COMMUNITY MORTGAGE LENDERS AMERICA

PRESERVING FAIR STANDARDS FOR COMMUNITY LENDERS

TESTIMONY

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HOUSE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

HOUSE COMMITTEE ON FINANCIAL SERVICES

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I am Paulina Sepulveda McGrath, President of Republic State Mortgage Co. in Houston. I am here today as the Chairperson of the Community Mortgage Lenders of America, a trade group representing both small mortgage bankers and community banks with mortgage lending expertise. CMLA is pleased Congress is moving forward with regulatory streamlining for community banks, and we support those measures.

However, if Congress does not provide the same streamlining for community-based, non-depository mortgage lenders this effort will fail consumers and small businesses in every community in our country.

These lenders originated approximately 40 percent of all conventional loans and roughly 50 percent of all loans insured by the Federal Housing Administration and Department of Veterans Affairs in 2014. We are a key piece of the mortgage market, especially for consumers looking to get on the first rung of the economic ladder and for those borrowers looking for, or needing, more personalized service.

Unfortunately, the current regulatory burden is driving consolidation among small mortgage lenders. If this consolidation continues, the reduced competition will lead to even higher costs and consumers will have fewer choices. As a country, we need to find a way to serve – with careful and safe underwriting – more families in their homeownership needs, particularly first-time homebuyers. If we cannot, these families will continue to pay ever-increasing rents that are outstripping income gains.

Remember: Dodd-Frank's goal was certainly to make lending safer for consumers; however, as we were told in 2009, the law was intended to regulate most closely the largest lenders and the bad actors. Subsequent experience with this statute shows it lacks the flexibility to distinguish the level of regulation necessary for lenders of different sizes, business models and performance records. Consequently, it levies the regulatory burden on everyone, including small lenders that operate in a prudent manner and who simply cannot amortize large fixed costs onto a relatively modest volume of mortgage lending.

We think it is important for Congress to take reasonable steps to help preserve small lenders as an important segment of the mortgage lending industry. Without these steps being taken, we are extremely concerned that the consolidation we see today will strengthen and consumers will face fewer choices among lenders, higher costs and the sort of impersonal, bureaucratic service so prevalent among larger lending organizations. We do not believe such an outcome would in any way be an advancement of consumer protection.

The CMLA would like to introduce a concept that will spur more community lending while not diminishing consumer protections: why not provide some targeted relief for small lenders, which have no recent enforcement actions, and which originate primarily loans that meet the Qualified Mortgage (QM) standard contained in the Truth-in-Lending statute? Why not streamline certain regulations for these lenders, which recognizes their unique role in the lending market and benefits the borrowers whose home financing needs they serve?

We propose that lenders would receive specified relief, so long as they remained (1) small, with (2) most of their annual loan origination volume composed of QM loans, and (3) only as long as they continue their excellent lending records. (If a lender grew too large, decided to pursue a non-QM market, or received an enforcement action, it would lose the streamlined regulation.)

If Congress adopted a framework like this, it would spur more community lending while maintaining the consumer focus intended by policymakers. The consolidation and shuttering of community mortgage lenders would subside, providing consumers more choices, better pricing and better service. This is most crucial for our country's underserved areas and communities – from the rural areas to the inner city.

What sort of streamlined regulations would make sense? The CMLA is proposing a series of regulatory changes to preserve strong consumer protections while, at the same time, providing prudent and safe regulatory relief for small and mid-sized lenders.

The first is a very straightforward, common sense type of change. Current disclosure rules require new disclosures if there is a change – for good or bad -- in fees, costs or interest rate cause the Annual Percentage Rate (APR) of a loan to change by more than a minimal amount prior to the close of the loan. A new disclosure must be made to the borrower and a three-day period must elapse prior to the closing of the loan following the revised disclosure. This is an appropriate consumer safeguard when the change results in a higher APR and therefore higher costs. However, it makes no sense when the change is resulting in a lower APR and therefore lower costs to the borrower. We recommend Congress mandate that the three-day waiting period be waived when a change results in a lower APR for the borrower than previously disclosed by the lender.

Vendor oversight requirements are another good example of the excessive regulatory burden faced by midsize and smaller mortgage lenders. Current rules do not differentiate between large and small lenders; instead, the rules levy the same vendor oversight duties and responsibilities on small to midsize mortgage lenders as they do on large banks.

Because the costs of conducting ongoing oversight and review of vendors are far more onerous for, smaller lenders they tend to choose large, national vendors. This decision provides smaller lenders with greater assurance of the vendor's integrity. Nevertheless, they must vet each of these national vendors on a regular basis, duplicating oversight that takes hundreds of staff-hours per year for each lender. Moreover, the impact of these necessary business decisions means that smaller, local vendors that traditionally provided these services are being shut out and job losses in these communities are meaningful.

Third, CFPB examinations are an important enforcement tool for the Bureau with large lenders and those lenders that may have broken the rules. However, the Dodd-Frank statute does not provide clarity or prioritization for the CFPB in the marketplace.

We suggest Congress establish a statutory priority for CFPB examinations, directing the Bureau to conduct examinations of small lenders only if there has been a referral by another regulator. Small lenders are routinely examined by a number of different regulators. Small banks are examined by state banking regulators and the FDIC at a minimum. Small non-depository lenders are examined by the regulator of each state in which they operate. In addition, many small non- depository lenders are approved FHA and VA lenders, as well as by Fannie Mae and Freddie Mac, and are examined by each of these organizations. Why not say that the disproportionate CFPB exam prep costs, including mock audits, together with the costs of the actual examination will not fall on small lenders unless a referral came from one of the existing regulators and agencies overseeing these lenders. Remember: the CFPB will still be able to go where it is most needed; the provision will help it focus its resources where these resources will truly add to consumer protection.

Fourth, the current rules around servicing provide no relief for nonbank servicers doing a good job. Nonbank lenders typically contract with a subservicer for the servicing of their loans in order to keep costs reasonable and offer a high level of service to borrowers. CMLA would propose that Congress statutorily define the definition of small servicer. We would further propose that relief granted to small servicers meeting this statutory definition not differentiate between small servicers that perform all servicing functions internally, and those small servicers that utilize contract subservices to keep costs low and consumer service high. Again, this streamlining would be for lenders of small size, doing QM lending, with good track records. We should not penalize these lenders solely because they use subservicers.

On these policy recommendations above, CMLA is working closely with the Community Home Lenders Association, an association exclusively representing nonbank mortgage lenders.

Fifth, CMLA suggest an amendment to the SAFE Act regarding the licensing of loan originators. Currently loan originators employed by non-depository lenders are licensed by state regulators. Those originators must take educational courses, pass an examination conducted by the state regulator and undergo a background check. Loan originators employed by depository lenders are registered in a database maintained by Federal banking regulators. Other employment requirements are left to the discretion of the depository employer, who will usually conduct a similar background check and utilize internal or external training courses to ensure the appropriate industry knowledge among their loan originators.

In every local community across the U.S., consumers interact on a daily basis with registered and state-licensed loan originators. These originators – regardless of which Federal or State regulatory body has oversight of their employers – perform the same tasks, working with consumers to assess their home finance needs and then taking the steps necessary to qualify the consumer for the financing that will allow them to purchase the home of their choice.

As you can appreciate, in the employment marketplace, it is a difficult process for a non-depository lender to recruit and employ a loan originator from a depository lender despite the fact of nearly identical duties and consumer interaction. Once a loan originator employed by a depository lender leaves that job and takes an identical position with a non-depository lender, usually within the same geographical market, they cannot originate any loans until they take the courses, and pass the examination and background check required by state regulations. By contrast, a licensed loan originator employed by a non-depository or a depository, can resign their position on a Friday and begin working for a depository as a registered loan originator the following Monday.

CMLA proposes that Congress amend the SAFE Act to direct state regulators to issue a 180-day transitional license to a loan originator registered with an insured depository who is hired by a non-depository lender. This transitional license would allow the loan originator to continue their employment for the period of time it takes them to satisfy the state licensing requirements.

<u>Effect of Increasing Compliance Costs</u>

We recently conducted a survey among our members to determine the impact of increasing compliance costs. We found that compliance costs on average had increased nearly 200 percent for small lenders since 2010 on an aggregate basis and approximately 125 percent on a per loan basis. Unfortunately, some of these costs have been passed onto consumers. Lenders have also absorbed a portion of these costs. However, to the extent the increases in these costs have made it impossible for small lenders to continue to operate economically, these smaller lenders have been forced to sell or shut down their companies, thereby continuing the reduction in consumer choices.

Obviously, a very large bank can more easily absorb compliance costs. Moreover, it is just as obvious that there is greater need and justification for stronger regulation of a large bank's mortgage lending. As we saw before and during the financial crisis, large institutional lenders can drive market behavior, and their failures can have devastating financial consequences for the market. Therefore, a tighter regulatory check on their activities is amply justified.

By contrast, most small mortgage banking companies are independently owned, do not retain a loan portfolio and have no access to bank deposits to fund operations and no access to the Federal Reserve window for liquidity. Instead, our lending operations are financed by warehouse lines of credit, which cost four to eight times more than insured deposits and overwhelmingly require personal guarantees by the company owners. In effect, our lenders risk their own capital in making mortgages and thus, our lending practices and quality control constitutethe primary safety net should a loan fail.

Ask yourself: how did these community lenders survive the worst downturn since the Great Depression? Although some community banks received TARP money, not one of the mortgage bankers did--yet they are still here today. How could this be? The answer is we continually and routinely executed with higher underwriting standards--and did not take advantage of our borrowers with shoddy products that provided short-term payoffs and long-term pain.

The last few years have been a struggle to continue to serve our borrowers. We are hiring more compliance and non-consumer facing personnel than ever before. Given our higher cost of funding, mortgage banking companies are more vulnerable, not less, to the higher fixed costs of legal and compliance operations mandated by Dodd-Frank. The average independent mortgage banker with up to 250 employees has increased compliance staff from two to seven according to our survey, with average annual compliance costs increasing from approximately $432,000 to $1. 3 million. The problem becomes painfully evident. The cost of auditing vendors runs about $75,000 annually. The cost of preparing for a mock audit for a CFPB exam that may or may not ever come is $50,000. Since 2010, CMLA data show that compliance costs per loan have more than doubled--and this, again, is for lenders doing predominantly QM lending, which has its own built-in consumer protections.

When you consider these high fixed costs, combined with other tightening factors such as GSE buybacks, the economics of originating small-balance loans look especially challenging. The Houston Association of Realtors data on home sales in

December 2014 compared to December 2013 show one way the market has been reacting:

- Sales volumes for homes below **$79,999 declined** 19.8 percent, year over year
- Sales volumes for homes $80,000 - **$149,999 declined** 8.1 percent, year over year
- Sales volumes for homes $150,000 - **$249,999 increased** 19.4 percent year over year
- Sales volumes for homes $250,000 - **$499,999 increased** 26.1 percent year over year
- Sales volumes for homes $500,000 - **$1 million+ increased** 20.4 percent, year over year

National data tell a similar story; according to NAR data, recent sales of homes in the $250,000 – 500,000 range increased 10 percent from a year ago, while homes valued at $100,000 and below declined by 10 percent, according to the NAR. Our CMLA data show a similar pattern. Some of this divergence is due to jobs and debt pressures at the lower end of the income scale, but some of the lending reflects the fixed costs for any loan and the losses that lenders may take on smaller loans. The inescapable economic fact is that lenders can recover their fixed costs in three ways – through higher fees charged to borrowers, higher interest rates or emphasizing the origination of higher balance mortgages. The first two options make it hard for consumers to buy the home of their choice because of greater out-of-pocket cash demands at closing or a higher monthly payment for the life of the loan. The third option disadvantages moderate-income borrowers and first time buyers who are typically buying smaller, lower cost homes. None of those results appears to advance the cause of consumer protection.

Some people argue that there is good reason to overlook mortgage bankers' need for regulatory relief. They say that since mortgage bankers sell all the loans they originate, and therefore have little or nothing at risk if the loans they originate perform poorly, they do not merit the same consideration.

This is patently false.

There has been a steady stream of repurchase demands issued in the aftermath of the financial crisis. Even if the repurchase demand is without merit, the costs to defend frequently outweigh the loss from the loan. This risk is quite personal to mortgage bankers, taking into account the personal guarantees and the fact that our own net worth is usually tied up in our companies. We have very, very little margin of error, and no access to federally insured funds. Our lenders did not build the business plan of their companies around the origination of Liar Loans, Exploding ARMs, NINJA loans and other toxic products then, and we certainly do not do those types of loans now. Our own money is on the line--which means our interests are aligned with that of our borrowers: carefully underwritten loans that will perform well over time.

In sum, we commend this Subcommittee and the full Committee for the work to ensure community banks thrive on behalf of local consumers, who depend on us for maximum choices and to keep costs low. We urge Congress to extend meaningful regulatory relief to all small community lenders, and to find ways to empower more lending while not compromising consumer protections. Let us return to the original framework of Dodd-Frank and make regulation work for everyone.