Senate Votes to Ban Stated Income Loans

May 13, 2010 - The Senate has voted to ban home mortgages without income documentation. The vote adds an amendment to the financial reform bill currently being debated. The amendment will require anyone applying for a mortgage to prove that they have the ability to pay the loan back at the interest rate offered. Borrowers will have to provide copies of their tax returns, W-2s or bank statements.

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One of the leading causes of the mortgage market meltdown in 2007 was the fact that virtually anyone could get a mortgage without any documentation. Publically, the loans were known as Stated Income-Stated Assets or No Income-No Assets. Within the mortgage industry they were referred to as "liar's loans" because nobody verified any of the information that was placed on the loan application. You didn't even need to have a good credit record to get one of these loans. If the finance reform bill passes, these loans will no longer be available.

The amendment to the bill also bans other lending practices. Lenders will no longer be able to pay loan brokers or their own lending officers' higher commissions on loans that bring in a higher interest rate. In the days that lead up to the housing market slump, brokers were encouraged to offer their customers higher priced loans even when they could qualify for less risky, lower priced loans. In return for selling these loans, the brokers involved were paid considerably more money.

As currently written, the bill will also require lenders to retain at least 5% ownership in every loan that they make. The thought process here is that if the lenders profits and losses are tied to the loans they make, perhaps they will be more careful to whom they lend. Frankly, that may sound good on paper but it simply won't work as long as the government is there to bail the lenders out. And there is nothing in the bill so far that will prevent the government from bailing out the banks again.

Furthermore, the bill still does nothing to regulate or eliminate FannieMae or FreddieMac. These two government owned companies have now cost American taxpayers well over $100 Billion for their flawed lending practices. They are owed more than $5 Trillion by borrowers. And because both companies are owned by the US Government - in other words, by taxpayers - that $5 Trillion should actually be added to the national debt. That hasn't happened though, largely because of accounting tricks that are being used by the government.

It remains to be seen how effective any of the new lending rules imposed by this law will be, but if history is any indicator, nobody should be taking much comfort. The vast majority of the financial problems faced by the United States today have been caused by flawed congressional legislation passed since the mid 1990's. If Congress has proven anything it is that it doesn't understand the economy at all.

byJim Malmberg

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