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On Focus and In Depth

Mortgage Bill Could Push Lenders Out

American Banker | Tuesday, March 31, 2009

By [Stacy Kaper](#)

WASHINGTON — House Financial Services Committee Chairman Barney Frank's bill to curb risky mortgage lending is sparking concerns that it could push some major players from the market and leave borrowers with little choice but 30-year fixed loans.

The bill, introduced late last week as a centerpiece of Frank's agenda, is significantly tougher than a similar measure the House passed two years ago. Among other changes, it would require loan originators to retain at least 5% of the credit risk of a mortgage, and it would give liability protection only to loans with a 30-year fixed rate.

"This would return mortgage lending back to the 1950s and has a limiting effect on mortgage products," said Scott Talbott, a senior vice president for the Financial Services Roundtable.

The overall impact of the 151-page bill was unclear Monday, with industry lobbyists still combing through it. But many said that if it passed in its current form, it would fundamentally alter the mortgage market.

"Everything in here is going to have a profound change on the way in which the mortgage lending business is carried out," said Steve Zeisel, a vice president and senior counsel at the Consumer Bankers Association. "There is nothing small about this."

The bill remains based on the Frank legislation that was passed in 2007 but not picked up by the Senate. The crux of the measure would establish basic underwriting standards to ensure borrowers qualify only for loans they can repay and would increase liability throughout the mortgage chain to ensure accountability.

It would provide banking regulators with discretion to write rules to help determine whether a loan is affordable or — in the case of refinancings — provides a net tangible benefit to the borrower.

The bill also includes penalty provisions that would let borrowers sue and even rescind a loan that fails to comply with the bill's standards, but it would offer a safe harbor to loans that fall within certain guidelines.

Qualified safe-harbor loans are defined as 30-year, fully indexed, fixed-rate loans with an annual percentage rate that does not exceed the average prime rate offer by more than 1.5 percentage points for the first lien, or 3.5 percentage points for any subordinate lien.

To be covered by the safe harbor, the borrower's income would have to be verified and documented, and the loan would have to meet a debt-to-income ratio test prescribed by the federal banking regulators.

Industry representatives said the safe harbor is too narrow and would effectively force lenders to stop offering adjustable-rate mortgages, or even 15-year fixed ones, for fear of liability.

"The goal should be to find safe-harbor provisions for mortgage products like the 15-year and the 20-year or even adjustable-rate mortgages," Talbott said.

Francis Creighton, the head lobbyist for the Mortgage Bankers Association, said it is also concerned the bill as drafted could overly restrict access to adjustable-rate products and other consumer choices.

"Different consumers need different mortgage products," he said.

Industry representatives are also raising issues about the proposed 5% risk retention standard. Frank is attempting to ensure lenders have some "skin in the game." The Massachusetts Democrat has said the financial crisis was caused in part by originators who sold loans without concern about whether a borrower could repay them.

But the standard would effectively require lenders to continue to hold capital against the mortgages they originate, regardless of whether they were sold off. Many nonbank mortgage companies, which typically hold much less capital than banks, could be forced out of the market by the change, according to industry observers.

"What if you are a nondepository lender that doesn't have a capital basis?" Creighton asked. "They essentially have a business-to-business loan from a lender. ... It will be very difficult for certain kinds of businesses to operate under that sort of situation, particularly independent mortgage bankers who depend on warehouse lines of credit."

Laurence Platt, a partner with K&L Gates LLP, said the risk retention standard would make mortgage financing a bank-only line of business.

"The single biggest issue is the risk retention issue," he said. "That will put non-depository institutions out of business because they won't have the capital to hold against that risk. By definition, nondepository institutions don't have deposits that they can use as capital. ... It means no more mortgage companies. It leaves the world to banks."

The idea of making finance companies retain skin in the game is a misnomer, Platt said.

"There is no skin on a corpse," he said. "In other words, it will kill them."

Talbott said the requirement would have a "negative impact on reserves."

"You would have to set aside reserves for that potential liability which would take capital away from loans and other products," he said. "We are supportive of the concept but we have concerns with 5%."

Jerry Buckley, a partner with BuckleySandler LLP, said that at a time when credit is so constrained, the government is issuing new initiatives every week, and bank examiners are cracking down harder on existing enforcement standards, posing a bill now that raises significant uncertainty could exacerbate the mortgage market.

"This is not happening in a vacuum," he said. "There is so much here to be digested, and there are so many changes that create significant uncertainties regarding lender liability. Anyone who is asking, 'Should I let making mortgage lending credit flow more profusely?' would have to take pause. ... I wonder if this legislation and the process of considering it may cause some to hang back and say, 'Maybe I ought to wait and see,' and that is not going to be good for the economy."

The bill also raises other questions. For example, lobbyists said if its liability provisions applied to lenders conducting loan modifications or refinancings — some are interpreting the measure that way — it could have a chilling effect on foreclosure mitigation efforts that are under way.

Other industry lobbyists cited a provision that would protect tenants renting properties on which lenders foreclose. Under the bill, banks owning the title would have to let the renter stay out the lease, effectively becoming the landlord for the property.

Frank had initially scheduled a committee vote on the bill for today, but he postponed it until after the Easter recess.

House Republicans had complained last week that they had not had time to digest the bill, and they urged

Frank to postpone the vote.

Even if the bill won House support, its fate in the Senate would be unclear. Senate Banking Committee Chairman Chris Dodd has committed to reforming the mortgage market, but he has not introduced his own measure.

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