

## A Mortgage and Consumer Finance Law Update

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### **New Details Emerge Regarding Congressman Barney Frank's Proposed Amendments to Federal Mortgage Laws**

On October 22, U.S. Representative Barney Frank (D.-Mass.), chairman of the U.S. House Financial Services Committee, announced new details of his proposed bill, H.R. 3915, which would make significant changes to the Truth in Lending Act and is designed to address what he claims are abusive lending practices responsible for the dramatic rise in mortgage foreclosures in some parts of the country. The bill calls for close federal supervision of mortgage brokers, who have become the predominant providers of sub-prime loans allegedly responsible for the foreclosure crisis.

In its current form, the bill's express purpose is "to reform consumer mortgage practices and provide accountability for such practices, to establish licensing and registration requirements for residential mortgage originators, [and] to provide certain minimum standards for consumer mortgage loans... [among] other purposes."

Representatives on both sides of the aisle have expressed the urgency and significance of the initiative. "Our goals should be to correct problems within the sub-prime market without choking off working Americans' access to credit," says Rep. Spencer Bacchus of Alabama, the senior Republican on the financial services panel, to the *Los Angeles Times*. "This is an important issue, and we need to get it right."

#### **What This Means for Mortgage Lenders**

While this legislation has not yet been passed, enactment of comprehensive legislation aimed at reforming residential mortgage lending is a near certainty. Those in the mortgage industry should, therefore, monitor the progress of proposed legislation, including Rep. Frank'.

Specific changes that the Frank bill proposes include:

- Restrictions on prepayment penalties for sub-prime loans, which discourage borrowers from seeking more favorable refinancing;
- A ban on rewards payments - or "yield spread premiums"- to brokers that convince borrowers to accept higher interest rates than those for which they might otherwise have been eligible;
- Companies that package loans as investments would be held liable for loans they purchase from lenders that violate the new federal standards;

- A mandatory licensing system for all loan originators - lenders in states that do not pass their own licensing legislation to match federal standards of care would be required to be licensed under the federal system;
- A private right of action by borrowers against entities that pool loans and sell them as securities to the secondary market; and
- Requirements that lenders do a better job of screening their borrowers.

In addition, unlike a number of recent state laws structured around a general suitability principle that requires lenders to write loans that are “suitable” for their borrowers, Frank’s bill specifically limits or prohibits certain kinds of loan terms. Frank sees this as an advantage: “We felt a suitability standard was too vague,” Frank told *The Boston Globe*. “We don’t want to give people an obligation that is too vague and obscure because you can scare people away from doing anything. We think these [rules] are less subjective than suitability.”

From an industry standpoint, however, there are concerns that when government carves loan terms into legislative stone, the industry will be limited in its ability to adjust to the market. “[T]he market has sort of adjusted already,” Roy DeLoach, executive vice president of the National Association of Mortgage Brokers, told *The Boston Globe*.

The bill proposes that lenders and mortgage brokers, acting as liaisons between lenders and borrowers, must only make loans to people who can be reasonably expected to repay them. Further, the bill would require that lenders give customers the “best product” for their needs. As reported by *The Washington Post*, Kurt Pfothner, a senior vice president at the Mortgage Bankers Association asks, “What is the best product, and is that the same for everyone, and how is it going to be determined?”

The bill has prompted criticism and praise from all sectors. The industry is concerned about the degree to which the bill will limit market innovation, but applauds the requirement of state and national licensing standards that should serve to drive bad actors from the field. Some worry that the new regulations will merely increase regulatory and compliance costs, and reduce consumer choice. In addition, by setting a “floor” for some regulations that states may freely exceed, some mortgage industry officials fear an increasing lack of national uniformity. “Without a uniform national standard, this legislation could only serve to foster more confusion in the marketplace,” Pfothner told *The Wall Street Journal*.

Consumer groups have applauded the restrictions on incentive-based pay and yield spread premiums, but some argue the legislation does not go far enough in holding the secondary investment market liable for encouraging and accepting bad loan packages. Some consumer groups say, allowing borrowers to sue investment plans directly may not go far enough to correct abuses in the industry.

Although Frank has expressed optimism that the bill will be passed by the Democrat-led Congress, its chances remain somewhat unclear and the specific terms of the bill are likely to change in negotiations across the aisle. Howard Glaser, a former senior official at the U.S. Department of Housing and Urban Development, says the bill’s chances also depend on how

much longer the real estate slump continues. Political observers expect the issue to play a major role in national political campaigns next year.

### **Resources**

Rep. Frank's bill, H.R. 3915, may be downloaded at: [http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110\\_cong\\_bills&docid=f:h3915ih.txt.pdf](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:h3915ih.txt.pdf).

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