MBA

Mortgage Bankers Association of America

January 31, 2001

Robert E. Feldman
Executive Secretary
Attention: Comments / OES
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429

Re: Comments—Draft Staff Advisory Memorandum: How to Avoid Purchasing Or Investing In Predatory Mortgage Loans (November 2000)

Dear Mr. Feldman:

The Mortgage Bankers Association ("MBA") appreciates the opportunity to submit comments on the draft advisory memorandum regarding purchasing and investing in predatory mortgage loans. The MBA is a trade association representing approximately 3000 members involved in all aspects of real estate finance. Our members include national and regional lenders, mortgage brokers, mortgage conduits, and service providers. MBA encompasses residential mortgage lenders, both single-family and multifamily, and commercial mortgage lenders.

The MBA fully supports the FDIC's initiative to inform its member institutions and resolve important issues surrounding abusive, or so-called "predatory," mortgage lending activities. MBA also commends the FDIC for taking the initiative to engage the public and the mortgage lending industry in a dialogue before releasing advisory opinions to its member banks. A full understanding of the issues based on complete and reliable data—not on anecdotes—is the only responsible way to address the important issues of abusive mortgage lending.

The MBA shares in the concerns about reports of abusive mortgage practices and has remained committed to eliminating unscrupulous lending activities. We, however, have serious concerns about the advice set forth in the FDIC's draft memorandum. Our reservations extend not only to the specific details of the proposal but also to the negative consequences that are certain to flow from the issuance of an advisory of the type contemplated here.

MBA believes that the FDIC Draft Advisory does not provide adequate and functional advice to lenders because it omits basic and essential guidance on the definition of "predatory" lending. The MBA believes that by not clarifying what constitutes "predatory" activity—the FDIC sets forth an unnecessarily vague standard of care that renders compliance with this Draft Advisory impossible and creates possible conflicts with CRA and other requirements. MBA warns that in its current form, this memorandum will lead to the creation of novel standards of diligence that could significantly expand liability for financial institutions. MBA fears that the unintended consequences will be to increase lenders' costs and exposure to risk. We also believe these standards will inadvertently contribute to the diminution of credit to subprime borrowers.

MBA respectfully requests that the FDIC refrain from publishing this advisory until the definitional issues are adequately resolved.

Introduction

Over the past few years, the mortgage lending industry has changed dramatically. The majority of these changes, which include new mortgage products, greater automation in the mortgage origination process, greater efficiencies, and the entry of new players into the field of mortgage lending, have greatly increased the availability of mortgages for American families who otherwise would not have been able to afford their own home. Much of this new lending has taken place in what is called the "subprime" market. This sector of the market focuses on a portion of the population composed of consumers that, for various reasons, have less than stellar credit records or other flaws. These consumers can very often still be considered viable credit candidates, often with the assistance of financing options that serve to mitigate the risks and achieve a balance between the consumers credit needs and the lenders goals of controlling risk. These innovative financing tools grant many credit-impaired individuals the opportunity to obtain loans that they would otherwise not receive in the traditional credit market.

There are, however, reports that the expansion of this new market area may have brought with it an increase in abusive and predatory lending practices. These abusive predatory lending practices harm all of us—borrowers whose financial lives are devastated, communities that must deal with the aftermath, and reputable lenders who suffer from "guilt by association." The discussions and attempts at resolving mortgage lending abuse are, however, plagued with ill-defined terms and misinformation, and driven by anecdote, as opposed to solid, market-wide information. In crafting solutions for the problems of abusive lending, regulators must advance thoughtfully and carefully to assure that additional rules promote, rather than restrict, credit extension to needy populations.

Lack of Adequate Definitions

MBA notes that the threshold question of how to define "predatory lending," or what constitutes "abuse" in the context of mortgage lending, remains unanswered. The terms "predatory lending" and "subprime lending" continue to be used interchangeably, and it is often openly asserted, for example, that higher-than-normal interest rates or the presence of certain terms, such a balloon provisions, are inherently predatory. These fallacies continue to make the discussion of addressing predatory lending particularly difficult. The absence of definitions in the FDIC's letter only confirms that there is still no consensus on a premise from which to advance in developing workable solutions.

To date the various regulatory agencies with jurisdiction over mortgage credit practices have failed to provide any consistent guidance on what constitutes "predatory lending." Those regulators that have attempted to craft comprehensive definitions have opted to provide either "categories" under which the abuses "tend to fall,"[1] or simply advancing descriptive examples and anecdotes of the more common abuses that they may have observed in the market.[2] Under either approach, however, the fundamental definitional issues are left unanswered.

We believe that until the regulators are able to define what constitutes "predatory lending," efforts such as these to develop a system of due diligence to identify "predatory" practices are premature. The current state of confusion mandates that the FDIC take pause—sound advice to the affected industry and remedial action aimed at protecting the public are both impossible unless the problem to be addressed is identified with precision.[3]

Specific Comments on FDIC Definitions

Despite uncertainty regarding what constitutes "predatory" or "abusive" behavior in the context of mortgage lending, the FDIC's Draft Advisory is premised on the assertion that "[p]redatory loan characteristics and practices are well known." Rather than defining this term, however, the FDIC sets forth a non-exclusive list of loosely drafted examples that may or may not, depending on their setting and frequency of occurrence, constitute a "predatory loan." The Draft Advisory states that "[t]his guidance suggests steps to identify some of these characteristics."

MBA's is concerned that the examples provided by the FDIC as indicia of "predatory" lending under Part One of the memorandum are so vague and ambiguous that they fail to properly define the problem. We request that the FDIC revisit this portion of the memorandum, as it provides the base for the entire due diligence system being proposed. Our comments are as follows—

- *"Loan Fees and Interest Rates Higher Than Necessary to Cover Profit and Risk"*

MBA agrees with the intent of this well-meaning provision, but believes that this is an impossible standard to apply for various reasons. First, it is not possible for regulators to properly define what rates are necessary to "cover profit and risk" in a free market system. Government incursions into rate setting in the area of mortgage lending have repeatedly failed. For example, under the Real Estate Settlement Procedures Act

[1] See, e.g., HUD/Treasury Report, at p.2
[2] See Board Notice of Public Hearings and Request for Comments, at p.3.
[3] This lack of adequate definitions at federal and state levels, and the problem of lack of organized and coordinated data on predatory lending is confirmed at length in a recent report issued by the Senate Banking Committee Staff to Chairman Gramm, released in August 2000.

(RESPA), the Department of Housing and Urban Development has, after various attempts, never been able to provide adequate standards or guidelines as to what constitutes a fair or "reasonable" level of fees or compensation for ancillary settlement services. It is instructive that, after 25 years of administering section 8 of RESPA, the Department's regulatory advice offers only that, in order to be deemed "reasonable," fees must be "commensurate" with prices in the same area or locality. The Truth in Lending Act has a similar requirement for purposes of exclusions under its APR calculations. The Board, equally confounded, has not been able to provide any workable guidelines and has, in effect, adopted the vague and unenforceable RESPA standard as its own definition.

More importantly, MBA respectfully submits that attempting to promulgate standards of reasonableness in pricing or profits is inappropriate in FDIC regulatory pronouncements. Price levels are dependent upon many considerations, including supply and demand of the instrument in question, rate of return preferences on the part of investors, and a myriad of other costs and factors that vary across markets and with time. We believe the FDIC should not intrude into a sphere currently reserved to market forces.

- "*Excessively priced products, such as single premium credit life insurance*"

The MBA submits that the wording of this example leads to the incorrect conclusion that all single premium credit life products are "excessively priced," and we believe this is incorrect. The reality is that states closely regulate rates of credit insurance products. Insurance companies generally cannot write insurance at higher rates than those deemed "reasonable" by the state insurance department unless the increase is warranted and specifically approved.

Moreover, we believe it is inappropriate to suggest that single premium products are *per-se* unreasonably priced or "predatory." The MBA agrees that the "packing" of credit insurance products or the fraudulent inclusion of this product without the consumer's knowledge should be prohibited. The MBA also agrees that single premium insurance may not be appropriate for everyone. However, the characterization that lump-sum insurance products are inherently overpriced or that this product is "predatory" *per se* is unwarranted.

- "*Large prepayment penalties that make it difficult to refinance affordably*"

The MBA submits that it is important to note that prepayment penalties are legitimate financing tools that allow lenders to cover their costs in cases of early loan repayment or refinancing. As such, they are used as a means of obtaining better rates for borrowers; sometimes enabling lenders to accept risk levels on loans that they would otherwise not accept. Protecting against the risk of early loan repayment is particularly important in subprime lending because these borrowers are more likely to seek to refinance to lower rates before the lender has had the opportunity to recover origination expenses which are generally higher for subprime loans. As the FDIC has acknowledged as part of its capital standards rule, it has proven extremely difficult to adequately estimate prepayment risk.[4] There is, therefore, no uniformity in the market, and each lender sets these penalties depending upon the market or the needs and circumstances of the lender or investor. Market realities render it virtually impossible for secondary market purchasers or investors to ascertain whether a prepayment penalty is "large" without fully inspecting the specifics of the market and the transaction.

The MBA believes that the wording of this example is so vague as to render it meaningless. For example, how in this context is the industry to determine "affordably"? Further, how "difficult" must it become to refinance before the unaffordability of the prepayment penalty crosses the line into "abusive"? If the penalty is "small" by all objective measures in the relevant market, must it still be judged under the "difficulty" and "affordability standards"? We believe his provision sets an excessively vague standard that lenders will not be able to meet and that, more disturbingly, will be subject to varying judicial definitions and interpretations.

- *"Balloon payments likely to result in default and foreclosure"*

Again, we believe this provision is unclear and impossible to implement. This standard provides no bright-line test; it merely advises that lenders do the impossible—look forward in time to guess whether there could, at some point, be a default or foreclosure. But the example is misguided because of more fundamental reasons. Balloon notes can be harmful, not because they call for early lump-sum repayment, but because they are undisclosed and inserted without the knowledge of unsuspecting or unsophisticated borrowers. When they are inserted as hidden terms, unscrupulous lenders take advantage of the surprise to force their victim into refinances under very oppressive terms. The MBA submits that the memorandum is unrealistic in its expectations that, by merely inspecting the balloon terms contained in the loan documents, a secondary market actor will be successful in unraveling an originator's fraudulent methods. MBA believes that the only real protection for the public is to require that balloon terms be fully and clearly disclosed prior to closing, and <u>not</u> in forcing the purchaser of the loan to delve into the negotiation process to ascertain what the originator promised to the applicant and whether the "balloon" was part of the bargain.

- *"Mandatory arbitration provisions"*

MBA disagrees that mandatory arbitration is in any way indicative of a "predatory" loan. The United States Supreme Court has consistently expressed its favor for this method of dispute resolution, recognizing that it provides fair, speedy, and inexpensive resolution to claims without the expenses and complications of litigation.[5] Congress has also frequently affirmed a national policy in favor of arbitration agreements and as an

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[4] 65 Fed.Reg. 57993, 57995 (Sept. 27, 2000).
[5] <u>See</u> <u>Green Tree Financial Corp. v. Randolph</u>, --U.S.--, No. 99-1235 (Dec. 11, 2000); <u>Gilmer v. Interstate/Johnson Lane Corp.</u>, 500 U.S. 20, 24 (1991).

alternative to litigation.[6] In effect, the efficiency and cost-saving benefits of arbitration ultimately reduce costs for lenders and consumers alike.

MBA urges the FDIC to delete this item from the list as we believe it suggests that mandatory arbitration is unethical which is clearly contrary to repeated judicial and legislative pronouncements, and therefore is simply contrary to public policy.

- *"Underwriting based on value of collateral rather than borrower's ability to repay"*

MBA believes that lenders must always follow prudent underwriting standards based on the borrower's ability to repay a loan. We point out, however, that it may be a mistake to assume that all underwriting based on the value of the collateral is abusive. The reality is that lenders often place strong reliance on the value of the collateral in loans where borrowers are unable (or unwilling) to prove actual income. Self-employed individuals, business owners that lack adequate employment history, recently widowed individuals, recent immigrants, or foreign nationals that lack documentation—in all of these cases, lenders would have to rely, perhaps exclusively, on the value of the collateral because traditional lending standards require at least two years of employment history. Without more guidance on actually identifying the abusive practice, the use of this example as an indicia of "predatory" lending is misguided.

MBA's concerns regarding the absence of definitional standards in this Advisory extend beyond the mere wording and articulation of the memorandum. More generally, MBA objects to the approach of defining so-called "predatory lending" through the use of examples. In attempting to provide guidance exclusively through illustrations, the FDIC accentuates only those terms that are included in the list. Without a comprehensive definition to temper this itemization and provide a fuller context for the exercise of judgment or discretion, this illustrative listing will concentrate attention only on the specific items listed therein. In effect, it forces a mechanical application of this Draft Advisory, leaving no room to engage in what should be the proper analysis of abusive lending—discerning the impact of the specific loan features given the totality of the circumstances of that transaction. As the FDIC observes in the text of the memorandum, abuse is not determined by "a few occurrences of these characteristics," but rather by "circumstances surrounding the loan." This memorandum leads to the opposite result—the codification of "abusive" practices through a list will, without doubt, result in their *de-facto* prohibition. Cautious compliance officers will simply rid their portfolios of the codified terms since they become, in effect, proxies and indicia of "predatory" lending.

When applied to real life circumstances, such features as balloon payments and prepayment penalties will become the narrow object of the scrutiny, without any further consideration of the usefulness of those terms under the circumstances. Likewise, a Good Faith Estimate irregularity coupled perhaps with the payment of a yield spread premium may, absent proper definitional guidance, be flagged as inherently "predatory."

[6] See 15 USC §§ 6601-6617 ("Y2K Act").

There is nothing extreme about these examples; in the absence of stricter guidance in the definitions that clearly describes that the scrutiny is broad and encompasses the totality of the circumstances, the narrow and isolated examples contained in the Draft Advisory will control the due diligence review.

In addition, the use of itemization may also lead lenders to altogether disregard other harmful terms or practices that also lead to abuse and equity stripping. The lack of an overarching definition leads to a standardless application of the written word. With such an approach, if the abuse is not specifically described in the list, it will not be considered as potentially "predatory."

Threat of Expanded Liability

MBA believes that the lack of definitional specificity not only makes the overall due diligence plan unworkable, it also has the potential to make the Draft Advisory enormously threatening from the point of view of lender liability. Through this memorandum, the FDIC is constructing an entire new system of due diligence controls that will now be subject to a further layer of examination review. Although the memorandum announces that it is merely "advisory" and "suggestive," the MBA is concerned that this issuance will give rise to a standard of strict enforcement as its contents are implemented into examination manuals. We note that the very nature of the bank examination process, and the demands placed upon individual examiners as they perform their many duties, will convert mere "suggestions" of the memorandum into "black letter law." In due course, this Advisory will grow and acquire the force and effect of a regulation, and its vagueness and lack of precision will translate into significant penalty repercussions for financial institutions that are subject to them.

MBA is also seriously concerned that the Draft Advisory will have the certain effect of expanding public, as well as legal, expectations with respect to the duties of member institutions. As published agency guidance, the perception will be that this memorandum is binding and must be followed strictly. This sets up a trap for financial institutions. By leaving open the definition of what exactly is encompassed within the term "predatory," the Draft Advisory creates a situation where single instance of default, or every subsequent discovery of "suspicious" terms in a purchased loan portfolio, will create a "presumption" of malfeasance. It is of no import that the lender maintained tight screening methods—even the strictest of systems cannot identify abuses that are either too loosely described or that are only subsequently added to the screening list. Nor will rigid screening ever be entirely effective in discovering terms and abuses that are designed to be concealed by unscrupulous and fraudulent methods.

Comments on "How to Avoid Purchasing Predatory Loans"

The second part of the Draft Advisory outlines a three-step process to allow purchasers to identify mortgage loans that might be "predatory." MBA generally agrees with the FDIC's broad recommendations that lenders take affirmative steps to learn about originators. The recurring problem, however, is that without clarifying the definitional issue of what constitutes "predatory" behavior, the specific steps outlined by the FDIC in this section will also prove ineffective. Regardless of how complete and how detailed the FDIC's due diligence advice purports to be, it will not succeed in its aims if it does not properly identify the harm that the due diligence review means to identify.

Further, MBA believes that the recommendations set forth by this part are likely to prove more onerous than anticipated by the FDIC. For example, it is not an easy task, without substantial efforts on the part of the prospective purchaser, to identify whether the originator's practices concerning "sales and marketing activities" are pristine and fully compliant. This will take more than a mere "look" as the Draft Advisory suggests. In order to undertake a proper review and ascertain that an originator is not misleading and is indeed offering the products it advertises under "Step One" of the analysis, the prospective purchaser will have to engage in a "Step Three" review of the originator's loan files. Also daunting is ascertaining whether there are complaints and litigation involving the specific loan originator. MBA is not aware of any comprehensive, reliable and up-to-date data base that assembles this information. To the extent that it exists, it is likely to be expensive to access and incomplete.

The Draft Advisory goes on to recommend two additional steps in the due diligence review that should be undertaken to the extent that information uncovered under "Step One" justifies the additional scrutiny. These further measures include reviewing underwriting and compliance programs and reviews of sample loan files. MBA notes that, in light of the limited information available to loan purchasers that are one step removed from the origination stage, these additional "full" reviews will be extremely time-intensive and involve significant costs. Moreover, engaging in the type of due diligence set forth in the memorandum will require specialized skill and expertise. To properly meet this standard, institutions will be required to hire additional staff to concentrate exclusively on this task. There is strong potential that the burdens associated with these reviews will lead many lenders to simply avoid such costs and purchase only conventional "vanilla" loans, shunning subprime purchases altogether.

In addition, our concerns extend beyond the additional burdens of the advice as written. As with any other standard of care that is imposed upon any other industry, the reality of our legal system is that such standards always extend and give rise to their own duties and liabilities. Even under the general "suggestive" advice set forth in the FDIC memorandum, liability will ensue for oversights in the review process or for failing to engage in that level of review that any court may see fit under the circumstances. Given that the memorandum combines vague definitions with very defined advice on due diligence review, it is entirely possible that, in the end, purchasers will be deemed "guarantors" of the originators' activities, and will be burdened with all the liabilities and legal responsibilities that belong at the retail level. To avoid such a transfer of liability, financial institutions will likely refrain from purchasing subprime loans altogether. Therefore, the repercussions of the Draft Advisory will take our industry one step backwards. Lenders will respond by eliminating subprime purchases since it is accompanied by expensive regulatory and due diligence complications and pose the risk of transferred liability. MBA believes that this will ultimately result in a significant drop in the flow of capital to the subprime market.

Comments on "How to Avoid Investing in Securities Backed by Predatory Loans"

Although MBA generally supports the concept that financial institutions review the reputation, performance and ratings of those issuers of mortgage-backed securities with whom they deal, our comments regarding added burdens and increased legal risks apply with equal rigor to this portion of the Draft Advisory. Under the terms of this memorandum, prospective purchasers of mortgage-backed securities will be required to conduct reviews to uncover the same type of information sought to be uncovered in the purchase of whole loans. Again, in light of unclear definitional guidance, purchasers are likely to incorrectly apply the specific characteristics contained in the Draft Advisory as indicia of "predatory" behavior regardless of whether such characteristics are legitimate when viewed in the context of the total circumstances surrounding the specific transaction.

MBA fears that the burdens of the FDIC's due diligence directives will have an even more onerous effect on investors seeking to purchase mortgage backed securities. This will occur because the search for "predatory" loans is simply too difficult and too subjective to be undertaken at this late stage of the mortgage process. The subjectivity results largely from the fact that none of the "indicators" of "predatory" behavior that the FDIC outlines in "Part Three" of the Draft Advisory are inherently illegal. It is simply not feasible, for example, to come to fair and objective conclusions about underlying loans by superficially reviewing loan distributions regarding market rates, "percentage of loans in a pool subject to prepayment penalties," or "distribution of loans with unusually low FICO scores." None of these "indicators," by themselves, suffice to prove that the originator engaged in foul play; they are merely "suspicious" and the memorandum suggests only that they be "flagged." Once identified, investors are then instructed to somehow leap to legal conclusions about whether the "indicators" do or do not translate into "predatory." In short, it is difficult, if not impossible, to divine an originator's intent or the appropriateness of the loan itself merely on the basis of combinations of specific characteristics.

Aggravating the subjectivity is that purchasers of mortgage-backed securities are one step further removed from the point where the "predatory" offenses actually occur. Again, it is simply unreasonable to expect a securities purchaser to make complex legal conclusions and judgments regarding the existence of "predatory" lending practices based on derived information such as reviews of statistical data in a prospectus, assessment of levels and types of credit enhancement, or discussions with securities underwriters.

These warnings should not be read to reflect that MBA is calling for inaction on issues surrounding abusive practices in the mortgage market. To the contrary, the MBA has long advocated for increased policing and more rigorous enforcement of consumer protection laws. But the efforts to curb these abuses should be undertaken with energy and using the appropriate level of resources <u>at the very point where the abuses occur</u>.

The efforts to remedy abuse and rid the industry of predators cannot be delayed to later stages of the process, where the harm is already done and the costs of adequate review of originators' practices by purchasers of mortgage-backed securities would be impractical to achieve and lead to astronomical costs for such purchasers. MBA believes that it is entirely unrealistic to push off the responsibility of protecting consumers to the secondary market and to delay action to a point in time in where the consumer can not be adequately protected.

Broad Impact of FDIC Action

MBA believes it is critical that the FDIC understand the very real threat that declines in capital flows are a very likely response to the proposed Draft Advisory. Although advocates and government entities have argued that this type of action will affect only unscrupulous originators, MBA predicts a much broader impact. The Draft Advisory casts an extremely wide net that covers all FDIC-regulated institutions, and in effect, supplies a new and very strict standard of care that is sure to be applied to the entire secondary market and the mortgage origination industry as a whole. Its vagueness will open the gates to significant legal and administrative hazards. The expense that will result from this new layer of due diligence and expanded legal risk is unpredictably large. The only effect that can be assured from this action is decreased liquidity in the secondary subprime market, and the deflection of resources from, and eventual diminution of capital to, non-conventional mortgage products.

As noted above, we believe the FDIC must understand that this memorandum, regardless of how "suggestive" it purports to be, inevitably carries the *imprimatur* of a regulation. As a primary banking regulator, FDIC issuances are accorded full weight by sister agencies, state regulators and the public at large. Such issuances create a precedent that inevitably serves as a basis for future government action on the subject of "predatory" and subprime lending. Accordingly, the FDIC should tread judiciously and engage, along with other federal agencies, in crafting effective and comprehensive definitions that are sorely missing in the area of "predatory" lending. MBA believes that the FDIC has the obligation when issuing any guidance on this issue to craft clear standards that allow institutions to achieve full and complete compliance. We further note that the FDIC is required to observe the statutory obligations set forth under the Riegle Community Development and Regulatory Improvement Act of 1994 to ensure that its mandates and activities are narrowly tailored and carefully balanced towards the fulfillment of substantial policy goals. By advancing a series of non-exclusive examples to illustrate what constitutes predatory behavior, we believe the FDIC is evading the all-important and fundamental task of developing a workable definition for "predatory lending."

Other Comments

Scope

A further concern regarding this memorandum deals with the undefined coverage of the Draft Advisory. The examples provided in the Draft Advisory appear to extend to all loans that are secured by real estate. The coverage is not restricted by term or fee "triggers." As currently drafted, the Advisory's examples, and therefore the definition of "predatory" loans under the memorandum, could extend to first-lien originations and other loans that may or may not defined as "high cost" under HOEPA or other state statutes. The Draft Advisory fails, in other words, to identify the scope of the due diligence responsibilities. MBA requests that the FDIC clarify whether the memorandum is intended to cover only those loans where abuses are more common, such as "high-cost" or whether it intends to cover the full universe of mortgage activity.

Yield Spread Premiums

"Step One" of the Draft Advisory infers that yield spread premiums may be indicators of "predatory" behavior. As recognized by HUD in a recent statement of policy, yield spread premiums—if reasonable—constitute a legitimate method for compensating brokers. MBA believes that, aside from legitimate suggestion that lenders inquire about the diligence in establishing relationships with brokers, the FDIC's advice should be limited to providing a warning about the RESPA implications in the use of yield spread premiums as a compensation mechanism. We suggest that any negative connotations should be deleted from this part.

Community Reinvestment Act

MBA requests that, in reviewing this Draft Advisory, the FDIC take into account the strains that the memorandum will impose upon financial institutions that face CRA responsibilities. In satisfying community reinvestment demands, financial institutions are required to meet the credit needs of their delineated communities, including those of low- and moderate-income neighborhoods. Lending institutions are judged under strict considerations, including product offerings, innovative and flexible lending practices, innovative and flexible lending criteria and responsiveness to community needs.

Since institutions are going to be subject to examinations with an eye towards ensuring that they are devoting adequate capital to low- and moderate-income areas, then the advice in this memorandum places compliance-minded institutions in a very serious bind. The vague and open-ended definitions advanced under the Draft Advisory will threaten to unravel advances made in the development of flexible lending programs that have been put in place to specifically satisfy credit needs of non-conventional borrowers.

In this respect, the Draft Advisory's suggestion that predatory lending characteristics may include "lending targeted to underserved areas" or to "specific low- and moderate-income areas" is particularly troubling. In the absence of more guidance and better definitions, this statement can be misconstrued as the creation of a presumption that loans made to borrowers in such areas are inherently suspect. This language requires modification as this interpretation would lead to disastrous results. In the face of any uncertainty, prospective purchasers and investors are sure to exercise an overabundance in caution and purchase only conventional loans made in adequately served areas.

The issues surrounding restrictions on financing features and the impact on CRA and subprime lending has yet to be squarely addressed by regulators. MBA recognizes that banking regulators have been engaged in interagency task force studies to address the quandary created by the interplay of abusive lending practices and the granting of CRA credits. It is critical to realize, however, that this CRA issue is too intimately related to the matters now being addressed under the Draft Advisory. These items should not be advancing on separate tracks. We repeat our request that FDIC delay issuance of this memorandum until it resolves all these related and intertwined issues in an orderly and systematic manner.

MBA's Mortgage Reform Proposal

MBA has consistently argued that no regulatory approach will deliver true consumer protection unless underlying market defects are addressed through a comprehensive reform of the mortgage lending laws. The real key to achieving true long-term reform in the subprime market does not lie in limited efforts to drive out bad practices and bad actors from the market. Rather, the critical reform objective should be to attract reputable lenders into a marketplace of consumers that are able to make educated decisions with a wide variety of terms and options. A competitive market with informed consumers provides the best protection against predatory activity.

It is also important to understand that the real estate mortgage lending industry is one of the most heavily regulated industries today. Mortgage lending is subject to pervasive regulation and must comply with a wide array of federal consumer protection laws including the Truth in Lending Act, the Real Estate Settlement Procedures Act, the Fair Housing Act, the Fair Credit Reporting Act, the Equal Credit Opportunity Act, the Fair Credit Billing Act, the Home Mortgage Disclosure Act, the Home Ownership and Equity Protection Act, and the Fair Debt Collection Practices Act. Mortgage transactions are also subject to state and local laws against fraud and deceptive trade and practices. The reality is that practically all of the abuses that are described as "predatory" by the FDIC and other federal regulators are, in one way or another, violative of existing law. Rather than expanding and complicating the current federal regulatory system, the priority should be to aggressively enforce the multitude of existing laws. Absent effective oversight and a legitimate commitment to engage in comprehensive enforcement, the expansion of the current laundry list of regulations and restrictions will be of negligible impact in ridding the market of unscrupulous actors.

In an appendix to these comments, the MBA sets forth its "Seven Point Plan" for mortgage reform. The MBA respectfully asks that the FDIC consider joining in the discussions to achieve broader reform to achieve the important objectives of ridding the market of "predatory lenders."

Conclusion

MBA requests that the FDIC reconsider releasing this Draft Advisory and give serious consideration to the practical effects of this issuance upon the mortgage lending market generally. As the memorandum does not clearly define any standards to identify "predatory" activity, we believe it is simply impossible to implement the due diligence advice that follows. In the absence of such standards, even legitimate lending activities could be potentially classified as "predatory." We believe that the effect of this Draft Advisory will be much more draconian than the FDIC envisions. MBA is concerned that the issuance will have negative repercussions that will negatively impact the availability of credit in the subprime mortgage market and will have disastrous consequences to the most underserved segment of the mortgage market.

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Once Again, the MBA appreciates the opportunity to comment on this very important issue. We would welcome the opportunity to discuss issues further as the rulemaking proceeds. If you or your staff have any questions about the foregoing, please feel free to contact Rod J. Alba, Director, Regulatory Affairs, at 202/557-2930.

Thank you for your consideration.

Sincerely,

Howard Glaser
Senior Staff Vice President
Government Affairs

APPENDIX:
MBA Mortgage Reform Proposal

As currently written, both the Real Estate Settlement Procedures Act (RESPA) and the Truth in Lending Act (TILA) are confusing to consumers, cumbersome in many aspects, and, as technology develops, increasingly outdated. Comprehensive reform is necessary, not only to increase accessibility and clarity of the laws, but also to accommodate improvements in technology that have taken place in the financial sector since the passage of the original statutes.

For over three years, MBA has been engaged in an ongoing cooperative effort with other industry groups, consumer advocates, the Department of Housing and Urban Development (HUD) and the Federal Reserve (Fed) to develop recommendations for change. MBA believes that RESPA/TILA reform is even more crucial now as we seek to stem predatory lending practices. <u>It is MBA's position that the most effective way to curb such abuses is to enact broad comprehensive reform of RESPA and TILA and provide simple, understandable disclosures so that all consumers can better understand the mortgage process</u>.

On June 15, 2000, MBA unveiled the Association's Seven Point Plan for Mortgage Reform. MBA believes that many of the problems associated with predatory lending arise from the complexities and ambiguity inherent in the current system. That is why MBA is committed to a comprehensive approach to mortgage reform that will benefit <u>all</u> consumers.

<u>The MBA Seven Point Plan for Mortgage Reform</u>:

1. Fully Enforce Consumer Laws. Most of the abuses currently cited as "predatory" are already illegal under current federal and state law. MBA believes that full enforcement of existing laws will eliminate virtually all of the unscrupulous activity occurring in the market. Consumer protection agencies should be fully funded and given the resources necessary to enforce these laws effectively.

2. Simplify the Mortgage Transaction to Protect Consumers: the Loan Closing Costs Guarantee. In order to simplify the process of mortgage shopping and settlement, MBA supports legislation to establish a guaranteed closing costs system. Under this system, lenders would be able to provide mortgage applicants with an early price guarantee that permits consumers to effectively shop for the best mortgage product.

Under MBA's plan, the closing cost guarantee provided to consumers would include all costs required by the lender to close the loan. While costs imposed by non-lender third parties (i.e. municipal or state taxes) would not be included in the guarantee, these costs would be fully disclosed separately as estimates.

The guaranteed disclosure system would let consumers know, early in the mortgage application process, the maximum settlement costs a lender could charge. Thus, consumers would be informed of current rates and points at initial contact with the lender, and would receive a guaranteed quote for lender settlement services immediately following application.

Those lenders operating under a guaranteed costs system would be subject to reformed disclosure requirements that would replace Truth in Lending Act (TILA) notices (except for HOEPA) and front-end disclosures under the Real Estate Settlement Procedures Act (RESPA). To facilitate packaging, these lenders also would be entitled to an exemption from Section 8 of RESPA.

3. Increased Disclosures for Consumers. The Loan Closing Costs Guarantee proposal includes clearer and more effective disclosures to consumers. Under the MBA's proposals, consumers would be provided with clear and comprehensive information about the mortgage shopping process at first contact with any real estate professional, and would receive easy to understand and reliable cost disclosures as they advance through the shopping and application process.

4. Enhance Enforcement Tools/Provide Effective Remedies for Consumers. MBA supports federal legislation to prohibit unscrupulous and improper lending practices. By substantially strengthening the penalties associated with these practices and by enabling federal authorities to enforce these penalties,

MBA believes that significant steps can be taken to combat abusive lending practices. MBA's Seven Point Plan for Mortgage Reform delineates abusive practices and also includes a new system of remedies for consumers involved in a mortgage transaction.

5. Increase Availability and Quality of Counseling for Prospective Borrowers. MBA has been a leader in developing and supporting counseling programs for prospective borrowers. MBA supports expanding counseling programs. MBA has established a national partnership with the American Homeowner Education and Counseling Institute (AHECI), which provides training and certification to the homeownership counseling industry. MBA supports the development of a uniform counseling program by the Federal Reserve and HUD, the availability of which would be described in a standardized "Mortgage Information Booklet".

6. Increase Consumer Education Programs. MBA supports increased consumer education to help borrowers make informed decisions about their credit. MBA has established a national partnership with the National Council on Economic Education (NCEE) to produce a classroom curriculum that teaches school children to understand credit and assist them in developing sound financial planning and management skills.

7. Industry Commitment to Fair Lending Practices. There is much the mortgage lending industry can do to promote fairness and integrity in the mortgage process. MBA recently adopted industry guidelines to combat abusive lending practices. MBA members endorsing these "best practices" agree to conduct their business according to certain standards of conduct. These standards are meant to serve as guidelines by which MBA members will meet their business goals and objectives while providing fair and equitable treatment to consumers.