NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

NCRC Analysis of H.R. 1728

The Mortgage Reform and Anti-Predatory Lending Act

Overview

On March 26, Chairman Barney Frank of the House Financial Services Committee, Rep. Brad Miller, and Rep. Melvin Watt introduced H.R. 1728, the *Mortgage Reform and Anti-Predatory Lending Act*. H.R. 1728 establishes duty of care other prudent underwriting requirements, such as ability to repay and net tangible benefit, for mortgage loans. The major flaw in the bill is the rebuttable presumption that most prime loans and FHA loans automatically meet the underwriting requirements established by the bill. Other flaws include limited liability for safe harbor loans and for secondary market institutions; and preempted state law regulating secondary market institutions. This bill also establishes additional protections for high-cost loans, and institutes prohibitions against servicing and appraisal abuse.

On March 30, Rep. Keith Ellison introduced H.R. 1782, the *Fairness for Homeowners Act of 2009*, which contains robust protections against abuses by brokers and lenders. While this analysis focuses on H.R. 1728, key provisions of H.R. 1782 will also be discussed.

Problematic Provisions in H.R. 1728

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. The safe harbor provision is intended to cover only fixed rate prime loans.[1] One significant difficulty is that the safe harbor would likely qualify most FHA loans, though FHA lending has recently been problematic because of its high-default rates. Therefore, NCRC believes that H.R. 1728's safe harbor provision should be either deleted or restricted to only a narrow range of non-FHA, fixed-rate prime loans.

Limited Liability: Lenders, securitizers, and assignees would have limited liability. They would not be required to compensate borrowers (in most cases) for any harm if the loans complied with the ability to repay standard and the net tangible benefit standard (the safe harbor provision means that all prime loans, including FHA loans, are assumed to comply with the ability to repay and net tangible benefit standards). 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 is a very difficult legal standard to overcome. In this instance, it is unlikely that a borrower will be able to defend himself or herself against abusive prime or FHA lending. In addition, investors in pools of loans have no liability, which may make it more difficult for borrowers to receive compensation. Moreover, class action law suits 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.

[1] The bill has a drafting error which makes it appear that prime option ARM loans are also covered by the safe harbor. We expect a manager's amendment to be introduced during the House Financial Services Committee mark-up that will clarify that the safe harbor only applies to fixed-rate prime loans. This analysis will be updated after mark-up which is expected to occur in late April.

In contrast, H.R. 1782 does make investors liable for violations of anti-predatory law. Investors must provide relief up to the amount of remaining borrower indebtedness and the total amount paid so far by the borrower.

Preemption: H.R. 1728 preempts state law that provides additional remedies to borrowers from assignees or securitizers. 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 was strong on secondary market liability then preemption would not be an issue. 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 is careful to note it does not preempt anti-fraud and deception laws but it would preempt laws holding secondary market institutions accountable for unfair practices, which include lending beyond a borrower's ability to repay.

Incomplete Coverage: Protections generally do not apply to open-end credit plan or reverse mortgages, except in certain provisions of the bill when open-end plans are included. NCRC believes that this structure should be reversed, and that protections should 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) does 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: H.R. 1728 does not prohibit or limit yield-spread premiums (YSPs or payments to brokers through higher interest rates). In contrast, Senator Dodd's bill in the 110th Congress (S. 2452) outlawed YSPs on subprime and non-traditional loans. Also, H.R. 1782 prohibits any fees or closing costs if a broker receives a YSP. YSPs encourage brokers to steer minorities and other protected classes to higher cost loans when they qualify for lower cost loans.

H.R. 1728 has an anti-steering provision which 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 permissiveness towards YSPs will undermine its anti-steering provision.

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 also does not require a residual income analysis. This analysis ensures that low-income borrowers have enough income left over after paying debts in order to afford the basic necessities of life.

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

Prepayment Penalties: Prepayment penalties are prohibited for subprime loans and other loans that do not qualify for safe harbor. 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. For variable rate mortgages qualifying for safe harbor, prepayment penalties cannot be charged during the three-month period preceding the first interest rate reset. This ban on prepayment penalties should be made consistent with the bill's disclosure requirement for hybrid adjustable rate loans. This provision requires disclosure regarding the first interest rate adjustment and the new monthly costs seven months before the interest rate is set to adjust. To be consistent with disclosure requirements, NCRC believes that the prepayment penalty should also end seven months before the first interest rate is set to adjust so that the borrower can start refinancing the loan if he or she desires.

H.R. 1782 goes further than H.R. 1728 by simply banning prepayment penalties on all loans secured by a borrower's home.

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 believes that this provision should 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: Regarding foreclosure, 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 will occupy the property as a homeowner, the tenant will have 90 days to vacate. Also, H.R. 1728 requires that pre-existing lease and housing assistance payment contracts for Section 8 recipients must be honored in the case of foreclosed properties.

Creditors to Assume Risk: 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. This provision will provide an incentive for creditors to offer prudent loans, but the provision should apply to all loans they sell and not exempt safe harbor loans.

Legal Assistance: H.R. 1728 provides grants for legal assistance organizations that provide defense against foreclosures for low- and moderate-income owners and tenants. HUD would establish a competitive bidding process for $35 million in grants each year from 2009 through 2012.

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 of comparable maturities, or total points and fees are more than 5 percent of the loan amount). Prepayment penalties are banned on high-cost loans when the loan amount is within FHA loan limits (this provision contradicts the previous prepayment ban for subprime and other loans that do not qualify for the safe harbor, so it will most likely be reconciled in mark-up). Balloon payments are banned on high-cost loans. Pre-loan counseling is required for high-cost loans, and loan flipping is prohibited.

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. (The Federal Reserve dropped a pattern and practice standard in its final HOEPA rules last summer.)

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.

Protections against Servicer Abuses: 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 exotic loans with unexpected fees and expenses. 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. Escrows must last for five years. 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: On-site appraisals by qualified appraisers are required for high-cost loans. Intimidation or coercion of appraisers with the intent to influence a valuation is prohibited.