Additional Views on H.R. 3915, "Mortgage Reform and Anti-Predatory Lending Act of 2007"

The undersigned Members of Committee on Financial Services Committee acknowledge the significant work that the Chairman, the Ranking Member, and other Members and staff have done to address some of H.R. 3951's most problematic provisions.

However, we continue to have very serious concerns about the bill, even as revised, and believe that it will hurt rather than help the consumers for which it is intended to provide relief. Never before have we adopted such far-reaching government restrictions and limitations on loan terms and products and underwriting decisions in the private market, that affect the ability of thousands of this country's borrowers to obtain a mortgage loan to finance or refinance their home. While the bill's breadth will affect the mortgage markets serving all segments of our society, its negative impact on the availability and affordability of credit to those borrowers, including minority borrowers, with blemished credit histories, will be most dire.

American consumers must be treated fairly when obtaining mortgage loans and the mortgage crisis clearly revealed organizational weaknesses in the mortgage finance system. These should be addressed by fostering greater understanding by borrowers of loan choices, by improving the regulation of and public knowledge of loan originators, and by ensuring that those persons involved in offering and making loans have a stake in the performance of the loans. But consumers are better off if lenders retain the freedom to offer and consumers have the freedom to choose from the widest range of financial products and options. We are committed to improving the mortgage process to empower consumers to make sound choices among these competing options. H.R. 3915, however, will drastically limit options for consumers, precisely at a time when the markets are already tightening, by imposing stringent restrictions, many of which are subjective, on loans that may be made, and creating severe liability for any lender that makes a loan that might be viewed as outside of those restrictions.

Among our major specific concerns with H.R. 3915 are the following:

Highly Subjective Duties and Standards. The bill creates federal duties for loan originators that are highly subjective, and thus difficult to define for purposes of compliance and potential liability. We remain concerned that any federal duty requiring a loan originator to identify loan products that are `appropriate' for the consumer, including those having a `net tangible benefit,' necessitate a determination whether the loan is suitable for the borrower. This type of standard can always be second-guessed, and should be determined by the borrower, after disclosure of the loan terms, not by the originator who is not the agent of the borrower. Even with regulations providing further clarity on terms such as loans with `predatory characteristics (such as equity stripping, excessive fees, and abusive terms),' the bill will understandably make lenders and assignees highly skittish about making or buying loans other than traditional loans to the most qualified customers. The accommodation of subprime borrowers through flexible underwriting will be sharply curtailed, to the detriment of many borrowers who, experience has shown, can and do repay their loans.

It has been noted that some states, such as North Carolina, have a `net tangible benefit' test in their high cost loan law and it has been suggested that this has not resulted in a reduction in loans. While there are conflicting studies regarding the impact on credit availability of the North Carolina law, the reason there have been few challenges under that law's net tangible benefit test is because of the unavailability of attorney's fees in actions brought by borrowers who choose not to accept the lender's previous offer to cure. H.R. 3915 does not have such a provision which would disallow attorney's fees in a borrower action. The full impact of other states' laws has yet to be felt. In any event, creating a federal `net tangible benefit' that applies across the country will undoubtedly cause a much higher focus on this subjective test, resulting in significant claims. Lenders consequently, will be more restrictive in their offerings.

Rebuttable Presumption. The bill creates a presumption that qualified safe harbor loans (those that meet a number of restrictions) will have a `reasonable ability to repay' and a `net tangible benefit,' but that presumption is rebuttable. As a result, there are no safe harbors to ensure lenders in advance of making a loan that the loan is compliant and thus insulated from challenge. Because of the subjective standards mentioned above, lenders will be very hesitant to make loans subject to this presumption because they will be unable to dispose of even unmeritorious litigation through a motion to dismiss, and thus will incur significant additional costs and exposure.

Excessive Potential Liability. The bill creates excessive potential liability for creditors for compliance with the bill's numerous requirements. In addition to a potential liability of three times the total amount `of direct and indirect compensation or gain accruing' in connection with the violation, which arguably includes all interest and fees, the bill creates an extended rescission right for up to 6 years for certain adjustable rate loans, and potentially allows class action rescission claims against creditors for vague and subjective standards.

Other Restrictions on Loan Terms. The bill contains various provisions that prohibit or severely restrict loan terms that consumers today use to their benefit, including:

arbitration, which is often fast, fair and affordable relief to consumers, who choose not to go to court; and

yield spread premiums, on higher cost loans, which has been a valuable mechanism for borrowers to finance upfront broker compensation rather than pay it at closing.

While these mechanisms clearly must be fully disclosed and chosen by a consumer, outlawing them simply restricts the potential pricing package that consumers may choose.

Intrusion into Internal Company Compensation Structures. The bill's prohibition on all types of `incentive compensation' is overbroad, pushing government regulation into companies' internal operations and incentives. We are not aware that the federal government has attempted previously to regulate that intrusively in American business,

whether in the financial industry or in any other industry. This unprecedented incursion into the internal operations and incentives of companies is a major departure from U.S. law, both as traditionally applied to lenders and as currently applied to every other industry. Lenders use incentive compensation for numerous legitimate purposes, including aligning employees' incentives with their company's incentives, ensuring that the company can obtain specific products when necessary to meet the terms of required loan sale commitments, when the company wants to readjust its portfolio to meet new strategic or risk objectives, and other purposes.

Interference with State Foreclosure Laws. The bill preempts state foreclosure laws that permit a foreclosing creditor to evict a renter in possession. This will greatly disrupt an investor's ability to transfer a property after foreclosure. Investors will demand higher rates, especially on higher risk loans, to compensate for their increased losses in the case of a foreclosure.

Expansion of HOEPA. Title III's lowering of the HOEPA thresholds, and including many additional items in the `points and fees' calculation, would result in far too many loans falling under HOEPA restrictions. Very few lenders have any appetite for making HOEPA loans, so in effect this would result in the establishment of a low usury ceiling--and one that would unintentionally cause many loans to be unsaleable. (For example, by adding prepayment penalties on pre-existing loans in refinancings to the `points and fees' calculation, lenders may be unable to refinance a loan subject to a prepayment penalty without the loan becoming an unsaleable HOEPA loan).

The combination of the bill's expansion of HOEPA, the subjective standards applicable to the loan origination and underwriting process, and the vastly increased liability will greatly reduce mortgage lending, other than to those borrowers with pristine credit records and substantial downpayments. That appears to be the general expectation of every industry participant with whom we have spoken. The Federal Reserve Board issued a credit scoring study in August that indicated that members of certain minority groups have, on average, substantially below-average credit scores. If that study is an accurate reflection of the credit scores of the overall population, we are very concerned that the reduction of lending that we foresee as a result of the bill will have particularly negative effects on minority applicants and communities. It would be a true shame if this bill, meant to protect American consumers, were to have the effect of making mortgage credit unavailable to many deserving borrowers who want a piece of the American dream.

We are confident that consumers can receive appropriate protections without unduly restricting credit or creating enormous liability for the mortgage lending industry. For the foregoing reasons, however, we believe H.R. 3915 must be significantly changed to achieve that objective.

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