NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

Testimony

Testimony of
John Taylor, President and CEO

On behalf of the
National Community Reinvestment Coalition

Before the
US House of Representatives
Committee on Financial Services

On the topic of
"H.R. 1728: *Mortgage Reform and Anti-Predatory Lending Act*"

Thursday, April 23, 2009

National Community Reinvestment Coalition

727 15th Street, N.W.
Suite 900
Washington, D.C. 20005
www.ncrc.org

Voice: 202-628-8866
Fax: 202-628-9800

I. Introduction

Good afternoon, Chairman Frank, ranking member Bachus, and other distinguished members of the Committee. I am John Taylor, President and CEO of the National Community Reinvestment Coalition (NCRC). I am honored to testify today on behalf of NCRC on the topic of "H.R. 1728: *Mortgage Reform and Anti-Predatory Lending Act*." NCRC supports the enactment of H.R. 1728 to address the crisis in the housing and credits markets and the need for comprehensive anti-predatory lending legislation.

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 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. Credit Suisse forecasts an additional 8 to 10 million foreclosures over the next five years given an 8 percent unemployment rate.[1] With the nationwide unemployment rate now at an unsettling 8.5 percent—the highest rate in more than 25 years—unemployment-driven foreclosures are further undermining the strength of the national economy. This past March alone, more than 650,000 jobs were lost, contributing to the more than 4.4 million total loss of jobs since the recession began in December 2007.

[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.

Loose underwriting combined with a rise in unemployment has contributed to 803,489 foreclosure filings during the first quarter of 2009, a 24 percent increase from the first quarter of 2008 according to RealtyTrac.2 On an annual basis, the first quarter filings would equal an astounding 3.2 million foreclosure filings for 2009. This past March alone saw an additional 290,000 homes fall into foreclosure.

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] According to the Federal Reserve Board, families have lost more than $13 trillion in total household wealth since mid-2007.[4] While the crisis is becoming widespread, it has not been an equal opportunity crisis. During the boom years of subprime lending, subprime lending was disproportionately targeted to minority communities. An NCRC report found that of all the conventional loans made to African Americans in 2005, 54.5 percent were high-cost. In contrast, of all the conventional loans issued to whites, only 23.3 percent were high-cost.[5] Subsequent research has shown that foreclosures, arising from the subprime lending, have also been concentrated in minority communities.[6] The situation is so dire within the African-American community that United for a Fair Economy, a

---

[2] "Foreclosure Activity Increases 9 Percent in First Quarter," April 16, 2009, RealtyTrac, via http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=6180&accnt=64847.

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

[4] Presentation to the Forecasters Club of New York, New York, NY, by Janet L. Yellen, President and CEO, Federal Reserve Bank of San Francisco, March 25, 2009, http://www.frbsf.org/news/speeches/2009/0325.html

[5] National Community Reinvestment Coalition, the 2005 Fair Lending Disparities: Stubborn and Persistent, May 2006. Also, see Robert B. Avery, Kenneth Brevort, and Glenn Canner, *Higher-Priced Home Lending and the 2005 HMDA Data*, Federal Reserve Bulletin, September 2006, via http://www.federalreserve.gov/pubs/bulletin/2006/hmda/bull06hmda.pdf.

[6] Kristopher S. Gerardi and Paul S. Willen, *Subprime Mortgages, Foreclosures, and Urban Neighborhoods, Public Discussion Papers*, Federal Reserve Bank of Boston, December 22, 2008 and Lisa Nelson, *Foreclosure Filings in Cuyahoga County* in A Look Behind the Numbers, Fall 2008, published by the Federal Reserve Bank of Cleveland, via http://www.clevelandfed.org/Our_Region/Community_Development/Publications/Behind_the_Numbers/2008/0908/BTN_20080929.cfm.

Boston-based policy group, estimates that African Americans could experience the greatest loss of wealth since Reconstruction.

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. In addition, the old predators are transforming themselves into new predators. NCRC's investigation into foreclosure scams shows that formerly abusive brokers are now reemerging as foreclosure mitigation consultants. These consultants exploit distressed families by charging exorbitant fees and not engaging in any legitimate foreclosure prevention. NCRC will be releasing a Fair Lending Audit using mystery shopping of more than 75 for-profit national foreclosure prevention service providers in May 2009. If regulatory enforcement is not immediately tightened, the unsafe and reckless lending practices of the past will continue to recycle into new abuses against consumers, thereby prolonging the economic crisis and hampering recovery.

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 originations of subprime loans."[7] 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.[8]

---

[7] 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.

[8] 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.

Credit rating agencies also had incentives to deal in mortgage-backed securities (MBS), since credit rating agencies were paid by the issuers of these securities. Credit rating agencies inflated ratings and facilitated the sale of hundreds of billions of dollars of MBS containing problematic loans that defaulted in large numbers.

Ludwig suggests that the final breaking point 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.[9]

The heightened pace of financing problematic lending occurred because institutions escaped penalties for making and financing abusive and risky loans. Economic theory 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 one investor would suffer unsustainable losses. The difficulty was that the financial industry did not anticipate the bursting of the housing bubble in the form of large-scale home value declines, which resulted in widespread foreclosures and devalued assets.

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."[10] Federal Reserve statistics reveal that the portion of subprime adjustable rate mortgage (ARM) loans with

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

[10] 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.

low or no documentation of borrower income rose from 20 percent to 40 percent in 2006. The Congressional Oversight Panel, in a recent report, also documents an increasing market share of subprime and ARM products with related increasing delinquencies, particularly between 2004 and 2007.[11] The great majority of reckless lending was originated by independent mortgage companies that were not covered by the *Community Reinvestment Act* (CRA) and other fair lending and safety and soundness regulations. According to the Federal Reserve Board, only 6 percent of the subprime loans issued in 2006 were made by CRA-covered banks to low- and moderate-income borrowers/neighborhoods and considered on CRA exams.[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 financial services industry. Coverage must not only extend to the entities commonly discussed (e.g., brokers, lending institutions, appraisers, and servicers) but also must 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. Future crises of a similar scale and magnitude will occur in the near future unless Congress enacts aggressive mortgage reform legislation that includes enhanced consumer protections and penalties for financial institutions that violate consumer protections.

[11] 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.

[12] Governor Elizabeth A. Duke At the Revisiting the CRA Policy Discussion, Washington, D.C., February 24, 2009, CRA: A Framework for the Future, http://www.federalreserve.gov/newsevents/speech/duke20090224a.htm and Federal Reserve Staff Analysis of the Relationship between the CRA and the Subprime Crisis http://www.federalreserve.gov/newsevents/speech/duke20090224a.htm.

II. Enact a Comprehensive Anti-Predatory Law

In order to be effective, an anti-predatory law must include several protections against abusive products and practices. H.R. 1728 provides rigorous protections banning and/or limiting a number of problematic practices. In addition, it extends important protections for tenants, which are particularly needed in this economic climate. Finally, H.R. 1728 provides resources for borrowers to pursue housing counseling and legal aid.

Important Protections in H.R. 1728 that Must be Preserved

Prepayment Penalties: NCRC strongly supports the bill's ban on prepayment penalties for subprime loans and nontraditional loans. Prepayment penalties have trapped borrowers in unaffordable and/or abusive loans. Prepayment penalties, which can total thousands of dollars, must be paid by borrowers before they are able to refinance with another lender. H.R. 1728 prohibits prepayment penalties for subprime loans and other loans that do not qualify for safe harbor (loans that qualify for safe harbor are automatically assumed to meet prudent underwriting standards, such as borrower ability to repay). Loans that qualify for safe harbor in H.R. 1728 can contain prepayment penalties, but the penalties must phase out over three years and must be a decreasing percentage of the loan amount during each of the three years. Our understanding is that variable rate prime loans are excluded from the safe harbor provision, though the current language in H.R. 1728 is not clear.

Ban on Single Premium Credit Insurance: H.R. 1728 bans single premium credit insurance, which has been an abusive product that significantly increases loan costs when it is financed as part of the loan. The bill also bans single premium credit insurance on open-end mortgage loans. H.R. 1728 exempts credit unemployment insurance from the ban, but NCRC recommends that this provision be deleted.

Ban on Mandatory Arbitration: H.R. 1728 bans mandatory arbitration for both closed-end and open-end loans. Mandatory arbitration often trapped borrowers who needed legal recourse to get out of abusive loans.

Tenant Protections: Tenant protections safeguard the interests of all parties, including the neighborhood, lender, and tenant, by ensuring that a foreclosed home is occupied until it is sold. When a house becomes vacant, surrounding property values plummet because of decay and vandalism of the vacant home. To avoid this, NCRC supports H.R. 1728's provision that after foreclosure proceedings, a tenant has the right to remain in the property until the end of the lease, or for at least 90 days for tenants without a lease. If the new owner of a foreclosed property plans to occupy the property as a homeowner, the current tenant will have 90 days to vacate the property. Also, NCRC supports H.R. 1728's requirement that pre-existing lease and housing assistance payment contracts for Section 8 recipients be honored in the case of foreclosed properties. NCRC recommends that tenants without a lease should have all of the rights afforded them under federal or state law, whichever is stronger and in the better interests of the renter.

High-Cost Protections: H.R. 1728 establishes additional protections for high-cost loans (defined as first-lien loans with annual percentage rates (APRs) that are greater than 8 percentage points above Treasury rates for comparable maturities, or total points and fees are more than 5 percent of the loan amount). NCRC supports the enhanced protections for high-cost loans, since abuses resulting in unaffordable loan payments are more likely on high-cost loans. Balloon payments are banned on high-cost loans. Pre-loan counseling is required for high-cost loans, and loan flipping is prohibited. In addition, prepayment penalties are banned on high-cost loans when the loan amount is below FHA loan limits (this provision contradicts the previous prepayment ban for subprime and other loans that do not qualify for safe harbor, but NCRC expects that this will most likely be reconciled in mark-up). The provision prohibiting prepayment penalties on subprime and other non-safe harbor loans must remain because it is broader than the prepayment provision in the high-cost loan section of the bill.

NCRC recommends a revision to the ability-to-repay standard for high-cost loans. H.R. 1728's pattern-and-practice standard of violating the ability-to-repay provision for high-cost loans is too high a legal standard to meaningfully assist struggling borrowers. A borrower would have great difficulty gathering evidence to document that the institution's lending as a whole exhibited a tendency to ignore the borrower's ability to repay. Recognizing this, the Federal Reserve Board dropped a pattern-and-practice standard in its final *Homeownership and Equity Protection Act* (HOEPA) rules last summer.

Protections against Servicer Abuses: H.R. 1728 requires escrows for subprime loans, on loans in which the debt-to-income ratio exceeds 50 percent, and on high loan-to-value loans of 90 percent or more. The bill requires escrows on these loans for five years. Escrows are funds that lenders and servicers establish to pay for homeowners insurance and taxes. A lack of escrows has confronted borrowers of subprime and non-traditional prime loans with unexpected fees and expenses. In addition, H.R. 1728 establishes a prohibition against force-placed insurance on borrowers by servicers. The bill also requires that servicers promptly credit borrower payments.

Appraisal Protections: NCRC believes that the appraisal protections in H.R. 1728 will help deter appraisal fraud on high-cost loans. While helpful, NCRC believes that more comprehensive measures be implemented to safeguard against appraisal fraud and adequately address overall appraisal practices. H.R. 1728 requires on-site appraisals by qualified appraisers for high-cost loans. A second appraisal must also be conducted if a property is sold within 180 days of a previous sale and the sale is financed by a high-cost loan. The second appraisal helps safeguard against property flipping schemes that have greatly inflated prices and victimized unsuspecting borrowers. NCRC recommends that the second appraisal be required for all loan transactions (not just high-cost loan transactions) since two successive sales within 180 days are not normal and thus warrant extra protection. Further, NCRC recommends full walk-through appraisals for non-traditional loans in addition to the bill's proposed language for high-cost loans. NCRC supports the bill's provision requiring a regulatory rulemaking process to further develop protections against intimidation and coercion of appraisers since market practices, including problematic practices, are likely to continue to evolve.

NCRC founded the Center for Responsible Appraisals and Valuations (The Center) after receiving a significant number of complaints from borrowers about overvalued appraisals. The Center encourages mortgage finance professionals to adopt a code of conduct pledging to ensure fair and accurate appraisals for borrowers; informs the public about those who have taken the code of conduct so that borrowers can make more informed choices about mortgage finance professionals; and mediates differences between professionals about valuations, as well as files complaints on behalf of appraisers when they report pressure by lenders, brokers, and others to inflate housing values.

Lenders to Assume Risk: NCRC supports H.R. 1728's requirement that lenders assume a portion of the risk for selling a loan. If a lender sells a loan to the secondary market, the lender must maintain at least 5 percent of any credit risk for a loan that does not qualify under safe harbor. A regulatory rulemaking process can increase the percentage of risk that must be maintained by the creditor. The regulatory rulemaking process is beneficial in that future developments in the marketplace may require greater risk retention in order to provide a deterrent against reckless and abusive lending. This provision will provide an incentive for lenders to offer prudent loans, but the provision should apply to all loans lenders sell and not exempt safe harbor loans. Safe harbor loans should not be exempt because the risk exposure is known to the lender and is in response to industry concerns about legislating potentially unknown costs to lenders.

Legal Assistance: H.R. 1728 provides grants for legal aid organizations that provide defense against foreclosures for low- and moderate-income owners and tenants. The US Department of Housing and Urban Development (HUD) would establish a competitive bidding process for $35 million in grants each year from 2009 through 2012. Sufficient funding for legal aid is especially critical in the light of the foreclosure crisis. Should H.R. 1728, or a similar bill, become law, this Committee should review legal aid funding levels at least annually to determine whether households facing foreclosure are obtaining adequate legal representation. If legal aid organizations are in short supply, NCRC recommends that this Committee allocate more funding to support these organizations and their work to assist struggling homeowners.

Office of Housing Counseling: H.R. 1728 establishes an Office of Housing Counseling at HUD and provides $45 million each year from 2009 through 2012 for operational use and for grants to entities, including non-profit organizations for housing counseling. Just as with legal aid organizations, NCRC recommends that this Committee determine whether housing counseling organizations are adequately funded; if they are not, NCRC recommends that this Committee allocate more funding to support these organizations and their work to assist struggling homeowners.

Provisions in H.R. 1728 that Should be Strengthened

While NCRC applauds the Committee for developing a series of comprehensive consumer protections in H.R. 1728, we urge the Committee to address certain weaknesses in the enforcement and liability sections of the bill.

Safe Harbor Assuming Certain Loans Not Abusive: H.R. 1728 includes a safe harbor provision that presumes that certain loans automatically comply with the bill's ability-to-repay and net tangible benefit standards. A presumption of compliance means that any consumer alleging a legal violation must prove that the loan violated H.R. 1728's provisions. This is a much more difficult standard for a consumer than in the case of loans that do not qualify for safe harbor. When loans do not qualify for safe harbor, a lender must prove that they were not unaffordable or lacked a net tangible benefit.

The safe harbor provision is intended to cover only fixed-rate prime loans.[13] NCRC recommends that the safe harbor provision be removed, and that equal protections be applied to all loans since safe harbor coverage creates a difficult legal standard for consumers to prove that a loan was illegal and unaffordable. This difficult legal standard for consumers creates an incentive for lenders to develop risky and abusive products that qualify for safe harbor, but are nonetheless harmful to consumers. If the Committee wishes to retain the safe harbor provision, it should be very narrow and not made any broader. NCRC recommends that safe harbor only apply to fixed-rate prime non FHA loans. NCRC's also appreciates the authority created in H.R. 1728 for the regulatory agencies to further amend safe harbor so that the regulatory agencies can address abusive features in any new loan products that should disqualify the new products from safe harbor.

[13] The bill has a drafting error which makes it appear that prime option ARM loans are also covered by the safe harbor. We expect and advocate for a manager's amendment to be introduced during the House Committee on Financial Services mark-up that will clarify that the safe harbor only applies to fixed-rate prime loans.

NCRC also believes that FHA loans should not automatically qualify for safe harbor. Prime-rate loans are the great majority of FHA loans and would therefore qualify for safe harbor. Recently, FHA lending has been plagued with high rates of default and risky practices. Since FHA lending is likely to replace subprime lending in the foreseeable future, it will probably comprise 20 to 30 percent of the loan market. In order to ensure that FHA lending does not become as problematic as subprime lending, NCRC urges the Committee to remove FHA loans from safe harbor. At the very least, if FHA loans continue to automatically qualify for safe harbor, a regulatory rulemaking mandated by H.R. 1728 must clarify the characteristics of FHA loans that would qualify them for safe harbor.

Limited Liability: H.R. 1728 provides that lenders, securitizers, and assignees would have limited liability. They would not be required to compensate borrowers (in most cases) for any loss if the loans complied with the ability-to-repay standard and the net tangible benefit standard. (In order to receive compensation in the form of rescission of the loan and attorney costs, a borrower would have to overcome the "presumption" in the case of safe harbor loans, which, as noted above, is a difficult legal standard to overcome.) In this instance, it is unlikely that a borrower will be able to successfully defend himself or herself against abusive prime or FHA lending.

Securitizers, investment banks, and investment institutions in pools of loans have no liability, which may make it more difficult for borrowers to receive compensation. The only case in which securitizers, investment banks, and investment institutions or "holders" of the mortgage may be liable for compensating the borrower is when the borrower is defending herself or himself against foreclosure. It would be more equitable to the borrower and more efficient for all stakeholders involved if the securitizers, investment banks, and investment institutions were involved in compensating the borrower for an illegal loan earlier in the process rather than a loan at the brink of foreclosure. Moreover, class action lawsuits against securitizers and assignees are prohibited, even if the securitizers and assignees have not developed due diligence procedures against unaffordable loans or loans that do not provide a net tangible benefit.

NCRC recommends that this Committee reevaluate the limited liability provisions in H.R. 1728 and develop a system that adequately compensates borrowers, while responding to industry concerns regarding unlimited liability. First, safe harbor should either be eliminated or the legal standard of presumption of compliance should be revised to make it easier for consumers to seek legal recourse and defend themselves against abusive loans. Second, this Committee should consider the provision in Senator Dodd's S. 2452 (introduced in the 110th Congress) which holds investors liable in all cases to individual borrowers, and liable in class action lawsuits when investors have not established due diligence mechanisms that disqualify abusive loans from MBS and other investment vehicles. The protection against class action lawsuits when due diligence mechanisms are employed motivates investors and secondary market institutions to monitor lending activity and finance only those loans that pass a responsible lending screen.

NCRC recommends that the Committee also establish through legislation or a required regulatory rulemaking process a fair method for distributing liability among all parties involved in financing a lending transaction. H.R. 1728's provision that lenders retain 5 percent of the credit risk is a start towards developing a fair method for distributing liability. Further development of distributed liability provisions would assign percentages of liability to securitizers, assignees, servicers, and investors. These provisions would also consider situations when the lending institution is both the originator and the servicer of the loan. Distributing liability among all parties would ensure that all parties are motivated by potential financial penalties to lend responsibly. In addition, liability can be carefully limited so that the parties involved in the transaction know in advance what their potential liability is.

H.R. 1728 has a sensible provision of requiring rescission of the loan (or its financial equivalent) and the coverage of costs, such as attorney fees, that a borrower has incurred in seeking recourse for an illegal loan. This provision makes a borrower whole, while limiting liability for the financial services industry.

Concerns about unduly burdening passive investors (e.g., pension funds) most likely prompted the carve-out on investor liability. While it is probably desirable to protect passive investors from exposure to unlimited liability, it is far worse to expose a borrower to total loss of wealth resulting from foreclosure (for many Americans, their home is their only form of wealth) when the borrower is preempted from seeking redress for abusive loans by an unduly restrictive liability provision. Moreover, NCRC recommends that provisions be created to ensure that passive investors and other stakeholders share liability, which also limits their liability exposure to manageable levels. Finally, requiring all financial entities to share the costs of compensating borrowers creates a powerful mechanism to encourage responsible lending. A lack of financial penalties and liabilities for all entities, including credit rating agencies and Wall Street investment banks, was a major enabler of irresponsible lending that fueled the current economic crisis.

Preemption: H.R. 1728 preempts state law that provides additional remedies from assignees or securitizers to borrowers. The bill specifies that preemption does not apply to creditors who also act as assignees or securitizers. It does not preempt state law that prohibits fraud and deception, nor does it preempt state law against assignees or securitizers for their own actions. If H.R. 1728 were strong on secondary market liability then preemption would not be an issue. Yet, though H.R. 1728's secondary market liability limitations and safe harbor provisions should be stronger, it will still preempt more vigorous state law. Also, H.R. 1728 does not preempt anti-fraud and deception laws, but it would preempt laws that hold secondary market institutions accountable for unfair practices, which include lending beyond a borrower's ability to repay.

NCRC appreciates that the Committee is sensitive to issues associated with enforcement and preemption (as evidenced by the Committee's providing specific exemptions from preemption, such as no preemption for the actions of the assignee or securitizer while preempting state laws that establish liability for the assigner or securizer based on the actions of the lender). Yet, the selective preemption from state law undermines stronger state law by encouraging activities to migrate to financial institutions exempt from liability in the weaker federal law. NCRC urges the Committee to reconsider preemption and consider following other federal laws, such as the *Fair Housing Act* and the *Community Reinvestment Act*, which do not preempt stronger state laws.

Incomplete Coverage: Protections in H.R. 1728 generally do not apply to open-end credit plans or reverse mortgages, except in certain provisions of the bill when open-end plans are included.

NCRC recommends that this structure be reversed, and that protections generally apply to all loans.

Absence of Fiduciary Duty: The bill states that its duty of care provisions (requiring that borrowers receive appropriate loan products) do not involve a fiduciary duty. A fiduciary duty is important because financial penalties for deceptive and unfair practices are needed to prevent brokers and/or lenders from placing borrowers into unaffordable loans.

No Limits on Yield Spread Premiums: YSPs encourage brokers to steer minorities and other protected classes to higher-cost loans when they qualify for lower-cost loans. H.R. 1728 does not prohibit or limit yield spread premiums (YSPs or payments to brokers through higher interest rates), except to specify that YSPs cannot be used to steer borrowers to high-cost loans when they qualify for lower cost loans. In contrast, Senator Dodd's bill (S. 2452) outlawed YSPs on subprime and non-traditional loans. Also, H.R. 1782, introduced by Rep. Ellison, prohibits any fees or closing costs if a broker receives a YSP.

H.R. 1728 has an anti-steering provision that prohibits "abusive or unfair lending practices that promote disparities among consumers of equal credit worthiness but of different race, ethnicity and gender, or age." The bill's flexibility toward YSPs has the potential to undermine its anti-steering provision. As described in NCRC's previous testimony before the Financial Institution's Subcommittee of the House Committee on Financial Services, YSPs have been abused repeatedly in subprime and non-traditional lending. Our previous testimony contained examples from NCRC's foreclosure prevention program (the National Homeownership Sustainability Fund) of brokers charging exorbitant YSPs, while the loans still contained usurious origination and other fees. Based upon our experience, we are not convinced that YSPs can be effectively constrained in subprime and non-traditional lending. Also, our experience suggests that unscrupulous lenders will circumvent H.R. 1728's ban on using YSPs for steering borrowers to high-cost loans. At the very least, the regulatory rulemaking process established in H.R. 1728 regarding steering should explicitly include the power to limit and/or outlaw YSPs if YSP abuses continue to occur.

Ability-to-Repay Provision is Incomplete: The ability to repay provision is incomplete in H.R. 1728. For variable rate loans, it requires an analysis at a fully-indexed rate, which is helpful but does not require an analysis at the maximum rate that can be charged under the loan contract. The maximum rate is often higher than the fully-indexed rate. In contrast, H.R. 1782 requires lenders to add 200 basis points to the fully-indexed rate in the ability-to-repay analysis. The approach in H.R. 1782 comes closer to assessing ability to repay at the maximum rate that can be charged.

H.R. 1728 does not require a residual income analysis. This analysis ensures that low-income borrowers have enough income left over after paying on debts in order to afford basic living expenses. NCRC believes that a residual income analysis would also be important to ensure that FHA loans are affordable for borrowers with limited incomes.

III. Address Emerging Trends and Other Issues Not Included in H.R. 1728

NCRC recommends that the Committee update H.R. 1728 to account for new and dramatic trends in the financial marketplace, such as new developments in FHA lending, misconduct among credit ratings agencies, scams related to foreclosures, and the need to broaden foreclosure mitigation efforts and loan modification programs.

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. NCRC also asks the Committee to reconsider the safe harbor provision in H.R. 1728 for FHA loans (as previously discussed). Recently, the *Washington Post* reported on the spike in defaults of FHA loans, and on the difficulties HUD is experiencing monitoring lenders using FHA.[14] 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

[14] 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.

previous years'). HUD's inspector general is quoted in the article 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 share from 2 percent to 33 percent of all loans in the marketplace. The number of FHA-approved brokers has likewise surged from 16,000 in 2007 to 36,000 currently, while the number of FHA lenders has increased more than five-fold since 2006 to 3,000. HUD's inspector general recently testified that some of the unscrupulous subprime lenders are now operating as FHA lenders.[15] The *Washington Post* article reports that HUD dismantled an FHA fraud unit in 2003, and that an office responsible for overseeing FHA lenders had not increased staff despite the rapid increase in FHA brokers and lenders. 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 could be repaid.

HUD acknowledges that the FHA guarantee may encourage loose underwriting practices by lenders. In a recent Mortgagee Letter 09-12, HUD states that "The Department expects each mortgagee to exercise the same level of care in originating, underwriting and servicing an FHA-insured mortgage as it would for a loan in which the mortgagee would be entirely dependent on the property as security to protect its investment."[16] This letter exhorts lenders to exercise as much care in making and servicing an FHA-guaranteed loan as a loan without a loan guarantee. Given the problems with FHA lending, NCRC recommends that H.R. 1728 include additional consumer protections for FHA loans, and that the Committee exclude FHA loans from the safe harbor provision and/or establish a regulatory rulemaking process to enact additional consumer protections for FHA loans.

---

[15] Inside Regulatory Strategies, Vol. 20, No. 8, April 13, 2009, "Legislative Fix for H4H Could Open Door to Mortgage Fraud," pp. 6-7.

[16] See Mortgagee Letter 09-12 issued April 2, via http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09-12ml.doc.

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 Oversight Panel asserted that credit rating agencies perhaps played the "decisive" role in endangering the financial system.[17]

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

[17] 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.

oversight of ratings agencies by creating a Credit Rating Review Board that would oversee ratings and generally monitor the ratings agencies.[18]

The *Washington Post* highlights an intriguing proposal from British financial analyst George Cooper that would require credit rating agencies to rate MBS on a curve.[19] Rating on a curve could reduce ratings inflation since MBS are judged against one another, meaning that only the highest quality MBS–as judged against other MBS–would earn ratings in the top 10th percentile. Rating on a curve, however, would not solve the ratings inflation problem if the overall ratings methodology remains opaque and subjective. In order to ensure rigorous ratings, NCRC recommends that compensation reform be accompanied by more vigorous regulatory oversight that demands accountability and transparency in ratings methodology.

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 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. NCRC is currently engaged in an investigative project that is revealing a multitude of exploitative practices directed towards distressed and financially vulnerable homeowners. We expect to release a report in May 2009 that details how former mortgage brokers and other predators are migrating to this unregulated business scheme.

This regulatory loophole that allows foreclosure scam artists to multiply must be eliminated. NCRC supports the passage of the *Foreclosure Rescue Fraud Act of 2009* (S. 117), introduced

---

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

[19] "Curve Cure," Editorial in the Washington Post, Sunday April 19, 2009, p. A18.

by Senator Herbert Kohl (D-WI) on January 6, 2009, and introduced as H.R. 1231 by Representative Gwen Moore (D-WI) and Representative Barney Frank (D-Mass) on February 26, 2009 in the House. This legislation requires that all contracts between a foreclosure consultant and a homeowner be in writing and fully disclose the nature of the services rendered 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.[20] Most of the laws require foreclosure rescue consultants to disclose a customer's right to cancel the agreement, cap fees, and rescind or ban the transfer of property to the consultant.

NCRC encourages the regulatory approaches supported by the FBI that include creating a provision that requires the mortgage industry to report fraudulent activity, and establishing safe harbor provisions that protect the mortgage industry through mandatory reporting.[21]

Replace Broker Price Opinions with Appraisals

NCRC recommends that H.R. 1728 amend its appraisal section to require that independent and professional appraisers estimate the values of Real Estate Owned (REO) properties and that Broker Price Opinions (BPOs) be outlawed.

Owners of REOs are eager to dispose of REOs because REOs 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.

[20] Colorado, Connecticut, Florida, Illinois, Iowa, Maryland, Massachusetts, New York, and Texas.

[21] See n1.

NCRC recommends that the Committee require that Appraisal Management Companies (AMC) be required to register with appropriate state oversight agencies, and be appropriately regulated by these authorities to ensure accurate valuations. NCRC also recommends that the Appraisal Subcommittee of Federal Financial Institutions Examination Council be charged with developing oversight standards for AMCs that ensure the integrity of the valuation process and the objectivity and independence of valuation professionals. The Subcommittee would also be responsible for proposing new guidance and quality control checks relative to the use of Automated Valuations Systems and BPOs.

As noted, NCRC's Center for Responsible Appraisals and Valuations endorses valuation best-practices for all industry participants. 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.[22]

Loan Modification Programs and Foreclosure Mitigation Efforts

A strengthened H.R. 1728 will prevent future foreclosure crises similar in scale and magnitude as the one the US is currently experiencing. To address the current crisis, the Administration has implemented a Home Affordable Modification Program (HAMP). HAMP is a voluntary program that provides monetary incentives to lenders, servicers, and borrowers to encourage financial institutions to modify mortgages and make them affordable to borrowers who experience difficulties paying their mortgages. HAMP is the most comprehensive approach to-date to stem the rising tide of foreclosures, as it commits up to $75 billion to assist 3-4 million homeowners faced with foreclosures. But, as several lenders have ended their voluntary moratoria on foreclosure proceedings, lenders estimate that only a small percentage of distressed

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

borrowers will qualify for HAMP. GMAC, for example, estimates that only 10 percent of their borrowers threatened with foreclosure would qualify for HAMP.[23] If these initial estimates prove to be accurate, lenders are likely to move the great majority of their distressed borrowers to foreclosure. Therefore, NCRC recommends that this Committee consider our HELP Now proposal, in which the government would purchase troubled mortgages at a significant discount using its power of eminent domain (or other strategies) to enable affordable and sustainable loan modification. After an initial outlay of up to $50 billion, the government would finance a HELP Now program by selling the modified loans to the private sector using a reverse auction approach. Unlike the voluntary efforts of the government-sponsored programs that are proving unsuccessful, HELP Now mandates that financial institutions participate in the discounted purchase of troubled assets to accomplish broad-scale loan modification.

The rapidly increasing unemployment rate is now driving foreclosures. In order to keep pace with rising unemployment, Congress and the Administration should consider implementing a program like Pennsylvania's Home Emergency Mortgage Assistance Program (HEMAP). When a homeowner becomes unemployed involuntarily, the state's housing finance agency will arrange for a two-year loan of up to $60,000 to enable the homeowner to continue making payments until the borrower's income recovers.[24] Since the program's inception in 1983, HEMAP has assisted more than 40,000 homeowners. The program is cost-effective, in that it received an initial state appropriation with subsequent funding that came from borrower loan repayments. A federal program like HEMAP would most likely require a significant initial capital outlay, but could be sustainable through self-financing. If the national unemployment rate continues to climb, Congress and the Administration should immediately implement a program like HEMAP in order to stave off a second foreclosure crisis.

---

[23] Ruth Simon, "Banks Ramp Up Foreclosures Increase Poses Threat to Home Prices; Delinquent Borrowers Face New Scrutiny," in the *Wall Street Journal*, April 15, 2009.

[24] See http://www.phfa.org/consumers/homeowners/hemap.aspx and http://www.phfa.org/forms/brochures/foreclosure_prevention/HEMAP_2008.pdf.

In a number of situations, the unemployed may be unable to find new jobs within a time period specified by a HEMAP-like program, or may have an income level that cannot sustain homeownership. In these circumstances, instead of immediate foreclosure, the unemployed should be allowed to remain in their homes as renters, using, for example, some portion of their unemployment insurance (and/or income from an employed spouse/partner when applicable) as monthly rent. The tenant protections in H.R. 1728 are essential in this context and should be complemented by crafting a provision that allows unemployed homeowners and renters to remain in their homes.

Conclusion

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, including credit ratings agencies, investment banks, and other secondary market institutions, be required to adhere to legislative mandates that increase consumer protection and eliminates predatory lending practices. The regulatory agencies responsible for enforcing fair lending and fair housing law repeatedly failed to heed warnings from community groups about the reckless lending practices that have now destabilized the national economy and driven widespread unemployment. NCRC believes that Congress must require that regulatory 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 must 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 enhanced consumer protections. Until the agencies prove that they are capable of monitoring and enforcing fair housing and fair lending laws, Congress should appoint an independent reviewing body to oversee enforcement activities and Congress should also hold annual oversight hearings.

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. The FPSC could also assume the federal banking agencies' CRA responsibilities of conducting CRA exams and enforcing CRA through the merger and applications process. Though the existing agencies have mostly succeeded in adopting a uniform approach to enforcing CRA during its three decades, the agencies did splinter recently in a potentially destructive race towards dismantling CRA. In order to prevent future regulatory arbitrage of CRA and to ease its implementation, it is time to consider enforcement of CRA by a single agency.

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

NCRC applauds the Chairman for planning to hold hearings on CRA modernization. NCRC recommends that this Committee consider the *Community Reinvestment Modernization Act of 2009*. If passed, this legislation would meaningfully expand access to credit and capital for affordable housing, small business creation, and community development for working neighborhoods and communities.

NCRC recommends that this Committee craft H.R. 1728 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 national economy trillions of dollars in lost assets. This Committee should also amend H.R. 1728 to incorporate consumer protections for emerging trends such as foreclosure scams, risky FHA lending, and BPOs. Additional foreclosure prevention efforts to assist struggling homeowners, the unemployed, and renters should be included in H.R. 1728 (or into other legislation Congress is currently considering).

NCRC supports H.R. 1728 as a necessary measure to address mortgage reform and the need for comprehensive anti-predatory lending legislation. We believe that our recommendations are critical to enhancing consumer protections and would substantially strengthen the provisions outlined in this legislation.