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July 19, 2011

<u>**VIA OVERNIGHT MAIL, FACSIMILE TRANSMISSION: (202) 452-3819 & E-MAIL: REGS.COMMENTS@FEDERALRESERVE.GOV**</u>

Jennifer Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Re: Regulation Z Docket No. R - 1417
RIN No. 7100-AD 75
Ability to Repay

Dear Ms. Johnson:

This letter responds to the request by the Board of Governors of the Federal Reserve System (the "Board") for comments on the Board's proposal to revise its Regulation Z, which implements the Truth in Lending Act ("TILA"). The Board is proposing to amend Regulation Z to implement amendments to TILA made by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). Under Dodd-Frank, authority for TILA regulation and these provisions transfers to the Bureau of Consumer Financial Protection (CFPB) on July 21, 2011.

As you know, Regulation Z currently prohibits a creditor from making a higher-priced mortgage without regard to the consumer's ability to repay that obligation. The current proposal would impose a substantially similar ability to repay requirement on any dwelling secured consumer credit transaction other than an open-end credit plan, timeshare plan, temporary loan or reverse mortgage. The proposal further offers a Qualified Mortgage ("QM") as a means of providing special protection from liability under Dodd-Frank's ability to repay requirement, in the form of either a rebuttable presumption of compliance or, alternatively, a true "safe harbor" from liability.

How the CFPB defines a QM will take on special significance for at least two reasons. First the scope of liability under the proposal is very significant providing enhanced civil penalties and assignee liability. Secondly, Dodd-Frank creates another class of mortgage loans exempt from risk retention requirements (and the subject of a separate rulemaking process), known as a Qualified Residential Mortgage ("QRM"). Dodd-Frank specifies that the definition of QRM may not be broader in scope than a QM. Because a mortgage loan not qualifying as a QM cannot qualify as a QRM, a non-QM will be significantly more costly to consumers (since it will be subject to risk retention), and may not be available at all, given that non-QRMs will very likely offer less liquidity for investors (since the loan will not fit within the standard RMBS market).

These issues are of concern to many, but of particular concern to a client of our firm, a start-up company on the forefront of innovation in the reverse mortgage space. It has developed a patent pending application for a proprietary mortgage product that, although sharing many of the characteristics of a reverse mortgage, is not a reverse mortgage (as defined under TILA), and therefore not exempt from Dodd-Frank's ability to repay requirement. Importantly, this product was developed during, and in response to, the current credit crisis as a means of better aligning consumer needs with the requirements of housing market investors. Although Dodd-Frank seeks to protect consumers, only innovative new products can remedy current product supply/market demand imbalances. Ideally, Dodd-Frank will enhance consumer protections, without simultaneously burdening new products which have been, and will be designed to complement and, where appropriate, overcome limitations in existing mortgage products, including reverse mortgages.

Before delving into our specific comments concerning how the QM is defined, allow me to begin by describing certain general trends and relevant facts for the purpose of highlighting how unintended consequences flowing from the proposal could dramatically and negatively impact a large and growing segment of the U.S. population, namely, our nation's seniors.

With the U.S. population living longer, health care costs rising, lending requirements more restrictive, and retirement accounts having dropped in value since 2007, there is significant and growing concerns over the ability of seniors to fund their retirement. Conversely, there are currently 34 million Americans aged 65 or older that own an estimated $3.5 trillion in home equity.[1] By 2030, that number is expected to more than double, to 71 million seniors, or 21% of the population.[2] Clearly, home equity release is a source of supplemental income for funding the longevity of older Americans and needs to be recognized as an important part of the retirement solution.

The reverse mortgage market is presently built upon a single product - the FHA Home Equity Conversion Mortgage (HECM). Last year, more than 95% of all reverse mortgage transactions closed were HECMs.[3] Due to the lack of product alternatives serving this large and diverse demographic, the reverse mortgage market is only 2% penetrated.[4] Making matters worse, to keep the HECM program viable the principal limit factors[5] underpinning the HECM program have been progressively revised to reduce loan-to-value ratios[6] and, beginning in HUD's fiscal year 2011, annual mortgage insurance premiums were increased from 0.50% to 1.25%[7].

In short, seniors currently have few options beyond the HECM product, and the HECM is becoming more expensive, and offers a lower loan-to-value benefit. As a result, unit volume for HECMs dropped approximately 35% in 2010.[8]

Clearly, additional programs are needed to serve this market, including proprietary products that resolve the conflicting needs of senior homeowners desiring high loan-to-value ratios, and investors who require a more secure investment return. To fill this void, the private sector, as exemplified by our client, is exploring innovative new proprietary mortgage products that blend attributes of debt and equity in a manner not fully contemplated by TILA and Dodd-Frank. Our concern is that Dodd-Frank's formulaic approach for defining riskier loans, and specifically both QMs and QRMs, will unintentionally stymie product innovation and the development of appropriate credit solutions for evolving markets.

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[1] Robert Schafer, *Housing America's Seniors*, Joint Center for Housing Studies at Harvard University, 2000.
[2] Robert Schafer, *Housing America's Seniors*, Joint Center for Housing Studies of Harvard University. 2000.
[3] Reverse Market Insight, Proprietary Data Repository.
[4] Reverse IQ Newsletter, Industry Data and Trends, May 17, 2011.
[5] Principal limit factors are the computational factors used to determine the amount of loan proceeds available to the borrower under the HECM program.
[6] See Mortgagee Letter 2009-34 (September 23,2009).
[7] See Mortgagee Letter 2010-28 (September 1, 2010).
[8] Reverse IQ Newsletter, Reverse Mortgage Retail Leaders, Reverse Market Insight, January 4, 2011.

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Turning to our specific comments concerning Dodd-Frank's criterion for a QM, it seems evident that Congress intended the ability to repay standard to apply only to the extent the source for repayment of the mortgage is contemplated to be other than the collateral itself. It is for this reason that Dodd-Frank specifically exempts reverse mortgages from the ability to repay requirement under Section 1412. As you are aware, TILA Section 226.33, provides that a reverse mortgage is a non-recourse consumer credit transaction that does not require repayment of principal, interest or shared appreciation or equity (other than in the case of default) until (i) the consumer dies, (ii) the dwelling is transferred or (iii) the consumer ceases to occupy the dwelling as a principal dwelling. Therefore, a non-recourse mortgage made to an individual 62 years or older requiring interest-only periodic payments, but meeting all of the other requirements of a reverse mortgage under Section 226.33, including the repayment of principal and an equity interest only after the consumer dies, the dwelling is transferred or the consumer ceases to occupy the property as a principal dwelling (hereinafter a "reverse mortgage-like loan"), is clearly not a reverse mortgage and would be subject to Dodd-Frank's ability to repay requirement. This makes perfect sense given that a creditor should establish the borrower's ability to pay the required interest-only periodic payments.

However, what doesn't make sense is that a reverse mortgage-like loan would never be a QM pursuant to the formulaic approach suggested under the current proposal, since the payment schedule does not fully amortize and the loan contemplates a balloon payment not meeting the requirements of Section 129C (b)(2)(E) of TILA, as amended by Dodd-Frank[9]. Similar to a reverse mortgage, principal and an equity interest under a reverse mortgage-like loan is intended to be repaid by the collateral itself, and the consumer can never be responsible for any deficiency. Under these circumstances it makes little sense that the reverse mortgage-like mortgage would not be considered to fit the reduced risk profile of a QM. On the contrary, to the extent that underwriting of the loan for such interest-only periodic payments is based on income and financial resources that are verified and documented, and takes into account applicable taxes, insurance and assessments impacting the collateral, there appears to be little reason why such a mortgage should not be a QM.

[9] Per Section 1412, Section 129C of the Truth in Lending Act is amended to add (b)(2)(E), which provides, at the Bureau's discretion, a Qualified Mortgage may include a balloon payment if the loan meets certain limited qualifications and underwriting requirements. Only creditors meeting certain asset size and annual residential mortgage origination thresholds, predominantly operating in rural or underserved areas, and retaining the loans in their portfolios are permitted to use this exception.

Dodd-Frank provides that the CFPB may prescribe regulations that revise, add to, or subtract from the criteria that define a QM upon a finding that such regulations are necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers. As demonstrated in our discussion above, the availability of responsible, affordable credit that meets the special needs of older Americans is not only a problem today, but one that will only grow more acute as baby boomers seek retirement at accelerating rates in coming years. Clearly then, the CFPB has both the authority and, we suggest, the responsibility, to take steps in its rulemaking to promote innovative mortgage solutions and properly distinguish the ability to repay requirement on mortgages where repayment of principal is intended from sale or liquidation of the collateral itself. In particular, the reverse mortgage-like loan, which shares many of the important characteristics of a reverse mortgage (including its non-recourse character and required repayment of principal and an equity interest only after the consumer dies, the dwelling is transferred or the consumer ceases to occupy the property as a principal dwelling), should be considered a QM, provided creditors properly underwrite such loans to ensure the consumer's ability to make any required interest-only periodic payments based on income and financial resources that are verified and documented, and taking into account applicable taxes, insurance and assessments affecting the collateral property.

Finally, our client strongly supports the notion that the QM should provide a bright-line legal safe harbor, rather than a rebuttable presumption (noted as Alternative 2 in the current proposal), and further believes that the standards for QRMs and QMs be substantially the same. As noted in our discussion above, liability for violation of the ability to repay requirement is very significant providing enhanced civil penalties, assignee liability, and a defense by way of recoupment to a foreclosure action without any time limits. The legal certainty associated with a safe harbor will better encourage investor interest and better promote an efficient secondary market for QM loans, ultimately resulting in lower interest rates and fees to consumers. For similar reasons, we believe that the QRM should be defined in substantially the same manner as the QM

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since, as a practical matter, non-QRMs will be far costlier than QRMs, or not available to consumers at all.[10]

We urge the CFPB, in exercising its broad rule-making authority, to avoid rote application of a construct under Dodd-Frank premised on current forward mortgage products and the existing forward mortgage marketplace. To do otherwise risks the still-born birth of innovative proprietary credit products, like that of our client's reverse mortgage-like product, having great social utility and potentially better meeting the needs of consumers in underserved markets.

We appreciate the Board's consideration of these comments with respect to this important proposal. Should questions about these comments arise, or additional information be helpful, please do not hesitate to contact the undersigned, at 949.754.3010 or at schiffman@wbsk.com.

Very truly yours,

Joel A. Schiffman

[10] We understand the Board and other agencies will promulgate rules on risk retention requirements in securitization transactions, with exceptions thereto for certain mortgage loans that meet the definition of a "qualified residential mortgage" under separate rulemaking. We intend to separately comment on that proposal.