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Licensing and Registration in the Mortgage Industry

Submitted to:

U.S. House of Representatives Committee on Financial Services
Subcommittee on Housing and Community Opportunity

Submitted by:

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My name is Eric Rodriguez, Director of the Policy Analysis Center for the National Council of La Raza (NCLR). As an advocate for Latinos, I have worked for more than a decade on planning and preparing policy analysis, legislative, and advocacy activities related to economic, employment, and financial security public policy issues. I am grateful to present our views for the hearing entitled, "Licensing and Registration in the Mortgage Industry."

As you know, NCLR is a private, nonprofit, nonpartisan organization established in 1968 to reduce poverty and discrimination and improve life opportunities for the nation's Hispanics. As the largest national Hispanic organization in the U.S., NCLR serves all Hispanic nationality groups in all regions of the country through a network of more than 300 affiliate community-based organizations.

NCLR has a deep interest in increasing the rate at which Latinos own and build equity in their home and thereby accumulate wealth that will provide financial stability in the years to come. Over the past two decades, NCLR has been a leader in advocating and conducting research on affordable housing issues important to the Latino community. This work focuses on issues such as asset accumulation and barriers to homeownership, access to affordable mortgage products, and programs and legislation that support fair lending. NCLR's most recent relevant publications include *Hispanic Housing and Homeownership*; *American Dream to American Reality: Creating a Fair Housing System that Works for Latinos*; and *Jeopardizing Hispanic Homeownership: Predatory Practices in the Homebuying Market.*

In addition, since 1997, NCLR has been a national intermediary designated by the Department of Housing and Urban Development (HUD) to distribute funds for housing counseling. The NCLR Homeownership Network (NHN) consists of 38 NCLR affiliates in 19 states that provide pre-purchase bilingual homeownership counseling to low-income families in predominately Latino neighborhoods. NHN counsels more than 20,000 families each year, more than 3,500 of which become homeowners. NHN has sophisticated partnerships with some of the nation's largest providers of home mortgages such as Bank of America, Countrywide, JPMorgan Chase, Washington Mutual, Wells Fargo, Fannie Mae, and Freddie Mac. Our extensive research and service delivery experience puts us in a unique position to comment on the role and impact of mortgage brokers in increasing Latino homeownership.

Latino Homeownership

Increasing Latino homeownership is critical to the financial security of Latino families and the economic stability of the broader community. While Hispanic homeownership still falls behind that of Whites according to HUD's most recent statistics (48% versus 76%, respectively), Hispanic families are entering the mortgage market in record numbers. Between 1993 and 2003, the number of Hispanic households grew by 92% while the number of Hispanic homeowners grew by 96%. For most American families, a home is their primary asset and homeownership represents their single greatest wealth-building vehicle. Home equity affords households and families significant financial opportunities. Unfortunately, the Latino homeownership rate lags behind that of Whites by 28 percentage points. Low homeownership rates are the primary factor contributing to the 27-to-1 wealth gap between White and Latino households.

Latino families face a number of barriers when attempting to purchase their first home, including:

- **Lack of information.** Many first-time Hispanic homebuyers are also first-generation homebuyers and many lack experience with mainstream financial institutions. In addition, overall lack of effective outreach from the financial services sector has contributed to poor information flow and insufficient access to affordable mortgage products for low-income Latino families.

- **Systemic barriers.** Many Hispanic households have "thin" or no credit files. For many Latinos, a preference not to incur and carry financial debt often translates into low credit scores that do not accurately reflect their credit risk. Due to a largely "one-size-fits-all" approach to financial and credit-scoring systems, an otherwise mortgage-ready family may be unable to qualify for a loan, or may be paying more than necessary for its financing.

- **Affordability.** Although the Hispanic population is growing in many areas of the country, more than one-third live in California and New York, two of the least affordable states in which to own a home, according to the National Low Income Housing Coalition. More than two in five Hispanic households, and more than a third of Hispanic owners, dedicate more than 30% of their income to housing, the federally-recommended standard for affordability.

- **Market failure.** Many financial institutions are experimenting with pilot products and innovative underwriting criteria; however, more should be done to meet the needs of a dynamic marketplace. Most institutions use a passive product-driven outreach system that assumes that the same product is sufficient to meet the needs of all or most buyers, rather than an assertive market-oriented approach that would value different credit behaviors and use innovative underwriting criteria (such as nontraditional credit). This approach would enable financial institutions to create products that more adequately serve a dynamic market.

Mortgage Brokers in the Latino Homebuying Market

Mortgage brokers play an important role in delivering much-needed mortgage financing to potential Latino homebuyers. Annually, mortgage brokers originate nearly two-thirds of the nation's mortgages and between 65% and 80% of nonconforming mortgages. In addition to offering a wide variety of mortgage products from various lenders, many brokers have adopted outreach techniques that mainstream lenders have not employed on a large scale and that resonate well among Latino home-shoppers. For example, many brokers spend a significant amount of time with their clients in an individual setting. Some brokers visit families or conduct closings at their homes and many of those working within the Latino community are bilingual or bicultural. However, limited oversight and inconsistent regulations between states translate into inadequate accountability standards for most brokers. Latino homebuyers, many of whom are vulnerable due to the barriers to affordable homeownership described above, feel the effects of those mortgage brokers that engage in unethical lending practices. In the interest of protecting and increasing homeownership for all families, NCLR has identified three areas of concern regarding mortgage brokers:

- **Limited accountability.** The Real Estate Settlement Procedures Act (RESPA) regulates all activities concerning the mortgage closing transaction and was passed in 1974 to prohibit excessive fees and illegal kickbacks to service providers. To the extent consumers have a complaint about being charged a fee unfairly, they can seek enforcement action under RESPA. Although HUD has jurisdiction over RESPA, neither they nor any of the other regulatory agencies have been charged with monitoring broker activities for fair housing compliance, best or sound practices, or licensing and registration requirements. In addition, there is only a limited enforcement mechanism, which is largely consumer-complaint driven. State laws vary widely, but do offer some important consumer protections such as a private right of action and lists of prohibited practices.

- **Risk of steering.** NCLR's recent report on predatory lending found that too many Hispanic homebuyers have been steered into mortgage products more expensive than their credit warranted. Mortgage brokers have a financial interest in pushing the cost of the loan higher. Known as a Yield Spread Premium (YSP), the broker profits from selling a borrower a loan with an interest rate higher than what the financial institution quoted the broker. Most borrowers are unaware their loan contained a YSP and that they may have been steered toward a more expensive mortgage product as a result.

- **Transaction lacks transparency.** The essence of the broker function is one of being an intermediary between the borrower and the lender. Many borrowers mistakenly assume that the broker is responsible for finding them the best mortgage deal for which they qualify. In reality, however, the broker's fiduciary responsibilities are not disclosed, and, in most cases, the broker is not the fiduciary agent of the borrower.

As the main interface between clients and their mortgage options, sufficient accountability standards are in the interest of the entire homeownership market. Such standards will maintain market integrity and prevent families from squandering hard-earned money on interest and fees rather than on principal that translates into home equity.

Mortgage Broker Licensing Standards

Throughout the 1990s, the mortgage market experienced dynamic and rapid growth. Now, most homebuyers have many mortgage products and lenders from which to choose. Choices regarding mortgages have become more complex because the interrelations between products and product features, banks and their subsidiaries are not always clear to the consumer. In such an environment, the broker function is an important one that holds considerable value for the consumer. In fact, NCLR has made substantial investments in housing counseling because it understands the demand for bridging the gap between lenders and borrowers. Although their clientele is slightly different – brokers work with families that are mortgage-ready and counselors work with families that need assistance before they are ready to purchase – the trust clients place in their counselor or broker and the role of an intermediary between them and a lender is very similar. Unfortunately, accountability standards have not kept pace with the growing sophistication and complexity of the homebuying market. We commend Chairman Robert Ney, Ranking Member Maxine Waters, and the members of this subcommittee for convening on the issue of mortgage broker licensing and registration requirements. However, while licensing requirements are important, they are only one piece of a broader strategy necessary for developing stronger accountability standards for mortgage brokering transactions.

Licensing requirements for mortgage brokers can be an effective way to limit bad actors from the marketplace and foster consumer confidence. However, it is not clear that licensing requirements sufficient for this purpose have yet been proposed. For example, for a housing counselor to become certified by NeighborWorks© America, which is the industry standard, he or she must complete at least 120 hours of coursework and pass an exam. In addition, HUD certifies housing counseling agencies and maintains the Housing Counseling Handbook which outlines all their duties and requirements. HUD-certified organizations are audited by HUD every two years and must comply with bookkeeping, data collection, and annual reporting standards. Although HUD-certification is not required to offer homeownership counseling services, it is considered a seal of approval by lenders, government agencies, and funders; most downpayment assistance programs require HUD-certified counseling. By comparison, the "Responsible Lending Act" (H.R. 1295), which is the only legislation before the committee addressing this issue, would only require 24 hours of coursework and does not provide means for other accountability measures such as recordkeeping and reporting.

Another example of a comparable industry's safety and accountability standards is of the Securities and Exchange Commission (SEC) and the National Association of Securities Dealers (NASD) for stock and securities dealers. These brokers are also responsible for helping consumers navigate a complicated financial process and are responsible for significant sums of their clients' money. The success and efficiency of the securities market depends on the investors' confidence that their broker is dealing fairly and the integrity of the system that holds them accountable. Brokers are required to register with all regulatory bodies that apply to the markets in which they are trading and to comply with each regulatory agency code and standard. Investors and regulators rely on enforceable standards, such as regulatory compliance, fiduciary disclosure, licensing and registration requirements, to hold securities brokers accountable. In much the same way, homebuyers need assurance that their mortgage broker is held to meaningful standards designed to protect their investment and maintain their confidence in the market. H.R. 1295 calls for the creation of a national registry that would list all mortgage brokers in good standing with their state and alert others to brokers that have violated a state law. This, however, falls short of creating the kind of oversight and accountability necessary for an industry the size and scope of mortgage brokerage.

The homeownership market can only be strengthened by creating measures that foster and maintain consumer confidence and market integrity. State regulations vary widely in regards to licensing requirements, regulations, disclosure of fiduciary responsibility, and continuing education, but many provide important safeguards that cannot afford to be lost. For example, some states require criminal background checks and registration, list prohibited practices, and set education standards. However, there are also significant gaps in protections available. For example, 36 states do not have laws that outline a broker's fiduciary duty or responsibility to disclose on whose behalf they are working. Many states could benefit from minimum standards and guidelines on mortgage broker education and licensing. However, the committee should also look to build on the SEC/NASD model to create a comprehensive approach to providing consumer and industry protections.

Recommendations

We would like to thank the members of the committee for convening on such an important issue. NCLR makes the following recommendations:

- **Increase market integrity.** Congress must create a new regulatory agency, fashioned after the SEC/NASD model, with a mission to foster and maintain consumer confidence and market integrity. To fulfill this mission, the new agency must have the authority to monitor mortgage brokering activity as well as individual brokers and agencies; to collect data similar to those collected from lenders and private mortgage insurance companies under Home Mortgage Disclosure Act (HMDA); and to set guidelines for recordkeeping, minimum licensing requirements, education standards, and registration. In addition, such an agency would need the authority to conduct investigations and take corrective action when necessary such as imposing fines, revoking licenses, and injunctions. H.R. 1295 proposes a national registry. This, however, does not advance the caliber of services brokers provide or consumer protections. To improve the quality of mortgage broker services effectively, new regulations and licensing requirements must increase transparency, accountability, and oversight.

- **Prevent Steering.** YSPs must be included in the Home Ownership and Equity Protection Act (HOEPA) points and fees calculation used to determine if a loan meets the definition of a "high cost loan," which thereby triggering additional protections, to curb incentives for steering clients into more expensive mortgage products. The "Prohibit Predatory Lending Act" (H.R. 1182), currently before the committee includes this protection. It is unclear whether H.R. 1295 includes a similar provision.

- **Increase transparency of mortgage broker services.** Mortgage brokers should be required to disclose their compensation and the impact of the YSP on the interest rate. A simple form would inform the consumer that they have a YSP, how this YSP compensates the broker, and the respective impact on the interest rate and fees with or without the YSP. Neither bill, H.R. 1295 or H.R. 1182, addresses this issue.

Conclusion

High quality mortgage broker services are an important part of America's homebuying market. To ensure market integrity, consumers must be assured that their mortgage broker is held to adequate standards. NCLR thanks the committee for the opportunity to share its views on this legislation.