



**Statement of John M. Robbins, CMB**

**Chairman of the Mortgage Bankers Association, Washington, D.C.**

**before the**

**Standing Committees on**

**Judiciary, Banks, Consumers Affairs and Protection, Housing  
and Oversight, Analysis and Investigation**

**New York State Assembly**

**Hearing on**

**“Subprime Lending Practices”**

**May 29, 2007**

**Albany, NY**

Chairwoman Weinstein, Chariman Towns, Chairwoman Pheffer, Chairman Lopez, Chairman Espaillat and members of the Assembly Standing Committees on Judiciary, Banks, Consumer Affairs and Protection, Housing and Oversight, Analysis and Investigation, my name is John Robbins and I am Chairman of the Mortgage Bankers Association (MBA).<sup>1</sup> I appreciate the opportunity to testify before you today as you review and consider issues related to the current state of the subprime lending practices in New York. These are issues that are of central concern to the MBA and, with years of mortgage banking experience, I am pleased to share industry's thoughts in these areas.

As we all are well aware, today's hearing is being held during a significant transition affecting subprime mortgage borrowers and the mortgage market. Let me start by saying that we all share the same commitment to assure that these borrowers continue to have the financing they need to buy and draw needed equity from their homes, and, most importantly, to stay in them.

We also share the same goal of developing better protections for consumers against abusive lending and foreclosures. When abusive lending happens, it is a stain on the mortgage industry just as it is a burden on our borrowers and communities. Foreclosures, likewise, are harmful and can be ruinous to both borrowers and to lenders as well. We do not and will not stand idly by while the dreams of our customers and the hard work of our industry are lost because of the excesses of a few.

In the wake of these events, we should not forget that the real estate finance industry has provided homeownership opportunities for the benefit of us all. It is the driving force in establishing communities, creating financial stability and wealth for consumers and fueling the overall economy. Our industry has helped our country reach a near 70 percent homeownership rate.

To meet these objectives, the industry has created an array of mortgage products to help borrowers get the financing they need to deal with record high house prices and to put home equity within their reach. Recently, however, because of an increase in delinquency rates, there have been claims that some of these products and financing tools are in themselves bad for consumers and have driven foreclosure rates to a state of crisis. This reaction overlooks the primary reasons for foreclosure namely employment loss, illness and other significant life events. Moreover, eliminating products will only take good financing options out of the hands of homeowners. The effect will be to undermine our mutual goal of putting Americans in homes and keeping them there.

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<sup>1</sup> The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 500,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the Nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 3,000 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field.

We believe the problem in today's subprime market was driven by a confluence of factors. These factors included over-capacity in the mortgage market, which the capital markets have swiftly responded to by tightening their guidelines. It was also driven by a drop in home price appreciation and an increase in unemployment. As a result of these and other changing market dynamics, the concern now is whether there will be adequate liquidity for borrowers who may be seeking to become first time homebuyers or are interested in refinancing adjustable rate products going forward. MBA and its lender members are committed to working with investors, advocacy organizations and others to serve these needs.

We strongly caution policy makers against any hasty action that could harm the very borrowers that we all wish to protect. In recent days, the market has changed the contours of many products. The regulators have issued new, comprehensive guidance related to nontraditional products and a proposed statement affecting subprime hybrid ARMs that will tighten underwriting of many mortgage products. The challenge now is to assure that credit is available.

Going forward, MBA believes that in addition to assuring the availability of mortgage credit, there are three things the government can do to help protect consumers. First, make financial education a priority in this nation, empowering consumers with knowledge and giving them the tools they need to make good decisions and protect themselves. Second, simplify and make more transparent the mortgage process so that consumers may better understand the details of the transaction and facilitate shopping more efficiently from lender to lender. Third, enact a strong and balanced uniform national standard for mortgage lending with increased consumer protections.

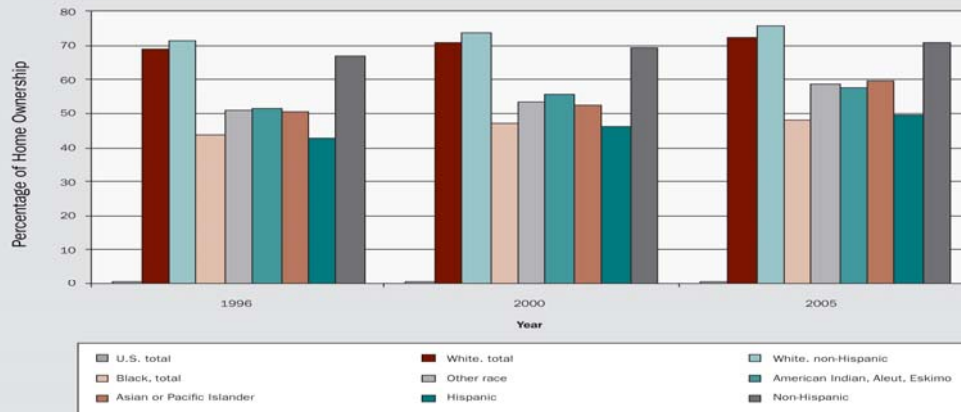
MBA respectfully asks policy makers to continue to rely on sober judgment and sound research in assessing the scope of the problem and in considering legislative approaches that will affect this key area of the nation's economy. While there have been excesses and some bad actors in our industry, there are many, many more stories of lenders who have helped borrowers achieve and maintain their homeownership dreams.

MBA has considerable data that we will continue to make available. We urge government experts to carefully review it and to resist the urge to create policy based on headlines and anecdotes. The mortgage market in general has done an outstanding job for consumers and the larger economy and any policy that is not based on sound facts has the potential to undermine these benefits going forward – particularly for those in most need of credit.

## **I. TODAY'S MORTGAGE MARKET**

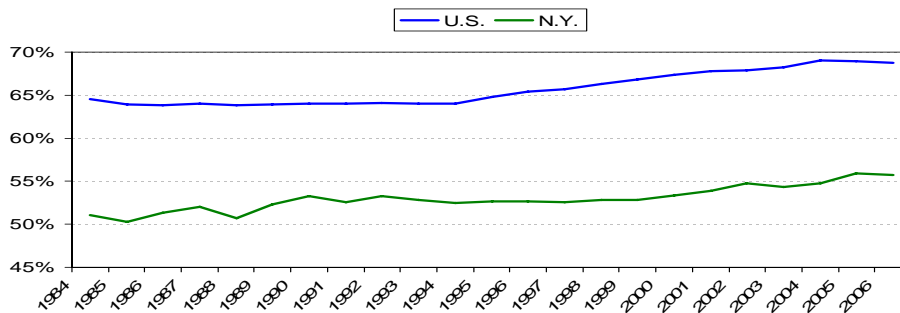
Homeownership is near its highest level in history – nearly 70 percent overall. Homeownership rates rose roughly 3.5 percentage points in the U.S. between 1989 and 2001. Looking at recent years, in 2001, the overall homeownership rate was 67.8 percent. In 2006, it was 68.9 percent. For African-Americans, the rate in 2001 was 47.7 percent, and in 2006 it grew to 48.2 percent (although it was 49.1 percent in 2004). For Hispanics, the rate in 2001 was 47.3 percent and in 2006 it was 49.5 percent.

### Homeownership Rates: 1995–2005



In the state of New York, the homeownership rate has been considerably lower as home prices are typically much higher than the national average. For example, in 2001, the overall homeownership rate in New York was 53.9 percent. The rate rose to record high 55.9 percent in 2005 and edged down to 55.7 percent in 2006.

### Homeownership Rates: US versus NY State



Source: Bureau of the Census

As a result of these increases in homeownership, across all demographics, Americans are building tremendous wealth by increasing their home equity through their monthly payments and through the impressive rate of home price appreciation seen in recent years. According to the Federal Reserve Board’s (FRB) Flow of Funds data, the value of residential real estate assets owned by households has increased from \$10.3 trillion in 1999 to \$22.6 trillion as of the fourth quarter of 2006, and aggregate homeowners’ equity now exceeds \$10 trillion. According to the FRB’s 2004 Survey of Consumer Finances, the median net worth for homeowners was \$184,000. For renters, it was \$4,000.

More than a third of all homeowners own their homes free and clear of any lien. Of the remaining two-thirds of homeowners who do have mortgages, three-quarters have fixed rate mortgages. Only one quarter of these borrowers, or about a sixth of all homeowners, have adjustable rate mortgages (ARMs).

**Homeowning Household Distribution**  
By Mortgage Type

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Household Mortgage Type	Percent	Percent of Those with a Mortgage
No Mortgage . . . . .	34.6	
Fixed Rate . . . . .	49.2	75.2
Adjustable Rate . . . . .	16.2	24.8
Jumbo . . . . .	3.9	6.0
Conforming . . . . .	12.3	18.8
<b>Total</b>	<b>100.0</b>	<b>100.0</b>

*Source: American Housing Survey; Mortgage Bankers Association*

For the state of New York, 83 percent of all borrowers with a mortgage have a fixed rate product and 17 percent have an adjustable rate product. Of all homeowners in New York, 11 percent have an adjustable rate product.

**Homeowning Household Distribution**  
By Mortgage Type

Household Mortgage Type	Percent of Homeowning Households*		Percent of those with a mortgage	
	US	NY	US	NY
No Mortgage	35%	35%		
Fixed Rate	49%	54%	75%	83%
Adjustable Rate	16%	11%	25%	17%
	100%	100%	100%	100%

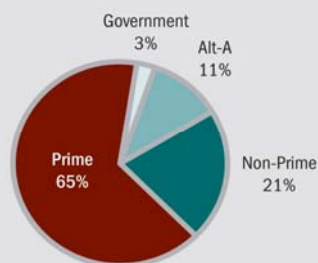
\*Assuming the same distribution of homeowners with no mortgages for NY and the US.

Source: The American Housing Survey and MBA National Delinquency Survey

According to MBA's Mortgage Originations Survey, in the first half of 2006, 62 percent of the dollar volumes of loans originated were prime loans, 16 percent were Alt. A, and 19 percent were nonprime, with government loans accounting for the remaining 3 percent.

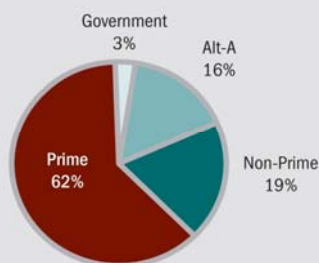
## Mortgage Originations by Loan Type

### First Half of 2005



By dollar volume

### First Half of 2006

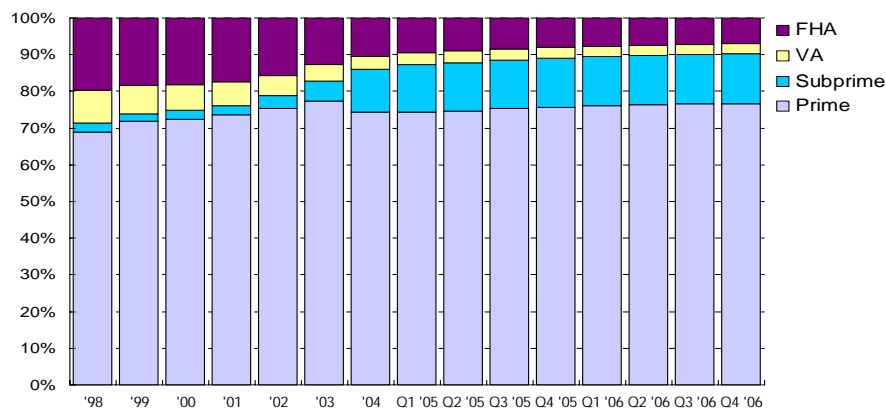


By dollar volume

Source: MBA's Mortgage Origination Survey

Estimates from the MBA's National Delinquency Survey (NDS) indicate that the number of nonprime loans serviced in the US has increased by 44 percent over the last three years (Q1 2004 to Q4 2006). For the state of NY, the number of nonprime loans has increased by 29 percent over the last three years.

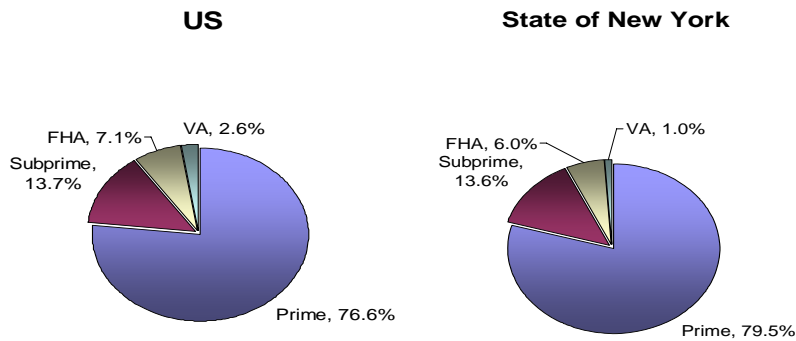
## Outstanding Loans by Loan Type: 1998 - Present



Source: Mortgage Bankers Association National Delinquency Survey

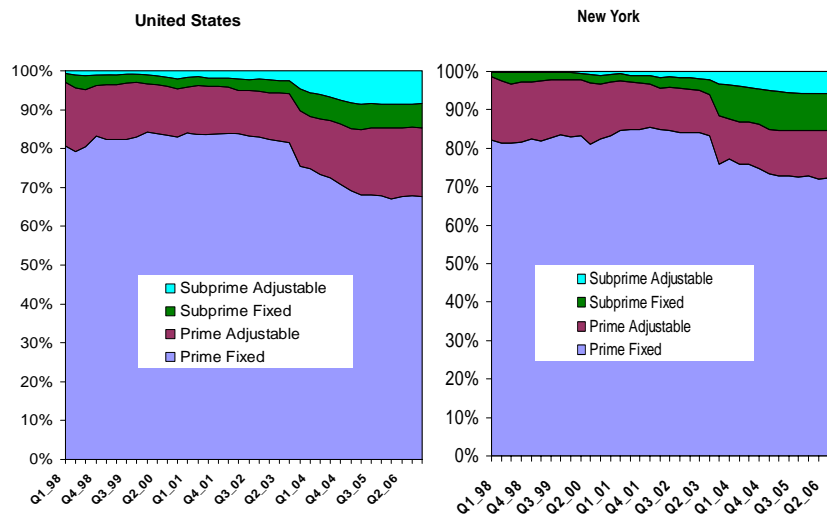
Based on first half 2006 data, nearly half of nonprime borrowers, or 45 percent, utilize nonprime loans to buy homes. One in four of these purchases was made by a first-time homebuyer. Also, notably, over the last several years the average difference between the interest rates of prime loans and nonprime loans has decreased markedly.

**2006 Q4 Loans Outstanding – Composition by Loan Type**



Source: MBA National Delinquency Survey

**Market share, major conventional loan categories, United States and New York, through 2006Q4**



Source: Mortgage Bankers Association National Delinquency Survey

**II. MORTGAGE PRODUCT INNOVATION – Creating Access and Affordability**

As we have indicated, the mortgage industry takes pride in its innovations in developing mortgage products. Innovation in combination with the liquidity provided by the secondary market has dramatically expanded the opportunity for consumers to become homeowners, particularly for traditionally underserved borrowers.

Over the past several decades, as mortgage lenders have sought to adapt to changing market conditions and changing consumer preferences, mortgage products have developed beyond the 30-year, fixed-rate, amortizing mortgage. In fact, in the early

1980s, in response to prohibitively high interest rates, the ARM began to gain wide acceptance.

In addition to ARMs, some lenders at the forefront of responding to consumer demand for product diversity, particularly in high cost markets, began to offer interest-only and payment-option mortgages. Mortgage lenders have successfully offered such products for decades, through different market cycles, without threatening their safety and soundness. It is therefore prudent to look to the practices of lenders regarding nontraditional mortgage products rather than imposing overly prescriptive requirements that would force them to change proven standards, disadvantaging institutions from effectively participating in this market.

Over the last decade, hybrid ARMs, where the initial interest rate is fixed for a period of time and then adjusts annually, also have gained wide acceptance in response to consumer demand. Through these products, borrowers now can take advantage of hundreds of different financing options based on their individual needs and circumstances. They can also choose among thousands of mortgage originators. MBA supports the opportunity for consumers to make their own choices. Consumers are in the best position to choose which mortgage option is best for them and their families.

#### **A. Nontraditional Mortgage Products**

“Nontraditional mortgage products” refer to financing options which have been developed to increase flexibility and affordability and otherwise meet the needs of homebuyers who have been purchasing homes in an environment where real estate prices have increased faster than borrowers’ incomes. Other homeowners have used these products to tap their homes’ increased equity for a variety of needs including home improvements and renovations, paying down other forms of debt, as well as education and healthcare needs. While these products have often been characterized as “new,” some of them actually predate long term fixed-rate mortgages. Nontraditional mortgage products include fixed- and adjustable-rate loans that permit interest only (IO) payments and payment-option loans including option ARMs.

MBA strongly believes that the market’s success in making these “nontraditional” products available is a positive development. Although these products have been used to finance a relatively small portion of the nation’s housing, they have offered and continue to offer new, useful choices for borrowers.

Notably, however, while nontraditional products have offered borrowers a variety of options, many of these products are not prevalent in the nonprime market. Payment-option loans are typically not available in the nonprime sector. In fact, according to Fitch Ratings, no nonprime loans carried a negative amortization feature in 2005. The IO share in the prime sector was 44 percent of dollar volumes, while it was 25 percent of dollar volumes in the nonprime sector. According to Standard & Poors, nonprime IO borrowers tend to have larger loans, typically indicating higher incomes, and better credit scores than nonprime borrowers who choose other products.

To be sure, as with all mortgage products, nontraditional mortgages must be underwritten by lenders in a safe and sound manner and their risks must be appropriately managed. As with other products, loan originators must provide

consumers necessary information on a product's terms so a borrower can determine whether the product matches his or her needs and financial abilities.

Reports by MBA members and other data reviewed by MBA indicate that interest-only and payment-option mortgage borrowers also generally have good credit scores and relatively low loan-to-value (LTV) ratios. These products also tend to be most prevalent in higher cost areas of the country where there is a greater need for affordability products. For example, California, a particularly high cost state, has always had a high ARM share. As the risk of a loan or its features increase, mortgage lenders take appropriate steps to offset the risk by requiring other features like higher credit scores to ensure a borrowers credit worthiness.

### **Interest-Only and Payment-Option Mortgages:**

Interest-only and payment-option mortgages are two different products. Each is treated differently by lenders in terms of credit policy, underwriting standards and risk management.

An interest-only mortgage is commonly a loan under which a borrower is permitted to make interest-only payments for a certain period of time, after which the borrower is required to make principal payments as well. The interest rate may be fixed or adjustable during the interest-only period and may be fixed or adjustable after amortizing payments are required. Borrowers are typically allowed at their option to make principal payments during the interest-only period.

A payment-option mortgage is a loan for which a borrower typically has an option each month to make one of four payments: an amortizing payment based on a 15-year repayment schedule; an amortizing payment based on a 30-year repayment schedule; an interest-only payment; or a minimum payment based on a start rate which is below the fully-indexed accrual interest rate.

Where the minimum payment is insufficient to pay all of the interest due at the accrual interest rate, negative amortization occurs. Negative amortization means that the principal balance owed by the borrower increases. Typically, the minimum payment is fixed for 12 months, after which it adjusts annually based on the fully-indexed rate. Payment increases are usually limited to 7.5 percent in any one year. The amount of negative amortization may range from 10 to 25 percent of the original mortgage amount; if this limit is reached, the loan is recast, requiring payments that will amortize the outstanding balance over the remaining term of the mortgage.

### **B. ARMs and Hybrid ARMs**

ARMs, including hybrid ARMs, significantly differ from interest-only and payment-option products and are not covered by the nontraditional guidance. As explained below, on March 7, 2007, the Federal financial regulators published a Proposed Statement on Subprime Mortgage Lending that, among other things, would cover hybrid ARMs.<sup>2</sup>

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<sup>2</sup> Proposed Statement on Subprime Mortgage Lending, 72 Federal Register 10533 (March 7, 2007)

ARMs, first developed in the 1970s, permit borrowers to lower their payments if they are willing to assume the risk of interest rate changes. Hybrid ARMs, introduced in the mid-1990s, combine the benefits of fixed rate mortgages and adjustable mortgages and allow borrowers to opt for a lower initial interest rate and lower monthly payments, which are fixed for a period of two to ten years (including 2-28 ARMs and ARMs with longer fixed payment periods). After the fixed payment period ends, the hybrid ARM converts to an adjustable rate mortgage with the interest rate and payments adjusting periodically (usually yearly) based on interest rate changes in the capital markets.

ARMs, including hybrid ARMs, are not simply refinancing tools; these mortgages are affordable financing and for some borrowers credit repair options that have helped millions of borrowers achieve the dream of homeownership. Hybrid ARMs offer a lower monthly payment during the fixed payment period than a fixed rate mortgage. Nearly half, or 45 percent, of nonprime loans are purchase loans, with 25 percent of nonprime purchase mortgages originated for first-time homebuyers indicating that a significant portion of the recent gains in homeownership are likely attributable to hybrid ARMs. In the first half of 2006, 67 percent of new subprime loans were ARMs.

Data available to MBA from large member companies indicate that for the 30 percent of hybrid ARM loans that borrowers refinance with their companies, 50 percent of these hybrid ARM borrowers refinance into a prime loan, half of which are fixed, half of which are ARMs. Of the remaining 50 percent of borrowers, 25 percent refinance into fixed rate subprime products and 25 percent refinance into other ARMs.

Hybrid ARMs are frequently underwritten using more flexible guidelines based on reasonable repayment expectations, allowing many more borrowers to qualify for these loans. Flexible underwriting for hybrid ARMs is appropriate. Relatively few hybrid ARMs experience any adjustment at all; hybrid ARMs are usually refinanced very early in their terms. Data from Fitch Ratings indicate that of the prime loans originated in 2003; only 44 percent remained outstanding as of the second quarter of 2006. For subprime loans originated in 2003, only 22 percent remain outstanding as of that time.

If ARMs and hybrid ARMs are required to be underwritten at the fully-indexed rate, as the guidance proposes (see below) then we must face the fact that many hybrid ARM borrowers simply will not qualify for mortgages to buy homes or to get needed credit. For many borrowers, the choice is not between an ARM and a fixed rate mortgage to finance the property they want; it is an ARM or no mortgage at all.

Hybrid ARMs are not “exploding mortgages.” Payment increases are generally much smaller than alleged and by virtue of borrowers moving or refinancing, frequently never come due. The rates and payments under hybrid ARMs do not normally increase by 40-50 percent, after the option period has expired, as has been alleged. In fact, whether there are any payment increases depends on the structure of the ARM and what happens to interest rates during the fixed period of the loan. Data from lenders demonstrate that today, on average, the change between the average start rate and the average fully indexed rate under these mortgages is generally no more than 2-3 percentage points. To protect borrowers from unmanageable payment increases, lenders structure hybrid ARMs so that there is a cap on the periodic adjustment. Also, as indicated, most subprime borrowers do not remain in their mortgages for more than three years. In any event, the potential increase in payments for borrowers later in the

life of a hybrid ARM pales by comparison to the initial up-front savings to these borrowers.

## **C. Federal and State Guidance**

### **1. Nontraditional Guidance**

On September 29, 2006, the federal financial regulators including the Board of Governors of the Federal Reserve (FRB), the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the Federal Deposit Insurance Corporation (FDIC) and the National Credit Union Administration (NCUA) jointly issued Final Guidance on Nontraditional Mortgage Products (the Guidance).<sup>3</sup> Key aspects of the guidance are the same as the proposed guidance issued for comment by the regulators, with a few significant clarifications.

The Guidance addresses risks posed to federally regulated financial institutions by the growing use of mortgage products that allow borrowers to defer payments of principal and, sometimes, interest. The guidance specifically covers interest only (IO) and payment-option adjustable rate mortgages (Option ARMs). It specifically excludes home equity lines of credit (HELOCs) and reverse mortgages.

The guidance applies to federally regulated institutions including federally chartered banks, savings and loans and credit unions but it has a “trickle down” effect since it requires such institutions to monitor the quality of third party originations so they reflect the institutions’ lending standards and compliance with laws and regulations.

The Guidance addresses three sets of concerns: (1) Loan Terms and Underwriting Standards; (2) Portfolio and Risk Management Practices; and (3) Consumer Protection Issues.

On November 14, 2006, the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR) encouraged the states to adopt guidance which generally tracked the Federal Guidance and, to this end, both organizations published their template as CSBS/AARMR Guidance. This guidance is based on the Federal Guidance, and only modified or deleted those provisions dealing with risk management that were inapplicable to non-depository institutions.

In their press announcement, the organizations noted that consistent guidance “will allow the opportunity to gauge the impact on the mortgage market and consumer behavior.” As of this date, 35 states and the District of Columbia have adopted or begun the process of adopting the CSBS/AARMR guidance.

Mortgage lenders have been subject to a patchwork of lending requirements, in areas other than nontraditional products, emanating from the federal, state and even local governments. These diverse standards, while well-intentioned, have lessened competition, increased regulatory costs and, thereby, increased costs to the consumer. Restrictions that vary from locality to locality lessen the number of entrants that are willing to learn and comply with particular requirements. Increased regulatory risks and

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<sup>3</sup> 71 Federal Register 58609 (October 4, 2006)

<http://www.federalreserve.gov/boarddocs/press/bcreg/2006/20060929/attachment1.pdf>

compliance costs for those who do compete translate into increased costs for consumers.

For this reason, MBA particularly appreciates the efforts of the regulators to develop guidance that is consistent among federal and state regulated institutions. Consistency of guidance better serves consumers, increases competition and lowers costs.

## **2. Proposed Statement on Subprime Lending**

On March 7, 2007, the federal financial regulators including the Board of Governors of the Federal Reserve (FRB), the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the Federal Deposit Insurance Corporation (FDIC) and the National Credit Union Administration (NCUA) jointly proposed for public comment a Statement on Subprime Lending (Statement).

The Statement addresses several items including: nonprime loans with a fixed introductory rate that expires after an initial period and then adjusts to a variable index rate plus a margin; low documentation loans; “payment shock;” product features likely to result in frequent refinancings; prepayment penalties; and loans made with inadequate information to the borrower concerning material terms and product risks including the borrower’s obligations for taxes and insurance. The Statement proposes guidance for federally regulated institutions regarding risk management and underwriting, control systems, consumer protection for these loans as well as plans for supervisory review. The Statement also poses several questions for comment including whether it should be extended beyond the subprime market and the effect of its underwriting provisions on borrowers due for a reset of their loan’s rate.

Notably, the Statement proposes to require that, in qualifying borrowers for nonprime ARM loans meeting the foregoing criteria, institutions should evaluate the borrower’s ability to repay the debt by final maturity at the fully indexed rate. It also provides that the higher a loan’s risk either from a loan’s features or borrower characteristics, the more important it is to verify the borrower’s income, assets and liabilities. The Statement reminds institutions of necessary consumer protections including warnings about payment shock, balloon payments, taxes and insurance and prepayment penalties.

MBA appreciates the efforts of the Regulators to provide separate guidance concerning underwriting, risk management and consumer protection issues concerning subprime short-term hybrid adjustable rate mortgage (ARM) products, subprime low documentation loans and subprime loans with prepayment penalties and other specified features. These products are not covered by the Regulators’ October 4, 2006 Guidance.<sup>4</sup>

The actions of the Regulators in providing guidance on short-term<sup>5</sup> hybrid ARMs and low or no documentation loans is particularly timely and appropriate considering the very high demand for these products and recent concerns that these products may present a higher risk of default depending on economic conditions including falling real estate prices. MBA also particularly appreciates that the Regulators ask questions about the potential effects of the Statement.

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<sup>4</sup> *Interagency Guidance on Nontraditional Product Risks*, 71FR 58609 (October 4, 2006).

<sup>5</sup> 2/28s and 3/27s.

The scope of and subjects covered by the Statement are of great significance to the real estate finance industry and to the consumers MBA and its members serve. While MBA believes that the subjects covered by the Statement are generally appropriate, we are concerned that the Statement, if finalized as proposed, would unduly limit credit and homeownership opportunities to credit worthy borrowers; unwisely make lenders responsible for third party mortgage brokers, increasing costs to all borrowers; and permanently add a new layer of disclosures without a comprehensive revision of the current disclosures that borrowers face and routinely ignore across the entire market.

MBA submitted a comment letter to the Regulators on May 7th, and in it expressed points that require further clarification or modification before making the Statement final. Those main points are:

1. The Statement should make clear that it does not cover subprime or prime mortgage products beyond those that it was designed to cover – subprime hybrid ARMs, subprime low documentation and other subprime loans with other identified features – to avoid an unnecessary tightening credit to subprime or even prime borrowers generally.
2. While the Statement should define “subprime” for purposes of specifying the Statement’s coverage, MBA questions the use of the definition contained in the 2001 Expanded Guidance for Subprime Lending Programs<sup>6</sup> which, among other things, provides that a credit score below 660 is subprime.
3. While MBA supports provisions of the Statement requiring that lenders underwrite loans based on a finding of a borrower’s ability to repay, the Statement should avoid adopting a rigid, one size fits all underwriting standard. The Statement should also provide exceptions and flexibility to avoid unduly restricting credit to credit worthy consumers and even risking foreclosure for some. The Statement should make clear that there are several means in addition to debt-to-income ratio to qualify borrowers, even for reduced documentation loans. In addition, any ability to repay guideline could become problematical if applied to investor-property loans. Therefore, the Statement should make clear that it only applies to owner-occupied properties.
4. The Statement should make clear that reduced documentation loans are appropriate options for some borrowers as long as the risks of the loan are appropriately evaluated and the borrower is informed of any increased cost resulting from the loan.
5. The Statement should support improved disclosures by mortgage brokers, along with the other disclosures required under the Statement, to address concerns about steering rather than simply requiring lenders to redesign compensation programs. In particular, mortgage brokers should provide much better disclosures of whether or not they are the consumer’s agent. Furthermore, brokers should disclose their fees to prevent steering to products that are more

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<sup>6</sup> 2001 Expanded Guidance for Subprime Lending Programs, January 31, 2001. Federally insured credit unions should refer to LCU 04-CU-13 – *Subprime Lending Activities*.

lucrative for the broker; Regulators also should support better licensing and bonding requirements for brokers.

6. Additionally, while MBA strongly supports the consumer protection provisions of the Statement requiring new disclosures, MBA also strongly believes that to be truly effective, disclosures and the disclosure process, including disclosures under RESPA, TILA and other laws, must be comprehensively overhauled and greatly simplified, so that the resultant disclosures are read, understood and useful to consumers, increase competition and lower consumers' costs.
7. Prepayment penalties lower subprime borrowers' mortgage interest rates and monthly payments. The Statement should allow borrowers to be given the choice of a lower rate loan with a prepayment penalty or a higher rate loan without one where one is available or may be available elsewhere. As long as there is clear disclosure, a real benefit of a lower rate, and a choice of a mortgage with and without a penalty, if available, borrowers should be permitted to opt for a prepayment penalty. However, MBA appreciates and supports the Regulators' strong encouragement that institutions that impose prepayment penalties structure them in such a way that they do not extend beyond the initial reset period and, further, provide borrowers a sufficient window of time immediately prior to the reset date to refinance without a penalty.
8. While MBA abhors predatory lending as a stain on the industry, it is important that the Statement not inadvertently eliminate good credit options.
9. The Regulators should recognize and encourage the development of products by the lending industry that lessen payment shock but, at the same time, recognize that for borrowers who understand and effectively use hybrid products, such products should remain available as financing options.
10. The Statement should address several other issues, including our responses to the Regulators' questions.

### **3. Underwriting Standards**

The establishment of underwriting standards is ordinarily the responsibility of lenders and mortgage investors who are constantly refining credit policies in response to risk analysis, market conditions, and consumer behavior. Mortgage lenders have successfully offered nontraditional as well as hybrid ARM products using credit reports, credit scores, and sophisticated modeling to ensure that the features of nontraditional loans are mitigated with features that reduce risk. While recent information assumes that some lenders and investors have developed products that have resulted in unsatisfactory delinquency levels, it is far too early to fully assess the extent of this problem. It is clear though that the capital markets have responded through changing the guidelines and underwriting standards of the products in which they will invest. Current credit options have become much more conservative.

While MBA and its members agree that borrowers should not be underwritten at teaser rates that are substantially below the fully-indexed accrual rate and are in effect for just the first few months of the mortgage, MBA has not favored the establishment of rigid, overly broad, underwriting standards that require analysis of borrowers' ability to repay

the debt by final maturity at the fully indexed rate, assuming a fully amortizing repayment schedule. We have commented that such an approach is far too prescriptive and forces lenders to apply credit policies that disadvantage products in a manner which is inconsistent with their risks.

The nontraditional guidance expects that interest-only and payment option mortgages be underwritten to the fully indexed rate, a result that will limit the availability of these products. The extension of this requirement to hybrid ARMs will have a similar effect. Moreover, under an approach requiring underwriting to the fully indexed rate, a 10/1 hybrid ARM with a 20-year amortization starting in year eleven would be disadvantaged against a 3/1 hybrid ARM with a 27-year amortization starting in year four despite the fact that most lenders would consider the 10/1 hybrid ARM a lower risk product.

Key risk factors of a hybrid mortgage include the initial length of time during which the interest rate is fixed, where an interest-only payment is required or the fact that the loan does not amortize. An overly broad standard may require lenders to invert this risk analysis and treat loans with a longer fixed rate or payment timeframe as higher risk than those with shorter timeframes.

MBA would caution that if the policy decision is to require underwriting of hybrid ARMs to the fully indexed rate going forward, any such policy must be flexible enough to ensure that all borrowers facing a reset will have access to credit to refinance. To that end, MBA is committed to consultations with Wall Street, the government sponsored enterprises and advocacy organizations to assure that credit is available. We cannot allow the current tightening of credit to strangle borrowers who, previously, could easily refinance.

#### **4. Portfolio and Risk Management Practices**

MBA and its' members share the view embodied in the guidance that lenders should pay particular attention to those products in their portfolios that carry higher risks and change credit policies and risk management practices when performance problems arise or risk analysis indicates there might be a problem.

There is also agreement with the requirement that mortgage lenders should have appropriate controls in place for the types of mortgage products they originate. Lending institutions work internally and with their regulators to ensure that their loan loss reserves are adequate given the risks in their portfolios.

#### **5. Borrower Information Concerning Nontraditional Products**

MBA and its members strongly believe that the features of mortgage products offered to consumers should be fairly represented so that consumers can decide for themselves which product makes the most sense given their personal financial position. Many consumers understand the array of products and have used them appropriately to their advantage.

Because there is no single, uniform, mandated disclosure for nontraditional products, lenders have developed their own disclosures to inform borrowers about the characteristics of these products. Many mortgage lenders have been originating these products for a considerable amount of time and have significant experience with them.

This experience has informed the development of disclosures.

Lenders also provide borrowers the range of information and disclosures mandated under the Real Estate Settlement Procedures Act (RESPA) and the Truth in Lending Act (TILA), including the Consumer Handbook on Adjustable-Rate Mortgages (CHARM) booklet.

MBA has reviewed the disclosures developed by several MBA members who originate significant volumes of nontraditional mortgages and have found them to be quite detailed and comprehensive in providing consumers the information they need to fully understand the mortgage product they are considering.

Mortgage lenders that successfully offer these products constantly review the performance of these loans. They make changes as warranted to credit policies and other practices, including disclosures, to improve performance and to facilitate customer understanding.

MBA and its members are working on what we think is a groundbreaking, new effort called Project Clarity. This effort will establish simple, plain English documents to be provided to all borrowers at the earliest possible time when they are shopping for a mortgage. First, we developed them, and now at the expense of the industry, we have been testing them around the country in focus groups. The draft disclosures are still under review and testing and we anticipate having them out this summer. We want these important documents to help our customers as quickly as possible.

MBA appreciates the efforts of the federal regulators to issue Proposed Illustrations of Consumer Information on Nontraditional Products published contemporaneously with the federal nontraditional product guidance and we strongly urge the regulators to use the existing authorities under TILA to improve disclosures for nontraditional products nationwide.

The regulators determined that new information as set forth in the Proposed Illustrations could not await a more comprehensive approach to disclosure as suggested by MBA in its comments on the Guidance. The regulators concluded that guidance was needed now, to ensure that consumers get the information they need about nontraditional products. There is a similar point of view respecting the products covered by the Statement. While MBA supports provision of all necessary information, we urge the regulators to regard the new disclosure illustrations as a temporary approach. MBA recommends that the regulators direct their energies toward a much more comprehensive approach of improving the mortgage disclosure process for consumers and require the provision of these disclosures from all mortgage lenders.

Consumers today confront a pile of disclosures when they apply for and close on a mortgage. Sadly, every new layer of disclosure simply increases the likelihood that the consumer will merely initial all of them without even a cursory reading. For this reason, the number of disclosures need not increase, rather, they need to be combined, streamlined and made much more user friendly.

Efforts at improvement should include all disclosures required by federal law. Because RESPA and TILA apply to regulated and unregulated entities, such an approach is the best means of assuring that virtually all consumers receive high quality information and

that a level playing field of disclosure requirements is established for all industry originators. These efforts should also consider the plethora of state disclosures.

MBA strongly believes that sound underwriting, risk management and consumer information are essential to the public interest. We also believe it is essential that the legislative and regulatory environment foster innovation in the industry to assure that borrowers confront a competitive marketplace offering low cost credit options. Such an environment allows lenders to provide borrowers the widest array of options to purchase, maintain and, as needed, draw equity from their homes to meet the demands of their lives.

### **III. THE PRIMARY REASON FOR DEFAULTS ARE EMPLOYMENT, FAMILY AND ECONOMIC DIFFICULTIES – NOT PRODUCT CHOICES**

There is no evidence that product choices by borrowers are determinative of defaults or foreclosures. Different products have different default rates but the product choice does not cause the default. Data consistently demonstrate that delinquencies among all borrowers are a function of a variety of factors including, first and foremost, economic difficulties caused by job losses. According to Freddie Mac, based on a sample of loans in Workout Prospector<sup>®</sup> from 1999 to 2005, the following sets out the reasons for delinquency:

#### **Reasons for Delinquency**

Variations in delinquencies from state-to-state reflect differences in the level of unemployment:

Unemployment Or Curtailment Of Income	41.5%
Illness or Death in Family	22.8%
Excessive Obligation	10.4%
Marital Difficulties	8.4%
Extreme Hardship	3.3%
Property Problem or Casualty Loss	2.1%
Inability to sell or rent property	1.6%
Employment Transfer or Military Service	0.9%
All Other Reasons	9.0%

The impact of employment on loan performance is illustrated in a comparison between New York and Michigan for the fourth quarter of 2006. The foreclosure inventory rate for conventional subprime ARMs in Michigan was 11.39 percent and in New York it was 1.11 percent during this period. At the same time, unemployment rates in Michigan were 7.2 percent compared with 4.2 percent in New York. The increased unemployment rate corresponds to the increased foreclosure rate in Michigan and the converse is true in New York.

The chart below sets out a comparison of the top five states that have the highest and lowest delinquencies across all loan categories including subprime ARM, subprime fixed, FHA, prime ARM and prime fixed. The same three states – Ohio, Michigan, and Indiana – make the top five states with the highest delinquencies all in five categories. It also happens that these three states have significant unemployment problems. It can not be denied that there is a causal relationship between employment and homeowners' ability to make their mortgage payments.

### 2006 Q4 Mortgage Delinquencies By Loan Type

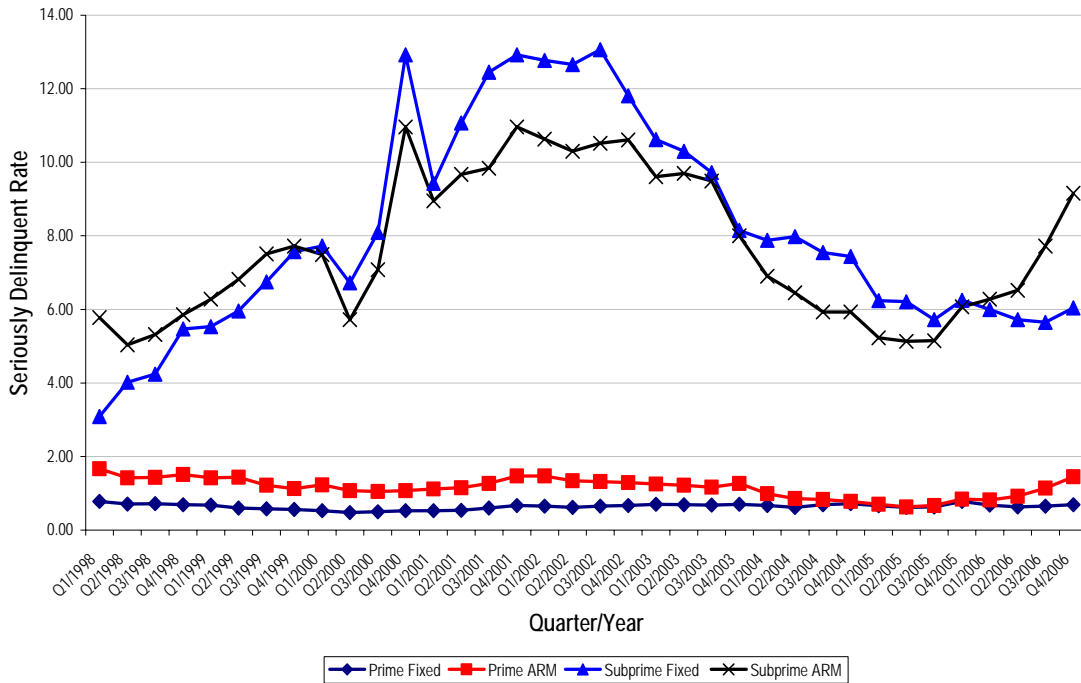
Subprime ARM		Subprime Fixed		FHA		Prime ARM		Prime Fixed	
<b>Highest Five:</b>									
Ohio	19.03	Ohio	13.05	Michigan	10.70	Ohio	3.89	Ohio	1.95
Michigan	17.70	Indiana	10.68	Ohio	9.43	Oklahoma	3.82	Indiana	1.76
Indiana	16.70	Michigan	10.60	Indiana	8.06	Indiana	3.74	Michigan	1.29
Iowa	15.21	South Carolina	9.17	South Carolina	7.73	Michigan	3.63	South Carolina	1.25
Kentucky	13.08	Pennsylvania	9.09	Georgia	7.51	Iowa	2.79	Kentucky	1.20
<b>US Total</b>	<b>9.16</b>		<b>6.04</b>		<b>5.78</b>		<b>1.45</b>		<b>0.69</b>
<b>New York</b>	<b>1.62</b>		<b>5.25</b>		<b>5.51</b>		<b>1.62</b>		<b>0.69</b>
<b>Lowest Five:</b>									
Hawaii	4.74	Oregon	2.22	Idaho	2.15	Washington	0.59	Wyoming	0.21
Washington	4.49	Arizona	2.10	California	2.05	Oregon	0.57	Montana	0.19
Utah	4.08	Wyoming	2.10	Montana	1.85	Arizona	0.53	California	0.17
Oregon	3.78	Hawaii	1.91	Wyoming	1.52	Idaho	0.53	Hawaii	0.13
Arizona	3.08	Alaska	1.17	Alaska	1.37	Hawaii	0.49	North Dakota	0.11

Seriously Delinquent loans defined as 3 or more payments late plus loans in foreclosure  
Excludes Louisiana and Mississippi

Source: Mortgage Bankers Association National Delinquency Survey

While overall delinquencies rose in the fourth quarter of 2006, assertions that delinquency rates are at crisis levels and a greater percentage of borrowers are losing their homes are not supported by data. In fact, delinquency and foreclosure rates have remained relatively low with increases over the last year. The chart below traces delinquencies from 1998 through the fourth quarter of 2006. It reveals the fact that delinquencies were higher in the subprime market at the end of 2000 as well as during 2002 than they were in the fourth quarter of 2006.

Chart 8. Seriously Delinquent Rate by ARM & Fixed



The delinquency rate for mortgage loans on one-to-four unit residential properties stood at 4.95 percent of all loans outstanding in the fourth quarter of 2006 on a seasonally adjusted basis, up 28 basis points from the third quarter, and up 25 basis points from one year ago, according to MBA’s National Delinquency Survey (NDS). All ARM loans had higher delinquency rates as compared to the third quarter of 2006. Delinquency rates for the fourth quarter increased 33 basis points for prime ARM loans (from 3.06 percent to 3.39 percent) and increased 122 basis points for subprime ARMs (from 13.22 percent to 14.44 percent). The delinquency rate for prime fixed loans increased 17 basis points (from 2.10 to 2.27 percent), while the rate increased 50 basis points for subprime fixed rate loans (from 9.59 percent to 10.09 percent).<sup>7</sup>

For New York, the delinquency rate for mortgage loans on one-to-four unit residential properties stood at 4.82 percent of all loans outstanding in the fourth quarter of 2006 on a non-seasonally adjusted basis, up 41 basis points from the third quarter, and up 58 basis points from one year ago, according to MBA’s National Delinquency Survey (NDS). All ARM loans had higher delinquency rates as compared to the third quarter of 2006. Delinquency rates for the fourth quarter increased 48 basis points for prime ARM loans (from 3.87 percent to 4.35 percent) and increased 135 basis points for subprime ARMs (from 13.68 percent to 15.03 percent). The delinquency rate for prime fixed loans

<sup>7</sup> These figures are based on MBA data. MBA defines “delinquency” as having one or more payments overdue. The loans in foreclosure are approximately a third of these numbers and the borrowers actually losing their homes are approximately a fourth of that group.

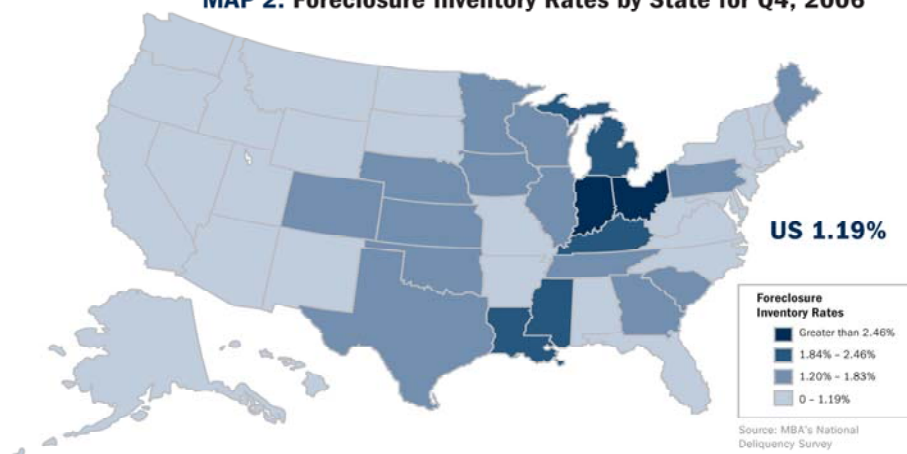
increased 21 basis points (from 2.45 to 2.66 percent), while the rate increased 96 basis points for subprime fixed rate loans (from 8.42 percent to 9.38 percent).

MBA's fourth quarter 2006 NDS found that the percentage of loans in the foreclosure process was 1.19 percent, an increase of 14 basis points from the third quarter of 2006, while the seasonally adjusted rate of loans entering the foreclosure process was 0.54 percent, eight basis points higher than the previous quarter. The foreclosure inventory rate for subprime loans in the fourth quarter of 2006 was 4.53 percent, up from 3.86 percent in the third quarter. The foreclosure inventory rate for prime ARMs went from 0.70 percent in the third quarter up to 0.92 percent in the fourth quarter; for nonprime ARMs from 4.68 percent to 5.62 percent. The foreclosure inventory rate increased for subprime fixed rate mortgage loans from 3.00 percent to 3.19 percent.

For New York, the percentage of loans in the foreclosure process was 1.11 percent, an increase of 9 basis points from the third quarter of 2006, while the non-seasonally adjusted rate of loans entering the foreclosure process was 0.44 percent, six basis points higher than the previous quarter. The foreclosure inventory rate for subprime loans in the fourth quarter of 2006 was 4.34 percent, up from 3.78 percent in the third quarter. The foreclosure inventory rate for prime ARMs went from 0.82 percent in the third quarter up to 1.05 percent in the fourth quarter; for nonprime ARMs from 5.76 percent to 7.07 percent. The foreclosure inventory rate increased for prime fixed rate mortgages from 0.37 to 0.39 and increased for subprime fixed rate mortgage loans from 2.71 percent to 2.83 percent.



**MAP 2: Foreclosure Inventory Rates by State for Q4, 2006**



In its most recent data, MBA is seeing increases in delinquencies and foreclosures for nonprime loans, particularly nonprime ARMs. Because of technology induced cost reduction and efficiency gains by the industry as well as the appetites of borrowers for credit, the share of outstanding loans that are nonprime has been increasing for the last several years. The higher average delinquency and foreclosure rates among these loans

mean the overall statistics for total outstanding mortgages are unlikely to fall as low as in the past.

It is important to note that nonprime loans have always had higher delinquency and foreclosure rates and lenders factor in these risks when lending to nonprime borrowers. Given the fact that nonprime borrowers have weaker credit profiles, this is not surprising. Foreclosures also can be accelerated by slow housing markets that limit borrowers' ability to quickly sell in order to cover their losses. MBA data has indicated that over the last several quarters a number of factors, including the aging of the portfolio, increasing short-term interest rates and high energy prices, have been putting upward pressure on delinquency rates.

Nevertheless, for each borrower whose loan goes into default and is foreclosed, the experience is a traumatic one, and it is not surprising that legal counsel for such borrowers would assert every claim available to permit their clients to hold onto their homes. However, policymakers need to understand that keeping the homeowner in their home paying on their mortgage is the best outcome for both the lender and the borrower.

#### **IV. FORECLOSURE PREVENTION AND SERVICING PRACTICES**

Mortgage servicers want to preserve homeownership and, in fact, have economic incentives to get borrowers back on their feet as quickly as possible and avoid foreclosure. Delinquencies and foreclosures are costly both from a hard and soft dollar perspective. Significant staff must be dedicated to handling delinquencies and foreclosures. Servicers also must advance principal and interest payments to investors and pay taxes and insurance premiums even though such payments are not received from the borrower. If the loan becomes seriously delinquent, servicers must hire foreclosure attorneys and pay for property preservation. All these costs can be a significant drain on capital. In the event of foreclosure, noteholders take significant losses on the loans. A 2003 Federal Reserve study notes that "estimated losses on foreclosures range from 30 percent to 60 percent of the outstanding loan balance because of legal fees, foregone interest, and property expenses."<sup>8</sup> From a pure economic basis alone servicers do not desire foreclosures.

It is important to note that servicer profits derive from receiving the servicing fee for administering the loans. Although the servicing fee is small, usually amounting to one fourth of one percent of the loan balance, when a loan is delinquent, that fee is not earned. When a loan is extinguished through foreclosure, the servicing asset represented on the balance sheet is also extinguished. Large numbers of foreclosures are detrimental to a servicer's earnings and net worth. Thus, long-standing claims that lenders knowingly put borrowers into products they cannot afford in order to take the property through foreclosure are simply unfounded.

In reality, everyone loses in a foreclosure – the borrower, the local community, the mortgage insurer, investors and the servicer. Lenders and servicers do not have

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<sup>8</sup> Foreclosing on Opportunity: State Laws and Mortgage Credit, Karen M. Pence, Board of Governors of the Federal Reserve System, May 13, 2003.

incentives to cause foreclosures, because profitability rests in keeping loans current and, as such, the interests of borrowers and lenders are aligned.

## A. Loss Mitigation Tools

Recognizing the significant downside to foreclosures and with a strong desire to assist their borrowers, servicers have, over the last 15 years, made deliberate and significant strides to provide workout alternatives to foreclosure. These alternatives include both home retention options, such as forbearance, repayment plans and modifications, and home relinquishment options when the borrower can no longer support the debt. Of course, servicers strive to provide home retention solutions whenever possible. The following is a brief overview of the home retention options used by servicers. The availability of these options is dependent on investor agreement.

- **Forbearance Plans:** These plans provide postponements in payments with a typical duration of six months, followed by repayment of the arrearage over time. The plans can be verbal or written.
- **Delinquent Refinances:** Although less common, borrowers that are less than three months behind may be able to refinance to lower rates and capitalize the arrearage.
- **Subordination of Unpaid Debts:** Servicers in some cases can also place the arrearages into a junior lien in order to bring the loan current. The borrower is required to pay both debts, similar to a repayment plan, but this option makes such payments more affordable because the balance owed is amortized over a longer period of time.
- **Temporary Modifications:** These modifications allow for a temporary reduction in interest rate or payments for a period of time, usually lasting about six months.
- **Permanent Loan Modifications:** These modifications result in permanent changes to one or more of the original loan terms, such as the interest rate and/or duration of the loan. A permanent modification is a very effective work out vehicle, because it provides an immediate resolution to the delinquency by taking the amount of arrearage and adding it to the balance of the modified loan (e.g. “capitalize the arrearage”) and re-amortizing the payments. The duration of the loan can also be extended to reduce monthly payments. While this option gives the borrower and loan servicer additional choices, its availability is limited for those mortgages that have been purchased by investors in the form of mortgage-backed securities. Because the MBS are held in trust, rules restrict servicers and trustees from altering the assets.

Two-thirds of all mortgage loans are placed in trusts to create mortgage-backed securities and then the MBS are sold to investors. Trust documents dictate what the servicer is permitted to do in the way of loss mitigation. In many cases the servicer is prohibited from modifying the loan. In other documents the servicer is permitted to follow standard industry practices—a very vague standard that could create liability for the servicer if there is a subsequent challenge from some investor group. Subprime and other private label servicers have had moderate

success in amending the investor documents, but such changes require the approval of all investors. There can be many investors in an MBS trust and locating the beneficial owner investor can be difficult or impossible. Under some circumstances, the MBS trustee has to seek a legal opinion that modification of delinquent loans will not affect the securities' REMIC tax status. This is costly and there is a risk that the IRS will have a different opinion and terminate the REMIC. Such a result would be financially catastrophic for the MBS investors because the loss of REMIC status results in taxation of the trust as a corporation and not as a pass-through entity. This means that the income from the MBS would be taxed at both the trust entity level and the investor level, rather than just at the investor level.

Non-home retention loss mitigation alternatives are useful when borrowers have no viable means to cure their financial situation. These options offer several benefits that should not be discounted. First, they avoid foreclosure which can severely impact the borrower's credit. Second, the servicer generally does not seek repayment of the deficiency, which is the difference between the value received for the property and the amount of the debt owed. Third, borrowers are often assisted with moving expenses. These options are most often used when home prices decline below the amount of outstanding debt:

- **Pre-Foreclosure Sales (PFS) or Short Sales:** Proceeds from a third party sale of the borrower's home are accepted as satisfaction for the mortgage, even though they represent less than the amount owed.
- **Deeds-in-Lieu of Foreclosure (DIL):** The borrower voluntarily deeds the property to the servicer as satisfaction for the mortgage even though the value of the property is less than the amount owed.

## **B. Servicer Practices**

Before borrowers ever reach the point of being seriously delinquent, servicers attempt to cure the delinquency. Experience has shown that early intervention is the key to curing delinquencies. As a result, servicers make significant attempts to contact borrowers early in the delinquency or even before a delinquency occurs. In fact, prime lenders have adopted some techniques from subprime lenders that have proven effective, including: providing welcome calls to new customers ensuring that they have important contact information; initiating reminder calls prior to the expiration of the grace period for at-risk borrowers; using automation to determine when a borrower's failure to make a payment is outside of their normal pay-behavior; and prioritizing out-bound assistance calls to the highest risk delinquent borrowers first. This allows servicing staff to focus their resources where they are most needed. These techniques have proven to be beneficial for consumers. In addition to personal contact, servicers send numerous notices to borrowers informing them of their delinquency, offering loss mitigation and providing helpful information on how to avoid foreclosure. Property preservation personnel in some cases also leave discrete information at the property address.<sup>9</sup>

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<sup>9</sup> The following are the notices/solicitations typically provided by servicers: a payment reminder that payment is past due (from 2-16th) (this is typically for high risk borrowers); late charge notice notifying the customer that payment is past due and late charge has been assessed; monthly account statement reflecting either the current and/or total amount past due; notice of availability

Some servicers are also using telecommunication tools to streamline contact with delinquent borrowers. Through automation, the delinquency status of in-bound callers can be determined very quickly and calls routed automatically to workout staff thus bypassing the company's standard customer service line. The process is seamless to the consumer and avoids wait times. Other companies provide dedicated toll-free numbers that go directly to the loss mitigation teams trained to address more complex borrower needs.

Servicers have also developed Web sites that allow borrowers to access loss mitigation information, obtain and submit required documents and in some cases apply for online.

Unfortunately, despite all this technology and effort, over half of borrowers in foreclosure proceedings have had no contact with their servicer.<sup>10</sup> This lack of contact is one of the biggest challenges servicers face in trying to cure delinquencies.

One situation that MBA believes contributes to this low contact rate is a provision in the Fair Debt Collection Practices Act (FDCPA). Under FDCPA, a lender who purchases servicing on a delinquent loan is required to announce itself as a "debt collector" prior to discussions with that customer. A servicer who purchases current servicing that subsequently becomes delinquent, however, is not required to make this announcement. This so-called "mini Miranda warning" effectively drives borrowers away by creating a misleading and conflicting message with loss mitigation efforts (especially when servicers request financial information from the borrower for purposes of structuring the loss mitigation plan). Servicers that purchase delinquent servicing should be treated like other servicers and not have to provide this statement.

Even with these obstacles, servicers are not just throwing in the towel. They are proactive in exploring new options that bring borrowers to the table -- ways that create approachable environments for borrowers who might be embarrassed or not trusting of the lender. This includes teaming up with non-profit and for-profit agencies to assist in *locating* borrowers and providing homeownership counseling.

Counselors work with borrowers and their servicers to achieve and execute loss mitigation arrangements. The hope is that homeowners who are hesitant to call their servicers will be more likely to contact a non-profit organization or other reputable intermediary to discuss alternatives.

Recognizing the value of third-party groups in helping connect borrowers with servicers and work out problems, MBA has partnered with NeighborWorks America, the

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of counseling and state/local payment assistance programs at 45 days (Federal Law); mail "How to Save Your Home" pamphlet at 60 days (Federal Law for FHA loans); mail internally created documents on how to save the home for non-FHA loans; separate letters soliciting for loss mitigation; multiple calls each month to solicit alternative collection/loss mitigation. Additional notifications are sent pursuant to state statutory requirements or preconditions to foreclosure including the breach (or demand letter); letter announcing acceleration of the debt; service of process notices, and foreclosure sale date.

<sup>10</sup> Foreclosure Avoidance Research, Freddie Mac, 2005.

Homeownership Preservation Foundation and the Ad Council in a campaign to prevent foreclosure that includes free mortgage counseling. Borrowers seeking assistance should call 1-888-995-HOPE or visit <http://www.995hope.org/>. Through this service, counselors are currently receiving 650 calls a day. About half of those callers enter into counseling sessions and 42 percent of those result in positive final outcomes, avoiding foreclosure.

MBA also makes valuable information available to borrowers in every stage and status of the mortgage process, including delinquency, on the Home Loan Learning Center Web site at <http://www.homeloanlearningcenter.com/>.

The paradigm has shifted from a decade ago. Borrowers need to know that lenders can help. A direct call to the lender or to a reputable housing counselor can save a borrower's home. We hope to convey that message whenever possible.

## **V. THE IMPOSITION OF A SUITABILITY STANDARD WOULD HURT THOSE IT IS MEANT TO HELP**

As indicated, the data does not show that unsuitable products or predatory lending are the cause of delinquencies and foreclosures. The foreclosure problem is based on economic difficulties that confront borrowers.

Notwithstanding, a number of advocacy organizations have urged that a "suitability standard" be imposed on mortgage lenders as a means of making the lender responsible for assuring the borrower is in the right loan to prevent foreclosure later. These organizations assert that a "suitability standard" applies to securities brokers and that there is no reason why a similar standard should not be imposed on mortgage lenders. MBA disagrees.

While a specific proposal for a "suitability standard" for the mortgage industry is not yet fully formed, a variety of approaches have been suggested. Most would simultaneously require more rigid, prescribed underwriting standards, a duty of fair dealing at the inception of the loan, a subjective evaluation by the lender whether a product is best suited for that borrower, the establishment of a fiduciary obligation by the lender to the borrower and a private right of action to redress any violations. Some suggest that a regulator be empowered to specify the parameters of the requirement. While many of these points might sound good at first, on closer examination of the facts, they each raise very significant concerns for consumers.

Earlier this year, MBA published a paper that explains why the imposition of a "suitability standard" on the mortgage lending industry risks unintended, negative consequences for consumers that would turn back the clock on hard won fair lending and homeownership gains. The New York State Assembly should resist pressure to enact a suitability standard for the mortgage lending industry and, instead, should turn its attention to the creation of a uniform national lending standard. A uniform national standard would be the best approach to addressing the current mortgage market challenges.

**A. Rigid Hard Wired Underwriting Standards Deny Credit Options to Borrowers**

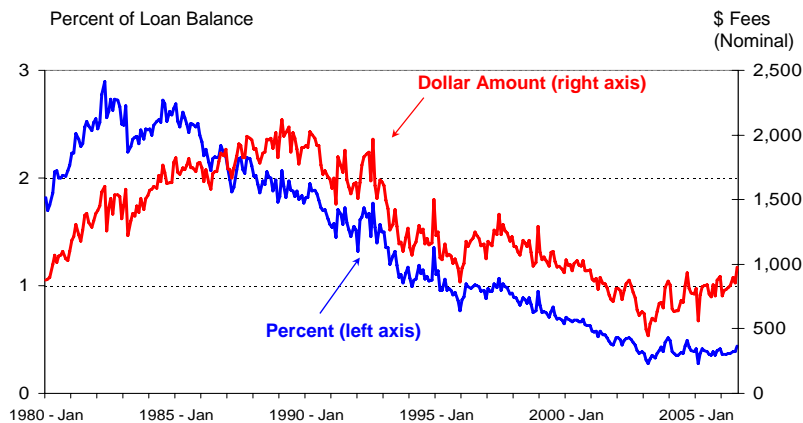
The most recent data provided by the mortgage lending industry under the Home Mortgage Disclosure Act (HMDA), on loans made in 2004 and 2005, demonstrate the greatest and widest availability of mortgage finance in our nation’s history, which in turn has made possible record homeownership rates. The data show that borrowers in virtually every area of the nation, of every race and ethnicity, and at every income level receive an unparalleled array of credit opportunities.

It is important to remember how we got to this point. The confluence of several factors has contributed to the growth in credit opportunities for prime and nonprime borrowers over the last 15 years. These factors include increased competition from an unparalleled number of loan originators including mortgage companies, banks, credit unions and mortgage brokers. They also include innovations in the mortgage market, resulting in the range of mortgage products available today including fixed-rate products and adjustable rate products as well as “nontraditional.”

Most importantly, the past 15 years has been marked by dramatic changes in the mortgage origination process made possible by technology. Computerization has enabled a much greater understanding of default risk and the development of objective underwriting criteria. It has also permitted the embodiment of these criteria in automated underwriting tools and the growth of risk-based pricing. As shown in the chart below, according to the Federal Housing Finance Board’s data from their Monthly Interest Rate Survey, the costs of originating a mortgage have declined tremendously both measured as a percentage of the loan balance and in nominal dollars.



Initial Fees and Charges on Conventional Purchase Mortgage Loans



Source: Federal Housing Finance Board

Risk-based pricing, in turn, has permitted the development of a market to serve the needs of nonprime borrowers “who have difficulty in meeting the underwriting criteria of ‘prime’ lenders because of blemished credit histories or other aspects of their profile.”<sup>11</sup>

Rigid new underwriting standards, no matter how well intentioned – even as seemingly innocuous as requiring a particular debt-to-income ratio, for example – will result in denying some borrowers’ credit who would otherwise qualify in today’s market. Some of these borrowers will even be denied homeownership although they would qualify today. The magic of today’s market is that the widest range of borrowers can get the widest spectrum of loans.

Similarly, while it might sound reasonable to require that all borrowers contending for a hybrid adjustable rate mortgage (ARM) that allow lower fixed payments for an initial period and higher payments after that be qualified at the fully indexed rate, such an approach will lock some borrowers out of the home of their dreams and deprive them of lower payments. It would also have the consequence of failing to allow these borrowers an opportunity to repair their credit so they can refinance into a lower priced prime loan before the rate adjusts. Moreover, ARMs allow borrowers to allocate more of their cash flow to other uses. For example, a borrower who saves on their mortgage payment can put more funds towards financial investments, potentially diversifying their overall portfolio.

Some insist that a borrower who can not meet fixed ratios should be denied credit if they don’t satisfy a particular test. Such a result is unnecessary in today’s financing world. Also, respectfully, MBA wonders if that opportunity should be withheld from 87 percent of borrowers, including those who qualified for nonprime loans who are making their payments and achieving the dream of homeownership.

Today, borrowers at nearly all points on the credit spectrum qualify for loans. The imposition of new rigid standards would change that.

## **B. The Imposition of a Suitability Standard Risks Unintended Consequences**

While certainly not intended to promote or authorize discrimination or reignite redlining, MBA is extremely concerned that the injection of subjective standards into the mortgage process would conflict with and potentially threaten fair lending, community reinvestment and homeownership gains particularly for first time homeowners and minorities.

The reason this would happen is not because anyone has bad motives but because new subjectivity would be injected into the market, the risks would increase markedly, driving many lenders to be much more cautious or even to withdraw from the market. Lessened competition and increased risks will decrease financing options and increase costs.

Since the 1990’s, the denial rates of African-American loan applicants, though still greater than white borrowers, have declined considerably. In 1992, the denial rate for conventional home purchase loans for African-American borrowers was 36 percent and

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<sup>11</sup> Remarks by Governor Edward M. Gramlich at the Federal Reserve Bank of Philadelphia, Community and Consumer Affairs Department Conference on Predatory Lending, Philadelphia, Pennsylvania (December 6, 2000).

in 2004 it was 24.7 percent. While there has been some increase in the institutions covered by HMDA over these years, the number of applications nearly quadrupled over this period.<sup>12</sup>

Although all homeownership has increased since the 1990s, the percentage increase in African-American homeownership has been greater than among whites and the national average. The African-American homeownership rate has increased almost six percentage points since 1994, while the overall rate has increased nearly five percentage points. If a subjective suitability standard is imposed, in the first instance, lenders will be required to assure that a loan is suited for the borrower. If such a standard is imposed, a lender facing a mortgage applicant who is a member of a protected class, and for whom a loan product may be “unsuitable,” might deny the borrower credit options to conform to the suitability requirement and, at the same time, violate the letter and spirit of fair lending and community investment requirements. Conversely, if credit is extended, the lender risks violating a suitability requirement.

Either way, by injecting **subjective** standards into the process, there will be much greater caution by lenders and less competition in the market as lenders shy away from these risks. There is real concern that subjectivity and even caution will disproportionately affect first-time homeowners, minorities and those with less wealth where suitability and fair lending concerns intersect.

Even if the facts suggest that a lender is in compliance with both fair lending rules and a suitability requirement, borrowers who go into default are likely to claim that the loan was “unsuitable.” This new cause of action will also drive lenders out of markets, lessening the availability of credit and driving up costs for consumers. It would seem that only the lawyers will benefit.

Although as indicated, advocacy organizations point to the securities industry as a model for a suitability standard, on examination, the industries are not analogous. Their business models differ and so do the policy imperatives that govern them.

While federal policy has been to encourage mortgage lenders to make credit available to as many borrowers as possible, by contrast those responsible for regulation of the securities industry have not made expansion of investment opportunities to underserved persons or neighborhoods a major policy initiative. The consequence of the suitability requirement for a securities firm is that overly cautious broker-dealers will lose out on commissions. The consequence of a suitability requirement for mortgage lenders is that overly cautious lenders may violate the letter of federal anti-discrimination laws and the spirit of community reinvestment laws.

As far as their business models are concerned, securities broker-dealers function as intermediaries between their customer and the market to invest their customers’ money; broker-dealers hold themselves out as investment consultants. Mortgage lenders, on the other hand, represent their companies and investors whose money they put at risk to make loans to borrowers; they do not function as agents or fiduciaries and they do not hold themselves out as such to borrowers. Consumers select their securities advisor on a long-term basis, but regularly shop among mortgage lenders when seeking a mortgage.

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<sup>12</sup> 1992 and 2004 HMDA data.

It is noteworthy that survey data indicates that an intrusion by lenders into the borrower's personal decisions is unwelcome by the borrower whom a suitability standard would be designed to protect. One recent study found that 88 percent of respondents would prefer to "decide for themselves whether or not a mortgage product is right for them, rather than leaving that responsibility to the mortgage lender."<sup>13</sup>

Also notably, borrowers subject to a pilot program in the City of Chicago that imposes mandatory financial counseling only for borrowers in specific ZIP codes have filed a law suit alleging that the program amounts to "state-sanctioned redlining."<sup>14</sup> Governor Blagojevich suspended this law on Friday, January 19, recognizing that it was hurting the people it was designed to protect, according to *The Chicago-Sun Times*.<sup>15</sup>

Lenders can and do offer valuable information to consumers. Lenders help consumers understand what mortgage products are available and for what mortgages they might qualify. For this reason, it pays for consumers to see lenders early in the home buying process, not only to determine what property they can afford, but also to consider their financing choices in relation to their particular situations, including their incomes, credit and plans to stay in their homes. Nevertheless, lenders cannot serve as agents and fiduciaries for borrowers as well as for their own companies.

Despite the wide range of market innovations, some borrowers have obtained loans with terms that negatively impact their ability to repay. Let us assure you, the fundamental goal that borrowers only obtain loans they can repay is shared by consumers, advocacy organizations, regulators and mortgage lenders alike. For this reason, the mortgage lending industry has a great stake in striving, along with advocacy organizations, legislators and regulators, to make the lending process as understandable and abuse-free as possible and more work is needed toward this goal. However, imposing a suitability standard is not an appropriate solution and would run the risk of turning back the clock on innovations that have greatly expanded home ownership opportunities.

The New York State Assembly, therefore, should resist pressure to enact a suitability standard which would harm consumers. Retaining the current "arms length" transaction model in the mortgage lending industry works best.

## **VI. STEPS THE NEW YORK STATE ASSEMBLY CAN TAKE TO PROTECT CONSUMERS**

There are at least three things the New York State Assembly can do to help consumers become better informed through the mortgage process, protect themselves and help them make the best choice for themselves.

First, considerable resources should be committed to improving borrower education to raise the level of financial literacy, including incorporating this issue into general educational programs and increasing access to transaction-specific borrower

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<sup>13</sup> See American Financial Services Association Press Release, "Borrowers, Not Lenders, Should Decide Appropriateness of Mortgage Products, Finds Survey," (Nov. 20, 2006).

<sup>14</sup> See Mary Umberger, "Home Buyer Counseling Challenged," Chicago Tribune, Nov. 2, 2006.

<sup>15</sup> See Lisa Donovan, "Gov Halts Mortgage Counseling," Chicago Sun-Times, January 21, 2007.

counseling. It would be a worthy undertaking to conduct a review of total government efforts in the area of financial literacy to see what is working is what is not. This study could also include the amount of resources expended for this purpose. MBA believes that better financial education would empower all borrowers to shop effectively among the array of competitors in the marketplace.

Second, the New York State Assembly can support efforts to bring about the simplification of the mortgage process and all necessary consumer information would make it much easier for an empowered consumer to navigate the market, and such improvements are long overdue. Consumers today face a pile of disclosures when they apply for and close on a mortgage. Efforts at improvement need to streamline the existing mandated disclosures and information, and must be comprehensive and well considered. A successful effort would result in much more effective information on the benefits, costs and features of the loan options presented by lenders. It would also go a long way to help borrowers shop for mortgages among lenders with an ability to make an apples-to-apples comparison.

Third, the New York State Assembly could support the creation of uniform lending standards that are clear and objective, but do not unduly restrict the market, would improve on the standards established under HOEPA to stop lending abuses. These standards must be national in scope to enhance competition in all markets for all borrowers, especially nonprime. Such standards will allow all borrowers to benefit from greater choices, competition and lower prices that a fair and fully functioning market brings. MBA would support the expansion of the types to loans to be covered in a uniform national standard to include purchase money loans and open-ended lines of credit.

MBA supports the framework for a national standard that includes the following principles and components.

**Broad Principles of a National Standard:**

- Uniform National Standard. A national law should recognize a national mortgage market by including broad preemption that facilitates competition and market efficiencies leading to low cost mortgage lending. It should apply to all lenders creating uniformity in the market. It should not change the current regulatory oversight, preemption or enforcement regime of those regulated by the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the National Credit Union Administration (NCUA), the Federal Reserve Board (FRB) and the Federal Deposit Insurance Corporation (FDIC).
- Protect Financing Options. The innovation of lenders to make mortgage credit more widely available through a variety of products and financing tools should be protected. Unduly limiting or outlawing finance options could put homeownership out of borrowers' reach, particularly underserved borrowers.
- Risk-based Pricing. Lenders' ability to efficiently price loans based on the risk of non-payment presented by a borrower has revolutionized and expanded the availability of mortgage credit. Through risk-based pricing, mortgage credit is more widely available to borrowers, especially to traditionally underserved communities. A national standard should recognize and protect the benefits of risk-based pricing.

- A Suitability Standard Should Not Be Imposed. Certain groups have suggested imposing a suitability standard on mortgage lenders. Lenders already make a “suitability” determination through assessing affordability when underwriting a consumer’s ability to repay a loan. A suitability standard beyond that threatens progress made in fair lending as well as the availability and affordability of credit to homeowners by reintroducing a subjective determination into a loan officer’s work. Further, the imposition of a suitability standard exposes lenders to significant liability and will increase the cost of mortgage credit since it could affect the mortgage-backed security marketplace.
- Objective Standards. The provisions of any national standard should include clear, objective standards so that consumers understand their rights and protections and lenders understand compliance requirements.
- Added Consumer Protections: MBA supports increased protections for consumers in a national standard.

### **Components of a National Standard:**

#### **A. HOEPA Triggers:**

- Reasonable High Cost Loan Triggers. Almost no lenders will make loans that meet the HOEPA high cost loan triggers because of the significant liability that attaches. Investors will not buy high cost loans because of the liability, which dried up liquidity for these loans. The triggers, therefore, act as a de facto usury ceiling in that lenders won’t make loans above the triggers. Therefore, the APR and point and fee triggers should be maintained at their current levels so that legitimate lending is not cut off. MBA would support the setting of triggers at a reasonable level to help assure that mortgage credit continues to be available to credit-worthy borrowers.
- Point and Fee Definition Should Not Be Overly Broad. A national standard should maintain the items included in HOEPA for making the point and fee calculation. Neither prepayment penalties, nor yield spread premiums should be included in the definition because doing so would threaten the use of these finance options and because the value of those items is already reflected in the interest rate and APR. Thus, including those items in a points and fees test would result in double counting. Lowering the point and fee trigger by excessively expanding the point and fee definition will invariably cut off legitimate credit to our neediest borrowers.

#### **B. HOEPA Protections:**

- Refinancing a Loan Should Provide a Benefit to a Borrower. Existing loans should not be refinanced into a high cost mortgage loan unless doing so provides a benefit to a borrower. A national standard should allow regulators to establish objective safe harbors for determining when the benefit threshold is met.
- No Asset Based Lending. Evaluating a borrower’s ability to repay a loan is fundamental to a lender in underwriting a mortgage application. A lender has every incentive to ensure a loan is properly underwritten since the lender takes the risk of loss on a defaulting loan and, through agreements with investors, can be forced to repurchase a loan from the secondary market. A borrower’s ability

to repay a high cost loan should not be solely based on the collateral value of the property.

- Assignee Liability. MBA supports the maintenance of the existing assignee liability regime provided in the Truth in Lending Act (TILA) and HOEPA.
- C. Consumer Protections for All Loans:
- Prepayment Penalties Should Be Limited to Three Years. Prepayment penalties reflect an agreement between the lender and borrower whereby the borrower agrees to stay in a mortgage for a period of time in exchange for a lower rate or a significant reduction in fees. If a prepayment penalty is offered, it should be limited to three years and clearly disclosed to the borrower.
  - Yield Spread Premiums Are a Valuable Financing Option. A yield spread premium (YSP) is a very good mortgage financing option that allows borrowers to pay closing costs through the rate. The inability to use yield spread premiums could bar creditworthy borrowers from homeownership. Where RESPA requires it, MBA would support improved YSP disclosures.
  - Borrowers Should be Given Choice to State Income. Stated income loans are important to certain borrowers, especially in the emerging markets, because documenting their income in connection with a mortgage application can be difficult. Further, interested borrowers should be given the option of choosing a stated income loan versus a fully documented income loan if the borrower so chooses and if the lender has disclosed any cost difference.
  - Home Improvement Contracts. Lenders should disburse loan proceeds to the borrower or jointly to the borrower and the contractor, or through a third-party escrow agent. Lenders must not disburse loan proceeds until the payment is approved in writing by the borrower, the contractor has signed a certificate of completion or the contract, and the property has been made available to the lender for inspection.

D. Standards for All Loans:

- Right to Cure. A national standard should permit lenders reasonable time to “cure” any unintended errors in the mortgage transaction without incurring any further or punitive liability.
- Accurate Appraisals. When formal valuation methods are required, lenders must evaluate properties through real estate appraisal professionals and/or through automated valuation models. Participants to the transaction must be careful not to either pressure or be pressured. Lenders must ensure that the appraiser is licensed as required by law and make a good faith effort to ensure the appraiser is in good standing.

Finally, while any increases in delinquencies and foreclosures are an important concern, prohibition of particular products is not a solution – because they are not the cause. Many borrowers have used a range of products effectively to realize their dream of homeownership and otherwise satisfy the financial demands that we all face.

## **Conclusion**

MBA members have worked hard to put Americans in homes, facilitating the development of communities, increasing consumer wealth and improving the stability of families across the nation. The transitioning of the subprime mortgage market and the affect it is having and will likely continue to have on access to mortgage credit is a challenge for us all. MBA implores the New York State Assembly not to act hastily but to partner with industry and consumer groups to develop new approaches to help borrowers get the mortgage credit to fulfill their dreams of homeownership or to refinance into a new loan.

MBA has been long committed to fighting predatory lending and we would welcome the opportunity to work with the New York State Assembly to develop policies that weed out bad actors and allow the mortgage industry to continue to serve borrowers. Financial literacy, mortgage simplification and a uniform national standard are goals that MBA can work with the New York State Assembly to achieve and help address abusive lending.

MBA wants to underscore the importance of innovation in making credit opportunities available to consumers. MBA believes that borrower choice should be protected. The imposition of a suitability standard risks undermining our hard won gains in the areas of homeownership and reaching underserved borrowers. It will take away consumer choice as well as access to affordable mortgage credit.

Lenders and consumers alike have every incentive to keep borrowers in homes. Foreclosure is a loss for everyone. Foreclosures are caused in large measure by life events like job loss, divorce and illness. Lenders work very hard to offset foreclosure and work with delinquent borrowers to try to keep them in their homes.

MBA looks forward to continuing to work with the members of the committees participating in this hearing today and the whole the New York State Assembly to address challenges in the housing market and we stand ready to assist you however we can.

Thank you.



# APPENDIX

# New York

	New York	United States
<b>Homeownership Rates*</b>		
2003	54.3	68.3
2004	54.8	69
2005	55.9	68.9
2006	55.7	68.8
<b>All Loans (Single Family)</b>		
Number of Loans	539,841	15,576,852
Dollar Volume	\$121,269,323,000	\$2,817,352,293,000
Average Loan Amount	\$224,639	\$180,868
<b>FHA Insured</b>		
Number of Loans	12,916	436,324
Dollar Volume	\$1,470,482,000	\$53,136,331,00
Average Loan Amount	\$113,850	\$121,782
<b>VA Guaranteed</b>		
Number of Loans	2,270	149,608
Dollar Volume	\$275,210,000	\$23,584,462,000
Average Loan Amount	\$121,238	\$157,642
<b>Rural Housing (FMHA)</b>		
Number of Loans	210	20,478
Dollar Volume	\$16,250,000	\$2,080,055,000
Average Loan Amount	\$77,381	\$101,575
<b>Single Family Prime Originations</b>		
Number of Loans	441,469	13,099,633
Dollar Volume	\$97,001,452	\$2,406,326,758
<b>Single Family Subprime Originations</b>		
Number of Loans	98,372	2,477,219
Dollar Volume	\$24,267,871	\$411,025,535
<b>Foreclosure Rate (NDS)**</b>		
4th Quarter 2006	1.11	1.19
<b>Unemployment Rate (BLS)***</b>		
4th Quarter 2006	4.1	4.5

\* Source: www.census.gov

\*\* Source: MBA National Delinquency Survey, Q4 2006

\*\*\* Source: U.S. Department of Labor – Bureau of Labor Statistics  
All other data from 2005 HMDA

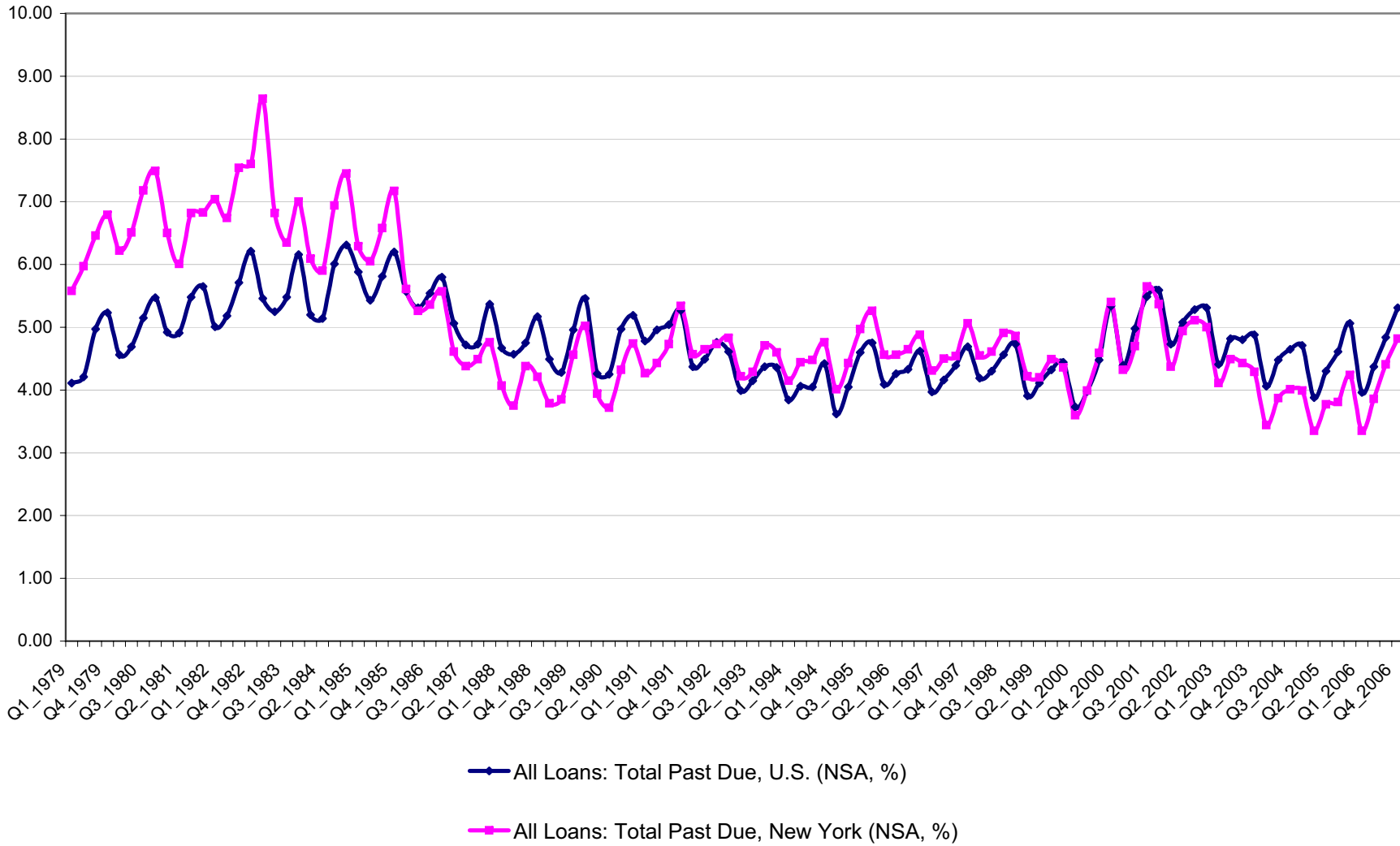
**The Real Estate Finance Industry** remains a key driver of the nation's economy. In 2005, real estate finance generated \$2.9 trillion in single-family loan originations and \$345 billion in commercial originations. Last year, new residential and commercial construction and housing-related expenditures represented nearly 11 percent of America's gross domestic product (GDP).

Harvard University's Joint Center for Housing Studies *The State of the Nation's Housing 2006* report notes that, "including residential investments, commissions and fees to brokers and real estate agents, spending on furnishings and yards, and spending on rents and utilities, housing contributed a record 23 percent of the nation's \$12.5 trillion GDP in 2005. This astounding number represents the larger reach and impact that the real estate finance industry plays in maintaining a strong economy. Additionally, the success of other sectors of the economy depends on a strong commercial and residential real estate market.

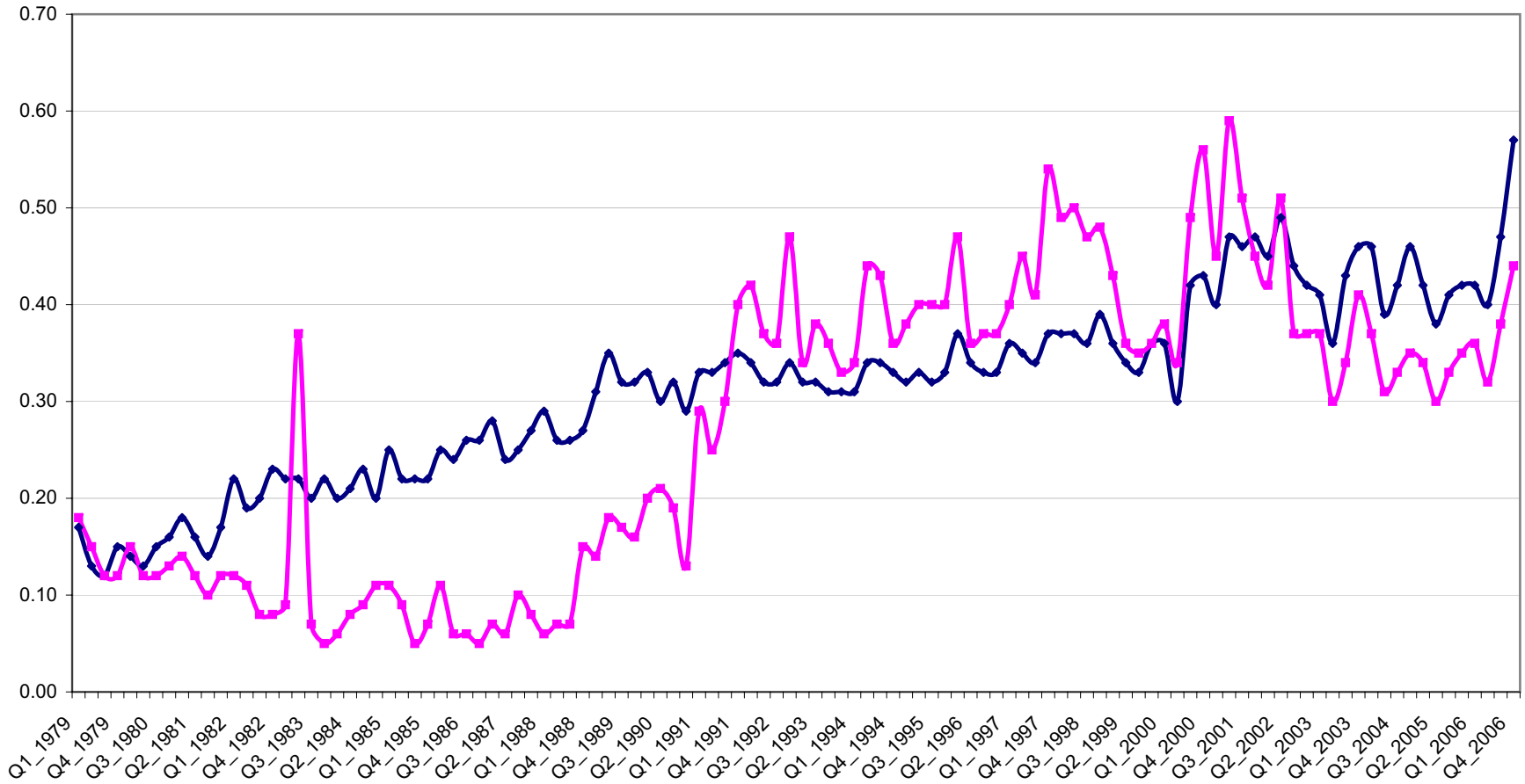
The real estate finance industry, not only facilitates financing of commercial and multifamily properties, but also allows people to achieve the American Dream of homeownership. It remains among the most important sectors of our economy.



### All Loans, Aggregated: Total Past Due, US v. NY



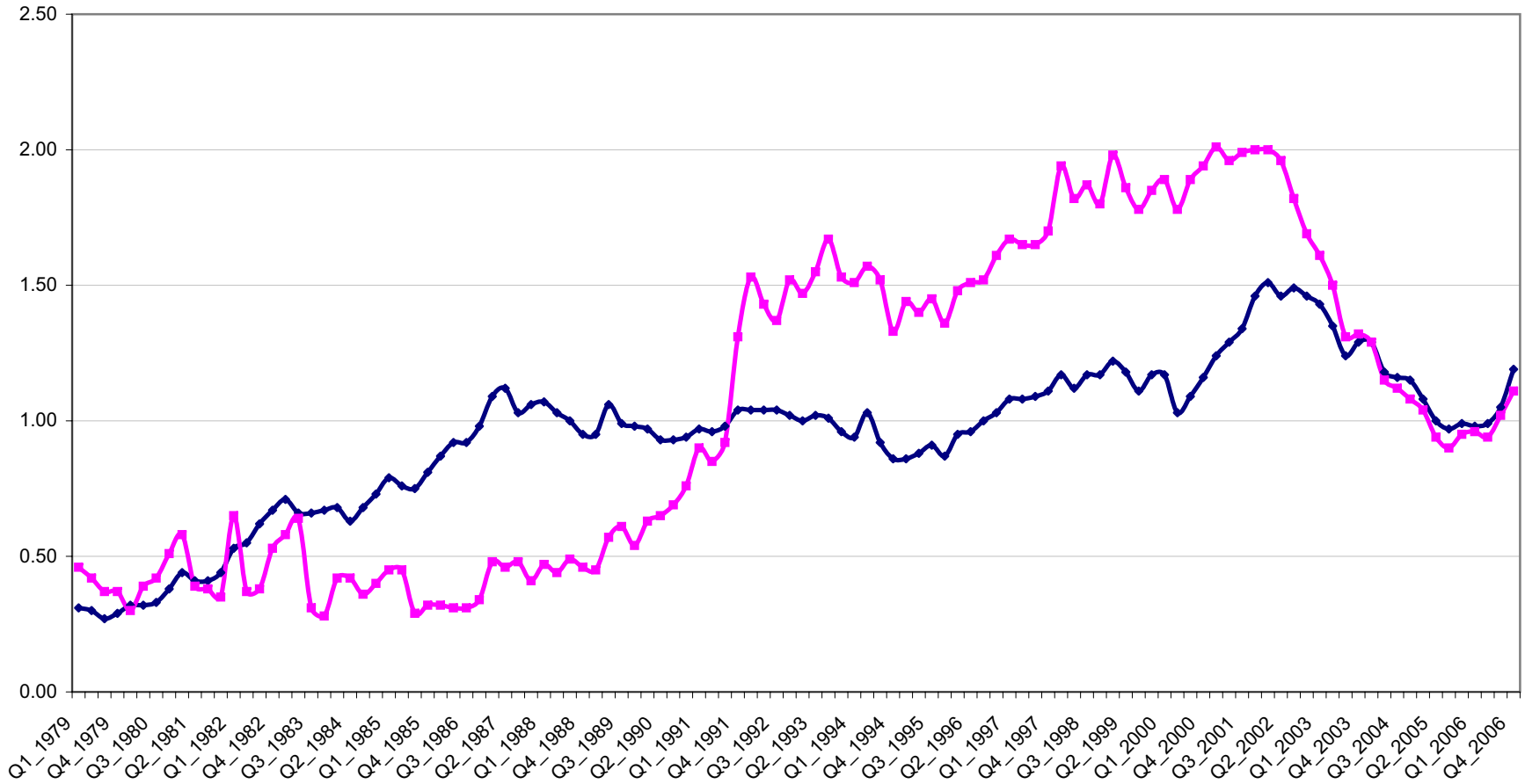
### All Loans, Aggregated: Foreclosures Started, US v. NY



—◆— All Loans: Foreclosures Started, U.S. (NSA, %)

—■— All Loans: Foreclosures Started, New York (NSA, %)

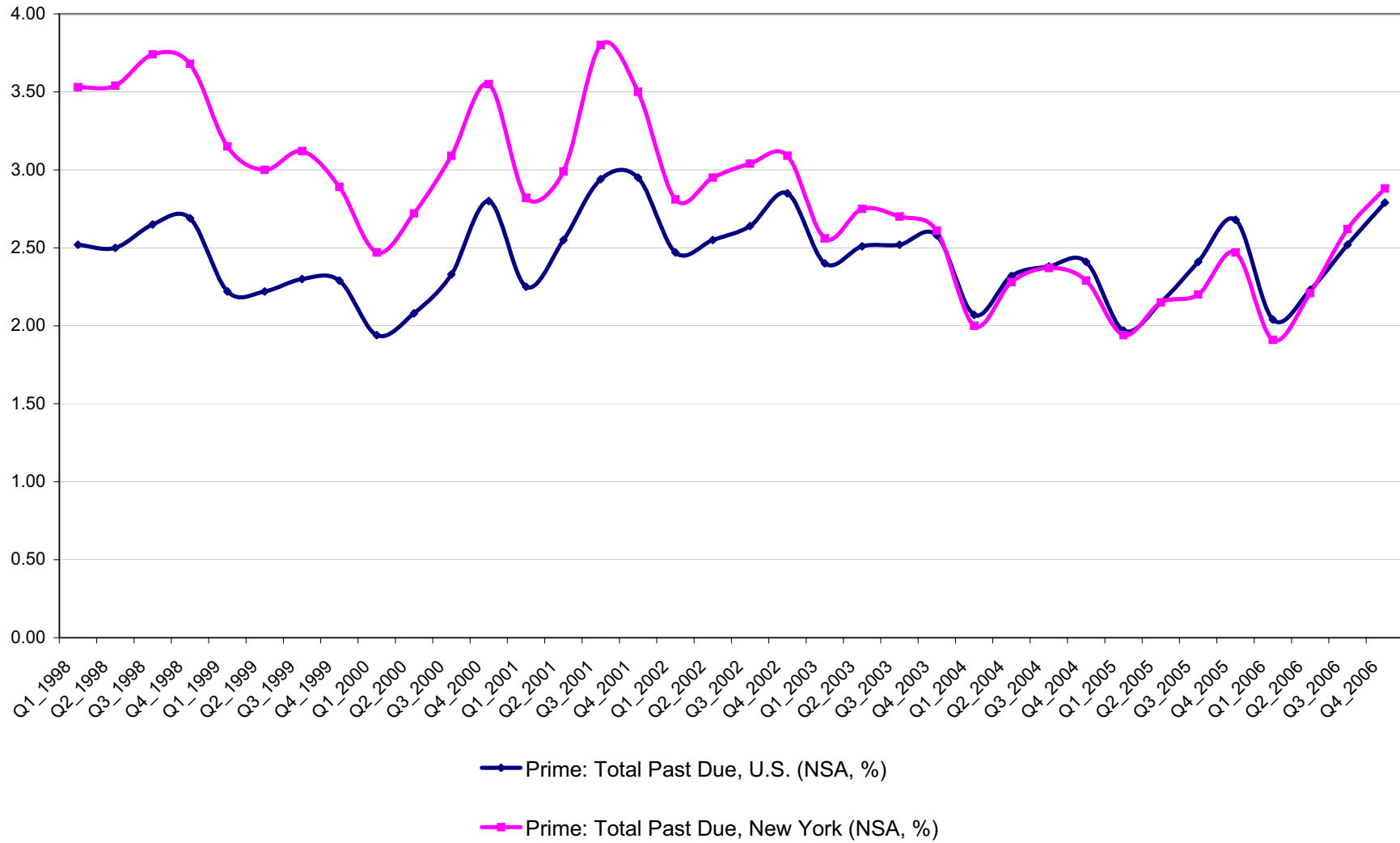
### All Loans, Aggregated: Foreclosure Inventory at the End of Quarter, US v. NY



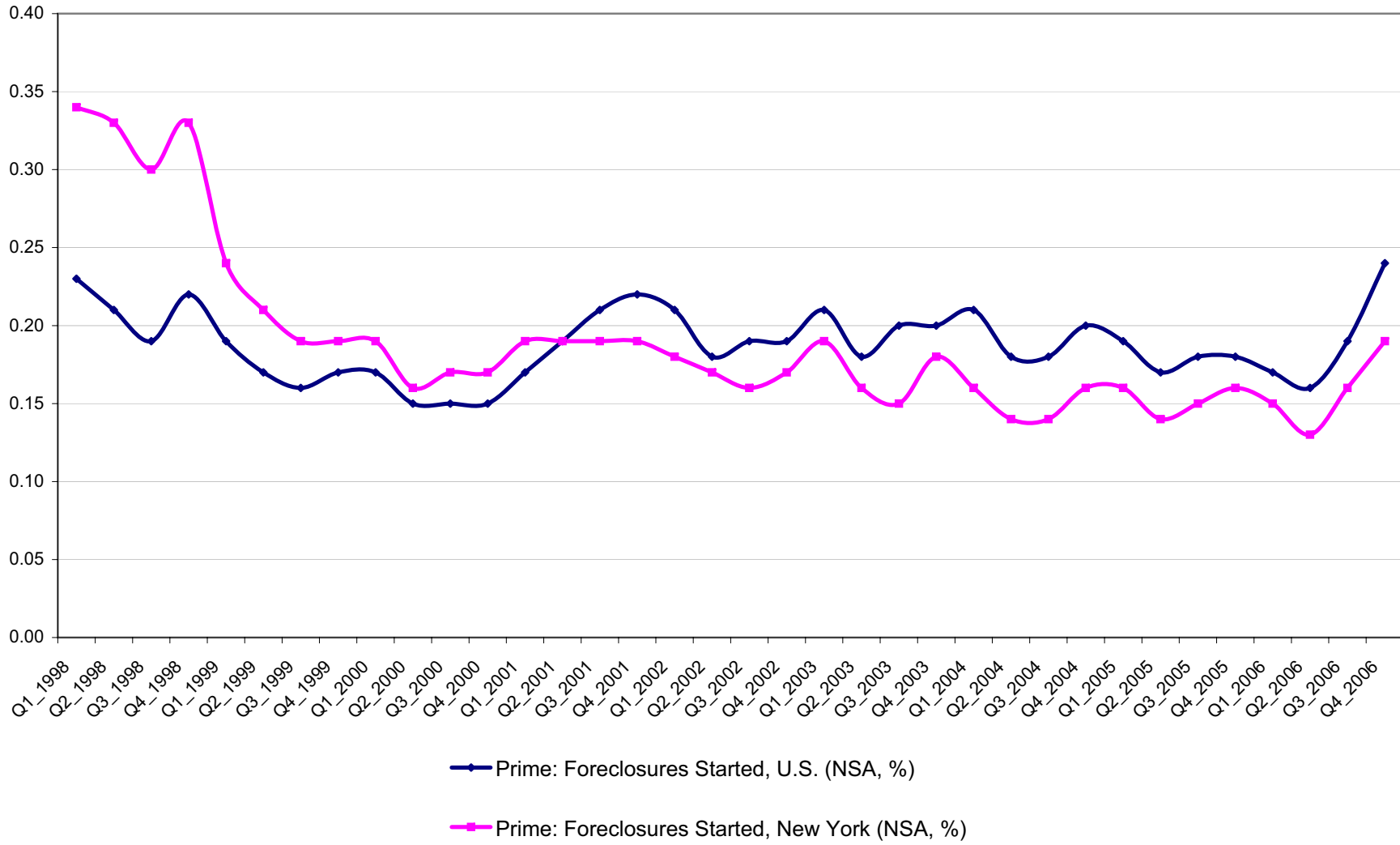
— All Loans in Foreclosure at End of Quarter, U.S. (NSA, %)

— All Loans in Foreclosure at End of Quarter, New York (NSA, %)

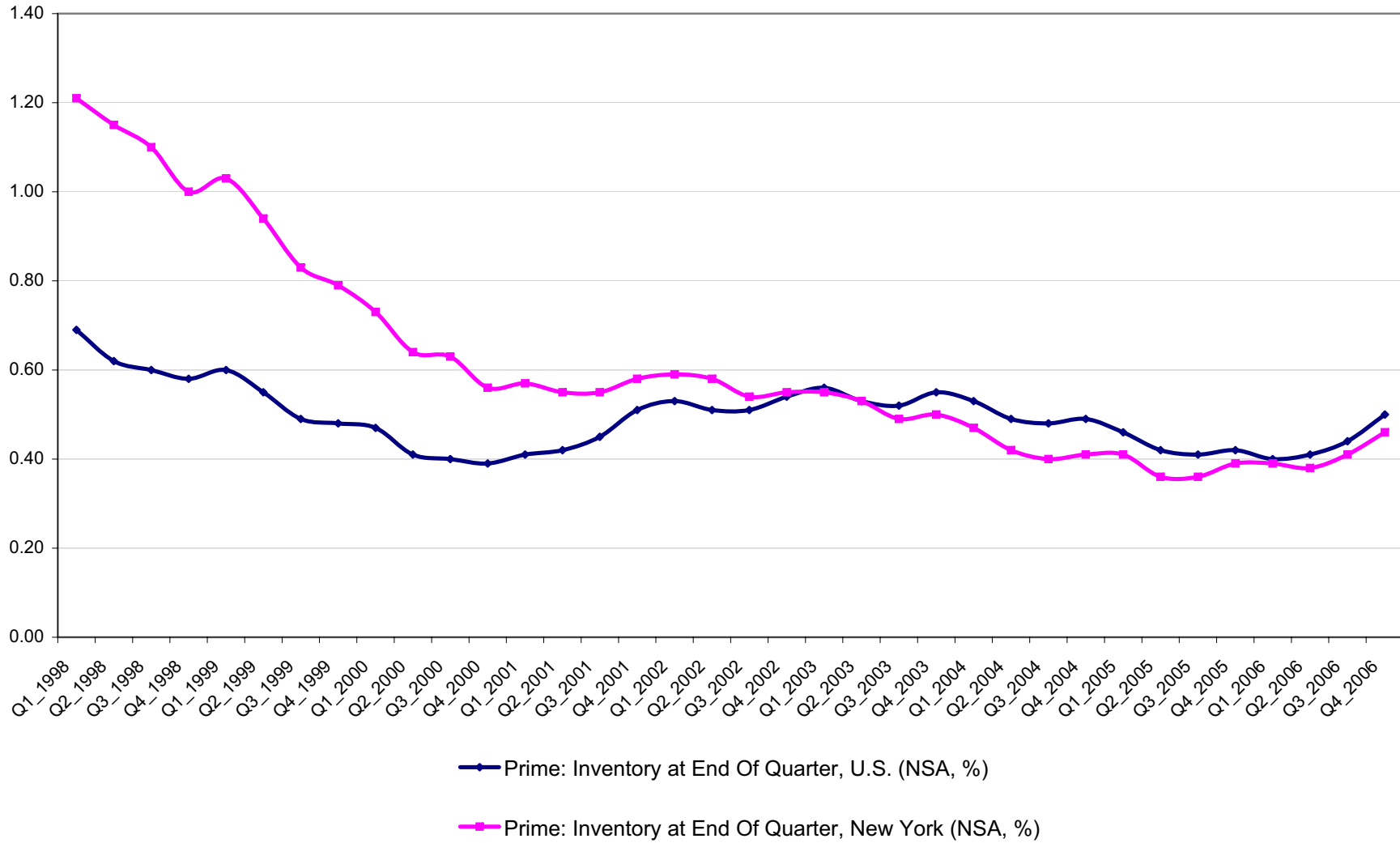
### Prime Loans: Total Past Due, US v. NY



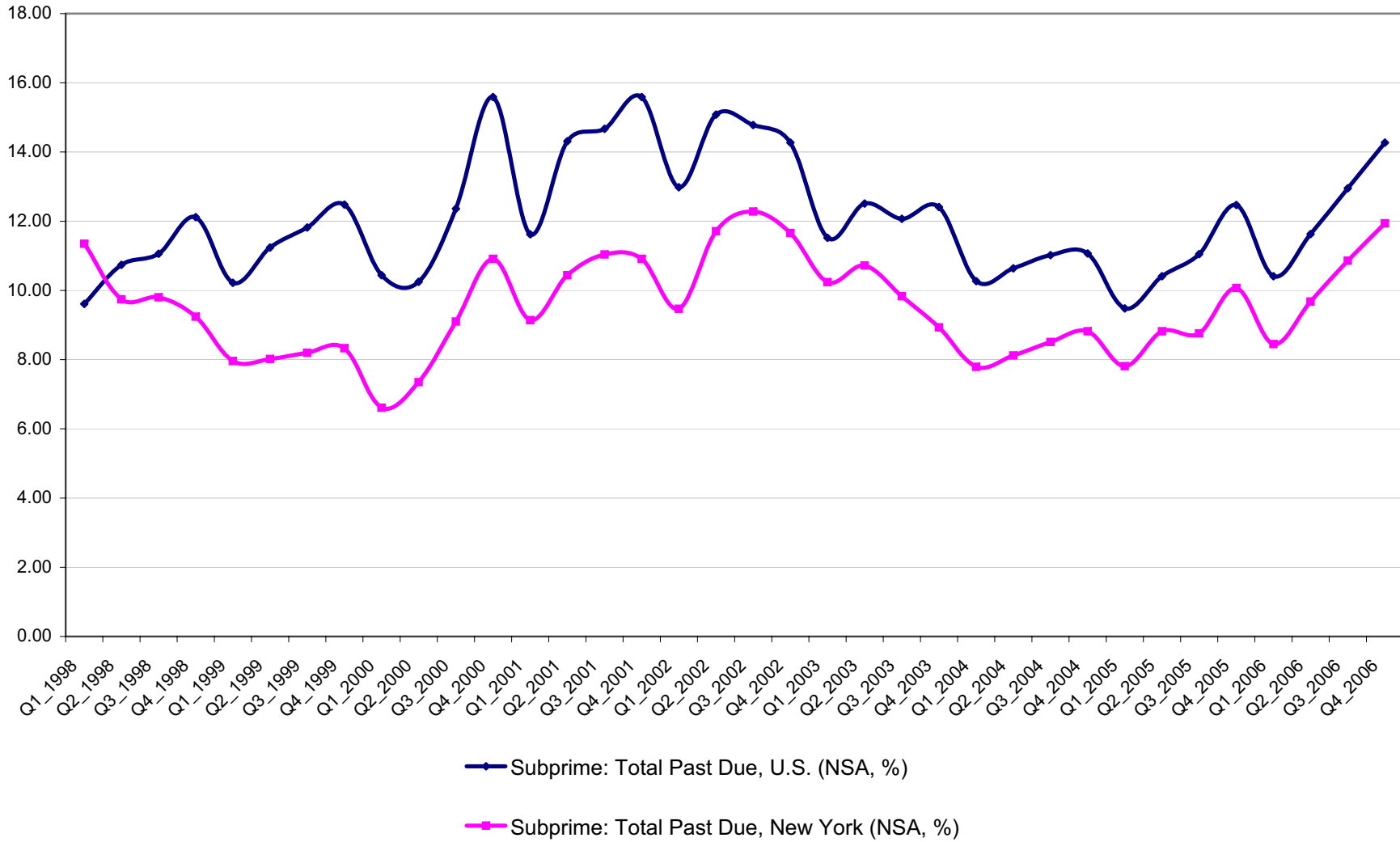
### Prime Loans: Foreclosures Started, US v. NY



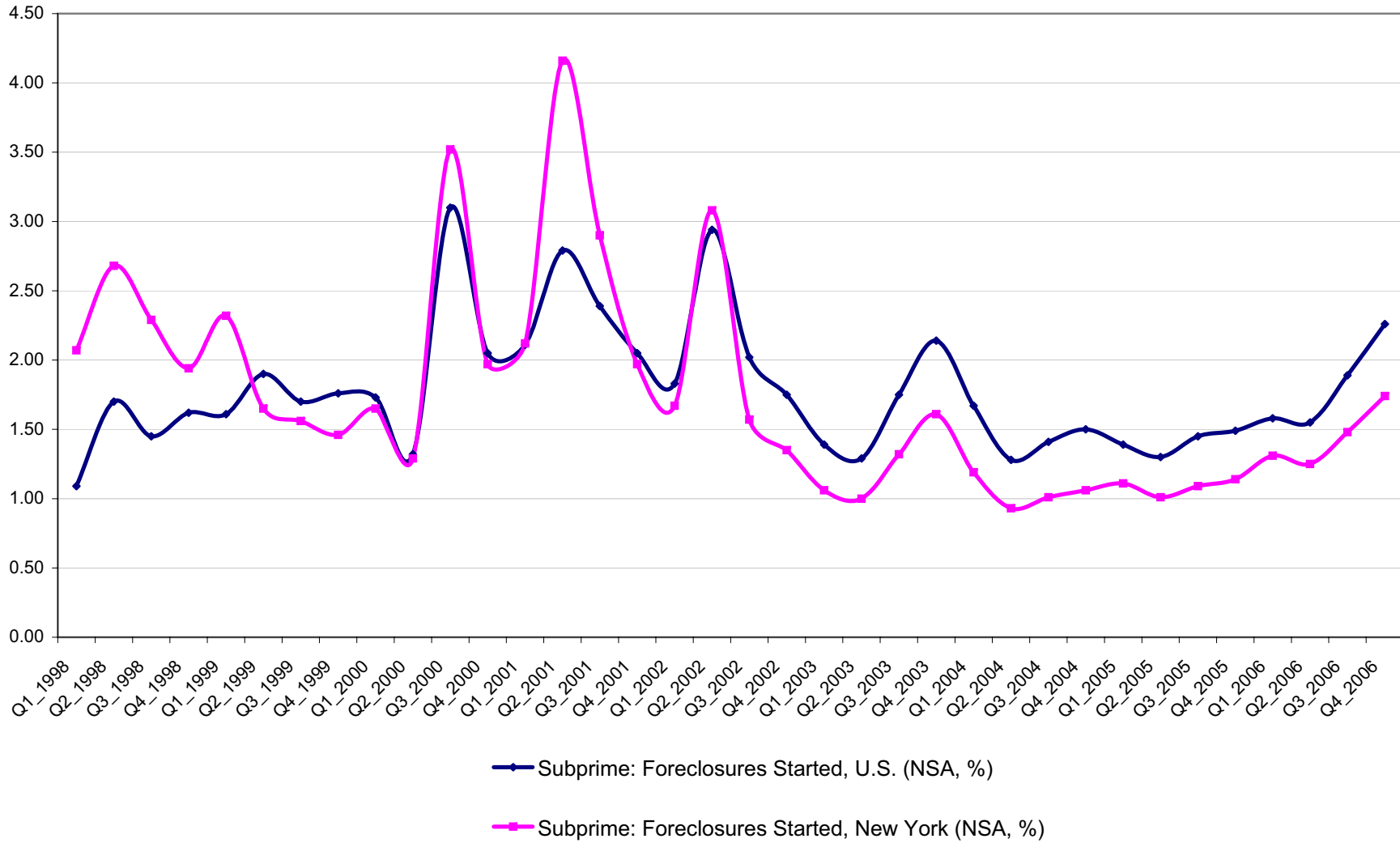
### Prime Loans: Foreclosure Inventory at the End of Quarter, US v. NY



### Subprime Loans: Total Past Due, US v. NY



### Subprime Loans: Foreclosures Started, US v. NY



### Subprime Loans: Foreclosure Inventory at the End of Quarter, US v. NY

