Testimony of Julia Gordon, Center for Responsible Lending
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Subcommittee on Financial Institutions and Consumer Credit

"Mortgage Lending Reform:
A Comprehensive Review of the American Mortgage System"

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Good afternoon Chairman Gutierrez, Ranking Member Hensarling, and members of the Subcommittee. Thank you for inviting us to testify about ways to reform mortgage lending so that we can prevent a repetition in the future of the foreclosure crisis that has brought today's economy to its knees.

I serve as Senior Policy Counsel at the Center for Responsible Lending (CRL), a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, a nonprofit community development financial institution that consists of a credit union and a non-profit loan fund. For close to thirty years, Self-Help has focused on creating ownership opportunities for low-wealth families, primarily through financing home loans to low-income and minority families who otherwise might not have been able to get affordable home loans. Self-Help's lending record includes a secondary market program that encourages other lenders to make sustainable loans to borrowers with weak credit. In total, Self-Help has provided over $5.6 billion of financing to 62,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across America.

Sixteen months ago, this chamber passed legislation designed to make the subprime mortgage market safer for consumers. Today, the market that legislation targeted has virtually disappeared, and the entire mortgage finance system has imploded. The long-standing bulwarks of that system, Fannie Mae and Freddie Mac, have failed, and are now under the care of the government and receiving taxpayer aid. The private investment banking system that created and operated the non-conforming secondary market has vanished, and the values of mortgage-backed assets once thought to be risk-free are now in free fall.

Under these circumstances, it is imperative that we rethink the way we regulate the mortgage market. The lending legislation that passed the House last session, H.R. 3915, was a narrowly focused effort to improve the subprime market, which at that time was still the epicenter of the foreclosure crisis. In that way, it resembles the HOEPA legislation passed in 1994, which was also a narrowly tailored law responding to the products and business products causing trouble at that time. Yet just as the relief provided by HOEPA did not prevent a whole new set of abusive and irresponsible practices from arising just a few years later, so we believe H.R. 3915's focus on subprime mortgages will prove inadequate to prevent the next wave of predatory practices.

In addition, H.R. 3915 was a highly complex piece of legislation due to Congress's effort to eliminate some particularly dangerous practices while satisfying industry demands for protecting various practices and products. For example, as a result of a last-minute change during the drafting of the legislation, H.R. 3915 created an irrebuttable presumption that all non-subprime loans were properly evaluated for a borrower's ability to repay – a presumption that in hindsight is clearly not warranted, given the performance of Alt-A and payment option ARM loans. Just as damaging, H.R. 3915 would have stripped homeowners' claims of unfair and deceptive practices against secondary market mortgage holders even as a defense against foreclosure. Now we know all too well that secondary market mortgage holders are the parties that hold the most control over whether homeowners in trouble have any hope of retaining their homes.

Therefore, we suggest a broader, simpler framework that addresses the entire mortgage market and that focuses on the underlying incentives in that market. The legislation should establish a bright-line ban on dangerous loan features such as prepayment penalties and "no-doc" loans as well as on market-distorting incentives such as yield-spread premiums. All mortgage origination should be subject to rules that discourage originators from placing people in mortgages that are more expensive than those for which they qualify or that they cannot afford to sustain. Most important, all participants in the mortgage origination and purchase chain must have "skin in the game" with real consequences for violating the law.

Such an approach provides several significant benefits. First, it allows the market to price for risk accurately, something the market did not do in recent years and that underlies its spectacular failure. Second, by harnessing the market's own power, there is a greater chance that this legislation will prevent similar problems in the future caused by products that have not yet been contemplated. Third, it can provide a much simpler, more administrable, and more easily enforceable piece of legislation than the complex system envisioned under H.R. 3915.

There are those who will once again reflexively object to a broader, simpler, incentive-based approach, claiming that they don't want to stop the "free flow of credit." Yet the ideology that lending should not be restrained at any cost – which was blindly followed by the country's banking oversight agencies, particularly the Federal Reserve under Chairman Greenspan – is exactly what has managed to lock down the flow of credit beyond anyone's wildest dreams. For years, mortgage bankers told Congress that their subprime and exotic mortgages were not dangerous. Then, after the mortgages started to go bad, they swore the damage would be easily contained.[1] As the global economy lies in tatters around them, any new request to operate without basic rules of the road is more than indefensible; it's appalling.

In this testimony, we discuss six important principles that this year's mortgage lending reform legislation should incorporate:

- Mortgage lending legislation should be simple and straightforward, which will benefit all market participants from the consumer through the investor.

- Mortgage originators should serve the best interests of their customers by putting them into appropriate products with sound terms and conditions that do not have prepayment penalties or yield spread premiums.

- The secondary market should have "skin in the game" by sharing responsibility for the terms of the loan.

- For homeowners in trouble, mortgage servicers must attempt to save the home before filing foreclosure.

- Consumers should be able to assert their rights in a timely, meaningful and comprehensible way.

- States and localities should be able to protect their residents quickly and effectively.

I. Background

A. Today's mortgage market

While statistics seem almost unnecessary to illustrate what everyone here knows, every part of the mortgage origination system is in deep trouble. Overall mortgage activity has plummeted. For 2008, residential loan production cratered: $1.61 trillion compared to $2.65 trillion in 2007, and industry projections suggest that 2009 production will total just $1.09 trillion.[2]

Furthermore, originations of subprime, Alt A, and other non-prime mortgages all but stopped in 2008. Only an estimated $64.0 billion in such mortgages was originated last year, according to an analysis by Inside B&C Lending.[3] At its high point in 2006, nonprime lending constituted 33.6% of all mortgage production. By the fourth quarter of 2008, it had fallen to 2.8%.[4] These loans are not being originated in large part due to the collapse of the secondary market for these mortgages, which was driving the demand and facilitating the production, and analysts predict that 2009 will see "little or no non-agency securitization."[5] Tens of thousands of mortgage brokers have lost their jobs, and more are positioned to lose their jobs as lenders stop using independent brokers, mortgage insurers place additional restrictions on loans originated by brokers, and banks increase net worth requirements on third-party lenders.[6]

On the demand side as well, every major indicator is down. Between 2006 and 2008, existing home sales dropped 24 percent,[7] while new home sales and new construction starts plummeted by 54 and 58 percent, respectively.[8] In February, mortgage applications for the purchase of homes hit their lowest levels since April 1998.[9]

In addition, while this hearing focuses on mortgage origination rather than on foreclosure prevention, the devastation of the foreclosure crisis is yet another factor that should guide our thinking as we craft lending legislation. Our most recent report on subprime mortgages shows that over 1.5 million homes have already been lost to foreclosure, and another two million families with subprime loans are currently delinquent and in danger of losing their homes in the near future.[10] New projections of foreclosures on all types of mortgages during the next five years estimate 13 million defaults from 2008Q4 until 2014.[11] Right now, more than one in ten homeowners is facing mortgage trouble.[12] Nearly one in five homes is underwater.[13]

The spillover costs of the foreclosure crisis are massive. Tens of millions of homes – households where, for the most part, the owners have paid their mortgages on time every month – are suffering a decrease in their property values that amounts to hundreds of billions of dollars in losses.[14] These losses, in turn, cost states and localities enormous sums of money in lost tax revenue and increased costs for fire, police, and other services. As property values decline further, the cycle of reduced demand and reduced mortgage origination continues to spiral downward.

B. A brief explanation of the recent meltdown.

Buying or refinancing a home is the biggest investment that most families ever make. For the vast majority of Americans, this transaction is often decisive in determining a family's future financial security. For this reason alone, prospective homeowners cannot be treated with a hands-off, caveat-emptor approach. But recent events have shown us the macroeconomic importance of affordable mortgages for homeowners. Rules of the road for mortgage lending are not just for the benefit of individual families, but for the benefit of the entire housing market and national economy.

A misalignment of incentives lies at the heart of today's mortgage meltdown.[15] Back in the days when families went to their local savings and loan to get a mortgage and the thrift held that loan among its own investments, the interests of borrowers and lenders were perfectly aligned: if the borrower did not pay the mortgage, the lender did not make money. But the proliferation of independent brokers and the growth of the secondary market upset that core alignment of interests between lender and borrower by creating a system where each actor was compensated early in the loan transaction, often within the first month of the loan term, thereby reducing or even eliminating the incentive to worry about how the borrower would fare later on.[16]

At the height of the housing bubble, independent mortgage brokers originated the vast majority of subprime loans, receiving their compensation from lenders immediately upon brokering the loan. Those lenders then sold the loan into the secondary market within weeks, where it was bundled together with other mortgages and sliced and diced into mortgage-backed securities (MBS). The facilitators of this process – the investment bankers, lawyers, and ratings agencies involved – were all paid their fees regardless of the performance of the MBS. Those securities were then sold to investors. At the same time, even more derivative products were layered on top of them, with credit default swaps at the top of the pyramid – what Warren Buffet identified as early as six years ago as "financial weapons of mass destruction."[17]

A legislative effort to help create a safer, more sustainable mortgage market should have the guiding principle of realigning both the market incentives and the legal incentives all the way up the chain, from brokers through investors.

II. Mortgage lending legislation should be simple and straightforward, which will benefit all market participants from the consumer through the investor.

The simpler and more straightforward this law is, the more easily the participants in the mortgage market can follow the rules and the more easily consumers can understand what the rules are supposed to be. While it is true that there are many principles articulated in this testimony that will require case-by-case analysis, bright lines such as bans on prepayment penalties and yield-spread premiums and a requirement of income verification and escrow will redound to everyone's benefit.

In addition to providing adequate and timely methods for consumers to enforce their own rights, the mechanisms by which they can be enforced must be simple and straightforward. The remedies available in H.R. 3915 for the two core protections – the ability to pay and the net tangible benefit protections – were available only after the consumer jumped a series of hurdles of unnecessary complexity. In prior testimony, we described the multiple gates that must be "unlocked" before relief can be obtained, and even then, it was not clear that it could be obtained against the holder of the note.[18] The complexity of the system alone would add to litigation costs, deter consumers from even trying to assert their rights, and confuse everybody. To provide necessary accountability, and to make the rights granted by the statute meaningful, the law's provisions must be adequate to provide meaningful and timely relief and be clear and comprehensible.

III. Mortgage originators should serve the best interests of their customers by placing them into appropriate products with sound terms and conditions.

A. All mortgage originators should have a duty of good faith and fair dealing, and independent mortgage brokers should have a fiduciary duty to their customers.

To change the incentives for mortgage originators, any legislation should establish a duty of good faith and fair dealing for all mortgage originators. Among other things, this requirement would require an originator to make reasonable efforts to secure a home mortgage loan that is appropriately advantageous to the consumer. The originator would have to sell a product that was appropriate with respect to – among other things – product type, rates, charges, and repayment terms of the loan.

Independent mortgage brokers, however, should be held to an even higher standard than retail lenders: they should have a fiduciary duty to their customers, just as stockbrokers do. Unlike retail lenders, who are obviously in business to sell loans to consumers, brokers hold themselves out to consumers as trusted advisers for navigating the complex mortgage market. Like stockbrokers, that is the value-added service they sell, and it is the service consumers assume they are buying. Yet most mortgage brokers and their trade associations deny that they have any legal or ethical responsibility to refrain from selling inappropriate, unaffordable loans, or to avoid benefiting personally at the expense of their borrowers. Moreover, because of the way they are compensated, brokers have strong incentives to sell excessively expensive loans to their customers, even when those customers qualify for better loans.

Experts on mortgage financing have long raised concerns about problems inherent in a market dominated by broker originations. For example, the chairman of the Federal Reserve Board, Ben S. Bernanke, noted that placing significant pricing discretion in the hands of financially motivated mortgage brokers in the sales of mortgage products can be a prescription for trouble, as it can lead to behavior not in compliance with fair lending laws.[19] Similarly, a report issued by Harvard University's Joint Center for Housing Studies, stated, "Having no long term interest in the performance of the loan, a broker's incentive is to close the loan while charging the highest combination of fees and mortgage interest rates the market will bear."[20]

B. Mortgage brokers must carry adequate bonding.

Another important way to align incentives for mortgage brokers is to require brokers to be bonded at a level sufficient so that consumers who receive illegal loans have some chance of obtaining redress from the broker who sold them those loans. While public enforcement – both civil and criminal – is a crucial part of this legislation and is discussed more below, the fact is that the best deterrent to illegal action is a private right of action for consumers. However, many brokers have been so thinly capitalized that even in the few cases where consumers are able to bring legal action against them, they are judgment-proof. For those brokers, the possibility of a lawsuit does not serve as a deterrent to illegal action.

C. Ban yield spread premiums.

In addition to imposing a clear fiduciary duty on brokers, Congress should also address the issue of how brokers are compensated by lenders. Right now, most brokers receive a yield spread premium (YSP) in return for making a loan on behalf of a lender. In theory, consumers can use YSPs to buy down upfront origination costs. The reality is that, especially in the subprime and nontraditional mortgage markets, this trade-off rarely (if ever) occurs. HUD, in the regulatory review accompanying the issuance of their recently-enacted proposed rule in March 2008, cited extensive evidence that, even in the prime market, borrowers with YSPs pay in the aggregate more in fees, interest, and other closing costs than borrowers who do not pay YSPs.[21]

Abusive YSPs create a perverse incentive for mortgage brokers to steer borrowers into loans that are more costly and dangerous even though they could qualify for a more affordable product. Lenders then provide additional compensation to brokers to lock borrowers into those higher-rate loans with a prepayment penalty to provide an income stream to pay off that upfront YSP payment. Banning YSPs would significantly reduce incentives for brokers to upsell borrowers into more expensive and riskier loans than those for which they qualify. [22]

Alternatively, YSPs should be banned for subprime and nontraditional loans and permitted in the prime market only when they are a true trade-off, i.e., when (1) the borrower pays *no* origination costs, either out of pocket or from the loan proceeds (except for fees paid to government officials or amounts to fund escrow accounts for taxes and insurance); and (2) the loan does not contain a prepayment penalty. If that approach is taken, any payment of such a premium by a lender should be recognized as a *per se* acknowledgment of agency between the broker and originating lender, with liability for the broker's acts and omissions irrebuttably attaching to the originating lender and subsequent holders of the note.

D. Ban prepayment penalties.

Previously, we have called for a ban on subprime and nontraditional prepayment penalties, and now we believe that ban should be extended to all mortgage loans. Since prepayment penalties are extremely rare in the current origination environment, we have the perfect opportunity to ban them without causing any repercussions for lenders.

Prepayment penalties were a pervasive and insidiously harmful feature of the now-collapsed subprime market. During the current crisis, many families that might have escaped their mortgage by refinancing before housing values became prohibitively low found themselves trapped by a prepayment penalty. Commonplace in the subprime market, a prepayment penalty on a $250,000 loan could be expected to be in the range of $8,000-$10,000—enough to prevent or discourage refinancing. Independent research has fixed the increased risk of default on subprime mortgages with prepayment penalties from 16-20% over already high baseline rates.[23]

Lengthy prepayment penalties and high loan fees rewarded originators by paying them handsomely regardless of the long-term sustainability of the loan. Prepayment penalties were also highly valued by Wall Street because they protected the income stream to investors. We now know that the harm caused by trapping borrowers in bad loans and stripping equity caused far more harm to those investors in the long run. In short, prepayment penalties are an anticompetitive practice and the direct and indirect costs of this market-distorting practice far outweighs the benefits.

Contrary to some industry claims, empirical analysis of the effects of anti-predatory lending laws, including those with limitations on prepayment penalties, shows that banning prepayment penalties and other predatory practices does <u>not</u> cause a restriction in access to credit.[24] Instead, it only causes a decrease in targeted abuses. In fact, in states that have limited prepayment penalties as part of their approach to curbing predatory lending, interest rates have stayed the same or even been lowered, compared with control states where such protections are absent.[25] In other words, rather than reducing access to legitimate credit, regulation has countered a market that had previously been governed by Gresham's Law (bad loans tended to drive out good loans). Careful regulation is a thereby an aid to competition as well as to consumers.

E. Discriminatory steering of borrowers into worse loans should be banned.

Mortgage lending legislation should absolutely prohibit racially discriminatory steering. While an efficient financial market theoretically would provide equally qualified borrowers with equally competitive prices on subprime home loans, both quantitative research and anecdotal evidence show that some borrowers, particularly African-American and Latino families, pay more than necessary for subprime mortgages.

In May 2006, CRL analyzed data submitted by mortgage lenders for loans made in 2004 to assess the effects of race and ethnicity on pricing in the subprime market while controlling for the major risk factors used to determine loan prices. Our findings showed that, for most types of subprime home loans, African-American and Latino families were at greater risk of receiving higher-rate loans than white borrowers, even after controlling for legitimate risk factors. In other words, if two families received subprime loans, one African American and one white, and they had the same credit score and were similarly qualified in every other way, the African-American family has a significant chance of receiving a higher-cost loan.

F. Limit equity-stripping excessive fees.

Eliminating prepayment penalties and yield spread premiums would be major steps forward in protecting consumers and returning fairness to the market for responsible lenders. Another key protection, and one that has long been at the forefront of preventing predatory lending, is limiting excessive fees.[26]

Historically, mortgage loans primarily generated income and profits through the performance of the loans and the payment of interest. In recent years, this model was abandoned for quick payments generated at closing that were divorced from the long-term sustainability of the loan. Longstanding and widespread state limitations on upfront mortgage fees were swept aside by federal preemption, and mortgage lending turned its focus from performance-tied returns to fees extracted at closing. The result has been the loss of home equity for families and an unstable and unsustainable mortgage system that has badly wounded our overall economy.

Legislation should provide transparent limits on up-front fees. Originator fees should be limited to 2%, with additional costs and profits recovered through the interest rate. This provides pricing transparency, which is essential for competition to work, and it rewards lenders who provide sustainable loans instead of lenders who extract the greatest amount of equity at closing. To the extent loans are permitted that exceed these limits, there should be additional safeguards and lender responsibilities to ensure that homeowners benefit from any additional charges.

This limitation on fees should include all direct and indirect fees and charges other than bona fide filing fees and escrow amounts. It is critical to have these equity-stripping protections in place as we move forward to ensure that as borrowers refinance into sustainable loans and as new homeowners enter the market, they can preserve and build on the core of their investment, maintaining and increasing their share of ownership and preserving a safety net for any future financial demands.[27]

G. Mortgage originators should evaluate the ability of the consumer to pay the loan and provide the consumer with a net tangible benefit when refinancing a loan.

Perhaps one of the most astonishing aspects of the recent reckless lending spree was that the market utterly ignored whether a borrower could actually afford the mortgage. This core underwriting principle – a basic, common-sense business principle that would be understood by virtually anyone – was not only ignored, it was affirmatively shunned. The mortgages that sparked the market meltdown were "designed to terminate" specifically to ensure a continuing stream of new originations.[28] Given that business model, sustainability was at best irrelevant and at worst affirmatively undesirable.

Not considering a borrower's ability to repay was especially dangerous in the case of adjustable rate mortgages (ARMs) that incorporated an element of payment shock to the borrower. Payment shocks are created by a variety of dangerous loan structures: loans made without documenting incomes because the families simply did not afford the payment; subprime exploding ARMs where the payment increases by 30% - 40% after the second year, even if rates in the economy stay constant; interest-only loans where the payment can increase by 50% when the loan starts amortizing over a shorter remaining life; and payment option ARMs where the payment can double when it recasts at the fifth year, for lenders who require recasting at that time rather than ten years out. If these loans were not carefully underwritten at the fully indexed, fully amortizing payment when made, as many lenders failed to do, they set the borrowers up for almost certain failure.

Most loan originators understood that they were putting borrowers into loans that were unsustainable and that would need to be refinanced prior to reset. In 2004, the General Counsel of New Century, then the nation's second-largest subprime lender, referred to its 2/28 interest-only product and stated that "we should not be making loans to borrowers with the expectation that the borrower will be able to refi in a couple years."[29] His warning was ignored.

What's more, during the recent heyday of reckless lending, loan originators – particularly independent mortgage brokers – encouraged borrowers to take out so-called "no doc" or stated-income loans even when those borrowers had easy access to their W-2s. Without adequate income verification, a lender's approval of a loan is meaningless. Borrowers often do not understand that they are paying a higher interest rate not to document their income, even though their W-2s are readily available. They also often do not realize that the broker has inflated their income on the loan application. A review of a sample of stated-income loans disclosed that 90 percent had inflated incomes compared to IRS documents and almost 60 percent of the stated amounts were exaggerated by more than 50 percent.[30] Overstated incomes leads to overestimated repayment ability and then to foreclosures.

In July of last year, the Federal Reserve Board finally exercised its authority under HOEPA to prohibit unfair and deceptive practices.[31] Its rule addresses some of the most destructive practices leading to this crisis, although only for subprime loans. It requires lenders to evaluate a borrower's ability to repay; reins in abusive prepayment penalties on short-term subprime ARMs; and requires escrowing for taxes and insurance.

Unfortunately, the Federal Reserve Board did not extend these common-sense protections far enough. To help prevent further abusive lending, Congress should expand the ability to repay and income verification requirements to include all mortgages. As we have seen from the crisis we are now in, no segment of the mortgage market is immune from dangerous lending practices. Such legislation would simply codify what responsible lenders are already doing.

An analysis of a borrower's ability to repay, the fundamental tenet of sustainable mortgage lending, should take the following into account:

- **Debt-to-income ratio.** This ratio must be at a reasonable level and should take into account all debt payments, including principal, interest, taxes and insurance, any other mortgages, and other household debt.

- **Residual income.** Lenders must ensure that there are adequate resources available to cover family living expenses after deducting all debt service requirements from monthly income.

- **Documentation of income.** Lenders should verify income through written materials, such as W-2 and 1099 forms if available, or if not, through, tax records, bank records, and/or other reasonable third-party documents.

Finally, federal legislation should mirror successful state laws requiring a net tangible benefit for mortgage refinances. Loan flipping has, since the beginning of the subprime market, been a prime tool for stripping the equity from homeowners. These laws prevent the serial refinancing by unscrupulous originators and have been shown not to reduce access to legitimate credit.[32]

H. Lenders should require escrow for taxes and insurance.

The failure to escrow directly contributes to high rates of foreclosure. By creating artificially low monthly payment figures, it deceives consumers about the actual cost of these mortgages relative to those offered by competitors that do escrow and lures them into refinancing into less advantageous loans. The failure to escrow for taxes and insurance also often puts those homeowners already in the tightest financial situations in the position of facing an unexpected tax bill, and brokers later target these borrowers for new high-cost refinancing.

Moreover, homeowners who do not escrow are much more likely to be subjected to the unnecessarily high cost of force-placed insurance. Because lenders can generate significant fees from force-placing insurance, the lack of an escrow requirement provides an opportunity for them to increase their revenue. Fannie Mae has expressed concern over this practice, warning lenders who might "make a practice of rarely or never establishing escrows for blemished credit borrowers with the intent of understating the true cost of financing and generating fees out of activities like lender-placed insurance."[33]

Mandatory escrow will benefit both consumers and lenders. Requiring escrows will increase the transparency of the mortgage transaction and make sure that the borrower is fully aware of the true costs associated with the mortgage. It will also place all lenders on equal footing: responsible lenders that already escrow would not be unfairly undercut by more reckless lenders. Lenders will no longer be able to use the absence of escrows to mask the true costs of the loan, and borrowers will be less vulnerable to the threat of having to refinance to cover unanticipated tax payments. Mandatory escrows will also make it easier for borrowers to accurately compare the true monthly costs of the loans they are offered.

The Federal Reserve Board's HOEPA rule imposing a one-year mandatory escrow requirement for subprime loans is inadequate in both scope and duration. As the foreclosure crisis spreads ever further beyond the confines of the subprime market, it is clear that anticompetitive practices need to be removed from the entire market.[34] In our view, a mandatory escrow requirement should both cover the entire mortgage market and last for at least five to seven years before there is any opt-out option.

IV. The secondary market should have "skin in the game" by sharing responsibility for the terms of the loan.

Although all parts of the mortgage origination chain bear some responsibility for the foreclosure crisis, perhaps nothing exacerbated the crisis as much as Wall Street's demand for predatory loans. As the subprime market grew, investment bankers sought more and more of these loans offering higher-risk investments with potential for higher returns.

In response to the Wall Street demand, lenders created new, dangerous loan products that appeared deceptively affordable to borrowers, and brokers pushed these products to earn high fees. After filing for bankruptcy, the CEO of one mortgage lender explained it this way to the *New York Times*, "The market is paying me to do a no-income-verification loan more than it is paying me to do the full documentation loans," he said. "What would you do?" Similarly, Alan Greenspan recently told *Newsweek*, "The big demand was not so much on the part of the borrowers as it was on the part of the suppliers who were giving loans which really most people couldn't afford. We created something which was unsustainable. And it eventually broke. If it weren't for securitization, the subprime-loan market would have been very significantly less than it is in size."[35]

Wall Street rating agencies also turned a blind eye to the increasingly high volume of poorly underwritten, extremely dangerous loans included in mortgage investments. Paid by the securitizers to rate the tranches, the agencies overlooked loans that any experienced underwriter would have known were headed for foreclosure, giving AAA ratings to the majority of the tranches created.[36]

The best way to prevent a reoccurrence of Wall-Street-fueled bad lending is for Congress to require the secondary market, too, to have skin in the game. What that means is that risk associated with the origination of a loan needs to travel with the loan, rather than be stripped from the loan when the loan is securitized. In that way, when Wall Street purchases high-risk mortgages and any corresponding financial benefits, it also accepts responsibility for what its purchases will encourage at the origination level. The holder of the loan – meaning the individual or entity that is entitled to foreclose on the loan if the homeowner defaults – should maintain some level of ultimate responsibility for the terms of the loan. The result of meaningful secondary market liability is that the market can accurately price risk and thereby police itself.

While both the borrower and the ultimate note holder may, in most situations, be without specific culpability, the holder is in a far better position than the homeowner to bear the risk of a bad mortgage for three reasons. First, the holder can spread this loss across thousands of other loans, while the borrower has but one home. Second, the holder can choose from whom to buy their loans and can therefore choose reputable originators who are likely to make quality mortgages and who are strong enough to purchase the loans back if they violate the representations and warranties that the secondary market purchaser imposes. Third, the holder can conduct stringent due diligence to ensure that it is not unwittingly purchasing bad mortgages.

Last session's mortgage lending legislation did not change the incentives for Wall Street sufficiently to change behavior. This year's legislation must do so. If the substantive provisions of this bill are to be enforced, it will be done because wronged homeowners are able to seek redress from the holder of their loan, just as they would have been able to do when lenders held the mortgage for the life of the loan.

V. Mortgage servicers should attempt to keep homeowners in their homes before filing foreclosure.

Mortgage loan servicing is the least-regulated part of the entire mortgage market. Yet at the same time, servicing is not an industry subject to typical economic incentives. Homeowners "cannot choose the servicer that handles their loan and cannot change servicers if they are dissatisfied."[37] Instead, servicers are driven by the desire to maximize their own profits and to maximize returns to the investors who now stand in the shoes of the original lender.[38]

Over the past year, we have witnessed the spectacular failure of the servicing industry. In the face of millions of defaulting loans, the current servicing model responded with a weak and ineffective loss mitigation effort. The servicers began by focusing on short-term workouts that were not at all effective to solve the current problems, and to the extent loan modifications were made, most were unsustainable. Unbelievably, servicers routinely wrote modifications that *increased* monthly payments on customers who already could not afford their mortgages.[39]

The time has come to require loan servicers to engage in loss mitigation prior to foreclosure. Such a requirement – already in existence for FHA and VA mortgage loan servicers – would make clear that continued homeownership is the highest goal of all servicers. As part of this requirement, homeowners should always be able to reach a live person with decision-making authority, and they should not need to sign away their legal rights just to get the modification. Perhaps most important, any agreement reached through loss mitigation should be affordable by the homeowner. Careful consideration of the borrower's income as well as any expenses, including debt and residual income left over for other living expenses, is critical in determining the affordability of any solution intended to keep homeowners in their home. Legislation should also impose reporting requirements so that policymakers and stakeholders have an accurate understanding of the kinds of loss mitigation being provided.

Last year, Congresswoman Maxine Waters introduced H.R 5679, the Foreclosure Prevention and Sound Mortgage Servicing Act of 2008. Legislation along these lines would provide servicers with a mechanism for maximizing returns to the investors as a whole, while reducing harm to homeowners and communities. Many of the bill's requirements – that the servicers contact borrowers, provide direct access to loss mitigation personnel, and refer delinquent borrowers to HUD-certified housing counselors – are measures that industry representatives have committed to undertake already. The progress that has been made by the Treasury Department in defining a sustainable loan modification will enable similar legislation to provide more certainty for servicers, homeowners, and investors alike. H.R. 5679 also addresses many other servicing issues that we believe are important.

VI. Consumers should be able to assert their rights in a timely, meaningful and comprehensible way.

There are two main reasons that any legislation governing lending must concern itself with the borrower's ability to assert its rights under that legislation through private action. First, it will guarantee a level of accountability that prevents market standards from sinking to the lowest common denominator that we've just seen. Second, it is a necessary corollary to providing consumers with the right to a fair and efficient marketplace. Legal rights atrophy if there are no effective means to vindicate those rates.

Over the years, there have been increasing efforts to effectively constrict the right of consumers to vindicate their rights, instead shifting the burden to public enforcement. Public enforcement unquestionably is necessary. However, as the recent mortgage meltdown demonstrates, relying on regulators alone is not enough – even if the regulators want to enforce the laws, there will never be enough public resources to take effective legal action in relation to the whole universe of players involved in the complex sales, delivery, and servicing network of the mortgage credit system.

It is also unfortunately true that public enforcement is ill-suited to enforce legal rights on an individual basis. For example, most victims of predatory loan practices are not aware that they had legal rights violated until they consult an attorney when foreclosure is imminent, but regulators cannot defend foreclosures for individual homeowners. Public enforcement actions are preceded by investigations, which can be quite lengthy. Furthermore, when the amounts at stake are large, as with mortgages, it is rare that the restitution obtained through a public enforcement action will be able to make victims whole. It is cold comfort for harmed consumers to get a small check months or even years after their home is lost.

Even the valuable injunctive relief available from public enforcement can be inadequate in a world of securitization. For example, the States obtained both monetary and excellent injunctive relief in their case against Ameriquest. If Ameriquest had still owned those loans, the states' relief could have included reformation of the loans to purge them of the effects of the illegal practices. That would have better served to provide a full measure of redress to the harmed consumers and would have required the company to disgorge the illegally obtained extra revenue. But Ameriquest had sold most of the loans at issue onto the secondary market, and therefore, the existing loans were no longer owned by Ameriquest but by an amorphous securitization trust. That closed off the possibility for an effective and efficient mass remedy as part of the official settlement of the case. Instead, to provide full relief to any individual victim of those practices, a state would have to require that Ameriquest buy the loan back out of the securitization pool to reform it on a one-by-one basis as an individual complaint resolution. That is a complicated extra step under any circumstances, but if the originator is gone – into bankruptcy or collapsed – it is an impossible step.

That brings us full circle to the reason why accountability must follow the loan all the way through the chain. We do not have to choose between a system that feeds irresponsible debt bubbles with too little accountability and a system that is too restrictive. Carefully crafted legislation can find the appropriate balance to ensure that consumers have adequate redress and that all players in the market have the necessary accountability without unduly restricting responsible credit.[40]

VII. For states and localities to protect their residents quickly and effectively, federal law should set a floor, not a ceiling, and not tie states' hands.

It is characteristic of most existing federal consumer protection laws that states may enact stronger laws.[41] It must remain a first principle that the federal law is a floor, not a ceiling.

For nearly a decade, we have heard demands for federal preemption in the name of "uniformity." The "patchwork quilt" of laws, it was argued, was a drag on the efficiency of the mortgage machine. Despite the fact that Congress, not the banking bureaucracy, should have been making preemption decisions, the federal bank regulatory agencies have explicitly or implicitly followed a sweeping preemption agenda in the name of uniformity.[42]

Some preemption was explicit, as is the case with the agencies' preemption of state anti-predatory lending laws.[43] But there were indirect effects, as well. Easy access to preemption through charter-shopping had spillover effects, leading to "preemption creep" towards the lowest common denominator.[44] This preemption creep was in part legal, as many states had enacted parity laws for fear of leaving their financial institutions at a competitive disadvantage, and it was in part political, as often the mere prospect of a potential competitive disadvantage prevented strong action. Since there were no effective federal laws or rules to replace that which was preempted, the result was, indeed, uniformity: a uniform disaster.[45]

The existing crisis vividly demonstrates why federal law must not prevent the states' ability to deal with the problems that they typically see first. It is rare that a problem impacts all states equally and simultaneously. The states are far more nimble than Congress and their role as laboratories is a literal one. States' laws give us a track record for Congress to examine when lobbyists – from all sides – make claims about the likely impact of proposed laws.[46]

Congressional discussions around mortgage reform in 2005 were still focused on the kinds of abuses that the states had begun targeting for legislative reform in 1999, but by then, the market had moved on. And while the federal banking regulators were denying that "their" institutions were engaging in these particular subprime origination practices, they failed to come to grips with the practices their institutions <u>were</u> engaging in – both in buying up the results of those practices, and in their own problem originations in the nontraditional market.[47] As we now know beyond a reasonable doubt, the incredible appetite for originations led to these new kinds of abuses: the abandonment of underwriting, and the market pushing inherently risky products for the reasons we have described.

But on the ground, the states recognized that the market was infecting their cities with a new virus. And, to the extent permitted by preemption, they took action. Ohio enacted the first of this "second generation" of anti-predatory mortgage lending laws as early as May 2006.[48] That legislation, among other things, addressed the ability to pay for all home loans and required a duty of good faith and fair dealing by non-preempted originators. It was followed by Minnesota and approximately ten other "second generation "mortgage reform laws.[49] As for Congress, we are here today – nearly three eventful years later – to talk about addressing those problems at the national level, despite the fact that the market self-destructed in the meantime.

There is another lesson to be learned from this crisis as to why preemption is a bad idea. The "second-generation" state laws took aim at one of the two defining fundamental flaws in the non-prime market – the death of underwriting. But the second defining characteristic was that the market pushed intrinsically dangerous products, and, even today, federal preemption law limits what states can do to protect their neighborhoods from those tainted products.

Most of us are familiar with the federal preemption law that, as interpreted, is constraining the ability of states to protect citizens from overreaching conduct by federally chartered lenders, as we discuss above. (Indeed, the agencies are even beginning to try to stretch the preemption umbrella over third party agents of these entities.[50]) But there is also a 27-year old federal preemption law that protects certain loan products and features from state law – even when sold by state regulated non-bank lenders.

Enacted in 1982, at a time when the mortgage market was constrained as a result of the Fed's policy to fight inflation with high interest rates, Congress enacted the "Alternative Mortgage Transactions Parity Act" (AMTPA).[51] Intended to preempt state laws limiting "creative financing terms," it provided that mortgage loans with any of these terms, such as adjustable rates, balloon payments or similar non-traditional features, would not be subject to state laws restricting those terms.[52] We now know that these are precisely the kind of terms that greatly increased the probability of default.

Ironically, the availability of AMTPA's federal preemption is likely to have been one of the factors that helped fuel the market's preference for them in the first place. Now, it is a confusing obstacle to necessary reform.[53] As its time has long since passed, CRL believes that AMTPA should be repealed in any event, but its enduring legacy should be an object lesson against any preemption that prevents states from responding when needed and as needed.

Conclusion

Today, as our nation struggles in the ruins of a broken mortgage market, it is important to remember that the benefits of homeownership have not changed. Long-term homeownership remains one of the best and most reliable ways that families can build a better economic future, and all of us have a strong national interest in ensuring that the mortgage market works to build our economy, not tear it down. In an effective home lending market, lenders and borrowers will enter transactions with the same fundamental measure of success – that is, a commitment to a mortgage that represents a solid investment both short-term and long-term. We urge Congress to strengthen the mortgage market not by creating impediments to sensible home loans, but by focusing on market-based solutions that result in competent risk management, profitable mortgage-backed investments, and sustainable homeownership.

[1] For example, in September 2006, Robert Broeksmit of the Mortgage Bankers Association told Congress, "Our simple message is that the mortgage market works and the data demonstrate that fact," and "I strongly believe that the market's success in making these "nontraditional" products available is a positive development, not cause for alarm." Statement of Robert D. Broeksmit, CMB Chairman, Residential Board of Governors, Mortgage Bankers Association, Before a Joint Hearing of the Subcommittee on Housing and Transportation and the Subcommittee on Economic Policy, U.S. Senate Committee on Banking, Housing and Urban Affairs, Calculated Risk: Assessing Non-Traditional Mortgage Products, *available at* http://banking.senate.gov/public/_files/broeksmit.pdf./. In May 2007, John Robbins of the Mortgage Bankers Association said, "As we can clearly see, this is not a macro-economic event. No seismic financial occurrence is about to overwhelm the U.S. economy. And we're not the only ones who think so." John M. Robbins, CMB, Chairman of the Mortgage Bankers Association at the National Press Club's Newsmakers Lunch – Washington, D.C. , *available at* http://www.mortgagebankers.org/files/News/InternalResource/54451_NewsRelease.doc.

[2] *National Mortgage News* (March 9, 2009).

[3] *Inside B&C Lending* (February 27, 2009).

[4] Id.

[5] *Inside Mortgage Finance MBS Database.*

[6] *National Mortgage News* (March 9, 2009).

[7] National Association of Realtors, http://www.realtor.org/research/research/ehsdata.

[8] US Census Bureau, http://www.census.gov/const/quarterly_sales.pdf and http://www.census.gov/const/www/quarterly_starts_completions.pdf.

[9] Based on the Mortgage Bankers Association's Weekly Mortgage Applications Survey for the week ending February 27, 2009. The four-week moving average for the seasonally adjusted Purchase Index reached its lowest level since April 1998. *See* www.mortgagebankers.org/NewsandMedia/PressCenter/67976.htm.

[10] Center for Responsible Lending, *Continued Decay and Shaky Repairs: The State of Subprime Loans Today*, p.2 (Jan. 8, 2009) [hereinafter "*Continued Decay*"], *available at* http://www.responsiblelending.org/issues/mortgage/research/continued-decay-and-shaky-repairs-the-state-of-subprime-loans-today.html.

[11] Goldman Sachs Global ECS Research, Home Prices and Credit Losses: Projections and Policy Options (Jan. 13, 2009), p. 16; *see also* Credit Suisse Fixed Income Research, Foreclosure Update: Over 8 Million Foreclosures Expected, p.1 (Dec. 4, 2008).

[12] Mortgage Bankers Association National Delinquency Study (March 5, 2009).

[13] First American Core Logic (March 4, 2009).

[14] *Continued Decay*, p. 3.

[15] For a much longer discussion of the roots of today's crisis, see Testimony of Eric Stein, Center for Responsible Lending, before the Senate Committee on Banking (Oct. 16, 2008), *available at* http://www.responsiblelending.org/pdfs/senate-testimony-10-16-08-hearing-stein-final.pdf.

[16] Chairman Bernanke makes this point in a recent presentation: "Housing, Housing Finance, and Monetary Policy," remarks by Ben Bernanke, Chairman, Board of Governors of the Federal Reserve System at the Federal Reserve Bank of Kansas City's Economic Symposium – Jackson, Hole, Wyoming (August 31, 2007), pp. 16 – 17.

[17] Berkshire Hathaway Annual Report (2002).

[18] Testimony of Michael D. Calhoun Before the U.S. House Committee on Financial Services, "*Legislative Proposals on Reforming Market Practices*," pp. 18-20 (October 24, 2007), *available at* http://www.responsiblelending.org/pdfs/calhoun-testimony-10_24_2007.pdf.

[19] Remarks by Federal Reserve Board Chairman Ben S. Bernanke at the Opportunity Finance Network's Annual Conference, Washington, D.C. (November 1, 2006).

[20] Joint Center for Housing Studies, "Credit, Capital and Communities: The Implications of the Changing Mortgage Banking Industry for Community-Based Organizations," Harvard University, pp.4-5. Moreover, broker-originated loans "are also more likely to default than loans originated through a retail channel, even after controlling for credit and ability-to-pay factors." *Id.* at 42 (citing Alexander 2003).

[21] Susan Woodward, *A Study of Closing Costs for FHA Mortgages*, HUD Office of Policy Development and Research (May 2008); *see also* Howell E. Jackson and Laurie Burlingame, Kickbacks or Compensation: The Case of Yield-Spread Premiums, 12 Stan. J. L, Bus & Fin. 289, 353 (2007).

[22] Last year, we released a study that showed broker-originated mortgages cost more for subprime loans but less for some classes of prime loans. Keith Ernst, Debbie Bocian and Wei Lei, Center for Responsible Lending, *Steered Wrong: Brokers, Borrowers and Subprime Loans* (Apr. 8, 2008), *available at* http://www.responsiblelending.org/issues/mortgage/research/steered-wrong-brokers-borrowers-and-subprime-l-oans.html.

[23] Roberto G. Quercia, Michael A. Stegman & Walter R. Davis, The Impact of Predatory Loan Terms on Subprime Foreclosures: The Special Case of Prepayment Penalties and Balloon Payments (vol. 18, issue 2, 2007), *available at* http://www.mi.vt.edu/data/files/hpd%2018.2/5.hpd_quercia_web.pdf.

[24] Wei Li and Keith S. Ernst, *The Best Value in the Subprime Market: State Predatory Lending Reforms*, pp. 2-3, 13-17, Center for Responsible Lending (February 23, 2006).

[25] *Id.* The study ranked states as to four substantive protections, prepayment penalties among them, as well as the scope of coverage to which the protections applied and the remedies available. The lowered interest rates likely result from the perverse relationship between yield spread premiums and prepayment penalties in the subprime market, as we discuss above. We also note that at least thirty-five states regulate prepayment penalties, including eleven states that have prepayment penalty bans on broad categories of mortgage loans. There is no evidence that consumers feel deprived of "choice" in those states. **Alabama** (unless approved mortgagee under National Housing Act or where creditor is exempt from licensing, per ALA. CODE § 5-19-31) (ALA. CODE § 5-19-4(c)); **Alaska** (except federally insured loans requiring prepayment penalty) (ALASKA STAT. ANN. § 45.45.010(g)); **Indiana** (prepayment penalty banned for a consumer loan (key requirement: secured by an interest in land or by personal property that is the borrower's principal dwelling) that is not "*primarily* secured by an interest in land" (i.e., that is not a first lien mortgage) as well as for a refinancing or consolidation (junior lien)) (IND. CODE ANN. § 24-4.5-3-209 (limitation on penalty); § 24-4.5-3-104 (definition of "consumer loan"); § 24-4.5-3-105 (explanation of "primarily secured by land")); **Iowa** (purchase money or refinance of purchase money loan secured by 1- or

2-family dwelling or by agricultural land)(IOWA CODE ANN. § 535.9.2); (reverse annuity or graduated payment mortgage loans) (IOWA CODE ANN. § 528.4); **Minnesota** (prohibited in residential mortgages under Fannie Mae conforming limit) (Minn. Stat. §58.137(2)(c); **New Jersey** (for loans with interest rates exceeding 6%) (N.J. STAT. ANN. § 46:10B-1, B-2); **New Mexico** (N.M. STAT. ANN. § 56-8-30); **North Carolina** (banned on first mortgage loans below $150,000) (N.C. GEN. STAT. § 24-1.1A(b)(1)); **Ohio** (prohibited in residential mortgage under $75,000) (Ohio Rev. Code §1343.011(2)(a); **South Carolina** (banned on loans below $150,000) (S.C. CODE ANN. § 37-23-80, 37-10-103);**Vermont** (Vermont Stat. Ann. tit. 8 § 2232a, tit. 9 § 45).

[26] When widespread abusive lending practices in the subprime market initially emerged during the late 1990s, the primary problems involved equity stripping—that is, charging homeowners exorbitant fees or selling unnecessary products on refinanced mortgages, such as single-premium credit insurance. By financing these charges as part of the new loan, unscrupulous lenders were able to disguise excessive costs. To make matters worse, these loans typically came with costly and abusive prepayment penalties, meaning that when homeowners realized they qualified for a better mortgage, they had to pay thousands of dollars before getting out of the abusive loan. *See, e.g*., Eric Stein, *Quantifying the Economic Costs of Predatory Lending*, Center for Responsible Lending (2001), *available at* http://www.responsiblelending.org/pdfs/Quant10-01.pdf.

[27] Before the current crisis, a strong housing market and largely favorable interest rates allowed borrowers with subprime loans to refinance when their payments rose. In this scenario, with each refinance, the borrowers lost significant equity as they incurred a whole new set of lender fees, broker fees, and third-party closing fees with each loan. In turn, this loss of equity meant that borrowers lost their single largest source of wealth and ended up trapped in a cycle of subprime loan after subprime loan, spiraling towards foreclosure. Breaking this cycle of equity stripping is a critical first step in the new era.

[28] Souphala Chomsisengphet, Timothy Murphy and Anthony Pennington-Cross, *Product Innovation and Mortgage Selection in the Subprime Era*, presented at The Subprime Housing Crisis: Interdisciplinary Policy Perspectives, Univ. of Iowa, October 10-11, 2008 (referring to loans "designed to terminate.") A former broker confirmed to CRL that applicants were steered to 2/28s to generate repeat business.

[29] Debra Cassens Weiss, *New Century GC Sounded Early Warning About Subprime Exposure*, ABA Journal (March 31, 2008).

[30] Mortgage Asset Research Institute, Inc., *Eighth Periodic Mortgage Fraud Case Report to Mortgage Bankers Association*, p. 12, *available at* http://www.mari-inc.com/pdfs/mba/MBA8thCaseRpt.pdf (April 2006); *see also* 2007 Global Structured Finance Outlook: Economic and Sector-by Sector-analysis, FITCH RATINGS CREDIT POLICY (New York, N.Y), December 11, 2006, at 21 (commenting that the use of subprime hybrid arms "poses a significant challenge to subprime collateral performance in 2007").

[31] The Federal Reserve Board was given the authority to regulate mortgages under the HOEPA law passed in 1994, but they did not exercise that authority until the summer of 2008.

[32] The practices of IndyMac, one of the largest originators of Alt A loans until it went defunct, demonstrate that perverse incentives drove abuse even outside of the subprime market. IndyMac routinely avoided including income information on their loans or pushed through loans with inflated income data, even from retirees. As recently as the first quarter of 2007, only 21% of IndyMac's total loan production involved "full-doc" mortgages.

[33] *See* Fannie Mae "Single Family Selling Guide" Part VII, Section 104.05.

[34] Most homeowners with conforming mortgages already maintain escrow accounts, so the new requirement would only impact those parts of the market that most need it. *See, e.g.*, Fannie Mae "Single Family Selling Guide" Part VII, Section 104.05.

[35] "The Oracle Reveals All," *Newsweek* (Sept. 24, 2007) pp. 32, 33.

[36] *See, e.g.* Allan Sloan, "An Unsavory Slice of Subprime," *Washington Post* (October 16, 2007) ("Even though individual loans … looked like financial toxic waste," 68% of the issue was rated AAA.)

[37] Testimony of Tara Twomey, National Consumer Law Center, Before the U.S. House of Representatives Subcommittee on Housing and Community Opportunity, p. 8 (April 16, 2007).

[38] *Id*. at 7 (cutting costs is one reason for heavy reliance on often frustrating voicemail and touch tone menu options, as well as for the lack of adequate staff to handle requests for negotiation or information).

[39] Alan White, *Deleveraging American Homeowners: December 18, 2008 Update to August 2008 Report*, Valparaiso University School of Law (Dec. 2008), p.2 (finding that of more than 3.5 million subprime and Alt A mortgages (all securitized) reviewed in November 2008, only 35% of modifications reduced monthly payments below the initial payment, while 20% left the payment the same and 45% increased the monthly payment).

[40] *See* Raphael Bostic, Kathleen C. Engle, Patricia A. McCoy, Anthony Pennington-Cross & Susan Wachter, *State and Local Anti-Predatory Lending Laws: The Effect of Legal Enforcement Mechanisms*, 60 J. Econ. & Bus. 47-66 (2008), full working paper version *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1005423, p. 18 (finding that stronger private enforcement regimes, including private right of action and assignee liability, did not constrict subprime originations in 2004 and had an elevated probability of originations in 2005).

[41]*See, e.g.* 15 U.S.C. §1610; Reg. Z, 12 C.F.R. § 226.18, Official Staff Commentary § 226.28(a)-2,3 (Truth in Lending); 15 U.S.C. § 1691d(f) (Equal Credit Opportunity Act); 15 U.S.C. § 1693q (Electronic Funds Transfer Act); 15 U.S.C. § 1692n (Fair Debt Collection Practices Act); 15 U.S.C. § 1677 (Restrictions on Garnishment).

[42] *See, e.g.* 69 Fed. Reg. 1904, 1908 (January 13, 2004) (supplementary information to OCC Preemption rule).

[43] 68 Fed. Reg. 46,264 (Aug.5, 2003) (preempting Georgia Fair Lending law); 69 Fed. Reg. 1904, 1911-12 nn.57,59 (2004) (suggesting OCC will take the position that other state HOEPAs are preempted as well.).

[44] Christopher L. Peterson, *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda,* 78 Temp. L. Rev. 1, 72-74 (2005).

[45] The one all-purpose federal law available, the FTC law prohibiting unfair and deceptive acts and practices, was rarely invoked by the federal agencies against federal banks and thrifts, and then, only against small banks, or when external events forced their hand. State enforcement was precluded since approximately 1999 by expansive assertions of visitation rights, currently under review by the Supreme Court, *Cuomo v. Clearing House, LLC,* No. 08-453 (pending.). Enforcement through private civil litigation was extremely hampered by arguments over whether the state law versions of the law were preempted.

[46] *See, e.g.*Wei Li and Keith Ernst, *Do State Predatory Lending Laws Work? A Panel Analysis of Market Reforms*, Housing Policy Debate 18:2, p. 347 (2007); Raphael Bostic, Kathleen C. Engle, Patricia A. McCoy, Anthony Pennington-Cross & Susan Wachter, *State and Local Anti-Predatory Lending Laws: The Effect of Legal Enforcement Mechanisms*, 60 J. Econ. & Bus. 47-66 (2008), full working paper version available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1005423 (includes literature review).

[47] *See, e.g.*, Testimony of Patricia A. McCoy Before the U.S. Senate Committee on Banking, Housing and Urban Affairs, *Consumer Protection in Financial Services: Past Problems, Future Solutions* (March 3, 2009).

[48] S.B. 185 (May, 2006), http://www.legislature.state.oh.us/BillText126/126_SB_185_EN_N.pdf.

[49] In addition to Ohio, Minnesota, North Carolina, Maine, Illinois, Kentucky and Colorado have enacted laws taking aim at at least some of these practices since May 2006. This wave of state laws continued in 2008, with New York, Maryland, Connecticut and Washington passing substantive legislation and the Massachusetts Attorney General's rules going into effect as well.

[50] For a full discussion of some of the issues this expansion may raise, *see* Christopher L. Peterson, *Preemption, Agency Cost Theory, and Predatory Lending by Banking Agents: Are Federal Regulators Biting Off More than They Can Chew?*, 56 Amer. U. L. Rev. 515 (2007).

[51] 12 U.S.C. § 3801, et.seq. AMTPA applies to "housing creditors," broadly defined. For loans with one of these features, the lender need not comply with certain state laws limiting creative financing terms such as adjustable rates, interest-only features, and even default rates, provided they comply with applicable federal rules, which tend to be inadequate for today's abuses. Furthermore, from 1996 to July 1, 2003, an OTS interpretation of AMTPA preempted state laws on prepayment penalties for non-federally chartered housing creditors. (State laws on prepayment penalties are independently preempted by the OCC and OTS for their charters.) For a more complete description of AMTPA, *see generally* National Consumer Law Center, *The Cost of Credit*, §3.10 (3d ed. 2005).

[52] *E.g.*, Cabrejas v. Accredited Home Lender, Inc.¸2007 WL 2044573 (D. Md. July 5, 2007) (state law on balloon payments preempted).

[53] *See, e.g.* Ill. Ass'n of Mortgage Brokers v. Office of Banks & Real Estate, 308 F.3d 762 (7th Cir. 2002) (some of Illinois' mini-HOEPA provisions may be preempted by AMTPA; remanding).