Colorado Mortgage Lenders Association

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July 21, 2011

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

Re: Docket No. R- 1417 and RIN No. AD 7100 AD 75

The Board of Governors of the Federal Reserve System (Federal Reserve) has proposed a rule to implement Congressional amendments to the Truth in Lending Act (TILA) concerning the ability-to-repay requirement which is to be finalized by the Consumer Financial Protection Bureau (CFPB). These amendments were included in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The Colorado Mortgage Lender's Association (CMLA) submits the following comments concerning various provisions in the proposed rule.

The Colorado Mortgage Lenders Association is a 56 year old organization made up of over 140 companies employing in excess of 3000 individuals involved in the Mortgage Lending Industry in Colorado. Our membership is made up of Mortgage Bankers, Mortgage Brokers, Banks and Credit Unions located throughout the State. Our members originate the majority of residential real estate loans made in the State of Colorado.

The proposed rule includes the standards that will be used to determine compliance with the ability-to-repay requirement, and these standards include the making of a "qualified mortgage" (QM). Congress included language in the Dodd-Frank Act that is designed to provide some certainty and protection from liability for a lender who makes a QM. This language will benefit consumers by helping to ensure an adequate supply of affordable and high quality mortgages. However, the Federal Reserve states in the proposed rule that it is unclear from the statutory language in the Dodd-Frank Act whether Congress intended that the QM provide a "safe harbor" or merely the presumption of compliance with the ability-to-repay requirement. The proposed rule therefore outlines each of the two options and asks for comments on both.

Alternative 1 in the proposed rule provides for the "safe harbor" QM. In order to qualify for Alternative 1, the "qualified mortgage" must provide for regular periodic payments that do not result in an increase of the principal balance (negative amortization); allow the consumer to defer payment of principal (interest-only payments); or result in a balloon payment; the loan term cannot exceed 30 years; total points and fees payable in connection with the loan generally

cannot exceed 3 percent of the loan amount; the loan is underwritten in a manner that includes full amortization and takes account of all mortgage related obligations that are to be paid by the borrower; and the lender considers and verifies the borrower's current or reasonably expected income or assets. Alternative 1 provides lenders and consumers with a bright line that includes clear standards that must be met in order to make a QM and qualify for the legal safe harbor for compliance with the ability-to-repay requirement.

Alternative 2 provides that a QM must meet the requirements of Alternative 1, as well as additional ability-to-repay requirements. The lender would be required to consider the borrower's employment status, any simultaneous loans, current debt obligations, and the borrower's credit history. If these requirements are met, the creditor is presumed to have complied with the ability-to-repay requirement. Alternative 2 provides merely a "rebuttable presumption" of compliance.

CMLA believes that Alternative 1 is essential for both consumers and lenders, and strongly urges the Consumer Financial Protection Bureau to adopt this approach once the proposed rule is transferred under CFPB jurisdiction (on July 21, 2011).

There are a number of reasons why a safe harbor is necessary. First, the penalties for non-compliance with the ability-to-pay requirements are severe. If lenders do not have a clear safe harbor, consumers will suffer because lenders will inevitably become much more cautious and risk averse. There is already a great deal of uncertainty and litigation in the mortgage market, anything short of a safe harbor will invite more of both. The legal reality is that a rebuttable presumption can be overcome by any evidence of a potential failure to comply with the ability-to-repay standard. The lender is then faced with litigation in order to demonstrate compliance. Widespread litigation will invariably increase costs for consumers.

Second, the legal standards associated with a rebuttable presumption will vary from one court to another and from one jurisdiction to another. The result is likely to be confusion and a significant increase in compliance costs. Again, this will ultimately harm consumers by making credit scarcer and more costly.

Third, vague regulations can help create an environment where marginal creditors flourish. Reputable creditors strive to operate in compliance, less than reputable creditors ignore the rules and move to capture temporary market share. Obviously, this is harmful to consumers.

Fourth, a bright line safe harbor will encourage use of the QM, this will in turn result in an increased supply of affordable and high quality mortgages for consumers. The weak state of the economy has much to do with the lack of a housing recovery. This is no time to make it more difficult for lenders to make quality loans. Rather, this is a time to encourage responsible lending through greater use of the QM.

Fifth, a safe harbor would still permit focused litigation. This litigation would deal with whether the lender has met the safe harbor requirements. This degree of litigation is manageable, and reputable lenders will know that they can rely on the "rules of the road" for protection from frivolous and endless litigation.

It is clear to the members of the CMLA that a safe harbor provides the best means to ensure compliance with the ability-to-repay requirements of the Dodd-Frank Act. A safe harbor will help to maintain a steady flow of affordable and high quality mortgages to the largest number of qualified borrowers.

There are aspects of the safe harbor that CMLA believes need to be clarified and modified to some extent.

Our first recommendation is that loan originator compensation paid to a loan originator by a creditor, a mortgage lender or a mortgage broker should be excluded from the calculation of points and fees. The reason for this is simple. The calculation of points and fees includes origination fees paid to the creditor, broker or lender in a transaction. Those origination fees are the source of revenue used by the creditor, broker or lender to compensate the loan originator. Including both the origination fees paid to the creditor, broker or lender, **and also including** the loan originator's compensation paid from those fees, results in double counting the loan originator's compensation.

Second, we recommend that the dollar amount of smaller loan definition be increased from the $75,000 proposed in the rule. The proposed rule recognizes that the point and fees cap could work to the detriment of borrowers on lower balance loans. Many of the costs that lenders incur on a loan are costs for processing, underwriting, closing and perfecting the final documentation for a loan. These costs may fluctuate with the volume of originations but they are hard costs that must be incurred on every loan and they are not for the most part dependent on the size of the loan. These costs involve salaried employees with their attendant benefit programs, office space, equipment and office supplies and all of the attendant costs of running any business. This translates into a component of the cost of loan origination that is relatively fixed. As the loan amount gets smaller and smaller, that fixed cost becomes a larger and larger percentage of the loan amount, and will eventually reach the point where the origination of the loan becomes economically unfeasible.

The average loan for the purchase of a home in Colorado based on the 2009 HUDA data (the most recent year for which HMDA data is available) was $216,600. Our suggestion would be to increase the smaller loan definition to $100,000 with the 3.5 to 5.0 fee scale suggested in alternative 1 adjusted accordingly.

Third, we believe that fees paid to affiliates for loan services and products should be excluded from the calculation of fees and points so long as they represent charges (such as title insurance charges) that are regulated by or filed with State, Local or Federal governmental agencies or do

not exceed an average fee for similar services based on a survey of the local market. It is an accepted practice, permitted under RESPA for lenders to be part of affiliated business relationships that offer "one stop" shopping opportunities to consumers. Those businesses are entities unto themselves and have their own risks and opportunities for profit. As long as the fees for those products and services do not exceed the averages for the market or those filed with the appropriate regulators, CMLA does not believe those charges should be included in the 3 point limit.

Finally, the proposed regulations in the definition of a "bona fide discount point" contain a requirement that creditors include in the points and fees calculation, an amount the creditor might expect to receive from the sale of the loan to secondary market mortgage investors. There appears to be a presumption that such an amount would be a positive number. Given the actual experience of the market, that presumption is not necessarily true. The ultimate sale of a loan can result in either a profit or a loss depending on the success of the hedging strategy employed by the creditor. Gain or loss on sale of the loan is generally unknown at the time of origination and likely not even known at closing of the loan. In most cases in mortgage origination today, the borrower has a free put to the mortgage lender when the lender quotes a firm rate and fees to the borrower, yet the borrower is not obligated to close the transaction. This model creates interest rate risk for the creditor. Should the lender sell the loan in anticipation of the loan closing, and ultimately the borrower chooses not to close, the lender has no alternative but to substitute another loan or pair off the commitment to sell the loan, since that loan is no longer available for deliver to satisfy the commitment to sell the loan. Given the volatility of the market, it is certainly possible that the creditor might lose money on the sale of the loan. Introducing estimates that could be a positive or a negative number like these, into the calculation of the 3 point cap serves only to detract from its usefulness in the QM regulation. By introducing uncertainty into the calculation it makes it all the more likely that the lenders who are really trying to comply with the regulation will err on the side of caution, while less scrupulous lenders may exploit the lack of clarity to their benefit and to the detriment of consumers.

The Colorado Mortgage Lenders Association strongly urges the Board to adopt a bright line safe harbor definition of the Qualified Mortgage with the following modifications:

- Exclude loan officer compensation paid to the originator by a creditor, lender or mortgage broker from the 3 point cap on points and fees;
- Increase the small loan definition to $100,000 with a corresponding adjustment to the 3.5 to 5 point scale;
- Exclude fees paid to affiliates for settlement services so long as those fees do not exceed fees filed with the appropriate regulatory agencies or an average of such settlement fees for the market in which the loan origination takes place; and

- Exclude gain or loss on the sale of the loan in the secondary market from the calculation of points and fees for the 3 point cap.

Respectfully submitted,

The Colorado Mortgage Lenders Association

By: T. K. Jones
Chairman, Legislative and Regulatory Affairs Committee