

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.

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

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.

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 Act¹⁷ 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

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/FLTITeInsMkt.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

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.

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 produced 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 would 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.

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.

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

<i>Number of foreclosures initiated in 2010 (by OCC/OTS reporting services)</i> ⁴⁰	1.4 Million
<i>Number of cases involving Truth in Lending & foreclosure 2010</i>	904
<i>Number of such cases also involving TIL rescission</i> 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, Tab13 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.