Consumer Mortgage Coalition

August 1, 2011

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551
Attn: Jennifer J. Johnson, Secretary
Docket No. 2011-1411, RIN 7100-AD-70

Department of the Treasury
Office of the Comptroller of the Currency
250 E Street, S.W., Mail Stop 2-3
Washington, DC 20219
Docket OCC-2011-0002, RIN 1557-AD40

Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429
Attn.: Comments, Robert E. Feldman,
Executive Secretary
RIN 3064-AD74

Federal Housing Finance Agency
1700 G Street, N.W., Fourth Floor
Washington, DC 20552
Attn.: Alfred M. Pollard, General Counsel
RIN 2590-AA43

Department of Housing and Urban Development
Regulations Division
Office of General Counsel
451 7th Street, S.W., Room 10276
Washington, DC 20410-0500
RIN 2501-AD53

Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090
Attn.: Elizabeth M. Murphy, Secretary
RIN 3235-AK96
Release No. 34-64148; File No. S7-14-11

Re: Credit Risk Retention and Qualified Residential Mortgages

Ladies and Gentlemen:

The Consumer Mortgage Coalition (CMC), a trade association of national mortgage lenders, servicers, and service providers, appreciates the opportunity to submit comments on the proposed credit risk retention and qualified residential mortgage (QRM) rulemaking.

While this rulemaking is undertaken by six agencies that do not include the new Consumer Financial Protection Bureau (CFPB), it is closely linked with a CFPB rulemaking. That rulemaking will implement an ability-to-repay requirement under the Truth in Lending Act (TILA). Depending on how it is finalized, it may offer protection from litigation and damages to creditors and investors who limit their activities to qualified mortgages (QMs). We write this letter to ensure you are aware of the interplay of the QRM and QM rulemakings so that you can consider them as part of the QRM rulemaking. The interplay has the ability to constrain consumer mortgage far more than Congress ever intended. At the same time, neither rule would address the need for transparency to prevent origination of unsound loans. Both rules have the potential to limit the availability and liquidity of consumer mortgage credit, an unintended but very real consequence.

Background

The government created the government sponsored enterprises (GSEs) with all of their attendant benefits, and allowed and encouraged them to move down the credit spectrum, taking on increasing amounts of credit risk with extremely low capital requirements that Congress set in 1992. The GSE system that the government created was designed to allow investors to rely on the GSEs' guarantees and implied government backing, thus eliminating the need for investor due diligence in analyzing MBS and the underlying loans. Indeed, Fannie Mae and Freddie Mac actually prevented investors from even being able to get access to the underlying data, and their actions were sanctioned by the government.

The government also created another government "monopoly" – the "other GSEs" – the rating agencies. And, like Fannie Mae and Freddie Mac, the government-created system was designed so that investors would rely on the rating agencies without researching the quality of the mortgage assets in which they were investing. And again, it was and remains difficult for independent analysts and potential investors to get access to the underlying data.

Not surprisingly, this non-transparent housing finance system that relied on government-sponsored enterprises for analyzing, assessing, underwriting, and monitoring the assets that they guaranteed, purchased, and/or rated was doomed to fail. Essentially, the system eliminated the normal investor "checks and balances" that occur in the marketplace, thus setting the stage for the disaster that unfortunately unfolded. To be sure, there were many participants who took advantage of the system, but the government created a system that allowed market participants, worldwide, to exploit it.

In response to the crisis, the Congress enacted the Dodd-Frank Act, which attempted to solve the problems that led to the crisis by controlling "outcomes," including types of loans available. While well-intended, this approach may inadvertently extend and worsen the existing crisis by significantly and permanently limiting the availability of consumer mortgage credit in this country.

Instead of trying to control for every "outcome," the government needs to focus on creating a process through which informed decisions can be made. We need a transparent system that makes loan-level information for every securitized asset widely available so analysts worldwide can analyze and debate investment opportunities, and price those risks/investments accordingly. This will also reduce the mortgage markets' dependence on the government and, eventually, on the guarantees or opinions of government-sponsored organizations. Finally, a transparent housing finance system will enable private capital to flow back into the consumer mortgage finance sector, provided that the regulations are clear and that the legal liabilities are both quantifiable and rational.

The QRM-QM Interplay

The QRM and QM rules are both required by the Dodd-Frank Act[1] but they were not designed together. The QRM rule is part of Title IX of the Dodd-Frank Act, while the QM rule is part of Title XIV. The overlap between the two rules was therefore not fully deliberated as the legislation was crafted and passed. Nevertheless, it is highly significant to the ability of both rules to accomplish their purposes.

Both rules arose out of the problem of high mortgage default rates, and a belief that the "originate to distribute" practice encouraged origination of loans that would have a high chance of defaulting. How the two rules would accomplish this is different. The risk retention rule would require originators or securitizers to retain five percent of the credit risk of their loans, although QRMs would be exempt from the risk retention requirement. The definition of QRM is therefore quite important.

The QM rule is designed to require certain underwriting procedures to ensure borrowers have a reasonable ability to repay their loans. Rather than requiring risk retention explicitly, this rule does so indirectly. It would provide severe liability for loans that do not meet the ability-to-repay requirements. If a creditor were to make a loan and sell it, the creditor could still be liable after the sale. That is, the rule imposes risk retention indirectly.

TILA liability can be severe. It reaches creditors and assignees. Damages can include statutory damages, actual damages, class actions, and a defense to foreclosure.[2] In addition to TILA liability, the CFPB's authority reaches covered persons and their service providers, with service provider being defined very broadly.[3] It is unlawful for covered persons and service providers to "commit any act or omission" in violation of TILA.[4] In addition, it is unlawful for any "person" to knowingly or recklessly assist a covered person or service provider in an "unfair, deceptive, or abusive" practice.[5] The CFPB has broad enforcement authority to require, among many other things, rescission of contracts and payment of damages and other monetary relief.[6] States can also bring actions for violations.[7] The CFPB can assess civil money penalties, for *un*intentional

[1] Pub. L. No. 111-203, 124 Stat 1376 (2010).
[2] TILA § 130(a), 15 U.S.C. § 1640(a), as amended by Dodd-Frank.
[3] Dodd-Frank § 1002(26), 124 Stat. at 1962-63.
[4] Dodd-Frank Act § 1036(a)(1), 124 Stat. at 2010.
[5] Dodd-Frank Act §§ 1036(a)(3), 1031(a), 124 Stat. at 2011, 2005.
[6] *See* Dodd-Frank Act § 1055, 124 Stat. at 2029-31.
[7] Dodd-Frank Act § 1042, 124 Stat. at 2012-14.

violations, of $5,000 per day.[8] With an unclear regulation, unintentional violations are likely.

The QM rule may offer some protection from liability for loans that meet a QM definition. The proposed rule contains two alternatives for this protection, a safe harbor from liability for QMs, and a presumption of compliance for QMs. Depending on how clear the QM definition turns out to be, and depending on whether the final rule contains a certain safe harbor, the QM definition may be important.[9]

If this definition, as finalized, is unclear or if there is no safe harbor, consumer mortgage lenders and investors would need some method to protect themselves from liability if they will continue making and investing in consumer mortgage loans. One available defense would be to constrain lending and investing to mortgage loans that meet the QRM definition. By statute, the QRM definition must be "no broader" than the QM definition.[10] By making only QRM loans, the creditor can defend TILA litigation by arguing that the loan must be within the QM definition because it is a QRM, a narrower definition. Moreover, when six federal agencies conduct a rulemaking to address consumer mortgage loan underwriting and define QRM, they would define QRMs as appropriate loans. Staying within the federal government definition of sound loan will provide a defense to TILA litigation.

It is possible that there will be no QM safe harbor, or that there will be one but the QM definition will be too unclear for creditors and investors to know how to comply with it. In either event, mortgage credit may well be constrained to QRM loans. The definition of QRM could therefore have a direct impact on the QM rulemaking.

Moreover, it is important to understand how another law, HOEPA[11] will limit the ability to manage risk retention requirements. HOEPA was designed to restrict predatory mortgage loans. It restricts loans that have either an interest rate or points and fees above thresholds. The Dodd-Frank Act lowered the HOEPA thresholds, and extended HOEPA to purchase-money loans. The new threshold is now either the average prime offer rate (APOR) plus 6.5 percentage points (8.5 for junior loans), or points and fees of 5 percent of the loan amount. Points and fees are defined broadly. Loans that have either a high interest rate *or* high costs will exceed the HOEPA threshold much more easily.

HOEPA affects the QRM rulemaking because, for those willing to make non-QRM loans, raising the rate or points to cover the cost of risk-retention might also result in the loan exceeding the HOEPA thresholds.

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[8] Dodd-Frank Act § 1055(c)(2)(A), 124 Stat. at 2030.
[9] We attach the comment letter CMC filed in the QM rulemaking because it details the issues in the QM rulemaking.
[10] Dodd-Frank § 941(b), 124 Stat. at 1895.
[11] Home Ownership and Equity Protection Act of 1994, part of the Truth in Lending Act (TILA).

In addition, Dodd-Frank increased HOEPA liability, so creditors will now be even less willing to exceed the HOEPA thresholds than in the past. Creditors typically have not made HOEPA loans and investors have avoided them because of the liability and reputation risks. HOEPA lending was never commonplace, and it has decreased steadily for years. In 2009, the latest year for which GAO has data, there were only 6,500 HOEPA loans nationwide.[12] Creditors will not make more than a handful of loans that exceed the HOEPA thresholds.

There is not enough room under the HOEPA threshold to cover both the cost of the risk retention requirement and the cost of QM litigation risk. This will seriously constrain mortgage credit.

We urge the regulators not to finalize the QRM definition apart from the QM definition because the QM definition may determine the maximum reach of the QRM definition.

Need for a Uniform National Servicing Standard

We urge the regulators to limit the QRM rulemaking to areas where it can have the intended positive impacts on the market. One area where it has the potential for unintended harm is the proposal for the QRM rule to set mortgage servicing standards. We certainly agree that standards need to be improved. However, we agree with the Financial Stability Oversight Committee (FSOC) that the standards need to be *uniform and national.* FSOC recommended as follows:

> Improve the overall quality of mortgage servicing by establishing national mortgage servicing standards and servicer compensation reform. The mortgage servicing industry was unprepared and poorly structured to address the rapid increase in defaults and foreclosures. To address this structural vulnerability, regulators should establish national mortgage servicing standards and promote alternative servicer compensation models.
>
> National mortgage servicing standards should provide clarity to borrowers and investors, and servicers should be held to the same quality and responsiveness standards regardless of whether the loans being serviced are held on the originator's books, have been sold, or have been securitized. National standards would align incentives and provide clarity and consistency to borrowers and investors, especially in the case of delinquency. These standards will enhance the integrity and efficiency of mortgage servicing and help reestablish investor

[12] According to GAO, in 2004, lenders made 23,000 HOEPA loans, or only 0.003 percent of all the originations of home-secured refinance or home improvement loans. The number of HOEPA loans rose to about 36,000 in 2005 but fell every year thereafter. In 2009, these loans numbered only 6,500. *Mortgage Reform: Potential Impacts of Provisions in the Dodd-Frank Act on Homebuyers and the Mortgage Market*, GAO-11-656, pp. 56-57 (July 2011).

confidence in the housing finance market.[13]

If the standards are to be uniform and national, they will need to be coordinated with existing regulatory efforts to reform the standards. Several agencies, including Fannie Mae and Freddie Mac, are in the process of redesigning and improving mortgage servicing standards outside of the present rulemaking. We strongly support this effort. It is broader than the servicing standards proposed in the QRM rulemaking, as it includes servicer compensation reform as well. Servicing compensation needs to be addressed as part of the reform project. The GSEs can help implement uniform national servicing standards because of their dominant market role today. When the private-label securitization market returns, it will be able to adopt the uniform nationwide standard.

Setting standards as part of a rule that affects only QRM loans will not reach the entire market, and would result in varied standards. Moreover, it would reform the standards in a piecemeal fashion, when a comprehensive redesign is more efficient. Further, mortgage securitizers and servicers are often not the same entity. If servicing standards were set in mortgage documents, the servicing may not be as liquid as it would with a uniform national standard. Varied, piecemeal standards would be counterproductive.

While we certainly appreciate the regulators' efforts to improve servicing standards, for these reasons, the QRM rulemaking is not the appropriate avenue for implementing reform to those standards.

We are further concerned that if the QRM rule sets mortgage servicing standards, it could inadvertently constrain QRM credit. Servicers will be disinclined to implement costly QRM servicing standards that differ from the GSE standards. It could serve as a disincentive to originate QRM loans.

Thus, as the QM rulemaking could constrain the market to making only QRM loans, piecemeal servicing standards in the QRM rule could prevent the market from making QRM loans. We are quite concerned that capital may avoid the consumer mortgage industry broadly. It is imperative that the rulemakings not destroy the fragile markets in an effort to improve them. The interplay of the QRM and QM rules needs to be addressed before any rule moves forward.

Points and Fees

As proposed, both the QRM and QM rules would limit points and fees on protected loans to three percent. This limit would be extremely tough for lenders to meet, especially on smaller loans. We encourage the rulewriters to consider the ramifications on the availability of mortgage credit under such a tight limit.

We also note that the two rules would not use the same definition of points and fees, although there is no policy reason for there to be a difference. The definitions need to be

[13] FSOC *Annual Report*, p. 13-14 (July 2011), available here.

aligned, if only to ensure proper compliance with the rule.

Moreover, neither rule uses a clear definition of points and fees. The attached CMC comment letter on the QM rulemaking walks through the issues with the confusing definition. We believe it includes many items that would be unworkable in a definition, or would be otherwise inappropriate.

Conclusion

We recommend that all six agencies carefully weigh the QM impacts on the QRM rulemaking, and of the QRM impacts on the QM rule. We urge the regulators to focus rulewriting on restoring the securitization markets, and to avoid unintentional credit constraints. We strongly urge that the QRM rule be delayed until the agencies have addressed the unintended consequences of the interplay of these rules.

Sincerely,

Anne C. Canfield
Executive Director

Attachment

July 22, 2011

Ms. Jennifer J. Johnson
Secretary, Board of Governors of
the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C.

Re: Qualified Mortgage Proposed Rule
Docket No. R-1417
RIN No. 7100-AD75

Dear Ms. Johnson:

The Consumer Mortgage Coalition (CMC), a trade association of national mortgage lenders, servicers, and service providers, appreciates the opportunity to submit comments on the proposed qualified mortgage (QM) rulemaking. While the Board of Governors of the Federal Reserve System (Board) proposed this rule, the Consumer Financial Protection Bureau (CFPB) will finalize it.

The CMC recognizes both the Board's efforts in drafting the Proposal and the difficulties the CFPB will face in finalizing a rule at a time when the mortgage market is expected to remain in turmoil for some years to come. Over the past two years, we have seen 1.4 million homes foreclosed or forfeited.[1] Housing economists are predicting five million more foreclosures over the next 18 to 36 months and 11 million foreclosures over the next six or seven years.[2] The government needs to ensure that its policies and regulations allow the housing sector to recover, rather than inadvertently thwart its recovery.

We believe that these rules are among the most important provisions of Dodd-Frank's consumer protection provisions. If they are not carefully crafted, serious disruptions in the availability of mortgage credit will occur. It is critical that the Bureau provide lenders with clear, understandable rules, and a safe harbor to properly shield lenders when they make safe loans. A final rule that does not give lenders clarity in standards and a safe harbor will not prove sufficient protection to achieve the goal of ensuring that consumer

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[1] According to OCC Mortgage Metrics Reports, available here: http://occ.gov/publications/publications-by-type/other-publications/mortgage-metrics.html.
[2] *See*, for example, Laurie Goodman, *Is Dodd-Frank Regulation Cutting off Mortgage Credit?*, at 3 (July 21, 2011), available here. http://www.aei.org/docLib/AEI%2007-21-2011%20Goodman.pdf

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mortgage credit is available to creditworthy borrowers, including vulnerable populations. With this in mind, we make the following recommendations:

- The final rule should be coordinated with the Dodd-Frank risk retention rule, recognizing the interplay of the two proposed rules with each other, and of both of these rules with the lower HOEPA[3] thresholds established by the Dodd-Frank Act.[4] The QM rule should also be coordinated with other existing statutory and regulatory requirements.
- "Qualified Mortgage" must be a safe harbor from liability under the ability-to-repay requirement to ensure that consumers have access to affordable and reasonably-priced consumer mortgage loans.
- The points and fees definition should be adjusted to avoid unintended consequences.
- The CFPB should broaden the category of loans eligible for a streamlined refinance under proposed § 226.43(d).
- The ability-to-repay rule should retain its flexibility but definitive guidance is needed.
- The CFPB should include "Know Your Rules" as an integral part of its "Know Before Your Owe" effort, and make a practice of writing consumer rules in plain English so that consumers will be able to understand the rules that govern their financial products and services.

I. Background

Before we provide our more detailed comments on the proposed rule, we would like to discuss how the structure of the U.S. housing finance system created the financial crisis that continues today, and to comment on the Dodd-Frank response to that crisis. We are making these observations so that the government is mindful of our views as it moves forward on this and other rulemakings and reforms to the housing finance system.

First, the government created the government sponsored enterprises (GSEs) with all of their attendant benefits, and then allowed and encouraged them to move down the credit spectrum, taking on increasing amounts of credit risk with extremely low capital requirements that Congress set in the 1992 GSE Act.[5] The GSE system that the government created was designed to allow investors to rely on the GSEs' guarantees and implied government backing, thus eliminating the need for investor due diligence in analyzing the underlying securities. Indeed, Fannie Mae and Freddie Mac actually prevented investors from even being able to get access to the underlying data, and their actions were sanctioned by the government.

[3] Home Ownership and Equity Protection Act of 1994, part of the Truth in Lending Act (TILA).
[4] Pub. L. No. 111-203, 124 Stat. 1376 (2010) (hereafter the Dodd-Frank or the Dodd-Frank Act).
[5] Pub. L. No. 102-550, 106 Stat. 3672.

Second, the government created another government "monopoly" – the "other GSEs" – the rating agencies. And, like Fannie Mae and Freddie Mac, the government-created system was designed so that investors would rely on the rating agencies without doing any research on the quality of the mortgage assets in which they were investing. And again, it was and remains difficult for independent analysts and potential investors to get access to the underlying data.

Not surprisingly, this non-transparent housing finance system that relied on government-sponsored enterprises for analyzing, assessing, underwriting, and monitoring the assets that they guaranteed, purchased, or rated was doomed to fail. Essentially, the system eliminated the normal "checks and balances" that occur in the marketplace, thus setting the stage for the disaster that unfortunately unfolded. To be sure, there were many participants who took advantage of the system that was created, but the government created a system that allowed market participants, worldwide, to exploit it.

In response to the crisis, the Congress enacted the Dodd-Frank Act, which attempted to solve the problems that led to the crisis by controlling "outcomes." While well-intended, this approach may inadvertently extend and worsen the existing crisis by significantly and permanently limiting the availability of consumer mortgage credit in this country.

Instead of trying to control for every "outcome," the government needs to focus on creating a process through which informed decisions can be made. We need a transparent system that makes loan-level information for every securitized asset widely available so analysts worldwide can analyze and debate investment opportunities, and price those risks and investments accordingly. This will also reduce the mortgage markets' dependence on the government and, eventually, on the guarantees or opinions of government-sponsored organizations. Finally, a transparent housing finance system will enable private capital to flow back into the consumer mortgage finance sector, *provided that the regulations governing the industry are clear and that the legal liabilities are both quantifiable and have a rational basis.*

The proposed rule is very unclear, as well as complex, and would impose enormous liability on the industry. The rule could potentially move mortgage investors towards pricing consumer mortgage credit as unsecured, rather than secured credit. At the same time, the rule is very likely to prevent many creditworthy borrowers from obtaining mortgage loans.

II. <u>The Final Rule Should be Coordinated With Other Rulemakings</u>

The Dodd-Frank Act perhaps was the most significant reform of the financial services industry ever enacted and will require the regulators to promulgate hundreds of rulemakings, many of which impact the mortgage finance industry. It is critically important that the rules be coordinated and implemented in a logical manner so that they are consistent, enable the industry to manage the changes that the rulemakings will require in a timely and cost-effective manner, and prevent the rules from having a negative impact on both the availability of consumer mortgage credit and the broader economy.

The most important need for coordination among rulemakings involves the CFPB's QM rulemaking and the interagency rule on credit risk retention and qualified residential mortgages (QRM). Six federal agencies published a proposed QRM regulation that would define QRM very narrowly. The interagency proposal would require five percent risk retention for securitized assets, but would exempt government loans and QRMs from this requirement. Among other limitations, the proposed rule would require a 20 percent down payment to purchase a home; limit the combined loan to value (CLTV) ratio on a rate-and-term refinance to 75 percent and on a cash-out refinance to 70 percent; and limit debt-to-income ratios to 28-36.

The Congress clearly viewed QRM loans as a subset of QM loans because it required the agencies to define QRM "to be no broader than" a QM.[6] The QM rule has not been finalized, so it is not possible to understand the impact of the risk retention and QRM rules together. Therefore, we recommend that the CFPB issue a final QM rule before the six agencies finalize the credit risk retention and QRM rule. In addition, as the CFPB develops the final QM definition, it should closely consult the six agencies working on the risk retention rule, as required by Dodd-Frank.[7]

The CFPB should also take into consideration the need to carefully coordinate the implementation of new mortgage disclosure reforms with the implementation of the ability-to-repay rule. The CMC has long history of supporting efforts to streamline mortgage disclosures and is now working with the CFPB on this important project, but we request that the implementation of these rules be coordinated so that the consumer mortgage finance market will not experience unnecessary disruptions and costs that would negatively impact both the industry and consumers.

The following are a just a few of the many examples where coordination is necessary:

- The proposed QM rule uses a comparison of an annual percentage rate (APR) to an average prime offered rate (APOR). The Dodd-Frank Act uses an APR-APOR comparison in seven places,[8] but the QM rulemaking considers only one of them. The better approach would be to consider all the APR-APOR comparisons together because they are similar. Very importantly, it would be considerably less burdensome for creditors to implement the APR-APOR comparison once rather

[6] Dodd-Frank § 941(b), 124 Stat. at 1895.

[7] [T]he Bureau shall consult with the appropriate prudential regulators or other Federal agencies prior to proposing a rule and during the comment process regarding consistency with prudential, market, or systemic objectives administered by such agencies[.] Dodd-Frank § 1022(b)(2)(B), 124 Stat. at 1981.

[8] Dodd-Frank Act § 1431(a), 124 Stat. at 2157, new TILA § 103(aa)(1)(A)(i); § 1431(d), 124 Stat. at 2159-60, new TILA § 103(dd); § 1411(a)(2), 124 Stat. at 2144, new TILA § 129C(a)(6)(D)(ii); § 1412, 124 Stat. at 2147, new TILA § 129C(b)(2)(C)(ii); § 1414(a), 124 Stat. at 2149, new TILA § 129C(c)(1)(B)(ii); § 1461(a), 124 Stat. at 2178-79, new TILA § 129D(b)(3); § 1471, 124 Stat. at 2187, new TILA § 129H(f)(2).

than seven times. Moreover, adopting them in a coordinated fashion will prevent inadvertent drafting differences that require an additional rulemaking and an additional implementation process.

- The Know Before You Owe project has not made clear whether a broker will be required or permitted to provide the initial Loan Estimate. This decision will affect what is needed to be compliant. It should be coordinated with any duty-of-care rules under § 129B.
- The new preclosing disclosures required by the amendments to § 128, the preclosing partial payment disclosure required by § 129C, the preclosing escrow disclosures required by § 129D, and the preclosing appraisal disclosures required by § 129H, should all be implemented as part of the Know Before You Owe disclosures.
- Escrow accounts are currently required on most higher-priced mortgage loans under § 226.35(b)(3). The QM rule proposes to repeal all of § 226.35. Logically, this would repeal the escrow requirement for existing higher-priced mortgage loans, but we doubt that was intended.

Under Dodd-Frank section 1400, rulemakings required by Title XIV must take effect within 12 months after they are issued in final form.[9] The QRM rule also has a 12-month implementation period after it is final.[10] Given that the industry has only 12 months to come into compliance with many Title XIV rules and the risk retention and QRM rule, coordinating the rulemakings is critical so that employee training and the time-consuming system changes can be completed in a timely and efficient manner.

Considering the rules in isolation presents a very real possibility that the rules will be inconsistent and have unintended consequences that will harm both consumers and industry alike.

III. Mortgage Markets Require a Safe Harbor and Clear QM Definition

Dodd-Frank's ability-to-repay requirement was enacted to ensure that mortgage loans be prudently underwritten and that borrowers have a reasonable ability to repay the mortgage loan when the mortgage is granted, while ensuring that consumers have access to affordable mortgage credit. The CMC supports those goals and wants to ensure that irresponsible lending practices of the past do not return to the U.S. mortgage market.

As we explain below, we are concerned that the proposed rule will further tighten and codify stringent credit standards, thereby limiting the availability of consumer mortgage credit only to borrowers with significant financial assets and pristine credit records.

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[9] Dodd-Frank Act § 1400, 124 Stat. at 2136.

[10] Dodd-Frank Act § 941(b), 124 Stat. at 1896, to be codified at 15 U.S.C. § 78o-11(i)(1).

A. A Safe Harbor is Needed to Ensure Continued Consumer Mortgage Credit Availability

The proposed rule contains two alternatives for determining compliance with the ability-to-repay requirement. One alternative is a safe harbor from liability; the other is a presumption of compliance with the requirement. The lack of a bright-line safe harbor and clear QM definition would result in greatly increased litigation risk for the mortgage industry. Dodd-Frank subjects creditors and investors to very significant litigation risk and legal liability for making or investing in loans that a borrower is not reasonably able to repay. Without a clear QM definition <u>and</u> an "air tight" safe harbor in a final rule, the mortgage industry will be unable to avoid extensive litigation.

Under TILA, when a creditor, assignee, or servicer brings a foreclosure or debt collection action, the consumer may assert a violation of the ability-to-repay requirement as a defense, without regard to the statutory time for bringing an action for TILA damages.[11] Default itself can indicate inability to repay. Under Dodd-Frank, borrowers will be able to default on their loans then sue the lender for TILA damages because the borrower defaulted. That is, consumers would be able to seek damages, not because of an inability to repay, but because of an unwillingness to repay. With or without a foreclosure action, the consumer can recover actual damages, statutory damages, and "all of the finance charges paid by the consumer[.]"[12] That is, damages would exceed all profit on the loan.

In addition to TILA liability, the CFPB's authority reaches covered persons and their service providers, with service provider being defined very broadly.[13] It is unlawful for covered persons and service providers to "commit any act or omission" in violation of TILA.[14] In addition, it is unlawful for any "person" to knowingly or recklessly assist a covered person or service provider in an "unfair, deceptive, or abusive" practice.[15] The CFPB has broad enforcement authority to require, among many other things, rescission of contracts and payment of damages and other monetary relief.[16] States can also bring actions for violations.[17]

Notably, these CFPB actions are not limited to intentional, reckless, or even negligent violations. In addition to other actions, the CFPB can assess civil money penalties, for *un*intentional violations, of $5,000 per day. With an unclear regulation, unintentional violations are likely. The potential liability for violations of the ability-to-repay rule is extensive. A clear rule and a solid safe harbor are therefore critical to preventing a retrenchment in mortgage lending.

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[11] TILA § 130(k)(1), amended at 124 Stat. at 2148-49.
[12] TILA § 130(a).
[13] Dodd-Frank § 1002(26), 124 Stat. at 1962-63.
[14] Dodd-Frank Act § 1036(a)(1), 124 Stat. at 2010.
[15] Dodd-Frank Act §§ 1036(a)(3), 1031(a), 124 Stat. at 2011, 2005.
[16] *See* Dodd-Frank Act § 1055, 124 Stat. at 2029-31.
[17] Dodd-Frank Act § 1042, 124 Stat. at 2012-14.

Even if a creditor were to prevail in a lawsuit, the cost of litigation, including the cost and business disruption of protracted discovery, would far exceed the potential profit on the underlying loans. Creditors will compare the costs to the profitability of mortgage lending. With open-ended litigation risk, many investors will be deterred from returning to the consumer mortgage lending market, thereby decreasing the liquidity in the mortgage market. All lenders, but particularly smaller community banks and other smaller lenders who cannot afford to hold loans in portfolio, will be forced to limit the participation in the consumer mortgage lending market. Ultimately, consumers will be negatively impacted because of the decreased access to consumer mortgage credit and higher costs for the limited amount of mortgage loans that may be available.

Other unintended, but unfortunate consequences of an unclear QM standard include:

- The banks' ability to meet their CRA obligations and their requirements under the Fair Lending laws will be negatively impacted.
- Safety and soundness regulators could potentially increase bank reserve requirements in light of the increased risks associated with the unquantifiable liability resulting from potential litigation.
- Investors can be expected to limit their investments to only seasoned loans.
- Given the experience of the past few years, the servicing of loans has become riskier and more expensive. Servicing non-QM loans will be riskier, thus more expensive.

B. Without a Safe Harbor, the QRM Standard Will Become the "De Facto" Safe Harbor

Understanding the interplay between the proposed QM and QRM rules is important. Six federal agencies will define well-underwritten mortgage loans, QRMs, under the QRM rule. What six agencies define as well-underwritten will drive what meets the QM reasonable ability-to-repay definition. Moreover, by statute the QRM definition may be no broader than the QM definition,[18] so limiting lending and investing to QRMs may serve as a defense, perhaps the only known defense, to unlimited QM liability. The lack of a clear QM definition and a bright-line QM safe harbor would make the QRM definition the *de facto* QM safe harbor.

QRM is proposed to have a very narrow definition. For example, it would include a 20 percent down payment to purchase a home; limit the CLTV on a rate-and-term refinance to 75 percent and on a cash-out refinance to 70 percent; and limit the debt-to-income ratio to 28/36.

The agencies explained that a stringent QRM test would leave a large number of well-underwritten loans outside of the QRM basket and, thereby, would enable a private

[18] Dodd-Frank § 941(b), 124 Stat. at 1895.

secondary market to develop to securitize non-QRM mortgages. We do not agree with that assessment, given the interplay between the proposed QM and QRM rules. It is also important to understand how these two proposed rules are limited by the lower HOEPA thresholds, as established by Dodd-Frank.

The Board's discussion of the proposed rule addresses the safe harbor question. It states a disadvantage of a safe harbor as follows:

> However, the drawback to this approach is that a creditor could not be challenged for failing to underwrite a loan based on the consumer's employment status, simultaneous loans, current debt obligations, or credit history, or for generally not making a reasonable and good faith determination of the consumer's ability to repay the loan.[19]

To the extent this is a concern, the CFPB could simply include these as requirements for a safe harbor.

Creditors, investors and consumers are best served by a clear safe harbor for QM loans. Without one, the availability of consumer mortgage credit will be very limited.

C. QM Definitions and Requirements

The proposed QM definition would prohibit negative amortization and interest-only payments, and would require underwriting based on the maximum rate that may apply during the first five years. We support this approach because these were sources of payment shock that made many loans difficult for consumers to repay.

Generally, the proposal contains two alternative approaches to underwriting (paragraph (e)(2)(v)), one general and another more specific. We acknowledge writing a QM definition is a difficult task because underwriting involves some subjectivity and risk. We urge the CFPB to make the QM definition extremely clear because any lack of clarity would result in creditors reverting to the QRM definition as the *de facto* safe harbor.

Generally, the standard should have some quantitative standards for clarity, and certain compensating factors so that credit will not be limited to those who meet only conservative and traditional credit profiles. We support requiring creditors to verify:

- Income, assets, and employment status on which the creditor relies.
- Current debt obligations.
- Monthly mortgage-related payment, including taxes, insurance, and related obligations.

[19] 76 Fed. Reg. 27390, 27396 (May 11, 2011).

Creditors will need more certainty than the proposal contains on how to document debt obligations. We recommend that creditors be able to rely on a credit report obtained within 90 days before consummation. This provides necessary certainty, and is consistent with GSE requirements and the QRM proposal.[20]

For ARMs, both the QM and QRM rules require consideration of the maximum rate that may apply during the first five years, which makes sense. The QRM rule would measure the five years from the first scheduled payment due date, while the QM rule would measure from the closing date, which would not reach the fully-indexed rate on popular 5/1 ARMs. We believe this was unintended, and that the QRM approach is more protective of consumers.

The proposal would require creditors to consider payments on any subordinate liens. It would require consideration of simultaneous loans the creditor "knows, or has reason to know will be made[.]"[21] This is a subjective and unclear standard and we cannot support it. We suggest that creditors be permitted to rely on FHA guidelines. If there is a HELOC held and serviced by a different creditor, the underwriting creditor will not know of its terms. The CFPB will need to incorporate into its rule a method by which creditors can know how to measure the payment on that HELOC, with certainty. Ultimately, we recommend that the CFPB support legislation to repeal the due-on-sale provision[22] that prevents first-lien investors from rejecting subordinate liens or, at a minimum, let them reject subordinate liens that push the CLTV above 80 percent.

Within the QM definition, there are two alternatives regarding debt-to-income (DTI) ratios. One alternative would require the creditor to consider and verify income and assets. Another would require the creditor to consider and verify six items, including DTI ratio or residual income. The Board explains that one alternative in the QM definition does not require consideration of DTI because a requirement to consider DTI would make QMs unavailable to those with insufficient DTI but who have compensating factors that enable them to repay their loans.[23] We agree that flexibility is helpful. We also agree that adding requirements to the QM definition would tend to constrain credit. However, it is also true that legal uncertainty would constrain credit. *The absence of a safe harbor and clear QM definition would constrain credit more than a DTI requirement in a safe harbor.*

Given two pairs of two alternatives (safe harbor, no safe harbor, DTI requirement, no DTI requirement), there are four possible permutations. Under two permutations, there would not be a bright-line safe harbor. In the absence of a bright-line safe harbor and clear QM definition, creditors would seek certainty. The only available certainty would be the QRM definition because of its government authorship and because, by statute, it is

[20] Proposed § 15(d)(5)(ii)(A), 76 Fed. Reg. 24090 (April 29, 2011).
[21] Proposed § 226.43(c)(2)(iv).
[22] Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, § 341(d)(1), 96 Stat. 1469, 1506, codified at 12 U.S.C. § 1701j-3(d)(1).
[23] 76 Fed. Reg. 27390, 27454 (May 11, 2011).

no broader than the QM definition. That is, without a safe harbor and clear QM definition, the QRM DTI requirement would become the *de facto* QM DTI requirement. This would be true regardless of whether the presumption of ability-to-repay were to have a DTI requirement. The lack of a safe harbor and clear QM definition would very severely constrain credit, regardless of any DTI requirement.

If there were a safe harbor without a DTI requirement, creditors would not be required to consider DTI. If there were a safe harbor with a DTI requirement, creditors would largely or exclusively limit lending to that requirement. That is, if the CFPB believes creditors should consider DTI or residual income, it should do so with a safe harbor. Any other of the four permutations would be ineffective or would drastically curtail consumer mortgage credit.

If the CFPB wants to influence how creditors nationwide manage DTI, it will need to do so by including DTI requirements in a safe harbor. We therefore urge the CFPB to include in a safe harbor the DTI ratio requirements that it finds will strike the appropriate balance between repayment ability and credit availability. Otherwise, creditors will revert to the QRM DTI requirements as the effective QM safe harbor. We recommend that 50 percent would be a reasonable back-end DTI ratio.

This DTI approach would not necessitate abandoning flexibility. The CFPB can incorporate flexibility by making exceptions within its DTI requirement, such as for loans where:

- The consumer has probability for future increased income based on education, job training, or length of time in a profession;
- The consumer's future expenses will be lower, such as child-support payments to cease soon, as a child will reach the age of majority, or the home is an energy-efficient building;
- The consumer has demonstrated ability to carry a higher total debt load while maintaining a good credit history for at least 12 months;
- The consumer has substantial verified liquid assets; or
- There are other appropriate exceptions the CFPB deems appropriate, by regulation or order.

In several places, the Commentary would permit creditors to rely on governmental and nongovernmental standards, such as relying on FHA standards for the definition of "debt" and "income," which we support. It provides clarity, and is consistent with the QRM proposal. For certainty, we request this be included explicitly in a regulation.

We would recommend adopting the credit history standards that are in the proposed QRM rule. These include the following:

- The consumer must be current on all accounts at consummation;
- In the previous two years, the consumer has not been more than 60 days late on any obligation; and
- In the previous three years, the consumer has had no bankruptcy, repossession, foreclosure, or foreclosure alternative.

This approach would provide creditors with much-needed certainty, while reducing regulatory burdens. Some consumers do have temporary circumstances such as job loss or serious illness that affects their credit histories but not their future repayment abilities, and creditors should be permitted to consider these factors. Minor delinquencies should not be determinative for a mortgage creditor, and creditors should be permitted to disregard them.

For those consumers with little credit history, creditors should be permitted to consider alternative payment histories, such as a history of paying rent, utilities, and other bills, for a certain number of months. Lack of credit history does not mean inability to repay, and these borrowers should not always be excluded from the ability to obtain consumer mortgage credit.

Creditors should be permitted to set a minimum credit score in underwriting mortgage loans because credit scores are proven to be good predictors of default risk. In fact, FHA and the GSEs rely on them.

The proposed rule would exempt creditors from certain underwriting requirements on streamlined refinances of non-standard loans into standard loans. We cannot see any reason to restrict streamlined refinances, which clearly benefit the consumer. We recommend that the exemption apply to refinances of standard loans. At a minimum, it should include refinances under HARP and similar programs. Creditors on streamlined refinances should not be required to consider the consumer's DTI ratio or residual income. The payment on the new loan will be lower than the payment on the refinanced loan, and the consumer must have a good payment record on the refinanced loan for two years. This demonstrates ability-to-repay. The requirement that the creditor must receive the streamlined refinance application before the nonstandard loan is recast is unnecessary and should be removed. The timing of an application is irrelevant to the consumer's ability-to-repay or to the consumer's need to refinance. Similarly, the requirement that the creditor consider "whether the standard mortgage will prevent a likely default"[24] should be removed because it irrelevant. Moreover, it is not defined.

Finally, the definition of 30-year term requires clarification. QMs would be limited to a 30-year term.[25] If a loan closes mid-month, the first payment is typically not due for more than a month. For example, if a 30-year loan closes July 22, 2011, the first

[24] Proposed § 226.43(d)(3)(i)(B).
[25] Proposed § 226.43(e)(2)(ii).

payment would be due September 1, 2011, and the 360th payment would be due August 1, 2041. August 1, 2041 is more than 30 years after July 22, 2011.

We do not believe the proposal intended to upset the standard practice of delaying the due date of the first payment. Consumers are accustomed to having a little extra time before the first payment is due. Changing this standard practice would require massive costs to revise systems and promissory notes. We believe the CFPB should define the loan term, for the purpose of § 226.43(e)(2)(ii), to start on the first scheduled due date instead of the closing date.

IV. QM Definition of Points and Fees

A. The Cap on Points and Fees Overly Constrains Consumer Mortgage Credit

Dodd-Frank imposed a three percent limit on points and fees on QM loans. Some people may be of the view that creditors can resolve the extra costs of not having a QM safe harbor and the cost of risk-retention by raising the interest rate or points on loans. Raising the interest rate and points can help, to some extent, but it creates other problems. First, of course, is that this is not a consumer protection, it is a direct consumer cost.

Moreover, in making QMs, raising the rate to cover QM litigation risk might cause the loan to exceed the HOEPA rate threshold. For those willing to make non-QRM loans, raising the rate or points to cover the cost of risk-retention might also result in the loan exceeding the HOEPA rate and points thresholds.

The Dodd-Frank Act lowered the HOEPA thresholds and extended HOEPA liability to purchase-money loans. The new thresholds are now either the APOR plus 6.5 percentage points (8.5 for junior loans), or points and fees of 5 percent of the loan amount. Points and fees are defined broadly. Loans that have either a high interest rate *or* high costs will exceed the HOEPA thresholds much more easily.

In addition, Dodd-Frank increased HOEPA liability, so creditors will now be even less willing to exceed the HOEPA thresholds than in the past. Creditors typically have not made HOEPA loans and investors have avoided them because of the liability and reputation risks. HOEPA lending was never commonplace, and it has decreased steadily for years. In 2009, the latest year for which GAO has data, there were only 6,500 HOEPA loans nationwide.[26] Dodd-Frank increased HOEPA liability, which will reduce HOEPA lending even more. Creditors will not make more than a handful of loans that exceed the HOEPA thresholds.

[26] According to GAO, in 2004, lenders made 23,000 HOEPA loans, or only 0.003 percent of all the originations of home-secured refinance or home improvement loans. The number of HOEPA loans rose to about 36,000 in 2005 but fell every year thereafter. In 2009, these loans numbered only 6,500. *Mortgage Reform: Potential Impacts of Provisions in the Dodd-Frank Act on Homebuyers and the Mortgage Market*, GAO-11-656, pp. 56-57 (July 2011).

There is not enough room under the HOEPA threshold to cover both the cost of the risk retention requirement and, more importantly, the cost of QM litigation risk. This will seriously constrain mortgage credit. The absence of both a very clear QM definition and a bright-line QM safe harbor would exacerbate this credit constraint because it would increase the litigation risk for which creditors must price. The HOEPA limits on rates and points will also constrain lenders' ability to make non-QRM mortgage loans, a fact regulators need to thoroughly consider.

B. The QM Definition of Points and Fees is Unclear

The QM definition of points and fees is extremely difficult to understand. TILA is a consumer protection law, so Regulation Z should be readily understandable to consumers.

Even the question whether the appraisal fee is included in points and fees is not apparent. This is a very basic and uncomplicated question, but the consumer will not know the answer. The commentary contains an illustration of whether the appraisal fee is included in the definition, but the fact that this illustration exists raises two issues.

First, an illustration should not be necessary. Whether a charge is included in the definition of points and fees has only three possible answers – yes, no, or conditionally.

Second, the definition should be included, in its entirety, in the regulation. Compliance with the commentary provides protection from liability. Creditors can comply with a mandate, with a restriction, or with a prohibition. It is not possible to comply with a definition. The commentary therefore cannot affect the definition.

A source of difficulty is the drafting method of adding items into the definition, then removing them. This follows the statutory drafting method, but it does not make the language available to consumers. For example, the definition begins by adding in "[a]ll items considered to be a finance charge under § 226.4(a) and 226.4(b)" (referred to in this letter as 4(a) and 4(b)). It then excludes interest, one of the items listed in 4(b). It would be far simpler to simply list what is in and list what is out.

Another example is hazard insurance. It is first excluded from the definition because it is "payable in a comparable cash transaction" within 4(a) because people who pay cash for homes normally purchase hazard insurance. Hazard insurance is unrelated to ability-to-repay. In fact, there is more reason for a homeowner to purchase hazard insurance in a cash purchase than in a financed purchase because the homeowner has much more equity at risk in a cash purchase.

Hazard insurance is then added to the definition because it is listed in 4(b)(8). It is also added by § 226.32(b)(1)(iv) because it is included in "Premiums or other charges payable at or before closing of the mortgage loan for any . . . accident . . . insurance[.]" The rule contradicts itself as to hazard insurance. How is a consumer to understand this?

Hazard insurance should be excluded from points and fees to avoid an unintended result. When a mortgage finances the purchase of a home, the creditor always requires hazard insurance at or before closing. In a refinance, hazard insurance is already in place, and the creditor will not require the consumer to replace the insurance policy. If hazard insurance were included in the definition of points and fees, points and fees would differ greatly simply based on whether the loan is a refinance. The purpose of the ability-to-repay requirement is to improve underwriting, not to treat home purchasers differently from refinancers. Hazard insurance has nothing whatever to do with a consumer's ability to repay a loan because it is payable on a comparable cash purchase, and it should be excluded from points and fees.

Further complicating the definition is that, when adding and removing items, the language does not always name the items, but rather cites to other provisions. Cross-referencing is not consumer-friendly. The definition would be easier for consumers to read if it simply quoted the intended words.

Additionally, cross-referencing can be unclear. For example, the definition includes "[a]ll items listed in § 226.4(c)(7) (other than the amounts held for future payment of taxes) payable at or before closing of the mortgage loan, unless . . . ." Section 226.4(c) lists items that are *excluded* from the definition of finance charge. Does adding the items in 4(c)(7), that 4(c)(7) excludes, include them or exclude them? If the intention is to add the items, referencing a provision that excludes them is unclear.

Another problem with cross-references relates to § 226.4(d). Items considered to be a finance charge under 226.4(a) or (b) are included in the definition. Among the items in 4(b)(7) is credit life insurance. But 4(d)(1) excludes credit life premiums in certain cases, meaning it is not a finance charge in those cases. Does that mean credit life premiums are "considered to be a finance charge under § 226.4(b)" because they are listed in 4(b) even though they are excluded under 4(d)? Or does the 4(d) exclusion override the 4(b) inclusion?

The Commentary states:

> Items excluded from the finance charge under other provisions of § 226.4 are not excluded in the total 'points and fees' under § 226.32(b)(1)(i), but may be included in 'points and fees' under § 226.32(b)(1)(ii) through § 226.32(b)(1)(vi) and § 226.32(b)(1)(iv).[27]

Even if consumers were to read the commentary and if the commentary could affect the definition, consumers simply will not understand this.

[27] Regulation Z Comment 32(b)-1.

Consumers should be able to read their mortgage rules. It is a natural component of the CFPB's important "Know Before You Owe" mission. We urge the CFPB to make a practice of writing rules in plain English and empower consumers to "Know Your Rules."[28]

Consumers are not the only ones who would benefit from understandable regulations. Lenders and servicers would benefit as well. Coming into compliance with new lending regulations requires programming systems. Information technology teams who program the changes, and the compliance teams who work with them, are experienced with mortgage lending issues. They should be able to pick up a new mortgage regulation and use it immediately. With a regulation this complicated, they cannot do so.

Programming to comply with a convoluted rule cannot begin until after many lawyers have analyzed and tried to decipher the rule. As the implementation process develops, questions inevitably arise, especially with an unclear rule. Every little question that arises with an unclear rule has to funnel through the legal team. With every new question, that means work is delayed until the legal review is complete. This lengthy, bureaucratic process is a completely unnecessary bottleneck.

In its section-by-section analysis, the Board addresses compliance issues:

> From a practical standpoint, the Board is concerned about the increased risk of confusion and compliance error if points and fees has two separate meanings in TILA—one for determining whether a loan is a high-cost mortgage and another for determining whether a loan is a qualified mortgage.[29]

We agree that it is less burdensome to comply with regulations if they use consistent definitions. We urge the regulators to use the same definition we include below for the risk-retention rule as well as for the QM regulation. There is no policy reason why they should differ.

We discuss below a number of substantive issues with the definition, and then include a recommended plain English definition of points and fees for a "Know Your Rules" approach.

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[28] The former Office of Thrift Supervision often wrote its newer regulations in plain English. There are different approaches, and we urge the CFPB to consider them. For example, one style is to use questions and answers. *See* 12 C.F.R. Part 507; 12 C.F.R. Part 555; 12 C.F.R. Part 557; 12 C.F.R. Part 561; 12 C.F.R. Part 563 Subpart H; and 12 C.F.R. Part 585. Even very technically complex regulations can be written in this manner. *See* 12 C.F.R. Part 563b. Another style includes tables or charts along with questions and answers, to display information graphically. *See* 12 C.F.R. Part 502; 12 C.F.R. Part 516; 12 C.F.R. Part 550; 12 C.F.R. Part 551; 12 C.F.R. Part 559; and 12 C.F.R. Part 563 Subpart E. A chart may have explanatory endnotes to keep the chart free of clutter. *See* 12 C.F.R. § 560.30. All of these regulations use clear language and simple sentence structures. ***Especially*** for consumer protection regulations, plain English is important.

[29] 76 Fed. Reg. 27390, 27402 (May 11, 2011).

C. The Proposed Small Loan Exception Would Unduly Constrain Small Loans

The proposed rule would relax the cap on points and fees for loans under $75,000. This number is simply too low. Small loans cost more to originate, in relation to their profit potential, than large loans.

By setting this limit so low, the rule would constrain credit to consumers who can afford only small loans. If the cost of originating a small loan is more than the potential profit, small mortgage loans will cease to exist. This would make credit unavailable to lower-income borrowers and those who live in areas where the cost of housing is low. The intent of Dodd-Frank was not to restrict credit only to the wealthy. We therefore recommend that the definition of small loan be increased to at least $100,000, and then indexed for inflation.

The proposed Alternative 1 for paragraph (e)(3)(i) sets out five tiers of loan sizes, with the permissible rate of points and fees increasing as loan size decreases. When a loan size drops by one penny, it can change tiers and increase the permissible rate of points and fees by a half of a percentage point. A loan of $75,000 would be permitted points and fees of $2,250. A loan of $74,999.99 would permit points and fees of $2,625. This probably was unintentional.

We suggest that the permissible points and fees should be as follows. This recommendation includes a fixed amount plus a percentage to lessen the impact of moving from one tier to the next.

Total Loan Amount	Cap
$20,000 or less	5%
$20,001 to $40,000	$1,000 plus 4.5% of loan amount above $20,000
$40,001 to $60,000	$1,900 plus 4.0% of loan amount above $40,000
$60,001 to $70,000	$2,700 plus 3.0% of loan amount above $60,000
$70,001 to $100,000	$3,000
Over $100,000	3%

The numbers should be increased annually with inflation, so the caps do not increasingly constrain credit over time.

D. Loan Originator Compensation Should be Excluded

The proposed points and fees definition includes loan originator compensation. While this is based on statutory language, we believe the CFPB should use its exception authority to exclude compensation from the definition. The result of a fixed, three percent limit on points and fees including compensation has the potential to prevent many loans from being made.

Congress already addressed loan originator behavior by, for example, requiring a comprehensive registration and licensure system for mortgage originators,[30] imposing a new duty of care on mortgage originators,[31] prohibiting yield spread premiums,[32] prohibiting compensation based on loan terms other than loan amount,[33] prohibiting dual compensation,[34] and requiring regulations to prohibit inappropriate steering.[35] The Board already finalized an anti-steering rule.[36] Given that there are a host of rules that align the incentives related to originator compensation, there is no reason for this rulemaking to do so as well.

One purpose of the ability-to-repay rule is to correct a problem of so-called payment shock. Congress reacted to mortgage loans that were affordable at origination but became unaffordable later because the payment increased too much.[37] Whether the originator's compensation is included in points and fees would not address payment shock, and would not address the problem Congress tried to address.

Another purpose of the ability-to-repay rule is to address loans where income and assets were not documented. Again, documenting income and assets and verifying employment are not related to the issue of whether originator compensation is included in the points and fees definition.

[30] The SAFE Act, 12 U.S.C. §§ 5101 – 1517, requires registration or licensure of mortgage originators nationwide, by July 29, 2011. 76 Fed. Reg. 6185 (February 3, 2011).
[31] TILA § 129B(b), 124 Stat. at 1981.
[32] TILA § 129B(c)(4)(A), 124 Stat. at 2140-41.
[33] TILA § 129B(c)(1), 124 Stat. at 2139.
[34] TILA § 129B(c)(2), 124 Stat. at 2139-40.
[35] TILA § 129B(c)(3), 124 Stat. at 2140.
[36] 75 Fed. Reg. 58509 (September 24, 2010).
[37] "In that same hearing, Senator Sarbanes said that:

> Too often . . . loans have been made without the careful consideration as to the long-term sustainability of the mortgage. Loans are being made without the lender documenting that the borrower will be able to afford the loan after the expected payment shock hits without depending on rising incomes or increased appreciation.

Several months later, as the problem worsened, Chairman Dodd noted in a March 22, 2007 hearing that:

> . . . a sort of frenzy gripped the market over the past several years as many [mortgage] brokers and lenders started selling these complicated mortgages to low-income borrowers, many with less than perfect credit, who *they knew or should have known* . . . would not be able to afford to repay these loans when the higher payments kicked in. (emphasis added).

Underscoring this point, the General Counsel of Countrywide Financial Corporation, one of the biggest subprime lenders in 2007, acknowledged in response to a question from Chairman Dodd that "about 60 percent of the people who do qualify for the hybrid ARMs would not be able to qualify at the fully indexed rate" (that is, at the rate a borrower would have to pay after the loan reset, even assuming interest rates did not rise)." S. Rep. No. 111-176, at 13 (2010) (footnote omitted).

The fact that payment shock and underwriting documentation are unrelated to compensation in points and fees indicates that Congress did not intend to include compensation in the definition for ability-to-repay purposes.

Further indicating that Congress did not intend to include compensation in points and fees for ability-to-repay purposes is the statutory language itself. While the statute does include originator compensation in the ability-to-repay definition of points and fees, it does so in a very indirect and imprecise manner. This indicates that Congress did not address the issue directly. In one provision, Congress included points and fees in the list of items that define QM.[38] That provision does not define points and fees, rather it refers to another provision for the definition.[39] The referenced provision does not define points and fees either. Instead, it refers back to the general definition of points and fees that predates Dodd-Frank.[40] Originally, that definition was for a HOEPA loan, on which points and fees exceeded at the time, usually, eight percent of the loan amount. Very significantly, this definition was not drafted to address payment shock or undocumented underwriting. It was drafted to define a category of subprime loans. Congress incorporated by reference a definition written for a different purpose without addressing the definition.

Adding to the likelihood that Congress did not address the definition of points and fees specifically when defining QM is that, had it done so, it would have noticed a drafting error. The definition begins, as it did before Dodd-Frank, "For purposes of paragraph (1)(B), points and fees shall include . . . ."[41] Before Dodd-Frank, this (1)(B) referred to the HOEPA points and fees threshold. Now it refers to the use of introductory rates on ARM loans in the HOEPA comparison of APR to APOR. This erroneous cross-reference was plainly unintentional.

Given the many other means Congress used to address loan originator behavior, and given that adding compensation to points and fees does not address payment shock or underwriting documentation, the best reading of the statute is that Congress did not intend to include compensation in the definition for ability-to-repay purposes. Had it intended to do so, Congress would have been more explicit, would not have used an indirect double cross-reference, and would have noticed an unintentional drafting error.

For all these reasons, we strongly urge the CFPB to address originator behavior only in its originator behavior rulemakings, and exclude originator compensation from points and fees for the ability-to-repay rule.

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[38] TILA § 129C(b)(2)(A)(vii), 124 Stat. at 2146.
[39] It refers to § 129C(b)(2)(C).
[40] It refers to § 103(aa)(4).
[41] TILA § 103(aa)(4), 124 Stat. at 2159.

E. Including Compensation That Varies During Underwriting Would be Harmful

The definition of loan originator is very broad. It includes a person who "arranges, negotiates, or otherwise obtains" a loan for a consumer. On any single loan, there are always several creditor employees who meet this definition. The definition includes mortgage brokers and their employees. On a loan with a mortgage broker, the broker's employees would often come within the definition.

The proposed definition of compensation is also extremely broad:

> All compensation paid directly or indirectly by a consumer or creditor to a loan originator, as defined in § 226.36(a)(1), including a loan originator that is also the creditor in a table-funded transaction[.][42]

Proposed Comment 32(b)(1)(ii)-2 is ambiguous. It gives an example of what is excluded from compensation:

> The base salary of a loan originator who is also the employee of the creditor, not accounting for any bonuses, commissions, pay raises, or other financial awards based solely on a particular transaction or the number or amount of covered transactions originated by the loan originator.

This example would mean compensation excludes base salary but includes financial awards based solely on a particular transaction or a number of transactions. For a loan originator who has no other job, base salary *is* a financial award based solely on a particular loan or loans. By this reading, the comment is consistent with the regulation because both include base salary in points and fees. If the intent was, as the regulation does, to include base salary in points and fees, the rule would not be workable, as we describe below.

The intent may have been to exclude base salary. The language in the proposed regulation includes base salary. The language in the proposed Comment is ambiguous at best. If the Commentary excludes base salary from points and fees, then it contradicts the regulation. The Commentary should not contradict the regulation.

If the intent is to exclude base salary, we suggest being clear, such as by saying, "Points and fees on a loan do not include any part of the base salary of any loan originator. Base salary in connection with a loan includes compensation a loan originator would have received even if that loan had never been made." This should be clear in the regulation without the need for clarification in a comment.

[42] Proposed § 226.32(b)(1)(ii).

We suggest a clarification that compensation is never double-counted. If a consumer pays a loan originator compensation of $10 and the loan originator pays $5 of that to its employee, the amount included should be $10, not $15.

The Commentary excludes compensation that cannot be attributed to a particular loan at consummation.[43] A question arises about later contingencies. A creditor may pay an employee a bonus based on the number of loans that originator closes during a calendar year, with the bonus payable in February of the following year, but only if the person is still an employee in February. At consummation, the originator will not know whether the employee will receive the bonus. Is this contingent bonus included? If so, and if the employee leaves before February, in our example, can a non-QM loan become a QM loan post-consummation?

The Commentary states:

> [L]oan originator compensation includes the dollar value of compensation paid to a loan originator for a covered transaction, such as a bonus, commission, yield spread premium, award of merchandise, services, trips, or similar prizes, **or** hourly pay for the actual number of hours worked on a particular transaction.[44]

We request clarification that the word "or" emphasized in this language means hourly pay is included in points and fees only if the loan originator does not receive any bonus, commission, yield spread premium, award of merchandise, services, trips, or similar prizes for that particular loan.

What is the difference between hourly pay and base salary? For a full-time employee, is not hourly pay simply annual base salary divided by 2000 hours?

For any loan when hourly pay is included in points and fees, there will be uncertainty until closing about the amount of the points and fees. A consumer may walk into a bank branch and talk to branch employees that the consumer knows about transferring funds to pay for an appraisal, even if none of them is a loan officer. If the branch personnel explain the payment arrangements, they could be deemed to be arranging or obtaining the loan for the consumer. Their compensation would therefore be included in points and fees under the proposed definition.

If the compensation a creditor or broker pays to every person who is involved in arranging, negotiating, or obtaining a loan were included within the definition, an unnecessary number of loans would hit the cap on points and fees.

Further, the procedure for tracking every employee who comes in contact with the loan would be an enormous administrative undertaking. For each employee who touches the loan, there would need to be a factual determination of whether the employee's activities

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[43] Proposed Comment 32(b)(1)(ii)-2ii.

[44] Proposed Comment 32(b)(1)(ii)-2i (emphasis added).

meet the definition of loan originator. For each employee who meets the definition, the amount of time spent on the loan would need to be translated into a number of dollars, and that would need to be tracked so that when the loan closes, the employee's compensation would be included within points and fees. This procedure would be a massive undertaking by itself.

Moreover, every aspect of every measure of loan originator compensation would be subject to litigation. The cost of discovery alone would be disproportionate to the benefit to a consumer of including in points and fees the compensation paid to a bank branch employee who helps a consumer transfer funds to pay an appraisal charge, as described in our example.

It would be unreasonably burdensome to require employers to bear the enormous costs of tracking hours worked on a loan just to calculate points and fees. Further, the hours a loan originator works on a loan can continue to accrue through closing. Even after closing, there is paperwork for the loan originator to complete or consumer questions to answer. This means the creditor would not know until after closing what the points and fees are, which we believe was unintended. This is an example of an unworkable definition. As the proposed commentary states:

> [L]oan originator compensation excludes compensation that cannot be attributed to a particular transaction at the time or [sic] origination[.][45]

Even if the hours were capped at the time of closing, the creditor would not know until minutes before closing the amount of the points and fees. Basing the definition of points and fees on compensation that changes during the loan application process would be unworkable. The creditor would not know at first whether the compensation would cause the loan to hit the cap. Consider what this would do to two creditors, one willing to make only QM loans and one willing to make non-QM loans.

If the creditor were willing to make only QM loans, once the loan hits the cap, the creditor would need to reject the loan on that basis. Described differently, the creditor would need to adopt procedures to avoid hitting the cap as underwriting progresses. Employees would be instructed to try to spend as little time on this loan as possible, consistent with safe and sound lending, to avoid hitting the cap. The purpose of the QM rule is to cause creditors to spend *more* time underwriting their loans, not less. This proposal would run directly counter to the purpose of the QM statute. Further, the creditor would need to institute procedures by which the employee answering consumer questions would be someone whose compensation does not count toward points and fees. This system would be unworkable. It would incent creditors to have those unfamiliar with a loan answering consumer questions. One of the overriding purposes of Title XIV was to improve consumer understanding of their mortgage loans, yet this would do exactly the opposite.

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[45] 76 Fed. Reg. 27390, 27488 (May 11, 2011).

For the creditor willing to make non-QM loans, the same incentives to avoid spending time on underwriting and to avoid having informed employees respond to questions would be in place. In addition, there would be another perverse incentive. Despite the creditors' efforts to avoid hitting the cap, some loans would reach the cap. In this event, this creditor would have only two options. First, reject the loan. Second, raise the interest rate on the loan to cover the litigation costs of non-QM loans. Described differently, this creditor would be unable to offer rate-locks to its customers who want QM loans. Rate-locks, especially during times of rising rates, are a consumer benefit.

In other words, the proposal to count employee compensation that can vary after receipt of a loan application would incent creditors to limit time spent on underwriting, have informed employees avoid consumer communication, and would reduce the availability of rate locks. These all are exactly the opposite of what Congress intended. A consumer protection rule that reduces consumer protections and benefits needs to be rethought and redesigned.

It is not reasonable to believe Congress intended to create such perverse incentives. The Dodd-Frank Act therefore does not require including loan originator compensation in the definition of points and fees. We urge the CFPB to exclude from the points and fees definition any amount of compensation.

There is another consideration – the privacy of loan originators. If compensation were counted in the Regulation Z definition of points and fees, detailed personal information about compensation would be subject to broad discovery. Disclosing details of peoples' compensation would be an unwarranted breach of privacy.

In this cost-benefit analysis, it will be important to identify the purpose of including loan originator compensation in the points and fees definition. The proposed rule does not identify a purpose. Regulating the cost of credit is not a permissible purpose under TILA.[46]

If the intent is to prevent creditors from paying their employees commissions for closing loans, it would be far simpler just to prohibit commissions. We leave to the CFPB the policy question whether this would be in consumers' interests, especially in an active market when rates are rising.

[46] TILA § 103(aa)(6), 124 Stat. at 2159.

F. Bona Fide vs. Reasonable Third-Party Charges

As proposed, points and fees may exclude 4(c)(7) items payable at or before closing. These items do not count towards points and fees if three conditions are met:

- The charge is not paid to the creditor's affiliate;
- The creditor receives no direct or indirect compensation in connection with the charge; and
- The charge is reasonable.

This may be based on the general points and fees definition.[47] However, there is conflicting statutory language that the proposed rule does not address. In several places, Congress excludes third party charges if they are *bona fide* rather than reasonable. In defining compensation on a mortgage loan to prohibit steering, Congress excluded:

> [*B*]*ona fide* third party charges not retained by the creditor, mortgage originator, or an affiliate of the creditor or mortgage originator.[48]

In language that is more specific, defining points and fees for ability to repay a streamlined refinance, Congress used this language:

> Total points and fees (as defined in section 103(aa)(4), other than bona fide third party charges not retained by the mortgage originator, creditor, or an affiliate of the creditor or mortgage originator) payable in connection with the refinancing do not exceed 3 percent of the total new loan amount.[49]

This excludes *bona fide* third party charges without imposing a reasonableness test. This language is more specific than the general definition of points and fees, and the more specific language should prevail. More specifically even than that, in defining points and fees specifically for the QM definition, Congress incorporates the definition in § 129C(b)(2)(C),[50] which is:

> For purposes of subparagraph (A), the term 'points and fees' means points and fees as defined by section 103(aa)(4) (other than *bona fide* third party charges not retained by the mortgage originator, creditor, or an affiliate of the creditor or mortgage originator).

Congress did not impose a reasonableness test, it used a *bona fide* test instead. That is, the statute, read properly, does not exclude from the points and fees definition third party charges on the basis that they are unreasonable in amount. It does, however, exclude them if they are not *bona fide*.

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[47] TILA § 103(aa)(4)(C).
[48] TILA § 129B(c)(2)(A), 124 Stat. at 2139-40.
[49] TILA § 129C(a)(5)(C), 124 Stat. at 2143.
[50] TILA § 129C(b)(2)(A)(vii), 124 Stat. at 2146.

The difference between requiring that third party charges be *bona fide* and requiring that they be reasonable is significant. Creditors do not set third party charges. Under a reasonableness test, if a third party imposes a charge that a court later finds unreasonable, the *creditor* would be liable. This would be wholly inappropriate.

There is no definition of what is a reasonable charge for each of the many third party charges inherent in mortgage lending. Using a reasonableness test would unleash a wave of post-closing litigation over whether a third party charge was a few dollars over some undefinable reasonableness limit.

Creditors do not set the level of third party charges, and do not necessarily even select the service provider. Creditors therefore should not be liable for third party charges simply because they are too high. The purpose of TILA is:

> It is the purpose of this title to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit, and to protect the consumer against inaccurate and unfair credit billing and credit card practices.[51]

TILA is intended to inform consumers about the cost of their loans so that they can select the best service providers. Second-guessing third party charges by suing creditors who did not set the charge is beyond the purposes of TILA. The CFPB does not have authority to make creditors liable for the level of third party charges.

We urge the CFPB to think through the practical problems of requiring creditors to determine whether third party charges are "reasonable."

Suppose a creditor permits a consumer to shop for a title agent, and the consumer selects one that is not affiliated with the creditor. Suppose further that the title agent charges a high fee. The consumer may knowingly elect to pay a high fee for any number of reasons. The title agent may provide extra services that the creditor does not require but the consumer wants. Or, the consumer may agree to pay a higher fee in exchange for a contractual agreement for the title agent to provide a lower fee to a family member on an unrelated loan. These facts will likely be unknown to the creditor.

The creditor may have a policy of making only qualified mortgages. In this example, the creditor would have to reject the loan application unless the consumer agrees to select a title agent with a lower charge. This would limit consumer choice.

Moreover, the creditor would likely not be aware of the title agent's specific charge until very close to the scheduled closing, and having to reject the loan application at the last minute would be quite disruptive.

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[51] TILA § 102(a).

The problem is compounded by the fact that creditors will not know what charge is "reasonable." To avoid liability, they will need to require borrowers to select only very low-cost service providers, or reject the loan. This would create an incentive to select the cheapest service provider regardless of the quality of the services. This is a perverse incentive.

Congress did not intend for creditors to select settlement servicers in all cases. Congress did not intend to require the selection of the cheapest service provider in all circumstances, even if the services provided are inferior. Yet the proposed rule would do both.

We recommend removing the requirement that the charge be reasonable to qualify for excluding it from the definition of points and fees. The charge would still need to be *bona fide*.

G. Real Estate Fees to Affiliates Should be Excluded

The proposed rule would include or exclude real estate fees from the points and fees definition based on whether they are paid to an affiliate. The Board did not support its proposal with a policy reason. It did not address the fact that affiliated service providers can often provide lower prices than others. Nor did the Board address the fact that creditors who use affiliated service providers for settlement services can make more certain disclosures about the costs of those services, even early in the application process, which enables better consumer shopping.

Nor does the Board address the purposes of TILA and of the ability-to-repay rule. TILA is designed to promote the informed use of credit. It is not designed to regulate affiliates. The proposal appears unrelated to any TILA purpose.

To the extent that the policy behind the proposal is a concern that creditors may be able to charge more when an affiliate provides a settlement service, TILA does not permit that policy to determine the rule.

> This subsection shall not be construed to limit the rate of interest or the finance charge that a person may charge a consumer for any extension of credit.[52]

Consumers need information about their mortgage loans. The CFPB can, and will, require disclosures that promote shopping for loans and lenders. The CFPB does not have authority to set or limit prices.

[52] TILA § 103(aa)(6), 124 Stat. at 2159.

Closing agent fees should be excluded in all cases. This fee is large in relation to the loan size on smaller loans. Further, it is only vaguely related to ability-to-repay. It has not been a cause of payment shock or of default.

We request clarification that loan-level pricing adjustments paid to Fannie Mae or Freddie Mac are excluded from points and fees because they are *bona fide* third party charges not retained by the creditor.

H. Points and Fees Need to be Known Before Closing

The proposed definition of points and fees is sometimes, but not always, restricted to charges payable at or before closing. In proposed § 226.32(b)(1)(i), points and fees include all items considered to be a finance charge under § 226.4(a) or (b), with no restriction to charges payable at or before closing. This is unworkable. The discussion of the proposed rule states:

> The Board is concerned that some fees that occur after closing, such as fees to modify a loan, might be deemed to be points and fees. If so, calculating the points and fees to determine whether a transaction is a qualified mortgage may be difficult because the amount of future fees (*e.g.,* loan modification fees) cannot be known prior to closing. Creditors might be exposed to excessive litigation risk if consumers were able at any point during the life of a mortgage to argue that the points and fees for the loan exceed the qualified mortgage limits due to fees imposed after loan closing. Creditors therefore might be discouraged from making qualified mortgages, which would thwart Congress's goal of increasing incentives for creditors to make more stable, affordable loans.[53]

The creditor needs to know before consummation whether the loan is a qualified mortgage, because the creditor needs to either refuse to make non-QMs, or price for the extreme litigation risk of making non-QMs. We agree with the Board that post-closing events should have no bearing on the definition.

Notably, Dodd-Frank does not require creditors to make non-QMs. Creditors have the right, and the safety-and-soundness requirement, to protect themselves from open-ended litigation risks and costs. If post-closing events can convert a QM into a non-QM, that would force the creditor into a non-QM. The CFPB has no statutory authority to force creditors into non-QMs.

The Board seems to be of the view that Congress intended to include some post-closing charges in points and fees because it removed the phrase "payable at or before closing" from the statute.[54] We disagree with the Board's conclusion. The reason Congress

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[53] 76 Fed. Reg. 27390, 27404 (May 11, 2011).

[54] 76 Fed. Reg. 27390, 27404 (May 11, 2011). Former TILA § 103(aa)(1)(B) defined the HOEPA points and fees threshold to include only points and fees payable at or before closing. The QM points and fees threshold is in TILA § 129C(b)(2)(vii), and does not use the phrase payable at or before closing.

removed the phrase was to prevent evasion of the limit by the simple expedient of making points and fees payable an hour after closing or the day after closing. It makes sense that Congress would have this concern.

Moreover, it is not reasonable to believe Congress intended loan modification points and fees to be within the QM points and fees definition. There is no support in the legislative history for including post-closing fees in the definition. Additionally, the commonly understood definition of points and fees on a mortgage loan includes only those payable at or before closing.

The creditor needs to know far enough in advance of closing to be able to make all required preclosing disclosures. If the amount of points and fees continues moving, the creditor will be unable to make the final preclosing disclosures and close the loan. The definition of points and fees needs to be limited to those that arise in connection with originating the loan.

I. Congress Required Separate QM Rulemakings for Specified Government Loan Programs

Congress required certain agencies to define QM for their loan programs:

> The following agencies shall, in consultation with the Bureau, prescribe rules defining the types of loans they insure, guarantee, or administer, as the case may be, that are qualified mortgages for purposes of paragraph (2)(A), and such rules may revise, add to, or subtract from the criteria used to define a qualified mortgage[.][55]

The agencies are Federal Housing Administration (FHA), Veterans Administration, Agriculture, and the Rural Housing Service. The CFPB does not have authority to define QM for these agencies' programs. The CFPB must consult with these agencies, but cannot decide for them.

This proposed QM rule would apply to FHA loans. Aside from the fact that the CFPB does not have authority to define QM for the FHA, this rulemaking would very significantly disrupt FHA lending as soon as it becomes effective. FHA permits prepayment penalties beyond three years, but the proposed rule would not.[56]

Even assuming FHA were to rewrite its notes to conform to this rulemaking, revising FHA notes would be a lengthy process because it would require systems changes. This rule could suddenly disrupt FHA lending until those changes are completed. It is not reasonable to believe Congress intended Dodd-Frank to disrupt FHA lending.

[55] TILA § 129C(b)(3)(B)(ii), 124 Stat. at 2148.
[56] Proposed § 226.43(g)(2)(i).

Additionally, FHA loans use a slightly different accounting method than non-FHA loans at loan payoff. Loan payoff occurs when the borrower is fully able to repay, so this issue should not arise under any part of any QM rulemaking. The proposed QM rule does introduce an FHA payoff issue, which is far beyond the scope of what Congress intended for any QM rule.

When an FHA loan pays off on a date other than an installment due date, FHA notes commonly charge interest through the next installment due date. That is, after a loan is fully paid, the borrower may still owe interest for a number of days. Ginnie Mae requires servicers to pass this interest through to Ginnie Mae, even if the servicer never collects the interest from the borrower. The proposed QM rule would include in points and fees the maximum prepayment penalty that may be charged on the loan.[57] It would define a prepayment penalty as "a charge imposed for paying all or part of a covered transaction's principal before" the due date.[58] The amount is unknown at consummation. Even if the creditor declines to charge the interest, the possibility that under the note the amount could be charged presents a problem because the proposed QM definition of prepayment penalty includes possible prepayment penalties.

The proposed rule would permit prepayment penalties only in limited circumstances. The loan must be a QM, must not be a higher-priced mortgage loan, and the interest rate must be fixed.[59] As drafted, the QM rule would prohibit making loans that use the FHA accounting method unless they are QMs. If the rule were finalized as proposed, FHA lending would be suddenly disrupted when this QM rule becomes final.

The reason Congress excluded FHA and other programs from this rulemaking is that Congress wanted to protect their unique features. Congress is aware that FHA uses somewhat different loan terms than other loan programs, and did not want to interfere with FHA lending. FHA is highly significant to the mortgage markets right now, and will remain so for the immediate future. The final rule should not inadvertently interfere so drastically with FHA lending.

Congress intended, and required, that HUD conduct a rulemaking for the FHA definition of QM. HUD will do so, and the CFPB will consult with HUD as it does so. There is therefore no reason to include FHA loans in this rulemaking. Proposed § 226.43(a) must be amended to exclude from coverage of this QM rule the programs Congress excluded in Dodd-Frank, including FHA.

J. Early Closure Fees Are a Payoff Item and Should be Excluded

Open-end loans secured by a non-owner-occupied residence would be covered by the QM rule. They may charge early closure fees. An early closure fee is only due when a loan is paid off and closed, or when it is never used and is closed. That is, it has nothing

[57] Proposed § 226.32(b)(1)(v).
[58] Proposed § 226.43(b)(10).
[59] Proposed § 226.43(g)(1).

whatever to do with ensuring the borrower is able to repay the loan. For that reason, early closure fees should be excluded from this rulemaking.

They may be viewed as a type of prepayment penalty. We certainly support disclosing the circumstances under which the fee is due. However, they should be permitted on non-QM loans. On QM loans, they should not be included in the definition of points and fees because they are wholly unrelated to the purposes of this rulemaking.

Further, *bona fide* third party charges paid at closing are excluded from points and fees because they do not go to the creditor. That is, they do not give the creditor an immediate-income incentive to make a loan without regard to the consumer's ability to repay. The fact that the servicer or investor may collect an early closure fee well after closing should be excluded from points and fees for the same reasons.

K. The Definition of Total Loan Amount Should be Visible to Consumers

The proposal has a very lengthy and complicated definition of "total loan amount" for the purpose of calculating the permissible points and fees.[60] It also has a lengthy Comment with multiple examples of how to calculate the total loan amount.[61]

This is a *consumer protection* rule. Consumers should be able to readily verify that their points and fees are within the permissible limit, as a fundamental consumer protection. A complex definition would prevent them from being able to do so. Consumers will look at the regulation, which states that:

> A covered transaction is not a qualified mortgage unless the total points and fees payable in connection with the loan do not exceed—
> (A) For a loan amount of $75,000 or more, three percent of the total loan amount[.][62]

They will most likely turn to the promissory note to find the total loan amount. If the loan has not yet closed, they will most likely look to their Loan Estimate. There is no reason to make it more complicated than this.

The proposed Comment would state as follows:

> 1. *Total loan amount.* For purposes of the "points and fees" test, the total loan amount is calculated by taking the amount financed, as determined according to § 226.18(b), and deducting any cost listed in § 226.32(b)(1)(iii), (b)(1)(iv) and (b)(1)(vi) that is both included as points and fees under § 226.32(b)(1) and financed by the creditor.

[60] 76 Fed. Reg. 27390, 27399-400 (May 11, 2011).
[61] Proposed Comment 226.32(a)(1)(ii).
[62] Proposed § 226.43(e)(3)(i).

Consumers will simply not be able to decipher this. The Board requests comment on whether additional guidance is needed to demonstrate how to calculate the total loan amount. No guidance should be needed at all. The total loan amount should be the amount in the promissory note or Loan Estimate.

If the CFPB believes it may be appropriate to deduct financed points and fees, we urge consideration of whether this will be apparent to consumers. Making it apparent would complicate the Know Before You Owe prototypes the CFPB is developing. The Board's proposal does not address consumer understanding of the total loan amount, but we believe this is very important.

L. Clarifications of Bona Fide Discount Points

Dodd-Frank limits points and fees on QMs, but makes an exception for *bona fide* points consumers pay in exchange for a lower interest rate. Consumers often prefer and benefit from being able to lower their interest rate. The proposed regulation would add a requirement that such discount points can be excluded only if they are:

> Accounts for the amount of compensation that the creditor can reasonably expect to receive from secondary market investors in return for the mortgage loan.[63]

This added requirement is problematic for several reasons. First, it exceeds the statute. Second, it is unrelated to ability-to-repay. Third, it adds uncertainty about how to comply because it is vague, and because what the creditor can or will receive fluctuates. Further, the definition of points and fees should not vary based on whether the creditor sells the loan.

We suggest adding to the margin above the APOR to accommodate jumbo loans and vacation homes. These loans have higher interest rates, yet consumers should have the option to lower the interest rate. We suggest adding one percentage point to the margin for these loans.

M. Some 4(b) Items Need to be Removed From the Definition

Some of the items in section 226.4(b) that are added to the definition of points and fees need to be removed. Whether they are included in the definition of points and fees is a separate question from how the charges should be disclosed to consumers. That is, they could be within the definition of finance charge for disclosure purposes while excluded from points and fees for QM purposes.

Section 4(b)(2) would add to the definition:

[63] Proposed § 226.43(e)(3)(iv)(B).

> Service, transaction, activity, and carrying charges, including any charge imposed on a checking or other transaction account to the extent that the charge exceeds the charge for a similar account without a credit feature.

"Service" charges mean servicing charges. These are unknown and unknowable at closing, and should be excluded from points and fees.

Many mortgage-related charges could be construed as "transaction" charges. Interest certainly is a "transaction" charge, yet the statutory definition of points and fees excludes interest. The word "transaction" needs to be omitted because it is too vague. The word "carrying" similarly needs to be omitted because it appears to mean, on a mortgage loan, the interest, and perhaps the servicing charges.

An "activity" charge similarly needs to be omitted because it could mean almost anything in the mortgage context. It certainly includes servicing charges and could readily be construed to include interest.

Section 4(b)(3) would add to the definition:

> Points, loan fees, assumption fees, finder's fees, and similar charges.

Discount points are excluded from the definition in some circumstances, by statute.[64] The regulation would include them in all cases. This is in error.

Loan fees is another vague term. It could include fees that the statute or regulation otherwise excludes, such as servicing fees, discount points, or charges payable in a cash transaction. The term needs to be removed because it is too vague.

Assumption fees are not paid at origination, they are paid if and when a loan is assumed. The term should be omitted.

The proposed definition includes mortgage broker compensation, and it excludes real estate agent compensation. The meaning of "finder's fee" appears to mean nothing beyond mortgage broker or real estate agent charges. This term should therefore be omitted from the definition to avoid a conflict within the definition, and because it has no apparent purpose.

Section 4(b)(7) would add to the definition:

> Premiums or other charges for credit life, accident, health, or loss-of-income insurance, written in connection with a credit transaction.

[64] TILA § 103(dd), 124 Stat. at 2159-60.

Proposed § 226.32(b)(1)(iv) covers credit protection products. This language does so as well, but it is different. There should not be two differing provisions covering the same charges.

In the mortgage context, accident insurance does not seem to have a meaning. Perhaps it means hazard insurance on the property. If so, it should be omitted because hazard insurance is payable in a comparable cash transaction.

Section 4(b)(8) would add to the definition:

> Premiums or other charges for insurance against loss of or damage to property, or against liability arising out of the ownership or use of property, written in connection with a credit transaction.

Including this contradicts the exclusion of charges payable in a comparable cash transaction. It should be omitted.

Section 4(b)(9) would add to the definition:

> Discounts for the purpose of inducing payment by a means other than the use of credit.

This is incomprehensible in the mortgage context. It should be omitted.

N. Clarification of Mortgage Insurance Premium

The proposed regulation would exclude from points and fees upfront mortgage insurance premiums that are:

> *Not in excess of* the amount payable under policies in effect at the time of origination under section 203(c)(2)(A) of the National Housing Act (12 U.S.C. 1709(c)(2)(A)), provided that the premium or charge is required to be refundable on a pro rata basis and the refund is automatically issued upon notification of the satisfaction of the underlying mortgage loan[.][65]

This means that if the premium is above the FHA premium, by even one penny, it is included in its entirety. The language in the statute, and the examples in the section-by-section analysis and commentary differ. They would exclude the premium "only to the extent"[66] it exceeds the FHA premium. The statute excludes "any amount that is not in excess" of the FHA premium.[67] The regulation needs to be clarified.

[65] Proposed § 226.32(b)(1)(i)(B)(2) (emphasis added).
[66] 76 Fed. Reg. 27390, 27401 (May 11, 2011); proposed comment 32(b)(1)(i)-3.
[67] TILA § 103(aa)(1)(C)(ii), 124 Stat. at 2158.

O. Clarification for Financed REO Sales

The proposed definition generally excludes compensation paid to real estate brokers.[68] However, if the creditor or originator compensates the real estate broker, that compensation counts toward points and fees.

The proposed rule did not address a related issue that is especially important in our depressed housing market. The issue is that creditors today have large inventories of real estate owned (REO) that they need to sell. When a creditor finds a potential buyer, the creditor has in incentive to offer attractive loan terms to induce the sale. It is highly likely that the creditor would compensate a real estate broker who found the buyer. Including that broker's compensation in points and fees might kill the sale. Compensation paid to a real estate broker for a creditor's sale of REO is unrelated to the loan transaction and is therefore beyond the scope of this rulemaking.

Encouraging sales of REO promotes neighborhoods by reducing the number of vacant properties.

Disposing of REO is a safety and soundness issue because real estate, especially foreclosed real estate, is not a liquid asset, and it can be costly to hold. Moreover, banks and thrifts are restricted in their legal authority to hold real estate.[69] We would encourage the CFPB to discuss REO sales with the safety and soundness regulators.

We believe it would be appropriate to exclude from the definition of points and fees compensation the creditor or its affiliate pays to a real estate broker in connection with the sale of real estate by the creditor, even if the creditor finances the purchaser's acquisition of the property.

P. Plain English Definition

We suggest below a definition of points and fees that would be easy for consumers to understand:

Points and fees on a loan include and exclude the following charges, as noted by checkmarks.

Charge	Included	Excluded
Balloon payments.		✔
Borrower's attorney's fees.		✔
Charges payable after the loan closes. This includes mortgage		✔

[68] Proposed § 226.32(b)(2)(ii).
[69] 12 C.F.R. §§ 7.1000; 560.37.

insurance premiums payable after closing. It includes all charges by a servicer. The only exception is prepayment penalties. *See* prepayment penalties below.		
Charges payable in a comparable cash transaction. These include: 1. Hazard and flood insurance on a property even if the lender requires the insurance. 2. Property taxes; 3. Costs relating to a purchase or sale of the property; and 4. Costs to prepare, file, or record documents that reflect the sale of a property from a seller to a buyer.		✔
Compensation paid to mortgage broker or loan originator.		✔
Credit protection products are: 1. Credit life protection; 2. Credit disability protection; 3. Credit unemployment protection; and 4. Debt cancellation or suspension agreements. Charges for credit protection products are included if they are paid at or before closing. Charges for credit protection products are excluded if they are paid after closing.	✔	✔
Document preparation fees related to the property purchase or sale.		✔
Flood insurance premiums, even if the lender requires flood insurance.		✔
Hazard insurance premiums, even if the lender requires the hazard insurance.		✔
Interest on the loan.		✔
Mortgage insurance premiums, paid at or before closing, if they are either: 1. Not for a federal or state agency program; or 2. Above the premium, at the time of origination, on an FHA-insured, single-family loan of the same size. If a mortgage insurance premium is not automatically refunded *pro rata* when the loan is paid off, it is above the FHA premium on a single-family loan of the same size.	✔ ✔	

Mortgage insurance premiums paid after closing.		✔
Notary fees related to the property purchase or sale.		✔
Origination fee paid to the lender.	✔	
Owner’s title insurance premium.		✔
Points paid on the loan, except discount points that are excluded. Discount points are points a borrower pays to get a lower interest rate than the starting rate. If the borrower pays discount points to get a lower rate, and if the lender does in good faith lower the rate, then: If the loan is a conforming loan on an owner-occupied home, discount points are excluded in either of the following cases: 1. If the starting rate is no more than one percentage point above the APOR, up to 2 points are excluded; or 2. If the starting rate is no more than two percentage points above the APOR, up to 1 point is excluded. If the loan is a jumbo loan or the property is not owner-occupied, discount points are excluded in either of the following cases: 1. If the starting rate is no more than two percentage points above the APOR, up to 2 points are excluded; or 2. If the starting rate is no more than three percentage points above the APOR, up to 1 point is excluded. Other discount points are included. The APOR is posted on the CFPB’s website at [url]. It changes from time to time. It is a measure of market rates for loans.	✔	✔ OR ✔ ✔ OR ✔
Prepayment penalties on the new loan. These are measured at the maximum possible amount even if the loan is not prepaid.	✔	
Prepayment penalties on a refinanced loan, if the new lender was the lender or servicer on the refinanced loan at the time of the refinance.	✔	
Principal on the loan.		✔
Real estate agent compensation, for real estate brokerage services, paid by someone other than the lender or its agent.		✔

Real estate agent compensation, for real estate brokerage services, that the lender or its agent pays in connection with the loan. The services are not in connection with the loan if the lender or the lender's affiliate is selling the property that the borrower is purchasing, even if the selling lender finances the purchase.	✔ 	 ✔
Real estate fees. These include charges for the following services, if the lender requires the services: 1. Appraisals. 2. Closing agent charges. 3. Credit report or credit history. 4. Flood hazard determinations. 5. Loan document preparation. 6. Mortgage insurance premiums, to the extent they are paid at or before closing. 7. Notary services. 8. Pest inspections. 9. Property inspections. 10. Survey. 11. Title examination. 12. Title insurance.		✔
Settlement fee for the loan.	✔	
Tax service charges.	✔	

VIII. Regulatory Process

A. Cost-Benefit Analyses Are Required

Even before the Dodd-Frank Act, a cost-benefit analysis requirement was put in place by Executive Order 12866[70] for all rulemakings promulgated by independent Federal agencies. To underscore the importance of cost-benefit analyses, Congress, by statute, required the CFPB to weigh the costs and benefits of its rulemakings, including the QM rulemaking.[71]

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[70] Executive Order 12866.
[71] Dodd-Frank Act § 1022(b)(2), 124 Stat. at 1980-81.

QRM Rule

The Securities and Exchange Commission (SEC) prepared an economic analysis[72] of the proposed QRM rule. The SEC states, ". . . the proposed rules are designed to promote efficiency, competition and capital formation." We disagree with this assessment, particularly when the interplay of all the rules is considered.

The Department of Housing and Urban Development (HUD) determined the QRM rule is an "economically significant regulatory action" and HUD is therefore required to assess the costs and benefits of the rule. Viewing HUD's assessment requires visiting HUD's headquarters.[73] We recommend that HUD make its assessment available to the public on its website.

QM Rule

Congress requires the CFPB to consider:

> [T]he potential benefits and costs to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products or services resulting from such rule[.][74]

The CFPB is required to weigh the costs and benefits of its rulemakings, including the QM rule. We believe that a thorough cost-benefit analysis of the impact of the *combined* rules, along with the lowered HOEPA thresholds, is most appropriate because the rules will all interact. Until a robust analysis is completed and reviewed thoroughly, no rulemaking should be finalized.

We are disappointed that the Board did not begin a cost benefit analysis with the proposed QM rule. The proposal does have an Initial Regulatory Flexibility Analysis, but that does not weigh the costs of constrained credit and of compliance with the rule against the benefits of the rule. We believe the CFPB should explicitly solicit comment on its cost-benefit analyses in all of its rulemakings so that its analyses will be informed.

The costs of implementing revised mortgage rules are significant. At one large lender, implementing the Regulation Z amendments that became effective October 1, 2009 required over 70,000 hours, and implementing the 2008 amendments to Regulation X took over 140,000 hours. This is just the cost of systems changes to comply with two revised rules. It does not include the cost of litigation. TILA litigation is a significant risk and cost to mortgage creditors. Dodd-Frank increased these litigation risks dramatically.

Nor does this statistic include the cost of outside counsel, which is especially high for a

[72] 76 Fed. Reg. 24090, 25154 (April 29, 2011).
[73] 76 Fed. Reg. 24090, 24155 (April 29, 2011).
[74] Dodd-Frank § 1022(b)(2)(A)(i), 124 Stat. at 1980.

rule that is not in plain English. The simple expedient of writing rules in plain English would significantly reduce not only the cost of coming into compliance, but it would also reduce the time required to come into compliance. Especially with the significant amount of work involved in coming to compliance with a number of Title XIV rulemakings and the QRM rule at the same time, and the extremely short implementation deadlines Congress imposed for these rules, being able to understand the rules is especially important. Enabling consumers to read and understand the rules that govern their financial products and services would, of course, benefit them immensely.

B. Rulemakings Require Consideration of Constrained Credit

Congress explicitly requires the CFPB to address the potential reduction in consumer access to credit, in this rulemaking mortgage credit. Reducing the availability of mortgage credit will make it more difficult for consumers to buy and sell homes. Reduced mortgage credit will remove many potential homebuyers from the market because they will not qualify for a loan. The QM rule will effectively lower demand for housing, which will then lower the price of housing. This aspect of the QM rule is far too important to ignore.

Mortgage loans are currently very difficult to obtain, even for consumers with strong credit profiles. If the final QM rule were to lack a certain safe harbor and clear QM definition, credit would be even more constrained. This would hurt all involved in the mortgage markets, including consumers, lenders, homebuyers, and home sellers.

Additionally, the restrictions on points and fees, combined with the restrictions on prepayment penalties, will make it more likely consumers will try to refinance when rates fall, even slightly, because the transaction costs are limited. Faster prepayment speeds with limited ability to recoup the cost of originating loans will reduce the profitability of mortgage lending.

As proposed, the QM rule would incent creditors to reduce mortgage lending because of the new difficulties in making profitable loans. The CFPB needs to expressly address the potential this rulemaking could have to cause creditors to exit the mortgage industry entirely.

C. Rulemakings Must Consider Smaller Lenders and Consumers in Rural Areas

Congress also requires the CFPB to consider:

> [T]he impact of proposed rules on covered persons, as described in section 1026 [depository institutions with assets of $10 billion or less], and the impact on consumers in rural areas[.][75]

[75] Dodd-Frank § 1022(b)(2)(A)(ii), 124 Stat. at 1981.

Again, we are disappointed that the Board did not address these requirements in its proposed rule. We believe the CFPB should specifically solicit comment on these matters in all of its rulemakings so that it will be able to conduct informed analyses. We also recommend that the CFPB consult with Fannie Mae and Freddie Mac to identify the number of mortgage lenders in the country that have assets of $10 billion or less.

The potential for harm to consumers in rural areas resulting from this rulemaking is high because this rule is likely to constrain mortgage lending by all creditors of all sizes, including those that lend in rural areas.

IX. Conclusion

We are concerned that the proposed QM rulemaking will dramatically constrain consumer mortgage credit and limit it to a small subset of creditworthy borrowers. We urge the CFPB to write a final rule that addresses the problems facing the mortgage markets today without driving creditors and investors away from this sector. At a minimum, this will require a bright-line safe harbor and a very clear QM definition, along with a restrictive definition of points and fees.

Ultimately, government policymakers should consider revisiting the direction taken in Dodd-Frank and move the U.S. housing finance system to a more transparent one that allows the market to function efficiently.

Sincerely,

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