Dissenting Views on H.R. 1728, "Mortgage Reform and Anti-Predatory Lending Act"

Economists agree that the roots of the current problems in the mortgage market can be traced to earlier this decade, when falling interest rates encouraged lenders to significantly relax--and in some cases abandon--sound underwriting criteria when qualifying borrowers for mortgages. Lenders pushed the envelope as they raised loan-to-value ratios to grow near term profits. As a result, borrowers who at one time might have been denied credit or granted limited credit found themselves able to borrow larger sums, and they took advantage of this opportunity to buy larger, more expensive houses than they otherwise would have been able to afford.

As a consequence of low interest rates and weak underwriting standards, home ownership rates rose from the 64 percent range in the 35 years prior to 1995 to an all-time high of 69 percent in 2004. The growing demand for houses caused home prices to skyrocket: according to the National Association of Realtors, the national median home price went from $110,500 in 1995 to $190,000 ten years later. Economists have pointed out that compared to other economic fundamentals, such as rental prices or incomes, these soaring housing prices were simply unsustainable.

Despite the higher risk associated with mortgages to borrowers with checkered credit histories, the opportunities to earn higher rates of return from subprime mortgages induced many lenders to further loosen their underwriting standards during the period 2005 to 2007, introducing even more risk into the system. Instead of protecting themselves against this increased risk by requiring borrowers to make higher down payments, lenders engineered new loans that permitted borrowers to buy with little or no money down, and compensated for this increased risk by charging these borrowers higher interest rates and fees. Lenders further eroded the integrity of the underwriting process by permitting borrowers to sign up for so-called `low documentation' or `no documentation' loans, which became known in the mortgage industry as `liar loans,' so named because they often featured loan applications characterized by misstated or falsified income.

As long as housing prices continued to rise, the risks inherent in such shoddy underwriting practices remained hidden. Borrowers who had stretched to purchase homes that they otherwise could not afford either refinanced their mortgages against home price appreciation or sold to other buyers and paid off their mortgages. Investors in securities collateralized by subprime residential mortgages believed their risk was limited: even if risky borrowers defaulted, home price appreciation all but guaranteed that the houses that secured the underlying mortgages could either be resold to other buyers through voluntary sales or, if necessary, foreclosed upon and resold at auction with only minimal impairment of the collateral securing the loan.

H.R. 1728, the `Mortgage Reform and Anti-Predatory Lending Act,' attempts to correct past excesses in the mortgage market by establishing new standards for mortgage origination and imposing greater legal liability on the secondary mortgage market. This is not the first time the Committee has considered comprehensive mortgage reform legislation. In the 110th Congress, H.R. 3915 was reported favorably out of the Committee and passed the House by a vote of 291-127, although no action was taken in the Senate. Included in Title I of H.R. 3915 was the S.A.F.E. Act, which created a national licensing and registration regime for all mortgage loan originators. The S.A.F.E. Act later became law as part of the Housing and Economic Recovery Act of 2008 (Public Law 110-289), and has, according to testimony by state regulators at the Committee's legislative hearing on H.R. 1728, already begun to yield significant benefits in combating mortgage fraud and weeding bad actors out of the industry. Many Republicans supported H.R. 3915 on the ground that it struck the right balance by protecting consumers from unscrupulous originators without constricting the ability of the secondary market to fund suitable loan products for credit-worthy borrowers or increasing the cost of mortgage credit.

Unfortunately, while it carries over many of the useful reforms contained in H.R. 3915, H.R. 1728 strikes a far different balance than that earlier legislation, one that will undermine the mortgage market just as Americans are starting to see preliminary signs of a possible housing bottom. H.R. 1728 lacks the clarity needed to provide meaningful protection to consumers. Rather than focusing on basic underwriting standards, as the Federal Reserve has done in promulgating comprehensive regulations to combat abusive lending practices under the Home Ownership and Equity Protection Act (HOEPA), H.R. 1728 imposes new and untested mandates and duties that regulators and industry participants do not know how to implement, if they can be implemented at all, and that may end up punishing the very consumers the Majority wants to protect.

The Fed's HOEPA rules, which are set to go into effect in October 2009, will bring an end to the shoddy underwriting standards that plagued the subprime market. Indeed, Chairman Frank has previously acknowledged that `the Federal Reserve . . . has adopted regulations . . . so that the predatory and deceptive lending practices that led to the subprime crisis will be prohibited.' But rather than allow the Fed's carefully vetted regulations to take effect, the Majority has chosen to superimpose onto those rules its own set of policy prescriptions, which seem likely only to inject legal uncertainty into the lending process, thereby raising the costs and reducing the availability of mortgage credit to consumers.

At the only legislative hearing that the Majority convened to consider H.R. 1728's complex and far-reaching provisions, representatives of the Federal Reserve, consumer advocacy groups, and affected industries expressed a number of concerns about various aspects of this bill. The director of the Federal Reserve's consumer affairs division, Sandra Braunstein, testified that the bill seemed `intended to drive the market into 30-year fixed loans,' which `could have the consequence of very much limiting the kinds of products that become available when the markets reset.' Even after the Committee adopted an amendment to expand the scope of the safe harbor and include certain prime ARMs within its coverage, the bill is still constructed in a way to expose to legal liability many safe and sustainable mortgage products, which will result in most lenders simply choosing not to offer those products. Interestingly, some of the most pointed criticism of H.R. 1728 came from consumer groups. Margot Saunders of the National Consumer Law Center, testifying on behalf of a coalition of consumer advocacy and labor organizations from across the country, called the bill `convoluted' and `virtually impossible as a mechanism to solve the current problem.'

One of the changes to last Congress' legislation that has drawn the most concern is a new `credit risk retention' requirement that would force loan originators to hold 5 percent of any mortgage that does not fit the bill's narrow safe harbor. While there was general consensus at the legislative hearing on H.R. 1728 that requiring lenders to retain more `skin in the game' was a worthy concept, there was general confusion as to how the execution of that concept in the bill language would work in practice, particularly for smaller non-bank lenders that do not enjoy the same reliable sources of funding as depository institutions. The Majority attempted to address those concerns through an amendment offered at the mark-up giving the Federal banking regulators greater discretion in writing rules to implement the `credit risk retention' requirement, but serious questions remain as to whether the requirement is either workable or necessary in light of the bill's other reforms imposing more stringent mortgage underwriting criteria.

Like H.R. 3915, H.R. 1728 contains provisions imposing liability on assignees and securitizers for loans that violate the `ability to repay' and `net tangible benefit' standards, giving consumers a cause of action for rescission of the loan and costs, unless the assignee or securitizer provides a cure to make the loan conform to the minimum standards within 90 days of receiving notice from the consumer. These liability provisions are considerably more stringent than H.R. 3915's, and eliminate one of the protections that H.R. 3915 offered to assignees: under H.R. 3915, assignees and securitizers could avoid liability if they could show that they had policies against buying loans that were outside the safe harbor, had exercised `reasonable due diligence' to adhere to such policies, and had obtained representations and warranties from the seller of the loans that the loans did not violate these minimum standards. Moreover, the Committee adopted an amendment authorizing suits by state Attorneys General to enforce H.R. 1728's provisions, magnifying the already substantial legal risks faced by participants in the mortgage market under the bill.

As if creating new avenues for additional litigation were not enough, H.R. 1728 provides a taxpayer subsidy for such activity by authorizing a $140 million fund for state and local legal organizations to provide foreclosure-related legal assistance to homeowners in default or foreclosure or tenants facing eviction due to foreclosure. Fortunately, the Committee adopted--with Chairman Frank's support--an amendment offered by Mrs. Bachmann that would render groups like ACORN ineligible for these legal assistance funds. The Bachmann amendment is identical to language signed into law in the Housing and Economic Recovery Act of 2008 (HERA) which barred any group indicted for federal election fraud from receiving housing counseling funds. Republicans will strongly oppose any attempt to remove or modify the Bachmann amendment as H.R. 1728 moves through the legislative process.

Finally, H.R. 1728 includes so-called `tenant protection' provisions creating new federal requirements that purchasers of foreclosed properties honor both private leases and Section 8 vouchers. While well-intentioned, these provisions could have a chilling effect on efforts to promote purchases of foreclosed properties and on owner participation in the Section 8 program, by making such participation more onerous. Currently, foreclosure is grounds for termination of a lease in the majority of states. While we share the Majority's concern for tenants facing eviction, we are not convinced that the provisions in H.R. 1728 are the most prudent way to provide tenant protections. It is important to note that a Section 8 tenant does not lose the government housing subsidy if his or her building goes into foreclosure. In fact, many new owners of these properties may well opt to renew existing Section 8 tenants or voluntarily agree to allow them to stay for the remainder of their Housing Assistance Payment (HAP) contract, but mandating owner adherence to a contract to which they were not a party is a dangerous precedent to set. It could also have the unintended consequence of discouraging sales of foreclosed properties, thereby frustrating the effectiveness of government policies designed to reduce the inventory of such properties and potentially prolonging the housing downturn. Mr. Neugebauer offered an amendment to strike these misguided restrictions from the bill, but it was defeated on a largely party-line vote.

Because we believe that the Majority's failure to remedy the many problems with H.R. 1728 identified during the Committee's consideration of the legislation will likely result in further damage to a fragile mortgage market in need of greater certainty--not untested and ill-defined mandates from Washington--we must reluctantly oppose it.

Spencer Bachus.

Jeb Hensarling.

Randy Neugebauer.

Erik Paulsen.

Scott Garrett.