MORTGAGE INDUSTRY UNDER ATTACK: HR3915

A detailed synopsis.

BY HERBERT THOMAS

New predatory lending legislation, HR Bill 3915 entitled "The Mortgage Reform and Anti-Predatory Lending Act of 2007", threatens your future by punishing the mortgage industry and Wall Street for causing the subprime meltdown in 2007 and the large number of potential foreclosures in 2008.

Your future may depend upon your understanding of this threat and your actions to eliminate the portions of this Bill that threaten the future of the industry. I will explain to you what the threats are and their impact on the mortgage industry, if enacted.

HR3915 ("HR3915"), which amends the Truth in Lending Act, was passed on November 15, 2007 by the House of Representatives by a vote of 291-127. HR3915 must still pass the US Senate and then be signed by the President before it becomes law.

I. What are the Three (3) Major Attacks against the Mortgage Industry and Wall Street?:

Attack Number 1: HR3915 creates liability and strict penalties on mortgage brokers for violations of a newly created duty of care standard to borrowers and establishes a national licensing system to identify mortgage originators and hold them accountable for violations of the law.

Attack Number 2: HR3915 eliminates or restricts yield spread premium compensation to mortgage brokers in certain situations.

Attack Number 3: HR3915 creates liability and strict penalties for mortgage bankers, investors and Wall Street securitizers for violations of newly created specific underwriting standards.

II. How will these Three (3) Major Attacks Impact Your Future in the mortgage industry?:

1. Impact of Attack Number 1: Duty of Care Standard and Liability of Brokers Will Result in Uncertainty and Increase Risk of Litigation.

Mortgage Brokers are being unfairly targeted and HR 3915 is not necessary. Most of the predatory lending circumstances have been corrected by market forces. The ability to make loans identified as "predatory lending" have disappeared and been replaced by FHA loans where safeguards are in place to prevent predatory lending abuses. The subprime meltdown in 2007 and the large number of potential foreclosures in 2008 was not the result of predatory lending practices but the result of the "prefect storm".

A. Circumstances under which loans were originally made:

- Borrowers made poor choices of loan programs to pay the least monthly rate, less cash upfront and enabled get the most house available.
- Rapidly increasing real estate prices.
- Historically low interest rates.

B. Change in circumstances that strained loans:

- Declining real estate prices.
- Increasing interest rates.
- Increase in monthly payment due to interest rate adjustments.
- Restrictive underwriting criteria preventing refinancing creating strain which resulted in failed mortgages.

C. Corrective market forces are already curing the predatory lending abuses:

- Over 200 mortgage companies have imploded, many of which were subprime companies.
- Secondary market has stopped buying loans that are deemed "predatory".
- Warehouse lenders have pulled their lines of credit on

subprime lenders.

• Credit underwriting criteria has tightened to eliminate the Subprime market and severely restrict the Alt-A market.

• Mortgage pool ratings and values have dropped thus punishing the Securitizers/assignees on Wall Street for investing in such mortgages.

2. Impact of Attack Number 2: HR3915 will eliminate Yield Spread Premium in certain circumstances.

• It presents a threat to the future of the mortgage broker industry.

• It could force mortgage brokers to become mortgage bankers.

• Elimination of Yield spread premium on Nonqualified loans.

• Difficulty in determining a Qualified Mortgage from a Nonqualified Mortgage with the threat of liability if the determination is later challenged.

• Borrower can finance origination points and closing costs and the broker can receive compensation under certain circumstances.

• This change in doing business may or may not be as agreeable to the borrower who may elect to borrow through a retail mortgage banker instead since yield spread premium does not have to be disclosed.

3. Impact of Attack Number 3: HR3915 will halt the recovery of the mortgage industry by further reducing Liquidity in the Primary and Secondary Markets.

• Risk of litigation to secondary market and Wall Street securitizers and potential loss of investment will cause uncertainty and cut off the source of funding the secondary market and ability to make loans.

• The burden of creating the presumption of qualified mortgage or qualified safe harbor mortgage is difficult.

• This Bill will retard liquidity in the secondary market and thus reduce availability and affordability of credit to borrowers.

• Return of liquidity to the mortgage market is critical to recovery of the mortgage industry.

• Major efforts are being made now to increase liquidity and access to credit in order to allow refinancing and prevention of massive foreclosures, such as Hope Now [freezing Interest for 5 years on certain ARMs], FHASecure, and private efforts with major lenders and servicers to modify existing loans.

• Liquidity is critical to the mortgage industry but will be crippled again by the Bill.

III. A summary of the major provisions of HR3915 are:

1. Liability of mortgage originators for violations of a newly created duty of care standard to borrowers. Each mortgage originator is prohibited from and liable for:

• **Reasonable Ability to Repay Standard.** Steering any borrower to a residential mortgage loan that the borrower lacks a reasonable ability to repay, in the case of an initial loan,

• **Net Tangible Benefit Standard.** Steering any borrower to a residential mortgage loan that does not provide the borrower with a net tangible benefit, in the case of a refinancing, or

• **Predatory Lending Characteristics Standard.** Steering any borrower to a residential mortgage loan that has predatory characteristics or effects (such as equity stripping, excessive fees, or abusive terms) or

• **Qualified Vs. Nonqualified Mortgage Standard.** Steering any borrower from a qualified mortgage to a nonqualified mortgage; or

• **Abusive or Unfair Lending Practices Standard.** Conducting any abusive or unfair lending practices that promote disparities among borrowers of equal credit worthiness but of different race, ethnicity, gender, or age.

• **Liability for Violating Any of the Above Standards.** The maximum amount of any liability shall not exceed an amount equal to 3 times the total amount of direct and indirect compensation or gain accruing to the mortgage originator in connection with the residential mortgage loan involved in the violation, plus the costs to the borrower of the action, including a reasonable attorney's fee.

• **Establishes a national licensing system to identify mortgage originators and hold them accountable for violations of the law.** A national mortgage originators licensing/registration system is already developed and maintained by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators and is a good system that 40 states have signed up to join. Using it to enforce arbitrary standards such as the "reasonable ability to repay" and "net tangible benefit" is an inappropriate use if this registry. It is structured to: [1] license mortgage originators of private mortgage companies with minimum loan originator standards required. [2] Register mortgage originators of federal banking agencies but no minimum standards are required. Loan originators of Federal banking agencies shall be registered as registered loan originators with the Nationwide Mortgage Licensing System and Registry and furnish employee's identity, fingerprints for submission to the Federal Bureau of Investigation, personal history and experience, receive a unique identifier. A nationwide mortgage licensing system and registry shall be established for the residential loan originators that provides a uniform license application and a comprehensive licensing and supervisory database, facilitates flow of information regulators, increases

accountability and tracking of loan originators, simplifies licensing process, easier borrower accessibility to information on loan originators, unique identifier, fingerprints for a State and national criminal history background check, personal history and experience, personal credit report. The minimum standards for loan originator include: no loan originator or similar license revoked in past 5 years, no conviction, guilty plea or nolo contendere plea of a felony during past 7 years, completed a pre-licensing 20 hour education course, passed a written test with score of not less than 75 percent correct answers, annual continuing education course of 8 hours.

2. Elimination or restriction of Yield Spread Premium compensation to mortgage brokers.

• **Elimination of Yield Spread Premium on Nonqualified Mortgages.** No mortgage originator can receive from any lender any incentive compensation, including yield spread premium, that is based on, or varies with, the terms (other than the amount of principal) of any loan that is not a qualified mortgage

• **Retention of Yield Spread Premium on Qualified Mortgages.** The ability to pay yield spread premium on qualified mortgages does not seem to have been eliminated.

• **Restricted Ability to Finance Points and Closing Costs on Nonqualified and Qualified Mortgages.** A borrower may finance any origination fees or closing costs and the loan originator may receive fees or costs (including yield spread premium) if, any only if, full and clear disclosure to the borrower, does not vary based on the terms of the loan or the borrower's decision about whether to finance such fees or costs.

• **Liability for Violation.** The maximum amount of any liability shall not exceed an amount equal to 3 times the total amount of direct and indirect compensation or gain accruing to the mortgage originator in connection with the residential mortgage loan involved in the violation, plus the costs to the borrower of the action, including a reasonable attorney's fee.

3. Liability of mortgage bankers, secondary market and Wall Street securitizers for violations of a newly created minimum mortgage loan standards.

Mortgage Bankers shall be prohibited from and liable for:

• **Reasonable Ability to Repay Standard** making a loan that the borrower does not have the ability to repay,

1. Upon a reasonable and good faith determination based on verified and

2. Documented information according to its terms, and all applicable taxes, insurance, and assessments.

3. Based upon the borrower's credit history, current income, expected income, current obligations, debt-to-income ratio, employment status, and other financial resources, fully-indexed amortization. or,

• **Net Tangible Benefit Standard** on a refinanced loan, the borrower did not receive a net tangible benefit,

1. Upon a reasonable and good faith determination based on verified and documented information.

2. "Net tangible benefit" does not exist if the costs of the refinanced loan, including points, fees and other charges, exceed the amount of any newly advanced principal without any corresponding changes in the terms of the refinanced loan that are advantageous to the borrower.

• **Presumption that Standard is Met: Qualified Mortgage or Qualified Safe Harbor Mortgage.** If the loan is a "qualified mortgage" or a "qualified safe harbor mortgage", then "ability to repay" and "net tangible benefit" are presumed is exist.

• **Definition of Qualified Mortgage.** A "qualified mortgage" means a mortgage with:

1. An APR no more than 3 percentage points of the yield on securities issued by Sec of Treasury with comparable maturity periods or

2. An APR not more than 175 basis points over the most recent conventional mortgage rate or it is a FHA or VA loan.

• **Definition of Qualified safe Harbor Mortgage.** A "qualified safe harbor mortgage" means

1. Income verified and documents,

2. Underwriting process based upon fully-indexed rates and

3. Takes into account taxes, insurance and assessments,

4. No negative amortization,

5. Payments fixed for at least 5 years,

6. APR of variable rate mortgage does not vary more than 3 percent above rate index,

7. Debts over income does not exceed a certain percentage [to be determined by regulation] and

8. Any other requirements later established by regulation.

• **Liability of Mortgage Banker for Violation of Standards.** The liability to the mortgage banker for violation is a civil action against the mortgage banker for the rescission of the loan, and such additional costs.

• **Ability of Mortgage Banker to Cure to Avoid Rescission.** A mortgage banker shall not be liable for rescission if, no later than 90 days after the receipt of notification from the borrower, the mortgage banker provides a cure.

• **Liability of Secondary Marker and Wall Street.** The liability any assignee or securitizer for violation is a civil action against the assignee or securitizer for rescission of the loan and such additional costs as the obligor may have incurred as a result of the

violation, including a reasonable attorney's fee.

• **Ability of Secondary Market and Wall Street to Cure to Avoid Rescission.** No assignee or securitizer shall be liable if

1. No later than 90 days after the receipt of notification from the borrower that the loan violates,

2. The assignee or securitizer provides a cure so that the loan satisfies the requirements or

3. The assignee or securitizer establishes a policy against buying residential mortgage loans other than qualified mortgages or qualified safe harbor mortgages, the policy is intended to verify seller or assignor compliance, exercises reasonable due diligence to adhere to such policy in purchasing residential mortgage loans, representations and warranties that the seller or assignor is not selling or assigning any residential mortgage loan which is not a qualified mortgage or a qualified safe harbor mortgage.

IV. Conclusion

The 3 Major Attacks of HR Bill 3915 threaten the future of mortgage brokers, mortgage bankers, secondary market assignees and Wall Street securitizers by subjecting them to liability for violating difficult and burdensome "reasonable ability to repay" and "net tangible benefit" standards and eliminating certain types of Yield Spread Premium. This unnecessary legislation will cause the liquidity in the mortgage industry to shrink and the recovery to halt. The US Senate needs to remove the 3 Major Attacks from HR3915, and if it does not, then the President needs to veto this bill.

Herb Thomas is President of Thomas Law Firm, P.C., Dallas, Texas, a company providing automated online mortgage licensing technology and services for mortgage brokers and lenders in all 50 states. For more information see http://www.thomas-law.com Mr. Thomas is a Juris Doctor and member of the State Bar of Texas. He has over 17 years of state and federal mortgage licensing experience as well as 35 years of tax, corporate and real estate law experience. He may be reached by telephone at 214-692-7611 and by email at hthomas@thomaslaw.com. Thomas Law Firm, P.C. is the premier mortgage licensing firm on state mortgage licensing.

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