Quicken Loans
Engineered to Amaze

July 22, 2011

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

Re: Docket No. R-1417 and RIN No. 7100—AD75 (Qualified Residential Mortgage)

Dear Secretary Johnson:

Quicken Loans Inc. ("Quicken Loans") is pleased to submit its comments on the Federal Reserve Board's ("Board") proposed change in Regulation Z relating to standards for complying with the ability-to-repay requirements in the Dodd-Frank Act. By way of background, Quicken Loans is an independent Detroit, Michigan-based conventional and FHA retail residential mortgage bank. We have been in business since 1985, and have approximately 4,000 employees. We do business in all 50 states and are one of the nation's five largest retail mortgage lenders, one of the three largest FHA mortgage lenders, and the largest online lender. We closed over $28 billion in retail mortgages helping over 135,000 homeowners in 2010.

General Comments

Quicken Loans appreciates the efforts the Board is taking to establish the new ability-to-repay requirements as mandated by the Dodd-Frank Act. We look forward to working with the Consumer Financial Protection Bureau ("Bureau") as it assumes the authority for this rulemaking. Our overriding objective is to ensure that at a minimum all consumers who qualify for mortgage financing in today's much more restrictive underwriting environment continue to do so even after the Qualified Mortgage ("QM") rules are implemented. Unfortunately, as the QM rules are currently written, we estimate 25% of consumers to whom Quicken Loans provided financing in the last 24 months would not meet the requirements as set forth in the proposed definition. Because of the high litigation and supervisory risk included in the proposed rule, we think that it will be extremely difficult, if not impossible, for consumers who do not qualify under the proposed QM guidelines to find lenders willing to make them a loan. Consumers who don't meet the QM requirements will essentially be shut out of the mainstream mortgage process, severely limiting their housing finance alternatives.

We strongly support the Board's efforts to establish underwriting standards that promote affordable and sustainable loans for all constituents: consumers, lenders, insurers, guarantors, and investors. Fortunately, many of the much-needed changes in underwriting and program availability have already been implemented and are now considered standard industry practice, such as doing away with negatively amortizing loans and no-documentation loans. Loans originated since the beginning of 2009 are among the best performing vintages in the modern lending era.

Tougher underwriting requirements, increased fees, and house price depreciation have already limited consumers' ability to obtain a new mortgage, despite historically low mortgage rates. Other regulations, such as the risk retention provisions of the Dodd-Frank Act, are also likely to make it more difficult and expensive for consumers to obtain credit. While we support many of the changes promulgated by the Dodd-Frank Act, we believe there must be balance between safe and sustainable mortgage products and credit availability. We fear that layering even more restrictive standards than presently exist in today's mortgage market will reduce lending availability even further, putting a halt to the already anemic housing recovery as well as eliminating tens of thousands of eligible consumers option to refinance or own their home.

Since most lenders are likely to join us in favoring a legal safe harbor rule as opposed to a rebuttable presumption, the specific definition of a QM is extremely important. As currently written, the QM definition eliminates many otherwise eligible consumers because they do not qualify for the ability-to-repay standard on a number of levels. We think it would be prudent to undertake an industry-wide study of the performance of loans originated since 2009 (i.e. loans underwritten using substantially more restrictive guidelines) to determine what, if any, additional guidelines are needed. No-documentation loans, negatively amortizing loans, and other non-traditional mortgage products have already been eliminated from the mortgage industry.

We also believe it is important to coordinate the rules for a QM and a pending Qualified Residential Mortgage ("QRM"). The two proposals should act in concert, supporting the key objectives of each individual rule as opposed to each becoming another layer of rules that are either indistinguish-

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able or conflicting with each other. These two standards will weigh heavily on product availability, financing costs, and the overall future of the U.S. housing finance system for the foreseeable future.

Recommendations for Change

In addition to our overall view that existing mortgage industry underwriting guidelines are already quite restrictive and have resulted in superior loan performance since 2009, we recommend that the Board should consider the following four changes prior to implementing even more restrictive QM guidelines.

First, one of our greatest concerns about a potential aspect of the QM proposal is the dramatically increased exposure to potential litigation in the absence of a legal safe harbor provision. We fear that without a clear legal safe harbor, and left only with a rebuttable presumption of compliance defense, lenders would not only significantly increase financing costs, but would also severely restrict financing availability. Akin to doctors and hospitals ordering unnecessary tests and performing unnecessary procedures, contributing to an out-of-control ever-increasing health care cost burden on society, a rebuttable presumption defense to a difficult and vague ability to repay criteria would force those lenders willing to wade into the waters to charge higher rates and require onerous and overly burdensome procedures for only the most stable, credit-worthy consumers. First-time homebuyers, immigrants, low-income consumers, credit rehabilitated consumers, consumers who benefit from the Community Reinvestment Act ("CRA") and non-standard housing markets would have severe limitations on housing finance. As a result, we agree with the Federal Reserve and strongly support a true legal safe harbor alternative if a loan meets a clear definition provided for a QM.

Second, the 3% limit on points and fees plus two bona fide discount points, and the definition of what is included in those points and fees, will substantially reduce the number of transactions that meet the guidelines as well as reduce the features and flexibility of mortgages to meet individual consumer needs. A points and fees test is unrelated to a consumer's ability to repay their mortgage. Based on a review of our loan originations since 2009, the 3% limit on points and fees would have reduced Quicken Loans' mortgage volume by 25% and by 53% for loan amounts under $150,000. Further, including certain affiliate fees within the 3% calculation restricts consumers' ability to freely choose their vendors, as well as eliminates the substantial process improvements and ease of com-

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pleting the already cumbersome mortgage process afforded with affiliate-related services. We recommend changes to the points and fees test, which is discussed in more detail below.

Third, the Federal Reserve Board in its Staff Interpretations has stated that compliance with various provisions of the rule can be met by complying with widely-accepted governmental and non-governmental underwriting standards. We believe these are appropriate references that clarify what would otherwise be vague and ambiguous regulatory standards, causing concern over whether different interpretations would be acceptable to a court or regulator sometime in the future. While Staff Interpretations carry weight, certainty is crucial. For that reason, we urge the Bureau to incorporate into the regulation itself the provision relating to reliance upon widely-accepted governmental and non-governmental underwriting standards.

Lastly, if FHA adopts the QM standard as its own then the prepayment penalty provision will be in conflict with existing FHA requirements that the consumer pay the entire month's interest charge for the month in which they pay off their loan. This practice allows lenders to meet Ginnie Mae's securitization program requirements to pay post-settlement interest, so that Ginnie Mae investors receive scheduled interest. The proposed QM rule prohibits the collection of this post settlement interest for any FHA loan that pays off after three years. While the QM definition would allow a prepayment penalty in certain circumstances, including prime loans that are otherwise QM compliant, such a prepayment penalty cannot be charged after the third year. FHA's accrual amortization method is applied for the life of the loan, so this provision would require the loan servicer to cover the additional interest payment due Ginnie Mae bondholders during the month in which an FHA loan is repaid in full. As a result, since a loan servicer doesn't know when consumers will pay off their loan they will ultimately pass on the cost of post settlement interest to all consumers rather than just those who pay off their loan within the month versus at the end of the month.

Legal Safe Harbor vs. Rebuttable Presumption

Because of the harsh penalties and remedies under the ability to repay provisions, Quicken Loans will likely restrict our loan programs to consumers who meet the definition of a QM. The liability and other legal risks associated with lending outside of the QM guidelines are too uncertain and difficult to quantify and the cost of doing so would likely far outweigh any potential benefits. We be-

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lieve many other lenders, large and small, will have the same perspective and, as a result, very few loans will be originated outside of the definition of a QM.

Since the QM standard will likely be the de facto minimum criteria for ***any*** mortgage, we believe it is imperative that a clear and concise legal safe harbor is established. A legal safe harbor will provide lenders with operational certainty so that we can promote lower financing costs, increase secondary market liquidity, obtain transaction efficiency, and ultimately make safe, sustainable mortgages for all market participants.

We believe that a legal safe harbor provision should be expanded to include the requirements from the rebuttable presumption proposal as well as the currently proposed legal safe harbor. Therefore, this will result in a more stringent standard than is needed to qualify for the legal safe harbor than the Board outlined in the proposal. Below is our proposal for a legal safe harbor:

Legal Safe Harbor Criteria

A loan *must not*:

- Include negative amortization resulting in an increase in principle balance
- Require a balloon payment or a deferment of principal
- Have a loan term that exceeds 30 years (except in connection with a loan modification that provides a consumer a lower monthly payment)
- Have total points and fees that exceed 3% of the total loan amount, subject to exemptions for smaller loan amounts as well as our proposed new definition of what's included in the calculation (See Calculation of Points and Fees below). Specifically, loan officer compensation, third-party fees regardless of affiliations, and certain up-front mortgage insurance premiums and up to two discount points including risk based price adjustments should be excluded/modified from the calculation.

A creditor *must* underwrite the mortgage:

- Based on the highest possible interest rate during the first five years
- Using a payment schedule that fully amortizes the loan over the loan term and takes into account any mortgage related obligations
- Considering:
    - The consumer's current or reasonably expected income and assets (other than the value of the dwelling that secures the loan)
    - The consumer's current employment status if a creditor relies on income from the consumer's employment in determining the ability to repay
    - The consumer's monthly payment for mortgage obligations
    - The consumer's monthly payment on any other debt that the creditor is aware of using commercially reasonable means

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- Consumer's credit history (the proposed rule provides flexibility in deciding particular credit criteria to address self-employed consumers and consumers with small credit files to use rental records or other means in lieu of standard credit criteria)
- Consumer's monthly debt-to-income ratio or residual income calculation

  *The Board specifically asked respondents to address whether DTI criteria should be included in the definition of QM. We believe that a specific number or range of numbers representing the DTI should **not** be included within the ability-to-repay standard. The QRM rule proposes a very stringent DTI ratio, so we do not believe another set of standards would make sense. Further, lenders and investors should have the flexibility to make independent decisions about what level of DTI ratio they deem an acceptable risk. The discipline of a free market will establish appropriate standards resulting from historical loan performance reviews and rating agency subordination levels. DTI is just a number without regard to an actual dollar amount.*

  For example, a 36% DTI (which most industry observers would deem acceptable) for a family earning the average annual household income of $68,500 would provide $3,653 of monthly cash after meeting debt obligations. Conversely, a household earning $97,500 per year with a 55% DTI (clearly outside of most acceptable ranges) would have the same monthly cash available to them after debt obligations. Additionally, lower-income consumers with higher education levels at the beginning of their career prudently can take on more debt relative to their current (but probably much less than their future) income. Hence, although DTI should be considered when evaluating a consumer's ability to repay, a specific, numbered criteria should not be part of the requirement.

If lenders meet the legal safe harbor criteria listed above, then we believe it will provide the marketplace with the flexibility, yet responsibility to underwrite a consumer's ability to repay and provide them with a mortgage that is straightforward and meets their individual needs. Further, it will provide lenders with the certainty they need regarding liability exposure so that mortgage products can be priced as efficiently and competitively as possible with little frictional waste on processes and procedures to combat unknown liability exposures. Most, if not all, of the criteria listed above currently exist in the mortgage market today (with the exception of the proposed points and fees test), so the implementation burden would be minimal.

In the absence of a legal safe harbor, lenders would have to rely on the rebuttable presumption that they met their obligations to determine the consumer's ability to repay the loan. Short of incredibly detailed guidelines providing specific and concrete criteria for the myriad considerations that go into underwriting a loan, the opportunity for a wide array of disparate interpretations by the regulators and courts would provide lenders considerable and difficult to quantify risk of litigation.

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Such risk would undoubtedly lead to higher rates, tighter guidelines, and further tightening of credit availability, all during a stagnant housing recovery. It seems that reliance on a rebuttable presumption as opposed to providing a legal safe harbor would expose the housing finance system to extensive potential litigation that would lead to irrational underwriting and documentation standards, higher rates, more transaction friction across the entire primary and secondary market spectrum, and ultimately fewer loans and less economic growth. Even if acceptable standards begin to evolve through various staff interpretations and court decisions over the years, it's likely they will depend upon the specific jurisdiction in which they are adjudicated. This will lead to a vast array of disparate guidelines depending on physical locations as opposed to consumer characteristics. For example, courts may determine that Midwest states losing population have inherently worse job prospects than those states gaining in population and, therefore, ability to repay standards could very well be different for each. Opening up the mortgage finance industry to open-ended litigation through the rebuttable presumption would cause unnecessary costs and overly-burdensome procedures, along with what would be a growing regulatory spider web of rules based on independent court interpretations of vague guidelines.

The legal safe harbor alternative provides certainty and clarity so that lenders can lend in the most efficient and prudent way without the need to price unknown risks, substantially tighten guidelines even from the current strict requirements, or add cumbersome, time-consuming procedures to defend themselves against prospective lawsuits. Thus, we believe a legal safe harbor offers the best solution to both promote safe and sustainable lending along with the lowest rates and most efficient mortgage process available.

Calculation of Points and Fees

The proposed rule limits points and fees to 3% of the total loan amount, excluding two bona fide discount points. By limiting the allowable points and fees on mortgage loans Dodd-Frank aimed to stop what Congress believed were excessive and abusive costs to consumers. A number of factors led to this assumption, including yield spread premiums, loan officer overages, excessive administrative charges, and non-bona fide discount points. However, instead of pinpointing and eliminating the specific abuses, Dodd-Frank arbitrarily caps all fees and decided assuming anything higher must be

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predatory. We believe this approach was misguided. While we agree that some of the aforementioned practices may have been predatory, many were not.

Capping points and fees doesn't necessarily have a direct connection to whether a consumer can repay the loan or not. If anything, it limits a consumer's choices by reducing rate/point combinations that meet their specific needs and eliminates their choice of vendors by prohibiting lender's affiliates from providing more convenient equally or maybe lower priced services. Most egregious is the negative impact on otherwise qualified consumers with loan amounts below $150,000.

To the extent abusive charges did occur by some unscrupulous lenders, most of the practices that led to them have already been prohibited or severely curtailed through other laws and regulations. For example, an overhaul of how loan originators are compensated was implemented on April 1st, 2011.

Our four concerns with the proposed definition of the points and fees calculation are:

1. The inclusion of loan officer total compensation at the *individual* level;
2. affiliate fees, including title insurance and appraisal fees;
3. limiting bona fide discount points to two; and
4. the effect on loan amounts under $150,000.

First, there is simply no rationale for including loan officer total compensation in the points and fees test. Loan officer compensation paid by the lender or the mortgage broker to its employee loan officer is no more a "point or fee" than a lender's rent payment. Such compensation is not directly paid by the consumer and has no connection to the consumer's ability to repay. Furthermore, any issues or concerns with loan officer compensation have been addressed by the Fed's loan originator compensation rule which went into effect in April of this year. The inclusion of loan officer compensation in points and fees simply defies all logic.

Second, there is no connection between a third-party fee and establishing a borrower's ability to repay. By including an affiliate's charge in the 3% cap, but not that of a non-affiliate, merely changes the "who" is charging the consumer not the "how much." In fact, a lender's affiliate may be able to

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charge lower costs due to the operation efficiencies gained through the affiliation, yet the 3% cap would prohibit the consumer from benefitting from those lower costs. Particular third-party services like an appraisal and title insurance make no sense to include in a cap regardless of the provider. Extensive rules governing appraisal fees were already implemented as of April of this year by the Board. Title insurance is a state-regulated product with the price set by state insurance regulators regardless of whether the company selling the insurance is classified as an affiliate of the lender or not.

Third, we believe that a consumer should be able to pay as many bona fide discount points as they want to get the lowest possible interest rate for their situation. Trading more points for a lower rate offers the consumer choices. The secondary market inherently values this rate point tradeoff each day by pricing up and down the MBS coupon stack. For example, secondary market investors can purchase a series of MBS coupons, say 4%, 4.5%, or 5%, each for a different price whether it's par or a premium or discount to par. Currently, this secondary market valuation across various mortgage rates is made available to consumers by "buying up or buying down" the interest rate they ultimately settle on. Consumers can take advantage of the optimal rate/point combination for them. Limiting the bona fide discount points to two is incredibly arbitrary and much more restrictive than a free-market pricing mechanism.

We also believe that the definition of bona fide discount points should include the risk-based price adjustments required by secondary market buyers. These charges would otherwise be expressed through higher rates, but charging upfront fees are the more efficient mechanism to compensate the market for higher risk of loss.

Fourth, even more troubling is the negative impact the points and fees cap has on borrowers with loan amounts lower than $150,000. By combining loan originator compensation, affiliate fees, and a maximum of two bona fide discount points, our research indicates that over 80% of the loans Quicken originated for less than $100,000 would not meet the 3% points and fees cap as proposed and by definition the ability to repay. For loan amounts between $100,001 and $150,000, 30% would not qualify. For the past three years, these very same borrowers have demonstrated some of the best loan performance we have ever seen, yet upon implementation of the proposed QM rules, somehow their ability to repay would undermined because their total fees, including those paid to our affiliates exceeded 3%. A simple increase in the lower loan amount from the currently proposed $75,000 to

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$150,000 combined with simplifying the existing point and fee scale to a flat 5% maximum would resolve this issue.

Conclusion

We thank the Board for their work on creating the proposed QM and ability-to-repay standard. Lenders, consumer groups, and the CFPB working together can create a meaningful QM standard that creates a sustainable mortgage market for decades to come.

Many of the necessary changes whether they be tightened underwriting standards, scrutinized compensation practices, or risk-based pricing, have already occurred. Today's loans are some of the safest, best performing ever despite continued declines in home prices, stubbornly high unemployment, anemic home sales and new home construction, and an extremely tepid economic recovery. A combination of strengthened underwriting standards, a true safe harbor, a modified definition of points and fees, and clear and concise government interpretation of guidelines, the QM standard can work well to suit all eligible consumers while promoting a vibrant, sustainable mortgage market.

We sincerely thank you for the opportunity to comment. Should you have any further questions, please contact Shawn Krause at (313) 373-7773 or at ShawnKrause@quickenloans.com.

William Emerson
CEO
Quicken Loans

1050 Woodward Ave. | Detroit, MI 48226 | www.quickenloans.com | (313) 373-3000