



American Association of Residential Mortgage Regulators

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August 5, 2005

The Honorable Bob Ney
U.S. House of Representatives
2438 Rayburn Office Building
Washington, D.C., 20515

Dear Representative Ney:

The Board of Directors of the American Association of Residential Mortgage Regulators (AARMR), a non-profit association of state regulators of mortgage lenders, mortgage brokers, and mortgage servicers would like to offer comments and perspective from state regulators on H.R. 1295, the Responsible Lending Act. I respectfully submit these views on behalf of the AARMR Board.

AARMR is comprised of 42 member states, the District of Columbia and Puerto Rico that pool their resources and talents through AARMR to train regulatory staff, coordinate regulatory efforts, conduct joint/concurrent examinations and investigations, share information, coordinate with federal regulatory agencies, and discuss policy issues with industry representatives. AARMR member states are represented by the regulatory agencies with primary supervisory and enforcement authority over much of the industry affected by H.R. 1295.

Much of H.R. 1295 will further the intended goal of protecting consumers from unfair and deceptive practices in connection with a high cost mortgage; however, significant consumer abuse can and does exist in loans intentionally structured to avoid the high cost triggers. **At AARMR we are concerned with patterns and practices of predatory lending in all lending transactions, not just those that meet the tests of high cost.** We strongly encourage the inclusion of adequate protections and disclosure requirements for all mortgage loans, not just those meeting the definition of "high cost."

The AARMR Board strongly opposes the sweeping nature of preemption of state laws contained within H.R. 1295. Both the Truth in Lending Act and the Real Estate Settlement Procedures Act have long provided for harmony with state laws that provide "greater protection to the consumer." Consumer protections in state laws have resulted from abusive practices identified at the local level and do not have to be dismissed as an impediment to commerce. The phenomenal growth in the subprime lending market over the last decade is clear evidence that state laws and regulations addressing consumer abuse

have not seriously impeded the ability of lenders to make high cost loans.¹ We note that much of the bill is focused heavily on creditors and not sufficiently focused on mortgage brokers. Mortgage brokers are responsible for the majority of loan originations in the country and H.R. 1295 currently does not adequately address this segment of the mortgage industry. This apparent omission of the dominant segment of the industry will result in a failure to adequately protect consumers.

The broad exemptions provided to mortgage brokers from state licensing laws under Sec. 501 of H.R. 1295 also generate significant concern. Many states define mortgage brokers to include companies allowed exemptions by H.R. 1295 under Section 501(2)(F). **Since H.R. 1295 provides enforcement authority to the states only where companies are licensed, this section of H.R. 1295 effectively removes any state enforcement authority over a large segment of the industry and leaves that portion of the industry virtually unregulated.** For example, mortgage brokers could avail themselves of the creditor exemption provided under Section 501(2)(F)(V) by simply making and selling five, \$200,000 mortgage loans per year despite the fact that the vast majority of the business was performed as a classic mortgage broker.² The Office of Housing and Urban Development (HUD), the Federal National Mortgage Association (FNMA), the Federal Home Loan Mortgage Corporation (FHLMC) and the Veterans Administration (VA) exemptions all provide similar methods to avoid license and regulatory oversight for mortgage brokers and mortgage lenders. Most states have determined that the activities of these four entities are not duplicative of state regulatory oversight³ and therefore do not allow exemptions from state regulation. We are especially concerned with exemptions for the non-government agencies FNMA and FHLMC for a variety of reasons.

State laws have been enacted specifically with consumer protection interests in mind. To impose a sweeping elimination of long-standing and highly effective regulatory coverage of an entire segment of the industry is an alarming proposition. We respectfully point out that two of the nation's largest predatory lending cases: First Alliance Mortgage Co., and Household International, Inc. brought by state regulatory agencies and Attorneys General, involved a classification of mortgage lender that H.R. 1295 would exempt from state jurisdiction. We are concerned that had H.R. 1295 been law at the time, the states would have been powerless to undertake such important and effective actions.

The issues raised above are the AARMR Board's primary concerns with the bill. However, we question other issues in the bill:

¹ Subprime lending grew 25% from 1993 through 2003. Source *Mortgage Statistical Annual March 2004*.

² A mortgage broker is considered a creditor if it makes \$1 million in loans per year.

³ Most state legislatures have determined that the oversight of the federal depository institution regulators is duplicative and therefore provide exemptions from licensing.

1. Points and Fees: Limiting financed points and fees in high cost loans is appropriate public policy. Such transparency will make a costly loan more difficult to misrepresent at the sales table. We are very concerned, however, with the lack of focus on the deceptive use of discount points.⁴ In Section 102, only “Bona fide” discount points appear to be considered. This leaves significant room for abuse as many mortgage brokers and lenders charge loan origination fees disguised as discount points. These non-bona fide discount points give the appearance of a reduction in the rate of interest charged to the borrower (generally by their placement on line 802 of the settlement statement and/or the sales promise of rate reduction) while in reality they are nothing more than origination fees having no impact on the rate whatsoever.

AARMR notes that a number of “legitimate” large lending institutions are known to play this game of discount point misrepresentation. Further, mortgage brokers frequently disclose loan origination fees or mortgage broker fees as discount points, which is clearly deceptive. The definition of bona fide discount points effectively defined non-bona fide discount points; however, H.R. 1295 stops short of banning their imposition. Therefore, we strongly recommend that this bill contain a provision that no lender or mortgage broker may charge or disclose discount points unless such discount points are bona fide.

2. Ability to Repay: The AARMR Board agrees that verification should be required for repayment ability under Section 103(g), however, we are concerned that Section 103(g)(2)(C) Rule of Construction, effectively reverses any verification requirement and removes the burden of proof from the mortgage entity and places it on the regulators. As with the industry, regulators are in need of tools of certainty. For years we have identified situations in which borrowers have knowingly and unknowingly assisted in the commission of fraud by signing statements of income that were false.

The application and underwriting process has employed prudent standards of verification adopted by most of the industry for quite some time. It is far less burdensome to assure compliance through retention of required documentation than to place the burden on the regulator of identifying each violation of Section 103(g). While we do not think that isolated instances of “absence of any means of verification” should be “construed as an assumption of violation,” clearly a pattern or practice of failing to retain verification information should be construed as an assumption of violation.

3. Limitations on Refinancing – Safe Harbor: the AARMR Board supports the anti-flipping language of Section 103(i); however, we are concerned with

⁴ This problem is increasingly identified as an abuse by regulators investigating predatory lenders

the unintended consequences of the Safe Harbor provision under this section. Specifically, we are concerned: i) that borrowers will be presented with a loan amount far greater than is needed or wanted (frequently facilitated by an over-value appraisal) in order to achieve tangible benefit status through cash back, or ii) that tangible benefit will be presumed to have been established by the refinancing of an adjustable rate mortgage with a fixed rate mortgage even though the adjustable rate mortgage was a better loan (e.g. a conservative FHA ARM product refinanced into a high cost fixed rate product).

4. Additional Specific Disclosures: In general, the AARMR Board supports the content of the additional disclosures required by Section 103(k); however, we are concerned with borrowers not receiving these disclosures with sufficient time to make an informed decision. The timing for these disclosures is found in 15 USC 1639(b)(1), and is three business days prior to consummation. There are two potential problems with this: i) “consummation” is undefined, and more importantly ii) if a borrower has been “baited” with a low cost loan and “switched” to a high cost loan just before closing, backing out of the transaction may not be a viable option.

5. Steering Prohibited: the AARMR Board supports the bill’s steering prohibition; however, nothing in Section 103(r) prohibits a creditor from misrepresenting their “best rate” as competitive when in fact it is not competitive. For example, a predatory lender could tell a borrower that they only qualify for a 10% rate, which is the creditor’s best rate, when in fact the borrower qualifies for a 7% rate with a non-predatory lender. Under Section 103(r), no steering violation would have been committed.

Additionally, the prohibition on mortgage broker steering is ineffective if the mortgage broker “regularly does business” with high cost creditors. For example, there is no violation if a mortgage broker regularly doing business with high cost creditors steers a borrower to those creditors despite the fact that the borrower might qualify for lower cost credit.

6. Waiver of Consumer’s Right to Rescind: While Section 105(c) effectively prohibits creditors from requiring, advising or encouraging borrowers to waive their right to rescind, nothing in this section prohibits a mortgage broker from doing such. When a borrower has chosen to work with a mortgage broker rather than a creditor directly, seldom will the creditor be in a position of contact or advice with the borrower.

7. Prepayment Penalties: Section 108 nullifies state laws and regulations that limit or otherwise prohibit prepayment penalties. Prepayment penalties are routinely identified as harmful elements of predatory lending transactions by both state and federal authorities. When misrepresented as a

prepayment “option” or “benefit,” borrowers may not fully understand the significance of the penalty. When misrepresented in conjunction with a high cost predatory loan, the borrower is effectively locked into the harmful transaction for at least the duration of the prepayment penalty. Even when adequately disclosed, prepayment penalties have the ability to severely harm borrowers if other elements of the transaction are misrepresented. For these reasons the AARMR Board requests that Section 108’s preemption of state law and regulation be reconsidered.

8. Escrow and Impound Accounts: The AARMR Board finds no cause for disagreement with Section 301; however we believe that a major predatory practice has been overlooked in this bill. Predatory lenders routinely misrepresent to borrowers that their monthly payment will contain taxes and insurance when in fact it does not. In the alternative, predatory lenders may simply fail to disclose that the monthly payment does not contain taxes and insurance. The purpose of this deception is to make the payments on the new predatory loan appear more attractive than the payments on the borrower’s existing mortgage loan. This “apples to oranges” comparison is very deceptive and further serves to hide the high cost nature of the predatory loan.

The AARMR Board acknowledges the formidable task undertaken in drafting legislation aimed at meeting the needs of consumers while attempting to minimize the burden placed upon industry. In general, and with qualifications discussed previously, we are encouraged by certain consumer protections, such as:

- Lower high cost loan triggers
- Clear identification of bona fide discount points
- Restrictions and disclosures on financed fees
- Loan structuring to avoid coverage
- Prohibitions on encouraging default or skipped payments
- Consumer’s ability to repay the loan
- Prohibition of single premium credit life insurance
- Prohibition on loan flipping
- Additional special disclosures pertaining to interest rate, costs and a borrower’s FICO score
- Limitation on fees and reduction in time of delivery for payoff requests
- Prohibitions on steering
- Notification of credit score
- Increases in civil money penalties
- State enforcement authority
- Establishment of escrow or impound accounts for certain transactions
- Enhanced property appraisal requirements
- Uniform licensing standards for mortgage brokers
- Database of licensed mortgage brokers

Thank you for considering these comments. The general membership of AARMR and the laws we enforce are the first line of defense for consumers in mortgage transactions. We encourage you to adopt enhanced consumer protections without eliminating those we have worked hard to bring to the industry.

Respectfully,



Chuck Cross
President

cc: Members of the U.S. Senate Banking, Housing, and Urban Affairs
Committee

Members of the U.S. House of Representatives Financial Services
Committee

- Members of the Housing and Community Opportunity Subcommittee
- Members of the Capital Markets, Insurance and Government Sponsored Enterprises Subcommittee