

Testimony of
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On behalf of the
Mortgage Bankers Association

Before the

U.S. House Committee on Veterans' Affairs
Subcommittee on Economic Opportunity

**“Home Loan Churning Practices and How
Veteran Homebuyers are Being Affected”**

January 10, 2018

Chairman Arrington, Ranking Member O'Rourke, and members of the subcommittee, thank you for the opportunity to testify on behalf of the Mortgage Bankers Association (MBA). My name is Dave Motley, and I am President of Colonial Savings, a privately-held, federally-chartered thrift headquartered in Fort Worth, Texas. I also currently hold the position of Chairman of the MBA. I am a Certified Mortgage Banker (CMB), and I have previously served as a Board member of the Texas MBA and a member of the Community Bank Advisory Council of the Consumer Financial Protection Bureau (CFPB).

MBA is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. The association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. MBA's membership of over 2,300 companies represents all elements of real estate finance, including firms serving both the single-family and commercial/multifamily markets. Our membership features commercial banks, community banks, credit unions, independent mortgage bankers, investors, brokers, conduits, and industry vendors, among others.

I applaud the subcommittee for its efforts to better understand problematic practices with respect to certain mortgage refinances marketed to servicemembers and veterans of the U.S. military. Servicemembers and veterans generally benefit from the streamlined process for refinancing mortgages backed by a partial guarantee from the U.S. Department of Veterans Affairs (VA). However, recent activity in this market appears to be resulting in increased fee income for a small group of lenders while leaving some borrowers in a worse economic position. Such conduct is unacceptable and should be put to an end.

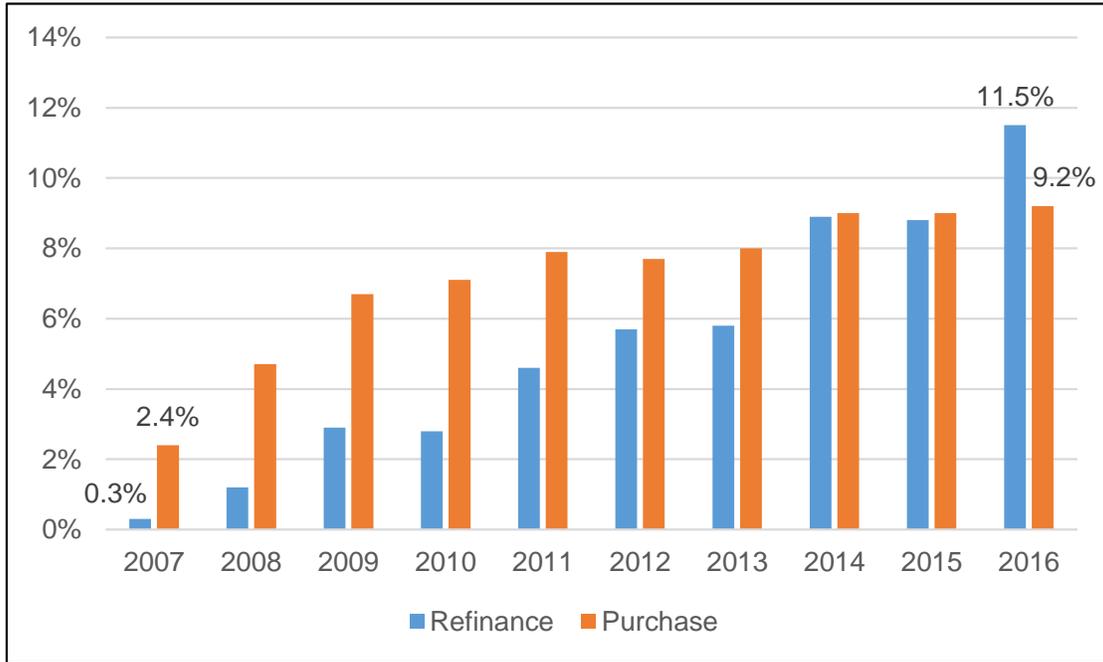
The remainder of my testimony will describe the VA mortgage market, the mechanics of loan "churning," the harm caused to borrowers by such churning, and options for addressing the recent churning we have witnessed in the market.

The VA Mortgage Market

VA mortgage loan programs play an important role in increasing the availability of mortgage credit for servicemembers, veterans, and surviving spouses. By guaranteeing a portion of the loan balance, VA enables lenders to offer loans with more favorable terms, such as no required downpayment. The VA share of the mortgage market has grown over the past decade, constituting 10.3 percent of total originations in 2016 versus 1.2 percent of total originations in 2007. Among purchase loans, the VA share

has increased from 2.4 percent to 9.2 percent over this period, while the VA share of refinances increased from 0.3 percent to 11.5 percent (see Figure 1).

Figure 1: VA Share of Total Originations (based on loan count)



Source: HMDA data

While borrowers seeking to refinance their VA loans may apply and be evaluated through their lender's full underwriting process, the VA Interest Rate Reduction Refinance Loan (IRRRL) allows for a streamlined refinance process that is often faster and entails lower costs. For example, IRRRLs do not require a traditional appraisal or credit underwriting package and can be originated with no additional funds provided by the borrower at the time of closing. IRRRLs are, however, limited to VA-to-VA refinances on properties for which the borrower has already used his or her VA loan eligibility, and the borrower cannot receive cash from the loan proceeds.

Generally, refinancing via an IRRRL allows the borrower to lower the interest rate on the mortgage. In doing so, the lender may charge the borrower origination fees, which are sometimes paid by the borrower at origination and in other cases are rolled into the principal balance of the loan. Depending upon the magnitude of both the fees and the interest rate reduction, it may take the borrower a number of years to recognize a net economic benefit on the refinance. The period of time after which the fees are fully recovered through lower interest payments is known as the "recoupment period." The longer the recoupment period, the less likely it is for a borrower to ultimately recognize a net economic benefit from the refinance.

Loan Churning

Most lenders with VA loan products offer both purchase and refinance loans to their servicemember and veteran customers. However, the recent extended period of low interest rates has encouraged some lenders to specialize in marketing and originating IRRRLs. A smaller subset of these lenders, who in many cases are not the lenders that originated the initial purchase loan, have reportedly undertaken aggressive—and potentially misleading—advertising and solicitation campaigns to generate increased IRRRL volume. In some cases, this advertising or soliciting targets VA borrowers who have already recently engaged in an IRRRL, convincing them to refinance yet again to lower their interest rate by a very small amount while adding even more fees to the principal balance on the loan. Some IRRRLs also move the borrower from a low, fixed-rate loan to a slightly lower, but now adjustable-rate, loan. In other instances, borrowers are promised “cash back” from their escrow account or the ability to effectively “skip a payment.” Such serial refinancing, or churning, provides little or no long-term benefit to the borrower while essentially stripping their equity and further extending the overall recoupment period.

VA borrowers are particularly susceptible to churning in an environment of falling interest rates, as these lower interest rates present more opportunities for lenders to offer IRRRLs. And lenders engaging in churning target IRRRLs due to their much lower origination costs relative to fully-underwritten refinances. Many borrowers may be unaware or may not fully comprehend the net economic impact of their decision to refinance (or continually refinance), leaving them vulnerable to situations in which they add substantial amounts to their overall loan balance or lose their fixed interest rate while achieving only small reductions in their monthly payments.

The harm caused by loan churning is not limited to the financial condition of the individual borrower, however. Aggressive use of IRRRLs by some lenders threatens to weaken investor demand for Government National Mortgage Association (Ginnie Mae) securities that are partially backed by VA loans. This outcome would negatively impact access to credit for a wide range of borrowers.

The vast majority of VA loans are bundled into mortgage-backed securities (MBS) that receive a guaranty of timely payment of principal and interest by Ginnie Mae. These Ginnie Mae MBS in turn receive a full faith and credit guaranty of the U.S. government. Importantly, however, Ginnie Mae MBS are backed not only by VA loans, but also by loans originated through the Federal Housing Administration (FHA), the U.S. Department of Agriculture's Rural Development (RD), and the Public and Indian Housing (PIH) insurance programs.

And like other mortgage refinances, IRRRLs represent a prepayment of the original VA loan along with the origination of a new loan (with new terms). Those prepayments flow

through to the Ginnie Mae investors. While these investors do not assume credit risk on the MBS due to the U.S. government guaranty, they are exposed to prepayment risk. More specifically, investors take into account the timing of future cash flows from a bond when determining the price they are willing to pay for that bond. If the rate of actual prepayments increases materially and beyond what was reasonably estimated by the investor, the anticipated income stream from the MBS will fall short of investor expectations. This outcome lowers demand for Ginnie Mae MBS, thereby decreasing the price of the bonds and increasing their yields.

The higher yields on Ginnie Mae MBS directly correspond to higher mortgage interest rates for not only VA borrowers, but also FHA, RD, and PIH borrowers. These higher interest rates broadly decrease access to credit and exacerbate affordability concerns in the housing market, particularly for first-time homebuyers and servicemembers and veterans.

It is worth reiterating that IRRRL churning does not appear to be a widespread problem among the mortgage lender community, but rather an activity that is confined to a small subset of lenders. Ginnie Mae has recently taken steps to meet with lenders that may be engaged in this practice, and to modify pooling requirements in order to limit the economic benefits of churning. While helpful, these efforts are not sufficient to end abusive activity.

MBA fully supports supervisory efforts to improve the policing of the market, as well as appropriate regulatory and legislative efforts to remove the ability or incentive for lenders to engage in churning. MBA is mindful that any changes must be carefully crafted so as to preserve legitimate refinancing options for servicemembers and veterans. Among MBA's core objectives is the promotion of best practices and standards that generate a healthy and responsible mortgage market, and the association stands ready to assist in developing and implementing solutions to the problem of churning.

Potential Policy Options

Many such solutions are available to address the problem. As noted, Ginnie Mae has already begun taking positive actions using its limited unilateral authority, first by issuing a six-month seasoning and payment requirement on all streamlined refinance loans prior to their eligibility for pooling, and then extending this requirement to all cash-out refinance loans, as well. Ginnie Mae and VA have also established a joint task force to analyze data and further develop coordinated policies.

While loan seasoning requirements and joint analysis are important steps, more is needed to fully prevent IRRRL churning. Fortunately, many other practical options fall within the existing authority of VA to implement. The most promising of these options

target churning while not impeding on the ability of servicemembers and veterans to obtain a refinancing that does result in an economic benefit to them. For example, a maximum recoupment period would inhibit lenders from charging substantial fees in exchange for minor reductions in mortgage interest rates. Further, a requirement instituting a net tangible benefit test, which is already present for FHA streamlined refinances, would more effectively ensure that the terms of the refinance produce real benefits for borrowers. Limits on the amounts that can be added to the principal balance would reduce equity stripping that can leave borrowers worse off as a result of the IRRRL. And finally, targeted consumer financial education regarding loan churning would better inform borrowers about the potential for abuse. Such efforts should focus particularly on servicemembers and veterans who are vulnerable to abuses in IRRRL lending. MBA firmly believes that some or all of these options—if crafted carefully—can eliminate abusive activities while preserving appropriate streamlined refinancing opportunities for VA borrowers.

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Once again, I appreciate the opportunity to present this testimony, and I look forward to working with the subcommittee to develop practical solutions that will curtail VA loan churning and better protect mortgage borrowers across the country.