CBA | CONSUMER BANKERS ASSOCIATION

July 22, 2011

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

Re: Regulation Z; Truth in Lending Act Proposal
Ability to Repay / Qualified Mortgages
Docket No. R–1417; RIN No. 7100–AD75

Dear Ms. Johnson:

The Consumer Bankers Association ("CBA")[1] appreciates the opportunity to comment on the recent notice of proposed rulemaking (the "Proposal") implementing the requirement under Section 1411 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Act") that creditors verify a residential mortgage borrower's ability to repay the loan according to its terms.

<u>SUMMARY</u>

- The proposal outlines two alternatives in which lenders may originate a "Qualified Mortgage" that would provide a presumption of compliance. CBA strongly urges that the safe harbor alternative be adopted that includes objective criteria for meeting this standard.
- With regard to the 3% points and fees test, the Consumer Financial Protection Bureau ("Bureau") should, at a minimum, clarify the extent that certain costs should be included.
- The definition of "prepayment penalty" should not include closing costs that are waived unless the borrower prepays the loan.

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[1] The Consumer Bankers Association is the only national trade group focused exclusively on retail banking and personal financial services — banking services geared toward consumers and small businesses. As the recognized voice on retail banking issues, CBA provides leadership, education, research, and federal representation for its members. CBA members include the nation's largest bank holding companies as well as regional and supercommunity banks that collectively hold two-thirds of the total assets of depository institutions.

DISCUSSION

CBA agrees that compelling policy reasons support the repayment ability verification requirement, and that creditors must be accountable for failing to comply in good faith with this new requirement. At the same time, the Act recognized that certain types of loans do not present undue risk to consumers or the broader market. The Act accordingly provides that a creditor may presume that a residential mortgage loan meets the new ability to repay requirement if the loan is a "Qualified Mortgage." The Act and the Proposal provide guidance on what constitutes a Qualified Mortgage and provides alternatives as to the legal certainty a creditor may expect in connection with the origination of such a loan. Unfortunately, the Proposal contains significant ambiguities both with respect to the definition of "Qualified Mortgage" and with respect to the presumption of compliance that will attach to such loans. The final rule must provide more certainty regarding these issues in order to reduce the legal risk to residential mortgage loan originators. A robust mortgage market depends on lenders' ability to implement clear compliance standards, and thereby originate loans that are enforceable in accordance with their terms and to enforce such loans. The rule also must be fine-tuned so that creditors remain able to offer mortgage loans to creditworthy borrowers, even if they cannot qualify under the strictest underwriting standards.

I. COMPLIANCE FAILURES CARRY SUBSTANTIAL LEGAL RISK

A creditor that fails to comply with the Act's requirement to make a good faith determination of a residential mortgage borrower's ability to repay the loan according to its terms is exposed to significant legal risk. First, if a creditor fails to comply with the repayment ability verification, the creditor is exposed to significant civil liability, without regard to whether the borrower actually suffered any harm. Indeed, the Act and other recent legislation have increased the damages available to a consumer in such an action. Specifically, the Truth in Lending Act ("TILA") now provides that a creditor that fails to comply with certain TILA requirements, including the ability to repay determination, is liable for: (a) actual damages (if any); (b) statutory damages of up to $4,000 in an individual action; (c) statutory damages of up to the lesser of $1,000,000 or 1% of the creditor's net worth in a class action; and (d) costs and reasonable attorney's fees.

In addition, for certain violations, including the new ability to repay requirement, a creditor may be liable for "enhanced" damages, equal to the sum of all finance charges and fees paid by the consumer (unless the creditor demonstrates that the failure to comply is not material). The types of violations that previously subjected a creditor to enhanced damages were limited to violations of the Home Owners Equity Protection Act ("HOEPA"), applicable to high cost mortgage loans. The availability of such significant enhanced damages for HOEPA violations, along with the fact that assignees may be held liable for those violations without holder-in-due-course protection, has lead to the death of any market (secondary and thus primary) for HOEPA loans. The availability of enhanced damages for violation of the ability to repay requirement could similarly impair the so-called non-Qualified Mortgage market (and even the Qualified Mortgage market, unless the safe harbor is solidified, as described below).

Further, the Act amended TILA to provide that in spite of otherwise applicable statutes of limitation, a consumer may assert a violation by the creditor of certain new prohibitions that the Act created (including the ability to repay requirement) up to the point when a creditor (or an assignee) of the loan initiates a foreclosure action or any other action to collect the debt. The consumer may thereby recoup or offset the amount owed in the foreclosure by the amount to which he or she could have sought in damages against the creditor under TILA (as described above). Thus, the civil liability may be significant, and there is essentially no time limit on the exposure to that liability.

While Qualified Mortgages are intended to enjoy some degree of protection against challenge, a non-Qualified Mortgage carries an open-ended and significant risk that a delinquent borrower may challenge a collection action by claiming that the creditor did not adequately underwrite the loan at origination. Virtually any foreclosure might be halted by this kind of subjective second-guessing of the original underwriting determination, which may impair the ability of creditors to enforce their loans or, to the extent that the loans have been sold into the secondary market, may expose the creditor to repurchase claims.

In light of this significant exposure to legal risk, creditors may reasonably consider not originating non-Qualified Mortgages. That outcome in itself is a significant concern for CBA's members, as those mortgages provide an important source of credit to homeowners with lower incomes or certain other factors that may prevent them from meeting the strict underwriting requirements in the Proposal. The disincentives to originating those loans (in this Proposal and in the separate rulemaking related to credit risk retention and qualified residential mortgage loans ("QRMs")) will leave many deserving consumers with no affordable credit options and creditors may also face significant risks in avoiding those loans. It is reasonable to predict that stricter underwriting standards will correlate with higher denial rates or increased pricing for low-or moderate-income (LMI) borrowers who rely on flexible underwriting, or may otherwise disproportionately affect protected classes of borrowers or LMI geographies. A decision not to originate non-Qualified Mortgage loans may thus lead to unjustified discrimination claims or, for depository institutions, to lower ratings under the Community Reinvestment Act.

II. THE PROPOSAL'S QUALIFIED MORTGAGE STANDARDS CREATE LEGAL UNCERTAINTY

In light of these substantial risks associated with violating the ability to repay requirement, it is clear that the concept of a Qualified Mortgage was intended to give creditors legal certainty by creating a presumption under which a creditor may originate such a Qualified Mortgage with assurance that the loan meets the ability to repay requirement. However, the standards set forth in the Proposal contain subjective and unspecified criteria that leave the creditor open to uncertainty as to whether or not it has complied.

A. The Rule Should Include Objective Criteria for Determining a Qualified Mortgage Safe Harbor

The Board of Governors of the Federal Reserve System (the "Board") states in the Proposal that it is unclear whether the presumption of compliance for Qualified Mortgages was intended to be an absolute safe harbor (*i.e.*, a violation of the repayment ability requirement could not be asserted against a valid Qualified Mortgage) or simple a rebuttable presumption of compliance that could be overcome by a showing that a creditor did not in fact consider and document the borrower's repayment ability. Even if the Bureau ultimately determines that Congress intended Qualified Mortgages to provide the stronger safe harbor, that definition of "Qualified Mortgage" is based on subjective factors that may make it difficult, if not impossible, for a creditor to determine whether it is making a loan that is subject to that protection.

For example, the Proposal would provide that a Qualified Mortgage is a residential mortgage loan, the underwriting of which is based on the maximum interest rate in the first 5 years, uses a payment schedule that fully amortizes the loan over the loan term, and takes into account any mortgage-related obligations. However, the Proposal does not provide any underwriting ratios or other guidance for creditors to implement those requirements with certainty that their good faith underwriting decisions will have any protection from scrutiny by courts or regulators in the future. Similarly, the Proposal would provide that a Qualified Mortgage is one "for which the income and financial resources relied upon to qualify the obligors on the loan are verified and documented." The Proposal's "General Ability to Repay Standard" (which provides no legal certainty) indicates that the creditor should consider and verify underwriting factors based on "widely accepted underwriting standards," such as those for Federal Housing Administration ("FHA") insured loans, and retains many other guidelines culled from the Board's previous commentary on underwriting higher-priced mortgage loans. However, not even that guidance is incorporated into the Qualified Mortgage safe harbor.

The final rule should establish objective guidelines for verifying or documenting a consumer's income or other resources, or for determining whether a borrower can afford any particular level of additional debt or obligations, because without clear guidelines, a creditor's good faith underwriting determination would always remain subject to second guessing. The Proposal suggests that the safe harbor alternative provides creditors with legal certainty, but if a court or regulator disagrees with the creditor's subjective determination, then the creditor is left with no legal certainty, and must prove that it made a reasonable and good faith determination at the time that the consumer could repay the loan.

CBA strongly advocates for a Qualified Mortgage safe harbor that includes objective criteria and provides the legal certainty that the Act intended. The Bureau must provide clear standards for the type of underwriting determinations and income verification and documentation that will satisfy the Qualified Mortgage definition. Lenders must be able to defend actions and contested foreclosures with clear, irrefutable proof that the loan is a Qualified Mortgage.

B. The Rebuttable Presumption Alternative for Qualified Mortgages Will Provide No Legal Certainty for Creditors

The rebuttable presumption of compliance suggested in the Proposal as an alternative to the safe harbor not only provides creditors with no incentive to make a Qualified Mortgage instead of another type of loan, but similarly provides no certainty with respect to the definition of "Qualified Mortgage." The Qualified Mortgage definition under this alternative contains even more subjective and uncertain underwriting criteria. Specifically, the creditor must make individualized determinations regarding: (a) the consumer's employment status; (b) the monthly payment for any simultaneous loan; (c) the consumer's current debt obligations; (d) the total debt-to-income ratio or residual income; and (e) the consumer's credit history. However, the Proposal does not provide any quantitative or clear standards for making those determinations. Moreover, the rebuttable presumption provides no legal certainty to a creditor, as it preserves the consumer's ability to challenge the creditor's subjective determinations in hindsight.

C. Mortgage Markets Depend Upon Objective Standards and Legal Certainty

A robust residential mortgage lending marketplace can only return if the risks can be measured and priced. A creditor must be able to determine with certainty whether it is originating Qualified Mortgages or non-Qualified Mortgages. Congress recognized this need for certainty by providing the Qualified Mortgage presumption of compliance. Congress similarly recognized this need for certainty with respect to the Act's risk retention requirements by proposing to define "qualified residential mortgages" by reference to objective ratios and criteria so that creditors can clearly determine the nature of a loan in order to craft securitization transactions and price for risk retention.[2]

If the Qualified Mortgage safe harbor or presumption is built upon subjective underwriting criteria, the creditor simply cannot determine whether any given loan meets those criteria. The risk that delinquent borrowers (or regulators) may bring factual disputes about the creditor's good faith underwriting in connection with civil actions, and even in connection with any foreclosure, will continue to prevent lenders from making such loans.

III. PRICING OF MORTGAGES HAMPERED

CBA members are also very concerned about the implications of the Proposal on the pricing of non-Qualified Mortgages. It is reasonable to assume that non-Qualified Mortgages will present greater default risk and will be priced accordingly. This is especially problematic considering the expansion of the HOEPA high cost mortgage triggers and the low points and fees threshold currently in the Qualified Mortgage definition.

Recent lowering of the HOEPA high cost mortgage thresholds mean that more loans (i.e., more non-Qualified Mortgages) will be considered HOEPA loans (now officially called "high cost mortgages"). Because of the additional restrictions associated with HOEPA loans and because most investors are unwilling to finance high cost mortgages, many creditors will be unwilling or unable to offer non-Qualified Mortgages that meet those lower thresholds to a broad range of consumers who present an elevated risk profile but still possess the ability to repay a loan. First, the Act amended the definition of a HOEPA loan by significantly lowering the points and fees threshold (as well as changing the annual percentage rate metrics). While the regulations previously set the points and fees threshold at 8% of the total loan amount (or an adjusting dollar amount, whichever is greater), the new threshold is a mere 5% for loans greater

[2] The Office of the Comptroller of the Currency, the Board, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, the Federal Housing Finance Agency, and the Department of Housing and Urban Development published a proposed QRM definition for purposes of credit risk retention in April 2011. 76 Fed. Reg. 24,090.

than $20,000.[3] Thus, there is a very small window of room for non-Qualified Mortgages – between the 3% points and fees limit for Qualified Mortgages (discussed further below) and the 5% limit for HOEPA loans.

In addition, the Act amended the points and fees calculation applicable to HOEPA loans (and non-Qualified Mortgage loans) to be significantly more inclusive. For example, the amount of compensation paid to a loan originator by a creditor must be included in that calculation. Previously, TILA required the inclusion of amounts paid by the consumer to a mortgage broker, and excluded from the calculation any yield spread premium that the broker may receive from the creditor. Under the Act, any incentive compensation paid by a creditor to its loan officer employees in connection with a particular loan would also have to be counted as points and fees, potentially including certain commissions, bonuses and other non-salary compensation.

The original inclusion of these amounts in the points and fees definition seems intended to address yield spread premiums paid by lenders to mortgage brokers. However, the concern over yield spread premiums is already adequately addressed in the Act's anti-steering provisions, and requiring those amounts to be included in the points and fees calculation will in no way help ensure that a creditor has determined the consumer's ability to repay. Further, the inclusion in a loan's points and fees calculation of compensation that a creditor pays its loan officer employees is unrelated to amounts paid by a consumer and thus wholly unrelated to the consumer's ability to repay the loan. The Proposal even recognizes that inclusion of those amounts will be considerably complex, by including amounts the creditor pays at any time, whether at or before closing or any time after closing (as long as that compensation amount can be determined at the time of closing). It is likely to make many otherwise solidly underwritten mortgage loans fall into HOEPA territory. If the Bureau decides to include a points and fees threshold in the Qualified Mortgage definition, it should use its authority to exclude from that calculation any compensation paid by a creditor to its employees, particularly any amounts paid after closing.

Not only is the pricing for non-Qualified Mortgages significantly hampered (because of the increased likelihood that they will fall into HOEPA territory), the incredibly tight 3% limitation on points and fees for Qualified Mortgages mentioned above (under both the safe harbor and the rebuttable presumption) is likely to push many residential mortgage loans into non-Qualified Mortgage territory, without adding to the Proposal's purpose, which is the assurance that the consumer has the ability to repay the loan. Since the points and fees limit for Qualified Mortgages is so tight, and the criterion has no significance to the underwriting determination of whether a borrower is able to make his or her payments on the loan, the Bureau should use its discretionary authority to exclude this criterion from the Qualified Mortgage definition.

If the Bureau decides to include a points and fees threshold in the Qualified Mortgage definition, it should use its authority to exclude certain amounts that unduly hamper a creditor's ability to price its residential mortgage loans. Currently, the Proposal's exclusions from the points and fees calculation are unclear and difficult to establish, making the origination of a Qualified Mortgage nearly impossible. For example, the exclusions from the calculation for

[3] Section 1431 of the Act; 15 U.S.C. § 1602(aa).

bona fide discount points and third party charges are welcome, but limited in amount and applicability, and arguably difficult to prove. The term "bona fide discount points" applies only to amounts the consumer knowingly pays for the purpose of reducing, and which in fact result in a bona fide reduction of, the interest rate or time-price differential applicable to the mortgage loan. The "bona fide" nature of those amounts, and the consumer's knowledge regarding those amounts, are subjective and difficult to prove. Further, as the Proposal recognizes, the points charged to the borrower generally include loan level price adjustments, such as those issued by Fannie Mae and Freddie Mac in publicly-disclosed tables based upon the risk features of a particular loan or consumer. These risk-based pricing elements are passed along to the consumer in setting the rates and points. Without the ability to pass those amounts along to the borrower as up-front costs for the loan, the creditor would be required to raise its interest rates. However, the Proposal does not expressly clarify that those amounts constitute either bona fide discount points or bona fide third-party charges. To the extent those amounts are not retained by the creditor, transparent and disclosed to the public, based on fully objective criteria, and result in the creditor's ability to charge lower interest rates, the Bureau should clarify that they may be excluded from the points and fees calculation.

IV. PREPAYMENT FEE RESTRICTIONS

The Act also amends TILA to provide significant restrictions on prepayment fees. Clearly those fees are a concern for Congress, and for regulators, as restrictions on those fees have multiplied in the past several years, particularly in connection with higher priced mortgage loans. In establishing the concept of a Qualified Mortgage, which represents a loan without certain risky features and/or that has undergone some degree of creditor underwriting, the Act provides that loans that fall outside the scope of Qualified Mortgage generally should not include prepayment fees.

The Proposal thus provides parameters for the types of loans that may and must not contain a prepayment fee. Under the Proposal, a residential mortgage loan must <u>not</u> include a prepayment fee <u>unless</u> the transaction is: (i) a Qualified Mortgage (according to whatever definition is finally promulgated); (ii) a fixed rate or step-rate mortgage loan; and (iii) not a higher-priced mortgage loan. Even under those circumstances, the prepayment penalty must not exceed 3% of the outstanding loan balance during the first year after consummation, 2% during the second year, and 1% during the third year after consummation. Thus, under the Proposal only fixed-rate Qualified Mortgages may have a prepayment fee.[4] (However, of course, Qualified Mortgages are subject to further prepayment fee restrictions, since those fees are included in the points and fees calculation.[5]) Further, prepayment fees are not permitted under any closed-end residential mortgage loan after the end of the third year after consummation. Additionally, a creditor offering a consumer a loan with a prepayment penalty (permitted only

[4] The Proposal does not address prepayment fees or other requirements applicable to open-end, reverse, or temporary mortgage loans.
[5] Prepayment fees also must be included in the points and fees calculation for purposes of determining whether a loan is a high-cost mortgage loan or HOEPA loan, and for determining whether a loan falls outside the boundaries of a "qualified residential mortgage" or "QRM" for purposes of the 5% credit risk retention requirements for securitized transactions.

under the limited circumstances above) must also offer that consumer a loan without a prepayment penalty.

The Proposal would define a prepayment fee broadly to include a fee, such as a loan closing cost, that is waived unless the consumer prepays the loan. However, the payment of (or waiver of requirement to pay) closing costs is fully distinguishable from a prepayment fee. Closing costs are up-front amounts a consumer must pay in order to obtain a loan, whereas a prepayment fee is an amount to compensate the lender (or more accurately the servicer) for the truncation of the stream of income it would otherwise receive. Both amounts generally correlate with a lower interest rate on the loan, but they serve different purposes (and are calculated differently).

Many lenders (including some of our members) offer to pay a consumer's up-front closing costs (excluding certain third-party charges, such as for title insurance), on the consumer's behalf. The loan may provide, however, that the consumer agrees to reimburse the lender if he or she pays off the loan in full within a relatively short period of time (*e.g.*, the first three years). The lender needs this provision in order to offer this benefit to consumers, because the provision allows the lender to recoup its outlay (at least in part), which it would otherwise recoup through the receipt of loan payments over time. The amount is not compensation to the lender; it is a reimbursement. If those amounts were considered to be a prepayment fee, and thus the offer to pay closing costs could only be made in connection with fixed-rate Qualified Mortgages (that are not higher-priced), and only to the extent they do not exceed the amounts and time limits for permissible prepayment fees, it would generally prevent lenders from offering this benefit to consumers. Such an outcome could not have been the intent of the Act.

V. CONCLUSION

The CBA understands that creditors must be held responsible for complying with the requirement to make a good faith determination of a borrower's ability to repay. At the same time, however, Congress recognized that certain loans present a lower risk of default by providing a presumption of compliance with respect to Qualified Mortgages. The final rule must define a Qualified Mortgage by reference to objective criteria and provide a safe harbor from liability with respect to such loans. Otherwise, it will be impossible for our members to manage their liability risk. The final rule also must recognize the importance of the continued availability of mortgage loans to borrowers such as first-time homebuyers, LMI borrowers, and others, who may not be able to meet the strict requirements under the Proposal. Finally, we urge the Bureau to define prepayment fee in a manner that distinguishes between such fees and the payment of (or waiver of) closing costs.

CBA appreciates the opportunity to comment on the Proposal. If you have any questions or require any additional information, please do not hesitate to call me at 703-276-3862.

Sincerely,

Jeffrey P. Bloch
Senior Regulatory Counsel