FINAL REPORT
BY THE
SUBPRIME LENDING WORK GROUP

TO THE

CONVENTIONAL FINANCE AND LENDING COMMITTEE

MAY 11, 2005
WASHINGTON

Mission of the Subprime Lending Work Group

The purpose of the Subprime Lending Work Group is to develop recommendations for consideration by the Conventional Finance and Lending (CFL) Committee for standards for NAR to use in evaluating proposed state and federal legislation and regulations. The objective is to develop standards that represent a balance for continued valid uses of subprime loans for borrowers with imperfect credit while avoiding predatory (abusive) lending practices.

Having detailed policy guidance will permit NAR to participate fully in complex negotiations likely among all affected groups and Congress.

Why REALTORS® Seek to Prevent Predatory Lending

REALTORS® have a strong stake in preventing predatory lending because:

- Predatory lending erodes confidence in the Nation's housing system.
- In a credit-driven economy, the legislative and regulatory response to lending abuses can go too far and inadvertently limit the availability of reasonable credit for prime as well as subprime borrowers.
- To the extent the response to predatory lending constrains the ability of the secondary mortgage market to provide liquidity for home finance, consumers will find it more difficult and expensive to buy a home.
- Citizens of communities, including REALTORS®, are harmed whenever predatory lending strips equity from homeowners, especially when the predatory lenders concentrate their activities on certain neighborhoods and create a downward cycle of economic deterioration.

Members of the Subprime Lending Work Group

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NAR Staff: Ed Miller, Jeff Lischer, George Griffin

How the Work Group Conducted Its Business

Starting in August 2004, the Work Group held nine 90 minute conference calls to discuss predatory lending issues and review the draft and final reports. The staff held roundtables for consumer organizations, lenders and their representatives, Fannie Mae, and Freddie Mac to listen to their concerns and recommendations and report back to the Work Group.

EXECUTIVE SUMMARY

Work Group Recommendations

The Work Group recommends that the Committee:

- Approve a 3-pronged approach to combating predatory lending, as described below; and

- Submit the report to the Board of Directors as an action item.

Although NAR is already on record, in general, as opposing predatory lending, the Work Group recommends that the Committee submit the report for approval as an action item to the Board of Directors because the report includes:

- A new policy recommending that REALTORS®:
  - Using existing programs as a resource, help consumers navigate the complex homebuying process and find fair and affordable financing, and
  - Refer consumers to financial literacy information (including how to avoid predatory lending); and
- A major enhancement and reaffirmation of NAR policy opposing predatory lending that will position NAR to play an important role in the consideration of any proposed legislation and regulations.

The Discussion (see next section) includes more details about each of the following initiatives.

I. Build on the Public Awareness Campaign.

For 2005, NAR has already broadened the scope of the NAR public awareness campaign by adding the following concept to the advertisements: "Talk to a REALTOR® First." This not only strengthens the REALTOR® brand generally, but provides a great platform for encouraging REALTORS® to use their central position in the purchase transaction to help consumers become more financially literate and avoid predatory lending.

II. Foster Consumer Education.

NAR should encourage REALTORS® to:

- Work with existing programs and community groups to help consumers, as early as possible in the process, to navigate the complex homebuying process and locate and qualify for fair and affordable financing; and
- Refer consumers to information about financial literacy in general and about how to avoid predatory lending in particular.
- Refer consumers, where appropriate, to reputable counseling organizations that provide credit and homebuying information and advice.

This should include highlighting links on Realtor.org to appropriate programs and information.

III. Support Stronger Anti-Predatory Lending Legislation and Regulations.

The Work Group has reviewed many possible improvements to the Home Ownership and Equity Protection Act of 1994 (HOEPA). It recommends a package of improvements to HOEPA to guide NAR as it considers proposed legislation and regulations. While not every item on the list is likely to be included in legislation or regulations, NAR should only support proposals that take a strong stand against predatory lending, including as many of the items as possible.

The Work Group recommends that it continue in effect so staff may consult its members in connection with implementing the report.

DISCUSSION

Work Group Recommendations

The Work Group recommends that NAR (a) approve a 3-pronged approach to combating predatory lending, and (b) extend the life of the Work Group so staff may consult its members in connection with implementation of the report. The situation on the Hill is fluid and action in 2005 or even 2006 is uncertain.

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Links to existing programs, literacy information, and reputable counselors will be added to the REALTOR.org website so NAR members can readily access them.

NAR staff will use a variety of ways to get the message out to NAR's membership, encouraging them to help consumers get the information they need. These may include:

- Publicizing the tools available for REALTORS® to help consumers in REALTOR Magazine, various Internal News Service (INS) publications, and the weekly Washington Report.
- Encourage State and Local Association Executives to communicate with the members of their Associations and consider educational programs for members and consumers.
- Surveying what state and local associations are already doing to identify good ideas that can be replicated elsewhere.
- Inviting Fannie Mae, Freddie Mac, and other organizations to offer anti-predatory lending and consumer literacy workshops at NAR meetings.
- Including predatory lending as a topic in the Regulatory Issues Forum (under active consideration for the San Francisco meeting).
- Working with communications and consumer education experts to identify and implement other ideas.

Examples of Existing Programs

Anti-predatory lending and homebuying programs include:

- **Fannie Mae's Borrow with Confidence Program.** Under this program, real estate agents learn to be a one-stop source of information for home buyers on credit and financing issues and on affordable lending. The program also brings responsible lenders into underserved areas.

- **Freddie Mac's Don't Borrow Trouble Program.** This program combines public education and counseling to help homeowners avoid predatory loans.
- The **NAR/Neighborhood Reinvestment Corporation Partnership.** This Partnership promotes housing opportunities through homeownership education.

Examples of Links to Websites on Financial Literacy, Homebuying, and Predatory Lending

Consumer literacy information sites include:

- **My Money—**the Federal Government's website with links to many sites, including those on the following subjects:
  - Budgeting and Taxes
  - Credit
  - Financial Planning
  - Homeownership, including links to HUD's site on avoiding predatory lending, finding housing counselors, and other information for homebuyers.

  http://www.MyMoney.Gov

- **HUD's Website—**a wealth of information about homebuying. http://www.hud.gov/buying/index.cfm
- **Freddie Mac's Credit Smart Program**—helps consumers understand, build, and maintain better credit. http://www.freddiemac.com/creditsmart
- **FDIC's Money Smart Program**, "a training program to help adults outside the financial mainstream enhance their money skills and create positive banking relationships." This site has relatively little about homeownership. http://www.fdic.gov/consumers/consumer/moneysmart/overview.html
- **Credit-Power** targets students and contains information about credit and homeownership, including links to other sites designed for young people. Its sponsors are the Illinois Association of Realtors, the Partnership for Homeownership, and Freddie Mac. http://www.credit-power.org/default_eng.asp

NAR should identify other financial literacy programs aimed at the high school and college levels and post information it finds on the NAR website.

Information about shopping for mortgages and avoiding predatory lending is available on many sites, including:

- **"Looking for the Best Mortgage"** is a brochure on how to shop, compare, and negotiate the best deal on a home loan. The brochure is a joint effort of 11 federal agencies, including FTC, the Federal Reserve

Board, HUD, and the Justice Department. http://www.federalreserve.gov/pubs/mortgage/mortb_1.htm.

- **HUD** has many resources on how to buy a home, including information on how to avoid predatory lending. **"Don't Be a Victim of Loan Fraud"** is a HUD brochure on how to avoid predatory lending. http://www.hud.gov/offices/hsg/sfh/pred/predlend.cfm
- **In conjunction with the FTC, NAR** has issued "The Fair Credit Reporting Act and Your Credit History." This brochure contains frequently asked questions about credit reports and credit scores and information on how to address inaccuracies. http://www.realtor.org/gapublic.nsf/files/FCRABroch.pdf/$FILE/FCRABroch.pdf
- **The Fannie Mae Foundation** offers free homebuying guides: "Knowing and Understanding Your Credit," "Opening the Door to a Home of Your Own," and "Choosing the Mortgage that's Right for You." http://www.homebuyingguide.com
- The **Federal Trade Commission** has a predatory lending pamphlet: "Home Equity Scams: Buyer's Beware." http://www.ftc.gov/bcp/online/pubs/homes/eqscams.htm.

Housing and Credit Counseling

Information for REALTORS® on the benefits and pitfalls of consumer counseling organizations should be included on REALTOR.org. Many entities that promote themselves as nonprofit credit counselors provide very little assistance to consumers but at a very high cost. Other organizations provide a useful service at a reasonable cost.

The key will be for REALTORS® to identify good counseling entities in their communities, refer consumers that would benefit from counseling, develop relationships of mutual trust with the counseling entities to help ensure referrals back to the REALTOR® (of the referred consumers and other potential clients), and stay in touch with the referred consumers during the counseling period so the REALTOR® will be in the best position to assist them when they are ready purchase a home.

The Work Group heard from the National Foundation for Credit Counseling (http://www.nfcc.org), a trade association with about 125 members, 80 of whom are also housing counselors. The Work Group learned about the history of NFCC, its current activities and practices of its members, its membership standards, and problems in other elements of the counseling industry. Members of the Work Group checked out the reputation of some of NFCC's members in their own communities, and NAR staff checked on NFCC's reputation with consumer groups. NAR should include a link to NFCC and other counseling organizations that REALTORS® could use as one way to identify good housing counselors. Mere membership in an organization would not be sufficient; REALTORS® should also check locally on whether they believe any particular counseling organization merits referrals.

The HUD website has a list of approved housing counselors, some of which are NFCC members. That list is also a good starting point for REALTORS® seeking to identify responsible housing counselors, but also requires REALTORS® to assure themselves that the organization merits receiving referrals. HUD approval does not guarantee the entity is a good counseling resource.

The Work Group recommends that NAR consider negotiating with NFCC and other appropriate counseling organizations to establish the terms under which (a) the NAR website would provide information about NFCC and other organizations, and (b) NFCC and other organizations would publicize this relationship to their own members. NFCC has indicated, preliminarily, that it agrees that its members should be advised of the expectation that a consumer referred by a REALTOR® to the counseling organization would ordinarily be referred back to the same REALTOR® when the consumer is ready to shop for a home. The REALTOR® has an important role in making sure this happens routinely in practice by building relationships with the counseling entity and staying in touch with the consumer.

In connection with the Housing Opportunity Program, NAR has already taken steps to promote homeownership education and counseling. Under a partnership with the federally-chartered Neighborhood Reinvestment Corporation (NRC), NAR is a founding sponsor of NRC's NeighborWorks Center for Homeownership Education and Counseling (NCHEC). NCHEC's mission is "to work with industry partners to train, certify and support homebuyer educators and housing counselors nationwide." NAR's support of NCHEC complements the recommendations of this report.

III. Guidance on Proposed Legislation and Regulations. The Work Group reviewed many possible amendments to the Home Ownership and Equity Protection Act of 1994 (HOEPA). HOEPA establishes anti-predatory lending protections for high-cost mortgages. The Work Group has developed a package of recommended HOEPA amendments to broaden and strengthen its coverage. These recommendations will guide NAR staff as they develop NAR comments on proposed legislation and regulations.

If Congress enacts significant HOEPA reform including many of the amendments listed below, the result would be a significant reduction in predatory lending.

- **Extend HOEPA to Purchase Money Mortgages.** The scope of HOEPA should be broadened to cover purchase money mortgages, and not be limited to refinancings and other loans taken out by existing homeowners. While predatory lending has been a particular problem in connection with refinancings by homeowners, homebuyers are also being victimized by predatory loans.

- **Lower Triggers to Apply HOEPA to More Mortgages.** HOEPA applies to high-cost mortgages, measured in terms of high interest rates and high fees and points.
  - The existing interest rate trigger should be lowered so HOEPA applies to more mortgages, but the decision of exactly what level is appropriate will depend on the strength of the overall package of reforms. The current trigger for subordinate mortgages is 10 percent above the rate for comparable U.S. Treasury obligations. The Federal Reserve Board has exercised its discretion to lower the trigger to 8 percent for first mortgages.
  - The definition of fees and points should be comprehensive (current law has too many exclusions), and the points and fees trigger should be set at about 5 percent of the loan. For example, the definition should include yield spread premiums and, if permitted, potential prepayment penalties. Some pending proposals would permit, in addition to the percentage cap, two bona fide discount points, which should be permitted, depending on the strength of the overall package of reforms.
  - In addition, NAR should consider supporting an additional HOEPA trigger based on excessive loan-to-value ratios, again with the details depending on the strength of the overall package of reforms. Since appraisal fraud—appraisals above the real market value of the property—may be coupled with predatory lending, an LTV trigger may have limited impact. NAR is on record in support of appraisals that are independent, unbiased, and objective for all segments of the market.

- **Protections from Predatory Terms and Conditions.** NAR should support a strong package of HOEPA reforms that includes as many of the following protections for high-cost HOEPA mortgages (and, where noted, other mortgages) as possible:

  - Seek to bar **prepayment penalties** but for all mortgages, not just high-cost HOEPA mortgages. If a complete prohibition is not feasible, support shortening the maximum permissible time for prepayment penalties from five years to three or preferably fewer years and capping them at a reasonable amount.
  - **Cap the amount of fees and points that may be financed at about 5%, plus up to two bona fide discount points.** This would minimize the ability of predatory lenders to hide the true cost to the consumer by avoiding the need for them to pay for excessive fees at settlement. Prohibit financing of fees and points in the case of a refinancing where the same lender made the loan being refinanced.

- Prohibit **single premium insurance** (or any equivalent)**.**
- Prohibit **mandatory arbitration clauses,** because of the need to offer borrowers with HOEPA mortgages stronger protections. (Mandatory arbitration clauses are becoming infrequent in the prime market because Fannie Mae and Freddie Mac no longer purchase mortgages with mandatory arbitration clauses, and other lenders have stopped including them in their mortgages as well.)
- Continue to prohibit lenders from engaging in a pattern or practice of lending without regard to the **ability of the borrower to repay the loan.**
- For **home improvement contractor loans,** continue to prohibit direct payments of loan proceeds to home improvement contractors, and make assignees and holders of HOEPA home improvement mortgages subject to the same claims a consumer has against the seller, contractor, broker, or creditor.
- Prohibit anyone from **encouraging default.**
- Prohibit **mortgage flipping—**refinancing within one year unless the refinancing provides a "reasonable net tangible benefit" to the borrower.
- Require lenders, each year, to provide **two free pay-off statements** within seven business days of the request.
- As a general rule, permit **modification and deferral fees** only when there is a change to a HOEPA loan that benefits the consumer.
- Require all institutional mortgage lenders to **report payment history** of borrowers on a monthly basis. Prime mortgage lenders typically already report payment histories to credit reporting agencies (credit bureaus), so imposing reporting on all lenders should not impose an additional regulatory burden on prime mortgage lenders.
- Retain prohibitions against **balloon mortgages** for mortgages with terms less than five years and against **negative amortization**.
- Require **counseling** for prospective borrowers, to be provided by independent, certified counselors.

- **Assignee Liability.** NAR should oppose any weakening of originator or assignee liability for HOEPA mortgages. There is no reason originators should not remain liable for violations of law they commit in connection with making a mortgage loan. As between an innocent borrower that risks losing the home and an innocent assignee in the secondary market that inadvertently purchases a HOEPA mortgage, the interests of the borrower should generally prevail. Fannie Mae, Freddie Mac, and others have policies against the purchase of HOEPA mortgages, and current law had not impaired the secondary market.

> HOEPA currently imposes liability on assignees of HOEPA mortgages and permits borrowers to defend against foreclosure based on defects in the mortgage, with limited exceptions. A HOEPA mortgagor in default cannot assert certain claims and defenses against an assignee that can demonstrate, by a preponderance of evidence, that a reasonable person could not determine that it had purchased a HOEPA mortgage, based on certain factors. But even where an assignee can make that showing, the mortgagor retains certain rights, including the right of rescission for certain violations.
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> NAR should consider supporting proposals to strengthen HOEPA, so long as they would not disrupt the secondary market. For example, HOEPA should continue to include reasonable limits on the amount of damages a mortgagor can claim, and class action litigation should not be permitted.

RESPA. In the belief that RESPA reform is a necessary piece of fighting predatory lending, the Work Group applauds NAR's support for a market-based approach to RESPA reform that encourages fair competition, protects consumer choice, and provides full disclosure to consumers of costs and services in the mortgage transaction.