# THE IMPACT OF DODD-FRANK'S HOME MORTGAGE REFORMS: CONSUMER AND MARKET PERSPECTIVES

## HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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## WITNESSES

### Wednesday, July 11, 2012



## APPENDIX



### Additional Material Submitted for the Record

# THE IMPACT OF DODD-FRANK'S HOME MORTGAGE REFORMS: CONSUMER AND MARKET PERSPECTIVES

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**Wednesday, July 11, 2012**

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 a.m., in room 2128, Rayburn House Office Building, Hon. Shelley Moore Capito [chairwoman of the subcommittee] presiding.

Members present: Representatives Capito, Renacci, Royce, Hensarling, McHenry, Pearce, Luetkemeyer, Huizenga, Duffy, Canseco, Fincher; Maloney, Watt, Hinojosa, Baca, Miller of North Carolina, Lynch, and Carney.

Also present: Representatives Miller of California and Green.

Chairwoman CAPITO. The Subcommittee on Financial Institutions and Consumer Credit is called to order. I would like to welcome everybody here today. As you know, this morning's hearing is the second installment in a series of Financial Services Committee hearings this month leading up to the 2-year anniversary of the Dodd-Frank Act.

This morning, our subcommittee will examine the implementation of Title XIV of the Dodd-Frank Act, which establishes new standards for mortgage origination and imposes liability on the secondary mortgage market for mortgages that do not meet these standards. It sounds like it might be kind of a boring hearing, but I don't think it will be. There is a lot of interest here, and it is going to cut across a lot of the economy, so it is extremely important that we get this right.

The financial crisis of 2008 was caused partly by relaxed underwriting standards which led to a proliferation of riskier mortgages; we all know that. There is little doubt that some lenders departed from traditional underwriting standards in order to meet the demand for mortgages from consumers with subprime credit.

The Dodd-Frank Act seeks to address these issues by establishing underwriting standards for all mortgage originations, focusing on the borrower's ability to repay the loan. While I have no doubt the intent of this section is to protect consumers, which we all want to do, we must be sure that these rules are being implemented by the Federal financial regulators, and that they are structured in a manner that provides an adequate level of consumer protection without restricting access to credit, particularly access to credit for those folks who maybe have less availability of credit to them as families.

Although the authority to promulgate these rules began with the Federal Reserve, we all know that was transferred to the Consumer Financial Protection Bureau (CFPB) in July of 2011. In addition to establishing these new underwriting criteria, the CFPB must determine what legal protections will be afforded to the lenders whose loans meet the Qualified Mortgage (QM) criteria.

They have two options: These loans can be determined to be—can be afforded a safe harbor that would preclude ability-to-repay lawsuits or lenders who originate loans that meet the criteria would enjoy a presumption that they have satisfied these requirements. However, the borrower can rebut the presumption if they have evidence that the loan did not meet the original criteria for a borrower to repay the loan.

Earlier this year, CFPB Director Roger Cordray testified in front of this committee that there might need to be brighter lines or bright lines in defining the standards in order to mitigate the litigation. To this point, later this week Representative Sherman and I, along with over 90 of our colleagues, will be sending a letter to the CFPB urging them to adopt a strong safe harbor for mortgages that meet the underwriting criteria. We must ensure that the underwriting standards and the subsequent legal protections provide sufficient consumer protection but do not overly, as I said before, restrict credit.

We all want consumers to have safely underwritten mortgages, however, we must ensure that these reforms do not increase the cost of mortgage credit, and therefore, restrict creditworthy borrowers from receiving their mortgages. If there is not sufficient legal certainty for these loans, the cost of credit could rise, and fewer mortgages could be issued. We want to make sure that the CFPB produces a workable rule, and we also want to see them do so in a timely fashion.

One of the great challenges facing our economy is the amount of uncertainty we have here in Washington. The CFPB has already announced they will not produce the final rule on a Qualified Mortgage until this fall, and they have until January 21st of 2013 to produce the final rules. I would urge the CFPB, and they know I am urging them, this is not new to them to meet this deadline, so lenders and borrowers have the certainty necessary to move forward. This morning's panel of witnesses will provide the subcommittee with an assessment of the current landscape and the effect the proposed rules will have on availability of credit.

I would now like to recognize the ranking member, Carolyn Maloney from New York, for the purpose of making an opening statement.

Mrs. MALONEY. I thank the chairwoman for calling this important hearing, and I welcome our distinguished panel, many of whom have testified before this Congress many times. I must acknowledge my former colleague and very good friend, Ken Bentsen, from the great State of Texas. It is good to see you again. You have been back here so many times testifying that I am beginning to think you are still a Member of Congress. But it is always good to see you.

We are now at that—2 years ago this month, we passed the important financial reform bill, and it brought many provisions that are important for the safety and soundness of our financial industry and institutions that will bring transparency to the over-the-counter derivatives market that will allow for the safe unwinding of a failing financial institution. But two reforms were particularly important to consumers.

The first was the creation of the Consumer Financial Protection Bureau, which is a bureau that—and this is a first—will make taking care of consumers and looking at their concerns their top priority. Too often, it was the second priority, or the third, or not thought about at all.

And the second was Title XIV of the Wall Street Reform Act that dealt with mortgage lending. It contributed, in many ways, to the financial crisis from early 2007 through the end of 2011. Approximately 10.9 million homes had started the foreclosure process. That is huge. And according to the testimony of Mark Zandi on February 9, 2012, when he testified before the Senate Banking Committee, he said, "$7.4 trillion in homeowner equity was lost in the housing crash with close to $500 billion of that occurring in 2011."

So this was a huge impact on the financial stability of our country, and getting this right is important for our recovery. Economists tell us to this day that the biggest challenge we face in our economy is the housing market, how we can get it moving again, how we can make it stable, how we can make it a productive part of our economy. Harmful lending practices were restricted by the Dodd-Frank Act for Qualified Mortgages specifically in two ways: One, 2/28 mortgages with 5-year teaser rates that then reset at unaffordable high amounts were banned; and two, interest-only loans leading to negative amortization were also banned.

The CFPB just closed their comment period. They are expected to come out with a rule before the end of the year. We look forward to hearing that rule. We look forward to your testimony. Getting that rule right is a big important part of not only protecting consumers, but I would say the industry and the overall economy. I look forward to your testimony. Thank you all for coming and for your hard work in trying to build a stable economy in our country. Thank you. I yield back.

Chairwoman CAPITO. I now recognize Mr. Royce for 1 minute.

Mr. ROYCE. Thank you, Madam Chairwoman. As we discuss the real-world impact of Dodd-Frank, it is becoming apparent that the biggest impact may fall on those consumers who are looking for a mortgage. Yesterday, we had a hearing on the Capital Markets Subcommittee, and there was a reference made to Mark Zandi's study which suggests that the premium capture cash reserve accounts portion of the risk retention rule would cause mortgage rates to increase between 100 and 400 basis points, and that is just that one PCCRA provision.

Today, we are talking about the potential for a narrowly-defined Qualified Mortgage rule with a murky safe harbor protection. It is a wonder why any financial institution would choose to make a loan with the potential added cost and liability of these proposed rules. With government entities exempted from most of these new rules, it appears Washington is doing everything in its power to prevent a robust recovery in the private mortgage market. I will note one point of bipartisan agreement on this front, and it is a fix on the points and fees definition in the QM rules with a goal of bringing it back to what Congress originally intended. I am pleased to be a co-sponsor of this legislation with Mr. Huizenga and Mr. Scott, and I thank the Chair for holding this hearing. I look forward to the testimony of the panel. Thank you.

Chairwoman CAPITO. Thank you. Mr. Hinojosa for 3 minutes.

Mr. HINOJOSA. Thank you. Thank you, Chairwoman Capito and Ranking Member Maloney. Here we are at yet another hearing that is purely what I believe is a political messaging opportunity for my friends on the other side of the aisle. While I am concerned about what impact the Dodd-Frank Wall Street Reform and Consumer Protection Act is having on community banks and credit unions, I would rather hear about specific issues and proposals rather than a broad brush attack on that law.

When we sat down back in 2008 to create a law to respond to the financial crisis, we listened carefully to the community banks and the credit unions, and we took into account that they were not the culprits in the financial crisis, and should not be treated in the same manner as the large international banks. To reflect this fact, we created many exceptions for small community banks. Additionally, the CFPB must consult with the community banks and credit unions to establish the impact of rules on these institutions I mentioned.

Today, we are discussing the impact of the Dodd-Frank Act on mortgage origination. Just this week, the CFPB released their prototype for standard, easy-to-understand mortgage documents, something that was greatly needed. Much of the subprime crisis was caused by mortgage products that were opaque and difficult for the layman to understand. These new forms are a step in the right direction and will add sunlight to the closing process for the average consumer.

While I am open to hearing legitimate concerns about the effects of particular upcoming rules, such as the Qualified Mortgage definition, and will listen to ideas about how to fine-tune the current law, I flat out reject any broad attack on the Dodd-Frank Act. It is political theater and unproductive in a time when so many Americans are looking to Congress for action, and I look forward to the testimony from each one of the panelists.

Before yielding my time, I want to acknowledge the presence of my good friend and former colleague, former Congressman Kenneth Bentsen, who sat on this committee for many, many years and did an outstanding job. I want to say to you that we miss you on this side of the aisle. With that, I yield back.

Chairwoman CAPITO. The gentleman yields back.

Mr. Huizenga for 1 minute.

Mr. HUIZENGA. Thank you, Madam Chairwoman, and Ranking Member Maloney. I appreciate you holding this hearing today. As we all know, mortgage rates have fallen to a record low while housing affordability is frankly at an all-time high, and we are here to discuss some of those specific reforms that need to happen. And I believe my bill, H.R. 4323, that Mr. Royce had mentioned—it is actually sponsored by myself, Mr. Clay, Mr. Royce and Mr. Scott—is going to help stabilize the housing market while ensuring access to affordable mortgage credit without overturning important consumer protections and sound underwriting. I believe we need to pass bills like H.R. 4323 and other bipartisan commonsense reforms that promote homeownership and protect the American dream for future generations.

So as we move forward, we are looking forward to your comments as to where we are and where we need to go. That is, I think, an important part of this. So again, Madam Chairwoman, I appreciate you holding this hearing and I look forward to hearing from our witnesses today. Thank you.

Chairwoman CAPITO. Thank you.

Mr. Lynch for 2 minutes.

Mr. LYNCH. Thank you, Madam Chairwoman. I would like to also thank and welcome the witnesses here. Thank you for helping us with our work. Today is the second day of hearings in which the committee highlights "unintended consequences of the financial reform" while ignoring the problems that brought us here. Let's take a minute to review the many bad practices in the subprime mortgage market that caused the housing bubble to inflate in the first place, and started the chain of economic events that led to the global economic meltdown.

In the years leading up to the crisis, underwriting standards in this country in the mortgage industry deteriorated so badly that some argued that they no longer existed. Because lenders could make more money dealing in exotic mortgage products than plain vanilla mortgages that were the hallmark of one of the strongest housing markets in the world, they started dealing more and more on stated income and no-doc loans. Instead of verifying even the most basic information such as proof of income, the industry was happy to accept certification from borrowers instead of doing their homework.

One of our witnesses, Ms. Cohen, states that—I read her testimony last night—some lenders actually redacted income information from their files. These products were then packaged and sold up the food chain with the knowledge that only two people would suffer from these bad underwriting standards: the last person who bought these mortgages; and the borrowers themselves. When the mortgage market collapsed, 3.6 million Americans lost their home, often their primary source of household wealth, to foreclosure, and the damage caused by reckless underwriting practices in the mortgage industry has been a catastrophic drag on our economy. Yet, we are here today to discuss in part how the modest commonsense reforms in Dodd-Frank are actually holding back the mortgage industry. How quickly we forget what brought us down in the first place.

Yes, I am happy to work with my colleagues to ensure that the rules written by the CFPB and others are reasonable and they are tailored to preventing another housing crisis. We do indeed need to make sure that the definition of Qualified Residential Mortgage (QRM) is not too narrow that it denies reasonable housing opportunities to otherwise creditworthy borrowers, but we cannot afford to forget why Dodd-Frank exists in the first place. Madam Chairwoman, I yield back.

Chairwoman CAPITO. The gentleman yields back.

Mr. Canseco for 1 minute.

Mr. CANSECO. Thank you, Madam Chairwoman. Recently, I heard from some community banks in Texas, including: Union State Bank in Kerville; the First State Bank of Paint Rock in San Angelo; Citizens State Bank in Luling; and Marion State Bank in Marion. And all of these institutions have ceased making mortgage loans largely because of Dodd-Frank and the burdens it places on small institutions across the country. But what I haven't heard yet is an explanation for how families and consumers in Kerville, San Angelo, Luling, Marion, and elsewhere are being protected or are better off when they can no longer go to their local community bank and get a mortgage loan. This is but one of the side effects of Dodd-Frank. And I look forward to bringing greater attention to it at today's hearing. I yield back.

Chairwoman CAPITO. The gentleman yields back.

Mr. Fincher for 1 minute.

Mr. FINCHER. I thank the chairwoman for having this hearing today. As we examine the impacts of the Dodd-Frank Act on mortgage reform, I want to call attention to the manufactured housing industry, which is currently facing several regulatory challenges. To address these challenges, Congressman Donnelly, Congressman Miller, and I introduced H.R. 3849, the Preserving Access to Manufactured Housing Act. One of the provisions in our bipartisan bill adjusts the threshold in which small balance manufacturing home loans are classified as high-cost mortgages under the Home Ownership and Equity Protection Act, which was revised in Dodd-Frank. Dodd-Frank expands the range of loan products that can be considered high-cost mortgages without recognizing the uniqueness of manufactured home loans compared to the rest of the housing industry. That one-size-fits-all approach is reducing the home buying public's access to manufactured homes.

I thank the chairwoman again, and I look forward to hearing the testimony today. I yield back.

Chairwoman CAPITO. The gentleman yields back. I think that concludes our opening statements. So I will recognize each witness as we move forward for the purposes of making a 5-minute statement.

But I would like to join my colleagues in welcoming our former colleague, Kenneth Bentsen, back to the committee. We served on the committee together, but I was way down there in the corner at that point. I am very happy to see you here.

Our first witness is the Honorable Kenneth E. Bentsen, Jr., executive vice president of public policy and advocacy for the Securities Industry and Financial Markets Association. Welcome back.

**STATEMENT OF THE HONORABLE KENNETH E. BENTSEN, JR., EXECUTIVE VICE PRESIDENT, PUBLIC POLICY AND ADVOCACY, THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION (SIFMA)**

Mr. BENTSEN. Thank you, Chairwoman Capito, Ranking Member Maloney, and members of the subcommittee. I also languished down at the very end for many years, and so I am envious of your post now. I was always glad that the witnesses were still alive by the time they got around to me to ask questions. I appreciate the opportunity to present SIFMA's views today on the Qualified Mortgage rulemaking proposal. Our views on the proposal were developed by our diverse membership which includes financial institutions that act as residential mortgage originators, securitization sponsors, broker/dealers that act as underwriters, placement agents, market makers and asset managers that include some of the largest most experienced investors in residential mortgage-backed securities and other structured financial products.

SIFMA has been an active participant in this rulemaking and will continue to advocate for a sensible outcome. SIFMA believes in the underlying concept of Title XIV of the Dodd-Frank Act, that a borrower should be required to show an ability to repay a mortgage. However, SIFMA believes it is important that the QM definition promotes the ability of secondary markets to provide funding for mortgage credits as over 90 percent of mortgage credit is currently funded through securitization and the secondary markets.

I will be focusing my statement today on two key points: first, that the parameters of the Qualified Mortgage definition must be scaled broadly; and second, that the QM definition must create clear bright lines for lenders and borrowers at time of origination and should provide a safe harbor for compliance.

We are very concerned that the QM regulations may be constructed in a narrow manner with unclear parameters that will not allow for the certainty of compliance at origination. We believe such an outcome would restrict the availability of credit through increased cost and restrictive underwriting and would be detrimental to consumers.

Title XIV of the Dodd-Frank Act imposes a requirement on lenders to determine ability to repay on virtually every residential mortgage loan and define the necessary criteria to demonstrate compliance with the ability-to-repay requirement. Thus, the QM definition should broadly outline the parameters of responsible lending. Defining QM broadly will create compliance guideposts for lenders that want to lend responsibly.

In our view, the vast majority of future mortgage lending will be loans that are QMs. Loans that are not QMs will carry with them liability for purchasers of the loans, so-called assignee liability. Due to this liability and supervisory, reputational, and other concerns, we do not expect significant origination of non-QM loans. We are aware of the contention that a narrower definition of QM will not be disruptive because lenders in secondary markets will be comfortable operating outside of the protection supported by QM with reasonable pricing and premium for those loans. These predictions contradict feedback from our member firms that run these businesses, and we believe that the CFPB would be ill-advised to implement QM rules based on those views. History has shown that loans that carry significant or uncertain liability are made with a significant pricing premium or not made at all. We believe that lenders in secondary markets would respond to the liability risk through very restrictive underwriting guidelines, significant pricing premiums or both. These actions will result in less available credit to creditworthy borrowers, borrowers who would have otherwise received it had the boundaries of QM been drawn more broadly.

Given the impact of assignee liability discussed above, SIFMA believes it is critical that the final rules provide for certainty of compliance with the ability-to-repay requirements at the time of origination. The proposal provided two options regarding assurance of compliance: a rebuttable presumption; and a safe harbor. SIFMA believes that consumer credit availability would be best protected through a safe harbor, as a rebuttable presumption provides no comfort. A rebuttable presumption will likely cause lenders of secondary market investors to implement standards conservatively as an overlay narrower than the actual bounds of the QM definition.

Credit-worthy borrowers with credit profiles within but close to the edge of the QM would be impacted negatively. Regardless of whether or not a safe harbor is provided, clear QM standards that provide certainty of compliance at the time of origination are paramount. Lenders and investors must know at the time of origination whether the loan meets the QM standards. The standards that define QM compliance must be clear, objective, and verifiable. If bright lines are not implemented in the final rule, borrowers will pay more for their loans and have a harder time obtaining them as once again, lenders will operate conservatively. We hope that in constructing the final rules, the CFPB creates a regime that not only corrects flaws exposed in recent years, but also serves as a basis for the development of a positive, inclusive, and forward-looking housing policy. A broad definition of QM and bright lines for compliance will help achieve this goal. Thank you, and I am happy to answer your questions.

[The prepared statement of Mr. Bentsen can be found on page 48 of the appendix.]

Chairwoman CAPITO. Thank you very much.

Our next witness is Alys Cohen, a staff attorney at the National Consumer Law Center. Welcome.

**STATEMENT OF ALYS COHEN, STAFF ATTORNEY, THE NATIONAL CONSUMER LAW CENTER (NCLC)**

Ms. COHEN. Chairwoman Capito, Ranking Member Maloney, and members of the subcommittee, thank you for the opportunity to testify today. As a staff attorney at the National Consumer Law Center, I provide training and technical assistance to attorneys across the country representing homeowners who are facing foreclosure, and I also lead the Center's Washington mortgage policy work. I have spent the last 15 years specializing in the regulations and laws governing mortgage lending and servicing, including the recent reforms of the Dodd-Frank Act. I testify here today on behalf of the National Consumer Law Center's low-income clients.

In 2007, a global economic crisis was unleashed by a meltdown in the mortgage market. The loans that triggered this international collapse were primarily high-cost adjustable rate mortgages and loans with other risky features made in violation of longstanding, prudential underwriting guidance but subject to little or no formal regulation. Dodd-Frank's regulation of the mortgage market is essential to our economic security. Underwriting traditionally served as a hedge against the origination of unaffordable loans. But in the years leading up to the foreclosure crisis, underwriting all but disappeared. Lenders relied on securitization to spread the cost of the inevitable foreclosures. Throughout the subprime market, pricing replaced underwriting as a risk control mechanism. One lesson from the crisis is clear: mortgage lending will endanger all of our economic well-being if it is not subject to regulation. The rules outlined in Dodd-Frank are nothing more than a codification of the basic precepts of residential underwriting for decades. Dodd-Frank's mortgage affordability rule would restore balance and fairness in the marketplace best if it contained a broad rebuttable presumption with clear lines, not a safe harbor. A safe harbor would provide legal insulation to creditors who make predictably unaffordable loans. Rule writers will always be several steps behind the market, but if the incentives are in the right place, the rule will do its job, even as new unanticipated developments arise. The essential incentive for the mortgage market is the rule that every mortgage must be evaluated for affordability.

A broad, clear, rebuttable presumption will still require a stiff uphill climb for homeowners, but will restore balance and provide a backstop to reckless lending. The claim that borrowers pose a significant litigation risk to creditors if there is a rebuttable presumption or otherwise is without basis. Most homeowners never find an attorney. Those who do will face courts which defer to the standards already set out by the CFPB. Anyone who prevails will be entitled only to 3 years of damages, a limited and predictable amount. And in relation to the size of the mortgage market, the incidence of truth-in-lending claims historically has been vanishingly small.

Further adjustments to the underwriting standards in Dodd-Frank are best done by agencies with substantive expertise, including the Consumer Financial Protection Bureau. Pending before the subcommittee is H.R. 4323, which seeks to narrow the protections afforded by Congress, including on payments to loan originators and payments to affiliates of the creditor such as title companies. Title insurance and ancillary title fees, among other third-party fees, are rightly subject to heightened standards. They have been a source of price gouging of consumers in recent years and are a significant source of undue profit to creditors. Typically, the mortgage lender, not the borrower, chooses the title company, even though the borrower pays the cost of title insurance. The result is a form of reverse competition. Title companies compete to offer lenders the best deal and lenders are free to steer homeowners to affiliated companies where the sometimes hefty profits from title insurance can be retained in-house.

Title insurance premiums are subject to little or no regulation at the State level. Coverage chosen by title insurers often meets the needs of the insurer, but not the broader needs of the homeowner, and loan amounts often are increased as a means of increasing the basis for the ancillary fees.

Dodd-Frank strikes a sensible balance in restoring fairness and efficiency to the market. Administrative rule writing is the best context for working out the technical details. The regulatory process should move forward in order to restore vigor to communities and to the mortgage markets. Thank you for inviting me to testify today.

[The prepared statement of Ms. Cohen can be found on page 56 of the appendix.]

Chairwoman CAPITO. Thank you very much. I would like to yield to my colleague, Mr. Fincher, for the purposes of an introduction.

Mr. FINCHER. Thank you, Chairwoman Capito. It is my pleasure to welcome Tom Hodges to today's subcommittee hearing. Tom is a fellow Tennesseean from Knoxville and has worked for Clayton Homes in multiple roles since 1995. He now serves as general counsel and is responsible for understanding how Dodd-Frank and related regulations will impact Clayton Homes and the manufactured home industry. Tom, it is good to have you, welcome, and we look forward to hearing your testimony.

**STATEMENT OF TOM HODGES, GENERAL COUNSEL, CLAYTON HOMES, INC., ON BEHALF OF THE MANUFACTURED HOUSING INSTITUTE (MHI)**

Mr. HODGES. Thank you, Chairwoman Capito, Ranking Member Maloney, and members of the subcommittee for the opportunity to testify today concerning the impact of Dodd-Frank's home mortgage reforms. Also thank you, Congressman Fincher, for that warm introduction. My name is Tom Hodges. I serve as general counsel for Clayton Homes, and I represent the Manufactured Housing Institute at the hearing today.

I have submitted my complete written testimony for the record. But in my oral remarks today, I would like to discuss some key challenges to our industry that will significantly impact the industry's ability to provide safe, reliable, and affordable manufactured housing. For over 60 years, manufactured housing has been an important source of housing for low- and moderate-income families across the country. There are approximately 22 million Americans living in about 8.7 million manufactured homes. The average cost of a new manufactured home is less than $61,000 versus roughly $208,000 for a new site built home. More importantly, the median income for manufactured homeowners is $32,000 compared to $60,000 for all homeowners.

An even greater indication of the Nation's reliance on manufactured housing as an affordable housing choice is that 72 percent of all new homes sold under $125,000 in 2011 were manufactured homes. In addition to its role as an important source of affordable housing, nearly 60,000 U.S. jobs were sustained by the manufactured housing industry in 2011.

Because of the smaller size of loans that the manufactured housing market relies on, the sections of the Dodd-Frank Act that have a unique impact on the industry are contained in HOEPA and the Qualified Mortgage provisions. The HOEPA APR and points and fees threshold, as well as the points and fees limitations for Qualified Mortgages, make it extremely difficult for a lender to offset the cost to originate and service small balance manufactured home loans. For example, the impact on a $200,000 site built loan and a $20,000 manufactured home loan is very different. Though the cost of originating and servicing these two loans is similar in terms of real dollars, as a percentage of each loan size, it is significantly different.

It is this difference that effectively discriminates against the small balance manufactured home loan which is at a much higher risk of either being categorized as a high-cost mortgage or failing the Qualified Mortgage standards. Of the loans our company originated in 2010 and 2011, approximately more than 40 percent would have been characterized as a high-cost mortgage. Likewise, for the same loans, nearly 40 percent or more would have failed the Qualified Mortgage standards.

The practical effect is that lenders will not make these loans, and credit will become less available for purchases of manufactured homes. The impact will be felt by low- and moderate-income families seeking to purchase new homes, as well as the 22 million Americans who are currently residing in manufactured homes who could see the ability to resell their homes effectively wiped out. For this reason, MHI supports H.R. 3849, the Preserving Access to Manufactured Housing Act, which would provide relief to consumers and the industry. Our industry's regulatory challenges are not limited to HOEPA and the Qualified Mortgage. The industry is already feeling the impact of the SAFE Act. H.R. 3849 also clarifies that sellers of manufactured homes who are not compensated for loan origination activity should not be licensed or registered under the SAFE Act.

Manufactured home sales people are fundamentally involved in selling homes, not originating mortgage loans. MHI is very grateful for the leadership and support of Representatives Stephen Fincher, Joe Donnelly, and Gary Miller, to help develop a bipartisan solution to provide modest relief to the manufactured housing market in these areas. MHI appreciates the consideration of Chairman Bachus and Ranking Member Frank to Congressmen Fincher, Donnelly, and Miller on these issues and for their long-term support and commitment to preserving manufactured housing as a viable and sustainable source of affordable housing. Thank you for the opportunity to testify, and I look forward to the questions.

[The prepared statement of Mr. Hodges can be found on page 76 of the appendix.]

Chairwoman CAPITO. Thank you.

Our next witness is Mr. John Hudson, on behalf of the National Association of Mortgage Brokers. Welcome.

**STATEMENT OF JOHN HOWLAND PELL HUDSON, CHAIRMAN, GOVERNMENT AFFAIRS, THE NATIONAL ASSOCIATION OF MORTGAGE BROKERS (NAMB)**

Mr. HUDSON. Thank you. Chairwoman Capito, Ranking Member Maloney, and members of the subcommittee, thank you for this opportunity to be here today to speak about the impacts of Dodd-Frank. I am John Howland Pell Hudson, the chairman of government affairs for the National Association of Mortgage Brokers, and the Central and South Texas manager for Premier Nationwide

Lending, part of a privately owned mortgage bank headquartered in Flower Mound, Texas.

NAMB is the only nonprofit trade association that represents mortgage brokers as well as mortgage loan originators employed by mortgage banks and depositories. NAMB advocates on behalf of more than 116,000 State-licensed mortgage loan originators in all 50 States and the District of Columbia. Since 1973, NAMB has been committed to enhancing consumer protection, industry professionalism, high ethical standards, and the preservation and promotion of small business and homeownership in this country.

My testimony highlights the fact that Dodd-Frank was passed in haste and some would say anger at the unknown of what happened during the Wall Street meltdown. The creation of the Qualified Mortgage, Qualified Residential Mortgage, hardwiring underwriting standards into legislation, capping fees at arbitrary percentages of a mortgage amount, and giving lenders no bright line regarding legal liability will ultimately harm consumers, the very people the Dodd-Frank Act was intended to protect.

NAMB is calling for an 18- to 24-month extension of all mortgage-related regulatory deadlines in the Dodd-Frank Act in order for Congress to amend sections of Dodd-Frank to take out or amend the unintended consequences that will harm consumers in the mortgage market today.

"Skin in the game" was a popular mantra during the years leading up to the passage of Dodd-Frank, and we certainly think the mortgage market is better at determining what that means than the regulators. What was a great sound bite has turned into a complex restructuring of the mortgage underwriting system that regulators, industry, and many in Congress have concluded is not going to work as intended and will ultimately be harmful to consumers.

Overlooked in this debate was evidence in the VA loan program that clearly shows that downpayment does not correspond to default: 91 percent of all VA home loans are made with no money down, meaning technically, these home loans are underwater at the time that they are closed. In addition, VA has higher debt-to-income ratios and lower credit scores on average than that of FHA loans, yet VA loans still perform better with an astonishingly low default rate when compared to other mortgage loans. QRM and QM should be completely placed on hold by the regulators or Congress in order for us to think through all aspects of harm that will result from moving forward with these shoot-from-the-hip ideas. For example, the 3 percent cap on fees and points in the QM debate is wrongheaded and will harm consumers. In Texas, we have a loan program known as the Texas Veteran Land Board, which offers below market interest rates for military veterans. In fact, this week, mortgage rates for disabled veterans in the State of Texas through this program will be an astonishing low 2.61 percent on a 30-year fixed-rate loan. However, the 3 percent cap will take away the viability of this program because of the free fee structure associated with it.

The land board allows originators 2 percent, leaving 1 percent for all other costs. This simply does not work. This problem will be found all across the country in many State and local bond money programs designed for low- to moderate-income home buyers, thereby destroying the specific loan programs which are there to help these consumers in need. Also, the problems with the affiliated company's revenue being included in the 3 percent will also cause harm for small businesses.

In many smaller communities, a business needs several revenue streams in order to stay in business. These small companies need the income for mortgage, title insurance, and other services needed to close a real estate loan in order to meet all payroll and other expenses. In addition to striking the points and fee caps from the QM, the industry must be given a legal safe harbor to originate safe loans. If not, credit standards will continue to tighten, consumers will pay more, and the economy will continue to drag. Among a myriad of concerns with Dodd-Frank, I would also like to point out that loan originators and mortgage broker entities are currently defined the same and what they are in effect doing is forcing small business mortgage brokers and lenders to limit compensation to employees and to limit loan programs.

There are some fixes with this which would mean that Dodd-Frank adopt the SAFE Act's definition of mortgage loan originator. Also, consumers are still paying more for property appraisals than they currently need to. Some appraisal issues could be fixed by allowing mortgage professionals to order directly, and for appraisals to be portable, meaning that consumers can purchase one appraisal and that appraisal can be transferred from lender to lender to lender during their loan shopping.

Again, Congress must act to make sure that arbitrary deadlines do not shut out credit for consumers and destroy the availability of mortgage credit. Thank you.

[The prepared statement of Mr. Hudson can be found on page 88 of the appendix.]

Chairwoman CAPITO. Thank you.

Our next witness is Mr. Rick Judson, first vice chairman of the board of the National Association of Home Builders. Welcome.

**STATEMENT OF RICK JUDSON, FIRST VICE CHAIRMAN OF THE BOARD, THE NATIONAL ASSOCIATION OF HOME BUILDERS (NAHB)**

Mr. JUDSON. Thank you. Chairwoman Capito, Ranking Member Maloney, and members of the subcommittee, thank you for the opportunity to be here with you today. My name is Rick Judson. I am a builder developer in Charlotte, North Carolina and the first vice chairman of NAHB. You all mentioned in your opening remarks the objective of having access to credit. NAHB believes that the housing finance system should provide adequate and reliable credit to home buyers at reasonable interest rates through all business cycles and conditions, and it is critical to our economic health in this country. The relative slowness of growth in housing can be traced, in large part, to respective home buyers finding it more difficult to obtain mortgage credit, ironically in a period of historically low interest rates.

According to an NAHB housing market index survey conducted in January of this year, almost 70 percent of the builders report that qualifying buyers for mortgages is a significant problem in their selling homes. As this subcommittee examines the Dodd-

Frank Act's mortgage lending reforms, NAHB believes it is critical if such reforms are imposed in a manner that causes minimum disruptions to the mortgage markets while ensuring consumer protections.

Great care must be taken to avoid further adverse changes in liquidity and erosion of affordability. Hence, NAHB believes it is essential that a definition of the Qualified Mortgage or QM loan and the ability-to-repay standards are well-structured and properly implemented. The QM is extremely important, given it will set the foundation for the future of mortgage financing, as all mortgages will be subject to these requirements. NAHB urges policymakers to consider the long-term ramifications of these rules on the market and not to place unnecessary restrictions based solely on today's economic conditions.

Overly restrictive rules will prevent willing and creditworthy borrowers from entering the housing market, even though owning a home remains an essential part of the American dream, according to all recent polls. NAHB has joined with 32 other housing, banking, civil rights, and consumer groups to urge the CFPB to issue broadly defined and clear QM standards. A narrowly defined QM would deny financing to many creditworthy borrowers, which would undermine the prospects of a national recovery. Many observers believe few lenders will pursue business outside the QM market. If made, these non-QM loans would be far more costly and will not include important protections, burdening families, particularly first-time home buyers who are least able to deal with these expenses. This seems to go against Congress' intention for the ability-to-repay requirement.

After carefully considering proposed alternatives for QM, NAHB supports the creation of a bright line safe harbor to define the QM to best ensure safer, well-documented, and sound underwritten loans without the decreasing the availability or increasing the cost of credit to borrowers. NAHB supports a QM safe harbor that provides a sufficient availability of funding to provide consumers with strong protection and provide lenders with definitive lending criteria that reduces excessive litigation potential. The safe harbor should incorporate specific ability-to-repay guidelines. The final rule should provide creditors with discretion to responsibly adapt debt income or residual income requirements based on changing markets and not impose simply a rigid American standard. This should be sufficiently objective to make sound underwriting and credit decisions.

NAHB recommends that the regulators at corporate NAHB and other industry stakeholders develop a workable safe harbor. It is important to note that the establishment of the safe harbor under the QM does not eliminate lender liability. Consumers must have access to a responsible and sustainable housing credit market so as we can strengthen the lending regulations to avoid past excesses that have been addressed. We must be careful not to create an environment where mortgage loans are subject to unnecessarily tightened litigation risks or costs. Excessive litigation exposure and overly severe penalties would cause unnecessary uncertainty, resulting in liquidity issues for the entire population, and could cause low- to moderate-income and minority populations to suffer disproportionately.

I thank you for the opportunity to speak, and I will be happy to answer any questions. Thank you.

[The prepared statement of Mr. Judson can be found on page 107 of the appendix.]

Chairwoman CAPITO. Thank you. Our next witness is Mr. Scott Louser, 2012 vice president and liaison of government affairs, National Association of REALTORS®. Welcome.

**STATEMENT OF SCOTT LOUSER, 2012 VICE PRESIDENT AND LIAISON, GOVERNMENT AFFAIRS, NATIONAL ASSOCIATION OF REALTORS® (NAR)**

Mr. LOUSER. Thank you, Chairwoman Capito, Ranking Member Maloney, and members of the subcommittee. Thank you for holding this important hearing on the impact of Dodd-Frank's home mortgage reforms. As mentioned, my name is Scott Louser. I am the 2012 vice president and liaison for government affairs for the National Association of REALTORS®, and I am honored to be here today to testify on behalf of the 1 million members who practice residential and commercial real estate.

I have been a REALTOR® for more than 15 years. I am the broker-owner of Preferred Minot Real Estate in Minot, North Dakota. In addition to being a REALTOR®, I am also a current member of the North Dakota State legislature representing District 5, so it is quite an honor to be on this side of the table today.

If you had asked economists and housing market analysts about the current state of the housing market, most would agree that today's underwriting standards are too tight and contribute to a slow housing recovery. Because of this, NAR believes that an unnecessarily narrow definition of the Qualified Mortgage that covers only a modest portion of loan products and underwriting standards and serves only a small portion of borrowers would undermine prospects for a housing recovery and threaten the redevelopment of a sound mortgage market. For this reason, NAR urges Congress and the Administration to work together on a broadly defined QM rule using clear standards. We believe that this is the only way to help the economy and at the same time, ensure that the largest number of creditworthy borrowers are able to access safe, quality loan products for all housing types, as Congress intended in the enacting of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

NAR also believes that the QM will define the universe of readily available mortgages for a long time to come and non-QM mortgages will be rarely made. Every version of the ability-to-repay provision introduced in Congress and including the final version of Dodd-Frank that became law paired the ability-to-repay requirement with the QM as the best means of ensuring sound lending for borrowers.

A narrowly defined QM would put many of today's loans and borrowers into the non-QM market, which means that lenders and investors will face a high risk of an ability-to-repay violation, and even a steering violation. As a result, these loans are unlikely to be made. In the unlikely event they are made, they will be far costlier to consumers. Creating a broad QM which includes sound underwriting requirements, excludes risky loan features, and gives lenders and investors reasonable protection against undue litigation risk will help ensure the revival of the home lending market.

The ability-to-repay provisions of Dodd-Frank include a provision that if a loan's fees and points do not exceed 3 percent, the loan will be considered a Qualified Mortgage. The problem is that the calculation of fees and points under the 3 percent cap discriminates against real estate and mortgage firms with affiliates involved in the transaction. When an affiliate is involved additional items beyond the points and fees typically associated with the industry must be also included.

NAR strongly urges the Financial Services Committee to hold a hearing on, and then work to pass, H.R. 4323, the Consumer Mortgage Choice Act, to correct this discrimination and level the playing field between affiliated and unaffiliated firms. If these provisions are not corrected, up to 26 percent of the market or more could be affected. Consumers will be denied the choice of using in-house services, there will be less competition in the lending and settlement services industry, as well as likely reduced access to credit.

REALTORS® believe that one of the biggest issues impacting the housing economy is uncertainty in the rules that govern the housing finance industry. This uncertainty impacts all participants in housing finance: lenders; investors; and consumers. Until there is market certainty that encourages the return of private capital, FHA and the GSEs—Fannie Mae and Freddie Mac—will continue to dominate the housing finance system with the taxpayer on the hook. Therefore, we believe it is crucial to break the regulatory logjam and complete work on the rules related to QM and the QRM now that the Fed Basel III proposal is known.

The very first step to creating certainty in the housing finance system is to define QM so that it encompasses the vast majority of high-quality lending being done today. An effective ability-to-repay rule that provides strong incentives for lenders to focus on making well-underwritten QMs affordable and abundantly available to all creditworthy borrowers will require a clear objective definition of the QM that itself is not unduly restrictive. This action, along with a correcting of the 3 percent cap on points and fees will ensure that credit and housing services are available and affordable to the consumer. If we are able to get these first steps right, the market will continue its recovery.

Once again, on behalf of the 1 million REALTORS®, thank you for the opportunity to testify on the impact of Dodd-Frank reform. And as always, the National Association of REALTORS® is available to Congress and our industry partners for any questions. Thank you.

[The prepared statement of Mr. Louser can be found on page 119 of the appendix.]

Chairwoman CAPITO. Thank you.

Our next witness is Mr. Eric Stein, the senior vice president of the Center for Responsible Lending. Welcome, Mr. Stein.

**STATEMENT OF ERIC STEIN, SENIOR VICE PRESIDENT, THE CENTER FOR RESPONSIBLE LENDING (CRL)**

Mr. STEIN. Thank you very much. Chairwoman Capito, Ranking Member Maloney, and members of the subcommittee, thank you for inviting me to testify today. I am senior vice president of the Center for Responsible Lending, which is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth. It is affiliated with Self-Help. Today, I am representing CRL.

During the housing boom years, the private market engaged in essentially a science experiment: What would happen if lots of mortgage lending happened almost entirely outside of government oversight? The resulting foreclosure crisis is a stark reminder in my view as to why Dodd-Frank was important. Private mortgage lending dominated. Fannie Mae's and Freddie Mac's shares of the mortgage market decreased by 20 percentage points while the private market, private label security market, Alt-A and subprime loans, increased by 30 percentage points to comprise 40 percent of the market by 2006. This market was largely unregulated. Mortgage brokers originated 70 percent of nonprime loans on behalf of nonbank lenders who sold those loans to investment banks on Wall Street, creating securities that credit rating agencies rated, and then sold to investors.

Each actor was motivated more by volume than by performance and none of these actors were regulated at the Federal level. The lending bypassed Fannie Mae and Freddie Mac, which had stricter standards, and really bypassed the banking system, which was regulated. And to the extent that the banks were involved, I think it is fair to say that the regulators didn't do that much.

These private loans were largely bad mortgages. They had harmful features that made it more likely that the borrowers wouldn't be able to repay the loans. Additionally, these were adjustable rate mortgages that had built-in payment shock even if interest rates stayed the same, and the lenders failed to determine whether the borrowers could afford the increase in payments.

Countrywide acknowledged that 70 percent of their loans wouldn't meet the basic standards of accounting for built-in payment shock. At CRL, we knew that these results would be bad, but we didn't know how bad they would be. In 2006, we estimated that abusive subprime lending would lead to 2.2 million foreclosures. We were accused of being very pessimistic, but, in fact, we were overly conservative. The private label security loans performed very poorly, much worse than conventional loans.

And it was in this context of massive Federal regulatory and private market failures that Congress enacted Dodd-Frank. Dodd-Frank addressed the abusive mortgage practices in the private label security market and charged the new CFPB with supervising bank and nonbank lenders alike and also with the research goal of seeing where emerging risks in the economy would develop that provide risk to consumers, like the rapid increase in Alt-A and subprime lending.

Now to move to two of the provisions of the mortgage bill, which is the ability to repay and the Qualified Mortgage provisions. The ability-to-repay provision requires lenders to assess a borrower's ability to repay the loan, which sounds commonsensical but clearly did not occur during the mortgage boom. Also, the Qualified Mortgage provision establishes a default standard that lenders can use to demonstrate that, in fact, the borrower had the ability to repay the mortgage. The Center for Responsible Lending joined with the Clearing House Association, which is owned by the large banks in the country which have the most significant share of the mortgage market, along with two other groups, the Consumer Federation of America, and the Leadership Conference on Civil and Human Rights, to make three to the CFPB on how to define QM, how to presume that a loan is, in fact, affordable. And those recommendations are attached to my testimony.

We at CRL make three recommendations, and the first two I think I have heard all down the line here, which is, first, that QM be defined broadly so that it encompass the entire existing mortgage market so that QM protections would be available for all borrowers, all creditworthy borrowers.

Second, that QM be defined with bright line standards so everybody knows whether the loan is a QM loan or not. And third, that once you have those first two elements, there should be a significant litigation advantage to the lender to provide an incentive to make QM loans, which would be safer for borrowers, but that advantage should be a rebuttable presumption and not a safe harbor which would be absolute immunity. We believe that once a loan is a QM, the burden on a borrower to raise a claim is very large and there is unlikely to be much borrower litigation in the QM space, and as long as QM is broad and there are clear standards, then you are not going to see that much litigation.

The biggest risk to lenders in terms of lending, and I think the current constraint on lending, is investor put-back risk where investors will buy a loan and then decide that they don't want it anymore and put it back on the originator, which makes the originators very conservative.

And that is happening now. Broad standards with—broad QM with clear standards and a litigation advantage would provide minimal put-back risk on lenders so they can originate with confidence that they can sell the loan and they wouldn't have to take it back.

Again, thank you for inviting me, and I am happy to answer any questions.

[The prepared statement of Mr. Stein can be found on page 126 of the appendix.]

Chairwoman CAPITO. Thank you.

And our final witness is Ms. Debra W. Still, chairman-elect of the Mortgage Bankers Association. Welcome.

**STATEMENT OF DEBRA STILL, CMB, CHAIRMAN-ELECT, THE MORTGAGE BANKERS ASSOCIATION (MBA)**

Ms. STILL. Thank you, Chairwoman Capito, and Ranking Member Maloney. I appreciate that you have called this hearing on one of the most significant regulations to impact the Nation's housing system. This Qualified Mortgage rule has the potential to significantly alter the landscape of homeownership. It must be crafted with a well-balanced, thoughtful approach to ensure it does not harm the very borrowers that Dodd-Frank is designed to protect. The Mortgage Bankers Association recognizes that the industry bears responsibility for its share of credit risk excess during the housing boom. Today's lenders agree that reasonable rules must be put in place so that the mistakes of the past can never happen again. Dodd-Frank achieved much by addressing several of the key drivers that contributed to the mortgage lending crisis. The prohibition of certain exotic loan products with high-risk features, and the requirement that all loans be fully documented, have gone a long way toward restoring responsible underwriting parameters.

In the aftermath of the housing crisis, mortgage credit is now tighter than it has been at any time during my 36 years as a mortgage lender. Chairman Bernanke recently commented on restricted credit availability, noting that the tight environment is preventing lending to creditworthy borrowers. And HUD Secretary Shaun Donovan observed that 10 to 20 percent of potential home buyers are capable of carrying mortgage debt, but are being locked out of today's market. Against this backdrop, it is critical that the CFPB structures the definition of a Qualified Mortgage such that credit qualification parameters do not become even more conservative than they already are. The MBA believes that the QM definition must be defined broadly so that all qualified borrowers enjoy access to safe and affordable mortgage credit.

It is our strong opinion that setting overly tight credit parameters will hurt middle-class home buyers. This is contrary to the spirit of Dodd-Frank and could also jeopardize the fragile housing recovery. For the rule to be effective, lenders must know how to comply. Clear and unambiguous standards and a strong legal safe harbor are essential for a vibrant mortgage market in the future.

Importantly, the safe harbor is misnamed. It is neither a pass for lenders, nor does it deprive consumers of an opportunity for court review. Under a safe harbor, a borrower may opt to go to court and seek review of an alleged violation. The issue is how extensive and expensive the legal proceedings will be. Uncertain and unbound legal exposure runs counter to the availability of affordable credit to qualified borrowers. Without bright line standards and a legal safe harbor, lenders will have no choice but to alter their business strategies: some lenders may choose to exit the business, lessening competition; others, to mitigate risk, will create even tighter credit guidelines than the QM definition; and still others will price their loans higher. Whether it is less competition, tighter credit or higher cost, all of these outcomes will harm consumers.

It is also extremely difficult to envision a secondary mortgage market for non-QM loans. Even if you can imagine the future with a non-QM marketplace, how long would it take for such a market to develop, and can our economy wait that long? Just as importantly, how much would it cost a non-QM consumer, who by definition would be the least likely to afford the higher cost?

MBA believes that the CFPB must carefully assess any unintended consequences resulting from the definition of QM. Of particular note is the cap on points and fees and how it is defined in the final rule. Unless this provision is amended, moderate-income households that need smaller loans or consumers who make large downpayments will find credit less available and more expensive.

MBA strongly supports the Consumer Mortgage Choice Act, and I want to personally thank Representatives Huizenga, Scott, Royce, and Clay for their work on this legislation. This bipartisan bill would clarify that escrow payments and loan officer compensation are not counted toward the 3 percent cap on points and fees. The bill also creates parity between affiliated and unaffiliated title services, ensuring consumers can choose the provider that is best for them.

Madam Chairwoman, it is impossible to overstate the importance of getting the QM rule right. This rule will define who does and who does not get mortgage credit in the future. It is imperative that the rule strike the perfect balance between consumer protection, fair and responsible access to credit for all qualified borrowers, and a competitive marketplace. The only way we are going to do that is by defining the QM broadly with clear standards and a legal safe harbor.

Thank you for the opportunity to testify.

[The prepared statement of Ms. Still can be found on page 149 of the appendix.]

Chairwoman CAPITO. Thank you.

I appreciate all of the testimony. I think I have heard, and I am sure my colleagues have heard, from all the presenters two themes, broad and clear—well, three—bright lines. It just depends on what bright lines, I guess, you wish to be drawn.

So I would like to ask Mr. Bentsen, does risk retention have the potential to promote consolidation of lending risk bearing and market share just amongst the very large institutions, in your opinion?

Mr. BENTSEN. Madam Chairwoman, I don't know that we know the answer to that question. I think, obviously, how risk retention is ultimately defined in the rulemaking process will have various impacts. But I don't know that we can look at it and say, at this point at least, that it will lead to consolidation. I don't think we know the answer to that.

Chairwoman CAPITO. I am trying to get to, with the Title XIV issue, how it might affect smaller lenders in more rural areas. My colleague from Texas mentioned that several banks in Texas have already ceased offering mortgages, and I think research is showing that some smaller institutions are moving away from this, and I think the QM definitions and whether they can meet those standards or whether they can meet the legal possibilities that they may see—

Mr. BENTSEN. Certainly with respect to QM, our view—and this is both a buy side and a sell side view—is that if you define QM so narrowly that it were to really almost be a QRM like that, it would not capture a very sufficient part of the mortgage marketplace. And so, from our members' perspective, fewer investors would likely move into that market. Were that to be the case, and you are pushing off a large non-QM market elsewhere, it is not clear who is going to pick up that market. And then when you lay on top of that the Basel III standards that will come into play. So the capital risk retention notwithstanding, the capital associated with that, it is likely it could have an impact on community banks and others.

Just from our perspective, if the QM is so narrow that our members don't believe that they will participate in that market, somebody else will have to pick up that slack; and it is not clear who will do it and who will have the capital to do it.

Chairwoman CAPITO. Ms. Still, would you like to respond to that?

Ms. STILL. Yes. I think another concern for the small community lender would be the uncertainty in a rebuttable presumption. Not knowing how to comply clearly would create liability and uncertainty.

If you look at the size of the penalties of not complying with QM, one infraction could be ruinous to a small lender. I think MBA originally estimated an infraction could cost between $70,000 and $110,000. Our new numbers, based on new research, would suggest that it could be as high as $200,000. If you liken that to the repercussions of a repurchase, those are the same extraordinary numbers that would cause small community lenders not to be able to lend.

Chairwoman CAPITO. In terms of the borrower in the lower range who maybe doesn't have as much credit availability, the consumer who doesn't have the options that some other, wealthier or better-credit-risk consumers would have, in terms of the rebuttable presumption versus the safe harbor, I said in my opening statement that I think the safe harbor is the way to go because I think that is the way that those who are on the bubble a little bit are going to be able to get into the market.

Mr. Judson, would you have an opinion on that?

Mr. JUDSON. Yes. Thank you.

The lenders would like to loan money. That is their business. The first-time buyer is about 40 percent of the market right now, and if they can't get construction loans or if they can't get a permanent loan because it doesn't meet the lending requirements, that may explain the rise in the rental market. So we feel that a clear definition for QM would perpetuate lending and encourage it.

Chairwoman CAPITO. When you say clear—and I don't mean to interrupt—but when you say clear definition, you really mean the safe harbor versus the rebuttable. That is the core of what we are—

I have heard a lot of talk about what the fees would constitute and what 3 percent constitutes and some exemptions. You mentioned title insurance that is not part of it that could become a large—

Ms. Cohen, would you like to respond? Expand a little bit on the title insurance issue.

Ms. COHEN. The question about the points and fees is, under the Qualified Mortgage definition now in Dodd-Frank, the limitation for a Qualified Mortgage is 3 points and fees. Some fees are included in that and some are not. And the ones that are included include those fees that are paid to the affiliate of the creditor because the creditor is getting that money in a way that is different from if the title insurance or another third party provider is not associated with the creditor. So the question you are alluding to is whether those parties should be in or out of that cap.

Chairwoman CAPITO. Right. Thank you.

Mrs. Maloney?

Mrs. MALONEY. Thank you.

It is rare that we have a panel who agrees on everything, and you all seem to agree with a broad definition and also of the bright lines and clear standards. I want to see if you all agree with the ability to repay.

Many of the analysts believe that if there had been an ability-to-repay requirement prior to the financial crisis, it would have significantly lessened, if not prevented, the mortgage meltdown. I know, leading up to the crisis the joke in New York was, if you can't afford your rent, go out and buy a home. And it was almost true. You didn't have to give any documentation or anything. You could just go out and buy a home.

I would like to ask all of the panelists, do you think it is reasonable to have an ability-to-repay requirement and to ensure that borrowers document their income in mortgage applications and that they can in fact repay it? To me, this is just common sense. Does anyone disagree with an ability to repay?

No one disagrees.

Then I would like to go to the testimony where there was an area of disagreement. Certainly, the purpose of a Qualified Mortgage is to incentivize mortgage originators to lend responsibly and to make loans that are safe for institutions and consumers. In the Federal Reserve's first proposed QM rule, it proposed two alternatives to that by either creating a rebuttable presumption for lenders or a safe harbor as a shield from liability and foreclosure proceedings. There was a difference of opinion on these two areas, and I would like to hear arguments in support, and then in opposition, and how these standards differ.

I would like first to hear from Mr. Stein and then Mr. Louser, then Ms. Cohen, then Mr. Judson and then anyone else who wants to justify. How do they differ? Could you comment on the pros and cons of these two standards? Your comments, please.

Mr. STEIN. Absolutely.

As I mentioned, the recommendation that we provided on this—on QM with the Clearing House, there are three components—broad, clear, rebuttable presumption—and they are all interrelated.

Because if you had a narrow QM—some of the panelists have talked about if it were narrow and you had a safe harbor, it wouldn't help you very much. Because a lot of the lending would be outside of QM, and there wouldn't be a safe harbor. There would be a lot of liability. And it is fraught to lend outside of QM.

If QM is fuzzy, if it just talks about Generally Accepted Underwriting Standards, there would be a lot of litigation over whether or not this loan is a QM. And, therefore, it gets to safe harbor.

So I think those first two elements are actually more important as to whether there is going to be litigation and whether there is going to be lending than the safe harbor question.

Mrs. MALONEY. But there is agreement from everyone on the panel on those first two. The disagreement is on the rebuttable presumption and safe harbor. And so, if you could direct your comments to the differences between the two?

Mr. STEIN. Absolutely.

A safe harbor would be an absolute immunity to the lender that, in an egregious case where they knew that the borrower couldn't afford the loan and they acted in bad faith, there is no ability to raise that claim, only whether it is in or out of QM. We think there is enough certainty once the loan is a QM and the rebuttable presumption is a strong enough incentive, strong enough litigation advantage, that there is going to be very little borrower litigation. And more importantly, secondary markets are not going to put those loans back on lenders, and they are going to have the confidence to lend vigorously.

Mrs. MALONEY. Thank you.

Mr. Louser?

Mr. LOUSER. Representative Maloney, from our testimony, we didn't address safe harbor versus rebuttable presumption. The REALTORS® would prefer the safe harbor, and our concern is not necessarily the potential for litigation up-front but, once that begins, that would be standard if it was a rebuttal presumption.

Maybe the lenders are a better indicator of this. One of my roles as vice president has been to meet with the large lenders across the country, and consistently, we have found that they agree with the safe harbor.

Mrs. MALONEY. Ms. Cohen?

Ms. COHEN. The difference between the rebuttable presumption and the safe harbor is whether, in an extreme circumstance, a homeowner has any recourse at all.

If the lines are bright and clear, it will be easy for a creditor to make a loan that is within a Qualified Mortgage. But if they have additional information that rule writers can't contemplate now, for example, extremely high costs that are documented and that they do have access to at the moment of making the loan and while they are preparing the loan, that homeowner with a predictably unaffordable loan will have no legal recourse at all in a safe harbor.

In the rebuttable presumption, the homeowner will still have a very steep hill to climb. They need an attorney, and the courts in general will defer to the standards set by the government agency writing the rules.

And in terms of whether there is a large amount of litigation risk, between 2005 and 2010, there were almost 65 million homes in foreclosure. There were, around the same timeline, 60 cases about the truth-in-lending rebuttable presumption that already exists.

Mrs. MALONEY. My time has expired. May I ask for 30 additional seconds for Mr. Judson to respond?

Chairwoman CAPITO. Mr. Judson?

Mr. JUDSON. We clearly support the ability-to-repay requirement. We would also support the safe harbor in that it is more likely to lead to availability of funding, which is really what this is about. Availability of funding makes more mortgages available to the average buyer, the consumer.

Chairwoman CAPITO. Mr. Renacci?

Mr. RENACCI. Thank you, Madam Chairwoman.

I want to thank all of the witnesses for being here.

Mr. Bentsen, I want to go back to your testimony. You say that your association is very concerned that the QM regulations may be construed in a narrow manner, parameters that will not allow for the certainty of compliance at origination. Would you tell me today, based on just that comment and the way that the Dodd-Frank rules are moving forward, that your industry does have some uncertainty and unpredictability of the future?

Mr. BENTSEN. Certainly within the housing finance sector, there is a great deal of uncertainty, because we don't know what the final QM rule is going to be. We expect the QRM rule and risk retention rules to come behind that. So maybe December, January QM comes out. Then, following on the heels of that, QRM risk retention. So that creates a lot of uncertainty in market participants as to what the structure of new mortgage finance will be. Not to mention, we still don't know what Congress—what you all are going to ultimately decide to do with the respect to the GSEs. So I think that does create a fair amount of uncertainty in the housing finance sector.

Mr. RENACCI. It is one of the things I hear back in my district in Ohio, that this uncertainty is one of our issues. Government is causing so much more uncertainty.

I know that you were on this side of the table at one point in time, so it is interesting to get your perspective now that you are on the other side that you do agree that Dodd-Frank is causing some uncertainty and unpredictability at this point in time.

Mr. BENTSEN. In our count, there are about 150 rulemakings—I guess you can slice and dice it any way you want to get to a count—that have to be done across all aspects of the financial markets, including a large part of the capital markets that we represent. And until all those rules are done, whether you agree with them or not—and we have questions certainly on a number of them—the markets—our member firms will have to adapt to what those final rules are. We know they are coming, but we don't know what they are going to be. So there will be a great deal of adaptation among market participants to comply with the new rules. But until they are done, there are still a lot of questions.

Mr. RENACCI. Sometimes we wonder why markets are frozen up or why capital is not out there. But when government causes the uncertainty, sometimes that could be the answer, too. That is what I was trying to get out, and I think that is what you are saying. I hear it all of the time back in my district. So it is interesting, some of your comments.

Mr. Hodges, in your written testimony you expressed frustration that half of all loans to purchase manufactured homes could be at risk by being categorized as high cost under Dodd-Frank. Could you explain why the economics of originating and servicing these small loans often result in APR fees being higher than conventional home mortgages?

Mr. HODGES. Absolutely.

It is best described by way of example. If the average cost to originate a loan is, let's call it $2,000, well, $2,000 is 1 percent of a $200,000 mortgage. It is 10 percent of a $20,000 mortgage. And of course that scale goes—it runs the scale there. Since most manufactured housing loans are smaller loans with the same cost to originate and service—or similar—it just adversely affects us just by virtue of applying the percentages in HOEPA and QM. It adversely—our transactions, it would be easier to hit those caps.

Mr. RENACCI. Mr. Hudson, you also describe in detail the concern with the 3 percentage point fee cap, that it is biased against mortgage loan originators who are not creditors. Can you explain that?

Mr. HUDSON. Again, just to follow up on my colleague with regard to it's best used by example, in the State of Texas, there is currently a 3 percent cap in existence on Texas home equity loans. Borrowers cannot pull cash out of their property unless it is in an ADLTV with a 3 percent cap. That does not include the items that are currently in the proposed QM.

Currently in the State of Texas, consumers are hard pressed to find any lender willing to make a home equity loan for less than $150,000 simply because it is so easy to hit that 3 percent cap, coupled with the fact that the State of Texas, on average, has the second-highest closing costs in the country, second only to Ranking Member Maloney's State of New York. So it is going to be very easy to hit that 3 percent cap.

And in particular, when it comes to home loan programs that are specifically designed for low- to moderate-income consumers, such as bond money programs—for example, my company has been the lender of the year for 3 years running now for the Texas Department of Housing and Community Affairs. We originate a lot of bond loans for first-time buyers. We don't necessarily do them because they are a profit center but because consumers need to have access to these products to participate in the American dream of homeownership.

So if this 3 percent cap comes into place, loan amounts will be set at a minimum standard. Otherwise, we will have to charge higher interest rates to offset that balance; and, therefore, you run into another whole new set of legal liability.

Mr. RENACCI. Thank you. I yield back.

Chairwoman CAPITO. Mr. Watt for 5 minutes.

Mr. WATT. Thank you, Madam Chairwoman.

Let me start by thanking the chairwoman and the ranking member for putting together a very balanced and broad-based panel. It is an important subject.

When I first saw the notice of the hearing, I actually shuddered a little bit, because I thought it was going to be another one of these hearings about the broad-based attack on Dodd-Frank. That was justified somewhat because we had just had a hearing yesterday in the Judiciary Committee that was kind of a broad-based attack on Dodd-Frank. I don't know why we were having it in Judiciary. It seemed to suggest that we were at the 2-year anniversary, and there was some concerted effort to just make this broad-based attack. But you have put together a good, balanced panel; and I think that is very important and instructive.

I want to applaud the work that has been done by this broad bipartisan industry/consumer/civil rights group of folks who put together the discussion draft that was apparently submitted to the CFPB as part of the comment process. Seldom will you see—except when I had to work with all of them in the back room to try to get to the language that we were trying to get to in Dodd-Frank—a public coalition between the Center for Responsible Lending, the Consumer Federation of America, the Leadership Conference on Civil Rights, and something called the Clearing House Association, which consists of Bankco Santander, Bank of America, the Bank of New York Mellon, BB&T, Capital One, Citibank, Comerica, Deutsche Bank, HSBC, JPMorgan Chase, KeyBank, PNC, RBS Citizens, Regions, UBS, U.S. Bank, Union Bank, Wells Fargo, City National, Fifth Third Bank, First Citizens, and M&T. That is one heck of a coalition when you put all of those people together and they come up with a joint proposal.

So I guess my question to the panelists—I know Mr. Stein's group was part of that coalition, and Ms. Cohen's group was part of that coalition. Does anybody else on this panel have a membership on that coalition?

Ms. COHEN. Excuse me, Representative Watt. We are not part of the coalition, just so you know.

Mr. WATT. I give you more credit or blame than you are due, and I apologize for that.

Maybe I should ask the question this way: Has anybody looked at the recommendation that this broad coalition made to the CFPB in its comment? Have you looked at it? Do you have substantial disagreement with any parts of it, Ms. Still?

Ms. STILL. Only one part of it. We very much think that the Clearing House document is a good place to start the discussion. We support the attempt to come up with some bright line standards.

Mr. WATT. What is it that you disagree with?

Ms. STILL. The piece we would observe and disagree with, first, I am not sure that a 43 percent back ratio is not too tight and wouldn't cut out qualified borrowers.

Mr. WATT. Okay, what else?

Ms. STILL. The second thing is we would put the bright line standards in a safe harbor at the Mortgage Bankers Association, not the—

Mr. WATT. So we are back to the safe harbor issue.

Does anybody else who has read this document have any concerns about it other than Ms. Still's group?

What about you, Mr. Louser, and you, Mr. Hudson, in particular? And you, Mr. Bentsen? You all represent broad coalitions of members. Are there specific things in this proposal that you are concerned about? Or have you read it?

Mr. HUDSON. I have not read the specific proposal.

Mr. WATT. Okay, then I won't ask the question.

What about you, Mr. Bentsen?

Mr. BENTSEN. Mr. Watt, I can tell you that I have not personally read it. Our team has looked at it. While we think there is much in there that we like, and we work with these various groups from time to time, our view still is from a concern about assignee liability, that we really believe the safe harbor is the better approach to go. So that is mainly where we disagree.

Mr. WATT. So this law, much of which was drafted by Mr. Miller and I, based on the North Carolina law, where there is a presumption but no safe harbor, very little litigation, that doesn't influence you on this issue?

Go ahead?

Ms. STILL. I think in North Carolina, you have loans over $300,000 that are excluded from consideration. You also have a 50 percent back ratio, and you don't have the recoupment of attorneys' fees and you have much lower penalties for infraction. So I think there is a huge difference between the two.

Mr. WATT. Mr. Stein may disagree with some of those points.

Mr. STEIN. Just for clarification, the North Carolina ability to repay is a later addition. Since 1999, North Carolina has required a net tangible benefit for all refinancing transactions. That has significantly greater damages than the ability-to-repay provision does and virtually no litigation. So I think that is the history of the North Carolina law.

Chairwoman CAPITO. The gentleman from Texas, Mr. Hensarling is now recognized.

Mr. HENSARLING. Thank you, Madam Chairwoman.

I want to pick up on the concept of the ability to repay. Ms. Still, you seem to be very anxious to say something, so I am going to give you the first crack. Representing the Mortgage Bankers Association, can you explain to me why it is in the interest of your individual members to loan money to people who can't afford to repay it? Why is that in your interest?

Ms. STILL. It is not.

Mr. HENSARLING. So it is not in your interest to loan money to people who can't pay you back?

Ms. STILL. We absolutely support the ability-to-repay rule. It is critical, though, that we get the rule correct. We have to make sure that we strike a balance between ability to repay and not restricting credit to deserving borrowers.

Mr. HENSARLING. But you need a rule to tell you not to loan money to people who can't pay it back?

Ms. STILL. I think good, balanced underwriting criteria is always advisable for all consumers. I think the clarity of that and the balance of that is going to be critical, absolutely. But the Mortgage Bankers Association—

Mr. HENSARLING. I don't disagree with you. We certainly had a huge erosion in underwriting standards. I just find it somewhat ironic, when I look at the affordable housing goals that were thrust upon Fannie and Freddie, when I look at CRA, to think that we essentially have had Federal regulation tell people to loan money to people who couldn't afford to pay it back. And now all of a sudden, we need a Federal regulation to tell you not to do what they told you to do in the first place. And I just can't help but recognize the irony of that.

Also, when we are talking about the ability to repay, who has the greater information base in figuring out whether or not you can repay a loan to buy a home? Having bought a home before, although there are voluminous amounts of disclosure, sooner or later I was given a piece of paper that told me how much I had to pay each month and how many months I had to pay it. I ended up with that piece of paper in the disclosure.

But, when I am sitting down with the people who are loaning me the money, I am trying to figure out, if I was about to send a kid to college, would I know that or would my banker know that? If I was about to get laid off from my place of employment, would I have the greater knowledge base of that or the person loaning me the money? The tragedy of divorce, as tragic as that is to a family, it is also a financial tragedy, so who would have the greater knowledge base of the ability to repay? Would that be the borrower or would it be the lender?

Ms. Still, your opinion?

Ms. STILL. There are certain objective criteria that any lender needs to look at: income; assets; job stability, et cetera. They are objective. They are verifiable.

There are other things that we don't take into consideration, and a lot of that is buyer intent. Will you send your kids to private school or will you send them to public school? Will you keep the air conditioning on 24 hours a day or will you be conservative in your energy bills?

And so, it is a shared responsibility. Certainly, the lender has to own the standards that are objective and that would keep a consumer in bounds in terms of—

Mr. HENSARLING. Forgive me. I see my time is starting to run out here.

In yesterday's hearing—and I see, Mr. Bentsen, you are becoming a frequent guest here. I guess you miss us from your days of service in this institution.

But I was a little taken aback when I saw this study—which I intend to study much more closely—from Mark Zandi of Moody's Analytics, whom I believe is the most frequently quoted economist from my friends on the other side of the aisle, looking at just one aspect of Dodd-Frank, the premium capture cash reserve account. In his study, he estimated that mortgage rates could increase 1 to 4 percentage points if the rule is implemented as proposed. Again, seeing that, I think 30-year fixed-rate loans are going for about 3¾ percent. Essentially, what Mark Zandi is saying is that one aspect of Dodd-Frank could double interest rates.

I am curious if anybody else has seen this study. Mr. Bentsen, I know that you have. Mr. Judson, have you seen this study? And if so, what would a doubling of interest rates do to home building?

Mr. JUDSON. It would hurt the home building industry and the ability to get financing.

Mr. HENSARLING. I would say you have a knack for the understatement, sir.

I see my time has expired. Thank you.

Chairwoman CAPITO. Mr. Hinojosa?

Mr. HINOJOSA. Thank you, Madam Chairwoman.

I have heard concerns from community banks in my congressional district and also others who have come into my office here in Washington. I have also heard from REALTOR® groups, both nationally and in deep south Texas, about the upcoming Qualified Mortgage rules that the CFPB is formulating.

My question is for Ms. Cohen and for Mr. Hudson: What do you predict the benefits will be of having a well-defined Qualified Mortgage and how will a broad criteria impact the industry versus a more narrow criteria?

Ms. COHEN. If the question is about broad versus narrow and clarity, the benefit from the perspective of the consumer is that the Qualified Mortgage definition is meant to provide affordable loans to homeowners. So if the definition is broad, it reaches more loans. And by definition, then it would reach out to more homeowners who would come under the purview of this more privileged and more predictably affordable loan category.

We still worry about people around the edges, but the fewer people you have around the edges, the better off for the population in this particular context.

With regard to clarity, it is also better for homeowners if the rules are clear because the creditors will have a better sense of what it means to make an affordable loan; and when the loan is not affordable, it will be easier to demonstrate whether the rules were complied with or not.

Mr. HINOJOSA. Mr. Hudson?

Mr. HUDSON. Thank you, Congressman.

I live in San Antonio, Texas. My family is from Brownsville, Texas. I have originated home loans as an originator in Brownsville, Texas. And I can tell you that one of the great things about measuring an ability to repay is that if I have some broad guidelines I can still do what I can to make sure that I am giving a consumer the loan that they deserve. If we get too narrow in scope, my real fear is that there is a large segment of consumers, particularly in south Texas, who will be limited in their access to credit and be forced into a permanent class of renters, which is, I think, a real shame.

With respect to ability to repay, I think I can pretty much say that everybody on the panel might agree with me on this, the industry—we are already determining a borrower's ability to repay. I think the chart that the CFPB put out for us to comment on with regards to debt-to-income ratios, the bottom line was 2009 numbers with regards to debt to income ratios.

So, post-collapse, pre-Dodd-Frank, you could already see where the industry has already come back and decided, you know what, we are going to actually verify that consumers can make a payment. If you simply look at those delinquency numbers, they will reflect that.

But my fear is if we get too narrow in scope, then we will be harming the consumers who need access to credit the most.

Mr. HINOJOSA. If Dodd-Frank had been in place, say 6 years ago, Countrywide lenders in Texas would not have had so many violations, as we now find out.

Looking at one of the Wall Street reports on the reforms containing a number of other reforms that will benefit consumers, including a requirement that the CFPB design a new disclosure form to be used at the time of a mortgage application—and we have seen some forms that have been given to us as examples, and so I will refer to that. In fact, just this week, the CFPB announced this proposed rule after using the last year or so to test draft forms with the industry, with consumers, and with other stakeholders, and all of these reforms were designed to level the playing field between consumers and loan originators so that we never have to see another multi-billion dollar settlement for weak servicing standards. Ms. Still, have you seen any of those proposed forms that would be tested?

Ms. STILL. Yes. We have had committees at the Mortgage Bankers Association that have done a review of every iteration of the rounds of activity to get to the final forms that have been proposed. We clearly support clear, transparent disclosures for consumers.

Mr. HINOJOSA. I think that all of us want consumers to understand exactly what the amount is, the principal and the projected payments. Honest costs for, say, appraisals. There were many, many violations that we learned about after having congressional hearings here. So I am pleased to see that an effort is being made by all of the stakeholders to be able to come up with something as simple as what I have in my hands that will tell the consumer exactly what he or she is getting into.

I yield back.

Chairwoman CAPITO. Mr. McHenry for 5 minutes.

Mr. MCHENRY. Thank you, Chairwoman Capito.

Ms. Cohen, you say in your testimony that a QM safe harbor will leave the door open to known types of abusive lending; is that correct?

Ms. COHEN. Yes.

Mr. MCHENRY. Mr. Bentsen, how do you respond to this concern? I will read it again. The QM safe harbor, Ms. Cohen says in her testimony, will leave the door open to known types of abusive lending.

Mr. BENTSEN. From our perspective, Congressman, our view looks at it from the standpoint of securitizers and investors.

Mr. MCHENRY. That is why I asked you.

Mr. BENTSEN. Yes. So we are looking at it from the standpoint of, we are getting the loan from the lender. So we really have two concerns. The main one is assignee liability, that a rebuttable presumption transfers the potential liability of litigation to the securitizer and to the investor in the mortgage. So we mainly are concerned about that.

We think a consequence of this also could be that lenders would become equally concerned and very conservative, and therefore they probably would be overly strict in their underwriting for fear of litigation.

So we think—from our standpoint, we are concerned about assigning liability.

Mr. MCHENRY. Let me interrupt, and I will ask something a little more specifically to you.

You said in your testimony that you expect any limited lending outside of the confines of the QM definition will be performed at far greater cost to the consumer and, therefore, will be more likely to be provided by less-regulated, less-well-capitalized and possibly less-reliable entities. Implicit in that, if I may, is that a narrow QM definition would have the unintended consequence—or the consequence of creating an active non-QM market; is that correct?

Mr. BENTSEN. Yes. But we also think that non-QM market, at least from the standpoint of the secondary market, would be very small. So there would be a non-QM market. It would be funded somehow. But our members don't believe that is a market they would participate in.

Mr. MCHENRY. I understand that they wouldn't participate in it, but who would this affect, then?

Mr. BENTSEN. It would affect those borrowers who don't meet the threshold of a QM, were they able to get credit—

Mr. McHENRY. I am asking who those are. Obviously, those who don't meet that QM threshold.

Mr. BENTSEN. Depending on where a QM is established, it could be lower-income borrowers whose debt-to-income ratio is above that certain level, that they would be priced out. They would be priced out of the market.

Mr. McHENRY. Okay. To that end, I want to ask Ms. Still, in terms of setting a downpayment requirement, what would the effect be on the marketplace here? If we simply set a 20 percent downpayment requirement, what impact would that have?

Ms. STILL. It would have an enormous impact.

Mr. McHENRY. Would it be positive or would it be negative?

Ms. STILL. It would be negative.

Mr. McHENRY. Mr. Judson, to the same question, do you think that would be beneficial to home building in America?

Mr. JUDSON. I would say it would not be beneficial, no. It would be quite negative.

Mr. McHENRY. That is a very soft way of saying it. I appreciate my neighbor saying that.

To that end, Mr. Judson, you said in your testimony that the establishment of a bright-line safe-harbor definition for QM, Qualified Mortgage, is the best way to ensure that safer loans are made without increasing the cost of credit. So there are obviously tradeoffs between consumer protection and maintaining credit availability. What is that balance, in your estimation?

Mr. JUDSON. I can't give you a numerical number for that, but common sense will say that if you are creating the cottage industries you referenced earlier, which is what would happen, you are going back to the same thing that got us into this dilemma in the first place. If we have a broader interpretation for the safe harbor and the bright line, you are going to get broader participation and more availability of funds, which casts its net over a broader segment of the buying public, particularly that first-time buyer and the minority, who are the ones who will be most impacted by this cottage industry of the non-QM lender.

Mr. McHENRY. Thank you.

I yield back.

Chairwoman CAPITO. Mr. Miller for 5 minutes.

Mr. MILLER OF NORTH CAROLINA. Mr. Stein, since the question wasn't addressed to you earlier, could you answer in just 30 seconds, or a minute at most, why a lender, if there were no risk retention rules or if there were still prepayment penalties or if we still had an appreciating housing market, why would a lender make a loan where the borrower did not have the ability to repay?

Mr. STEIN. I think the private label security market was a perfect example where no one was bearing the risk and they didn't really care if the loan performed. And so, you had the 2/28 exploding ARMs, you had yield-spread premiums where brokers were paid more if the interest rate was higher, prepayment penalties that locked people out of bad loans, didn't escrow to make it look cheaper, those are all things that increased volume; and so people received fees, but they caused a lot of defaults and hurt the economy. Those are exactly the things that Dodd-Frank cracked down on in the no-doc lending.

Mr. MILLER OF NORTH CAROLINA. And if the lender no longer owned the mortgage, the default was not really their problem?

Mr. STEIN. Exactly.

Mr. MILLER OF NORTH CAROLINA. Mr. Stein, in your testimony, you have urged a rebuttable presumption as opposed to a safe harbor, which presumably means an irrebuttable presumption. You don't really offer any examples of the kind of conduct that might rebut the presumption, the kind of circumstances that might rebut the presumption. Can you imagine any? Or, failing that, can you think of some practices that existed at the time Congress passed HOEPA that did not exist at the time of HOEPA and so would not have been forbidden if Congress then very thoroughly forbid abusive practices?

Mr. STEIN. I think the important thing about the ability-to-repay test for the lender, it is true that borrowers—going back to the previous question—know more about their circumstances. All that lenders are being held to is what they knew at the time the loan was made, what they have received the information on.

I think because the practice—I never could have predicted the yield spread premiums' prepayment penalties, the abuses that occurred, and I don't have the creativity to predict abuses that may happen in the future, and so I think having this little fail-safe for egregious cases available to borrowers would be prudent. And lenders have enough certainty, and they are going to win the vast majority of cases while the loan is QM.

Mr. MILLER OF NORTH CAROLINA. The old cases—when I say "old cases," 300- or 400-year-old cases on fraud—the courts say in very quaint language that there should not be a fixed definition lest crafty men find ways to evade it.

Ms. Cohen, can you think of some practices that have been hailed as innovations that were really just an innovation to get around regulation?

Ms. COHEN. When HOEPA was first passed, at the time I was working at the Federal Trade Commission, and I got a lot of calls from homeowners. The problems at the time were that the points and fees were very, very high. They were 10, 12, and higher percent.

The other big innovation at the time was credit insurance.

Both of those abuses dried up when HOEPA was passed, and the exploding ARMs that Mr. Stein was just talking about and similar loans where there was a jump in the interest rate essentially or prepayment penalties that were quite excessive came much later for the most part and locked people into their abusive loans in ways that were permitted by HOEPA.

Mr. MILLER OF NORTH CAROLINA. So if we had a rigid definition that did not allow other circumstances and innovation, might a new practice evade the existing definition, the rigid definition in a way that we don't anticipate?

Ms. COHEN. That seems quite likely.

Mr. MILLER OF NORTH CAROLINA. Mr. Hodges, the GSEs are supposed to recognize the secondary market for personal property as well—in other words, manufactured homes that are not affixed to dirt—but they haven't done much to create those markets, and they say it is because there is not much demand. Do you think the

GSEs, by helping to create more of a secondary market, what effect do you think that might have on the demand for loans secured by real property? In other words, manufactured homes?

Mr. HODGES. The Manufactured Housing Institute—what you are alluding to is the duty to serve obligation in the Housing Economic Recovery Act. So the Manufactured Housing Institute, we are big supporters of that.

And so, to answer your question, we do believe that if the GSEs would create a viable market for personal property, for purchasing personal property manufactured home loans, what it would do at the least is make that market available and in some ways more attractive for other lenders to get back into it. We haven't really had it ever from the personal property side, so we would really like to think that it would be helpful in bringing lenders into that market.

Mr. MILLER OF NORTH CAROLINA. Thank you. My time has expired, Madam Chairwoman.

Chairwoman CAPITO. Mr. Luetkemeyer for 5 minutes.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman.

I appreciate all of you being here today. It is an interesting discussion that we are having.

We are in a situation where the government pushed the lenders to loosen up some of the lending standards and we had a disaster, and now we have the pendulum going in the other direction where we are probably tightening up too much to the point where we are restricting the availability of credit. And now we are trying to figure out where that fine line is between where we can loan safely, encourage home building, encourage homeownership, and yet don't go so far as to get back into the same problem that we had. So I appreciate the chairwoman's ability to put this hearing together. It is quite interesting today.

To follow up with Mr. Hodges on something Mr. Miller brought up, how has the money accessibility been since 2008 in your industry? Has it dried up significantly or is there still plenty of access to loans? Can you tell me about your industry as a whole?

Mr. HODGES. Are you asking from the GSE standpoint or securitization or just lending in general?

Mr. LUETKEMEYER. No, just lending in general for your product.

Mr. HODGES. I would say, since 2008, it is safe to say there is less lending for small balance manufactured home loans, especially personal property, than there may have been 10 years before that.

Mr. LUETKEMEYER. I would have thought it would have increased as, obviously, your product that you are selling is less in cost than a bricks-and-mortar home. Is it because there are not as many people who have jobs to be able to do this? Or is it because access to credit has restricted the ability of people to buy homes? Why is it less?

Mr. HODGES. I think in some ways it is because manufactured housing finance is really affordable housing credit. So a lot of the buyers who come to the manufactured housing sector would be low- and moderate-income people who are worthy buyers but may not have the credit history that other bigger financial institutions want to really maybe entertain that market.

Mr. LUETKEMEYER. So what you are saying is, because of the restricted credit analysis that goes on, they have lost the ability to enter into your market; is that right?

Mr. HODGES. As credit scores have tightened, as lenders have gotten more conservative on credit scores, for example, it takes our low-income buyer really out of that market. It makes it a lot harder for them to find financing, which is why we believe supporting the manufactured housing market, which will loan to people who are worthy in that regard, is really important to this type of housing.

Mr. LUETKEMEYER. That is very interesting.

I was listening to Mr. Hudson's testimony a while ago, and he made the comment about veterans being basically a better group to loan to than the average citizen. So it was interesting to listen to your testimony, sir.

Mr. HUDSON. Yes, Congressman. With regards to VA loans, in all honesty, they are relatively simple: verify that they have a job; verify that they have income; and verify that they have some assets. And there is another little piece in there known as residual income, meaning we are going to make sure that a borrower has a certain amount of cash at the end of the month to cover other cost-of-living items that we don't currently include when we underwrite loans.

Mr. LUETKEMEYER. I would submit that there may be another issue there, and that would be the character of the individual to whom you are loaning money.

Mr. HUDSON. Yes and no, Congressman. Some people could say that because these people are military, that they have a better sense of duty and honor in paying back debts. But, at the same time, I would like to point out that there are lots of members of our military who do not meet credit standards, who do not have good enough credit scores. So I think, honestly, when it boils down to consumers and borrowers, it is less the fact that they are in the military as much as the fact that we are actually verifying their income.

Mr. LUETKEMEYER. As somebody who has been on the other side of the table and loaned money to people, I would certainly like to see a veteran across the table from me. It certainly makes my job a little bit easier.

Ms. Still, you mentioned something a while ago about downpayments. You were asked a question about it. What do you think is an adequate level for downpayments? I know you said 20 percent is going to dry up the market, but yet I think everyone would agree the home buyer needs to have a little skin in the game as well. What do you feel would be an adequate figure?

Ms. STILL. That is very difficult to answer, because every borrower is different. I think it depends on the loan program. If you look at the VA program, which is 100 percent financing, we have just touched on that. If you look at the borrowers that the FHA loan program targets, 3.5 percent downpayment compared to maybe 5 percent plus in the GSE lending, I do think that skin in the game absolutely helps.

I am not sure that I believe skin in the game would be determinant of ability to repay. I think as we talk about this rule, income and debt load is probably a better driver, although maybe not the single driver, of ability to repay.

Mr. LUETKEMEYER. Thank you. I see my time is up.

Thank you, Madam Chairwoman.

Chairwoman CAPITO. Mr. Lynch for 5 minutes.

Mr. LYNCH. Thank you, Madam Chairwoman.

Ms. Cohen, I think the import of Dodd-Frank is really to reinject the ability to repay as a controlling concern of lenders.

Earlier in the hearing, the gentleman from Texas asked a question, rhetorical in some regard, but he asked what would cause a lender to extend a loan to someone who did not demonstrate the ready ability to repay; and I think in your testimony you pointed out that a lot of these loans that went into default were very high-cost loans where the fees were evaluated and that these lenders had the ability—the originators had the ability to push these out in the securitization stream, and so they could escape any consequences of making an unstable or a loan to a non-creditworthy person. Are those factors that you think led to the original problem that we had with subprime?

Ms. COHEN. That appears to be the main factor in how the machine was oiled. If the party making the loan doesn't care whether it performs because they sell it right away and they earn their fees up front, then they have no incentive to make sure that the loan is affordable. And, on the other hand, the assignee liability that Mr. Bentsen was talking about before is key for the homeowner, because it is the party who holds the loan at the time of the loan payment problem who needs to be accountable to the homeowner so that the homeowner can get a remedy.

Mr. LYNCH. Let me go over to the safe harbor versus the rebuttable presumption argument. The safe harbor appears to be a structure, sort of a check-the-box situation, where if the lender can fit their product and their process within the safe harbor guidelines, then we can check that box, and they are pretty much immune to any backlash, any litigation, any liability further on down the road.

We had such a structure in the mortgage rating or the security rating portion where, regardless of the real quality of some of these asset-backed, mortgage-backed securities, as long as they had that AAA stamp on them, they were fine and people were buying them up and they were fungible, even though behind that check-the-box, AAA situation, we had some wholly unsustainable securities, and they weren't anywhere near the quality of a U.S. Treasury.

Are we getting into that same situation here where we create this safe harbor, check-the-box type of situation, yet we all know that through innovation and creativity, you might have a situation where a lender could check the box but yet still convey a mortgage that is really, given the circumstances of that individual customer, not repayable or is of highly questionable ability to repay? Ms. Cohen?

Ms. COHEN. I will focus on the safe harbor. I am not an expert on the ratings agencies.

With regard to this question about whether if you check the box you are golden, no matter what you have done, that is essentially what the safe harbor does. Several witnesses said it is not an absolute insulation to litigation. To the extent that you don't meet the Qualified Mortgage definition, you can raise the question of whether you have done that or not. But once you have properly checked those boxes and you can prove it, the homeowner has zero recourse even if you made a predictably unaffordable loan.

Mr. LYNCH. And if you are a lender and you basically have to prove that you have investigated the applicant's ability to repay, wouldn't you have evidence that you have walked through that process? Wouldn't that be extremely valuable to a lender, having that information regarding that particular applicant?

Ms. COHEN. That is the underwriting process that the statute hopes to reinvigorate.

Mr. LYNCH. Ms. Still?

Ms. STILL. Congressman, I think you have touched on exactly why it is so important to get these standards right. If we could all agree on a set of standards that legitimately evaluated a borrower's ability to repay, then it would be good to have the certainty of a safe harbor and we would all agree that the checklist, if you will, was very appropriate for any given borrower.

I think by having a safe harbor and a very explicit checklist, you incent good behavior and lenders know exactly how to comply, and so we will get a better business result at the end because there will be clarity on how to do this right.

The only other thing I would point out is that, in the past, lenders were managing to guidelines, whether it was GSE guidelines or private investor guidelines. This is law, and it is not a guideline. It is the law. And so I think you do get much higher levels of compliance than in the past.

Mr. LYNCH. But the difficulty with legislation is that sometimes it is better to have the rule-making agency deal with the particulars. It is very difficult for us with 435 Members of Congress to sometimes agree on the precise word and not its second cousin in terms of crafting legislation.

So I am just worried about the innovative, creative lender who might be able to push out a loan to a non-creditworthy customer and that creates a certain advantage for that firm and pushing the envelope. We want to provide some type of recourse, perhaps this rebuttable presumption, for the borrower who gets snookered, so to speak.

Thank you. I yield back. And thank you for your indulgence.

Chairwoman CAPITO. The gentleman from Tennessee, Mr. Fincher, for 5 minutes.

Mr. FINCHER. Thank you, Chairwoman Capito.

Mr. Hodges, how can Congress and the Administration be proactive in providing relief in terms of ensuring that potential manufactured home loan customers continue to have access to financing options?

Mr. HODGES. For one, I think supporting House Resolution 3849 helps. Anything that would help adjust both the HOEPA and QM thresholds and caps to help make more low balance manufactured home loans come under those thresholds keeps financing available in that market.

I think the CFPB also has authority in this area on both HOEPA and QM to provide regulatory assistance. So anything coming from this body or others who can help promote that with the CFPB—and we have enjoyed our discussions with them—can be very helpful.

And then just I guess lastly, if anybody is concerned or questionable about manufactured housing and its impact and its value to low- and moderate-income customers, ask us. We would love to help educate and provide more information, just so you can feel comfortable like we are with these issues.

Mr. FINCHER. Okay. Second question: In your testimony, you explain that the Dodd-Frank Act recognized the need to regulate big banks and small banks differently. Could you explain the challenges inherent in trying to regulate small manufactured home loans on par with larger site-built home loans?

Mr. HODGES. Sure. And sort of harkening back to the question earlier, by way of example, fixed cost to originate and service of around $2,000 per loan, that is 1 percent of a $200,000 loan or 10 percent of a $20,000 loan, which makes hitting those thresholds and caps much more risky for the manufactured housing transaction.

Mr. FINCHER. Okay. One more just to wrap up.

I think you said a few minutes ago you expressed the need for the CFPB to clarify that individuals who assist and aid customers in the manufactured home buying process are not categorized as loan originators for purposes of the SAFE Act. Have you had discussions with them about this issue; and, if you have, has there been any action on their part following the meeting?

Mr. HODGES. MHI has had discussions with the CFPB staff on guidance coming from the SAFE Act. At this point, we haven't heard exactly where that guidance may go. We would be very pleased to help participate in that and receive guidance from the CFPB with respect to manufactured home retailers and sellers and whether they would be loan originators under the SAFE Act.

Mr. FINCHER. Thank you, Tom. I appreciate it.

I yield back.

Chairwoman CAPITO. Mr. Carney for 5 minutes.

Mr. CARNEY. Thank you, Madam Chairwoman.

I would also like to add to Congressman Watt's comments about the panel today. Thank you for putting together a very helpful and balanced panel. I appreciate that very much. The information being shared and the conversation has been very helpful.

I have heard kind of agreement—basic agreement from everybody across-the-board that we need, in terms of a QM, something that is broad and something that is clear with bright lines. Does everybody—I see everybody pretty much shaking their head with that.

Is your expectation that it will be easy to figure out what that is, what constituents broad and clear? I ask Ms. Still if she has a notion of what that—I suspect at some point, the question is going to get to be, where do you draw the line?

Ms. STILL. Yes, exactly. And I don't think the expectation is easy at all. I think the Clearing House document tried to make an attempt at starting that dialogue.

Mr. CARNEY. Is that the document Mr. Watt was referring to?

Ms. STILL. Yes, exactly. I would look to the Colorado Housing Authority, which has set ability to repay at about a 50 percent back ratio. Fannie Mae has a waterfall that starts at 45 and goes to 50. North Carolina has set the number at 50. I think the interagency guidance from a couple of years ago provided the notion that 50 would be a good number. And so, for me, that would be part of the review: to look at what the States have done already and look at what the current lending levels are.

Mr. CARNEY. There are good practices. There have been good underwriting practices, notwithstanding what has happened in the last several years, and good underwriting practice among institutions out there in the marketplace currently. So one would think that you could arrive at some close place.

Anyway, Mr. Stein, do you have a view of that?

Mr. STEIN. Yes. We were part of the Clearing House recommendations, and the thought there was to set a back end debt-to-income ratio as the baseline, which we picked 43, which is FHA's manual underwriting standard. So anybody under 43 would be a QM. But we recognize that there are a lot of borrowers who can afford a 43 and shouldn't be denied a home loan or the safer type of home loan provided by QM, so we have added the compensating factors that lenders have used historically. If you have a lot of reserves, if your new loan doesn't cost more than your old loan that you successfully paid, if you have a low mortgage payment, or if you have residual income, which somebody mentioned, if any of those are true, you also could become a Qualified Mortgage.

Mr. CARNEY. So this is a really important issue, right? I have gotten a lot of calls and a lot of comments from people at home and here. But your sense is that everybody—so everybody has a pretty compelling interest to engage and to try to come up with something that works.

Is there anyone on the panel who has a different view as to whether this will be able to come up with something that works?

Mr. Bentsen, how does it relate to your interests, the folks that you represent?

Mr. BENTSEN. Congressman, I think largely QM will become the mortgage market.

Mr. CARNEY. You said that. So it is really, really important, right?

Mr. BENTSEN. Yes. If you consider the fact that 90 percent of mortgages are funded through the secondary market or through securitization, this is where investors—the main investors are going to be. This is where the securitization market will be. So it is a very difficult process, no doubt, in how these clear and bright lines are determined, but it will define the mortgage market.

Mr. CARNEY. So, we didn't talk about this much. You referred to it briefly, I think, in response to a question about the future of the GSEs. How might that affect this whole question as well?

Mr. BENTSEN. Certainly you, Congress, are going to have to make the determination on what you do.

Mr. CARNEY. Let's just take, for example, the Administration—about a year-and-a-half ago, the Treasury came in here and presented their White Paper, I guess, and their preferred option, which was kind of a hybrid government-private kind of an option. How would that affect what we are talking about today?

Mr. BENTSEN. Obviously, QM, QRM, whatever the GSE conforming market, all of those things are going to have to be in correlation or coordination with one another. They can't be in conflict. And so, wherever QM ends up based upon the final rule, risk retention, and then wherever Congress determines what to do with the GSEs going forward, whatever that may be, all of those things have to be considered in coordination with one another.

Mr. CARNEY. Thank you. I see my time is up.

Chairwoman CAPITO. Thank you.

Mr. Canseco?

Mr. CANSECO. Thank you, Madam Chairwoman.

In all my years as a community banker in Texas I have never met a banker who made loans that he knew wouldn't get repaid. This makes the ability-to-repay requirement and corresponding QM and QRM rules included in Dodd-Frank all the more curious. And there appears to me a belief behind these rules that perpetual liability and the ever-present threat of litigation will somehow make the mortgage market function better for consumers. And nothing could be further from the truth.

As I already noted, a number of banks and community banks in Texas and around the country have ceased making mortgage loans because of Dodd-Frank; and this cuts off a very vital source of credit for families in small towns who have relied for years on their local institutions.

This is not consumer protection. In fact, this is harmful to the families who are supposed to be protected by all these new rules. As we have already learned today, credit could be even further restricted to worthy borrowers if common sense is not applied to pending rules by the CFPB. So if you want proof of just how bad Dodd-Frank is for our economy and the housing market, look no further than today's hearing.

So, Ms. Cohen, as I mentioned in my opening statement, there are financial institutions in Texas and around the country that have stopped making mortgage loans largely because of new compliance regulations. Do you view this as an acceptable consequence of the mortgage rules included in Dodd-Frank?

Ms. COHEN. Congressman, I don't have any information about why those particular banks closed. What I can tell you is that I have gotten calls every week for the last 15 years from homeowners who got loans they could not afford, largely not from community banks, but sometimes from community banks. And the protections in Dodd-Frank are intended to address those excesses. If the standards are broad and clear and balanced, then many lenders intending to make home loans should be able to make good loans.

Mr. CANSECO. So do you think that these community banks in Texas were making those types of loans that were being forced to— these banks that are being forced to exit the market are making these type of bad loans?

Ms. COHEN. I am not in any way saying they were making bad loans. My observation generally is that the economy has been in a hard place. The economy has been in a hard place because of the excesses of the lenders and Wall Street, not because of the excesses of consumers.

Mr. CANSECO. Thank you for your opinion.

Mr. Hudson, I understand that there is a concern from the Texas Veterans Land Board over the QM rule and how it will affect mortgage availability for veterans in Texas. Could you expound on that a little bit, please?

Mr. HUDSON. Yes, Congressman.

Two weeks ago, the Texas Veterans Land Board, which is an agency of the State of Texas, contacted me with their concern with the Qualified Mortgage, particularly with reference to the 3 percent cap on points and fees. Because it is a State bond money program, there is no secondary market income or revenue for any originating lender. So that money needs to be collected up front in order for us to pay for the cost associated with originating a loan.

The Texas Vet Land Board loan is specifically designed for Texas veterans. And, like I said, this week, if you are a disabled veteran in the State of Texas, you would have a mortgage interest rate on a 30-year fixed-rate loan of 2.61 percent. So the Texas Vet Land Board contacted me because they see the threat to their viability to assist Texas veterans, in particular disabled veterans, because they see that with this 3 percent cap, it is going to be impossible for them to allow for anybody to originate these loans.

Mr. CANSECO. Have you seen any signs from the CFPB that they are aware of this issue in Texas or potentially other States?

Mr. HUDSON. Yes. We actually just recently met with the CFPB and brought to their concerns the bond money programs that will be affected.

We are also going to be contacting every State agency now with regards to their home loan programs to make sure they are aware of these issues, too.

Mr. CANSECO. What, in your opinion, should the CFPB do in order to address this issue?

Mr. HUDSON. Right off the bat, the first thing that really needs to be done is to delay this arbitrary deadline for this Qualified Mortgage rule and with respect, also exclude the 3 percent cap from the ability-to-repay standard.

Mr. CANSECO. Thank you very much. I see that my time has expired, and I yield back the 3 seconds I have left.

Chairwoman CAPITO. Thank you.

Mr. Green for 5 minutes.

Mr. GREEN. Thank you, Madam Chairwoman. And I thank the ranking member as well, the two of you, for allowing me to interlope. This is not my committee assignment, but these things are of great interest to me, and I try to make my way over so as to be a part of these informative sessions.

Let's just start with what has been said, but some things bear repeating. We find ourselves here today because, at some point, loans were no longer maintained in-house; they were moved to a secondary place. And then after they were packaged and moved to the secondary place, they went to a tertiary place, securitized, and then they went to a quaternary place and became a part of credit default swaps.

So when all of this happened, the person making the loan no longer concerned himself or herself with the ability to repay. And by no longer being concerned, I don't have to keep it on my books. It is going to someone else. These standards became—to be kind, they varied.

Some had pretty good standards. Among the many that had pretty good standards were the small banks, because they were keeping the loans in-house. And because they kept them in-house, they were a little bit concerned about your ability to repay that loan.

One of the things that I do hear from my small bankers is that they are concerned about the paperwork. They tell me that we are creating a lot of paperwork for them, and they have to hire people to do this. I have not heard a lot about the standard that is being set as much as I have—and I have heard some about the standards—but as much as I have about just the fact that they have to do the paperwork. And that causes me some degree of concern.

So, given that we do have the large institutions or institutions that maintain these loans in-house—and I understand the difference between the QM and the QRM and how they apply. But the small banks that have this paperwork that they have to contend with, has anyone actually looked at the amount of paperwork that a small bank would have to contend with?

Ms. Still, you are nodding yes. So have you had a chance to look at the paperwork?

Ms. STILL. Certainly, we do. We know that the cost of manufacturing a loan has gone up considerably.

I would start first with what we are doing to the consumer, though. We are defensive underwriting. I would suggest that in a rebuttable presumption environment, we will ratchet that up even more and over document all of our loan files for the unknown and the uncertainty. I think it is a real issue for the consumer who is trying to buy a home.

Mr. GREEN. Okay. You have identified a concern, expressed consternation. Now give me a possible solution, because I find myself having to do this balancing act. I am concerned about the unintended consequences, but I am also very much concerned about consumers not going back to where they were and when we have this wholesale distribution of loans with standards, as I said, that varied. So now give me some indication as to what the solution is.

Ms. STILL. I think the solution is a clear definition for the ability to repay, a clear, confident way for lenders to lend, require the documentation from the consumer that is applicable, and make sure that we can lend with confidence and not have to over-document loan files because of the uncertainty of a rebuttable presumption.

Mr. GREEN. Now, I am in complete agreement with you of what you just said, but I don't know that it addresses what the small bankers tell me about the paperwork and how they have to employ additional help for the paperwork. I think you are right. I am with you. But I am still trying to help them. Is there some way to shrink, condense?

Ms. STILL. I think we will never go back to stated income loans where there was no paperwork in the file. So I think some of that paperwork is very applicable. I don't think we are going to solve the problem. I think we need to acknowledge that a well-documented loan file is one of the advantages, one of the benefits that Dodd-Frank has brought us. I wouldn't try to go back all the way to where we were.

Mr. GREEN. I concur. I don't want to go back. Because I remember the no-doc loans, and I don't want to go back to loans that had these balloons and teaser rates that coincided with prepayment penalties. I understand where we were. I don't want to go back either.

But I just try to do what I can to help the little guy that is involved in this, and the little guy is a small bank. Now, we are not talking about little guy in the sense that you are poor.

But I thank you, and I have to yield back, sir, or I would come to you. Thank you. I have to yield back.

Chairwoman CAPITO. Thank you.

Mr. Huizenga?

Mr. HUIZENGA. I will grant the first 30 seconds of my time to Mr. Stein to answer that.

Mr. STEIN. Thank you very much. That is very kind.

I was just going to say that I will be curious what your banker constituents think about the new form that the CFPB put out, the disclosure form which combines two forms into one. It simplifies it and makes it clearer for borrowers. I think that is an improvement in terms of reducing paperwork and making people better understand what they can buy.

Thank you very much.

Mr. HUIZENGA. I appreciate that. Because I am interested as well. I have a background in real estate, developing, my family is still involved in construction, and this is an issue a bit near and dear to my heart.

I do have to make one quick comment, though, about the Zandi report. I have not read it yet. I am looking forward to that.

But it seems to me that this is the—the estimate that the 1 to 4 percent increase in our mortgage rates may come about if this is fully implemented, the way that it has been proposed, strikes me as running completely counter to what Chairman Bernanke at the Federal Reserve is trying to do by driving interest rates down some of us would argue maybe below market rates by—through quantitative easing and some of those other things.

But, Ms. Cohen, I know you had made a comment about a couple of things. One, you were saying about if there were clear, broad, and balanced guidelines, that you didn't think there would be a problem, and that this was not excesses of the consumers but of banks and of Wall Street.

I think part of the problem is the balanced part of those guidelines. My bill, H.R. 4323, dealing with the 3 percent cap that I think Mr. Hudson had referred to and a couple of others had referred to is trying to restore some of that balance. And I would respectfully put forward that this notion that somehow consumers don't have some culpability in this may be a little off.

I am advancing, but I am 43, all right? I know what my generation is looking for and those who are slightly younger. They are trying to figure out why they can't have the same size house mom and dad had, even though mom and dad ended up saving 50 percent for their downpayment and they bought that home when they were 55, not 35. And there is definitely some generational element to this, which is why I think we have seen sort of that norm go from 20 percent down to 10 percent down to 5 percent down to zero down to 120 percent loan to value.

Nobody wants to go back to those days. It doesn't make sense. It didn't make sense at the time, obviously, as we know.

But it seems to me that we have to have that true balance in there. And we know that properly done homeownership is one of the most stabilizing aspects in a neighborhood, and we need to encourage that.

I think, as Mr. Luetkemeyer had put forward earlier, that pendulum swung way too far where we were encouraging, "we" being—I wasn't here yet; I am first term—the Congress as a whole and others were encouraging lending practices that may have brought on some of that. And now it is our job, my job, to make sure that the pendulum doesn't swing back so far that we lock up the construction, we lock up mortgages, we lock up the real estate industry, and really ultimately end up destabilizing these neighborhoods further.

So I don't know if you care to make a quick comment, but I also want to get to Ms. Still, as well. So I would like you to maybe put forward a little bit about what types of disclosures you have to do, and ultimately are customers benefiting from being able to use affiliated businesses?

So if either want to make a quick comment?

Ms. COHEN. I will answer first, since you asked me about it first.

I, too, am a member of the same generation as you, and the other thing that is really challenging people is their lack of economic security, their lack of retirement money. And all of that has been exacerbated by the recent crisis.

So as we go forward and we think about what do we want the market and our economy and our country to look like and our neighborhoods, the question really is, will people have access to loans they can afford? If there are incentives to inflate fees, we are back into the mid-1990s when there were abusive fees that HOEPA tried to get rid of.

One of the key things that HOEPA introduced was a limit on fees that could be paid, and it focused in part on affiliated fees. Because it is those companies which can funnel more money to the creditor, and the creditor has an incentive to inflate the loan amount and to inflate the fees. That is our concern.

Mr. HUIZENGA. Okay. Ms. Still?

Ms. STILL. Thank you, Congressman Huizenga, for your Consumer Mortgage Choice Act.

As it relates to affiliates, yes, we do want consumers to have choice. And in today's housing environment, the value of working in an affiliate relationship, the value of the one-stop shop is beneficial to consumers. And so in your bill not aggregating the title affiliate and the mortgage affiliate is very helpful for consumers to be able to use those services. We certainly appreciate that.

We have talked about the three-point rule, and I just want to make one comment. There is a way to address the three-point rule. In MBA's comment letter, our recommendation is we, the CFPB, change the definition of a low loan amount. I think it is set right now at $75,000. Our research would suggest that $150,000 would be a better definition of a small loan. And if, in fact, we set the definition of a small loan at $150,000, which is about the median loan amount in the country, in most States the majority of costs would be addressed appropriately with that level.

Chairwoman CAPITO. The gentleman's time has expired.

Mr. Miller?

Mr. MILLER OF CALIFORNIA. I want to thank Chairwoman Capito for allowing me to ask questions. I am not a member of this subcommittee, so it is very much appreciated on your part.

You have to wonder what we are doing in this country anymore. FHFA is bulk selling foreclosed properties in California right now in a market where you go in any real estate office and there is a list of buyers looking for homes to sell. We asked them why they were doing this, and they said because the homes have been on the marketplace far too long. We said then give us the definition or breakdown of how long the homes have been on the marketplace, just to find out that 70 percent of the homes were never even listed for sale.

And so, instead of listing them in the normal, traditional way, and selling them off and making a profit for the government, we are going to sell those houses to the same people who got us in trouble, Wall Street, and give them a great deal for doing it, and somebody is going to pay the price later. And I think we need to look at what we are doing.

But then you have to look at QM, and you say, how are they going to define it? What is it going to do to the marketplace? Any loan that does not meet the Qualified Mortgage designation marketplace is going to be a real problem loan. And I am concerned about the CFPB. What happens if they adopt a rebuttable presumption definition versus a safe harbor? How does that impact the marketplace?

Mr. Bentsen, it is good to see you again. Maybe you would like to address that a little bit?

Mr. BENTSEN. Thank you, Mr. Miller.

Our view is that the rebuttable presumption has the risk of assigning liability that will basically force or cause investors to consider in their underwriting and investment in a loan whether they are going to invest for 5 years, 10 years, or 30 years. Thirty-year loans tend to prepay often, as you know, in an interim period.

They are also going to be underwriting assigning liability, and that is a risk that investors are not inclined to take.

And, furthermore, given the fact that the government is by statute and mandate through rulemaking establishing underwriting criteria for the loan, we think that a safe harbor is a much more appropriate approach to take.

Mr. MILLER OF CALIFORNIA. So it is almost like defects litigation that occurred. We know how that was expanded on and abused. Do you see the same thing that could possibly happen here?

Mr. BENTSEN. We think there is a risk, and we think that risk will have, at the very least, a price effect. But, let me be clear, we think as part of that, we agree with the other panelists that you have to start with what is the broad definition and then you have to be very explicit about what that definition is. So there are the bright lines that we understand where the QM market is.

Mr. MILLER OF CALIFORNIA. The other one I am having problems with is loan origination compensation for mortgages. And I understand the concern that was expressed when we got involved in this, but it is becoming detrimental now to actually closing loans. You have a situation where they might need to modify compensation in some fashion at the end even downwardly, and they are prohibited from doing that.

Mr. Hudson, can you expand on the loan origination and compensation rule and how you believe it is harming consumers and individual mortgage brokers?

Mr. HUDSON. Yes, Congressman. Thank you.

Currently, the way that the loan originator rule from the Federal Reserve Board and now the CFPB is adopting is taking us to where once I have a payment or a compensation agreement with my loan originator and they in effect quote a mortgage rate to a consumer, if that consumer were to shop and try and come back and say, hey, well, the guy down the street is offering me a lower interest rate, can you match that or beat it, under the current rule my loan originator cannot. In effect, we have taken out the consumer's ability to shop for the better home loan program.

Another concern with the originator compensation piece is, in the very definition, creditors and noncreditor mortgage companies, which not only are just typically mortgage brokers but now more depositories are acting more as a mortgage broker as well, are treated differently. So as to where a creditor can actually not have to disclose their compensation, what they are making on that loan, our mortgage brokers do have to disclose everything.

And where this is going to fall in the piece with the Qualified Mortgage definition is, because all of our costs or compensation are being disclosed up front, it is going to hit that 3 percent trigger much more quickly than a creditor would because they are not having to disclose that compensation.

But with respect to—you have a bill out there, Mr. Miller, that will solve some of the problems with regards to allowing consumers to shop or even at the same time allowing my loan originator to make less—earn less money in order to give that consumer a better deal.

Mr. MILLER OF CALIFORNIA. And it allows you to pay your employees, that is traditional in the marketplace, where you are prohibited from doing that right now.

There has been recently a proposal from the CFPB, and you think it will affect consumers. Can you expound on that a little bit, too?

Mr. HUDSON. I am sorry?

Mr. MILLER OF CALIFORNIA. The most recent proposal from the CFPB, how that will affect consumers?

Mr. HUDSON. Their most recent proposal with regards to LL compensation?

Mr. MILLER OF CALIFORNIA. Yes.

Mr. HUDSON. It actually wasn't a proposal, an official proposal, but their idea was to generate a flat fee compensation amount, which would mean that our originators would make the same on an $80,000 loan as they would on an $800,000 loan.

The problem we see there is that in today's environment, everything is built around basis points, percentage of a loan amount. And, in effect, my originators or myself as a company and mortgage brokers and mortgage bankers, higher loan amounts are in effect subsidized to lower loan amounts. So if we reduced that ability to compensate an originator on a lower loan amount that they were making—

Mr. MILLER OF CALIFORNIA. I just wanted you to put that on the record. Thank you very much.

Chairwoman CAPITO. The gentleman's time has expired.

Mr. MILLER OF CALIFORNIA. Thank you.

Chairwoman CAPITO. Thank you.

Well, I think that concludes the 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 30 days for Members to submit written questions to these witnesses and to place their responses in the record.

I would like to thank all of the witnesses for their great answers and very candid responses.

And, with that, this hearing is adjourned.

[Whereupon, at 12:33 p.m., the hearing was adjourned.]

# A P P E N D I X

July 11, 2012

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Testimony of

Kenneth E. Bentsen Jr., Executive Vice President, Public Policy and Advocacy

Securities Industry and Financial Markets Association

Before the

U.S. House Subcommittee on Financial Institutions and Consumer Credit

Hearing on

"The Impact of Dodd-Frank's Home Mortgage Reforms: Consumer and Market Perspectives"

June 11, 2012

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Chairman Capito, Ranking Member Maloney, and other members of this Committee, thank you for inviting me here to testify at today's important hearing. I have been asked to discuss the Securities Industry and Financial Markets Association's ("SIFMA")[1] views on the so-called "Qualified Mortgage" rulemaking proposal, and am pleased to do so. Our views on the proposal were developed by our diverse membership, which includes financial institutions that act as residential mortgage originators, securitization sponsors, broker-dealers that act as underwriters, placement agents, market makers and asset managers that include some of the largest, most experienced investors in residential mortgage-backed securities ("RMBS") and other structured finance products. SIFMA has been an active participant in this rulemaking[2] and will continue to advocate for a sensible outcome.

As you know, the Federal Reserve Board of Governors ("Board") proposed a set of rules to implement the ability-to-repay requirements found in Title XIV of Dodd-Frank on April 19, 2011. The authority of the Board in this area was transferred to the Consumer Financial Protection Bureau ("CFPB") in June 2011, and it will be the CFPB that will finalize the rulemaking later this year. The concept of a "qualified mortgage", or QM, was embedded in the statutory language of Title XIV and will be implemented by the CFPB through its regulations.

Title XIV of Dodd-Frank amends the Truth in Lending Act ("TILA") to prohibit creditors from making mortgage loans without regard to the consumer's repayment ability. Consistent with the Act, the proposal provides four options for complying with the ability-to-repay requirement.

[1] The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit www.sifma.org.

[2] See "SIFMA Submits Comments to the Federal Reserve on Proposed Changes to Regulation Z and the Definition of Qualified Mortgage" (July 22, 2011) available here: http://www.sifma.org/issues/item.aspx?id=8589934840, and "SIFMA Submits Comments to the CFPB on Qualified Mortgage Regulation" (April 30, 2012) available here: http://www.sifma.org/issues/item.aspx?id=8589938566.

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1. Origination of a mortgage loan for which the lender considers and verifies eight underwriting factors (including expected income or assets, debt-to-income, credit history) to determine repayment ability assuming application of the fully indexed rate.
2. Origination of a "qualified mortgage" which provides special protection from liability under the Act.
3. Refinancing a "non-standard mortgage" into a "standard mortgage" (i.e., a mortgage that does not contain negative amortization, interest-only payments or balloon payments and has limited points and fees).
4. Origination of a balloon-payment qualified mortgage by a small lender operating predominantly in rural or underserved areas.

SIFMA's primary focus in consideration of this topic relates to the ability of secondary market participants to provide funding for mortgage credit; this is critical, as over 90% of mortgage credit is currently funded through these markets. SIFMA's goal is to ensure that the final rules maintain capital flow to the residential mortgage market and maintain the flow of affordable credit to qualified American consumers.

For the purposes of this hearing, focus should be drawn to the first two items above. In our view, the vast majority of future mortgage lending is likely to comport with the guidelines established by the QM definition. Due to liability, supervisory, reputational, and other concerns, we do not expect significant origination of non-QM loans. Thus focus has correctly been on the establishment of the definition of the QM.

SIFMA is very concerned that the QM regulations may be constructed in a narrow manner with parameters that will not allow for the certainty of compliance at origination. Our members believe such an outcome would restrict the availability of credit, through increased costs and restrictive underwriting, and would be detrimental to consumers.

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We will address two key points in this testimony: (1) the parameters of the qualified mortgage definition must be scaled broadly, as opposed to narrowly, as QM loans will be the predominant source of widely available mortgage credit; (2) due to the risk of liability inherent in non-QM lending, the parameters of the definition must provide clear, bright lines, and a safe harbor for compliance.

### *1. __Broad vs. Narrow: Mainstream Institutions Will Operate Only Within the Bounds of the QM__*

SIFMA and its members strongly support the concept that lenders should determine if borrowers have an ability to repay their loans before they extend credit. Discussions with our members have made clear that the liability attendant to the failure to adequately determine such ability to repay will result in the parameters of the qualified mortgage definition, when finalized, broadly determining the availability of affordable mortgage credit. We expect that any limited lending outside of the confines of the QM definition will be performed at far greater cost to the consumer, and due to a variety of reasons, be more likely to be provided by less regulated, less well-capitalized, and possibly less reliable entities. Further, the mortgage credit products that may be offered outside of the QM parameters will likely have little appeal in secondary markets, suggesting lower consumer benefits (e.g., accessibility, transparency, affordability, and prudential terms). This makes clear the need for the creation of a broader, as opposed to narrower, definition of a QM.

As a threshold matter, the ability to repay provisions of Title XIV of Dodd-Frank were not intended to outline the parameters of mortgage lending for the most creditworthy borrowers; that is the purpose of a provision within the risk retention statute that exempts Qualified Residential Mortgages (QRMs) from those requirements.[3] Indeed, *the ability to repay provisions impose a requirement on lenders to*

[3] The QRM provisions of Dodd-Frank were intended to provide a specific, preferential treatment for higher credit quality loans. QRM was intended to create a smaller group of loans which represent higher credit quality to lenders, and for which risk would not need to be retained in securitizations. The ATR provision, on the other hand, was intended to outline a path for lenders to

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*determine an ability to repay on virtually every residential mortgage loan*, and the QM definition is intended to define steps needed to show compliance with the ability to repay (ATR) requirement. ***Thus QM should broadly outline the parameters of responsible lending.***

Defining QM to encompass the conventional mortgage market will not result in lenders ignoring a borrower's repayment ability when underwriting a loan. The ATR analysis required by the statute and a responsible underwriting analysis are related, but separate. The analyses are related because many of the statutory factors of the ATR test—consideration and verification of current and expected income, obligations and DTI ratios—are important parts of a responsible underwriting analysis that lenders employ for all loans. However, the analyses are separate because the ATR test is a compliance matter, while a complete underwriting analysis is done to ensure safety and soundness and to meet investor demands. It is entirely possible that an underwritten loan consistent with acceptable underwriting practices will be determined by the courts to not meet the ATR requirements. Thus, defining QM broadly will create compliance guideposts for lenders that want to lend responsibly.

We are aware of the contention that a narrower definition of QM will not be disruptive because lenders and secondary markets will be comfortable operating outside of the protections afforded by a QM, possibly with a reasonable pricing premium for those loans. Such predictions contradict feedback from our member firms, and we believe the CFPB would be ill-advised to implement QM rules in accordance with these views. History has shown that loans that carry with them significant or uncertain liability are simply not made, or are made with a significant pricing premium, which restricts the availability and affordability of those loans. Accordingly, we believe that lenders will respond to the liability risk through very restrictive underwriting guidelines, or significant pricing premiums, or both. These actions will result in less available credit to borrowers who would have otherwise received it had the boundaries of QM

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determine a borrower's repayment ability. The QM provision was intended to be an incentive for lenders to avoid the most risky loans and products after determining a borrower's repayment ability.

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been drawn more broadly. Likewise, secondary market participants will take steps to avoid or price the risk of assignee liability; this will also make loans more expensive and less available.

It is clear that the risk of liability will increase costs to consumers of non-QM loans – but SIFMA does not see a compensating benefit in a narrow QM definition. While a non-QM borrower may have more opportunity to challenge the origination of the loan, the loan may have riskier terms than permitted by a QM, will be significantly more expensive, and harder to obtain. Secondary market investors would likely demand risk-adjusted yield above what would likely be affordable for many borrowers. At the same time, non-QM borrowers would not receive significantly greater protections in the underwriting process than QM borrowers because the requirement to determine ability to repay applies to all loans. If reputable lenders are reluctant to bear the risk of liability for these loans, and secondary markets are reluctant to purchase them, there will be few avenues for their responsible production. For these reasons, we believe that the CFPB should implement broad, but sensibly structured parameters for the determination of a QM.

2. ***Bright Line Standards and a Safe Harbor Will Promote Responsible Lending; Uncertainty of Compliance will Constrain Responsible Lending***

Given the impact of assignee liability discussed above, SIFMA believes it is critical that the final rules provide for certainty of compliance with ability to repay requirements. The Board's proposal provided two options regarding assurance of compliance: a rebuttable presumption of compliance, and a safe harbor for compliance. ***SIFMA believes that consumer credit availability would be best protected through a safe harbor.*** The proposed rebuttable presumption approach could inhibit a lender's certainty of its compliance, and effectively call the compliance of many loans into question after-the-fact. Because of this lack of certainty, a rebuttable presumption may cause lenders and secondary market investors to implement standards conservatively, as an overlay comfortably within the bounds of the QM definition. Such an overlay on QM guidelines would be similar in nature to the overlay some

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lenders place on Federal Housing Administration or Government Sponsored Enterprise minimum standards due to repurchase risk. Borrowers with credit profiles within but close to the edges of QM would be impacted, as credit availability under such a regime will be narrower than what was intended or envisioned by the CFPB.

***Regardless of whether or not a safe harbor is provided, clear QM standards are paramount.*** Lenders and investors must be able to know at the time of origination whether the loan meets the QM standards. The standards that define QM compliance must be clear, objective, and verifiable. The secondary market for mortgage loans and the securitization markets will *require* verification of the QM status before a pool of loans is purchased or securitized. Not only must lenders represent and warrant that their lending practices comply with their underwriting guidelines, but also that their lending complies with all applicable laws and regulations, including the ability to repay rules. Subjective compliance standards will require increasingly costly due diligence efforts, will increase repurchase risk, and will reduce the value of loans in the secondary markets. Vague standards for QM could lead to secondary market investors imposing their own more objective requirements well within the bounds of QM to assure compliance with the standards. In other words, ***if bright lines are not implemented in the final rule, borrowers will pay more for their loans and have a harder time obtaining them.*** Objective standards will promote the legal certainty that is essential for lenders and their assignees to effectively price the mortgage loans in a manner that creates affordable outcomes for borrowers.[4]

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[4] While SIFMA is still considering this issue more fully, we express further concern about the compliance and examination process to be employed by CFPB in the context of our discussion of bright-line standards. It is imperative that the ability to repay and QM rules be based on clear and objective standards, so that judgments of compliance or non-compliance may be based on similarly objective tests. If the CFPB's regulatory examination process is other than fully objective, the subjective guidance to field examiners will result in differential application of the regulations, resulting in a functional morphing of the regulations that could negate the critically necessary assurance of compliance we discuss above.

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We hope this testimony is helpful in focusing attention on what we view as two of the most critical aspects of the QM rulemaking from the perspective of the ability of the secondary markets to fund mortgage lending. Because QM will essentially define the scope of mortgage lending, it must be drawn in a responsible but broadly inclusive manner. It also must be drawn with objective, verifiable criteria, so that secondary market purchasers can avoid unexpected liability for loans they purchase in whole loan or securitized form.

Thank you.

**Testimony of Alys Cohen**

**On behalf of the low income clients of the National Consumer Law Center On**

**The Impact of Dodd-Frank's Home Mortgage Reforms: Consumer and Market Perspectives**

**Before the U.S. House of Representatives Committee on Financial Services Subcommittee on Financial Institutions and Consumer Credit**

**July 11, 2012**

Chairman Capito, Ranking Member Maloney, and Members of the Committee, thank you for the opportunity to testify today on the impact of the home mortgage reforms of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank.)

I am a staff attorney at the National Consumer Law Center (NCLC).[1] In my work at NCLC, I provide training and technical assistance to attorneys across the country representing homeowners who are facing foreclosure, and I also lead the Center's Washington mortgage policy work. I have spent the last several years following and advocating for reforms to the regulations governing mortgage lending and servicing, including the reforms of the Dodd-Frank Act.

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1 The **National Consumer Law Center, Inc.** (NCLC) is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of eighteen practice treatises and annual supplements on consumer credit laws, including *Truth In Lending* (6th ed. 2007) and *Cost of Credit: Regulation, Preemption, and Industry Abuses* (3d ed. 2005) and *Foreclosures* (2d ed. 2007), as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low-income people, conducted training for thousands of legal services and private attorneys on the law and litigation strategies to deal predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. This testimony was written by Alys Cohen, Staff Attorney, and Diane E. Thompson, Of Counsel, NCLC.

Prior to my work at the National Consumer Law Center, I focused on mortgage lending issues as an attorney at the Federal Trade Commission's consumer protection bureau, where I was involved in investigations and litigation regarding lending abuses (and where I drafted the Commission's first testimony regarding predatory mortgage lending in the late 1990s). For over 15 years I have worked to address the harms caused by predatory mortgage lending and have seen firsthand the harms caused in communities nationwide. I testify here today on behalf of the National Consumer Law Center's low-income clients. On a daily basis, NCLC provides legal and technical assistance on consumer law issues to legal services, government and private attorneys representing low-income consumers across the country.

In 2007, a global economic crisis was unleashed by a meltdown in the mortgage market. The loans that triggered this international collapse were primarily high-cost adjustable rate mortgages made in violation of long-standing prudential underwriting guidance, but subject to little to no formal regulation. During the decade leading up to the collapse, lenders had watched default rates on these loans climb towards 40% but had continued to extend ever more risky credit. The refinancing house of cards that kept this system afloat collapsed when increasing housing values could no longer support serial refinancing.

The Dodd-Frank Act was a sensible and overdue response to that crisis, to prevent the recurrence of the widespread dislocation that followed in the wake of those excesses.

In this testimony I make the following points:

- Regulation of the mortgage market, as structured under Title XIV of the Dodd-Frank Act, is essential to our national economic security.

- Given the complexity of the modern mortgage market, rulemaking is best done via administrative rulemaking rather than legislation. Adjustments to the underwriting standards in Dodd-Frank are best done by the agencies with substantive expertise.
- Promoting transparency in rulemaking, as the Consumer Financial Bureau has done in reopening the comment period on the Qualified Mortgage rule, is appropriate and prudent.
- Both homeowners and the mortgage market are well served by standards that allow homeowners to challenge a lender's deliberate or egregious failure to make a reasonable determination of the borrower's ability to repay. A rebuttable presumption will not result in substantial litigation risk from borrowers.

**Title XIV of Dodd-Frank provides a necessary corrective to the market excesses that led to the collapse of the global economy.**

Underwriting traditionally served as a hedge against the origination of unaffordable loans, but in the years leading up to the current foreclosure crisis, underwriting all but disappeared.[2] Both brokers and lenders both found stated-income

[2] *See, e.g.*, 74 Fed. Reg. 44,522, 44,540-44,541 (July 30, 2008) (discussing evidence that adjustable-rate mortgages were not appropriately underwritten); *Wall Street and the Financial Crisis: The Role of High Risk Home Loans: Hearing Before the Subcomm. on Investigations of S. Comm. on Homeland Security and Governmental Affairs*, 111th Cong. 2d Sess. 4 (2010) (memorandum by Sen. Carl Levin, Chair, & Sen. Tom Coburn, Ranking Minority Member) (noting lack of underwriting coupled with surging delinquencies in Washington Mutual's portfolio); Kurt Eggert, *The Great Collapse: How Securitization Caused the Subprime Meltdown*, 41 Conn. L. Rev. 1257, 1272-1284 (2009) (discussing studies documenting decline in underwriting of subprime loans); M. Diane Pendley, Glenn Costello & Mary Kelsch, Fitch Ratings, The Impact of Poor Underwriting Practices and Fraud in Subprime RMBS Performance (Nov. 28, 2007), *available at* www.fitchratings.com/corporate/reports/report_frame.cfm?rpt_id=356624 (noting the absence of adequate underwriting contributed significantly to the elevated default rates in 2007; Terwin Mortgage Trust Asset-Backed Certificates, Series Tmts 2004-11he, Terwin Advisors L.L.C., Seller, Merrill Lynch Mortgage Investors, Inc., Depositor, Prospectus Supplement dated Sept. 27, 2004, to Prospectus dated June 18, 2004, at S-39 (stating that seller only knows the underwriting guidelines used for approximately 32% of the loan pool).

lending more profitable than verifying income documents,[3] and so substituted certifications by borrowers for underwriting.[4] The prevalence of both no-doc loans, loans without any documentation of the homeowner's income,[5] and loans with falsified income information,[6] soared. Lenders went so far as to require that any income information that made it into their files be redacted.[7] All too-often, the payments presented to borrowers (and used to measure affordability in-house, when lenders made any effort to determine affordability) omitted any mention of taxes or insurance.[8] Borrowers put in loans without escrow accounts struggled to manage the payment shock of taxes and insurance on top of

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[3] *See, e.g.*, Office of Policy Dev. & Research, U.S. Dep't of Hous. & Urban Dev., Report to Congress on the Root Causes of the Foreclosure Crisis 33 (2010), *available at* www.huduser.org/portal/publications/hsgfin/foreclosure_09.html.

[4] *See, e.g.*, Emigrant Mortg. Co., Inc., v. Fitzpatrick, 906 N.Y.S.2d 874, 881 (Sup. Ct. Suffolk Cty. 2010) (describing one such certification signed by a borrower certifying that the borrower had sufficient funds to repay the loan when the borrower's actual income was less than the monthly payment).

[5] *See, e.g.*, 74 Fed. Reg. 44,522, 44,540, 44,541, 44,541 n.53 (July 30, 2008) (discussing prevalence of stated document loans and incentives for originators to make these loans, including inflated loan amounts, inflated interest rates, and ease of origination; recognizing that stated income loans did not accurately predict risk or ability to repay); Interagency Guidance on Nontraditional Mortgage Product Risks, 71 Fed. Reg. 58,609, 58,614 (Oct. 4, 2006) (discussing and cautioning against increasing reliance on "reduced documentation");Ruth Simon, James R. Hagerty & James T. Areddy, *Housing Bubble Doesn't Scare Off Foreigners*, Wall St. J., Aug. 24, 2005, at 1, 7 (reporting that 70% of subprime pools rated by Standard & Poors in the first half of 2005 had less-than-full documentation); Susan E. Barnes, Patrice Jordan, Victoria Wagner & David Wyss, Standard & Poor's, Standard & Poor's Weighs in on the U.S. Subprime Mortgage Market 12 (Apr. 5, 2007), *available at* www2.standardandpoors.com/spf/pdf/media/TranscriptSubprime_040507.pdf (20/-/30% of pools rated by Standard & Poors contain subprime loans with no documentation); Gov't Accountability Office, GAO No. 09-741, Home Mortgages: Provisions in a 2007 Mortgage Reform Bill (H.R. 3915) Would Strengthen Borrower Protections, but Views on Their Long-Term Impact Differ 19 (2009), *available at* www.gao.gov/new.items/d09741.pdf (increasing percentages of subprime loans had less than full documentation, ranging from 27% in 2000 to nearly 60% in 2007).

[6] *See, e.g.*, McGlawn v. Pa. Human Relations Comm'n, 891 A.2d 757 (Pa. Commw. Ct. 2006) (broker created false income information for low-income borrowers); California v. Ameriquest (Cal. Super. Ct. Alameda County Mar. 21, 2006) (complaint, ¶ 10H) (Ameriquest fabricated income and assets), *available at* http://ag.ca.gov/newsalerts/cms06/06-005_0a.pdf; 74 Fed. Reg. 44,522, 44,541 (July 30, 2008)(noting that income was falsified).

[7] Comments of the National Consumer Law Center, et al., Regarding Proposed Regulations Relating to Unfair Trade Practices in Connection with Mortgage Lending 10 (Apr. 8, 2008), *available at* www.consumerlaw.org/issues/predatory_mortgage/content/HOEPACommentsApril08.pdf.

[8] *See, e.g.*, 74 Fed. Reg. 44,522, 44,541 (July 30, 2008)(noting that creditors did not include tax and insurance payments in assessing ability to repay).

inflated mortgage payments.[9] Lenders subverted traditional standards of underwriting, consciously courting high rates of default.[10]

Lenders had various rationales for embracing the increased risk of default in abandoning underwriting. Some cynically counted on foreclosure to recoup the loan based on the sale of the home. Often, loans were made with the expectation that ever-rising housing values (coupled with ever more "nontraditional" products) would permit serial refinancing, thus postponing default and foreclosure indefinitely.[11] Such collateral-based lending is a classic hallmark of predatory lending.[12] But, as the lenders ratcheted up the loan-to-value ratios every year from 2000-2006, leaving homeowners with ever-smaller equity cushions,[13] lenders could not realistically expect to be repaid from the foreclosure sale.

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[9] 74 Fed. Reg. 44,522, 44,541-44,542 (July 30, 2008).

[10] *See, e.g.*, Assurance of Discontinuance, Commonwealth v. Morgan Stanley & Co., No. 10-2538, ¶ 20 (Mass. Super. Ct. June 24, 2010), *available at* www.mass.gov/Cago/docs/press/2010_06_24_ms_settlement_attachment3.pdf (recounting Morgan Stanley's predictions that nearly half of New Century's loans would become unaffordable at reset); Aames Mortgage Trust 2001-1 Mortgage Pass-Through Certificates, Series 2001-1, Aames Capital Corporation As Sponsor, Countrywide Home Loans, Inc., As Servicer, Prospectus Supplement to Prospectus Date March 13, 2001, S-10 (predicting high rates of prepayment at rate reset).

[11] *See, e.g.*, 74 Fed. Reg. 44,522, 44,541 (July 30, 2008) (noting that "creditors were often extending credit based on an expectation that the house's value would increase rapidly"); Office of Policy Dev. & Research, U.S. Dep't of Hous. & Urban Dev., Report to Congress on the Root Causes of the Foreclosure Crisis 22/-/23 (2010), *available at* www.huduser.org/portal/publications/hsgfin/foreclosure_09.html (arguing that foreclosure crisis delayed by early--and expensive--prepayment of subprime loans as a method of managing unaffordable payments).

[12] OCC Advisory Letter 2000-7, Abusive Lending Practices 1 (2000), *available at* http://www.occ.gov/static/news-issuances/memos-advisory-letters/2000/advisory-letter-2000-7.pdf. *Cf.* U.C.C.C. § 5-108(4)(a) (1974) (especially cmt. ¶ 4: selling goods to low-income consumers without expectation of payment, but with expectation of repossessing goods sold and reselling at a profit, is illustrative of unconscionable transaction).

[13] Gov't Accountability Office, GAO No. 09-848R, Characteristics and Performance of Nonprime Mortgages 9 (2009), *available at* www.gao.gov/new.items/d09848R.pdf (documenting increasing stated loan-to-value ratios; note that these do not account for falsified appraisals, which in many instances left homeowners completely underwater). *See* Yuliya Demyanyk, Fed. Res. Bank of Cleveland, Ten Myths About Subprime Mortgages (July 23, 2009), *available at* www.clevelandfed.org/research/commentary/2009/0509.cfm (arguing that the decline in home values did not cause the subprime mortgage crisis).

Instead, lenders relied on securitization to spread the cost of the inevitable foreclosures. In particularly egregious cases, lenders allowed the loan proceeds or an escrow funded by the broker or seller to fund the regular monthly payment, in clear contravention of basic underwriting standards.[14] Throughout the subprime market, pricing replaced underwriting as a risk control mechanism,[15] with lenders tolerating abandonment of underwriting in exchange for increased origination of expensive (and risky) subprime loans.[16]

Post-crisis, there has been a temporary tightening of credit standards and much talk about the need for regulatory enforcement of basic underwriting norms. Going forward, the Dodd-Frank Act[17] mandates that all residential mortgages be made with respect to ability to repay. The Consumer Financial Protection Bureau is, as we write, in the midst of implementing minimum underwriting standards originators would have to comply with under the Dodd-Frank Act in order to achieve "Qualified Mortgage" status for their loans. But all of these standards are set against a much older backdrop of

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[14] Lee Tam-Blumenthal & Huxley Somerville, Fitch Ratings, U.S. Residential Mortgage Loan Representations and Warranties 2 (2008).

[15] *See, e.g.*, Edward Golding, Richard K. Green & Douglas A. McManus, Imperfect Information and the Housing Finance Crisis 11 (Feb. 1, 2008), *available at* www.jchs.harvard.edu/publications/finance/understanding_consumer_credit/papers/ucc08-6_golding_green_mcmanus.pdf.

[16] *See, e.g.*, Assurance of Discontinuance, Commonwealth v. Morgan Stanley & Co., No. 10-2538, ¶ 30 (Mass. Super. Ct. June 24, 2010), *available at* www.mass.gov/Cago/docs/press/2010_06_24_ms_settlement_attachment3.pdf (roughly a third of New Century's loans sampled for due diligence review did not meet New Century's underwriting guidelines); *Wall Street and the Financial Crisis: The Role of High Risk Home Loans: Hearing Before the Subcomm. on Investigations of S. Comm. on Homeland Security and Governmental Affairs*, 111th Cong. 2d Sess. 4 (2010) (memorandum by Sen. Carl Levin, Chair, & Sen. Tom Coburn, Ranking Minority Member) ("Despite fraud rates in excess of 58% and 83% . . ., no steps were taken to address the problems . . . ."); Office of Policy Dev. & Research, U.S. Dep't of Hous. & Urban Dev., Report to Congress on the Root Causes of the Foreclosure Crisis 38 (2010), *available at* www.huduser.org/portal/publications/hsgfin/foreclosure_09.html.

[17] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 1411-1412, 1414, 124 Stat. 1376 (July 21, 2010), *codified at* 15 U.S.C. 1602(cc)(5) (definition of residential mortgage loan), 15 U.S.C. 1639c (ability to pay requirements).

prudential underwriting, drawn from industry practice, guidance from the banking agencies, and long-standing, limited regulation under the federal Truth-in-Lending Act.[18]

One lesson from the crisis is clear: mortgage lending will endanger all of our economic well-being if it is not subject to regulation. Prudential guidance is not enough. The rules outlined in Dodd-Frank are nothing more than a codification of the basic precepts of residential underwriting for decades. Mortgage lenders ignored these rules, with the result that we are still suffering through foreclosure rates higher than during the Great Depression and a sluggish economy.

**Further adjustments to the underwriting standards in Dodd-Frank are best done by agencies with substantive expertise, including the Consumer Financial Protection Bureau.**

Pending before this subcommittee is H.R. 4323. H.R. 4323 would do three things: adjust the definition of mortgage broker compensation under Dodd-Frank to exempt payments made to employees of the mortgage loan originator; exclude, for the first time since the passage of HOEPA in 1994, fees paid to the creditor or an affiliate of the creditor under affiliated business relationships, thus gutting the restrictions on creditor profiteering embedded in HOEPA's point and fees test; and exclude, for the first time since the passage of HOEPA in 1994, fees for title insurance from the calculation of points and fees test even if the charge is per se unreasonable, wholly retained by the creditor, or an illegal fee.

[18] *See, e.g.,* Villalobos v. Deutsche Bank National Trust Co. No. C09-1450-JCC (W.D. Wash. May 3, 2011), *available at* www.nclc.org/unreported; Commonwealth v. Fremont Inv. & Loan, 2008 WL 517279 (Mass. Super. Ct. Feb. 25, 2008), *aff'd*, 2008 WL 2312648 (Mass. App. Ct. May 2, 2008), *aff'd*, 897 N.E.2d 548 (Mass. 2008).

Prior to the enactment of Dodd-Frank, the Federal Reserve Board had engaged in extensive fact-finding regarding the proper regulation of mortgage originator compensation. The Board's ultimate rulemaking,[19] issued on the same day as the enactment of Dodd-Frank, parallels Dodd-Frank but does not duplicate its provisions. The Consumer Financial Protection Bureau has the task before it of synchronizing the Federal Reserve Board's rulemaking, already in effect, with Dodd-Frank, which requires rules effective in January 2013. Tinkering further with the Dodd-Frank definition at this point will complicate and delay already difficult rulemaking and could introduce further uncertainty into the mortgage markets. Moreover, while abusive markups were endemic in the brokered-loan market, incentives to make unaffordable loans also were common in loans made directly by lenders.

Changing the definition of points and fees for the riskiest loans after nearly two decades risks unsettling established precedent. It is also bad policy. Fees from affiliates continue to form a significant part of creditor's profits. They are totally opaque to consumers. Moreover, there is extensive evidence that title insurance, in particular, has been a source of price gouging of consumers in recent years.[20]

Typically, the mortgage lender, not the borrower, chooses the title company, even though the borrower pays the cost of title insurance. The result is a form of reverse

[19] 75 Fed. Reg. 58,509 (Sept. 24, 2010), 12 C.F.R. § 226.36(d),(e). Note the Board initially proposed to address the issue through disclosure regulations, 73 Fed. Reg. 1672 (Jan. 9, 2008), however the Board's own testing showed that disclosures would not effectively address the problem and that proposal was withdrawn, 73 Fed. Reg. 44,522, 44,563-44,565 (July 30, 2008).

[20] *See, e.g.*, Florida Office of Insurance Regulation, An Analysis of Florida's Title Insurance Market: Three Studies that Provide a Comprehensive, Multi-Faceted Review of the Florida Title Insurance Industry (July 2006), *available at* http://www.floir.com/siteDocuments/FLTitleInsMkt.pdf; Office of Pol'y & Dev., Dep't. of Hous. & Urban Dev., RESPA: Regulatory Impact Analysis and Initial Regulatory Flexibility Analysis, FR-5180-P-01: Proposed Rule to Improve the Process of Obtaining Mortgages and Reduce Consumer Costs, 2-24 to 2-43 (2008); Susan Woodward, U.S. Department of Housing and Urban Development, Office of Policy Development and Research, A Study of Closing Costs on FHA Mortgages (2008), *available at* www.urban.org/UploadedPDF/411682_fha_mortgages.pdf.

competition; title companies compete to offer lenders the best deal and lenders are free to steer homeowners to affiliated companies where the sometimes hefty profits from title insurance can be retained in house. Consumers, when they shop for a mortgage, are focused on the loan terms, not the closing agent or closing terms; as a result, consumers seldom question the choice of the title insurer or the cost or coverage of title insurance. Strong incentives to pay lenders kickbacks exist in the very structure of the title insurance market, even when the title companies are not affiliates of the lender.[21]

Nor is state regulation much help. Title insurance premiums are regulated not at all in some states, including large states like Illinois and Massachusetts. In other states, the premiums are regulated, but the same rate structure often does not apply to all carriers, meaning that carriers can price differentially.[22] Often states allow title agents to share their commission with homeowners; homeowners that accede to the bank's suggestion that its affiliate provide title services are unlikely to benefit from the title agent's generosity. Many states regulate some aspects of title insurance, but not the fees charged for, say, the title exam. As a result, the ancillary title fees become a profit center for whoever retains them. In the case where the creditor employs an affiliated title company, the ancillary title fees will be retained by that affiliate of the creditor.

Aside from cost and unregulated fees, the lender's and homeowner's interests also diverge as to coverage. Even if the affiliate is not writing the policy, the homeowner will want and need more extensive title insurance than the lender: the lender only needs coverage to the extent of its mortgage lien. Thus, a lender is unlikely to push for

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[21] *See, e.g.,* Florida Office of Insurance Regulation, An Analysis of Florida's Title Insurance Market: Three Studies that Provide a Comprehensive, Multi-Faceted Review of the Florida Title Insurance Industry (July 2006), *available at* http://www.floir.com/siteDocuments/FLTitleInsMkt.pdf.

[22] *See, e.g.,* Johnson v. Banc One Acceptance Corp., 278 F. Supp. 2d 450 (E.D. Pa. 2003) (rate-setting bureau's rates only applicable to member companies).

protection against springing easements at some future date or object to blanket coverage exceptions in a low loan-to-value loan. This inherent conflict of interest is inflamed when the lender is writing the insurance, and therefore has a strong incentive to except all possible claims from coverage. The lender, after all, can always go after the homeowner if the title turns out to be worthless, but the homeowner has no other recourse.

One clear and common instance where the lender and homeowner's interests diverge is in refinancing transactions. In many cases, homeowners in a refinancing transaction can get a discounted rate on the title policy, a re-issue rate, to reflect that the work of examining the title has largely already been done. Unsurprisingly, homeowners refinancing their homes often do not receive the benefit of this lower re-issue rate, but are charged the higher rate.[23] Lenders whose affiliates write the title insurance have an active incentive to ignore the homeowner's entitlement to the lower reissue rate. Such price gouging is unlikely to go detected by the average homeowner.

Finally, where the creditor's affiliate writes the title insurance, the incentives for the creditor to increase arbitrarily the size of the loan are multiplied. Title insurance pricing increases with the size of the loan, even though the work does not increase and the risk, due to the widespread use of exclusions from coverage in the title insurance world, only increases marginally. Most commentators would agree that inflated loans contributed directly to the current economic crisis; creditors should not be encouraged to inflate loans.

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[23] *See, e.g.,* Fields v. Option One Mortg. Corp., 2008 WL 2553030 (3d Cir. June 27, 2008); Chiles v. Ameriquest Mortg. Co., 551 F. Supp. 2d 393 (E.D. Pa. 2008); Madera v. Ameriquest Mortg. Co. (*In re* Madera), 388 B.R. 586 (E.D. Pa. Nov. 8, 2008); Davis v. Deutsche Bank Nat'l Trust, 2007 WL 3342398 (E.D. Pa. Nov. 8, 2007); Escher v. Decision One Mortg. Co. (*In re* Escher), 369 B.R. 862 (Bankr. E.D. Pa. 2007); Glauser v. Deutsche Bank Nat'l Trust Co. (*In re* Glauser), 365 B.R. 531 (Bankr. E.D. Pa. 2007); Stump v. WMC Mortg. Corp. 2005 WL 645238 (E.D. Pa. Mar. 16, 2005); Strong v. Option One Mortg. Corp. (*In re* Strong), 356 B.R. 121 (Bankr. E.D. Pa. 2004)

**Promoting transparency in rulemaking, as the Consumer Financial Bureau has done in reopening the comment period on the Qualified Mortgage rule, is appropriate and prudent.**

In reopening the comment period, the Bureau sought comment only on the new information it had received, much of it obtained from ex parte communications, including extensive meetings with industry.[24] There is nothing inherently inappropriate about ex parte communications with the Bureau; indeed, the Bureau's receptiveness to such meetings should do much to allay industry concerns about potential surprises or missteps in the rulemaking. Nonetheless, it is appropriate where those ex parte communications go to the heart of difficult, complex, and important issues, as they do here, to give other stakeholders full notice of the content of those communications and an opportunity for further comment.

The stakes for the Qualified Mortgage definition are high. The definition of Qualified Mortgages likely will define the contours of mainstream mortgage lending for generations to come. Concerns about the balance between access to credit and protecting homeowners from unaffordable lending are complex. Moreover, much disastrous lending in the 1990s and early 2000s was done to under-served communities in the name of access to credit. In the wake of the collapse of the housing market, and unprecedented loss of wealth in communities of color, it is clear that not all credit is good credit and some credit can be worse than none. The terms of such a critical matter of national economic policy and basic economic justice must be openly debated in a transparent process. Concepts identified in ex parte conversations should not be adopted by the Bureau without public discussion in light of the important and complex process of setting

[24] Consumer Financial Protection Bureau, Notice of Reopening of the Comment Period, 77 Fed. Reg. 33,120, 33,121 (June 5, 2012).

the determination of ability to repay standards. There is a range of perspectives on these difficult issues and a full and open debate will best serve the public interest.

The Bureau has committed to issuing the rule on time.[25] It seems unlikely that this reopening of the comment period is the occasion for any delay in the issuance of the final rule. Mortgage markets should be reassured by the Board's candor and accessibility; markets are unlikely to be stymied merely by the greater transparency the Board afforded all stakeholders in reopening the comment period. Moreover, a final rule with greater clarity and basis will serve the mortgage markets well.

**Both homeowners and the mortgage market are well served by standards that allow homeowners to challenge a lender's deliberate or egregious failure to make a reasonable determination of the borrower's ability to repay.**

In writing the definition of ability to repay a mortgage loan, the CFPB will focus on the contours of loans that are likely to be affordable. But it is impossible for the CFPB to define affordability with perfect precision, for every homeowner, every creditor, every type of mortgage and every mortgage practice that might arise far out into the future. Creditors should be encouraged to make mortgages that meet the definition of a qualified mortgage, and those that do are entitled to a presumption that the loans meet the ability-to-pay requirement. But it would be a terrible mistake to create a safe harbor that is irrebuttable, regardless of whether the loan was foreseeably unaffordable by the creditor.

We cannot anticipate now all of the ways in which irresponsible lending practices could arise. When predatory lending became a problem in the 1990s, the Home Ownership Equity Protection Act (HOEPA) did its best to attack those practices. But the

[25] Consumer Financial Protection Bureau, Notice of Reopening of the Comment Period, 77 Fed. Reg. 33,120, 33,121 (June 5, 2012).

HOEPA reforms were powerless to protect consumers from the new wave of mortgage "innovations."

*Even more important than the details of any specific rule is getting the incentives right.* Rulewriters will always be several steps behind the market. But if the incentives are in the right place, the rule will do its job even as new, unanticipated developments arise. The essential incentive for the mortgage market is the rule that *every* mortgage must be evaluated for affordability. A safe harbor that deems certain types of mortgages affordable no matter the circumstances will not build in incentives for creditors to ensure affordability. A rebuttable presumption, while still requiring a stiff uphill climb for homeowners, will provide a backstop to reckless lending. A rebuttable presumption rule with clarity will deliver what lenders need the most: clear guidelines about how to proceed in reviving the mortgage market. This clarity will minimize the main risk creditors have faced in this crisis, repurchase risk from the secondary market.

If the ability to repay rule provides a safe harbor, some creditors will focus on only the letter but not the spirit of the rule. It will leave the door open to known types of abusive lending and will predictably encourage the emergence of adjustable rate mortgages timed to reset at the end of six years instead of five. Creditors will find other ways of evading the protections of the ability to repay definition that we cannot anticipate right now. The spirit of the rule is true ability to pay. If we want creditors to comply with that spirit, the general ability to pay requirement must apply even to loans that meet the specific contours of the ability to repay definition.

A safe harbor would shut the court house door to borrowers. Once there was a determination that a loan met the ability to repay standards, there would be no redress for the homeowner, even if the creditor made the loan with full knowledge that the borrower could not afford it. There are many possible examples of these loans. For example, homeowners with limited residual income and high medical bills might have no residual income, even at a 31% DTI. In that circumstance, if ability to repay only required a 31% DTI, without residual income, the creditor would be free to engage in the purest form of asset-based lending and the homeowner would have no redress. Similar results would apply for any of the many possibilities in which a creditor extended credit, knowing that the borrower could not reasonably be expected to repay, unless the ability to repay definition specifically identified the precise circumstances posed by that case. Such micromanagement of credit decisions serves no one's interest and would be cumbersome to implement. With an irrebuttable safe harbor, creditors would be encouraged to ignore obvious warning signs so long as they were not listed as a criteria in the Bureau's rule. Predictably unaffordable loans would come with total legal insulation.

Finally, a safe harbor could interfere with state sovereignty and reduce the rights that consumers currently have under state laws to challenge reckless and bad faith underwriting. A safe harbor under Dodd-Frank would make it much more difficult for homeowners to raise state legal claims, such as fraud, where a creditor can show it has satisfied the ability to repay definition. A court might be inclined to view the satisfaction of such a standard as the last word on affordability (either as a matter of preemption or of persuasiveness). Moreover, some states have statutes or developed case law that provide that any loan that satisfies the Truth in Lending Act per se complies with state law. Accordingly, it is essential that a rebuttable presumption be preserved so that unsustainable loans are not immune if they are unfair, deceptive or unconscionable.

It would be unwise and contrary to the purpose of the law to adopt a safe harbor. A safe harbor would upset Dodd-Frank's finely tuned balance of market incentives and market discipline.

**A rebuttable presumption will not result in substantial litigation risk from borrowers.**

Creditors will face no significant litigation risk from borrowers under a rebuttable presumption. Even if a loan is unaffordable from the start, exceedingly few homeowners will even find an attorney to assist them. The foreclosure crisis has brought the imbalance in access to representation into harsh light, as a number of local and state reports have found. The Brennan Center for Justice report, *Foreclosures: A Crisis in Legal Representation*,[26] found that the majority of homeowners in foreclosure went without representation. For example, in Stark County, Ohio, 86% of foreclosure defendants in 2009 were unrepresented. In Queens County, NY, 84% of defendants in foreclosure proceedings involving non-prime loans proceeded without full representation from November 2008 to May 2009. In Staten Island, 91% were unrepresented and 92% in Nassau County were unrepresented. In Maine, legal services providers found that only 6% of requests for help in connection with foreclosure "received the level of attention necessary to resolve the problem," leaving 94% without access to that kind of representation.[27]

When borrowers manage to find an attorney, the facts will need to paint a pretty severe picture to overcome the presumption. And then, should a homeowner thread the

[26] Melanca Clark and Maggie Barron, *Foreclosures: A Crisis in Legal Representation*, Brennan Center for Justice, (Oct. 6, 2009) at 12-17.

[27] Nan Heald, *Justice for Some, Report on Unmet Legal Needs in Maine.* Pine Tree Legal Assistance.

needle and prevail, Dodd-Frank caps the damages at a relatively small amount in comparison to the value of the mortgage—three years of payments. [28]

If a consumer claims that a loan is unaffordable, and if the loan meets the ability to repay standard, the homeowner will have the burden to demonstrate that the loan was not reasonably reviewed for affordability. Litigation burdens are very difficult to overcome, as the paucity of litigation under the existing higher cost mortgage rules demonstrates.

This is especially true when a party has satisfied the presumptive requirements of a statute, as creditors making loans under the qualified mortgage standard would. For example, the Truth in Lending Act provides a rebuttable presumption that the borrower has received the required notice of the right to cancel when the borrower signs an acknowledgment of receipt at closing.[29] Courts have often required homeowners to do more than assert the non-receipt of the documents, even at the pleading stage.[30] Borrowers typically only prevail ultimately in rebutting the presumption of receipt when

[28] While the Federal Reserve Board's proposed rule notice discussed some concerns about risk associated with the longer timeline of a foreclosure defense, 76 Fed. Reg. 27390, 27453 (May 11, 2011), these damages still would be capped at three years. Moreover, it will be the exceedingly rare case where a homeowner who has made regular mortgage payments for years will be able to prevail in a claim that the original loan was unaffordable. While the Board notes that the presumption introduces some additional uncertainty due to the innate flexibility of underwriting guidelines, *id.*, as noted above, clarity in the ability to repay guidelines would substantially address that concern. In addition, the Board observed that a safe harbor will substantially reduce incentives for creditors to make affordable loans.*Id.* Such a result would contravene the goal of the statute.

[29] 15 U.S.C. § 1635(c).

[30] *See, e.g., In re* Perks, 2011 WL 1298555 (Bankr. N.D. W. Va. Mar. 31, 2011); Fortune v. AM. Window & Siding Sys., Inc. (*In re* Fortune), 2010 WL 4053107 (Bankr. D. Kan. Oct. 13, 2010); *In re.*Hastings, 2010 WL 3909207 (Bankr. N.D. Ala. Sept. 30, 2010); Sias v. Washington Mut. Bank, 2010 WL 2103448 (E.D. Tenn. May 20, 2010); Lee V. Countrywide Home Loans, Inc., 2010 WL 1487131 (N.D. Ohio Apr. 13, 2010); Douglas v. Wilmington Fin., Inc., 2009 WL 3852458 (N.D. Ill. Nov. 18, 2009); St. Hill. v. Tribeca Lending Corp., 2009 WL 691977 (E.D. Pa. Mar. 17, 2009); Abbott v. Washington Mut. Fin., Inc., 2008 WL 756069 (E.D. Pa. Mar. 20, 2008); Strang v. Wells Fargo, 2005 WL 1655886 (E.D. Pa. July 13, 2005); Hershey v. Deutsche Bank Nat'l Trust Co., 2005 WL 1420813 (D. Minn. June 16, 2005); Williams v. G.M. Mortg. Corp., 2004 WL 3704081 (E.D. Mich. Aug. 18, 2008); Parker v. Long Beach Mortg. Co., 534 F. Supp. 2d 528 (E.D. Pa.); Sewell v. Option One Mortg. Corp., 2007 WL 4355393 (E.D. Pa. Dec. 12, 2007); Oscar v. Bank One, N.A., 2006 WL 4018853 (E.D. Pa. Feb. 17, 2006); Evans v. Ameriquest Mortg. Co., 2003 WL 734169 (Mich. Ct. App. Mar. 4, 2003).

they can establish a chain of custody of their closing documents akin to that required in criminal drug cases.[31]

The ability to repay standard may create an even higher bar because the presumption will reference an agency determination of a complex process, the ability to repay test. Unlike the TILA acknowledgment of receipt, an ability to repay determination involves many interrelated components. Courts are likely to give great weight to the Bureau's determination of what is an affordable loan and will be unlikely to impose further requirements.

Moreover, as the Ninth Circuit has noted, "presumptions are not rebutted by allegations; they are rebutted by evidence."[32] The evidence of the lender's determination of a consumer's ability to repay will all be in the lender's hands. In order to demonstrate a case under a rebuttable presumption, homeowners will need to credibly allege, and then prove, that the lender did not make a reasonable determination of ability to repay. What the lender did or did not consider, as well as the ultimate basis for its decision, will always be information uniquely in the province of the lender, not the homeowner. Rare indeed will be the cases where a homeowner can allege and then prove that the lender did not reasonably determine that the borrower had an ability to repay.

Even without Dodd-Frank's protections, lenders who make unaffordable loans have been subject to litigation risk. Courts have recognized lending when there is no

[31] *See, e.g.,* Cooper v. First Gov't Mortg. & Investors Corp., 238 F. Supp. 2d 50 (D.D.C. 2002) (homeowner produed lockbox in discovery; homeowner had placed all documents in lockbox after closing); *In re* Jaaskelaninen, 391 B.R. 627, 642-43 (Bankr. D. Mas. July 7,2008), *rev'd on other grounds*, 407 B.R. 449 (D. Mass. 2009) (after reviewing detailed chain of custody of closing documents presented by borrowers noting that perfect chains of custody cannot be required in TIL cases because "*A lender wuld never be satisfied with any chain of custody.*" (italics in original).
[32] Balderas v. Countrywide Bank, N.A.. 664 F.3d 787, 790 (9th Cir. 2011).

ability to repay as a per se unfair and deceptive act or practice.[33] This may be the case even where the loan was a refinancing of an earlier loan, itself unaffordable.[34] Failure to follow the basic precepts of underwriting for affordability and sustainability can subject the originating creditor, the assignee, or even the investment banks who facilitated the origination of the loans to liability.[35] These claims are usually brought under a range of state common-law theories. Rulemaking under Dodd-Frank may, in fact, reduce the litigation risk occasioned by unaffordable lending by delineating what is and is not a reasonable determination by the lender of the borrower's ability to repay.

Finally, a look at the actual numbers makes clear that borrower-driven litigation poses no significant threat to creditors. While comprehensive statistics are not available on mortgage-related litigation, the experience of the lawyers who represent homeowners is that most homeowner litigation is not proactive. Even when the litigation would be initiated by a consumer, it tends to be in reaction to an impending or existing foreclosure.

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[33] *See, e.g.*, Martinez v. Freedom Mortgage Team, Inc., 527 F. Supp. 2d 827 (N.D. Ill. 2007) ("Martinez is stuck in a loan he did not want and may not be able to pay."); Commonwealth v. Fremont Inv. & Loan, 2008 WL 517279 (Mass. Super. Ct. Feb. 25, 2008), *aff'd*, 2008 WL 2312648 (Mass. App. Ct. May 2, 2008), *aff'd*, 897 N.E.2d 548 (Mass. 2008); Emigrant Mortg. Co., Inc., v. Fitzpatrick, 906 N.Y.S.2d 874, 881 (Sup. Ct. Suffolk Cty. 2010)(finding allegations that the creditor "knew or should have known that [the homeowner] could not afford the terms of the agreement sufficiently states a claim for substantive unconscionability"). *See also* U.C.C.C. § 5-108(4)(a) (1974) (one factor in determining unconscionability is belief by seller, lessor, or lender at consummation, that there is no reasonable probability of payment in full of the obligation by the consumer or debtor).

[34] *See, e.g.*, Beneficial Mortgage Co. of Ohio v. Leach, 2002 WL 926759 (Ohio Ct. App. May 9, 2002) (issue of material fact existed as to whether lender's conduct in refinancing loan after borrower defaulted on a prior loan was unconscionable as defense to lender's foreclosure action; lender did not inform borrower that mortgage was variable rate, rate was potentially much greater than prior mortgage on house, loan agreement was one of adhesion, lender purportedly threatened borrower with "other action" if she failed to sign the new note and mortgage, and borrower was in a worse financial position after refinancing); Vern Countryman, *Improvident Credit Extensions*, 27 Me. L. Rev. 1 (1975); Hersbergen, *The Improvident Extension of Credit as an Unconscionable Contract*, 23 Drake L. Rev. 225 (1974).

[35] *See* Assurance of Discontinuance, Commonwealth v. Morgan Stanley & Co., No. 10-2538 (Mass. Super. Ct. June 24, 2010), *available at* www.mass.gov/Cago/docs/press/2010_06_24_ms_settlement_attachment3.pdf; Settlement Agreement, Mass. Att'y Gen. & Goldman Sachs & Co. (May 7, 2009), *available at* www.mass.gov/Cago/docs/press/2009_05_07_goldman_settlement.pdf; Villalobos v. Deutsche Bank National Trust Co. No. C09-1450-JCC (W.D. Wash. May 3, 2011), *available at* www.nclc.org/unreported. (denying motion to dismiss claims against trustee of securitized trust and the securitizer, Barclay's Capital).

Consequently, the volume of foreclosure filings provides a reasonable proxy to put homeowner litigation in perspective. Furthermore, the litigation from the past few years would represent a high-water mark.

In relation to the size of the mortgage market and the apogee of mortgage litigation, the added risk from a Truth in Lending claim is vanishingly small.

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|---|---|
| *Number of home loans made 2005-2010*[36] | 63.9 Million |
| *Number of homes entering foreclosure during crisis (est.)*[37] *(Q107-Q211)* | 8 Million |
| *Number of cases involving existing TIL rebuttable presumption in last 5 years*[38] | 59 |
| *As percentage of homes entering foreclosure, above* | .00074% |
| *Number of cases involving existing TIL rebuttable presumption scheduled for trial*[39] | 35 |
| *As percentage of homes entering foreclosure* | .00044% |

Another reasonable proxy for exposure to a TIL claim used in relation to foreclosure litigation would be rescission claims – one of the most important tools homeowners have to contest bad mortgage practices. Again, in context, the likely litigation risk is minimal overall.

| | |
|---|---|
| *Number of foreclosures initiated in 2010 (by OCC/OTS reporting services)*[40] | 1.4 Million |
| *Number of cases involving Truth in Lending & foreclosure 2010* | 904 |
| *Number of such cases also involving TIL rescission*[41] | 660 |

[36] Sum of home purchase, refinance and home improvement home loan activity reported under HMDA for 2005-2010,. Robert B. Avery, et al, *The Mortgage Market in 2010: Highlights from the Data Reported Under the Home Mortgage Disclosure Act*, Table 3, p. 42 (forthcoming). The Board estimates that HMDA data covers 90=95% of FHA lending and 75-85% of other first lien home loans. Id at 1, note 2.
[37] Center for Responsible Lending calculations based on MBA National Delinquency Survey, scaled to account for MBA's 85% market coverage.
[38] Comment of Mortgage Bankers Association Proposed Rule, Docket No. R-1417 (Ability to Repay and Qualified Mortgage) (July 22, 2011).
[39] *Id.*
[40] Sum of 2010 quarterly figures from OCC and OTS Mortgage Metrics Report, First Quarter 2011, Tabl3 38, p. 43.
[41] NCLC calculation from Westlaw Search, October 6, 2011. Of the 904 cases, 352 were *pro se.*

*2010 rescission cases as percentage of 2010 foreclosures filed* .047%

**Conclusion**

Thank you for the opportunity to testify before the subcommittee today. Regulation of the mortgage market, as structured under Title XIV of the Dodd-Frank Act, is essential to our national economic security. Given the complexity of the modern mortgage market, rulemaking is best done via administrative rulemaking rather than legislation. Adjustments to the underwriting standards in Dodd-Frank are best done by the agencies with substantive expertise. Promoting transparency in rulemaking, as the Consumer Financial Bureau has done in reopening the comment period on the Qualified Mortgage rule, is appropriate and prudent. Both homeowners and the mortgage market are well served by standards that allow homeowners to challenge a lender's deliberate or egregious failure to make a reasonable determination of the borrower's ability to repay. A rebuttable presumption will not result in substantial litigation risk from borrowers. The regulatory process should move forward in order to restore fairness and vigor to the mortgage markets.

MHI
Manufactured Housing Institute

**Testimony of Mr. Tom Hodges**
**Manufactured Housing Institute**

**Before the**
**Subcommittee on Financial Institutions and Consumer Credit**
**Committee on Financial Services**
**U.S. House of Representatives**

**Hearing on**
**The Impact Dodd-Frank's Home Mortgage Reforms:**
**Consumer and Market Perspectives**
**July 11, 2012**

**Washington, DC**

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**Thank you, Chairwoman Capito, Ranking Member Maloney and Members of the Subcommittee for the opportunity to testify this morning on the impact that the Dodd-Frank Wall Street Reform and Consumer Protection Act, and coming regulations from the Consumer Financial Protection Bureau (CFPB), will have on the manufactured housing market.**

My name is Tom Hodges. I am appearing here as a member of the Manufactured Housing Institute. I am also General Counsel for Clayton Homes, Inc. headquartered in Maryville, Tennessee. In my role, I am responsible for oversight of the legal affairs of the company, including the implementation of the provisions of the Dodd-Frank Act and the related regulations.

**The Manufactured Housing Institute (MHI) is the national trade organization representing all segments of the factory-built housing industry.** MHI members include home builders, lenders, home retailers, community owners, suppliers and others affiliated with the industry. MHI's membership includes 50 affiliated state organizations.

Since its founding more than 35 years ago, our company has built in excess of 1.5 million homes and won multiple awards for design and construction. In fact, we are the largest home builder in the country. The Clayton family of companies builds, sells, finances, leases and insures manufactured and modular homes as well as re-locatable commercial and educational buildings. Clayton employs approximately 10,000 team members and has 33 home building facilities that support more than 1,000 retail home centers. Our financial services companies finance home purchases for more than 325,000 customers and insure approximately 160,000 families. Though we are still family-led, in 2003, Berkshire Hathaway Inc. acquired Clayton Homes.

**About Manufactured Housing**

Manufactured housing is a key source of quality, affordable housing for more than 22 million Americans. During this critical time for our nation's housing markets, manufactured housing can play an important role in providing reliable, sustainable housing for current and future homeowners looking to meet a variety of housing and lifestyle needs.

Manufactured housing is a highly-regulated industry, with three distinct qualities: manufactured homes are safe, they are energy efficient and they are affordable.

Manufactured homes are built almost entirely in a controlled environment, transported to the building site, and completed at the home-site in accordance with federal building codes and enforcement regulations administered by the Department of Housing and Urban Development (HUD). These governing rules are commonly referred to as the "HUD Code."

As the only federally-regulated residential building code, the HUD Code regulates home design and construction, installation requirements for strength and durability, resistance to natural hazards, fire safety, electrical systems, energy efficiency, and other aspects of the home. Homes are inspected by a HUD-approved third party during the construction process and our industry adheres to a robust quality assurance program which offers greater controls than others forms of housing in the home building industry.

Our greatest attribute is delivering quality and value to consumers. Through cost savings and technological advancements in the factory-building processes, the manufactured housing industry can produce homes for 10 to 35 percent less than the cost of comparable site-built construction.

The affordability of manufactured housing can be attributed directly to the efficiencies emanating from the factory-building process. The controlled environment and assembly-line techniques remove many of the challenges encountered during traditional home construction, such as poor weather, theft, vandalism, damage to building products and materials and unskilled labor. Factory employees are trained and managed more effectively and efficiently than the system of contracted labor employed by the site-built home construction industry.

Manufactured housing's affordability means it has long been the housing choice for many low- and moderate-income families, including retirees on fixed incomes and first-time homebuyers. When compared to all homeowners, the median annual income of manufactured homeowners is nearly 50 percent less—$60,000 vs. $32,000 (Source: 2009 American Housing Survey).

Manufactured housing's importance as a sustainable source of affordable housing is reinforced by data (Source: U.S. Census Bureau) indicating that in 2011 it accounted for.:

- 72 percent of all new homes sold under $125,000;
- 47 percent of all new homes sold under $150,000; and
- 27 percent of all new homes sold under $200,000.

Manufactured homes serve many housing needs in a wide range of communities—from rural areas where housing alternatives (rental or purchase) are few and construction labor is scarce and/or costly (nearly two of three manufactured homes are located in rural areas), to higher-cost metropolitan areas as in-fill applications. Without land, the average purchase price of a new manufactured home is $60,600 versus nearly $208,000 for a new site-built home (Source: U.S. Census Bureau).

In addition to the valuable role it plays in providing reliable, efficient and affordable housing for nearly 8.7 million American families, the manufactured housing industry is an important economic engine. In 2011, the industry produced over 51,000 new homes, which were produced in more than 120 home building facilities, operated by 45 different companies, and generating nearly 60,000 full-time, good-paying American jobs.

Despite its role as a valuable source of affordable housing; a driver of the U.S. economy; and a model of efficiency and sustainability in the larger housing industry, the manufactured housing industry has had ongoing challenges over the past decade. Since 2005, the pace of new manufactured homes sold in the U.S. has declined by nearly 65 percent (146,881 in 2005 vs. 51,618 in 2011) and there has been a decline of nearly 80 percent since 2000 (when 250,419 new manufactured homes were produced).

While the pace of sales for new single-family site-built housing has also declined by roughly 75 percent since its peak in March 2005, the decline in manufactured home sales actually pre-dates the 2007 housing market crash. The decline in the manufactured housing market coincides with a number of challenges:

- the growth of subprime lending in the traditional site-built lending market diminished the affordability advantage of manufactured housing;
- the lack of liquidity and credit in the manufactured housing finance sector has limited financing options for our homebuyers; and
- the uncertainty and impact of new financial services and mortgage finance regulations has hindered growth.

Like the site-built housing market, the manufactured housing industry can appreciate the difficulty and uncertainty of operating in a stressed environment. New manufactured home construction has fallen roughly 80 percent over the past decade, which has accounted for more than 150 plant closures, more than 7,500 retail home center closures, and the loss of over 200,000 jobs. More importantly, thousands of manufactured home customers have been left unable to buy, sell or refinance homes. Without Congressional and regulatory action, the people who live in manufactured homes and whose livelihood is connected to this industry are at significant risk.

It is estimated that more than 60 percent of manufactured homebuyers finance their purchase using a personal property loan product where the dwelling alone is financed (i.e., no real estate securing the loan). The ability for lenders to securitize manufactured home loans in the secondary market, particularly those secured by personal property, has been very limited.

MHI and its members have long demonstrated to rating agencies, investors, Fannie Mae, Freddie Mac, the Federal Housing Administration (FHA), Ginnie Mae and others that manufactured housing lenders operate using strong underwriting and regulatory standards.

Despite this performance, the government-sponsored enterprises (GSEs) have had little involvement and displayed little interest in financing and securitizing manufactured home loans. Less than one percent of GSE business comes from manufactured housing and none of that comes from manufactured home personal property loans.

In 2011, as a percentage of its single-family credit guarantee activities, manufactured housing constituted only 0.11 percent of Freddie Mac's portfolio. It is estimated that Fannie Mae's level of single-family manufactured housing activity is below even this. This is in spite of data indicating that since 1995 manufactured housing shipments have averaged 14 percent of all new single-family housing starts and more than 18 percent of all new single-family home sales.

This barrier has effectively shut off the development of a viable secondary market for manufactured home loans leading to higher financing costs. The development of a viable secondary market would dramatically improve liquidity in the credit-constrained manufactured housing market and provide potential buyers with more ready access to loans to purchase affordable manufactured housing.

As federal policymakers debate the form, shape and structure of a new housing finance system and secondary market mechanism, MHI agrees with many in Congress and other housing stakeholders that any secondary market housing finance structure should be supported by private capital. In addition, MHI believes that any secondary market – particularly if it is supported by a government backstop – should provide equal and open access to manufactured home loans secured by either real or personal property.

As part of the Housing and Economic Recovery Act of 2008 (HERA; P.L. 110-289), Congress directed Fannie Mae and Freddie Mac to establish a secondary market for manufactured home loans, including those secured by personal property. However, given the conservatorship status of the GSEs, the continued sluggishness of the housing market, the uncertain regulatory environment, and concern over taxpayer exposure, this mandate has remained unimplemented by the GSE's regulator and conservator —the Federal Housing Finance Agency (FHFA).

In moving forward, we encourage Congress to support the creation of a secondary market that allows for loan products, including all manufactured home loans, to compete on a level playing field absent barriers and prejudicial treatment. Improving the prudent flow of capital to the manufactured housing financing sector will lower lenders' cost of capital. This will draw more lenders to the market, increasing competition, lowering financing prices, and enabling more consumers to choose manufactured housing.

The manufactured housing industry has always been fully committed to protecting consumers throughout the home buying process. MHI recognizes the importance of responsible lending and improving the consumer experience. MHI has also consistently urged Congress to consider the unique nature of manufactured housing lending and to avoid measures that would inadvertently curtail lenders' ability to make manufactured housing loans.

MHI has been working on a bipartisan basis to educate Members of Congress and the Administration of some of the unforeseen impacts recently enacted legislation would have on limiting access to credit for the purchase of affordable manufactured housing.

Specifically, provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd Frank Act; P.L. 111-203) and the Secure and Fair Enforcement of Mortgage Licensing Act (SAFE Act; P.L. 110-2890—which is now under the jurisdiction of the CFPB—would have the unintended consequence of limiting the availability of and access to credit for the purchase of low-cost affordable manufactured housing.

**With respect to Dodd-Frank's impact on housing, my testimony will focus on three areas that could have the unanticipated consequence of limiting the availability of, and accessibility to, affordable manufactured housing. Specific regulations being developed and enforced by the CFPB of key concern to the manufactured housing industry include:**

- new high-cost mortgage definitions that do not adequately account for the price pressures on small-balance manufactured home loans, which may diminish consumer accessibility to this form of sustainable housing;
- lack of regulatory guidance in applying the SAFE Act definition of a mortgage originator to the unique activities of those selling manufactured homes may diminish the level of customer assistance available to those seeking to purchase affordable manufactured housing; and

- limitation on points and fees for "qualified mortgages" that could serve as a disincentive for serving the already credit constrained manufactured housing market due to the fact that the costs to originate such loans cannot adequately be recouped.

**HOEPA: MANUFACTURED HOME LOANS UNDULY SUSCEPTIBLE TO HIGH-COST MORTGAGE TRIGGERS**

First, the manufactured housing industry is concerned that the significant revisions to mortgage finance and anti-predatory lending laws contained in the Dodd-Frank Act will disparately impact manufactured home lending. The Act adds significant new requirements on residential mortgage loans, including limitations on mortgage origination activities and high-cost mortgages, which will make it more difficult for manufactured home buyers to obtain affordable financing.

Many of the new regulations that would be imposed on mortgage lenders by the Dodd-Frank Act are designed to curtail questionable lending practices such as zero-down payment loans, balloon notes, and stated-income loans, which helped bring about the recent decline in the housing market. Although the manufactured housing industry and manufactured homeowners did not partake in these questionable practices, and maintained prudent underwriting standards, the Act would unfairly lump manufactured housing small balance loans into the same category as subprime predatory site-built mortgages.

Section 1431 of the Dodd-Frank Act expands the range of loan products that could now be classified as "high-cost mortgages" under the Home Ownership and Equity Protection Act (HOEPA). A loan would be considered "high-cost" if the Annual Percentage Rate (APR) or "points and fees" exceeds certain thresholds. Unfortunately, the limits established in the Dodd-Frank Act were set without a full understanding of the economics of originating and servicing small balance manufactured home loans.

While drafters of the Dodd-Frank Act recognized that large multi-national banks and small community banks could not be regulated in identical ways; the same realization was not reached for manufactured housing loans. Specifically, statutory thresholds for a $200,000 loan and a $20,000 loan cannot be set and evaluated in the same fashion, which is the effect of Section 1431. The cost of originating and servicing these two different size loans is essentially the same in terms of real dollars. However, the cost, as a percentage of each loan's size, is significantly different. It is this difference that causes the smaller-sized manufactured home loan to potentially exceed the thresholds in the Act and be categorized as "high-cost" or predatory under HOEPA, even though there is nothing predatory about the features of the loan.

In addition, the lack of a secondary market means lenders that want to participate in the manufactured housing market must hold these loans in their portfolios, which makes the cost of capital associated with originating manufactured home loans - whether they are real property or personal property - higher for these lenders versus those which are able to securitize real property mortgages through the GSEs or through asset-backed securities. Additionally, since only the lenders that have the financial ability to hold the loans they originate on their balance sheets can participate in a meaningful way, this either eliminates or severely limits the ability of smaller lenders to enter the manufactured housing market. The resulting effect is that credit availability is further reduced for low- to middle-income consumers.

Under this new provision, the propensity for a loan to be classified as "high-cost" greatly increases as the loan size diminishes. According to the American Housing Survey (AHS), the median purchase price of a manufactured home (including new and existing home sales) is $27,000 (versus $107,500 for all occupied units according to 2009 American Housing Survey data). Potentially half of all loans to purchase manufactured homes, or more than four million (out of 8.7 million nationwide), could be at risk of being categorized as "high-cost."

An internal analysis of our company's lending activities yields concerning results. Of all loans originated in 2010 and 2011, approximately 40 to 60 percent *would have exceeded* one or both of the "high-cost mortgage" thresholds under the HOEPA revisions outlined in the Dodd-Frank Act.

Due to the increased liabilities, responsibilities and stigma associated with making and obtaining a HOEPA "high-cost mortgage," it is likely that a majority of these loans would not be made. Potentially millions of families could see the ability to re-sell their homes effectively wiped out because lenders would be unwilling to provide the financing needed to sell them.

While a significant percentage of manufactured home loans may have rates higher than traditional site-built mortgages, the terms typically associated with manufactured home loans—namely fixed interest rates, full amortization, and the absence of alternative features (such as balloon payments, negative amortization, etc.)—allow them to satisfy the requirements of what the Dodd-Frank Act would consider conservative and prudent underwriting standards.

In addition, existing regulatory requirements and additional statutory guidelines outlined in the Dodd-Frank Act provide significant consumer protections and disclosures while prohibiting many predatory loan features. These provisions ensure that substantial protections are available to consumers without having to subject a majority of manufactured home loans to the onerous HOEPA "high-cost mortgage" designation.

**SAFE ACT: CLARIFY TREATMENT OF MANUFACTURED HOME SELLERS**

The SAFE Act is a well-intended law designed to enhance consumer protection and reduce fraud by requiring states to establish minimum standards for licensing mortgage loan originators. However, the manufactured housing industry has concerns over the lack of clarity in the implementation of the SAFE Act.

There has been substantial confusion among states in applying the SAFE Act to manufactured home retailers and their salespersons; those financing the sale of their own manufactured homes; and those engaging in a minimal level of loan origination.

Prior to the issuance of final federal regulations for the SAFE Act, states began adopting versions of a "model" state law. Well after most states had adopted their state SAFE Act laws, HUD finally issued its final rule in July 2011 that provided some regulatory clarification in recognizing the delineation between the treatment of individuals who undertake the sale of manufactured homes and individuals who engage in the loan origination business, but uncertainty in application of the rule still exists.

Specifically, additional statutory guidance is necessary to ensure that individuals who assist and aid customers in the manufactured home buying process are not categorized as loan originators for purposes of the SAFE Act.

The process of purchasing a manufactured home has some substantial differences from purchasing a site-built home. The ability of a manufactured home retail salesperson to provide key customer assistance in the home buying process absent the risk of being arbitrarily classified as a mortgage loan originator for purposes of the SAFE Act is critical.

Similar to real estate brokers whose activities Congress specifically exempted from SAFE Act licensing requirements, manufactured home retailers are fundamentally in the business of selling homes; they are not in the loan origination business. However, like real estate brokers, manufactured home retailers and sales personnel are fundamentally engaged in providing customer assistance throughout the home buying process. Their core mission is to help a customer through the home *buying* process. It is not to originate mortgage loans.

In addition, due to the limited financing options available to manufactured home buyers, the ability of retailers and sellers of manufactured homes to provide buyers with adequate information regarding lending options available is critical to preserving the availability of manufactured homes as an affordable housing source.

MHI is grateful for the diligent support Chairman Bachus and Ranking Member Frank have provided on this issue over the years. In 2010, during HUD's rulemaking process, Reps. Bachus and Frank formally requested that HUD provide clearer guidance to states on the treatment of manufactured home retailers and that HUD clarify that states have the ability to provide exemptions to those engaging in minimal levels of loan origination or activity that is occurring outside of a habitual and commercial context. The manufactured housing industry and MHI hopes to build on this guidance so that the statute and regulations can provide clearer guidance and relief to manufactured home sellers.

MHI firmly believes that individuals receiving compensation from lenders, mortgage brokers or others involved in the mortgage origination sphere for performing loan originator activities, or who derive their livelihood from the sale and distribution of mortgage loans should be registered and licensed in accordance with SAFE Act, including those serving the manufactured housing market.

However, the law makes clear distinctions that those who perform certain activities – like taking an application - and receive no compensation or gain from the sale or distribution of mortgages are not considered to be mortgage originators and thus not subject to SAFE Act registration and licensing requirements.

Unfortunately, due to a lack of clarity stemming from the regulatory process, there has been confusion at the state level in excluding those who sell manufactured homes and whose compensation comes from the sale of the home, not from the origination of mortgages, from licensing and registration requirements pursuant to the SAFE Act's statutory guidelines.

Given the uniqueness of the sales activity in the manufactured housing market, additional clarity both in statute and regulation would serve as the ideal fix for this challenge. With regulatory enforcement of the SAFE Act now falling under the jurisdiction of the CFPB, it is critical that the agency begin to fill in the gaps with regards to the SAFE Act's applicability to those operating within the specialized manufactured housing market.

**PRESERVING ACCESS TO MANUFACTURED HOUSING ACT:**
**BIPARTISAN BILL WILL MINIMIZE UNINTENDED IMPACTS ON AFFORDABLE MANUFACTURED HOUSING**

Earlier this year, Representatives Stephen Fincher, Joe Donnelly and Gary Miller introduced the *Preserving Access to Manufactured Housing Act* (H.R. 3849) to reduce some of these unintended consequences that could significantly reduce access to affordable manufactured housing. The bipartisan bill addresses two issues impacting the ability of consumers to obtain mortgage financing for manufactured homes.

**First, the measure would amend the threshold by which designated small balance manufactured home loans are classified as high-cost mortgages under HOEPA** (as revised by the Dodd-Frank Act), which will thereby reduce the number of loans subject to punitive and onerous liabilities. The proposed statutory change would more accurately take into account the price pressures unique to manufactured home lending while still maintaining significant consumer protection from predatory lending practices.

The legislation **would not exempt** lenders from HOEPA's high-cost mortgage provisions; it would merely adjust the APR triggers—for classification as a HOEPA high-cost mortgage—for transactions that primarily involve manufactured homes.

Adjusting the APR triggers would decrease the number of manufactured home loans that could be categorized as HOEPA high-cost mortgages thereby preserving access to credit for those seeking to purchase affordable manufactured housing. However, under the proposed revision, consumers would receive no less protection from predatory lending activities.

Based on existing requirements within the Truth in Lending Act (TILA)—including those for higher-priced mortgage loans—and the Real Estate Settlement Procedures Act (RESPA), new requirements within the Dodd-Frank Act (such as those for "qualified mortgages") and even within a variety of existing state laws, consumers applying for manufactured homes loans would still receive substantial levels of protection in the form of disclosures and prohibitions on certain activities that are similar to those found within the HOEPA statute. However, these protections would come without having to attach the onerous high-cost mortgage designation to a majority of manufactured home loans—a designation that would effectively prevent a lender from making a loan needed by a consumer to purchase a home.

**Next, the bill provides legislative clarification and guidance beyond that which was provided in the SAFE Act final rule for employees of manufactured home retailers.** It is important to point out that the language in the bill does not provide an exemption to all individuals who may be involved in selling manufactured homes from registering as mortgage originators under the SAFE Act. It merely seeks to reinforce that individuals only become subject to licensing and registration requirements when they both take a loan application, **AND** offer and negotiate with a consumer the terms of a loan in exchange for compensation (income) which is consistent with the Act.

Similar to a real estate broker/agent, a manufactured home retailer's (and sales person's) compensation comes from the sale of a home and *not* from the sale of a loan product, such as a residential mortgage. The legislation would preserve existing requirements that an individual selling manufactured homes be licensed as a mortgage originator ***if*** they perform the regulated activities and receive compensation from a lender, mortgage broker or mortgage originator for loan origination activity.

The legislation seeks to reinforce and amplify the existing statutory dividing line between an individual being compensated for home sales activity and an individual being compensated for the sale or distribution of a residential mortgage. Unfortunately, due to a misapplication and misinterpretation of the statute that occurred during the rulemaking process, there exists substantial confusion at the state levels in interpreting this differentiation of activity.

MHI is grateful for the bipartisan leadership from Reps. Fincher, Donnelly and Miller in introducing this bill. In addition, we are particularly thankful for the consideration by Chairman Bachus and Ranking Member Frank to work with the bill sponsors on providing relief to the manufactured housing market. We are truly appreciative of the Chairman's and Ranking Member's dedicated support of manufactured housing as an indispensible form of sustainable, reliable and affordable housing.

**QUALIFIED MORTGAGE AND ABILITY-TO-REPAY GUIDELINES:**
**MINIMIZE DISINCENTIVES TO SERVING MANUFACTURED HOUSING MARKET**

Another issue of critical importance to MHI is the impact "qualified mortgage" criteria will have on the availability of credit in the manufactured housing market. These criteria will form the basis of evaluating a borrower's ability to repay to a loan, as required by the Dodd-Frank Act (Sec. 1412).

A "qualified mortgage" would not be permitted to contain certain characteristics that helped contribute to the decline of the housing markets, such as negative amortization, balloon payments and stated income loans. One of the most important facets is the requirement that a lender not make a qualified mortgage without determining that a borrower has a reasonable ability to repay the loan.

The proposed rule and request for comments, which closed for comment in July 2011, was recently reopened by the CFPB to seek additional feedback and data on a variety of issues, including information concerning the impact on litigation and litigation costs associated with mortgage loans not considered "qualified mortgages."

Given the substantial impact this rulemaking will have, it is important to ensure that it serves the best interests of the entire housing market, including that which is served by manufactured housing. Because of this, MHI was appreciative of the CFPB's decision to reopen the comment period. While it would be optimal to have a sense of certainty and clarity as soon as possible, as a business that relies on a clear and level regulatory playing field it is essential that no ambiguity exists in these lending guidelines.

MHI believes that clear standards are essential. Clarity ultimately reduces the frequency of litigation and allows lenders to resolve issues without the need for costly legal action. Without clarity, lenders will likely operate strictly with the known qualified mortgage parameters in order to minimize these risks. This would reduce the availability and affordability of credit for millions of creditworthy low- and moderate-income families seeking to purchase manufactured homes.

Additionally, MHI believes that the safe harbor alternative for implementing the qualified mortgage standards would create the certainty and clarity lenders need in establishing policies and procedures for complying with these standards. While clear qualified mortgage standards would equip lenders to defend their origination practices, a safe harbor would provide a disincentive for bringing frivolous litigation that increases costs to lenders and consumers. At the same time, the existence of clear standards and a safe harbor would preserve the opportunity for legitimate claims to move forward.

While those few lenders still serving the manufactured housing market will likely endeavor to conform and comply with the qualified mortgage criteria outlined by Congress and being further developed by regulators, the manufactured housing market is uniquely affected by the qualified mortgage standards in ways that adversely impact low- and moderate-income consumers.

Specifically, given the fundamentally smaller balance size of manufactured home loans, lenders will have an inherently more difficult task in recouping the fixed costs of originating a manufactured home loan compared to their much larger site-built equivalents, due to statutory limitations (three percent) on the points and fees that a lender may charge for a qualified mortgage.

Congress recognized the challenge this provision could prove to lenders making smaller-balance loans and directed regulators to develop rules adjusting this requirement for smaller loans in order to meeting the "presumption of compliance" with the qualified mortgage guidelines.

The proposed rules promulgated by the Federal Reserve Board, CFPB and others in May 2011 made a diligent attempt to adjust the three percent points fees cap for "smaller loans," but falls short of providing manufactured housing lenders with sufficient ability to recover the costs associated with making a small-sized residential mortgage loans.

Data included in the proposed rule (FRS-2011-0124-0001) indicates that in 2009 nearly 75 percent of all loans made to purchase a manufactured home were $75,000 or less. This data is bolstered by our own company's activities. Of the loans originated by Clayton finance subsidiaries in 2011, the average loan amount was approximately $42,000 and $61,000 for each lender.

Unfortunately, even with the elevated points and fees caps outlined for smaller-sized loans in the ability-to-repay proposed rule, approximately 40-49 percent of loans made by Clayton finance subsidiaries would have fallen outside the allowable limits to be considered a qualified mortgage. Had the proposed limits been in effect during this time period, it is likely that these loans would not have been originated and borrowers may have been unable to acquire the financing needed to purchase homes.

Similar to others, the manufactured housing industry has urged regulators to not rely solely on a percentage-based limit on points and fees, but to consider allowing lenders an option that includes a dollar amount for points and fees to cover the cost to originate a residential mortgage (i.e. $2,000-$3,500).

Such a mechanism would serve as a transparent rule that provides a bright-line standard that would be easier for creditors, while protecting consumers from unreasonable fees, and would encourage lenders to make smaller-sized loans that are relied on by manufactured homes buyers.

MHI believes the limits outlined in the proposed rule will make it difficult for lenders to fully recoup costs associated with making low-balance manufactured home loans and, unintentionally, act as a disincentive to serving low- and moderate-income families seeking to purchase affordable manufactured housing.

The manufactured housing industry fully supports the intent of the law: that fees associated with the origination of loans should be maintained at reasonable levels. However, when lenders are not allowed to recover even a base level of the costs associated with originating a loan, such rules only serve as a roadblock to those most in need of access to affordable housing.

Related to the points and fees limitation for qualified mortgages, MHI believes that the proposed regulatory amendments to the definition of "points and fees" in Regulation Z to the Truth in Lending Act may also be served with more clarity in order to help preserve manufactured housing lending. Specifically, proposed section 226.32(b)(2)(i) excludes from points and fees, compensation paid to an employee of a retailer of manufactured homes who does not take a residential mortgage loan application, offer or negotiate terms of a residential mortgage loan, or advise a consumer on loan terms (including rates, fees, and other costs) but who, for compensation or other monetary gain, or in expectation of compensation or other monetary gain, assists a consumer in obtaining or applying to obtain a residential mortgage loan. While MHI is very appreciative of the recognition that compensation paid to retailer employees deserves to be excluded, clear guidance should be provided that compensation paid in connection with the *selling* of the home is *not* to be included in "points and fees" under any circumstances.

In conclusion, MHI appreciates the opportunity to shares its point of view concerning the impact that the Dodd-Frank Act will have on our sector of the housing market that strives to serve the low- to middle- income families of our country with quality, affordable housing. We are eager to work with both legislators and regulators to protect the consumers who benefit from this very necessary industry.

Thank you very much for the opportunity to testify on this important issue and I welcome any questions.

NAMB®
The Association of Mortgage Professionals

**Prepared Testimony**

**of**

**John H. P. Hudson**

**Chairman of Government Affairs**

**National Association of Mortgage Brokers**

**On**

**"The Impact of Dodd-Frank's Home Mortgage Reforms: Consumer and Market Perspectives"**

**before the**

**Subcommittee of Financial Institutions and Consumer Credit**

**Committee of Financial Services**

**United Stated House of Representatives**

**July 11, 2012**

I am John Howland Pell Hudson the Chairman for Government Affairs for the National Association of Mortgage Brokers ("NAMB") and the Central and South Texas Area Manager for Premier Nationwide Lending ("PNL"), a division of NTFN, Inc, a privately owned regional mortgage bank headquartered in Flower Mound, TX.

NAMB is the only non-profit national trade association that represents both mortgage brokers as well as mortgage loan originators employed by mortgage banks and depositories. NAMB advocates on behalf of more than 116,000 state licensed mortgage loan originators in all 50 states and the District of Columbia. Since 1973, NAMB has been committed to enhancing consumer protection, industry professionalism, high ethical standards and the preservation and promotion of small business and home ownership in this country.

Over the past three years, PNL has funded over $6 billion between both wholesale and retail origination channels. $3.5b was originated by PNL loan originators directly to consumers while $2.5b was originated by mortgage brokers through its wholesale division. I oversee both retail and wholesale operational areas and was responsible for over $683 million since 2009.

To summarize my testimony, the Dodd-Frank Act was passed in haste and some would say anger at the unknown of what happened during the Wall Street melt down. The creation of a qualified residential mortgage (QRM), qualified mortgage (QM), hard wiring underwriting standards into legislation, capping fees at arbitrary percentages of a mortgage amount, and giving lenders no bright line regarding legal liability will ultimately harm consumers, the very people DFA intended to protect. NAMB is calling for an 18-month extension of all mortgage related regulatory dead-lines in order for Congress to amend sections of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA or Dodd-Frank Act").

## I. Damage to the Mortgage Market from the Dodd-Frank Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law more than two years ago with the best of intentions. America was attempting to recover from the economic collapse of prior years partially fueled by a housing boom in which players from "Main Street" to "Wall Street" took part. Changes were perceived as necessary to insure that crisis would be avoiding moving forward. The mortgage industry for the most part had identified the problems and was already transforming. Despite the fact that mortgage industry underwriting standards had already tightened, subprime mortgages loans had disappeared from the marketplace, HUD's 2010 Good Faith Estimate insured borrowers would not be up-charged at closing, and non-bank originator licensing required by the SAFE Act[1] were already in place, the Dodd-Frank Act was hastily passed and fraught with unintended consequences effecting the

[1] "Secure and Fair Enforcement for Mortgage Licensing Act" (12 United States Code, Section 5100, *et seq.*), passed by Congress and signed by President G.W. Bush in 2008, required all states to implement a Mortgage Loan Originator (hereafter: "MLO") licensing and registration system by August 1, 2009

housing market which would not be realized for years. In effect, the market (and industry actions) had already solved the problem, but panic had set in where it was accepted the "Congress should do something", and the result was the DFA – fraught with destructive consequences.

### II. Qualified Mortgages – The Future of Housing

The Qualified Mortgage ("QM") concept is found in Title XIV of the Dodd-Frank Act states that a creditor may not make a mortgage loan without first determining that the borrower has a reasonable ability to repay the loan. In April of 2011, the Federal Reserve Board issued the original 474 page rule proposal for Regulation Z; Truth in Lending, No. R-1417 and solicited public comments until July 2011 before transferring responsibility to the Consumer Financial Protection Bureau ("CFPB"). In May 2012, the CFPB reopened and extended the comment period for QM's until July 9, 2012 and is expected to have the final rule prepared by mid November 2012. NAMB, industry professionals, and every consumer wanting to participate in homeownership supports common sense underwriting which verifies consumers can repay a loan. However, the QM and a measurement of a consumer's ability to repay from the Dodd-Frank Act and the CFPB must be fair for consumers, originators, and creditors. The Federal Reserve Board has stated "the extraordinarily tight standards that currently prevail reflect, in part, obstacles that limit or prevent lending to creditworthy borrowers. Tight standards can take many forms, including stricter underwriting, higher fees and interest rates, more-stringent documentation requirements, larger required down payments, stricter appraisal standards, and fewer available mortgage products."[2] Considering the current state of the housing market and the Federal Reserve Board's assertion that credit is already too restrictive, the housing market and overall economy will continue to show weakness if the QM is released in its current proposed form.

### III. Qualified Mortgages – Measuring Ability to Repay

Pursuant to the Dodd-Frank Act, the proposal from the Federal Reserve Board to the CFPB

[2] FRB White Paper "The US Housing Market: Current Conditions and Policy Considerations" – January 4, 2012

would provided four options for complying with the ability-to repay requirement. However, this testimony has been prepared to address the two most pertinent options surrounding the QM definition.

1. General Ability-to-Repay Standard

A creditor can meet the general ability-to-repay standard by:

- Considering and verifying the following eight underwriting factors:
    - Income or assets relied upon in making the ability-to-repay determination;
    - Current employment status;
    - The monthly payment on the mortgage;
    - The monthly payment on any simultaneous mortgage;
    - The monthly payment for mortgage-related obligations;
    - Current debt obligations;
    - The monthly debt-to-income ratio, or residual income; and
    - Credit history; and
- Underwriting the payment for an adjustable-rate mortgage based on the fully indexed rate.

2. Qualified Mortgage

A creditor can originate a "qualified mortgage," which provides special protection from liability. Two alternatives have been proposed to meet the standard of the QM:

- Alternative 1 would operate as a legal safe harbor and define a "qualified mortgage" as a mortgage for which:
    - The loan does not contain negative amortization, interest-only payments, or a balloon payment, or a loan term exceeding 30 years;
    - The total points and fees do not exceed 3 percent of the total loan amount;
    - The income or assets relied upon in making the ability-to-repay determination are considered and verified; and
    - The underwriting of the mortgage (1) is based on the maximum interest rate that may apply in the first five years, (2) uses a payment scheduled that fully

amortizes the loan over the loan term, and (3) takes into account any mortgage-related obligations.

- Alternative 2 would provide a rebuttable presumption of compliance and would define a "qualified mortgage" as including the criteria listed under Alternative 1 as well as additional underwriting requirements from the general ability-to-repay standard. Thus, under Alternative 2, the creditor would also have to consider and verify:

    - The consumer's employment status,
    - The monthly payment for any simultaneous mortgage,
    - The consumer's current debt obligations,
    - The monthly debt-to-income ratio or residual income, and
    - The consumer's credit history.

From the outset, the proposals sound very reasonable. Lenders need to make sure consumers actually have the ability to make mortgage payments. The economy and housing market would not be in its current shape were lax underwriting standards mixed with exotic loan programs such as Subprime, Alt-A, Stated Income, No-Doc, Pay Option ARMs been available to every consumer with a desire for such loan programs. Again, once the housing crisis began to unfold, the industry quickly made adjustments, removed such mortgage products and returned to sound underwriting principles. Despite concerns that credit is currently too tight and restrictive, the mortgage loans originated today by both mortgage brokers and mortgage bankers are arguably the safest and best performing because the industry does not want to be in any positions for more foreclosures or "buybacks". The housing bubble came in part from national housing policy. The market corrected the error. Now the problem has been compounded with the Dodd-Frank Act.

### IV. Underwriting Standards

Despite the Dodd-Frank Act's intention for the definition of the QM to be broad in order to ensure it was not limiting responsible and affordable credit to consumers, it has become clear the CFPB's intent is to create a narrow scope for QM's based on issues reopened for comment. The

CFPB has requested commentary regarding debt to income ("DTI") ratios, residual income, asset reserves for mortgage payments and all monthly liabilities. In addition, the CFPB has asked for specific commentary regarding the following table based on Federal Housing Finance Agency loan delinquencies when cross referenced with DTI ratios.

**Table 2: Ever 60+ Delinquency Rates**

| Year | All DTI | DTI < 32 | DTI < 34 | DTI < 36 | DTI < 38 |
|---|---|---|---|---|---|
| 1997 | 4.44% | 3.27% | 3.49% | 3.73% | 3.96% |
| 1998 | 3.51% | 2.66% | 2.80% | 2.96% | 3.11% |
| 1999 | 4.38% | 3.38% | 3.51% | 3.65% | 3.80% |
| 2000 | 4.19% | 3.31% | 3.40% | 3.53% | 3.66% |
| 2001 | 3.67% | 2.63% | 2.75% | 2.88% | 3.01% |
| 2002 | 3.56% | 2.44% | 2.57% | 2.69% | 2.82% |
| 2003 | 4.48% | 2.95% | 3.12% | 3.29% | 3.46% |
| 2004 | 7.28% | 4.74% | 5.01% | 5.28% | 5.57% |
| 2005 | 11.90% | 7.22% | 7.72% | 8.23% | 8.78% |
| 2006 | 16.82% | 9.84% | 10.51% | 11.22% | 11.94% |
| 2007 | 21.21% | 10.56% | 11.42% | 12.33% | 13.31% |
| 2008 | 9.41% | 3.77% | 4.16% | 4.57% | 5.02% |
| 2009 | 1.06% | 0.49% | 0.52% | 0.56% | 0.60% |

| Year | DTI < 40 | DTI < 42 | DTI < 44 | DTI < 46 | Missing* |
|---|---|---|---|---|---|
| 1997 | 4.17% | 4.29% | 4.35% | 4.38% | 5.34% |
| 1998 | 3.25% | 3.34% | 3.40% | 3.43% | 4.20% |
| 1999 | 3.94% | 4.05% | 4.13% | 4.19% | 5.66% |
| 2000 | 3.79% | 3.88% | 3.95% | 4.02% | 4.56% |
| 2001 | 3.14% | 3.24% | 3.33% | 3.41% | 4.01% |
| 2002 | 2.95% | 3.06% | 3.17% | 3.25% | 3.69% |
| 2003 | 3.64% | 3.79% | 3.92% | 4.03% | 3.88% |
| 2004 | 5.85% | 6.10% | 6.32% | 6.50% | 5.15% |
| 2005 | 9.30% | 9.76% | 10.18% | 10.52% | 6.14% |
| 2006 | 12.71% | 13.39% | 14.02% | 14.55% | 12.79% |
| 2007 | 14.34% | 15.35% | 16.32% | 17.12% | 19.58% |
| 2008 | 5.52% | 6.04% | 6.53% | 6.99% | 8.61% |
| 2009 | 0.65% | 0.70% | 0.74% | 0.78% | 4.93% |

*Missing not included in All DTI column [3]

The data from this table is clear, empirical evidence supporting two positions; one, that DTI ratios alone cannot be used as a sole predictor of delinquency rates, and two, loan performance of FHFA mortgages post collapse yet prior to the passage of the Dodd-Frank Act have improved tremendously. It should also be noted that a consumers "willingness to repay" cannot be measured. The bottom line is that the entire mortgage industry is already adhering to the general ability to repay standards by originating and underwriting fully documented loans and verifying that consumers do have employment, income, assets, etc. It will be unfortunate to both consumers and industry alike should the CFPB create a one size fits all underwriting standard with relation to DTI ratios, assets, employment, etc.

[3] https://federalregister.gov/a/2012-13608, 77 FR 33120, 12 CFR 1026, Docket No. CFPB 2012-0022

### V. Points and Fees Caps Will Cause Problems

The 3% limit on points and fees as required by the Dodd-Frank Act does not determine a consumer's ability to repay a mortgage loan as an underwriting requirement. This statute alone has the largest potential for determining which consumers will have access to mortgage credit as well as which origination channel consumers can obtain mortgage loans. As currently drafted and proposed, the 3% cap on points and fees could include: affiliated title fees, loan originator compensation, credit life insurance, the amount of insurance and taxes held in escrow and much more.

By default, the Dodd-Frank Act in its 3% cap on points and fees provision of the ability to repay standard is biased against non-creditor mortgage loan originators (small business mortgage brokers). This bias applies to all entities "brokering" a loan such as a credit union, small community bank, and lenders not acting in their capacity of a creditor. As the net-worth requirements increase to a projected $10 million, more and more entities will be acting as non-creditors. As the law is currently written, non-creditor mortgage professionals and creditors are treated differently in accordance with the calculation of the points and fees included in the cap. For example:

> Creditor (bank) – a bank only needs to include the cost of the internal loan officer's compensation in connection with the loan. The bank does not include its internal compensation (gain on sale, service release premium) on the loan
>
> Mortgage Professional (broker) – A mortgage broker must include both the broker and the loan officer's compensation in connection with the origination of the mortgage loan.

The attached "Points and Fees Illustration" shows that a $150,000 loan with an equal interest rate will cost a borrower the same at closing and throughout the life of the loan. However, the calculation of the broker's points and fees will be $4,695 and fail the 3% cap, while the calculation of the bank's points and fees will be $2,445 and under the cap. The calculation of the 3% cap will harm consumers by reducing competition between mortgage brokers and banks, resulting in higher borrowing costs and fewer options for consumers. The modern mortgage broker origination channel is mainly comprised of individuals who have been top performers in their field while working for other origination channels, such as banks or mortgage lenders. These individuals, aspiring to the dream of owning and operating their own business, establish themselves in cities large and small, urban and rural, and generally hire between three and fifty employees, making mortgage broker entities which pride themselves on service a truly valuable small business participant in their communities. Irreparable harm will be forced on thousands of small business owners and employees should this 3% cap include originator compensation. If it is not this Congress's intent to squash small business and support the policy of "too big to fail", then either the law must be changed or the CFPB must use their statutory authority to remove this cap. It is an example of government action, arguably with the best of intentions, destroying the livelihoods of thousands of middle class Americans in the midst of a struggling economy. Please consider this important matter.

In addition to blatantly discriminating against small business, the 3% cap on points and fees discriminates against millions of low to moderate income and minority consumers by limiting access to mortgage credit to only those with the means to afford higher loan amounts. A perfect example of this is the restrictions of home equity loans in the state of Texas. [4] Due to the 3% cap on points and fees which is much less restrictive that that written in the Dodd-Frank Act, consumers are hard pressed to find lenders willing to make home equity loans less than $150,000. (Texas is a high closing cost state[5]) If originator compensation, affiliated title fees and escrows are included in the 3% cap, consumers will have difficulty finding access to loans for less than $250,000. Again, it should be stressed that points and fees paid by a consumer do not substantiate a consumer's ability to repay and no empirical evidence exists to suggest that fully documented loans with points and fees over 3% which include originator compensation, affiliated title fees, and escrows yet still meet required HOEPA[6] thresholds have a higher tendency to default. In fact a GAO study examining the impacts of the Dodd-Frank Act on

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[4] Section 50(a)(6), Article XVI of the Texas Constitution allows certain loans to be secured against the equity in your home. Sections 50(a)(6)(e) fees and charges to make the loan may not exceed 3% of the loan amount.

[5] Bankrate.com 2011 closing cost survey reports Texas has the 2nd highest closing costs in the country. http://www.bankrate.com/finance/mortgages/2011-closing-costs/

[6] Home Ownership and Equal Protection Act of 1994 establishes requirements for loans with high rates/fees

consumers found that certain QM criteria would limit mortgage options for consumers[7]. This study did not include data on points and fees. NAMB recommends Congress request the GAO to evaluate the impact on consumers and mortgage markets with all criteria mandated by the Dodd-Frank Act prior to implementation of the QM rule. The alternative to minimum loan amounts would be to place loan level price adjustments forcing consumers with lower loan amounts to pay higher interest rates which will complement the practice seen today for FHFA mortgage loans. In addition to the GAO study, a June 5, 2012 Congressional Research Service study concluded "The restrictions on points and fees along with the change in the definition of a high-cost mortgage loan would reduce the profitability of "risk-based" pricing or the practice of charging riskier borrowers more to offset their greater levels of default risk. Disadvantaged or weaker borrowers, therefore, would face additional difficulties obtaining mortgage credit". [8] In the current environment of 30 year fixed mortgage rates hovering around 4%, a consumer paying 4.5% for a smaller loan amount may not appear to be bad. However, this comes with its own set of consequences. Higher interest rates not only mean less qualified buyers, but the potential for litigation to lenders because the legal term disparate impact could then be applied considering racial and economic demographics when applied to loan amounts and loan terms offered. Recent actions by the Department of Justice have been problematic for the industry with regards to the legal theory of disparate impact.

## VI. Safe harbor vs. Rebuttable Presumption

Violations of the Dodd-Frank Acts ability to repay standards will prevent the origination of non-QM mortgage loans. Under the law, consumers are allowed to sue for a violation of ability to repay requirement to recover special statutory damages equal to the sum of all finance charges and fees paid by the consumer. Damages may be in addition to actual damages; up to a prescribed threshold; and court costs and attorney fees available for violations of other TILA provisions. The statute of limitations for violations of TILA Section 129C have been extended to three years from the date of occurance. Also, Section 1413 of the Dodd-Frank Act provides

[7] USGAO July 2011 Report: Mortgage Reform, Potential Impacts of Provisions in the Dodd-Frank Act on Homebuyers and the Mortgage Market. http://www.gao.gov/assets/330/321168.pdf

[8] Congressional Research Service: Ability to Repay, Risk-Retention Standards, and Mortgage Credit Access - Darryl Getter, Specialist in Financial Economics, June 5, 2012 - http://www.fas.org/sgp/crs/misc/R42056.pdf

consumers may assert a TILA violation as a defense to foreclosure by recoupment or set off without time limitations against the lender and assignee of the mortgage. In translation, lenders will not originate non-QM loans.

However, the debate does not end there. Two alternatives exist to originating a QM, alternative 1, a legal safe harbor and alternative 2, a rebuttable presumption of compliance. Under the safe harbor alternative, litigation could only be considered if the standards identified for the QM are not satisfied meaning the originator will be protected from certain liabilities and legal challenges. Under a rebuttable presumption, evidence and arguments may be introduced in court about standards beyond those identified in the definition of QM. Even in cases where a mortgage lender could establish it met the presumption of compliance, a party could still challenge this in court be reference to some other set of facts or evidence. By limiting the legal liability and exposure with a safe harbor, costs to consumers will be limited and more competition will exist in the marketplace. However, under the rebuttable presumption alternative, lenders that choose to remain in the marketplace will be forced to tighten credit standards well within the realm of QM leading to increased costs for consumers, fewer qualified homebuyers, more downward pressure on home prices, and ultimately a further strain on an economy which is currently in a precarious state. The safe harbor alternative (**without the 3% cap on points and fees**) is the only way to help rebuild stability in the mortgage market.

### VII. VA Mortgages – An Example of Quality Mortgages

Mortgage loans guaranteed by the Department of Veterans Affairs should be examined as example of how simple underwriting guidelines have managed to protect consumers, homeownership and competition without restrictive Qualified Mortgage definitions. 91% of all VA mortgage loans are originated with 0% down payment by the consumer. In these cases, the consumers are also financing a funding fee up to 3.3% meaning these borrowers are underwater the minute closing occurs. In addition to requiring no money down, VA loans allow for high DTI ratios and have an average fico score lower than FHFA loans. In fact, VA's foreclosure rate at the end of the 4th quarter for 2011 was an astonishingly low 2.37%.[9] The reason for VA's success is simply sound underwriting requirements. In an environment where legislators and

[9] Mortgage Bankers Association – Quarterly Data Report

regulators are in a hurry to impose restrictive guidelines on originators and consumers, it should be noted that VA loans are also the best performing loans on the market. This is an example of how mortgage markets can function without unnecessary and overly restrictive regulation.

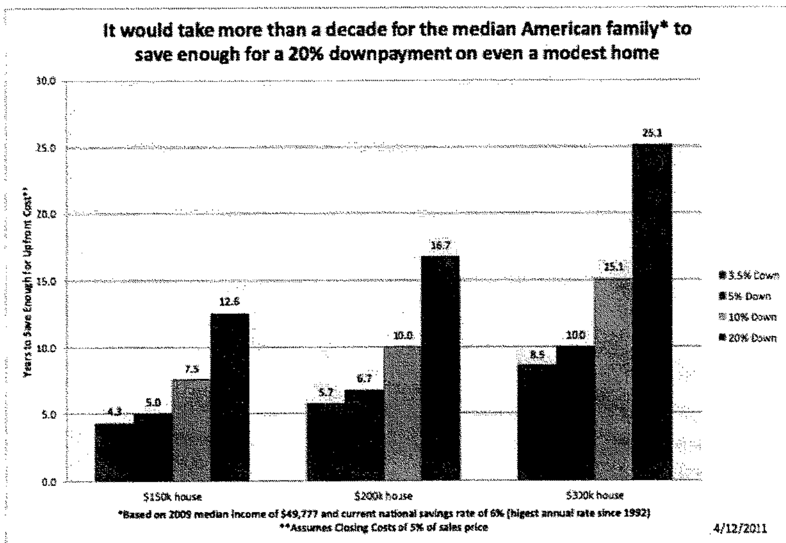
**VIII. Other Areas Of Concern With the Dodd-Frank Act**

- QRM and Risk Retention

Despite the congressional intent for the Qualified Residential Mortgage under the Dodd-Frank Act to not include hardwired minimum down payment requirements, regulators have chosen to create an extremely narrow definition for the risk retention portion of law. In addition to DTI ratio restrictions of 28%/36%, regulators are also going to mandate down payments of up to 20%. Consumer groups including the Center for Responsible Lending, the National Urban League, the National Community Reinvestment Coalition and many more have joined the mortgage industry to protest these harmful restrictions. In August 2011, the Coalition for Sensible Housing Policy submitted a white paper to regulators detailing that minority and low-income households would be particularly hard hit by too narrow regulations.[10] The charts below

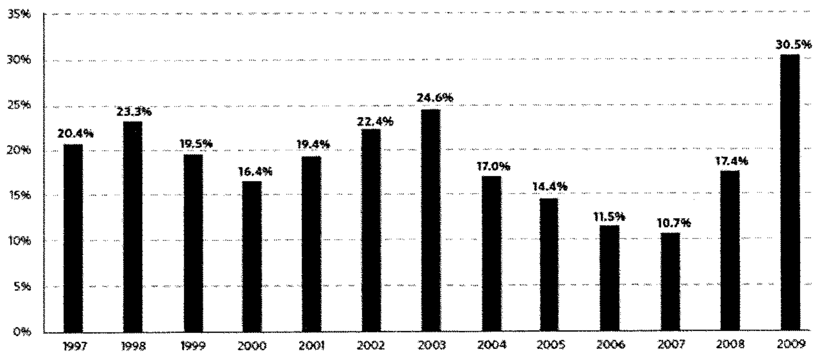
[10] Coalition For Sensible Housing Policy: "Proposed Qualified Residential Mortgage Definition Harms Creditworthy Borrowers While Frustrating Housing Recovery"
http://www.sensiblehousingpolicy.org/uploads/Coalition_for_Sensible_Housing_Policy_-_QRM_White_Paper.pdf

show examples of the impact QRM will have on consumers.



**More than 80 Percent of GSE Business 1997-2009 Would Not Have Been QRM**

Percent of all Mortgages that Would Have Met all Requirements under the Proposed QRM Standard, by Year of Origination




*Source:* FHFA. "Mortgage Market Note 11-02: Qualified Residential Mortgages." April 11, 2011.

(It should be noted that only 30.5% of all mortgage loans originated in 2009, well after the industry had tightened underwriting guidelines, would have met the proposed QRM definition. Congress should carefully consider this staggering statistic and apply this to other industries. What if auto makers lost their ability to finance 70% of their product?)

- CFPB Authority

Congress should be concerned with the powers granted to the CFPB. It has become clear the regulators are using their authority to rewrite the Congressional intent of the Dodd-Frank Act with respect to many aspects regarding mortgage loans. Attached, the committee will find a letter from Representative Barney Frank writing the Federal Reserve Board Chairman Bernanke concerned the regulators went beyond intent and would "unnecessarily interfere with borrowers' ability to obtain loans from mortgage brokers". This letter was regarding the loan originator compensation rule implemented by the Federal Reserve Board and now is dictated by the CFPB. Without proper oversight, regulators will continue to implement rules and regulations with little or no regard from Congressional intent or industry expertise.

- Appraisal Independence Regulations

The Dodd-Frank Act included language directing the Federal Reserve Board to prescribe interim final regulations on appraisal independence to replace the Home Valuation Code of Conduct (HVCC). The Interim Final Regulations, released on October 18, 2010, define acts or practices that violate appraisal independence for all individuals involved in the mortgage process. While the Fed's Rule allows mortgage professionals to order appraisals, FHFA guidelines still prohibit mortgage professionals from ordering appraisals. The Dodd-Frank Act called for the repeal of the HVCC and directed the Federal Reserve Board to prohibit improper influence on appraisers and ensure appraisal independence in its interim regulation. The GSE's promptly issued Guidelines that countermanded the appraisal ordering rules in the DFA. FHFA should follow the law and allow mortgage professionals to order appraisals. The Dodd-Frank Act also included language directing the regulators to come up with standards regarding appraisal portability. Such appraisal portability standards have not yet been promulgated. Regulators should allow for the portability of appraisal reports. Appraisal portability allows an appraisal to be used across lenders, so homebuyers can shop for the best loan without paying for additional appraisals. Regulators should direct lenders to accept appraisals that meet industry standards, even if ordered by another lender.

- Loan Originator Compensation (LO Comp)

The CFPB recently announced an "idea" to propose a flat fee form of originator compensation in order to prevent a statutory "glitch" in the Dodd-Frank Act that will prevent consumers from having the ability to pay any points for fees for a mortgage loan beginning in January 2012. The "idea" is that by fixing loan originator compensation to a flat fee, the CFPB will have prevented the problems associated with instant "no fee" mortgages. However, the Dodd-Frank Act already prohibits mortgage originator compensation that varies based on the terms of the loan (other than the amount of the principal). A flat fee would lead to consequences that would hurt the most vulnerable in our housing system, low to moderate income borrowers purchasing smaller homes. Mortgage originators must have enough flexibility to be responsive to the uniqueness of each transaction.

- Disclosures

NAMB and its members applaud the efforts of the CFPB to simplify mortgage disclosures. However, consumers must still have the ability to truly shop and compare mortgage loan offers. Currently creditors are still allowed to earn revenue on mortgage loans without disclosure to consumers. Meanwhile, mortgage brokers must disclose their total compensation which confuses consumers into believe they are receiving a higher cost mortgage loan. The FTC concluded in 2004 mortgage broker compensation disclosure proposed by the Department of Housing and Urban Development (HUD) is likely to confuse consumers, cause a significant proportion to choose loans that are more expensive than the available alternatives, and create a substantial consumer bias against broker loans, even when the broker loans cost the same or less than direct lender loans.[11] Mortgage loan disclosures must be simple and allow for consumers to truly shop for the best deal.

## IX. Conclusion

The Dodd-Frank Act defines five objectives for the CFPB:

- to ensure that consumers have timely and understandable information to make responsible decisions about financial transactions;
- to protect consumers from unfair, deceptive, or abusive acts or practices, and from discrimination;
- to reduce outdated, unnecessary, or unduly burdensome regulations;
- to promote fair competition by consistent enforcement of the consumer protection laws in the Bureau's jurisdiction; and
- to encourage markets for consumer financial products and services that operate transparently and efficiently and to facilitate access and innovation.

These five objectives are truly admirable and NAMB is a supporter of these. However, the interpretation of these objectives and how they are applied leaves much to be desired along with

[11] Federal Trade Commission, Bureau of Economics Staff Report: "The Effect of Mortgage Broker Compensation Disclosures on Consumers and Competition: A Controlled Experiment" – February 2004

the Congressional intent of the Dodd-Frank Act. CFPB Deputy Director Raj Date has stated a vibrant economy requires a vibrant housing market. In order to achieve this, three things must be present, transparency, free market, and fair competition. Again, interpretation of these items is the dilemma lawmakers, regulators, industry, and consumers face when applied to mortgage loans and the availability of credit to consumers.

Consumers deserve protection from bad actors. However, the unintended consequences from hastily crafted legislation will harm the very people it is meant to protect. Homeownership is still the American Dream and every consumer deserves the opportunity to participate in that dream without the fear of being forced into a permanent class of renters. In today's environment of historically low interest rates, consumers find themselves having difficulty obtaining mortgage financing which is continuing the downward drag on the overall economy. The committee's question "Could Title XIV of the Dodd-Frank Act limit the availability of credit for borrowers?" should be "how quickly consumers will be harmed by Title XIV of the Dodd-Frank Act and what can be done to prevent it?". "What is going to happen to housing affordability and housing prices when interest rates increase?" .

## Points and Fees Illustration

When a loan is made, it is sold on the secondary market and generally has a premium paid for the rate secured by the borrower. This premium or price could be 103 or higher depending on the note rate. That premium is not disclosed to the consumer when the consumer obtains a loan from a banking institution. In a Brokered loan, it is. Banks can pay expenses and book profit and not have to disclose those costs and profits to the consumer. The consumer is focused on interest rate and out of pocket costs for the loan. In our comparison, we show the difference when a cosumer obtains a loan through a Broker and a loan through a Bank based on the same note rate (fixed rate term).

| | Broker Fee | Lender Fee | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Brokered loan** | | | | | | | | | | | | |
| Loan Amount | | | $75,001 | $100,000 | $125,000 | $150,000 | $175,000 | $200,000 | $225,000 | $250,000 | $275,000 | $300,000 |
| Borrower Paid Origination 0% | | | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| (Lender paid) Total Origination 2.25% - includes comp to Company and LO | x | | $1,687.52 | $2,250.00 | $2,812.50 | $3,375.00 | $3,937.50 | $4,500.00 | $5,062.50 | $5,625.00 | $6,187.50 | $6,750.00 |
| Underwriting | | x | $995 | $995 | $995 | $995 | $995 | $995 | $995 | $995 | $995 | $995 |
| Doc Prep | | x | $150 | $150 | $150 | $150 | $150 | $150 | $150 | $150 | $150 | $150 |
| Appraisal Review | | x | $175 | $175 | $175 | $175 | $175 | $175 | $175 | $175 | $175 | $175 |
| Processing Fee | x | | | | | | | | | | | |
| Admin Fee | | x | | | | | | | | | | |
| Total Points & Fees for QM test | | | $3,007.52 | $3,570.00 | $4,132.50 | $4,695.00 | $5,257.50 | $5,820.00 | $6,382.50 | $6,945.00 | $7,507.50 | $8,070.00 |
| ***Maximum Allowed*** | | | $2,250.03 | $3,000.00 | $3,750.00 | $4,500.00 | $5,250.00 | $6,000.00 | $6,750.00 | $7,500.00 | $8,250.00 | $9,000.00 |
| Meets 3% Fee Test | | | FAIL | FAIL | FAIL | FAIL | FAIL | PASS | PASS | PASS | PASS | PASS |
| **Total loan fees paid by Consumer** | | | **$1,320.00** | **$1,320.00** | **$1,320.00** | **$1,320.00** | **$1,320.00** | **$1,320.00** | **$1,320.00** | **$1,320.00** | **$1,320.00** | **$1,320.00** |
| **Banks-Retail** | | | | | | | | | | | | |
| Loan Amount | | | $75,001 | $100,000 | $125,000 | $150,000 | $175,000 | $200,000 | $225,000 | $250,000 | $275,000 | $300,000 |
| Borrower Paid Origination 0% | | | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Loan Officer Compensation (.75%) | | x | $562.51 | $750.00 | $937.50 | $1,125.00 | $1,312.50 | $1,500.00 | $1,687.50 | $1,875.00 | $2,062.50 | $2,250.00 |
| Underwriting | | x | $995 | $995 | $995 | $995 | $995 | $995 | $995 | $995 | $995 | $995 |
| Doc Prep | | x | $150 | $150 | $150 | $150 | $150 | $150 | $150 | $150 | $150 | $150 |
| Appraisal Review | | x | $175 | $175 | $175 | $175 | $175 | $175 | $175 | $175 | $175 | $175 |
| Processing Fee | | x | | | | | | | | | | |
| Admin Fee | | x | | | | | | | | | | |
| Total Fees for QM test | | | $1,882.51 | $2,070 | $2,258 | $2,445 | $2,633 | $2,820 | $3,008 | $3,195 | $3,383 | $3,570 |
| ***Maximum Allowed*** | | | $2,250.03 | $3,000.00 | $3,750.00 | $4,500.00 | $5,250.00 | $6,000.00 | $6,750.00 | $7,500.00 | $8,250.00 | $9,000.00 |
| Meets 3% Fee Test | | | PASS | PASS | PASS | PASS | PASS | PASS | PASS | PASS | PASS | PASS |
| **Total loan fees paid by Consumer*** | | | **$1,320.00** | **$1,320.00** | **$1,320.00** | **$1,320.00** | **$1,320.00** | **$1,320.00** | **$1,320.00** | **$1,320.00** | **$1,320.00** | **$1,320.00** |
| **How Banks show no fees, increase rate by .25%** | | | | | | | | | | | | |
| Loan Officer Compensation (.75%) | | x | $562.51 | $750.00 | $937.50 | $1,125.00 | $1,312.50 | $1,500.00 | $1,687.50 | $1,875.00 | $2,062.50 | $2,250.00 |
| Underwriting | | x | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 |
| Doc Prep | | x | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 |
| Appraisal Review | | x | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 |
| Processing Fee | | x | | | | | | | | | | |
| Admin Fee | | x | | | | | | | | | | |
| Total Fees for QM test | | | $562.51 | $750.00 | $937.50 | $1,125.00 | $1,312.50 | $1,500.00 | $1,687.50 | $1,875.00 | $2,062.50 | $2,250.00 |
| ***Maximum Allowed*** | | | $2,250.03 | $3,000.00 | $3,750.00 | $4,500.00 | $5,250.00 | $6,000.00 | $6,750.00 | $7,500.00 | $8,250.00 | $9,000.00 |
| Meets 3% Fee Test | | | PASS | PASS | PASS | PASS | PASS | PASS | PASS | PASS | PASS | PASS |
| **Total loan fees paid by Consumer*** | | | **$0.00** | **$0.00** | **$0.00** | **$0.00** | **$0.00** | **$0.00** | **$0.00** | **$0.00** | **$0.00** | **$0.00** |
| ***Increased Interest Expense to Consumer*** | | | **$2,855.50** | **$3,807.28** | **$4,759.10** | **$5,710.92** | **$6,662.74** | **$7,614.56** | **$8,566.38** | **$9,518.21** | **$10,470.03** | **$11,421.85** |

* Total loan fees paid by the consumer are the sum of the underwriting, doc prep, appraisal review, processing, and admin fees.

SPENCER BACHUS, AL, CHAIRMAN

United States House of Representatives
Committee on Financial Services
Washington, D.C. 20515

BARNEY FRANK, MA, RANKING MEMBER

March 24, 2011

The Honorable Ben S. Bernanke
Chairman
Federal Reserve Board
20th & Constitution Ave. NW
Washington, DC 20551

**Federal Reserve Final Rule on Loan Originator Compensation**
***Regulation Z: Docket No. R-1366, Truth in Lending***

Dear Chairman Bernanke:

I am writing to urge that the Federal Reserve take immediate action to make two changes to the rule cited above, which is scheduled to take effect on April 1st.

It is important at this point that the rule take effect, and that the Federal Reserve immediately thereafter amend the rule to make these two changes. I urge these changes both for substantive reasons and to dispel the misperception that all the elements in the rule were called for under the "Wall Street Reform and Consumer Protection Act" (P.L. 110-203) (or as it is sometimes referred to, as the Financial Reform Act).

As the Federal Reserve noted in its September 24th rule publication, much of the rule is consistent with the Financial Reform Act. However, I believe it was a mistake for this rule to go beyond what was required in the Financial Reform Act. The two problems I am citing unnecessarily interfere with borrowers' ability to obtain loans from mortgage brokers and their resolution would not damage the core underlying consumer protections. Therefore, I believe it is important that the rule take effect as scheduled, and that the Federal Reserve take immediate action to correct the two problems created by the rule.

First, the rule appears to prohibit a mortgage brokerage firm that is receiving compensation for a loan from the consumer from paying any compensation related to that loan to an employee of that firm. This is because the rule appears to include language that states that when a loan originator receives compensation from the consumer on a loan, no loan originator at all can receive compensation related to that loan from any source.

This differs from Section 1403 of the Financial Reform Act, which merely states that if a loan originator receives compensation from the consumer, that originator cannot receive compensation from another source. This statutory provision prevents double dipping, while the more restrictive Fed rule prevents the sharing of the consumer-paid compensation by the firm with an employee for that employee's work on the loan. I would note that such sharing of compensation would not involve an increase, directly or indirectly, in the level of fees paid by the consumer. I believe this language should be revised to allow employee compensation in this circumstance. Of course, any such compensation should be subject to

Page Two

the same rule as laid out in the Rule of Construction (A) in Section 1403 of the Financial Reform Act – that such compensation cannot vary based on terms of the loan, other than the amount of principal.

The second issue relates to a common occurrence in which mortgage brokers offer to make small fee reductions at loan closing, to cover shortfalls which sometimes result because of last minute third party fee changes, or to cover the cost of a short extension of a loan lock when the loan failed to close within the window of the original loan lock. I believe this practice should be allowed if the fee reduction is at the request of the borrower and is made within a short period (eg., 24 hours) of the loan closing. I believe that permitting such a practice does not undermine the rule's essential consumer protections. However, I am cognizant of the potential for a loan originator to systematically make use of such a practice with the intent of circumventing the rule's consumer protections. Therefore, it would be appropriate to limit the frequency of such use and to limit either the dollar or percentage amount of the reduction, and to monitor a loan originators' use of this flexibility to ensure that such flexibility is not abused.

I believe that both of these provisions should be revised expeditiously by the Federal Reserve through an appropriate action or proceeding at the earliest possible time.

Thank you for your consideration of these requests.

BARNEY FRANK
Ranking Member

National Association
of Home Builders

**Testimony of Rick Judson**

**On Behalf of the**
**National Association of Home Builders**

**Before the**

**House Financial Services Committee's Subcommittee on Financial Institutions and Consumer Credit**

**Hearing on**

**"The Impact of Dodd-Frank's Home Mortgage Reforms: Consumer and Market Perspectives"**

**July 11, 2012**

## Introduction

Chairman Capito, Ranking Member Maloney and members of the Financial Institutions and Consumer Credit Subcommittee, I am pleased to appear before you today on behalf of the National Association of Home Builders (NAHB) to share our views on the definition of a "qualified mortgage" (QM) included in the ability-to-repay standard currently being developed by the Consumer Financial Protection Bureau (CFPB). We appreciate the invitation to appear before the committee on this important issue, which will have a wide-ranging impact on the mortgage finance system and the availability of mortgage credit.

My name is Rick Judson and I am NAHB's First Vice Chairman of the Board and a home builder from Charlotte, North Carolina. NAHB represents over 140,000 members involved in a wide variety of housing activities, including the development and construction of single-family for-sale housing; the development, construction, ownership, and management of affordable and market-rate multifamily rental housing; and the development and construction of light commercial properties.

*Importance of Availability of Mortgage Credit*

NAHB believes a housing finance system that provides adequate and reliable credit to home buyers at reasonable interest rates through all business conditions is critical to our nation's economic health. Home buyers and builders continue to confront challenging credit conditions weighed down by strict underwriting requirements and an uncertain future regulatory environment. According to an NAHB Housing Market Index survey conducted in January 2012, 69 percent of builders report that qualifying buyers for mortgages is a significant problem for them.

While mortgage rates have fallen to record lows and housing affordability is at a record high, access to mortgage credit is limited to those home buyers with pristine credit histories who can qualify for government-backed programs. Presently, FHA, VA, Fannie Mae and Freddie Mac account for more than 90 percent of mortgage originations. Furthermore, borrowers are increasingly relying on government housing programs (FHA, VA and USDA) for home purchases. A recent study shows that Ginnie Mae securities, which are backed by government insured or guaranteed mortgages, accounted for more than 50 percent of the purchase market in 2011.[1] A reasonable ability-to-repay standard is critical to an adequate flow of mortgage credit in the future, particularly in convincing private capital to return to the housing market, and to extending safe mortgage credit to home buyers.

*Homeownership Still Matters – Consumer Demand is on the Rise*

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[1] Amherst Securities, *The Coming Crisis in Credit Availability*, May 30, 2012, p. 5

NAHB estimates that 2.1 million household formations have been postponed for economic reasons. Household formations (e.g., adult children leaving parents' households, singles leaving shared housing arrangements, etc.) are the largest component of demand for additions to the housing stock. With the recent positive signs indicating a recovery in the housing market, many of these consumers will come back into the market.

According to a poll[2] conducted on behalf of NAHB earlier this year, home owners and non-owners alike consider owning a home essential to the American Dream. The survey results show that Americans see beyond the immediate housing market to the enduring value of homeownership. About three-in-four voters say owning a home is worth the ups and downs of the housing market, and almost all of the home owners said they are happy with their decision to own a home.

Even in today's market, people who don't own say they want to buy a house. More than two-thirds of those who do not currently own a home say it is their goal to be a home owner one day. However, saving for a downpayment and closing costs was cited as one of the biggest barriers to homeownership.

These key findings were supported by independent studies. For example, a survey by The Tarrance Group that was presented in May at the Woodrow Wilson International Center for Scholars found that despite the bursting of the housing bubble, an overwhelming majority of Americans still feel that homeownership is both important to them and a part of the American Dream. A majority also said homeownership should be a national priority.[3]

## Background

In response to the financial crisis, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act or the Act) which authorized significant changes to mortgage lending practices, including the ability-to-repay standard which will set the ground rules for mortgage financing going forward.

The ability-to-repay provisions set minimum standards for mortgages by requiring lenders to establish that consumers have a reasonable ability to repay at the time the mortgage is consummated, and state that certain high-quality, low-cost loans (defined as "Qualified Mortgages") are presumed to meet this standard. The Federal Reserve Board (Fed) issued proposed QM rules in May 2011, but the responsibility for the final rules has now shifted to the Consumer Financial Protection Bureau (CFPB) as mandated by the Dodd-Frank Act. The CFPB has announced that it will publish a final rule by the end of this year and prior to the January 2013 statutory deadline.

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[2]This national survey of 1,500 likely 2012 voters was conducted January 2-5, 2012 by Public Opinion Strategies of Alexandria, Va., and Lake Research Partners of Washington, D.C. It has a margin of error of +2.5%.
[3] http://www.wilsoncenter.org/article/new-national-poll-americans-still-want-to-be-homeowners

*Proposed Options to Comply with the Ability-to-Repay Standard*

The Fed's proposal provides four options for complying with the ability-to-repay requirement.

1. General Ability-to-Repay Standard

A creditor can meet the general ability-to-repay standard by:

- Considering and verifying the following eight underwriting factors: current or reasonably expected income or assets; current employment status; the monthly payment on the mortgage; the monthly payment on any simultaneous mortgage; the monthly payment for mortgage-related obligations; current debt obligations; the monthly debt-to-income ratio, or residual income; and credit history.
- Underwriting the payment for an adjustable-rate mortgage based on the fully indexed rate.

2. Qualified Mortgage

A creditor can originate a "qualified mortgage," which provides special protection from liability based on the alleged failure to comply with the "ability-to-repay standard." Consistent with the Dodd-Frank Act, the Proposed Rule defines a QM as a mortgage that meets the following requirements:

- The loan does not provide for negative amortization, interest-only payments, or a balloon payment, or have a loan term exceeding 30 years.
- The total points and fees do not exceed 3% of the total loan amount (with exceptions for smaller dollar amount loans).
- The income or assets relied upon in making the ability-to-repay determination are considered and verified.
- The underwriting of the mortgage (1) is based on the maximum interest rate that may apply in the first five years, (2) uses a payment schedule that fully amortizes the loan amount over the loan term, or the outstanding principal balance over the remaining term as of the date the rate adjusts to the maximum, and (3) takes into account any mortgage-related obligations.

The Fed explained in the preamble to the proposed rule that it is not clear under the Dodd-Frank Act whether Congress intended to establish a safe harbor or a rebuttable presumption of compliance.[4] Due to statutory ambiguity, the Fed proposed two alternatives for meeting the QM standard.

[4] 76 Fed. Reg. 27396 (May 11, 2011).

Alternative 1 would operate as a legal safe harbor and define a "qualified mortgage" based on the criteria listed in the Act and outlined above.

Alternative 2 would provide a rebuttable presumption of compliance and would define a "qualified mortgage" as including the criteria listed under Alternative 1 as well as additional underwriting requirements from the general ability-to-repay standard. Thus, under Alternative 2, the creditor would also have to consider and verify:

- The consumer's employment status,
- The monthly payment for any simultaneous mortgage,
- The consumer's current debt obligations,
- The monthly debt-to-income ratio or residual income, and
- The consumer's credit history.

3. Balloon-Payment Qualified Mortgage

A creditor operating predominantly in rural or underserved areas can originate a balloon-payment qualified mortgage. This option is meant to preserve access to credit for consumers located in rural or underserved areas where creditors may originate balloon loans to hedge against interest rate risk for loans held in portfolio. Under this option, a creditor can make a balloon-payment qualified mortgage with a loan term of five years or more by complying with the requirements for a qualified mortgage and underwriting the mortgage based on the scheduled payment, except for the balloon payment.

4. Refinancing of a Non-Standard Mortgage

A creditor can refinance a "non-standard mortgage" with risky features into a more stable "standard mortgage." This option is meant to preserve consumers' access to streamlined refinancings that materially lower their payments. Under this option, a creditor complies by:

- Refinancing the consumer into a "standard mortgage" that has limits on loan fees and that does not contain certain features such as negative amortization, interest-only payments, or a balloon payment;
- Considering and verifying the underwriting factors listed in the general ability-to-repay standard, except the requirement to consider and verify the consumer's income or assets; and
- Underwriting the "standard mortgage" based on the maximum interest rate that can apply in the first five years.

*Proposed Points and Fees in a Qualified Mortgage*

The Dodd-Frank Act defines a QM as a loan for which, among other things, the total points and fees do not exceed three percent of the total loan amount. Consistent with the Act, the proposed rule revises Regulation Z to define "points and fees" to now include: (1) Certain mortgage insurance premiums in excess of the amount payable under Federal Housing Administration (FHA) provisions; (2) All compensation paid directly or indirectly by a consumer or creditor to a loan originator; and (3) the prepayment penalty on the covered transaction, or on the existing loan if it is refinanced by the same creditor. The proposal provides exceptions to the calculation of points and fees for: (1) Any bona fide third party charge not retained by the creditor, loan originator, or an affiliate of either (2) certain bona fide discount points.

The proposed rule did not include an exemption for fees paid to creditor-affiliated settlement services providers because Congress appears to have rejected excluding from points and fees real estate-related fees where a creditor would receive indirect compensation as a result of obtaining distributions of profits from an affiliated entity based on the creditor's ownership interest in compliance with RESPA.

**NAHB Position**

*NAHB Supports Balancing Consumer Protections and Mortgage Credit Availability*

NAHB believes that loans should be prudently underwritten and adequately disclosed. Stronger requirements related to borrower's ability-to-repay are needed to diminish the rate of borrower defaults. Such changes will also help reduce the probability of additional damaging economic consequences associated with widespread foreclosures that we have witnessed over the last few years due to previous breakdowns in the mortgage process. NAHB believes it is critical that mortgage lending reforms are imposed in a manner that causes minimum disruptions to the mortgage markets, while ensuring consumer protections. Great care must be taken to avoid further adverse changes in liquidity and affordability.

In early 2007, NAHB, concerned with the state of housing finance, passed policy and began working with other stakeholders in the housing and mortgage lending/investment industries as well as Congress and federal, state and local financial institution regulators to find and implement effective solutions to problems in the mortgage markets. NAHB believes it is extremely important that all such efforts ensure that the regulation of mortgage products and practices does not unnecessarily disrupt the mortgage lending process, limit consumer financing options or increase the cost or reduce the availability of responsible mortgage credit.

NAHB encouraged then, and adamantly supports today, continued mortgage market innovation to improve housing affordability and expand homeownership opportunities as long as these loans have appropriate features and are prudently underwritten to ensure that the form of financing is appropriate for the borrower, the market and that consumers are fully aware of the features and risks of the loan.

NAHB believes that it is essential that the definition of the QM loan and the ability-to-repay standards are well structured and properly implemented. While much attention has been paid to the definition of the "Qualified Residential Mortgage" (QRM), which is another mortgage rule mandated by the Dodd-Frank Act, the QM is more important given that the ability-to-repay standard will most likely govern the types of mortgages made in the future. The importance of the QM rule cannot be overemphasized. It will set the foundation for the future of mortgage financing, as all mortgages will be subject to the ability-to-repay requirements.

As the various agencies craft new rules governing the future of mortgage financing, it is important to remember that these decisions will determine the future of the mortgage market for years to come. NAHB urges the CFPB and policy makers to consider the long-term ramifications of these rules on the market, and not to place unnecessary restrictions on the housing market based solely on today's economic conditions. Overly restrictive rules will prevent willing, creditworthy borrowers from entering the housing market even though owning a home remains an essential part of the American Dream.

*NAHB Supports a Broad QM Definition*

NAHB has joined with 32 other housing, banking, civil rights and consumer groups to urge the CFPB to issue broadly defined and clear QM standards. A narrowly defined QM would put many of today's sound loans and creditworthy borrowers into the non-QM market, which would undermine prospects for a housing recovery.

A narrowly defined QM would expose lenders and investors to a high risk of an ability-to-repay violation and even a steering violation. As a result of these increased risks, these loans are unlikely to be made. In the unlikely event they are made, they will be far costlier, burdening families least able to bear the expense. Beyond that, these higher-priced loans would not be required to include important protections that are embedded in QM to restrict loan practices and features that drove the highest failures in the mortgage boom.

A review of the legislative history of the QM provision indicates that it was meant to be broad. The statutory language does not indicate that the QM was meant to be narrow or that Congress wanted to establish a market for non-QM loans[5].

Creating a broad QM, which includes sound underwriting requirements, excludes risky loan features, and gives lenders and investors reasonable protection against undue litigation risk, will help ensure revival of the home lending market.

*NAHB Recommends Establishing a Strong Safe Harbor*

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[5] Barnett Sivon & Natter, P.C, *Congressional Intent Regarding the Qualified Mortgage Provision,* May 18, 2012

The proposed rule establishes various compliance options for determining whether the creditor has met the ability-to-repay requirements. The Dodd-Frank Act provides special protection from liability for creditors who make QMs.

As noted previously, the Fed determined that the Dodd-Frank Act is unclear on whether the QM protection is intended to be a safe harbor or a rebuttable presumption of compliance. The Fed determined that there are sound policy reasons for interpreting a QM as providing either a safe harbor or a presumption of compliance. Due to the statutory ambiguity and competing concerns the Fed proposed two alternatives for the QM standard.

The first alternative defines the QM based on the criteria listed in the Dodd-Frank Act and would operate as a safe harbor and an alternative to complying with the general ability-to-repay standard. Under this alternative, the creditor would not be required to consider and verify the borrower's employment status, the payment of any simultaneous loans that the creditor is aware of or has reason to know about, the borrower's current obligations or credit history. In addition, this alternative does not include requirements to consider the borrower's debt-to-income ratio or residual income.

The second alternative defines a QM to include the requirements listed in the Dodd-Frank Act as well as the other underwriting requirements that are in the general ability-to-repay standard. This definition provides a presumption of compliance that could be rebutted by the consumer. The drawback of this approach is that it provides little legal certainty for the creditor, and thus, little incentive to make a QM. NAHB is concerned that the second alternative may reduce credit liquidity if conservative lenders establish criteria stricter than the presumption's standards to minimize litigation risk.

After carefully considering the proposed alternatives for the QM, NAHB supports the creation of a bright line safe harbor to define the QM to best ensure safer, well documented, and underwritten loans without limiting the availability or increasing the cost of credit to borrowers. NAHB supports a QM safe harbor definition that promotes liquidity by providing consumers stronger protections than those proposed by the Fed and provides lenders definitive lending criteria that reduces excessive litigation exposure. The safe harbor should incorporate specific ability-to-repay standards.

To strengthen the safe harbor definition, NAHB suggests the CFPB evaluate the eight general ability-to-repay underwriting criteria and other general underwriting factors that are based on widely accepted underwriting standards. The final rule should provide creditors with discretion to responsibly adapt debt-to-income or residual income requirements based on changing markets, and not impose a rigid numerical standard. This should be sufficiently objective to make sound underwriting and credit decisions. NAHB recommends that the regulators work with NAHB and other industry stakeholders to develop a workable safe harbor.

NAHB believes this construct would provide the strongest incentive for lenders to operate within its requirements and allow lenders the ability to provide sustainable mortgage credit to the widest array of qualified borrowers. Just as important, the safe harbor will protect consumers by allowing focused litigation to determine whether the safe harbor requirements have be met. This should provide strong incentives for lenders who best serve consumers while maintaining clear avenues to enact severe penalties for lenders who do not.

It is important to note that the establishment of a safe harbor under the QM does not eliminate lender liability in any meaningful way. Failure to meet stringent underwriting requirements under the QM will result in the loss of the safe harbor. All penalty provisions under the Dodd-Frank Act would apply, as would traditional lender liability claims such as the duty of good faith and fair dealing.

Consumers must have access to a responsible and sustainable housing credit market so as we strengthen lending regulations to avoid past excess we must be prudent to not create an environment where mortgage loans are subject to unnecessary heightened litigation risks. Excessive litigation risks and severe penalties for violating the ability-to-repay standards would cause uncertainty resulting in liquidity issues for the entire population and could cause low to moderate income and minority populations to suffer disproportionally.

*NAHB Supports Reinstating the Affiliate Exception to Increase Consumer Choice*

The current definition of points and fees discriminates against lenders with affiliates for no apparent reason. NAHB strongly supports reinstating the affiliate exception so it allows consumers access and choice in determining their mortgage providers.

NAHB supports H.R. 4323, the Consumer Mortgage Choice Act which would amend the definition of points and fees to remove affiliated title charges, clarify exclusion of loan officer compensation and clarify escrow charges.

Both home builders and lenders have a strong interest in establishing and maintaining long term positive relationships with consumers who are looked to for repeat business and referrals, which is not possible unless consumers are satisfied with their experiences. Consumers will only refer their friends and relatives when they believe they have been treated fairly and received excellent value for their investment.

As part of the effort to build strong consumer relationships, many home builders and lenders have established settlement service affiliates, such as mortgage and title companies. Collectively, these relationships have successfully facilitated home purchases for consumers by obtaining mortgages and providing settlement services for hundreds of thousands, perhaps millions, of consumers over a span of more than a decade.

These affiliates have been formed primarily to improve the likelihood that the financing of the home buying process occurs as promised and in a timely manner. These affiliates provide economic benefits to the consumers that far outweigh the income received from the partnerships in the business. Therefore, consumers directly benefit from affiliated relationships.

In the conditions that have prevailed during the past few years, where mortgage financing has become unstable and uncertain, these relationships have taken on greater importance. The affiliate relationship fosters a high degree of accountability between the companies, which leads to well-coordinated, efficient transactions that decrease the likelihood of any "surprises" for the consumer.

Many times affiliated settlement service providers are more efficient because they have integrated platforms that facilitate communication and enable them to achieve a quicker, more streamlined closing process. In a December 2010 Harris Survey of recent and prospective buyers, respondents said that using affiliates saves them money (78%), makes the home buying process more manageable and efficient (75%), prevents things from "falling through the cracks" (73%) and is more convenient (73%) than using separate services. This response is consistent with data from similar surveys in 2008 and 2002.

Requiring affiliate fees and points to be included in the 3 percent cap creates a disincentive for lenders to establish affiliated relationships, which as mentioned above, provide measurable benefits to consumers. For this reason NAHB strongly urges excluding fees and points from affiliated firms in the 3 percent cap, thereby giving equal treatment to affiliated and non-affiliated settlement service providers.

*NAHB Supports Inclusion of Mortgage Insurance in the Proposed Rule*

Mortgage insurance (MI) has provided consumers access to well underwritten, lower downpayment loans making homeownership a reality for many consumers including low- and moderate-income families. MI also provides many benefits to the housing finance industry including shared risk in the event of default and an additional and independent underwriting evaluation. Existing data reveals that loans carrying MI experience lower default rates primarily because of this additional underwriting step, or extra eyes, to the origination process.[6]

*NAHB Supports Balloon Payments in Rural Areas*

NAHB supports an exception to the definition of a QM for a balloon-payment made by a creditor that meets the criteria set forth in the Dodd-Frank Act. Consumers in rural and underserved areas must have access to credit and in their communities sometimes the only source of credit available may originate from community banks. Because community banks typically hold these loans in portfolio a balloon mortgage is necessary to provide the banks a means of reducing interest rate risk.

*NAHB Supports Incentives to Refinance Non-Standard Mortgages*

[6] Coalition for Sensible Housing Policy, *Proposed Qualified Residential Mortgage Definition Harms Creditworthy Borrowers While Frustrating Housing Recovery*, July 11, 2011, p. 13.

NAHB supports the proposal to exempt creditors of refinancing a non-standard mortgage, under certain limited circumstances, from the requirement to verify income and assets in determining whether a consumer has the ability to repay a covered transaction. This flexibility in underwriting will be an important resource for consumers who have been affected by the housing crisis and assist those homeowners who are in financial need that have behaved responsibly in handling their mortgage and other financial obligations avoid foreclosure.

*Fair Lending Concerns*

While NAHB supports the general principle of ability-to-repay, we are concerned the proposed QM requirements could have a disparate impact on minority consumers, who are less likely to be offered mortgage products under the QM's more stringent underwriting requirements. These results may run afoul of existing fair lending requirements including the Fair Housing Act.[7] The impact of these requirements on the availability of mortgages to minority borrowers has not been adequately examined under the proposed regulations.

Because mortgages originated under the QM will be disproportionately offered to more affluent consumers, the availability of safe mortgage products may actually decline in many minority communities. The General Accountability Office acknowledged that the QM criteria may increase the cost and restrict the availability of mortgages to lower income and minority borrowers.[8] These criteria will necessarily limit lender's discretion and therefore consumers most eligible for a QM will be disproportionately more affluent. Thus, in certain communities, lenders' lack of discretion will necessarily have a disparate impact on minority consumers.

Further, the ability of lenders to offer products outside of the qualified mortgage will be limited by the penalties for failure to comply with the ability-to-repay standards. Section 1416 of the Dodd-Frank Act allows for special statutory damages in addition to actual damages. This severe penalty may lead to the resurgence of "redlining" by lenders—denying mortgages to minority communities based on their racial composition. It is well-accepted that "the practice of denying the extension of credit to specific geographic areas due to the income, race, or ethnicity of its residents," may violate federal civil rights laws, including the Fair Housing Act.[9]

These concerns run counter to the CFPB's stated charge to promote access to affordable loan products. Notably, the administration's Housing Finance Reform Report, issued in February 2011, emphasized the need to maintain housing finance availability to creditworthy borrowers in a

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[7] The Fair Housing Act prohibits businesses engaged in residential real estate transactions, including "[t]he making... of loans or providing other financial assistance...secured by residential real estate," from discriminating against any person on account of race. 42 U.S. C. § 3605(a), (b)(1)(B).

[8] The report also examined five QM criteria to determine whether loans made over the past nine years would still be made under the criteria. The report determined that 25 to 42 percent of past mortgages would not meet an illustrative 41 percent debt service-to-income ratio. *See Potential Impacts of provisions in the Dodd-Frank Act on Homebuyers and the Mortgage Market*, GAO Report to Congressional Committees, 19-32 (July 2011).

[9] *See United Cos. Lending Corp. v. Sargeant*, 20 F. Supp. 2d 192, 203 n. 5 (D. Mass. 1998) (citing S. Rep. No. 103-169, at 21 (1993)); *Swanson v. Citibank, N.A., et al.*, 614 F.3d 400, 405 (7th Cir. 2010) (holding that plaintiff had properly stated a Fair Housing Act claim for bank's refusal to underwrite her loan).

variety of communities[10]. The report states that the administration will "work with Congress to ensure that *all* communities and families—including those in rural and economically distressed areas, as well as those that are low- and moderate-income—have the access to capital needed for sustainable homeownership . . ."[11] In other words, the federal government will continue to ensure that lenders are meeting their legal obligations to serve all communities. Thus, it is important that the CFPB reconcile the potential effect of the QM requirements with their intent and mandate to further affordable housing and fair lending goals.

Because the CFPB has taken on the bulk of oversight for a wide range of fair lending statutes, it will bear the brunt of the fair lending impacts of the qualified mortgage requirement. Therefore, prior to finalizing this rule, the CFPB should carefully consider the likelihood that the QM requirements could result in an influx of challenges under fair lending laws.

**Conclusion**

The Dodd-Frank Act authorized significant changes to mortgage lending practices. The ability-to-repay rules and the standards for a qualified mortgage may be the most important as it will form the foundation for mortgage lending for years to come. The QM rule is enormously complex and interlinks with numerous other regulatory standards.

NAHB urges policy makers to consider the long-term ramifications of these rules, and not to place unnecessary restrictions on the housing market. NAHB strongly believes that the ability-to-repay standard must balance both consumer and industry interests. Consumers must have access to affordable credit and responsible lenders should be able to operate in an environment without excessive litigation.

Thank you for the opportunity to participate in this important and timely hearing. NAHB looks forward to working with all stakeholders to develop an effective as well as safe and sound means to provide a reliable flow of housing credit under all economic and financial market conditions.

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[10] *See Reforming America's Housing Finance Market, A Report to Congress A Report to Congress* (February, 2011).
[11] *Id.* at 21.

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# TESTIMONY OF

# SCOTT LOUSER
# 2012 VICE PRESIDENT AND LIAISON TO GOVERNMENT AFFAIRS
# NATIONAL ASSOCIATION OF REALTORS®

# BEFORE THE

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

# HEARING TITLED

# THE IMPACT OF DODD-FRANK'S HOME MORTGAGE REFORMS: CONSUMER AND MARKET PERSPECTIVES

# JULY 11, 2012

## INTRODUCTION

On behalf of the 1.1 million members of the NATIONAL ASSOCIATION OF REALTORS® (NAR), who are involved in residential and commercial real estate as brokers, sales people, property managers, appraisers, counselors, and others engaged in all aspects of the real estate industry, thank you for holding this very important hearing on the impact of Dodd-Frank's home mortgage reforms.

My name is Scott Louser, and I am NAR's 2012 Vice President and Liaison to Government Affairs. I have been a REALTOR® for more than 14 years, and I am the broker \ owner of Preferred Minot Real Estate in Minot, N.D. I have served the REALTOR® community in many capacities from leadership of my local board to Vice-President of my Region to member of the National Associations' Board of Directors. Lastly, I am a current member of the North Dakota State Legislature, representing District 5.

Most economists and housing market analysts in government and in the private sector agree that today's underwriting standards are tight and are contributing to a slow housing recovery. NAR believes that an unnecessarily narrow definition of the Qualified Mortgage (QM) that covers only a modest proportion of loan products and underwriting standards and serves only a small proportion of borrowers would undermine prospects for a housing recovery and threaten the redevelopment of a sound mortgage market.

NAR urges Congress and the Administration to collaborate to construct a broadly-defined QM rule using clear standards. We believe that is the only way to help the economy and at the same time ensure that the largest number of credit worthy borrowers are able to access safe, quality loan products for all housing types, as Congress intended in enacting the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).

### Congressional Intent Calls for Broadly Defined QM

Every version of the Ability to Repay provisions introduced in Congress, including the final version of Dodd-Frank that became law, paired the Ability to Repay Requirement with the QM. The reasoning was that pairing the prospect of liability with an exception for well underwritten, safer, more sustainable loans was the best means of ensuring sound lending for borrowers.

To add incentives for QM lending, the law also added liability for steering consumers from QM to non-QM loans. Further, the Consumer Financial Protection Bureau (CFPB) was given broad flexibility to define the QM in a manner that will "ensure that responsible, affordable mortgage credit remains available to consumers." All of these provisions demonstrate Congress's intent that all creditworthy borrowers – especially low- and moderate-income borrowers and families of color – should be extended the important protections of a QM.

### The Reasonable Ability to Repay Standard

Under the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA or Dodd-Frank Act), no creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination, based on documented and verified information, that the consumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance and assessments. This determination must be made as of the time the loan is consummated.

In making this determination, the creditor must consider and verify a number of factors, such as the borrower's credit history, current income, expected income reasonably assured of being received, current obligations, debt-to-income ratio, employment status, and financial resources other than the real property that secures the loan. The amount of income and assets must be verified by reviewing IRS transcripts of tax returns or another method that effectively verifies income documentation by a third party.

Failure to comply with the "ability to repay standard" subjects the creditor to civil liability that includes minimum statutory damages, and potential class action liability. The statutory damages include the consumer's attorney fees. Further, such failure can be raised at any time as a defense to foreclosure proceeding brought by the holder of the mortgage, whether the holder is the initial lender or an assignee.

**Qualified Mortgage Safe Harbor and Rebuttable Presumption**

Section 1412 of the DFA, entitled "Safe Harbor and Rebuttable Presumption," provides that the creditor may presume that the loan has met the "ability to repay" standard if the loan is a "qualified mortgage" (QM). The statute lists the minimum qualifications for a QM as:

- There is no negative amortization;
- No balloon payments (except in rural or underserved areas);
- No ability to defer payments of principal, e.g., no "interest only" payments;
- Income and financial resources of the borrower are verified and documented;
- The loan is underwritten based on payments reflecting full amortization and takes into consideration all mortgage-related obligations, such as taxes, property insurance and assessments;
- Variable rate loans are underwritten based on the maximum rate permitted in the first five years and a payment schedule that reflects full amortization;
- Complies with any regulatory guidelines on debt-to-income ratios;
- Total points and fees generally do not exceed 3 percent of total loan amount; and
- The term does not exceed 30 years, unless this limit is extended by regulations;
- In the case of a reverse mortgage, meets guidelines established by regulation.

**Significance of QM for Housing Finance**

The QM definition has a very large impact on the availability and cost of housing finance. First, as explained above, a lender making a loan meeting the definition of a qualified mortgage will enjoy at least a presumption of having satisfied the "ability to repay" standard. Anyone making a loan, or purchasing a loan, that is later found to have not met this standard will be subject to significant liability, including the risk that a borrower can raise this issue as a defense to a foreclosure at any time. Thus, even if an originator uses best efforts to comply with the "ability to repay" requirement when making a non-QM loan, the loan will create meaningful liability risks for the originator. Similarly, anyone purchasing a non-QM loan will also face the risk that the borrower can raise the "ability to repay" issue as a defense in any foreclosure action. As a result, both originators and secondary market participants may be very reluctant to make or purchase non-QM mortgages, and if these mortgages are issued, the cost of the mortgage will increase to reflect this risk.

The definition of QM also is linked to the prohibition on "steering" found in section 1403 of the Dodd-Frank Act. This section prohibits mortgage originators from steering customers to a non-QM loan if the customer could obtain a QM loan. For example, even if a consumer specifically asks for a balloon loan, a mortgage originator cannot offer that product if the borrower would qualify for a QM loan that, by definition, cannot include a balloon payment. In order to avoid potential liability for "steering," it is likely that mortgage originators will only recommend QM loans unless very unusual circumstances exist.

The definition of a QM is also important because under the Dodd-Frank Act, it is directly linked to the imposition of a risk retention requirement. Under section 941 of the Dodd-Frank Act, a "securitizer" or a loan originator has to retain an economic interest in a portion of the credit risk transferred to investors through a mortgage-backed security. This requirement is likely to raise the cost of mortgage lending by making the securitization process more costly and cumbersome for loan originators and securitizers. In light of this concern, the statute exempts securitization transactions for "qualified residential mortgages" (QRM), as such term is to be defined in regulations issued by the federal banking agencies, HUD, FHFA and the SEC. However, the Dodd-Frank Act states that the definition of a qualified residential mortgage "can be no broader than the definition [of] a qualified mortgage." Therefore, the definition of a QM directly limits the definition of a QRM, and thereby controls the extent to which the banking agencies, HUD, FHFA and the SEC can expand the scope of mortgages that are not subject to risk retention. In other words, a narrowly defined QM eliminates the ability of the other agencies to have a more inclusive definition of QRM, even if these agencies determined that public policy dictates that risk retention should not apply broadly.

Finally, the definition of a QM loan is linked to the ability to include a prepayment penalty in a mortgage loan. Only a QM may include such a penalty, and in any case the penalty must be phased out over a 3-year period.

As a practical matter, faced with the adverse consequences of making a non-QM loan, explained above, very few non-QM mortgages will be made. Mortgage brokers will face liability for "steering" consumers obtaining non-QM loans, creditors will face liability for failing to comply with the "ability to repay test," and secondary market participants will face the possibility of having to defend against a charge that the loan did not meet the "ability to repay test" for the life of the loan. This alone is likely to make the development of a secondary market for these loans very problematic. This is compounded by the fact that non-QM loans will not qualify for the exemption from risk retention under the QRM test, and cannot contain a prepayment penalty. In light of these impediments, few non-QM loans are likely to be made.

**Regulatory Discretion to Alter QM Requirements**

The Dodd-Frank Act contains explicit authority for the Federal Reserve Board to revise the qualified mortgage definition. This authority was transferred to the Consumer Financial Protection Bureau (Bureau) on July 21, 2011. The statutory authority to modify the QM definition provides:

The [Bureau] may prescribe regulations that revise, add to, or subtract from the criteria that define a qualified mortgage upon a finding that such regulations are necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of this section, necessary and appropriate to effectuate the purposes of this section and section 129B, to prevent circumvention or evasion thereof, or to facilitate compliance with such sections.

This legislative language is ambiguous. The problem is created by the lack of semicolons in the statutory language, which are typically used to separate different alternatives. Without the semicolons, the language is not clear. It can be read as requiring the regulator to make one of three independent findings before issuing regulations, or it can be read as requiring the regulator to make one finding that covers several points.

A review of the legislative history indicates that the second interpretation better reflects Congressional intent. Congress was concerned with the possible adverse consequences of this legislation on mortgage availability, and, therefore, wanted the regulator to consider that factor when issuing regulations to change the criteria for a QM mortgage. Chairman Frank personally guaranteed that this would be included in the bill that passed the House.

**Non-QMs Will Be Less Protective, Less Available and More Expensive**

A narrowly defined QM would put many of today's loans and borrowers into the non-QM market, which means that lenders and investors will face a high risk of an ability to pay violation and even a steering violation. As a result of these increased risks, these loans are unlikely to be made. In the unlikely event they are made, they will be far costlier, burdening families least able to bear the expense. Beyond that, these higher-priced loans would not be required to include important protections against certain practices and the loan features that drove the highest failures in the mortgage boom – negative amortization, interest- only payments and the like— that are embedded in QM.

There is no question that some residential mortgage underwriting standards were too lax during the housing boom, and that strong regulatory standards are needed to make sure that those mistakes are not repeated. We support the establishment of such standards and we believe the establishment of the QM is central to that effort. Rather than narrowing the QM market, we believe the CFPB should work to ensure that the QM market becomes the market. Creating a broad QM, which includes sound underwriting requirements, excludes risky loan features, and gives lenders and investors reasonable protection against undue litigation risk, will help ensure the revival of the home lending market.

**Clear Standards are Critical to Any QM Definition**

Vague parameters for the QM also will add legal uncertainty, increase costs and limit access to credit. If the parameters of the QM are not clear, risks become unpredictable, forcing lenders to decrease their risk tolerance and operate well within the standards. Such an outcome will, lessen both the availability and affordability of credit for far too many borrowers. For these reasons, the CFPB should establish clearly defined standards in the QM definition that are objectively determinable at origination in any QM definition.

The impending Ability to Repay (ATR) Qualified Mortgage (QM) rule will shape access to mortgage credit for the foreseeable future. Even if the rule is done perfectly, it will tighten access to credit in an already tight lending environment. It is critical therefore that Congress and the Administration strongly lean towards maximum consumer access to mortgage credit in the QM. The broadest possible QM with strong legal protections for lenders will ensure maximum access to credit and minimal market disruption.

**3% Cap on Points and Fees Provision**

The "Ability to Repay" provisions of Dodd-Frank include among other provisions, a provision that if a loan's fees and points do not exceed 3%, the loan will be considered a "Qualified Mortgage" (QM). NAR believes that the QM will define the universe of readily available mortgages for a long time to come and non-QM mortgages will be rarely made. The problem is that the calculation of fees and points under the 3% cap discriminates against real estate and mortgage firms with affiliates involved in the transaction. NAR strongly urges Congress to pass H.R. 4323, the 'Consumer Mortgage Choice Act", to correct this discrimination and level the playing field between affiliated and unaffiliated firms and also makes a technical correction that prevents the potential double-counting of compensation against the 3% cap.

The basic definition of fees and points covers what is often traditionally thought of as fees and points in the industry. However, when an affiliate is involved, additional items must also be included under the HOEPA definitions including title charges and money that is held in escrow to pay homeowners insurance and possibly even property taxes. In the case of title charges, this industry is heavily regulated at the state level with 44 states requiring rates to be filed or set by the state so the differences among providers are not likely to be significant. With regard to escrow, those charges are paid to third parties or the state. In both cases, it makes no sense to discriminate against the affiliated lender by making them count these charges toward fees and points when an unaffiliated lender would not.

If these provisions are not corrected, up to 26% of the market or more could be affected. The ultimate effect would be that consumers would be denied the choice of using in house services and there would be less competition in the lending and settlement services industry as well as likely reduced access to credit. The choice of affiliated services has achieved growing popularity over the years and in the most recent Harris Interactive Survey on the topic (December 2010), consumer satisfaction levels were a full 10 points higher for those who used affiliates than for those who did not. Consumers reported that using affiliated services saved them money (78%), made the process more manageable and efficient (75%), prevented things from falling through the cracks (73%), and was more convenient (73%).

**Conclusion**

REALTORS® believe that one of the biggest issues impacting the housing economy is uncertainty in the rules that govern housing finance. This uncertainty impacts all participants in housing finance: lenders, investors, and consumers. Until there is market certainty that encourages the return of private capital, FHA and the GSEs (Fannie Mae and Freddie Mac) will continue to dominate the housing finance system with the taxpayer on the hook.

We believe that a first step to creating certainty in the housing finance system is to broadly define QM so that it encompasses the vast majority of the high quality lending being done today. An effective ability to repay rule that provides strong incentives for lenders to focus on making well-underwritten QMs affordable and abundantly available to all creditworthy borrowers will require both a legal safe harbor for lenders and investors, and a clear, objective definition of the QM that itself is not unduly restrictive. This action, along with correcting the 3% cap on Points and Fees, will ensure that credit and housing services are available and affordable to the consumer. If we are able to get this right, the market will continue its recovery and move toward stability.

NAR thanks you for this opportunity to share our thoughts on the impact of Dodd-Frank's mortgage reforms. As always, the National Association of REALTORS® is at the call of Congress, and our industry partners, to help continue the housing and national economic recovery.

**Testimony of Eric Stein**
Senior Vice President, Center for Responsible Lending

Before the House of Representatives Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

**The Impact of Dodd-Frank's Home Mortgage Reforms: Consumer Market Perspectives**

July 11, 2012

Chairman Capito, Ranking Member Maloney, and Members of the Subcommittee, thank you for inviting me to testify at today's hearing.

I am Senior Vice President of the Center for Responsible Lending (CRL). CRL is affiliated with Self-Help, a nonprofit community development lender that creates ownership and economic opportunity, for which I also serve as Senior Vice President. Self-Help has provided $6 billion in financing to 70,000 homebuyers, small businesses and nonprofits and serves more than 80,000 mostly low-income families through 25 retail credit union branches. CRL is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. In between two periods of employment at CRL and Self-Help, I served as Deputy Assistant Secretary for Consumer Protection at the U.S. Department of the Treasury from 2009 to 2010.

The ongoing foreclosure crisis is dramatic in its reach and is a constant reminder of why we need the reforms in the Dodd-Frank Wall Street Reform and Consumer Protection Act, including regulatory reforms to better protect consumers from harmful financial practices and the mortgage market reforms in Title XIV. According to a CRL analysis, from early 2007 through the end of 2011, approximately 10.9 million homes had started the foreclosure process.[1] Millions more Americans are current on their mortgage but owe more than the home is worth as a result of decreased property values. While today's hearing is not focused on the foreclosure crisis itself, the reforms in Title XIV and the establishment of the Consumer Financial Protection Bureau (CFPB) are crucial to preventing future turmoil in the housing and financial markets similar to the experience of recent years.

In addition to providing further context to the mortgage market improvements made in Dodd-Frank, my testimony today will also touch on the Ability-to-Repay and Qualified Mortgage

[1] CRL calculation based on MBA National Delinquency Survey from 2007q1 through 2001q4, scaled to reflect market coverage. As per MBA's claims, we assume 85% market coverage for 2007a1-2010q2 and 88% coverage for 2010q3 and after.

(QM) rulemaking currently being conducted by CFPB. In the years before the crisis lenders often failed to determine whether a borrower had an ability to repay their mortgage – in addition to offering mortgages with harmful features. Dodd-Frank now requires lenders to assess a borrower's ability to repay their mortgage. Additionally, the Qualified Mortgage concept was included in Dodd-Frank to establish default mortgage standards that lenders can use to demonstrate a borrower's ability to repay the mortgage. Along with The Clearing House Association[2], which is owned by banks comprising a significant share of the mortgage market, the Consumer Federation of America, and The Leadership Conference on Civil and Human Rights, CRL submitted joint recommendations to the CFPB on designing this rulemaking. These joint recommendations are attached as an appendix to this testimony.

In discussing the QM rulemaking, I will touch on three inter-related recommendations:

- **Qualified Mortgage should be broadly defined:** We recommend a broad definition that includes the current conventional mortgage market, because creditworthy borrowers should benefit from the substantial protections – fees no greater than 3 percent, prohibiting balloon payments, interest only payments, negative amortizations, and unaffordable teaser ARMs – that are included for QM loans. Additionally, a broad QM definition will protect against shrinking the current conventional mortgage market.

- **Qualified Mortgage should include the use of clear, bright line standards:** The Qualified Mortgage definition should also use clear, bright line standards instead of guiding principles that provide less clarity about whether an individual mortgage should count as a Qualified Mortgage. Bright line standards will provide easy-to-understand rules of the game so everyone will know if a loan is a QM or not. This is good for both lenders and borrowers.

- **Rebuttable presumption standard, not a lender safe harbor:** A broad Qualified Mortgage definition using clear, bright line standards should also have a rebuttable presumption and not a safe harbor. Putting in place a rebuttable presumption hurdle for borrower litigation gives lenders a considerable litigation advantage but allows a borrower to bring a case when there is a rare, starkly unaffordable QM loan and strong evidence available at the outset.

[2] The Clearing House Owner Banks are: Banco Santander, Bank of America, The Bank of New York Mellon, BB&T, Capital One, Citibank, Comerica, Deutsche Bank, HSBC, JPMorgan Chase, KeyBank, PNC, RBS Citizens, UBS, U.S. Bank, Union Bank, and Wells Fargo.

1. **Harmful mortgage features and lending practices were prevalent in the pre-crisis mortgage lending market and led to massive foreclosures.**

In the fallout of the foreclosure crisis, the alphabet soup of harmful lending products and practices – such as YSPs, IOs and NINJA loans – is now well known. Many of these features and practices were at one time touted as innovations to serve borrowers. As the foreclosure crisis has made plain, such rhetoric has failed to match reality.

Over the last ten years, CRL has produced research highlighting the increased foreclosure risk posed by abusive lending practices. In 2006, which pre-dated the worst of the foreclosure crisis, CRL released a report estimating that abusive and predatory lending would lead to approximately 2.2 million foreclosures among subprime mortgages.[3] At the time, our report was denounced by the mortgage industry as absurdly pessimistic. As we all now know, the system was loaded with much more risk than CRL originally reported.

At the end of last year, CRL released a report entitled *Lost Ground* that builds on our pre-crisis research and confirms the link between risky mortgage features and foreclosure rates. For mortgages originated between 2004 and 2008, this research shows that loans originated by a mortgage broker, containing hybrid or option ARMs, having prepayment penalties, and featuring high interest rates (i.e., subprime loans) were all significantly more likely to be seriously delinquent or foreclosed upon than a 30-year fixed-rate mortgage without a prepayment penalty.

CRL's research also demonstrates that African-American and Latino borrowers were much more likely to receive mortgages with these harmful features. For example, African-American and Latino borrowers with FICO scores above 660 were **three times** as likely to have a higher interest rate mortgage than white borrowers in the same credit range.[4] Although the majority of foreclosures have affected white borrowers, *Lost Ground* confirms that African- American and Latino borrowers have faced a disproportionate number of foreclosures and delinquencies than white borrowers within every income range.

The foreclosure crisis could have been prevented, but it wasn't, and it bears revisiting in more detail the kind of harmful lending practices that fueled the crisis still affecting communities across the country.

- **2/28s and other ARMs:** Adjustable rate mortgages (ARMs) – including "2/28s" where starter rates reset after the first two years – were widespread in the years leading up to the foreclosure crisis. These 2/28s and other ARMs led to payment shocks for many

[3] *See* Ellen Schloemer, Wei Li, Keith Ernst, and Kathleen Keest, *Losing Ground: Foreclosures in the Subprime Market and Their Costs to Homeowners*, (December 2006), available at http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosure-paper-report-2-17.pdf
[4] *Id.*

households who were unprepared for higher monthly payments once the interest rates increased. As of 2009, subprime mortgages with short-term hybrid ARMs had serious delinquency rates of 48 percent compared to 21 percent for subprime fixed-rate mortgages and 36 percent for the total universe of active subprime mortgages.[5] In fact, were it not for the Federal Reserve lowering interest rates to historically low levels following the financial crisis, it's easy to imagine the payment shock from expiring teaser rates leading to an even higher number of foreclosures than has occurred so far.

A related product called interest-only (IO) ARMs let borrowers make interest only payments during an introductory period, which jeopardized any ability to build equity as well as leading to payment shock for borrowers once the loan started amortizing over a reduced loan life. Going even further, payment option ARMs (POARMs) allowed borrowers to make monthly payments where the amount paid could vary from month-to-month, including payment amounts that did not cover the full interest due. This resulted in negative amortization. Too many lenders structured these loans so that the payments would substantially increase in five years or less when borrowers hit their negative amortization cap, underwrote the loans only to the very low introductory teaser rate, and failed to document income.

- **Prepayment penalties:** Many borrowers facing payment shock from increased interest rates once an introductory period ended also faced penalties when trying to exit into a new mortgage or to sell the property. These prepayment penalties are a feature associated with a higher likelihood of default,[6] and were present in the great majority of subprime mortgages, and increasingly in Alt-A mortgages (which generally consisted of limited documentation mortgages to higher credit score borrowers), during the mortgage boom.[7] To avoid default, the typical subprime borrower had to sell or refinance before the rate reset. This produced prepayment penalties, generally equal to six months' interest—typically 3.5 percent to 4 percent of the loan balance. Because the average borrower did not have the cash on hand sufficient to cover the prepayment penalties and refinancing fees, they had to pay them from the proceeds of the new loan. This produced ever-declining equity even when home prices were rising. Once home prices declined, foreclosure risk climbed catastrophically.

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[5] *See GAO Nonprime Mortgages: Analysis of Loan Performance, Factors Associated with Defaults, and Data Sources*, at 12-13 (August 2010) (available at http://www.gao.gov/assets/310/308845.pdf).

[6] *See, e.g.*, Lei Ding, Roberto G. Quercia, Wei Li, Janneke Ratcliffe, *Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Score Models*, at 49 (Working Paper: May 17, 2010) (stating "[w]e also found that subprime loans with adjustable rates have a significantly higher default rate than comparable CAP loans. And when the adjustable rate term is combined with the prepayment-penalty feature, the default risk of subprime loans becomes even higher.") (available at http://www.ccc.unc.edu/documents/Risky.Disaggreg.5.17.10.pdf).

[7] See *Report to Congress on the Root Causes of the Foreclosure Crisis*, U.S. Department of Housing and Urban Development, Office of Policy Development and Research, at 23 (January 2010) (citing Demyanyk, Yuliya, and Otto Van Hemert. 2008. Understanding the Subprime Crisis. Working paper. St. Louis, MO: Federal Reserve Bank of St. Louis.) (available at http://www.huduser.org/Publications/PDF/Foreclosure_09.pdf).

- **No-doc or low-doc loans:** The practice of failing to document a borrower's income and assets was also prevalent in the subprime and Alt-A market. For example, low-doc loans comprised 52 percent of Alt-A originations in April 2004 and rose to 78 percent at the end of 2006.[8] By 2006, no-doc or low-doc loans made up *27% of **all** mortgages*.[9] These loans without proper documentation were frequently underwritten with inflated statements of the borrower's income.[10] Lawyers representing borrowers in predatory lending cases often found the borrower's tax returns included in the file of those who were nevertheless given "no doc" or "low doc" loans. Unbeknownst to these borrowers, they paid higher interests rate for the "privilege" of receiving a no-doc loan, even where they provided full documentation to the broker.

- **Yield Spread Premiums:** The proliferation of mortgages with these harmful features was driven in significant part by the use of yield spread premiums (YSPs) as a way to compensate mortgage brokers. Because YSPs paid mortgage brokers higher payments when a mortgage had a higher interest rate than the borrower qualified for, these YSPs gave mortgage brokers incentives to steer borrowers into loans that were more expensive and less stable than they qualified for. And, by 2006, mortgage brokers accounted for 45 percent of all mortgage originations and 71 percent of all non-prime mortgage originations.[11] In fact, most borrowers who received subprime loans could have qualified for better, more sustainable loans. Many qualified for lower-cost prime loans[12]; those who did not often would have qualified for sustainable, 30-year fixed-rate subprime loans for at most 50-80 basis points above the introductory rate on the unsustainable

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[8] Rajdeep Sengupta, *Atl-A: The Forgotten Segment of the Mortgage Market*, Federal Reserve Bank of St. Louis *Review*, January/February 2010, 92(1), pp. 55-71 at 60 (available at http://research.stlouisfed.org/publications/review/10/01/Sengupta.pdf).

[9] *See* Financial Crisis Inquiry Commission, *Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States* at 165 (Jan. 2011) [hereinafter *FCIC Report*], available at http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf.

[10] Over ninety percent of a sample of stated income loans exaggerated income by 5 percent or more and almost 60 percent exaggerated income by over 50 percent. Mortgage Asset Research Institute, Inc, Eighth Periodic Mortgage Fraud Case Report to Mortgage Bankers Association at 12 (April 2006), (available at http://www.mortgagebankers.org/files/News/InternalResource/42175_Final-8thAnnualCaseReporttoMBA.pdf)..

[11] Ren S. Essene & William Apgar, *Understanding Mortgage Market Behavior: Creating Good Mortgage Options for All Americans* at 8 (Joint Center for Housing Studies, Harvard University Apr. 25, 2007) (citing Mortgage Bankers Association, *MBA Research Data Notes: Residential Mortgage Origination Channels* (2006) (available at http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/mm07-1_mortgage_market_behavior.pdf).

[12] For example, a *Wall Street Journal* study found that 61 percent of the subprime loans originated in 2006 that were packaged into securities and sold to investors "went to people with credit scores high enough to often qualify for conventional [i.e., prime] loans with far better terms." *See* Rick Brooks & Ruth Simon, "Subprime Debacle Traps Even Very Credit-Worthy As Housing Boomed, Industry Pushed Loans To a Broader Market," *Wall Street Journal* at A1 (Dec 3, 2007). Freddie Mac estimated in 2005 that more than 20 percent of borrowers with subprime loans could have qualified for prime. *See* Mike Hudson & E. Scott Reckard, "More Homeowners With Good Credit Getting Stuck With Higher-Rate Loans," Los Angeles Times (Oct. 25, 2005), available at http://articles.latimes.com/2005/oct/24/business/fi-subprime24.

"exploding" ARM loans they were given.[13] This 50-80 basis point increase is modest compared with the 350 to 400 basis point prepayment penalty (plus additional refinancing fees) that the borrower had to pay to refinance the typical 2/28 loan before the end of the second year.

- **No Escrows for Taxes and Insurance:** Subprime lenders commonly did not escrow for taxes and insurance, attracting borrowers with the deceptive lure of lower monthly payments. This practice increased the risk of default twice a year when the tax and insurance bills came due and produced further equity-stripping cash-out refinancings where the borrower had the equity to cover the bills and refinancing fees and penalties.

On top of these harmful loan features and lending practices, many lenders also failed to determine whether a borrower had an actual ability to repay their mortgage. Proper underwriting is particularly important for mortgages with resetting interest rates or negative amortization or interest-only payments (or all of the above) to ensure that borrowers can afford the larger monthly payments when they kick in down the road. However, for many mortgage originators, this straightforward underwriting never happened. For example, at the time when Federal regulators proposed that lenders fully underwrite mortgages with ARMs, interest-only and negative amortization features at the fully indexed rate and payment, Countrywide estimated that 70% of their recent borrowers would be unable to meet this standard.[14] This recklessness set borrowers up for failure and, as a result, caused a foreclosure crisis.

**2. Regulatory failures leading up to the crisis demonstrate the need for the Consumer Financial Protection Bureau.**

Federal regulators should have been able to reign in the worst practices in the private market in the years leading up to the burst of the housing market bubble and the beginning of the foreclosure crisis. Instead, federal regulators aided and abetted the lending binge, ignoring the inherently risky practices in the marketplace. The agencies responsible for protecting depositors, shareholders, taxpayers, borrowers, and the general financial market stood by as predatory practices and dicey lending became commonplace, ravaging the mortgage market and setting off a chain reaction of financial devastation.

During these years of lax regulation, the private market essentially engaged in a failed experiment on conducting wide scale mortgage lending outside of government oversight. From

[13] January 25, 2007 letter from the Coalition for Fair and Affordable Lending ("CFAL") to Ben S. Bernanke, Sheila C. Bair, John C. Dugan, John M. Reich, JoAnn Johnson, and Neil Milner, at 3. CFAL was an industry group representing subprime lenders.
[14] Countrywide Financial Corporation, "3Q 2007 Earnings Supplemental Presentation," Oct. 26, 2007.

mortgage brokers to bankers on Wall Street to credit ratings agencies acting as rubber stamps, the private-market created a securitization system for private label mortgage-backed securities that was designed for failure and largely unregulated.

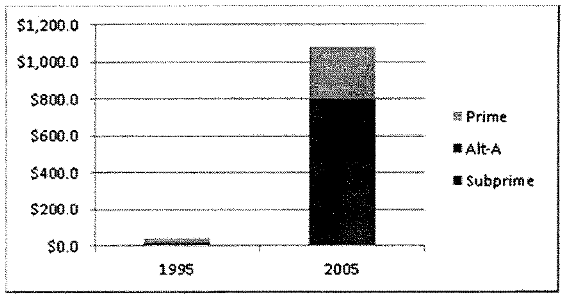
The private label securitization (PLS) chain started with originators that were often steering borrowers into higher cost and riskier loans than they qualified for. This included an increasing number of mortgage brokers incented by yield spread premiums. CRL released a study in 2008 showing that brokered loans, when compared to direct lender loans, cost subprime borrowers additional interest payments ranging from $17,000 to $43,000 per $100,000 borrowed over the scheduled life of the loan.[15] Even over a fairly typical four-year loan term, the subprime consumer paid over $5,000 more for brokered loans.[16]

Market participants readily admit that they were motivated by the increased fees offered by Wall Street firms in return for riskier loans. After filing for bankruptcy, the CEO of one mortgage lender explained it this way to the *New York Times*, "The market is paying me to do a no-income-verification loan more than it is paying me to do the full documentation loans...What would you do?"[17] Beginning in 2000, subprime lender New Century implemented a plan that "concentrated on 'originating loans with characteristics for which 'whole loan buyers' [i.e., Wall Street firms] will pay a high premium,'" and increased its sale of loans from $3.1 billion in 2000 to $20.8 billion in 2003.[18]

These unsustainable mortgages helped expand the housing bubble and primed the financial system for the 2008 financial crisis. Leading up to the foreclosure crisis there was a substantial and rapid increase in the volume and share of non-prime mortgage originations. As the chart below illustrates, the growth in the PLS market was heavily driven by subprime loans, which increased from $17.6 billion to $464 billion between 1995 and 2005, and Alt-A loans, which though virtually non-existent in 1995, reached $333.6 billion by 2005.

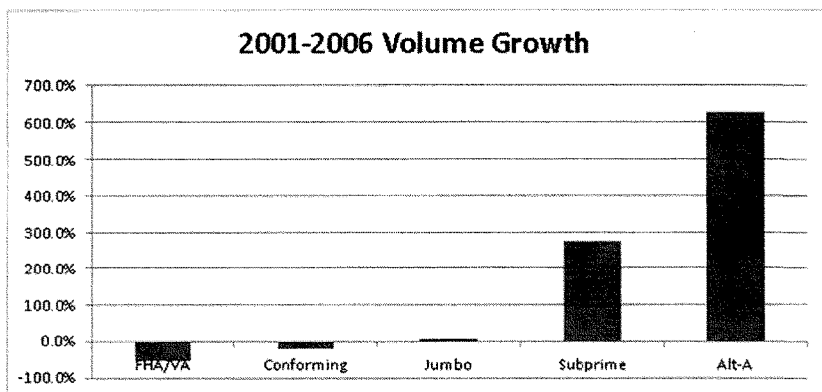
[15] *See generally* Keith Ernst, Debbie Bocian & Wei Li, *Steered Wrong: Brokers, Borrowers, and Subprime Loans*, (Center for Responsible Lending Apr. 8, 2008), available at http://www.responsiblelending.org/mortgage-lending/research-analysis/steered-wrong-brokers-borrowers-and-subprime-loans.pdf.
[16] *Id.* at 14 (explaining that a typical subprime borrower who received a brokered loan paid $5,222 more in interest during the first four years of a $166,000 mortgage compared to a similar borrower who did not use a broker).
[17] Vikas Bajaj & Christine Haughney, "Tremors at the Door: More People with Weak Credit Are Defaulting on Mortgages," *New York Times* (Jan. 26, 2007), (available at http://www.nytimes.com/2007/01/26/business/26mortgage.html).
[18] *FCIC Report* at 89 (citing *In re: New Century TRS Holdings, Chapter 11*, Case No. 07-10416 (KJC) (Bankr. D.Del. February 29, 2008) (Final Report of Michael J. Missal, Bankruptcy Court Examiner at 42)).

**Non-Agency Issuance of Mortgage Backed Securities (in $billions)**




**Source: CRL calculations based on data from**
**http://www.fdic.gov/bank/analytical/regional/ro20063q/na/2006_fall01_chart02.html**

Additionally, as the subprime and Alt-A markets rapidly grew in size from 2001-2006, the volume of conforming (i.e., loans purchased by Fannie Mae or Freddie Mac) and government-backed mortgages actually decreased.




**Source: CRL calculations of data from Inside Mortgage Finance's**
**2008 Mortgage Market Stastistical Annual, Volume 1.**

The subprime and Alt-A originations bundled into private label mortgage-backed securities have failed at much greater rates than GSE-backed mortgages – even the ill-advised GSE Alt-A mortgages that have caused their greatest losses. While the GSEs generally required strict underwriting (until they followed the private market in to the no-doc fray by purchasing Alt-A loans), and used standardized forms, documents and financial models to provide stability and liquidity in the secondary market, subprime originators, backed by private securitizations, did not have such standards or homogeny. And, private label securitization was responsible for 42% of all serious delinquencies through 2009, despite accounting for only 13% of all outstanding loans. In contrast, Fannie Mae and Freddie Mac, which had a combined share of 57% of loans outstanding, accounted for only 22% of serious delinquencies.[19]

Although the failure of toxic subprime and Alt-A mortgages bundled in private-label mortgage-backed securities sparked the foreclosure crisis, the wider economic impacts of the 2008 financial crisis, particularly widespread unemployment, led to an increase in delinquencies for other mortgages as well, including prime fixed-rate mortgages.[20]

It was in the context of these massive federal regulatory and private market failures that Congress enacted Dodd-Frank, which included the creation of an independent CFPB. By establishing the CFPB, Congress wisely consolidated the consumer protection functions of the federal prudential regulators into an independent agency with a mission to protect borrowers from abusive financial practices. These consolidated consumer protection responsibilities include broad rule-writing authority as well as supervision and enforcement authority. Although its supervision authority only extends over depositories with more than $10 billion in assets, it also supervises payday lenders, mortgage-related companies, private student lenders, and other large non-bank entities.

Creation of the CFPB was the correct response to the regulatory failures that permitted these destructive mortgage lending practices to continue. Subprime abuses first developed in the non-bank sector with large subprime lenders, which had no federal regulator to mind the store. The same was true with mortgage brokers and servicers. A race to the bottom ensued, where bank practices progressively deteriorated as banks struggled to compete. Instead of stepping in, safety and soundness regulators failed to prioritize consumer protection and looked the other way. In addition, no federal regulator was charged with using its research capacity to look across the financial system and identify emerging risks to consumers such as the rapid build-up of subprime and Alt-A lending. CFPB has just this charge, along with the responsibility to supervise non-bank and large bank mortgage lenders. Going forward, we will need this capability.

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[19] James B. Lockhart, "FHFA's First Anniversary and Challenges Ahead," Speech before the National Press Club, July 30, 2009. (available online at http://www.fhfa.gov/webfiles/14715/FHFA1stAnnSpeechandPPT73009.pdf ).
[20] *See, e.g., FCIC Report* at 216 ("Prime fixed-rate mortgages, which have historically been the least risky, showed a slow increase in serious delinquency that coincided with the increasing severity of the recession and of unemployment in 2008.)

**3. Dodd-Frank reforms will help prevent reckless mortgage lending from returning to the mortgage market.**

The Mortgage Market Reform and Anti-Predatory Lending Act, which is Title XIV of Dodd-Frank, is an important step forward in reigning in harmful lending practices. These are basic reforms to ensure that the mortgage market remains focused on sound underwriting and sustainable lending.

As a result of the new law, loan originators such as mortgage brokers can no longer receive more compensation for putting borrowers in higher rate loans than they qualify for – compensation cannot vary according to the terms and conditions of the loan (except for principal balance). Prepayment penalties that lock borrowers into bad loans are significantly restricted. No-doc lending is prohibited. Escrows of taxes and insurance are required for higher interest rate loans (except for rural community banks). Up-front fees are limited to 5 percent or the loan becomes a disfavored HOEPA loan (though interest rates can rise to 6.5 percent over conventional rate without the loan hitting these limits). Loans must be underwritten to the fully indexed rate.

If Title XIV had been in place earlier, there never would have been a crisis, and millions of Americans would not have lost trillions of dollars of wealth or their jobs. Rather than stifling legitimate lending, these reforms will provide a level playing field and sensible rules of the road so that we will avoid the constriction of credit we're facing now that invariably follows a crisis. These are reforms for the long-term to prevent future abusive lending and foreclosure waves from resurfacing. If Congress were to reverse or weaken Title XIV, we could return to a marketplace where short-term gains prevail over the long-term financial stability of both our markets and household balance sheets.

The costs of the current crisis confirm that such a reversal would be a mistake. CRL's *Lost Ground* analysis shows that as of February 2011, about 3.6 million homeowners with mortgages made between 2004 and 2008 were delinquent or already in foreclosure. This is in addition to the millions who have already lost their homes to foreclosure, and the over 16 million homeowners who are currently underwater on their mortgage.[21] In other words, those who suggest that Dodd-Frank is unnecessary are being shortsighted.

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[21] Tiffany Hsu, *Zillow: 31.4% of U.S. homeowners are underwater on mortgages*, Los Angeles Times (May 24, 2012) (available at http://www.latimes.com/business/money/la-fi-mo-zillow-underwater-20120524,0,165710.story); Stan Humphries, *Despite Home Value Gains, Underwater Homeowners Owe $1.2 Trillion More than Homes' Worth*, Zillow Real Estate Research (May 24, 2012) (available at http://www.zillow.com/blog/research/2012/05/24/despite-home-value-gains-underwater-homeowners-owe-1-2-trillion-more-than-homes-worth/).

One of the main reforms in Title XIV is a straightforward and good one. Section 1411 requires lenders to make a reasonable and good faith determination on whether the borrower has an ability to repay the offered mortgage. Said a different way, this section requires lenders to do the basic underwriting that so often failed to happen in the years leading up to the crisis. In making its determination on whether the borrower has an ability to make the monthly payments, this section requires the lender to look at a fully amortizing payment schedule.

It's important to highlight that the Ability-to-Repay section does *not* require lenders to predict the future. By this I mean that Dodd-Frank only states that lenders must determine whether *at the time the loan is consummated* there is an ability to repay and make the monthly payments. This means that lenders are not responsible for predicting whether widespread layoffs are going to happen several years in the future or whether a borrower might become ill and have to cut back his or her hours.

Additionally, I want to emphasize that the Ability-to-Repay requirement does not prevent lenders from also – and separately – considering whether borrowers have a willingness or propensity to repay a mortgage. In other words, the ability to repay factor is just one part of a lender's underwriting decision making process. Lenders may use other, although non-discriminatory, factors to determine whether to offer a borrower a mortgage, and this is not restricted by the Ability-to-Repay requirement in Dodd-Frank.

Dodd-Frank also establishes a category of mortgages called Qualified Mortgages (QM), which is a default standard that lenders can use to demonstrate that the borrower has an ability to repay the mortgage. This designation has benefits for lenders and borrowers. For lenders, it makes it significantly easier to demonstrate compliance with their Ability-to-Repay determination and substantially reduces the risk of investor buy-back claims and borrower litigation. Reduced exposure to buy-back claims is a substantial lender benefit that should not be underestimated. For borrowers, the QM category means they can avoid a list of risky mortgage features that are either prohibited or restricted, including interest only loans, loans with negative amortization, and balloon payment loans. Additionally, lenders must underwrite all ARMs by looking at the maximum interest rate that could apply during the first five years of the mortgage and fully amortize the remaining payments. The allowable points and fees that lenders can charge on QM loans are also limited to 3 percent.

These Ability-to-Repay and Qualified Mortgage reforms will lead to improvements in the mortgage market's long-term stability by reducing the likelihood of unaffordable and predatory mortgages.

**4. The CFPB should establish a broad Qualified Mortgage definition using clear, bright lines that also includes a rebuttable presumption and not a safe harbor.**

The Consumer Financial Protection Bureau is currently engaged in the rulemaking process to define what counts as a Qualified Mortgage and to implement the overall Ability to Repay requirements in Title XIV. The CFPB recently took the prudent step of reopening the comment period on this rulemaking to get additional data analysis to assist in defining a Qualified Mortgage, and this comment window closed earlier this week on July 9, 2012. As the CFPB recognizes, it is much more important for them to get this rulemaking right, using the best data available, than to finish it six months earlier. This reopened comment period does not interfere with the January 2013 deadline established in Dodd-Frank. When finalized, this rulemaking will have the ability to ensure that homeowners have broad access to 30-year, fixed-rate or long-term ARM fully-amortizing loans with limited fees instead of products with high fees and deceptive terms that borrowers cannot afford.

There are three aspects to how CRL – along with the Consumer Federation of America, The Clearing House Association, and The Leadership Conference on Civil and Human Rights – believe that Qualified Mortgage should be defined. First, we support creating a broad definition that will encompass the entire currently constrained market with room for additional lending beyond today's levels. Second, we support using clear, bright line standards – on issues such as back end debt-to-income ratio and cash reserves – in delineating this broad definition. Third, we support establishing a rebuttable presumption for borrowers to contest the presumption in the limited situations where a lender should have reasonably known at the time the loan was made that a borrower could not afford the mortgage.

For the rule to function as a whole, each of these three prongs must be present. I address each in more detail below.

**A. Qualified Mortgage should be broadly defined.**

On the issue of whether the CFPB should use a broad or narrow definition of Qualified Mortgage, we strongly support a broad definition that includes the current conventional mortgage market. More specifically, we support establishing a broad QM definition where lenders can use a number of well-established underwriting factors.

A broad QM definition is key to this rulemaking. First, creditworthy borrowers should benefit from the substantial protections included in QM mortgages. These protections include fees no greater than 3 percent, prohibiting balloon payments, interest only payments, negative amortizations, and unaffordable teaser ARMs. A narrow QM definition that uses an unnecessarily low debt-to-income ratio would push creditworthy borrowers, including many low-income borrowers and borrowers of color, into the non-QM market. This would harm borrowers – and potentially recreate a dual mortgage market – because non-QM mortgages could still have harmful features in addition to likely being more expensive.

Second, without a broad QM definition, the overall size of the lending market is likely to shrink. Lenders are likely to scale back lending for mortgages that do not qualify as QM, because of increased litigation risks, including possible buy-back claims, for non-QM loans. Therefore, if creditworthy borrowers are pushed out of the market for QM loans, the non-QM market is not likely to pick up the slack. This will needlessly leave creditworthy borrowers with restricted access to credit. This problem is avoidable, however, if a broad QM definition is adopted.

**B. Qualified Mortgage should include the use of clear, bright line standards.**

The Qualified Mortgage definition should also use clear, bright line standards instead of guiding principles that provide less clarity about whether an individual mortgage should count as a Qualified Mortgage. Bright line standards will provide easy-to-understand rules of the game so everyone will know if a loan is a QM or not, and they can be set in a way that does not overly restrict the QM market. This is good for both lenders and borrowers.

Using bright line standards requires creating some cut off points, and we think this can be done in a nuanced way that incorporates traditional underwriting techniques. Our joint proposal with the Consumer Federation of America, The Clearing House Association, and The Leadership Conference on Civil and Human Rights recommended a two-step process for evaluating a borrower's total debt-to-income (DTI) ratio. In step one, the borrower meets the DTI test if they fall below an initial DTI limit, which we stated should be 43 percent and is the Federal Housing Administration's current manual underwriting limit. In step two, lenders can review a list of compensating factors like cash reserves, low housing payment, lack of payment shock with demonstrated payment history, and residual income for those borrowers above the initial DTI limit. If the borrower meets one of the compensating factors, then they meet this part of the QM definition.

This above approach strikes the right balance in creating a QM standard. It will be straightforward for lenders to implement since it uses common underwriting factors. In addition, it does not create the problem of having a narrow QM definition where the DTI threshold is too low and unnecessarily excludes creditworthy borrowers from the QM market.

### C. A broad Qualified Mortgage definition using clear, bright line standards should also have a rebuttable presumption and not a safe harbor.

On the last issue, the CFPB should establish a rebuttable presumption that borrowers would need to overcome in order to raise a challenge about the affordability of a QM loan. Not only does this structure follow the statutory language, but it also makes sense when creating a broad Qualified Mortgage that is defined using clear, bright line standards. In this structure, lenders get considerable benefits from a broadly defined QM market even though we know that some loans will be unaffordable for some borrowers, not least of which is reduced liability exposure from investor buy-back claims. If QM is defined narrowly, then lenders will retain extensive buy-back risk on all non-QM loans, to the extent that they make non-QM loans at all. The prospect of buy-back risk with a narrow QM definition far exceeds the borrower litigation risks that lenders would face with a broad QM definition and rebuttable presumption standard.

Putting in place a rebuttable presumption hurdle for borrower litigation gives lenders a considerable litigation advantage but allows a borrower to bring a case when there is a rare, starkly unaffordable QM loan and strong evidence available at the outset. With all three pieces in place, the Qualified Mortgage system will provide the market with widespread access to affordable and safe credit, lenders will have certainty due to the bright line standards and reduced litigation risk, and borrowers will have access to good loans with the ability to raise claims in rare, extreme cases. This overall system is one that will work for the entire market, and one supported by major lenders in the joint recommendations attached as an appendix to this testimony.

Straying from these inter-related recommendations will be harmful for the market and for borrowers. If the QM market is narrow, not broad, a safe harbor would be of limited use to lenders. If QM is defined fuzzily rather than with bright lines, there could be significant litigation over whether a loan is QM or not. Additionally, a safe harbor standard would prevent borrowers from bringing any claim concerning an unaffordable QM loan even in situations where the lender has acted in bad faith.

Thank you for the opportunity to testify today, and I look forward to answering your questions.

Appendix

**Ability-to-Repay ("ATR") Analysis and Qualified-Mortgage ("QM") Determination**

**DISCUSSION DRAFT**

**by**

**Center for Responsible Lending**
**The Clearing House Association**
**Consumer Federation of America**
**Leadership Conference on Civil and Human Rights**

**For a Meeting With**

**Consumer Financial Protection Bureau**

**on**

**March 7, 2012**

This document represents consensus recommendations concerning the ability-to-repay ("**ATR**") and qualified-mortgage ("**QM**") requirements of Dodd-Frank. These recommendations are interrelated and dependent upon each other.

**1.0 Qualified Mortgage**

Congress intended QMs to comprise the vast bulk of the mortgage market, and they should. QM loans by statute have safer features associated with responsible lending and lower default rates than loans without those features, such as limited fees, full amortization, and limited terms. Congress gave loans with these features a litigation advantage precisely to incent lenders to make QM loans.

If the QM definition is construed narrowly, it will be more difficult for low-income and minority families to qualify for safer loans, and, to the extent that mortgage credit is available to them at all, many of these borrowers will be left to the part of the market where they will be significantly more vulnerable to equity stripping through high fees and bad practices. A large non-QM market would not by its size alone protect consumers, and the broad availability of loan features that experience has shown to entail greater risks for consumers and investors will add to costs without providing commensurate consumer benefits.

By contrast, a broad definition of QM would combine prudent lending with less litigation, benefiting homeowners, investors and lenders alike. It would also support access to credit, since secondary market standards are very likely to require loans to be QM.

**2.0 Ability-to-Repay Determination**

**2.1 General standards**

**Statutory requirement**

The statute states that "no creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance (including mortgage guarantee insurance), and assessments." TILA Section 129C(a)(1).

**The ability-to-repay analysis should be based on factors that reflect capacity to repay as of the time of consummation, not willingness or propensity to repay.**

- The determination of ability to repay is separate and distinct from the underwriting decision, which properly includes factors other than just ability to repay.

- The regulations and accompanying commentary should clarify that:

    - the statutory ATR analysis concerns the borrower's capacity (the statute uses the term "ability") to repay a loan through current income, assets (other than the home), and funds available, not the propensity to make such payments.

    - other factors unrelated to ATR that influence the credit decision (e.g., credit score, LTV, appraisal) should not be used by creditors in establishing the borrower's ATR or in challenging a creditor's determination of ATR.

    - while the statute refers to a consumer's "credit history," this reference was intended to ensure only that a lender obtained a consumer's credit report (which contains the consumer's credit history) to verify the consumer's debts and associated monthly obligations,[1] not that lenders should use the credit history or credit report to otherwise determine the borrower's ability to repay. Otherwise, it would make no sense that QM establishes a rebuttable presumption of ATR when QM does not discuss creditworthiness.

- The CFPB should adopt the portion of proposed commentary Paragraph 43(c)(1)-1, which clarifies that a creditor is required to "determine that a consumer will have a reasonable ability *at the time the loan is consummated* to repay the loan" (emphasis added). A change in a consumer's circumstances after consummation of the loan is not relevant to determining compliance with the rule, unless such events are documented in the consumer's application or by information provided by the consumer reasonably prior to consummation of the loan. For example, the creditor must consider the potential impact of a consumer's impending retirement and the consumer's ability to repay if the consumer's application contains a notation that the consumer plans to retire six months after the loan is made. However, a significant reduction in income due to a job loss that occurs after consummation or a significant obligation arising from a major medical expense arising after

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[1] The proposal would require, as part of an ability-to-repay determination, a consumer's credit history. Proposed Regulation section 226.43(c)(2)(vi); Proposed Commentary Paragraph 43(c)(2)(viii). This improperly conflates the full underwriting analysis that all lenders must undertake in order to ensure safe and sound underwriting practices—which includes assessing creditworthiness, loan-to-value ratios, and other factors—with the statute's requirement to consider the borrower's capacity to repay. An analysis of a borrower's ability to repay a debt is simply one important part of a lender's full underwriting analysis.

the loan is consummated would not be relevant to an ability to repay challenge. *See* Paragraph 43(c)(1)-1.

**The regulation and commentary should require creditors to verify and document income, assets, and debts using third-party sources.**

- **Income or assets:** The final rule should adopt the proposed regulatory provisions and commentary that require verification of income or assets using third-party documentation that provides reasonably reliable evidence of the consumer's income or assets and that permit creditors to consider expected income if it is reasonable and documented. Proposed Rule section 226.43(c)(4); Proposed Commentary Paragraph 43(c)(2)(i)-1; Proposed Commentary Paragraph 43(c)(2)(i)-3. Dodd Frank requires that income and assets be appropriately documented and verified. However, this requirement can pose barriers to obtaining credit for some borrowers who have non-traditional or alternative income sources, such as boarder income and informal self-employment income, which is more difficult to document and verify. Since CFPB will have to confront and resolve these issues in issuing the final regulations, the parties would like to work with the CFPB to develop standards that specifically address how such non-traditional or alternative income sources can be considered by the creditor in the underwriting process and verified, including working through parties that work closely with borrowers, such as HUD-approved housing counselors.

- **Debts:** The CFPB should adopt Proposed Commentary Paragraph 43(c)(2)(vi)-1, which provides that creditors may look to widely accepted governmental and nongovernmental underwriting standards to define debts, and a creditor may, for instance, look to credit reports, as well as statements for student loans, auto loans, credit cards, etc., to determine a consumer's outstanding debts. However, see the discussion below regarding expenses not on a credit report or the consumer's application.

- **Reconciling different information:** The CFPB should adopt Proposed Commentary Paragraph 43(c)(2)(vi)-2, which provides that the creditor must consider debts in the credit report that are not listed on the consumer's application. The credit report is deemed a reasonably reliable third-party record under § 226.43(c)(3). "For debts not listed in the credit report, but offered by the borrower through the application process, the creditor need not verify the existence or amount of the obligation through another source. If a creditor nevertheless verifies an obligation, the creditor must consider the obligation based on the information from the verified source."

**Ability to repay—when the creditor must consider expenses not listed on the credit report or the borrower's application**

- The commentary should clarify that the lender must consider additional information that the borrower provides [in writing] a reasonable time before consummation about regular/recurring expenses that would have a material impact on the borrower's ability to repay the loan. However, the borrower would have the burden of proving that she had offered such information [in writing] reasonably prior to the consummation of the loan and that it would have a material impact on her ability to repay the loan. **[Note to CFPB: The parties disagree about whether this information must be provided in writing.]**

[There is agreement that the borrower needs access to information that describes how the lender conducted the ability-to-repay determination. The parties will attempt to propose a solution at a later date.]

**2.2 Payment used to qualify the borrower—treatment of ARMs**

For all ARMs, the ATR standard should require the following:

- The contract interest rate and payment *cannot*:
  - adjust more frequently than annually;
  - increase by more than 200 basis points in any annual rate adjustment; or
  - adjust by more than 500 basis points over the life of the loan.

- The borrower must be qualified based on the *maximum* rate and payment that could occur in the first 6 years of the term of the loan (that is, the rule would not allow the creditor to ignore the first rate and payment adjustment on a 5-1 ARM in the ATR analysis).

[**2.3** Potential ATR Carve-Out for Certain Streamlined Refinancings: There is agreement that an exception to the ability-to-repay and qualified-mortgage requirements should be established for certain streamlined refinancings. The parties will attempt to propose such an exception at a later date.]

**3.0 QM Definition**

All items below must be met in order for the loan to be a designated as a qualified mortgage:

**3.1 Loan Terms**

A qualified mortgage cannot have terms that provide for:

- an increase of the principal balance as a result of negative amortization based on regular required payments
- interest-only payments
- balloon payments
- a term greater than 30 years
- points and fees that exceed the greater of $3,000 or 3 percent of the total loan amount so long as the loan is not a HOEPA loan
- the contract interest rate and payment to:
  - adjust more frequently than annually;
  - increase by more than 200 basis points in any annual rate adjustment; or
  - adjust by more than 500 basis points over the life of the loan
- In addition, the borrower must be qualified based on the *maximum* rate and payment that could occur in the first 6 years of the term of the loan (that is, the rule would not allow a creditor to ignore the first rate and payment adjustment of a 5-1 ARM in the ATR analysis).

**3.2 Documentation Requirements**

The following documentation requirements would be required for QM loans:

- Verification of borrower income;
- Verification of employment ("**VOE**") status, if applicable (either written or oral VOE);
- Documentation of current debt obligations (based on credit report and borrower application); and
- Documentation of payments on simultaneous seconds and any other subordinated loans in place at origination.

**3.3 Additional QM Underwriting Requirements**

In order to be a qualified mortgage, a loan must meet at least one of the "waterfall" tests described below. However, the fact that a mortgage might qualify under one of these tests does not imply an obligation on the creditor's part to make the loan or to otherwise forego the underwriting process. All references to housing debt, housing obligations, and housing payments below would include principal, interest, taxes, insurance, condominium association fees and other housing-related obligations.

- If the borrower's total debt-to-income ratio ("TDTI") is 43 percent or less (with a bona fide error cushion), the loan would meet QM requirements. No other tests would be required.
- If the borrower's TDTI is more than 43 percent, the following tests could be applied:
  - *Front-End Ratio*: Is the borrower's housing debt-to-income ratio 31 percent or less of the borrower's gross monthly income and is TDTI 50 percent or less?
    - If yes, the loan meets QM requirements; no further test required. If no, continue.
  - *Previous Housing Payments.* Has the borrower had stable income for the past six months and made timely mortgage or rental payments over a specified period of time (TBD), and will her new monthly housing obligations be no more than 5 percent higher than her current housing expenses? [Parties are still discussing the appropriate definition and timeframe for establishing a history of "timely" payments.]
    - If yes, the loan meets QM requirements; no further test required. If no, continue.
  - *Reserves.* Does the borrower meet one of the following tests: 1) at least 6 months of liquid financial reserves available to meet mortgage-related obligations and a TDTI of 50% or less; or 2) greater than 18 months in liquid financial reserves (i.e., no TDTI cap required)? (Only 60 percent of any reserves with a withdrawal penalty would be allowed to count.) [Parties agree that some degree of seasoning should be required but do not have a specific recommendation.]
    - If yes, the loan meets QM requirements; no further test required. If no, continue.

- *Residual Income.* Is the borrower's net residual income above the minimum threshold established by the CFPB and/or other government agency (e.g., U.S. Department of Veterans Affairs ("**VA**")?

  - ➢ If yes, the loan meets QM requirements; no further test required. If no, the loan will only be made as a non-QM loan unless one of the prior tests in the waterfall is met.

  The residual-income test could be based on tax-adjustment tables and income guidelines prepared by CFPB, VA guidelines, or industry standards.

Even if the loan does not meet any of the QM tests, there is no implication that the loan fails to meet the ability-to-repay test.

**4.0 Contesting the Presumption**

We propose the following process:

- Borrower rebuts presumption when a borrower demonstrates that the loan fails to meet the basic tests of QM—product type, fee levels, etc.

- If the loan is a QM, the borrower can still assert that the ability-to-repay requirement was not met by demonstrating that the lender failed to take into account information provided to it that, if properly considered, would have prevented a reasonable and good faith finding of a reasonable ability to repay.

  - For example, the borrower shows that she provided information to the creditor before consummation that she owed debt that was not listed on the borrower's credit report. Failure to consider this debt could be grounds for challenging whether the ability-to-repay requirement was met. The lender could still have met the requirement if the existence of the debt did not materially affect a reasonable determination of the borrower's ability to repay.

  - Similarly, if a creditor alters or omits information collected in the course of the application, without reasonable basis, that is relevant to the borrower's ability to repay, the borrower can challenge whether the ability-to-repay standard was met.

  - Absent further information or evidence submitted by the borrower that either contradicts the creditor's records and assertions or documents information that the lender had but did not reasonably consider, the presumption for qualified mortgages should provide a sufficient shield to the lender.

- If the loan is not QM to begin with, the burden of proof that the lender did not appropriately consider the borrower's ability to repay falls on the lender. In this case, the lender will not have the benefit of the presumption of ability to repay when defending borrower claims that the lender failed to consider relevant information provided by the borrower.

- Accordingly, revise proposed Alternative 2 Commentary Paragraph 43(e)(1)-1 as follows [*additions in bold and deletions in strikethrough*]:

In general. Under § 226.43(c)(1), a creditor must make a reasonable and good faith determination at or before consummation that the consumer will have a reasonable ability, at the time of consummation, to repay the loan according to its terms, including any mortgage-related obligations. **A borrower raises a claim or defense of violation of sec 226.43(c)(1) by setting forth specific facts that, at the time the loan was consummated, the creditor did not make a reasonable and good faith determination that the borrower had a reasonable ability to repay the loan based upon information provided by the borrower reasonably prior to closing.** Under § 226.43(e)(1), a creditor or assignee of a covered transaction is presumed to have complied with the repayment ability requirement of § 226.43(c)(1) if the terms of the loan comply with § 226.43(e)(2)(i)-(ii) (or, if applicable, § 226.43(f)); the points and fees do not exceed the limit set forth in § 226.43(e)(2)(iii), and the creditor has complied with the underwriting criteria described in § 226.43(e)(2)(iv)–(v) (or, if applicable, § 226.43(f)). If a loan is not a qualified mortgage (for example because the loan provides for negative amortization), then the creditor or assignee must **prove** ~~demonstrate~~ that the loan complies with all of the requirements in § 226.43(c) (or, if applicable, § 226.43(d)). However, even if the loan is a qualified mortgage, the ~~consumer may rebut the presumption of compliance evidence that the loan did not comply with~~ **lender has not necessarily complied with the ability-to-repay requirement** in § 226.43(c)(1). For example, **(1)** evidence of a high debt-to- income ratio with no compensating factors, such as adequate residual income ~~could be sufficient to rebut the presumption~~, **or (2) evidence that the lender did not reasonably consider information provided to it relevant to the borrower's ability to repay could be used by the borrower to establish that the creditor did not meet the ability-to-repay requirement. When a loan is a qualified mortgage, the consumer has the burden of proving that the creditor did not comply with the repayment ability requirement of § 226.43(c)(1).**

**The Clearing House Owner Banks**
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The Bank of New York Mellon
BB&T
Capital One
Citibank
Comerica
Deutsche Bank
HSBC
JPMorgan Chase
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RBS Citizens
Regions
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Wells Fargo
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# Statement of Debra Still

## On behalf of the Mortgage Bankers Association

## House Financial Services Committee
## Subcommittee on Financial Institutions and Consumer Credit

## "The Impact of Dodd-Frank's Home Mortgage Reforms: Consumer and Market Perspectives"

**July 11, 2012**

*1717 Rhode Island Avenue, NW, Suite 400 | Washington, DC 20036 | www.mortgagebankers.org | (202) 557-2700*

Chairwoman Capito, Ranking Member Maloney and members of the subcommittee, my name is Debra W. Still and I currently serve as President and Chief Executive Officer of Pulte Mortgage, a nationwide lender that is headquartered in Englewood, Colorado. My company employs 520 individuals throughout the United States and, since 1972, has helped more than 350,000 homebuyers finance their new home purchases.

I am testifying today in my capacity as Chairman-Elect of the Mortgage Bankers Association[1] and as a Certified Mortgage Banker (CMB). MBA uniquely represents mortgage lenders of all sizes, from federally-chartered institutions to the smallest community lenders who serve the mortgage financing needs of families and neighborhoods throughout the nation.

We very much appreciate your holding this hearing on the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). It could not be timelier. During the next month, several major rules to overhaul the disclosure process, provide new requirements for high-cost lending and servicing, as well as compensation and qualification of loan officers, will be proposed for comment.

Notably, just two days ago, MBA responded to the request of the Bureau of Consumer Financial Protection (CFPB or Bureau) for further comments regarding the Ability to Repay – Qualified Mortgage (QM) rule. The Bureau specifically sought comments on requirements that might be included in the definition of QM and the liability and risks of various approaches to crafting the rule. The Bureau has also announced that it will be finalizing the QM rule late this fall.

How it is finalized – what it contains and how it is structured – will determine how many consumers will have access to safe, affordable and sustainable mortgage credit for generations to come.

The fact is lenders are continuing to tighten credit over the 2011 book of business, which was already far tighter than we have seen in years. Access to credit is taking on some disturbing characteristics that will have long term impacts if not addressed. Without lending, the economy will not recover, especially for the middle and lower/middle class who buy starter homes and lower priced homes.

Federal Reserve Chairman Ben Bernanke has observed:

> "One reason for the very slow recovery in mortgage credit, despite monetary policy actions that have helped drive mortgage rates to historically low levels, is that many lending institutions have tightened underwriting conditions dramatically, relative to the pre-recession period. Given the lax standards during the credit boom, some tightening was doubtless appropriate to protect consumers and ensure lenders' safety and soundness.

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

However, current lending practices appear to reflect, in part, obstacles that are limiting or preventing lending even to creditworthy households."[2]

In a similar vein, Secretary of Housing and Urban Development Shaun Donovan has said he believes that in today's market 10-20 percent of potential home-buyers who could adequately carry the debt were being "locked out" of the market because credit was either not available or was available only at a restrictive price. "We had risk-amnesia going into the crisis and I think now we've gone a bit too far in the other direction," he said.[3]

While an ability to repay rule is a good protection, against this backdrop, we must find the right balance between consumer protection and access to credit.

If this rule is not finalized appropriately, the impact will likely be worse for the very borrowers we are trying to protect and hinder the availability of credit for far too many borrowers who are otherwise qualified. We will undoubtedly end up with a far more restrictive lending environment then we have today, and simultaneously harm the larger economy for years to come.

As we told the CFPB, we do not believe there can be too much deliberation on this rule. It is absolutely essential that the Bureau implements this proposal without unwittingly undermining the availability and affordability of credit and the nation's economic recovery.

## I. Introduction

MBA recognizes that the mortgage industry must take responsibility for its share of excesses during the recent housing boom. We agree changes are needed to ensure such excesses cannot be repeated in the future, and we favor reasonable ability to repay requirements to achieve that end.

Even though the mortgage industry has implemented some of the most conservative underwriting standards in decades, and toxic mortgage products are no longer available, we understand the value of embedding sound product and underwriting standards into the law to assure consumers are protected going forward. Establishing an ability to repay requirement, along with an unambiguous set of standards in the form of a clear safe harbor, is the right way to accomplish this.

Nevertheless, as this process goes forward, we must be mindful of the fact that these new rules come on top of the tightest credit standards in decades. It is crucial this work does not exacerbate the situation.

When considering the QM rule, MBA has established four principles we believe should guide its completion:

- First, in order to reach as many borrowers as possible with safe, affordable and sustainable financing, the QM needs to be broadly defined.

- Second, the rule must include clear, specific and objective standards, by incorporating unambiguous requirements.

[2] Speech before the National Association of Home Builders, Orlando, FL, 2/10/12
[3] As quoted in Reuters, 5/10/12

- Third, the QM should provide lenders and borrowers the legal certainty that meeting the standards will provide them a clearly defined safe harbor.

- Finally, given the QM's massive effect on the existing market, the rule should be designed in a way that avoids unintended consequences.

**II. The Ability to Repay Requirement and the Qualified Mortgage Rule**

*A. Background*

Dodd-Frank requires that a lender may not make a residential mortgage loan unless the lender makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance (including mortgage guarantee insurance), and assessments.

The law provides great liability (and stiff remedies and penalties) for violations. For example, a mortgage lender who fails to comply with this requirement for a hypothetical $200,000 loan would face liability on the order of:

(1) $20,000 in actual damages, assuming the borrower made a 10 percent down payment;

(2) Statutory damages of up to $4,000;

(3) All loan fees and up to three years of finance charges paid by the consumer, which on an average loan of $200,000 at 4.5 percent may be approximately $25,000; and

(4) Court costs and reasonable attorney fees associated with the enforcement action, which based on the attached memorandum could be anywhere between $26, 000 and $155,000 depending on how the QM is structured).

Dodd-Frank also extends the statute of limitations for a claim based on a violation of the ability to repay requirement from one year to three years. Well beyond three years, the law allows a consumer to assert a violation as a claim in foreclosure whenever it occurs. The claim may be made against any creditor, assignee or holder of the mortgage as well.

*B. The QM – Safe Harbor or Rebuttable Presumption*

Against the backdrop of this enormous potential liability – considering how unpredictable litigation can be – Dodd-Frank provides a principled avenue for compliance.

Lenders who make QM loans, which under the law cannot have risky features, must be well underwritten and meet other restrictions (including limits on points and fees), may "presume" that their loans meet the ability to repay requirements.

Accordingly, great attention has been focused on how QM will be defined and how it is to be constructed.

The law grants wide discretion to the regulator for this purpose. As a result, the Federal Reserve, which originally proposed the rule for the Bureau to later finalize, offered two alternatives: "a legal safe harbor" or a "rebuttable presumption." The rule was clear that only one should be adopted.

Importantly, the "safe harbor" is misnamed. That approach, if adopted, is neither a pass for lenders, nor does it deprive consumers of an opportunity for court review. Under either a "safe harbor" or a "rebuttable presumption," a borrower may opt to go to court and seek review of an alleged violation.

The difference, however, is that in a proceeding where a safe harbor is established, the court's inquiry is focused only on whether or not the standards for the QM were met.

Under a rebuttable presumption, the scope of the inquiry is left to the court, with wide variations from one court to another on how to apply the presumption, including when and how extrinsic evidence may be brought in beyond the standards.

Such an inquiry, in all cases, is more open-ended, unpredictable and far more costly.

C. *Three Percent Limit on Points and Fees*

Before I describe these subjects in greater detail, I wish to highlight another area of particular concern. Dodd-Frank limits the points and fees that can be charged for a QM loan. The statute specifies three percent as the limit but permits adjustments including for smaller loans.

Based on our reading of the proposed rule, points and fees may include: (i) charges to affiliated (but not unaffiliated) title companies, (ii) compensation paid to loan originators, including employees; and (iii) amounts of insurance and taxes held in escrow.

This definition would be overly inclusive and will bring unintended consequences. These include that many loans, especially to low- and moderate-income borrowers, will not qualify as QMs (even if they meet all other QM requirements) and therefore may not be available, or require higher rates and payments – ironically the opposite of the rule's intention.

## III. MBA's Principles for the Establishment of the QM

A. *The QM Must Be Broad to Reach as Many Qualified Consumers as Possible with Safe, Affordable and Sustainable Financing*

In the spring of this year, we learned that the CFPB was considering establishing a narrow QM to ensure an active non-QM market. MBA, along with a wide coalition of consumer, civil rights, and industry organizations, strongly opposes such an approach.

First, because of the very significant liability under Dodd-Frank, it is not clear to what extent there will be any non-QM lending. Some believe non-QM loans will be made only to the most qualified, wealthy borrowers and kept in institutions' portfolios. Others believe there will be lending with significant pricing premiums that will raise costs to borrowers, particularly those least able to bear them. Either way, as noted in an April 12, 2012, joint letter with our coalition partners, defining QM to be broad and inclusive is critical to ensuring maximum consumer access to safe, affordable and sustainable financing. (Attachment A).

As the letter pointed out, every version of the Ability to Repay provision introduced in Congress, including the bill that ultimately became law, paired the Ability to Repay Requirement with the QM. The reasoning was that pairing the prospect of liability with an exception for well underwritten, safer, more sustainable loans was the best means of encouraging such lending. The law also added liability for steering consumers from QM to non-QM loans. In our view these provisions clearly demonstrate Congress's preference for QM loans.

Prohibitions against risky loan features and a host of protections are all included in the QM. For this reason, QMs should not be a subset of the market, they should *be* the market, and hopefully broaden the market that exists today.

*B. The QM Must Include Clear Objective Standards*

MBA believes it is essential that a sound QM must be constructed with clear standards. Our July 21, 2011, comment letter supported the original proposal that suggested that the QM could require compliance and evidence of compliance with widely accepted underwriting standards such as Fannie Mae's Desktop Underwriter® (DU) and Freddie Mac's Loan Prospector® (LP) standards. However, a mechanism must also be established to approve current and future standards available from sources other than these two companies. We still believe the incorporation of these standards, including the use of automated underwriting systems, offers a reasonable approach. The approach has the virtue of assuring that the standards are dynamic as understanding of mortgage performance and ability to repay deepens.

The other approach that has been offered would involve embedding objective, numerical standards in the definition such as a particular DTI and a "waterfall" of alternative criteria. In March 2012, some lenders and consumer groups met with the CFPB and proposed a maximum total-debt-to-income ratio (TDTI) of 43 percent that, if not met, could be satisfied through a waterfall.

While these efforts to establish clear standards for the safe harbor and bound the issues before the court are understandable, the 43 percent TDTI, which would ensure a loan is regarded as a QM, is problematic. Using Federal Housing Finance Agency (FHFA) data, from 1997-2009, 23 percent of the loans acquired by the Enterprises had DTIs of 44 percent or greater. Over the same time period, 19 percent of these loans had DTIs of 46 percent or greater.

Based on the FHFA data, there is no reason to choose 43, 44 or even 46 as a default standard. Loan performance and ability to repay does not markedly change at any of these points.

Notably, the Colorado Housing Finance Agency permits DTIs up to 50 percent, North Carolina allows lenders to presume a loan meets an ability to repay standard at 50 percent and Fannie Mae caps eligibility for their loans in its waterfall at 50 percent.

Beyond the issue of a 43 percent DTI, a fatal flaw in the proposal is that it includes its waterfall in a rebuttable presumption and it does not confine the litigation to whether the QM standards are met. Any waterfall should be embedded in a safe harbor if this approach is adopted by the CFPB.

MBA also does not believe that relying exclusively on debt-to-income (DTI) ratio is wise. What is most clear to us is that there are multiple factors that along with DTI have a significant impact on predicting mortgage performance and ability to repay.

MBA believes this effort should be a starting point, not an end. Numerous issues must be resolved. For example, trying to embed a DTI also necessitates clear, rational standards on what is to be considered debt and what is to be considered income. This is the essence of underwriting a mortgage, i.e., gaining a clear understanding of a borrower's earning power and their liabilities.

In our most recent QM comment letter, we indicated we were working on a more acceptable approach embedded in a safe harbor. We look forward to sharing it with the Bureau shortly. Unless any standards are embedded in a safe harbor, considering the enormous liability, we do not believe this approach is useful.

C. *A Safe Harbor with Clear Standards is the Best Path to Ensure that the Maximum Number of Qualified Borrowers Receive Safe, Affordable and Sustainable Financing.*

MBA has employed counsel and sought a range of opinions on different aspects of the issue of whether the QM should be structured as a safe harbor or a rebuttable presumption. All agree that the costs of litigation for consumers and lenders will be higher if the Bureau adopts a rebuttable presumption.

This is because the extent of litigation costs depends on whether a matter can be resolved at an early stage, principally on a motion, assuming the standards have been met, or whether resolution must await a more protracted process, at a summary judgment or even at trial.

If a safe harbor is established and a consumer can show the requirements were not met, the consumer is granted relief at an early stage. At the same time, if a transaction fits within the standards of a safe harbor, a lender can be reasonably certain the matter will be dismissed at an early stage as well.

Establishing the QM as a safe harbor, because of the certainty it provides, will result in lower costs for borrowers. Cases will not be brought unless performance under the standards is questionable. Those cases that are brought can likely be resolved early in the process, thus lowering costs.

Moreover, considering that attorney fees can be awarded, that a rebuttable presumption offers an opportunity to offer evidence above and beyond any QM standards, and that the potential damages are large, not only will the costs per suit in a rebuttable presumption be greater but there will be a far greater number of suits.

MBA data indicates that there were approximately 2.2 million loans in foreclosure in the first quarter of this year. Assuming such claims became perfunctory, the costs ultimately borne by consumers could be enormous.

These costs will be built into increased loan charges for all borrowers and threaten to decrease competition going forward. Raising the liability risks by establishing vague and unpredictable legal standards will make it far more difficult for smaller lenders to compete. At the same time, large institutions with choices may opt out of the mortgage business as simply not worth the cost.

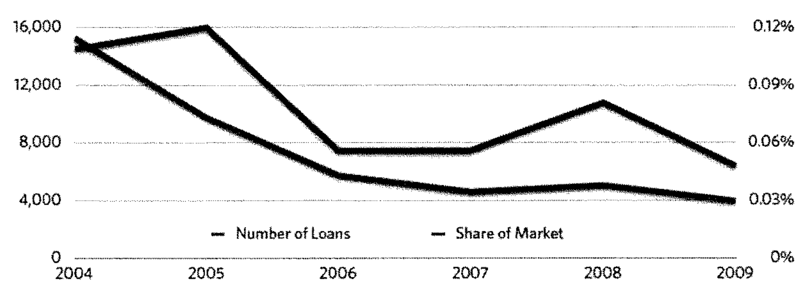
The potential costs of put back claims also should militate strongly in favor of a QM constructed as a safe harbor rather than a rebuttable presumption. If the QM is established as a safe harbor, we expect a more active secondary market with clearer standards, fewer buyback claims and far lower resultant pricing for consumers

If the QM is established with a rebuttable presumption, we expect continuation of uncertain standards, claims and counterclaims and thus increased costs. It is also likely that both investors and lenders will impose additional underwriting standards both to limit their risks as sellers and purchasers. These costs, too, will ultimately be borne by consumers.

The only check on costs – and a very regrettable one at that – will be that fewer qualified borrowers will receive loans because of the potential costs of each claim. This is because lenders will be forced to adopt more conservative lending standards than any lending standards established as part of the QM test. Fewer loans will be available, particularly to qualified borrowers at the margins. Considering that fewer loans will be available, the dollar costs will be limited somewhat as the societal costs of unduly curtailing homeownership to qualified borrowers increase.

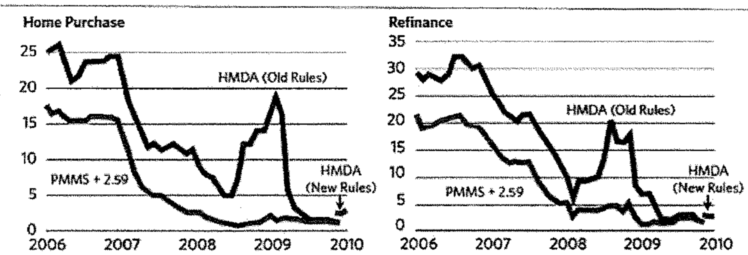
It has been asserted that state laws (such as North Carolina's), which include ability to repay provisions, have not engendered litigation and therefore, there would not be increased litigation arising from a rebuttable presumption. North Carolina law, however, does not provide for the mandatory award of attorney fees and the damages are far lower. Beyond that, the North Carolina law includes presumptions of compliance if a borrower has a DTI of 50 and it does not encompass loans in excess of $300,000 – both factors that exclude most claimants.

It is more instructive to observe the effects of the Home Ownership and Equity Protection Act (HOEPA) triggers that carried significant assignee liability and higher priced loan rules that offered a rebuttable presumption. In both cases, the result was a precipitous drop in both categories of loans, as demonstrated in the graphs below:



## Higher-Priced Lending Has Been Limited Since New Rules

**Higher-Priced Share of Lending, by Annual Percentage Rate Threshold, 2006-2009**




*Note:* The data are monthly. Loans are first-lien mortgages for site-built properties and exclude business loans. Annual percentage rates are for conventional 30-year fixed-rate prime mortgages. PMMS = Freddie Mac Primary Mortgage Market Survey. HMDA = Home Mortgage Disclosure Act.
*Source:* Avery et al, 2010, Federal Reserve Bulletin.

- The Federal Reserve has implemented new rules for "higher-priced lending" — for first mortgages, 150 bps over the Average Prime Offer Rate.
- These rules establish "rebuttable presumption" that ability to repay is satisfied for loans if certain requirements are met.
- Before the rules were issued, share of higher-priced lending peaked above 25 percent in 2006, but has since fallen to well below five percent.

[

On April 27, 2012, we wrote to the CFPB along with other associations urging a safe harbor (Attachment B).

We have heard from some that a safe harbor might not address all hypothetical cases. If that is so, then the Bureau's energies should remain focused on ensuring the standards are properly constructed and then embedding them within a safe harbor to serve all. The interests of the vast majority of consumers should not be sacrificed to allow for an as yet unspecified claim or claims by a tiny few.

*D. The Definition of Points and Fees Requires Revision and Attention to Smaller Loans*

As I indicated earlier, the QM requirements include a limit on points and fees that is 3 percent of the loan amount. MBA is concerned that if the current definition remains, it will cause several unintended consequences.

1. *Fees of Title Affiliates*

The definition as it stands includes title charges paid to an affiliate but excludes title charges paid to an unaffiliated title company. This result is both anti-consumer and anti-competitive. Economic studies have shown that affiliated title providers, which currently comprise more than 26 percent of the market, offer services that are competitive in cost with those of unaffiliated providers.

Where affiliates have been excluded from the market, title insurance charges have risen. National consumer surveys have shown that consumers who take advantage of the one-stop shopping that affiliated businesses offer have a satisfactory home purchase experience. At the same time, consumers are free to choose not to use affiliated providers. Indeed, the Real Estate Settlement Procedures Act (RESPA) requires a clear disclosure of affiliated relationships and their cost and does not permit a consumer to be required to use an affiliated entity.

Concerns that lenders may augment their fees through the charges of affiliated title companies are not valid. In fact, title insurance premiums and in many cases title services are highly regulated. Forty-four states and the District of Columbia require that title premiums be set by the state, approved by the state, or filed with the state (23 states also include title examinations and searches). Of the remaining six states, one state (Iowa) does not recognize title insurance.

2. *Compensation to Originator Employees*

One interpretation of the definition of "points and fees" in Dodd-Frank is that it requires the inclusion of all compensation paid by a lender to its individual employee loan originators as well as the sums creditors or mortgage brokers receive for the transaction.

Such a result in our view is unfair and simply unworkable.

First, much of these amounts are counted already as origination fees to lenders.

Second, while charges to these companies are appropriate for inclusion in the points and fees calculation, money paid out by lenders for compensation or otherwise is not.

Third, considering bonuses are part of loan officer compensation, creditors will be unable to accurately ascertain such compensation at the time the loan is made, making application of the limit impossible.

While the term "loan originator" encompasses both mortgage brokerage entities and individuals who perform origination functions, it appears that Congress had no intention of including employee compensation in points and fees, and only was intending to include compensation paid to entities in points and fees.

3. *Escrow Amounts*

At present, the definition of "points and fees" in Dodd-Frank is ambiguous regarding whether the dollar values for amounts paid to lenders and held for the payment of insurance and taxes in an escrow account also are included in the points and fees calculation.

There is no sound public policy rationale for them to be included. Amounts for insurance and taxes are not retained by the lender or its affiliates; they are paid to insurance companies and governmental entities. Additionally, under RESPA amounts held in escrow that exceed specified limits are returned to the consumer. Finally, these amounts historically excluded from the points and fees calculations under HOEPA.

4. *H.R. 4323, the Consumer Mortgage Choice Act*

MBA has urged the CFPB to amend the definition of points and fees to exclude affiliated title fees and clarify that loan officer compensation and escrow amounts from the calculation for purposes of applying the 3 percent limit.

We strongly believe action in this area is essential to: (i) maintain a competitive marketplace, (ii) prevent higher prices resulting from the withdrawal of affiliated title service providers in low- and moderate-income marketplaces; and (iii) preserve the ability of consumers to choose the benefits of one-stop shopping when they purchase or refinance their home.

Despite our belief that the CFPB can make these revisions under existing law we strongly urge your support of H.R. 4323, bipartisan legislation introduced by Representatives Bill Huizenga, David Scott, Ed Royce, and William Lacy Clay, and cosponsored by nearly 20 members of the U.S. House of Representatives, to achieve these important purposes.

5. *Smaller Loans*

The 3 percent limit on points and fees for QM may be adjusted for smaller loans under Dodd-Frank and MBA supports such adjustment. We believe this is the only means to ensure the availability of loans at reasonable rates to lower balance borrowers.

The original proposal would provide that the limits would be adjusted to 3.5 percent for loans lower than $75,000 on a sliding scale up to a 5 percent for loans below $20,000.

However, MBA's July 21, 2011, comment letter provided data that shows that if the limit were set at 3 percent and affiliated title insurance, loan originator compensation and appraisal fees were included the great majority of loans up to $100,000 would not meet the points and fees requirements. Moreover, high proportions of loans in virtually every state from $100,001 to $150,000 would not meet the limits.

Our comment letter points out that if the cap were raised to $150,000, less than 10 percent of loans in nearly all of the states would fail to meet the limits.

Considering that $150, 000 is near the average loan amount, and based on the chart to follow, $150,000 is the right amount to apply adjustments above the 3 percent limit. We urge members of this subcommittee to support that approach.

| Purpose | Loan Balance | Share |
|---|---|---|
| Purchase | <=75K | 12.0% |
| Purchase | >75K and<=100k | 10.6% |
| Purchase | >100K and<=125k | 10.2% |
| Purchase | >125K and<=150k | 10.7% |
| Purchase | >150K and<=175k | 8.7% |
| Purchase | >175K and<=200k | 8.2% |
| Purchase | >200K and<=250k | 11.1% |
| Purchase | >250K and<=300k | 8.2% |
| Purchase | >300K and<=417k | 12.7% |
| Purchase | >417K | 7.7% |

| Purpose | Loan Balance | Share |
|---|---|---|
| Refinance | <=75K | 10.1% |
| Refinance | >75K and<=100k | 11.9% |
| Refinance | >100K and<=125k | 11.9% |
| Refinance | >125K and<=150k | 11.5% |
| Refinance | >150K and<=175k | 9.5% |
| Refinance | >175K and<=200k | 8.2% |
| Refinance | >200K and<=250k | 11.6% |
| Refinance | >250K and<=300k | 8.2% |
| Refinance | >300K and<=417k | 11.8% |
| Refinance | >417K | 5.2% |

6. *Other Issues*

Because the limit on points and fees is based on the loan amount, the limit becomes tighter as the borrower increases their down payment. We believe the CFPB also should look at this issue carefully in setting the 3 percent limit. We certainly do not want to discourage borrowers from putting more equity into their homes by increasing their loan rates and payments to cover loan fees.

**CONCLUSION**

We appreciate the efforts of the subcommittee to examine these enormously important regulations. No matter how well intentioned these rules may be, they cannot be allowed to harm American families, the mortgage market and the nation's still fragile economic recovery.

While MBA commends the CFPB's efforts to date, we remain concerned that the QM rule may not be properly structured to truly serve consumers.

We urge your support of correspondence spearheaded by Chairwoman Capito and Representative Brad Sherman to the CFPB in support of a safe harbor, and would further urge your support of H.R. 4323 to revise the point and fees provisions.

I look forward to your questions and to MBA continuing its work with this subcommittee to ensure that our nation has a vibrant market of sustainable mortgages, for as many qualified borrowers as possible, for generations to come.

***ATTACHMENT A***

April 12, 2012
The Honorable Richard Cordray
Director
Bureau of Consumer Financial Protection
1700 G St. NW
Washington, DC 20552

Dear Director Cordray:

The undersigned organizations representing a very broad spectrum of lenders, investors, housing professionals, consumer advocates and civil rights groups write to you today to strongly urge that a broadly-defined Qualified Mortgage (QM) be central to the forthcoming Ability to Repay regulation.

Most economists and housing market analysts in government and in the private sector agree that today's underwriting standards are tight and are contributing to a slow housing recovery. Our organizations believe that an unnecessarily narrow definition of QM that covers only a modest proportion of loan products and underwriting standards and serves only a small proportion of borrowers would undermine prospects for a housing recovery and threaten the redevelopment of a sound mortgage market.

Admittedly, the undersigned hold different views about whether the QM should be designed as a safe harbor or a rebuttable presumption (both options were included in the proposed rule). Nevertheless, we stand united in urging the Bureau of Consumer Financial Protection (CFPB) to construct a broadly-defined QM using clear standards. We believe that is the only way to help the economy and at the same time ensure that the largest number of credit worthy borrowers are able to access safe, quality loan products for all housing types, as Congress intended in enacting the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).

**Congressional Intent Calls for Broadly Defined QM**

Every version of the Ability to Repay provisions introduced in Congress, including the final version of Dodd-Frank that became law, paired the Ability to Repay Requirement with the QM. The reasoning was that pairing the prospect of liability with an exception for well underwritten, safer, more sustainable loans was the best means of ensuring sound lending for borrowers.

To add incentives for QM lending, the law also added liability for steering consumers from QM to non-QM loans. Further, the Bureau was given broad flexibility to define the QM in a manner that will "ensure that responsible, affordable mortgage credit remains available to consumers." All of these provisions demonstrate Congress's intent that all creditworthy borrowers – especially low- and moderate-income borrowers and families of color – should be extended the important protections of a QM.

**Non-QMs Will Be Less Protective, Less Available and More Expensive**

A narrowly defined QM would put many of today's loans and borrowers into the *non*-QM market, which means that lenders and investors will face a high risk of an ability to pay violation and even a steering violation. As a result of these increased risks, these loans are unlikely to be made. In the unlikely event they are made, they will be far costlier, burdening families least able to bear the expense. Beyond that, these higher-priced loans would not be required to include important protections against certain practices and loan features that drove the highest failures in the mortgage boom that are embedded in QM.

There is no question that some residential mortgage underwriting standards were too lax during the housing boom, and that strong regulatory standards are needed to make sure that those mistakes are not repeated. We support the establishment of such standards and we believe the establishment of the QM is central to that effort. Rather than narrowing the QM market, we believe the CFPB should work to ensure that the QM market becomes the market. Creating a broad QM, which includes sound underwriting requirements, excludes risky loan features, and gives lenders and investors reasonable protection against undue litigation risk, will help ensure revival of the home lending market.

**Clear Standards are Critical to Any QM Definition**

Vague parameters for the QM also will add legal uncertainty, increase costs and limit access to credit. If the parameters of the QM are not clear, risks become unpredictable, forcing lenders to decrease their risk tolerance and operate well within the standards. Such an outcome will lessen both the availability and affordability of credit for far too many borrowers. For these reasons, the CFPB should establish clearly defined standards in the QM definition that are objectively determinable at origination.

All of us would appreciate the opportunity to meet with Bureau staff at your earliest convenience to discuss all of these concerns and to share our data. We are convinced that the choices around this important rule, including in large measure the breadth of the QM standard, will affect sustainable homeownership for generations to come.

Sincerely,

American Bankers Association
American Escrow Association
American Financial Services Association
American Land Title Association
American Securitization Forum
Asian Real Estate Association of America
Center for NYC Neighborhoods
Columbus Housing Partnership
Community Associations Institute
Community Mortgage Banking Project
Community Mortgage Lenders of America
Consumer Bankers Association
Consumer Mortgage Coalition
Financial Services Roundtable
Habitat for Humanity International
Housing Policy Council

Independent Community Bankers of America
Leading Builders of America
Mortgage Bankers Association
Mortgage Insurance Companies of America
National Association of Hispanic Real Estate Professionals
National Association of Home Builders
National Association of Mortgage Brokers
National Association of Neighborhoods
National Association of Real Estate Brokers
National Association of Realtors®
National Community Reinvestment Coalition
National Council of State Housing Agencies
National Housing Conference
Real Estate Services Providers Council, Inc. (RESPRO®)
Real Estate Valuation Advocacy Association
The Appraisal Institute
The Realty Alliance

***ATTACHMENT B***

April 27, 2012

Honorable Richard Cordray
Director, Bureau of Consumer Financial Protection
1700 G Street, NW
Washington, DC

Dear Director Cordray:

The undersigned trade associations representing the financial services, home building and real estate industries as well as other concerned organizations write to you today regarding the Qualified Mortgage (QM) under the Ability to Repay rule to be issued by the Bureau of Consumer Financial Protection (CFPB). Our purpose is to reiterate our very strongly held view that the QM should be structured as a legal safe harbor with clear, well-defined standards. The standards must embody requirements for sound mortgages for consumers and specify the grounds on which there can be litigation or enforcement action as to whether those requirements have been met.

**Safe Harbor versus Rebuttable Presumption**

Structuring the QM as a safe harbor and focusing litigation and enforcement activity on whether the standards are met is the only means of ensuring that the largest number of borrowers possible will enjoy the safest and most affordable options for sustainable credit available through the QM. In contrast, establishing the QM as a rebuttable presumption of compliance—even with clear substantive standards but lacking clarity or limitations regarding the scope of litigation—will markedly lessen the availability and affordability of sustainable mortgages to consumers.

**Effects of Rebuttable Presumption**

A QM rule with a rebuttable presumption can be overridden by facts or evidence beyond, and completely unrelated to, the requirements of the QM. This unpredictability, in a setting where the potential liability for each claim can be extensive, will force lenders to retreat to far more conservative lending standards.

Smaller lenders will have great difficulty managing this degree of risk and the resultant litigation costs. A presumption can be expected to result in the exit of lenders—large and small—from the market and a reduction in credit from those remaining. This will harm consumers by depriving them of robust competition and lower costs.

**Benefits of Safe Harbor**

The undersigned believe the establishment of clear standards and defined proceedings, in the form of a safe harbor, is the only practicable approach. While a consumer is just as entitled to judicial review of an alleged failure to determine ability to repay through litigation involving a safe harbor, any such review would be appropriately focused only on whether the QM's standards or factors have been met. Such an approach will require the CFPB to develop the right standards rather than simply leaving the matter to the courts.

Carefully defining the standards for litigation in the form of a safe harbor also will have the advantage of reducing the number of groundless claims, whose costs are ultimately borne by all. It will allow lenders of all sizes to compete. Most importantly, it will allow lenders to comfortably operate within the boundaries of the standards prescribed, allowing the maximum number of families to qualify for traditional, affordable and sustainable loans.

**Conclusion**

We firmly believe the way the QM is finally structured is the most critical mortgage lending issue facing the CFPB today and will have ramifications for consumers for years to come. We urge the CFPB to carefully evaluate the potential impacts of a safe harbor versus a rebuttable presumption on consumers, financial services providers and the economy as a whole before issuing the final rule. The final rule should increase the availability and affordability of sustainable mortgage credit to consumers as Congress intended, not unduly reduce its availability or increase its costs.

We appreciate your attention to this matter. We also would welcome an opportunity to meet with you at your earliest convenience.

Sincerely,

American Bankers Association
American Escrow Association
American Financial Services Association
American Land Title Association
Community Mortgage Banking Project
Consumer Mortgage Coalition
Community Mortgage Lenders of America
Consumer Bankers Association
Financial Services Roundtable
Habitat for Humanity
Housing Policy Council
Independent Community Bankers of America
Leading Builders of America
Mortgage Bankers Association
Mortgage Insurance Companies of America
National Association of Federal Credit Unions
National Association of Hispanic Real Estate Professionals
National Association of Home Builders
National Association of Realtors®
The Realty Alliance
Real Estate Services Providers Council, Inc. (RESPRO®)
Securities Industry and Financial Markets Association
The U.S. Chamber of Commerce

July 11, 2012

**Statement for the Record**

*On behalf of the*

**American Bankers Association**

*before the*

**Subcommittee on Financial Institutions and Consumer Credit**

*of the*

**Committee on Financial Services**

**United States House of Representatives**

American Bankers Association

**Statement for the Record**

*On behalf of the*

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*of the*

**Committee on Financial Services**

**United States House of Representatives**

**July 11, 2012**

Chairman Capito, Ranking Member Maloney, and members of the Subcommittee, ABA appreciates the opportunity to comment on the impact of Dodd-Frank's home mortgage reforms. ABA represents banks of all sizes and charters and is the voice of the nation's $14 trillion banking industry and its two million employees.

We would like to focus our comments today on the ability to repay provision and the qualified mortgage (QM) definition. We believe that the rules developed to implement the QM are among the most important provisions of DFA's consumer protection provisions. For that reason, we are including with this statement both comment letters ABA has submitted to date on the proposed QM rule as well as all supporting documents. The changes contained in these rules when they are finalized are significant. If not correctly crafted, the final rule will lead to serious disruptions in the availability of mortgage credit and we believe it is important to provide the CFPB and the Congress with the most detailed analysis and information available. Our comments below will summarize our views which are expressed in greater detail in the attached submissions for the record.

These rules represent a game-changer for the mortgage market because of the impact that the rule will have on qualified borrowers' ability to access credit at a reasonable cost, the harsh consequences of non-compliance and the costs associated with that compliance . Lenders that violate repayment ability requirements will be subject to the same damages applicable to Home Ownership and Equity Protection Act (HOEPA) loans, recoupment by the consumer, new enforcement authorities by state attorneys general, the potential to face liability for violation of ability-to-repay for the life of the loan, and more. Because of these severe potential consequences, the QM definition, which is intended to provide assurances that a lender has met the ability-to-repay requirements, will be vitally important. Our members have assured us that the QM will become the limit and extent of their lending under the new "ability to pay" regime. Quite simply, few loans are likely to be made outside of the QM definition.

***The QM standard will become the stage on which most mortgage lending will take place.*** As such, the QM must be designed, not as a small subset of selected loans, but rather, as a platform upon which the great majority of the mortgage market will now operate.

Dodd-Frank's ability-to-repay and QM proposals were crafted in reaction to a period of lax underwriting and other credit qualification failings across much of the industry. Those lapses have been addressed and corrected by the marketplace, even absent the implementation of new rules. While it is vital to ensure that such lapses do not occur again, it is equally important, both for economic recovery and for future availability of affordable credit, not to over-regulate and unnecessarily constrict the mortgage market. If the mortgage market is to rebound, it is critical that the Consumer Financial Protection Bureau (Bureau) provide lenders with clear, understandable rules that allow for the kind of safe lending that is happening today and a safe harbor to properly shield lenders from unreasonable litigation risks when they make safe, quality loans. A final rule that does not give lenders clarity and breadth in standards and a safe harbor will not prove sufficient to achieve the stated goal of the Congress: to promote a robust mortgage lending market for all borrowers and to satisfy our nation's reasonable housing finance expectations.

We would like to make the following points today.

- **The QM standard should be broad enough to encompass the vast majority of loans being made today.** Since it will serve as the basis for the entire mortgage market, it should be established with as much flexibility as possible.
- **The QM must afford lenders the legal certainty of a safe harbor against liability** This is the only way that banks will take on the incredible risks associated with the new mortgage lending platform.
- **The final rule must take into account all of the other changes that are being mandated by other Dodd/Frank requirements and other regulations.**

We discuss these items in detail below.

## I. The QM standard should be broad enough to encompass the vast majority of loans being made today.

***ABA, and most other industry representatives, along with many consumer groups all agree that the QM should be a broad category encompassing most loans being made today.*** The loans being made now are well underwritten without exotic or troublesome features, unlike some of the loans made prior to the economic crisis. If the QM does not include most of these loans, it will unnecessarily restrict credit, harming efforts toward recovery in the mortgage sector. Even HUD Secretary Shaun Donovan has argued that the QM should be broad enough to include most loans made today.

For this reason, we are concerned about proposals to use inflexible or inappropriate methods to determine whether a loan is a QM. In our attached comment letters we address in some detail our concerns over using a Debt-to-Income (DTI) ratio of 43 percent, as some groups have proposed as a "bright line" for the QM.

ABA understands and appreciates the usefulness and desirability of using "bright line" standards for determining whether a borrower has an ability to repay. Clear bright lines help to provide certainty against legal liability and expense. We note however, that all bright line standards have limitations and unintended consequences. One of those consequences is that borrowers who may be otherwise well qualified for a loan, but who fail a specific DTI cutoff, could be denied credit. Additionally, because neither mortgage loans nor mortgage borrowers are homogenous, a hard and fast DTI will have differing effects upon different mortgage lenders and different mortgage applicants. For example, community banks, and the communities they serve, could be adversely impacted by too low a DTI. Community banks tend to engage in more relationship lending, where a long-standing relationship with a borrower and knowledge of that borrower's credit history and history with the bank is a key aspect of the underwriting of any loan. Such an institution (and their borrowers) would be far more likely to be impacted by a median DTI than would a larger institution which relies primarily on anonymous data averages in a standard underwriting model or program.

A representative sample of ABA mortgage lenders found that on average 14.3 percent of mortgages originated between October 1, 2010 and April 1, 2012 had a DTI of 43 percent or more. About 10 percent of institutions reported 30 percent of mortgages with a DTI of 43 percent or more, including portfolio lenders with outstanding loan performance records. Given the high underwriting standards currently being utilized, it can be reasonably inferred that setting a DTI of 43 percent or lower will negatively impact a significant portion of borrowers who would otherwise qualify for credit even under today's stringent underwriting standards. For some institutions (and borrowers) a 43 percent DTI will have a pronounced impact on ability to qualify for the QM designation. A DTI cutoff of 43 percent will have an even more pronounced impact on low income and minority borrowers, who tend to have higher DTI ratios.

This impact on low and moderate income borrowers triggers a number of concerns related to fair lending and the potential for unintended consequences of the QM on banks' efforts to ensure compliance with fair lending laws.

ABA believes that this is a crucial element that must be addressed in any final rule dealing with repayment ability. As ABA identified in its July 2011 comments, the very core of the Qualified Mortgage rulemaking is to codify sensible mortgage underwriting standards and to discourage creditors from making mortgage loans outside of those standards. By design, therefore, these ability-to-repay rules narrow the alternatives to "safer" categories of loans. Such a structure, when imbedded in law, will reduce the diversity of lending products and will diminish banks' abilities to tailor financial products to fit consumers' specific needs.

The Bureau cannot turn a blind eye to this very significant dilemma—the rigidity of these rules will mean that individuals and populations with damaged or undeveloped credit will likely be excluded from the QM portions of the market, and that will mean significantly more expensive credit, or worse, no credit at all. These distinctions will be made even within the Qualified Mortgage marketplace. All Qualified Mortgage loans will not have the same risk of default, and many banks will – justifiably – not wish to face a single lawsuit alleging that the bank made a loan that the consumer did not have the ability-to-repay.

In our initial comments to the Bureau on this rulemaking, ABA asked that "regulators be cognizant of this point and remain vigilant of the real world impact that these new provisions will have on communities all across America." After further consultation with members and legal experts, ABA now urges more than mere recognition and vigilance. For purposes of safety and soundness, in order to achieve appropriate and orderly oversight of lending practices, in order to guard the reputational risk of the entire industry, and in order to ensure adequate levels of funding to all populations, ABA requests that the Bureau adequately discuss and define the appropriate and feasible interplay between discriminatory lending and ability-to-repay requirements.

The Bureau must, for instance, carefully articulate its views on the statistical differences among borrowers (which could be portrayed as disparate impact) that could result from limiting lending to Qualified Mortgage segments only. The Bureau must address the legal analysis that will apply to premium pricing in instances where lenders dare to lend outside of the Qualified Mortgage boundaries. We urge that these crucial clarifications be part and parcel of any final rule issued by the Bureau. We are not pointing out mere probabilities or hypothetical scenarios—we are referring to obvious discrepancies that are absolutely certain to arise. Ignoring or overlooking the disparate effects of this regulation will exacerbate a very crucial issue of basic fairness and will only create more confusion and disharmony in an already unsettled and highly charged issue area.

## II. The QM must afford lenders the legal certainty of a safe harbor against liability.

The Board proposed two possibilities to provide protections to lenders, a rebuttable presumption and a safe harbor. The rebuttable presumption is an assumption that is made in the law that will stand as a fact unless someone comes forward to challenge the factual basis of the assumption. The "presumption" is only good until it is contested and shown to be wrong to a judge or jury. Clearly, this opens the doors to extensive and expensive litigation. The safe harbor would still allow for a challenge based upon the ability to repay. However, unlike the rebuttable presumption, there are methods to dispose of the challenge at an earlier stage of any legal proceeding, so long as the elements of the safe harbor are proven. We would like to commend you, Chairman Capito, as well as Rep. Brad Sherman, for your efforts in organizing a letter signed by over seventy five of your colleagues to the CFPB urging the adoption of a safe harbor.

Because liability for an ability to repay challenge runs for the life of the loan, without a safe harbor, lenders will face potential costly lawsuits for the life of any loan they make. The potential costs for defending against such claims will increase the cost of loans (because costs will be priced into the loan) or drive lenders from the marketplace (because they will not want to take on the liability). Even groups like Habitat for Humanity have told CFPB that without the legal certainty of a safe harbor they would be unable to continue their mission, because a single legal challenge would require more resources than they could afford. The potential cost of litigation will be of particular concern for medium- and smaller-sized banks that do not have the kind of legal department or budget to be able to assume the potential costs that will result from a rule without a safe harbor.

ABA was pleased that the CFPB listened to our concerns about potential litigation costs associated with a choice between a rebuttable presumption and a safe harbor and chose to reopen the comment period to gather further input on this topic. In our attached comment letter of July 9th, 2012 we discuss these issues in detail, but provide a summary of our views for you here as well.

To respond to the CFPB's request for additional information regarding litigation costs, ABA undertook a survey of a representative sample of ABA members to more methodically analyze the scope of lender reactions to this rulemaking. In this survey (see Attachment 3), ABA reached out to bank legal counsel and mortgage business line professionals to gather their views on the litigation and legal risks that they believe will be posed under the alternative Qualified Mortgage definitions of "rebuttable presumption" versus "safe harbor," as set forth in the proposed rule. ABA also requested that legal counsel respondents estimate potential litigation costs associated with a rebuttable presumption standard versus a safe harbor.

Finally, the survey collected opinions from both legal counsel and chief real estate lending officers on the likely business decisions which may result from the alternatives presented in the proposed rule. The results of this survey, described below, decisively validate the concerns that ABA expressed in its July 2011 comments.

***Costs:*** ABA's survey requested legal counsel to approximate historical costs of litigation of all types, on a per case basis, where the bank prevailed at the summary judgment stage. Respondents estimated the average cost to be $25,000 per case, with a maximum estimate of $75,000 per case. By comparison, the survey inquired about the historical cost of litigation on a per case basis where the bank prevailed and the case was fully litigated. In such instances, the estimates jumped to an average cost of $100,000 per case, with a maximum estimate of $400,000 per case. These figures illustrate why banks are very concerned about the potential for a high-volume of ability-to-repay litigation. For community banks, one legal challenge could cancel out years of mortgage-related profits.

***Rebuttable Presumption:*** To collect information regarding the rule's impact on lending, ABA surveyed bank counsel and real estate lending officers on their forecast of the effect that a rebuttable presumption standard would have upon the use of risk-based pricing methodologies. The poll reflects the prediction that changes in fee structures would occur, with 52 percent of respondents stating that they expected "significant" changes in fee structure to offset litigation risk, and 46 percent expecting a "small change."

In terms of the effect that a rebuttable presumption standard would have on underwriting methodologies, respondents unanimously discarded the possibility that there would be no change from current landing standards. In fact, 71 percent believe their bank will adopt "significantly" more conservative underwriting standards, while 29 percent believe that they would adopt only "somewhat" more conservative underwriting.

Finally, 71 percent of respondents believe that a rebuttable presumption standard would lead to reductions in mortgage lending, with 45 percent asserting that the reduction would be "significant." If there is a rebuttable presumption rather than a safe harbor in the definition of a Qualified Mortgage, 10 percent of respondents believe their bank may exit the mortgage origination business. The survey revealed that only 19 percent of respondents could assert that this choice would lead to "little change" in the bank's commitment to mortgage lending.

***Conclusions of Survey:*** These somber numerical results portend significant reductions in mortgage credit if the rule's legal standards are not clearly crafted as a safe harbor to properly shield lenders when they make safe and compliant loans. By rather wide margins, the banks' business officers and legal counsel believe that the application of a rebuttable presumption standard will result in higher fees, stricter underwriting and less credit availability.

## III. The final rule must take into account all of the other changes that are being mandated by Dodd/Frank and other regulations.

It is vital to remember that the implementation of ability-to-repay and QM requirements is not occurring in a vacuum, but instead is taking place in parallel with an unprecedented number of other regulatory changes. Among these, are RESPA/TILA integration (on which ABA testified before the Subcommittee on Housing and Insurance on June 20th 2012) and reform mandated by Dodd/Frank, new Mortgage Loan Originator Compensation rules, reforms to the appraisal process and the development of new servicing standards. Implementation of all of these rules must occur in an orderly and coordinated fashion to ensure that disruptions are not created for borrowers, and to provide lenders with adequate time to adjust forms, products and implement training and reprogramming.

ABA believes that this rulemaking will demand significant implementation efforts and will therefore require expanded time periods for compliance. ABA has asked the Bureau to set a compliance date of, at minimum, 18 months from the issuance of the final rule.

ABA advances this request by noting that this rulemaking concerns loan underwriting—the most fundamental element in lending and one that will cause ripple effects across bank functions involving origination, settlement and regulatory compliance. These ability-to-repay requirements will force banks to re-analyze their product lines, retrain staff, and reorganize the processing and administrative elements of their mortgage operations. Banks will be required to make very broad system adjustments at many levels. As ABA expressed in its comments to the Bureau, the technology systems that ensure proper compliance with regulations and that generate the proper disclosures for individualized transactions are integrated rather than isolated. A change in a bank's documentation requirements or qualifying considerations will force a change in the compliance software. These changes must be identified, incorporated into existing systems, and tested to ensure that they respond adequately to all product lines.

There is no question that these rules will force broad scale changes to lending guidelines—as we describe above, secondary market players and investors will have to ensure that none of the loans they purchase fall outside the standards set forth by this rulemaking. The administrative and quality assurance efforts that must be devoted to these investor guideline changes demand considerable implementation resources. Depending on the final shape of the regulations, the ability-to-repay changes will require a reconsideration of most product lines as well as their pricing. Finally, it is important to realize that the scope of the reformation undertaken here will require that regulators develop new enforcement procedures and interpretative guidelines, and examination staff will have to develop new examination procedures for all their visits.

**Conclusion**

The Dodd-Frank Act's ability-to-repay provisions contain the most consequential policy implications of any other mortgage-related regulation. As expressed above, this rule will effectively delineate the scope of residential mortgage lending across all market segments, making it imperative that these provisions be thoroughly weighed and accurately considered. We commend the subcommittee for holding this hearing and for your efforts to work with all interested parties as well as the CFPB to ensure that we achieve a workable, enforceable and efficacious final rule. Again, ABA appreciates this opportunity to submit these comments, as well as the attached comment letters to the CFPB, for the record.

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BILL CHENEY
President & CEO

July 11, 2012

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

Dear Chairman Capito:

On behalf of the Credit Union National Association (CUNA), I am writing regarding the upcoming hearing entitled, "The Impact of Dodd-Frank's Home Mortgage Reforms: Consumer and Market Perspectives". CUNA is the largest credit union advocacy organization in the United States, representing nearly 90% of America's 7,200 state and federally chartered credit unions and their 95 million members. We appreciate your continued work on this important issue, and for the opportunity to submit this letter for the record.

The Committee is examining whether the mortgage reforms in the Dodd-Frank Act addresses weaknesses in current mortgage origination and securitization practices or whether these reforms have overreached and thus made it more difficult to revive the housing market. The hearing will also examine whether the Dodd-Frank Act's mortgage reforms will increase the cost of mortgage credit and reduce access to mortgage credit for otherwise credit-worthy borrowers. To help the Committee examine these concerns, I will focus my comments on three topics relative to the Dodd-Frank Act mortgage reforms: the Consumer Financial Protection Bureau's (CFPB) Know Before You Owe Real Estate Settlement Procedures Act (RESPA)/Truth In Lending Act (TILA) Combination rulemaking; CFPB rulemaking exemption authority; and the definition of Qualified Mortgages (QM).

**RESPA/TILA**

CUNA supports providing consumer disclosures that are meaningful and clear for borrowers to understand the important terms of a financial transaction. When the Dodd-Frank Act was being considered by Congress, CUNA strongly supported combining certain RESPA/TILA forms to improve efficiencies in disclosures and minimize disclosure burdens on credit unions as well as on consumers, who are overloaded with financial information that is not practical or useful. During the development of the proposed integrated forms, the CFPB reached out to CUNA on numerous occasions to solicit information on credit unions' views and concerns.

The Honorable Shelley Moore Capito
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However, we have several concerns with the proposal issued July 9, 2012 to implement the combination of the RESPA/TILA forms that the CFPB has issued for comments. At 1,099 pages in length, the proposal is massive and review of the document will be problematic for some stakeholders, particularly in light of other CFPB issues that are pending or in the pipeline. **We are reviewing the proposal, as well as the one on high cost mortgage loans also issued July 9, and would appreciate the opportunity to provide the Subcommittee with additional comments when we complete our reviews. Initially, we are concerned with the Bureau's cost estimates included with the proposed rule on combining RESPA/TILA forms that have led the agency to conclude: "Based on the overall impact of the proposal...the Bureau does not believe that the proposal would lead to an increase in the cost of mortgage lending."**

*Finance Charge*
One aspect of the new RESPA/TILA proposal would be to expand the definition of the finance charge as defined under Regulation Z. As the Bureau has acknowledged, a more-inclusive finance charge as proposed would have the following effects:

- Cause more closed-end loans to trigger HOEPA protections for high-cost loans;
- Cause more loans to trigger requirements to maintain escrow accounts for first-lien higher-priced mortgage loans;
- Cause more loans to trigger requirements to obtain one or more interior appraisals for "higher-risk" mortgage loans;
- Reduce the number of loans that would otherwise be "qualified mortgages" under the ability-to-repay requirements, given that qualified mortgages cannot have points and fees in excess of 3% of the loan amount.

Comments are due to the CFPB on the finance charge definition by September 7, 2012, and CUNA will be focusing on the substance and impact of the proposed expansion of the finance charge definition.

*Effective Dates*
The Bureau is proposing to delay beyond their statutory compliance deadline certain requirements relating to new disclosures required under the Dodd-Frank Act and is seeking comments on this approach. While Congress is responsible for creating these requirements, it has given the CFPB authority to mitigate compliance burdens and we appreciate the CFPB's willingness to consider how best to use that authority as it relates to these disclosures.

The Bureau is considering the appropriate compliance deadline for the RESPA/TILA proposal, ignoring the fact that Congress did not set a specific date for compliance to begin. We urge Congress to support as much as time possible for credit unions to comply with a final rule, while we also support broad use of the agency's authority to exempt credit unions from new regulations to the greatest extent possible.

**CFPB Exemption Authority**

We are very concerned that the Bureau seems to be picking and choosing when to use statutory flexibility Congress has provided to it to extend relief to credit unions and others from certain compliance responsibilities. We believe the agency has more authority than it has been exercising, such as in the area of remittances, to provide regulatory relief and we will continue to pursue this concern with the agency.

Credit unions were not the cause of the financial and mortgage crisis that prompted Congress to enact legislative remedies to prevent such a calamity from happening again. However, the rules to fix the mortgage market and protect consumers do not solely impact the bad actors – they affect those that acted responsibly as well, such as credit unions. The repeated changes in rulemaking and final rules have a real dollar impact on consumers, especially at credit unions. A dollar spent on regulatory compliance is a dollar diverted from lending. So, in fact, some mortgage reforms in the Dodd-Frank Act do negatively impact access to mortgage credit for consumers.

CUNA believes that the CFPB has the authority to exempt certain entities under Section 1022(b)(3) of the Dodd-Frank Act from a number of regulations the agency is developing. Under this section, the Bureau, "by rule, may conditionally or unconditionally exempt any class of covered persons, service providers, or consumer financial products or services, from any provision of this title, or from any rule issued under this title as necessary or appropriate to carry out the purposes and objectives of this title." CUNA has urged the CFPB to include an analysis of its exemption authority with every proposal and final rule so that every time the agency considers a new regulation, it will also consider whether institutions such as credit unions that are already heavily regulated should be exempted.

The CFPB already has the authority to exempt credit unions from rulemaking. We encourage Congress to request that the CFPB exercise its authority as broadly as possible to protect credit unions from burdensome overregulation, which ultimately affects consumers.

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**<u>"Qualified Mortgage" Definition</u>**

CUNA generally supports the proposed definition of "qualified mortgage" and offers the following comments regarding specific provisions of the proposal.

*"Safe Harbor" Alternative*
CUNA strongly supports the proposed "safe harbor" alternative ("Alternative 1") which would treat "qualified mortgages as a legal safe harbor because the safe harbor approach would provide greater legal protection for credit unions than "Alternative 2" (a "presumption of compliance") with respect to the borrower's "defense to foreclosure" under TILA section 130(k), 15 U.S.C. §1640(k), against creditors that do not do sufficient "ability to repay" analyses.

Credit unions have historically engaged in safe and sound mortgage underwriting that includes a robust ability to repay analysis. Credit unions are concerned that, without a safe harbor, they could be faced with significant amounts of frivolous foreclosure defense litigation with respect to future foreclosures. A credit union making a qualified mortgage should be entitled to significant legal protections because it will have gone well beyond its statutory obligations under TILA to do an "ability-to-repay" analysis.

For these reasons, CUNA supports your efforts, Chairman Capito, along with those of Representative Brad Sherman, and others, in urging the CFPB to issue a final rule that structures the QM as a strong legal safe harbor, not a rebuttable presumption.

*Prepayment Penalties*
CUNA does not support the proposal to include within the definition of "prepayment penalties" waived closing costs that can be recouped in the event of prepayment or certain amortized interest because it would discourage the very member-friendly practice of sometimes waiving some of the costs. In addition, the courts and agencies such as the National Credit Union Administration (NCUA) do not consider these items to be "prepayment penalties".

CUNA opposes including within the prepayment penalty definition fees, such as closing costs, that are waived unless the consumer prepays the loan because NCUA has determined that such arrangements are not "prepayment penalties."[1] Federal credit unions

[1] See, for example, "Prepayment Penalties – Loan Incentives," Letter of Richard S. Schulman, Associate General Counsel, NCUA, to David A. Jones, VP, Hartford Telephone FCU (June 13, 1996) ""When the FCU waives the closing costs, it confers a benefit on the borrower. If the borrower repays his loan within two years and must reimburse the FCU for closing costs, the borrower has simply lost the benefit.") available at http://www.ncua.gov/Legal/OpinionLetters/OL1996-0522.pdf

are currently not permitted to charge prepayment penalties pursuant to 12 U.S.C. § 1757(5)(A)(viii). Conflicting regulatory definition of "prepayment penalty" will lead to increased confusion by credit unions and consumer, and will increase credit union regulatory burden.

CUNA also opposes the proposed treatment as a "prepayment penalty" of amortized interest occurring after prepayment (such as if a mortgage amortizes monthly on the first of the month and the borrower prepays in full on the 5th of the month, but the creditor continues to charge interest as though the loan were still outstanding until the end of the monthly amortization period). The courts have held that such computation methods are not "prepayment penalties"[2] and requiring credit unions that use this type of periodic amortization calculation to treat this method as a "prepayment penalty" for disclosure purposes would be confusing to consumers and would impose significant regulatory burdens on credit unions while providing limited benefits to consumers.

**Conclusion**

We appreciate this Subcommittee's work to ensure that financial regulations do not negatively impact America's credit unions from providing credit to our members. Credit unions did not cause the financial crisis, and continue to serve their members well with financial products and services that are in the best interest of the consumer.

On behalf of America's credit unions and their 95 million members, thank you very much for your consideration of our views.

Best regards,

Bill Cheney
President & CEO

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[2] In *Goldman v. First Federal Sav. & Loan Ass'n*, 518 F.2d 1247 (7th Cir. 1975), Judge (and later Supreme Court Justice) John Paul Stevens' majority opinion specifically held that prepaid unearned interest retained by a federal thrift after the borrowers prepaid their loan was not a "prepayment penalty" within the meaning of the Federal Home loan Bank Board regulations. See id. At 1249-54.

Habitat for Humanity®

*Now More Than Ever.*
Help Build It!

***Testimony for the record***

***Financial Services Subcommittee on Financial Institutions and Consumer Credit***

***U.S. House of Representatives***

***"The Impact of Dodd-Frank's Home Mortgage Reforms:***

***Consumer and Market Perspectives"***

***Elizabeth K. Blake***

***Senior Vice President, Advocacy, Gov't Affairs & General Counsel***

***Habitat for Humanity International***

***July 11, 2012***

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*Habitat for Humanity International appreciates the opportunity to share how the implementation of Dodd-Frank, particularly the qualified mortgage (QM) and ability-to-repay regulations, threaten the important work of Habitat's more than 1500 affiliates around the United States. It may come as a surprise to some on this committee, as it did to many at Habitat, that these reforms, intended to prevent irresponsible and costly lending to borrowers with insufficient resources to pay off their mortgages, could adversely impact Habitat, an organization with over 35 years' experience enabling low-income families to become successful home buyers and owners. Even as the nation's housing market and broader economy struggle to regain their footing, the ongoing success of Habitat's self-help homeownership model—a unique approach to home building and mortgage lending that is thriving—merits federal support, not regulatory intervention that threatens its survival.*

Habitat for Humanity holds the welfare of its low-income partner families as its highest priority, and is encouraged that Congress and the Consumer Financial Protection Bureau are focusing their attention on ensuring their continued access to safe, sound homeownership opportunities. The housing crisis demonstrated the value and effectiveness of focusing on true affordability, as evidenced by the continued success of homeownership models such as that of Habitat for Humanity's 1500 U.S. affiliates. Habitat effectively and consistently serves a key underserved sector of the mortgage market. The mortgages Habitat affiliates originate and service, by design, pose no risk to our partner families or the market.

The implementation of and compliance with the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203) are among the most challenging and complicated tasks ever required of a federal agency, or newly regulated entities, such as Habitat. It is our hope that Dodd-Frank implementation will not result in unintended adverse consequences for Habitat affiliates and our partner families. Habitat recognizes the importance of ensuring adequate protections for consumers in the marketplace. Habitat is also hopeful that these protections will be designed in a manner that rewards (or at least does not penalize) existing good actors already working on behalf of consumers within the market. It would be unfortunate if one-size-fits-all regulatory requirements necessitated difficult decisions on our part, i.e. to divert our ministry's limited resources toward ensuring compliance rather than assisting families in need. Unfortunately, this has become a zero-sum game in the current economy – compliance costs directly impact our ability to help families in need. As rulemaking continues, Habitat encourages Congress and the CFPB to focus their attention on punishing bad actors while taking steps to ensure that those who are doing things right can continue their work.

Specifically, as the CFPB moves forward with the development and implementation of qualified mortgage (QM) and ability-to-repay regulations, Habitat believes it is essential that the final rule considers the impact on all mortgage lenders, nonprofit lenders as well as traditional banks and mortgage banks. Unnecessarily burdensome regulatory requirements that anticipate only the for-profit market will hinder Habitat's unmatched ability to enable low-income families to become home owners, relegating deserving potential Habitat partner families to higher priced, substandard housing.

Since 1976, Habitat has served more than 500,000 families, constructing, rehabilitating and repairing homes around the world. In the United States, Habitat has been ranked as the country's sixth largest homebuilder on Builder magazine's top-100-list for the last two years. But what is not as well known is that Habitat's U.S. affiliates also serve as mortgage lenders and servicers for its families. Although the number of loans originated is small as compared to a large traditional mortgage company, Habitat's ability to provide and service mortgages has been a key factor in our Habitat partner families' continued success. Unlike conventional home loan programs, Habitat's low-income partner families purchase their homes with affordable no-profit mortgages provided through local Habitat affiliates. Habitat's no-profit/zero percent interest loans are made affordable through the use of mandatory sweat equity (families must help build their homes), volunteer labor, and cash and in-kind donations. All home sales and mortgage financing transitions are conducted in such a way as to ensure that the monthly payments of a Habitat homeowner do not exceed 30 percent of the household's gross income.

Additionally, all Habitat partner families receive extensive pre-purchase counseling through the affiliate, focusing on issues such as financial responsibility, budgeting, home repair, and being a good neighbor. The relationship between Habitat affiliates and their partner families is a true partnership, not simply a contractual relationship between a home builder and mortgagor and a purchaser. Habitat affiliates and partner families are financially and physically invested in one another and are dedicated to achieving successful homeownership. Habitat affiliates understand that serving low-income households successfully means putting processes in place to assist partner families when life events result in their being unable to make their mortgage payments, and affiliates partner with families to develop plans, sometimes including forbearances or loan modifications, to remedy their delinquencies. Partner families, by the same token, know that when they face hardships, their affiliates' family services coordinators are there to help.

It is this focus on partnership and true affordability that has kept Habitat's national foreclosure rate at less than two percent, even as home foreclosure and abandonment rates reached record levels across the country in the broader mortgage market. Based on our unique model and this strong record of success, Habitat affiliates never expected to be affected by financial services reforms. In fact, in determining need, our Habitat affiliates specifically focus on those families that cannot qualify for a conventional mortgage. The broad scope of Dodd-Frank has, however, swept Habitat affiliates under many of the same regulations intended to apply to banks and other for-profit lenders, potentially threatening the ability of Habitat affiliates to continue meeting the housing needs of their communities and the nontraditional borrowers they serve.

For that reason, Habitat echoes the view of the broader housing community in recommending a broadly defined QM standard, flexible enough to incorporate uniquely effective lending opportunities such as those presented by Habitat affiliates. A QM that is too narrowly defined, or which anticipates only for-profit underwriting standards by focusing only on rigid LTV ratios or strict credit score minimums, will preclude Habitat affiliates from being able to serve their communities. A narrow QM definition could also limit our ability to partner effectively with banks and state housing agencies by pushing our loans into the non-QM market.

Habitat was pleased to see the original qualified mortgage language proposed by the Board of Governors of the Federal Reserve System, which included an alternative that would allow for a legal safe harbor, provided four common sense factors were met. Habitat's no-profit mortgage model would fit well within this definition, so long as none of the factors were further narrowed in a manner that would preclude our families from participating.

The impact of relegating Habitat loans to non-QM status would be devastating. Thousands fewer families would be served each year. Strong partners such as banks and state housing finance agencies would likely be unable to partner with us, owing to liability concerns. Such an omission would also endanger our nationally recognized FlexCAP program, which provides liquidity to affiliates to enable additional building, as well as our affiliates' ability to leverage their mortgage portfolios at the state and local levels – potentially impacting millions of dollars. The reputational risks would also be severe, as donors and partners questioned why our loans couldn't meet federal standards. In summary, designating Habitat loans as non-QM loans would likely put an end to our ability to help those in need in the United States.

Habitat affiliates are similarly concerned about their ability to predict and manage liability risks. The QM has important implications in this regard, including the need to structure the QM as a safe harbor. More than half of all Habitat affiliates are small, making only one or two loans each year, and are frequently managed solely by volunteers. Because a single adverse judgment could devastate or even bankrupt an affiliate, it is vitally important both that mortgage standards are clearly defined and that the scope of potential litigation is limited and predictable. In order to manage their risks effectively, affiliates need to know that mortgages meeting QM standards will not be subject to litigation under the ability-to-repay rule. Inclusion of a safe harbor provision based on the QM will both protect consumers and preserve Habitat affiliates' exceptional ability to serve low-income families with homeownership opportunities.

Thank you for your consideration of Habitat's concerns regarding these critical aspects of the Dodd-Frank reforms. Habitat looks forward to working with the members of this subcommittee and with the CFPB, to preserve low-income households' access to well-structured, affordable Habitat mortgages, to protect Habitat affiliates from unwarranted litigation, and to continue to support the recovery of the housing market by providing affordable homeownership opportunities to first-time homebuyers.

**Alys Cohen**
**National Consumer Law Center**

**Answer to Question from Rep. Huizenga re: July 11, 2012 Hearing, "The Impact of Dodd-Frank's Home Mortgage Reforms: Consumer and Market Perspectives"**

The points and fees calculation should not double count compensation paid to loan officers who are employees of the mortgage originator.

With regard to taxes and insurance, taxes already are excluded from the points and fees definition, as is property insurance that is reasonable, for which the creditor receives no direct or indirect compensation and is paid to a third party not affiliated with the creditor.

At this juncture, it is the Consumer Financial Protection Bureau's role to implement these and many other provisions of the Dodd-Frank Act. As the agency with substantive expertise charged with drafting implementing regulations for Truth in Lending, it is the Bureau's role to address inconsistencies and ambiguities in the statute. The task of addressing such matters is squarely within the purview of the Bureau and, as it is a technical matter, is best suited to regulators rather than the legislative process.