QUALIFIED MORTGAGES: EXAMINING THE IMPACT OF THE ABILITY TO REPAY RULE

HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

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QUALIFIED MORTGAGES: EXAMINING THE IMPACT OF THE ABILITY TO REPAY RULE

Tuesday, May 21, 2013

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:02 a.m., in room 2128, Rayburn House Office Building, Hon. Shelley Moore Capito [chairwoman of the subcommittee] presiding.

Members present: Representatives Capito, Miller, McHenry, Campbell, Pearce, Posey, Fitzpatrick, Westmoreland, Luetkemeyer, Duffy, Stutzman, Pittenger, Barr, Cotton; Meeks, Maloney, Watt, Hinojosa, Scott, Green, Ellison, Velazquez, Lynch, Capuano, Murphy, Delaney, and Heck.

Ex officio present: Representative Hensarling.

Also present: Representatives Huizenga and Rothfus.

Chairwoman CAPITO. The subcommittee will come to order. Without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

I now recognize myself for 5 minutes for an opening statement. In January, the Consumer Financial Protection Bureau (CFPB) released the final Ability-to-Repay rule for Qualified Mortgages (QMs). This is a very important topic.

Called for by Title 14 of the Dodd-Frank Act, this 800-page rule will potentially forever change the mortgage market in this Nation. While the intent is to protect consumers from fraudulent mortgages, the practical implications of this rule could result in the constriction of mortgage credit for consumers.

I fear, and I have heard this anecdotally, that this approach of "Washington knows best" will harm the very people that the rule seeks to help: borrowers who are on the fringe of lacking access to mainstream financial services.

Since the release of this rule, I have heard from many community banks and credit unions in my district about the adverse effect of this rule and the adverse effect on the communities that they serve.

These financial services professionals are on the front lines of lending in their communities. They know their customers and they also know what type of financial products are appropriate for their customers based on their unique circumstances.

Many of them have expressed great concerns about their continued ability to serve their community's needs for mortgage credit under the regime established by the rule.

One of the most glaring concerns of the rule is the overly restrictive definition of what is a rural community. Bill Loving, who is president and CEO of Pendleton County Bank in my district in West Virginia, raised this issue at a subcommittee hearing last month.

He said, "I think the members of this committee would be surprised at what counties in their own States and districts fail to qualify as rural. For instance, in the State of West Virginia, 26 out of 55 counties fail to meet the definition of rural. Under any reasonable definition, the entire State of West Virginia would be considered rural."

I am certain my ranking member would consider my entire State rural compared to where he lives. To assert that nearly half of the State of West Virginia is not rural demonstrates a lack of familiarity with what constitutes a rural community.

Having an accurate rural definition is essential for community banks and credit unions that currently offer balloon loans to their customers.

Linda Ashley, who is president and CEO of Poca Valley Bank in my district, recently wrote to me about the importance of this project: "Balloon loans enable us to better manage interest rate risk and balloon loans are a product with which our customer base has been comfortable for many, many years. We encourage you to help preserve our ability to serve our customers."

There is a niche demand for these types of loans in rural communities. These loans allow borrowers who would not otherwise be able to access credit to purchase a home. The decision of whether or not a borrower should be able to access this type of credit is best determined by the lender working with the individual borrower. This type of labor-intensive relationship lending is the linchpin of community-based lending.

I see my time is running out, so I am going to shorten my statement and submit the rest of the statement for the record.

I would also like to submit letters from my community bankers for the record. Without objection, it is so ordered.

There is a very real concern that the implementation of this rule will result in less credit, less borrowing, and less availability of mortgages for many of our constituents.

With that, I would like to recognize the ranking member of the subcommittee, Mr. Meeks, for 3 minutes for an opening statement.

Mr. MEEKS. Thank you, Madam Chairwoman, for holding this hearing today.

And I would like to thank the distinguished panel for being here as we examine what is very important: the impact of the Ability-to-Repay rule on Qualified Mortgages.

Sometimes, I come to hearings and you have in your mindset what should or shouldn't happen based upon what you have talked about. Sometimes, you may come with a different perspective, and in Washington, sometimes it might be a Democratic idea or it might be a Republican idea.

This is what we have to get right. I still believe in the American dream. And the American dream is owning a home, and owning a home can mean the difference for a family and a community.

It can mean the difference in someone's getting an education and not getting an education. And that is why it is tremendously important that we get this as right as we possibly can.

I have never seen a perfect bill in my 14 years in this House of Representatives, so I know that no bill is perfect, but this really affects and can affect peoples' lives, so how we get it done and how we do it is important.

I have concerns when we start talking about the QM rule and the QRM rule and the differences and it becomes complicated and individuals don't—especially some of the banks, small community banks which did not cause the financial crisis that we entered into; it seems as though they may be unfairly hurt by this.

In fact, I was talking to one banker last night who said, "Look, we are just going to stop giving out mortgages altogether." In fact, they have, but they have made arrangements with Morgan Stanley—they have Morgan Stanley in the bank—to do the mortgages and they just got out of the business altogether because they said they can't take the risk of fines and not knowing what qualifies and what doesn't qualify because a lot of the rules are not clear to them.

When you talk about whether or not the cap, the 3 percent cap and what is included therein, it is not clear. And whether or not you take in the whole person, as opposed to just having a cookie box situation where you have to fall in this box and you are not allowed to take in the consideration of the whole person, that customer.

I have said it before in this committee and I say it again, if it wasn't for someone taking in the fact that my parents, their whole situation, they would have never owned a home. Had they not owned a home, I would not be sitting here today because that home helped finance my and my sister's education.

I want to make sure that we are not cutting out opportunities for individuals who want to own a home which will make the community good, and which changes their lives and their children's lives for generations yet to come.

And I am concerned from what I have seen thus far and what I am hearing from community banks and small banks that that very well may happen if we don't get this thing right.

So I will be looking forward to hearing from the witnesses as we move forward, and I yield back the balance of my time.

Chairwoman CAPITO. Thank you.

I would like to recognize Mr. Duffy for 2 minutes for an opening statement.

Mr. DUFFY. Thank you, Madam Chairwoman.

I want to address my comments at the CFPB in a broad sense. I think this is an appropriate time after what has happened over the last several weeks, the issues that have come out with the IRS and the AP to reflect on the structure of the CFPB.

When my friends across the aisle in the House wrote this portion of Dodd-Frank, they had talked about having a commission of bipartisan members to run the CFPB.

The way the rule has come out, the CFPB is run by a single, politically appointed Director. The CFPB is a very, very powerful agency that has a huge impact on the kind of credit and access to credit people in all of our districts receive.

And you look at that powerful agency and I think we can learn some things from what happened with the IRS. You have an agency that is also very powerful that targets Americans for their political beliefs, their political views, and it has a chilling effect on people with that political view and belief to organize around that set of ideas; it has a chilling effect. What has happened with the press? You have had an attack on the AP, Fox News, I don't know who else; but they have told us that has had a chilling effect on their ability to access information from informants and whistleblowers in regard to how the government is working.

What relationship does that have to the CFPB? I have a chance to talk to a lot of bankers, big and small, and they talk about the exams that are going on from the CFPB that are nothing like the other regulators do to them.

You are very powerful. You are very aggressive, and when I say, "Golly, that is great information, we should expose this. Come on in and testify. We want to hear your story," guess what they say? "No way, because we are afraid of the retribution. We are afraid of the impact on our institution from the CFPB because we are going to talk about what they are doing to us."

Again, a powerful agency that has a huge impact on a very important segment of our economy shouldn't be run by one director. It should be bipartisan, so we have a whole set of people with different views overseeing what the agency is doing. I yield back.

Chairwoman CAPITO. Thank you. The gentleman yields back.

I would like to recognize Mr. Ellison for 3 minutes for an opening statement.

Mr. ELLISON. Let me thank the chairwoman and the ranking member for this excellent hearing; it is very important.

I think it has been said by some that if we have greater rules regarding mortgages, and if rules contemplated now regarding Qualified Mortgages go into place, it could result in fewer loans and less borrowing. I must say, I hope so.

The fact is, there were a lot of loans that should not have been issued in the last several years. Let's never forget that we are not here simply by accident. We are not here because people like regulation; 4 million foreclosures happened.

As a matter of fact, 92 percent of subprime mortgages were rated AAA, but then after the meltdown, nearly all of them were considered junk bonds.

So it is not entirely a bad thing that some mortgages which seemed like a good idea before the meltdown may now be looked at with greater scrutiny.

A great many of the products that we saw were predatory in nature. As a matter of fact, 70 percent of the subprime loans from 2005 to 2007 were refis with features like exploding ARMs, negative amortization, and balloon payments.

Of course, balloon payments may be okay for some, but they weren't okay for all the people who got them. And we should be more diligent in making sure that the product fits the customer.

The products weren't designed to extend credit to creditworthy borrowers but to target vulnerable homeowners with little equity built up in their homes.

Lenders often stood to gain more from a default and foreclosure than the loan performed. And it was exactly this perversion of economic incentives that led to a meltdown in the economy and the foreclosure crisis that has only recently shown any sign of slowing.

In the wake of that crisis, there have been many injustices visited upon homeowners, and it is unlikely that many of the homeowners and many Americans who were forced to bear the burden of the economic crisis will ever be made whole.

But we did manage to do one thing right, and I think that is the establishment of the Consumer Financial Protection Bureau. Now as the ranking member very wisely said, there has never been a perfect piece of legislation, there has never been a Federal agency or a corporation that works perfectly.

Therefore, this committee will have the responsibility to monitor and offer oversight, and where it appears that the agency is too aggressive, we should say something. But where it appears that consumers don't have an advocate, we should say something there, too. What we are striving for is balance, not to side with consumers or producers, but balance.

I yield back.

Chairwoman CAPITO. The gentleman yields back.

I recognize Mr. Miller for 1½ minutes for an opening statement.

Mr. MILLER. Thank you, Madam Chairwoman.

We see the housing market starting to recover and the economy is going with it, which I think we all agree is important. We need to ensure that policies we pass in Washington don't disrupt that in a negative way, and that is the problem I have with QM today.

It is not a personal attack, I just think we need to look at the reality of what we are doing out there. The ATR rule will govern lending for the foreseeable future. I think none of us will disagree with that comment.

The definition of QM, which is meant to protect consumers versus predatory lending, is a good definition. In 2001, I started introducing language that defined predatory versus subprime and that should be a goal we have. But I am concerned that the QM definition as written will probably hurt more people than it will help.

I looked at a recent study by CoreLogic, and it said that mortgages made in 2010, half of them would not qualify under the QM definition, and I have talked to loan originators up and down the State, I have talked to GSA's and they say those are some of the best performing loans that they have on the books today because they used good underwriting standards.

But the lenders I am talking to say that we will not originate mortgages that do not fall under the QM label. I know that there is a period we have to come into that in the GSE's but I don't think it is going to happen. They are saying they won't do it, and I think the 3 percent point cap as determining the ability to repay a mortgage need to be more flexible.

I think it is drawn too narrowly, but we need to identify modifications to the QM that would make it workable in the marketplace, and I don't believe it is today.

Like I said, the housing market is showing signs of recovery and we need to make sure that eligible borrowers—I don't want to be making loans to people who can't repay them, but the QM rule has to be flexible enough to allow eligible buyers to buy homes.

And I see my time has expired. I yield back.

Chairwoman CAPITO. The gentleman yields back.

I would like to recognize Mrs. Maloney for 2 minutes for an opening statement.

Mrs. MALONEY. Thank you.

And I welcome the witnesses. There were a number of provisions within Dodd-Frank that tackled the important issue of consumer lending, and the Qualified Mortgage rule is certainly among the most important.

The CFPB in my opinion has worked diligently to write a fair and balanced rule that followed the intent Congress laid out for responsible home lending.

No one disputes that in the years leading up to the financial meltdown, mortgage lending got out of hand, and underwriting was nonexistent. The new QM rule will ensure that borrowers are protected from the risky lending practices that contributed to so many homeowners ending up in delinquency.

The Bureau has handled over 150,000 complaints. It has helped 6 million consumers reap over $400 million in refunds as a result of enforcement actions against deceptive practices, all while testifying before Congress at least 35 times.

I want to especially mention the rule that the chairlady and I worked on to treat stay-at-home moms fairly in their access to credit and credit cards, and the Bureau has worked diligently towards its mission, and I look forward to hearing more about your work in your testimony today.

And thank you.

Chairwoman CAPITO. Thank you.

I would like to recognize Mr. Westmoreland for 1½ minutes for an opening statement.

Mr. WESTMORELAND. Thank you, Chairwoman Capito, and thanks for yielding and for holding this hearing.

I do not believe that I have ever heard a good word from my constituents about the Qualified Mortgage rule. From homebuyers, I hear many might not be able to qualify for a home because they fall outside QM's government-anointed standards.

From bankers, I hear that credit will not be available for some borrowers and they have to prepare for possibly 30 years of potential litigation from borrowers who cannot repay.

Policies like QM are the most dangerous to economic freedom in this country. If a borrower doesn't fit into the government-approved box, you pay higher prices. Ironically, for the minority and low-income borrowers the QM rule will supposedly help, in reality, it will limit the opportunities for these Americans to better their lives through homeownership.

In the end, QM will create another housing bubble just like the Clinton affordable housing goals of the 1990s created the 2008 housing crisis. This country needs sensible housing regulation that allows the market to set the price and the qualifications for eligible borrowers.

I urge this committee to swiftly vote to repeal QM and to return all Americans to their economic freedom.

And with that, Madam Chairwoman, I yield back.

Chairwoman CAPITO. The gentleman yields back.

Mr. Green, for 2 minutes.

Mr. GREEN. Thank you very much, Madam Chairwoman.

I thank you and the ranking member.

And I thank the witnesses for appearing.

Somewhere along the way, in the 1980s we ceased to qualify people as homeowners and we started to qualify them as homebuyers. In fact, the Internal Revenue Code provided certain advantages to buying homes and selling them within a certain amount of time.

We decided that for some reason, it was not important to have the person who qualified the purchaser, to maintain some relationship such that that person wanted to be assured that the person borrowing could in fact afford the loan.

This is how we got into the 3-27s, the 2-28s, the no-doc loans, the loans that were in some ways making it available for those who wanted to buy and flip and take advantage of the fact that the market was moving, but it didn't help people who wanted to simply buy a home and live in a home, and many persons received mortgages that were not suitable for their circumstances.

I am proud to say that we have this Consumer Financial Protection Bureau. It is important that consumers have advocates for them. There were allegedly agencies available to help consumers at the time all of these things came into being, but for whatever reason, they did not function efficaciously for consumers.

I am hopeful that we will achieve the balance that Member Ellison called to our attention. Balance is important, but as we achieve the balance, let's make sure we continue to focus on the consumer and make sure that the consumer receives the type of product that he or she can afford.

I am also interested in a definition. I have heard many definitions of community bank, community banks versus small banks, and I am curious as to whether or not you have embarked upon defining community banks versus small banks.

And finally, your Office of Servicemember Affairs; I care a great deal about the persons who serve us in our military, and my hope is that we will help protect them from some of those who seek to encroach upon their financial circumstances with fraudulent items.

I thank you Madam Chairwoman, and I yield back.

Chairwoman CAPITO. Thank you.

I would like to recognize Mr. Fitzpatrick for 1½ minutes.

Mr. FITZPATRICK. Thank you, Madam Chairwoman.

As I have been meeting with bankers and credit unions in and around my district, the conversation inevitably turns to this new Qualified Mortgage rule.

Lenders in Pennsylvania are very concerned, and understandably so, because they serve the community by making loans, and their ability to provide that service depends on the ability to assess creditworthiness. And there is concern that by constructing a box in which they must operate that is inappropriate, that qualified buyers and borrowers won't have access to credit.

We all want business to be successful and for capital to be available in our communities but when it comes to this issue, I mainly want to ensure that responsible, working-class families in my district can still buy their first home.

We are all unified in our opposition to ever going back to the prebubble days; however, we can't allow overregulation to dry up credit for the families trying to participate in the American dream.

So I hope to receive those assurances here today. I look forward to the testimony, and I yield back.

Chairwoman CAPITO. The gentleman yields back.

That concludes our opening statements. I would like to ask all of the guests and Members to join with me in a moment of silence of our thoughts and prayers for those victims and families in the State of Oklahoma. Thank you.

[moment of silence]

Thank you.

I would now like to welcome our panel of distinguished witnesses. Our first witness is Mr. Peter Carroll, the Assistant Director for Mortgage Markets at the Consumer Financial Protection Bureau.

Ms. COCHRAN. Actually, I will start and—

Chairwoman CAPITO. All right. Let me introduce you, then. Excuse me.

Ms. COCHRAN. Thank you.

Chairwoman CAPITO. Ms. Kelly Thompson Cochran is the Assistant Director for Regulations at the Consumer Financial Protection Bureau. Welcome, and we will recognize you for your 5-minute statement.

STATEMENT OF KELLY THOMPSON COCHRAN, ASSISTANT DIRECTOR FOR REGULATIONS, CONSUMER FINANCIAL PROTECTION BUREAU

Ms. COCHRAN. Thank you, Chairwoman Capito, Ranking Member Meeks, and members of the subcommittee for this opportunity to testify about the Bureau's Ability to Repay a Qualified Mortgage rule and address the concerns that you have raised this morning.

I am Kelly Cochran, the Assistant Director for Regulations at the Bureau, and my colleague, Peter Carroll, and I are honored to represent the Bureau here this morning.

During the years leading up to the mortgage crisis, too many mortgages were made to consumers without regard for their ability to repay the loans. Loose underwriting practices by some creditors such as failure to verify the consumer's income and assets, so-called no-documentation loans, and qualifying consumers for loans based only on their ability to repay low introductory interest rates contributed to a mortgage crisis that led to this Nation's most serious recession since the Great Depression.

Congress, in the Dodd-Frank Act, adopted a provision to protect consumers from such irresponsible practices by requiring creditors to make a reasonable, good-faith determination of consumers' ability to repay their loans based on verified and documented information.

The Act also provides a presumption of compliance with this requirement for a certain category of loans called Qualified Mortgages. However, the statute did not define how strong the presumption would be, for instance, whether it would function as a Safe Harbor or could be rebutted upon certain showings by consumers. And it also left significant discretion as to how Qualified Mortgages would be defined.

The Federal Reserve Board issued a proposal to implement these provisions prior to the transfer of authority to the Bureau in July 2011. In January of this year, the Bureau issued both a final rule to implement these provisions and a proposal to make certain additional adjustments both to facilitate access to credit and to clarify certain provisions defining Qualified Mortgages.

We are now working to finalize that proposal so that the new rule as a whole can take effect on January 10, 2014. Our written testimony contains a summary of the outreach that we conducted in connection with the rulemaking and of the rule itself.

Today, we wanted to briefly highlight some of the major policy considerations that underlie the features of the rule. Our first consideration in crafting the rule was to protect consumers by preventing the return to irresponsible lending practices.

The General Ability to Repay Standard is designed as a commonsense measure to ensure that creditors use reliable information when they are underwriting and that they evaluate consumers' ability to make payments throughout the life of the loan.

Although this statute was not as specific with regard to documentation and the underwriting requirements for Qualified Mortgages, we felt that it was important to ensure that creditors also consider consumers' individual financial circumstances when making Qualified Mortgages.

Accordingly, the rule requires that creditors consider consumers' debts, incomes, and assets in making Qualified Mortgages in addition to meeting certain statutory limitations on loan features and up-front costs.

At the same time, we also carefully consider the need for long-term flexibility. We do not believe that it is possible by rule to define every circumstance in which a mortgage is affordable given that underwriting is a highly complex and individualized process.

We therefore worked to structure the rule in a way that allows room for a range of reasonable underwriting practices and models that are used by different types of creditors today.

We were also concerned that as the mortgage market strengthens, the rule should provide appropriate safeguards without becoming a straitjacket.

We balance these considerations in many places within the rulemaking, including both leaving flexibility under the general ability-to-repay standards for reasonable underwriting practices and creating different types of Qualified Mortgages that use different sets of safeguards to ensure that affordability is being appropriately considered.

My colleague, Peter Carroll, will now discuss those Qualified Mortgage provisions and some of the additional policy considerations that went into their formulations.

[The joint prepared statement of Ms. Cochran and Mr. Carroll can be found on page 49 of the appendix.]

STATEMENT OF PETER CARROLL, ASSISTANT DIRECTOR FOR MORTGAGE MARKETS, CONSUMER FINANCIAL PROTECTION BUREAU

Mr. CARROLL. Thank you, Chairwoman Capito, Ranking Member Meeks, and members of the subcommittee for this opportunity to testify about the Bureau's Ability to Repay and Qualified Mortgage rule.

I am Peter Carroll, the Bureau's Assistant Director of Mortgage Markets. I am also honored to represent the Bureau here this morning.

Building on our policy considerations, the Qualified Mortgage provisions of the rule were the most complex part of the rulemaking. This was in part because the creation of a general ability-to-repay requirement that carries potential liability for creditors and asset needs has created anxiety in the market.

A 2008 Federal Reserve Board rule that requires assessment of a consumer's ability to repay certain higher-priced mortgage loans does not appear to have a caused a significant increase in litigation; however, we recognize that concerns about liability under the Dodd-Frank Act, the ability-to-repay requirement might cause creditors to constrain their lending, particularly in the first few years after the rule takes effect.

Access to mortgage credit is already constrained in this market and we were concerned about unduly exacerbating these constraints throughout rulemaking, while still ensuring responsible lending. Several features of the rule address this concern.

First, we provided for different types of Qualified Mortgages that we expect will cover the vast majority of today's mortgage market. We created a general definition of Qualified Mortgage based on bright line standards that include a 43 percent debt-to-income ratio.

Second, we created a temporary Qualified Mortgage definition based on eligibility for purchase or guarantee by the GSE's while they are in conservatorship and certain government agencies whether those loans were sold or held on portfolio.

This definition makes it easier for creditworthy consumers with debt-to-income ratios above 43 percent to access credit while the industry gets more comfortable with the rule.

Third, we calibrated the strength of the presumption of compliance for Qualified Mortgages based on the loan's pricing. We believe the Safe Harbor will provide certainty to creditors in the prime market and the rebuttable presumption of compliance will create strong incentives for more responsible lending in the nonprime market.

At the same time, the rebuttable presumption preserves important consumer remedies in the nonprime market.

Therefore, we believe that the Qualified Mortgage definition is structured to encourage responsible credit in all parts of the market over time.

As my colleague, Kelly, stated, we do not believe that it is possible by rule to define every instance in which a mortgage is affordable, but we are also concerned that an overly broad definition could stigmatize responsible nonqualified mortgages or leave insufficient liquidity for those loans which could restrict access to credit for some consumers.

For this reason, we defined Qualified Mortgages to provide greater protection to consumers and certainty to creditors while leaving room for a market for nonqualified mortgages where appropriate.

We will continue to watch the health of mortgage markets once this rule takes effect to ensure it is working as we expect it will. To address access to credit concerns, we also made changes to the part of the rule that treats certain balloon payment loans as Qualified Mortgages if they are originated and held in portfolio by small creditors in rural or underserved areas.

We significantly expanded the definition of rural areas from the Federal Reserve Board's original proposal and made other adjustments to make it easier for small creditors to continue making responsible balloon loans going forward.

Several elements of the proposed rule that we issued along with the final rule, particularly the proposal to extend Qualified Mortgage status to certain portfolio loans by small creditors, are also intended to address access-to-credit concerns.

Finally, we want to highlight that the Bureau has made an agency-wide commitment to provide implementation support for this and our other mortgage rules. We did this in part because we realized that such efforts are particularly important to small creditors that do not have large legal and compliance teams.

We recognize that an efficient implementation process will ultimately benefit consumers in the market as a whole. For example, we have published a plain English summary of the rule and a compliance guide designed particularly for smaller institutions that will need to update their policies and procedures and provide training for staff on the rule.

We are also publishing clarifications to the rule as needed to respond to questions from various stakeholders. We are coordinating with other agencies to develop examination procedures and are developing videos, checklists, and other tools that might be useful to creditors as they prepare for the implementation date.

Thank you again for the opportunity to appear before you today and provide you with an overview of the Ability to Repay and Qualified Mortgage rule. We would be happy to answer your questions.

[The joint prepared statement of Ms. Cochran and Mr. Carroll can be found on page 49 of the appendix.]

Chairwoman CAPITO. Thank you.

Thank you both, and I will recognize myself for 5 minutes for questioning.

You mentioned in your statement, Mr. Carroll, that you expect over time to see markets developed for the nonqualified mortgage. That sort of goes against anecdotally what I have seen and heard; most folks who write mortgages feel if it doesn't fall within the QM, there is no way they are going to write the mortgages. What evidence do you have that this market is going to develop around this rule?

Mr. CARROLL. Chairwoman Capito, thank you very much for this question.

The definition of the nonqualified mortgage space was something that was definitely a major part of the work we did in defining the Qualified Mortgage.

We are really trying to calibrate the definition of a Qualified Mortgage based on feedback we received from broad sections of the market, including both industry advocates as well as consumer advocates.

There was certainly consensus that a broad Qualified Mortgage was needed, so the Qualified Mortgage would cover a broad sector of the market. This was a key concern that was expressed to us during the rulemaking process.

Also, that bright lines be created so that creditors knew how to comply with whatever the Qualified Mortgage definition would be, is something of which we heard a lot.

In the short term, while the market is recovering, we feel it is very clear that the markets are going to be looking to the Qualified Mortgage space. That is why we did extend our definition to cover a majority of the market.

We are expecting that over time—based on our analysis, we do think that it is possible to quantify the risks associated with nonqualified mortgage lending—

Chairwoman CAPITO. Could you move the microphone up close to you?

Mr. CARROLL. I am sorry. Yes.

Chairwoman CAPITO. I might have to interrupt you here, because I only have 5 minutes, but go ahead.

Mr. CARROLL. Sure. No, no, it is fine.

We do think it is possible to quantify the risks associated with nonqualified mortgage lending. We think that is something market participants will do over the course of the next few years as they become comfortable with the rule, but in the short term, I think we agree that a broad Qualified Mortgage space is going to be important—

Chairwoman CAPITO. So the statistics that I think Congressman Miller pointed out, that 52 percent of the loans that were written in 2010 would not fall into this Qualified Mortgage space, that is, half the people are not going to be able to get a Qualified Mortgage and therefore the lenders are going to be much less and probably will be unable to write those mortgages.

I have a banker in West Virginia who has written 3,800 loans a year. He says, "The QM rules will cause us to offer less credit and generally the customers who will fall off the table are higher-risk, lower-income customers, and West Virginia has many of these." And I think you will hear this concern expressed a lot.

One of the questions you mentioned is that the phase-in is going to be complicated. You are reaching out to help institutions to do that. Do you have any contingency plans that if we get up to January 10th and there is still mass confusion when this comes on stream, you could push these dates back?

Ms. COCHRAN. If I can take that one, the Dodd-Frank Act itself in Section 1400 sets certain requirements with regard to the implementation process.

That provision required us, where rules are required to be promulgated under the statute, to issue them by January 21st of this year. Also, it requires for required regulations, that they be implemented within 1 year after they have been issued in final form.

That is why we are investing so much into the regulatory implementation process, to facilitate and support particularly with regard to small creditors. We realize that they have a limited compliance and legal staff, and it is important for us to do everything we can to help meet that deadline.

Chairwoman CAPITO. So at this point, no. No contingency plans to push back.

My last question is—I have a bank in the northern part of the State which has a charitable organization sort of modeled after Habitat for Humanity, but they help folks who really—it is under $100,000 loans—would and it is a gift basically, but their customers who have, that they vet very well and it is a wonderful charitable program are not going to fall into this ability-to-repay tranche and this bank is saying, "We are going to have to stop this charitable program because we can't take the risk."

What kind of provisions do you have for exceptions to this where you really—these folks are going to have no other way to get a home, no other way to access credit without a charitable program, confined to one county by a small and very benevolent family who many years ago decided that housing was critical to these families?

Ms. COCHRAN. As we mentioned, at the time that we issued a final rule we also issued a proposal to make certain additional adjustments. A number of those adjustments were focused on the potential exceptions to the Ability to Repay and Qualified Mortgage regime to address access to credit.

So this includes certain types of nonprofits, certain housing stabilization programs, housing finance agencies, and other very specialized lenders that are specifically focused on low- to moderate-income populations and making sure that they can access credit in situations where conventional lenders are not willing to make those loans.

That proposal is still pending. We are working to finalize it as quickly as possible because we think it is an extremely important issue. It had not been proposed as part of the original rulemaking, so we wanted to seek comment on it before finalizing, but we are working very hard to tie that up.

Chairwoman CAPITO. Well, I would encourage you to move forward on that.

And I will now recognize my ranking member for 5 minutes.

Mr. MEEKS. Thank you.

And let me say as I have heard on both sides we know that especially no-doc loans were the cause of this problem that we had, the financial crisis. What my concern is, most of the loans that we saw that caused the problem really were not issued by credit unions or community banks.

Yet, it seems as though the rule as promulgated is going to have a direct effect on them more so than anyone else. Now I know that there was a comment period that was open where individuals could raise comments and concerns in regards to what you were looking at.

So my question to you is, did you receive comments and concerns from some of the community banks and the credit unions? What were those? And are any reflected in some of the decisions that you made when you promulgated the rules?

Ms. COCHRAN. Thank you so much for the question.

Yes, we received extensive comment from small community-based creditors, banks, credit unions, and so on, both in the original rulemaking and as part of the concurrent proposal that I just mentioned.

So in the final rule, we made a number of adjustments to address concerns that had been raised by these institutions, including significantly increasing the size of the provisions for Qualified Mortgages that involve balloon payments.

Generally, the Dodd-Frank Act strongly disfavors balloon payment loans, but Congress did provide a provision that allows such loans under certain circumstances to receive Qualified Mortgage status if they are made by small institutions that are operating predominantly in rural or in underserved areas.

We significantly increased the size of the definition, and in the concurrent proposal we also sought additional comments about creating a fourth category of Qualified Mortgages that would be available to small creditors, regardless of whether they operated in rural or underserved areas.

We recognize that these institutions are using relationship-based lending, that is highly effective, that often leads to much lower foreclosure rates, and we believed it was appropriate to propose a separate category of Qualified Mortgages to recognize the fact that these institutions, when they are holding the loans on portfolio, have significant reasons to do a good job of underwriting, and are serving their consumers well.

That proposal is still pending, but we are working to tie that off as quickly as possible. We are very sensitive to concerns about how this rule will impact small institutions. That is one of the main reasons we went back out for comment to continue to consider how the different parts of the rule were going to influence small institutions.

We have also proposed increasing the threshold between Qualified Mortgages that receive a Safe Harbor and those that receive a rebuttable presumption for small creditors in light of the fact that they often have higher costs of funds. So those are still live issues, but we are taking them very seriously, and are hoping to tie them off quickly.

Mr. MEEKS. On those live issues, for example, because that is what I also have concern about where the debt to income capital for 43 percent looks like it unduly reduces the credit for low- and moderate-income borrowers especially, you have young people who are buying homes for the first time or who still have student loans, so this could just knock them out of the market altogether, of being able to look forward to buying a home, and so that is a huge impact, I would think.

Ms. COCHRAN. For the balloon Qualified Mortgage rules, which have already been finalized, we require that small creditors consider debt-to-income ratios but not be bound by a 43 percent threshold. We have proposed the same approach with regard to the new category of small portfolio Qualified Mortgage.

As I said, we know that these institutions are using highly individualized relationship lending models and that they are highly effective. We did not feel in that circumstance it was necessary to provide a bright line threshold as long as they are considering consumers' debt, income, and assets.

Mr. MEEKS. I only have 39 seconds, so I don't know if I can get everything in.

My question is to Mr. Carroll, in that the CFPB addressed the issue of affiliate discrimination in the calculation of fees and points in the final QM rule, and I was wondering if that has been causing a big issue in New York because of the pending costs and whether or not that can be re-calculated?

Mr. CARROLL. Thank you, Congressman.

Affiliate fees are required by the statute to be included in the 3 percent point and fee cap. We did receive a lot of comments on this issue.

On the one hand, there are arguments that affiliates create challenges to competition in the market for those services. On the other hand, there are arguments that affiliates create a more streamlined process that can reduce costs in the market.

We have considered these arguments in our rulemaking and right now we have reflected the statute's requirement that those be counted in the points and fees test.

Chairwoman CAPITO. Thank you.

Mr. Duffy, for 5 minutes.

Mr. DUFFY. Thank you, Madam Chairwoman.

Everyone on this committee, and probably in Congress, agrees that we needed some changes to how our lenders were making loans. Many of us are concerned about the no interest, the negative amortization, the low or no downpayments. We weren't verifying income or assets. There were big problems that needed to be fixed, and I think all of us would agree with that.

But I think what we are starting to see here too is an agreement that we understand one size doesn't fit all, and I know that we have tasked you to try to make one size fit all, but you start to see all of the problems that come from a government that is very large, very expansive, and says, this is the cookie-cutter system that we are going to make you work in.

And I think we see this pendulum swinging back and forth where we had gone too far over, lax standards and that helped us create the crisis.

Now I think with this rule we have swung the pendulum all the way over to the other side, instead of maybe going back to some of the standards that we used when the system actually worked.

When we talked about the five C's—the character, capital, capacity, collateral, and conditions—we did pretty well, and we actually empowered people in this industry, our bankers to evaluate their clients with sound standards to make good loans. That actually did work.

Now, we have taken all of the discretion out of banking and really we can get rid of all of our bankers. You can just go fill out a form online and submit it and it can be approved or denied based on the very rigid standards that we have with the QM rule, and that is one of my concerns with how rigid this is.

And I also have a concern that many of the loans that have been made over the last several years wouldn't fit this definition—many of our mortgages wouldn't fit this definition. Has the CFPB done a study to look at the mortgages that have been made and what percentage of them would fit within the QM rule that has been drafted and the percentage that would not fit within your rule?

Mr. CARROLL. Yes, Congressman, we did do that study as part of our cost-benefit analysis within our rulemaking. We did size the market, and by our numbers, we got our general definition of a 43 percent debt-to-income ratio, and by our calculations, that is roughly three-quarters of the market of recent vintages that is covered. And that—

Mr. DUFFY. So three-quarters of the mortgages you analyzed would have fit within your QM—

Mr. CARROLL. Within the Qualified Mortgage definition we have laid out. Our objective with the rulemaking was to get closer to 100 percent, which was why we created this temporary definition for loans that are eligible for insurance or purchase by the GSE's or FHA. When we size that in, we get closer to 100 percent of recent year loans.

Ms. COCHRAN. If I might add to that, on two aspects.

First, with regard to the analysis we did, the one area where we could not model was with regard to the 3 percent points and fees cap because we did not have the data for that.

We were able to consider the loan features and other underwriting requirements, so we were able to build that in and model it. And as the chairman mentioned, there have been, I think, other analyses of these that have come to different percentages. We believe that our percentage and analysis was in fact correct and that the overall number is above 90 percent.

One of the things that I wanted to mention about the flexibility point is—and I discussed this in my original testimony—we thought very hard about that issue and we really did not believe that a one-size-fits-all approach makes sense.

So for instance, the ability-to-repay requirements provide a fair amount of coverage with regard to using reasonable, reliable, third-party methods, but even there, we provided flexibility for lenders to use reasonable sources.

Also, the statute provides specific rules with regard to how you calculate the monthly payments so that negative amortization loans and so on are treated consistently.

But when it comes to considering underwriting criteria such as how much you weigh debt-to-income ratio versus credit score versus other features, the rule requires that it be considered, but it does not dictate underwriting models.

We felt that it was extremely important to leave room for reasonable underwriting practices in a range of models that are being used today. So we were very carefully balancing it both on the ability-to-repay side and through the different types of Qualified Mortgages.

Mr. DUFFY. And I don't know that the committee has received that study—have you seen it, Madam Chairwoman?

Chairwoman CAPITO. I do not have that study.

Mr. DUFFY. Would you mind providing your analysis to the committee so we could take a look at what you have done?

Ms. COCHRAN. Absolutely. It is part of our Federal Register notice on the final rule, but we can excerpt it and provide it to the committee.

Mr. DUFFY. Thank you, and I just want to make one other point in my last 15 seconds.

There is a great concern in the part of the country where I live, in rural Wisconsin, and the definition that allows for our rural balloon mortgages.

I have a rural Wisconsin map here on the northwest corner, and if you are driving between Chippewa and Taylor County or Rusk and Chip or Dunn and Barron and Lincoln, listen, there is no difference.

It is farms as far as the eye can see for 30 miles on either side of the county line. And it creates some real problems and disadvantages within my community the way the rule is written.

Hopefully, we can consider some different standards on how we are doing our balloon mortgages. I yield back.

Chairwoman CAPITO. Thank you. Mr. Watt?

Mr. WATT. Thank you, Madam Chairwoman, and Ranking Member Meeks for convening this very important hearing.

I want to start by expressing my appreciation to the CFPB for what I think is a very good effort in a very, very difficult terrain and reminding the committee that one of the reasons that we punted this responsibility to somebody other than this committee or the Senate Banking Committee or the conference committee was because of the difficulty of addressing all of these are very delicate nuances.

We were operating in a period where obviously the pendulum had swung way too far in the direction of allowing loans that shouldn't have been allowed to be made and there was concern that we were going to swing the pendulum back too far in the opposite direction.

And so our desire under this bill, of which Representative Miller and I were the primary sponsors, initially at least, was to try to find a new balance without constraining credit unduly, at least credit to people who were worthy of getting credit, and still not allow the kinds of abuses that had taken place in the marketplace.

So a lot of the the detail of this was really punted to the CFPB and the Federal Reserve initially and then to the CFPB to work out these nuances and the CFPB was very responsive in listening to a whole range of people, including those of us who had advocated aggressively for constraints on the market to clean it up back in the opposite direction to define what a Qualified Mortgage was.

And I think we really got to a pretty good balance as an initial proposition. Obviously, there are always going to be people second-guessing whether you got the correct balance. Probably the people we would prefer to see doing this wouldn't be Members of Congress sitting on this committee trying to do this.

I do want to ask about this 3 percent cap. I know the 3 percent cap is in the law itself. You said you couldn't model the 3 percent cap because you didn't have sufficient information.

What would it take to do that model, because there are a lot of questions being raised now about whether the 3 percent cap itself, which is statutory, not something that the CFPB did, is an appropriate cap? What would it take to model that?

Mr. CARROLL. Thank you, Congressman.

It is a terrific question. I think what we would need is a representative sample of affiliate fees across the country that would represent just an ordinary course of typical mortgage transactions—

Mr. WATT. Okay, so you could undertake that study and help of the committee going forward if the committee decided to look more closely at where the 3 percent ought to be 3.25 percent or 3.5 percent?

Mr. CARROLL. We would be very happy to provide technical assistance, yes.

Mr. WATT. Okay.

The second thing is that when we introduced the bill, Mr. Clay on our side on this committee offered an amendment that struck this differentiation between affiliated and unaffiliated title insurance companies.

We actually supported Mr. Clay's amendment and the bill we reported out did not have this affiliated/unaffiliated dichotomy. You have looked at that. Do you think that the affiliated/nonaffiliated distinction serves a useful purpose at this point?

Mr. CARROLL. With regards to affiliated title?

Mr. WATT. Yes.

Mr. CARROLL. We have heard many comments, Congressman, about affiliated title versus non-affiliated title. Specifically, in that particular sector there could be safeguards in place that should be considered, and that there is generally State oversight of the premiums charged around affiliate title. We did hear those comments during the rulemaking process and—

Mr. WATT. My time is up, but could you just submit to the committee some of the alternative approaches you think might be considered to address this affiliated/unaffiliated title issue?

Mr. CARROLL. I would be happy to follow up, Congressman.

Mr. WATT. Thank you so much.

Thank you, Madam Chairwoman.

Chairwoman CAPITO. Thank you.

Mr. Miller, for 5 minutes.

Mr. MILLER. Am I safe in saying that you are hearing bipartisan unhappiness with your rule? If it is not—I think we can all raise our hands saying we are on happy to begin with.

It appears to me that the rule is much more restrictive than the legislation that enabled you to do what you are doing and I can't believe you can't make this work without us having to pass a new law to clarify a law that should have given you flexibility to make it work.

So I think we are trying to tell you that we have a problem with what we are hearing out there and you said you used—they said three-quarters of the loans you reviewed met the QM rule. What year were those loans made?

Mr. CARROLL. That was looking at 2011 loans.

Mr. MILLER. Okay, so half of them in 2010, CoreLogic says would not meet your QM rule. Three-quarters in 2011 don't meet the QM rule, and everybody, Freddie Mac and Fannie Mae, everybody is saying that loans made in 2010 are performing very well. FHA's are performing very well.

So, that is problematic. It raises a big flag saying, hey guys, let's go back and see what we can do out there. You are going to get us a copy of the study you used to make your determination, is that correct? I heard you say that. Okay.

Recently, you gave a 7-year exemption to Freddie and Fannie to implement the QM rule. Is that correct?

Mr. CARROLL. Yes, Congressman.

Mr. MILLER. That raises a huge concern on my part of why would you give them 7 years if it is a good rule and then they are coming back saying no, we are going to implement it immediately, which is even more bothersome.

Can you please address that?

Ms. COCHRAN. If I might explain. We, as I mentioned, created multiple definitions of Qualified Mortgage under the rule. The first definition of Qualified Mortgage, the general definition, uses a 43 percent debt-to-income ratio. We did that because we received extensive comment from industry saying they needed bright lines to determine exactly what was a Qualified Mortgage and what was not.

This threshold, 43 percent, is the historical threshold that has been used by the Federal Housing Administration and is familiar to lenders. It is a relatively broad threshold compared to certain other ones that are used and we felt it was an appropriate and familiar threshold to use.

At the same time, we realized there was concern that responsible, creditworthy borrowers over 43 percent would have a difficult time in the first few years after the regulation took effect—

Mr. MILLER. That is a concern right there.

Ms. COCHRAN. —in getting—

Mr. MILLER. And right on that point, we are in a very moderate recovery, very moderate.

Ms. COCHRAN. We were very concerned about that.

Mr. MILLER. Very sensitive. I am really concerned about it and they are saying, FHA is saying no, we are going to implement it day one. That has to create some concern for you because your study obviously said we need to allow this more time.

So I am saying based on their decision to implement immediately, I am asking you I think you are hearing the concern on both sides to go back and look at it and say maybe we need to do something a little differently than we have because every lender I am talking to, everybody says we are not making any loans that do not meet the QM rule.

Ms. COCHRAN. Right.

Mr. MILLER. That is a recipe for immediate disaster come—this coming January, in my opinion. I am looking at a marketplace that has been devastated for years. Now we are looking at—I would say near the third quarter of last year you started to see it get a little healthier.

This year, you are even seeing a little better marketplace. Peoples' home values are starting to come back up a little bit. Should we decide to implement a rule that devastates the lending industry overall, those values are going to go right back down. I am not mad—I am concerned.

Please don't take my comments as a personal criticism. I am saying that I am hearing both sides of this saying, "We have a huge concern." I am hearing the private sector saying, "We have a major concern because we are not going to do anything that puts us outside of the QM rule," and based on that, I think you need to do something and also I heard a comment on the 3 percent cap on points and fees—none of those were used in your study because they weren't implemented in so that didn't even apply.

And I am not sure you knew what was supposed to be even put into the 3 percent when you implemented the rule. Legislatively, it was kind of—it allowed you a broad area to review before you implemented that, and I am not certain that it is not critical that you did that.

So I think that needs to absolutely be revisited. Mr. Watt also said the same thing. We don't have to go rewrite a law to give you leeway that you already have, but I have a lot of questions and I am not going to get to them because I am really concerned about the comments you made because they are very enlightening and they are not negative, they are just enlightening and the comments that you are hearing us up here, we are very concerned and if we don't do something to modify this rule before January, I think you see the same recipe coming that I see and it is not healthy. It is not good and I would strongly encourage you to not force us to legislatively change the rule to be more flexible in the rule.

I yield back the balance of my time.

Chairwoman CAPITO. Thank you

Mr. Green, for 5 minutes.

Mr. GREEN. Thank you, Madam Chairwoman.

Please permit me to extend to Mr. Cordray my best wishes, and let him know that I am looking forward to a future meeting with him.

Madam Chairwoman, I would like to, if I may, call to our attention an article in the New York Times entitled, "U.S. Consumer Watchdog to Issue Mortgage Rules." This article calls to our attention the following: "Mortgage bankers generally applaud the new regulations saying they clear up uncertainty that has hung over the home-lending business since the financial crisis."

It goes on to say, "These rules offer protection for consumers and a clear, safe environment for banks to do business. I understand that you have not created a perfect rule. But I also understand that we cannot allow the perfect to become an enemy of the good," something we often say here.

So I am going to segue now to something else that I call to your attention because I am concerned about servicemembers and I am concerned that too many of them are still falling victims to scams.

Some might ask, how many is too many? One is too many, and here are some of the things that cause me a good deal of consternation. I understand that the postdated check scam still looms large.

Car titles are being utilized, too, as a part of scams. They have businesses located just outside of military bases because they can't engage in on-base solicitation.

We still have retirement benefits that may be a part of scams. They are being reassigned. Some of these scams originate in foreign countries. So could you just tell me quickly, are we looking at the scams that are being perpetrated upon our military personnel?

Ms. COCHRAN. Obviously, our Office of Servicemember Affairs is taking the lead for the agency in working on all these issues. They coordinate very closely with other parts of the Federal Government and are trying to bring greater transparency and awareness to all sorts of issues, including scams.

I believe that they have been aware and gathering information about all of these issues, and we would be happy to relay your question and provide more specifics. I don't think either of us can speak to the details of what they have learned.

Mr. GREEN. Thank you. I think that is a fair answer, because I know what you came prepared to discuss today. I just could not pass up the opportunity to speak up for servicepeople.

Ms. COCHRAN. It is something we take very seriously. We appreciate it.

Mr. GREEN. Thank you very much.

Let's move quickly to another topic that we brought up, community banks versus small banks. I appreciate greatly the question that the ranking member posed and I thought you gave an answer that was acceptable, but could you kindly give me a quick indication as to whether or not you are making a distinction between a community bank and a small bank, and if so, what is that distinction?

Ms. COCHRAN. We have looked at the impact on small creditors throughout the Dodd-Frank Act mortgage rulemakings, and in a number of places we have made accommodations or changes in the way the rules apply to smaller institutions.

But we have done that in a context-specific setting. So we are not applying a single definition in all circumstances. Instead, we are looking at the particular activities at issue.

So for instance, in the Qualified Mortgage and escrow rulemakings, we looked at a definition of small creditor that was focused on what types of creditors might have difficulty in escrowing and providing adjustable rate mortgages as compared to balloon mortgages.

So we set one threshold there for those provisions and we are proposing to continue that threshold with regard to the new category of Qualified Mortgage. In the—

Mr. GREEN. If I may intercede just quickly, are you focusing more on a small institution as opposed to a community bank?

Ms. COCHRAN. We are looking at a number of factors when we set those thresholds. What we set as a threshold was $2 billion in assets and that the institution along with its affiliates was originating no more than 500 first lien mortgages a year.

We were doing that because we were looking for institutions that are using relationship-based lending that are accountable to a specific community, so not only are they holding these loans in portfolio, but because of the nature of their lending practice, they have very strong incentives and very strong practices to protect consumers.

In the servicing context, we also looked at and exempted small servicers from certain parts of those rules.

Mr. GREEN. Let me intercede quickly to ask—

Ms. COCHRAN. But we put a different definition there—

Mr. GREEN. —because I have 3 seconds—

Ms. COCHRAN. —based on—

Mr. GREEN. —quickly, I must ask, when will this new rule be available for us to visit with you about?

Ms. COCHRAN. We are working to implement it as quickly as we can. We will issue it shortly because we want to get it finished. We know it is extremely important as people are working towards implementation.

Mr. GREEN. It is, and I thank you very much.

I yield back, Madam Chairwoman.

Chairwoman CAPITO. Thank you.

Mr. Luetkemeyer, for 5 minutes.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman.

Just one question, out of curiosity. Has either one of you ever worked in the private sector and made a housing loan?

Mr. CARROLL. Congressman, I have worked in the private sector serving banks.

Mr. LUETKEMEYER. Serving? What do you mean? Have you ever made a house loan?

Mr. CARROLL. No. No, Congressman.

Mr. LUETKEMEYER. Ms. Cochran?

Ms. COCHRAN. I was in private practice mostly for financial institution clients prior to going into government.

Mr. LUETKEMEYER. But you never made a loan?

Ms. COCHRAN. No.

Mr. LUETKEMEYER. Okay.

Just out of curiosity—one of the things you are working through this morning is the results of the low-doc loans. We went in and we thought we were really bright. We wanted to start to make it all quick and easy and available. The system was working and now all of a sudden we have low-doc loans and now it is all messed up and now we are trying to fix it. Is that roughly right?

Ms. COCHRAN. That was certainly one of the concerns—

Mr. LUETKEMEYER. One of the problems we have? Okay.

So as we try and fix this, you now have been directed by the law that Congress passed to try to figure out how Qualified Mortgage—to come up with a standard.

I guess the question is—and I have this difficulty sometimes with a lot of individuals who serve in the bureaucracy from the standpoint of interpreting those laws sometimes can be difficult and the intent of Congress.

And when they make a rule, suddenly they believe that is the only way that this rule can be made and they become very inflexible.

Do you have enough flexibility that you believe with the way this rule was or the law was propagated, the law was put before you that you have the flexibility to be able to make the changes that can accommodate the things we are talking about this morning?

Ms. COCHRAN. We structured the rule in a way that specifically provided for flexibility. As—

Mr. LUETKEMEYER. I am not talking about the lenders. I am talking about you.

Ms. COCHRAN. Yes.

Mr. LUETKEMEYER. Do you have enough flexibility to go back and make the changes we are talking about this morning?

Because we have talked about a lot of things. We talked about—Mr. Watt talked about the 3 percent, Mr. Miller talked about a lot of things with regard to this. Somebody else, I think it was Mr. Duffy, talked about the rural definition here. There are a lot of things that need to be worked on. Do you have enough flexibility to make those changes and are you willing to do that?

Ms. COCHRAN. We have created a structure that we believe will be helpful in considering where further adjustments are necessary in the rulemaking. One of the things that we did, in addition to creating the main definition of Qualified Mortgage and the temporary definition of Qualified Mortgage, which is not an exemption for Fannie and Freddie—

Mr. LUETKEMEYER. You are not answering my question. All due respect, Ms. Cochran, you are not answering my question.

It is very simple. Do you have the flexibility and are you willing to use it to make the changes we are requesting this morning and discussing? Yes or no?

Ms. COCHRAN. We made the best decisions that we could in the rulemaking process—

Mr. LUETKEMEYER. Okay. I will grant you have done—you have made your decision. Now are you willing to go back and take a look at changing it based on the things we are discussing this morning?

Ms. COCHRAN. We are continuing to consider a number of the issues that were discussed this morning in the context of the concurrent proposal, and as I discussed we want to tie that off as quickly as possible.

We do believe that we have flexibility there and we proposed those changes to make sure that we address some of the concerns that have been raised.

We have also structured the rules so that as the 7 years progresses and the temporary category of Qualified Mortgage would come to a close, we would have the ability to look at the market, how it is developing, if it is developing as we predicted, and make adjustments to the rule at that time, if necessary.

Mr. LUETKEMEYER. Okay, so is there enough flexibility in the rule then to allow you to do that? Or in the law? You feel you have enough flexibility then apparently, is that right?

Ms. COCHRAN. We believe that we have flexibility to make important decisions and that we are continuing to use that appropriately, yes.

[laughter]

Mr. LUETKEMEYER. Okay. Well, no wonder we can't get anything done here. We can't get a straight answer.

Okay, with regards to the level of participation you anticipate by the different groups, agencies, you broke it down to different banks, small lenders, big banks, mortgage lenders, and we have had two different, three or four different numbers around here this morning with regards to participation.

It would seem to me by the definition of a Qualified Mortgage and the Safe Harbor that it provides that those loans that are made outside that Safe Harbor would then have an inordinate amount of liability risk for the lender, will they not?

Do you not believe that will be the inference from protecting and having Safe Harbor loans that are made that way and those obviously that are not? Wouldn't you believe that would be the case?

Mr. CARROLL. Congressman, that is a very good question.

We calculated what we believe the litigation risk might be in our 1022 analysis for nonqualified mortgages and then the lesser amount of litigation risk for Qualified Mortgages that carry rebuttable presumption of compliance.

Mr. LUETKEMEYER. Where I am going with this is if there is more risk, inherent risk with those mortgages that are made outside that, and the lenders then are less willing to do that, there is going to be an access to credit problem.

If you have an access to credit problem, where are they going to go? Some will go to agencies like FHA, which is making loans according to this testimony we have heard in this committee, before that are kind of like Freddie and Fannie were making, that are kind of beyond the scope.

Now, we are going to wind up forcing them into a government agency that is already in trouble. So, this is a self-fulfilling problem with the way we are structuring this.

And I see I am out of time, I appreciate the indulgence of the chairman.

Thank you.

Chairwoman CAPITO. Thank you.

I would like to state that without objection, members of the full committee who are not members of this subcommittee may sit on the dais and participate in today's hearing.

I would also like to submit statements for the record from the American Land Title Association; the Credit Union National Association; the Independent Community Bankers of America; the National Association of Federal Credit Unions; the National Association of REALTORS®; and the West Virginia Bankers Association.

Without objection, it is so ordered.

Mr. Ellison is recognized for 5 minutes.

Mr. ELLISON. Thank you, Madam Chairwoman, and Ranking Member Meeks.

Please do convey my appreciation to Mr. Cordray. I hope he does get confirmed. I think it will be for the benefit of the country.

I would like to ask a question. There has been some discussion about mortgages that may or may not be made that are outside of the QM. I wonder if you could talk about those a little bit and what the last several years has taught us about, I don't know, no job, no income, no money down-type loans, prepayment penalties, balloon payments, 2-28s, 3-27s.

There is a reason that you guys have focused on certain types of loans, to say these would be considered the safe ones, and there is a reason why some are not.

I wonder if you could elaborate on that, and I also wonder if you could even discuss this question. The point has been made there may be fewer loans made, some loans that were made may not be made.

Is that necessarily a bad thing given some of the difficulties that we have seen over the last several years with loans that probably should have never been made? Would you care to elaborate on that, please?

Mr. CARROLL. Thank you, Congressman.

When we were creating the Qualified Mortgage definition, we were working with a few kind of core principles.

At its core, it is an Ability-to-Repay rule where the objective of the rulemaking is to eliminate some of the practices that were problematic during the financial crisis.

So eliminating no-doc lending was an important part. Making sure that when creditors do a debt-to-income ratio calculation they are using the fully indexed rate, the actual rate, not the introductory or teaser rates. It is just some basic practices that creditors do today and have been doing for a long time.

We did hear very broadly, in the midst of the rulemaking process, that a broad Qualified Mortgage definition was important because, since the crisis, there has been a lot of concern about risks of all shapes and sizes, whether they would be operational, credit, interest rate, compliance-related, litigation-related.

And so, we did hear very broadly that a broad Qualified Mortgage was important particularly in this stage of the market's recovery. We have endeavored to try to do that and create a broad Qualified Mortgage space, but we did also in the course of our work, try to analyze what we think the risks would be in the non-qualified mortgage space.

And when we run numbers, we find that in a normal market environment, that should be a fairly manageable risk that lenders should be able to account for and really what it relates back to is that when we draw a Qualified Mortgage space, we want to try to draw standards that we think are reasonable.

So what is a reasonable debt-to-income threshold if we are going to provide clarity and bright lines to industry? We locked onto 43 percent. We felt that was a standard that has served consumers in the past.

It has represented an outer boundary of risk that the FHA has used for a number of years and we felt that, as a core definition, did cover a pretty broad set with about three-quarters.

We were challenged in the short term to try to find a mechanism that would get us closer to 100 percent. That is why we did decide to look to the standards of FHA and the GSEs to accomplish that, and this is an important point.

We are talking about this extension definition. What we are really trying to accomplish is a way that we can, in this stage of the market's recovery, have a mechanism so creditors can extend beyond the 43 percent debt-to-income ratio. That was our objective with this rulemaking.

Mr. ELLISON. Thanks a lot. I guess the only point I am trying to make is I am glad my colleagues on both sides of the aisle are concerned about making sure there is credit availability, but I hope we all also can agree that we believe there was a bunch of loans that were done that probably never should have been done.

And I hope that we keep that in mind, too. Because we can go back to the Wild West and that won't be good either, so let's keep the balance concept in mind.

Also too, last month the CFPB fined 4 private mortgage insurers about $15 million for illegal kickbacks. There have been other problems with inflated appraisals in other ways consumers overpaid. Do you think a 3 percent cap on points and fees will make loans more affordable and fair to borrowers?

Ms. COCHRAN. As we mentioned, the 3 percent points and fees cap is in the statute itself. It does allow for up to two bona fide discount points in addition to that threshold depending on the rate of the loan.

We believe that Congress was looking at the up-front costs to consumers and concerns that potentially, where up-front costs are very high, creditors and other participants in the process may not be as focused on the long-term performance of the loan but rather the up-front cost recovery.

So we have implemented that as directed by the statute and we are continuing to consider some aspects of that rule in the concurrent proposal particularly as it relates to loan originator compensation.

Chairwoman CAPITO. Thank you.

Mr. McHenry, for 5 minutes.

Mr. MCHENRY. Thank you, Chairwoman Capito.

Now, it is interesting, because so many of us have looked at the Qualified Mortgage rule, the QM rule and realized that our community bankers and our community credit unions are telling us that they are not going to lend outside of the QM standard—and you are nodding your head.

You have heard this as well, and I am sure you have heard it this morning but Citizen Cordray, Richard Cordray, I like to call him "citizen" rather than "director" based on the non-Senate confirmed nature of his directorship, but Citizen Cordray said in front of CUNA, the Credit Union National Association, a short time ago, "I know that complying with our new regulations is a worry for many of you, so allow me to make a few points clear. First, the criteria for Qualified Mortgages are intended to describe only the least risky loans that can be offered to consumers. But plenty of responsible lending remains available outside of the Qualified Mortgage space, and we encourage you to continue to offer mortgages to those borrowers you can evaluate as posing reasonable credit risk. Those that lend responsibly, like credit unions, have no reason to fear the Ability-to-Repay rule."

Now, it is not clear to me based on my conversations with community bankers and credit union leaders that that is in fact true.

Right? So if Mr. Cordray claims that this question of the ability to repay is all right, you are not going to be subject to it if you lend outside of it. So why did the CFPB create the Qualified Mortgage so narrowly, Mr. Carroll, if in fact the intent was to have lending well beyond?

Mr. CARROLL. Thank you, Congressman, for the question. I think our objective was to try to make it broad, and it sounds like there is some disagreement today if we have succeeded in doing that.

Our intention in developing the rule was to build a broad Qualified Mortgage and it sounds like there has been some concern about that.

Mr. MCHENRY. Okay. So we will just disagree on that.

Let me ask you a separate question. Do you believe that lenders are going to originate nonqualified mortgages?

Mr. CARROLL. We see it happening today—

Mr. MCHENRY. No. It is happening today because is the QM rule imposed upon institutions?

Mr. CARROLL. No, not until January.

Mr. MCHENRY. Okay. So therefore, you are talking about pre-QM, and it is artful. It is a very artful, nice answer, but technically, you are correct. Post-QM, let me restate the question. Do you think the lenders are going to originate nonqualified mortgages?

Mr. CARROLL. We think some will, Congressman.

Mr. MCHENRY. Some?

Mr. CARROLL. Yes.

Mr. MCHENRY. Okay. Based on what belief?

Mr. CARROLL. We just believe that there will be lenders who are going to make loans or that are, where they understand the nature of the loans they are working with. For example, we have seen some interest-only jumbo products that we suspect will continue when the rule takes effect.

Mr. MCHENRY. Which is how much of the marketplace?

Mr. CARROLL. It is not a very large—

Mr. MCHENRY. Excessively small or incredibly small?

Ms. Cochran, let me ask you this question about legal liability. If an institution offers a Qualified Mortgage, there are some liability protections, right? And if they do not offer a Qualified Mortgage, what are the penalties?

Ms. COCHRAN. The statute provides a 3-year period during which a consumer could bring an affirmative claim. The penalties are up to 3 years of the finance charge within that phase.

If the consumer goes into foreclosure, they can also raise a claim as an offset and again, penalties are limited to 3 years. So it is less than what occurs under the current rule that is already in effect—

Mr. MCHENRY. Let me ask you, if you have a box that gives legal protection and then people—you have institutions lending outside of that box, does that become a safety and soundness issue?

Ms. COCHRAN. We believe that if people are doing responsible loans, this is manageable and appropriate. There is already an—

Mr. MCHENRY. Does it go to safety and soundness for institutions?

Ms. COCHRAN. There is already an ability-to-repay standard in effect for higher-priced mortgage loans. Institutions that are managing—

Mr. MCHENRY. Higher-priced mortgage loans, okay.

Ms. COCHRAN. Yes, and institutions are managing that risk—

Mr. MCHENRY. So those mortgages are a large portion of the marketplace?

Ms. COCHRAN. They are a smaller portion of the marketplace.

Mr. MCHENRY. They are a very small portion of the marketplace. So your reference points are very small and you are being artful about your answers today.

We have deep concerns about the impact this is going to have and the CFPB's mismanagement of a really overly burdensome rule.

I yield back.

Chairwoman CAPITO. Thank you.

Ms. Velazquez?

Ms. VELAZQUEZ. Thank you, Madam Chairwoman. Please bear with me. I am suffering from laryngitis.

Most of my issues and concerns regarding this rule have been asked. Of course, I am very much concerned about the fact that the private capital has yet to reenter the mortgage market and we have to strike a balance between protecting consumers, and at the same time, keep access to capital and credit flowing into underserved communities.

I have a question that I believe has not been asked, and I would like to address it to Mr. Carroll. CFPB's final rule applies the legal Safe Harbor to only low price loans whereas the high-priced loans are tied to the rebuttable presumption.

Could you please explain the CFPB's reasoning for selecting this structure rather than instituting a single lender protection for QMs across-the-board?

Mr. CARROLL. I would be happy to. Thank you for the question, Congresswoman.

The statute required us to define a level of protection the creditors would receive from the ability-to-repay liabilities if they make a QM loan and so we had to navigate this question and we ended up coming up with this bifurcation that says if the loan is a prime loan, meaning the APR for the loan is within 150 basis points over the average prime operate, we would provide it Safe Harbor status.

And if it is above that in the nonprime space, we would provide the creditor with a rebuttable presumption of compliance. The intent here was to say that if you are generally within the QM space and you are working in the prime segment, these are borrowers who have a little bit stronger credit profile, may not need as much protection as consumers who are higher-priced who are in the nonprime space, and so we thought it was appropriate to provide a little bit of extra protection for the consumers in that nonprime space so that they do have some remedies if the market is getting into some of the subprime issues that we saw during the crisis.

Ms. VELAZQUEZ. Ms. Cochran, would you like to—

Ms. COCHRAN. Yes, we wanted to provide a certainty for the market going forward. We wanted to provide strong incentives to provide safer loans, and we believe the rebuttable presumption Qualified Mortgage strikes that balance.

It does provide incentives for lenders to provide Qualified Mortgages at the same time it preserves consumers' rights in the event that there is a problem. We think such problems would be extremely rare, but we thought it was important to preserve that flexibility.

Ms. VELAZQUEZ. Thank you.

Thank you, Madam Chairwoman. I yield back.

Chairwoman CAPITO. Thank you.

Mr. Pittenger, for 5 minutes.

Mr. PITTENGER. Thank you, Madam Chairwoman.

Thank you, Mr. Carroll and Ms. Cochran, for your testimony.

I would like to pick up or where Congressman McHenry left off. Given that the FHA decision, that Fannie and Freddie would only lend or only buy QM mortgages, do you believe that the lenders will continue to lend given that they have to hold these loans on their balance sheet?

Mr. CARROLL. Congressman, I am sorry, which loans were you referring to? I couldn't hear; I apologize.

Mr. PITTENGER. Loans outside the Qualified Mortgages.

Mr. CARROLL. Outside the Qualified Mortgages. Particularly in the short-term, we heard loud and clear from industry that non-qualified mortgages will be a smaller part of the market in the short term.

That is precisely why we endeavor to create both the general definition for a Qualified Mortgage as well as this temporary extension. At least for the next few years, while the market is continuing its recovery, what we hear from most creditors is that they are going to want to stick to the Qualified Mortgage space while they get acclimated to the rules and get acclimated to the possible risks associated with doing non-QM loans.

We do feel that over time, people will acclimate to that risk, which is why we created this temporary extension which covers, by our calculations, not including points and fees, roughly three-quarters of the market.

So that would be a significant retrenchment from what we now think is the vast majority of the market, the three quarters of the market where we have a significant delta.

We intend to monitor the market to make sure that the rule that we have constructed is operating as we expect it to, and it is something we need to keep tabs on as it moves forward, but we do think that over time, people will get acclimated with those risks and we will see a market for non-QM loans.

Mr. PITTENGER. You will assess that over time and make adjustments if needed?

Ms. COCHRAN. Right. We expected that it would develop in niches and specific parts of the market over time as people get more comfortable and see specific business opportunities that make sense for their models.

The thing that is helpful about the temporary category of Qualified Mortgage is that it is based on eligibility for purchase or guarantee or insurance by the designated entities.

It does not actually have to be purchased by them. And we believe that provides a good balance that will allow people to get comfortable both with portfolio loans and securitized loans.

So it is an important bridge and a mechanism for us to continue to assess how the market evolves. We know there are a number of other capital, regulatory, and economic conditions that are affecting the market causing uncertainty and this gives a bridging mechanism and breathing room for the market to evolve and for us to continue to assess as that temporary provision comes closer to—

Mr. PITTENGER. Okay.

Let me move on to something else. Given the severity of the damages associated with violating the ability-to-repay requirement, in writing this rule, did you consider the effect on the safety and soundness of small banks and credit unions that hold nonqualified mortgages on their balance sheets?

Ms. COCHRAN. The statute sets the remedies that are provided here, and as I started to say earlier, the remedies are actually more narrow than what is provided under existing rules today for higher-priced mortgage loans. Under those remedies, because of the way the rules were written, all finance charges are recoverable.

In the Dodd-Frank Act, Congress specifically limited it to a 3-year period, which we thinks helps significantly in terms of being able to model litigation risk.

So yes, that is obviously something that we looked at. We looked at litigation risks. We consulted with the prudential regulators and they are of course continuing to evaluate that issue as well.

Mr. PITTENGER. But you do believe that this could lead to further deterioration of the community banks?

Ms. COCHRAN. We are working very hard to structure the rule both in the final rule and the concurrent proposal to accommodate and recognize that small community banks provide critical access to credit and that their processes and practices are very responsible and should be accommodated within the scope of the regulation. So, we are working very hard to make sure that it does work for small banks as well as other types of lenders.

Mr. PITTENGER. I hope you will continue to talk to them, especially the ones I talk to.

Thank you. I yield back the balance of my time.

Chairwoman CAPITO. The gentleman yields back.

Mr. Hinojosa?

Mr. HINOJOSA. Thank you.

Thank you, Chairwoman Capito and Ranking Member Meeks, for holding this important hearing.

And thank you to the distinguished panel members for sharing your insights this morning.

We cannot forget how the housing market bubble happened. Shortly, let me say that unaffordable and balloon mortgages were sold to families who were not fully aware of the terms. We also saw agents targeting communities of color to push their most predatory mortgage products.

Fast-forward to 4 million foreclosures and the housing market meltdown, and we are now faced with ensuring that these unsafe practices never happen again.

With the mortgage rules written by the CFBP, including the Qualified Mortgage rule discussed today, we begin the long process of creating a healthy housing market for the long term. There is a thin line between too little regulation and too much. It seems to me that the QM rule released by the CFBP comes close to that line.

My first question is for Mr. Carroll. Some of us have constituents in rural areas such as in my congressional district in deep south Texas or places where there just aren't that many institutions that are able to extend credit to worthy borrowers.

In our districts, it actually makes sense for borrowers to have terms like balloon payments or other specialized products they work out with their local banker. As the chairman of the rural housing caucus, I have been fighting for affordable quality housing in rural America for over a decade.

What kind of exceptions exist in the Qualified Mortgage rule for small or rural lenders operating in these areas so that they can participate?

Mr. CARROLL. Thank you, Congressman, for the question.

We do recognize that rural communities in particular have been hit hard by the financial crisis and that the creditors who serve them have also had a difficult run during the recovery.

We have tried to do a few things in the rulemaking process to address smaller creditors operating in rural areas who have these challenges. One is, we have attempted to increase the coverage of designated rural areas for the purposes of treating balloon mortgages as Qualified Mortgages. My colleague, Assistant Director Cochran, mentioned this earlier.

We also have proposed, as part of a concurrent proposed rule, an exemption for small creditors where, if you are within $2 billion in assets, you don't originate more than 500 loans a year, and you hold the loans in portfolios, as long as the loan meets the Qualified Mortgage features of a fixed-rate loan or an adjustable rate mortgage, and some of the other protections built into QM, they can have an easier method of getting Qualified Mortgage status, meaning they don't have to look specifically to the 43 percent DTI. They can use their own DTI measure and they have an easier access to the Safe Harbor; a little bit broader space in the pricing where we used 350 basis points over APOR rather than 150.

And we think these are some methods for providing some relief to small creditors. We would be happy to hear from your office if you have views on it.

Mr. HINOJOSA. My second question will be directed to Ms. Kelly Cochran.

I am going to give you a picture of a congressional district that I represent which is in deep south Texas, 250 miles from San Antonio, South to McAllen Edinburg, and in the middle, the coastal bend has what they call the Eagle Ford Shale Oil and Gas Mine, which is bigger than Alaska's mines.

In the last 2 years, the actual production has been twice as much as was estimated, so that of the 8 counties I represent, 4 of them only have plus or minus 10,000 people, and they have lots of banks because Karnes County, as an example, received $2 billion in royalties and they have 10,000 people.

So the banks in that area have plenty of money, yet they are not lending money. Do we in Congress need to soften up the regulations because first, they said there wasn't enough money to meet the requirements. Now, they have lots of money, and they are still not lending money. So tell me, what do we have to do in Congress to open it up?

Ms. COCHRAN. I think—obviously, I wouldn't purport to advise Congress on what it should do, but I can say some of the ways in which the Bureau is thinking about these issues.

As Pete talked about, we have expanded the definition of rural and underserved under the regulation. The way it was proposed originally, it would have covered counties that only included 3 percent of the United States population.

We increased that to 9 percent and we also made a number of other adjustments with regards to balloon payment loans to make it easier for these institutions to keep lending.

As Pete mentioned, we also have a concurrent proposal which is looking at a number of issues with regard to small creditor impact and ways that we can accommodate them within the rule.

In general, this is a very complicated area. We are very sensitive and thinking very hard about it. One issue that is difficult is that there are so many different ways to define "rural."

Different Federal agencies do it differently for many purposes. So, we know there are a number of issues here. We are working very hard and we will be happy to report back to you as we are tying off this concurrent proposal on what other measures we have adopted that may be helpful here.

We would be happy to provide technical assistance.

Mr. HINOJOSA. My time has run out, and I yield back.

Chairwoman CAPITO. Thank you.

Mr. Pearce?

Mr. PEARCE. Thank you, Madam Chairwoman. I appreciate you holding this hearing.

And I appreciate the participation of the witnesses today.

The subject of the high-cost loans is something that I wonder about. What is the logic behind that? The logic behind the concept of high interest or high-cost loans and why we are going to regulate those?

Ms. COCHRAN. High-cost loans—are you talking about under the—

Mr. PEARCE. Section 1431, I think.

Ms. COCHRAN. With regard to high-cost mortgages under the Home Ownership and Equity Protection Act (HOEPA)? HOEPA is an existing regime that applies to certain lows depending on their points and fee—

Mr. PEARCE. Yes, just get down to the fine-tuning part of why is it there.

Ms. COCHRAN. It was there because there were a number of practices with regards to refinancing that were problematic in prior decades. Congress enacted a law—

Mr. PEARCE. Okay, just trying to stop corruption from occurring, basically the high-cost people jacking up stuff. So who on your staff is a specialist on manufactured housing?

Ms. COCHRAN. We have a number of people who have worked on manufactured housing—

Mr. PEARCE. No, who is a specialist? Who is the one that represents this loan type as you have these discussions? What is their name?

Ms. COCHRAN. We had a team of people who were—

Mr. PEARCE. Now, do you lead that team?

Ms. COCHRAN. They report to me. Yes.

Mr. PEARCE. Okay. So you understand the economics of originating loans? Basically, it costs the same thing to originate a $200,000 loan as a $20,000 loan?

Ms. COCHRAN. We analyzed this question through other rules. We do understand, and we adjusted the thresholds for points and fees based on the size of the loan because we realize that was a concern.

The Dodd-Frank Act changed the thresholds and changed the coverage for high-cost mortgages. We implemented the statute as directed and have made adjustments—

Mr. PEARCE. So you are telling me that the people who quit making trailer house loans are interpreting incorrectly? Because they are coming under the high-cost loans now because the cost of origination of the loan is the same.

Whether it is $200,000 house or a $20,000 mobile home, that percentage then mathematically works out to be above the threshold and so a lot of the—most of the banks in New Mexico have quit making new loans for trailer houses.

Fifty percent of the people in New Mexico live in trailer houses, so you have effectively shut off the mortgage market to basically half of New Mexico.

We have an average income of $31,000 to $35,000, something in that range. So what you have is a de facto war on the poor, and I just wonder if anybody up there is thinking about it, and who is the person saying, we can't quite do this because they are shutting off these poor people who were making $20,000 and $30,000 loans, they are just in there trying to get into something.

So who is it? Is that you, Ms. Cochran?

Ms. COCHRAN. We looked at this issue intensively during the rulemaking for the high-cost mortgage loans, and I would be happy to talk to you about our analysis.

Mr. PEARCE. I would be happy for you to—

Ms. COCHRAN. We made adjustments with regard to both the points and fees and the rates thresholds for high-cost mortgages to account for the fact that manufactured housing has certain unique features and also that smaller loans in general have certain costs to originate.

It is something we thought a lot about, that we requested data on, and that we looked at very hard. We have heard from some people that they will cease to make loans if they are above the threshold.

Mr. PEARCE. I will just tell you that almost every bank in New Mexico, and in fact, the one bank who still does it, Texans are coming across trying to borrow money out of New Mexico. So across the State line, it is the same.

The second—and by the way, I would gladly invite you to our office to discuss this because it is a serious problem for us.

Ms. COCHRAN. We would welcome that. Thank you.

Mr. PEARCE. The second question is, so you have these QMs and then do you have a Director, with Mr. McHenry's footnote, who says, don't worry about it. Who is going to decide who should have worried about it?

In other words, if people make nonqualified mortgages, who is going to decide whether or not they come up against some action or not. Is that the agency? Is that you all?

Ms. COCHRAN. If there is a violation, it could be—

Mr. PEARCE. No, no, no. Mr. Cordray says, go ahead and do those loans outside the QM. We have created a little box here, but go ahead and feel free to step outside. Who is going to decide you shouldn't have stepped outside the box?

The reason I am asking the question is we have an Administration that is willing to check your Internal Revenue Service returns. They are willing to subpoena all of the records for all of the AP, not just the one or two people, but everybody in the entire workroom. They have released information on the whistleblowers and "Fast and Furious" and tried to discredit them.

And I wonder, is the same Administration going to be the one who decides who shouldn't have stepped outside the box and who should have stayed in the box?

That is my question, but I think it is more rhetorical.

Chairwoman CAPITO. Thank you.

Mr. Scott, for 5 minutes.

Mr. SCOTT. Thank you very much, Madam Chairwoman.

I am one of the cosponsors of H.R. 1077, and I am trying to work with this issue. Let me just ask you, why didn't you, the CFPB, address the issue of affiliate discrimination and the calculation of fees and points in the final QM rule?

Ms. COCHRAN. The Dodd-Frank Act specifically requires that affiliate fees be counted towards the cap on up-front points and fees for qualified—

Mr. SCOTT. Could you do me a favor and just move your microphone a little bit closer?

Ms. COCHRAN. Yes, I'm sorry.

The Dodd-Frank Act mandated treatment of affiliate fees with regard to the 3 percent threshold for Qualified Mortgages. There are a number of places in Dodd-Frank where Congress made a deliberate policy decision with regard to treatment of affiliates of creditors and brokers.

Given that very clear policy choice had been made throughout the statute, we did not feel it was appropriate for us to vary from that. We implemented that provision as provided in the statute because Congress had made the decision.

Mr. SCOTT. Do you think it doesn't make sense to discriminate against affiliates on the basis of these fees? To do so reduces the competition and the choice of title services and insurance providers. Can the CFPB do with this without repurposing the rule?

Ms. COCHRAN. As Pete mentioned, we have received a great deal of comment on this issue on both sides. We recognize they are very strongly held views. We—as we said—believed, given the clear mandate from Congress, that it was our responsibility to implement that.

Mr. SCOTT. So is it being considered?

Ms. COCHRAN. No, it is not. We would certainly not be able to do it without a re-proposal as a matter of administrative law that simply—

Mr. SCOTT. Wait a second. You would be able to do it if you received some help from Congress, is that right?

Ms. COCHRAN. Congress made a very clear policy choice. If Congress changes that policy choice, we would implement it as directed.

Mr. SCOTT. Okay, now let me ask you about Fannie and Freddie. What is the rationale of the CFPB for including Fannie and Freddie loan level price adjustments in the calculation of the fees and the points?

Mr. CARROLL. Thank you, Congressman. That is a good question. Loan level price adjustments is a topic that has come up during our Qualified Mortgage rulemaking—

Mr. SCOTT. Maybe it is me, and I need to clean out my ears. If you will just talk louder; I can't quite hear you. Go ahead.

Mr. CARROLL. At the end of the day, loan level price adjustments are additional costs imposed based on the credit profile of the borrowers. The more credit risk posed by the consumer, the more fees will be charged whether they may be charged as an up-front fee to the consumer or may be factored into the interest rate.

This was a tricky one for us, but when we look at these types of charges, we don't see them like bona fide third-party charges, which are just services like title or appraisal; we see them as charges that are fairly integral to the rate itself, to the product itself being offered to the consumer and these are ultimately costs that are borne by the consumer.

They may manifest through, in this case, the GSE is charging a fee to the lender for their guarantee services, but that could just as easily be, in the private label space, an aggregator who also originates loans.

We felt, given that these price adjusters are really specific to the consumer, that they are borne by the consumer and paid for by the consumer at origination, we thought it was appropriate to keep them in the rules so that the rule would function as we expected it to.

Mr. SCOTT. Would you consider changing that policy?

Mr. CARROLL. We would always consider having a conversation with Members of Congress to understand your concerns and have a dialogue on that.

Mr. SCOTT. Now, let me ask you about escrows. Would escrows for taxes and insurance ever be included in the calculation of fees and points?

Ms. COCHRAN. No, we don't believe so.

Mr. SCOTT. Why?

Ms. COCHRAN. Because those are collections of charges to be paid along the life of the loan distinct from the up-front points and fees that are charged in connection with the origination of the loan.

Mr. SCOTT. Okay.

Thank you very much, Madam Chairwoman.

Chairwoman CAPITO. Mr. Fitzpatrick?

Mr. FITZPATRICK. I thank the Chair, and I very much appreciate the hearing.

I hope we can all agree that small community banks did not cause the mortgage crisis of 2008. When I am back home in my district in Pennsylvania meeting with local lenders, they tell me that the QM rule is or will essentially and assuredly take away the judgment that they have and have always had as local lenders and will otherwise drive credit for qualified borrowers.

One lender back home tells me that a main concern, and I think the CFPB has heard this several times, is that by branding a mortgage as "qualified," you are essentially saying that all mortgages that don't meet that criteria are "unqualified."

Even if the intent is not to create categories of desirable or undesirable and not desirable mortgages, that is essentially what is happening. So the question is, who is going to want to have or to hold an "unqualified" mortgage?

Community banks often have certain niche programs that are perfectly legal but serve small consumer bases because it is specifically tailored for those consumers' or customers' needs, and when the CFPB introduces qualified and unqualified Mortgages, they are disregarding the necessity of these programs and penalizing the local and community banks that know their customers, know them well, what they want, and what is in their best interest.

So my question for either Mr. Carroll or Ms. Cochran is, was there any consideration for or would you be opposed to providing exemptions for small institutions that keep these mortgages in their own portfolios? And what is the chance that is going to happen?

Ms. COCHRAN. If I could address that in a couple of ways.

First of all, of course, Qualified Mortgage is the term used in the statute so we have continued to use that. I think there are important pieces of consumer education that will come with this rule as we get closer to implementation to make sure the consumers understand what a Qualified Mortgage is, and what it is not.

In terms of small lender programs, there are three different types of Qualified Mortgages under the final rule and we have proposed a fourth category of Qualified Mortgage that is specifically for small creditor portfolio loans.

Many of the loans that small institutions make will fall within the definition of Qualified Mortgage, and the reason we proposed a fourth category is that we believed it was appropriate to look at this, because we realized that relationship lenders, small community institutions, have many reasons and business models that are of great service to consumers.

They provide critical access to credit and they have extremely low foreclosure rates, and typically very responsible lending practices. We wanted to make sure that we encouraged and accommodated that type of lending within the scope of the rule and so we have thought very hard to both, in the balloon payment context and with regard to this new proposal, which we are hoping to finalize as quickly as possible, to accommodate exactly those kinds of—

Mr. FITZPATRICK. So, you have just described the community lenders in my area of southeastern Pennsylvania. Do you agree that those lenders did not contribute to or create the mortgage crisis of 2008? We agree on that, correct?

Ms. COCHRAN. Exactly. And as I mentioned, their foreclosure rates, their lending, their profile of the data shows that they have generally very responsible models. We wanted to accommodate and recognize that within the course of the rule.

Mr. FITZPATRICK. And those lenders most likely to hold the loans in their own portfolio, correct?

Ms. COCHRAN. Right. Both of the Qualified Mortgage provisions for small creditors, both the balloon payment and the proposed new category, are specifically for portfolio loans.

Mr. FITZPATRICK. So why not just exempt the small community bankers from the rule? Why not?

Ms. COCHRAN. We believe that balance is important. This strikes the appropriate balance by providing greater protection, greater certainties for those creditors, recognizing their good models, and at the same time providing in the event that there is an abuse, that there is a small creditor that is not operating under those same practices, a consumer would have an ability to seek redress in such situations.

Mr. FITZPATRICK. I yield back.

Chairwoman CAPITO. Mr. Capuano?

Mr. CAPUANO. Thank you, Madam Chairwoman.

Mr. Carroll, Ms. Cochran, I have heard a lot of detail today and a lot of concern. I think some of it is legitimate. I am sure you share some of the same concerns. My first, and possibly my only question, is kind of simple.

I am interested in the availability of credit. Several million people got mortgages last year.

There is no doubt that a handful of them probably shouldn't have gotten a mortgage. They are going to get into trouble. My question is, have you made an internal judgment as to how many fewer loans will be made when this rule is adopted next year?

How many people who got loans this year do you expect to not be able to qualify next year, not be able to get loans next year, I guess?

Mr. CARROLL. We think it will be small, Congressman.

I think that we have tried to calibrate this rule so that again, going back to this notion of a broad QM, is to provide minimal disruption to the market in the short term while we are transitioning into this—

Mr. CAPUANO. When you say small, can you give me—1 percent, 10 percent, 20 percent?

Mr. CARROLL. The vast majority are covered in the Qualified Mortgage space. We expect those loans will continue to get made.

There may be some loans on the margins that banks would have to do as a nonqualified mortgage and choose not to because they don't match our Qualified Mortgage—

Ms. COCHRAN. Part of it is that the lending practices have changed so much from the height of the build-up to the crisis that we think things like no-doc loans—

Mr. CAPUANO. I am not—that is why I asked about last year. I didn't ask about 2008. I can't imagine anybody in their right mind would want us to go back to the 2008 standard, and if they do, I think they should say so.

So I am using last year because I am not sure we are at the right point yet but I am just trying to get an idea. I think most of us would see that last year was a pretty tight market and most mortgages being made are probably pretty conservative lately.

And I guess I am just trying—the reason I ask is because there is one number out here that suggests 48 percent of the loans made in 2010 would no longer be made because banks will stop making them.

If that is the number, obviously I think that should concern a lot of people and I am just wondering if you have a competitive number—I am not going to hold you to a specific number; a range, anything.

Mr. CARROLL. Yes, let me describe the distinction, I think, between our numbers and some of the other numbers that might be in the market. We put our core definition at roughly three-quarters of the market being covered by QM and then adding this extension—

Mr. CAPUANO. The explanation can come later. I am just looking for a relatively simple answer if there is one.

Mr. CARROLL. I—

Mr. CAPUANO. Do you have a number, an estimated number, as to how many people who got loans in the last year or the year before, whatever your base your might be—how many of them would not be able to get loans next year? Either based on QM or because the people will not be making nonqualified mortgages.

Mr. CARROLL. Based on QM, we think it will be a small number. I would say though at the same time there is the potential for credit to continue to loosen in the market on the basis of factors that—

Mr. CAPUANO. Good. I am glad you said that. I agree with you. When you say small, I need to get—is it less than 10 percent? Less than 5 percent?

Mr. CARROLL. Yes, less than 10 percent. I would put the number in my office and our calculations around the 5 percent margin, at most.

Mr. CAPUANO. That is good. Thank you for the answer. I guess the next question I have really is, what if you are wrong?

What if this 48 percent number is right? And you find it out, after a period of adjustment all of a sudden come March of next year and mortgages given have plummeted, do you have the ability to make quick adjustments to your rules?

And again, I know how long it takes to make a rule, have you allowed yourself a back door out of this rule to make an emergency declaration or whatever? What if you are wrong?

I am not arguing that you are. I am not qualified to make that argument. What if they are right and you are wrong and all of a sudden most of America can no longer get a loan or if there is a hole—an unforeseen one for trailers or whatever it might be? Do you have the ability to make a quick, even if temporary, adjustment to your rule to address something that maybe your estimates were wrong on?

Ms. COCHRAN. Yes, we would have to go through certain procedures to do a quick adjustment.

We are in the process of making quick clarifications to the rule now as different interpretive issues come up and we can do some of these procedures in the event that there was a problem.

I think a lot of the debate is really about what happens as the temporary provision expires. As we discussed, that is a longer-term question. We specifically set the outside threshold at 7 years because the Bureau is required to do a thorough—

Mr. CAPUANO. When you say quick, could you again, give me a general idea, for the sake of discussion, come February 15th, all of a sudden the entire country agrees that okay, you have tightened up too much, 3 percent should be 4 percent or whatever it might be. If you decide February 1st that you agree, everybody agrees that it has to be changed, when can you change it? March 1st, June 1st, next January?

Ms. COCHRAN. We would have to look at the specific circumstances. Generally, we have to provide a brief notice and comment period before we would change a rule.

Mr. CAPUANO. How brief?

Ms. COCHRAN. Obviously, there are different circumstances under which the Administrative Procedure Act can allow expedited process—

Mr. CAPUANO. Yes, but you are not—I am a defender of the CFPB and I am concerned about some of the details and that is all well and good, but for me details—we will work out what we can do.

What I am concerned with is okay, with all of the best interests at heart, with all of your best estimates, I am not qualified to say that your estimates are wrong. I mean, they are estimates. That is what they are based on. And you are just more qualified than I am.

My concern is if you are wrong and it takes 9 months to adjust that problem, then we are possibly on the brink of another economic crisis that could be averted.

All I am asking is, have you built in or will you build in a back door in case you are wrong? Not because I think you are wrong, but if you decide you are wrong, and say, "Oh my God, the estimates were wrong," and it happens.

On occasion, even I have made a mistake that I have wanted to correct, and I am simply asking, have you allowed yourself the opportunity to do that and if it is 6 months, I have a problem.

Ms. COCHRAN. The circumstances depend on what happens, but we do have more flexibility than that—

Mr. CAPUANO. That is not an answer.

Ms. COCHRAN. —it would not be a matter of 9 months—

Mr. CAPUANO. I appreciate—

Chairwoman CAPITO. The gentleman's time has expired. Thank you.

Mr. CAPUANO. Not good for a friend.

Chairwoman CAPITO. Mr. Barr?

Mr. BARR. Thank you, Madam Chairwoman.

Mr. Carroll, Ms. Cochran, thanks for your testimony today.

I think what you are hearing today is not any kind of objection to the idea that there was some response that was warranted to the mortgage subprime prices, but more concern that the overreaction involved here is something that is depriving the market, the mortgage marketplace of flexibility, depriving consumers of access to mortgage credit, which is what you all spoke to at the very beginning in terms of what you all want to avoid.

But what I want to do is talk about, and I would encourage you to take back to the Bureau, some of the bipartisan concerns that have been expressed here today, and I would like to echo or follow on the comments from the gentleman from Texas, Mr. Hinojosa, in talking about the rural designation issue.

My district in central and eastern Kentucky includes a number of counties that are manifestly rural, but fall outside of the rural designation under your QM rule.

So my question would be to you all, obviously Kentucky bankers, bankers all across this country use balloon mortgages to mitigate interest risk, interest rate risk, balloon loans held in portfolio give consumers significant interest rate flexibility.

With these rural communities—and in my case, Bath County, Kentucky, is a rural community but for whatever reason the CFPB does not recognize it as a rural community, a rural county.

In light of this feedback that you are getting from both sides of the aisle, what is the CFPB doing to revisit this definition of rural? Are you thinking about changing the definition through maybe use of the rural housing loan program definition, or I have heard a process whereby interested parties could petition the Bureau to be considered rural? What are you doing to address this problem?

Ms. COCHRAN. As we discussed, there is a concurrent proposal out right now that is looking at small creditor issues with regard to access to credit, not just in the question of rural balloons, but more broadly.

We are looking at that and looking at our options and how then we can appropriately balance those considerations. We have heard a great deal of comment about the rural definition in particular.

There are a lot of interesting ideas about different ways to define it, and over time, that is something I think that we want to continue to consider.

We are looking holistically at this right now. We cannot talk about a pending proposal, but our goal is to get it out as quickly as possible. We are extremely sensitive to what we are hearing about consumers on this issue and we are working to strike an appropriate balance that will preserve access to credit.

Mr. BARR. When you talk about regulatory straitjackets, this is what we are talking about. When you define Bath County, Kentucky, as nonrural, you are just flat out wrong. So please consider that and take that back to the Bureau.

One quick additional question: I hear frequently from our bankers that they are receiving mixed signals from regulators, particularly with respect to the Community Reinvestment Act mandates and the QM rule. And so what I want to ask you all is what assurances can you give to Kentucky community banks that they will not receive a negative CRA audit if their mortgage lending decisions reflect compliance with your QM rule?

Ms. COCHRAN. The Community Reinvestment Act is administrated by other agencies, not the CFPB. We have been working with the prudential regulators and other appropriate Federal regulators throughout our rulemaking process to coordinate and get their feedback on our QM rule and also as they think about implications of QM for their—

Mr. BARR. Do you acknowledge that there is a conflict? Do you acknowledge that there is a conflict between the requirements of the CRA and your Qualified Mortgage rule?

Ms. COCHRAN. I have not studied this issue in detail. I would not, at this point, be comfortable saying that there is a conflict. I can say that it is something we would be happy to take back as we continue our discussion with prudential regulators to continue to discuss and make sure that agency coordination is appropriate.

In general, we think that is an important issue throughout the rulemaking. We would be happy to follow up with you about specifically what you are hearing on CRA.

Mr. BARR. We are hearing it. We are hearing it very loud and clear, and what is really a problem is the contradictory messages that lenders are receiving from the regulators.

My final question is on cost of compliance. Lenders are obviously going to be tasked in implementing the QM rule with systematically and comprehensively documenting that even though they have followed safe and sound practices, they have to prove that they followed the prescribed underwriting processes to determine that the borrower has the ability to repay.

Have you all analyzed the cost of compliance of documenting following all of the requirements to achieve a Safe Harbor status, and what additional compliance costs that is going to impose on some of these small community banks that simply don't have the staffing that would be required to properly implement this rule?

Ms. COCHRAN. Yes, we did consider, as Pete talked about earlier, the cost of compliance and other impacts of this regulation. Our sense is that, given how much underwriting practices have changed, this is not a significant deviation from what people are doing now.

Obviously, there are always concerns when a new rule comes in and people need to calibrate and make sure that they are in compliance. That is why we are working so hard on the regulation implementation efforts, to make sure that we facilitate that process as much as we can.

We are very sensitive to the concerns of small institutions on this, and that is why we are providing a compliance guidance and videos and all of the other things that Pete talked about.

Mr. BARR. My time has expired. I yield back.

Chairwoman CAPITO. Mr. Murphy?

Mr. MURPHY. Thank you, Madam Chairwoman. And thank you both for your testimony.

Back to this 3 percent rule. It looks like originally the threshold was $75,000 and now it is $100,000. Number one, how did you come to raise it? What happened there?

And then number two, did you think of tying this to an average cost for an area, considering that New York City might be different than a rural area in my district?

Ms. COCHRAN. We looked at this issue and we received extensive comment on it. We did what analysis we could around the costs to try and calibrate properly. I don't know that we got a suggestion specifically about average costs in specific areas, so that might be something that would be helpful to follow up on.

It certainly was a concern and we adjusted significantly from the proposal because we thought more flexibility was needed. We understand that there are certain costs in originating a loan that don't vary much based on the principal side and so we were trying to accommodate that rule in how we set the threshold. So it is something to which we are very sensitive.

Mr. MURPHY. Okay, so you would be open to perhaps tying it to an average rate for a market, because as was mentioned earlier, there are a certain amount of fixed costs that do go into issuing these mortgages?

Ms. COCHRAN. We did the best analysis we could with the information we had. I would be very interested in talking to you about the idea. Obviously, it is something we have to look at.

Mr. MURPHY. Okay. One more question. With this Safe Harbor approach, the CFPB is giving lenders the ability to know and say that certain people meet this ability-to-repay standard. Does this create an implicit inability to repay for loans that are outside QM?

Ms. COCHRAN. No, as we have discussed, we have really set the long-term threshold for Qualified Mortgage in a way that we believe was important to recognize and acknowledge that there are responsible good loans to be made outside of the Qualified Mortgage space.

We believe it is appropriate for those loans to be considered on an individualized basis without a presumption that they automatically comply. We believe that there is significant responsible credit in that and, over time, creditors will see those opportunities and expand into that space.

In the short term, while they are figuring that out and getting comfortable, we have also expanded the definition of Qualified Mortgage to provide the bridge as we discussed earlier.

Mr. MURPHY. So the complaints I am hearing from community bankers and credit unions, do you think they are temporary or do you think they are justified?

Ms. COCHRAN. We know this is a difficult time. We know that there is uncertainty around this rule and a number of other conditions in the market. And we believe those concerns are real and they will affect business decisions in the short run.

That is why we structured the rule to provide a transition mechanism over time. We do believe that, as conditions become more certain, as other pieces fall into place and people get more comfortable with the rule, they will feel more comfortable expanding into other parts of the market.

We really tried hard to design a rule that would, in the long-term, provide accessible credit in all parts of the market. Obviously, that is a balancing act and it is a difficult process to manage over time with so many sources of uncertainty, but we believe this is a good framework for doing that.

Mr. MURPHY. Have you all sort of come up with some ideas and theories for what you can do if you do see in a year or 2 years, kind of adding on to what Mr. Capuano said, that we can do to loosen up to ensure that the private sector does in fact enter the market if we see in a year that they are really not because of the cost?

Ms. COCHRAN. We will continue to monitor the market on an ongoing basis. That is part of the Bureau's basic mission and also an important part of the accountability after any rulemaking. So we expect we will continue to monitor over time and specifically at the 5-year mark, when the Bureau is required to do a very extensive evaluation of significant rules. So we certainly expect that would happen before the expiration of the 7-year period for the temporary definition.

We also expect to be doing this on an ongoing basis. This is a core part of our mission, and if we start to see things that are not developing as we expected, then obviously we would have to consider whether adjustments would be appropriate.

Mr. MURPHY. Okay, great. Thank you.

Chairwoman CAPITO. Mr. Westmoreland?

Mr. WESTMORELAND. Thank you. I think Mr. Luetkemeyer asked you both if you have ever made a loan and I think both of your answers were no. What experience professionally or just in life have you had to come up with what a qualified borrower was if you never made a loan? Have you ever made a loan to anybody in your family or to anybody?

Mr. CARROLL. No, Congressman, I have not made a loan to anybody.

Mr. WESTMORELAND. Ms. Cochran?

Ms. COCHRAN. No.

Mr. WESTMORELAND. Okay. So how do you go about figuring out who is a qualified borrower?

Mr. CARROLL. First, we are working with the statute and when—

Mr. WESTMORELAND. No, I am talking about—what if somebody came in, what makes them a qualified borrower? Is it how much he owes, what his credit history is, who his mom and dad are—what gave you that insight to say, all right, this guy would be a qualified buyer, and this guy is not.

Ms. COCHRAN. So, if I may address it. The statute set out and directed the Bureau to define what is a Qualified Mortgage. It did not tell us to define what is a qualified borrower. And as I talked about in my original opening testimony—

Mr. WESTMORELAND. It is kind of the same thing. If you have somebody who fits the Qualified Mortgage, isn't he going to be a qualified buyer?

Ms. COCHRAN. What we believed was important was to create flexibility. As I said in the beginning, we don't believe that by rule we can define every single instance of an affordable mortgage. Underwriting was too complex for that and it is too individualized.

So what we were doing was defining a class of loans where it made sense to presume that the creditor had properly evaluated the ability to repay. Overall, that would provide flexibility so that creditors will make that determination using reasonable standards.

Mr. WESTMORELAND. But you are creating the rules, right?

Ms. COCHRAN. Yes. We are doing it the way Congress directed us to do in defining Qualified Mortgage, but we very specifically did not consider that to be defining the outer limits of what is a qualified borrower.

We believe that is best left to the market. What we were trying to do was implement the statutory provisions in a way that provided certainty for the market so that they could go ahead and use reasonable practices to continue doing what they do best.

Mr. WESTMORELAND. Okay.

Now, Mr. Carroll, you had previously been at Overture. Is that correct?

Mr. CARROLL. Correct.

Mr. WESTMORELAND. And when did you leave Overture?

Mr. CARROLL. 2011

Mr. WESTMORELAND. 2011. Did Overture come up with a program or somebody at Overture come up with a program where Fannie Mae could reduce their approval time from say 30 days to 30 minutes or less?

Mr. CARROLL. The company, Overture Technologies, was involved in developing automated underwriting capabilities and credit risk models for a variety of different banks.

Mr. WESTMORELAND. Okay. So you cut the time down from 30 days processing to 30 minutes or less.

Mr. CARROLL. One of the features of automated underwriting is to create a more efficient underwriting—

Mr. WESTMORELAND. Okay. So you can do a qualified borrower in less than 30 minutes. What kind of documentation did you have to get or how long did it take to fill out this online application to get this Qualified Mortgage or buyer or whatever you want to call it in less than 30 minutes? Was it like a no-doc loan?

Mr. CARROLL. The underwriting programs that were used by the customers of the company ranged from full documentation programs to Alt-A programs and subprime programs.

Mr. WESTMORELAND. So you could do a full documentation and have it approved in less than 30 minutes online? That is amazing.

Mr. CARROLL. Well, it just—

Mr. WESTMORELAND. Great technology.

Mr. CARROLL. The technology was very good to do full documentation decisioning, but you still have to go and look at the paperwork after the fact.

Mr. WESTMORELAND. Okay.

Ms. Cochran, you previously worked at a law firm and did litigation, as far as I guess borrowers or consumers? What kind of lawsuits were you involved in or who did you sue?

Ms. COCHRAN. Generally, my claims were financial institutions that were defending against lawsuits. I also did a fair amount of regulatory counseling and how to comply with Federal consumer financial law for those same clients as well as some other types of litigation that were not related to the financial sector.

Mr. WESTMORELAND. So these consumer financial laws that you were defending—

Ms. COCHRAN. I was generally working as a defense attorney for financial institutions which had been sued for violations of the Truth in Lending Act or other statutes and regulations, and working with them both in defense of the lawsuit and in counseling them in terms of ongoing compliance requirements under those regulations and statutes.

Mr. WESTMORELAND. So you actually represented the institutions that were being sued by consumers?

Ms. COCHRAN. Yes, in many cases I did.

Mr. WESTMORELAND. So now you are on the other side of the fence.

I yield back.

Chairwoman CAPITO. Mr. Heck?

Mr. HECK. Thank you.

I think my question is most appropriately addressed to Ms. Cochran. I am trying to better understand that this issue of what happens to what is incentivized in the way of lending practices vis-a-vis QM and non-QM.

And what I can't quite get my arms around is what the change will be next year for borrowers in terms of their rights of action under non-QM versus what it is today.

Ms. COCHRAN. So, under the rules that were adopted by the Federal Reserve Board, the ability-to-repay requirement applies today to higher-priced mortgage loans. If there is a violation of that loan, the consumer can sue and recover all of their finance charges.

The Dodd-Frank Act basically expands that requirement so it applies to the broader mortgage market, not just higher-priced mortgage loans, and it limits the remedies so that only up to 3 years worth of finance charges will be recoverable in the event that there is a successful suit.

As we have talked about before, there are different gradations here with regard to Qualified Mortgage, Safe Harbor, and rebuttable presumption, inability to repay, but that is the basic framework that applies to the statute.

Mr. HECK. I didn't follow you.

Ms. COCHRAN. Okay.

Mr. HECK. I am trying to understand if I am a non-QM borrower next February—

Ms. COCHRAN. Right.

Mr. HECK. —on what kind of an expanded basis can I sue my lender versus today?

Ms. COCHRAN. Today, the ability-to-repay requirements only apply to a higher-priced mortgage loan. After January, they would apply more broadly to the market in general. If the loan was not a Qualified Mortgage so it was originated under the general ability-to-repay standard, then in that case, the consumer remedies would be up to 3 years of finance charges in the event that the consumer was successful on the suit.

Mr. HECK. And today they—

Ms. COCHRAN. Today, they can recover the entire length of finance charges, so depending on when the suit was brought, that could actually be a larger amount of money. It depends on the circumstances of the case.

Mr. HECK. Thank you, I think. I also want to ask about the loans and fees. First of all, quickly, did I understand you correctly that the 3 percent is actually specifically stipulated in Dodd-Frank?

Ms. COCHRAN. It is. The statute provides for up to 2 bona fide discount points in addition to the 3 percent depending on the rate of the loan, but that is the general threshold.

Mr. HECK. Part of what I don't understand is how we have over time allowed for increasing Federal regulation of title insurance and what I don't understand is how that relates to the foundational insurance regulation law, namely McCarran-Ferguson.

I don't understand how it is that we can say regulation of insurance is up to the States in exchange for which you are not subject to antitrust but then first I gather it was in HOEPA and now in this we effectively have intruded upon that territory. Do you follow me?

Ms. COCHRAN. The statute provides that affiliate fees in certain circumstances count toward the threshold for Qualified Mortgage and the threshold for a high-cost mortgage.

So in the case of title insurance that is affiliated with the creditor, that would count towards those thresholds. That was the decision that Congress made in the Dodd-Frank Act, with regard to Qualified Mortgages, and as we discussed earlier, we have implemented that as the statute directed us.

Mr. HECK. Does that in any way compromise the underlying covenant of McCarran-Ferguson?

Ms. COCHRAN. I am not sure that I am qualified to speak to that. I think it is a decision that Congress made in the Dodd-Frank Act based on a number of policy parameters, and I don't know all that went into that decision. We have implemented the statute as directed.

Mr. HECK. Thank you very much.

Thank you, Madam Chairwoman. I yield back the balance of my time.

Chairwoman CAPITO. Thank you. I believe that concludes our hearing.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

The hearing is now adjourned. And thank you both.

[Whereupon, at 12:17 p.m., the hearing was adjourned.]

A P P E N D I X

May 21, 2013

OPENING STATEMENT OF REP. BILL HUIZENGA

House Financial Services Subcommittee on Financial Institutions and Consumer Credit

"Qualified Mortgages: Examining the Impact of the Ability to Repay Rule"

May 21, 2012

Good morning, and thank you Chairwoman Capito and Ranking Member Meeks for holding this important hearing and allowing me the opportunity to participate today. As someone who worked in the housing industry, this is very important to me and more importantly, to our constituents.

We are here today to discuss the Qualified Mortgage (QM)/Ability to Repay Rule as mandated by the Dodd-Frank Wall Street Reform Act. The QM rule is the primary means for mortgage lenders to satisfy its "ability to repay" requirements. Additionally, Dodd-Frank provides that a QM may not have points and fees in excess of 3 percent of the loan amount. As currently defined, "points and fees" include (among other charges): (i) fees paid to affiliated (but not unaffiliated) title companies, (ii) salaries paid to loan originators, (iii) amounts of insurance and taxes held in escrow, (iv) loan level price adjustments, and (v) payments by lenders to correspondent banks, credit unions and mortgage brokers in wholesale transactions. As a result of this problematic definition, many affiliated loans, particularly those made to low- and moderate-income borrowers, would not qualify as QMs and would be unlikely to be made or would only be available at higher rates due to heightened liability risks. Consumers would lose the ability to choose to take advantage of the convenience and market efficiencies offered by one-stop shopping.

I, along with Ranking Member Meeks, introduced bipartisan legislation that would clarify the way "points and fees" are calculated. Our legislation, H.R. 1077, the Consumer Mortgage Choice Act, is narrowly focused to promote access to affordable mortgage credit without overturning the important consumer protections and sound underwriting required under Dodd-Frank's "ability to repay" provisions.

Mrs. Chairwoman, thank you again for holding this important hearing and I look forward to hearing from the witnesses today.

Written Testimony of
Peter Carroll, Assistant Director for Mortgage Markets, and
Kelly Thompson Cochran, Assistant Director for Regulations,
Consumer Financial Protection Bureau
Before the
House Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit
May 21, 2013

Introduction

Thank you Chairman Capito, Ranking Member Meeks, and members of the Subcommittee for this opportunity to testify about the Bureau's Ability-to-Repay/Qualified Mortgage rule. We are honored to represent the Bureau here this morning to present an overview of the rule, our rulewriting process, and some of the policy considerations that shaped its development.

During the years preceding the mortgage crisis, too many mortgages were made to consumers without regard to their ability to repay the loans. Loose underwriting practices by some creditors—including failure to verify the consumer's income or assets (so called "no-doc" loans) and qualifying consumers for mortgages based only on their ability to pay low "teaser" interest rates that would allow monthly payments to jump to potentially unaffordable levels after the first few years—contributed to a mortgage crisis that led to the nation's most serious recession since the Great Depression.

The Dodd-Frank Act protects consumers from such irresponsible practices by requiring creditors to make a reasonable, good faith determination based on verified and documented information that consumers have a reasonable ability to repay their mortgages. The provision effectively extends to most of the mortgage market a 2008 Federal Reserve Board rule that prohibits creditors from making "higher-priced mortgage loans" without assessing consumers' ability to repay the loans. The Dodd-Frank Act also established a presumption of compliance with the ability-to-repay requirement for a certain category of loans called "qualified mortgages." The Board proposed a rule to implement these requirements before authority passed to the Bureau to finalize the rule. In January, the Bureau issued a final rule to implement the statute and provide further clarity as to what will be required of creditors. The rule will take effect on January 10, 2014.

In developing the final rule, the Bureau considered the record, including nearly 2,000 comment letters. We also received additional information and new data pertaining to the proposed rule. For this reason, we reopened the comment period to further encourage dialogue and gather feedback on the new data. We also reached out to stakeholders to gain a better understanding of potential impacts on small creditors, for example, by holding a roundtable.

With the help of public feedback and our data analysis, we concluded that, in today's market, access to credit remains so constrained that some consumers, even those with strong credit, may have difficulty refinancing or buying a home. For this reason, we designed the rule not just to ensure more responsible lending by curtailing certain problematic practices, but also to encourage creditors to provide responsible loans to consumers in all segments of the covered market. We recognized that, while providing transition mechanisms and certain bright-line standards can help industry adjust to the new rule, it was also important to provide flexibility for a range of reasonable underwriting practices as the mortgage market changes over time. So the rule strikes a careful balance between providing bright lines to give certainty and clarity to creditors while also allowing flexibility for the mortgage market to evolve and innovate in ways that encourage the provision of responsible credit. We know that there is much work to do as industry works to implement the rule. However, we believe that the broad positive feedback we have received in response to the rule—and to our processes for rulewriting and implementation support—suggest that the rule will help the market over time reach a more sustainable equilibrium for both consumers and providers of responsible credit.

Ability-to-Repay Determinations

The final rule implements the statutory requirement that creditors make reasonable, good faith determinations of consumers' ability to repay their mortgages at the time the loan is made. While the final rule describes certain minimum requirements for creditors making such determinations, it does not dictate that they follow particular underwriting models. Rather, the Bureau believes that—subject to certain floors created by the Act—it is entirely appropriate for creditors to employ a variety of standards to evaluate their customers' repayment ability.

At a minimum, the rule requires creditors to evaluate the borrower's income, savings, other assets, and debts. Creditors must generally use reasonably reliable third-party records to verify the information they use to evaluate these factors, which means creditors can no longer make "no-doc" loans. The rule also provides that monthly payments must generally be calculated by assuming the loan is repaid in substantially equal monthly payments during the loan term. For adjustable-rate mortgages, the monthly payment must be calculated using the higher of the fully indexed rate or an introductory rate. This means that creditors can no longer qualify borrowers based only on low introductory "teaser" rates.

The final rule also provides special rules to encourage creditors to refinance "non-standard mortgages"—which include various types of mortgages which can lead to payment shock that can result in default—into "standard mortgages" with fixed rates for at least five years that reduce consumers' monthly payments.

By rooting out reckless and unsustainable lending without dictating specific underwriting models, we believe the rule protects consumers and strengthens the housing market while preserving flexibility for creditors.

Qualified Mortgages

The final rule also implements the statutory provision creating a category of loans called "qualified mortgages" that are entitled to a presumption that the creditor making the loan satisfied the ability-to-repay requirements because they are subject to additional safeguards.

The Act did not specify whether the presumption of compliance for qualified mortgages is conclusive (*i.e.*, creates a safe harbor) or whether it can be rebutted by the consumer. The final rule provides a safe harbor for loans that satisfy the definition of a qualified mortgage and are not "higher-priced" (which is similar to the pricing threshold defined by the Board's 2008 rule). The final rule provides a rebuttable presumption for higher-priced qualified mortgages, but defines with particularity the grounds for rebutting that presumption, to provide additional certainty to creditors and consumers. The line the Bureau is drawing is one that has long been recognized as a rule of thumb to separate prime loans from subprime loans and we believe it strikes the appropriate balance between providing certainty to creditors making qualified mortgages and extending important protections to consumers in riskier loans.

Although Congress defined some of the criteria for these qualified mortgages, it also recognized that it may be necessary for the Bureau to prescribe further specifics. As such, the final rule implements the statutory criteria, which generally prohibit loans with negative amortization, interest-only payments, balloon payments, or terms exceeding 30 years from being qualified mortgages. "No-doc" loans also cannot be qualified mortgages. Qualified mortgages also cannot have upfront costs in points and fees above the level specified by Congress.

The rule also establishes general underwriting criteria for qualified mortgages. For example, the rule requires that the loans be underwritten based on the highest monthly payment that will apply in the first five years of the loan. Most importantly, the rule provides that the consumer's total monthly debts—including the mortgage payment and related housing expenses such as taxes and insurance—cannot add up to more than 43 percent of the consumer's monthly gross income. The appendix to the rule details the calculation of debt-to-income for these purposes. The Bureau believes that these criteria will protect consumers by ensuring that creditors use a set of underwriting requirements that generally safeguard affordability. At the same time, these criteria provide bright lines for creditors who want to make qualified mortgages.

In defining the boundaries of qualified mortgages, the Bureau did not intend to stigmatize loans that fall outside those boundaries or to signal that responsible lending can or should take place only within the qualified mortgage space. Quite the contrary, the final rule makes clear that the Bureau expects over time to see markets develop for non-qualified mortgages. At the same time, we recognize that, in light of the current state of the mortgage market, creditors and investors remain concerned about managing risks and may initially be reluctant to make loans that are not qualified mortgages, even if such loans were responsibly underwritten.

The final rule therefore provides for a second, temporary category of qualified mortgages that have more flexible underwriting requirements so long as they satisfy the general product feature requirements for a qualified mortgage (no negative amortization, interest-only, or balloon payments and meet the loan term restriction and points and fees cap) and also satisfy the underwriting requirements of Fannie Mae or Freddie Mac (the government sponsored entities, or GSEs) or certain federal agencies. This temporary provision will phase out over time as the various federal agencies issue their own qualified mortgage rules and, at the latest, after seven years. The temporary provision for GSE loans also will expire if GSE conservatorship ends. The Bureau will continue to observe the health of the mortgage market going forward to ensure the availability of responsible credit outside the qualified mortgage space.

Small Creditors

The Bureau recognizes that, with few exceptions, community banks and credit unions did not engage in the type of risky lending that led to the mortgage crisis. At the same time, the Bureau knows these institutions may be more likely to retreat from the mortgage market if the regulations implementing the Dodd-Frank Act are too burdensome, which could restrict access to credit for some borrowers. For this reason, the Bureau tailored the final rule to encourage small creditors to continue providing certain credit products, while carefully balancing consumer protections.

For example, the final rule implements a special provision in the Dodd-Frank Act that would treat certain balloon-payment loans as qualified mortgages if they are originated and held in portfolio by small creditors operating predominantly in rural or underserved areas. This provision is designed to assure credit availability in rural areas, where some creditors may only offer balloon-payment mortgages. Loans are only eligible if they have a term of at least five years, a fixed interest rate, and meet certain basic underwriting standards; debt-to-income ratios must be considered but are not subject to the 43 percent general requirement. The Bureau significantly expanded the definition of rural and made other adjustments to the original proposed rules to make it easier for small creditors to continue making responsible balloon loans going forward.

In addition, at the same time it issued the final rule, the Bureau proposed amendments to the rule to accommodate mortgage lending by smaller institutions—particularly for portfolio loans made by small creditors—including those operating outside of what are designated as rural or underserved areas. The proposal generally would treat these loans as qualified mortgages even if the loans exceed the 43 percent debt-to-income ratio, as long as the creditor considered debt-to-income or residual income before making the loan, and as long as the loans meet the product feature and other requirements for qualified mortgages. This proposed provision would cover institutions that hold less than $2 billion in assets and, with affiliates, extend 500 or fewer first lien mortgages per year. The Bureau estimates that approximately 9,200 small institutions, such as community banks and credit unions, would likely be affected by the proposed definition. The Bureau expects to issue a final rule on this aspect of the proposal shortly.

The Bureau has also made an agency-wide commitment to provide implementation support, in part because we realize that such efforts are particularly important to small creditors that do not have large legal and compliance teams. We recognize that a smooth, efficient process will ultimately benefit consumers and the market as a whole. For example, at the same time we issued the final rule, we published a plain-English summary of the rule on our website. We have also published a compliance guide designed particularly for smaller institutions who will need to update their policies and procedures and provide training for staff on the ability-to-repay rule. We are also publishing clarifications to the rule as needed to respond to questions and inquiries from various stakeholders in an effort to ease implementation burdens. We are coordinating with other agencies to develop examination procedures and are developing videos, checklists, and other tools that may be useful to creditors as they prepare for the implementation date.

Policy Considerations

As outlined above, several policy considerations helped to shape development of the ability-to-repay rule, and in particular the definition of qualified mortgage. That definition was the most complex part of the rulemaking, in part because the creation of a general ability-to-repay requirement that carries potential liability for both creditors and assignees has caused some anxiety in the market. Although we found no evidence that the existing ability-to-repay requirement under the 2008 Federal Reserve Board rule has caused a significant increase in litigation, we recognized that concerns about the liability regime in the Dodd-Frank Act might cause creditors to tend to constrain their lending, particularly in the first few years after the rule takes effect.

The first consideration was to protect consumers by ensuring that certain practices such as "no-doc" loans and underwriting based solely on initial "teaser" rates would not return in future credit cycles. The general ability-to-repay requirements are designed as common sense measures to ensure that creditors use reliable information in their underwriting process and calculate monthly payments appropriately, while leaving flexibility as to how various factors are considered in the underwriting process. We also considered consumer protections carefully in the context of qualified mortgages, where the statute left flexibility for the Bureau to determine appropriate documentation and underwriting requirements. We believed it was important to ensure that creditors consider consumers' individual financial situations with regard to debts, income, and assets before extending qualified mortgages, too.

The second consideration was how to ensure access to responsible credit in all parts of the market, particularly given anxiety levels regarding litigation risk. Several features of the rule are designed to address this concern, including calibrating the strength of the presumption of compliance with the ability-to-repay requirements based on whether a qualified mortgage exceeds the threshold for "higher-priced." We believe the safe harbor will help to provide greater certainty to creditors operating in the prime market, and that the rebuttable presumption will create strong incentives for more responsible lending in the non-prime space as well. At the same time, the rebuttable presumption also preserves certain consumer remedies in the unlikely event that a qualified mortgage loan did not leave the consumer with sufficient residual income to meet monthly living expenses.

The general definition of qualified mortgage is also structured in a way to encourage responsible credit in all parts of the market over time. We do not believe that it is possible by rule to define every instance in which a mortgage is affordable, given that underwriting is a highly complex and individualized process. We were also concerned that an overly broad definition of qualified mortgage could stigmatize non-qualified mortgages or leave insufficient liquidity for such loans, which would curtail access to responsible credit for consumers.

Accordingly, we defined the general category of qualified mortgages, including the bright-line 43 percent debt-to-income ratio, in order to provide greater protection to consumers and certainty to creditors, while also allowing room for the market to grow for non-qualified mortgages. We also created the temporary definition of qualified mortgage based on eligibility for purchase or guarantee by the GSEs and several federal agencies, primarily to make it easier for creditworthy consumers with debt-to-income ratios above 43 percent to access credit over the next several years while the industry adjusts to the new rulemaking requirements. Our changes to the balloon-payment qualified mortgage provisions and several elements of the concurrent proposal that we issued in January, particularly the proposal to extend qualified mortgage status to certain portfolio loans by small creditors, are also designed to address access to credit concerns.

The third major consideration was to attempt to balance the desire for short-term certainty with the need for long-term flexibility that can benefit consumers and responsible creditors alike. Because we do not believe it is possible to define by rule every instance in which a mortgage is affordable, we sought to structure the rule in a way that allows room for a range of reasonable underwriting models used by different types of creditors in today's market. We were concerned that as the mortgage market strengthens, the rule should function to provide appropriate safeguards without becoming a straightjacket. We balanced these considerations in many places, both in leaving flexibility for reasonable underwriting practices under the ability-to-repay standard and in crafting different types of qualified mortgages that use different sets of safeguards to ensure that affordability is being appropriately considered.

Conclusion

In carrying out our statutory requirement to issue the Ability-to-Repay/Qualified Mortgage rule, we have worked hard to strike the appropriate balance between ensuring more responsible lending, providing certainty to the mortgage market, enhancing access to responsible credit, and preserving flexibility for the mortgage market to evolve and innovate over time. We have been encouraged by the largely positive feedback to the rule. While we are proud of the work that we have done, we understand that much work remains for the market to adjust to our rule, other regulatory initiatives, and changes in economic conditions. For that reason, we are committed to continuing to observe the health of the mortgage market to ensure that our rules are working to help speed the recovery from the financial crisis while preserving access to credit.

Thank you for asking us to testify today. We would be happy to answer your questions.

AMERICAN
LAND TITLE
ASSOCIATION

May 21, 2013

The Honorable Shelley Moore Capito
Chairman
Subcommittee on Financial Institutions
and Consumer Credit
House Financial Services Committee
U.S. House of Representatives
Washington, DC 20515

The Honorable Gregory W. Meeks
Ranking Member
Subcommittee on Financial Institutions
and Consumer Credit
House Financial Services Committee
U.S. House of Representatives
Washington, DC 20515

RE: Statement for the Record

Dear Chairman Capito and Ranking Member Meeks:

On behalf of the American Land Title Association (ALTA)[1] thank you for holding this important hearing entitled "Qualified Mortgages: Examining the Impact of the Ability to Repay Rule." The importance of getting the ability to repay/Qualified Mortgage (QM) rule right cannot be understated for the future health and success of our mortgage market. This hearing should give the subcommittee important information to measure the success of the Consumer Financial Protections Bureau's final rule and help the subcommittee determine whether amendments to the relevant sections of the Dodd-Frank Wall Street Reform and Consumer Protection Act are necessary.

ALTA is eager to serve as a resource on issues related to title insurance and real estate closings. As the subcommittee considers proposals to amend the QM provisions of Dodd-Frank, including the Consumer Mortgage Choice Act (H.R. 1077), and other proposals impacting title insurance, we thought it would be helpful to provide the subcommittee with an overview of title insurance including how title insurance and real estate closings are regulated by state and federal laws.

What is Title Insurance?

Title insurance plays a fundamental and essential role in facilitating ownership and investment in real estate in the United States. Real estate is the largest asset class in the United States. For most Americans their home is their single largest investment. Title insurance protects the American dream of homeownership.

Title insurance is an indemnity against financial loss from defects in title to real property and from the invalidity, unenforceability or lack of priority of mortgage liens. Title insurance is a fundamental consumer protection that shields consumers from the risk that they don't own their property.

In any real estate transaction, the buyer wants to be certain that he or she will ultimately be acquiring ownership (or title) of the property subject only to those liens and encumbrances they know about and are willing to accept. The seller wants to be certain that he or she will not be contractually liable to the buyer if the title conveyed is subject to any claims of title. The mortgage lender wants to be certain

[1] The American Land Title Association, founded in 1907, is a national trade association and voice of the real estate settlement services, abstract and title insurance industry. ALTA represents more than 4,300 member companies. ALTA members operate in every county in the United States to search, review and insure land titles to protect home buyers and mortgage lenders who invest in real estate. ALTA members include title insurance companies, title agents, independent abstracters, title searchers and attorneys, ranging from small, one-county operations to large national title insurers.

that the buyer, whose purchase is being financed, will have title to the property and that the mortgage lender will obtain a valid and enforceable mortgage lien that is not subject to any other lien or claim that could adversely affect the priority of their mortgage interest. In the United States., all of this is done through title insurance.

In general, there are two main types of title insurance policies, both of which are typically issued after the closing of a real estate or mortgage refinance transaction: an owner's policy and a loan policy. The owner's policy insures the buyer's ownership interest in the real property while the loan policy protects the lender's interest. In virtually all areas of the country, if an owner's policy is issued in the transaction, the cost of a loan policy that is "simultaneously issued" with the owner's policy involves a relatively small additional charge to the cost of the owner's policy.

Both types of policies protect against defects that may be found in public records but were not discovered during the search of those records or their significance was not appreciated, and also against those non-record defects that even the most comprehensive search of the records would not reveal. These risks include, among others:

- fraud or forgery in the execution of documents in the chain of title (in deeds, mortgages, mortgage satisfaction pieces, etc);
- mistakes in interpretation of wills, divorce decrees, bankruptcy court directives and other legal documents;
- the execution of documents by minors or incompetent persons who could not legally convey property interests;
- the existence of undisclosed heirs who did not consent to a prior transfer;
- deeds executed under an expired power of attorney or on behalf of someone who has died; and
- mistakes in the recording or indexing of documents in the public records.

A key feature of both policies is the duty to defend. Under the policy, the title insurer is obligated to pay for the costs of defending the title as insured against any covered claim. In addition, the title insurer also has the right to cure any claim that is presented.

How Does Title Insurance Work?

Title insurance is fundamentally different from other types of insurance, such as homeowners or life insurance. Understanding these differences can help correct some of the misconceptions about the product.

Indemnification against past events instead of future events

Homeowners, auto, life, health and professional lines of insurance indemnify the policyholder against events that occur after the policy has been issued – such as a fire, an accident, a death, a trip to the doctor or a professional liability claim. Title insurance protects against existing title defects that arose before the policy is issued. While the claim may not be asserted until after the policy is issued, it has to be based on legal rights established before the policy was issued.

One-time cost vs. yearly renewals

Most other forms of insurance provide protection for a limited period of time on a prospective basis, and the policy must be periodically renewed. With other forms of insurance, if the policy is not renewed and the premiums are not continued to be paid, the policy lapses. Title insurance is issued for a one-time premium. There are no renewals. The owner's policy protection extends for as long as the owner or their heirs own the property or has liability in connection with the property. The insured lender's protection extends as long as there is a balance due on the loan secured by the mortgage.

Underwriting

Unlike property and casualty companies which underwrite their policies based actuarial data, the underwriting of title insurance operates almost entirely on the basis of identifying, evaluating, and addressing title problems before the policy is issued.[2] This demonstrates two methods of insuring title. On the one hand, an insurer could use revenue from a one-time premium primarily to identify and, if possible, eliminate title risks prior to the issuance of the policy and therefore reduce the likelihood of having to pay claims. Alternatively, an insurer could perform little or no search, examination and correction and use the revenue from a one-time premium primarily to pay claims that will inevitably arise. Consumers and lenders benefit when a risk is identified and eliminated to provide a certain, secure, and peaceful use of the property they acquire.

This curative action includes obtaining releases or pay-offs for discovered liens (e.g., prior mortgage liens, child and spousal support liens, judgment liens, tax liens, homeowner's association debts, mechanic liens); obtaining releases for deeds and mortgages; and correcting typographical recording and indexing errors that could create problems (misspelled names, incorrect legal descriptions).

On the basis of the title examination, a commitment to insure is then sent to the prospective policyholder. It sets forth the conditions that must be met for a title insurance policy to be issued such as documents to be produced (e.g., the execution of a deed, the execution of a new mortgage in favor of the buyer's lender), items to be removed (payoff of mortgages, judgments, liens, taxes, municipal bills), and exceptions to be taken from policy coverage found during the title search and examination process.

Losses and expenses

Title insurance losses are considerably lower than other forms of insurance and title insurance operating expenses are considerably higher than other forms of insurance. When title insurance losses are combined with operating expenses, the overall profitability of title insurance and property & casualty insurance is similar. In title insurance, operating expenses include the cost of the title search, examination and curative work performed before a policy is issued to prevent potential claims.

Unlike other lines of insurance, it is possible (and from the consumer and lender's standpoint desirable) for the title company to discover and correct all potential claims before issuing the policy. By spending a high proportion of their revenue on the title search, examination, and curative functions, which result in fewer losses and claims, title insurance helps promotes certainty in the ownership of real estate. This makes title insurance unique. Low claims are good for consumers.

How is Title Insurance Regulated

Title insurance is primarily regulated by state insurance law. However, federal law and state real property statutes and customs also govern the industry. Since real property and mortgage laws are different from state to state, title insurance practices also differ from one state to the next.

State departments of insurance regulate both title insurance practices and rates. Virtually all states regulate title insurance rates by making sure that rates they are not excessive, inadequate or unfairly discriminatory. In addition, most states require that rates be filed with or set by the state insurance department.

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[2] Just as no homeowner's insurance company would insure a house if it knew at the time that a fire was raging in the basement, a title insurer will not insure against a significant lien or claim it knows to exist and to be enforceable against the property. Having informed the prospective insured in its preliminary commitment that the matter will be excepted from policy coverage, it is up to the prospective insured to decide whether to accept that defect as a limitation on the title, to negotiate with the seller for its removal, or to decline to go ahead with the transaction if the defect is serious enough (e.g., it could affect the marketability of the property).

State regulators coordinate together through the National Association of Insurance Commissioners (NAIC) Title Insurance Task Force. The NAIC explains the purpose and structure of insurance regulation to include: company licensing, producer licensing, product regulation, financial regulation, market regulation and consumer services.

With the long loss nature of the policy coverage, there are an array of solvency requirements imposed on title insurers including heightened capitalization and reserve requirements. Title insurance is one of the few lines of insurance that is required to be monoline. With a monoline statute, a licensed title insurer is not permitted to offer any other line of insurance. Monoline restrictions prevent insurance companies from mixing title insurance risks with other kinds of insurance risks. These restrictions were imposed for the benefit of policyholders to ensure the solvency of title insurers whose policies remain in effect for indefinite periods of time. This structure served as an effective backstop during the housing crisis. Finally, it is important to note that rates and solvency are interrelated. When rates are increased, the risk of insolvency decreases. When rates are decreased, the risk of insolvency increases.

Title insurance and real estate closings are also governed by the Real Estate Settlement Procedures Act (RESPA), which is a federal consumer financial law regulated by the Consumer Financial Protection Bureau (CFPB) under the Dodd-Frank Act. RESPA requires that consumers receive disclosures at various times in a real estate or mortgage refinance transaction and outlaws kickbacks that increase the cost of settlement services.

ALTA looks forward to continuing to serve as a resource to Financial Services Committee members, staff and any other interested party regarding title insurance and real estate closings. We welcome the opportunity to inform public policy, respond to questions and correct misconceptions about title insurance. If you have any questions about this statement or would like further information, please contact Justin Ailes, Vice President of Government and Regulatory Affairs at (202) 261-2937 or justin@alta.org.

Sincerely,

Michelle L. Korsmo
Chief Executive Officer

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May 21, 2013

The Honorable Shelley Moore Capito
Chairman
Subcommittee on Financial Institutions and Consumer Credit
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Capito:

On behalf of the Credit Union National Association (CUNA), thank you for holding a hearing entitled: "Qualified Mortgages: Examining the Impact of the Ability to Repay Rule." CUNA is the largest credit union advocacy organization in the United States, representing nearly 90% of America's 7,000 state and federally chartered credit unions and their 96 million members.

Earlier this year, the Consumer Financial Protection Bureau (CFPB) issued a final "Ability to Repay" rule to implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act regarding a borrower's ability to repay a residential mortgage loan and establishing requirements for "qualified mortgage" under the Truth in Lending Act, Regulation Z.

Under the rule, creditors generally must consider eight underwriting factors for a residential mortgage loan to assess the borrower's ability to repay the loan: current or reasonably expected income or assets; current employment status; the monthly payment on the covered transaction; the monthly payment on any simultaneous loan; the monthly payment for mortgage-related obligations; current debt obligations, alimony and child support; the monthly debt-to-income ratio or residual income; and, credit history. Creditors must generally use reliable third-party records to verify the information they use to evaluate the factors. These are factors that credit unions generally consider in granting loans.

It is important to note that credit unions also make every effort to tailor a loan product that meets our member's needs, and do so in a way that minimizes risk and default. While the CFPB has made several changes to the rule in response to our concerns, we continue to have several issues with the rule. These are concerns that we have already raised with the CFPB.

First, for a loan to be considered a "qualified mortgage" the consumer's total monthly debt to total monthly income at the time the loan is made cannot be higher than 43%.

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We believe this ratio should be expanded. Credit unions often write mortgage loans for members that have a 45% debt-to-income ratio and may even go as high as a 50% debt-to-income ratio under certain limited circumstances. Even so, our mortgage losses remain very low.

Second, for a mortgage to be considered a "qualified mortgage" total points and fees generally may not exceed 3% on a loan of $100,000 or greater. While these amounts are indexed for inflation, these limitations may be problematic for some credit unions. As the loan amount decreases, certain fees cannot decrease alongside of it – some fees are fixed and are not dependent upon the size of the loan. Therefore, the smaller the loan amount, the easier it is for fees to constitute a higher percentage of the total loan. This is especially true as the fees are currently defined as including loan originator compensation, and affiliate and non-affiliate fees.

Finally, credit unions should be allowed to continue writing non-qualified mortgage loans where necessary and appropriate for their members, without retribution from examiners In order that creditworthy borrowers with debt-to-income ratios somewhat above 43% can still have access to mortgage credit. CFPB Director Richard Cordray has recently indicated that he agrees with this position.

However, CUNA understands that there may be little interest on the investment side for non-qualified mortgage loans. Also, examiners may be critical of credit unions and assess their CAMEL ratings accordingly if credit unions do not make mortgages that meet the Qualified Mortgage standards. We believe credit unions should retain the flexibility they currently have to either hold a loan in portfolio or sell it on the second mortgage market based on the needs of the credit union to manage its assets and obligations.

On behalf of America's 7,000 credit unions and their 96 million members, thank you again for holding today's hearing.

Best regards,

Bill Cheney
President & CEO

ICBA
INDEPENDENT COMMUNITY
BANKERS of AMERICA®

May 21, 2013

Qualified Mortgage Rule Will Jeopardize Access to Credit

On behalf of the 7,000 community banks represented by the Independent Community Bankers of America (ICBA), thank you for convening today's hearing titled: "Qualified Mortgages: Examining the Impact of the Ability to Repay Rule." We appreciate this opportunity to submit this statement for the record. Reform of the qualified mortgage/ability-to-repay ("QM") rule is a key plank of ICBA's Plan for Prosperity: A Regulatory Relief Agenda to Empower Local Communities.

Balloon Mortgages Play Essential Role in Rural Communities

Community banks are responsible mortgage lenders that did not participate in the abuses that contributed to the financial crisis. Community banks help borrowers in rural communities where non-traditional loans such as balloon mortgages are prevalent due to the unique nature of rural properties. These loans are not eligible to be sold into the secondary market and are kept in portfolio, which gives community banks a vested interest in the quality of these loans and allows them to work out a solution directly with the borrower if repayment problems arise. In addition, these loans often meet the regulatory definition of "higher priced mortgage loans." Because the loans cannot be securitized they must be funded through retail deposits which include higher cost certificates of deposits, and this results in a higher interest rate. The regulatory definition is heavily weighted toward the pricing that Fannie Mae and Freddie Mac set based on their ability to access capital and funding markets that are not available to community banks. In addition, in today's historically-low interest rate environment, it is more likely that a reasonably-priced loan will meet the Federal Reserve's definition of "higher priced."

QM Rule Does Not Adequately Protect Community Bank Balloon Mortgages

While the CFPB's QM rule allows balloon loans made by small creditors that operate predominantly in rural or underserved areas to be qualified mortgages, the Bureau's definition of "rural" is too narrow and assumes an entire county is either rural or non-rural, which is inherently inaccurate. As a result, too many communities are denied rural status and unnecessarily cut off from access to credit. When a balloon loan does not receive QM safe harbor protection, the lender is exposed to undue litigation risk. Many community banks are not willing to assume that risk and will exit the mortgage lending business.

Community Bank Qualified Mortgage Survey

Because of the significance of the QM rule to community bank mortgage lending, ICBA recently conducted the Community Bank Qualified Mortgage Survey to gather data on the impact of the CFPB's new rule. The survey, which is attached to this statement in full, found that provisions for balloon-payment mortgage loans and rural community banks in the new rule need to go

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further to adequately protect the customers of many Main Street community bank lenders. In particular:

- Among the 75 percent of respondent community banks that currently make balloon-payment mortgage loans, less than half (46 percent) would qualify for the rule's provision for balloon mortgages.
- For respondent community banks that consider themselves to be rural banks, 44 percent do not qualify as "rural" under the rule's definition.
- Among the community banks that do not qualify for the balloon exception, most are disqualified primarily on the basis of the definition of "rural" (43 percent).
- Respondent community banks hold an average of 64 percent of originated residential mortgage loans in their portfolio for the life of the loan. The majority of respondent banks (52 percent) hold at least 80 percent or more of the loans originated for the life of the loan.
- Most respondents (64 percent) indicate they make higher-priced mortgage loans and provide escrow accounts for them (as required by federal regulation).

Attached to this statement is a state-by-state map of rural county designations. Members of this committee may be surprised at the rural county designations within their own states and concerned that many areas of the state are not covered.

ICBA is encouraging the Bureau to expand the definition of rural to include all counties outside metropolitan statistical areas and all towns with fewer than 50,000 residents. ICBA is also encouraging the Bureau to extend the safe harbor conclusive presumption of compliance for community bank mortgage loans held in portfolio with annual percentage rates up to the higher of the average prime offer rate plus 3.5 percent or the community bank cost of funds plus 4 percent, subject to the Home Ownership and Equity Protection Act threshold.

A Clean Fix is Needed

However, ICBA is pressing for a clean solution, rather than complex and unbalanced rural designations requiring tortuous analysis by the CFPB. Our preferred solution relies on the natural incentive of lenders to ensure that loans held in portfolio are affordable to the borrower and to work with the borrower should they encounter difficulty in repayment.

ICBA's Plan for Prosperity solution to this new regulatory threat is simple, straightforward, and will preserve the community bank lending model – safe harbor "qualified mortgage" status for community bank loans held in portfolio, including balloon loans in rural and non-rural areas and without regard to their pricing. When a community bank holds a loan in portfolio it holds 100 percent of the credit risk and has every incentive to ensure it understands the borrower's financial condition and to work with the borrower to structure the loan properly and make sure it is affordable. Withholding safe harbor status for loans held in portfolio, and exposing the lender to litigation risk, will not make the loans safer, nor will it make underwriting more conservative, it will merely deter community banks from making such loans in the many counties that do not meet the definition of rural and where a bank's cost of funds results in "higher priced mortgages."

The CLEAR Relief Act

ICBA thanks Representative Blaine Luetkemeyer, a former community banker, for including a provision in the CLEAR Relief Act (H.R. 1750) that would accord qualified mortgage status to mortgages originated and held in portfolio for at least three years by a lender with less than $10 billion in assets. ICBA strongly supports the CLEAR Relief Act because it contains this provision in addition to other key mortgage and non-mortgage provisions of the Plan for Prosperity, and we encourage this committee to consider it.

Thank you again for the opportunity to submit this statement for the record. ICBA looks forward to working with this committee to reform the QM rule to properly recognize the importance to our rural economies and housing market of balloon loans originated by community banks and held in portfolio.

Attachments

- **Community Bank Qualified Mortgage Survey**
- **State-By-State Rural County Designation Maps** (blue counties are rural; yellow are non-rural)

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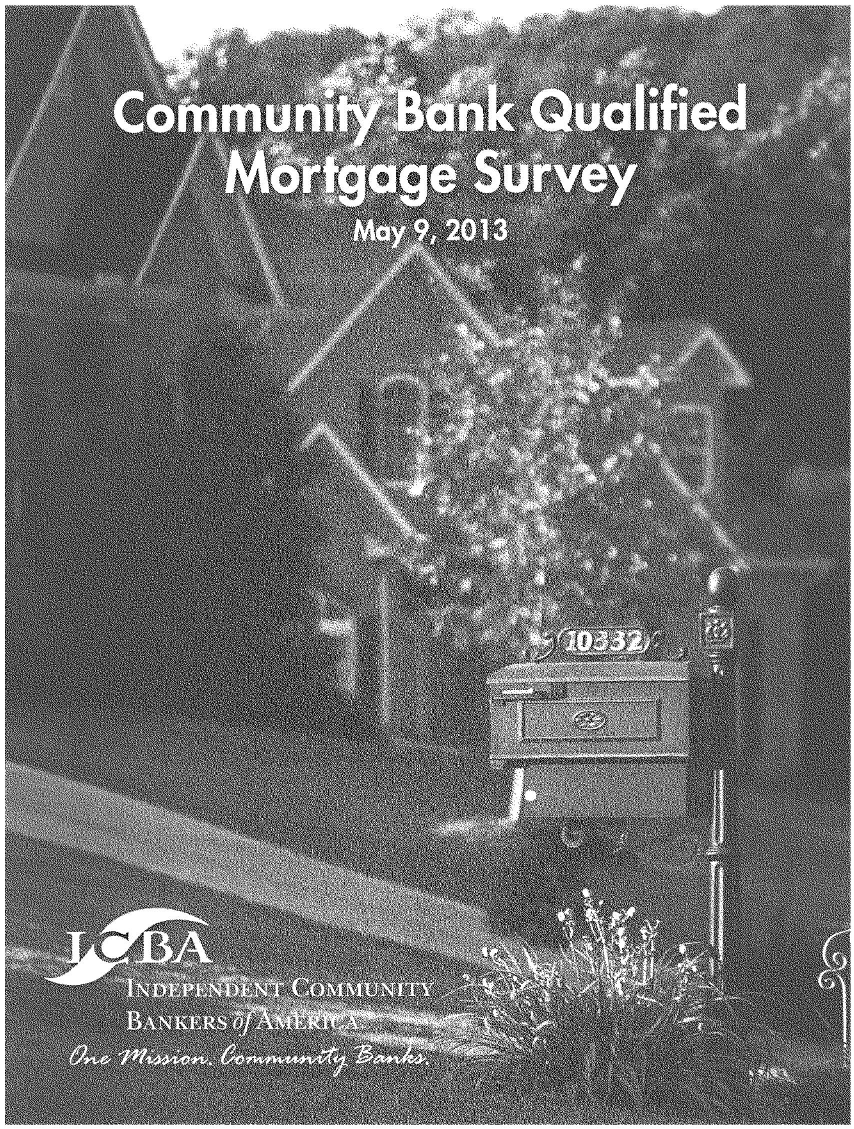
Community Bank Qualified
Mortgage Survey
May 9, 2013
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Community Bank Qualified Mortgage Survey: Summary of Findings

ICBA conducted a survey to gather data on the impact of the accommodations for community banks in the CFPB's Qualified Mortgage/Ability to Repay rule. ICBA requested information on community banks' residential first-lien mortgage lending activities for 2012.

ICBA distributed the survey to its membership between February 7 and February 14, 2013 and requested that the survey be directed to the member of bank staff best prepared to answer questions on the topic. ICBA received 380 responses, a response rate of approximately 8%.

For the purposes of our analysis, respondent community banks were selected for peer groups based on their responses to questions on their asset size and the geographic areas served.

Key Findings

- **Among the 75% of respondent community banks that currently make balloon mortgages, less than half (46%) would qualify for the balloon mortgage exception to the Qualified Mortgage/Ability to Repay rule.**

- **For respondent community banks that consider themselves to be rural banks, 44% do not qualify as "rural" under the rule's definition.**

- **Among the community banks that do not qualify for the balloon exception, most are disqualified primarily on the basis of the definition of "rural" (43% overall) or limited by a combination of the 500 loan annual originations cap and the definition of "rural" (9% overall).**

- **Among respondent community banks, an overall average of 64% of originated residential mortgage loans are held in the bank's portfolio for the life of the loan. The majority of respondent banks (52%) hold at least 80% or more of the loans originated for the life of the loan.**

- **Only 33% of the respondents originate and hold ARMs in portfolio. Smaller community banks are less likely than average to originate and hold ARMs in portfolio.**

- **Most respondents (64%) indicate they make higher-priced mortgage loans and provide escrow accounts for them (as required by federal regulation).**

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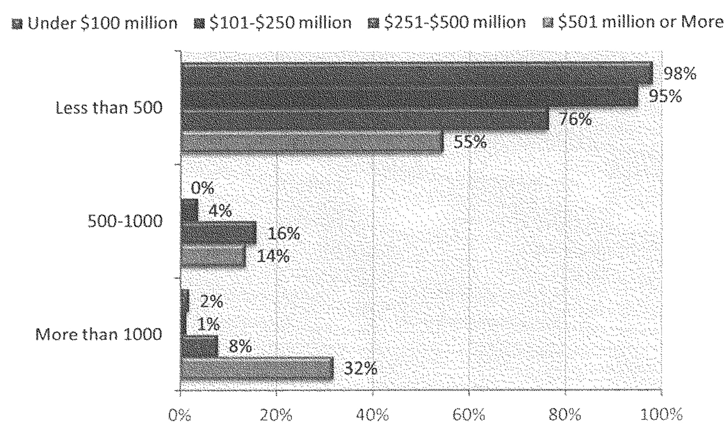
Mortgage Originations

Most of the responding banks (90%) originated fewer than 500 mortgage loans in 2012. Almost all responding banks with less than $100 million in assets did so (98%). Most banks with $101-$250 million in assets originated fewer than 500 mortgages (95%).

While the balloon exception is for banks with up to $2 billion in assets, larger community banks find it more difficult to qualify for the exception based on the number of mortgages originated. Nearly one-fourth (24%) of respondent banks with $251-500 million in assets will be unable to use the balloon exception because they originate more than 500 mortgages. Only 55% of banks with more than $500 million in assets originate fewer than 500 loans, so 45% of banks in this category will be unable to qualify for the balloon exception based on the number of originations (Figure 1).

Figure 1: How many residential first-lien mortgage loans did your bank originate during the calendar year 2012?



Loans Held in Portfolio

Among respondent community banks an overall average of 64% of residential mortgage loans are held in the bank's portfolio for the life of the loan. The majority of respondent banks (52%) hold at least 80% or more of the loans originated for the life of the loan (Figure 2).

Larger community banks hold a smaller percentage of loans in portfolio for the life of the loan. Among respondent banks with more than $250 million in assets, 46% of originated loans are held in portfolio for the life of the loan, compared to 65% for banks with $101-250 million and 72% for banks with less than $100 million in assets. Also, rural banks hold a higher percentage of originated loans in portfolio (68%) compared to suburban (53%) or urban (43%) banks (Figure 2). When we examine the data as the percentage of respondents that fall within percentage ranges, the same trends are apparent (Figure 3 & 4).

Figure 2: What percentage of the loans originated in 2012 are to be retained in the bank's portfolio for the life of the loan? - Mean

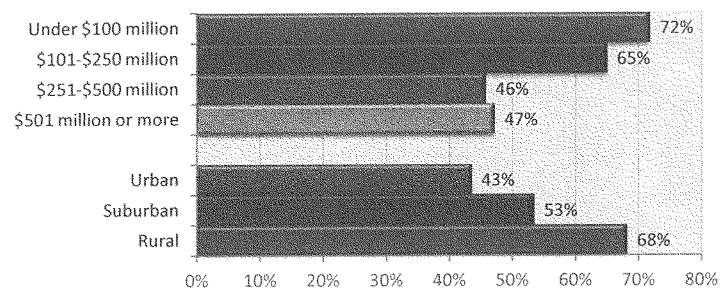


Figure 3: What percentage of the loans originated in 2012 are to be retained in the bank's portfolio for the life of the loan? – Percent within Ranges by Asset Size

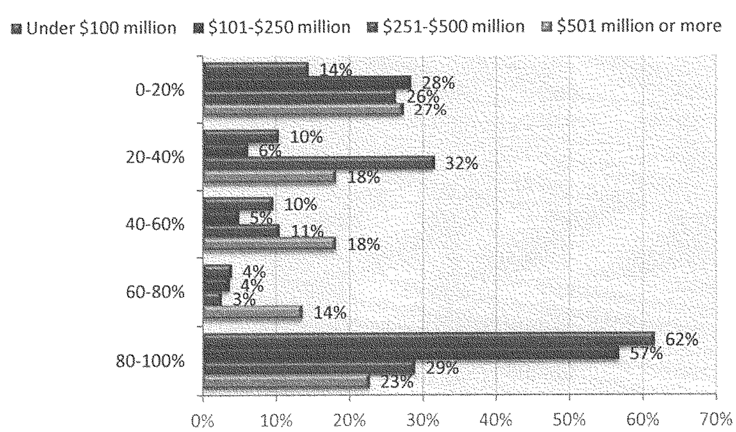


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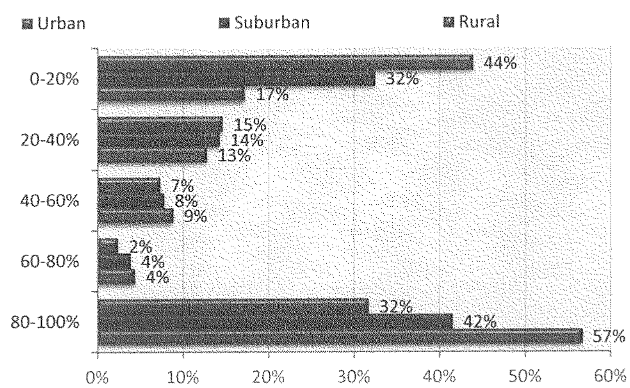
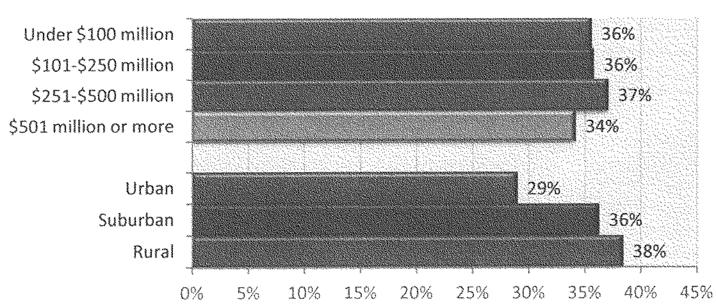
Figure 4: What percentage of the loans originated in 2012 are to be retained in the bank's portfolio for the life of the loan? – Percent within Ranges by Geography



Adjustable Rate Mortgages

Asset size makes little difference to the percentage of adjustable rate mortgages (ARMs) with all peer groups close to the overall average of 36%. However, banks that report serving urban markets made fewer ARMs as a percentage of overall loans than other banks (29%, Figure 5).

Figure 5: What percentage of your bank's residential first-lien mortgage loans held in portfolio have adjustable rates (ARMs)?



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One-third (33%) of respondent banks indicate they have no ARMs in their portfolio and institutions with less than $250 million in assets are even less likely to have ARMS in their portfolio (Figure 6 & 7).

Figure 6: What percentage of your bank's residential first-lien mortgage loans held in portfolio have adjustable rates (ARMs)? – Percent within Ranges by Asset Size

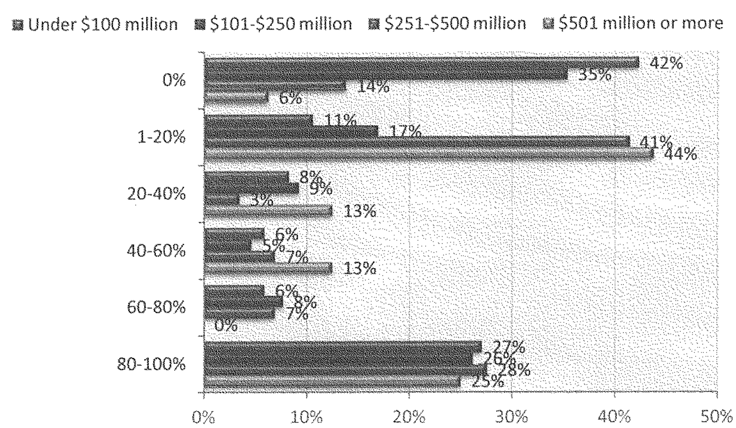
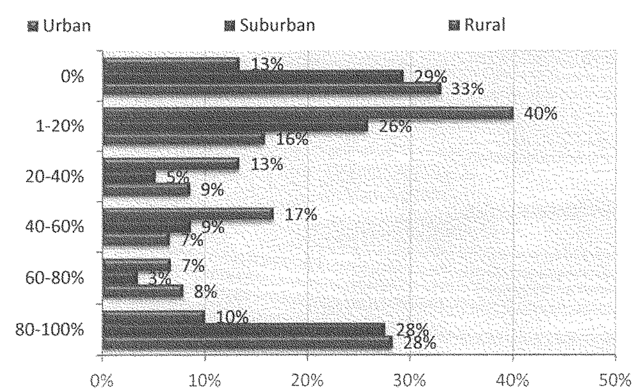


Figure 7: What percentage of your bank's residential first-lien mortgage loans held in portfolio have adjustable rates (ARMs)? – Percent within Ranges by Geography



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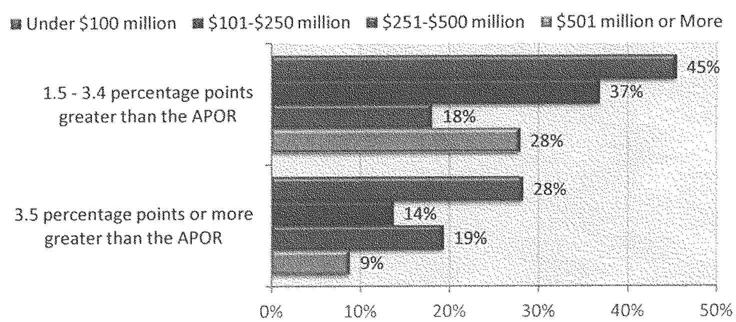
Higher-priced Loans

Bank asset size has a more substantial impact on loan pricing. For respondent banks with less than $100 million in assets, most loans (74%) have an APR that exceeds the APOR by more than 1.5 percentage points. For banks serving rural areas, 62% of loans exceed the APOR by 1.5 percentage points and 22.5% exceed the APOR by more than 3.5 percentage points (Figure 8). This reflects the higher cost of funds and operations for smaller banks and rural banks.

Figure 8: What percentage of residential first-lien mortgage loans originated by your bank have an Annual Percentage Rate (APR) that exceeds the Average Prime Offer Rate (APOR) for mortgage by the following amounts?



Most respondents (64%) indicate they make higher-priced mortgage loans and provide escrow accounts for them (as required by federal regulation, Figure 9). Fewer banks with less than $100 million in assets provide escrow accounts, with one-third (33%) indicating they do not provide higher-priced loans because they cannot or choose not to satisfy the escrow requirements.

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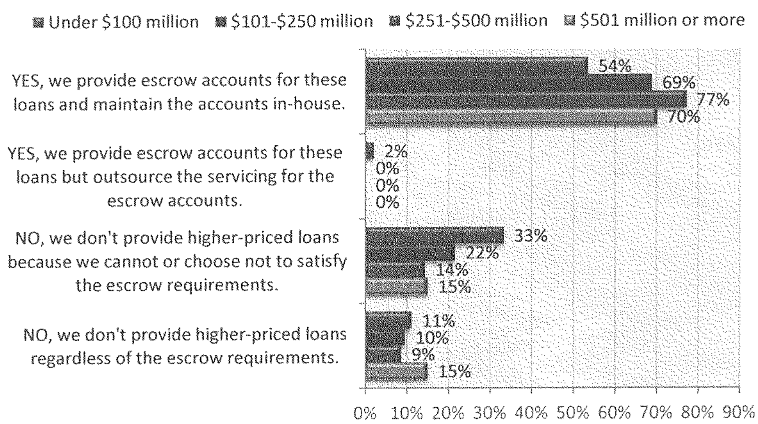
Figure 9: Does your bank currently provide escrow accounts for loans deemed to be higher-priced mortgage loans?



Most respondents (62%) have had a borrower request an escrow account, with institutions with more than $250 million in assets being more likely to have had such a request (more than 80%). The majority of respondents (55%) provided at least one escrow account at the borrower's request during 2012, but most often less than five (24%).

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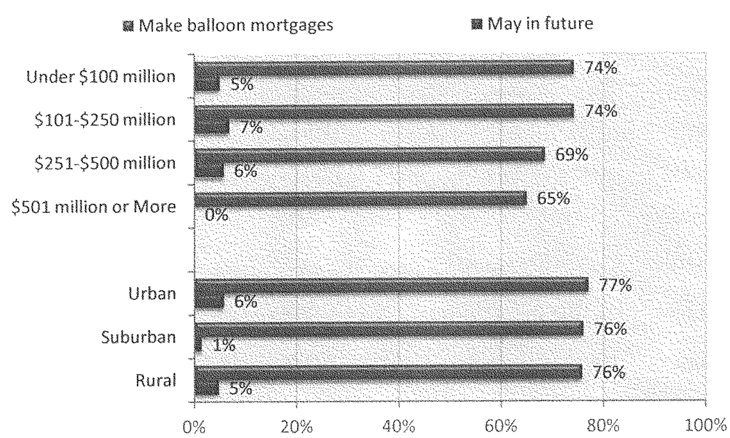
Balloon Mortgages

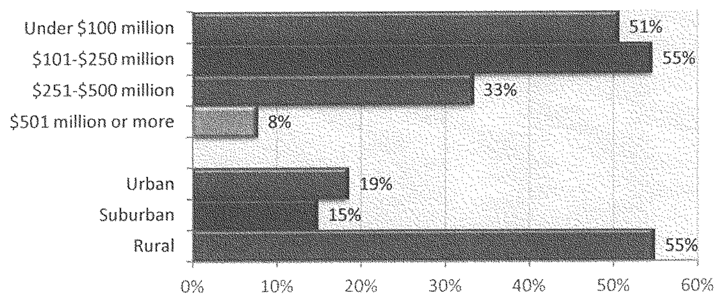
Most respondents (73%), including a majority of banks in all peer groups, currently make balloon mortgages. Many that do not currently make balloon loans may do so in the future (5%). Smaller banks are more likely to currently make balloon mortgages (Figure 10).

Figure 10: Does your bank currently offer balloon mortgages?



Among survey respondents that currently make balloon mortgages less than half (46%) of community banks would qualify for the balloon mortgage exception. Approximately half of community banks with less than $100 million in assets, between $101-$250 million in assets and indicating that they serve rural areas would qualify (Figure 11). Few larger community banks would qualify, including only one-in-three (33%) of community banks with $251-$500 million in assets and one-in-twelve (8%) community banks with more than $501 million in assets would qualify.

Figure 11: Percentage of Community Banks Qualifying for Balloon Mortgage Exception by Peer Group



Community banks that do not qualify for the exception are disqualified primarily on the basis of the definition of "rural" (43% overall) or a combination of the number of originations and the definition of rural (9% overall). Only 1% of banks are disqualified based solely on the number of originations.

Most banks with less than $250 million in assets that currently make balloon mortgages but would be unable to qualify for the exception are disqualified by the definition of rural. Larger banks with more than $250 million in assets are likely to be disqualified by both the number of originations and the definition of rural (Figure 12). Given the impact of these factors the $2 billion asset cut-off has little meaning, and few community banks with $501 million - $2 billion in assets will qualify for the balloon exception.

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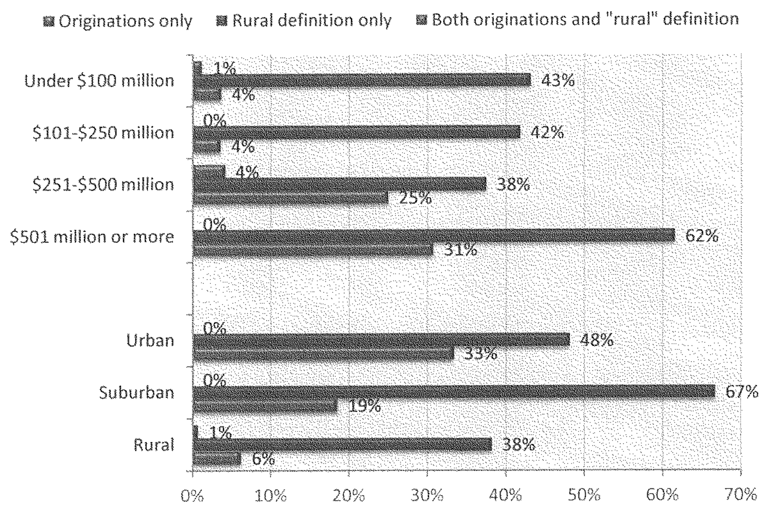
Figure 12: Percentage of Community Banks Disqualified for Balloon Mortgage Exception by Qualifying Factor



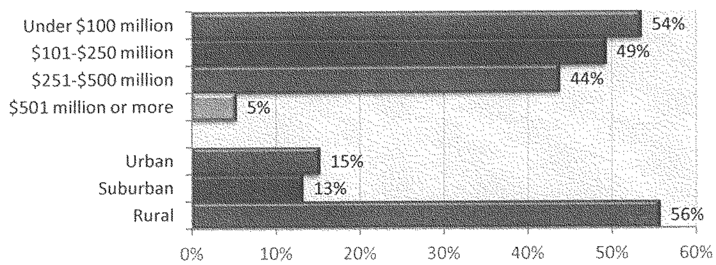
Qualifying under the Rural Definition

Most small and rural banks originate loans in only one or a handful of counties, with 92% of banks with less than $100 million in assets serving 5 or fewer counties and 98% of banks in this size category serving 10 or fewer counties. For rural banks, 72% serve 5 or fewer counties and 90.5% serve 10 or fewer counties.

Overall, fewer than half of respondent banks (47%) indicate they make more than 50% of mortgage originations in qualifying counties in neither a metropolitan statistical area (MSA) nor an adjacent micropolitan statistical area under the definition of rural in the Ability-to-Repay/Qualified Mortgage rule.

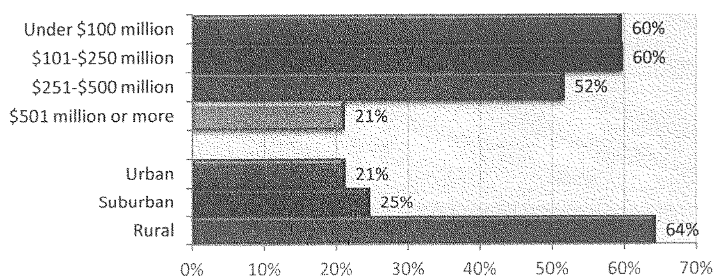
Significantly, among banks that indicate they serve rural areas, 56% make more than 50% of their mortgage loans in qualifying counties – that means 44% of respondent rural banks will not meet the standard of "rural" in the QM rule. Only 5% of respondent banks with more than $500 million in assets indicate that they will meet this requirement (Figure 13).

Figure 13: Does your bank provide over 50% of its residential first-lien mortgage loans in counties that are neither in a metropolitan statistical area (MSA) nor in a micropolitan statistical area adjacent to an MSA? - Yes Responses



If the definition of rural were expanded to include all counties outside MSAs, more banks would qualify as rural, including 21% of banks with more than $500 million in assets. However, banks serving urban and suburban markets in addition to rural markets will continue to find it difficult to qualify for the exemption.[1] And 36% of banks that characterize themselves as rural still would not meet the QM definition of rural (Figure 14).

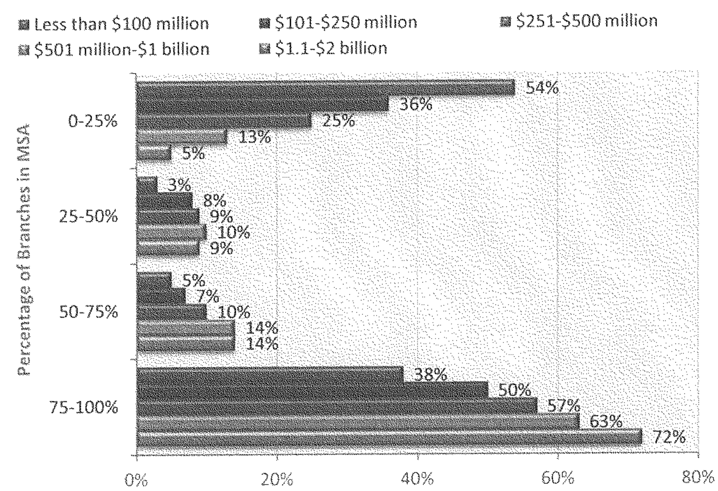
Figure 14: Does your bank provide over 50% of its residential first-lien mortgage loans in counties that are outside an MSA (even if some are in micropolitan counties)? - Yes Responses



[1] Among banks serving rural areas, 11% indicate they also serve urban areas and 19% indicate they also serve suburban areas. This degree of overlap is slightly higher than previous ICBA surveys, including the 2012 ICBA Community Bank Overdraft Study (7% and 18% respectively) and the 2011 Community Bank Payments Survey (9% and 18%, respectively).

The majority of banks of all asset size groups except those with less than $100 million in assets have most of the branches located inside an MSA (Figure 15).

Figure 15: Percentage of Branches Located in MSA from FDIC Summary of Deposits 2011



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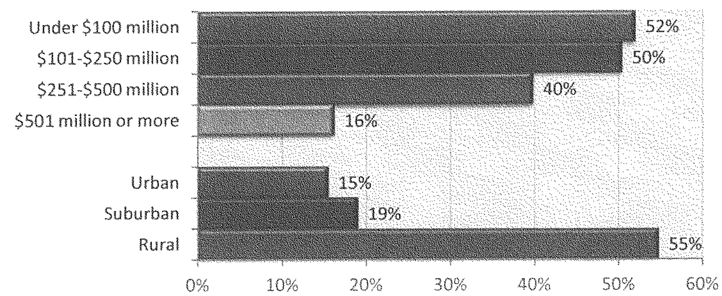
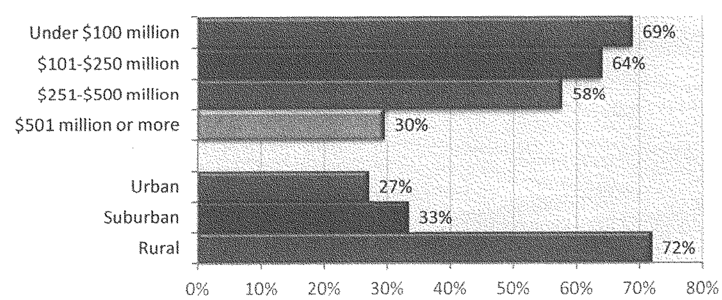
Detailed Data on Mortgage Lending in Rural Areas
Banks with under $100 million and $101-250 million in assets originate an average of half of their mortgage loans in qualifying counties that are in neither an MSA nor an adjacent Micropolitan Statistical Area (52% and 50% respectively, Figure 16).

Figure 16: What percentage of the residential first-lien mortgage loans originated in 2012 were located in counties meeting the following description? Neither in MSA nor in Adjacent Micropolitan - Mean



Banks with less than $500 million in assets originate an average of more than 50% of their mortgage loans outside of MSAs (Figure 17).

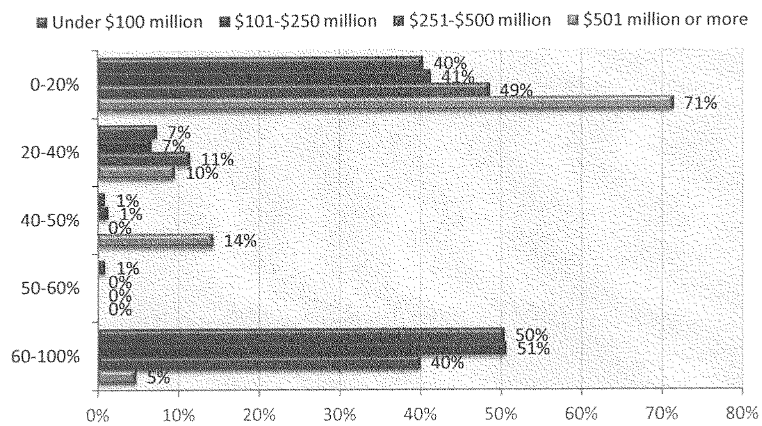
Figure 17: What percentage of the residential first-lien mortgage loans originated in 2012 were located in counties meeting the following description? Not in MSA - Mean



However, 47% of banks with less than $100 million in assets and 48% of those with $101-250 million in assets originate fewer than 40% of their loans in qualifying counties. For banks with $251-500 million in assets, 60% originate less than 40% of mortgage loans in qualifying counties

(Figure 18). This means most banks larger than $250 million in assets will not qualify under the structure of the current definition, even if the threshold is shifted significantly.

Figure 18: What percentage of the residential first-lien mortgage loans originated in 2012 were located in counties meeting the following description? Neither in MSA nor in adjacent micropolitan - Percent within ranges



Few community banks with more than $500 million in assets will meet the 50% standard, with only 5% making more than 50% of mortgage loans in qualifying counties. An additional 14% of banks with more than $500 million in assets make between 40-50% of their mortgage loans in qualifying counties.

Including Micropolitan Statistical Areas adjacent to MSAs in the definition of rural might be expected to increase the number of banks that qualify for the exception; however, the impact is limited. While the average percentage of mortgages originated outside MSAs is below 50% for all assets size peer groups under $500 million in assets, when respondents are grouped into ranges, few banks fall near the threshold (Figure 19).

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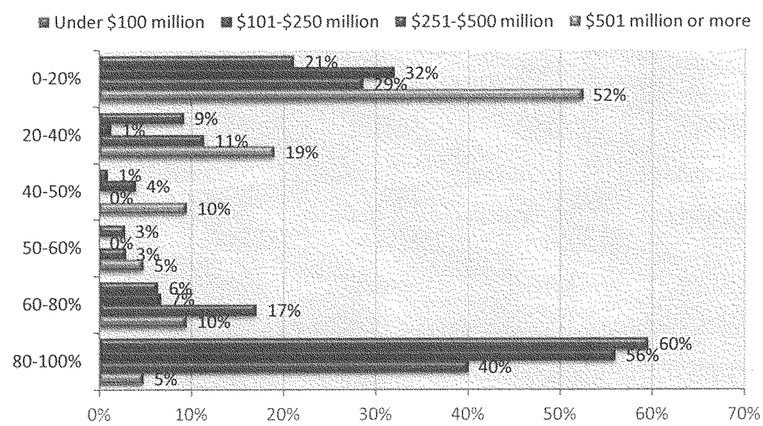
Figure 19: What percentage of the residential first-lien mortgage loans originated in 2012 were located in counties meeting the following description? Not in MSA - Percent within Ranges



Balloon Lending Alternatives

Some banks would consider providing ARMs as an alternative to balloon loans (36%) or increasing ARM lending (29%). However 19% of respondents indicate they would greatly limit mortgage lending or exit the business altogether if restrictions on balloon lending become too burdensome, with the impact greatest among banks with less than $100 million in assets (34%) and those serving rural areas (21%, Figure 20-21).

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Figure 20: If federal restrictions on balloon mortgage loans became too burdensome would your bank ever consider providing ARMs as an alternative? By Asset Size

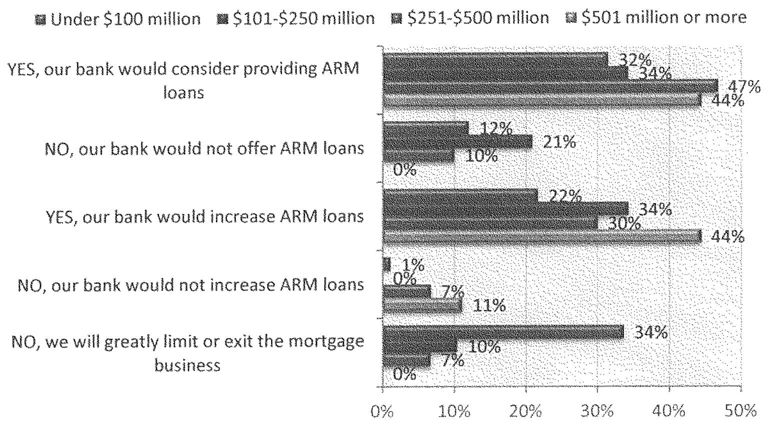
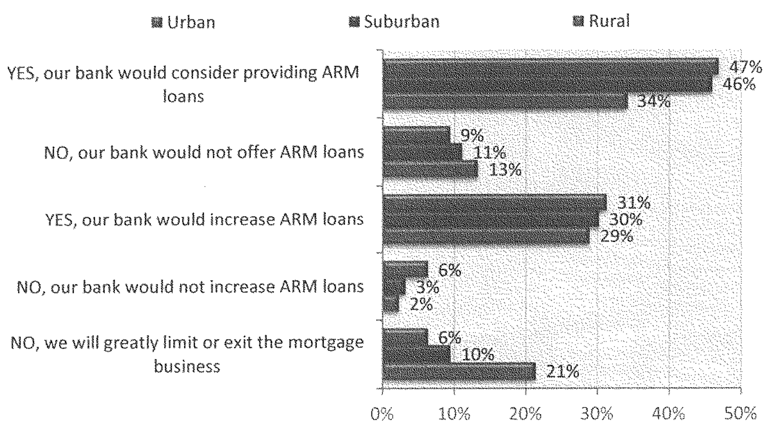


Figure 21: If federal restrictions on balloon mortgage loans became too burdensome would your bank ever consider providing ARMs as an alternative? By Geography



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Appendix A: Selected Banker Text Responses

We have one bank location in Sauk Centre, MN with a population of 4,300 but are pulled into an MSA area for Stearns County because St. Cloud, MN is located 45 miles away. We are as rural as it gets, but not per MSA's standards. We only have 3 stoplights, tractors drive down main street and we are surrounded by farm land - how much more rural can you get? Thank you.

Due to the government purchasing mortgage backed securities in order to drive the rate down, the only mortgage applications we get are for borrowers/properties which don't qualify for the secondary market. We are too small to escrow, therefore we have to do these higher risk loans at a low rate according to the government table. If any more restrictions and/or requirements are jammed down our throats by the government we will stop doing mortgage loans and as the balloons come due we will call the loans and foreclose if they can't pay them in full. Tell me how this will help the customer?

We provide a good mortgage borrowing option for all of our customers that cannot qualify for fixed rate secondary market borrowing. These loans balloon periodically and are always made and maintained at market rates. These are our bread and butter customers that come into the bank every month. We need them to survive as a smaller independent community bank. We are not out to take advantage of the customers we rely on for our existence.

Our bank is located on the far eastern edge (four miles from the county line) in McLean County, IL, the largest county in land area in the state of Illinois. To the east is Ford County, an almost entirely rural county. McLean County contains Bloomington/Normal, a two city community of 100,000 plus population. The several small towns in the rest of McLean county have populations of 2,000 or less. The entire county is considered a MSA, due to Bloomington/Normal. Our bank is located in Anchor, a town of 150 population in a rural area, about 25 miles east of Bloomington/Normal, but unfortunately still in McLean County.

Up until the recent change in regulations, our bank made three, five, and seven year residential balloon loans to low and moderate income residents of Anchor, surrounding rural areas, and neighboring small towns. Most of these loans were less than $100,000 (many $50,000 or less) and were not of much interest to large institutions. [All the larger "prime" loans went to larger institutions in Bloomington/Normal who are active in the secondary market.]

We kept all loans in our in-house portfolio and did our own loan servicing. We never had any difficulty with arranging extensions/modifications with customers who reached a balloon maturity. With a small staff of three full time employees (including me) we did not feel we could afford the extra expense of escrow accounting and compliance. With the increasing complications of lending under the HOEPA and higher-priced mortgage regulation we felt forced to discontinue residential real estate lending (except for rental properties) in 2010. Prior to the regulation changes, if a residential loan customer asked about escrow, we offered to set up a separate savings account and make monthly transfers from their checking of 1/12th the amount needed to pay real estate taxes and homeowner's insurance. It was up to the customer to make sure they took out the money and paid their taxes and insurance when they were due. This arrangement has worked fine since I came to the bank in 1979.

While it may not be politically correct to say it, our first duty as bankers is to make a profit for our shareholders. If we do not, the bank is not here to serve our community. We would like to resume small

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residential real estate lending. Our customers want it and it would help our profitability. BUT, it appears the proposed regulations will require us to do formal escrows (with the accompanying accounting and compliance burdens), even though we are located 25 miles from the large community which lands our county in the MSA classification. Please feel free to contact me if you need additional information or elaboration.
An arbitrary floor of $2 billion is not sufficient for Banks in Montana. It is a large state with low population, and this level would exclude our two largest institutions ($7B in size). These two institutions still serve a great portion of Montana - much of which is rural. We need a consistent floor applied across the regulations.
We used to offer balloon mortgages before all the changes several years ago. It served our bank and our market very well. We started up our escrow accounts out of necessity to meet regulations not because we or our customers wanted them. I hope CFPB will pay attention to this.
1) The vast majority of our residential mortgage are "outside the box" of one or more secondary market guidelines (acreage, mixed use, D/I ratios, etc.) 2) 20% down (or equity on refinances) is required on all residential mortgage loans. 3) In our 100+ year history, the Bank has never initiated foreclosure on any residential mortgage loan.
The proposed CFPB regulations may well drive us out of residential mortgage lending
The balloon loans that we are making are to consumers who otherwise would not be eligible for mortgage credit for various reasons. We are taking additional risk by making these loans and we provide a valuable service to our customers by doing so. I know that we are considered to be in an MSA but we are very rural and I don't think we should be subjected to the new rules. Sometimes the current appraisal underwriting guidelines create a lot of problems for borrowers because of the lack of sales of similar type properties because we are so rural. We end up having to find other alternatives to Freddie and Fannie. That includes booking loans on our books instead of selling them.
We just started escrow services this month in anticipation of the new HPML rules. We have one loan on the books that has escrow that we booked this month. We have always originated balloon loans. We would prefer not to offer ARM loans but that may be a necessity.
The current HPML regulations are extremely burdensome on our staff & also confusing for the average customer. Most customers do not understand why we have to escrow, why we give them some of these disclosures, or why they have to wait so long to close their loan. As we are forced to escrow more & more loans, it may become necessary for our bank to hire one or two more employees to keep up with this regulation alone. That's a huge expense for a bank our size!
Our little bank was forced by regulations to offer escrow on mortgage loans starting in April 2010. However, not all counties in our area will send tax bills to the bank which causes confusion for our customers. Of course, I'm still curious how the lack of escrow on a mortgage loan contributed to the mortgage crisis caused by poor underwriting.

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Our bank will not make a loan that would be classified as a higher-priced mortgage due to the additional regulatory burden required by these mortgages including escrow requirements. Requests that would result in a Higher-priced Mortgage are either modified or we simply refuse to make the loan.
Most of our current business is very rural, but we have a growing presence in a MSA. I think the rule should not apply to loans made out of the MSA even if we go over 50%. In January of 2013 2/3s of our loans were made in the MSA.
If the definition of urban includes a micropolitan county then our bank is going to have serious problems. We operate in Randolph County, Missouri which has an approximate population of 25,000. To consider us anything other than rural is absurd.
We have a major rural presence but the rural balloon loan option is not open to us because we are over the $2 Billion threshold. The qualifying standard should be changed to more accurately address the lending needs community banks serve in rural areas. Balloon loans should be allowed in rural areas regardless of bank's size. Forcing banks back into ARM loans may present even larger problems down the road.
We are located in rural southern Carlton County, MN which is included in the Duluth MSA which makes no sense. 1.5% over the APOR & 3.5% for 2nd REMs. How are we supposed to make payroll, maintain capital and get any ROE? Where do theses APOR's come from? FANNIE & FREDDIE? Is that really fair considering their source of funding & ours? If they need to cover losses they fire up the printing press. Our regulators would just padlock our door being we're not "too big to fail". Sorry I had to vent a little. Thanks for doing this survey. I hope the Feds will turn up their hearing aids and get a grip on reality.
The new requirements for required escrows are a burden to our staff. We are a small community bank.
You are absolutely correct that rural has been defined too narrowly and will keep the majority of banks from qualifying.
There should be NO connection between "high priced" mortgage loans and Mandatory Escrow Accounts. With all of the regulations requiring escrow accounts, it is prohibitive for small community banks to offer them.
Our bank began offering escrow accounts in 2012, so the APR's on our mortgages will likely increase in the future. The only mortgages we offer have balloon features because we service our loans and cannot risk long term fixed rates. The vast majority of our mortgage borrowers would not qualify for 15 - 30 year, fixed, low rate loans. Their default risk is higher, therefore, requiring a higher interest rate. Otherwise, these potential home owners will have to continue renting.
Our bank has not foreclosed on a residential mortgage during the past 15 years and perhaps only 2 homes during the preceding 10 years. We have never refused to renew a balloon payment loan at its maturity. The renewal process is a beneficial opportunity to meet with borrowers and advise them on debt structure and financial progress.

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We are a small community bank located in Houston County, Minnesota with the City of LaCrosse, WI located across the river (the real MSA). We are totally NOT a metropolitan area. We have an ag concentration with approximately 80% of our loan portfolio in ag related loans. We do in-house balloon loans for borrowers who do not qualify for a secondary market loan due to a ding in their underwriting (approximately 10% of our portfolio). None of the balloon loans are over 30 days delinquent. We will discontinue offering in-house loans if we cannot offer balloon loans. We are considering discontinuing loans not qualifying for the secondary market already, due to required escrow accounts, which we do not offer. Rates on this type of loan do not reflect risk, due to limiting the interest rate by not offering escrow accounts.
It is the bank's policy to require escrow's on all 1st mortgage residential loans. We do get about 3% requests for exclusion.
We agree that rural is too narrowly defined, and that once again we find a regulation intended to help the consumer that will actually prevent the consumer from getting financing.
Even though we belong to the St. Louis MSA, we are in a very rural area. We are the only bank in 2 of the 4 towns we have branches in. We are an hour from the suburban area.
Our bank has 2 offices located in the eastern, rural portion of Pottawattamie County, IA (which is part of the Omaha/CB MSA), so, even though we are certainly in a "rural" farming area, and the population of our 2 communities is less than 1,400 people, we are explicitly excluded from the "rural" exemption due to a large city located in our county, approx 20 mi away. Our bank has 10 employees covering 2 offices. We have 3 loan officers, one of which is our only mortgage loan officer - in other words, we have a mortgage department of "1". Due to staggering regulatory burden placed on community banks during the recent mortgage reform, our bank has had to stop offering consumer owner-occupied loans. Recent mortgage revisions and prohibitions have made mortgage lending not only impractical, but impossible for a small community bank such as ours.
We have been doing ARM loans and escrowing taxes and insurance for years. We portfolio all of our loans.
We are a small community bank, but we regularly do more than 500 first mortgage originations per year. We believe that this number should be increased for the exemption. We also think that the 43% maximum on the debt-to-income is too restrictive to self-employed borrowers along with S-corp. or sole proprietors.
The margin of 1.5% over the APOR needs to be increased to at least 3.5%. Our bank cost of funds is not the same and is higher than a national cost of funds or the Mega Bank cost of funds on which the APOR is based. Since we hold 100% of our originations in portfolio, we need to be able to price off our internal cost of funds. If we sold into the secondary market the 1.5% margin would be OK, but since we are a portfolio lender, staying under the 1.5% margin squeezes our NIM and if we exceed the 1.5% the escrow requirement makes our cost to service our limited number of loans too high. In 2012 the bank originated 31 1-4 family first lien loans in our small rural community that is located within the Waco Texas MSA. The regulation as currently written by the CFPB will have a substantial negative impact on our bank.

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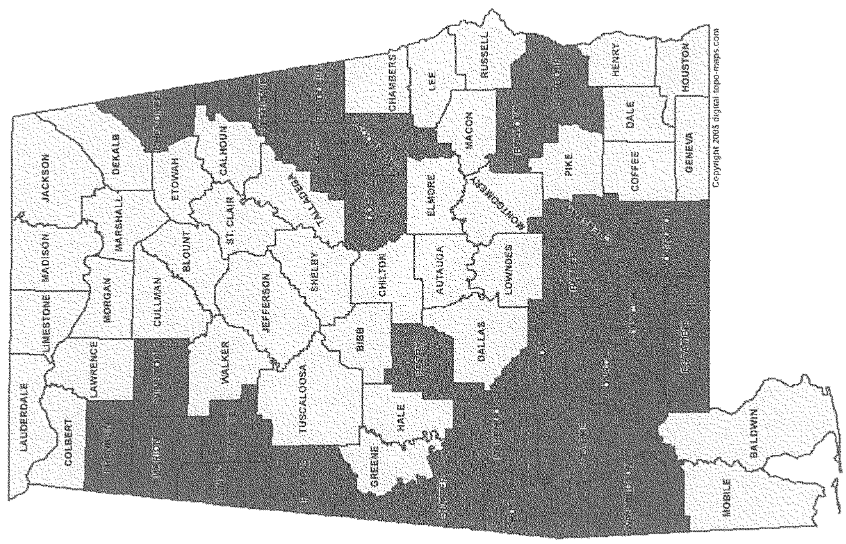
We currently do not fall in the exception because only 43% of our loan originated fall within the definition of rural/underserved. Many of these counties are located adjacent to a metro area; however, clearly should be considered rural or underserved. I think the rural underserved classification should be re-examined.
Please remember that most of our customers that have portfolio loans are low income and purchase the lower dollar houses. The secondary market is not interested in these low dollar houses. If it becomes too burdensome to provide portfolio loans and the bank restricts or stops providing these loans it will truly hurt the low income people. One must remember that portfolio loans generally have very low closing costs which help low income people to get into the house in the first place.
Most loans are HPML and balloon. We offer no ARM's now and only started escrow to try to service the mortgage need in our community for those loans not qualifying for the secondary market because of appraisal issues, acreages, sole proprietorship needing income verification, time in job, etc. We want to make mortgage loans to our customer base, but it is becoming extremely difficult and expensive to be compliant. We have a strong history and virtually no delinquencies but are being overpowered by compliance regulation.

State-by-State Impact of CFPB "Rural" Definition

Rural (blue) and Non-Rural (yellow) Counties Under the Consumer Financial Protection Bureau's Final "Ability to Repay" Rule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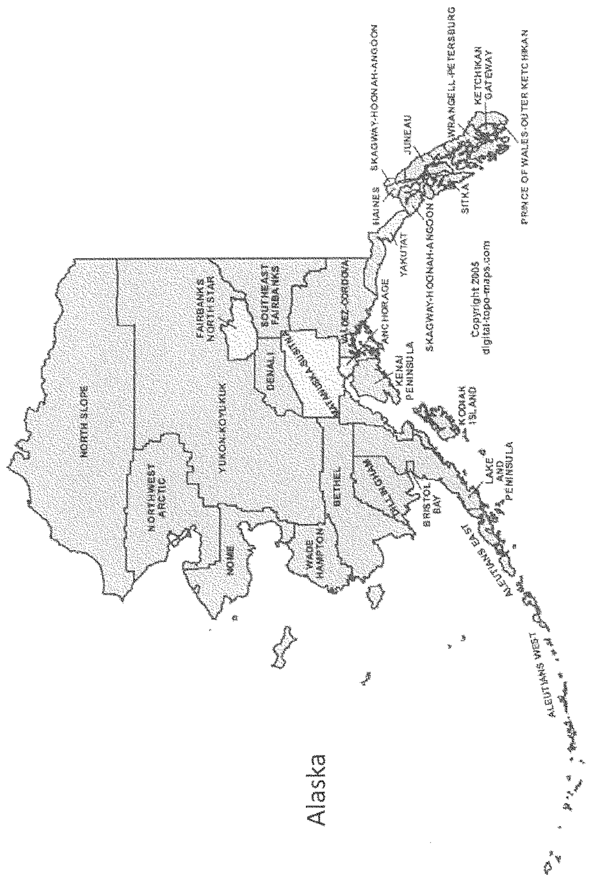
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VALDEZ-CORDOVA
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KODIAK ISLAND
BRISTOL BAY
LAKE AND PENINSULA
ALEUTIANS EAST
ALEUTIANS WEST
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HAINES
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JUNEAU
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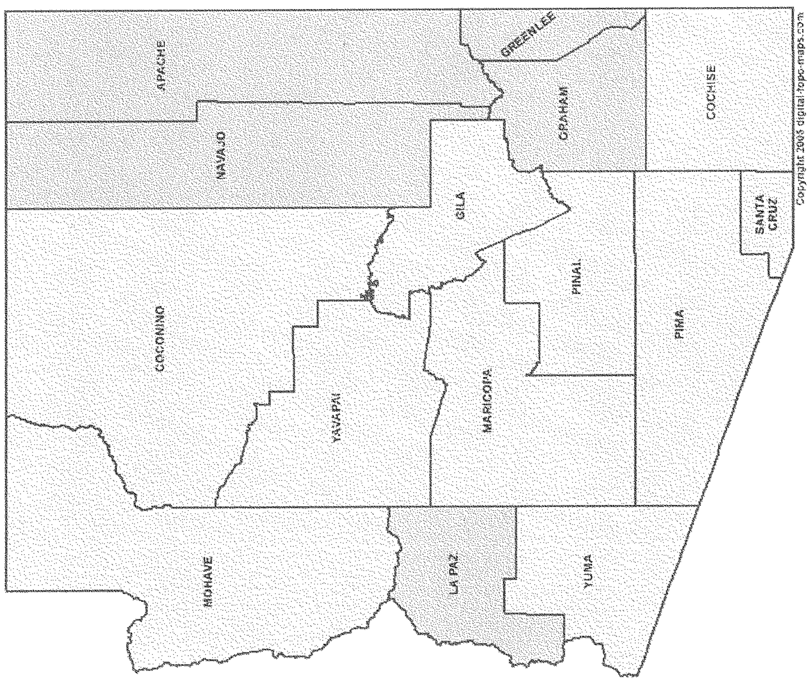
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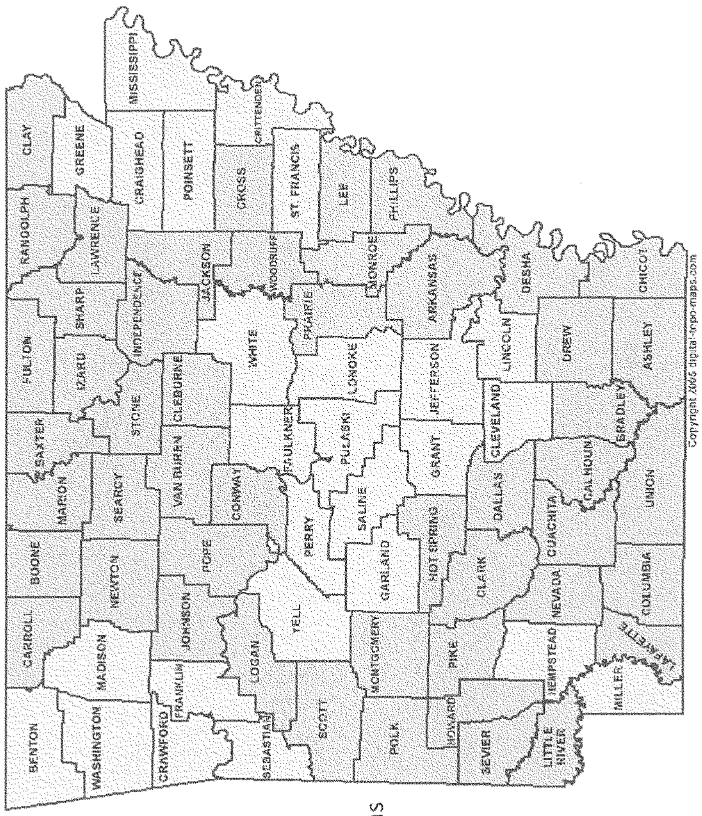
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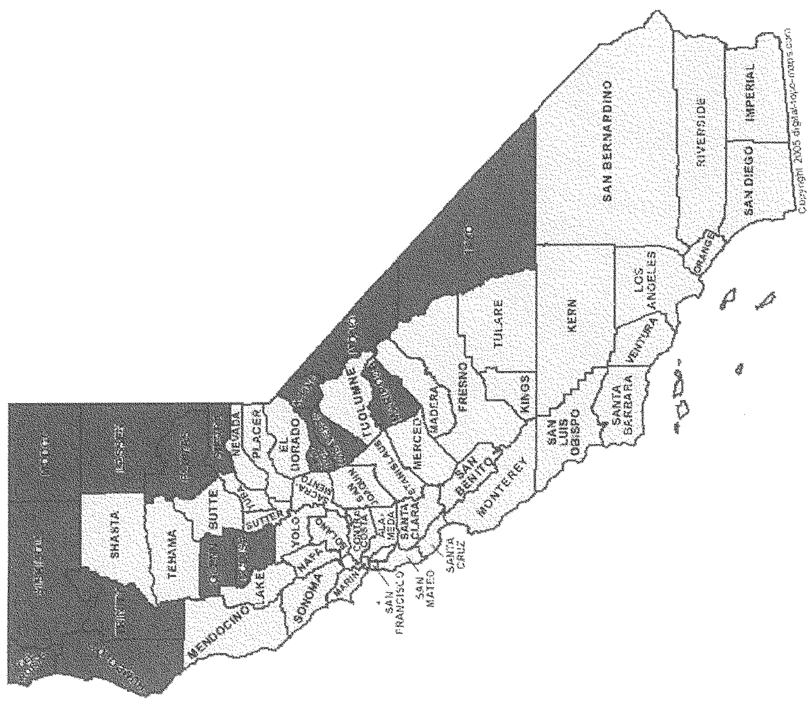
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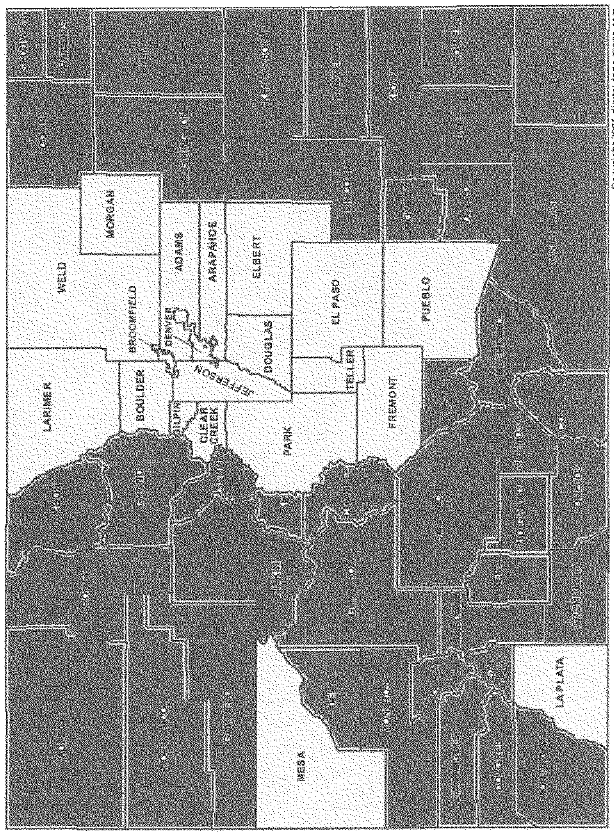

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CLEAR CREEK
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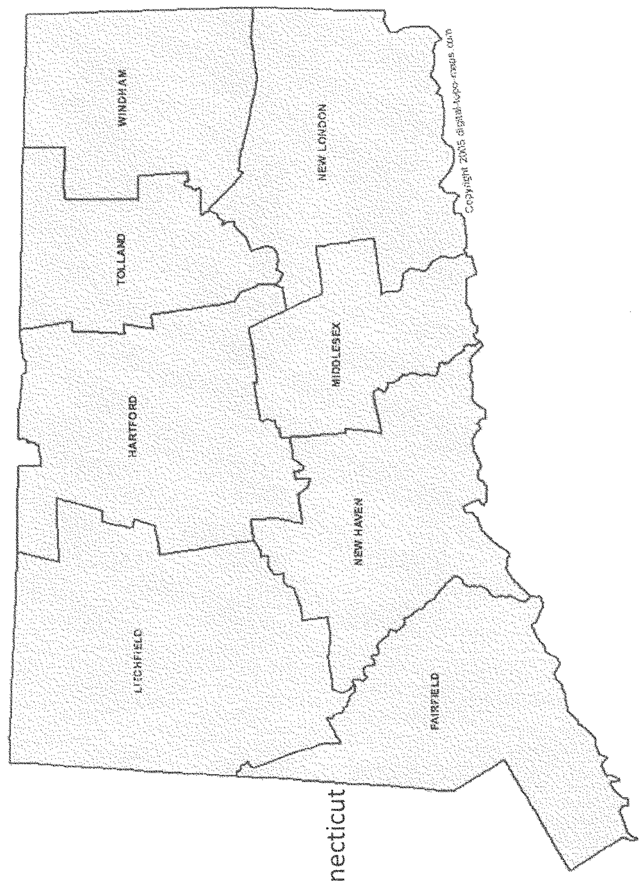

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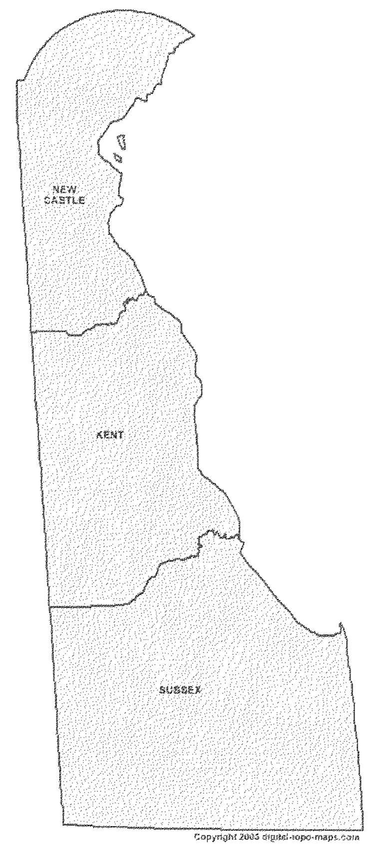
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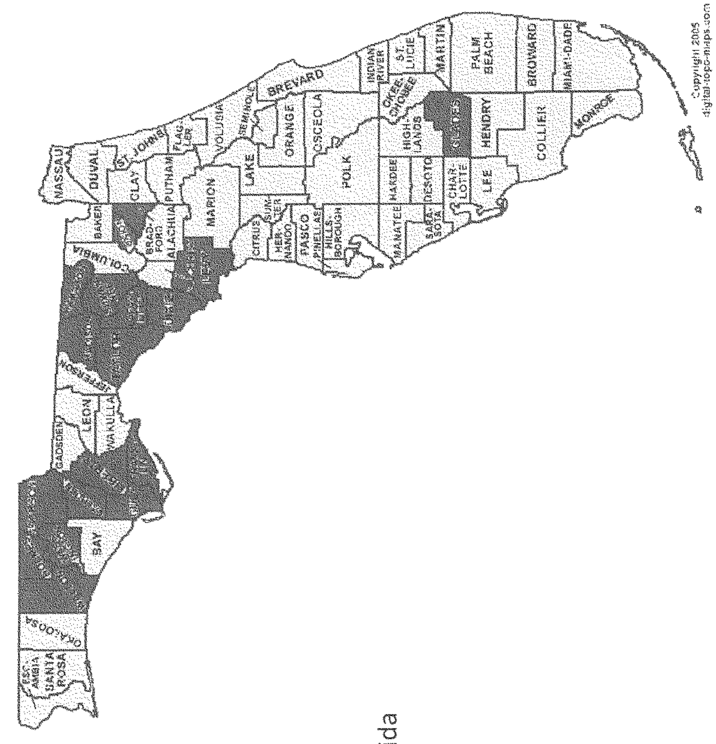
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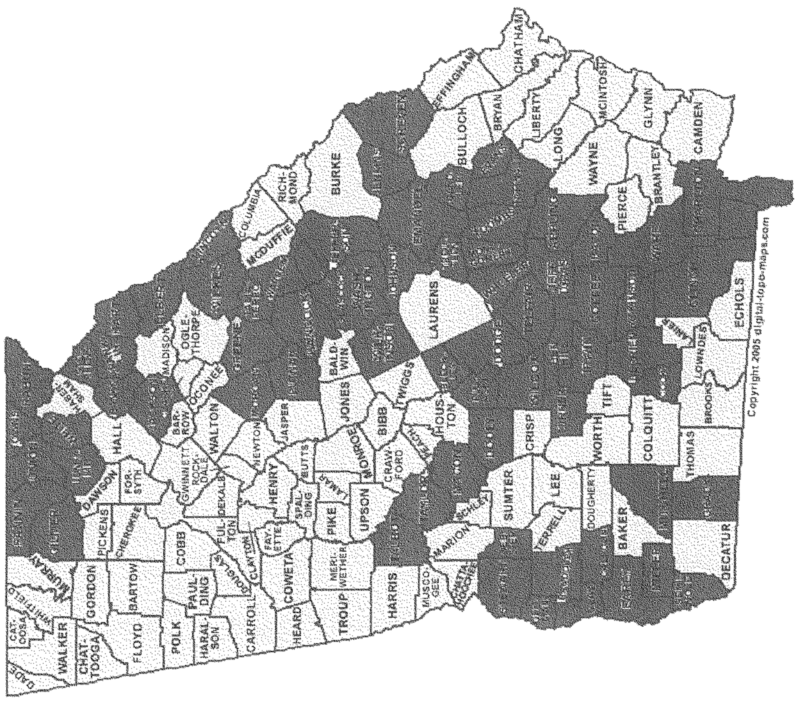
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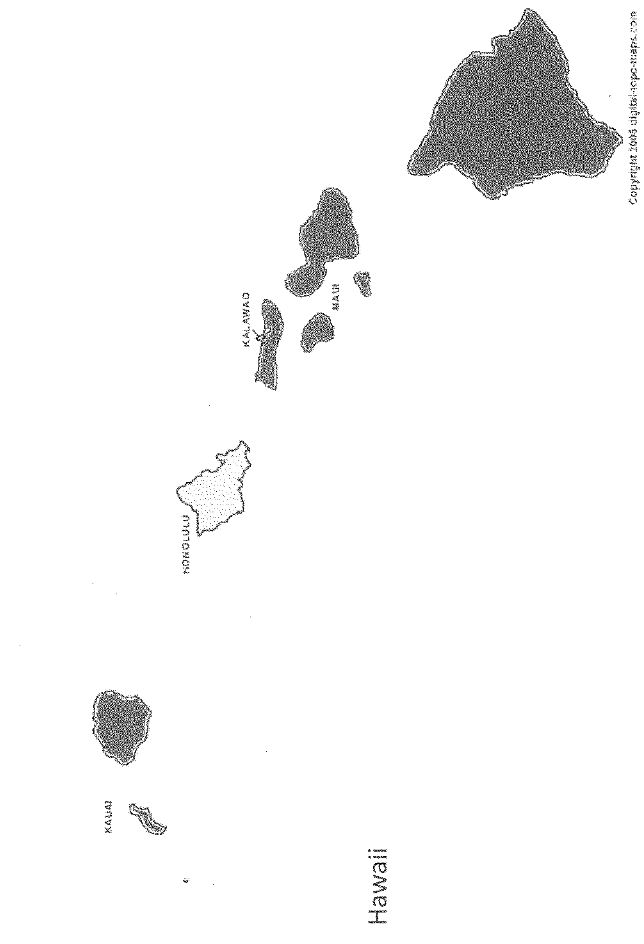
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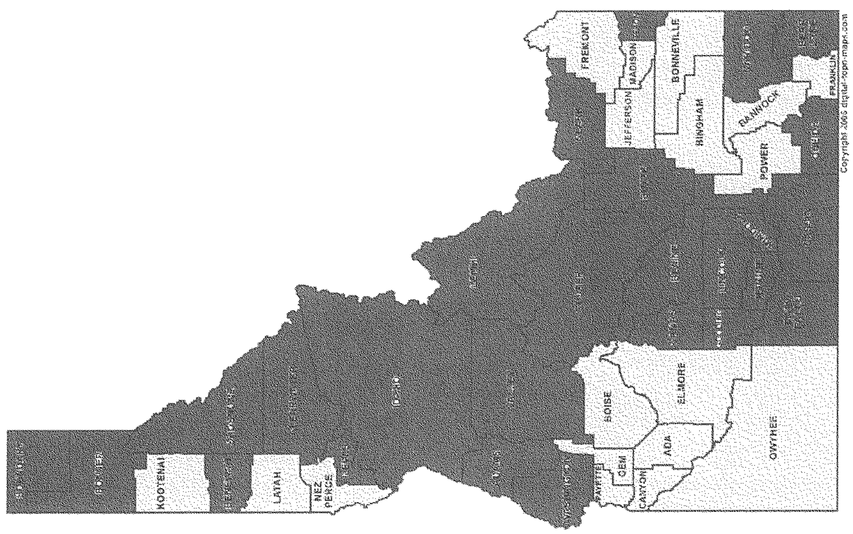
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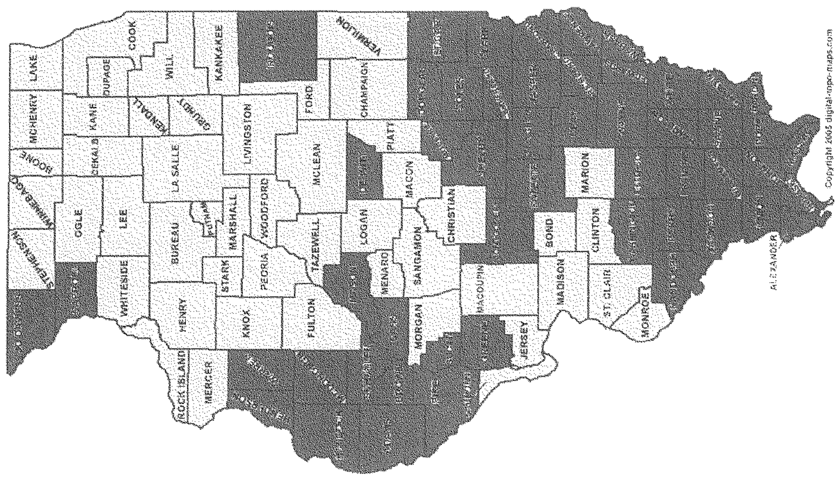
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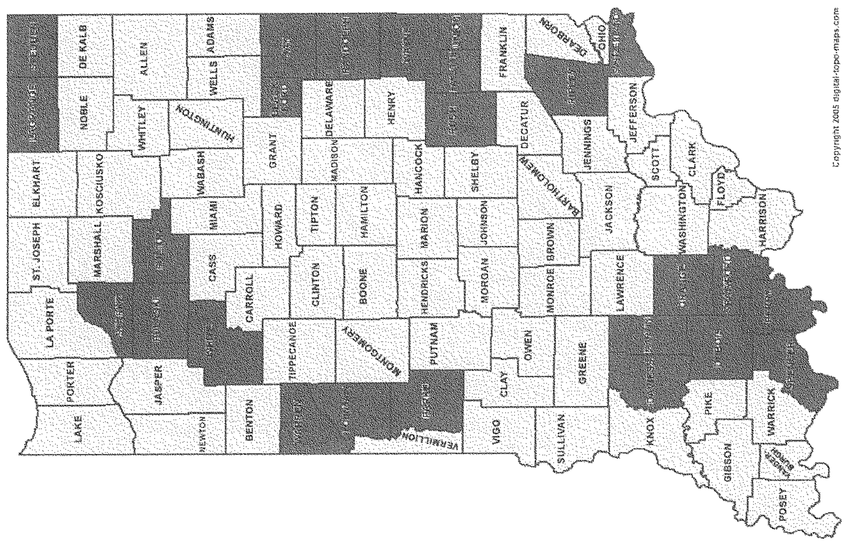
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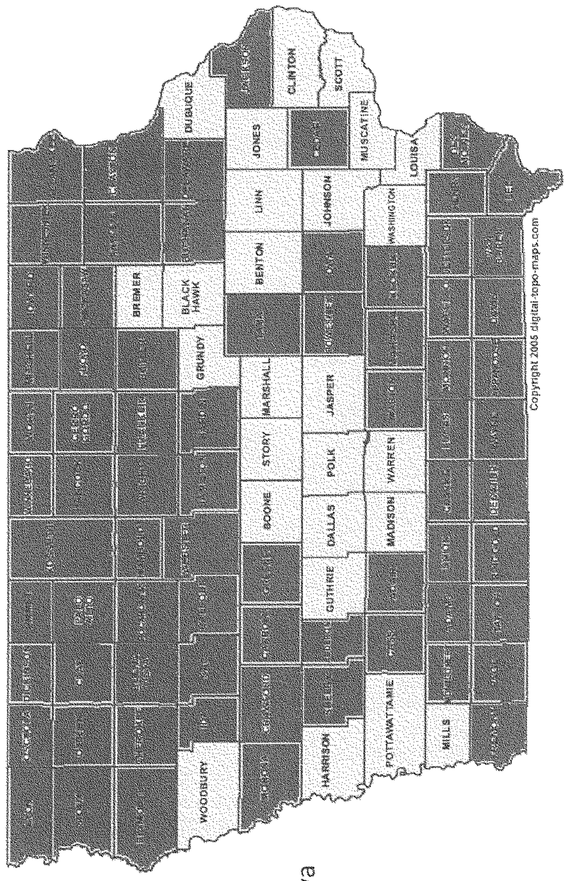
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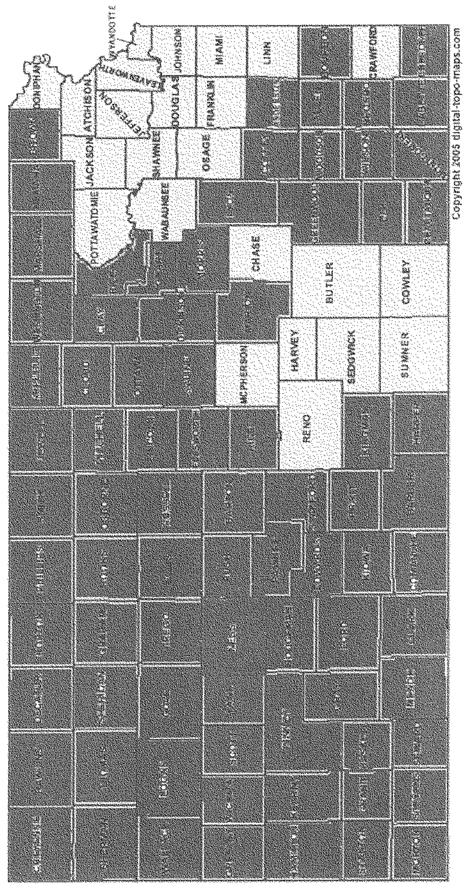
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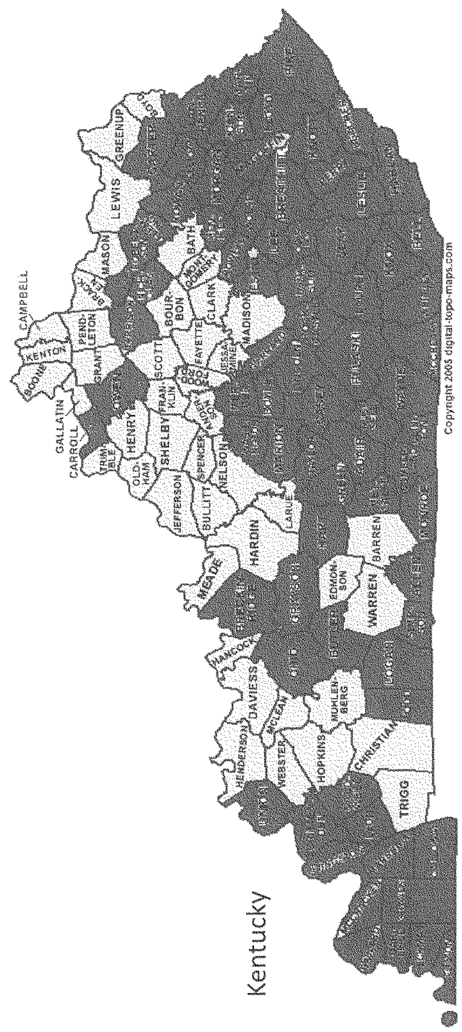
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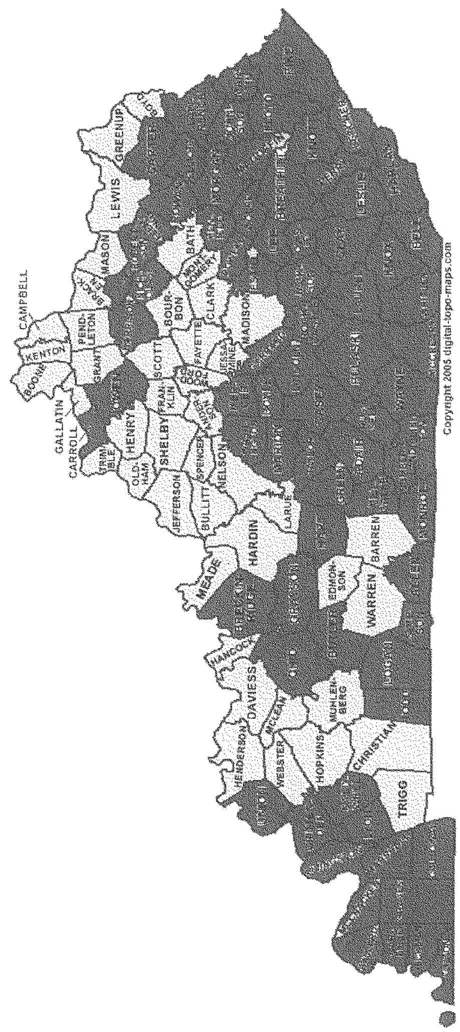
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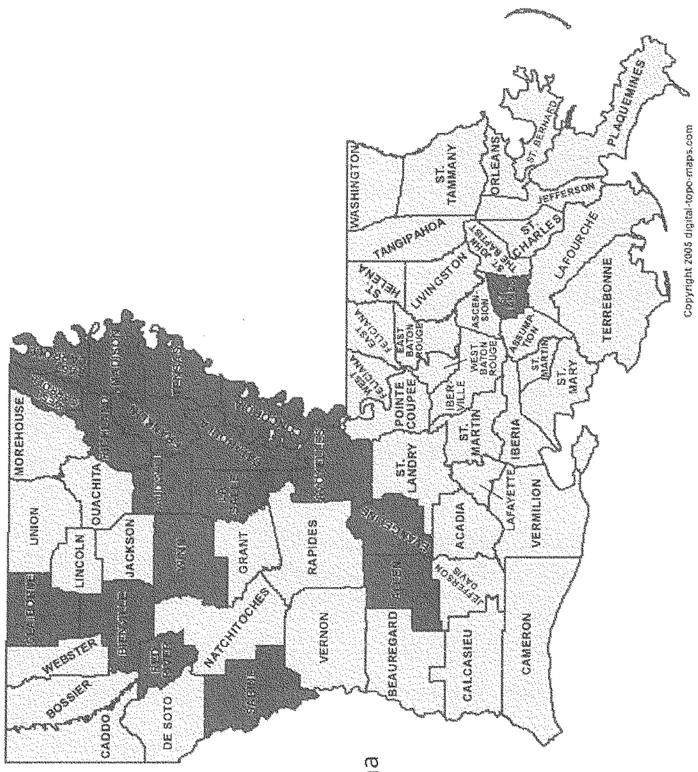
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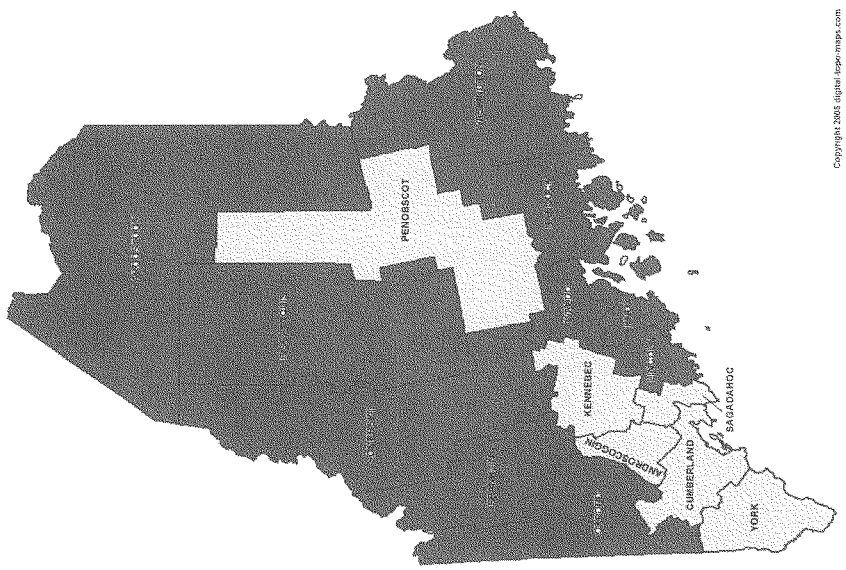
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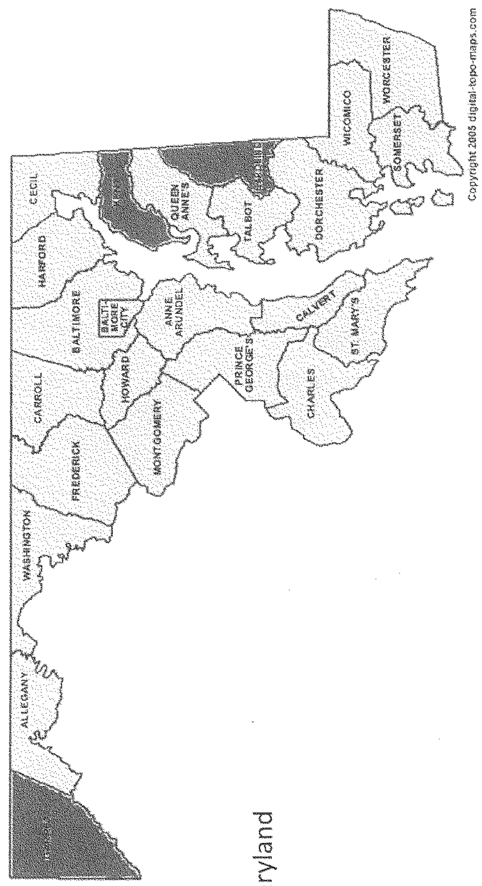
Maine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CALVERT
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WASHINGTON
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DORCHESTER
WICOMICO
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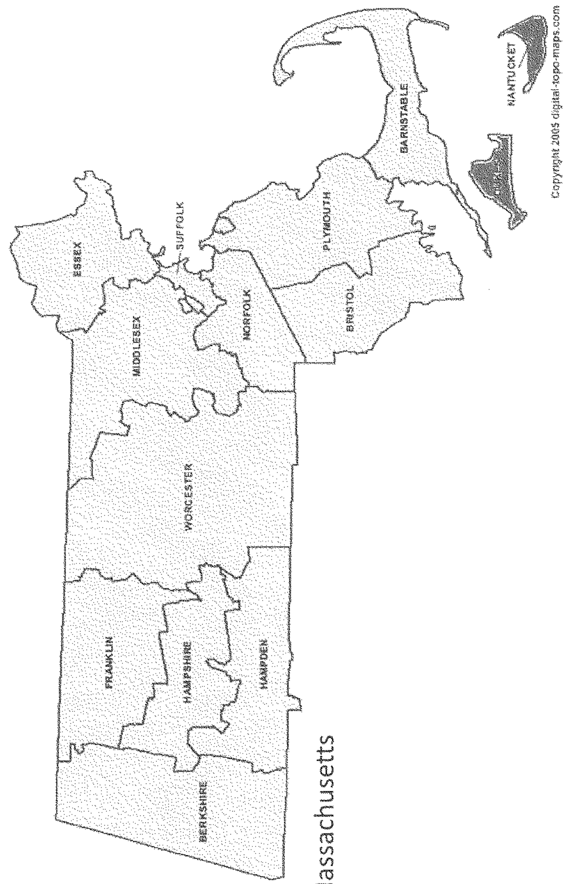
Maryland



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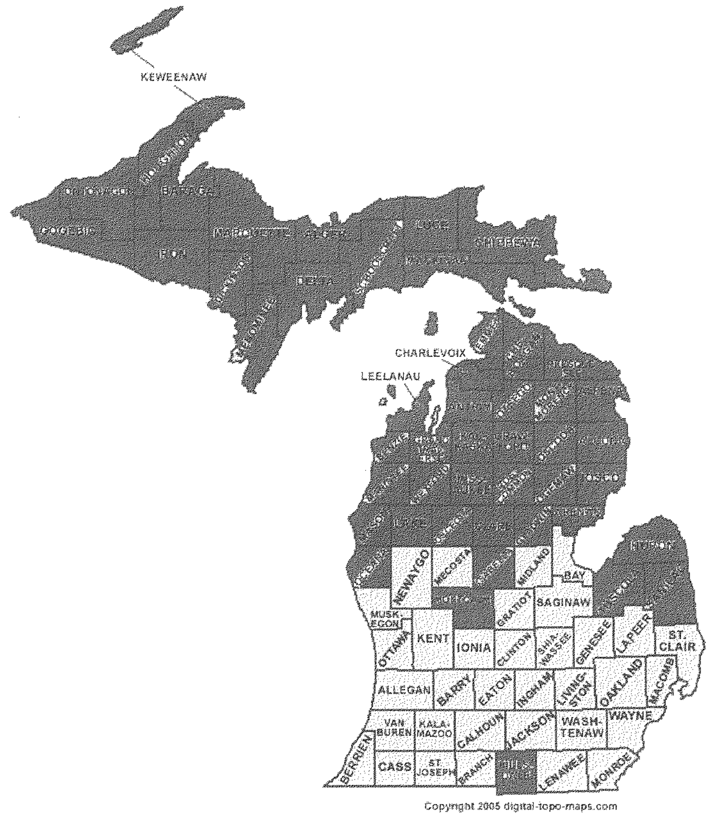
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MECOSTA
MIDLAND
BAY
GRATIOT
SAGINAW
MUSK-EGON
OTTAWA
KENT
IONIA
CLINTON
SHIA-WASSEE
GENESEE
LAPEER
ST. CLAIR
ALLEGAN
BARRY
EATON
INGHAM
LIVING-STON
OAKLAND
MACOMB
VAN BUREN
KALA-MAZOO
CALHOUN
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CASS
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WASHINGTON
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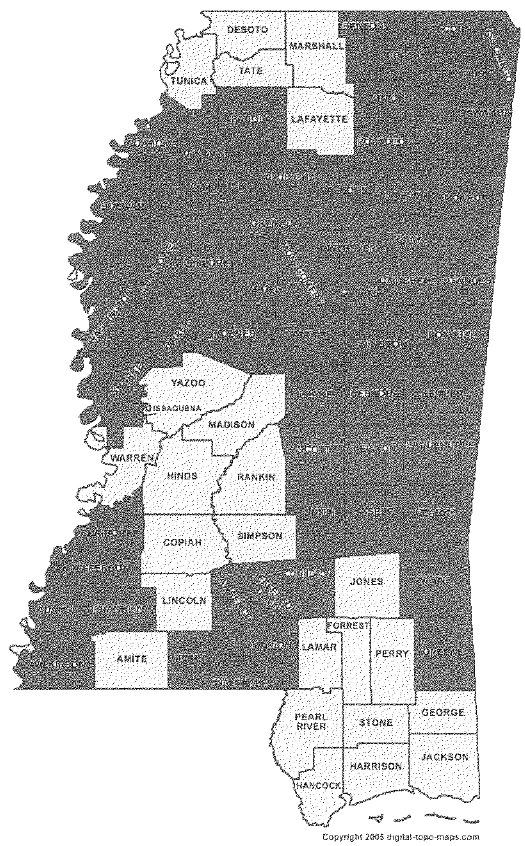
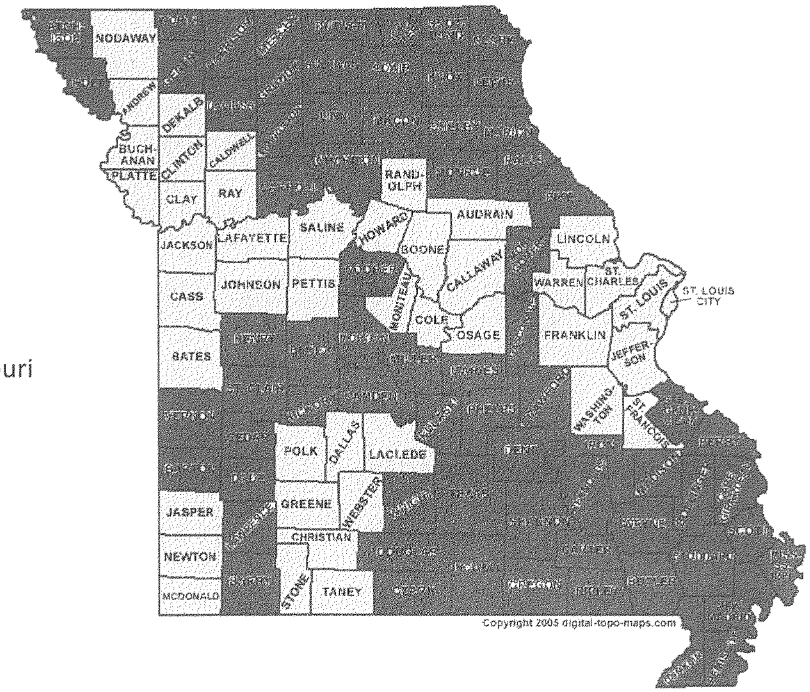
HENNEPIN
DAKOTA
SCOTT
CARVER
SHERBURNE
WRIGHT
BENTON
STEARNS
KANDIYOHI
MCLEOD
MORRISON
OTTER TAIL
CLAY
WILKIN
POLK

Minnesota

Mississippi

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SALINE
HOWARD
BOONE
LINCOLN
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LAFAYETTE
CALLAWAY
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ST.
CHARLES
ST. LOUIS
ST. LOUIS
CITY
JOHNSON
PETTIS
MONITEAU
CASS
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OSAGE
FRANKLIN
JEFFER-
SON
BATES
WASHING-
TON
ST.
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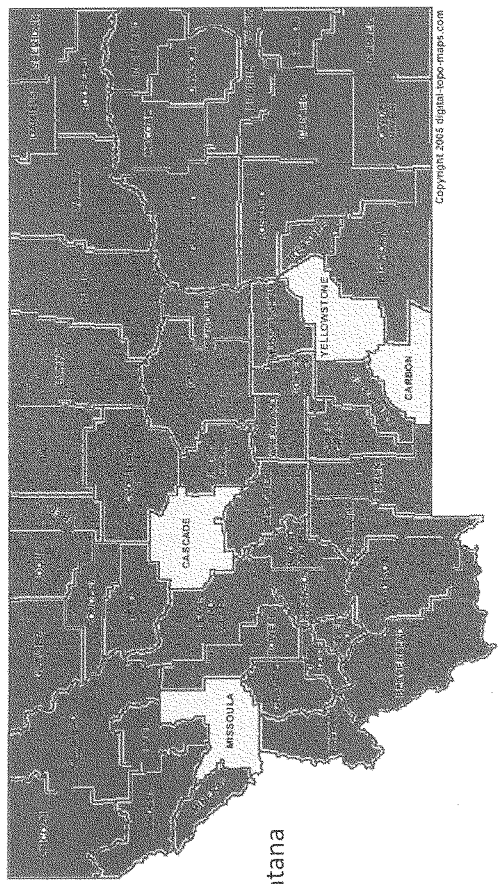
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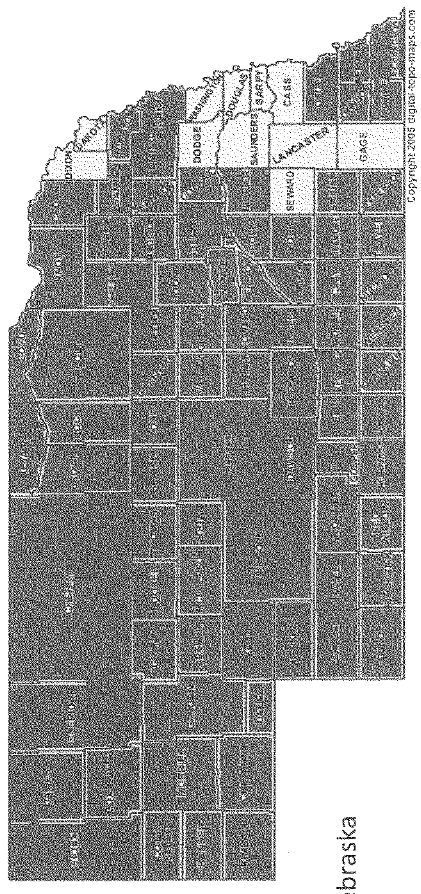
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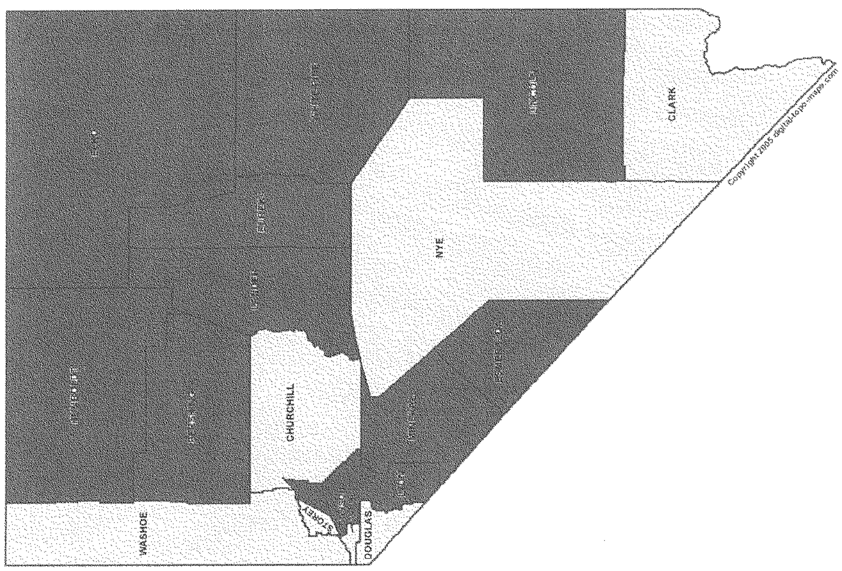
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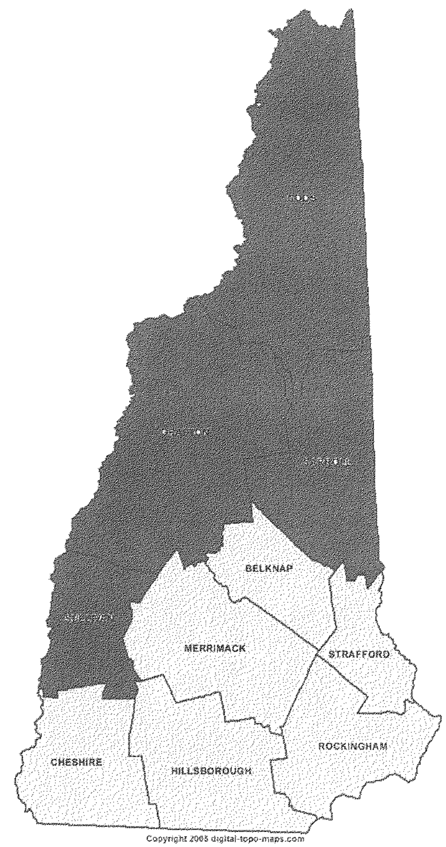
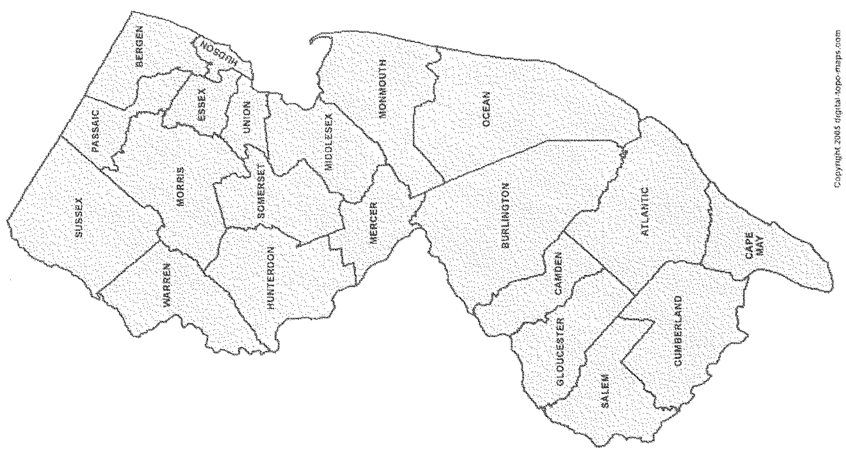
Nevada

New Hampshire

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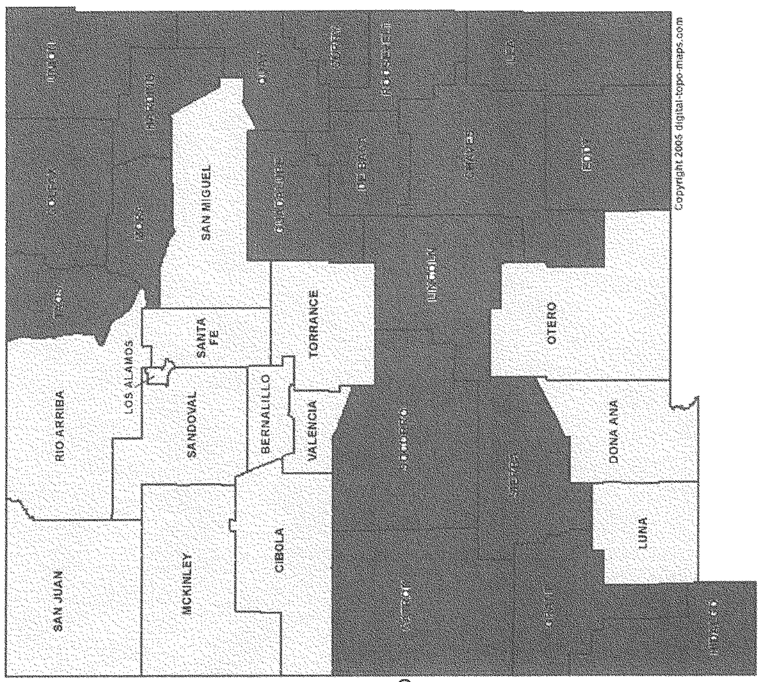
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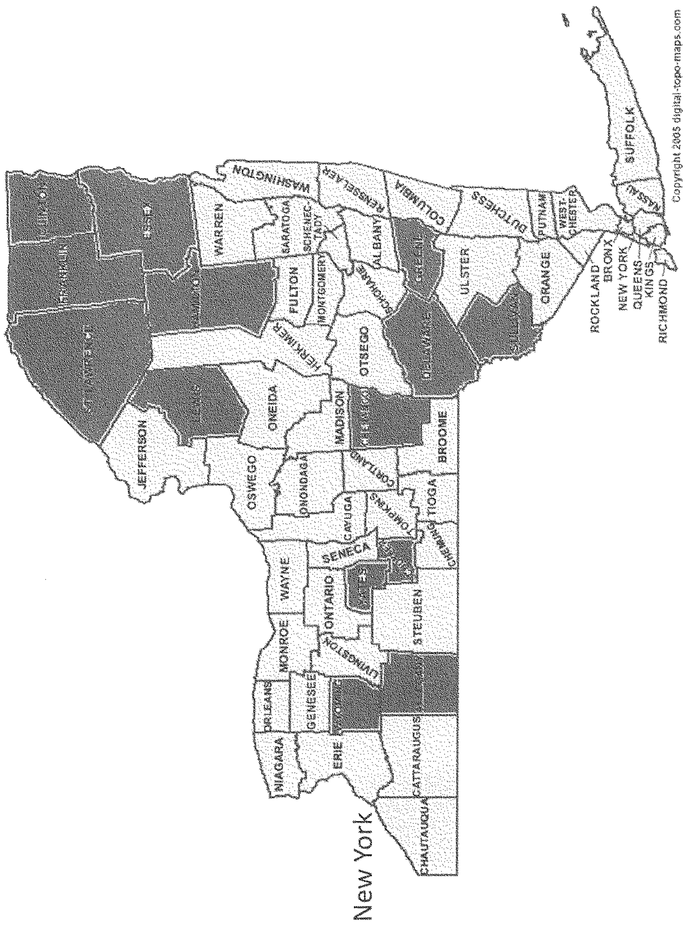
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HERKIMER
OTSEGO
DUTCHESS
PUTNAM
WEST-CHESTER
ULSTER
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NASSAU
SUFFOLK
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ONEIDA
MADISON
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ONONDAGA
CORTLAND
BROOME
TIOGA
TOMPKINS
CAYUGA
CHEMUNG
SENECA
WAYNE
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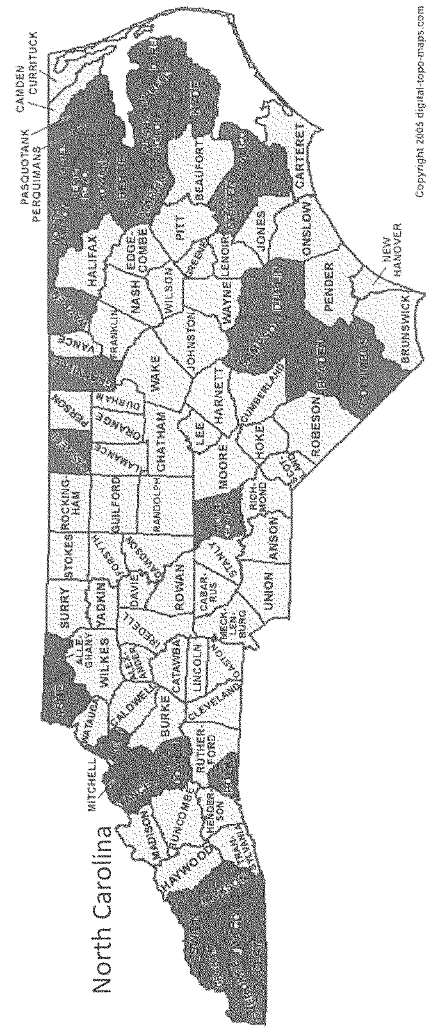
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NASH
WILSON
GREENE
LENOIR
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VANCE
FRANKLIN
JOHNSTON
WAKE
DURHAM
PERSON
ORANGE
HARNETT
CUMBERLAND
ROBESON
LEE
HOKE
CHATHAM
ALAMANCE
MOORE
RICH-MOND
ROCKING-HAM
GUILFORD
RANDOLPH
ANSON
STOKES
FORSYTH
DAVIDSON
STANLY
UNION
SURRY
YADKIN
DAVIE
ROWAN
CABAR-RUS
MECK-LEN-BURG
IREDELL
ALLE-GHANY
WILKES
ALEX-ANDER
CATAWBA
LINCOLN
CLEVELAND
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MADISON
HAYWOOD
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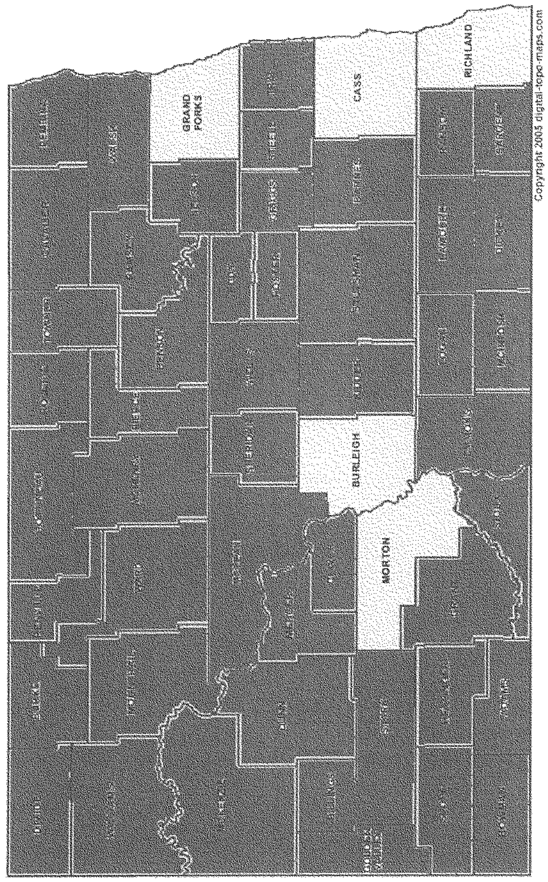

North Dakota


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LAKE
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CUYAHOGA
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SUMMIT
MAHONING
LORAIN
MEDINA
ERIE
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LUCAS
FULTON
WOOD
SANDUSKY
SENECA
HURON
DEFIANCE
HENRY
HANCOCK
PAULDING
PUTNAM
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ALLEN
HARDIN
WYANDOT
CRAWFORD
RICHLAND
ASHLAND
WAYNE
STARK
COLUMBIANA
CARROLL
JEFFERSON
TUSCARAWAS
HOLMES
HARRISON
MERCER
AUGLAIZE
MARION
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KNOX
COSHOCTON
LOGAN
SHELBY
UNION
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LICKING
DARKE
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CHAMPAIGN
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MUSKINGUM
GUERNSEY
BELMONT
PREBLE
MONTGOMERY
GREENE
MADISON
FAYETTE
PICKAWAY
FAIRFIELD
PERRY
MORGAN
NOBLE
MONROE
BUTLER
WARREN
CLINTON
ROSS
HOCKING
WASHINGTON
ATHENS
VINTON
HAMILTON
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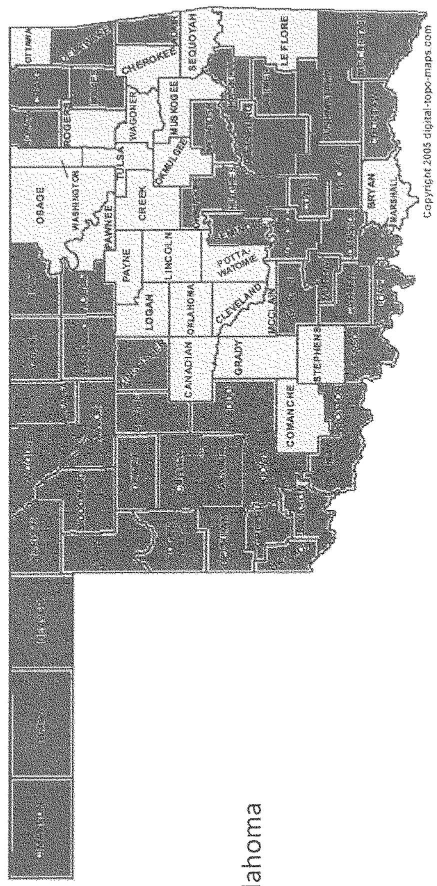
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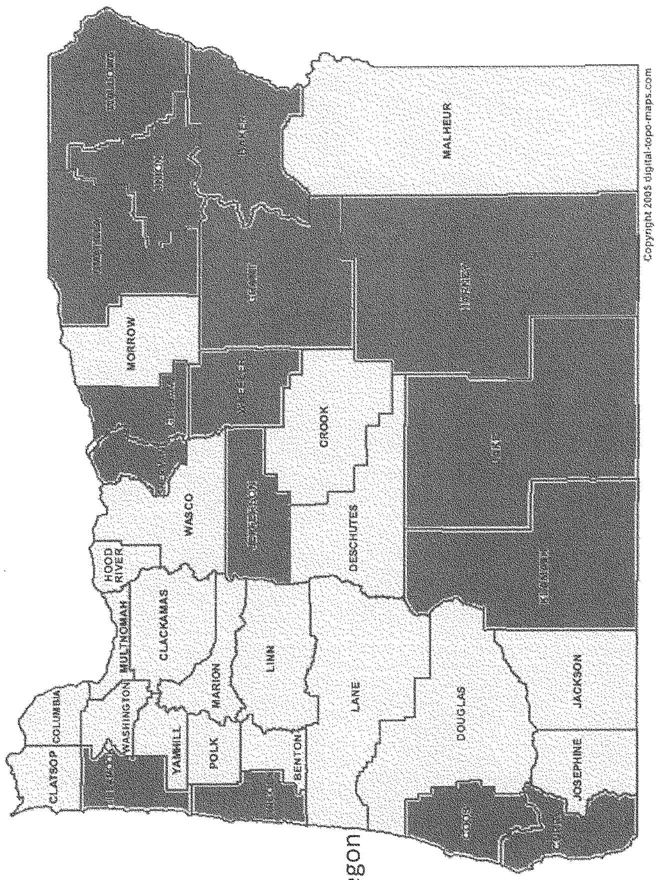
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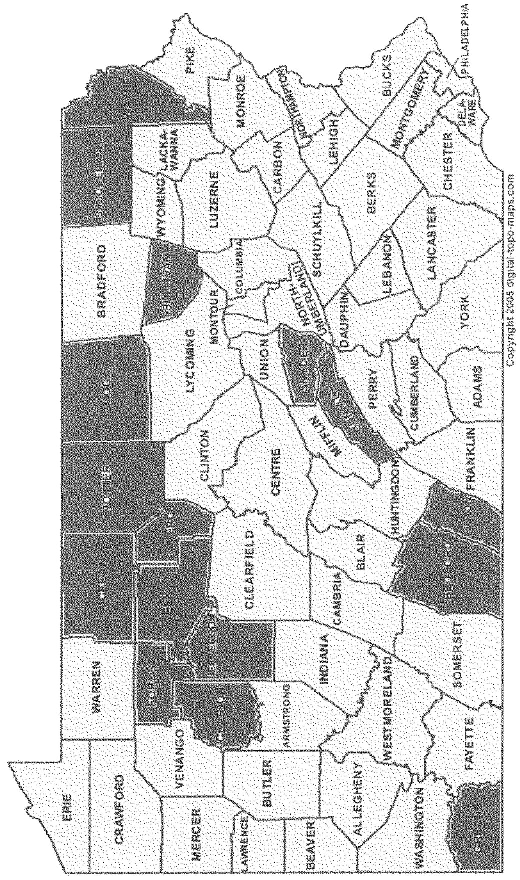

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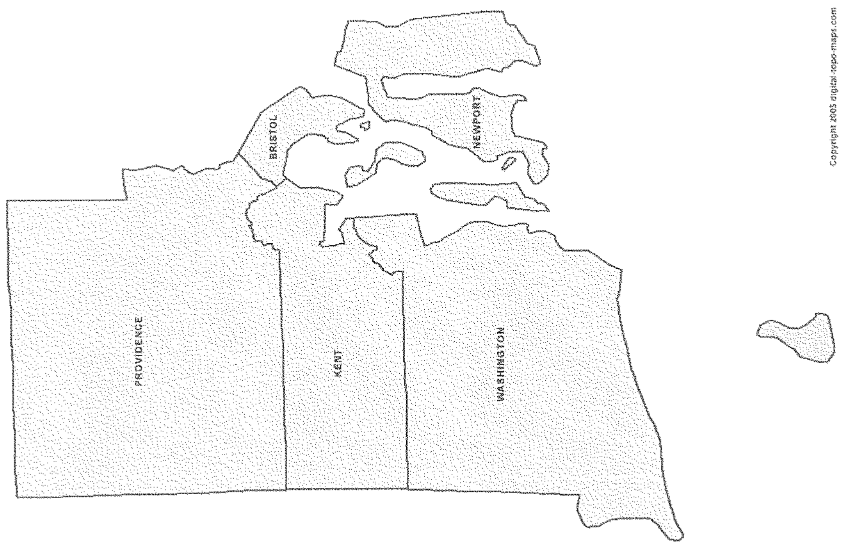

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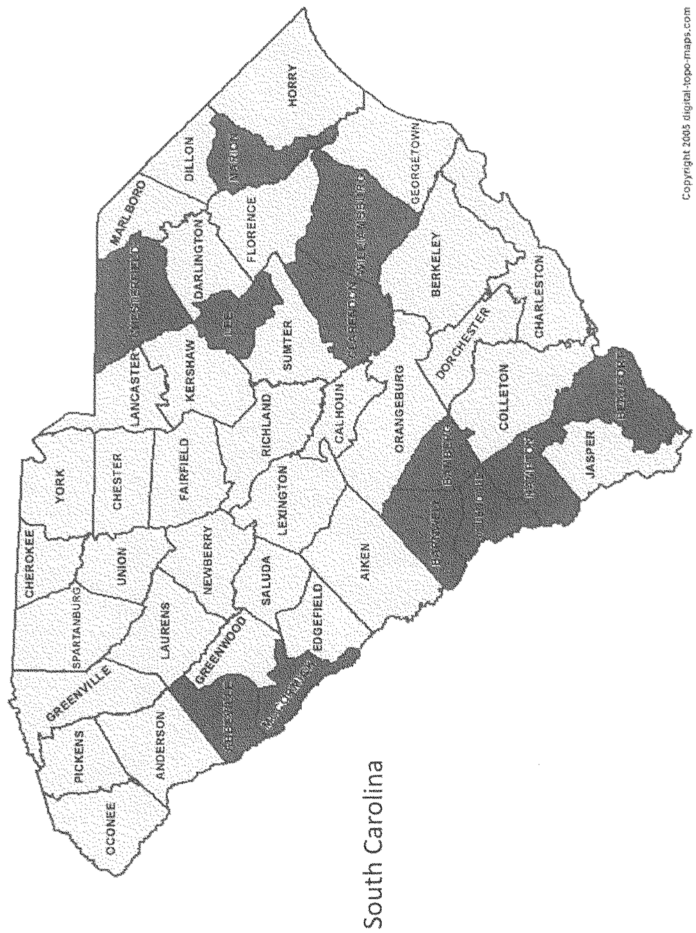
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CALHOUN
ORANGEBURG
COLLETON
JASPER
RICHLAND
FAIRFIELD
CHESTER
YORK
LEXINGTON
CHEROKEE
UNION
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SPARTANBURG
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EDGEFIELD
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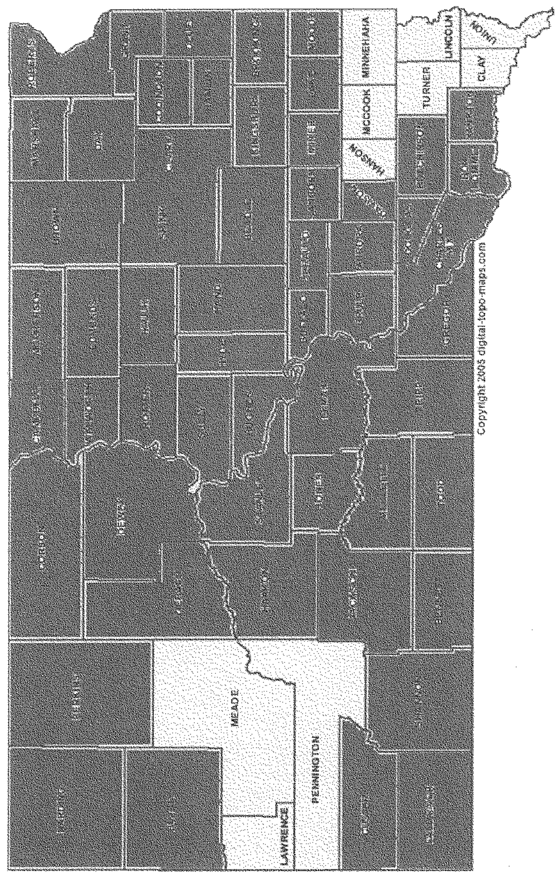
GREENVILLE
ANDERSON
PICKENS
OCONEE
South Carolina



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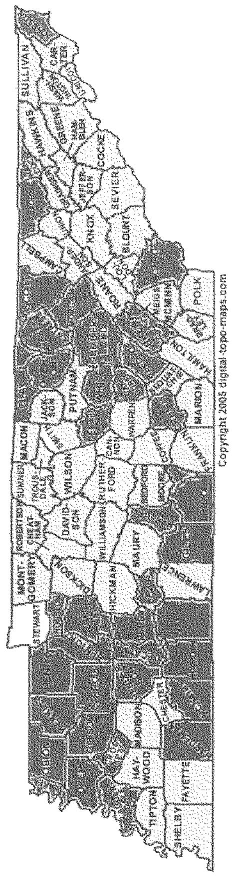
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WILSON
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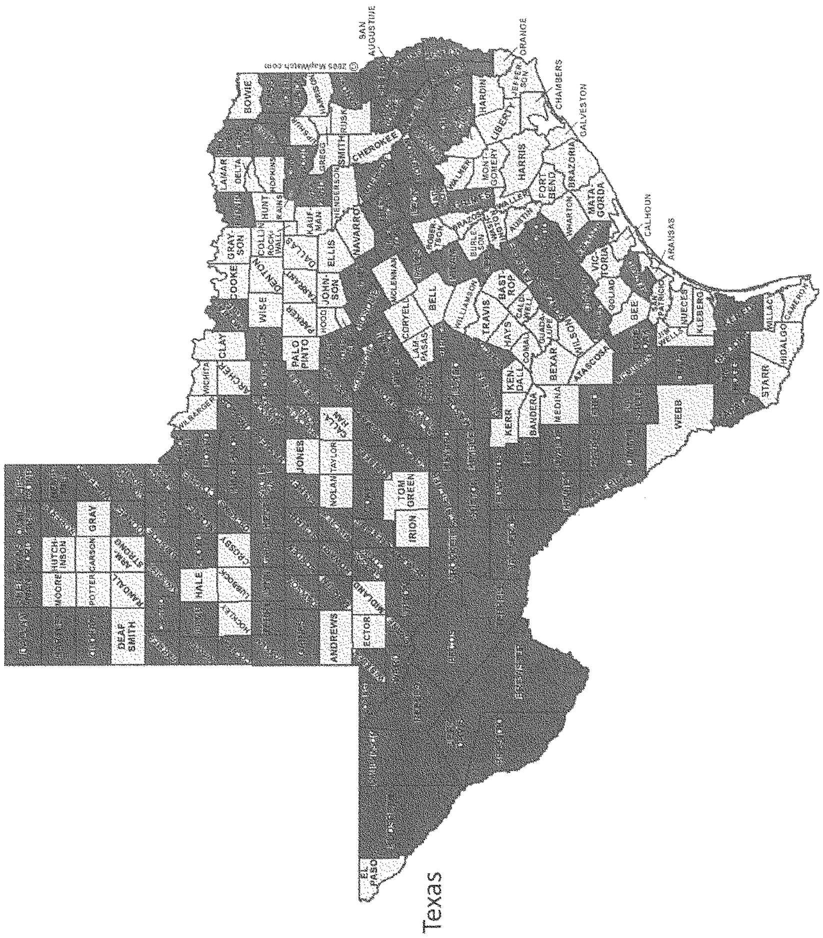
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HOPKINS
GREGG
SMITH
RUSK
CHEROKEE
HENDERSON
KAUFMAN
NAVARRO
COLLIN
ROCKWALL
DALLAS
ELLIS
GRAYSON
COOKE
DENTON
TARRANT
JOHNSON
HOOD
PARKER
WISE
PALO PINTO
CLAY
ARCHER
WICHITA
WILBARGER
HARDIN
JEFFERSON
LIBERTY
HARRIS
MONTGOMERY
WALKER
WALLER
FORT BEND
BRAZORIA
MATAGORDA
WHARTON
AUSTIN
BRAZOS
BURLESON
ROBERTSON
WASHINGTON
BASTROP
TRAVIS
WILLIAMSON
BELL
CORYELL
MCLENNAN
LAMPASAS
HAYS
CALDWELL
COMAL
GUADALUPE
BEXAR
WILSON
ATASCOSA
KENDALL
KERR
BANDERA
MEDINA
VICTORIA
GOLIAD
BEE
SAN PATRICIO
NUECES
KLEBERG
WILLACY
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HIDALGO
STARR
WEBB
CALLAHAN
JONES
TAYLOR
NOLAN
TOM GREEN
IRION
HUTCHINSON
GRAY
CARSON
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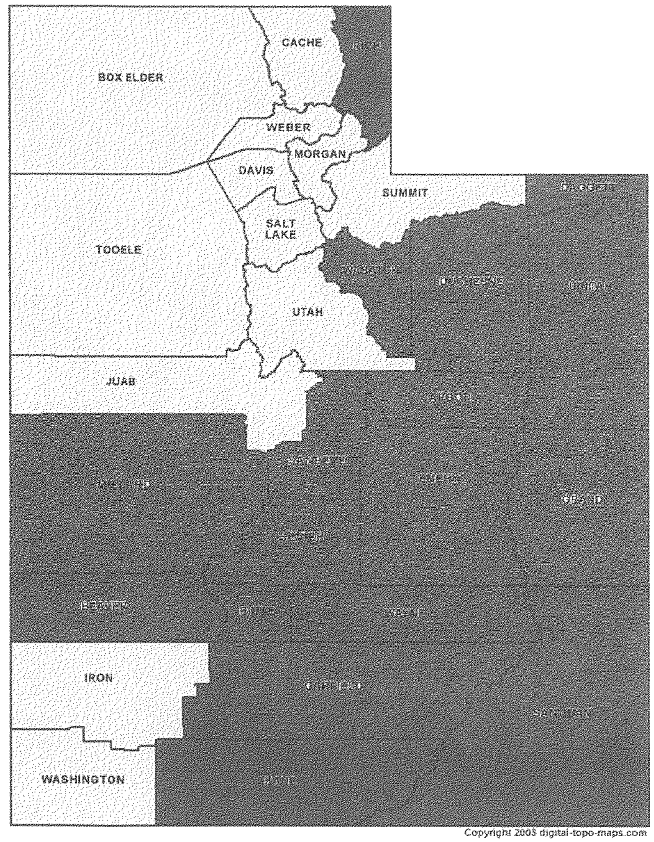
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UTAH
JUAB
CARBON
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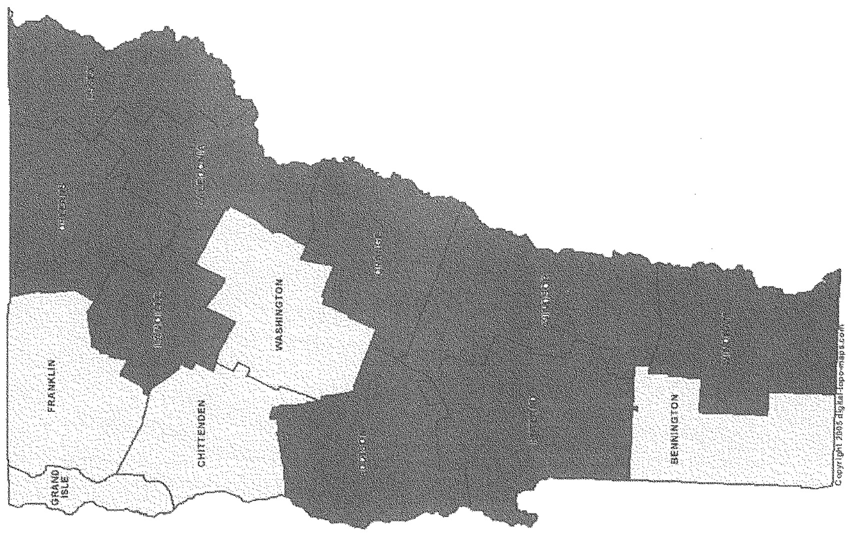
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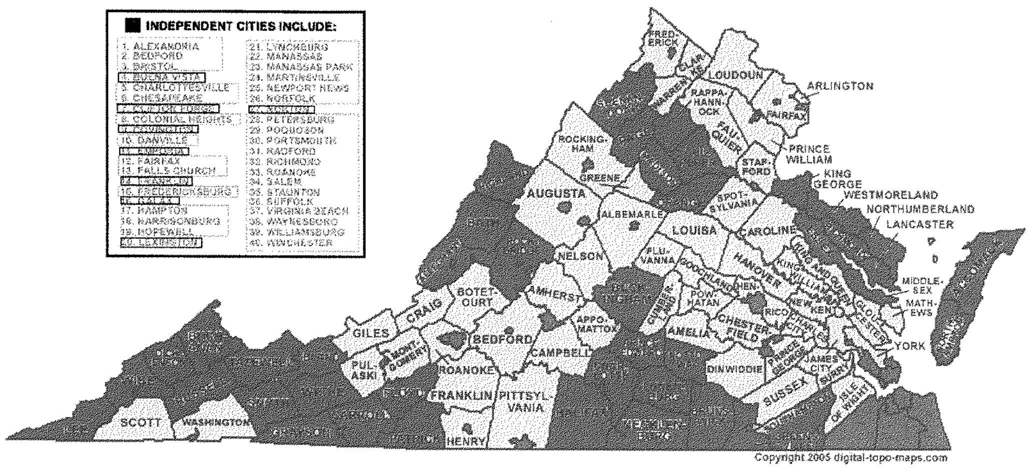
Vermont

Virginia


INDEPENDENT CITIES INCLUDE:
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2. BEDFORD
3. BRISTOL
4. BUENA VISTA
5. CHARLOTTESVILLE
6. CHESAPEAKE
8. COLONIAL HEIGHTS
10. DANVILLE
12. FAIRFAX
13. FALLS CHURCH
16. FREDERICKSBURG
17. HAMPTON
18. HARRISONBURG
19. HOPEWELL
20. LEXINGTON
21. LYNCHBURG
22. MANASSAS
23. MANASSAS PARK
24. MARTINSVILLE
25. NEWPORT NEWS
26. NORFOLK
28. PETERSBURG
29. POQUOSON
30. PORTSMOUTH
31. RADFORD
32. RICHMOND
33. ROANOKE
34. SALEM
35. STAUNTON
36. SUFFOLK
37. VIRGINIA BEACH
38. WAYNESBORO
39. WILLIAMSBURG
40. WINCHESTER
FRED-ERICK
LOUDOUN
ARLINGTON
RAPPA-HANN-OCK
FAIRFAX
FAU-QUIER
PRINCE WILLIAM
STAF-FORD
KING GEORGE
WESTMORELAND
NORTHUMBERLAND
LANCASTER
ROCKING-HAM
GREENE
AUGUSTA
SPOT-SYLVANIA
ALBEMARLE
LOUISA
CAROLINE
NELSON
FLU-VANNA
HANOVER
MIDDLE-SEX
MATH-EWS
CRAIG
BOTET-OURT
AMHERST
POW-HATAN
GILES
BEDFORD
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AMELIA
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YORK
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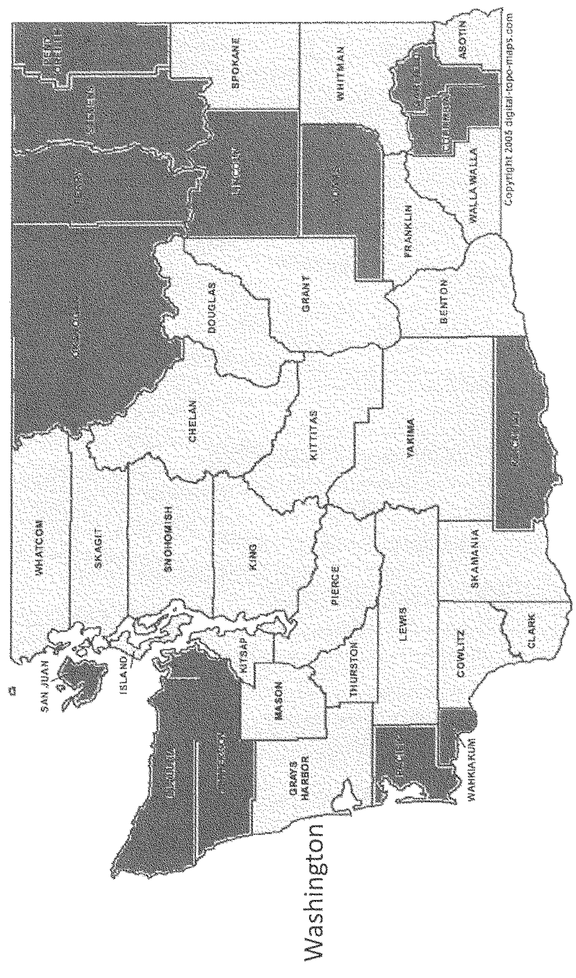

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KING
PIERCE
CHELAN
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GRANT
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ASOTIN
FRANKLIN
WALLA WALLA
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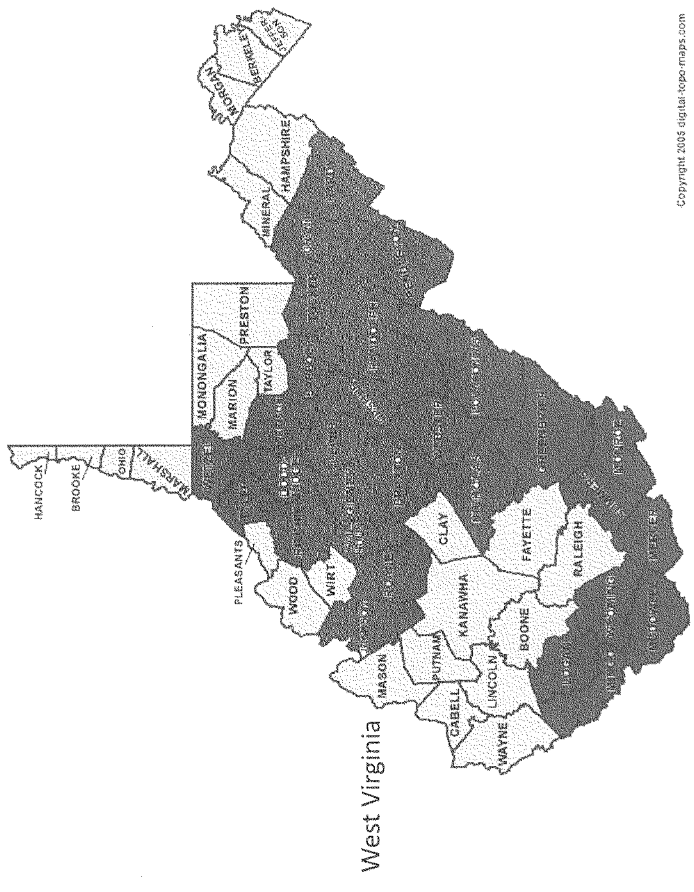
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BERKELEY
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MINERAL
PLEASANTS
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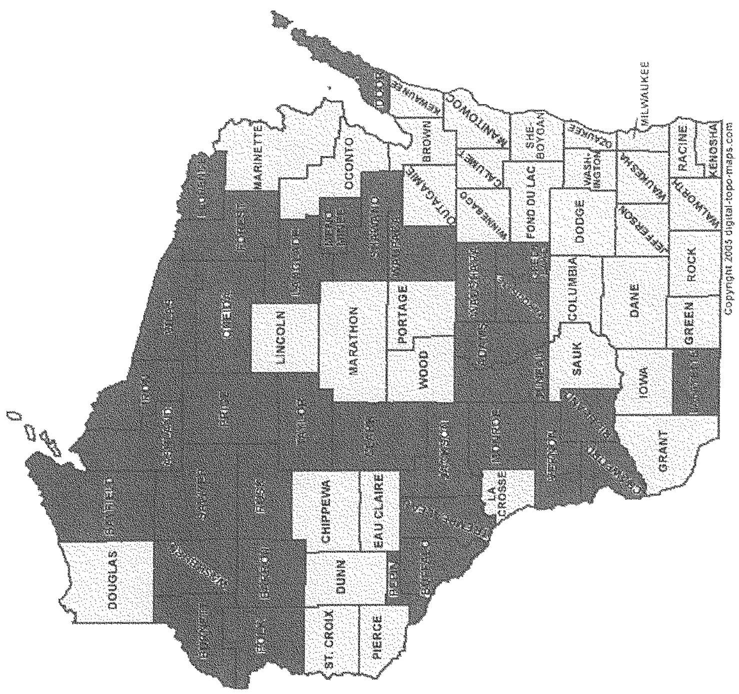
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ROCK
COLUMBIA
DODGE
JEFFERSON
WALWORTH
WAUKESHA
RACINE
KENOSHA
MILWAUKEE
OZAUKEE
WASH-INGTON
SHE-BOYGAN
FOND DU LAC
WINNEBAGO
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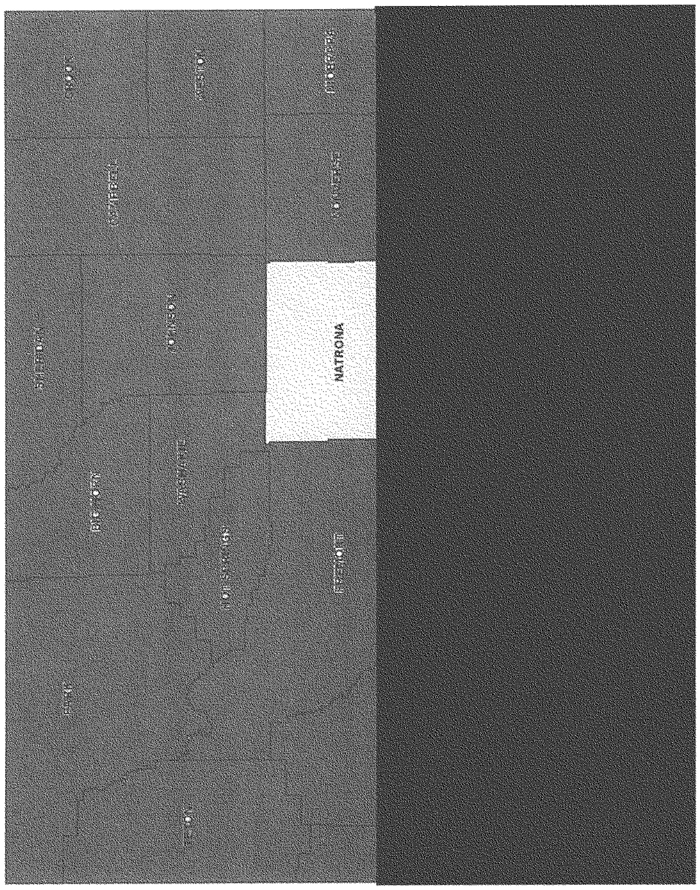

Wyoming

NAFCU
3138 10th Street North
Arlington, VA 22201-2149
703.522.4770 | 800.336.4644
F: 703.524.1082
nafcu@nafcu.org
National Association of Federal Credit Unions | www.nafcu.org

May 20, 2013

The Honorable Shelley Moore Capito	The Honorable Gregory Meeks
Chairman	Ranking Member
Subcommittee on Financial Institutions and Consumer Credit	Subcommittee on Financial Institutions and Consumer Credit
House Financial Services Committee	House Financial Services Committee
United States House of Representatives	United States House of Representatives
Washington, D.C. 20515	Washington, D.C. 20515

Re: Credit Union concerns with the CFPB's Ability-to-Repay Rule

Dear Chairman Capito and Ranking Member Meeks:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents the interests of our nation's federal credit unions, I write today in conjunction with tomorrow's hearing, "Qualified Mortgages: Examining the Impact of the Ability- to-Repay Rule." NAFCU member credit unions and their 95 million member-owners appreciate the subcommittee's timely focus on this complex final rule scheduled to take effect in January of 2014.

As members of the subcommittee are aware, a host of mortgage related rules have been promulgated and taken individually or in their cumulative effect, will undoubtedly alter the mortgage market in unintended ways. The ability-to-pay rule is of particular concern moving forward as the stringent requirements contained in the final rule will require credit unions to make major investments and incur significant expenses. Accordingly, as indicated by NAFCU member credit unions in our recent *Economic and Credit Union Monitor Survey*, nearly 44% of respondents said they will cease originations of non-qualified mortgages (QM). Another 44% indicated they will reduce originations that fall outside of the QM guidelines.

NAFCU has taken advantage of every opportunity available to discuss with the Consumer Financial Protection Bureau (CFPB) aspects of the ability-to-repay rule that are likely to be problematic for credit unions and their members. While credit unions understand the intention of the rule and importance of hindering unscrupulous mortgage lenders from entering the marketplace, we cannot support the ability-to-repay rule in its current form. A major issue, for example, is the underwriting criteria that dictates a consumer have a total debt-to-income ratio that is less than or equal to 43 percent in order for that loan to be considered a QM. NAFCU believes this arbitrary threshold will prevent otherwise healthy borrowers from obtaining

obtaining mortgage loans and will have a particularly serious impact in rural and underserved areas where consumers have a limited number of financial service options. In addition, as the subcommittee is aware, the rule excludes from the definition of QM those mortgage loans with terms exceeding 30 years. By definition this punishes credit unions and their members if a longer-term product is the best choice under a particular set of certain circumstances.

Before the ability-to-repay rule goes into effect, we also urge the subcommittee to review and address the definition of "points and fees" contained in the rule. As currently defined, "points and fees" will include, among other charges, fees paid to affiliated title companies, salaries paid to loan originators, amounts of insurance and taxes held in escrow, loan level prices adjustments, and payments by lenders to correspondent banks, credit unions and mortgage brokers in wholesale transactions. As a result of this troublesome definition many affiliated loans, particularly those made to low- and moderate-income borrowers, would not qualify as QMs and would be unlikely to be made or would only be available at higher rates due to heightened liability risk. NAFCU supports Rep. Huizenga's bipartisan legislation– the *Consumer Mortgage Choice Act* (H.R. 1077) – that would satisfactorily address this important aspect of the ability-to-repay rule.

Thank you for holding this important hearing and for providing us with the opportunity to comment on the ability-to-repay rule on behalf of our member credit unions. If you have any questions or would like further information about any of these issues, please do not hesitate to contact me or NAFCU's Vice President of Legislative Affairs Brad Thaler by telephone at (703) 842-2204 or by e-mail at bthaler@nafcu.org.

Sincerely,

Carrie Hunt
Vice President of Regulatory Affairs and General Counsel

cc: Members of the Subcommittee on Financial Institutions and Consumer Credit

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STATEMENT OF THE

NATIONAL ASSOCIATION OF REALTORS®

SUBMITTED FOR THE RECORD TO

THE UNITED STATES HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

HEARING REGARDING

QUALIFIED MORTGAGES: EXAMINING THE IMPACT OF THE ABILITY TO REPAY RULE

MAY 21, 2013

INTRODUCTION

On behalf of the 1 million members of the National Association of REALTORS® (NAR), who are involved in all types of real estate transactions, thank you for holding this very important hearing on the Qualified Mortgage (QM)/Ability to Repay (ATR) rule.

The Dodd-Frank Wall Street Reform Act established the QM as the primary means for mortgage lenders to satisfy its "ability to repay" requirements. NAR has been generally supportive of the Consumer Financial Protection Bureau's (CFPB) efforts to craft a QM rule that is not unduly restrictive and provides a safe harbor for lenders making QM loans. NAR has had policy supporting the idea that lenders measure a consumer's ability to repay a loan since 2005.

However, Dodd-Frank also provides that a Qualified Mortgage (QM) may not have points and fees in excess of 3 percent of the loan amount. As currently defined by Dodd Frank and in the Consumer Financial Protection Agency's (CFPB) final regulation to implement the "ability to repay" requirements, "points and fees" include (among other charges): (i) fees paid to affiliated (but not unaffiliated) title companies, (ii) salaries paid to loan originators, (iii) amounts of insurance and taxes held in escrow, (iv) loan level price adjustments (LLPAs), and (v) payments by lenders to correspondent banks and mortgage brokers in wholesale transactions.

As a result of this problematic definition, many loans made by affiliates, particularly those made to low- and moderate-income borrowers, would not qualify as QMs. Consequently, these loans would be unlikely to be made or would only be available at higher rates due to heightened liability risks. Consumers would lose the ability to choose to take advantage of the convenience and market efficiencies offered by one-stop shopping.

It has been argued that CFPB has the authority to fix this problem. However, it is very clear that the CFPB feels constrained by Congress's apparent intent and the language of Dodd-Frank particularly with regard to affiliates. As the Bureau indicated in its statement in the January 2013 final rule:

> *The Bureau is adopting § 226.32(b)(1)(iii) as proposed but renumbered as § 1026.32(b)(1)(iii). TILA section 103(bb)(4) specifically mandates that fees paid to and retained by affiliates of the creditor be included in points and fees. The Bureau acknowledges that including fees paid to affiliates in points and fees could make it more difficult for creditors using affiliated service providers to stay under the points and fees cap for qualified mortgages and that, as a result, creditors could be disincented from using affiliated service providers. This is especially true with respect to affiliated title insurers because of the cost of title insurance. On the other hand, despite RESPA's regulation of fees charged by affiliates, concerns have nonetheless been raised that fees paid to an affiliate pose greater risks to the consumer, since affiliates of a creditor may not have to compete in the market with other providers of a service and thus may charge higher prices that get passed on to the consumer.* ***The Bureau believes that Congress weighed these competing considerations and made a deliberate decision not to exclude fees paid to affiliates.*** *This approach is further reflected throughout title XIV, which repeatedly amended TILA to treat fees paid to affiliates as the equivalent to fees paid to a creditor or loan originator. See, e.g., Dodd-Frank Act sections 1403, 1411, 1412, 1414, and 1431. For example, as noted above, TILA section 129C(b)(2)(C)(i), as added by section 1412 of the Dodd-Frank Act, provides that for purposes of the qualified mortgage points and fees test, bona fide third-party charges are excluded other than charges "retained by *** an affiliate of the creditor or mortgage originator." Similarly, TILA section 129B(c)(2)(B)(ii), added by section 1403 of the Dodd-Frank Act, restricts the payment of points and fees*

but permits the payment of bona fide third-party charges unless those charges are "retained by an affiliate of the creditor or originator." ***In light of these considerations, the Bureau does not believe there is sufficient justification to use its exception authority in this instance as the Bureau cannot find, given Congress's clear determination, that excluding affiliate fees from the calculation of points and fees is necessary or proper to effectuate the purposes of TILA, to prevent circumvention or evasion thereof, or to facilitate compliance therewith.*** *(Emphasis added)*[1]

For this reason, NAR believes that only Congress can fully rectify the law's discrimination against affiliates, small and mid-size lenders, community banks, and credit unions in the calculation of fees and points.

H.R. 1077 – THE CONSUMER MORTGAGE CHOICE ACT

H.R. 1077, introduced by Representatives Huizenga (R-MI), Bachus (R-AL), Royce (R-CA), Stivers (R-OH), Meeks (D-NY), Scott (D-GA), Clay (D-MO), and Peters (D-MI), addresses this discrimination against smaller lenders, brokers, and lenders with affiliates in the calculation of fees and points for purposes of meeting the 3% cap on fees and points in the Ability to Repay/Qualified Mortgage (QM) provisions of Dodd-Frank. The bill helps maintain consumer choice in selecting the type of mortgage originator best able to meet their mortgage credit needs.

Key Components of H.R. 1077

The key components of H.R. 1077 include:

- The bill removes affiliate title charges from the calculation of fees and points. The title industry is heavily regulated and competitive. It does not make sense to discriminate against affiliates on the basis of these fees. To do so would only reduce competition and choice in title services and insurance providers.

  Furthermore, owners of affiliated businesses can earn no more than a proportionate return on their investment under RESPA. RESPA also prohibits referral fees or any compensation at all for the referral of settlement services. As a result, there is no steering incentive possible for individual settlement service providers such as mortgage brokers, loan officers or real estate professionals.

- The bill removes a manner of counting fees and points that would unfairly discriminate against Mortgage Banking and Mortgage Brokerage entities by only counting as fees and points monies paid directly by the consumer to the originator, be they a broker or a mortgage bank loan officer.

- The bill removes from the calculation of fees and points Fannie Mae and Freddie Mac Loan Level Price Adjustments (LLPAs). This money is not revenue to the lender. These adjustments are essentially risk based pricing established by the GSEs and can sometimes exceed 3 points in

[1] **Federal Register** /Vol. 78, No. 20 /Wednesday, January 30, 2013 /Rules and Regulations pg. **6439.** It is also on page 33 of the pdf version- http://www.gpo.gov/fdsys/pkg/FR-2013-01-30/pdf/2013-00736.pdf

and of themselves. Including these LLPAs would limit access to affordable mortgage credit to many borrowers or force borrowers into FHA or Non-QM loans unnecessarily.

- The bill removes from the calculation of fees and points escrows held for taxes and insurance. The tax portion is a clarification of poor language in Dodd-Frank. In the case of insurance, these escrows are held to pay third party homeowner's insurance. They are not retained and cannot be retained under RESPA since RESPA requires excess escrows to be refunded.

This bill is essential to maintain competition and consumer choice in mortgage origination. Without this legislation, one-quarter to as much as one-half of loans currently being originated would likely not be eligible for the QM safe harbor and would likely not be made or would be concentrated amongst the largest retail lenders whose business models are protected from the fees and point definition discrimination in most cases since their retail branch employees are not compensated on a per transaction basis or if they are, the amount is not as significant. Therefore, NAR believes that Congress should pass HR 1077 before the "ability to repay" provisions take effect in January 2014.

OTHER AREAS OF CONCERN

43 Percent Debt to Income Limit (DTI) - The biggest area of concern with regard to the underwriting standards for QM will be jumbo loans with DTI in excess of 43% and other loans particularly when the exception for GSE loans expires. For lower loan amounts, FHA and other government backed loans will be the only loans that will satisfy the QM safe harbor when DTI exceeds 43%. Even if the GSE exception is maintained, jumbo loans and non-GSE or government backed loans will be subject to the 43% DTI cap making them more costly or less likely to be made.

QM and Qualified Residential Mortgage (QRM) – NAR believes that assuming the concerns above are addressed, the QRM (which does not require risk retention by securitizers) should be constructed to match the QM. Dodd-Frank establishes that the QRM can be no broader than the QM, but it does not say it cannot be substantially the same. NAR has conducted significant research and has determined that the further imposition down payment requirements and tighter debt-to-income and credit standards will greatly decrease access to credit without creating substantial improvements in loan quality. For this reason, Congress should support, and regulators should establish, a QRM that substantially mirrors the QM.

CONCLUSION

The National Association of REALTORS® supports a broad QM rule that does not discriminate against affiliates, smaller lenders, community banks, or credit union. Furthermore, NAR supports a QM rule that gives consumers maximum choice in service providers. Finally, NAR supports a QM and QRM rule that does not needlessly cause credit to be more costly or unobtainable.

We are already in a tight credit environment. The QM and other rules effectively ban the types of products and processes that led to the mortgage crisis. Congress and the CFPB should improve the QM rule to ensure that consumers who have the ability to repay their loans will have the access to affordable credit they deserve.

James C. Gardill
Chairman of the Board

WesBanco

May 24, 2013

Via email to: aaron.sporck@mail.house.gov

Mr. Aaron Sporck
Honorable Shelley Moore Capito
Subcommittee on Financial Institutions
and Consumer Credit
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Washington, D.C. 20515

Dear Aaron and Chairman Capito:

Thank you very much for the opportunity to submit additional comments concerning the Ability to Repay and Qualified Mortgage Standards. In reviewing the comments previously provided to Chairman Capito regarding these regulations by other financial institutions, we have identified a couple of additional issues which are worthy of discussion. We also generally agree with the comments and concerns expressed about the new rules and share in the concerns previously communicated to the Subcommittee. We would offer these additional comments for the Subcommittee's consideration. We have utilized summaries of the regulations provided by the American Bankers Association ("ABA") in this material to ensure a consistent description of the applicable requirements.[1]

Background

On January 10, 2012, the Consumer Financial Protection Bureau ("CFPB") officially issued the final Ability to Repay and Qualified Mortgage Standards under the Truth in Lending Act. This final rule implements Sections 1411, 1412, and 1414 of the Dodd-Frank Act and created new TILA section 129C, which establishes, among other things, new ability to repay requirements, alternative methods to ensure compliance with such requirements, and certain new limits on prepayment penalties. The rule is effective January 10, 2014. The Ability to Repay final rule implements the most important mortgage related legislative reform of the Dodd-Frank Act, and is expected to significantly impact real estate finance activities going forward. The objective of the law is to ensure reasonable and good faith determinations in loan underwriting. Pursuant to this legislation, the rule sets forth comprehensive legal standards to govern the

[1] ABA Staff Analysis: Ability-to-Repay and Qualified Mortgage Standards Under TILA, January 2013.

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underwriting of residential mortgage loans, requiring creditors to follow precise guidelines regarding the consideration and evaluation of a borrower's repayment capacity.

Under the rules issued by the CFPB, a lender extending a residential mortgage loan must make a reasonable and good faith determination of a borrower's ability to repay the loan or otherwise face very significant monetary consequences. This rule first sets forth the regulatory elements defining this ability to repay standard. Second, the rule implements legislative provisions that provide that creditors originating qualified mortgages ("QM") would have special protection from liability under the Ability to Repay requirements. The rule defines the qualification criteria for a QM, and the standards that lenders must follow to access its legal protections. The rule also describes an exemption for refinancing non-standard mortgages, and allows other additional and temporary protections for certain riskier mortgages.

We are aware that the CFPB solicited comments on proposed revisions to the final rules that would extend QM protection to specifically defined categories of community banks and credit unions. We are also aware of the subsequent comment letters provided by numerous organizations, including the comments provided by the ABA in its letter of February 25, 2013 and we join in their comments that the definition of small lender is too narrow, as therein defined. Both the $2 billion limit and the 500 loan limits are simply too low. As the ABA suggested, to have a meaningful impact on credit availability for borrowers served by small portfolio lenders, the limit should be expanded to cover a more accurate representation of a small portfolio lender. Lenders with up to $10 billion in assets and with loan limits of at least 2,000 loans should be used as the applicable bench marks. As noted by the ABA, setting the asset size lower will have the impact of unnecessarily curtailing credit availability for many community banks, including WesBanco. Perhaps even more harmful will be setting the loan limit cut off too low. If a lender is based with the cutoff of their ability to gain the QM if they exceed the 500 loan limit, they will likely limit the number of loans they are willing to make, particularly low dollar loans. This could have the unintended consequence of making it more difficult for rural and underserved borrowers who are seeking small loans ($40,000 or less) which are not generally purchased by the secondary market. A more reasonable loan limit number for banks in the $10 billion asset range is 2,000 loans per year. This is still a modest number, but allows enough breathing room for small lenders to serve all of their community without the risk of losing the protection of the QM safe harbor.

Supplemental Comments

There are several sections of these proposed rules which pose particular concerns for West Virginia banks. Though West Virginia has a non-judicial foreclosure process, Courts in West Virginia have recently entertained a broader array of tort claims in defense to foreclosure actions filed in the form of tort cases either in a direct response to the initiation of a trustee sale under a deed of trust or as an adversary proceeding in bankruptcy as a counter attack to the enforcement of a secured lien by a lien creditor. The relative explosion of these cases in the last two years in state and federal courts in West Virginia is causing a significant increase in expense to secured creditors in pursuing their legal remedies, significantly delaying the transfer of real estate in foreclosure proceedings thereby reducing the value of homes through neglect and abandonment and significantly increasing the expenses for financial institutions in pursuing routine default claims. The proposed rules have several troubling provisions which will exacerbate this litigation explosion and create further uncertainty and delay in the process of collection of past due loans and enforcement of credit instruments.

Penalties and Liability Provisions

The new Ability to Repay provisions broadly cover consumer credit transactions that are secured by a dwelling, as currently defined under TILA §1026.2(a)(19). See §226.43(a). The final rule does not contain descriptions or elaborations of the penalty and liability provisions applicable to the Ability to Repay provisions. These provisions are, however, relevant for a full assessment of the impact of these rules. The legislation sets out the following penalty provisions:

i. Section 1416 of the Dodd-Frank Act amended TILA section 130(a) to provide that consumers who bring timely action against creditors for violations of the Ability to Repay requirements may be able to recover special statutory damages equal to the sum of all finance charges and fees paid by the consumer.

ii. The statute of limitations is three years from the date of the occurrence of the violation.

iii. Notwithstanding the statute of limitations, TILA section 130(k) provides that when a creditor, assignee, or other holder initiates a foreclosure action, a consumer may assert a violation of the Ability to Repay requirements as a matter of defense by recoupment or setoff. There is no time limit on the use of this defense, but the amount of recoupment or setoff is limited with respect to the special statutory damages to no more than three years of finance charges and fees.

As noted above, there is no time limit on the use of the Ability to Repay as a defense by recoupment or setoff even though the amount of the recoupment or setoff is limited with respect to the special statutory damages to no more than three years of finance charges and fees. This provision greatly expands the opportunity to raise consumer damage claims in routine mortgage foreclosure cases and will significantly increase litigation in consumer loan enforcement actions. It is within the framework of these additional penalty and liability provisions, with essentially no statute of limitations with respect to assertion as a matter of defense by recoupment or setoff, that we frame our comments which follow.

Ability to Repay Standard

The objective of this rule is to assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are not unfair, deceptive or abusive. The basic directive of the Ability to Repay rule is that creditors may not make a loan that is a covered transaction unless the creditor makes a reasonable and good faith determination at or before consummation that the consumer will have a reasonable ability to repay the loan according to its terms. The rule goes on to provide eight underwriting factors that need to be met for non-QM loans.

Our concern centers on the legal standard of "reasonable and in good faith". The Dodd-Frank Act and the final rule prohibit a creditor from making a covered transaction unless the creditor makes a reasonable and good faith determination, based on verified and documented information, that the consumer has a reasonable ability to repay the loan according to its terms. Whether a particular ability to repay determination is reasonable and in good faith will depend on the underwriting standards adopted by the creditor, and on the facts and circumstances of an individual extension of credit and how the creditor's underwriting standards were applied to those facts and circumstances.

Part of the problem stems from the fact that post closing behavior is specifically included as a criteria upon which the creditor's judgment will be measured. Comment 43(c)(1)-1 lists elements that may be evidence that a creditor's ability to repay determination was reasonable and in good faith. Included in those elements are whether the consumer demonstrated actual ability to repay the loan by making timely payments, without modification or accommodation, for a significant period of time after consummation or, for an adjustable rate, interest only, or negative amortization mortgage, for a significant period of time after recast. It is ludicrous to base an analysis upon a creditor's reasonable and good faith determination under a facts and circumstances standard by considering the payment history of the borrower after the time the determination is to be made and which is based in part on the volition of the borrower to make the payments legally required of the borrower. An astute borrower, or a well coached borrower, can obtain a loan, voluntarily default on the loan and then assert that the creditor breached the Ability to Repay standard and therefore is entitled to damages and attorney fees.

The second problem with this rule is that any modification or accommodation of credit extended to a borrower who encounters difficulties after inception of the loan would create an element of violation of the rule thereby motivating banks not to make modifications or accommodations in credit facilities after the effective date of the loan to avoid a claim that the creditor thereby breached its duties under the Ability to Repay rule.

One additional problem arising from comment 43(c)(1)-2 deals with the question of "reasonably anticipated" issues which could affect the consumer's ability to repay. The comment notes that creditors are required to make a predictive judgment at the time of consummation of the loan that a consumer is likely to have the ability to repay a loan in the future. A change in the consumer's circumstances after consummation (for example, a significant reduction in income due to a job loss or a significant obligation arising from a major medical expense) that cannot be "reasonably anticipated" from the consumer's application or the records used to determine repayment ability" is not relevant in determining a creditor's compliance with the rule. The problem with this comment is that it is qualified by the proviso that the change in circumstances could not have been "reasonably anticipated" by the creditor at the time of the consumer's application.

The proviso permits a consumer to assert at a later time after closing the loan that the consumer communicated to a creditor some potential change in circumstances such as an impending layoff, the expiration of a labor agreement, future surgery, a medical condition for which the consumer was receiving treatment, an anticipated divorce or the illness of a family member, all of which could have an impact on the ability of the consumer to repay a loan in the future. As we will note in the following section, this issue is significant since the rule permits oral statements by the borrower to be used to demonstrate knowledge of the creditor.

The rule should require some type of disclosure by the consumer of any anticipated future circumstances which might impact the borrower's ability to repay of which the borrower is aware at the time of application. Absent such a clarification, a creditor is completely at the mercy of the imagination of the borrower, or the borrower's counsel, of "reasonably anticipated" future circumstances of which the creditor should have been aware. Litigation cases are replete with filings alleging that the party "knew or should have known" standard which puts creditors clearly in an indefensible position.

This issue is exacerbated by the legal standards set forth under the qualified mortgage rules. Some background on the qualified mortgage rules follows with additional comments tying the two sections together.

Qualified Mortgage

Overview:

The Dodd-Frank Act sets forth TILA section 129C(b), providing that loans that meet certain requirements shall be deemed "qualified mortgages," and entitled to a presumption of compliance with the ability to repay requirements. The purpose of the QM provision is to define a category of loans with delineated standards that eliminate risky terms and ensure safe loans for consumers. To this end, the final rule defines QM through three general categories. First, the QM focuses on prohibiting certain risky features and practices (such as negative amortization and interest-only periods or underwriting a loan without verifying the consumer's income). Second, the QM establishes limits on certain loan costs. Finally, the QM establishes certain underwriting criteria (verification and documentation of income and fully amortizing schedules based on maximum rates of the loan) for covered loans.

The final rule bifurcates the QM into two segments. It provides a safe harbor (where compliance is deemed conclusive) for loans that satisfy the definition of a QM and are not "higher-priced mortgage loans." Second, the final rule provides a rebuttable presumption (where compliance can be challenged in court) for loans that meet the QM conditions but qualify as "higher priced mortgage loans," as described below. The term "higher priced mortgage loan" ("HPML") is generally defined by the Board's existing TILA regulations, as set forth in the 2008 HPML rule.[2]

Rebuttable Presumption:

The final rule provides that consumers may show a violation with regard to a subprime qualified mortgage (HPML loans) by showing that, at the time the loan was originated, the consumer's income and debt obligations left insufficient residual income or assets to meet living expenses. The analysis would consider the consumer's monthly payments on the loan, loan related obligations, and any simultaneous loans of which the creditor was aware, as well as any recurring, material living expenses of which the creditor was aware.

In the Rule's preamble, the Bureau explains that under the rebuttable presumption standard, a consumer can rebut the legal presumption by showing that, in fact, at the time the loan was made the consumer did not have sufficient income or assets (other than the value of the dwelling that secured the transaction), after paying his or her mortgage and other debts, to be able to meet his or her other living expenses of which the creditor was aware. In short, the

[2] Higher priced mortgage loans are defined under TILA as loans with an annual percentage rate (APR) equal to or greater than the Average Prime Offer Rate (APOR) by 1.5 percentage points for first-lien loans, or 3.5 percentage points for subordinate lien loans for a comparable transaction.

Bureau is limiting the ability to rebut the presumption to the specific issue of insufficient residual income or assets other than the dwelling.

Guidance accompanying the rule notes that the longer the period of time that the consumer has demonstrated actual ability to repay the loan by making timely payments, without modification or accommodation, after consummation or, for an adjustable rate mortgage, after recast, the less likely the consumer will be able to rebut the presumption based on insufficient residual income.

The final rule does not preclude the use of oral evidence in rebuttable presumption cases, to impeach evidence contained in the loan file. The Bureau believes that courts will determine the weight to be given to such evidence on a case-by-case basis.

The supplementary information that accompanies the Rule makes clear that oral communications between a borrower and creditor may also factor into the underwriting analysis for purposes of determining QM status:

> A consumer may seek to show that a loan does not meet the requirements of a qualified mortgage by relying on information provided orally to the creditor or loan originator to establish that the debt-to-income ratio was miscalculated. Alternatively, a consumer may seek to show that the creditor should have known, based upon facts disclosed orally to the creditor or loan originator, that the consumer had insufficient residual income to be able to afford the mortgage.

As you can see, the rule again permits post loan closing behavior through voluntary payments by the borrower to be considered in judging the decision of the creditor to approve the loan under the Ability to Repay rule. More importantly, it permits the use of oral evidence in rebuttable presumption and QM cases to impeach evidence contained in the loan file. This is a serious flaw in the regulations since the determination which would be made by a court subsequent to the loan closing specifically require the court to consider matters of which the creditor was aware and permits the borrower to assert oral evidence to refute or assert matters which were not disclosed or considered by the creditor at the time of making the decision.

This express provision permitting oral evidence to modify written documents and agreements is contrary to established law and runs contrary to American jurisprudence. It makes these cases relatively indefensible in that an astute borrower, or a borrower adequately coached, could easily assert that he disclosed any number of potential issues which could affect the borrower's ability to repay and therefore that the creditor should have been aware and reasonably anticipated those issues impacting the borrower's ability to repay. The combination of these rules together with the express commentary noting that it does not preclude the use of oral evidence creates an impossible legal environment in which federally insured financial institutions, or any good faith creditors, would be deterred from pursuing enforcement of credit instruments. It also exposes them to damages and attorney's fees which are not otherwise available to borrowers.

Laughlin Plan

You also asked that we address the Bank's administration of the Laughlin Plan and our concerns about the impact upon that program of the ability to repay and qualified mortgage rules.

The Laughlin Plan is actually a charitable trust created under the Will of George A. Laughlin and is administered by the Bank as Trustee of the Trust. The general purpose of the Trust, as set forth in the Will, was to encourage the heads of large families to own their own homes by providing financial aid to the heads of those families residing in Ohio County, West Virginia, who are sober, industrious and have good general character. The financial aid is to be made available to those who, without the aid of such assistance, would find it difficult, if not impossible to acquire homes of their own.

The Laughlin Plan provides interest free loans to heads of households and single parent families with at least 2 or more children during the term of the loan. The Trust provides life and accident insurance on the borrower and fire and flood insurance, where applicable, at no cost to the borrower. The Bank has used the Laughlin Plan to assist in the construction of new homes under certain Habitat for Humanity's programs, as well as purchasing existing homes for purposes of the Laughlin Plan. The Bank currently has approximately 100 loans in which such families participate through which it is providing interest free loans that made homes available to first-time home buyers as well as those who previously owned a home but do not currently own a home. Laughlin loans are not made available to applicants who already own a family residence or have the ability to purchase a home through a conventional mortgage. The Trust pays all of the closing costs associated with the sale of the property.

We have concerns about the administration of the program in light of the proposed exemptions as the exemptions which are proposed do not seem to be broad enough to cover the program. The proposed exemptions related to non-profit creditors is found in Section 1026.43(a)(3)(v). As described in the commentary, the proposal exempts creditors "... designated as non-profit organizations under Section 501(c)(3) of the Internal Revenue Code, provided that the extension of credit is to a consumer with income that does not exceed the qualifying limit for moderate income families as is established pursuant to Section 8 of the United States Housing Act of 1937, that during the calendar year preceding receipt of the consumer's application, the creditor extended credit no more than 100 times, and only to consumers with income that did not exceed the above qualifying limit, and that the creditor determines, in accordance with the written procedures, that the consumer has the reasonable ability to repay the extension of credit." The qualifications to the proposed exemption limit its usefulness and, in our judgment, do not provide a clear exemption which would permit the Bank to safely continue the program without necessarily complying with the ability to repay rule which will preclude its availability to certain borrowers. Thus, we do not believe that the current proposed exemption will be sufficient to provide the Bank, in its capacity as Trustee of the testamentary trust, with the ability to continue to administer the program as currently constituted. This is unfortunate as this has helped low and moderate income families in Ohio County, West Virginia, obtain access to home ownership.

Conclusion

The impact of these rules will significantly narrow the willingness of financial institutions to extend credit outside of the qualified mortgage standards and severely restrict consumers' access to credit. If banks can only safely offer QM loans, credit will be reduced for low to moderate income lending which will impact fair lending results and CRA performance under the lenders test. We are alarmed at the erosion of established legal standards in the search for enhanced consumer protection and would ask Congress to address these rules in some meaningful manner.

The number of exceptions being proposed by the CFPB serves as its own indictment of the regulations. Before the regulations can even go into effect, numerous exceptions have been created and, as noted in the CFPB's own commentary, these exceptions have been created to preclude a severe curtailment of credit. The scope and nature of the exceptions, and the complexity and structure of the rules are eliminating the exercise of discretion by community banks in tailoring loan products to meet the needs of their customers. This will have an impact of greatly reducing credit opportunities for consumers. Equally as important, we appear to be creating another Internal Revenue Code replete with complexity and exceptions which will significantly increase the costs of compliance and greatly reduce consumer choices and opportunities.

We would be happy to meet and discuss these comments in further detail if that would be of assistance to you.

Yours very truly,

James C. Gardill

JAMES C. GARDILL

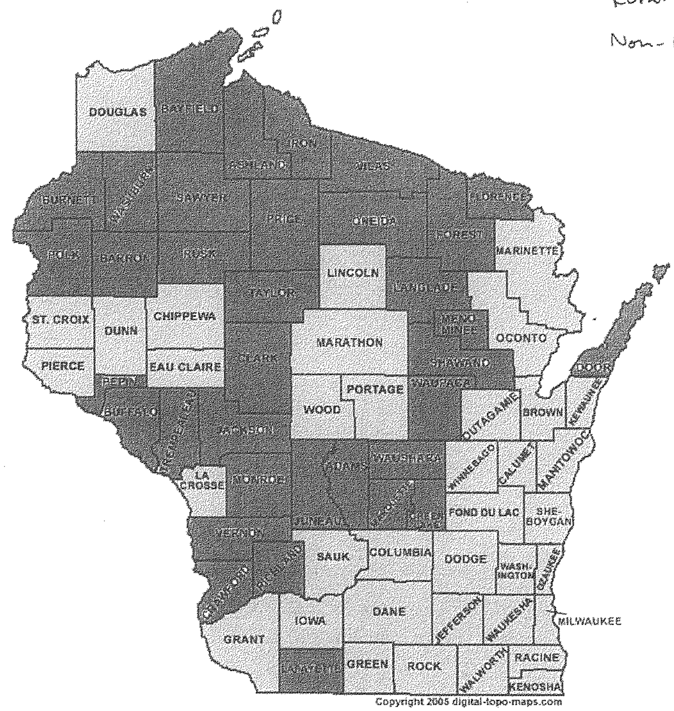
JCG/eab

CFPB QM Rule

Rural = blue

Non-Rural = yellow

Wisconsin



Written Testimony

By

The Real Estate Services Providers Council, Inc.
(RESPRO®)

Before the

U.S. House of Representatives

Subcommittee on Financial Institutions and Consumer Credit

Committee on Financial Services

"Qualified Mortgages:
Examining the Impact of the Ability to Repay Rule"

Tuesday, May 21, 2013

Dear Chairwoman Capito, Ranking Member Meeks, and Members of the Subcommittee:

The Real Estate Services Providers Council, Inc. (RESPRO®) appreciates the opportunity to provide testimony on issues raised in the Subcommittee's May 21, 2013 hearing entitled "Qualified Mortgages: Examining the Impact of the Ability to Repay Rule".

RESPRO® is a national non-profit trade association of providers from all segments of the residential home buying and financing industry, including real estate brokerage firms, homebuilders, mortgage lenders, financial institutions, and title agents/underwriters. The common bond of RESPRO® members is that they offer a diversified menu of services (commonly referred to as "one-stop shopping") for home buyers and home owners through wholly-owned subsidiaries or through joint ventures with other providers, both of which are designated under the Real Estate Settlement Procedures Act (RESPA) as "affiliated business arrangements."[1]

During the May 21 hearing, certain Subcommittee Members asked witnesses from the Consumer Financial Protection Agency's (CFPB) why affiliated businesses are discriminated in the "points and fees" definition used to determine which loans qualify as Qualified Mortgages (QMs). This unnecessary discrimination against affiliated businesses and other inequities in the Final Rule's "points and fees" cap would be rectified by the Consumer Mortgage Choice Act (H.R. 1077), which was introduced in the U.S. House of Representatives on March 12, 2013.[2]

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[1] Recognizing the potential benefits that affiliated businesses can offer consumers, Congress amended RESPA in 1983 to exempt from the 1974 law's referral fee prohibition (12 U.S.C. § 2607(a)), the return of an ownership interest (e.g., a dividend based on stock ownership) in an affiliated business as long as the following conditions are met:

- The person who refers business to an affiliated business discloses at or before the time of the referral the existence of the arrangement to the person being referred;
- The referred person is not required to use any particular provider of settlement services; and
- The only thing of value that is received from the arrangement, other than certain other payments permitted under RESPA Section 8(c), is a return on the ownership interest or franchise relationship.

See 12 U.S.C. § 2607(c)(4). In 1996, the United States Department of Housing and Urban Development (HUD) issued a RESPA Policy Statement setting forth certain guidelines on affiliated businesses. HUD stated that the affiliated business exemption was not intended to apply to "sham" arrangements that are not "bona fide" providers of settlement services, and attempted to provide guidance to affiliated businesses as to what factors HUD considers when making this determination. *See* HUD Statement of Policy 1996-2, Regarding Sham Controlled Business Arrangements, 61 Fed. Reg. 29,258 (June 7, 1996) ("HUD Sham Joint Venture Guidelines").

[2] H.R. 1077 was introduced as bipartisan legislation by the following sponsors: Representatives Huizenga (R-MI), Bachus (R-AL), Royce (R-CA), Stivers (R-OH), Meeks (D-NY), Scott (D-GA), Clay (D-GA), and Peters (R-MI). H.R. 1077 excludes from the definition of "points and fees "all title charges, regardless of whether they are charged by an affiliated company, provided they are bona fide and reasonable." It also addresses other inequities in the "points and fees" definition by (1) preventing double-counting of loan officer compensation; (2) clarifying that funds held in escrow for taxes and insurance are excluded; (3) excluding loan level price adjustments (LLPAs) charged by Fannie Mae and Freddie Mac;

RESPRO® supports the Consumer Mortgage Choice Act because it will alleviate the negative impact that the "points and fees" definition in the Final Rule will have on mortgage affordability and availability, particularly in low-income and moderate income marketplaces, without compromising the goals of the Dodd-Frank Act.

I. The Consumer Benefits and Cost-Competitiveness of Affiliated Businesses

The affiliated business model is not new in the home buying and financing industry. Over the last several decades, real estate brokerage firms, homebuilders, and mortgage lenders increasingly have recognized the value of using affiliated companies to ensure that each transaction is completed as quickly and efficiently as possible. According to an economic study performed by CapAnalysis Group LLC, [3] the national market share of affiliated title companies alone is 26.3%.

Consumer surveys have consistently shown that consumers who use one-stop shopping programs that affiliated businesses offer appreciate their benefits. In a 2010 Harris Interactive survey, home buyers said that using affiliates saves them money (78%), makes the home buying process more manageable and efficient (75%), prevent things from falling through the crack (73%), and is more convenient (73%) than using separate services.[4] These results are consistent with a 2002 survey of 2,052 recent and potential home buyers, which found that 64% of home buyers who had recently used one-stop shopping programs had a better overall experience with their home purchase transaction.[5]

Economic studies over the last two decades have shown that affiliated title services are competitive in cost compared to unaffiliated title services. The CapAnalysis study referred to above analyzed title and title-related charges in more than 2200 HUD-1 Settlement Statements in 2003 and 2005. It concluded that title premium and other title-related settlement charges were statistically the same whether offered by affiliated or unaffiliated businesses.

The CapAnalysis Study reinforced an earlier national economic study on the costs of affiliated vs. unaffiliated title services. The economic research firm of Lexecon, Inc. analyzed title and closing costs of over 1000 home sales transactions for both affiliated and unaffiliated title agencies during a one-week period in September 1994. Like

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and (5) excluding lenders' compensation to correspondent banks, credit unions, and mortgage brokerage firms.

[3] Donald L. Martin PhD. & Richard E. Ludwick, Jr. PhD., CapAnalysis Group LLC, "Affiliated Business Arrangements and Their Effects on Residential Real Estate Settlement Costs: an Economic Analysis" (Oct. 10, 2006).

[4] Harris Interactive, "One-Stop Shopping Consumer Preferences" (2010), performed by Harris Interactive and commissioned by the National Association of Realtors (NAR).

[5] Murray Consulting, "Consumer Perspectives on Realty-Based One-Stop Shopping" (2002).

CapAnalysis, Lexecon concluded that title services for transactions involving affiliated title companies were competitive with those provided by unaffiliated title companies.[6] The Department of Housing and Urban Development (HUD) reviewed the Lexecon findings and stated the following:

> RESPRO®, an association of controlled businesses, commissioned a study by an independent contractor, Lexecon, Inc ... [The study may be] biased in favor of the unaffiliated firms. Therefore, the [study] results might suggest that affiliated firms on average have lower prices than their competitors. Consumers may benefit additionally from reduced shopping time and related hassles.[7] (Emphasis added).

II. The Negative Impact of the 3% "Points and Fees" Cap on Mortgage Affordability and Availability

Title XIV of the Dodd Frank Act provides that a mortgage loan would *not* be a QM for purposes of the Act's Ability to Repay standards if the total "points and fees" paid by the consumer in the transaction exceed 3% of the loan amount.[8] In determining what "points and fees" are included in the 3% cap, Congress adopted (with slight variations) the "points and fees" definition under the Home Owners Equity Protection Act (HOEPA), which counts fees retained by a mortgage lender's affiliated company towards the 3% cap, but not fees paid to an unaffiliated third party.[9]

Therefore, loans in which a consumer uses a mortgage lender's affiliated title company would much more likely exceed the cap and therefore disqualify as a QM -- even if the costs of the services offered by the affiliated company are equal to or less than the cost of equivalent services from unaffiliated companies.

[6] Lexecon, Inc., Economic Analysis of Restrictions on Diversified Real Estate Services Providers (Jan. 3, 1995). Lexecon found that affiliated title services were 2% lower than unaffiliated title services but concluded that this percentage was "statistically insignificant".

[7] HUD Economic Analysis accompanying HUD's 1996 Sham Joint Venture Guidelines. HUD found that because there likely was an attempt by the provider to convince the consumer to use the affiliated services that consumers who used unaffiliated title providers likely had a greater propensity to price shop compared to those who preferred the one-stop convenience of using an affiliated provider. Thus, it concluded that the price of unaffiliated title providers in the sample was likely biased downward below the actual average market price for unaffiliated title providers because those providers likely were patronized by "price shoppers" in the sample.

[8] Dodd Frank, Pub. L. 111–203, §§ 1411, 1412, 124 Stat. 1376, 2142-2148 (2010).

[9] *See id* (relying on the HOEPA definition of "points and fees," Section 103(aa)(4) of the Truth in Lending Act (TILA) (15 U.S.C. § 1602(aa)(4)), as amended by Dodd Frank, Pub. L. 111–203, § 1431(c), 124 Stat. 1376, 2159 (2010)). The Dodd-Frank House-Senate Conference Committee did not report out the "Clay amendment", a provision in Title XIV of the House-passed version of Dodd-Frank that would have corrected the discrimination against affiliated title fees by excluding them from the 3% HOEPA "points and fees" threshold to the same extent as unaffiliated title fees. The House had passed the Clay amendment on two previous occasions as part of legislation never acted upon by the Senate.

If not corrected by the January 10, 2014 effective date of the final QM rule, the inclusion of affiliated title fees – but not unaffiliated title fees – in the 3% QM "points and fees" cap would decrease competition in the mortgage market that would negatively impact mortgage affordability and availability. The impact would be greatest in low- and moderate-income marketplaces and on first-time home buyers.

To assess the potential impact of the 3% QM cap, RESPRO® conducted a Member Survey on October 1, 2012. Collectively in 2011, respondents originated nearly 60,000 closed-end loans and issued more than 255,000 title policies through affiliated title companies serving customers of affiliated and unaffiliated creditors.

All respondents would be impacted by the 3% QM cap because of the requirement that charges paid to affiliated settlement service companies must be included in the "points and fees" calculation. Collectively, they originated a total of 17,920 loans in 2011 that would have exceeded the 3% QM cap, representing 34% of all loans originated by the respondents.

Not surprisingly, RESPRO® Survey respondents reported that the percentage of loans in which the total amount of fees exceeds the 3% cap increases with lower loan amounts. Survey data showed that the average loan amount that exceeded the 3% QM cap ranged from $80,100 to $175,901.

The 2012 Survey also inquired how a mortgage lender with an affiliated title company would respond if faced with a loan that would exceed the 3% QM "points and fees" cap due to its inclusion of affiliated title fees. RESPRO® specifically asked members whether they would choose to (1) continue offering mortgages but not offer affiliated title services in conjunction with loans that would exceed the 3% QM cap ("non-qualifying mortgages"); or (2) offer title services but not mortgages.

Many respondents were real estate brokerage firms and homebuilders that offer their customers mortgages and title services through affiliated companies. The majority of these respondents reported that they would discontinue offering non-qualifying mortgages through their affiliated mortgage company, but would continue to offer affiliated title services to consumers who purchase their homes. Because of the negative consequences of originating a non-qualifying loan, they reported that it would be important to have certainty as to which loans would exceed the applicable thresholds. The cost of mortgage origination services is highly dependent on the customer's individual decisions and is more difficult to predict on an aggregate basis, while title fees can be more easily predicted since title premiums either are regulated or must be filed in the majority of states.

Survey respondents reporting that they would discontinue offering non-qualifying mortgages through their affiliated mortgage company collectively offered 19,977 mortgages for $966,270 in 2011. These respondents collectively would have discontinued offering 6,750 mortgages (over 10% of the Survey sample) had the discriminatory QM threshold been in place.

Other RESPRO® members reported that they would discontinue offering affiliated title services on non-qualifying loans. RESPRO® believes that the potential reduction in the market share of affiliated title companies alone would create an upward pressure on title fees that would reduce mortgage affordability. For example, when Kansas enacted a law in 1992 that caused realty-based affiliated title companies in the state to shut down their operations, the remaining title firms filed rates the following year that were 50-60% higher. [10]

III. **The Exemption of Certain Affiliated Fees Would Not Undermine the Goals of Dodd-Frank**

Not only are there compelling reasons to exempt certain affiliated fees from the QM "points and fees" cap, there is no justification for including them.

The definition of "points and fees" already requires that any charge that is not "reasonable" shall be included in the respective thresholds under the Ability to Repay standard and HOEPA.[11]

There are numerous ways for federal regulators to enforce this "reasonableness" requirement for title charges. First, because RESPA prohibits a mortgage lender from requiring a consumer to use an affiliated title company, federal regulators can compare closing documents in which both affiliated and unaffiliated title providers are used by a mortgage lender. Second, 44 states require that title insurance rates be set by the state, approved by the state, or filed with the state, which enable federal regulators to determine if the affiliated title fees are reasonable. Of the remaining six states and the District of Columbia, one (Iowa) does not recognize title insurance.[12] Third, web sites provide easily obtainable information on the costs of title insurance and title searches for all states.

In summary, This unnecessary discrimination against affiliated businesses and other inequities in the Final Rule's "points and fees" cap would be rectified by the Consumer Mortgage Choice Act (H.R. 1077), which was introduced in the U.S. House of Representatives on March 12, 2013.

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[10] The economic firm of Anton Financial Economics researched title and closing rates in Wichita County, Kansas (the largest county in Kansas) before and after the effective date of the Kansas legislation, and found that the two largest unaffiliated title companies in Wichita County (in which affiliated businesses operated) subsequently raised their rates 50-60% in their first filings after the legislation took effect. [note: I would delete the following in this footnote: Anton Economics, Inc., Economic Issues Relating to the Title Insurance Industry in Minnesota: Would Further Regulation be Helpful? (1992). Anton Financial Economics, Inc. researched the price of title services in the Minneapolis-St. Paul marketplace in 1992 by sampling 16 firms that together operated 77 offices in the Twin Cities area (70% of the offices in the marketplace) and concluded that affiliated title companies in the Minneapolis-St. Paul marketplace charged approximately $13 less for title services than unaffiliated title companies.

[11] TILA section 103(bb)(4)(C)(i).

[12] A.M. Best, Report to National Association of Insurance Commissioners (NAIC).

In view of the reasons stated above, RESPRO® urges members of the Subcommittee to support the Consumer Mortgage Choice Act (H.R. 1077) because it will alleviate the negative impact that the "points and fees" definition in the Final Rule will have on mortgage affordability and availability, particularly in low-income and moderate income marketplaces, without compromising the goals of the Dodd-Frank Act.

RESPRO® appreciates this opportunity to provide testimony. If you have any questions, feel free to contact me at 202-862-2051, Ext. 210 or at sjohnson@respro.org.

Sincerely,

Susan E. Johnson

Susan E. Johnson, Esq.
Executive Director

Questions for the record from Rep. Keith Ellison

CFPB Staff: Peter Carroll and Kelly Cochran

May 21, 2013

Question: Using Unemployment Insurance databases to verify income and employment

- *How do lenders verify that information such as tax returns and pay stubs that are provided by borrowers are accurate?*

A. Lenders have various options. For example:

- Lenders can use one or more commercial services that are repositories of employment and/or income information. Our understanding is that some of these services receive the data from private sector employers through the national payroll processors. Generally these databases do not cover the full population.
- Lenders can also request a verification of income through the IRS using the Income Verification Service (http://www.irs.gov/Individuals/Income-Verification-Express-Service). The IRS provides return transcript, W-2 transcript and 1099 transcript information.

- *Are there ways to use existing databases to make it easier for borrowers to demonstrate their credit worthiness rather than carrying in a shoebox full of receipts?*

A. There are some ways borrowers may demonstrate their credit worthiness using information not typically reported to the three national credit reporting companies. It is our understanding that utility and telecommunications companies routinely field inquiries from employers, lenders, landlords, and other screening services to verify that a consumer has been paying bills. These companies' responses are often governed by state utility regulators and sometimes require that the consumer also be on the phone to verify that the inquiry is valid.

Many of the largest utility and telecommunications participate in a cooperative data repository called the National Consumer Telecommunications and Utility Exchange (NCTUE). This is a consumer reporting agency owned by its furnishers and that its members use to identify when consumers have not paid bills. It is our understanding that the NCTUE historically only collected negative information, but has recently begun collecting positive payment history from members that could be used to verify when a consumer has an open account in good standing. We do not know at present what services NCTUE is planning to provide with respect to reporting this information to non-member entities such as lenders.

Utilities and telecommunications companies are able to report to the three national credit reporting companies (TransUnion, Equifax, and Experian); however, most do not. This is for a variety of business reasons and, in some cases, state utility regulations may prohibit reporting. Thus there is very limited information on consumers' utility and telecommunications payment histories at the national credit reporting companies at present.

There are a number of rental history databases. We understand that most collect negative information for tenant screening purposes but that a few collect positive rental history as well. Coverage is generally limited to data reported from the largest property management companies. As most landlords are very small businesses, the rental market is quite fragmented and there are no databases that can practically obtain positive rental history from more than a small portion of landlords.

- *Eleven states enacted laws allowing third party consumer reporting agencies access to state Unemployment Insurance databases if requested to do so by the consumer.*
  - *Has this access to the State Workforce Agencies database been discussed within the CFPB and/or as part of the Smart Disclosure Task Force?*

A. We are not aware that the Smart Disclosure Taskforce has discussed this. However, we believe working groups or staff of federal agencies participating in the Smart Disclosure Taskforce may be assessing opportunities to develop databases that could provide real-time income verification using IRS data. The Smart Disclosure Taskforce is an initiative of the White House. The CFPB, along with other independent agencies, has been a participant in some task force-sponsored activities, but we may not be aware of all of the activities the Task Force has undertaken.

  - *Would the CFPB be willing to work with Mr. Ellison's office to make sure that states that enact legislation are able to use their Unemployment Insurance databases to help consumers access affordable credit?*

A. We would be pleased to provide technical support on these questions.

Question: Kickbacks and high payments

- *One of the reasons for placing a cap on fees for mortgages was the prevalence of kickbacks, high fees and other costs that were harmful to borrowers in many different areas including appraisals, private mortgage insurance and title insurance. Could you briefly detail some of the abuses that the qualified mortgage is intended to prevent? Are you satisfied that the limits within the qualified mortgages will make it easier for borrowers to avoid these high-priced and unnecessary fees?*

A. Section 1412 of the Dodd-Frank Act provides that, in general, a qualified mortgage cannot have points and fees that exceed 3 percent of the total loan amount and directs the Bureau to prescribe different limits for smaller loans. The statute also provides that certain private mortgage insurance premiums and charges paid to affiliates of creditors for items such as appraisals and title insurance are included in points and fees. The final rule implemented these provisions. The Bureau expects that many creditors generally will prefer to make qualified mortgages. Accordingly, the general 3 percent limit on points and fees for qualified mortgages likely will exert some downward pressure on such charges. To the extent that creditors prefer to originate qualified mortgages, the underwriting requirements for qualified mortgages, in conjunction with the limits on points and fees, should help ensure that creditors are appropriately concerned about the long-term sustainability of loans and less able to impose excessive upfront charges as a method of ensuring that their loans are profitable.

Question: Performance of Manufactured housing loans.

- *Some have asserted that buyers of manufactured homes should pay higher costs than those of site-built homes. What data do you have that demonstrates the delinquency and foreclosure rates of buyers of manufactured homes? How does that data compare to those of site-built homes by similar borrowers? Why would manufactured home borrowers be entitled to less protection than other home buyers?*

  A: Data reported under the Home Mortgage Disclosure Act (HMDA) indicate that loans for manufactured homes are more likely than site-built homes to have relatively high interest rates, even after controlling for differences in loan size, borrower income, and other factors reported in HMDA that may differ systematically between owners of manufactured homes and other homeowners. This difference may reflect other factors that are not captured in the HMDA data, including not only differences in predicted loan performance of manufactured housing loans compared with other loans but also differences in credit scores and collateral value. Data on the performance of manufactured home loans are quite limited. A recent study by the Corporation for Enterprise Development provides suggestive evidence that many manufactured home loans perform similarly to general mortgage portfolios (see http://cfed.org/knowledge_center/resource_directory/cfed_publications/directory/toward_a_sustainable_and_responsible_expansion_of_affordable_mortgages_for_manufactured_homes), but the Bureau has not reviewed that study in depth.

2. *In your final rule issued on January 10, 2013, you noted that creditors may, but are not required to, increase the interest rate charged to the consumer to offset the impact of the LLPA instead of increasing their upfront costs.*
    a. *If a creditor decides to increase the rate to cover the LLPA, is that cost also included in the points and fees calculation? Why or why not?*
    b. *If not, why the different treatment (upfront payment of costs vs. financing the costs) for what appears to be the same charge?*
    c. *Since industry is concerned about the inclusion of upfront LLPA costs in the points and fees calculation, is recouping the cost via an interest rate increase (if it is not included in the points and fees calculation) a viable and/or a practical alternative to easing the pressure they claim they will feel on points and fees? If yes, please explain.*

A: If LLPAs are imposed as an interest rate increase, rather than as additional discount points, the interest rate increase is not counted toward the points and fees threshold under the Bureau's rule. The statutory definition of points and fees expressly excludes interest. It bears noting that more traditional (less granular) forms of risk-based pricing and other forms of upward pricing adjustment, which also are manifested either as interest rate increases or as discount points, also are counted toward the points and fees threshold only when imposed as discount points. Accordingly, as the Bureau noted in the final rule's preamble, imposing LLPAs in the form of interest rate increases often does offer creditors a means of limiting the impact of LLPAs on points and fees. The Bureau recognizes that interest rate increases result in greater periodic payments for consumers. Therefore, there necessarily is an upper limit on the extent to which creditors can increase consumers' interest rates, whether to cover LLPAs or otherwise: Consumers who already are at or near their maximum permissible debt-to-income ratios, beyond which they cannot qualify for the credit, will have little to no room for the payment of LLPAs (or any other upward pricing adjustments) through increased interest rates. In those cases, the loans may not meet the qualified mortgage requirements, but the Bureau considers it appropriate that such loans be evaluated individually under the general ability-to-repay standards.

3. *Industry participants have objected to the way compensation for mortgage brokers is calculated under the rule. However, others are concerned that altering that calculation may lead to the return of yield spread premiums and steering behaviors by lenders.*
    a. *Can you explain the way mortgage compensation is calculated in points and fees test and why the CFPB chose that structure?*
    b. *Does counting such compensation put mortgage brokers at a competitive disadvantage when compared to their retail lending counterparts? If so, please explain.*

    c. *Given the Federal Reserve Board's 2010 rule, which prohibits lenders from basing compensation on the interest rate or other loan terms (i.e., yield*

Hearing on "Qualified Mortgages: Examining the Impact of the Ability to Repay Rule"

Subcommittee on Financial Institutions and Consumer Credit
May 21, 2013

Questions for the Record Submitted by Representative Melvin L. Watt

The Dodd-Frank Wall Street Reform and Consumer Protection Act requires that for residential mortgages, creditors make a determination that a consumer has a reasonable ability to repay the loan. However, the Act presumes compliance with the ability to repay requirements for qualified mortgages. One of the features of the qualified mortgage is a "points and fees" test. Under this test, a loan cannot be a qualified mortgage if the points and fees paid by the consumer exceed three percent (3%) of the total loan amount. Some in the industry have expressed concerns that the current guidelines for calculating "points and fees" (i.e., the inclusion of affiliated title fees, Loan Level Price Adjustments (LLPAs) and loan originator compensation) will make originating loans for some consumers unaffordable for the lender.

1. *Loan Level Price Adjustments (LLPAs) charged by Fannie Mae and Freddie Mac are currently counted towards the "points and fees" calculation.*
    a. *Can you explain the rationale for their inclusion?*

A: LLPAs are essentially a very sophisticated form of risk-based pricing that existed, first in the subprime market, well before the government-sponsored enterprises (GSEs) began applying them to conforming transactions. Historically, LLPAs may have been imposed by secondary market investors or directly by creditors themselves. With respect to GSEs, LLPAs are transaction-specific pricing adjustments added to the baseline pricing currently available from Fannie Mae or Freddie Mac to reflect risk factors attributable to an individual consumer's credit-risk profile (e.g., credit score) and the specific transaction's characteristics (e.g., loan-to-value ratio). In that sense, LLPAs function no differently from more traditional risk-based pricing and other upward pricing adjustments (whether risk-based or not), which always entail either increasing the interest rate or charging additional discount points. When imposed as discount points, such charges have always been included in both the finance charge and points and fees, and this is true notwithstanding that more traditional discount points, like LLPAs, ultimately may have been "charged" by a secondary market investor. The Bureau sees LLPAs as no different in principle and therefore treats them just as any other component of overall loan pricing. The Bureau does not consider it appropriate to treat LLPAs as a third-party settlement charge, such as an appraisal or credit report fee, because LLPAs are a key component of loan pricing and therefore should be reflected either in the interest rate or in points and fees. Creditors can choose to build LLPAs into the interest rate if that makes it easier to satisfy the points and fees limit for qualified mortgages, as discussed below in the response to the next question.

spread premiums) and also prohibits loan originators from receiving compensation from both the consumer and the lender, are there still opportunities within the mortgage brokers and/or lenders' compensation structure that could lead to the return of yield spread premiums and/or steering behavior? If so, please explain.

A. Section 1431 of the Dodd-Frank Act amended TILA to require that "all compensation paid directly or indirectly by a consumer or creditor to a mortgage originator from any source, including a mortgage originator that is also the creditor in a table-funded transaction," be included in points and fees. The Bureau implemented this provision by adopting a rule requiring that all compensation paid directly or indirectly by a consumer or creditor to a loan originator that can be attributed to that transaction at the time the interest rate is set is included in points and fees. However, to prevent double counting compensation that already is included in points and fees and to reduce the compliance burden, the Bureau excluded certain types of compensation from points and fees. Thus, under the regulation, points and fees do not include loan originator compensation paid by a consumer to a mortgage broker when that payment has already been counted toward the points and fees threshold as part of the finance charge. Points and fees also do not include compensation paid by a mortgage broker to an employee of the mortgage broker because that compensation is already included in points and fees as loan originator compensation paid by the consumer or the creditor to the mortgage broker. Finally, points and fees do not include compensation paid by a creditor to its loan officers. With respect to the last exclusions, the Bureau concluded that there were significant operational challenges to calculating individual employee compensation accurately early in the loan origination process, and that those challenges would lead to anomalous results for consumers. In addition, the Bureau concluded that structural differences between the retail and wholesale channels lessened risks to consumers. The Bureau therefore decided to exclude from points and fees compensation paid by retail creditors to their loan originators when the rule takes effect in January of 2014, although it is still continuing to study the issue. Points and fees do include compensation paid by a creditor to a loan originator other than an employee of a creditor (i.e., a mortgage broker), as well as compensation paid by a consumer (though, as noted above, only once).

Counting in points and fees compensation paid by a creditor or consumer to a mortgage broker may make it more difficult for mortgage brokers (as compared to retail loan officers) to originate loans with up-front charges and still remain under the qualified mortgage points and fees limits and the high-cost mortgage threshold. Nevertheless, even in transactions in which a mortgage broker's compensation is two percentage points of the loan amount—which the Bureau understands to be at the high end of mortgage broker commissions—the creditor would still be able to charge up to one point in up-front charges that would count toward the qualified mortgage points and fees limits, under certain circumstances. Moreover, the creditor may reduce the costs it needs to recover from origination charges or through the interest rate by having the consumer pay the mortgage broker directly. In addition, creditors in the wholesale channel that prefer to originate only qualified mortgages in many cases will have the flexibility to recover more of their origination costs through the interest rate to ensure that their transactions remain below the points and fees limits.

As adopted by the Board, effective in 2010, and as retained by the Bureau in 2013, Regulation Z prohibits a loan originator from influencing a consumer to accept a credit transaction available from a particular creditor, over those available from other creditors, to obtain greater compensation than the loan originator would receive from the other creditors, where doing so is not in the consumer's interest. In general, because this rule contemplates a loan originator "steering" a consumer to transact with one out of two or more prospective creditors, the rule primarily affects mortgage brokers rather than individual loan originators employed by retail creditors. During the Bureau's rulemaking process leading to the January 2013 final rule, consumer advocates nevertheless expressed concern that, particularly in the subprime market, loan originators could specialize in originating transactions with above-market interest rates (from all creditors with which they do business), with the expectation they could arrange to receive above-market compensation for all of their transactions notwithstanding the rule's prohibition on steering to a particular creditor to maximize their compensation. Including compensation paid by creditors to mortgage brokers in points and fees may reduce the potential consumer injury from such practices by limiting the ability of creditors to impose high up-front charges and also pay high loan originator compensation and still remain under the points and fees limits applicable to qualified mortgages.

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