Mortgage Bankers Association Testimony
Before the
U.S. House of Representatives Financial Services Committee's,
Subcommittee on Housing and Community Opportunity and
Subcommittee on Financial Institutions and Consumer Credit

Joint Hearing on Legislative Solutions to
Abusive Mortgage Lending Practices

May 24, 2005

I am Regina Lowrie, the President of Gateway Funding Diversified Mortgage Company located in Horsham, Pennsylvania and I have been in the mortgage business for more than 28 years. I founded Gateway Mortgage in 1994, with seven employees and $1.5 million in startup capital. The company now has more than 800 employees, more than 58 offices and is Greater Philadelphia's largest independent mortgage company, serving consumers in all of Pennsylvania, Delaware, New Jersey and Maryland.

I am also Chairwoman Elect of the Mortgage Bankers Association (MBA)[1]. Thank you very much for the opportunity to testify this morning on behalf of MBA at this joint hearing on legislative solutions to abusive mortgage lending practices .

I want to begin by saying that I believe that everyone in this room shares the same ultimate goal: to end abusive lending practices in the mortgage market. Mortgage lending abuse is a stain on an industry that has served consumers extraordinarily well and has been a key engine of our nation's economic growth over the last decade.

I also know that we all share the same goal of ensuring that families in all parts of this nation continue to reap the benefits of a robust and competitive mortgage market. This vibrant competition has driven the development of innovative credit options in recent years that have made mortgages available to thousands of families for whom mortgages were traditionally out of reach.

---

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 400,000 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 prospects through increased affordability; and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters excellence and technical know-how among real estate finance professionals through a wide range of educational programs and technical publications. Its membership of approximately 2,900 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

The only difficult question I think we're all grappling with at this point is what is the best way to end abusive lending practices while still preserving this newly expanded access to capital?

The good news is we do have a fair amount of information about the best way to strike this balance. We know from experience what does not work: states and localities taking matters into their own hands.

In recent years, state and local governments have begun to enact a wide range of laws and regulations to deal with abusive lending. These laws, which often include subjective standards, create a tremendous compliance burden for companies. In the best case scenario, these burdens increase the cost of lending for consumers. In the worst case, they chase legitimate lenders out of the jurisdiction altogether, reducing access to capital. The evidence of the detrimental impact of these laws has been growing in recent years.

We also know what would work: a well-conceived federal anti-predatory lending law that sets forth strong consumer protections and objective and reasonable compliance standards. A uniform national standard would strike the right balance between preserving capital access and fighting abusive lending practices.

MBA, accordingly, strongly supports a uniform national standard. My testimony today will go into detail about the specific elements MBA views as critical in a national standard. It will also explain why we believe that the "Responsible Lending Act" (H.R. 1295), introduced by Congressmen Ney and Kanjorski, is the most promising vehicle for achieving this standard.

While MBA also recognizes the hard work of Congressmen Miller and Watt in developing the "Prohibit Predatory Lending Act" (H.R. 1182), as I will discuss, H.R. 1295 is a superior bill because it provides comprehensive protections and eliminates the current patchwork of state and local laws.

The Housing Market

This year the nation's homeownership rate rose to nearly 70 percent, the highest in our nation's history. This historic figure represents a five percent increase over the rate at the beginning of the last decade. Moreover, of particular note, it includes an increase in African-American homeownership of 16 percent and Hispanic homeownership of 17.2 percent between 1994 and 2004.

A significant part of the increase in homeownership is attributable to the recent development of the non-prime mortgage market. The non-prime market occupied one- twentieth of the mortgage market in 1994. By 2004, the non-prime market and the Alt-A market occupied one-third of the mortgage market.

The growth of the non-prime mortgage market has helped increase the nation's homeownership rate because this market basically serves families for whom homeownership has been traditionally out of reach. Non-prime borrowers commonly have low- to moderate income, less cash for a down payment and credit histories that range from less-than-perfect to none-at-all. These borrowers include first-time homebuyers, borrowers whose credit has been damaged by divorce or illness, single moms and dads, teachers and firefighters as well as business and professional people who have gone through difficult times but whose credit needs and dreams of homeownership have not abated. Before the advent of this new market, these borrowers were either simply denied the dream of homeownership or, in a very limited number of cases, served exclusively by FHA or other government-subsidized financing.

By virtue of the higher credit risk presented by non-prime borrowers, the foreclosure and default rates are greater. However, lower interest rates from rigorous competition, as well as an improving economy, have caused the default rates to drop. It would be a shame to deny legitimate borrowers non-prime credit because a very small percentage of loans go into foreclosure.

Tremendous competition in the non-prime market has brought many good things: The price of borrowing in the non-prime market has gone down as lenders have developed greater efficiency and expertise in assessing credit risk. At the same time, lender competition for borrowers has spurred the development of creative options such as prepayment provisions.

The Proliferation of Abusive Lending Laws

Unfortunately, yet not surprisingly, the rise of the new non-prime market has also attracted some unscrupulous actors who have taken advantage of the novelty of these loan products to victimize consumers in ways that are abusive and predatory. These practices range from outright deception or fraud, manipulating the borrower through aggressive sales tactics, or taking unfair advantage of a borrower's lack of understanding to saddle him or her with unfair loan terms.

In 1994, to address abusive lending in high-cost loans, Congress enacted the Home Ownership and Equity Protection Act (HOEPA). Under HOEPA, loans that meet certain criteria or triggers—currently loans with fees in excess of eight percent and having annual percentage rates (APRs) in excess of eight points over comparable Treasuries—are subject to specific restrictions and protections. These restrictions include the prohibition of certain loan terms, such as short-term balloon payment requirements, as well as the establishment of additional disclosure requirements. Under HOEPA, assignees of high-cost loans are subject to significant liability and for this reason almost no investors will purchase high-cost loans, which hurts liquidity and the availability of lower rates to borrowers in the high-cost loan market. Moreover, HOEPA protections are a

floor, not a ceiling, allowing states to enact more restrictive predatory lending laws.

Since 1999, beginning in North Carolina, states also responded to lending abuses by passing at least 30 state and 17 local laws. These laws are ordinarily modeled on HOEPA but tend to have lower triggers, cover more loans and provide additional and disparate requirements.

While well-intended, this proliferation of diverse laws has created enormous compliance burdens for lenders, costs which are necessarily passed on to borrowers, increasing the costs of credit. Frequently, legitimate lenders eschew lending altogether in particularly “difficult” states, depriving that state’s citizens the benefits of further competition and lower costs.

As a result of subjective state assignee liability provisions, ratings agencies have announced that they will not rate mortgage securities that include certain loans originated in certain states, i.e. Massachusetts. Fannie Mae and Freddie Mac have also announced policies limiting their involvement in certain states. Consequently, there is little securitization of certain mortgages in states like Massachusetts, further depriving the market of liquidity and borrowers of high-cost loans from the better rates that accompany loan securitization. Without a securitization outlet, lenders are unable to originate high-cost loans drying up legitimate, competitively priced lending for deserving families.

A National Standard

A far superior alternative to the patchwork of state laws is the enactment of a uniform national standard to combat lending abuses. Such a solution would provide significant and equal protection to borrowers throughout the country and a level playing field to increase competition and lower the cost of credit for all consumers.

Amend HOEPA

As a first step in establishing a national standard, HOEPA should be amended to extend its coverage to more loans and increase its protections. HOEPA currently only applies to refinanced loans. MBA also supports extending HOEPA coverage to purchase money loans and open ended lines of credit secured by real estate.

MBA also supports expanding HOEPA’s protections by modifying the HOEPA triggers to bring more loans with high points and fees within HOEPA’s coverage as a first step toward a uniform national standard. MBA also supports expanding HOEPA’s protections by restricting more terms and practices for HOEPA-covered loans, for example by largely eliminating balloon payments and negative amortization in high-cost loans.

In addition, as a first step towards a uniform national standard, MBA supports the application of certain protections to all mortgage loans, not just those that meet the HOEPA triggers, as detailed below.

Determining the High-Cost Mortgage Threshold

Since many lenders will choose not to make high-cost loans, the choice of where to set and how to calculate the high-cost thresholds is enormously important. There are a number of states that have set their triggers well below the HOEPA trigger and included considerably more fees in the calculation. As a consequence, few triggered-loans are originating in these states, depriving borrowers of legitimate lending as well as the benefits of competition and lower costs.

Points and Fees Trigger

As indicated, HOEPA currently has two high-cost mortgage triggers:

(1) The points and fees charged on a loan are equal to or exceed eight percent of the total loan amount; or
(2) The APR of a loan exceeds eight percentage points above comparable treasuries for first mortgages.

MBA does not object to lowering the points and fees trigger to a level which is calculated in a reasonable manner and will not encompass loans that simply do not need HOEPA's protections or unnecessarily limit the options available to borrowers.

Prepayment Penalties Should be Excluded

In calculating points and fees, MBA strongly believes that prepayment penalties should be excluded. The option of a prepayment penalty in connection with a mortgage allows a borrower to choose a lower rate and lower monthly payments in return for agreeing not to refinance within a set period unless he or she pays a fee. A lower rate can be offered because the presence of a prepayment penalty assures a more reliable income stream for investors in pools of such mortgages and, consequently, better pricing for securities and consumers themselves. Conversely, including these penalties in the calculation would increase the likelihood that a particular loan will meet the high-cost threshold, causing lenders to drop this option resulting in decreased borrower choices and, increased borrower loan rates and monthly payments. Investor interest in buying securities backed by non-prime loans would be significantly reduced if not eliminated.[2]

[2] The Pentalpha Group LLC, "Analysis of the Impact of Prepayment Penalties on Residentail Sub-prime Lending Coupons" May 12, 2004.

MBA has long been committed to transparency and informed consumer choice and, in that vein, believes that prepayment penalties should always be optional and result from true consumer choice. Accordingly, MBA would support a requirement that originators provide borrowers with a choice of a loan rate with and without a prepayment penalty, if available.

Yield Spread Premiums

MBA also believes that yield spread premiums should be excluded from the points and fees trigger calculation. Yield spread premiums are payments by lenders to mortgage brokers as compensation for their role in a mortgage transaction..[3] Since these payments are reflected in the rate, the Federal Reserve has traditionally taken the view that yield spread premiums should be addressed as part of the annual percentage rate or APR for purposes of TILA ("Truth in Lending Act") and accounted for in the rate trigger under HOEPA. The Federal Reserve has said that to also count these payments as points and fees would be double counting.[4] MBA shares this view.

Like prepayment penalties, yield spread premiums offer borrowers additional financing options to address their particular cash situations and credit needs. As HUD recognized in considering the legality of yield spread premiums, these payments offer borrowers the option of choosing to defray origination costs by selecting a higher rate and higher monthly payments instead of paying them up front.[5] Forcing these premiums to be part of the point and fees trigger will reduce the availability of yield spread premiums and financing options for borrowers.

The approach of H.R. 1182 would include yield spread premiums in the point and fees definition which, as noted, would constitute double counting.

Limitations on High-Cost Mortgages

MBA supports increased limitations on high-cost mortgages including prohibiting certain terms and adding new protections as part of a national uniform standard. Any new limitations must have clear and objective standards to ensure easy and consistent compliance. Any additional disclosures and other requirements must tangibly and directly aid consumers. Borrowers are not well-served by additional ill-conceived disclosures.

---

[3] HUD has made clear that these payments are legal under the Real Estate Settlement Procedures Act's (RESPA's) Section 8, as long as they are reasonably related to the goods and services provided. See, RESPA Statement of Policy 2001-1, Clarification of Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, and Guidance Concerning Unearned Fees Under Section 8(b), 64 FR 53052 (October 18, 2001); RESPA Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, 64 FR 10080 (March 1, 1999).

[4] See 60 FR 62764 (December 7, 1995).

[5] *Ibid.*

Prohibited or Restricted Terms and Practices in High-Cost Mortgages

As part of a uniform national standard, MBA supports the prohibition of certain loan terms and practices. These terms and practices include selling single-premium credit life insurance in conjunction with loans, most types of balloon payments, negative amortization loans, most types of call provisions, requiring borrowers to waive their rescission rights, encouraging borrowers to default and provisions that allow for a defaulting rate of interest. While these provisions can be legitimate features of some mortgage transactions, their exclusion from high-cost mortgages may be warranted in the interest of protecting borrowers. MBA also supports reasonable limits on the financing of points and fees, limits on modification and deferral fees, limits on late fees and limits on prepaying payments from the loan proceeds.

Disclosures for High-Cost Mortgages

MBA also supports better disclosures for consumers entering into high-cost loans including provisions that make borrowers aware of housing counseling before the loan closes. The mortgage process is excessively complicated and, while lenders are working to make it more transparent and user-friendly, MBA believes it is also useful for borrowers to receive the guidance of qualified counselors before they enter into high-cost loan transactions. Informed consumers are one of the best weapons against unscrupulous lenders and brokers.

Assessing a Borrower's Ability to Repay

Assessing a borrower's ability to repay a loan is fundamental to the underwriting process. Nevertheless, some bad actors, in hopes of earning higher origination fees, have disregarded this critical criteria – something a legitimate lender would never do. Accordingly, MBA would consider supporting a requirement that lenders determine a borrower's ability to pay before entering into a high-cost loan.

Any new standard in this area must recognize how a lender makes such a determination and offer a clear safe harbor that recognizes lender compliance. At the same time, any new standard must also allow lenders latitude to determine that a borrower in unique circumstances is able to pay. It is not in the interest of a legitimate lender to originate a loan that a borrower cannot repay and it is important to preserve the ability of lenders to provide loans to borrowers in unique situations.

Protecting Against Loan Flipping

One of the most fundamental benefits of homeownership is the ability of a homeowner to draw on the accrued value of his or her home to meet financial

needs, such as home remodeling, medical bills or even the costs of a family member's education. At the same time, abusive lending laws appropriately seek to prevent loan flipping. Loan flipping occurs when an unscrupulous lender initiates a high-cost loan to a borrower seeking to reap the benefits of origination costs that can result in stripping equity from the home.

It is critically important in addressing this area to preserve the legitimate instances where refinancing is beneficial to the borrower. To prevent loan flipping, Congress should identify the particular circumstances, through "bright line" safe harbors, where refinancing of high-cost loans is acceptable, including for example, when a lower rate is offered or a specified percentage of additional funds are provided. An overbroad legal standard would make a lender unnecessarily subject to liability for refinancing a consumer's mortgage, will force borrowers to either sell their homes as the only means of extracting needed funds or turn to other higher cost loan alternatives.

H.R. 1295 provides a balanced and objective standard that fairly protects consumers from excessive loan flipping and equity stripping without preventing a borrower of a high-cost loan from accessing their home equity.

Assignee Liability and High-Cost Mortgages

In MBA's view it is essential that a uniform national standard amend HOEPA to establish a clear and objective standard if assignees are to be held liable for the claims of high cost borrowers. Current HOEPA fails in that it contains a subjective standard giving rise to significant liability that holds assignees liable for the claims of borrowers "unless they can demonstrate by a preponderance of the evidence that a reasonable person exercising ordinary due diligence could not determine" that the loan was a high cost mortgage.

The subjectivity of this test under HOEPA and similar tests under some state laws have caused investors to avoid securitizing higher cost loans depriving high-cost borrowers of the lower rates resulting from securitization. If HOEPA is to be amended, MBA believes the establishment of an objective test of assignee liability should be among the highest priorities. When an assignee fails to meet specific criteria such as obtaining representations from originators or fails to conduct a specific level of due diligence, only then should liability be possible subject to defense by the assignee. Primary and secondary market participants require objective standards for determining liability. The ratings agencies and the government sponsored enterprises evaluate the assignee liability standards to determine risk and its affect on mortgage-backed securities. If that risk is indeterminate, it threatens the availability or significantly increases the cost of credit. Clear and objective assignee liability standards are essential as provided for under H.R 1295.

An Opportunity to Cure Errors

It is in the best interest of the lender and the consumer to rectify any errors in a high-cost mortgage transaction as soon as those errors are discovered. Accordingly, MBA strongly believes that a national standard should include a consumer-friendly, non-adversarial procedure where a lender has a first opportunity to promptly correct an error without additional legal liability. The standard must allow for the parties to cure an error in a way that maintains their relationship, steers the parties away from the expensive and adversarial nature of litigation and provides both with a simpler and more satisfactory result.

Protections Under a Uniform National Standard for All Mortgage Loans

As a first step towards establishing a uniform national standard to protect against abusive lending, MBA believes that increased protections for all mortgage borrowers should be considered. Items that may bear consideration include improved borrower education, increased broker licensing and new requirements for the use of appraisals.

Education

MBA is strongly committed to borrower education to help consumers understand the mortgage process and shop for the best mortgage that meets their needs. MBA also believes that education protects borrowers against lending abuses. Accordingly, MBA would support further government activity to facilitate borrower education as part of a national law to combat abusive lending.

Broker Licensing

Mortgage lenders are currently subject to a range of licensing, worth, capital and repurchase requirements that provide significant consumer protections. These rigorous requirements ensure that mortgage lenders adequately train and oversee the performance of all of their employees, particularly their loan officers. These same protections, however, are missing in the case of mortgage brokers who are self-employed and are not subject to the same requirements as mortgage bankers.

Appraiser Standards

Lenders rely on accurate and legitimate appraisals to verify the sale value of a home and give the lender confidence in extending a particular amount of mortgage credit. To avoid potential loss, it is critical that lenders receive appraisals that reflect the true value of property. Therefore, the appraiser's ability to exercise independence in making a value determination as an unbiased arbiter of a property's value is critical to a lender. As part of a national standard, MBA supports efforts to prohibit parties to a loan transaction from illegally

influencing, or attempting to improperly influence, an appraiser through coercion, extortion or bribery in developing or reporting an appraisal.

Enforcement

MBA has consistently called for greater enforcement of current laws and welcomes new reasonable enforcement requirements to rid the industry and consumers of abusive lenders and brokers. In particular, we support a toughening of reasonable enforcement requirements under HOEPA and RESPA as part of a national uniform standard.

OCC-OTS Preemption

Consistent with its support for national standards to address lending abuses, MBA supports the actions of the Office of the Comptroller of the Currency ("OCC") and Office of Thrift Supervision ("OTS") to preempt the national banks and federal savings associations from state predatory lending laws. The OCC and OTS have established significant requirements to protect against lending abuses in lieu of state requirements. [6] Moreover, under a uniform national standard these institutions would be subject to the new standards as well. Such an approach assures that these institutions meet national standards benefiting industry and consumers alike. Notably, the Federal Reserve estimates that OCC and OTS regulated institutions comprise approximately 14 percent of the originations in the non-prime mortgage market.

Servicing Implications of H.R. 1295

We note, however, that H.R. 1295 would impose significant new risks and obligations on servicers, including shorter timelines for responding to qualified written requests and recording lien releases, mandatory escrowing and new disclosure obligations. These servicing provisions are not restricted to loans meeting the new "high-cost loans" definition but generally apply to all home loans. While we have a number of technical recommendations with regard to the servicing provisions, we would like to focus on a particularly onerous provision:

Federal Expansion of the Interest on Escrow Requirements

H.R. 1295 calls for the payment of interest on escrows if state or federal law requires it. There is no federal law mandating interest on escrows at this time. However 14 states currently have interest on escrow laws. Under the current federal statutory and regulatory regime, federally chartered financial institutions are preempted from some of these state laws. H.R. 1295 appears to change this, placing federally chartered institutions under the state's authority in this

---

[6] Pursuant to HOEPA, State attorneys general have the authority to enforce its provisions against OTS and OCC regulated institutions in a United States District Court, provided certain steps are taken. See 5 USC 1640(e).

area. Regardless of whether required by state or federal law, mandating that servicers pay interest on escrows dramatically increases the cost of doing business and the cost of credit to consumers. MBA has long opposed state interest on escrow laws and we object to any federal expansion.

Contrary to popular belief, mandating the payment of interest on escrows is not a "pass–through" situation. Mortgage companies do not earn interest on escrows that they collect on behalf of borrowers. In fact, the payment of interest on corporate demand deposit accounts -- where these funds generally reside -- is prohibited by federal law. As a result, mandating that servicers pay interest on escrows translates into a direct capital outlay for servicers. These capital outlays can be extensive and could significantly affect the cost of credit.

Moreover, because the bill mandates escrows for the majority of loans originated in today's market, the servicer would be unable to control these costs by choosing not to escrow. Servicers would also be held captive if states increase the rate of interest above market or fail to promptly reduce rates in declining rate environments. The potential for this risk is real. Servicers have experienced this very problem in the past when states imposed rates four to nine times higher than prevailing pass book rates. With such a windfall, borrowers began over-funding their escrow accounts, which in turn overwhelmed servicing staff's ability to maintain statutory cushions and refund the money. Servicers were forced to release escrows to control this problem. Moreover, because the bill is effectively retroactive to loans already originated, servicers cannot price these costs into the borrower's rate. The servicer is held captive. The bill will likely encourage states to impose interest on escrow laws -- further driving up costs to possibly unmanageable levels for servicers.

H.R. 1295

After careful review of H.R.1295, MBA believes that, while it is a tough bill, it addresses many of MBA's concerns. It strikes the right balance between providing strong consumer protections and ensuring clear, objective compliance standards to facilitate market competition. In particular, MBA supports the bill's replacement of the patchwork of state and local laws with a better and more comprehensive uniform national law. The bill's clear assignee liability provisions will facilitate consumer recourse and protect liquidity. The provisions that allow for non-adversarial, prompt corrective action to address errors and consumer claims will help many borrowers and lenders work out their problems more efficiently. The bill's balanced and objective standards will fairly protect consumers from excessive loan flipping and equity stripping without preventing borrowers from accessing needed credit. And the new disclosures, borrower education, and counseling provisions will also provide greater consumer protections. As the process goes forward, MBA will work to protect these provisions of the bill and to evaluate and refine other sections.

MBA believes that H.R. 1295 provides standardization, predictability and uniformity which will give the market -- consumers, lenders and investors alike -- clear standards which will increase competition and efficiency. This will ultimately decrease the cost of mortgage credit to the benefit of consumers.

H.R. 1182

As indicated, MBA applauds the hard work of Congressmen Miller and Watt in their efforts to address predatory lending. While well-intended, their bill, H.R. 1182 fails to take into account the operation of the mortgage market and the need for uniformity, standardization and predictability. Specifically, the bill sets forth new and more inclusive HOEPA triggers that would hurt competition among legitimate lenders. The bill does not set forth a uniform national standard but rather adds a new set of federal requirements to the patchwork of state and local anti-predatory lending laws and, at the same time, gives the states the opportunity to pass even more individual state laws. This approach will further the proliferation of state and local laws which will ultimately increase the cost of and threaten the availability of credit for borrowers.

Conclusion

Once again, MBA commends the House Financial Services Subcommittees for holding a joint hearing on the need for a national response to predatory lending. MBA believes that the only way to address predatory lending abuses while preserving the increased access to capital brought by recent credit innovations is to pass a uniform national standard that will bring predictability and uniformity as well as increased protections to the national mortgage market. This approach, embodied in H.R. 1295, would best serve the interests of borrowers, lenders and investors alike.

We appreciate the opportunity to testify and look forward to responding to any questions by members of the Committee.