COMMUNITY MORTGAGE BANKING PROJECT

July 22, 2011

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

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

Dear Sir or Madam:

This statement is being filed on behalf of the members of the Community Mortgage Banking Project.[1] We appreciate the opportunity to comment on these proposed regulations, which will have a profound effect on the scope and shape of the home mortgage market well into the future. The continued availability of stable, affordable sources of funds for home loans is of paramount importance to consumers, the housing market and our economy. Our letter will begin with some general comments regarding the proposed regulations, followed by comments on specific sections within the proposal.

While this letter is addressed to the Federal Reserve Board (FRB or the Board) we are aware that the final regulations will be promulgated by the Consumer Financial Protection Agency (CFPB or the Bureau). Please read our remarks as addressed to both entities.

I. General Comments

Our member companies are engaged in the business of home mortgage lending. This is not simply a line of business for them, or one financial product among a number that they offer; home loan lending is their business. Based on the specific focus of our members' businesses, and our lengthy collective experience in the home loan industry, we know that sound underwriting and consumer-friendly mortgage features are essential to a well-functioning

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[1] The Community Mortgage Banking Project is a public policy organization representing the interests of independent mortgage bankers. For decades, the community-based mortgage banker has delivered value and choice to consumers by leveraging local market expertise, quality service, and lower costs for borrowers. The CMBP supports financial market reforms that promote consumer access, borrower and investor transparency, local competition and choice, and a value added mortgage chain. For more information visit www.communitymb.com.

mortgage market. Consumers require transparency of mortgage terms and features to understand the obligation they are undertaking and what that obligation will cost them.

Similarly, the needs of the mortgage banking industry, which includes independent mortgage banking companies, banks, credit unions and investors, are aligned with consumer needs. Lenders and mortgage investors also need transparency in regulations, objective standards, and legal certainty so we can determine our obligations and how to meet them. Having to guess at compliance, or to estimate compliance, only to find out in a court room years later that what we thought was in compliance actually is not, creates uncertainty, confusion and greater cost and less credit availability for consumers. That is why it is vitally important to consumers, to lenders and to the marketplace, to have a clear, well-defined safe harbor standard for Qualified Mortgages (QMs).

In particular, the penalties for non-compliance with the ability to pay regulation are so severe that vague Qualified Mortgage standards will inevitably lead to lenders setting their own loan approval parameters well within what they perceive to be the allowable standards. This behavior is clearly evident today, with the major lenders who buy FHA-insured loans on a correspondent basis from mortgage banking companies. These major lenders are setting their own underwriting standards that are significantly more stringent than those required by the FHA. The reason for this is simple – these major lenders view the risks of indemnification or other sanctions associated with purchasing and securitizing FHA loans where underwriting standards approach FHA's benchmark minimums as greater than the financial benefits of increased loan volume and additional loan servicing rights. **Lenders and investors will have commensurately greater response to vague or indeterminate Qualified Mortgage standards that are not a true safe harbor.**

In a mortgage transaction, both the consumer and lender benefit at the outset from clear and objective standards that reflect a balancing of the parties' risks. Under the ability to repay provisions of the Dodd Frank Act, incentives to follow the Qualified Mortgage standards are quite strong: any compliance failures will subject both lenders and investors to substantial legal liability and risk of loss. Specifically, a violation of the standard provides borrowers the ability to recover significantly enhanced monetary damages and a life-of-loan defense to foreclosure.

However, if lenders that follow the QM standard are provided only a rebuttable presumption of compliance, borrowers and the trial bar can overcome the legal presumption with just about any evidence to the contrary -- even a single affidavit signed by the plaintiff may be sufficient. The result is likely to be excessive challenges to QM compliant loans in court in order to garner significant financial damages and/or stave off otherwise legitimate foreclosures.

If origination of a QM establishes a only rebuttable presumption of compliance for lenders and investors, a presumption that can be easily dispensed with in a court proceeding, then lenders will have little incentive to originate QMs, since they will have to ensure full compliance with the ability to pay regulations in order to fully protect themselves. As a result, rather than encouraging the use of loan products within the QM definition, lenders will originate many more loans with higher risk product features. This would not be the result that Congress intended in enacting the QM provisions. We agree with the Board's analysis of the preferability of a safe harbor as the best way to fulfill Congressional intent.

Further, if the final rule provides for only a rebuttable presumption for Qualified Mortgages, increased litigation means the QM standard will inevitably vary from court to court and from judge to judge, which will make it impossible for industry to determine what is required for compliance. In today's market, lenders and investors need assurances that reasonable underwriting risk will not be unduly punished. Failure to adopt a clear and objective QM safe harbor that provides legal certainty for loans that meet the standards will force responsible lenders to restrict the availability of credit and assiduously avoid lending to all but the most credit worthy borrowers.

Vague, hard-to-determine or indefinite regulatory standards are bad for consumers and for the industry for another reason as well. Such standards allow the marginal operators – those that will stretch the regulations to their limits – to gain a temporary market advantage. More established companies with reputations and capital at risk would be forced into an agonizing choice – respond in kind, or pull back and risk being marginalized in the marketplace. This is the same dynamic that drove the mortgage market in the 2005-08-time period, with disastrous results for consumers, the industry and our economy.

It is for these reasons that a Qualified Mortgage safe harbor, rather than a rebuttable presumption, is an absolute necessity for lenders and investors, and the choice that will provide the most benefit to consumers. With a safe harbor:

- responsible lenders will have the certainty of objective standards to determine their compliance with the ability to pay regulations;
- responsible lenders will have a strong incentive (reduced legal risk) to originate QMs, while marginal operators will not have any regulatory ambiguity to exploit; and
- consumers will benefit from competition between lenders that emphasizes service and products to meet their financing needs, rather than products that appear to meet their needs but are injurious to their financial health.

II. Specific Comments

A. Adopt the Safe Harbor – Alternative 1 (with modifications)

We agree with the Board's proposed Alternative 1 to establish a Qualified Mortgage Safe Harbor that will offer lenders certainty that the loans they originate are in compliance with the ability to pay regulations. A safe harbor is not a guarantee that a lender will not face litigation regarding questions of fact about whether the standards indeed were met. However, a safe harbor based on objective standards will provide lenders and investors with the legal certainty that following those standards will not subject them to costly, drawn-out litigation defenses with highly uncertain outcomes. Such litigation would focus on whether the standards were met, and not on subjective issues of whether the lender "should have known" the borrower couldn't afford the loan even though it met the standards.

As the Board recognizes, a safe harbor will provide lenders with a positive incentive to originate Qualified Mortgages, which will provide consumers a stable source of affordable mortgage credit with loan features that are generally considered consumer-friendly.

As has been demonstrated with both Higher Priced Mortgage Loans (HPML) and HOEPA loans, when lenders are faced with exposure to severe penalties associated with certain types of mortgages, they will avoid originating those types of loans. This is particularly true for those lenders, like the members of the Community Mortgage Banking Project that sell or securitize all of the loans they originate. Investors will avoid unquantifiable legal and compliance risks, even if the loans may otherwise be sound from a credit perspective. Investors need the ability to measure and price risk.

Even investors seeking higher *credit* risks will avoid securities with excessive or difficult to measure *legal* risks. This was best demonstrated in the mid-2000s when some states (e.g., Georgia was the most notable example) enacted anti-predatory lending laws that exposed assignees to draconian legal risks that virtually shut down lending in the state until the legislature enacted emergency changes. *Conversely, in a deeply risk averse market like today, difficult-to-measure legal risks will cause investors to avoid even lower credit risk QMs, resulting in a further tightening of credit.*

Since three-fourths of all mortgages outstanding at the end of Q1 2011 had been securitized or otherwise sold into the secondary market, the market for non-Qualified Mortgages will be limited. So it is vitally important that the final ability to pay regulation ensure that capital market funding, which is the source of financing for three-quarters of all outstanding mortgages, remains readily available on affordable terms for American consumers. The way to achieve that goal is with a strong, clear and well-defined safe harbor that will give lenders and investors the confidence to originate and securitize loans to all qualified consumers.

While we endorse Alternative 1 in the proposed regulations we do have some revisions and/or additions to suggest to the proposal:

B. Suggested Modifications to Alternative 1

1. *Exclude loan originator compensation from the calculation of points and fees*

   If there is one issue that has been closely covered and controlled by recent Federal Reserve Board (FRB) regulations it is loan originator compensation. FRB regulations now prohibit loan originator compensation from varying according to the terms and conditions of the loan. In addition loan originators are prohibited from steering consumers to loans that are not in the interest of the consumer, solely to earn higher compensation. Additional rules restricting loan officer compensation are wholly unnecessary.

   Beyond the issue of adequate regulation of loan originator compensation is the fact that compensation paid to the originator is already included in the cost of the loan being paid by the consumer. If the creditor is compensating the loan originator then the creditor has built that cost into either the interest rate or the loan origination fee, or both. As a result, adding the amount of compensation paid by the creditor to the loan originator to the points and fees calculation to determine compliance with the 3-percentage point cap will amount to double-counting of the compensation amount.

   Similarly, if consumer is paying a mortgage broker company directly out of pocket (as permitted in the Fed's compensation rule), the amount of that compensation will already be part of the amount that is calculated to determine compliance with the three percentage points QM cap. Again, including the portion of that fee that is being paid to the individual broker/employee will constitute double counting of loan originator compensation.

   Including employee compensation in the Qualified Mortgage points and fees test also raises major compliance problems that cannot be untangled. Most mortgage loan officers are paid bonus compensation based on volume, loan quality or other permissible factors. It will be impossible to factor those amounts into the points and fees test for a particular loan since it is not known at time of origination whether those bonus metrics will be met or the amount that will be paid. Compliance would require radical changes in industry compensation practices that are well beyond the scope and purpose of this rule.

The purpose of points and fees charged by lenders is to cover the costs of origination. Part of that cost is the compensation paid to the loan originator; another part of the cost is for the underwriting, processing and funding personnel that play a key role in the creation of the loan. Lenders cannot operate profitably without recoupment of these costs. If this double counting of loan originator compensation is not addressed, then lenders will be forced to build these costs into the interest rate. As a result, rather than paying these costs upfront, consumers will pay for them in the form of a higher interest rate over the life of the loan. We fail to see how this benefits or protects consumers.

To the extent that the CFPB feels that inclusion of loan originator compensation is compelled by the statutory provisions of DFA, we urge the Bureau to exercise the discretion granted by Congress in Section 129C(b)(3)(B)(i) of the Truth-in-Lending Act that grants the (Bureau) the "*...authority to revise, add to, or subtract from the criteria that defines a Qualified Mortgage upon a finding that such regulations are necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers...*"

Double counting of loan originator compensation offers no additional benefit or protection to consumers because of the earlier regulation of loan origination compensation. We believe the prospect of needlessly increasing home loan interest rates to consumers compels the use of the Bureau's discretionary power in this instance, and we urge you to do so.

2. *Increase the dollar limit for a small loan for the points and fees cap calculation to $125,000 from the proposed $75,000.*

In Dodd Frank Congress recognized that a 3 point cap on fees and points could work to the detriment of lower balance loans, given the fact that while costs for loans are often computed in terms of a percentage of loan amount, lenders in fact have significant fixed costs that need to be met in order to make loan origination financially viable. A 3 point cap that may be eminently workable when the loan balance is $250,000 does not work nearly so well at the $125,000 level. The question really is where to draw the line as far as granting greater flexibility on the fees and points cap.

The Board's proposed $75,000 limit is simply too restrictive, given today's average loan balances, even with flat to declining home prices nationally. With the median home price in the $170,000 range[2], a 5% down payment would require a loan balance slightly above $160,000. So we would urge that the line for lower balance loans be drawn at $125,000 rather than $75,000 with the 3.5 to 5.0 scale suggested in Alternative 1 adjusted accordingly.

3. *Exclude bona fide fees paid to affiliates for loan-related services and products from the calculation of fees and points.*

A number of lenders are affiliated with companies that provide other types of settlement products or services. Consumers of course are free to use these affiliated companies or not. Typically these affiliated companies provide products such as title insurance, hazard insurance and the like, that are required for the loan, and which are supplied by a large number of firms, both lender affiliates and non-affiliates. Many of these companies have created technological and proximity efficiencies with the lenders with whom they are affiliated. These efficiencies allow the lenders to provide on time or even expedited closings with reduced waiting times to consumers. In addition, many of these affiliated companies are title insurance agencies whose fees vary by state and a re regulated by state insurance commissioners. These fees can be extensive based on the cost to insure title in many states.

The Bureau will possess ample authority under RESPA to police the activities of settlement service providers to ensure that consumers are being charged reasonable fees for bona fide settlement services or products, and are not being charged referral fees. A requirement that fees paid by a consumer to an affiliate company that is providing a bona fide settlement product or service serves absolutely no public policy purpose. In addition, affiliated companies such as title agencies that handle multiple states' business will likely be forced to close their doors since there often will not be enough room in the 3 point cap to cover the origination costs as well as the title services fees charged on loan amounts under $125,000. The consumer will therefore no longer benefit from the time saving efficiencies offered by these affiliated vendors.

We urge the Bureau to exercise its discretionary authority cited above, under Section 129C(b)(3)(B)(i) of the Truth-in-Lending Act to remove the payment of bona fide fees for settlement products and services to lender affiliates from the calculation of the 3 point fees and point cap

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[2] The median home sales price for existing homes sold in the U.S. in 2010 was $172,900 according to the National Association of Realtors. That same figure for May 2011 was $166,500. Naturally these figures vary by region and the variance is even greater down at the locality level.

C. Revise Definition of Bona Fide Discount Points

The proposed regulations defines bona fide discount points, which lenders can charge borrowers of Qualified Mortgages, as a percentage of the loan amount paid by the consumer that reduces the interest on the mortgage by an amount based on a calculation that is consistent with industry practice. We believe this is an amount that can be readily determined by the creditor.

However the proposed regulations add an additional prong to the definition – one that requires creditors to account for the amount of compensation that the creditor can reasonably expect to receive from secondary market investors on the sale of the mortgage. This is a much more difficult determination and factors may make it an impossible determination at the time of the origination of the mortgage.

The explanation for this is relatively straightforward. Creditors who sell the loans they originate will ordinarily resist designating the loan for a specific investor until after the loan has closed (sometimes well after). The reason is that creditors are constantly seeking the best execution on a sale, and that may change from day to day, in fact it may change from hour to hour. Thus it is quite likely that the amount of compensation that the creditor calculated it could reasonably expect from the loan sale prior to the disclosure to the borrower, which comes early in the origination process, may turn out to be quite different from the actual result.

Also, some creditors may decide to hold the loans they originate and sell them at a later time. If the creditor calculated the three percentage points and fees cap at the time of origination, and market prices subsequently move such that the secondary market gain on the loan causes it to exceed the three point cap, the creditor may be prevented from selling that loan because it will no longer be a QM. Such a result could not possibly be intended by these proposed rules, nor would it comport with Congressional intent.

In addition it appears that the proposed regulation assumes that creditors always realize a gain upon the sale of loans. However, that clearly is not the case. Depending upon market fluctuations, delivery method (mandatory delivery or best efforts), the effectiveness of the creditor's hedge and the actions of the consumer (e.g., lock or float), there could well be a loss. Would that loss then serve to increase the allowable fees and points cap? We doubt that result is one the Board and the Bureau believe is a good public policy outcome.

Given the legal and market risks (e.g., no secondary market for non-QMs) associated with the QM/non-QM designation, proving that the calculation was done correctly at a future time, particularly when the calculation differs dramatically from the actual result, will be highly problematic. It will also expose lenders to severe penalties. We believe the second prong of the test adds needless legal risk and complexity with little or no value to consumer. As long as the borrower is getting what they paid for – a reduction in their interest rate in exchange for the upfront payment of discount points – it is difficult to see exactly what borrower interest is being protected with this second test. We urge the Bureau to drop this second prong of the test.

D. Mitigating Impact of False, Misleading or Incomplete Information from Borrower

The final regulations should make clear that creditors will not be held responsible for a failure to comply with the ability-to-pay regulations if the consumer submits false, misleading or incomplete information to the creditor as part of, or in the course of, applying for the loan. As written, the proposed regulation places an affirmative duty upon creditors to either determine a consumer's ability to pay the loan that the creditor is originating for the borrower, or to originate a loan in compliance with the Qualified Mortgage safe harbor. It is not clear what happens when the consumer submits false, misleading or incomplete information to the creditor as part of their application. In a subsequent legal action could the consumer assert that a failure by the creditor to comply with the ability-to-pay regulations as an affirmative defense to foreclosure?

To illustrate, the industry is currently grappling with the issue of undisclosed consumer debt liabilities, which is often alleged in repurchase demands from Fannie Mae, Freddie Mac and other investors. This issue frequently arises in the context of the consumer incurring additional debt *after* applying for the mortgage but *before* the closing. If the creditor becomes aware of the new debt they are required to re-underwrite the loan to re-determine the consumer's eligibility. However if the consumer does not disclose the debt to the creditor, and the time lag in the credit bureau reporting does not permit the creditor to discover the new debt, there can be a situation where a consumer who was qualified for a mortgage is no longer qualified following the new debt obligation.

What creditors do to protect themselves in such situations is to have the consumer specify at closing whether they have incurred any post-application debt and the amounts. But consumers do not always disclose such debts at closing. We urge CFPB to add a provision to the final regulations to specify that a creditor will not be deemed out of compliance with the ability to pay regulations if the consumer submitted false, misleading or incomplete information to the creditor as part of their application or supporting information.

III. Conclusion

Properly constructed, the ability to repay rules could form the strongest line of defense to ensuring that we never again experience the kind of housing-led financial calamity that continues to dampen our economic growth. However, with underwriting standards already tight as a result of market corrections and prior regulatory actions, the ability to repay rule also runs the risk of further constricting credit, undermining chances for a housing recovery, and creating a major barrier to homeownership for lower income and minority families.

If the credit pendulum is to swing back to center – toward common sense underwriting and safe, stable mortgage products – lenders and investors will need assurances of a true safe harbor to ensure that reasonable risk taking will not be unduly punished. We strongly support the adoption of Alternative 1, the Safe Harbor, is the best course for consumers, lenders and the efficient functioning of the mortgage marketplace. It is important that the mortgage market function in a way that will make affordable mortgage credit available to all credit-worthy consumers that are financially qualified to repay the credit on the agreed terms. Lenders are in business to provide that credit and will provide that credit to all qualified applicants, provided that they can readily determine their compliance with the applicable rules and regulations that govern their activities.

Alternative 1 will permit that ready determination and we urge its adoption together with the following suggested modifications:

1. Exclude loan originator compensation from the calculation of points and fees under the 3 percentage point cap;
2. Exclude bona fide fees paid to affiliates for settlement products and services from the calculation of points and fees under the 3 point cap;
3. Set the dollar limit of small loans at $125,00 for which lenders can charge more than 3 points and stay within the Qualified Mortgage boundaries;
4. Change the proposed definition of bona fide discount points to include only the first prong of the proposed test (a percentage of the loan as calculated in a manner consistent with industry practice);
5. Ensure lenders do not lose the QM safe harbor protections as a result of false or misleading information submitted by the borrower.

Thank you for this opportunity to comment. Please contact us with any questions at 571-357-1036 or glen@mortgagepolicy.org.

Sincerely,

Glen S. Corso
Managing Director