

# THE TRUSTED PROFESSIONAL

Government Agencies Weigh In on Subprime Woes

By Forrest Whitesides

WASHINGTON- In the wake of the recent downturn of the subprime mortgage market as a result of a slowdown of real estate markets nationwide and a subsequent epidemic of defaulted home loans and foreclosed properties, a group of federal agencies has issued a “Proposed Statement of Subprime Mortgage Lending” that is currently open for public comment. Agencies collaborating on the statement include the Office of the Comptroller of the Currency, Treasury; The Board of Governors of the Federal Reserve System; the Federal Deposit Insurance Corporation; the Office of Thrift Supervision, Treasury; and the National Credit Union Administration.

The statement discusses three main areas of concern, the most critical of which outlines the need for policies and procedures to assure that subprime mortgage lending is conducted in a “safe and sound manner”. The statement also discusses “criteria and factors; including payment shock, that an institution should assess in determining a borrower’s ability to repay a subprime loan,” and also outlines issues related to consumer protection, including “reminders about some of the existing statutes, regulations and guidance intended to protect consumers from unfair, deceptive and other predatory practices.”

## **Government Intervention?**

Specifically, the statement calls for lenders to institute and adhere to internal procedures to allow for maximum consumer protection and also compliance with federal regulations.

“Institutions should have procedures and systems in place to monitor compliance with appropriate laws and regulations, applicable third-party agreements or internal policies. An institution’s controls also should include appropriate corrective actions in the event of failure to comply with applicable laws, regulations, third-party agreements or internal policies. In addition, institutions should initiate procedures to review consumer complaints to identify potential compliance problems or other negative trends,” the federal agencies stated in the draft document.

While stopping short of calling for direct government regulation and intervention, the statement does mention supervisory review:

“The agencies will carefully scrutinize risk management and consumer compliance processes, policies and procedures at regularly scheduled examinations... [and] will take action against institutions that fail to implement or adhere to safe and sound standards, exhibit predatory lending practices or violate consumer protection laws.”

**Jacob Renick**, chair of the NYSSCPA’s Bankruptcy and Financial Reorganizations Committee, thinks that government intervention is inevitable.

“I definitely believe that Congress will step in and legislate some guidelines—certain criteria that must be met in order to lend money, for example,” Renick said, adding that he is opposed to that type of intervention.

“I’d much rather see mandatory loan information disclosure guidelines enforced on subprime lenders than have the government dictate how and to whom money should be loaned,” he said.

Renick did say, however, that there is a need for federal regulation on how subprime lenders are established.

“I think there should be some oversight on who can become a lender; perhaps some kind of licensing or registration process,” he said. “I don’t think that someone should be able to decide, overnight, that they’re going to start a mortgage lending business. Banks and credit card companies are regulated in this way, so it seems logical that subprime mortgage lenders should be also.”

### **Congressional Testimony**

Congress also is hosting hearings on the current state of affairs in the subprime market.

Testifying March 27 before the U.S. House of Representatives’ Subcommittee on Financial Institutions and Consumer Credit on the issue of subprime and predatory lending practices, Alex Pollock, a Resident Fellow at the American Enterprise Institute, called for a one-page loan term disclosure sheet to be given to borrowers prior to loan closing.

“I believe the superior strategy is equip [borrowers] to protect themselves, by ensuring short, simple and clear disclosures of mortgage loan terms,” Pollock said in his testimony. “I would like to see the design of a one-page form which gives the essentials of the loan, which would be given to every mortgage borrower a week before the closing.”

Pollock testified that the one-page document should contain, among other items, information on the amount of loan, prepayment fee, balloon payment, points and closing costs, the initial interest rate on the loan in percent and monthly payment in dollars, the length of the term of the initial rate, and the fully indexed interest rate on the loan in percent and monthly payment in dollars.

Pollock cautioned, however, that the disclosure statement should be easy to understand in order for it to have any effect.

“But this page must be something simple and clear: 90 percent of the relevant information which is clear and understandable is better than 100 percent which is complex and opaque.”

### **Hindsight or Foresight?**

The question of who has the larger share of the blame for the current state of affairs—the lenders or the borrowers—remains the key point of debate.

“I think, ultimately, that the responsibility for understanding the conditions of loan lies with the borrower,” said **Ginger Broderick**, CPA, president of Broderick & Company CPAs P.C., who

specializes in money management and tax and business planning. “However, in a lot of cases the borrower may not know what they are doing. People often make decisions based on emotion, and they’ll borrow 100 percent of their mortgage just so they can tell people they own a home.”

Broderick did say, however, that there are cases in which she is unsure how lenders make the decision to loan money to home buyers.

“I have one client with no income at all who was able to secure a mortgage loan,” she said. “The lender gave the loan based on a good credit score but with no income verification. I find that to be very irresponsible.”

Renick said a big part of the problem stems from the fact that, over the past few years, subprime lenders have been lending 100 percent or more of the property value.

“Up until recently, you could borrow up to 120 percent of the fair value of a property from a subprime lender, whereas more-traditional banks will generally only lend up to about 80 percent of the fair value,” he said. “It is less than prudent, especially from the perspective of the lender, to loan more than the value of a property.”

Renick also echoed Broderick’s concerns about a general lack of income verification in the subprime industry.

“Many of these lenders are at fault for failing to verify if borrowers have the ability to pay back a loan,” Renick said. “This is bad for both the lender and the borrower, obviously.”

When asked if the subprime industry players should have foreseen the current crisis of foreclosures and defaulted loans, Renick’s answer was unequivocal:

“Absolutely.”

Forrest Whitesides, Editor, can be reached at [fwhitesides@nyssscpa.com](mailto:fwhitesides@nyssscpa.com)