Prepared Testimony

of

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on

Mortgage Origination:
The Impact of Recent Changes on Homeowners and Businesses

before the

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I. The Modern Mortgage Broker Business

The typical mortgage broker business operating in today's marketplace is an origination channel, existing alongside other competing origination channels, through which consumers can obtain credit to purchase or refinance their home. Not unlike an insurance broker representing a large number of carriers from which their customer can choose a product, the modern mortgage broker typically offers loan products

from between ten and fifty different banks and lenders across the country through what is referred to as the "wholesale channel."

The modern mortgage broker origination channel is mainly comprised of individuals who have been top performers in their field while working for other origination channels, such as banks or mortgage lenders. These individuals, aspiring to the dream of owning and operating their own business, establish themselves in cities large and small, urban and rural, and generally hire between three and fifty employees, making mortgage broker entities a truly valuable small business participant in their communities.

The modern mortgage broker business model is centered on customer service. Mortgage broker businesses generally seek and obtain approval from numerous creditors to submit mortgage files for underwriting and closing in order to provide consumers with greater access to a wider range of mortgage products and programs than are typically available through other distribution channels.

II. The Impact of Recent Changes on Mortgage Broker Businesses & Consumers

The recent regulatory changes in our industry have had a profoundly negative impact on mortgage brokers and on consumers. However, before we specifically address *how* these regulations have affected our businesses and our customers, it is important to explore *why* these changes that were aimed at creating a more consumer-friendly borrowing environment have had mainly the opposite effect.

The primary reason why recent regulatory changes have done more harm than good for both businesses and consumers is that these regulations, by design or through implementation, disproportionately target individuals, entities, and the disclosure of information rather than addressing specific issues related to faulty products or bad behavior.

For example, in the pharmaceutical industry when a faulty product is discovered to be causing harm to consumers using that product, the U.S. Food and Drug Administration ("FDA") typically steps in and requires the distribution and use of such product to be discontinued. In such circumstances, the FDA does not attempt to impose further restrictions on the pharmacies or pharmacists distributing the product or the physicians who prescribe it.

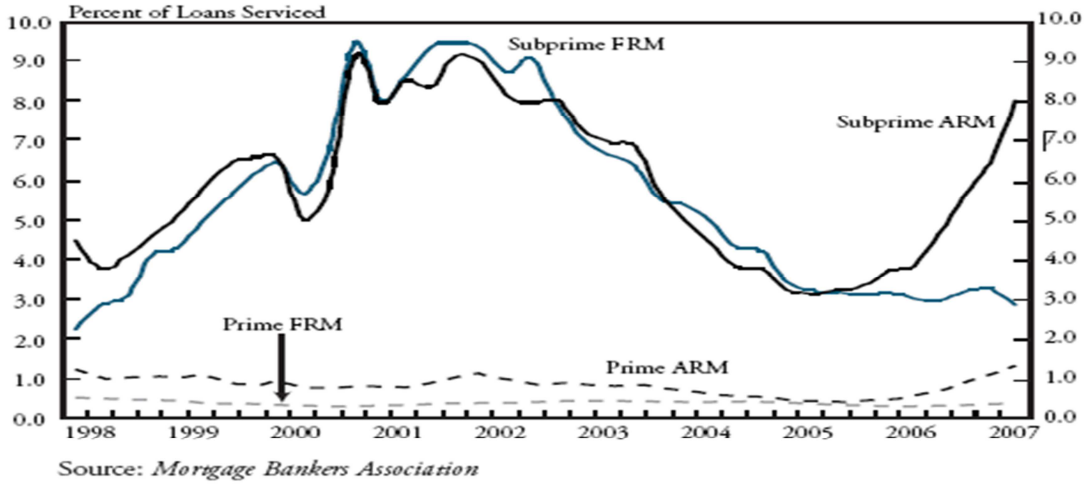
Unfortunately, exactly the opposite is happening in the mortgage industry. At the epicenter of our current mortgage and housing crisis are faulty loan products, such as the pay-option ARM, stated income, no-doc loans, and Alt-A and sub-prime mortgages. Much like a drug that was released onto the market, but later discovered to cause harmful and previously unforeseen side effects, these loan products were created and distributed in the mortgage marketplace before anyone really understood the potential for harm that these products brought to homeowners, entire communities and the economic stability of our mortgage and housing market.

However, unlike the FDA's typical response to the discovery of a harmful product falling within its purview of regulation, the Federal Reserve Board and Congress have gone far and beyond removing these harmful mortgage products from the shelves, which has led to a protracted economic recovery at best, and at worst has actually caused greater harm to the market than any faulty loan product has previously.

The chart below, created by the Federal Reserve Bank of Kansas City, helps illustrate the point that the largest underlying problem in our mortgage market has been the proliferation of faulty products.

Chart 4

FORECLOSURE RATES BY LOAN TYPE, 1998-2007



Data for 2008 through 2010 are very similar as 1998 through 2007

However, despite evidence of the harm that these loan products have caused, the Federal Reserve Board and Congress have, to date, focused the vast majority of their attention, resources and regulatory authority on manipulating how providers of these products conduct their businesses rather than on how these products were created originally and why the harmful effects of these loan products were not realized until it was too late.

Recent regulations have been directed primarily at individuals, entities and disclosures within the mortgage industry and not at the products that are the root cause of so much of the economic damage consumers have already suffered. Because of these regulations, the livelihood of individuals and the survival many entities, large and small, within our industry is being severely threatened. Consumers too are already suffering, as competition continues to deteriorate and the mortgage marketplace becomes increasingly dominated by only a few of the industry's largest entities.

Consumer fees have increased substantially as lender and originator expenses per-loan are estimated to have risen by nearly $1,000.00 from the 4th Quarter of 2010 to the 1st Quarter of 2011. Consumers are also facing increased out-of-pocket costs for appraisals and higher loan fees in order to cover originators' costs in the event they are required to cure errors on the Good Faith Estimate ("GFE"), since the originator's compensation cannot be lowered. Additionally, many consumers are not receiving the time and attention they deserve from their loan originator, particularly if the consumer is seeking a smaller loan amount because such smaller loans have become increasingly unprofitable for the originators and their employers. In fact, in some areas, entities are instituting minimum loan amounts because it has become too cost-prohibitive for these entities to continue to originate smaller loans.

Additionally, there are far too many stories being relayed to us by our members and being shared in the media of highly qualified borrowers who are simply unable to obtain the mortgage financing they need to become homeowners or to transition into a larger or smaller property. This is in large part due to the glut of recent changes to underwriting, appraisal and credit score requirements, waiting periods and mortgage

disclosures that have knocked the industry back on its heels and have severely stunted any progress we might otherwise be making toward economic recovery.

Across the board, entities in the mortgage origination business have seen their profits-per-loan drop by an estimated 66%, and individual loan originators have seen their compensation cut by 33% or more in some areas. According to a recent survey conducted by the Mortgage Bankers Association, the average per-loan profit for an entity in the 1st Quarter of 2011 was just $346, which was down from a $1,082 in the previous quarter, and down from $608 just one year earlier. The survey also found that 63% of the 329 responding firms posted pre-tax profits for the 1st Quarter 2011, compared to 84% in the quarter prior. While it's not unusual for profits to decline at the end of a refinancing boom, it is clear to many in the industry that this most recent downturn in profitability has been significantly more severe due to the increased compliance costs associated with the new regulatory requirements.

NAMB is gravely concerned that the recent changes promulgated by the Federal Reserve Board and Congress have done little to address the significant root causes of our mortgage and housing crisis, facilitate a recovery in the market, or create a more consumer-friendly mortgage lending environment.

III. Federal Reserve Board Rule on Loan Originator Compensation & Steering

In the few short months since the Federal Reserve Board's rule on loan originator compensation was implemented, mortgage broker businesses have suffered significant and irreparable harm as a result of these new requirements. However, what's worse is that these new requirements are having an even more profoundly negative effect on consumers.

Under the new rules, mortgage broker businesses can no longer accept compensation from both the lender and the borrower in connection with a loan transaction. Instead, mortgage brokers now are forced to choose, and in doing so limit their customers' ability to choose, whether the broker will be paid by the lender or the customer, but under no circumstance both. Additionally, the new rules prohibit a mortgage broker from ever adjusting its origination fee, once disclosed to the borrower, regardless of whether the price adjustment is down and for the benefit of the consumer.

An example of just one of the many ways that this rule is negatively impacting consumers was recently relayed to us by one of our members. This member was working with a customer that was prepared to close a loan on the purchase of a bank-owned property. One day before closing, the borrower's insurance company went out to physically inspect the property. As a result of this inspection, the insurance company raised the borrower's premium, making it impossible for the borrower to obtain mortgage insurance. Prior to implementation of the Board's new rules, the mortgage broker would have been able to reduce his/her fee for originating the loan and thereby reduce the borrower's interest rate and allow the loan to close as scheduled. However, under the new rules, this same borrower is forced to either delay closing and attempt to find a more affordable insurance provider, put substantially more money down upfront to close the deal on time, or walk away from the purchase of the home altogether one day prior to closing because the mortgage broker is unable to make any reduction in his/her fee after it has been disclosed to the borrower.

The primary flaw in the rule that is causing the harm illustrated above, as well as many other similar instances of harm to consumers, is the Federal Reserve Board's definition of the term "loan originator." The Board has defined "loan originator" to include mortgage broker businesses, as well as the individual loan originator employees working for those businesses. However, the Board has chosen to exempt mortgage lending businesses (*i.e.*, "creditors") from this definition, even though their individual loan originator employees are also covered by the definition of "loan originator" in the rule.

This disparity in the treatment of mortgage broker businesses and mortgage lending businesses has placed mortgage brokers at a considerable competitive disadvantage in relation to their competition in two primary respects. First, a mortgage broker is prohibited from ever adjusting its price, up or down, to benefit a consumer or secure a transaction, while a mortgage lender remains free to adjust its pricing for any reason as circumstances may warrant. Additionally, a mortgage broker is prohibited from compensating its employee loan originators on a commission basis, which remains the most economically viable means for a small business mortgage originator to compensate its individual loan officers.

NAMB continues to steadfastly believe that the Federal Reserve Board acted outside of the scope of its authority in regulating loan originator compensation in the manner prescribed in the rule. NAMB specifically takes issue with the Board's decision to arbitrarily sweep mortgage broker businesses into the rule's definition of "loan originator," over the objection of numerous industry leaders and contrary to the legislative intent of Congress, which crafted the original and proper definition of "loan originator" in the SAFE Act (12 U.S.C. 5101, et. seq.).

However, because the Board proceeded with implementation of its rule despite the concerns raised by industry leaders and members of Congress, and because multiple legal challenges to the rule have proven unsuccessful, NAMB believes it is now imperative for Congress to explore amending the Truth in Lending Act ("TILA") to limit the breadth of the negative impact of the Board's rule.

Specifically, NAMB believes TILA should be amended to include a definition of "loan originator" that mirrors the definition of "loan originator" found in the SAFE Act (12 U.S.C. 5101, et. seq.). The statutory definition of "loan originator" found in the SAFE Act should be carried throughout the framework of federal financial laws and regulations. Defining the same term differently in different statutes and regulations that affect the same industry and individuals only causes confusion and unnecessarily increases the costs and complexities of compliance. NAMB believes that specifically adding the definition of "loan originator" to the TILA statute and defining the term in the same manner as in the SAFE Act will help to clarify some of the confusion and controversy surrounding the Board's rule, and will also help bring a measure of even greater consistency to the federal regulation of our industry. NAMB also believes that the SAFE Act should be amended to provide state regulators with greater flexibility with regard to licensing loan originators.

IV. Consumer Financial Protection Bureau Proposals to Simplify Mortgage Disclosures

NAMB is very encouraged by the Consumer Financial Protection Bureau's ("CFPB") commitment to developing more consumer-friendly mortgage disclosures and the effort that is being made to solicit feedback on these forms from our industry.

Because buying a home is often one of the largest and most significant financial decisions in a person's life, NAMB believes it is critical to give consumers clear, easy-to-understand information that empowers them to compare mortgage products and providers and identify those that best meet their individual needs and goals.

Current mortgage disclosure forms are unnecessarily complex and entirely too difficult for most consumers to understand and use effectively. These forms are also redundant and therefore costly for originators to fill-out, which in turn increases the overall cost of obtaining a mortgage for consumers.

NAMB has specifically stressed the importance of removing the annual percentage rate ("APR") from any new mortgage disclosures that are developed, as most within our industry agree that the APR is extremely confusing and very difficult for borrowers to understand, even with the help of a knowledgeable loan originator. NAMB also believes that the sale price and estimated value of the

property should be added to such disclosures, along with information about any mortgage insurance that that may be required in order to obtain the loan. In the end however, a truly consumer-friendly mortgage disclosure should help a borrower answer two basic questions: (1) can I afford this mortgage; and (2) can I find a better price or product elsewhere.

To date, the efforts being made by the CFPB to simplify consumer mortgage disclosures seem to be on track toward achieving a clearer more consumer-friendly set of forms. However, as the CFPB moves forward with testing and analyzing its draft forms, NAMB strongly encourages the CFPB to seek out and engage a qualified third-party verifier to conduct or monitor any consumer testing and assist in evaluating the results. As we have learned from prior efforts to review and revise consumer mortgage disclosures, relying on agency testing of agency-developed forms or procedures does not always yield the desired result, which is a better form for both consumers and the industry.

Because consumers ultimately bear the cost of implementation of any new disclosure form or procedure, NAMB believes it is imperative that the CFPB's new disclosures not only provide consumers with critical information in an easy-to-use format, but also that such disclosures are able to be implemented without further disruption to the industry or the home buying process.

V. Increase in Mortgage & Appraisal Fraud

Mortgage and appraisal fraud has been and continues to be a serious problem in our industry. Although recent studies have shown that instances of mortgage fraud are down as much as twenty-five percent (25%) from the peak numbers seen during the subprime and exotic loan boom between 2005 and 2007, a cloud continues to hang over our industry.

Industry self-policing and policy changes, such as enhanced employment verification at closing, additional credit report requirements, and authenticated IRS tax transcripts have served as an effective deterrent and detection mechanism for many types of fraud. However, with the historically high number of homeowners across the country who are in trouble with their mortgages, we have witnessed significant increases in fraudulent activity surrounding short sales, foreclosure rescue schemes, and some loan modification programs. Additionally, instances of appraisal fraud have more than doubled (from 16% of all fraud cases in 2006 to 33% of all cases since 2009) following implementation of the still highly controversial Home Valuation Code of Conduct ("HVCC"). Although the HVCC was designed to reduce the instances of fraud occurring in the appraisal process, it instead sparked significant turmoil, decreased competition in the appraisal industry, and eliminated virtually all checks and balances historically associated with home appraisals.

Critics of the HVCC maintain that appraisal management companies ("AMCs") offer only nominal compensation compared to what appraisers have traditionally been paid for their services, and this has led to more inexperienced appraisers who are unfamiliar with a particular area taking on appraisal assignments. It has also been suggested that AMCs are requiring appraisers to complete work in un-realistic time frames, which is resulting in sometimes fraudulent and often wildly inaccurate appraisal reports.

NAMB members have brought us countless examples of the specific hardships their customers have faced because of these and other issues surrounding the HVCC. Multiple members have reported that customers were unable to obtain the loan they applied for after an appraiser located fifty (50) miles or more away from the subject property and unfamiliar with the local market was selected by an AMC to provide the appraisal report; and because the appraisal process has made appraisers essentially anonymous, there are virtually no checks or balances and very little quality control that can be exercised in such situations.

Additionally, NAMB members across the country have shared with us examples of consumer appraisal costs that have risen between 120%-150% from pre-HVCC pricing. Before implementation of the HVCC, the average cost of a conventional single-family residential appraisal was roughly $300-$325 and an FHA appraisal typically cost the consumer between $350-400. Now our members are seeing conventional single-family residential appraisals cost their customers $425 or more and FHA appraisal costs are toping-out at or above $500.

While consumer appraisal costs have risen substantially following implementation of the HVCC, we have also seen a dramatic decrease in appraiser compensation. It has become an unsettling trend to see borrowers pay in excess of $450 for an appraisal, where the appraiser only earns half of that amount in compensation for his/her services, the rest being retained by the AMC responsible for hiring the appraiser. This particular financial arrangement is largely what has led to the increase in inexperienced appraisers being awarded more assignments, because the AMC will charge the borrower the same amount regardless of the skill or experience of the appraiser, but the AMC is able to compensate the appraiser based on his/her skill or experience.

The cumulative effect of all of this is that consumers are tending to pay significantly more money for lower quality appraisals, which in turn is making it more difficult, and sometimes impossible, for many consumers to obtain mortgage financing. Mortgage and appraisal fraud is jeopardizing the recovery of our housing market, causing countless problems for financial institutions and limiting opportunities for consumers. Moreover, because mortgage fraud is a crime that is often not vigorously investigated or prosecuted unless significant sums of money or large numbers of individuals are involved, NAMB believes that alternative enforcement mechanisms and other checks and balances need to be put into place. Specifically, NAMB believes that mortgage originators should not be permitted to own, in whole or in part, any AMC that the originator intends to or does in fact conduct business with.

VI. Qualified Mortgages ("QM") / Qualified Residential Mortgages ("QRM")

"Qualified mortgages" and "qualified residential mortgages" are mortgage loans with underwriting and product features that historical performance data suggests carry a lower risk of default (see chart above). As the rulemaking process for implementing the Dodd-Frank Act continues to move forward, these terms will be even more specifically defined.

NAMB believes that the definition of a "qualified mortgage" or "qualified residential mortgage" should include any fixed-rate mortgage with a term of ten (10) years or more, which is fully amortized and requires full documentation of the borrower's income and assets. NAMB does not believe it is necessary or appropriate for the Federal Reserve Board to be imposing debt-to-income or minimum credit criteria on these mortgages, particularly in light of the historical data showing how well these types of loans have generally performed. In fact, NAMB believes that this over-regulation is a prime example of the precise problem we highlighted earlier in our testimony. Rather than specifically identifying those mortgage products that were causing the vast majority of harm to consumers and to our mortgage and housing market and effectively removing those products from the shelves, the Board instead promulgated overly broad regulations that have failed to achieve their desired effect and have negatively impacted the origination of traditionally high-performing loans.

For this reason, NAMB strongly believes that "qualified mortgages" and "qualified residential mortgages" should be specifically exempt from the Board's discretionary regulatory authority under TILA. These mortgages, by definition, carry a lower risk of default based upon their features, terms and underwriting, and the Dodd-Frank Act already exempts "qualified residential mortgages" from risk-retention requirements.

By exempting "qualified residential mortgages" from the risk-retention requirements of the Dodd-Frank Act, the cost of securitizing these mortgages is reduced, thus providing a market incentive for the wide origination of responsible loans. NAMB believes this same principal is applicable in the case of rules enacted by the Board under its broad discretionary authority under TILA. Exempting "qualified mortgages" and "qualified residential mortgages" from onerous Board rules and regulations will further incentivize the origination of these responsible loans and will help ensure that these loans are less expensive for borrowers than other products carrying more risky features and less restrictive underwriting standards.

VII. Conclusion

NAMB and the mortgage professionals we represent nationwide are committed to strengthening our industry and serving and protecting our customers. However, we do not believe it is appropriate or even possible to legislate or regulate our way to an economic recovery.

We urge Congress and each of the federal financial regulatory agencies to pause from any efforts to promulgate or implement further changes or regulatory requirements on our industry for at least twenty-four (24) months. Allow our customers, our processes, and the market to catch-up to the numerous significant changes that have already taken effect, and at the same time, evaluate which of those changes may have gone too far and should be rolled-back in the interest of facilitating a swifter recovery.

NAMB appreciates all of the work that this Committee does on behalf of consumers and our industry, and we are particularly grateful for the opportunity to share our thoughts with you today on these issues that are of such great concern and importance all of us. Thank you for inviting NAMB to testify, and we look forward to continuing to work with you to find solutions to these issues that continue to delay our economic recovery and negatively affect consumers' ability to obtain affordable mortgage financing.