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Testimony of the Massachusetts Mortgage Bankers Association On the Division of Banks' proposed high rate mortgage loan regulations September 19, 2000

Introduction

On behalf of the Massachusetts Mortgage Bankers Association (MMBA) and its 300 member companies, we are offering this testimony on the Division of Banks' proposed high rate mortgage loan regulations. While MMBA supports the Division of Banks' efforts to eliminate predatory lending from the Commonwealth, we are concerned with a number of provisions in the proposed regulations.

The issue of predatory lending continues to receive a great deal of attention at both the national and local levels. In addition to extensive media attention, the issue continues to be addressed in a number of studies and speeches by each of the federal agencies that regulate financial institutions as well as by a joint task force of the Department of Housing and Urban Development and the Treasury Department. No less than nine federal regulatory agencies have initiated actions to assess the nature and scope of predatory lending and to recommend solutions.

Let us begin by stating the obvious: MMBA and its members abhor predatory lending practices. Unfortunately, the egregious actions of a few unscrupulous lenders have painted the mortgage lending industry with a broad brush, tarnishing an industry's reputation. MMBA shares the Division's desire to eliminate these players from the marketplace. However, we are concerned that the proposed regulations, while attempting to prohibit predatory practices, will have the unintended consequence of negatively impacting responsible lenders and consumers in both the subprime and prime markets by limiting choice and increasing costs.

MMBA also wishes to make the distinction between subprime lending and predatory lending. Subprime lending is not predatory. However, predatory practices can be found in this niche. The growth in subprime lending has enabled many consumers who are unable to qualify for conventional products to achieve homeownership or refinance their debt. These borrowers usually pay a higher fee in order to offset the increased risk in the transaction. Subprime loans can be beneficial for borrowers with blemished credit histories. Predatory lending employs tactics that take advantage of the consumer, often placing them in a worse financial situation. These predatory practices are not unique to the mortgage lending industry.

As the leading mortgage association in New England, and the largest, MMBA has attempted to take a leadership role in the fight against predatory lending. In November 1998, after discussions with the Division of Banks, MMBA denounced those practices employed by rogue lenders preying on innocent consumers. In the spring of 1999 we issued an industry advisory letter detailing the Division of Banks' zero-tolerance position and offering suggestions for compliance to lenders. Last year we partnered with the Massachusetts Bankers Association in issuing *Guidelines for Subprime Lending*. This

January we joined with other industry partners to provide funding for sponsorship of Mayor Menino's "Don't Borrow Trouble" campaign. MMBA is also currently exploring the establishment of a consumer hotline for reporting of abuses and answering of consumers' questions. In addition, MMBA has been selected as one of five pilot states partnering with the MBA of America and the National Council on Economic Education to implement a pre-purchase counseling program that includes advising potential homeowners on predatory lending and the "32 dirty tricks employed by predatory lenders."

While there seems to be unanimous agreement that predatory lending should be abolished, the difficulty arises in trying to define predatory lending and to legislate it. There is no universally accepted definition of predatory lending. However, practices that have been involved with predatory lending generally involve deception, fraud and misrepresentation i.e., equity stripping, flipping, packing, traps such as balloon payments, prepayment penalties and mandatory arbitration. It is important to note though that some practices associated with predatory lending can be legitimate when used properly.

The Association also continues to believe that the existing federal and state regulatory framework, if adequately enforced, would prove sufficient to address the predatory lending problem. Federal statutes include Section 5 of the Federal Trade Commission Act, the Equal Credit Opportunity Act (ECOA) and Regulation B, the Fair Housing Act, the Fair Debt Collection Practices Act, the Truth in Lending Act (TILA) and Regulation Z and the Real Estate Settlement Procedures Act (RESPA). TILA and Reg Z require accurate disclosure of the cost and terms of credit to be provided to the consumer before the consummation of the transaction and also prohibit certain predatory lending practices. A portion of TILA known as the Home Ownership and Equity Protection Act (HOEPA) requires certain disclosures and restricts certain loan provisions on so-called "high-cost" mortgages.

Massachusetts does have existing laws that restrict certain practices associated with such lending. The legislature and the Attorney General's office have enacted statutes and regulations that address unfair and deceptive practices. The Division of Banks also has jurisdiction over consumer protection laws governing the disclosure of lending terms and deceptive business practices. The Division has spoken out strongly against predatory lending and is currently observing a 5-point threshold as a trigger for increased scrutiny during the examination process. The Division has not hesitated to bring action against those lenders not in compliance.

General Concerns

As stated earlier, we support the Division's attempt to eliminate predatory lending and we pledge our continued involvement and assistance in crafting workable solutions. We also prefer to work with the Commissioner through the regulatory process rather than through the legislative process. We do believe, however, that the proposed regulations go too far in their attempt to curtail predatory lending. In fact, we are concerned that the potential exists to dramatically restrict legitimate lending, particularly for loans less than $100K.

We have identified a number of "unintended consequences" of the proposal that we believe merit attention.

The Division's proposals covers purchase money transactions, open-end credit and refinances. Currently, section 32 only covers refinances (where the majority of abuses occur). We question the extension of these regulations to purchase and open-end transactions when there may not have not been abuses in this area.

The proposed regulations dramatically increase the number of calculations that must be performed during any loan transaction. The requirements of the proposal will make it necessary for lenders to use a worksheet for **all** loans to determine if they fall into the "high cost" category. By increasing the number of calculations, the potential for error also increases. And while the cost of compliance with the proposed regulations is high, the cost of a single, honest mistake is prohibitive. In fact, we are very concerned with the move to an "isolated event" versus a "pattern or practice" litmus test. Legitimate lenders will be penalized for what may be a single, human error rather than a deliberate practice.

Specific Concerns

MMBA has some concerns about the new thresholds for determining a high-cost loan. There is currently a federal law which sets forth criteria for a high-cost home loan. The proposal would establish a rate cutoff and point maximum that is lower than the federal law. Presently, there are multiple bills in Congress that would lower the current rate and point thresholds. We believe that any law enacted in Massachusetts should have the same thresholds as the federal law.

The proposal calls for new **fee triggers** at "5% of the *total* loan amount or $400". The MMBA believes that this section needs further clarification to properly ascertain exactly what is included and excluded in this calculation. MMBA members have raised concerns that the minimum reduction adjustments in the definition of a bona fide point are too high. As written, few discount points would qualify as bona fide discount points eligible for the exclusion from the fees and points threshold. We believe the definition of a point as currently included in the regulation may have unintended consequences for responsible lenders in both the prime and subprime markets. Convention lenders may now find a large portion of their portfolio classified as high cost. We are also very concerned that lowering the threshold to 5% runs the risk of virtually eliminating small balance loans (those under $70K). An unintended consequence of this section is that lenders will increase their own thresholds for the minimum loans they will do. In essence, this will push those consumers that we want to help over to finance companies. Also, the $400 is inconsistent with the Federal high cost regulations. When written in 1995, the fee threshold was set at $400 and is indexed annually. For 2000 the trigger $451. An alternative might be to set different limits for loans under $100K and over $100K.

The proposal does not cite the index to be used to determine the yield on a Treasury security for the **annual percentage rate test** leading to additional confusion.

The proposal call for **additional disclosures** to be provided – one at or prior to application and one to be printed on the application – and mandates point size. Most lenders use computer-generated application forms provided by national suppliers. The costs associated with making changes to information systems is prohibitive and places Massachusetts lenders at a competitive disadvantage. In addition, lenders may not know at the time of application whether a borrower will actually receive a high cost loan. The proposal is inconsistent with federal regulations, which do not mandate type size, font or manner of presentation. (Alternative: a single high cost loan disclosure)

Under the heading **limitations**:

Prepayment penalty: Prepayment penalties lower the rate for the borrower making the loan more affordable. According to an August 11, 2000 Salomon Smith Barney report on Prepayments on RFC Fixed Rate Subprime/Home Equity Loans "Currently, the most common penalty terms are three years and five years with the proportion of five year penalties steadily growing over the past five years."

Repayment ability: The proposal does not define who/how/when to track MSA median family income. MMBA has no objection to the requirement that the lender consider the borrower's ability to repay the loan and not rely exclusively on the value of the property. However, the proposal attempts to impose specific underwriting criteria. Such criteria may not be applicable in all situations and may become out of date. There may be instances where a lender exceeds the 50% DTI but "the borrower is in a better position than they were before" (such as in paying off a tax lien). The more appropriate review of high-cost home loan underwriting is through regulatory oversight and examination. MMBA believes that specific underwriting criteria should not be imposed on lenders.

Flipping: A consequence of the proposal will prevent a borrower from legitimately refinancing for more favorable terms. If the borrower refinances with the same lender or an affiliate, the prohibition on points and fees should not apply if the borrower receives more favorable terms such as a lower rate or lower payment. One needs only to look to the refinance booms of 1993 and 1997 when borrowers refinanced 2 or 3 times in a year to see that it is possible to better one's position during a 24-month period. The exemption in the proposal for additional funds advanced should remain.

Advertising: Prohibits advertising that you will reduce a borrower's monthly debt without the disclaimer. Essentially, all ads will need a disclaimer because you won't know if they are high cost loans until you do the calculation.

Unconscionable rates and terms: contrary to the notion that "risk precedes loss' Will cause an inability to bring new products to the market.

Unreasonable charges: MMBA has several concerns with this section. In essence, a lender must justify any fees and charges based on services actually performed. RESPA regulations use this language to determine if referral fees have been paid. At no other time or situation has any federal agency ever imposed a "services actually performed"

requirement. This requirement does not take into account the risk incurred by the lender nor does it allow a lender to make any profit at all on the transaction. It will call into question any fee for the purpose of clarification.

Mandatory arbitration and class action: This section is inconsistent with secondary market practices as outlined in the new Fannie Mae guidelines. An unintended consequence of the proposed lower thresholds and this prohibition will further eliminate what had been legitimate lending.

Credit history reporting: While the association supports the concept behind this section, we are concerned about the "single event versus pattern of practice" distinction that applies here. We also believe that the proposal should read "intentionally failing to report..."

Single premium credit insurance: no problem

Call provisions: no problem

Modification or deferral fees: no problem

Counseling: While we support the concept of counseling, we question making it mandatory for those sixty years of age or over. This requirement could be considered discriminatory. MMBA proposes an alternative that might include 1) review by an independent third party to waive the counseling or 2) a form signed by the applicant electing not to participate in the counseling. To go to the root of the problem (the overextending of credit), we might go so far as to require all creditors to send their customers notification of counseling options once they are 60 days delinquent.

Conclusion

The Association supports the Division's intentions and goals in establishing these new regulations. We do fear, however, that the lower thresholds (particularly the fee triggers) will move what had been legitimate lending into the high-cost loan category. An unintended consequence of this is that a significant number of legitimate subprime and prime lenders will elect to curtail their businesses or exit Massachusetts entirely. This will only serve to further narrow the lending choices for many consumers.

We appreciate the opportunity to submit this testimony to the Division of Banks and we look forward to working with you to further refine these proposed regulations.