Response to MBA Policy Paper on Suitability

National Consumer Law Center
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Claim: *"Most [proposed suitability standards] would . . .require . . . a subjective evaluation by the lender whether a product is best for that borrower."*

> **Reality:** Suitability does not require an originator to make the best loan, but simply to refrain from making an unsuitable loan. The standard would allow borrowers to choose among appropriate loan products and simply require that the originator refrain from offering products that are not suited to the needs and ability-to-repay of the borrower. This approach would not prohibit any product in a blanket fashion but simply ensure that originators are doing what borrowers already believe their lenders are doing—help them take out a loan that works for them.

Claim: *The suitability standard is "vaguely worded."*

> **Reality:** A suitability requirement is not ambiguous. It is intended to be borrower specific and would provide an incentive to the mortgage industry to consider the circumstances of the particular homeowner. The suitability requirement simply enshrines in the law what a borrower already has the right to expect: that a lender will provide a loan that is affordable in the short and long term. It would require that the lender determine what is appropriate for the borrower based on what the lender already knows through its routine underwriting process: family size, home value, family income, employment and income information.

Claim: *"Although the concept of 'good faith and fair dealing' can apply during the life of the loan, imposing the requirement on the origination of the loan creates new and undefined risks."*

> **Reality:** A suitability requirement simply demands that parties discussing a contract should treat each other fairly during the complex process before entering into the contract. In a mortgage transaction the access to information, understanding and bargaining power between the two parties to the contract are markedly skewed against the borrower. The idea that protections should apply to borrowers before the contract is consummated is not new, however borrowers nationwide do not have universal access to such protection. While several common law doctrines and state laws prohibiting unfair or deceptive acts or practices ("UDAP" laws) have evolved to protect borrowers during contract formation, they are often unavailable in a borrower's state or demand a level of proof that a borrower will not have the resources to meet. Only recognizing this duty on the federal level can ensure universal fairness in the making of mortgage loans.

Claim: *"The injection of subjective underwriting standards would conflict with and potentially threaten . . . homeownership gains."*

> **Reality:** Homeownership rates increased only four percent between 1980 and 2004, while foreclosures during that period increased 346.4%, according to data from the National Delinquency Survey of the MBA, the U.S. Census Bureau and the American Housing Survey. Moreover, the recent *Losing Ground* study by the Center for

Responsible Lending projects that 20% of subprime loans originated in 2005 and 2006 will end in foreclosure. Borrowers who enter into multiple subprime refinancings have a 35% or greater chance of ending up in foreclosure. This crisis needs a serious response.

Claim: *"Were a suitability standard imposed . . . lenders may be obliged to deny or discourage members of protected classes . . .from particular types of mortgages such as those with adjustable rates. . . . On the other hand, if the lender chose to ignore the standards . . . the lender may risk . . . violating a suitability standard."*

Reality: This is a false claim. Suitability is based on objective characteristics about the loan, the property, the borrower's ability to repay, and the borrower's equity. It would not introduce any level of analysis that is not already present when an automated underwriting program requires further review to determine the propriety of a loan for a particular borrower. In the MBA's hypothetical example of a test involving a young, white borrower and an older, African-American borrower, the question of whether either or both of the applicants would be eligible for an ARM would be related to current income, the scheduled payments under the loan, and other objective factors.

Claim: *"If borrowers are in effect granted a new 'suitability' defense to foreclosure actions by law, costs will increase and credit options will narrow."*

Reality: A suitability standard would curtail abusive loans and ensure a safer market for all participants. Borrowers with unsuitable loans now are enduring the very expensive costs -- as well as the heartbreak and costs to the community – of diminished equity and home loss. A business (and investment) model built on the backs of these borrowers needs an adjustment.

Claim: *"Uniform lending standards that are clear and objective, but do not unduly restrict the market, would improve on the standards established under HOEPA . . . ."*

Reality: While improvements to HOEPA, such as those in the Miller-Watt-Frank bill, would provide some needed additional protections, any thorough response to today's broken origination market requires additional flexibility to respond to an evolving market. A suitability standard would provide just that, while supporting market innovation. Moreover, similar protections are needed for the post-origination period.

Claim: *"The securities industry is not analogous to the mortgage lending industry."*

Reality: The MBA notes that investment professionals "possess greater skill and knowledge about the securities markets . . . [and] the customer reasonably relies on the professional's skill and knowledge . . ." This also is true of the mortgage market. Mortgage transactions are complex and underwriters receive extensive training. Borrowers rightly rely on the originator to exercise a degree of judgment in recommending loan products. The imperative of expanding homeownership demands such analysis.