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Summary of the Ney-Kanjorski “Responsible Lending Act”

Representatives Bob Ney (R-OH) and Paul Kanjorski (D-PA) are sponsoring a new bill, the “Responsible Lending Act,” that would set uniform national mortgage lending standards and prevent abusive practices. This legislation is expected to attract strong bipartisan support and to be the mark used by the House Financial Services Committee for addressing these issues.

The bill amends the “Home Ownership and Equity Protection Act of 1994” (HOEPA), the primary federal law intended to protect borrowers from so-called “predatory” lending practices. HOEPA only covers closed-end loans (i.e., loans that are paid off over a set period with set monthly payments) that refinance an existing home mortgage. Its protections are targeted at the highest cost nonprime loans¹ made to higher risk borrowers because this is the market segment where the most significant abuses occur. HOEPA requirements apply when either of two specified cost thresholds, commonly called the “APR trigger” and the “Points and Fees trigger,” are exceeded.

Title I of the Ney-Kanjorski (NK) bill would extend HOEPA protections to cover far more loans, add many new protections (summarized below) for covered loans, strengthen penalties for violations, apply limited liability in certain instances to secondary market purchasers of loans (so-called “assignee liability”) and set uniform national standards by preempting state laws dealing with these issues. The four other NK titles provide for: (1) enhanced borrower financial education and counseling opportunities; (2) escrow accounts and mortgage servicing protections; (3) property appraisal requirements to prevent “property flipping” and appraisal fraud; and (4) mortgage broker licensing standards and a national broker registry.

Although the bill provides strong borrower protections, it is balanced and carefully drafted so lenders can continue providing affordable loans to meet borrowers’ credit needs and further expand home ownership.

Improper Lending Practices - The primary improper lending practices addressed by the NK bill include: (1) “loan flipping,” which refers to frequently refinancing a loan with high point and fee charges and little or no meaningful benefit to the borrower; (2) asset based lending, which entails making loans without regard to the borrower’s ability to repay, relying instead on the property’s foreclosure value; (3) excessive prepayment penalties; (4) charging unjustifiably high points and fees; (5) “steering” borrowers, often on a racially targeted, discriminatory basis, to purchase more expensive loan products when they actually qualify for less expensive

¹ “Nonprime” loans represent roughly 20% of the overall residential mortgage market. These loans are made to borrowers who pose higher risk and are charged somewhat more than the lowest risk borrowers who receive less expensive so-called “prime” loans.



products; (6) selling overpriced single premium credit insurance; (7) home improvement loan scams where contractors perpetrate various frauds with the borrower paying for work not performed or for shoddy, incomplete work; and (8) “property flipping,” which involves reselling homes several times employing inflated appraisals and other fraudulent sales practices with unsuspecting borrowers paying inflated prices well in excess of the property’s value.

Additional Background

States’ Patchwork Regulations - Congress has failed to pass amendments needed to strengthen the relatively weak HOEPA provisions. Beginning in 1999 with North Carolina, many states and some localities began passing their own laws seeking to address abuses not adequately covered by HOEPA. While well intended, these laws are all different and have resulted in a very uneven and often burdensome regulatory mosaic. Some of these laws have gone too far, while some are too weak. A number of states have passed no additional protections, and all laws that have been passed are different. In addition to this very unequal protection scheme for borrowers in different localities, inconsistent protections also apply depending on the type lender the borrower uses. Federal statutes and regulatory interpretations provide preemption of such state requirements for federal depositories and their operating subsidiaries. Most consumer advocacy groups contend that while HOEPA should be amended to provide greater protections, it should not preempt the many conflicting state laws. Some say if there is to be preemption, it should be a floor, not a ceiling, and states should be allowed to pass statutes that provide even more restrictive laws. Lenders take essentially the opposite view, contending that housing finance now is handled mainly through large, nationwide lenders who face undue compliance burdens with the myriad of conflicting state laws. Most lenders say that they are willing to support much tougher federal statutory protections, but they want uniform national standards with state and local requirements being preempted.² Lenders also emphasize that amendments must be carefully drafted because experience has shown that overly restrictive legislation can severely limit higher risk borrowers’ ability to obtain affordable mortgage credit.

Other Consumer Advocate vs. Industry Perspectives – In addition to the practices noted earlier, industry critics attack many lenders’ requirement that borrowers agree to resolve disputes by mandatory arbitration instead of judicial proceedings. Lenders, including many that do not require arbitration, take the position that arbitration should be an available dispute resolution option as it is fair, less expensive and provides borrowers quicker relief.

Advocates also contend that secondary market loan purchasers should be held strictly liable for violations by the loan originators. Critics would like to see greater transparency in loan pricing and sales practices. A major goal of some consumer advocacy groups is to drive all costs, or as many as possible, into the loan interest rate. They say that this would make it much easier for borrowers to compare loan prices, and that it would preserve borrowers’ home equity as it would not be used to pay loan closing costs. Industry counters by noting these advocates generally fail to point out that rolling all costs into the rate would result in a much higher interest

² Some federally chartered depository institutions may not actively support amendments to increase HOEPA’s protections. These institutions currently benefit from federal preemption and may view such legislation as ending their competitive advantage and forcing them to comply with a much tougher law.



rate and therefore a much higher monthly payment. This would make loans unaffordable for many borrowers. Industry also points out that imposing broad liability on secondary market loan purchasers would severely restrict capital access and would accordingly make credit less available and more expensive. While few will not say so publicly, many critics' real goal may be to severely restrict lenders from making loans and higher risk borrowers from obtaining them because the critics feel these borrowers must be protected from themselves as they may be likely to act irresponsibly and end up losing their homes.

Both advocates and industry have recognized that some mortgage servicers have used improper practices and that additional protections are needed in this area. Most parties also agree that additional broker licensing requirements may be appropriate.

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Major Provisions in Ney-Kanjorski Bill – The following table summarizes key issues and concepts addressed in the NK legislation:

Issue / Concept	NK Bill <i>(generally apply to “higher-cost” loans only unless otherwise noted)</i>	Comments
Title I	“The Responsible Lending Act”	
Apply HOEPA Protections to More Loans	Expands coverage to include open-end loans (e.g., a home equity line of credit) and loans for home purchase; lowers HOEPA’s coverage threshold by reducing the “points and fees” trigger from 8% to 5% of the total loan amount (or 6% if the loan is \$40,000 or less), and by counting prepayment penalties on an existing loan if the refinancing is by the original mortgage holder or an affiliate as a “fee” so the trigger is reached quicker	These changes would deem significantly more mortgages to be “higher-cost” loans which are subject to HOEPA’s special protections
“Loan Flipping”	Prohibits lenders from knowingly and intentionally engaging in loan flipping and requires that any refinancing of a higher-cost loan within 24 months must provide a “reasonable tangible benefit” to the borrower; certain safe harbors are specified to help lenders know what is required to comply	This “anti-flipping” provision incorporates and further refines concepts contained in a number of state statutes and imposes a substantially tougher test than the present “borrower’s interest” test contained in Federal Reserve Board regulations
Ability to Repay	Requires lenders to consider a borrower’s repayment ability and creates a presumption of repayment ability if a borrower meets a 50% debt-to-income test and a residual income test; also requires additional verification in some cases (e.g., where borrower has no earned income)	This repayment ability test is quite similar to those now used in a number of state laws; it is workable for lenders and provides far more protection than the current HOEPA repayment provision which requires proving a “pattern or practice” before a violation can be established
Excessive and/or Undisclosed Prepayment Penalties	Prepayment penalties would be limited to a maximum of 3 years and to an amount not to exceed 6 months’ interest on 80% of the original loan balance; moreover, the borrower must be given a clear choice of a loan with and without a penalty; these restrictions apply to all loans, not just higher-cost	This prepayment limitation will prevent abuses while allowing borrowers to make an informed choice and to receive the benefit of a lower rate if they agree to a prepayment penalty
Excessively High Points and Fees	Limits the amount of fees that can be financed to no more than 5% of the total	Imposing a cap on the financing of points and fees, as well as lowering



	loan amount (or 6% if the loan is \$40,000 or less)	the trigger percentage from 8% to 5% (or 6% if the loan is \$40,000 or less), discourages lenders and brokers from charging excessively
Single Premium Credit Insurance	Prohibits sale of single premium credit insurance or comparable non-insurance products in connection with mortgage financing; allows monthly premium insurance	Although most major mortgage lenders no longer offer single premium credit insurance products, some lenders still sell the product; the bill prohibits the sale of such products
“Steering” Borrowers to More Expensive Loans	Prohibits lenders and brokers from knowingly or intentionally steering to products not based on borrower’s best credit grade and also in broker’s case the best applicable product offered by lenders with whom broker regularly does business	This steering provision, modeled on the California law, is intended to address racial targeting and discrimination against borrowers who qualify for a better loan than what the broker or lender may have available and yet not offer them
Balloon Payments	Prohibits balloon payments	Balloon payment terms too often have been used in higher-cost mortgages where the borrower has little or no hope of having the cash needed to meet the large balloon payment when it comes due; this provision prevents this situation from arising by prohibiting such balloon payment provisions
Home Improvement Scams	Mortgage proceeds cannot be used to make final payment or payment in full to contractor without a completion certificate, and if the improvement exceeds \$10,000 without an independent inspection	These requirements provide borrowers with additional tools to avoid being ripped off by unethical home improvement scam artists
Mandatory Arbitration	Prohibits mandatory arbitration but only in the case of higher-cost loans; allows post-controversy arbitration agreements, provided certain safeguards or conditions apply, but a borrower could still bring a lawsuit if unsatisfied with the arbitration	Although many consumer advocates and trial lawyers object of arbitration, lenders view it as a fair and reasonable way to manage litigation risk while adequately protecting borrowers; this provision is targeted so that it only applies to the higher-cost loans where more vulnerable borrowers may need the additional options of seeking relief through judicial proceedings; the fact that a post-controversy voluntary arbitration could be appealed makes such voluntary agreements less likely
Right to Cure	The bill allows lenders 45 days after closing to correct any errors, and 60 days after discovery to correct errors, in	Given the millions of mortgage transactions, errors are certain to occur; current HOEPA is essentially

	which case the lender must pay a borrower who discovers an error a penalty of \$2,000 plus reasonable attorney's fees, if any	a "got you" statute with inadequate error correction procedures; these new provisions are intended to give lenders a reasonable opportunity to correct errors, promptly make full restitution to the borrower and avoid expensive litigation
Counseling Requirements	Lenders are required to recommend that higher-cost borrowers consider seeing a counselor and provide them with list of qualified government approved counselors	Although some favor mandatory counseling, most parties---including borrowers---oppose mandatory counseling; the approach taken here puts borrowers on notice and lets them make their own choice of whether to seek counseling assistance
Other Mortgage Terms and Lending Practices		
Negative amortization; encouraging default; call provisions; modification or deferral fees; payoff statements; late fees; increasing interest on default; prepaid payments; failure to report to credit bureaus; inadequate disclosures or warnings; bad faith avoidance of statutory protections; waiver of rescission rights; loan servicing abuses; etc.	The bill includes prohibitions and/or restrictions on a variety of other terms or practices that might be unfair to borrowers	These second-tier concerns are addressed in many state bills and there is relatively broad consensus on adding the proposed safeguards
Procedural & Liability Concerns		
Inadequate Penalties	Current dollar caps on statutory penalties for individual and class actions are doubled to \$4,000 and \$1,000,000 respectively; special additional penalties are applied for steering violations	These higher fines should provide additional deterrent effect and better compensation for victims

Statute of Limitations	The one year statute of limitations is increased to two years	This increase will allow borrowers more opportunity to seek redress but will not extend so long that lenders cannot manage their litigation risks
Assignee Liability	Limited liability is imposed for assignees of higher-cost mortgages with borrowers being able to assert affirmative claims or defenses in certain cases and assignees being able to defend against claims provided certain due diligence requirements are met	Broad assignee liability would shut down the secondary market for any loans to which it applies; this limited liability provision appears more viable as it essentially imposes liability only if the assignee or secondary purchaser knew or should have know of a violation
State Enforcement	The bill maintains the “status quo” with regard to state officials’ enforcement powers	The “status quo” enforcement concept avoids making any change that raises the contentious issue of OCC preemption of state laws
Conflicting State Laws	The bill provides broad federal preemption of the current patchwork of conflicting state “predatory lending” and related laws	The current patchwork of state laws poses a huge and costly compliance burden for lenders and very unequal protections for borrowers; the bill recognizes that mortgage finance today is a national marketplace dominated by nationwide lenders; it would preempt the states’ patchwork scheme and impose workable uniform federal lending standards that adequately protect all borrowers, regardless of where they live or how the lender is chartered or structured
Title II	Counseling & Financial Education	
Borrower Housing Counseling and Financial Education	The bill includes a separate title creating an Office of Housing Counseling at HUD with authority to better coordinate, enhance and regulate consumer education and counseling programs; it also authorizes \$75 million for each of fiscal years 2006-2009 for counseling grants and related counseling and educational related activities; it also contains an innovative provision allowing borrowers to voluntarily opt-in when the mortgage is originated to help borrowers who later encounter difficulties in paying the mortgage to obtain foreclosure prevention counseling	Borrower education and counseling is one critical element of any effort to prevent lending abuses; these counseling provisions, which are based on concepts developed by Rep. Scott and others, should greatly enhance the availability and effectiveness of counseling and educational programs; the opt-in provision for foreclosure counseling also should help many borrowers avoid foreclosure

Title III	Servicing	
<p>Mortgage Servicing Abuses</p>	<p>Updates the Real Estate Settlement Procedures Act with regard to mortgage servicing practices. Mortgage servicers are prohibited from: (1) force placing insurance unless there is a reasonable basis to believe that the borrower has failed to comply with the requirement to maintain property insurance, and from charging fees for responding to qualified written requests placed by the borrower; (2) failing to take timely action to respond to a borrower’s requests to correct errors relating to allocation of payments, final balances for purposes of paying off the loan or avoiding foreclosure, or other standard servicer duties; and (3) failing to respond within 10 days to a request from a borrower to provide the identity of and contact information for the owner assignee of the loan; and failing to comply with any other obligation to protect consumers established by the HUD Secretary. RESPA penalties would be increased by doubling existing monetary levels. Mandates decreases in response times to certain consumer inquiries, establishes response times for obtaining pay-off amounts, and requires the prompt refund of escrow accounts upon the payoff of a loan HUD also would be required to prepare two studies relating to mortgage servicing fraud</p>	<p>These provisions address a number of concerns that have arisen regarding a range of unfair or abusive practices by some mortgage servicers</p>
<p>Failure to Escrow Funds for Taxes and Insurance</p>	<p>Requires lenders/servicers to set up escrow accounts for most nonprime mortgages (not just higher-cost)</p>	<p>These provisions address the problems many nonprime borrowers, who often have chronic cash shortages, have when property insurance and taxes periodically are due because many nonprime lenders do not require escrow accounts where a portion of each month’s payment is set aside for the payment of property taxes and insurance</p>



Title IV	Appraisals	
“Property Flipping”	Requires a written appraisal from a qualified appraiser who has performed a physical inspection of the property; if the property has been sold within 180 days at a lower price, a second such appraisal is required	These new appraisal requirements address property flipping concerns and should prevent borrowers from being victimized by fraud artists who sell properties at grossly inflated prices
Appraisers	<p>To enhance the independence of appraisers and help to ensure that they serve as an unbiased arbiter of a property’s value, the bill prohibits the parties interested in a real estate transaction involving an appraisal from improperly influencing or attempting to improperly influence, through coercion, extortion, or bribery, the development, reporting, result, or review of a real estate appraisal</p> <p>Streamlines the process for obtaining appraisal practice permits, provides for reciprocity in State appraiser licensing, makes certain other changes relating to the appraisal process and requires the Comptroller General to conduct a comprehensive study within 18 months of enactment on possible improvements in the appraisal process and how to improve appraisals</p>	The bill makes needed improvements in the appraisal process and ensures greater appraiser independence
Title V	Mortgage Brokers	
Mortgage Broker Abuses	The bill includes a title establishing minimum standards for mortgage brokers and a national broker registry to help identify and track “bad apple” brokers who abuse borrowers	Over half of all nonprime mortgages are made by mortgage brokers; while most are fair and ethical, all too many are not; state broker licensing requirements are quite uneven; these new federal requirements should significantly raise broker standards and make it much easier to shut down unethical brokers who move to new jurisdictions to avoid sanctions