Credit Access and Consumer Protection: Searching for the Right Balance

North Carolina Banking Institute
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Michael D. Calhoun

Homes Prices in Real Terms Are Mean Reverting

US Single-Family Market Cycles in 30 Years
(1976Q1-2007Q1)
Impact On Consumer Finances

Already New Rapidly Appreciating Home Markets

- Overall national home price growth is robust
- Many markets are experiencing rapid annual price appreciation again
  - Phoenix – 23%
  - Las Vegas- 16%
  - San Francisco 16%
  - Los Angeles- 12%
Delinquency by Loan Type

CAP Equity Accumulation
Mortgage Lending Standards in the Boom: A Race to The Bottom

- **Subprime Loans**
  - 2/28 loans with built in 200+ bp teaser rate
  - 55% DTI based on the teaser rate
  - Half were no doc
  - Three fourths had no escrow
  - Majority of loans were originated by lightly supervised mortgage brokers

- **Alt A loans**
  - Likewise underwritten with little income documentation and extremely low teaser payments

Consumer Protection Challenges

- Center for Responsible Lending research in 2006 predicted millions of subprime foreclosures
- More important for today, it found that in 2001-before the bubble and crash, one in three subprime borrowers were losing their homes
- Post crisis lending includes models of equity based lending
## Racial Impact

- Half of African-American loans were subprime, and nearly half of these will result in foreclosure.
- African-American and Hispanic homeownership rates peaked in 2004 and is trending towards 40%, compared to 70% for white homeownership.
- A generation of wealth was lost from families of color.
- Wealth disparity is at historic levels: 20 to 1.

## Other Consumer Mortgage Issues

- Fees, discount points
- YSPs
- Title insurance
- Servicing
  - Forced placed insurance
  - Suspense accounts
  - Foreclosure fees
Housing Affordability

- Historically low interest rates and reduced home prices have pushed the housing affordability index to a record high.

- Yet, credit remains tight, constraining family opportunity, lending volumes and overall economic growth - average FICO of declined GSE loans exceeds 730.

Underwriting Limitations

- Tightened GSE and FHA underwriting
- Creditor overlays
- Additional appraisal requirements and the challenges of REO impacts on comparable sales
- FHA lender performance comparisons and the cost of servicing distressed FHA loan
Buyback Risk

- Unprecedented levels of buyback claims have been brought and recovered by government and private investors, and more are pending
- These claims are based on loans not meeting warranted underwriting standards, without a showing that these variations were the cause of default

Regulatory Factors

- The response to the housing crash and the financial crisis includes a rewriting of many of the basic laws and regulations for mortgage lending
- Individually, these rules have significant impacts
- Uncertainty over the direction of the rules has, by itself, dampened lending activity
- Recently, several of the major rules have been issued and provided more clarity for the market
Current Rulemakings

- Qualified Mortgage Rule
- Qualified Residential Mortgage Rule
- Mortgage Servicing
- Basel III
- Disparate Impact
- TILA/RESPA

Qualified Mortgage Rule

- The QM rule was recently issued by the CFPB, with some remaining issues still open for further comment.
- Three primary issues
  - Size of the QM market
  - How QM markets are defined
  - What legal protection QM loans receive, e.g., a presumption of compliance or a safe harbor
Summary of QM Rule

- QM loans were defined broadly, designed to encompass most lending
- The CFPB used bright lines to determine QM status - generally a 43% back end DTI or eligibility for purchase or insurance by the GSEs or a government entity
- A safe harbor for prime QM loans and a rebuttable presumption for subprime QM loans

Litigation Risk

- Standard is “reasonable determination” at time of origination
- De facto requirement of borrower in default soon after origination or payment reset
- Not amenable to class action treatment
- Often requires expert testimony
- Remedy often is loan modification that does not provide a fund for a contingent fee
Experience With Other Claims

- North Carolina and other state predatory lending laws
- Federal Reserve ability to repay
  - Facts and circumstances test
  - No safe harbor

Affiliate Fees

- Challenge of not disadvantaging affiliates without incenting steering to affiliates or offloading core services to affiliates to expand fee limits
- Major issue is affiliate title insurance
Broker Commission/YSPs

- Impact of other antisteering provisions
- Business to business transactions structure
- Experience with higher fees for:
  - forced placed insurance
  - title insurance
  - mortgage insurance

Proof of Violation

- Residual income
- Can forms be determinative
- Limits of fraud claims as a deterrent
- Use of oral evidence
  - Expense or debt must be proven
  - Lender procedures
Possible Lessons of The Crisis and Early Rule Writing

- Basic Rules of the Road can create better models for lenders and consumers
- Uncertainty is expensive in terms of compliance costs and reduced access to credit
- It’s hard to get it right
- Bright lines are often the most effective
- A regulator with market wide authority and the ability to provide details for compliance and prevent subterfuge and evasion is needed

Risk of Financial Marginalization of Many Families

- Impact of:
  - Foreclosures
  - Student Loans
  - Debt collections
  - Overdraft fees
  - Payday and Car title loans
Foreclosure Impacts

- CRL research found that the leading factor in predicting default was the type of loan received by the borrower.
- African-American and Hispanic borrowers were 2 to 3 times as likely to receive loans with abusive features as other borrowers with the same income and credit profile.
- Foreclosures from abusive loans and the economic fallout are locking borrowers out of a favorable housing market.

Student Loans

- Student debt now exceeds $1 trillion and exceeds total credit card debt.
- Private for-profit schools rely on federally guaranteed debt; and are generating high default rates.
- Debt is protected from bankruptcy discharge and may be offset against government payments.
- Parent co-signers are also impacted.
Robo-Signed Debt Collection

- Debt is sold to purchasers with limit information provided, acknowledge errors, and disclaimer of correctness
- Debt companies file robo-signed collection actions, relying on default judgments
- Judgments may be used for collection or garnishment, and create long term liens
- Impacts millions of families each year

Overdraft Fees

- Average fee is $32 and average repayment is in 2 days
- Many banks reorder transactions to increase frequency of fees
- The average low income, high frequency overdraft consumer spends over $1,600 per year in fees, a little over 4 fees per month
- High fees are the leading cause of bank account closures
Payday Loans

- Loans are very costly, with an average 300 to 500% APR
- Borrowers are unable to repay the loans and still pay other bills, so they are flipped over and over
- This leaves the average borrower in high-cost debt for nearly half of each year
- Social security recipients are twice as likely to receive a payday loan
- 40+% ultimately default

Conclusion

- The financial crisis has created more consensus in the consumer financial markets
- The argument has shifted to what types of rules are needed and how to ensure access to credit
- As demonstrated by early rule writing, it is hard to get this right, but progress is being made
- Successful efforts will establish more competitive markets that provide better results for consumers and financial service providers