Housing-Finance, CRA Reform

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S. 1368; American Housing and Economic Mobility Act of 2021

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Impact Assessment

- CRA would be expanded in requirements, coverage, and penalties. BHC, IDI, nonbank-mortgage company, and nontraditional charter business models and strategy could thus be redefined. This would likely benefit LMI communities and individuals, but also accelerate the transition of non-mortgage retail finance outside the reach of federal regulation either directly or via some bank/fintech partnerships.
- Extensive new data-collection and disclosure requirements would increase BHC, IDI, and nonbank-mortgage company compliance, legal, and reputational risk.
- Mortgage origination and servicing would be redefined not only by new CRA requirements, but also by restrictions on how foreclosures could be declared and loans or OREO sold to third parties. Even seemingly-permissible asset dispositions would be subject to retroactive challenge and revocation. Costs would likely go up significantly and reduced demand for distressed-mortgage assets would at the same time drive down prices with adverse impact on lenders, servicers, the GSEs, and taxpayers.
- FHA's and perhaps the GSEs' federal backstops would likely enable them to continue despite these challenges but the market could become still more dependent on them. Their charters might need to be expanded if traditional origination and servicing providers abandon single- or multi-family finance.
- Homeowners could also be better protected and communities become more stable if the owner-occupants and community groups empowered to acquire non-performing loans and resulting property are able to absorb this supply and ensure continued habitability.

Overview

Senior Senate and House Democrats have introduced sweeping housing-finance reform legislation that includes significant changes to the Community Reinvestment Act (CRA) and mortgage-servicing practices that will have significant policy impact even if the overall bill – which is very costly and controversial – never passes. Not only could provisions on their own advance to enactment in other measures, but selected provisions could also be implemented by federal regulators should they wish to do so. Retail and mortgage finance would come under greater compliance, legal, and reputational risk as well as many new duties to enhance affordable housing and community development, with nonbank-parent companies and credit unions also captured in numerous ways that directly or indirectly apply CRA to their operations. While this could well enhance social welfare, it would surely increase operating costs and alter business models in ways that might accelerate reliance on companies outside the reach of federal regulators and/or the taxpayer.

Impact

Much in this legislation is aimed at increasing housing supply and thus reducing its cost. To accomplish this, the bill establishes an array of new federal programs, and funding to several existing ones is significantly increased. Numerous programs would also address prior avenues of housing discrimination embedded in federal programs with assistance targeted at Black borrowers and those living in formerly-redlined or still-segregated areas. All of this is funded via changes to the estate tax, another controversial provision attracting considerable public attention. However, little-noticed provisions would have sweeping strategic impact not only on mortgage finance, but also more broadly across all consumer-banking activities subject to federal regulation.

Although some of the changes proposed for CRA regulation are presaged in the FRB's advance notice of proposed CRA reform,[1] the legislation goes farther in scope and reach. For example, Congress now makes it clear that CRA is a direct responsibility of covered entities, not a duty to "help" or "encourage" low-and-moderate income development as stipulated in current law. The range of activities subject to CRA scrutiny is significantly widened beyond deposit-taking and the assessment areas in which covered companies are judged are defined not only to capture more areas, but also rope in online delivery channels. As a result, CRA examinations would be considerably more stringent.

In addition to new, CRA-like standards for credit unions, the bill also expands the companies subject to CRA, expressly including nonbank mortgage originators (defined broadly). This would subject them to supervision and regulation by the Bureau of Consumer Financial Protection which might not only agree with the toughened CRA framework mandated in this bill for banking organizations as implemented by the banking agencies, but also adopt its own, still stiffer requirements. The Bureau would also play a newly-influential role in

[1] See **CRA30**, *Financial Services Management*, October 13, 2020.

CRA rulemakings and might even – drafting is unclear – assume at least some CRA authority over banking organizations within its purview.

The law now also applies CRA to banks and saving associations regardless of whether they gather insured deposits. This would thus end the window for CRA exemptions opened by a nonbank company seeking a limited purpose charter[2] and likely also capture the new crypto-custody and similar special-purpose banks chartered by the OCC.[3] Banks serving as the "true-lender" for purposes of a fintech or similar arrangement would also now be more fully captured in CRA judgments.[4] Expansion and M&A across all institutions covered by the redefined CRA would also be significantly complicated, giving the Act still more authority over strategic decisions.

The bill's provisions with specific regard to mortgages not only subject nonbanks to CRA, but also redefine how mortgage servicing is conducted and how non-performing loans (NPLs) and other-real-estate-owned (OREO) may be sold. The drafting here is also unclear; thus, provisions related to mortgage sales might also cover performing-mortgage sales in the ordinary course of business although this does not appear to be the draft's intent. Aimed at preventing the foreclosures that devastated families and decimated communities during the great financial crisis, the legislation gives delinquent homeowners far more opportunities to contest a foreclosure or receive a significant loan modification. In the event these procedures are not followed, foreclosures would be reversed and borrowers would return to their homes, apparently without any further mortgage obligation (again, drafting is unclear). This will significantly increase not only servicing costs, but also add a significant level of uncertainty for lenders, securitizers, and investors that may lead them to shun the sector and/or seek added credit enhancement at considerable cost to both borrowers and mortgage-market participants.

The legislation also seeks to bar NPL and OREO sales to private-equity firms and similar ventures along with the many other distressed-asset buyers who are not the owner-occupants or community groups given almost exclusive rights to these assets under the legislation. Servicers would thus need to provide advances far longer to mortgage investors and portfolio lenders would go considerably longer without principal-or-interest payment, increasing the cost of mortgage finance and almost surely that also of eventual NPL and OREO disposition. The CFPB has proposed rules along these lines,[5] but this measure would codify these requirements and go still farther. Like foreclosures, asset sales could be reversed if all of the borrower and purchaser requirements are not met.

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2 See Client Report **CHARTER28**, December 8, 2020.

3 See **CRYPTO17**, *Financial Services Management*, January 12, 2021.

4 See **PREEMPT35**, *Financial Services Management*, November 2, 2020.

5 See **GSE-040621**, *GSE Activity Report,* April 6, 2021

Although over-rapid foreclosure has not only proved often unnecessary, but also destructive to long-term financial and neighborhood security, undue delays may also just increase the amount of unpaid debt, raise the risk of property damage, and accelerate house-price depreciation in the absence of borrowers able quickly to improve or occupy the premises. Owner-occupants and community groups may in many cases be able to do so, but only after significant asset-price discounts that then have an adverse impact on surrounding house prices. Reduced demand for a supply of possibly damaged or costly assets could also contribute to discounted prices and adverse community, market, and social-welfare costs. Further declines in mortgage finance by both regulated institutions and reduced nonbank capacity due to both these new costs and the CRA rules noted above might also exacerbate shortages in mortgage credit for higher-risk borrowers that lengthen the time it takes to move foreclosed properties back into vibrant markets.

The legislation also adds extensive data-collection and disclosure requirements for most non-mortgage retail-finance products. These filings would appear to be mandated only for banking organizations, unlike the Home Mortgage Disclosure Act (HMDA) standards that govern all mortgage originators; again, legislative language is unclear. Any covered entity would find itself subject to extensive data-collection and compliance challenges as well as to increased reputational and litigation risk. However, this transparency – which extends also to small-business loans – would inform public debate about the extent to which credit is provided on equitable terms across an array of borrowers and markets.

Finally, the legislation adds and expands protections against housing-finance and more general discrimination for persons of color and those with non-traditional sexual identities. This reflects growing social pressure and, more recently, concerted moves by the Biden Administration. In response, many financial institutions have voluntarily provided similar protections. The CFPB is also exploring a sweeping rewrite of anti-discrimination standards in a pending review of the Equal Credit Opportunity Act (ECOA), which goes well beyond the types of lending covered directly in this bill.[6] Senate Banking Chairman Brown (D-OH) last year also proposed changes to the Civil Rights Act that go beyond those proposed here, bringing financial-services firms under a wide range of anti-discrimination requirements to which none is formally obligated even those most adhere to them.[7]

What's Next

S. 1368 was introduced on April 26 by Sen. Elizabeth Warren (D-MA) and five of her Democratic colleagues. The House companion, H.R. 2768, was introduced on April 22 by Rep. Cleaver (D-MO) and nine Democrats. The most immediate target for legislative action will be the Administration infrastructure bill which includes numerous provisions aimed at increasing affordable housing and racial equity. This bill is also proceeding through the reconciliation process that makes it less susceptible to opposition based on deficit concerns.

6 See **FAIRLEND7**, *Financial Services Management*, July 31, 2020.

7 See **FAIRLEND9,** *Financial Services Management,* October 30, 2020

Current law would not bar one or more federal banking agencies from doing as the bill mandates should they choose to do so. No proposals in this arena have yet been released.

Analysis

A. CRA

This section of the bill is entitled the "Community Reinvestment Reform Act of 2021" and significantly rewrites the Act with respect to all of its requirements, not just those related to affordable housing.

1. Overall Framework

Among other provisions, the bill would:

- rewrite Congress' intent to stipulate also that financial institutions are to serve community needs not only with regard to credit, but also deposits, transaction services, "other financial services," and community-development loans;
- hold covered entities directly responsible for an array of social-welfare and community-development goals;
- expand CRA's reach to nonbank mortgage originators. This term is defined to include most servicers;
- give the CFPB regulatory and supervisory power regarding CRA which appears to extend to all entities it covers, not just nonbank mortgage originators. Special CRA obligations are also prescribed for nonbank mortgage originators and the rules the CFPB would issue with respect to them. As drafted, these rules in some cases would not recognize that nonbanks do not deliver services through channels akin to those common at banks. The measure thus includes provisions that appear inapplicable unless intended to reach to affiliates of such ventures housed in BHCs;
- expand the obligations of the banking agencies for CRA examination and compliance;
- include a statutory definition of "assessment area" that goes beyond current law to encompass areas in which there is non-deposit activity and/or a significant online presence;
- expand CRA's purposes and eligible activities to include environmental improvements to housing and efforts to ensure that residents may remain in their communities;
- increase the transactions, facility openings, and M&A that require prior public hearings at which CRA performance is evaluated not only by regulators but also via expanded opportunities for public notice and comment along with hearings;
- expressly include consumer-law compliance as a CRA criterion and mandate disclosures when any federal regulator or state has deemed an institution's practices to be unfair, deceptive, or abusive;
- allow any federal banking agency or the CFPB to change the CRA rating system or include additional ratings; and

- make CRA-rating appeals a matter of public discussion.

2. Data Collection and Disclosure

This section of the bill also mandates a significant new data-collection effort in which all federal banking agencies and the CFPB would gather loan-by-loan data on each major consumer-loan category linked to borrower income and on community-development lending and investments, with these data made public by each institution on a county-by-county basis. Data collection and dissemination would also be required on deposit-taking activities by census-track and other categories.

The federal agencies would also need to create aggregate forms providing all these data on an institution-by-institution and overall basis. The bill adds additional categories to these aggregate disclosures (e.g., ethnicity) not expressly mentioned in the language on the individual data-collection efforts it also mandates, suggesting that efforts in each arena would be significantly more demanding in a manner akin to HMDA requirements.

The bill also includes provisions to protect borrower personal information and a mandate for the FFIEC to create a new data repository for all these filings.

3. M&A

Financial holding companies could not acquire any company engaged in any of the businesses mentioned in this section of the bill unless the FRB provides an opportunity for public notice and comment and, for low-rated companies, a public hearing. The FRB is also directed to consider all of the issues noted above along with CRA ratings under a more stringent set of criteria designed to increase the likelihood of disapproval.

4. Credit Unions

CRA-like obligations for federal credit unions are also mandated.

B. NPL and Real-Estate Owned Disposition

1. FHA

The bill requires that at least 75 percent of NPL dispositions involving single-family homes go to LMI households, either directly to prior owner-occupants or via designated community groups. HUD would need to establish standards for doing so governing FHA within one year of enactment that among other things bar groups that purchase these homes from reselling them for fifteen years and make it very difficult for HUD to transfer FHA mortgages to third parties unless the MMI Fund is in distress. Even then, borrowers would be given an array of protections before an FHA-insured mortgage could be transferred.

In addition, lenders or servicers would need to send a certificate detailing their loss-mitigation actions before submitting a claim to FHA; any false statements on such certifications would revoke insurance payments and/or property sales and subject the lender or servicer to additional penalties, including a private right of action. Purchasers of such mortgages would also need to offer loss-mitigation options to homeowners under rules to be promulgated by HUD even if all of these loan-mod options had been previously offered by the lender or servicer. Failure to follow the loss-mitigation rules would revoke foreclosure. Finally,

ninety percent of covered mortgages would need to be sold to owner-occupants or community groups.

2. GSEs

The bill also includes similar requirements for Fannie Mae and Freddie Mac, adjusting them as needed to reflect FHFA's jurisdiction and the different nature of their business from FHA. However, drafting errors seem to assume that the GSEs issue rules for public comment, not FHFA. The GSEs are also at risk since their failure to perform or that of a transferee creates a defense against foreclosure.

Further, the GSEs are required to undertake actions similar to those required for single-family mortgages for multi-family loans backed by their guarantee except that, since there are no owner-occupants, foreclosures do not directly grant right to renters beyond eviction protection but the GSEs are required to convert foreclosed multi-family properties into low-income homes or affordable housing. They could also donate the property to an entity that will do so.

C. Anti-Discrimination Coverage

The bill would also extend the Fair Housing Act and other anti-discrimination protections without regard to gender identity and veterans' status as well as an expanded definition of marital status, sexual orientation, source of income, and race or color. The bill would also make it clear that special loan programs for veterans include certain direct descendants.

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