U.S. NEWS

Administration Takes Heat on Mortgages

Banks, advocacy groups say overly strict rules have kept lenders away from risky borrowers

By Joe Light

A rare coalition of mortgage lenders and left-leaning consumer advocates are calling on the Obama administration to ease up on lawsuits they say are driving banks away from making loans to borrowers with weak credit histories.

In three nearly identical proposals, the Mortgage Bankers Association, 15 left-leaning advocacy groups, and researchers from the Urban Institute and Moody's Analytics are asking the administration to restrict one of the most powerful tools the U.S. government has used to punish banks for mortgage mistakes.

Some lenders say fears of being sued and slammed with financial penalties have caused them to adopt more-stringent mortgage rules than what the federal government requires, shutting out borrowers near the margins.

The Urban Institute, a think tank in Washington, D.C., has estimated as many as 1.2 million more mortgage loans would be made annually if not for tight credit restrictions put in place by lenders in the years since the financial crisis as regulators and attorneys ramped up mortgage-related lawsuits and penalties.

But the proposals, if they gain traction, could also limit the Justice Department's discretion in pursuing banks for mistakes.

At issue is the Federal Housing Administration, which is run by the Department of Housing and Urban Development and is responsible for backing more than one in 10 mortgage loans.

The FHA is a favorite program for first-time home buyers and borrowers with weak credit because it allows them to make down payments of as little as 3.5% with a credit score of 580 on a scale of 300 to 850.

The Justice Department has pursued lawsuits aimed at holding banks accountable for shoddy loans with errors—such as misstating borrowers' credentials or inflating values of homes purchased—that in part led to large losses at the FHA after the loans went bad.

The groups behind the new proposals say the problem is that under current rules, FHA lenders must promise that everything in the loan paperwork is accurate. If there are mistakes, even minor ones such as misstating a borrower's income by a tiny amount, the lenders can be liable for up to three times the damages.

"In all of these efforts, we're balancing access to credit and oversight. The best way to do that, the easiest way to do that is to maximize clarity for lenders," said Julia Gordon, senior director for the Center for American Progress, a left-leaning group that didn't sign on to the broader proposal but supports many of its ideas.

The Justice Department has used the rules to extract multimillion-dollar settlements from banks including J.P. Morgan Chase & Co., Bank of America Corp. and SunTrust Banks Inc., while litigation against other major lenders, such as Quicken Loans Inc., is continuing.

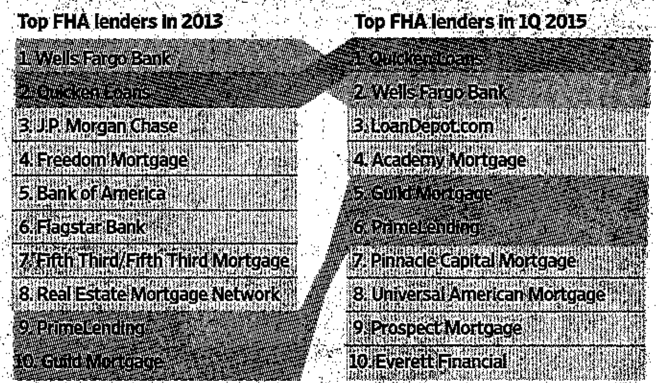
Justice Department officials say the cases they have pursued have been for significant violations, rather than for minor errors. In its lawsuit against Quicken filed this year, for example, the department cited an instance in which it said Quicken made a loan to a borrower who was having trouble feeding her family. At the time, Quicken Loans said the lawsuit relied "on a handful of out-of-context email conversations skimmed from the communication between Quicken Loans employees."

A spokeswoman said the Justice Department hadn't seen the new proposals but added, "The conduct that the government has pursued reflects clear, systematic, and knowing violations of meaningful and substantive FHA requirements, rather than isolated, good faith efforts to comply with those requirements."

HUD unveiled a preliminary draft of changes to the so-called certification in May. The three proposals came in response.

Changing Landscape

As regulators have ramped up lawsuits and penalties tied to FHA-backed mortgages, some big banks have stepped back from the sector, while smaller lenders have piled in.



Source: Inside Mortgage Finance

THE WALL STREET JOURNAL.

Under the groups' plan, lenders would face liability for triple-damages claims only when they knowingly or recklessly make a mistake affecting the insurability of the loan. Lenders also could be held liable if they don't have a quality-control process that follows the FHA's guidelines or consistently fail to follow their own process.

A HUD spokesman declined to comment on the proposals but said the agency would respond to comments it received and then open another 30-day comment period before releasing final language on the new FHA requirements.

"HUD is truly between a rock and a hard place," said Isaac Boltansky, a policy analyst with Compass Point Research & Trading in Washington, noting that Democrats worry about letting banks off the hook while Republicans are concerned about fiscal impacts of changing policies.

In presenting a united front, the groups hope to sway the FHA to change its policies. Joint efforts have been successful in the past, such as pushing for reduced FHA fees and changes to some proposed federal mortgage rules.