

## REFORMING MORTGAGE LENDING

Jim Campen, Senior Fellow, Americans for Fairness in Lending

January 7, 2010

An unprecedented wave of abusive and irresponsible mortgage lending during the first seven years of the twenty-first century stripped wealth from millions of borrowers, led to the ongoing tsunami of foreclosures, and played a central role in the collapse of the financial system. This policy note presents a brief analysis of key elements for a reform agenda, as well as current legislation that might favor these reforms.

### Key Elements of a Reformed System for Regulating Mortgage Lending

*Responsible underwriting.* Lenders must be prohibited from making loans on which borrowers do not have the documented ability to make their monthly payments.

*Appropriate incentives.* All actors in the mortgage process must have incentives that align their interests with the interests of borrowers and must be accountable for their actions.

*Understandable and timely disclosures – and more.* Regulations should require clear, concise, and timely disclosure of loan costs and terms, highlighting particularly costly or risky features. In addition, some lending practices are so inherently unfair and abusive they should be prohibited altogether.

*Community reinvestment obligations.* The Community Reinvestment Act (CRA) should be modernized by extending CRA-type obligations to all lenders who account for a significant share of lending in a local area and by clarifying that CRA evaluations will be based on the quality as well as the quantity of loans to traditionally under-served borrowers and neighborhoods.

*Fair Lending Enforcement.* Regulators should vigorously enforce fair lending laws to eliminate racial and ethnic discrimination from the mortgage market.

*Comprehensive and uniform regulation.* All parties that provide the same product or service should be subject to the same rules and regulations, enforced by the same regulator.

*Multiple levels of enforcement.* The primary responsibility for enforcement should lie with the single federal mortgage lending regulator. However, other federal agencies, such as the bank regulators, could be given back-up enforcement powers for the entities that they oversee. More important, state attorneys general should have the right to enforce federal laws and regulations within the boundaries of their states.

*Expanded data collection and analysis.* The new single federal mortgage regulator should develop and maintain its own database(s), including systematic data on loan performance, delinquencies, and foreclosures. Moreover, the Home Mortgage Disclosure Act should be amended to require additional data about borrowers (e.g., age and credit score indicator), about loan originators, and about loan characteristics.

## Current Legislative and Regulatory Initiatives

Among the legislative and regulatory measures currently under active consideration four are particularly relevant for moving toward the reformed system for regulation of mortgage lending envisioned above:

- H.R. 4173, the Wall Street Reform and Consumer Protection Act of 2009 (approved by the House in December and awaiting action in the Senate), would establish a Consumer Financial Protection Agency (CFPA). The sole mission of the CFPA would be consumer protection, which it would promote through strong rule-writing, supervision, and enforcement powers.
- H.R. 1728, the Mortgage Reform and Anti-Predatory Lending Act (approved by the House and awaiting action in the Senate) covers all mortgage lenders, mandates many important reforms, including requirements that lenders verify the borrower's ability to repay the loan and that refinance loans provide a tangible net benefit to the borrower; prohibitions on predatory features such as single-payment credit insurance, prepayment penalties on adjustable rate loans, and binding mandatory arbitration; and standards for appraisers and loan servicers.
- A Federal Reserve proposal for changes to its Regulation Z (Truth in Lending) would greatly improve the disclosures to consumers who apply for mortgage loans, and make them available earlier in the process.
- H.R. 1479, the Community Reinvestment Modernization Act, the subject of a September 16 hearing by the House Financial Services Committee, includes provisions that would extend CRA-type obligations to all mortgage lenders, whatever their corporate form or charter.

## References

Campen, Jim (2009). "Reforming Mortgage Lending," Political Economy Research Institute, October.