



OHIO CREDIT  
UNION LEAGUE

July 22, 2011

Jennifer J. Johnson, Secretary  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, NW  
Washington, D.C. 20551

**Re: Docket No. R-1417 and RIN 7100-AD75  
Regulation Z-Determining a Consumer's Ability-to-Repay Mortgage Loans**

Dear Ms. Johnson:

The Ohio Credit Union League (OCUL) appreciates the opportunity to comment on the Federal Reserve Board's (Fed) proposed rule that will amend Regulation Z (Truth in Lending) to implement amendments required under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The Ohio Credit Union League is the credit union trade association in Ohio advocating on behalf of Ohio's 384 federal and state chartered credit unions and their 2.7 million credit union members. The comments reflected in this letter represent the recommendations and suggestions of the OCUL.

This proposed rule would implement statutory changes to implement the minimum mortgage underwriting standards required by Title XIV of the Dodd-Frank Act. Congress intended this part of the Act to require, among other things, at least some minimal underwriting of mortgage loans, in response to evidence that many non-depository mortgage lenders did not engage in safe and sound underwriting practices before the financial crisis.

### **Summary of the Proposed Rules**

The Fed has issued this proposed rule, ability-to-repay, as required under the Dodd-Frank Act. Currently, Regulation Z prohibits a creditor from making a higher-priced mortgage loan without regard to the consumer's ability to repay the loan. The proposed rule would expand the scope of the ability-to-repay requirements to cover any consumer credit transaction secured by a dwelling, excluding an open-end credit plan, timeshare, reverse mortgage, or temporary credit with terms of 12 months or less. In addition, the proposal would establish standards for complying with the ability-to-repay requirement, which include making a "qualified mortgage," implementing limits on prepayment penalties, and requiring creditors to retain evidence of compliance with this rule for three years after a loan is consummated.

### **Overview**

OCUL generally supports the intent of the proposed rule, which requires creditors to determine a consumer's ability to repay a mortgage before making the loan. It is in the best interest of not only the consumers, but also credit unions and other financial institutions to ensure to the best of their ability that the consumer will be able to meet their repayment obligations prior to issuing a loan.



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However, OCUL also believes that this proposed rule needs to include a number of clarifications and modifications to ensure that consumers have continued access to mortgage credit at fair terms and conditions. OCUL is also concerned with the possibility of an increase in regulatory burden and unintended consequences.

Further, it is OCUL's belief that while there should be some reform to mortgage lending practices, it should first address those entities that did not engage in safe and sound underwriting practices, and those areas that have been construed to have helped cause the mortgage crisis over the past few years.

### **“Qualified Mortgage”**

The Fed has proposed two alternative definitions of “qualified mortgage” – the making of which would either provide a “safe harbor” or a presumption of compliance.

“Alternative 1” would provide a safe harbor and define “qualified mortgage” as a loan of 30 years or fewer, without negative amortization, interest-only payments, or a balloon payment; that has fees and points under 3% of the loan value; is underwritten with a “considered and verified” ability-to-pay determination. The underwriting of the mortgage is (a) based on the maximum interest rate that could apply in the first 5 years (in the case of an ARM); (b) uses a payment that fully amortizes the loan; and, (c) takes into account any other mortgage obligations of the borrower.

OR

“Alternative 2” would provide a rebuttable presumption of compliance (instead of a safe harbor) and would require the “Alternative 1” underwriting criteria as well as also require consideration and verification of (a) the consumer employment status, (b) the monthly payment on any simultaneous mortgage, (c) the consumer's debt obligations, (d) the consumer's monthly debt-to-income ratio or residual income, and (e) the consumers credit history.

### **Safe Harbor**

The Dodd-Frank Act provides special protection from liability for creditors who make a “qualified mortgage.” Under the safe harbor provision, Alternative 1 would be treated as a legal safe harbor, while Alternative 2 would be a rebuttable presumption of compliance. OCUL supports the proposed Alternative 1 in that it would treat “qualified mortgages” as a legal safe harbor and would provide greater legal protection for credit unions that would only have a rebuttable presumption of compliance. Under Alternative 2, a borrower would have a private right of action against creditors that do not perform a thorough and sufficient “ability-to-repay.”

### **Prepayment Penalties**

Under this proposed rule, the Fed requires that in order to offer a consumer a mortgage with a prepayment penalty the creditor must offer an alternative without a prepayment penalty. In addition, the Fed has proposed definition of a “prepayment penalty” that is more expansive of NCUA’s definition and most judicial decisions. Therefore, OCUL is not in support of this proposed definition of prepayment penalties. Currently the definition of “prepayment penalties” does not include waived closing costs that can be recouped in the event of prepayment of certain amortized interest.

### **Income Verification/Lower Documentation Loans**

OCUL supports documented income verification for simple wage earners. OCUL believes that stated income and reduced documentation loans to borrowers should be acceptable for refinancing by an existing borrower to a lower monthly payment amount if there are mitigating factors that clearly minimize the need for direct verification of the ability to repay. Reliance of those factors should be documented. Income documentation verification may include:

- Review of borrower’s tax returns, pay stub, financial institution statements or reasonable third-party verification. Reasonable third-party verification includes, but is not limited to, statements from investment advisors, broker-dealers and others in a fiduciary relationship with the borrower.
- Review of reasonable alternatives to borrower’s tax returns, payroll stubs or financial institution statements.

However, OCUL is concerned that some credit unions serve significant numbers of self-employed people and/or immigrant populations who may not have documents such as W-2 forms, pay stubs, and other documentation. In order to ensure continued access to mortgage credit for these groups, OCUL suggests clarification that “qualified mortgages” can be underwritten based primarily or exclusively on financial institution records so long as those records show an ability to repay.

### **Third Party Charges and Points and Fees**

Included in the qualified mortgage definition are points and fees. The Dodd-Frank Act defines “points and fees” to now include:

- Certain mortgage insurance premiums in excess of the amount payable under Federal Housing Administration provisions;
- All compensation paid directly or indirectly by a consumer or creditor to a loan originator; and,

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- The prepayment penalty on the covered transaction, or on the existing loan if it is refinanced by the same creditor.

We believe that the total loan amount should be defined as the principal loan amount minus charges that are points and fees and are financed by the creditor. This will make it easier to figure out the 3 percent rule.

OCUL supports the exclusion for legitimate third party charges not retained by the creditor, such as it pertains to purchase mortgage insurance, credit insurance and debt cancellation or suspension coverage. It is OCUL's opinion that none of these fees should be included in the points and fees. These are generally voluntary add-ons that are not required by the Lender. However, if the Lender is requiring one of these products as a condition for approval or closing, then some consideration should be given as to whether or not these add-ons should be added into the points and fees.

The proposal provides two alternative approaches for limits on points and fees for qualified mortgages:

**Alternative 1-** A covered transaction is not a qualified mortgage unless the total points and fees do not exceed:

- For a loan of \$75,000 or more, 3 percent of the total loan amount;
- For loan of at least \$60,000 but less than \$75,000, 3.5 percent of the total loan amount;
- For a loan of at least \$40,000 but less than \$60,000, 4 percent of the total loan amount;
- For a loan of at least \$20,000 but less than \$40,000, 4.5 percent of the total loan amount; and
- For a loan of less than \$20,000, 5 percent of the total loan amount.

**Alternative 2-** A covered transaction is not a qualified mortgage unless the total points and fees do not exceed:

- For a loan of \$75,000 or more, 3 percent of the total loan amount;
- For a loan of at least \$20,000 but less than \$75,000, 3.5 percent of the total loan amount
- For a loan of less than \$20,000, 5 percent of the total loan amount.

OCUL proposes that the threshold for 3 percent be raised to \$100,000. OCUL also supports the "Alternative 1" approach because it provides the lender with a higher cap compared to "Alternative 2." However, for both approaches OCUL believes capping fees at 5 percent for loans of less than \$20,000 will be challenging for our credit unions due to the amount of required underwriting and

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verification. OCUL is concerned that by capping fees for loans less than \$20,000 may result in a reluctance to underwrite those loans to the detriment of their members.

### **Balloon Payment Qualified Mortgages for Lenders in Rural and Underserved Areas**

The proposed rule would allow some types of balloon-payment mortgages to be considered “qualified mortgages” if the loan is made by a creditor operating predominantly in an “underserved” or “rural” area. As drafted, OCUL supports the proposal to allow balloon payment mortgages to be considered “qualified mortgages” if made by lenders under \$2 billion in assets that operate predominantly in “underserved” and “rural” areas. OCUL believes that by allowing these mortgages, consumers will continue to have access to mortgage credit in these areas because it allows smaller institutions to control interest risk. However, it is important that the borrower understands the process and transaction.

In addition, OCUL does not agree nor support the Fed’s proposed definitions of “underserved” and “rural” because these proposed definitions are limiting and most likely will be narrowly construed, thereby being of little benefit to consumers in these areas as “defined.” It is OCUL’s suggestion that the Fed adopt more expansive definitions to “underserved” and “rural” more consistent with NCUA and other federal agencies.

### **Ability-to-Repay Analysis**

In general OCUL is in support of the proposed ability-to-repay analysis. Credit unions, unlike some other mortgage lenders, have historically engaged in safe and sound mortgage underwriting that includes a thorough ability-to-repay analysis. OCUL believes that requiring all mortgage lenders to follow similar ability-to-repay mortgage underwriting criteria will help eliminate abusive practices and facilitate consumers’ ability to compare mortgage products. Emphasis should be placed on standard 30, 20, 15, year fixed rate mortgages and 1, 3, 7, 10 adjustable rate mortgages. Other “exotic” or “non-conforming” loans should be scrutinized closely. One consideration in making mortgage loans is that they must be underwritten using “prudence,” “common sense,” and “logic.” Making a loan to an individual that does not have the ability to repay should not benefit any individual or entity.

### **Verification Using Third-Party Records**

A creditor must use “third-party records” specific to the consumer in question, such as credit reports, pay stubs, tax returns, bank statements, and so forth to verify the consumer’s repayment ability (which can be transmitted electronically and/or obtained directly from the consumer), including a form a creditor provides a third-party, even if the creditor fills out parts of the form unrelated to the information sought like the name of the consumer or the third-party, except:

- A consumer can orally verify his or her employment status if the creditor makes a record of this information.

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- A creditor does not need to verify the existence of a debt that is not listed on the consumer's credit report but which the consumer listed on his or her loan application.

In general OCUL supports the proposal as set forth in the staff commentary in the proposed rule that clarifies that a credit union's own deposit account information falls within the definition of "third-party records." OCUL also supports the contents of the proposal allowing consumers to orally verify their employment status, using the Department of Defense personnel database to verify employment status of military personnel, and not requiring creditors to verify with third-party records or debts listed on the loan application that are listed not on his or her credit report.

In addition, OCUL believes that a creditor may use accounting documents, which have not been reviewed by a Certified Public Accountant, by self-employed consumers if those documents are consistent with the consumer's tax records and/or financial institution records.

### **Circumvention and Evasion**

The Fed has proposed anti-evasion rules concerning loans documented as open-end credit, but that do not meet the definition of open-end credit, as demonstrated by the features and terms or other circumstances. In this case, the loan is subject to the rules for closed-end credit. OCUL is concerned that the proposed "circumvention and evasion" prohibition does not limit the ability of credit unions to offer HELOCs in first position and respectfully request that the Fed clarify the intent and meaning of this rule.

### **Scope of Liability**

The creditor's liability for originating a loan that does not satisfy the proposed rules is substantial. Assignees of such loans may also be subject to liability. While other Regulation Z violations have a one-year statute of limitations, the proposed rules enhance civil remedies for violations of Truth in Lending Act (TILA) Section 129C of the ability-to-repay rule for a three-year period. Additionally, the Act provides that a consumer may assert a violation of TILA Section 129C (a) as a defense to foreclosure by recoupment or set off, with no time limits stipulated on the use of this defense. Granting the consumer a 30-year window to assert a violation may prevent a lender from enforcing the terms of the loan agreement and justifiably foreclosing on a defaulting borrower. The liability of this magnitude can cause lenders to mitigate their risk by implementing very strict underwriting requirements, thus eliminating borrowers who may be otherwise qualified. While OCUL is aware of this provision in the Dodd-Frank Act, OCUL respectfully requests that the Consumer Financial Protection Bureau monitor the affects of this provision on making mortgages available and affordable to consumers.

### **Consumer Financial Protection Bureau (CFPB)**

There is uncertainty surrounding the transfer of jurisdiction from the Fed to the CFPB. The proposed rule was drafted by the Fed but the implementation of the final rules passes to the CFPB on July 21, 2011 when comments are due. It remains to be seen whether CFPB will agree with the

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background analysis conducted by the Fed and whether the agency will take the comments on the proposed rule into consideration when drafting the final rules. It is difficult to predict how CFPB will proceed in finalizing this important regulation which will define the scope of all mortgage loans.

### **Conclusion**

OCUL supports the intent of this proposed rule to require a lender to make a reasonable determination that the borrower has the ability to repay the loan at the time the loan is made. OCUL respectfully requests the CFPB to consider the comments and recommendations herein and adopt final rules that focus on establishing underwriting standards that have the flexibility to consider a multitude of factors in underwriting a loan instead of trying to fit all borrowers in one box.

Finally, while OCUL appreciates the effort of the Fed in developing and drafting these proposed rules, OCUL is concerned of the effect that these proposed rules will have on the respective lenders when authority for these rules transfer to the CFPB. Specifically, OCUL is concerned that these rules will be reviewed, redrafted, and revised for comment thereby creating an atmosphere of uncertainty for mortgage lenders. OCUL also respectfully requests that the CFPB communicate how it will address these proposed rules and comments and maintain ongoing communication with all interested parties.

The Ohio Credit Union League appreciates the opportunity to provide comments on this proposal to the Federal Reserve Board and subsequently to the Consumer Financial Protection Bureau. OCUL is also available to provide additional information or additional comments if so requested. If you would like additional information, or if the Ohio Credit Union League can be of additional assistance, please do not hesitate to contact the Ohio Credit Union League at (800) 486-2917, ext. 266, or [jkozlowski@ohiocul.org](mailto:jkozlowski@ohiocul.org).

Respectfully submitted,



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