Dodd-Frank Measures Fundamentally Reform the Mortgage Market

Mike Calhoun

A major trigger of the financial crisis was that millions of families were put into home loans that they could not repay unless house prices rose rapidly and borrowers were able to refinance the loans. The mortgage market, worth more than $10 trillion, is a crucial component of the financial system. When housing prices leveled off and then fell, this mortgage market collapsed, driving the housing market and the entire economy into free fall.

The Dodd-Frank Act responded with a comprehensive overhaul of the mortgage markets, setting out detailed statutory standards and requirements. It also revamped the supervision of the mortgage industry, creating for the first time an agency with unified authority over mortgage lending laws. Together, these dramatically improve the safety of the housing market for individual homebuyers and the overall economy.

Perhaps unique among parts of the Dodd-Frank Act, these reforms have been executed swiftly and well by the newly created Consumer Financial Protection Bureau (CFPB). However, understanding what challenges remain, and where reform could be unwound, is essential to correcting the major failures that took place in the financial markets leading up to the crisis.

The Housing Market Collapse Triggers the Financial Crisis

The housing and mortgage markets have historically been cyclical markets. Home values have risen and fallen in real, inflation adjusted dollars, as mortgage rates, housing price expectations and other factors impacted prices. For example, in the early 1980s and again in the early 1990s, after national house prices had risen quickly, they then fell by 15 percent and 16 percent, respectively in real, inflation-adjusted dollars.[1] Overall, during the past 50 years, house prices have increased by slightly more than inflation, with the exception of the housing boom of the late 1990s through 2006. During that period, housing prices rose by 80 percent in real terms, before they fell rapidly. Low interest rates, designed to spur the post-9/11 economy, encouraged this rise, but other factors helped push this boom to levels that had not been seen before.

Principal among these was the large increase in new mortgage products and subprime lending. These mortgages, designed to have artificially low initial monthly payments, were promoted and financed by Wall Street. Mortgage brokers and lenders received huge fees for steering borrowers into these loans, so not surprisingly, the volume of these products exploded, going from being a very small part of the market to becoming the dominant mortgages at the peak of the housing boom. For example, no documentation or stated income loans, where the loan file contains only an income figure with no documentation, went from being a rare loan type designed for business owners with complicated finances to comprising nearly half of subprime loans and a third of other loans.[2] Similarly, negative amortization loans, where the borrower pays less than the accruing interest each month, so that the principal amount owed actually increases over time, had been initially designed for borrowers who could afford the much larger monthly payments that would become due in a few years when fully amortizing payments were required. These loans, though, were then aggressively marketed to borrowers who could barely afford the initial, very reduced payments, much less the larger later ones. Subprime mortgages, with built-in large payment increases, grew twentyfold, from a small market in the 1990s to over $600 billion dollars of loans made in 2006.[3]

What these subprime and exotic loans had in common was that mortgage brokers and lenders who sold the loans were paid double or more for putting a borrower into one of these loans as compared to providing a standard thirty-year prime loan. The firms that packaged these loans and sold them to investors likewise earned far more from these loans.

Those who received these loans were at great risk of losing their home, indeed, the rate of foreclosures from the housing boom has been heavily determined by the type of loan households received. African-American and Hispanic families were far more likely to receive these dangerous loans and end up in foreclosure, and these disparities persist even after controlling for borrowers' credit record and income. The Center for Responsible Lending, in a groundbreaking study, combined and matched different data sources to follow borrowers and determine their credit standings, the type of loan they received and whether they ended up in foreclosure.[4] The research found that the type of loan was the leading predictor of foreclosure and that families of color were steered to the riskiest loans. Risky loan types had foreclosure rates four to five times that of standard loans. African-American and Hispanic families were much more likely to receive risky loans even after accounting for other factors, and they were twice as likely to face foreclosure. For example, families of color with good credit were three times more likely than white families to receive subprime loans.

The flood of foreclosures from these unsustainable mortgages was delayed as long as borrowers could refinance when they fell behind on payments or could not afford impending payment increases. However, once housing prices leveled off and then fell, these loans failed in droves, accelerating the plunge in housing prices. The result was widespread hardship for homebuyers, collapsing housing prices for all homeowners and communities, losses for investors, and a deep and widespread general recession. For families of color, a generation of wealth building was lost. Wealth disparities between them and white households grew to record levels—white households now have more than 15 times the median wealth of African-American and Hispanic families.[5]

A Dysfunctional Mortgage Market

In earlier decades, lenders and investors had favored loans that were fully underwritten and documented to established standards. This changed as Wall Street investment banks were attracted first to subprime loans, then to more exotic loans, and the high interest rates they both carried. Types of loans that were previously offered by small portfolio lenders now became part of an "originate to distribute" model, where most lenders quickly sold loans into the secondary market rather than holding them. Wall Street investment banks not only provided funding for all of the loans they could buy, they set up their own subprime lenders to acquire more loans. The demand for the resulting securities was so great that large amounts of so-called synthetic securities were produced. These synthetic securities were not used to fund actual loans, but instead paid yields based on the performance of loan portfolios. This greatly expanded the amount of investment tied to these loans, which in turn multiplied the losses produced when these loans ultimately failed.

Early on, there were warnings from community and consumer advocates about the dangers of subprime loans, including that they were driving many established homeowners into foreclosure.[6] These concerns, however, were drowned out by the financial industry's defense of the products and the flood of money produced by the high fees and interest of these loans. Federal regulators not only failed to oversee this new market, they actively blocked efforts by the states to establish protections. State legislatures had seen growing problems in mortgage lending practices, and in response they had passed laws regulating mortgage lending.[7] The federal banking agencies, principally the Office of the Comptroller of the Currency (OCC), which regulated national banks, and the Office of Thrift Supervision (OTS), which regulated national thrifts, both used their preemption rules to block the application of state laws to their members. In addition, the Federal Reserve had been given the authority and responsibility under the 1994 Home Owners Equity Protection Act to prevent abusive home lending practices by all mortgage lenders, but it refused to use that authority prior to the crisis. [8]

The resulting mortgage market was a classic "race to the bottom" where, in the absence of standards or oversight, lenders competed with each other to offer complex loan structures that few borrowers understood. The quality of loan originations plummeted, as the rising home prices temporarily hid the defects. Entities with the duty to provide quality control, such as loan underwriters, appraisers and credit rating agencies, acted as enablers, all earning huge fees for looking the other way as standards continued to erode.

The Dodd-Frank Act Established Basic Safeguards and Standards for the Mortgage Market

This dysfunctional system was flawed in myriad ways, and the Dodd-Frank Act addressed a broad range of issues to reform this key market. First, it required that lenders make a determination of the borrower's ability to repay the loan, and that lenders document the borrower's income and debts as part of this process. This makes mortgages more transparent, and it reduces unsustainable lending—allowing the market to better judge, price and reserve for risks. Second, the Dodd-Frank Act updated and added key protections for high-cost and subprime loans. Third, it addressed the steering of borrowers to riskier loans. Fourth, it reduced the ability of federal banking regulators to use preemption to undercut state mortgage protections. Fifth, it also improved servicing standards, so that loans that fell behind would have a better chance of being modified and cured. Finally, it established a market wide regulator, the CFPB, with a broad mandate to supervise mortgage companies that had operated under weak and fragmented regulators.

Qualified Mortgage/Ability to Repay Requirement

The most significant and prominent of the Dodd-Frank Act mortgage provisions is its requirement that lenders do the common sense work of making a reasonable determination that the borrower has the ability to repay the loan, based on the circumstances at the time the loan is made.[9] While this provision might seem unnecessary, as any rational lender would do this, this was not the case during the crisis, when unsustainable lending was widespread. Several features of the mortgage market encouraged the unaffordable lending that proliferated before the crisis. First, the party originating the loan often did not have or retain any of the economic risk if the loan failed. Mortgage brokers and others were, and still are, paid at closing, and are incented to get the borrower into a loan even if the loan is unsuitable. Lenders then and now sell most of their loans into the secondary market, and have limited recourse for loans that fail.[10] Finally, other loans, including many subprime loans, were "asset based lending." The lender was lending based on the borrower's substantial home equity, and could reap high interest rates and do well even if the loan defaulted, as the home equity would protect against losses.[11]

The Dodd-Frank Act established a new lender duty to determine the borrower's ability to repay the loan. Lenders must also verify and document the borrower's income and expenses that establish that ability. This new duty to determine ability to repay carries liabilities if it is violated, including penalties and damages, and it can be raised as a defense if the loan is foreclosed. The statute directs the CFPB to define a class of safe loans that, in exchange for meeting certain clear standards, will be assumed to meet ability to repay rules, and where lenders will be partially shielded from liability. These so-called "Qualified Mortgages" (QM) and the accompanying ability to repay provisions have become known as the QM rule. The goal of these rules is to return the market to much safer and more transparent loans. The exotic loans, which took over the market and led to the housing collapse, are either prohibited or limited to borrowers who can afford the large payment increases that are often imbedded in these loans.

Under the Dodd-Frank Act statute and implementing regulations, lenders must verify and calculate the borrower's income for all loans. 'No-doc' loans, where income is not documented, are prohibited.[12] These no- doc loans were major contributors to the crisis; they made up, for example, the largest portion of losses for Fannie Mae and Freddie Mac, even though they were a small percentage of their loans.[13] Negatively amortizing loans, and other exotic loans such as interest only loans, and loans with initial teaser payments that later increase are not prohibited, but they are sharply limited and discouraged. Borrowers must be qualified for these loans based on a monthly payment that includes the full interest rate of the loan and amortizes the principal. That is, they cannot be considered able to afford the loans if they cannot, at the time of origination, afford payments at the full interest rate—not an initial, temporary teaser rate—that are fully paying down the principal of the loan.

To qualify as a QM loan, loans have to meet additional standards. First, adjustable rate loans have to be underwritten to the maximum possible payment in the first five years. So, if the interest rate and payment on the loan can increase, the lender's determination of the borrower's ability to repay must be based on the highest possible interest rate and payment that the borrower could face in the first five years. For example, if an adjustable rate mortgage loan starts at 4 percent interest, but the interest rate could increase in the upcoming years if overall interest rates increase, the affordability determination must assume that the mortgage interest rate rises to its highest permitted level. Second, the borrower cannot have an excessive total debt to income ratio (calculated based on the borrowers' gross, pretax income and recurring debts, the housing obligation, and debts like car payments and credit card loans). Debt to income ratios are a standard industry measure of affordability, reflecting how much of a borrower's income is used to pay debts, and how much is left for other expenses. The CFPB set this debt ratio at 43 percent, which is the standard used by the government-sponsored enterprises (GSEs) and Federal Housing Administration (FHA). These agencies permit a borrower to exceed 43 percent only if there are compensating factors that show the borrower can afford a higher payment, for example higher credit scores, larger down payment, or borrower reserves. A lender can go over 43 percent and still meet QM only if the loan meets these additional Fannie Mae, Freddie Mac, FHA or other government loan programs standards.[14] Finally, these loans can have no more than 3 percent in points and fees charged on the loans.[15] Loan points and fees are earned immediately when the loan closes; they are not refundable if the borrower refinances or pays off the loan early. This encouraged brokers and lenders to focus on the money earned at closing rather than on the successful performance of the loan over time. Also, high points and fees strip borrower equity, as in refinancing transactions they are almost always taken out of the home equity, by being added to the amount being financed. Limiting the points and fees on QM loans aligns lender and borrower incentives, by having the lender earn more of its revenue from the performance of the loan, rather than just the fees it collects at loan closing. It also discourages equity stripping, a practice that was widespread during the housing boom.

These new lender duties are enforceable by borrowers, both against the original lender, and in the limited circumstance of defending against foreclosure, against subsequent holders of the loan, including trusts that hold mortgage securities. All lenders must establish they properly determined and documented the borrower's income. For loans that do not meet the QM standards, the lender must also show that based on the information it had when the loan was made, it reasonably concluded the borrower could afford the loan. The Dodd-Frank Act provided that loans that meet the additional QM standards were to be provided some legal protections against claims that the loan was unaffordable; they are presumed to meet the ability to repay requirement. For these loans, the lender must document borrower income and expenses. If the lender can further show that the loan meets all of the QM additional standards, it is presumed under the statute that the loan was reasonably affordable.

The specific legal protection that QM loans should receive was the subject of much debate. Consumer advocates argued that the presumption that loans that meet the QM standard are affordable should not be conclusive. That is, the borrower should be able to show that in the specific facts and circumstances of its loan, the loan was still unaffordable even though it met the QM standards. The standards for QM loans do make them safer. However, in order to make the standards flexible enough to not unduly limit access to credit, it was set at a place where there will be some borrowers who meet the standard but will still not be able to afford the loan. For example, a 43 percent debt ratio is a standard measure, but for a family on limited, fixed income, it may not leave enough money for their other essential expenses, such as food, utilities, health care and transportation. If the presumption is conclusive, these loans would be immune from a challenge that the lender should have known the loan was unaffordable. The financial industry, repeating arguments from before the crisis, claimed that if lenders and investors faced liability for unaffordable loans, they would respond by lending only to wealthier borrowers who were less likely to default.

The CFPB chooses to take a divided approach. Its final rule provides that for QM loans that have prime or near prime interest rates, the presumption of affordability is conclusive, and constitutes a "safe harbor." For QM loans above this interest rate standard—more than 1.5 percent above the best mortgage rate—the presumption may still be rebutted by showing that, based on information provided to the lender before the loan closed, the borrower did not have sufficient money left after paying other expenses to be able to repay the loan. This distinction reflects that for prime loans there is more alignment of borrower and lender incentives, as the lender's profitability is tied to the loan performing. With a limited interest rate and limited points and fees, a prime interest rate QM lender, including anyone who buys the loan, primarily makes its revenue from the ongoing payments of a sustainable loan. For subprime loans, the higher interest rate enables lenders to make many more loans that the borrower may not have an ability to repay, since losses are covered by the higher interest payments.

QM standards incentivize loans that are safer, and more sustainable, as well as more consumer friendly. Among the open questions regarding these rules are whether the safe harbor for prime QM loans will permit abusive and unaffordable lending to continue in some numbers in this particular space. Ongoing oversight and supervision by the CFPB will be important to understanding the impact of this rule, and the CFPB may have to take further action if there are problems. In addition to the CFPB's supervisory and enforcement authority, there is also a more public check on loan performance established by the Dodd-Frank Act in the form of the mandated foreclosure and default database. Another open question is how much non-QM lending there will be at all, given the greater potential legal liability, and the public designation as "less safe" of such loans. There is not doubt, in the meantime, that there will be continuing industry efforts to roll back pieces of the QM statute or rule, including through changing the definition of points and fees, slowing its implementation, or arguing that despite its flexibility the rule already excessively restricts access to credit.[16]

High-cost and subprime loan protections

The Dodd-Frank Act also specifically targeted high-cost and subprime loans, including enacting long overdue updates to the Home Ownership and Equity Protection Act (HOEPA).[17] The HOEPA was enacted by Congress in 1994 in response to predatory lending that had developed at that time with very high fees and interest rates. The law provided strong protections for loans defined as "high-cost." However, the definition had huge loopholes that lenders easily learned to exploit. High-cost loans were defined as those with very high fees—8 percent or more—or very high interest rates—equivalent to 6.5 percent higher interest than prime loans. Very few loans exceeded the triggers, as lenders sought to avoid the high-cost loan rules. In practice, the triggers set the outer fee and interest rate boundaries for most lending and they were very high boundaries indeed. Lenders had learned to continue to charge high fees and interest rates, but avoid the law by charging just below the eight point standard, and to charge additional fees that were not included in the calculation of the trigger. In addition, the HOEPA protections only applied to refinance loans, not home purchase loans.

The Dodd-Frank Act revisions of the HOEPA lowered this fee threshold to five points, and more important, included key fees such as payments to mortgage brokers and prepayment penalties that had previously been excluded. They also expanded coverage of the law to include purchase loans.

The Dodd-Frank Act also added to the protections that apply to the broader set of subprime mortgages that do have fees or interest rates high enough to trigger the new revised HOEPA protections. It required that subprime loans have escrow for taxes and insurance, so that borrowers would not be hit with payment shocks when those bills come due. During the boom, 75 percent of subprime mortgages had no escrow, which made the monthly payments look lower when the loans were marketed to borrowers, but put them at risk of default when the lump sum annual bill for taxes and insurance was owed.

Anti-Steering provisions

The Dodd-Frank Act also sought to deal with mortgage abuses by preventing the financial incentives that encouraged brokers and lenders to steer borrowers to more expensive and riskier loans than they qualified for, which had ultimately harmed both individual consumers and the market as a whole.

Other things being equal, a loan that has a higher interest rate sells for a higher price in the secondary market. For example, if the prevailing market rate for a mortgage to a borrower was 5 percent, a loan at the rate would sell in the secondary market for the face amount of the loan, or par. For a $100,000 loan, it would be sold for close to $100,000.[18] If the borrower could be persuaded to take out a loan with a higher interest rate, for example 6 percent, this produced higher monthly payments and a higher return to investors. The loan would then sell to the secondary market at a higher price, above par, at approximately $104,000.[19] This extra money, which was paid by the borrower through the higher interest rate and higher monthly payments, was divided up among the mortgage broker or loan officer, the lender, and the secondary market participants who packaged and sold the loans. The bonus paid to mortgage brokers was called a "yield spread premium." This name reflects that the loan was selling at a premium because it had a higher yield or interest rate.

In addition to this "up selling" of loans within the same loan type—that is, simply raising the interest rate on an otherwise similar loan—there was also frequent steering to particular loan products, with brokers and lenders directing borrowers to types of loans that generally had higher interest rates. The exotic loan types, including no documentation loans and interest only loans, had higher interest rates than traditional loans.[20] Again, mortgage brokers, lenders, and others in the mortgage system made far more by steering borrowers to these exotic loans.[21] As one lender explained: "The market is paying me to do a no-income-verification loan more than it is paying me to do the full documentation loans. What would you do?"[22]

Steering borrowers to more expensive and riskier loans was facilitated by the complexity of these loans, which made it much harder for consumers to judge the true cost of the loans. Borrowers also expected mortgage brokers, whom they hired to help find a loan, to watch out for their interests. The brokers, on the other hand, disclaimed that they had this duty, and openly demanded the payment of premiums from lenders, shunning those lenders who did not pay them. The resulting steering inflicted disproportionate harm on communities of color, where nearly half of borrowers were put into expensive subprime loans, even though many qualified for cheaper prime loans.[23]

The Dodd-Frank Act reined in these steering practices in several ways. First, it created a general prohibition against steering, and provided remedies for borrowers. Financial incentives for steering were also reduced. The Dodd-Frank Act prohibited mortgage broker and loan officer compensation from being tied to loan structures, such as negative amortizing or no interest loans, or to the interest rate of the loan. As a result, the previous widespread practice of lenders paying mortgage brokers and loan officers additional fees for steering borrowers to more expensive or riskier loans is now prohibited.

Importantly, the Dodd-Frank Act also substantially restricted prepayment penalties, which were an important component of the steering incentives. If a lender or a loan purchaser was going to pay a substantial premium on a loan, it required that the borrower be locked into the loan with a prepayment penalty. Otherwise, there was the risk of paying the premium to the mortgage broker, but not collecting higher interest if the borrower was able to refinance into a better loan. Thus lenders and investors insisted on prepayment penalties as a condition of paying substantial yield spread premiums to brokers, and, of course, brokers preferred loans with yield spread premiums. From the borrower perspective, prepayment penalties locked borrowers into bad loans, especially in the subprime market, and they stripped equity if borrowers refinanced and paid the substantial penalty, as many did. The Dodd-Frank Act prohibited all prepayment penalties for subprime loans (loans with an interest rate more than one and half percent above the best mortgage rate), sharply limited the amount and duration of them for other loans, and further substantially discouraged them by counting them towards the three point fee limit for QM loans. Together, these provisions greatly reduce the risk of steering.[24]

Restriction of preemption by federal bank regulators

Another problem that contributed to abuses in the lead up to the crisis was the aggressive use of preemption by federal banking agencies to block state law mortgage protections. During the pre-crisis years, the bank regulators competed with each other to favor the banks that they supervised (which paid supervision fees to them and funded their budgets) with extensive preemption of state consumer protection laws.

In the Dodd-Frank Act, consumer advocates sought a restoration of the space for state law making. The national banks fought back hard, and the resulting provisions were a compromise that rolled back some preemption claims, but not as much as consumer advocates believed necessary. The Dodd-Frank Act blocked the most aggressive regulator claims of preemption and established a more limited range of state laws that could be preempted. Also, stronger standards of review of preemption action were established, and banks were blocked from setting up subsidiaries and claiming preemption for them. Still, the law leaves opportunities for federal regulators to block common sense state consumer protections from being applied to national banks. This is offset in part by the applicability of the rules of the new CFPB, which will apply to all actors, including the national banks.

Mortgage servicing reforms

The Dodd-Frank Act addressed the widespread failure of the mortgage market to properly service loans. This failure resulted in millions of unnecessary foreclosures, which further aggravated the distressed housing market, as well as causing catastrophic harm to families and their communities. Going into the crisis, the mortgage servicing industry was largely unregulated, and it depended on very low staffing levels and the imposition of abusive fees for it profitability. Consumers had no say in who serviced their loans. When record numbers of troubled loans occurred, servicers failed to take reasonable steps to modify loans when that would have increased the value for the loan investor as well as kept the homeowner in the house.

The Dodd-Frank Act added new servicing protections and empowered the CFPB to oversee and regulate the servicing industry. The CFPB in turn issued regulations that created new standards for servicers, including the correct credit of borrower payments, limitations on fees, and enhanced duties to modify loans. The rules require servicers to make any loan modification programs they offer for any servicer available to other borrowers they service, unless prohibited by their servicing agreement with the investors. Yet, the rules stopped short of mandating consideration of modifications for all borrowers. Going forward, the CFPB has made overseeing the servicing industry a major priority.

Additional protections
Other Dodd-Frank Act provisions enhance the safety and transparency of the mortgage market. These include new appraisal standards that were needed because in the lead up to the crisis, appraisals often far overvalued properties. Also included were simplified standard disclosure forms to help borrowers better understand loans and enriched Home Mortgage Disclosure Act Data, which will allow the public to better understand who is getting what kind of mortgages. It also mandated a new mortgage delinquency and foreclosure database that will track and provide regulators and the public with timely information about both local and national trends on mortgage performance.

The CFPB oversight of mortgage lending
The overall lax supervision of mortgage lending during the housing boom, along with inconsistent standards based on the legal charter of the lender, substantially contributed to the housing crisis. One of the most important Dodd-Frank Act mortgage reforms was the creation of the CFPB with the authority to establish rules for all mortgage lenders and servicers. [25] Leading up to the crisis, oversight of mortgage lenders was patchy and weak. Responsibility for different rules was divided among different agencies, and consumer protection was usually a low priority for all of them. Lenders had different regulations and regulators depending on how they were organized, and they were able to "regulator shop" in pursuit of the laxest oversight. Nonbank lenders (including non bank lenders who were subsidiaries of banks) were often able to escape any effective federal supervision at all. The CFPB was created to consolidate, increase and standardize oversight of consumer financial services across markets. This is an enormous change for the mortgage market; it now has a single agency focused on the safety and interests of consumers, with the authority to deal with key players in this market and effectively address a wide range of mortgage practices.

Mortgage Reform

Ongoing challenges

While substantial progress has been made in reforming the mortgage market, as with other areas of financial reform, opponents are not only fighting additional reform, they are attempting to roll back the reform measures that have been adopted to date.

The QM/ability to repay rule and the new mortgage servicing rules are effective January 2014. Some lenders and trade associations are pushing Congress for the creation of new loopholes in the standards. One leading bill would amend the QM standard to allow unlimited payments to mortgage brokers, leading to the resumption of steering of borrowers that was a core cause of the financial crisis. The bill would also exempt other loan fees, such as inflated charges for title insurance, allowing them to be piled on to loans with the lender still receiving the QM legal protections. Other efforts call for long delays in implementation of the rules, delaying reform and gaining more time for industry to attempt to gut the standards.

These attacks on the reforms are also directed at the CFPB. Industry representatives have far greater resources available to them than consumer and civil rights advocates. Consequently, the CFPB is under a continued and coordinated widespread attack on its rules and procedures. The CFPB—notwithstanding the long-delayed confirmation of its director, Richard Cordray—remains the target of legislative efforts to handcuff the agency. While these bills are unlikely to be passed in regular Congressional order, those who oppose the CFPB repeatedly attempt to add them to "must pass" bills, including continuing appropriations resolutions.

Conclusion

The enactment and implementation of the Dodd-Frank Act mortgage provisions, combined with the creation of the CFPB, has created a fundamentally reformed mortgage market. Basic standards have ended many past practices that so harmed consumers and the overall economy. Equally important, new attempted abusive practices face scrutiny and oversight by the CFPB. These protections make it safer for families who are engaged in their most important financial transaction, one that often determines their long-term financial trajectory. These reforms also protect mortgage investors and the overall economy, as mortgage risks are reduced, and the mortgage market now is safer, more transparent and less volatile. Yet, as with other areas of financial reform, substantial work remains in both finishing these reforms and rebuffing the efforts of those who want to return to the practices of the past.

Endnotes

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7. Wei Li and Keith S. Ernst, The Best Value In The Subprime Market: State Predatory Lending Reforms, Center For Responsible Lending, February 23, 2006.
8. The Home Ownership and Equity Protection Act of 1994, 103rd Cong., 108 Stat. 2160.
9. The Dodd-Frank Wall Street Reform and Consumer Protection Act, Sections 1411-13.
10. A separate Dodd-Frank Act provision provides for lenders or securitizers who sell riskier loans to retain a portion of the risk- the Qualified Residential Mortgage rule, or QRM. Mortgage loans that do meet the standards for QRM, which include all of the QM requirements, and any additional requirements that the six implementing agencies may jointly require, are subject to the risk retention. The implementing agencies are in the process of finalizing this rule.
11. Center for Responsible Lending, "Subprime Lending: A Net Drain on Homeownership." CRL Issue Paper No. 14. March 27, 2007.
12. The rule provides flexibility to account for the income of self-employed borrowers and nontraditional employment.
13. "Fannie Mae 2008 Q2 10-Q Investor Summary,"(Aug. 6, 2008), p. 36, available at www.fanniemae.com/media/pdf/webcast/080808transcript.pdf. By the middle of 2008, Alt-A loans accounted for roughly 10 percent of the GSEs' risk exposure, but 50 percent of their combined losses. Federal National Mortgage Association, U.S. SEC Form 10-Q, for quarterly period ended June 30, 2008, p.6, available at www.fanniemae.com/ir/pdf/earnings/2008/q22008.pdf; Federal Home Loan Mortgage Corporation, United States SEC 10-Q, for the quarterly period ended June 30, 2008, p.71, available at www.freddiemac.com/investors/.
14. This provision for loans with greater than 43 percent DTI will expire at the earliest of seven years, or for the GSE eligible mortgages, when the GSEs' conservatorship ends.
15. Higher fee limits are provided for smaller loans of less than $100,000.
16. Non-QM loans, which do not receive any presumption of compliance, will also be available, though it is uncertain how much of the future mortgage market they will comprise.
17. The Dodd-Frank Wall Street Reform and Consumer Protection Act, Sections 1431-33.
18. The actual price can vary to reflect whether the right to service the loan is being transferred with the loan and whether the lender collected origination fees from the borrower, or added them into the rate, so that they will collect them when they sell the loan.
19. The exact price would vary depending on prevailing interest rates at the time and other factors.
20. During the housing boom, these exotic loans paid high premiums because they carried higher interest rates, yet credit rating agencies wrongly predicted they would not have significantly higher default rates.
21. Of course, the lower initial payments were appealing to borrowers who often did not understand the future higher payments they would owe.
22. Vikas Bajaj and Christine Haughney, Tremors at the Door: More People with Weak Credit Are Defaulting on Mortgages, New York Times (January 26, 2007).
23. Rick Brooks and Ruth Simon, Subprime Debacle Traps Even Credit-Worthy Borrowers, Wall Street Journal, December 3, 2007; accessed at: http://online.wsj.com/article/SB119662974358911035.html.
24. Specialty lenders and brokers, though, can still market only risky, high-cost products, and can even pay and receive high fees for selling these mortgages, so long as the fee does vary by mortgage type or interest rate.
25. All lenders are subject to the rules of the CFPB. The CFPB also supervises the mortgage operations of all depository lenders except for community banks and credit unions with assets of less than $10 billion, for whom the primary supervisors remain their primary prudential state and federal regulators.

Mike Calhoun

Michael Calhoun is President of the Center for Responsible Lending, which is the policy affiliate of Self-Help, the nation's largest community development lender that has provided over $6.4 billion in financing for first time homeowner loans and small business loans. The Center for Responsible Lending is a nonpartisan, nonprofit research and policy institute focusing on consumer lending issues. Mr. Calhoun was a principal drafter of the North Carolina acts regulating predatory mortgage loans and mortgage brokers and lenders, and he has more than twenty five years experience in consumer lending. He has authored numerous papers on the subject and has testified before Congress and many state legislatures. Prior to working for CRL, he was head of several lending divisions at Self-Help, including secondary mortgage market programs. He is a former member and chair of the Federal Reserve Consumer Advisory Committee. Mr. Calhoun received his B.A. degree in economics from Duke University, and his J.D. degree from the University of North Carolina.