Oral Testimony of Steve Nadon
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& Chief Operating Officer of Option One Mortgage
On
"Legislative Solutions to Abusive Mortgage Lending Practices"
Before the
Committee on Financial Services'
Subcommittees on Housing and Community Opportunity & Financial Institutions and Consumer Credit
U.S. House of Representatives
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Introduction & Overview

The Coalition for Fair and Affordable Lending ("CFAL") appreciates the opportunity for me to testify on its behalf today. I am Steve Nadon, CFAL's Chairman, and Chief Operating Officer of Option One Mortgage, which is a subsidiary of H&R Block, and which is one of the nation's largest nonprime mortgage lenders.

My oral testimony will focus on provisions in Title I of H.R. 1295, the Ney-Kanjorski bill, and on H.R. 1182, the Miller-Watt bill, amending HOEPA's points and fees trigger, prepayment penalties, discount points, lender-paid broker compensation and the financing of loan closing costs. These issues, which impact greatly on loan affordability, are at the heart of much of the debate surrounding these two bills. Committee Members need to understand the practical----and potentially very harmful---- effects for borrowers if some of the proposed restrictions are adopted.

CFAL Supports H.R. 1295 - CFAL commends the lead sponsors of H.R. 1295 and H.R. 1182, and their staffs, for the thought and hard work they have put into these bills. Both bills are well-intended and have a number of good concepts, but both have some problematic provisions. Having reviewed both bills, CFAL favors H.R. 1295, but believes that the Committee should further refine it, including where appropriate, incorporating certain of the Miller-Watt bill's concepts.

The Ney-Kanjorski bill significantly enhances current federal law, covering more loans, improving existing provisions and adding effective and workable new safeguards on other specific lending practices. Most of these provisions equal or exceed those of most state laws. Quite importantly, its provisions are designed to prevent abusive lending practices without limiting borrowers' access to affordable mortgage credit and their ability to choose flexible mortgage financing options. In addition, Ney-Kanjorski has titles that would improve mortgage broker regulation, prevent appraisal fraud and help control "property flipping," and address mortgage servicing concerns.

Uniform Standards Are Needed - Ney-Kanjorski provides for uniform national mortgage lending standards, which CFAL strongly supports. Current state regulations provide very unequal levels of protection from borrowers. About half of the states have passed special anti-predatory lending statutes. None of these laws is the same. Some have provisions that go too far, while others do not provide adequate protections. The other states have not passed such comprehensive laws, and their residents for the most part must rely primarily on only the relatively weak current federal law. Furthermore, many borrowers in all states, including those that have special anti-predatory lending laws, can only rely on current HOEPA provisions because their lender is a depository institution that is exempted from compliance with stronger state lending laws. Uniform national standards can ensure that all borrowers in this country, wherever they live and whatever lender they choose, enjoy a high level of protection and that all communities have mortgage capital available on fair and affordable terms. CFAL believes that both federal and state regulators should actively enforce these nationwide standards.

Importance of Borrower Education - H.R. 1295 also has very important additional provisions to greatly enhance financial counseling and education programs that are based on legislation developed earlier under Rep. David Scott's leadership, who we commend highly for making such a vital contribution to this comprehensive bill. We share Rep. Scott's confidence that provisions in the bill that mandate establishing and widely publicizing the existence of both a toll-free telephone number and an internet website that the public can use for information about reputable credit counselors to assist them in making mortgage decisions will be practical, important tools for helping consumers navigate the mortgage process intelligently. We believe that enhanced borrower educational opportunities are critical for empowering people to make more informed financial choices and to avoid abusive practices. The ultimate answer to many of these problems is education as Rep. Scott has recognized, not restrictive legislation. We want to highlight the significance of the toll-free number as it provides a human touch connecting consumers to a live trained advisor who can provide assistance. In addition, we support Rep. Scott's concept of having the 800-number program develop data that may provide an early warning system regarding problem areas based on the call volume and questions asked. We think that the Committee also should consider having lenders pay a modest $2 fee when loans are recorded after closing to help support state and community based education and counseling programs. A portion of this fee also could be used as a funding mechanism for enhanced state enforcement efforts.

Further Refinements Are Needed In Ney-Kanjorski - However, H.R. 1295 is not perfect, and it needs a number of further technical and substantive refinements. For example, while we strongly support preemption, the provisions in Ney-Kanjorski need to be scaled back so that they do not sweep in almost all mortgage-related laws (e.g., foreclosure laws) and are instead targeted primarily to state and local laws aimed at regulating mortgage lending practices whether based on a "loan trigger rate" or some other mechanism. It also needs to be clarified to ensure that the Federal Reserve Board has authority to define and prohibit other abuses that may arise subsequently. Likewise, a

number of more technical corrections are needed, such as making it clear, as we understand the lead sponsors intended, that the sale of single premium credit insurance and comparable products are prohibited in connection with all mortgage loans. Also, while CFAL believes that some of the Miller-Watt bill's provisions would adversely affect many borrowers, other concepts from that bill might be worked into H.R. 1295. We look forward to working with Committee Members and other interested parties to help ensure that the final Committee product will be the best bill possible for borrowers and will have strong bipartisan support.

Preserving Loan Affordability

Nonprime lenders offer their borrowers a wide array of loan products, most of which have certain basic flexible loan financing options that borrowers can choose from in order to make their loans more affordable. These financing options include:

- Accepting a prepayment penalty provision in exchange for a lower interest rate (or in some cases, lower closing costs);
- Having the lender pay all or a part of the broker's compensation for them in exchange for a somewhat higher interest rate;
- Allowing borrowers to "buy down" their interest rate by paying discount points at closing in exchange for a lower interest rate; and
- Voluntarily choosing to finance their closing costs as a part of the loan (i.e., they borrow enough to cover those costs) as this allows them to deploy their available cash resources elsewhere, or if they are cash-short, to avoid having to borrow elsewhere, often at more expensive rates.

The overwhelming majority of nonprime borrowers (like many prime borrowers) now voluntarily elect to use one or more of these financing options to make their loans more affordable by lowering their monthly payments or lowering their loan closing costs.

CFAL recognizes that unscrupulous lenders or brokers can apply any of these financing options in an abusive manner. Therefore, we support having reasonable safeguards to prevent abuse, while also preserving these important options for borrowers. We believe that the Ney-Kanjorski bill for the most part strikes a good balance between adding protections against abuse of these financing options and allowing lenders to continue offering these choices to borrowers so they can make their loans more affordable. However, the Miller-Watt bill takes a fundamentally different approach on each of these issues, which has substantially negative impacts on loan affordability.

Virtually no reputable lenders are making high-cost loans under restrictive state statutes, like North Carolina's, and we do not believe that they could do so under the Miller-Watt bill. However, the far greater problem Miller-Watt poses is the adverse impact it would have on many nonprime borrowers who would be seeking to obtain a loan below the new HOEPA trigger thresholds. Let me explain this problem.

Both Ney-Kanjorski and Miller-Watt lower the 8% trigger to 5%, but they take very different approaches in dealing with prepayment penalties, YSPs and discount points. As noted above, Miller-Watt includes both YSP and the potential maximum prepayment penalty in the calculation of points and fees and its exclusion of discount points essentially does not apply with respect to most nonprime loans. The result of this is that in real terms the 5% trigger is more like 2% or less. This forces the lender to put more costs into the rate, significantly raising the rate, and therefore raising the borrower's monthly payment. Under Miller-Watt, the borrower also is generally no longer able to use discount points to buy down his or her rate or a prepayment penalty to lower the rate, and the *de facto* prohibition on the use of prepayment penalties would further cause all nonprime loans to go up about 1%.

The bottom line here is unmistakable and inescapable: Most nonprime borrowers would have no flexible loan financing options that are so essential to meeting their needs and circumstances, and would find that loans would be much less affordable. Moreover, many borrowers who want to purchase homes would find that, with the much higher rates and monthly payments they could no longer qualify for a large enough loan so they would have to shift to a less expensive home and a smaller loan.

For example, under current federal law and under Ney-Kanjorski, a borrower who qualifies for a 30-year, $160,000 fixed rate loan at an annual interest rate of 8%, and who elects to use a prepayment penalty to lower the rate to 7% and to pay 2 discount points to lower the rate further to 6 ½%, and who elects to finance the points and fees, can lower his or her monthly principal and interest payment from $1,174.02 to $1051.76 a difference of $122.26 per month. On the other hand, under Miller-Watt, not only would this borrower not be able to choose the prepayment and discount point terms to make the loan more affordable, but mortgage rates generally for all nonprime borrowers would be raised around 1% (because prepay penalties are essentially prohibited), so the borrower would be paying a 9% rate, instead of a 6½% rate, making this monthly payment $1313.14 instead of $1051.76 as under Ney-Kanjorski, or 25% more per month.

Ney-Kanjorski vs. Miller-Watt Loan Affordability Comparison				
NEY-KANJORSKI			MILLER-WATT	
Home Price	$200,000		Home Price	$200,000
Mortgage Loan	$160,000		Mortgage Loan	$160,000
Mortgage Terms			Mortgage Terms	
	30 years			30 years
	8% Fixed Interest Rate			8% Fixed Interest Rate
	1% Broker's Fee			1% Broker's Fee
	2% Discount Points			No Discount Points
	1% Lender's Fee			1% Lender's Fee
	2 year Prepayment Provision			No Prepayment Provision
Payment Calculation			Payment Calculation	
Total Loan Amount (finance points & fees)	$166,400		Total Loan Amount (finance points & fees)	$163,200
Interest Rate	6 ½ % (8% - 1% for prepay provision – ½ % for 2 discount points = 6 ½ %		Interest Rate	9% *(Miller-Watt essentially prevents nonprime loans from offering prepayment provisions; this is projected to raise ALL nonprime borrowers' rates approximately 1%; so instead of being able to reduce an 8% rate to 7% with a 2 year prepay provision, the 8% rate would increase to 9% and the bill also essentially prohibits discount points)*
Monthly Payment	$1051.76 (= 25% Less than Miller-Watt)		Monthly Payment	$1313.14 (= 25% More than Ney-Kanjorski)

Mr. Chairman, I suspect this is a classic case of unintended consequences, and I do not believe that the Miller-Watt bill's sponsors ever intended such adverse consequences for borrowers. In any case, I sincerely hope that the Committee will not adopt the overly restrictive approach on these flexible loan financing options that is proposed in the Miller-Watt bill. CFAL believes that Ney-Kanjorski's provisions here generally provide reasonable protections that preserve borrowers' choices and their options for making their loans much more affordable than under Miller-Watt. As I noted

earlier, some of these Ney-Kanjorski provisions can be tweaked or tightened somewhat, but they are basically sound and should be retained.

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CFAL is confident that the Financial Services Committee can work together on a bipartisan basis to fairly resolve the various issues addressed in these legislative proposals, and can report out a balanced bill that provides effective national standards for fair lending that protect nonprime borrowers without unduly limiting their financing options and access to affordable mortgage credit. We look forward to continuing to work constructively with Committee members and all other interested parties to help enact such legislation.