights in a timely, meaningful and comprehensible way.

There are two main reasons that any legislation governing lending must concern itself with the borrower's ability to assert its rights under that legislation through private action. First, it will guarantee a level of accountability that prevents market standards from sinking to the lowest common denominator that we've just seen. Second, it is a necessary corollary to providing consumers with the right to a fair and efficient marketplace. Legal rights atrophy if there are no effective means to vindicate those rates.

Over the years, there have been increasing efforts to effectively constrict the right of consumers to vindicate their rights, instead shifting the burden to public enforcement. Public enforcement unquestionably is necessary. However, as the recent mortgage meltdown demonstrates, relying on regulators alone is not enough – even if the regulators want to enforce the laws, there will never be enough public resources to take effective legal action in relation to the whole universe of players involved in the complex sales, delivery, and servicing network of the mortgage credit system.

It is also unfortunately true that public enforcement is ill-suited to enforce legal rights on an individual basis. For example, most victims of predatory loan practices are not aware that they had legal rights violated until they consult an attorney when foreclosure is imminent, but regulators cannot defend foreclosures for individual homeowners. Public enforcement actions are preceded by investigations, which can be quite lengthy. Furthermore, when the amounts at stake are large, as with mortgages, it is rare that the restitution obtained through a public enforcement action will be able to make victims whole. It is cold comfort for harmed consumers to get a small check months or even years after their home is lost.

Even the valuable injunctive relief available from public enforcement can be inadequate in a world of securitization. For example, the States obtained both monetary and excellent injunctive relief in their case against Ameriquest. If Ameriquest had still owned those loans, the states' relief could have included reformation of the loans to purge them of the effects of the illegal practices. That would have better served to provide a full measure of redress to the harmed consumers and would have required the company to disgorge the illegally obtained extra revenue. But Ameriquest had sold most of the loans at issue onto the secondary market, and therefore, the existing loans were no longer owned by Ameriquest but by an amorphous securitization trust. That closed off the possibility for an effective and efficient mass remedy as part of the official settlement of the case. Instead, to provide full relief to any individual victim of those practices, a state would have to require that Ameriquest buy the loan back out of the securitization pool to reform it on a one-by-one basis as an individual complaint resolution. That is a complicated extra step under any circumstances, but if the originator is gone – into bankruptcy or collapsed – it is an impossible step.

That brings us full circle to the reason why 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 credit.[40]

VII. For states and localities to protect their residents quickly and effectively, federal law should set a floor, not a ceiling, and not tie states' hands.

It is characteristic of most existing federal consumer protection laws that states may enact stronger laws.[41] It must remain a first principle that the federal law is a floor, not a ceiling.

For nearly a decade, we have heard demands for federal preemption in the name of "uniformity." The "patchwork quilt" of laws, it was argued, was a drag on the efficiency of the mortgage machine. Despite the fact that Congress, not the banking bureaucracy, should have been making preemption decisions, the federal bank regulatory agencies

have explicitly or implicitly followed a sweeping preemption agenda in the name of uniformity.[42]

Some preemption was explicit, as is the case with the agencies' preemption of state anti-predatory lending laws.[43] But there were indirect effects, as well. Easy access to preemption through charter-shopping had spillover effects, leading to "preemption creep" towards the lowest common denominator.[44] This preemption creep was in part legal, as many states had enacted parity laws for fear of leaving their financial institutions at a competitive disadvantage, and it was in part political, as often the mere prospect of a potential competitive disadvantage prevented strong action. Since there were no effective federal laws or rules to replace that which was preempted, the result was, indeed, uniformity: a uniform disaster.[45]

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.[46]

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 were engaging in – both in buying up the results of those practices, and in their own problem originations in the nontraditional market.[47] As we now know beyond a reasonable doubt, the incredible appetite for originations led to these 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.[48] 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.[49] 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.

There is another lesson to be learned from this crisis as to why preemption is a bad idea. The "second-generation" state laws took aim at one of the two defining fundamental flaws in the non-prime market – the death of underwriting. But the second defining characteristic was that the market pushed intrinsically dangerous products, and, even

today, federal preemption law limits what states can do to protect their neighborhoods from those tainted products.

Most of us are familiar with the federal preemption law that, as interpreted, is constraining the ability of states to protect citizens from overreaching conduct by federally chartered lenders, as we discuss above. (Indeed, the agencies are even beginning to try to stretch the preemption umbrella over third party agents of these entities.[50]) But there is also a 27-year old federal preemption law that protects certain loan products and features from state law – even when sold by state regulated non-bank lenders.

Enacted in 1982, at a time when the mortgage market was constrained as a result of the Fed's policy to fight inflation with high interest rates, Congress enacted the "Alternative Mortgage Transactions Parity Act" (AMTPA).[51] Intended to preempt state laws limiting "creative financing terms," it provided that mortgage loans with any of these terms, such as adjustable rates, balloon payments or similar non-traditional features, would not be subject to state laws restricting those terms.[52] We now know that these are precisely the kind of terms that greatly increased the probability of default.

Ironically, the availability of AMTPA's federal preemption is likely to have been one of the factors that helped fuel the market's preference for them in the first place. Now, it is a confusing obstacle to necessary reform.[53] As its time has long since passed, CRL believes that AMTPA should be repealed in any event, but its enduring legacy should be an object lesson against any preemption that prevents states from responding when needed and as needed.

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 the mortgage market not by creating impediments to sensible home loans, but by focusing on market-based solutions that result in 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] Testimony of Michael D. Calhoun Before the U.S. House Committee on Financial Services, "*Legislative Proposals on Reforming Market Practices,*" pp. 18-20 (October 24, 2007), *available at* http://www.responsiblelending.org/pdfs/calhoun-testimony-10_24_2007.pdf.

[19] Remarks by Federal Reserve Board Chairman Ben S. Bernanke at the Opportunity Finance Network's Annual Conference, Washington, D.C. (November 1, 2006).

[20] 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).

[21] 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).

[22] 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.

[23] 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.

[24] 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).

[25] *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).

[26] 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.

[27] 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.

[28] 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.

[29] Debra Cassens Weiss, *New Century GC Sounded Early Warning About Subprime Exposure*, ABA Journal (March 31, 2008).

[30] 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").

[31] 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.

[32] 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.

[33] *See* Fannie Mae "Single Family Selling Guide" Part VII, Section 104.05.

[34] Most homeowners with conforming mortgages already maintain escrow accounts, so the new requirement would only impact those parts of the market that most need it. *See, e.g.*, Fannie Mae "Single Family Selling Guide" Part VII, Section 104.05.

[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] 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).

[38] *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).

[39] 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).

[40] *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).

[41] *See, e.g.* 15 U.S.C. §1610; Reg. Z, 12 C.F.R. § 226.18, Official Staff Commentary § 226.28(a)-2,3 (Truth in Lending); 15 U.S.C. § 1691d(f) (Equal Credit Opportunity Act); 15 U.S.C. § 1693q (Electronic Funds Transfer Act); 15 U.S.C. § 1692n (Fair Debt Collection Practices Act); 15 U.S.C. § 1677 (Restrictions on Garnishment).

[42] *See, e.g.* 69 Fed. Reg. 1904, 1908 (January 13, 2004) (supplementary information to OCC Preemption rule).

[43] 68 Fed. Reg. 46,264 (Aug.5, 2003) (preempting Georgia Fair Lending law); 69 Fed. Reg. 1904, 1911-12 nn.57,59 (2004) (suggesting OCC will take the position that other state HOEPAs are preempted as well.).

[44] Christopher L. Peterson, *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda,* 78 Temp. L. Rev. 1, 72-74 (2005).

[45] The one all-purpose federal law available, the FTC law prohibiting unfair and deceptive acts and practices, was rarely invoked by the federal agencies against federal banks and thrifts, and then, only against small banks, or when external events forced their hand. State enforcement was precluded since approximately 1999 by expansive assertions of visitation rights, currently under review by the Supreme Court, *Cuomo v. Clearing House, LLC,* No. 08-453 (pending.). Enforcement through private civil litigation was extremely hampered by arguments over whether the state law versions of the law were preempted.

[46] *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).

[47] *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).

[48] S.B. 185 (May, 2006), http://www.legislature.state.oh.us/BillText126/126_SB_185_EN_N.pdf.

[49] 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.

[50] For a full discussion of some of the issues this expansion may raise, *see* Christopher L. Peterson, *Preemption, Agency Cost Theory, and Predatory Lending by Banking Agents: Are Federal Regulators Biting Off More than They Can Chew?*, 56 Amer. U. L. Rev. 515 (2007).

[51] 12 U.S.C. § 3801, et.seq. AMTPA applies to "housing creditors," broadly defined. For loans with one of these features, the lender need not comply with certain state laws limiting creative financing terms such as adjustable rates, interest-only features, and even default rates, provided they comply with applicable federal rules, which tend to be inadequate for today's abuses. Furthermore, from 1996 to July 1, 2003, an OTS interpretation of AMTPA preempted state laws on prepayment penalties for non-federally chartered housing creditors. (State laws on prepayment penalties are independently preempted by the OCC and OTS for their charters.) For a more complete description of AMTPA, *see generally* National Consumer Law Center, *The Cost of Credit*, §3.10 (3d ed. 2005).

[52] *E.g.*, Cabrejas v. Accredited Home Lender, Inc.,2007 WL 2044573 (D. Md. July 5, 2007) (state law on balloon payments preempted).

[53] *See, e.g.* Ill. Ass'n of Mortgage Brokers v. Office of Banks & Real Estate, 308 F.3d 762 (7th Cir. 2002) (some of Illinois' mini-HOEPA provisions may be preempted by AMTPA; remanding).

Testimony of David G. Kittle, CMB

Chairman

Mortgage Bankers Association

Before the

Subcommittee on Financial Institutions and Consumer Credit

Committee on Financial Services

United States House of Representatives

Hearing on

"The Current State of the American Mortgage Lending System and Proposals to Reform that System"

March 11, 2009

Chairman Gutierrez, Ranking Member Hensarling and Members of the Subcommittee, my name is David G. Kittle, CMB, and I am Chairman of the Mortgage Bankers Association[1] as well as Executive Vice President of Vision Mortgage Capital, LLC. I appreciate the opportunity to testify on proposals to reform mortgage lending.

After all that has transpired since the House of Representatives passed H.R. 3915, the "Mortgage Reform and Anti-Predatory Lending Act of 2007," we believe that we need a fundamental reform of mortgage regulation. That reform should take into account not only the many problems exposed since the end of 2007, but also the many legal and regulatory changes that have occurred since then.

In July of 2008, the Federal Reserve Board undertook a careful review of the mortgage process. The Board then finalized comprehensive rules addressing the central issues in H.R. 3915. These rules, which go into effect on October 1, 2009, include greater protections for subprime borrowers with new requirements for underwriting (ability to repay/documentation), escrows and prepayment penalties. The rules also address appraiser coercion and abuses in mortgage servicing and advertising. MBA believes that the Board's rules, coupled with other important requirements, should serve as the basis for a uniform national standard to protect consumers.

As you know, many domestic regulatory agencies, as well as the G-20 nations, have been working on regulatory reform proposals. MBA has been studying and learning from these proposals and we believe that a comprehensive package would be most effective.

At the same time, we have been developing our own policy approach to mortgage reform. We believe that, while the mortgage industry is not the sole cause of today's difficulties, our industry must be central to solutions that restore faith in the market and protect future borrowers. We know that these proposals will constrain some in our industry, but they will also help our members and their customers in the long-run.

MBA is working to complete our comprehensive proposal for reform and we plan to announce it shortly. In the meantime, we are able to share the principles embodied in that proposal.

1). Reform proposals directed to the mortgage lending industry should be considered in a comprehensive, not piecemeal, manner. Issues, including the type of regulatory structure, the respective roles of federal and state agencies, which rules should

[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.

apply and how enforcement should be carried out, should be considered carefully to achieve the optimal overall approach.

2). Mortgage lending deserves special attention. While consumer protection, systemic risk and safety and soundness all deserve attention, MBA believes special attention to mortgage lending is warranted.

3). Reform legislation should provide a rigorous new regulatory standard that should protect consumers regardless of where they live. Just as emergency efforts to return credit to the market have been national in scope, long-term solutions to mortgage lending challenges must also be national. Federal and state officials should work together in developing and enforcing uniform standards.

4). A new standard should build on recent work. MBA believes a new standard should start with the Federal Reserve's Home Ownership and Equity Protection Act (HOEPA) rules, proposals from 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 initiatives, such as proposals to define originator responsibilities.

5). A single set of consumer protection rules should be dynamic and able to quickly respond to new concerns. Federal and state officials should work together to revise the national standard to address new abuses and concerns. Regulators should be authorized to make necessary changes through a public rule-making process.

6). Standards, including assignee liability restrictions, must be clearly defined to facilitate the flow of affordable capital into the mortgage market.

7). Regulated entities should pay the costs of regulation and enforcement at the federal and state level. MBA favors effective regulation and enforcement, and believes that regulated entities should pay the costs to assure sufficient funding (as long as charges are reasonable and not duplicative).

8). All players in the mortgage industry should be subject to consistent federal regulation including rigorous licensing, education requirements, net worth and bonding requirements as well as regular review and examination.

9). Regulatory reform must improve transparency for borrowers. Consumer disclosures are governed by TILA and RESPA, but the Federal Reserve Board's and HUD's disclosure changes have not been compatible. Reform must address this problem to ensure that consumers have optimal information to understand loan transactions.

10). Regulatory reform should also assure better resources for counseling, financial literacy and fighting mortgage fraud. MBA supports mandatory counseling for some products if adequate resources are available.

We look forward to providing the details of our proposals shortly and working with this Subcommittee and the Congress to achieve efficient and effective regulatory reform going forward.

Testimony of
Donald C. Lampe
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Charlotte, NC

Before

Subcommittee on Financial Institutions and Consumer Credit
U.S. House of Representatives
Committee on Financial Services

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

March 11, 2009

Mr. Chairman, Ranking Member Hensarling, Members of the Subcommittee, thank you for the opportunity to appear here today. I am Don Lampe, a partner in the Charlotte, North Carolina office of Womble Carlyle Sandridge & Rice, PLLC. I have been involved on behalf of industry trade organizations, mortgage lenders and others, either as a legal consultant or registered lobbyist, in the enactment of state and local mortgage lending laws and regulations over the past ten years, including high-cost home mortgage loan laws and other subprime-related legislation, in Georgia, Kentucky, Tennessee, Oklahoma, New Mexico, Ohio, Rhode Island, Minnesota, North Carolina and Maryland. Because the legislation that the Subcommittee is reconsidering today, i.e., H.R. 3915, the Mortgage Reform and Anti-Predatory Lending Act of 2007, is based on residential mortgage lending laws from various states, I hope to be able to

respond to the Committee's questions regarding our experiences in with similar state laws. In any event, my testimony today will focus on reform of mortgage loan origination practices, while others here have or will speak on other important issues such as mortgage securitization.

Action v. Inaction

Our elected representatives, including many if not all members of this Subcommittee, are hearing from constituents who are facing the devastating loss in foreclosure of their most important asset, the dwelling places of their families, their homes. There is a consensus that the crisis today resulted from an overabundance of consumer mortgage loans being made to borrowers who didn't understand them and ultimately were not able to pay them back. Too many borrowers obtained subprime loans or Alt-A loans that contained built-in risky features such as 100% loan-to-value, low initial teaser rates followed by significant payment increases, prohibitive prepayment penalties and negative amortization. In too many instances, these unfortunate borrowers were put into home loans by mortgage "salesmen," without regard to income or assets of the borrower or basic verifications. This troubles all of us today, and our families, friends and communities. So, any assertion that Congress should not act to reform regulation of consumer mortgage lending is untenable. But then, what should Congress do to protect consumers now and prevent this crisis from ever occurring again?

It would be easy for Congress to consider simply banning "subprime" mortgage loans. Perhaps H.R. 3915 already would do this or should be amended thusly. In a sense, this occurred already, with the enactment of the Home Ownership and Equity Protection Act of 1994 ("HOEPA") and with the passage of approximately 40 state and local laws or regulations that similarly limited "high-cost home loans." It was thought that high-cost home loans could be

inherently "predatory" and that any consumer getting one should be entitled to additional protections and enhanced remedies. In retrospect, these laws did not head off the "subprime crisis" or ameliorate widespread distress among homeowners. These loans effectively were banned, yet this did not head off the housing crisis, which began in earnest in 2007.

Do we need a new definition of "subprime loans"? Perhaps, but under the current legal regime even prohibiting a broader class of home mortgage loans may not achieve the goals of protecting new borrowers today and preventing another housing crisis in the future. Instead, Congress should consider a real overhaul of consumer protection laws and regulations for all consumers, while giving weight to other current efforts to reform the market.

Three Concerns

In the brief time that I have, I would like to make three points that, in my view, bear additional attention by this Subcommittee as you consider further legislation. These points are built around a central theme: first and foremost, it is critically important that any legislation provide strong and effective consumer protections while preserving access for consumers to fairly priced, nondiscriminatory, lawful and appropriate mortgage credit. The three points are as follows.

1. The Federal Reserve Board exercised its authority under HOEPA last year to prohibit a host of unfair or deceptive mortgage lending practices across the board. These amendments to Regulation Z also strengthened regulation of high-cost home loans and created a new category of "higher cost home loans" that are subject to significant new consumer protections. Members of Congress and many observers on all sides of the debate praised Chairman Bernanke for exercising the Fed powers that Congress originally granted in 1994.

Congress at this time should give due regard to the Fed's groundbreaking rules, consider carefully whether these rules already address consumer protection adequately and consider whether these rules form a basis for additional legislation.

2. Reform of consumer mortgage lending laws should be real reform, and not just the adding of additional layers of conduct requirements, disclosures and liabilities to existing laws. There is a real opportunity now for Congress to overhaul what many describe as a "broken" system of regulation of mortgage loan origination.

3. It is widely held that "too much credit" contributed to, if not caused, the current housing crisis. It is all too easy to believe that making less mortgage credit available in the future will prevent a recurrence of today's problems. However, serious, thoughtful and heartfelt consideration needs to be given to current homeowners who wish to refinance (sometimes out of unfavorable, if not unfair, loans) and the new homeowners looking for new loans.

The Fed's Approach

The Federal Reserve Board's amendments to Regulation Z cover much of the same ground as previous proposed legislation, including H.R. 3915. These amendments include, for all residential mortgage loans, comprehensive new requirements for advertising and promotion, prohibitions on coercing or unduly influencing appraisers and new mandates on mortgage servicers. The regulations impose new restrictions on HOEPA loans, in ways similar to H.R. 3915. Importantly, the regulations establish a new category of "higher-priced home loans." These regulations impose similar requirements as those set forth now in Title II of H.R. 3915, albeit tailored to this class of loans. According to the new regulations, all mortgage lenders must determine the borrowers ability to repay, with appropriate verifications. Again, Congress should

attempt to harmonize future legislation with the Fed's carefully-crafted, comprehensive protections.

Overhaul

For years, many commentators, whether from industry, consumer groups or academia, have observed that the disclosure-based system of consumer protection in mortgage transactions is broken. Disclosure-based consumer protection laws took root in the 1960's and have grown by accretion since then. Over the years, as laws have expanded, neither Congress nor the federal regulators have been able to rationalize and harmonize dozens of pages of disclosures and loan documents in the typical loan closing package. Now, the disclosures required by federal laws such as the Truth-in-Lending Act and the Real Estate Settlement Procedures Act (not to mention state laws and FHA guidelines) are nearly incomprehensible to consumers. This is so across-the-board, whether a loan is "subprime," conforming, jumbo or government-insured and regardless of the consumer's level of financial sophistication. In short, what increased disclosures have brought to consumers is more information but drastically less understanding.

So, it becomes difficult to justify more disclosures and additional liabilities related to often technical disclosure violations. At this time, Congress is presented with a unique opportunity to reconsider the overly complex, and at times inconsistent, regime of consumer protection laws. The result could be game-changing, and would go a long way toward ensuring that borrowers understand the terms of credit transactions presented to them, are able to determine if a particular loan is fair, competitively priced and affordable and are otherwise capable of paying the loan back. This outcome, as much as any other, would assure that the mistakes of the past are not repeated.

Fair Lending that is Fair to Everyone

Was it too much credit or too much of the wrong type of credit that brought us to the breakdown in our financial system? After all, widespread availability of credit has benefited minorities and other protected classes of homeowners and homebuyers. At one time in history, too many lenders knowingly discriminated based on the "suitability" of particular home mortgage borrowers, using factors at the time that seemed "reasonable" and "in good faith." Today, such rationalizations in the name of discrimination are totally unacceptable. So, there is a danger in any legislation that appears to mandate subjective determinations based on a list of factors that must be considered to the detriment of other factors that could actually benefit a particular borrower. Listing of mandatory underwriting standards in federal legislation that must be considered in determining a borrower's "ability to repay" may discourage borrowers who do not have "standard" credit histories and W-2 income sources from getting mortgage credit. As to lending practices that led to the subprime debacle, if minorities have been overly marketed-to and disproportionately placed in unfair and unaffordable subprime loans, the situation may not be reversed if even fewer fair, reasonable and affordable credit choices are available to all borrowers in the future. Policymakers must be very careful here, and seriously consider implications of new programs and laws, such as whether government-insured credit such as FHA loans will provide sufficient homeownership opportunities to all Americans.

Again, thank you for having me here today. I am happy to answer any questions.

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Governing Committee, The Conference on Consumer Finance Law

Board of Advisors, The Center for Banking and Finance, University of North Carolina School of Law

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TESTIMONY OF

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2009 PRESIDENT OF THE

NATIONAL ASSOCIATION OF REALTORS®

BEFORE THE

U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

HEARING REGARDING

"LENDING REFORM: A COMPREHENSIVE REVIEW OF THE AMERICAN MORTGAGE SYSTEM."

March 11, 2009

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Introduction

Chairman Gutierrez, Ranking Member Hensarling, and Members of the Committee, thank you for inviting me to testify today regarding mortgage lending reform.

My name is Charles McMillan, and I am the 2009 President of the National Association of REALTORS®. 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 Financial Institutions and Consumer Credit Subcommittee for holding this hearing on an issue that is paramount to the success of the housing market and the U.S. economy,

REALTORS® Support Efforts to Encourage Responsible Lending

Past irresponsible and abusive lending practices are largely responsible for causing the major problems that our nation's housing market and overall economy are currently experiencing. Some lenders abused their role and took advantage of vulnerable borrowers by charging extremely high interest rates and loan fees unrelated to risk, using aggressive sales tactics to steer consumers into unnecessarily expensive or inappropriate loan products, advertising "teaser" interest rates that steeply increased after the first few years of the loan and based their lending on artificially high appraisals. The consequence of these abuses in the housing market are high rates of foreclosures that have lead to the loss of families' homes and wealth, increased vacancy rates which, in turn, have caused homes in neighborhoods across our nation to lose value, and a destabilization of our overall economy.

REALTORS® have a strong stake in preventing abusive lending because:

- Abusive lending erodes confidence in the Nation's housing system, and

- Citizens of communities, including real estate professionals, are harmed whenever abusive lending strips equity from homeowners. This is especially the case when irresponsible lenders concentrate their activities in certain neighborhoods and create a downward cycle of economic deterioration.

NAR's Principles of Good Faith and Fair Dealings for all Mortgage Originators

As abuses in the housing market were becoming evident, NAR adopted a set of "Responsible Lending Principles" in May 2005 that we have updated and shared with the Committee at earlier stages of your deliberations. NAR is a strong advocate of protections for consumers in the mortgage transaction; therefore, REALTORS® support the general principle that all mortgage originators should act in good faith and with fair dealings in a transaction, and treat all parties honestly. Here is a list of NAR's Responsible Lending Principles:

1. Affordability. 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, without having to refinance or sell the home.[1] Lenders should consider all relevant facts, including the borrower's income, credit history, future income potential, and other life circumstances. Lenders should not makes loans to borrowers that make loss of the home through sale or foreclosure likely if the borrower is unable to refinance the mortgage or sell.

- Underwriting Subprime Loans with "Teaser Rates." Some subprime loans were structured with a significant jump in monthly payments often resulting in "payment shock" for the borrower. While these mortgages may be a reasonable choice for borrowers who can afford them, a majority of borrowers do not understand the unique terms and conditions of these risky mortgage products that can result in a significant "payment shock." Therefore, lenders (including mortgage brokers) should exercise more caution when underwriting such loans to subprime borrowers to make sure the borrower is able to afford the mortgage. Examples of these risky mortgage products include loans with a short-term interest "teaser" rate for the first two or three years (known as 2/28s and 3/27s), loans with an initial interest-only period, and mortgages that negatively amortize.[2] For the most part, regulatory guidelines have addressed these concerns.

- Reasonable Debt-to-Income Ratio. NAR supports requiring lenders to make subprime loans that have a reasonable debt-to-income ratio. Borrowers should have enough residual income after making their monthly mortgage payment, including taxes and insurance, to meet their needs for food, utilities, clothing, transportation, work-related expenses, and other essentials. Requiring underwriting at a fully amortizing, fully

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1 The limited exceptions to this general principle would include prime borrowers with sufficient verifiable assets to handle a balloon mortgage or a significant jump in mortgage payment.
2 Negative amortization ordinarily results if the mortgage permits a borrower to pay less than the interest on the mortgage for a limited time, in which case the difference is added to the total amount of the loan the borrower must repay.

indexed rate is meaningless if the lender uses such high debt-to-income ratios that the family doesn't have enough income remaining to pay for other necessities.

- Escrow/Reserve for Payment of Taxes and Insurance. Lenders that make subprime mortgage loans should generally require that the monthly payment include an amount to be held by the mortgage servicer in an escrow/reserve/impound account for the payment of the borrower's periodic payments, such as taxes, insurance, and homeowner/condo fees. Similar to the exception for prime loans in some jurisdictions, borrowers that make at least a 20 percent downpayment should have the option to budget for these payments independently.

2. Limit Stated Income/Stated Assets Underwriting. Because mortgages underwritten based on "stated income" and/or "stated assets" (also known as "no income verification" or "no doc" loans) typically have higher rates, lenders making subprime loans should, as a general rule, underwrite loans based on verified income and assets.

3. Flexibility for Life Circumstances. NAR believes that a standard for determining a borrower's ability to repay must be flexible to accommodate borrowers with unique circumstances, such as:

- ✓ Borrowers who have demonstrated the ability to make monthly payments, over a long term, that are higher than underwriting standards would otherwise allow. Lenders should consider, for example, the borrower's history of making rent and student loan payments.
- ✓ Borrowers with high assets but low income who, for cash management or other financial planning reasons, elect a mortgage with a monthly payment that their current income is not sufficient to cover.
- ✓ Borrowers who anticipate a jump in income or assets due to life events such as graduation, completion of professional training, completion of payment obligations for student or car loans, another member of the household entering the work force when young children start school, or an inheritance.

4. Anti-Mortgage Flipping Policy. 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 is the loan must provide a "reasonable net tangible benefit" to the borrower). The lender should consider the circumstances of the borrower, as discussed above, all terms of the new loan including taxes and insurance, the fees and other costs of refinance, prepayment penalties, and the new interest rate compared to that of the refinanced loan.

5. Bar Prepayment Penalties. NAR opposes prepayment penalties for all mortgages. Prepayment penalties often work to trap borrowers in loans they cannot afford by making it too expensive to refinance. If complete prohibition of prepayment penalties is not feasible, NAR supports permitting prepayment penalties for the shortest time and the lowest amount possible. For example, a borrower in a 2/28 mortgage should be able to

refinance by the end of the initial two-year "teaser" rate period without having to pay a prepayment penalty.

6. Improvements for Assessing Creditworthiness. Borrowers with little or no credit history, as traditionally measured, usually have lower credit scores and must pay more every month for their mortgage than those with higher scores. NAR supports ongoing efforts to take into account consumer payment history not typically considered, such as rent, utility, telephone, and other regular payments and urges HUD, the regulators, the GSEs, and lenders to work to strengthen these efforts. Use of alternative credit approaches will be especially beneficial for low- and moderate-income first-time homebuyers and borrowers with problematic loans that need to refinance their mortgage to avoid foreclosure.

Another public policy issue associated with credit histories is the failure of furnishers to report good payment histories to the consumer reporting agencies. NAR has heard reports that many problematic subprime lenders purposefully withhold information on timely mortgage payments from the credit bureaus in order to prevent their customer from refinancing with another lender. The result is obvious—the borrowers with no positive payment histories for their subprime loan keep treading the waters of high-interest rates and expensive credit products. NAR supports requiring all institutional mortgage lenders, or the mortgage servicers acting on their behalf, to report payment history of all borrowers to at least the three national credit bureaus on a monthly basis.

7. Mortgage Choice for Borrowers. NAR supports requiring mortgage originators to offer borrowers one or more mortgages with interest rates and other fees that appropriately reflect the borrower's credit risk. It remains the responsibility of borrowers to decide which is the best mortgage for their needs and circumstances, but they may only do so if they understand all the facts so they can make an informed decision. The following are suggested principles for consideration;

- For originators who offer nontraditional mortgage products, the originator should:
  - offer all borrowers a choice of several significantly different mortgage options;
  - include at least one traditional loan product as one of the options for the borrower to consider, if the borrower qualifies for such a product offered by the originator; and
  - before application acceptance, disclose information about the maximum potential payment over the life of the loan and the date the initial payment will increase to a fully amortizing, fully indexed payment amount.

- For subprime borrowers, originators that offer FHA-insured mortgages or VA home loan guaranty mortgages should consider whether these types of mortgages should be offered as an appropriate option.

- If the originator does not offer mortgages with rates and fees appropriate for the borrower's credit risk, the originator should inform the borrower a lower interest rate may be available from another originator or that the borrower may wish to seek housing counseling, to allow the borrower an opportunity to shop elsewhere or receive

counseling before proceeding. For example, a prime borrower that applies for a loan to a lender that only makes subprime loans should be advised that other options may be available.

- For loans originated by a mortgage broker, the broker should offer mortgage options that are among the lowest-cost products appropriate for the borrower.

8. Enforcement/Remedies. NAR supports enactment of strong remedies and penalties for abusive acts by mortgage originators. Among the options for consideration are:

- Criminal penalties similar to those under RESPA.
- Civil penalties similar to those under RESPA.
- Assignee liability that balances the need to protect innocent borrowers with problematic loans against the risk that increasing the liability of innocent holders of mortgages in the secondary market could reduce the availability of mortgage credit.
- Prohibition of mandatory arbitration clauses that bar victims' access to court.

9. **Strengthen Appraiser Independence**. NAR believes that the independence of appraisers should be strengthened to ensure that appraisals are based on sound and fair appraisal principles and are accurate. There are reports that appraisers have been pressured to meet targeted values or risk losing business. Appraisal pressure undermines the integrity of the mortgage lending process if the result is a mortgage loan made based on an inaccurate property valuation. NAR 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 at no additional cost.
- 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.

In addition to our Responsible Lending Principles, NAR believes that the following duties should be considered by policy makers when establishing minimum standards of care for all federally and state regulated mortgage originators:

1. A mortgage originator shall act in the borrower's best interest and in good faith toward the borrower.
2. Mortgage originators shall use reasonable care in performing duties.
    a. Reasonable care includes following strong underwriting standards that require verification of the borrower's ability to repay the loan based on all its terms, including property taxes and insurance, without having to refinance or sell the home.
    b. Reasonable care also includes giving consideration to the totality of the borrower's circumstances, including income, credit history, future income potential and other life or unique circumstances.
    c. Reasonable care does not require a mortgage originator to obtain a loan containing terms or conditions not available to the originator in their usual course of business, or to obtain a loan for the borrower from a broker or lender with whom the originator does not have a business relationship.
3. A mortgage originator shall not accept, give, or charge any undisclosed compensation or realize any undisclosed remuneration, either through direct or indirect means, that inures to the benefit of the mortgage originator on an expenditure made for the borrower.
4. Mortgage originators shall carry out all lawful instructions given by borrowers.
5. Mortgage originators shall disclose to borrowers all material facts of which the mortgage broker has knowledge which might reasonably affect the borrower's rights, interests, or ability to receive the borrower's intended benefit from the residential mortgage loan.
6. Mortgage originators shall account to a borrower for all the borrower's money and property received from the borrower.
7. Mortgage originators shall not pressure or improperly influence appraisers to meet targeted values.

Violations of a mortgage originator's duty to act in good faith and with fair dealings should include:

- Making a loan where the loss of the home through sale or foreclosure is likely if the borrower is unable to refinance the mortgage or sell.
- Misrepresenting or concealing material factors, terms or conditions of the transaction.
- Making false statements or promises, fraud, dishonest dealing, negligence, and criminal convictions.
- Failing to disclose all material facts about a loan to a borrower or misrepresenting facts to a lender (such as knowingly misstating a borrower's income) would also be actionable offenses.
- Not acting in the best interest of the borrower.
- Improperly refusing to issue a satisfaction of a mortgage loan.

Strengthening the Independence of Appraisers Benefits the Housing Market

Consistent with NAR's Responsible Lending Principles, NAR believes a strong and independent appraisal industry is vital to restoring faith in the mortgage origination process. H.R. 3915, the "Mortgage Reform and Anti-Predatory Lending Act of 2007," which passed

the House on November 15, 2007, was one attempt to prohibit undue influence on home appraisers. H.R. 3915 would have struck an appropriate balance by strengthening the accountability and oversight of appraisers while also creating new consumer protections such as allowing borrowers to obtain a copy of all appraisals prior to closing.

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. H.R. 3915 would have strengthened 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.

The GSEs and New York Attorney General Andrew Cuomo have signed an agreement that, among other things, provides for a Home Valuation Code of Conduct (HVCC). Like H.R. 3915, the HVCC attempts to strengthen appraiser independence. The Code provides examples of coercive activity such as allowing the removal of an appraiser from a list of qualified appraisers without cause, withholding or threatening to withhold payment, or requesting that an appraiser provide an estimated or predetermined valuation. The HVCC also ensures that the borrower is provided a copy of the appraisal report no less than 3 days prior to closing and at no additional cost to the borrower.

Despite its efforts, the HVCC is not without flaws. Implementation of the Code on May 1, 2009, could lead to an over-reliance on automated valuation models (AVMs) by both government sponsored enterprises (GSEs), Fannie Mae and Freddie Mac. While this would appear to address appraiser influence in a transparent way, a deeper look at automated valuations generally reveals they are not able to consider qualitative factors with the same level of reliability that professional licensed and certified appraisers produce. Professional appraisal organizations and licensed and certified appraisers should work closely with the GSEs to ensure the highest quality appraisals remain the preferred method of valuation for residential real estate transactions.

The Code also fails to address the costs of the real estate transaction. Appraisers will now have to consider their obligations to Unified Standards of Professional Appraisal Practice (USPAP) and the Appraisal Foundation with the additional burden of ensuring compliance with the Code. This may also be an issue for lenders. The creation of a new set of standards to follow and a new oversight organization, the Independent Valuation Protection Institute (IVPI), may lead to increasing cost of the real estate transaction. NAR recommends the Independent Valuation Protection Institute be affiliated with an already existing appraisal organization. This will help to ensure that the code is implemented in such a way that it adds value to the appraisal process rather than becoming a duplicative layer of bureaucracy.

The "Mortgage Reform and Anti-Predatory Lending Act of 2007" and the HVCC both work towards a strong and independent appraisal industry yet fail to mention the regulation of appraisal management companies (AMC). In many states these companies operate without oversight from any level of government. In fact, the HVCC was a response to inappropriate activities by an AMC with Fannie Mae and Freddie Mac. NAR will likely support the regulation of AMCs by the states through the Financial Institutions Reform, Recovery and Enforcement Act

(FIRREA). This may include requiring AMCs to maintain a licensed or certified appraiser in the state where the AMC is doing business.

Foreclosure Avoidance and Mitigation

NAR supports legislative, regulatory, and private-sector foreclosure avoidance and mitigation efforts. We urge lenders, especially lenders that have made loans without considering the ability of the borrower to make payments under the loan, to act promptly to help borrowers resolve the problem. Possible steps should include recasting the mortgage, forbearance, favorable refinancing, waiving of prepayment penalties, and other appropriate tools. Prompt action will almost always be in the best interests of the lender, as well. We are encouraged by President Obama's Making Home Affordable program that seeks to prevent the foreclosure of between 7 and 9 million homes through refinancing of GSE loans and modification of GSE and other types of loans.

NAR also supports increased funding for programs that provide financial assistance, counseling, and consumer education to borrowers to help them avoid foreclosure or minimize its impact. We also believe that Congress and the regulators should examine alleged abuses by mortgage servicers, some of whom are engaging in predatory servicing by imposing unjustified high fees on borrowers. These abusive practices can contribute to, or even cause, delinquencies and foreclosures.

Implementation of these core priorities will only go so far if the federal government and the mortgage lending industry do not address additional fundamental operational issues that are beginning to impede the delivery of mortgage credit and increase foreclosures. To successfully facilitate a housing market, the following issues must be acted upon:

- Mortgage lenders and private mortgage insurers should (1) reexamine underwriting standards to determine whether they have over-corrected in response to abuses in the mortgage market, and (2) remove unnecessarily strict underwriting standards (such as (i) requiring excessively high credit scores that result in qualified borrowers being arbitrarily turned down for a loan, and (ii) coupling much tighter investor underwriting criteria with a lower cap on the number of financed properties an investor may own).

- Consumer reporting agencies (credit bureaus) should improve compliance with the Fair Credit Act, including prompt responses to consumers who seek to correct files and prompt correction of errors.

- FHASecure should be reinstated. HUD's FHASecure program successfully helped more than 450,000 families modify their mortgages and stay in their homes. However, this valuable program was allowed to sunset on December 31, 2008. The Hope for Homeowners program, which was expected to take the place of FHASecure, has not yet achieved the same levels of success. We have urged HUD to reinstate FHASecure, so that homeowners have all the tools available to them to avoid foreclosure.

- As families consider buying a foreclosed home, they find that many properties need work in terms of rehabilitation or renovation. FHA's section 203(k) program is a valuable tool that allows homeowners to obtain one insured mortgage to rehabilitate a property in need of repair. However, this program is not available to investors, who may be interested in purchasing these homes and repairing them so they are ready for sale or for conversion to rental units. If the program were made available to them, vacant, dilapidated homes will be renewed and provide safe, comfortable homes for families. Investors will be able to access credit that is unavailable because of the current economic crisis. Finally, neighborhoods will be stabilized and previously vacant homes will contribute to the local property tax base. We have urged HUD to once again open the section 203(k) program to investors, with appropriate safeguards and oversight.

Conclusion

Irresponsible and abusive lending is a disaster not only for the borrower and his or her family, but for the community and the national economy, as well. Problematic loans are often made in concentrated areas and are more likely to result in foreclosures. High foreclosures of single-family homes are a serious threat to neighborhood stability and community well-being. Foreclosures can lead to high vacancy rates which, in turn, can devastate the strength and stability of communities, and ultimately our economy.

REALTORS® help families achieve the dream of homeownership. The National Association of REALTORS® supports responsible lending, based on sound independent appraisals, with increased consumer protections to ensure that the "dream" our members help fulfill does not turn into a family's worst nightmare.

I thank you for this opportunity to present our thoughts on mortgage reform. The National Association of REALTORS® stands ready to work with Congress and our industry partners to reform the mortgage market, facilitate a housing recovery, and bring our nation out of this economic nightmare.

March 11, 2009

Testimony of

Michael Middleton

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Subcommittee on Financial Institutions and Consumer Credit

Committee on Financial Services

United States House of Representatives

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Chairman Gutierrez, Ranking Member Hensarling and members of the Subcommittee, my name is Michael Middleton, President of the Community Bank of Tri-County, located in Waldorf, Maryland, and former Chairman of the Federal Home Loan Bank Committee of the American Bankers Association (ABA). The Community Bank of Tri-County is a locally owned community bank with assets of approximately $725 million. We have served the Southern Maryland community for over 58 years. I am honored to be here today on behalf of 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 possible legislative initiatives to improve mortgage lending standards, particularly as they relate to subprime mortgages. I wish to make it clear from the outset that the Community Bank of Tri-County is one of many banks that never varied from traditional underwriting standards and offers both prime and affordable housing loan products. Our residential loan portfolio is strong, with very low delinquency rates especially among our affordable housing portfolio. We have a "High Satisfactory" lending rating for CRA purposes and have a zero default rate on our "affordable housing" portfolio. Like other community banks, we work closely with the Federal Home Loan Banks to secure grants and affordable housing funding.

As you will find, 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. Many of those originators, the biggest abusers of the subprime market and predominantly non-bank mortgage brokers, are no longer in business. They should not be permitted to reestablish similar operations in the future.

Any regulation and/or legislation should promote a return to universal and conservative underwriting practices like those maintained at most banks. They must be codified and promote those practices ***for all lenders at the same time, not, as has been suggested in legislation, for an implementation period of two years for non-bank originators. At a minimum, legislation must*** ensure that the prudent, federally regulated survivors are not subject to greater burdens than their less regulated competitors. Additionally, the outcome of any legislation cannot restrict housing credit or we will face dire economic consequences.

In July of last year, the Federal Reserve issued amendments to Regulation Z that addressed many issues that led to the house price bubble and the ensuing overextension of credit: the use of subprime 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. Among other things, the amendments define a new category of loan based on its Annual Percentage Rate 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 may force State Housing Authorities to change their pricing to avoid the "higher cost" standards which in turn could curtail their ability to serve many borrowers. Conservative banks like the Community Bank of Tri-County are reevaluating lending practices to ensure we are in compliance and to consider whether or not to exit the residential mortgage product line.

In today's testimony, I would like to address three key points:

- Traditional lending practices – especially the use of conservative, standardized underwriting – have helped banks avoid troubled loans and aided borrowers in avoiding difficult financial situations.

- Amendments to Regulation Z will continue to work change in the mortgage market; and
- Further legislation should avoid major changes that would override the effects of the new regulation.

I will discuss each of these in turn.

I. Traditional lending practices – including the use of conservative, standardized underwriting – have helped banks avoid troubled loans and have helped borrowers avoid difficult financial situations.

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 Congressman Barney Frank, Chairman of the House Financial Services Committee, 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, we community bankers tried to warn consumers against subprime loans and deals that were too good to be true, only to watch those consumers seek out non-regulated originators.

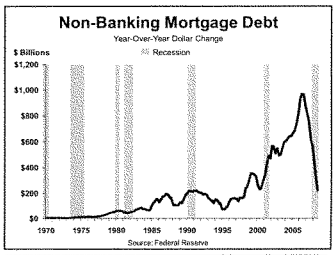
Many forces combined to create the problems we face today. The greatest was the migration of household sector financial assets from FDIC insured institutions to Wall Street. This flow of funds to the uninsured sector was driven in part by pressure to seek ever-increasing returns. The scope of the migration was impressive. Money market and mutual funds accounts grew about $16 trillion dollars from 1990 to 2008, while FDIC insured deposits grew by only about $2 trillion in the same time period. Much of that money was then directed into the housing sector, where securitized credit helped to fuel a boom in home prices. The vendors of choice for this allocation of funds were largely state licensed non-bank mortgage originators.

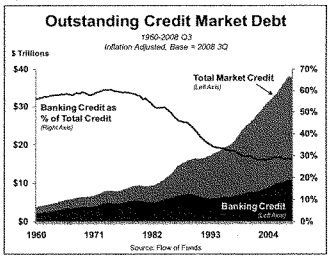
[1] *Boston Globe*, September 14, 2007.

In the frenzy that ensued, ***sound underwriting practices were sacrificed by non-bank originators because standards were lax and there was no regulator to examine them.*** The result was catastrophic. Contaminated loans populated the supply of housing assets flooding the mortgage backed securities market. Housing prices plummeted. Many homeowners found themselves upside down on their mortgages, and the housing sector collapsed.

The worsening economic situation would be difficult by itself, but banks are also struggling with mark-to-market accounting rules, which have often resulted in over-stating economic losses. For banks like mine, whose businesses are not based on buying and selling securities in the markets, current mark-to-market rules provide neither the most relevant nor the most reliable information as to our performance or financial condition. Part of the problem is improper "other than temporary impairment" (OTTI) rules. In today's illiquid market, the results of irrational OTTI rules can be severe: (1) capital is artificially eroded despite solid fundamental credit performance, (2) the lending capability of a bank is greatly reduced by the capital reduction in OTTI.

The difficult economic environment combined with irrational OTTI rules has taken its toll on lending and stock values. Even so, 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.





It is important to note that banks will find it impossible to make up for the gaps created in the non-bank lending market. Whereas thirty years ago, banks provided about 60 percent of all credit – today banks provide less than 30 percent. Non-bank funding, particularly over the last several years, has dominated credit markets. The financial turmoil of the last 18 months has changed this balance. Suddenly, investors have become completely risk-averse. This leaves traditional banks as not only the lenders of choice, but often as the only lender available. Given the fact that funds migration drained

the system of its funding, it is challenging to fill the mortgage gap. The continued role of the Federal Home Loan Banks in providing funding to our banks is absolutely critical. Those funds that migrated to Wall Street are still there – not on Main Street – and can be accessed through the Federal Home Loan Banks.

Further complicating the current situation, bank regulators continue to caution banks about adding risk to their lending portfolios in this environment. This means that loan volume will likely decline in response to risk factors. This, I might add, is precisely why Wall Street chose unsupervised mortgage originators to funnel its money into the housing sector when investors seemed heedless of risk.

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. 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 activity by non-banks is a clear obstacle to banks trying to lend in a safe manner when the competitive situation favors the non-bank originators operating under the old rules which are still acceptable to FHA.

II. Amendments to Regulation Z will continue to work change in the mortgage market.

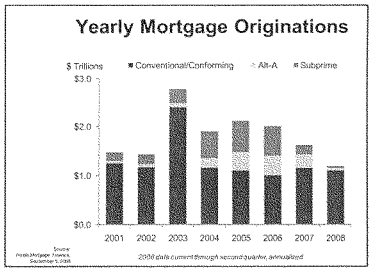
Recent changes to Regulation Z finalized by the Federal Reserve to implement the Home Owners' Equity Protection and Truth in Lending Act emphasize the need for more prudent and traditional underwriting. ABA supports many of these changes including regulations to strengthen the integrity of appraisals 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. We also believe that had the secondary market provided for some degree of

"skin in the game" for all market participants, there would have been far less abuse and fewer bad loans made. 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. It is noted with concern that Section 209 of H.R. 3915 would double the penalties and would, unintentionally, affect parts of the prime market rather than the high-cost mortgage market.

Based on my knowledge of examination and enforcement under Regulation Z, the limited number of bank violations were discovered by federal examiners during on site exams rather than from consumer complaints. For state licensed non-bank originators there is no on-site examination. How then will violators be caught? Banks have their federal regulators on site every year; the others have nothing. Who is subjected to actual enforcement and how? Preventing bad practices is far better than catching those practices after the fact. The risk of discovery was clearly absent in the non-bank originators' business model. Further, raising the penalties will force small hometown bankers to consider exiting the market completely due to the regulatory risk of doing business.

Similarly, ABA will work with the banking agencies to help ensure that other regulatory responses to past mortgage origination and underwriting practices do not unintentionally worsen the credit crunch by impeding the offer of credit for good loans that consumers can repay and that will help communities grow and prosper. We want a return to universal underwriting practices like those maintained at most banks, and we want to codify and promote those practices ***for all lenders.*** The prudent extension of credit cannot be restricted or we will face dire economic consequences. Therefore, we stand ready to assist in restoring housing and mortgage markets in which both borrowers and lenders have confidence.



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 Federal Reserve's amendments to

Regulation Z ensure that extreme products will not come back to haunt future borrowers who are not appropriate candidates for these loans. The amendments do this, in part, by dramatically changing the threshold that defines "higher-priced mortgage loans." While the rules for higher-priced loans certainly apply to loans that have historically been categorized as subprime, the definition is based on the loan's APR instead of borrower credit or loan product characteristics. As a result, this new category is likely to include many prime loans in certain markets, depending on market conditions. The amendments come with teeth – including strict regulatory requirements, 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, reducing available credit for less creditworthy borrowers.

III. Further legislation, including a revised version of H.R. 3915 from the last Congress, should avoid major changes that would make the new regulation less clear in both intent and effect.

We understand congressional concern about the loosely regulated and largely unexamined mortgage originators operating ***outside of the regulatory structure*** within which federally insured depository institutions function. For that reason, the ABA did not oppose H.R. 3915 when it passed the House of Representatives in November of 2007. Since that time a number of important things, which we have already discussed in this testimony, have occurred: the implementation of Regulation Z changes by the Federal Reserve; the passage into law of the SAFE Act requiring the licensing of mortgage brokers and registration of bank loan originators; and the drastic changes in the marketplace. We would urge Members of Congress to take these events into consideration when crafting a new bill. We are concerned that such legislation could have a negative impact on banks that are already subject to considerable regulation and on-site examinations as well as on creditworthy customers seeking to buy homes.

As such, ABA has formulated the following principles to keep in mind when considering legislative action on subprime mortgages:

- All new standards should be national standards, preempting the myriad numbers of state laws and regulations.
- Terms should be specific and well-defined, limiting the potential for unnecessary litigation.

- Any new mortgage standards should give enough guidance to regulators to ensure that the standard is both ***meaningful*** and ***measurable.***
- ***Prime loans should be given safe harbor*** from additional requirements, recognizing that the new amendments to Regulation Z restrict the definition of "prime" to a well-defined type of loan unlikely to be problematic for qualified borrowers.
- Basic underwriting standards should be an important element of loan origination at a time in the process where a lender would reasonably expect to exercise judgment and adhere to those standards. Expecting a firm offer of credit which requires full underwriting too early in the process (such as when a consumer is merely shopping among many lenders) could expose lenders to significant liabilities.
- We remain concerned that the SAFE Act's hurdle for non-bank originators is minimal and easily met. There are no mandates for on-site examination. As noted before, consumer-initiated complaints are *de minimus* when compared to on-site examinations. Without such mandates for prevention, the state licensing requirement is of little or no value.

Conclusion

The vast majority of banks have served their communities for decades. These banks have staying power because they have maintained traditional lending practices. Even so, the most conservative banks are revising processes to ensure compliance with the new amendments to Regulation Z, which represents a dramatic change to the mortgage market. Any new legislation should recognize the strong requirements established in the amendments to Regulation Z and avoid pushing beyond those requirements, particularly in the definition of prime loans. We urge Congress to keep in mind that overly prescriptive legislation could have the unintended effect of discouraging legitimate lenders from making loans to qualifying borrowers, which would have very undesirable consequences in the current economic atmosphere.

Testimony of

Laurence E. Platt

Partner, K&L Gates

On behalf of

Securities Industry and Financial Markets Association / American Securitization Forum

Before the

House Committee on Financial Services

Subcommittee on Financial Institutions and Consumer Credit

Hearing on:

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

March 11, 2009

Chairman Gutierrez, Ranking Member Hensarling, and members of the Subcommittee, thank you for the privilege of testifying here today on behalf of the Securities Industry and Financial Markets Association (SIFMA) and the American Securitization Forum (ASF) regarding reform of mortgage finance and in particular certain mortgage origination practices that contributed to the housing crisis affecting the nation today. We were pleased to have worked on this issue constructively with the Committee as it moved toward November 2007 passage of H.R. 3915, the "Mortgage Reform and Anti-Predatory Lending Act of 3915" ("H.R. 3915" or the "bill"). We appreciate the opportunity to highlight the key considerations that guided the involvement of SIFMA in the earlier legislative initiative and that remain important to SIFMA/ASF today.

At the outset, let me state the obvious. The market is very different today than it was in the fall of 2007. We believe the House at that time wisely sought to limit the majority of the bill's provisions to subprime loans by focusing on the core practices that it believed contributed to the subprime 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 subprime borrowers 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, of course, the availability of subprime credit has evaporated. This market has not returned. The conforming prime market is functioning but fragile. Congress and the Administration have made several attempts to address the current foreclosure and housing crisis. When the Federal Reserve Board (the "Board") adopted its final regulations to the Home Ownership Equity Protection Act in July 2008, it sought to address certain of the major underwriting concerns that H.R. 3915 covered. As a result, it appears that any new legislative initiative will be largely in anticipation of the eventual return of a private lending and securitization market. 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 the proposed 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 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 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 we hope that any newly proposed legislation will do the same.

I. BACKGROUND ON H.R. 3915

A. Substantive Requirements

H.R. 3915 essentially would have imposed four substantive obligations, two on mortgage lenders (defined as "creditors") and on two on mortgage brokers (defined as "mortgage originators"). First, it would have prohibited 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. 3915 would have provided 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 H.R. 3915's ability to repay and net tangible benefits standards technically applied to all "residential mortgage loans," it established presumptions that would have resulted in the standard essentially applying only to subprime mortgage loans based on a quantitative test of the cost of the loan; loans that qualified for the presumptions were referred to as "safe harbor" mortgages .

Third, H.R. 3915 would have 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 have mandated 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 have applied to both prime and subprime, consumer purpose, residential mortgage loans. Fourth, H.R. 3915 would have prohibited mortgage originators from receiving, and any person from paying, incentive compensation (such as yield spread premiums) that is based on, or varies with, the terms of the loan. It expressly excluded variations in compensation based on the amount of principal. This fourth restriction only would have applied to the same subprime loans to which the ability to repay and net tangible benefits would have applied.

B. Remedies for Violations

The remedies for violations of these provisions differed depending on the violations. The standard civil liability provisions of the Truth in Lending Act would have applied to violations of the H.R. 3915's provisions. H.R. 3915 would have increased the type and amount of monetary damages that would have been available for violations. Congress later doubled the statutory penalties applicable to closed end mortgages when it enacted The Housing and Economic Recovery Act of 2008.

TILA currently imposes liability primarily on lenders who fund loans in their name; it applies to "creditors," but not mortgage brokers. H.R. 3915 would have extended TILA civil liability to include mortgage originators. A mortgage originator that violated the duty of care and anti-steering provisions would have been liable for actual and statutory damages but not enhanced damages. However, those monetary damages would have been capped at 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.

H.R. 3915 also would have materially expanded 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. 3915 would have provided an extended right to rescind for certain of its new loan origination provisions. Rescission would have been available to consumers under the bill as a remedy for violations by creditors of the proposed underwriting requirements. However, mortgage originators that violated the duty of care and anti-steering requirements would not have been expressly subject to rescission claims. If the creditor could not have provided, or a consumer could not have obtained, rescission because the loan was held by somebody else, the liability would have to have been satisfied by providing the financial equivalent of a rescission, plus costs and reasonable attorney's fees. Further, a creditor would not have been liable for this new rescission remedy if the creditor had cured the violation within 90 days after the consumer notified the creditor of the violation. H.R. 3915 created an exemption from liability and rescission in the context of borrower fraud or deception.

H.R. 3915 would have imposed limited assignee liability for violations by creditors of the bill's underwriting requirements but not for violations by mortgage originators, although it did not define the term "assignee." Liability would have extended to assignees and "securitizers." A "securitizer" was defined as any person that assigns residential mortgage loans, to any securitization vehicle. The bill exempted "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 have been liable for violations. The consequence of this distinction was significant. Under the bill, a holder of an interest in a mortgage-backed security or collateralized debt obligation would have not borne the economic risk of loss for a violation of the loan origination requirements.

An assignee or securitizer that acted in good faith would have been liable in an individual action for rescission, costs and attorney's fees, but not for money damages. It could have avoided rescission as a remedy in two circumstances. First, it could have cured a violation within 90 days by modifying or refinancing the loan, at no cost, to provide terms that would have complied with TILA (as amended) at time of origination, plus refund costs and pay reasonable attorney's fees. Second, an assignee or securitizer would not have been subject to assignee liability under

the House bill if the assignee or securitizer could satisfy a due diligence safe harbor, which is referred to as the "securitizer safe harbor." To qualify, the assignee would have to demonstrate that it:

1. established a policy against buying residential mortgage loans other than "qualified mortgages" or "qualified safe harbor mortgages";

2. required the seller to represent and warrant in the loan sale agreement that all of the loans are qualified mortgages or qualified safe harbor mortgages; and

3. in accordance with rules to be promulgated by federal banking agencies and the Securities and Exchange Commission exercised reasonable due diligence to adhere to its policy in purchasing mortgage loans, including through "adequate, thorough, and consistently applied sampling procedures."

The language was silent on the required scope or method of due diligence, and on the consequence of adverse findings from the samplings, leaving those details to regulation.

H.R. 3915 expressly stated that these were the exclusive liabilities that could have been imposed on an assignee for violation of the proposed underwriting requirements. The bill provided a limited preemption of state laws that would have applied additional rules and penalties to secondary market participants with regard to the construct in H.R. 3915. The remedies described in the new liability provision would have constituted 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, the bill expressly would not have preempted the applicability of state laws against creditors. The bill also would not have preempted the availability of state law remedies for fraud, misrepresentation, deception, 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. 3915 was 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, Title III of the bill also would have increased the universe of loans that would have been subject to HOEPA and the substantive restrictions that would have applied to such loans.

II. POSITIVE ELEMENTS OF H.R. 3915

The final version of H.R. 3915 had many provisions that we considered extremely helpful. It properly differentiated 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 generally limited the applicability of its provisions to subprime loans, recognizing that the lending abuses that afflicted the subprime market were generally absent in the prime market. It qualified the responsibilities of creditors to lessen the

likelihood of successful claims for errors in judgments made in good faith. While it increased the monetary damages that would have been available for violations, it limited the availability of "enhanced" or penalty damages to ensure some level of proportionality between the violation and the remedy. While it increased the availability of the extraordinary remedy of rescission, at least the bill offered a creditor the ability to avoid rescission by curing the violation. The bill also properly balanced its treatment of assignees, although the term remained undefined.

Underlying these positive measures was the belief that consumers with troubled credit histories may have required greater protections but deserved the opportunity to obtain home financing. The House understood at the time that there was (and still is) no functioning market for "high cost" loans under HOEPA, because the industry refuses to make, finance, buy, or securitize these loans in response to the "bet your company" liability that HOEPA imposes. While not all agreed, there was a sense that the balancing of interests noted above would comfort the industry to participate in the higher cost loans that would have been regulated under H.R. 3915.

III. LINGERING CONCERNS OVER H.R. 3915

Although SIFMA / ASF continue to have concerns about several issues from H.R. 3915, we appreciate the Committee's balanced approach and beginning the discussion with the final version of H.R. 3915.

Issues that we would like to continue to discuss include:

- The narrow scope of loan products that would have been eligible for the safe harbor. The bill envisioned a class of non-safe harbor mortgages that were not deemed high-cost loans. We felt the market would have difficulty in determining risk and pricing for these loans and they may become prohibitively expensive for many borrowers. Because of the significant penalties and expanded assignee liability provisions under HOEPA, high cost loans generally are not made, financed, purchased, sold, or securitized. The interaction between the lowered HOEPA triggers in H.R. 3915 coupled with other financing limitations in the bill will not have allowed a market to return for these non-safeharbor loans.

- Rationalizing the provisions permitting a consumer to assert claims following the expiration of the statute of limitations in the defense to foreclosure section. The bill could be interpreted as having provided a consumer with a perpetual right to obtain money damages against creditors and assignees following the expiration of the statute of limitations. The bill gave a consumer the right to assert a civil action against a creditor and assignee for violations of the ability to repay and net tangible benefit requirements for the greater of three years and one year after the initial reset or conversion of the loan, but no more than six years. That should be a sufficient time for a consumer to figure out whether they could afford the loan or have received a net tangible benefit from the loan.

Thank you very much for the opportunity to raise these issues. SIFMA/ASF looks forward to working with the Committee to craft legislation that protects homeowners while ensuring a vigorous home finance market. We pledge to continue to work constructively with you on these matters as the bill is developed.

Testimony of

Joe R. Robson

On Behalf Of the
National Association of Home Builders

Before the
United States House of Representatives
House Financial Services Committee
Subcommittee on Financial Institutions and
Consumer Credit

Hearing on

Mortgage Lending Reform: A Comprehensive Review of the American Mortgage System

March 11, 2009

On behalf of the more than 200,000 members of the National Association of Home Builders (NAHB), I thank you for the opportunity to submit this statement on the issue of mortgage lending reform. My name is Joe Robson, and I am a builder and developer from Tulsa, Oklahoma, and the 2009 NAHB Chairman of the Board.

Overview

The housing market, the financial system and the economy's performance continue to reel from the impacts of the mortgage market excesses of earlier this decade. Soaring mortgage foreclosures and declining home prices are interacting in an adverse feedback cycle that shows no signs of diminishing. While the nation will continue to suffer these consequences in the months ahead, the mortgage system itself has already undergone radical reform and change.

The mortgage products and lending practices most responsible the current troubles are no longer in use. Federal and state banking regulators have taken significant steps to curb risky mortgage lending activities, establish sounder underwriting and loan management policies, and improve consumer information and safeguards. Congress has taken action to improve standards for and oversight of mortgage lending. In addition, the private-label securities market, which was the primary vehicle for exotic mortgages, has shut down as investors fled to safer havens, while the mainstream lenders have shifted to an extremely cautious posture. The pendulum, in fact, has swung back well past center so that mortgage credit is currently available only to those with unblemished credit histories who have resources to make a heavy downpayment on their home.

NAHB's members have supported steps to ensure that mortgage lending occurs in a safe and sound manner, with sound underwriting, prudent risk management and appropriate consumer safeguards and disclosure. Home builders and their customers, however, have been significantly impacted by the upheaval in the financial marketplace and, therefore, are highly focused on what might lay ahead. There is a great deal of uncertainty with regard to how the mortgage lending system will function when the housing and financial markets finally stabilize and return to more normal operation, and there is a deep concern that additional market dislocations will increase the depth and length of the current downturn. As Congress considers additional actions to avoid future mortgage lending problems, NAHB urges careful evaluation of steps already taken, ongoing market impairments and structural shifts in the housing finance system, and the immediate and longer-term impacts on the cost and availability of mortgage credit for qualified borrowers.

Changes in Mortgage Regulation

A host of anti-predatory legislative and regulatory proposals have been introduced, in addition to regulatory guidance, to reform and tighten mortgage lending requirements over the last several years.

Nontraditional Mortgage Guidance

On December 21, 2005, the federal banking agencies jointly issued proposed guidance expressing their supervisory concerns regarding nontraditional mortgages, especially those instruments with negative amortization such as interest-only and payment option mortgages. These mortgages typically provide borrowers low monthly payments during the first five years of the loan, but a higher loan balance and payments over the remaining 25 years of the loan. Regulators were correctly concerned that home buyers took out such loans, especially in high price appreciation markets, to purchase homes they could not otherwise afford and that they would be unable to meet the higher payments as interest rates rise and home values decline. On September 29, 2006, the agencies issued the *Final Interagency Guidance on Nontraditional Mortgage Products,* which was aimed at ensuring that these products are offered in a safe and sound manner and in a way that clearly discloses their risks and benefits to consumers.

Subprime Mortgage Lending Statement

On March 2, 2007, the federal banking agencies issued a proposed *Statement on Subprime Mortgage Lending* (Statement) to complement the *2006 Final Interagency Guidance on Nontraditional Mortgage Products*. The final Statement, which was issued on June 29, 2007, requires that lenders use the fully indexed, fully amortizing rate when underwriting a subprime mortgage loan. The Statement cautions against risk-layering features, including an expectation that stated income and low documentation loans should be accepted only if there are documented mitigation factors that minimize the need for repayment capability verification. In addition, borrowers should be allowed to refinance a loan within a minimum of sixty days of its reset period without incurring a prepayment penalty.

Prior to finalizing the Statement, financial institution regulators convened a summit on subprime lending on April 16, 2007. Participants included senior executives of regulatory agencies, lenders and secondary market firms. The federal banking regulators issued a *Statement on Working with Mortgage Borrowers* at a hearing before the House Financial Services Committee on the following day. That statement encouraged financial institutions to work constructively with residential borrowers who are financially unable to make their contractual payment obligations on their home loans. In the press release accompanying the final Subprime Statement on June 29, the regulators stressed that the final guidance reinforced their April statement, noting that workout arrangements are in the best interest of both financial institutions and mortgage borrowers.

The Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR) endorsed both the guidance on nontraditional mortgages and the Statement on Subprime Mortgage Lending and developed their own model statements that state regulatory bodies could adopt at their discretion.

Mortgage Reform and Anti-Predatory Lending Act of 2007

Responding to the turmoil in the nation's subprime markets, the House on November 15, 2007, passed the *Mortgage Reform and Anti-Predatory Lending Act of 2007* (H.R. 3915) by a

vote of 291-127. The bill, which seeks to curb abusive mortgage lending practices, would require lenders to make sure borrowers have a reasonable ability to pay back a loan; bring loan originators and mortgage brokers under a nationwide licensing registry; expand some limits on high-cost mortgages; and establish some legal liability standards for mortgage securitizers. Lawmakers also adopted provisions from separate legislation (H.R. 3837) sponsored by Rep. Paul Kanjorski (D-Pa.) that would establish federal standards for appraisers and would require lenders to establish escrow accounts for certain loans to protect borrowers against unexpected tax bills and insurance premiums. Finally, the bill would expand the definition and consumer protections for high-cost loans, prohibit prepayment penalties, provide protections for renters affected by single-family foreclosures, and establish new disclosure requirements for all loans.

Homeownership Preservation and Protection Act of 2007

In the Senate, *The Homeownership Preservation and Protection Act of 2007* (S. 2452), sponsored by Banking Committee Chairman Christopher Dodd (D-CT), was introduced on December 12, 2007. In general, S. 2452 established new protections for borrowers of subprime and "non-traditional" loans. It prohibits mortgage brokers from steering prime borrowers to more expensive subprime loans; creates a fiduciary duty between mortgage brokers and borrower; prohibits prepayment penalties and yield spread premiums for nontraditional loans; requires analysis by lender of the borrower's ability to repay and determination that a subprime loan will provide a net tangible benefit a borrower.

Home Ownership and Equity Protection Act and Truth in Lending Act Regulations

On December 18, 2007, the Federal Reserve Board released proposed changes to regulations issued under the *Home Ownership and Equity Protection Act* (HOEPA) and the *Truth in Lending Act* (TILA) to better protect consumers and facilitate responsible lending. A final rule was approved on July 14, 2008. The rule prohibits unfair, abusive or deceptive home mortgage lending practices and contains borrower protections that are similar to those outlined in H.R. 3915 and S. 2452. The proposal would expand the range of loans covered by establishing a threshold for "higher-priced mortgage loans" (HPML). The rule's definition of HPMLs was intended to capture virtually all loans in the subprime market, but generally exclude loans in the prime market. To provide an index, the Federal Reserve Board will publish the "average prime offer rate," based on a survey currently published by Freddie Mac. A loan is an HPML if it is a first-lien mortgage and has an annual percentage rate that is 1.5 percentage points or more above this index, or 3.5 percentage points if it is a subordinate-lien mortgage. This definition overcomes certain technical problems with the original proposal that was based on a spread between mortgage and Treasury yields.

The Board established four consumer protections for HPMLs, including: (1) lenders would be prohibited from engaging in a pattern or practice of extending credit without considering borrowers' ability to repay; (2) lenders would be required to verify borrower income and assets; (3) the use of prepayment penalties would be restricted (no penalty could apply for at least 60 days before any possible payment increase); and (4) lenders would have to establish escrow accounts for property taxes and insurance. For all mortgages, lenders would be required to increase mortgage loan disclosures. In addition, lenders would be prohibited from

compensating brokers through yield-spread premiums unless there is a written agreement with the borrower that discloses such an arrangement, and lenders and brokers would be prohibited from pressuring appraisers for higher valuations.

S.A.F.E. Mortgage Licensing Act

Through the S.A.F.E. Mortgage Licensing Act (Division A, Title V of the *Housing and Economic Recovery Act of 2008*), states are encouraged through the Conference of State Bank Supervisors and American Association of Residential Mortgage Regulators to establish a Nationwide Mortgage Licensing System and Registry for residential loan originators. S.A.F.E. will cover all persons who take residential mortgage loan applications and offer or negotiate mortgage terms. The Act establishes minimum standards for licensing and registration. Licensees must demonstrate financial responsibility, character, and general fitness; complete pre-licensing educational requirements; pass a written test; and meet either net worth or a surety bond requirement. HUD is required to establish a backup licensing and registry system for the licensing and registration of loan originators for any state that fails to establish a state system within one year from enactment. The Act also requires Federal banking regulators to jointly establish a registry of loan originators for federally regulated bank and thrift institutions and their subsidiaries.

Forty-two state regulatory agencies have indicated their intent to transition into the CSBS/AARMR system and have committed to participating in the Nationwide Mortgage Licensing System (NMLS) which was launched on January 2, 2008 (all 50 states are expected to join the system). The NMLS is just one aspect of a multi-faceted plan being implemented by CSBS and AARMR to improve regulation and bring about greater uniformity across state lines in mortgage supervision.

Changes in Mortgage Market Conditions Since 2007

In the fall of 2007, when the House Financial Services Committee deliberated on H.R. 3915, mortgage markets were in disarray because of the turmoil in the subprime mortgage market that was beginning to spill over into the conforming and jumbo markets. As documented in the previous section, many steps have been taken by regulators since that time to rein in the mortgage origination practices that have ultimately resulted in record loan delinquencies and foreclosures.

In late 2007 and 2008, as private label investors realized that they had miscalculated the risks of the mortgage securities they were holding, valuation of these securities became difficult or impossible to determine. The investor backlash affected all mortgage products not backed by the federal government (FHA or VA loans) or the government-sponsored enterprises (Fannie Mae and Freddie Mac). First, the subprime market seized up, which then spread to Alt-A ARMs and the jumbo market – loans to credit-worthy borrowers with loan amounts greater than the conforming loan limit.

Higher Loan Limits Provide Limited Relief

In efforts aimed at adding liquidity to mortgage markets, actions by Congress[1] in 2008 increased the size of loans that could be held or securitized by Fannie Mae and Freddie Mac, insured by the Federal Housing Administration (FHA), and guaranteed by the Department of Veterans Affairs (VA). These changes have resulted in record volumes and increased market share for FHA and VA, however, overall purchase money mortgage market activity has continued to decline steadily. In addition, the jumbo mortgage market, which is funded by privately held securities, has failed to reappear for all but the most creditworthy borrowers – and then only at interest rates far above those for conforming loans.

Tighter Credit Underwriting Standards

Fannie Mae, Freddie Mac, and the private mortgage insurers have eliminated their lower-downpayment programs while tightening underwriting standards in the face of increasing loan delinquencies and defaults as well as corporate financial problems. Unlike Fannie Mae and Freddie Mac, which were placed into Conservatorship by the federal government in 2008, the private mortgage insurers are endeavoring to preserve their capital by withdrawing from all but their mainstream business lines and by tightening their standards in the segments of the mortgage markets they continue to serve. Mortgage credit standards are even tighter for prospective home buyers in areas such as Florida, where housing markets continue to be severely impacted by foreclosures and new homes that remain unsold two or three years following construction.

Foreclosure Moratoriums

As the end of 2008 approached and loan delinquencies continued to increase, Fannie Mae, Freddie Mac, and numerous loan servicers agreed to cease their pursuit of foreclosures in favor of placing greater emphasis on loan modifications and workouts. These efforts have continued into the first quarter of 2009. It is generally believed that the costs of foreclosure and its impact on families and neighborhoods are greater than the costs that are associated with efforts to modify or restructure loans in ways that allow homeowners to remain in place. Questions have been raised recently regarding the effectiveness of loan modifications, with some sources stating that up to half of the borrowers whose loans are modified will fail to meet the restructured obligations.

Administration Refinance and Modification Program

On February 18, President Obama outlined the multifaceted Homeowner Affordability and Stability Plan (the Plan) that is aimed at preventing millions of foreclosures. The Plan has three main elements: refinance program for borrowers with diminished equity, but current payments; a $75 billion loan modification program for struggling homeowners; and, steps to bolster Fannie Mae and Freddie Mac's support to the mortgage market. Details of the mortgage

[1] The Economic Stimulus Act of 2008 (Pub.L. 110-185), the Housing and Economic Recovery Act of 2008 (Pub. L 110-289), the Recovery and Reinvestment Act of 2009 (ARRA) (Pub. L. 111-5), and the Veterans' Benefits Improvement Act of 2008, (Pub. L.110-389).

refinance and modification initiatives were released on March 4 as the "Making Home Affordable" (MHA) program.

The Home Affordable Refinance program applies to conforming loans owned or guaranteed by Fannie Mae and Freddie Mac where the loan-to-value ratio has risen above 80 percent because of a decline in house value. Such borrowers have until June 10, 2010, to refinance to a lower interest rate mortgage if they are an owner occupant, current on their loan, and have a loan-to-value ratio no greater than 105 percent.

The Home Affordable Modification program builds on the loan modification protocol developed by the FDIC, where a loan is modified by reducing the interest rate, increasing the term and/or deferring/reducing principal payments, if such adjustments result in a better net present value for the mortgage investor than disposition through foreclosure. The goal of this program is to reduce homeowners' monthly mortgage payments to sustainable levels.

Of course, the effectiveness of these programs to stem the tide of defaults remains to be seen, as does their long-term effect on investors' willingness to return to the mortgage markets.

Impact of Mortgage Lending Conditions on Home Builders

Tighter Mortgage Lending Standards

NAHB's members and their customers have been significantly impacted by the mortgage market upheavals since 2007 and there is deep concern that the dislocations in the financing markets will increase the depth and length of the housing downturn.

In a recent NAHB survey, 68 percent of the home builders responding said that home buyers think it is hard to get financing to purchase new homes. Mortgage financing is also a significant barrier to greater sales of existing homes, which keeps current homeowners from being able to sell their homes in order to purchase a new home.

Single Family Appraisal Problems

NAHB is concerned that many appraisers have adopted an overly cautionary approach to valuation because of widespread criticism of overly optimistic appraisals as one cause of the current housing and credit crisis. NAHB's members have reported numerous instances of homes that failed to be appraised at the agreed-upon sales price or even the cost of construction. Depending on the degree of the appraisal shortfall, the home builder faces the decision of reducing the sale price or canceling the sale.

NAHB's members have in recent months frequently expressed concern that appraisers have often used sales of homes in foreclosure or other distressed circumstances as comparables for appraisals of new homes without having made the appropriate value adjustments. Properties that are used as comparables are not subject to the same degree of scrutiny as the subject property. In the case of new home appraisals, comparable properties are often older and, if involved in a foreclosure or distressed asset sale, may suffer from neglect and damage that would

not be known unless the appraiser conducted thorough inspections. Unfortunately, most agencies require only cursory reviews of the condition of comparables, which means that appraisers may overlook damage and neglect and, as a result, insufficiently adjust the values of properties that are used as comparables. NAHB has asked Fannie Mae and Freddie Mac to review and reiterate their guidance to seller-servicers in this regard.

The concern about inappropriate choices of comparables or insufficient adjustments is frequently voiced by NAHB members in conjunction with observations that the appraisers in question are from outside of the area of the subject property and are working under contact with an Appraisal Management Company (AMC) at a level of compensation that is less than the prevailing rate in the area. Below-market appraiser compensation, when combined with short turnaround times, may mean that appraisers who perform appraisals for AMCs are the least experienced and therefore less competent to perform appraisals during these times of turbulent market conditions.

Appraisers bear the responsibility to "disclose the lack of knowledge or experience to the client before accepting the assignment" under the standards as promulgated in the Uniform Standards of Professional Appraisal Practice (USPAP).[2] While the foregoing requirement is very clear, it is not clear that the AMC has an obligation to inform the client that the appraiser lacks the appropriate level of knowledge regarding a market with which he or she may not be familiar.

Appraiser competence is also a concern. Most lenders require appraisers only to be licensed, which is minimum standard for appraisal practice. While many licensed appraisers produce quality work, those who are certified have met higher standards for education and experience. Section 1404 of the *Housing and Economic Act of 2008* (Pub.L. 110-289) no longer allows licensed appraisers to perform appraisals in conjunction with FHA-insured single family loans. After June 1, appraisers who choose to perform FHA appraisals will have to be certified.

Positions and Recommendations

NAHB supports and encourages continued mortgage market innovation to improve housing affordability and expand homeownership opportunities as long as such loans are prudently underwritten to ensure that the form of financing is appropriate for the borrower and market and consumers are fully aware of the features and risks of the loan. NAHB opposes predatory lending practices. NAHB has supported efforts of the federal and state banking regulators to issue guidance on nontraditional and subprime mortgage lending, although NAHB's support is conditioned on the regulators exercising care in the banking supervision/examination process to avoid unnecessarily reducing the flow of mortgage credit, limiting consumer mortgage options, or raising housing credit costs for qualified home buyers.

[2] Uniform Standards of Professional Practice 2008-2009 edition, Appraisal Standards Board, p.U-11

At its most recent board of directors meeting, NAHB adopted policy expressing the following principles for mortgage lending:

- Underwriting standards and decisions should be based on documented borrower credit and repayment capacity rather than expectations of rising collateral value.
- There should not be overly rigid adherence to loan-to-value limits that results in inappropriate rejections of creditworthy borrowers.
- Underwriting decisions should be based on mortgage quality and not driven by fee income.
- Mortgage brokers and lenders should be subject to adequate oversight.
- Mortgage originators, lenders and investors should have appropriate accountability and liability for the instruments in which they are involved.
- The process for mortgage securitization must be more transparent, providing adequate collateral and risk information for investors and regulators.
- Credit rating organizations must have adequate oversight and restrictions to ensure objective evaluations and avoid conflicts of interest.
- Appraisals should be undertaken by fully qualified individuals and should accurately reflect values under orderly market conditions.
- The appraisal system should not exacerbate price volatility.
- Distressed sales should not be used to determine value.

NAHB has also supported efforts to improve consumer education on financing and owning a home. NAHB provided financial support for and served on the board of the American Homeowner Education and Counseling Institute, which established and promulgated standards for home buyer education and counseling. NAHB has worked with the NAACP to improve the quality and flow of information for minority home buyers and with a unit of the Department of the Treasury on similar efforts.

NAHB believes it is important that efforts to ensure prudent mortgage lending and risk management practices as well as adequate consumer disclosures are comprehensive and uniform for all institutions and organizations that are involved in providing mortgage credit. NAHB also believes institutions' control systems should encompass both institution personnel and applicable third parties, such as mortgage brokers and correspondents. Further, institution compensation programs should avoid providing incentives that are inconsistent with prudent underwriting or that steer consumers to subprime loans to the exclusion of other products for which the borrower may qualify.

NAHB also believes that continued coordinated regulatory efforts among federal and state agencies is necessary to ensure prudent lending practices and effective consumer protections while facilitating efficient operation of the residential mortgage markets. Most importantly, any steps to reform mortgage lending practices should not include provisions that would inadvertently or unnecessarily disrupt the mortgage lending process, limit consumer financing options, or increase the costs or reduce the availability of mortgage credit.

NAHB offers two specific policy recommendations:

Federal Pre-emption – NAHB urges Congress to implement a clear national framework for mortgage origination standards to replace the current patchwork of state and local laws, which often lead unnecessary restrictions on mortgage credit. Specifically, Congress should establish a federal pre-emption statute creating essential uniformity in the mortgage market.

Arbitration – NAHB strongly supports the use of alternative dispute resolution techniques, including binding arbitration, as the most rapid, fair and cost effective means to resolving disputes. Invalidating binding arbitration provisions in contracts would undermine decades of jurisprudence strongly favoring arbitration of disputes where the parties have agreed to use the arbitration process. NAHB opposes any attempt to prohibit the use of pre-dispute arbitration in contracts.

Conclusion

Thank you once again for this opportunity to provide the home builder perspective on the issue of mortgage lending reform. The home building industry has been significantly impacted by the recent upheaval in the financial marketplace and, therefore, is highly focused on what may lay ahead. There is a great deal of uncertainly with regard to how the mortgage lending system will function when the housing and financial markets finally stabilize and return to more normal operation, and there is a deep concern that additional market dislocations will increase the depth and length of the current downturn. NAHB has supported efforts to ensure that mortgage lending occurs in a safe and sound manner and that abuses in lending practices be properly addressed. We look forward to working with this Subcommittee, and the full House Financial Services Committee, to ensure that any steps taken in this effort do not unnecessarily reduce the flow of mortgage credit during this time of extreme market turmoil. I welcome any questions you may have for me.

Mortgage Lending Reform:
A Comprehensive Review of the Current Mortgage System

Subcommittee on Financial Institutions and Consumer Credit
House Financial Services Committee

March 11, 2009

Testimony provided by:

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on behalf of the:

Low-income clients of the National Consumer Law Center
National Association of Consumer Advocates

Mortgage Lending Reform:
A Comprehensive Review of the Current Mortgage System

Chairman Gutierrez, Congressman Hensarling, Members of the Committee: thank you for inviting me to testify today on behalf of the low income clients of the **National Consumer Law Center,**[1] and the **National Association of Consumer Advocates.**[2] I am here today expressing the views of the hundreds of legal aid and consumer attorneys who, on a daily basis, are fighting the foreclosures and attempting to assist homeowners across the country maintain their homes in the face of today's mortgage crisis.

At this hearing, we have been asked to discuss the current state of mortgage lending and proposals to reform the system, changes to HR 3915 – as passed by the House, issues of specific concern to low and moderate income homeowners and mortgage applicants, as well as servicing issues. In this testimony, we provide the following information:

- Section I – Principles to be used to create the mortgage regulation for the 21st century.
- Section II – Detailed explanations of how these principles should be translated into explicit regulations of the mortgage industry;
- Section III – Background on the problems in the current marketplace relevant to the recommended principles of reform.

I. Introduction

It is common knowledge that mortgage delinquencies and foreclosures are at higher levels than ever before recorded.[3] Mortgage originations have plummeted to historic lows: issuance of

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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 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.

[3]National Delinquency Survey from the Mortgage Bankers Association • Fourth Quarter 2008 at 2.

non-prime mortgage securities virtually ceased by the end of 2008, and analysts do not expect it to rebuild anytime soon.[4]

The current mortgage market is a mess. The big question is how the mortgage production system should changed – to encourage *good* credit to be accessible, and to protect homeowners and investors from credit which is neither sustainable nor secure.

We propose today a different orientation to the question: 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.

HR 3915, passed by the House in November, 2007, was an aggressive bill for *its* time. It was an attempt to balance the perceived need to change current laws and regulations while preserving access to credit. The bill essentially maintained the current structure of loose regulation of mortgage origination, while tweaking the obligations of various parties – mostly the originators – to enhance their obligations to consumers. The repeatedly expressed counter-balance to stronger consumer protections was the fear of inhibiting credit: it was believed that too much regulation would impair the ability of the mortgage market to provide loans.

With six million foreclosures looming in the near future and the subprime mortgage market in a complete shambles, now is the time to reevaluate the issues raised by the current mortgage regulatory structure. New approaches should be considered to creating a mortgage regulatory system which will work for everyone in the future. We propose to you an approach which carries the following three key characteristics:

A **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.

B **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?

C **Appropriate Incentives** – The current system rewards originators for making bad loans – because the originators are paid regardless of whether the loan is unfair, fraudulent, or unaffordable. Similarly, mortgage servicers are rewarded for servicing

[4] *Inside B&C Lending* (February 27, 2009)

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.*

II. 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.

III. Rationale – The Problems of the Current Mortgage Market and the Lessons from the Past

This section will provide a brief discussion of three issues:

A. **Payment Option Arm Loans** ("POARMS") – Much has been written about subprime adjustable rate mortgages and their dangers,[5] but less is known about the equally toxic mortgages known as Payment Option ARM loans. These are some of the most problematic loans in the marketplace, and their prevalence – among both middle and low income homeowners – serve to illustrate the serious failures in underwriting allowed by today's mortgage regulatory structure.

B. **Problems in the Loan Servicing Industry** – The mortgage servicing industry has itself contributed substantially to the current foreclosure crisis. The rules governing this industry need to be changed.

C. **The Role of Preemption and Private Rights of Action Against Enforcers of Illegal Mortgage Instruments** – The last bastion of hope for individual homeowners when faced with illegal mortgages or improper servicing is the private attorney seeking to stop a foreclosure using state law remedies: these must be preserved.

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[5] *See generally,* National Consumer Law Center's website on predatory mortgage lending: http://www.consumerlaw.org/issues/predatory_mortgage/index.shtml and the website of the Center for Responsible Lending: http://www.responsiblelending.org/issues/mortgage/.

A. Payment Option Arm Loans – Danger in the Loan.

In the past few years, payment option ARM loans ("POA"s) became a popular type of mortgage offered to many homeowners. Nearly $750 billion in these loans were issued between 2004 and 2007, and they are a substantial cause of the foreclosure crisis facing the United States.[6] Yet they were largely issued to prime borrowers, and for that reason, they are still considered prime loans.[7] **These loans exemplify the essential basis to cover *all* mortgages in the mortgage regulation for the 21st century.**

Like the adjustable rate mortgages that were common in the subprime market since the early part of this decade, POAs include a variable rate component as part of a systematic shifting of risk from lenders to borrowers. The signal factor in POA loans is a set period of time during which the minimum payment is fixed – such as one to several years – but the interest rate varies, which leads to negative amortization and a steady increase in the principal owed on the loan.

Under a payment option ARM a borrower has, in theory, a choice of three payments: a minimum payment based on an initial, low teaser interest rate; an interest only payment that covers the actual interest accruing; and a fully amortizing payment. Three-quarters of all borrowers pay only the minimum payment.[8] The minimum payment is generally sold as a "fixed rate" payment, although the interest rate is usually not fixed for more than a month and may be fixed for only a day.[9] Given the low initial teaser rates (1% to 2%), negative amortization occurs whenever minimum payments are made beyond the initial fixed rate period and the rate becomes adjustable. Most payment option ARM loans limit the negative amortization that can accrue to an amount between 110% and 125% of the original principal.

Once the negative amortization cap is reached, the monthly payments regime is completely changed. There is no longer a choice of payments. Now the borrower must pay an amount sufficient to pay off the loan in the remaining time of the loan term. This means that if the original loan term was 30 years, and the remaining term is now twenty-five years, the – now swollen – principal will be amortized over the remaining twenty-five years of the loan. The combination of negative amortization and low teaser rates results in significant payment shock, often a doubling or tripling of the borrower's payment obligations thirty to sixty months after loan consummation, generally with no more than thirty days notice.

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[6]Ruth Simon, *Option Arms See Rising Defaults,* Wall Street Journal, January 30, 2009.

[7]*Id.*

[8]Joint Ctr. for Hous. Studies, *State of the Nation's Housing 2007*, at 17.

[9]*See, e.g.*, Andrews v. Chevy Chase, 240 F.R.D. 612 (E.D. Wis. 2007) (describing payment option ARM sold as "fixed rate" when interest only fixed for one month, although payments fixed for a year).

Payment option ARM loans are very problematic for borrowers. They are complex, involve concepts that are unfamiliar and confusing to most, even fairly sophisticated, homeowners.[10] Brokers and lenders can easily take advantage of the complex nature of the products and the lack of specific guidance in the regulations governing disclosures to mislead consumers and make abusive loans.[11]

The dangers of adjustable rate loans for borrowers is considerably exacerbated by additional characteristics on these loans such reduced verification of the borrowers' ability to repay the loan.[12] As more risk factors are piled into the same loans – adjustable rates plus reduced documentation – unsurprisingly, the likelihood of foreclosure rises as well.[13] It is well recognized that particularly the failure to adequately underwrite mortgage loans leads to increased foreclosures creating horrible home losses for homeowners and significant losses for investors.[14]

In 2006 and 2007, federal regulators issued guidance and statements addressing the widespread failure of underwriting in POA loans and other adjustable rate loans.[15] These five federal banking regulators specifically challenged the practice of substituting rate increases for underwriting.[16]

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[10]*See e.g.* Consumer Fed'n of Am. press release, Lower-Income and Minority Consumers Most Likely to Prefer and Underestimate Risks of Adjustable Mortgages 3, July 26, 2004, (consumers cannot calculate the increase in the payment in an adjustable rate mortgage and minimize the interest rate risk by understating the increase in the payment) available at http:// www.consumerfederation.org/releases.cfm#Consumer%20Literacy.

[11]Fed. Trade Comm'n v. Chase Financial Funding, Inc., No. SACV04-549, Complaint at 4 (C.D. Cal. May 12, 2004), available at www.ftc.gov/os/caselist/0223287/040602comp0223287.pdf (describing payment option ARM); Gov't Accountability Office, GAO No. 06-1021, Alternative Mortgage Products: Impact on Defaults Remains Unclear, but Disclosure of Risks to Borrowers Could Be Improved 22 (2006) (describing advertisement for payment option ARM that promised 45% reduction in monthly mortgage payments and interest rate of 1.25%, yet interest rate of 1.25% only applied for first month, and this fact disclosed in "much smaller print" on second page), available at www.gao.gov/new.items/d061021.pdf.

[12]*See* Gov't Accountability Office, GAO No. 06-1021, *Alternative Mortgage Products: Impact on Defaults Remains Unclear, but Disclosure of Risks to Borrowers Could Be Improved* 3 (2006), available at www.gao.gov/new.items/d061021.pdf.

[13]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. Thus, balloon payments and ARMs appear to be markers for lack of loan affordability and consequent default risk rather than the cause of default in themselves.

[14]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).

[15]Statement on Subprime Lending, 72 Fed. Reg. 37,569 (July 10, 2007); Interagency Guidance on Nontraditional Mortgage Product Risks, 71 Fed. Reg. 58,609 (Oct. 4, 2006).

[16]71 Fed. Reg. 58,609, 58,614 (Oct. 4, 2006) ("While higher pricing is often used to address elevated risk levels, it does not replace the need for sound underwriting.").

They identified three main failures of underwriting typical of these loans:

- the failure to take into account future rate adjustments and negative amortization in determining ability to repay,
- the failure to include tax and insurance payments in determining ability to repay, and
- the widespread prevalence of stated income loans.

The 2006 Interagency Guidance on Nontraditional Mortgage Products issued by these five federal banking regulators focused on the payment shock occasioned by rate resets and periods of negative amortization.[17] The guidance urged lenders to underwrite loans to the fully indexed rate, as opposed to an initial teaser rate.[18] This focus on the fully indexed rate was a large step forward from the practices of many lenders – and one which was vigorously objected to by the mortgage industry.[19]

Despite these statements from federal regulators, the loans written *after* the pronouncements are expected to default at a greater rate than those written before.[20] According to a recent Wall Street Journal article, based on reports issued by Goldman Sachs and Countrywide:

> As of December, 28% of option ARMs were delinquent or in foreclosure, according to LPS Applied Analytics, a data firm that analyzes mortgage performance. . . .
>
> **Nearly 61% of option ARMs originated in 2007 will eventually default**, according to a recent analysis by Goldman Sachs, which assumed a further 10% decline in home prices. That compares with a

[17] 71 Fed. Reg. 58,609, 58,613-58,614 (Oct. 4, 2006).

[18] The fully indexed rate is the interest rate that would be in effect at the time of origination, based upon the index identified in the loan note plus the listed margin, absent a teaser rate. Even the fully indexed rate does not reflect the possible risk that interest rates will increase; it is not the maximum rate that can be charged under the note. It is only the rate that would be charged on the note had the interest rate calculations under the note been imposed at the outset.

[19] Subprime Mortgage Market Turmoil: Examining the Role of Securitization, Hearings Before the S. Comm. on Banking, Hous., & Urban Dev., 110th Cong. (2007) (statement of Sandor Samuels, Executive Managing Dir., Countrywide Fin. Corp.) (60% of borrowers from Countrywide could not qualify at the fully indexed rate), available at http://banking.senate.gov/index.cfm?Fuseaction=Hearings.Detail&HearingID=256; Steven Sloan & Joe Adler, How Freddie Cutbacks in Hybrids May Reverberate, Am. Banker, Feb. 28, 2007 (quoting Wright Andrews, a lobbyist for nonbank lending institutions, as saying that most subprime borrowers cannot afford the fully indexed rate and requiring underwriting to the fully indexed rate would prevent adjustable rate mortgages from being made).

[20] *See, e.g.*, American Home Mortgage Assets, LLC Prospectus supplement dated August 29, 2006 (to prospectus dated April 21, 2006), American Home Mortgage Assets Trust 2006-4; Issuing Entity: American Home Mortgage Servicing, Inc.; Servicer: American Home Mortgage Corp. showing that the lender *underwrote these POA loans only for the first year's payments* (at 9), also showing the 73% of the loans covered by this prospectus were refinance loans.

> 63% default rate for subprime loans originated in 2007. Goldman estimates more than half of all option ARMs outstanding will default. (Emphasis added.)[21]

Unfortunately, this only makes clear that guidances and statements from federal regulators are not sufficient to change the marketplace. Instead the basic incentives governing the mortgage origination process have to be changed. There should be clear rules that only permit originators, lenders and holders to profit from the *payment stream* of the loan, the borrower's ability to repay the actual payments that will be required by the loan must be verified to be sufficient before the loan can be made; loans made in violation of these basic rules should not be permitted to be enforced.

B. Problems in the Loan Servicing Industry Substantially Contribute to Foreclosures

While the servicing industry stands at the center of the foreclosure crisis, and thus is in the best position to turn the situation around, the basic structure of the servicing business requires a recognition that this industry will not lead the way out of this foreclosure nightmare – Congressional action is needed.

Mortgage servicers are the link between mortgage borrowers and the mortgage owners. Since the 1990s, mortgage servicing has become an increasingly specialized and lucrative industry, driven in part by the need for one party to coordinate the distribution of mortgage revenues to the investors in securitized loans. Despite the important functions of mortgage servicers, borrowers have few market mechanisms to employ to ensure that their needs are met. Rather, in the interest of maximizing profits, servicers have engaged in a laundry list of bad behaviors, which has considerably exacerbated foreclosure rates.[22] The most common abuses in loan servicing include misapplication of payments, use of suspense accounts, failure to make timely escrow disbursements, and cascading fees imposed upon homeowners in default.[23] These abuses exist because there are market incentives rather than deterrents for this type of behavior.[24] Any new regulation of the mortgage marketplace must account for these dynamics and move beyond them.

1. Servicers – Cutting Cost, Cutting Service.

As with all businesses, servicers add more to their bottom line to the extent that they can cut costs. Servicers have cut costs by relying more on voicemail systems and less on people to assist borrowers, by refusing to respond to borrowers' inquires and by failing to resolve borrower disputes. Recent industry efforts to "staff-up" loss mitigation departments have been woefully inadequate. As a

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[21]Ruth Simon, *Option Arms See Rising Defaults,* Wall Street Journal, January 30, 2009.

[22]See National Consumer Law Center, *Foreclosures*, Ch. 6 (2d ed. 2007)(describing the most common mortgage servicing abuses).

[23]*Id.*

[24]*See* Kurt Eggert, Comment on Michael A. Stegman *et al.'s "Preventive Servicing Is Good Business and Affordable Homeownership Policy": What Prevents Loan Modifications?*, 18 Housing Pol'y Debate 279 (2007).

result, servicers remain unable to provide affordable and sustainable loan modifications on the scale needed to address the current foreclosure crisis. Instead borrowers are being pushed into short-term modifications and unaffordable repayment plans.

These "kick the can" approaches to solving the foreclosure crisis do not provide real solutions for those affected borrowers. Instead, they merely postpone the day of reckoning. As is evident from the most recent analysis of the loan modifications currently being made – in most cases the modifications only provide very temporary band-aids to situation that need major surgery:

> Modifications increasing loan balances still dominate, with 89% of modifications involving some capitalization of arrears, and only 12% involving any write-offs of principal, interest or fees . . . . Monthly payment reductions accounted for 49% of all modifications, essentially unchanged from November and December, while 13% of modifications did not change the payment and 38% increased the payment.[25]

The single-minded pursuit of foreclosures is costing investors far more than affordable loan modifications would:

> Investors lost $3.8 billion from foreclosure sales, compared with $73 million from write-downs in connection with mortgage modifications. Looking only at the 12% of modified loans with write-offs, the average write-off was $26,000, or about 13.5% of the original loan amount. For liquidated foreclosures, the average loss was $130,000, representing about 61% of the original loan amount.[26]

Creating affordable and sustainable loan modifications for distressed borrowers on a loan-by-loan basis is labor intensive.[27] Under many current pooling and servicing agreements, additional labor costs incurred by servicer's engaged this process are not compensated by the loan owner. By contrast, most servicers are paid a fee to foreclose on a borrower. Under this cost and incentive structure, it is no surprise that servicers continue to push borrowers into less labor-intensive repayment plans or towards foreclosure.

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[25]Alan White, Update - January's Subprime Mortgage Modifications. Consumer Law & Policy Blog, Feb. 13, 2009. Available at: http://pubcit.typepad.com/clpblog/2009/02/update-januarys-subprime-mortgage-modifications.html.

[26]*Id.*

[27]Joseph R. Mason, Mortgage Loan Modification: Promises and Pitfalls, at 7(Oct. 3, 2007), available from SSRN at papers.ssrn.com/sol3/papers.cfm?abstract_id=1027470.

2. Servicers Maximize Income in ways that Hurt Borrowers and Investors.

Customarily, the servicer collects a monthly fee in return for the services provided to the trust (or investors). The servicing fee provides the largest income stream for servicers. The fee is based on the unpaid principal loan balance and typically ranges from 25 basis points (prime loans) to 50 basis points (subprime loans). In addition, ancillary fees are imposed on borrowers to compensate servicers for the occurrence of particular events. The most common ancillary fee is a late fee, although a variety of other "servicer" fees exist. Such fees are a crucial part of the servicers' income because servicers are typically permitted under Pooling and Servicing Agreements to retain such fees. This behavior may benefit the servicers, but it hurts the investor, the homeowner, and communities.

3. The Rules Governing Mortgage Servicers Need to be Changed: Servicers Interests Should be Aligned to those of Homeowners

Getting to Affordable Loan Modifications Takes Work. Creating affordable and sustainable loan modifications for distressed borrowers is labor intensive. It is no surprise, then, that servicers continue to push borrowers into less costly repayment plans and short-term modifications. While the current government loan modifications at least promise better outcomes, these measures are voluntary and temporary.

New legislation should prioritize loan modifications where they are more profitable to investors than foreclosure, and should value loss mitigation in general over foreclosure. Loan modifications must be based on an affordability analysis centered on the debt to income ratio with some consideration of a homeowner's residual income and the person's full debt profile, including junior liens on the property.

Mandating Borrower Access to a Decision Maker. From the homeowner's perspective one of the biggest obstacles to loan modification is finding a live person who can provide reliable information about the loan account and who has authority to make loan modification decisions. Federal law should require that mortgage servicers provide borrowers with contact information for a real person with the information and authority to answer questions and fully resolve issues related to loss mitigation activities for the loan.

Requiring Information and Dispute Resolution Prior to Foreclosure. While the Real Estate Settlement Procedures Act currently requires servicers to respond to borrowers' request for information and disputes within 60 days, in practice many such inquires go unanswered. Despite this failure to respond, servicers are still permitted to proceed to collection activities, including foreclosure.

Essential changes to this law governing servicers would ensure that borrowers facing foreclosure should no longer be at the mercy of their servicer. There should be transparency in the servicing process by allowing the homeowner to obtain key information about the loan and its servicing history. Servicers should be prohibited from initiating or continuing a foreclosure proceeding during the period in which and outstanding request for information or dispute is pending.

Most importantly – foreclosures should be prohibited unless an analysis of the comparative costs between an affordable loan modification and foreclosure shows that the investor will reap more income from the foreclosure.

C. The Role of Preemption and Private Rights of Action Against Enforcers of Illegal Mortgage Instruments

Homeowners who have been victimized by predatory mortgages routinely bring actions against the holders of their loans under common law and statutory theories such as 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 these claims are routinely the basis for saving homes around the nation. These claims 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, 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.

1. Don't Repeat the Preemption Problems in HR 3915.

One serious problem with HR 3915 as passed by the House in 2007 was the preemption of claims against holders. Section 208 would preempt all claims against assignees and holders when net tangible benefit or ability to pay issues are involved. While there are some exceptions to this wholesale preemption, important claims that are currently saving homes all over the nation would be eliminated. *This is a serious problem which must not be repeated in any upcoming legislation.*[28]

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[28]SEC. 208. EFFECT ON STATE LAWS –

(a) In General- Section 129B(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 129B 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 129B.

(b) Rules of Construction- No provision of this section shall be construed as limiting--

(1) the application of any State law against a creditor;

(2) the availability of remedies based upon fraud, misrepresentation, deception, 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; or

(3) the application of any other State law against any assignee, securitizer, or securitization

The preemption would apply 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 law. This preemption of essential claims against assignees would eradicate the ability of homeowners 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 the loan. Lawyers who represent homeowners in most states—both defensively against and affirmatively—routinely use non-fraud consumer claims to challenge the predatory nature of the loans.[29] Moreover, these claims are routinely raised against holders of the loans – which is generally essential to do to stop threatened foreclosures.[30]

2. 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.

Borrowers deserve direct access to the party who can save their home. This can only be ensured through applying assignee liability to every mortgage loan. Market incentives and interests must be aligned 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.

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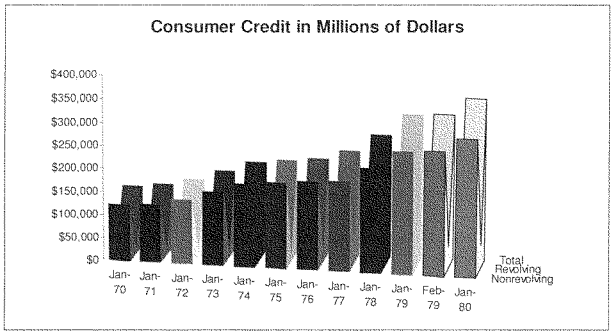
vehicle except as specifically provided in subsection (a) of this section.

[29]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 some of these states the bond requirements are prohibitively expensive, so that the only way to stop a foreclosure is to file a bankruptcy.

[30]Our report issued a few months after HR 3915 passed the House, details this analysis and provides extensive examples of real life claims brought to save homes from foreclosure against holders which would be preempted if HR 3915 passed the Congress. *See*, National Consumer Law Center, *Key Home-Saving Measures at Risk: The Threat of H.R. 3915's Preemption Rule*, March 14, 2008. Available at http://www.consumerlaw.org/issues/predatory_mortgage/content/HR_3915_Preemption_Analysis.pdf.

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.[31] 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.[32] The rule reallocates the cost of seller misconduct from the consumer to the creditor,[33] so that a consumer who has been harmed may obtain a remedy by abrogating the Holder in Due Course doctrine.[34]

At the time 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.[35] The finance companies and the banks argued that they did not want the responsibility of policing sellers, sellers 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.[36] These nightmare scenarios did not materialize.



There was no reduction in available consumer credit; there were no indications that sellers were hurt in any way; there was no discernable

[31] 16 C.F.R. 433, 40 Fed Reg. 53506 (November 18, 1975).

[32] 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.

[33] Maberry v. Said, 911 F. Supp. 1393 , 1402 (D. Kan. 1995).

[34] 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.

[35] 40 Fed. Reg. 53506 (November 18, 1975) at 53517.

[36] *Id.*.at 53518.

increase in defaults. This is a chart that illustrates that there was simply no effect on credit availability from passage of the Holder Rule by the FTC. The level of "non-revolving credit" is indicated in the last 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 halfway through that decade – had more than doubled.[37] 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.[38] In the area of auto loans, this FTC rule has not interfered whatsoever with the securitization of auto credit.[39] Auto ABS volume for 2005 for prime and subprime loans combined exceeded $75 billion.[40]

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[37]Federal Reserve Statistical Release G.19, 1970 to 1980.

[38]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.

[39] 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.
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> 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. 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.

[40]ASF 2006 Retail Auto ABS Sector Review, available at http://www.americansecuritization.com/uploadedFiles/Retail%20Auto%20Loan%20ABS%20Sector%20Panel%204pm.ppt#646,1,ASF 2006 Retail Auto ABS Sector Review.

C. The Answer – Simply Prohibit Enforcement of Illegal Loans.

The complexities of assignee liability are confusing and nonsensical. The goal of avoiding liability for the bad acts of those who came earlier in the origination chain simply encourages irresponsible behavior – just the sort of behavior which has brought us to where we are today. An alternative approach, which would further simplicity, transparency and responsibility, would be simply to prohibit the enforcement of a mortgage which violates the simple rules governing the making and servicing of the home loan.

This rule would create incentives for everyone involved in the process to ensure that the rules are followed, rather than ignored. It would also provide an easily determinable degree of risk to those who might purchase the loan: the amount at risk would be the total loan amount. This certainty is all that the ratings agencies have ever said they need.

D. Private enforcement is essential.

We firmly believe that the key to make systemic, meaningful changes in the structure of the mortgage market is to change the incentives, as we have described above. The incentives are established by new rules. The rules we propose are simple, straightforward, and will result in a transparent structure governing mortgage origination and servicing. However, when there are violations of these rules, someone must enforce these violations.

Federal and state regulators are essential ingredients to the enforcement of these rules: Federal regulators must be motivated to keep the nation's lending appropriately flowing and appropriate safe for homeowners and investors. State enforcement agents are essential to be able to respond nimbly to the problems evident in their area.

Private enforcement by lawyers who will be paid by the defendants if the case prevails are also an indispensable part of protecting homeowners. Only private lawyers are able to stop individual foreclosures. Only private lawyers are able to articulate the particular problems with a specific homeowner's situation. Only private lawyers are likely to be able to assist the homeowner in the design of the most appropriate loan modification if the servicer fails to follow those requirements. These attorneys – generally legal services and *pro bono* attorneys – must be able to recover their fees from the defendants when they prevail on their claims. Without this fee shifting, attorneys will not be available, as defaulting homeowners will not have the funds to pay attorneys.

Conclusion

Thank you for providing me the opportunity to testify today on behalf of the low income clients of the National Consumer Law Center, as well as the National Association of Consumer Advocates. I will be happy to answer any questions.

Prepared Testimony of

Marc Savitt, CRMS
President

National Association of Mortgage Brokers

On

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

Before the

Committee on Financial Services,
Subcommittee on Financial Institutions & Consumer Credit

United States House of Representatives

Wednesday, March 11, 2009

Good morning Chairman Gutierrez, Ranking Member Hensarling, and Members of the Committee. I am Marc Savitt, President of the National Association of Mortgage Brokers ("NAMB"). Thank you for inviting NAMB to testify today on "Mortgage Lending Reform: A Comprehensive Review of the American Mortgage System." We appreciate this opportunity to discuss an issue that is 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. 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.

Although parties acting as mortgage brokers defy simple characterization, in today's market it can generally be said that a real estate financing professional or entity acts in a mortgage broker capacity when the professional or entity works with both borrowers and lenders, though representing neither, to obtain a mortgage loan.

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. The Mortgage Reform & Anti-Predatory Lending Act of 2007 ("H.R. 3915")

H.R. 3915 was a comprehensive piece of legislation aimed at reining-in abusive lending practices that contributed to the mortgage and housing crisis in this country. H.R. 3915 included provisions to establish national standards for mortgage loans and mortgage loan originators, and addressed certain aspects of high-cost mortgage lending. H.R. 3915 also contained provisions concerning required disclosures under the Real Estate Settlement Procedures Act ("RESPA") and established property appraisal and escrow requirements.

While NAMB shares many of the concerns that H.R. 3915 was drafted to address, we were unfortunately unable to support the bill in its entirety due to provisions relative to Title III in the bill. Nevertheless, NAMB was extremely supportive of many aspects of this legislation, particularly the uniform, all-originator approach to regulating our industry's activities and participants. This balanced and even approach ensures that every mortgage originator who will sit down with a consumer and help them through the loan application and origination process will be held to the same standards. In the end, H.R. 3915 represented a tremendous step forward in the effort to increase the standards and professionalism in our industry.

As we reevaluate the current state of the American mortgage lending system and contemplate additional reform, 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. Taking into consideration the many legislative, regulatory, and market changes that have already occurred since the passage of H.R. 3915, we are confident that a comprehensive and constructive bill can be put forth addressing the most pressing issues facing industry participants, consumers, and the mortgage market itself.

II. Changes in the Market Since the Passage of H.R. 3915

Nearly sixteen months have passed since the U.S. House of Representatives approved H.R. 3915. In this time, our mortgage, housing, and financial markets have endured tremendous turmoil and significant changes.

To begin with, we have seen a fundamental shift in our understanding of what lies at the heart of the crisis we find ourselves still mired in today. At the very beginning of this 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.

A. The Calm Before the Storm

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 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 downpayment 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 only rise, and a good number of people were able to get rich relatively quickly. Unfortunately, however, this only made everyone involved hungry for more.

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 and incentivized loan officers and brokers to originate more loans, which 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," and Wall Street firms made billions of dollars from their sale to domestic and international investors clamoring for their share of profits from the booming U.S. real estate market.

As was noted in a New York Times Editorial this past Sunday, "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]

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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).

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 went south. 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.

B. The Bubble Burst: First on Main Street, then on Wall Street

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.

C. Legislative & Regulatory Changes Since the Passage of H.R. 3915

In addition to the recent turmoil in our mortgage and financial markets, a great deal of change has also 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.

i. 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 and establishes a nationwide licensing and

registration system for loan originators. Under this system, all loan originators, regardless of whether they are state or federally-regulated, 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 in loan originator licensing for many years now and is pleased to see it come to fruition. Education and testing of every 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 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.

Although the SAFE Act represents much needed changes for loan originator licensing standards, there continues to be a problem with the implementation of the SAFE Act by state regulators particularly as it relates to current state loan originator licensees.

ii. 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 HOEPA 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 first-lien loans. The final rules do not contain an originally proposed provision affecting the disclosure of yield spread premium ("YSP"), because the Federal Reserve relied on what it considered to be "compelling evidence from consumer testing" that such a disclosure would create confusion among borrowers and cause many consumers to choose more expensive loan products.

In its final rule, the Board stated it is "concerned that the proposed agreement and disclosures would confuse consumers and undermine their decision-making rather than improve it."[3] The Board recognized that the disclosure of the YSP, as proposed, would not serve in the consumers' interest, and in fact would further confuse the consumer.

The Board stated that they will "continue to explore available options to address potential unfairness associated with originator compensation arrangements such as YSP. As the Board comprehensively

[3] 73 Fed. Reg. at 44,563.

reviews Regulation Z, it will continue to consider whether disclosures or other approaches could effectively remedy this potential unfairness without imposing unintended consequences."[4] We do believe, however, that in order to provide the most useful and clear information to consumers without further confusion, the Federal Reserve Board should work in conjunction with the U.S. Department of Housing and Urban Development ("HUD") in producing disclosures that are straightforward and effective. Since disclosures required under both the Real Estate Settlement Procedures Act ("RESPA") and the Truth In Lending Act ("TILA") are to be presented to the consumer at application and again at closing, such disclosures should work in tandem with each other so that they reach the desired benefit of providing clarity and information to the consumer during these two important times of the home buying process.

iii. Real Estate Settlement Procedures Act Revisions ("RESPA Rule")

HUD released its long-awaited RESPA Rule in November 2008. 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 mortgage brokers, but no other loan originators, to make detailed disclosures regarding their 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 – mortgage brokers and lenders alike – 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.

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 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.

HUD's Proposed Rule stated, "As HUD moves forward to finalize this rule, it will continue to work with the Board to make the respective rules consistent, comprehensive, and complementary."[5] Merely noting this intention, however, is of no real consequence. Just as the Proposed Rule must explain how it relates to existing law, it must explain how it relates to the Board's amendments to Regulation Z. The Administrative Procedures Act (APA) requires as much, as does sound rulemaking.

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

[4] 73 Fed. Reg. at 44,565.
[5] 73 Fed. Reg. at 14,034.

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 continue to move forward in its RESPA reform process, but should do so in conjunction with the Federal Reserve Board in its ongoing review of Regulation Z. 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.

iv. 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."

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. Moreover, the HVCC targets industry participants and practices which are entirely unrelated to the investigation that precipitated its enactment, and the rule was promulgated by the FHFA in violation of the Administrative Procedures Act. Despite being the product of an investigation into appraisal fraud at a lending institution and its affiliated appraisal management company ("AMC"), the HVCC targets mortgage brokers and independent appraisers, and forces consumers to rely exclusively on lenders and their AMCs for home appraisals. 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.

Nevertheless, NAMB remains supportive of legislative efforts to provide for appraisal independence standards like the ones included in HR 3915. Unlike the HVCC, these appraisal standards have gone through the legislative process, were subject to open and public debate, and were ultimately approved by a majority of the House of Representatives. Representatives Kanjorski and Biggert, as well as Senators Casey and Martinez, are responsible for leading the legislative effort on this very important issue.

v. 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 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.

III. Revisions Required to H.R. 3915 in Light of Recent Changes in the Market

With these and other significant changes throughout our mortgage lending industry, there are a number of key revisions to H.R. 3915 that should be considered.

A. Facilitate State Implementation of the SAFE Act

The SAFE Act was signed into law on July 30, 2008. Under the provisions of the SAFE Act, states are charged with the task of enacting licensing standards that meet the requirements of the Act before a July 31, 2009 deadline. However, the overall responsibility for interpreting, implementing, and ensuring states comply with the SAFE Act rests with HUD.

To assist states in meeting their July 31, 2009 compliance deadline, the Conference of State Bank Supervisors ("CSBS") and the American Association of Residential Mortgage Regulators ("AARMR") drafted model legislation that states could use to ensure they meet the minimum requirements of the SAFE Act. While these organizations should be commended for their efforts, the CSBS/AARMR model state legislation exceeds the minimum requirements and lacks critical components important to legislators, regulators, loan originators, and consumers in many states. Moreover, these organizations are not governmental entities, they are trade associations charged primarily with promoting the interests of their respective members. In the end, it is the right and responsibility of each state, not CSBS and AARMR, to create a licensing and registration system that meets or exceeds the minimum requirements of the SAFE Act.

With the deadline for compliance with the SAFE Act rapidly approaching, many states, despite their best efforts, are struggling to implement the new licensing and registration requirements. We believe Congress should step-in to help facilitate states' transition into the new nationwide licensing and registration regime. There are three specific steps that we believe are necessary to ensure a smooth transition into this system for state regulators, loan originators and the consumers they serve.

i. Extend the July 31, 2009 Compliance Deadline by 24 Months

Given current market conditions and the severe economic hardship being felt by so many states, we believe additional time should be given for the states to enact new mortgage licensing legislation. When enacting SAFE Act legislation, it is imperative that states take adequate time to thoughtfully consider all possible alternatives to ensure the requirements of the Act are satisfied, the interests of consumers are sufficiently protected, and mortgage origination within the state is not unnecessarily disrupted.

Because of the complexity involved with amending state law to implement these new requirements, and the other serious economic challenges facing state lawmakers today, we believe a twenty-four (24) month extension of the July 31, 2009 compliance deadline is necessary and appropriate. Such an extension will afford states ample time to contemplate and implement a licensing system that will best serve the long-term interests of both licensees and consumers in their state.

This extension will also allow states to focus more attention on larger and more immediate economic concerns like managing budget shortfalls, stabilizing their economies, and helping homeowners avoid foreclosure and remain in their homes.

ii. Direct HUD to Promptly Issue Any Necessary Regulations Relating to the SAFE Act

In addition to extending the compliance deadline, we also encourage Congress to direct HUD to issue any regulations relating to implementation of the SAFE Act as quickly as possible. Although states are charged with enacting licensing standards that meet the requirements of the SAFE Act, the responsibility for interpreting, implementing, and ensuring state compliance with the SAFE Act rests with HUD.

Any implementing regulations that HUD can issue prior to states opening up and revising their statutes as required will help ensure a smoother transition and significantly reduce the likelihood that court or Congressional intervention will be sought in the future thereby disrupting the spirit of the law.

iii. Provide Clarification on States' Ability to Interpret Silent or Ambiguous Provisions in the SAFE Act

Lastly, because there are issues important to many states where the language of the SAFE Act is vague or silent, and there are requirements in the SAFE Act that are ambiguously defined, we believe that each state must be permitted to exercise independent judgment in interpreting silent or ambiguous provisions in the SAFE Act and ultimately implement legislation that is in the best interests of the citizens of that state, consistent with the intent of the law.

One issue that many states are currently struggling with is the integration of current licensees into the new system prescribed in the SAFE Act. The SAFE Act encourages states to establish minimum standards for licensing and registration and requires all mortgage loan originators to hold a valid license and registration in the state or states where they operate. However, the SAFE Act offers no direction to the states regarding the integration of current licensees into the new system.

Because nothing in the language of the SAFE Act evidences a Congressional intent to prohibit states from exercising independent judgment on issues where the Act is silent, we believe it must be left to the individual states to determine the treatment of pre-existing licensees in the new system, provided the letter and spirit of the law are not compromised. Specifically, we believe that state legislators must be permitted to determine whether phasing in of existing licensees is a necessary and appropriate component of their state's SAFE Act legislation.

Many states have licensed mortgage brokers and loan officers for years and have required licensees to undergo extensive education and training. To preserve the efficient functioning of the mortgage markets in these states and to ease the administrative burden of relicensing every originator within the state, we believe states should be allowed to phase in current licensees into the new system, provided those licensees immediately submit fingerprints to the Nationwide Mortgage Licensing System and Registry for submission to the Federal Bureau of Investigation and any other governmental agency or entity authorized to receive such information for a state and national criminal background check, and satisfy all

requirements for license renewal prior to the expiration of their current license, including completing a minimum of 8 hours of continuing education courses. Loan originators that have never been subjected to state licensing standards due to the absence of any such state requirement must still be required to comply with all of the minimum standards set forth in the SAFE Act, including fingerprint submission for background checks, pre-licensing education and testing.

Since the language of the SAFE Act is silent on the issue of phasing in, and there is an absence of any implementing regulations, we feel that states would benefit from a clarification of their right and ability to interpret silent or ambiguous provisions in the SAFE Act and legislate accordingly.

B. Create a Federal Standard of Care for All Loan Originators

Mortgage markets have evolved rapidly in recent years, as have the roles of mortgage professionals and the entities with whom they are employed. Today, it is not uncommon for these individuals or entities to work in multiple capacities or to assume different roles, even within a single mortgage transaction.

Historically, mortgage brokers and mortgage lenders could be readily distinguished. Brokers did not lend money, and lenders did not serve as portals for competing providers of funds. However, in recent years, the lines between distribution channels have blurred, as the "originate to distribute" model of mortgage financing (where lenders promptly repackage and sell the loans they originate) has become commonplace.

Additionally, dramatic advances in technology have served to accelerate this convergence of the roles of mortgage originators. The introduction of automated underwriting, web-enabled credit scoring, and the ubiquity of computers have helped blur the distinctions between historically different functions. In fact, originators today tend to use the same software regardless of whether they are acting as broker or funding the loans they originate. The distinctions that still exist between mortgage originators are largely being determined by the click of a mouse.

To the consumer, none of this is readily apparent. Because consumers are largely unaware of, and indifferent to, the technical distinctions drawn between the originators with whom they are dealing, it is imperative that consumers be given the same information about the mortgage transaction and that the originator be held to the same standards, regardless of the type of originator or entity involved.

Since 2002, NAMB has advocated for more stringent standards for all loan originators to protect consumers and curb abusive lending practices in the mortgage 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.

Such a federal standard should apply whenever a person is acting as a loan originator under the definition in the SAFE Act, and should be comprehensive enough to operate as a ceiling, not a floor, in establishing a loan originator's responsibilities when working with consumers.

Because the acts of originating, funding, selling, servicing, and securitizing mortgage loans may all be conducted separately and independently, or may be engaged in collectively under one corporate structure or through affiliated business arrangements, it is important for consumer protections to relate to the function, as opposed to the structure of entities. In the end, consumers deserve the same level of protection no matter where they choose to obtain a mortgage loan.

i. The Federal Standard of Care Should be "Good Faith & Fair Dealing"

Any person required to be licensed or registered as a loan originator under the SAFE Act should have a federal statutory duty to exercise good faith and fair dealing in all communications and transactions with consumers. All loan originators should be held to the same standard of conduct toward consumers so that all consumers are shielded from bad acts and bad actors, regardless of whether they are working with a federally-chartered bank, state-chartered lender, credit union, or mortgage broker.

The federal standard of care should not be construed to require a loan originator to obtain any loan containing terms or conditions not available in the loan originator's usual course of business, or to obtain a loan for the borrower from a third party with whom the loan originator does not have an existing business relationship.

Specifically, NAMB believes a federal standard of care should consist of:

- The duty to make reasonable inquiry into the borrower's current and prospective income, existing debts, and other obligations, as well as any other information known to the loan originator to be helpful in making, brokering, or otherwise originating a mortgage loan for the borrower.

- The duty to use reasonable efforts to make, broker, or otherwise originate a mortgage loan that takes into consideration all of the information submitted to the mortgage loan originator by the borrower.

- The duty to use reasonable efforts to make, broker, or otherwise originate a mortgage loan that is reasonably advantageous to the borrower, considering all circumstances, including rate, charges, repayment terms, and the loan options offered by the originator for which the borrower qualifies.

- The duty to act with reasonable skill, care, and diligence at all times and in all transactions with a borrower or prospective borrower.

- The duty to safeguard and account for any money or property handled on behalf of the borrower.

- The duty to follow all reasonable and lawful instructions from the borrower.

- The duty to timely and clearly disclose all material information to the borrower that is reasonably accessible to the loan originator and may reasonably be expected to influence the borrower's decision, including, but not limited to the total compensation the loan originator expects to receive from any and all sources in connection with each loan option presented to the borrower.

- The duty to use reasonable means to provide borrowers with prompt credit decisions on loan applications where the loan originator has the ability to make credit decisions; and, where credit is denied, to comply fully with all applicable federal and state notification requirements.

- The duty to provide applicants to who credit has been denied an opportunity to correct or explain adverse or inadequate information, or to provide additional information.

In addition to any activities prohibited under other provisions of state or federal law, NAMB also believes the federal standard of care should prohibit loan originators from:

- Recommending or inducing a borrower to enter into a transaction that is not reasonably beneficial to the borrower, considering all of the circumstances, including, but not limited to the terms of the loan, the cost of the loan, and the borrower's circumstances.

- Misrepresenting or concealing any material facts, or making false promises likely to influence, persuade, or induce an applicant for a mortgage loan to take such mortgage loan.

- Failing to account for or to deliver to any person any funds, documents, or other thing of value obtained in connection with a mortgage loan, including money provided by the borrower for a real estate appraisal or a credit report, which the loan originator is not entitled to retain under the circumstances.

- Paying, receiving, or collecting in whole or in part any commission, fee, or other compensation for making, brokering, or otherwise originating a mortgage loan in violation of the provisions of the SAFE Act.

- Engaging in unfair, misleading, or deceptive advertising related to a solicitation for a mortgage loan.

- Engaging in a practice or course of business related to the making, brokering, origination, purchase, or sale of any mortgage loan that amounts to a fraud upon any person or is conducted in the absence of good faith and fair dealing.

- Failing promptly to pay, when due, reasonable fees to a licensed appraiser for appraisal services.

- Improperly influencing or attempting to influence the development, reporting, result, or review of a real estate appraisal sought in connection with a mortgage loan.

Ongoing events in the mortgage market provide clear examples of why all mortgage originators should be subject to uniform minimum standards. The mortgage market of the 21st century has evolved in conjunction with the burgeoning growth of the secondary market for mortgages, but the laws, regulations and oversight of this market have lagged behind to the severe detriment of consumers.

We do not deny that differences exist between depository and non-depository institutions, both in terms of their business models and how they are regulated, however, when it comes to the origination of mortgage loans, these entities are virtually indistinguishable, particularly in the eyes of consumers, and should be held to a singular federal standard.

ii. The Yield Spread Premium

Yield Spread Premium ("YSP") is a financial planning tool for consumers and provides consumers with a choice of when and how they would like to spend their money. YSP gives consumers the choice of paying for their mortgage origination fees and costs in cash up front or paying a portion or all of those fees and costs each month over the life of the loan through the interest rate. YSP is not a kickback. YSP is not a bonus. YSP is how mortgage originators get paid for their services when a consumer does not want to pay some or all of the fees upfront and instead elects to finance those fees through the rate.

YSP has existed from the time loan origination services expanded out of the S&Ls and the banking industry moved away from holding its loans in portfolio. Today, every originator that does not hold loans in portfolio receives compensation through YSP or its equivalent (SRP or Gain on Sale). SRP or gain on sale is what a lender, banker, or wholesaler receives as payment from their investor or the secondary

market—again, for costs absorbed, services performed, the financing of any closing costs, and/or the value of the loan. In today's market, the real difference that exists between SRP, gain on sale and YSP is that only YSP is disclosed. SRP and gain on sale are not disclosed anywhere, anytime—this is back-end compensation that remains undetected and therefore, has escaped scrutiny.

Regardless of the name, YSP, SRP or gain on sale is very beneficial for many consumers who are ready to own a home but have to overcome the high hurdle of significant closing costs, as well as those consumers who choose to allocate their cash to other investments or expenditures. At the same time, YSP, SRP or gain on sale may not be beneficial if a borrower reasonably believes he or she is not going to sell the home or refinance the mortgage during the 30 year term of the loan. Under these circumstances, the borrower may wish to make a one time upfront cash payment to cover all of the closing costs, fees, and originator compensation in exchange for a lower monthly payment for the life of the loan. In any case, YSP provides consumers with greater choice and additional options for financing the purchase of their home.

Any efforts to ban YSP would eliminate choices for consumers and effectively destroy the small business mortgage broker industry that has helped many consumers achieve and retain homeownership, which would have additional negative consequences for consumers. As was recently reported on CNNMoney.com, "some big banks have cut back on doing business with mortgage brokers - and if the trend continues, many mortgage brokers could close down. That may be bad news for consumers because fewer brokers could lead to a less competitive marketplace and more expensive home loans resulting from consumers not being able to easily comparison shop rates."[6]

NAMB has always been supportive of prohibiting the steering of consumers into loans based simply on a loan originator's compensation. However, it is inaccurate to assume that steering has taken place simply because a loan originator is compensated through YSP, SRP or gain on sale. We cannot support efforts to prohibit loan originators from simply getting paid for their work; for helping consumers and for providing consumers with greater choice. This is an important distinction to be made and considered when moving forward on any legislative mortgage reform efforts.

C. Retain the Anti-Steering Provision from H.R. 3915

As was mentioned above, NAMB believes that it is important to prohibit loan originators from being incentivized to push specific loan products based solely upon the compensation they or their employer are likely to receive (*i.e.*, steering). However, we strongly believe that an anti-steering provision will only be effective if its reach does not limit or remove financing choices from borrowers.

NAMB was very supportive of the final anti-steering provision included in the version of H.R. 3915 that passed the House of Representatives, and we appreciate that Congress recognized the importance of ensuring that the reach of the anti-steering provision in H.R. 3915 did not limit or remove financing choices from consumers. The language in H.R. 3915 ensured that borrowers would continue to have the ability to finance their origination fees and closing costs as they deem appropriate for their individual circumstances, which in turn allows consumers to continue to enjoy the benefits derived from having various financing options and choosing a zero-point or no-cost loan by financing the fees and/or costs through the rate or loan amount.

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[6] *CNN Money: Lenders Drop Mortgage Brokers*, Les Christie (February 12, 2009).

NAMB appreciates the importance of ensuring that loan originators are not incentivized to steer borrowers into particular loan products purely for personal gain, and we believe that a strong anti-steering provision, like the one included in H.R. 3915, should be a component of any comprehensive mortgage reform legislation. The anti-steering provision in H.R. 3915 provides an excellent model for effectively protecting consumers from being steered into loans for the purpose of higher originator compensation without eliminating consumer financing options.

D. Ensure any Standards Articulated for Mortgage Loans Compliment the Federal Reserve Board's 2008 HOEPA Amendments

Titles II and III of H.R. 3915 endeavored to amend the Truth-in-Lending Act ("TILA") to establish certain minimum standard for mortgage loans and address specific issues relating to high-cost mortgage loans under HOEPA. While NAMB was generally supportive of the provisions outlined in Title II of H.R. 3915, we were extremely concerned that specific provisions in Title III would only result in further harm to many consumers who were (and likely still are) most in need of available and affordable credit.

However, since the passage of H.R. 3915, the Federal Reserve Board has promulgated new rules amending Regulation Z, which implements both TILA and HOEPA ("HOEPA Rules"). 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 is a strong supporter of the HOEPA Rules, and believes they represent a clear victory for consumers and a definitive step toward increased professionalism and accountability in the mortgage lending industry. Moreover, NAMB believes that these HOEPA Rules strike at the heart of a number of concerns originally addressed in H.R. 3915.

Among other things, the HOEPA Rules prohibit creditors and mortgage brokers from coercing real estate appraisers to misstate a home's value, and require creditors to provide consumers with transaction-specific mortgage loan disclosures within three business days after application and before they pay any fee except for a reasonable fee to review their credit history. The rules also establish standards for advertising designed to eliminate misleading or deceptive representations and facilitate the communication of more balanced information to consumers. The advertising rules ban several deceptive or misleading advertising practices, including making representations that a rate or payment is "fixed" when it can change.

Additionally, the HOEPA 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 HOEPA Rules, which are set to take effect October 1, 2009. We are concerned that any additional restrictions which may be placed on the availability of mortgage credit could harm consumers and potentially exacerbate the current market problems we are experiencing.

The Federal Reserve Board carefully considered information obtained from testimony, public hearings, consumer testing, and over 4,500 comment letters before promulgating the final HOEPA Rules. We believe these amendments to TILA and HOEPA are positive and significant regulatory changes that will ultimately yield benefits to consumers and strengthen and stabilize the mortgage industry.

If it is determined that legislative action is needed to supplement the HOEPA rules, we strongly encourage Congress to work with the Federal Reserve Board and industry participants to ensure any proposed requirements complement and enhance the foundation for regulatory reform that was laid with these amendments.

E. Direct Federal Agencies to work together to Establish a Universal Residential Mortgage Loan Disclosure Form and Good Faith Estimate

Title V of H.R. 3915 instructed the Secretary of HUD to work in consultation with the Secretary of Veterans Affairs, the Federal Deposit Insurance Corporation, and the Director of the Office of Thrift Supervision to develop and prescribe a Standard Universal Residential Mortgage Loan Disclosure form and Good Faith Estimate ("GFE"). NAMB strongly supports the interagency development of a universal mortgage disclosure and GFE like the one prescribed in H.R. 3915. However, NAMB believes it is imperative for any such disclosure to be consumer-tested and proven effective, and contain the same information regarding consumer settlement costs regardless of the originator making the disclosure.

Although H.R. 3915 did not become law, the Secretary of HUD seemingly responded to the challenge set-forth in the bill to establish and prescribe a uniform GFE for all federally-regulated mortgage loans. On November 17, 2008, the Secretary promulgated a "Final Rule to Simplify and Improve the Process of Obtaining Mortgages and Reduce Consumer Settlement Costs" under RESPA. Among other provisions in this long-awaited rule were revisions to the GFE disclosure requirements and the inclusion of a standardized GFE form that would be required for all mortgage loans covered by RESPA.

Despite HUD's clear commitment to protecting consumers from unnecessarily high settlement costs and the agency's laudable goals in prescribing a new universal mortgage disclosure form, the final RESPA

Rule issued in 2008 falls far short of what was envisioned in H.R. 3915 and what is needed in the mortgage marketplace.

H.R. 3915 properly identifies the critical information that is most important to consumers and should be required on the GFE, including: (1) loan amount, (2) whether the loan is fixed or adjustable-rate, (3) loan term, (4) estimate interest rate, (5) estimated monthly payment (6) rate lock period, (7) existence of a balloon payment, (8) existence of a prepayment penalty, (9) total estimated settlement charges, and (10) total estimated cash required at closing. In contrast, HUD's standardized GFE extends for three pages and contains complex and superfluous information that not only fails to help consumers understand their mortgage options, but has been shown to sufficiently confuse consumers into selecting higher priced loans. Although HUD identifies consumer protection and the simplification of mortgage disclosures as primary policy goals for the 2008 RESPA Rule, the agency failed to consult with other regulatory agencies as directed in H.R. 3915 and neglected to give proper consideration to the conclusions and recommendations put forth by multiple public and private entities, which suggest that consumers are more confused and more likely to choose a higher-cost loan when presented with certain misleading information contained on the new GFE.

NAMB strongly believes that the 2008 RESPA Rule will impede competition and dramatically increase consumer costs because of the baseless imposition of dramatically different regulatory burdens on certain mortgage originators and the inclusion of complex and confusing disclosures on the new GFE.

Today, we urge Congress to step-in and direct the Secretary of HUD to promulgate a new rule and GFE disclosure form that is more in line with RESPA's stated purpose of providing consumers with effective disclosures and protecting consumers from unnecessarily high settlement costs. In crafting such a rule, it is imperative that the Secretary work in concert with other federal agencies, including the Federal Trade Commission and the Federal Reserve Board, to help ensure the end result is a truly universal mortgage disclosure form that compliments and may be used together with other disclosures (*i.e.*, TILA) to help consumers shop for and ultimately understand the mortgage product they choose.

F. Establish Uniform Appraisal Standards which are Overseen by an Independent Regulator & Encourage the FHFA to Withdraw the HVCC

Title VII of H.R. 3915 endeavored to establish certain property appraisal requirements designed to improve appraisal quality and promote appraiser independence. NAMB strongly supports policy initiatives that seek to ban coercion of appraisers, and NAMB was very supportive of the appraisal reforms in H.R. 3915.

NAMB believes that there should be increased standards for loan 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. However, NAMB also believes that no mortgage or real estate professional should be prohibited from lawfully and ethically challenging an appraiser's valuation of a particular property or engaging an appraiser in meaningful discussion regarding the methods or manner in which a value determination was made.

Just over one year ago, the HVCC was announced by FHFA Director Lockhart and billed as a means of combating appraisal misconduct and promoting appraiser independence in the mortgage lending industry. The HVCC is actually the product of a 2007 New York Attorney General's Office ("NY AG") investigation into fraudulent appraisals associated with Washington Mutual ("WaMu") – at that time the largest savings and loan in the United States and a key player in the subprime lending market – and its affiliated Appraisal Management Company ("AMC"), eAppraiseIT.

In conjunction with its investigation and subsequent lawsuit against WaMu, the NY AG sent a letter to Fannie Mae and Freddie Mac informing the GSEs that the NY AG was "expanding its investigation to determine the extent of Fannie Mae's and Freddie Mac's knowledge of, and actions regarding, [appraisal] problems as they relate to past mortgage purchases and securitizations" by the GSEs. The NY AG also issued subpoenas to Fannie Mae and Freddie Mac requesting information regarding mortgage loans purchased by the GSEs from any bank, as well as the due diligence practices of the GSEs and their policies and procedures regarding valuations and appraisals by originating lenders and the GSEs themselves. Following receipt of this letter and the accompanying subpoenas, FHFA Director Lockhart met with the NY AG to discuss the expansion of the investigation into the GSEs.

On March 3, 2008, FHFA announced that it had entered into agreements with the NY AG and Fannie Mae and Freddie Mac ("Agreements"). Among other things, these Agreements required the GSEs to adopt a new policy regarding home appraisals, called the "Home Valuation Code of Conduct," and to stop purchasing loans originated by lenders who fail to comply with the HVCC by January 1, 2009 (this date has since been pushed-back to May 1, 2009). In turn, the NY AG agreed to terminate its investigation of Fannie Mae and Freddie Mac, and the GSEs agreed to cooperate with the NY AG's continued investigation of the mortgage industry.

It was not until some time after the March 3, 2008 announcement of the Agreements and impending implementation of new appraisal standards that Fannie Mae and Freddie Mac decided to seek industry comments regarding the HVCC. This comment period ran from March 14, 2008 to April 30, 2008. During this comment period, the GSEs collected comments from industry participants and forwarded everything they received to the FHFA and the NY AG. Following the close of this comment period, the FHFA and the NY AG did engage in closed-door negotiations with various mortgage lenders regarding the HVCC, however, mortgage brokers, appraisers, and other interested parties were excluded from this process.

As it stands today, the HVCC is set to take effect May 1, 2009, and this rule overwhelmingly favors lending institutions to the detriment of mortgage brokers, appraisers, and consumers. Despite being the product of an investigation into appraisal fraud at a lending institution and its affiliated AMC, the HVCC targets mortgage brokers and independent appraisers, and forces consumers to rely exclusively on lenders and their AMCs for home appraisals.

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.

Although NAMB strongly supports policy initiatives that seek to ban coercion of appraisers, on February 23, 2009 we felt it was necessary to initiate legal proceedings against FHFA Director Lockhart to prevent the HVCC from taking effect. We believe the HVCC will impact mortgage brokers, independent appraisers, and consumers in a profoundly negative way. The HVCC places small-business mortgage professionals and 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. Additionally, we believe the FHFA was required to utilize notice and comment rulemaking proceedings under the Administrative Procedures Act when promulgating the HVCC, but the agency failed to do so. Because the HVCC is a substantive rule that *de facto* regulates the entire mortgage industry and the FHFA failed to follow proper rulemaking procedures, we believe the HVCC is void, invalid, and unenforceable.

Appraisal independence is essential to protecting consumers from fraud and from unscrupulous actors. To that end, legislation was introduced last year to prohibit interference with an independent appraisal and to prohibit dishonest originators and appraisers from artificially inflating the value of properties, while retaining legitimate investors' ability to improve properties for resale.

NAMB commends and appreciates Representatives Kanjorski and Biggert for their work towards reforming and strengthening oversight of our appraisal system, and urges Congress to once again take-up this legislation to establish new uniform appraisal independence standards. Our only recommendation for changing the language originally proposed would be to amend the Equal Credit Opportunity Act ("ECOA") in addition to amending TILA to reflect the appraisal independence standard and to provide for copies of such appraisals to applicants. At the same time, we ask Congress to encourage the FHFA to withdraw the HVCC in its entirety and allow these new federal appraisal standards to take effect.

IV. Conclusion

NAMB greatly appreciates this opportunity to share its views on reforming the American mortgage lending system. Everyday our members live and go to work in their communities alongside consumers who continually relay to us that what is most important to consumers is simply being able to get a mortgage they can afford and one that they 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. NAMB was extremely supportive of the broad and even approach to regulation taken in H.R. 3915 (with exception to Title III) and we believe a similar approach is critical to the effectiveness of any future consumer protection legislation.

As we touched on in our testimony today, consumers, industry participants, and the market for mortgages generally have all suffered tremendously from the greed and unchecked financial innovation of the previous decade. However, we have turned a corner. Since the passage of H.R. 3915, we have seen significant and positive changes effected through both legislation and regulation that have laid a solid foundation upon which we hope to rebuild our industry.

Even though there are significant challenges that lay ahead, it is important to think carefully and act deliberately when contemplating additional legislative or regulatory reforms in our industry. In an already fragile economic environment, we must be especially mindful of the harmful unintended effects that an overcorrection in any area could have on consumers and our market's recovery. The positive changes that were affected through legislation and agency regulation over the past year must be given an opportunity to take effect while we turn our attention to the inefficiencies and excesses that remain in other segments of our industry.

NAMB looks forward to continuing to work with this committee, and other House members, 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 businesses across the country.

Thank you again for this opportunity to appear before the committee and discuss these very important issues.

Statement from Attorney General Andrew Cuomo March 11, 2009

In March 2008, after a year-long investigation into conflicts of interest in the residential real estate appraisal industry, my office entered into cooperation agreements with Fannie Mae and Freddie Mac, the country's two largest purchasers of home loans. These agreements required Fannie Mae and Freddie Mac to buy loans only from those banks that met standards designed to ensure independent and reliable real estate appraisals.

These standards were articulated in the Home Valuation Code of Conduct. The core principles underlying the Code were that Fannie Mae and Freddie Mac would refuse to buy loans from any lender or loan originator unless the lender put systems in place that:

- Bolster appraiser independence through specific provisions governing appraiser selection, solicitation, compensation, blacklisting, and conflicts of interest;

- Eliminate systemic conflicts of interest in institutions that order appraisals, in part by prohibiting mortgage brokers and bank loan officers (who are paid on commission when loans close) from selecting or communicating with appraisers.

From March 2008 to December 2008, we reviewed hundreds of comments and, working with Fannie, Freddie & OFHEO/FHFA, revised the Code to respond sensibly to useful critiques. The revised Code agreement with Fannie Mae and Freddie Mac preserves the core goals of the Home Valuation Code of Conduct by ensuring appraiser independence and eliminating systemic conflicts of interest, and also incorporates common-sense suggestions of industry participants that increase flexibility and efficiency.

Under the revised Code, Fannie Mae and Freddie Mac again committed to purchasing only those loans that are supported by appraisals conducted independently and honestly. By erecting and enforcing meaningful firewalls between appraisers and lenders, the Code forces Fannie Mae and Freddie Mac to stop working with unscrupulous lenders and brokers. The revised Code clearly directs Fannie and Freddie to enforce all their rights and remedies, including refusing to buy loans from a lender if the lender violates the Code and fails to remedy that violation. These are key steps in cleaning up the mortgage industry and avoiding another crisis like this in the future.

I am pleased that the Financial Institutions Subcommittee is conducting a Hearing to Evaluate Mortgage Lending Reform, and I urge the Subcommittee to implement further reforms in this very troubled industry. I also urge the Subcommittee to ensure that future reforms do not undermine the Home Valuation Code of Conduct. I want to especially thank Chairman Kanjorski for all his hard work and expertise on these issues and for giving me the opportunity to submit this statement.

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March 4, 2009

Honorable Emanuel Cleaver
1027 Longworth House Office Building
Washington, D.C. 20515

By Fax: 1 202 225 4403
This Page & 1 More

Re: Cram Down Legislation

Dear Congressman Cleaver,

You represent a district that is becoming a vast wasteland. Vacant houses are popping up like dandelions. If your district is to survive with owner-occupied houses it is absolutely essential to allow bankruptcy judges to reduce the principal amount of mortgage loans for struggling borrowers consistent with current fair market values.

How have inflated house values affected lenders? They have lost money and produced vacant houses. Inflated appraisals allowed me recently to purchase a vacant house for $14,000 that was appraised for $63,000. (I am representing *pro bono* Rev John Wandless, a Catholic priest whose nonprofit URBAN RANGER CORPS has invested $600,000 of his funds to beautify your district. But the blight of vacant houses is outdistancing the beauty.

In the case of the $14,000 house (as in all cases where I have negotiated purchases of houses for Rev. Wandless) the lenders have taken a beating because they have not kept the borrowers in the houses.

Let me tell you the story of Mrs. Sherrita Richardson, a 37 year old African-American mother of four children, a bus driver for nine years. Four years ago Mrs. Richardson acquired a house in your district at 3413 East 60th street with an inflated appraisal of $93,000 requiring a 10% down payment she didn't have. Yet, virtually penniless Mrs. Richardson acquired title to a house for $93,000.

A Kansas mortgage broker purchased a $9,300 cashier's check payable to the seller, made a copy to show the 10% down payment was made, then redeemed the $9,300 check 24 hours later. He told Mrs. Richardson it was OK not to have $9,300 because Mrs. Richardson would give the seller a $9,300 promissory note. The California lender, relying on a Settlement Statement that $9,300 cash was in the hands of the seller, approved a mortgage loan of $83,700. Mrs. Richardson was a victim of mortgage fraud.

What's my first point? The need for bankruptcy judges to reduce mortgage balances consistent with current fair market values is absolutely essential if we are to get out of the economic mess our nation finds itself in.

It made no economic sense for the California lender to foreclosure a house it ultimately sold for $14,000 when it could have crammed down the loan balance

and let the people remain in the home. Had the house been occupied and valued, say, for $40,000, Rev. Wandless would have probably paid more for the house located in a model block he is trying to beautify.

For Mrs. Richardson to be vacated from her home (as will happen soon), the California lender will take another economic hit.

For those who give hope to "Mortgage Modification" I tell them that two years ago Mrs. Richardson's mortgage was modified. Her monthly payments were increased $250 and with accrued interest Mrs. Richardson today owes more than $102,000 on the house. That's $9,000 more---yes, $9,000 more than the original sales price of $93,000. "Mortgage Modification" is an illusion. Lenders increase the monthly payments. Accrued interest ups the mortgage balances.

One more point. The American Bankers Association and others of like mind talk about the "moral hazard" of cram downs. What about the moral hazard of bankers accepting millions in executive compensation and spending millions on lavish life styles? Those who worry about the future of the capitalistic system had better look at the future of mothers and children displaced by the system. The history of destroyed civilizations shows what happens when the gap between the "haves" and "have-nots" grows too wide.

Let me put it another way. Some call a "cram down" a form of "pork." But helping Mrs. Richardson in her time of need is no "bridge to nowhere." Mrs. Richardson's house is somewhere.

Let us not blame Mrs. Richardson for the predicament she now faces. The people with superior knowledge (such as mortgage brokers and title companies acting as escrow agents) have a duty to people like Mrs. Richardson who have no experience in buying a house.

The foreclosures facing our nation arise from too many people with superior knowledge ignoring the bedrock principal of lending, namely, fairly and honestly evaluating the property and the borrower's ability to repay before lending money.

In summary, let us allow bankruptcy judges to keep the Mrs. Richardsons and their children in their homes based on current fair market values. This will save lenders chunks of money in the long run and bring order to a chaotic housing market that is destroying families and the neighborhoods of America.

Sincerely,

Sidney L. Willens

P. S. Rev. Wandless and I welcome the opportunity to testify before a congressional committee.