CFPB About to Issue New Mortgage Lending Rules

May 1, 2012 - The Consumer Financial Protection Bureau is deciding on new lending rules for home mortgages, and may issue a final determination this month. On its face, the rule is designed to insure that borrowers actually have the ability to repay their home loans. But one version of the rule that is being considered would offer lenders complete immunity from law suits even if they use unsound judgment when issuing a loan. If that version of the rule is implemented it will almost certainly lead to consumer and investor abuses which can't easily be foreseen today.

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One of the primary driving factors for the collapse in housing prices was the fact that lenders were making loans to consumers who had absolutely no hope of ever repaying what they had borrowed. The only reason that the market didn't collapse sooner was because housing prices continued to rise rapidly. This allowed banks to relax their lending standards to the point that they were virtually non-existent; allowing borrower to refinance their mortgages over and over again regardless of their income. It was a house of cards that ultimately came tumbling down.

When the collapse occurred, it became glaringly apparent that loan underwriting standards used by the banks were based on the false assumption that housing prices would never drop. You don't have to be a rocket scientist to know that this is an assumption that was bound to fail.

In order to avoid a repeat of 2007's collapse, the CFPB rule would require lenders to use underwriting standards that are much more stringent. Lenders would have to verify income and asset information from borrowers. In return for that they would receive certain legal protections.

There are two versions of the rule currently being considered by the CFPB. One would grant the banks some protection against law suits, but still allow them to be sued by borrowers and investors in mortgage backed securities under certain conditions. This particular version attempts to strike a balance between consumer rights and badly needed tort reform in the mortgage industry.

The second version - known as the Safe Harbor rule - would grant the banks blanket immunity from lawsuits on new loans as long as they use the underwriting procedures dictated in the rule. This is almost certain to lead to consumer abuses. It could also backfire on the banks, which rely on the ability to sell off their mortgages in order to fund new loans. Immunity could make mortgage backed securities and bank bonds less attractive to investors. If that happens, getting a mortgage could become even more difficult.

byJim Malmberg
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