American Financial Services 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: Docket No. R-1417 – Ability to Repay Proposal

Dear Ms. Johnson:

The American Financial Services Association ("AFSA") appreciates the opportunity to comment on the Federal Reserve Board's (the "Board") proposed Ability to Repay Rule ("Proposal"). As stated in the Proposal, all comment letters will be transferred to the Consumer Financial Protection Bureau (the "Bureau") for the Bureau's consideration. AFSA is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. Its 350 members include consumer and commercial finance companies, auto finance/leasing companies, mortgage lenders, mortgage servicers, credit card issuers, industrial banks and industry suppliers.

The AFSA members that engage in mortgage lending are traditional finance companies that typically offer a broader product range than conventional Fannie, Freddie or FHA lenders. AFSA lenders provide an important source of credit for consumers who live in underserved small towns and urban settings and those who have less than perfect credit. AFSA members engage in rigorous underwriting to ensure that borrowers have the ability to repay the loan.

AFSA members are concerned that the general ability to repay standard is based on and favors conventional lenders that participate in the Fannie, Freddie and FHA markets. Further, AFSA members believe that the qualified mortgage ("QM") safe harbor/rebuttable presumption, as currently defined, will produce a marketplace that disfavors non-QM loans, which may disenfranchise most of the customers AFSA members serve unless the proposed QM definition is revised. AFSA members respectfully ask that the Board reconsider the general ability to repay standard and the QM safe harbor/rebuttable presumption proposal with the non-Fannie, -Freddie and -FHA markets in mind in order to preserve this important source of credit.

Recently, both the financial services industry and housing advocates have expressed concern that the qualified residential mortgage rules being developed in connection with the new risk retention requirement will restrict the availability of credit by making certain loans more expensive. While the qualified residential mortgage rules are a concern, the QM proposal would have a much more direct and immediate effect on consumers by potentially eliminating lending to the markets served by AFSA members.[1] If a loan does not qualify as a QM and does not meet the general ability to repay test, the

[1] Concerns that these rules would adversely affect access to credit, particularly among the underserved and those with blemished credit histories, were underscored in a recent GAO study. *See,* "MORTGAGE REFORM Potential Impacts of Provisions in the Dodd-Frank Act on Homebuyers and the Mortgage Market," U.S. Government Accountability Office, GAO-11-656 (July 2011). For example, the GAO study noted: "However, some consumer and industry groups stated that some of the QM criteria could increase the cost and restrict the availability of mortgages for some borrower groups, including lower-income and minority borrowers." *See,* page 19.

potential penalties are substantial. The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") imposes the HOEPA penalties in Section 130 of the Truth in Lending Act when a mortgage loan does not comply with the ability to repay rules. These penalties include the sum of (i) actual damages; (ii) up to twice the amount of the finance charges, but not less than $400 or more than $4,000 [or up to $1,000,000 in a class action]; (iii) attorneys fees; and (iv) all finance charges and other fees paid by the consumer. Dodd-Frank also expands to three years the statute of limitations for claims involving the ability to repay standard and provides that a claim that the original lender failed to meet this standard can be raised as a defense to a foreclosure action at any time. Given this potential liability, lenders and the secondary market need to be able to determine, at the time the loan is made, whether the ability to repay rules have been satisfied.

Unless the uncertainty is removed from the ability of repay standard and the QM definition is expanded, lenders may not be able to sell, securitize or pledge for funding loans made in many underserved markets. This lack of capital would cripple this important mortgage market and make such loans not just more expensive, but unavailable at any price.

Ability to Repay Standard

The general ability to repay standard in the Proposal appears to be based on and favors the Fannie, Freddie and FHA mortgage markets. However, most Fannie, Freddie and FHA loans will likely fall under the definition of a QM and will therefore not be subject to the general ability to repay analysis. Conversely, the loans typically made by AFSA lenders will fall largely outside of the proposed QM definition and will be subject to the general ability to repay analysis. Therefore, the general ability to repay standard should be developed with the non-Fannie, -Freddie and -FHA market in mind, as these are primarily the loans to which the standard will be applied.

The proposed ability to repay standard is subjective in that it does not provide a clear rule as to how creditors should evaluate the eight enumerated factors to be considered. The lack of a bright line rule creates uncertainty in that it is difficult to determine with confidence when a creditor has complied with the ability to repay requirement. AFSA members believe that this ambiguity will prevent non-QM loans from being purchased in the secondary market and will make them ineligible to be pledged as collateral against lines of credit. Further, non-QM loans may become a target for litigation if the ability to repay standard remains vague. In order to protect the continued viability of the non-QM market, the general ability to repay rule must provide more certainty.

AFSA members particularly take issue with the provision in the proposed Commentary stating that, in evaluating a consumer's ability to repay, creditors may look to "widely accepted governmental or non-governmental underwriting standards, such as the underwriting guidelines found in the Federal Housing Administration's handbook on Mortgage Credit Analysis for Mortgage Insurance on One- to Four-Unit Mortgage Loans." The term "widely accepted governmental or non-governmental underwriting standards" is not defined and is unclear. Many traditional finance companies do not originate loans for the Fannie, Freddie and FHA markets, and use proprietary underwriting standards that are not publicly available and have not been subject to review by any other party. It is unclear under the proposed standard whether any proprietary underwriting standards could be considered "widely accepted." It is important to note that traditional finance companies were not responsible for the subprime mortgage crisis. The traditional proprietary methods of underwriting are effective and should be considered an appropriate method of evaluating a consumer's ability to repay.

Additionally, the Proposal offers the standards in the FHA's handbook as an acceptable tool for evaluating the ability to repay. This reference is not useful for non-FHA lenders and is inappropriate. First, the FHA handbook is neither widely accepted nor used as an underwriting tool outside of the FHA program. Second, many FHA loans will be prime mortgage loans that will satisfy the QM standard, and further, Section 1412 of Dodd-Frank gives the FHA the ability to deem FHA loans QMs automatically. Thus, either based on their own terms or by the FHA's decree, FHA loans will be QMs and will not be subject to the ability to repay standard. It does not seem appropriate for the FHA handbook to be the only recognized benchmark for evaluating the ability to repay when these standards are not widely accepted outside the FHA program, and FHA loans will not be subject to the ability to repay analysis.

AFSA members do not believe Congress intended for the Board to decree a single set of underwriting standards for the diverse mortgage markets in this country. Also, AFSA members do not believe Congress intended lenders to be restricted to a limited number of "widely accepted" underwriting standards that would constrain the market and replace the robust proprietary underwriting standards that have worked so well for AFSA members and their customers.

The Board should provide more flexibility in terms of acceptable underwriting standards used to evaluate a consumer's ability to repay. The rule should recognize that some of the lenders relying on this provision of the rule are finance companies that make non-Fannie, -Freddie and -FHA loans and that their traditional methods of underwriting have been effective. The rule should only require lenders to document and verify the credit history, current income, expected income, current obligations, debt-to income ratio or residual income of their applicants and then to make a reasonable and good faith determination that the borrower can repay the loan based on the lender's underwriting standards. Such a flexible test that can be documented at the time the loan is made will help ensure that non-QM loans remain available and that an already underserved portion of the marketplace will not be completely disenfranchised.

AFSA members believe that is vitally important that lenders and the secondary market be able to determine, at the time the loan is made, that the lender has satisfied the ability to repay test. Otherwise, non-Fannie, -Freddie or -FHA loans will constitute ongoing compliance risks and be deemed unacceptable to the investors and lenders that fund the loans originated by AFSA members. Particularly vulnerable will be consumers with less than perfect credit or others that do not fit traditional underwriting standards and that cannot qualify for a QM loan.

Qualified Mortgage

As noted above, the ambiguity surrounding the ability to repay standard in the proposed regulations will make it difficult to determine with certainty when a non-QM loan has satisfied the ability to repay requirement. Unless this ambiguity is eliminated, there may not be a marketplace for non-QM loans. Thus, the QM safe harbor/rebuttable presumption needs to be clarified and expanded as well. In addition to creating more certainty around the general ability to repay standard, AFSA members urge the Board to adopt the safe harbor proposal – which will provide certainty within the marketplace – and to broaden the definition of QM to offer this protection to a larger number of loans.

As currently drafted, the QM definition is too limited. One AFSA member reviewed over 250,000 of its recent loans and found that under the proposed definition, 100% of its loans in amounts of less than $75,000 and 50% of its loans in amounts of less than $125,000 would not qualify as QMs based on the points and fees test alone.[2] This illustrates the perverse effect the current proposal would have on the customers of AFSA members. The underserved market is more likely to seek smaller loans, but without the protections offered by the QM definition, such loans may not be available.

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[2] AFSA members believe that a wider sampling of traditional finance companies that make mortgages would show an even greater number of their loans would fall outside of the protection offered by the QM definition.

The Board should revise the Proposal in the following ways to be certain that the QM market is broad enough to provide access to most Americans who are homeowners or who want to become homeowners.

- ***Points and Fees.*** AFSA members ask that the definition of QM be revised to increase the acceptable points and fees to 5% and exclude from this cap the loan originator compensation and any fees associated with affiliated title companies or services.[3] Further, the rule should allow two discount points, including loan-level price adjustments. AFSA members note that 5% is the points and fees limit adopted by Fannie Mae and Freddie Mac.

- ***Underwriting Standards.*** To ensure that the QM market is available to other non-agency lenders, the acceptable underwriting standards should be expanded to include an acceptable alternative to a debt-to-income standard. The Board should adopt the residual income calculation method used by the U.S. Department of Veterans Affairs (VA).[4] The Board should then adopt a bright line test for this residual income test such that any loan that leaves the borrower with a residual monthly income that exceeds $600 is a QM. Such a bright line test would encourage non-Fannie, -Freddie and -FHA lenders to offer the safe, consumer-friendly terms required under the QM standard, and would significantly promote the availability of credit to the underserved population.

Furthermore, we believe it is important that any QM test establish a safe harbor for lenders and the secondary market. Any uncertainty after closing about whether a loan qualifies as a QM will chill the mortgage market and significantly reduce the availability of credit. A QM rule that provides a safe harbor, coupled with the revisions noted above, will help ensure that adequate credit is available for the American housing market.

HOEPA Concerns

In creating the QM test, Congress referred to the points and fees test for mortgage loans defined in Section 103(aa) of TILA ("high-cost mortgages"). Thus, the Board has amended this test in Section 226.32 for use with the QM definition. However, the Board has not proposed at this time to address all of the changes Dodd-Frank makes with respect to high-cost mortgages. As stated in the Supplemental Information to the Proposal:

> The Board proposes amendments to the definition of "points and fees" to implement the limitation on points and fees for qualified mortgages. The Board is not currently proposing regulations to implement the Dodd-Frank Act's amendments to TILA's high-cost mortgage rules generally. For example, the Board is not proposing at this time to implement revisions to the points and fees thresholds for high-cost mortgages that exclude from the threshold calculation "bona fide third party charges not retained by the mortgage originator, creditor, or an affiliate of the creditor or mortgage originator" and that permit creditors to exclude certain "bona fide discount points." By contrast, identical provisions in the Dodd-Frank Act defining the points and fees threshold for qualified mortgages are proposed to be implemented in new Sec. 226.43(e)(3), discussed below. 91 F.R. 27390 at 27398-27399 [footnotes omitted]

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3 As noted in the Proposal, Section 129C(b)(2)(D) of the Truth in Lending Act, permits the Board to adjust the three percent limit for smaller loans or loans in rural areas and other areas where home values are lower.

4 The VA guidelines define residual income as follows: "Residual income is the amount of net income remaining (after deduction of debts, obligations and monthly shelter expenses) to cover family living expenses such as food, health care, clothing, and gasoline." See, page 35 of the *VA Home Loan Program, Lenders Training Guide, http://www.vba.va.gov/ro/houston/lgy/Lender%20Training%20Guide%20May%202009.pdf.*

The language above seems to state clearly that the proposed changes in the points and fees test will only apply to QMs, not high-cost mortgages. However, there is nothing in the language of the proposed rules that makes this clear. It is important for two reasons for the Board to clarify that any change made to the definition of points and fees will be applicable only to QMs, and not to high-cost mortgages. First, Dodd-Frank makes additional changes to the test for high-cost mortgage loans. It excludes certain fees that are not addressed in the Proposal and it abandons the "total loan amount" concept for high-cost mortgages. If the Board imposes the proposed points and fees test on high-cost mortgages, more loans will be captured by this new definition, even though the other changes in Dodd-Frank that are not being implemented at this time would have offset the proposed changes and reduced the number of loans that are considered high-cost mortgages. Because the industry and the secondary market generally avoids making any high-cost mortgages, the Proposal, if not clarified, will further limit access to credit by capturing more loans in the high-cost definition. Second, creditors will program their computer systems separately for the high-cost and QM tests. If the high-cost mortgage points and fees test is changed by this Proposal, and then revised again when the Board implements the other provisions of Dodd-Frank affecting high-cost mortgages, creditors will have to undergo costly computer reprogramming and testing on the high-cost mortgage rules twice. Given all the other changes Dodd-Frank is requiring in creditors' systems, the Board should not unnecessarily require creditors to reprogram their computer systems for this purpose twice within a short period of time.

For these reasons, AFSA members request that the Board clarify that creditors may, at their option, continue to rely on the prior definition of points and fees in order to determine whether a loan is a high-cost mortgage loan until such time as the Board fully implements the changes to the definition of high-cost mortgages contained in Dodd-Frank.

Finally, AFSA members also request that the Board restate in the final rule its intention not to implement Sections 1431 through 1433 of Dodd-Frank at this time. Except for the changes to the definition of points and fees, the Proposal is clear on this point, and it is important that the final rule be clear as well.

Technical Comment

The proposed amendments to 226.32(b)(1)(i)(B) and (iv) regarding the exclusion of certain insurance premiums, credit loss charges and debt cancellation fees track the statutory amendments made by Dodd-Frank except in one regard. The proposed amendments fail to exclude premiums, charges or fees "calculated or paid in full on a monthly basis." See Section 1431 of Dodd-Frank, amending TILA Section 103(aa)(4)(D). This exclusion is important because some monthly insurance premiums, credit loss charges or debt cancellation fees are paid in advance, which would mean the first monthly payment would be collected at closing. Under the Proposal, these premiums, charges or fees would appear to be included in the points and fees test. However, under the Dodd-Frank amendments, this first monthly payment should be excluded from the points and fees test. AFSA members request that the Proposal be revised to reflect the statutory amendment.

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Given the significant possibility that a final rule could unduly restrict access to credit for underserved markets, AFSA members strongly urge the Board (or rather the Bureau) to consider working sessions with industry and with consumer advocates to better understand the potential effects of this rule and how those effects can be mitigated while still providing strong consumer protections. AFSA members, through the association, look forward to working with the Bureau in such an effort.

AFSA thanks the Board for the opportunity to comment on the Proposal. Please feel free to contact me with any questions at 202-296-5544, ext. 616 or bhimpler@afsamail.org.

Respectfully submitted,

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American Financial Services Association