WELLS FARGO

MAC X2401-064
One Home Campus
Des Moines, IA 50328-0001

wellsfargo.com

July 18, 2011

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

RE: 12 CFR Part 226: Truth in Lending; Proposed Rule amending Regulation Z
Federal Reserve System Docket No. R-1417: May 11, 2011

Dear Ms. Johnson:

This letter is being submitted on behalf of Wells Fargo & Company and its affiliates (Wells Fargo) in response to the Federal Reserve Board's May 11, 2011 proposal to amend Regulation Z to implement amendments to the Truth in Lending Act made by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank), relevant to a consumer's ability to repay certain types of consumer credit transactions.

Wells Fargo is committed to making home financing available to a broad spectrum of consumers and communities, in a manner that is consistent with responsible lending principles. We therefore strongly support the adoption of ability to repay (ATR) principles applicable to a broad range of dwelling-secured loans, and applaud the efforts of the Federal Reserve Board (Board) to propose a rule that will protect consumers without unduly restricting the flow of credit. We appreciate this opportunity to comment, and respectfully request that the Board consider adopting the suggestions made in this letter.

This rule will have a significant impact on consumer dwelling-secured lending, including secondary market liquidity. Wells Fargo's comments are therefore directed to issues we believe must be addressed in order to ensure that the adopted ATR standards will allow for continuing availability of credit across all segments of the market. In this new environment, many lenders and secondary market purchasers will focus on originating, selling, and purchasing less risky loans, especially given the increased penalties under Dodd-Frank, which are substantial and enduring and significantly enhance risks for lenders and assignees. To ensure availability of responsible credit, and the salability of loans, the ATR standards must include clear and unambiguous criteria that, when followed, provide lenders adequate protection from liability and instill confidence in secondary market purchasers.

We recognize that crafting a rule to achieve the dual goals of consumer protection and access to credit is a complex and delicate balancing act, and would therefore urge the Board, and following transfer the Consumer Financial Protection Bureau (for ease of reference, in the remainder of this letter collectively, the Board), to pursue the adoption of this proposal in a deliberative and collaborative manner. Specifically, given the inherent risk posed to the accessibility to credit, and the likely complexity and as yet unrealized impacts of the ATR standards that are ultimately adopted, Wells Fargo strongly encourages the Board to engage in working sessions and other cooperative efforts with industry and consumer groups prior to adoption of either an interim final rule or a final rule. Moreover, if such early efforts lead to prospective provisions that vary significantly from this proposal, we encourage the Board to consider issuing a further proposed rule, rather than proceeding directly to an interim final rule or final rule. Because we believe the consumer is best served by pre-adoption collaborative efforts, which will allow the Board to tailor the eventual standards to facilitate continued access to responsible consumer credit, we urge the Board to follow this suggested approach when adopting the rule.

Wells Fargo's comments on specific parts of the proposal are summarized in the categories set out below. Please refer to the attached Appendix Materials for additional details.

**A. Qualified Mortgage (QM) Safe Harbor.**

***A QM Safe Harbor is required.*** Wells Fargo believes that, in order to ensure availability of mortgage loans to a broad spectrum of consumers, as well as secondary market liquidity for those mortgages, the QM criteria must result in a safe harbor, be "bright line" standards that provide lenders clear and objective guidelines, and allow lenders to determine compliance based on documentation in the lender's paper or electronic loan file. We therefore strongly endorse the adoption of proposed Alternative 1, with the modifications to the 3% points and fees tests, and certain other proposed criteria, as recommended in this letter. We also support the adoption of additional QM criteria – specifically verification of the consumer's employment status and consideration and verification of any simultaneous loans – based on our view that these criteria would also meet a bright line test.

***The QM Safe Harbor Should Include Certain Streamlined Refinances.*** We recommend the Board structure the final QM criteria in a manner that allows rate and term streamlined refinances to qualify for the QM safe harbor. In a rate and term streamlined refinance, looking to good payment history adequately validates the consumer's current ability to repay the existing loan, an ability that will be further enhanced under the terms of the new loan. Allowing a QM rate and term streamlined refinance option also would be consistent with the exception under Dodd-Frank for certain governmental streamlined refinance programs, helping to create a more consistent and easily understood set of standards for refinance lending. We believe that consumers seeking a rate and term refinance should be afforded a streamlined option, which can be simpler and less time-consuming for that individual. To ensure the continued availability of such an option, we suggest that a rate and term refinance loan qualify for a QM safe harbor if the lender considers and verifies good payment history on the existing loan, in lieu of the requirement to consider and verify income and assets.

**B. QM Criteria.**

***Points and Fees Threshold***. Wells Fargo believes the proposed QM points and fees test is problematic and may lead to adverse consumer impacts, including negatively affecting the availability of credit. As proposed:

1. The points and fees thresholds are overly restrictive for smaller loans, and will disproportionally penalize certain segments of the market;

2. The inclusion of loan originator compensation in the points and fees calculation may lead to double counting in certain circumstances, inconsistencies between various compensation models, and difficulty in ascertaining compensation amounts;
3. The inclusion of affiliate-retained fees in the points and fees calculation does not facilitate the goal of ensuring a consumer's ability to repay the loan, and may deny consumers access to benefits that can only be derived from affiliated business arrangements; and
4. The calculation of bona fide discount points is complicated and overly technical, and limiting the exclusion to two bona fide discount points unnecessarily restricts consumer options.

***Other QM Criteria***. Wells Fargo believes there is a need for greater clarity in regard to certain of the other QM criteria discussed under *A. QM Safe Harbor*, to ensure lenders are able, with reasonable certainty, to originate loans meeting the QM standards. In particular, we seek clarification regarding the requirement to verify the consumer's income and assets.

**C. ATR Minimum Standards**. Wells Fargo supports in principle the Board's ATR minimum standards that would generally need to be met for non-QM loans. However, we believe further guidance is warranted in certain areas, including the lender's use of widely accepted governmental and non-governmental underwriting standards, use of assets as a loan repayment source, and the treatment of simultaneous HELOCs.

**D. Scope of Covered Transactions – Temporary Loans.** Wells Fargo supports the applicability of ATR principles to a broad range of dwelling-secured covered transactions, but is concerned by the proposal to limit the exemption for temporary loans to loans of 12 months or less. We believe that such a limitation will negatively impact construction lending, as construction loans, and construction phases of construction-to-permanent loans, often exceed 12 months. We therefore would recommend that the exception for temporary loans be defined by purpose rather than duration, and that construction-to-permanent loan products be treated in a manner that ensures the permanent loan will not lose its eligibility for treatment as a QM.

**E. Other Issues.**

***Prepayment Penalties***. Consistent with our comments in response to the Board's September 24, 2010 proposal to revise Regulation Z, Wells Fargo does not support requiring that the assessment of interest for a period after loan payoff be treated as a prepayment penalty. We again urge the Board to work with the Department of Housing and Urban Development (HUD) to reconcile this requirement with the current Federal Housing Administration (FHA) and Government National Mortgage Association (GNMA) requirements to assess and collect such interest on FHA loans, in order to ensure FHA loans remain widely available and affordable to consumers.

***Non-Standard to Standard Refinance***. Because Wells Fargo believes the most effective and consumer-focused streamlined refinance option is one that qualifies for the QM safe harbor, as discussed above under *A. QM Safe Harbor*, we will not be providing detailed comments on the proposed non-standard to standard streamlined refinance option. However, we do note that the proposed refinance option does not appear to track with the underlying purpose of this rule, which is assurance of the consumer's ability to repay a new loan. Rather, it seems to be directed toward loss mitigation for existing loans, where the consumer is likely to default because the existing loan contains a risky feature such as negative amortization or a balloon payment. We believe such a goal would be better addressed outside of this rule, in the servicing context.

Wells Fargo thanks the Board for this opportunity to provide comments.

Sincerely,

Michael J. Heid
Co-President
Wells Fargo Home Mortgage

**Appendix Materials**

# Appendix Materials

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# Appendix A – QM Safe Harbor

Wells Fargo strongly endorses the adoption of the QM criteria as proposed by the Board in Alternative 1 (Safe Harbor), with the modifications suggested in this letter. As discussed below, Wells Fargo believes QMs must have legal protection in the form of a safe harbor with clear, unambiguous, and not overly restrictive qualifying criteria. We believe a safe harbor is fundamental to ensuring broad access to credit, as well as liquidity in the secondary market and transparency for both sellers and purchasers in that market. We also believe that the benefit of this QM safe harbor should be extended to properly qualified streamlined refinances.

***Safe Harbor and the QM Criteria***

1. <u>Increased Penalties Associated with New ATR Standards</u>

Under Dodd-Frank, the financial penalties for failure to meet the ATR standards are substantial and enduring. Prior to Dodd-Frank, the enhanced TILA section 130 penalties for failure to assess a consumer's ability to repay – the refund of all finance charges and fees paid by the consumer – were limited to high cost mortgages (HCMs), which very few mainstream lenders originate, and higher-priced mortgages (HPMs), which are made in relatively small numbers today. In addition, prior to Dodd-Frank, while there was not a limitations period on a consumer's ability to assert a violation as an offset in an action to collect the debt, bringing a private action to recover this enhanced penalty for an ability to repay violation was subject to a statute of limitations period of one year after consummation of the loan.

Under Dodd-Frank, these penalties have been expanded in two significant ways:

- First, the one-year claim period for a private action has been extended to three years, and a consumer is now expressly authorized to make a claim against the lender or its assignee for these expanded damages as an offset in foreclosure, even if the three-year statute of limitations for filing a claim has expired. These changes significantly increase the initial duration of and potential economic loss to the lender.
- Second, and more impactful, the applicability of the claim and remedy is greatly expanded beyond the very small numbers of HCMs and HPMs, to any dwelling-secured covered transaction, for which the creditor must make a reasonable and good faith determination that the consumer will have a reasonable ability to repay the loan, including any mortgage-related obligations.

These changes significantly increase the risk of financial loss (1) to a creditor in any case where the lender's compliance with the ATR standard(s) can be challenged, and (2) to any assignee against whom an action can be pursued, who will suffer the economic loss if the original creditor who allegedly failed to adequately assess the consumer's repayment ability is no longer available to make the assignee "whole." As a result, these changes have the potential to significantly increase the cost, and limit the availability of, credit , particularly to consumers whose desired loan features or individual credit characteristics fall outside the highest quality credit and for which skilled traditional underwriting is required.

In addition, due to the open-ended nature of the ATR standards, lenders have less ability to manage risk than with respect to HCMs and HPMs. Most lenders have chosen not to originate HCMs at all. This was easily accomplished through implementation of high-cost calculations to identify any loans that would exceed the points and fees thresholds. Lenders could then choose to decline or restructure any transactions that would exceed the applicable threshold. Similarly, with respect to HPMs, lenders could calculate whether a loan would be an HPM, and make the choice of whether to decline or restructure the transaction, or make the loan subject to HPM requirements.

While the ability to repay test was somewhat subjective, obtaining documentation to verify income and assets and underwriting using the largest principal and interest payment scheduled within the first seven years following consummation resulted in a presumption of compliance, and a number of lenders determined this risk was reasonable given the small portion of their business that HPMs represented. In addition, if a lender chose to make HPMs, the additional requirements were clear-cut: a requirement related to escrow, and a straightforward limitation on prepayment penalties.

Under the proposed regulations, the existing ability to repay test is removed and replaced with the broader ATR provisions, which impose an underwriting test that requires consideration of additional factors, and eliminates the presumption of compliance that HCMs and HPMs could claim when underwritten according to the existing Regulation Z provisions. As a result, even loans formerly classified as HPMs have become riskier to originate unless they are QMs.

2. Need for QM Safe Harbor to Support Continued Availability of Home Mortgage Credit at a Reasonable Cost

In this new environment many lenders, as well as secondary market purchasers, will focus their efforts on originating, selling, and purchasing less risky loans. Originating QMs entitled to a safe harbor would materially reduce risk for lenders, particularly if the safe harbor provides significant protection from assertions the consumer did not in fact have the ability to repay the loan. We believe a safe harbor, as contemplated in Alternative 1 and with the additional criteria suggested below, is essential to ensure that home mortgage credit continues to be readily available within the stated QM criteria.

The ATR minimum standards as outlined in the proposed rule will require detailed loan-by-loan review to determine if the minimum standards criteria have been met. We believe this fact, combined with the increased liability discussed above, means that non-QM loans – even those with traditional features that fail only one QM criterion, such as the points and fees test – will generally not be saleable and likely will be originated only by lenders that are both willing and able to maintain those loans in portfolio. This will result in reduced competition in the marketplace, reduced availability and affordability of non-QM loans for consumers, and reduced liquidity for those lenders who do originate non-QM loans.

We further believe that if the Board determines a QM qualifies only for a rebuttable presumption of compliance, a similar contraction of credit is likely to occur, even with respect to QMs. In an effort to ensure salability and avoid costly challenges later in the life of the loan, lenders are likely to apply only the most conservative lending standards in order to ensure that their loans will survive attempts to rebut the presumption of compliance. Moreover, due to the substantial penalties associated with failure to meet ATR standards, if the QM protection is limited to a presumption of compliance, lenders will likely tighten their underwriting standards to ensure they are lending well within the margins of affordability. Finally, providing only a rebuttable presumption of compliance will significantly increase the likelihood of counterclaims in foreclosure. Loans will be challenged based on technicalities, in an effort to delay foreclosure, with resulting increases in the costs of holding and servicing loans subject to the rule.

In contrast, a safe harbor will provide real benefits to lenders and their customers. In the Supplementary Information to the proposed regulation, the Board states that under a safe harbor alternative, as long as the loan meets the specified criteria, the consumer could only assert that the lender failed to comply with a required QM safe harbor criterion, and could not assert that the lender had generally failed to make a reasonable and good faith determination of the consumer's ability to repay the loan. The benefits of such a distinction are clear:

- First, if the safe harbor has clear and well-defined criteria, such as the proposed product feature restrictions on negative amortization and interest only loans, lending within the defined criteria can occur with greater confidence, by more lenders, and to a wider spectrum of consumers.
- Second, to the extent satisfaction of the criteria can be easily determined through due diligence by a subsequent purchaser, the liquidity of the QM loan is enhanced.
- Finally, where the likelihood of challenge to the loan in the future is reduced, the value of the QM loan in the secondary market is stabilized and sustained.

3. <u>QM Safe Harbor Criteria</u>

Wells Fargo believes that the Board's approach in Alternative 1 should be adopted, with the modifications and additional criteria listed below.

The QM safe harbor criteria should include the following criteria as proposed in Alternative 1:

- The loan does not allow negative amortization, have an interest only feature, or include a balloon payment (except as allowed under the limited exemption for QM balloon loans).
- The loan term does not exceed 30 years. With respect to this criterion, as will be further discussed in Appendix B, Wells Fargo recommends the final rule make clear that the construction period for any construction-to-permanent loan is treated separately.
- The total points and fees do not exceed a specified limit, taking into consideration the issues discussed in Appendix B. In particular, as further detailed in Appendix B, we believe additional consideration of the allowance for small loans is required to ensure continued flow of home mortgage credit to this segment of the market.
- The loan is underwritten, taking into account any mortgage-related obligations, and using the maximum interest rate permitted during the first five years after consummation and periodic payments of principal and interest that will repay either (a) the outstanding principal balance over the remaining term of the loan as of the date the interest rate adjusts to the maximum interest rate noted above, or (b) the loan amount over the loan term.
- The lender considers and verifies the consumer's current or reasonably expected income or assets, other than the value of the dwelling, to the extent needed to qualify. Wells Fargo's concerns regarding this criterion, in particular regarding the verification requirement, are set out in Appendix B. In addition, for certain streamlined refinances, Wells Fargo advocates the use of payment history on a consumer's current mortgage in place of the income and asset verification requirement. Please see below for further discussion on this topic.

We also recommend the Board consider including the following additional criteria in the QM safe harbor, compliance with which should be easily ascertained from the lender's origination file:

- Verification of the consumer's current employment status if the creditor relies on income from employment in determining the consumer's ability to repay the loan. However, we believe a lender that verifies the employment as required in the proposal and at a time reasonably close to consummation must be entitled to rely on the information obtained if the consumer subsequently experiences a change in status and either does not inform the lender, or affirmatively represents continuing employment. This concern is further addressed under *Assessing and Confirming Safe Harbor Compliance,* below.
- Consideration and verification of the consumer's monthly payment on any simultaneous loan that the lender knows or has reason to know will be made.

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***Streamlined Refinances in QM Safe Harbor Coverage***

Wells Fargo further recommends that streamlined rate and term refinances qualify for QM treatment where the following criteria are met:

- With respect to the QM criterion to consider and verify the consumer's income or assets, the lender instead is allowed to consider and verify the consumer's good payment history on their existing loan. We recommend the Board look to a Home Affordable Refinance Program (HARP) standard, such as a requirement that the consumer is current on the existing loan, with no payments 60 or more days late, within the prior 12 months.
- The new loan meets the other QM criteria as proposed above, including verification of the consumer's employment and consideration and verification of simultaneous loans.

In a rate and term streamlined refinance, looking to good payment history adequately validates the consumer's current ability to repay the existing loan, an ability that will be further enhanced under the terms of the new loan. Moreover, allowing a streamlined refinance QM alternative would be consistent with Dodd-Frank's treatment of FHA and other governmental streamlined refinance programs, creating a more uniform and easily understood set of lending standards. Finally, for the reasons outlined above under *Safe Harbor and the QM Criteria*, we are concerned about the continuing availability of non-governmental streamlined refinances if they are not included within the QM definition. Consumers are typically attracted to rate and term streamlined refinance products because they can be a simpler and less time-consuming option. In order to ensure that streamlined rate and term refinances remain available to qualified consumers, we urge the Board to adopt a QM streamlined refinance option.

***Assessing and Confirming Safe Harbor Compliance***

Wells Fargo believes that any party originating, selling, or acquiring QM loans must be able to assess and confirm compliance with the QM criteria using evidence including: (1) the loan documents themselves; (2) the consumer's application and other information provided by the consumer; (3) the lender's or assignee's worksheets; (4) third party records (including, as defined in the proposal, records the lender maintains for an account of the consumer held by the lender), or (5) system data commonly collected as part of the origination process and analyzed in connection with secondary market sales. This ability to determine compliance within the "four corners" of the loan file is essential to ensure a liquid market for QM loans.

We further believe that compliance of loans with the QM safe harbor must be tested based on information reasonably available to the lender at the time of underwriting and closing of the loan. The lender must be able to rely on information that satisfies the requirements of the regulation and is collected in the ordinary course of its loan origination process, including the consumer's loan application. The failure of the consumer to alert the lender to unanticipated changes in the consumer's status with respect to employment, income, or other material circumstances that change shortly prior to closing – that the lender would not have reason to know, anticipate, or discover during routine due diligence in the course of originating the loan – should not be the lender's responsibility. The consumer must have responsibility for informing the lender of any changes in material circumstances.

Moreover, loans meeting the QM safe harbor criteria should be shielded in cases where the consumer has committed fraud that was not reasonably knowable to the lender at the time the loan was underwritten and closed. We believe that while Dodd-Frank section 1417 provides an exemption from liability and rescission only where the consumer has been convicted of actual fraud, the Board should use its expanded authority under TILA section 105 to provide relief to lenders who have provided a QM to a consumer in good faith reliance on information provided by that consumer.

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## Appendix B – QM Criteria

***Three Percent Points and Fees Criterion***

A key component of the proposed definition of a QM is a requirement that the total points and fees cannot exceed 3% of the total loan amount, with two proposed alternatives for increasing that percentage for smaller loan amounts. Wells Fargo believes that, as drafted, the proposed points and fees test is likely to have adverse consumer impacts, including significant impacts to the availability of credit for consumers. Key areas of concern include:

- The impacts to certain consumers, in particular consumers seeking smaller loan amounts, due to the proposed points and fees thresholds;
- How to appropriately include "loan originator compensation" into the points and fees test;
- Inclusion in the points and fees test of real estate broker commissions paid by the lender;
- Repercussions of including affiliate fees, but not other third-party fees, in the points and fees test;
- The treatment of bona fide discount points; and
- Clarification of what fees paid after closing, if any, should be included in the test.

Wells Fargo is recommending that changes be made to the points and fees test, as discussed below, to lessen the impacts of the test on the availability of credit.

1. Impacts of Thresholds

The Board requests comment on the proposed alternative loan sizes and corresponding points and fees thresholds. Our internal analysis indicates that the small loan size points and fees alternatives remain too restrictive, and that the proposal will have a significant impact on the availability and affordability of consumer credit.

An analysis of historical loan data by state indicates that for the states where consumers have the lowest average loan sizes, a significant percentage of the volume of loans in those states may not meet the QM definition. Moreover, while low loan sizes are primarily impacted, there are several states – such as in New York and Florida where costs and fees are higher – where higher loan sizes would also exceed the 3% threshold even if individual loan originator compensation were not included in the calculation. Consider a small loan amount of $100,000 in New York, which has on average points and fees of approximately $7,600. This loan would exceed the points and fees threshold by approximately $4,600. Even a medium loan amount of $300,000 in New York, which has on average points and fees of approximately $10,000, would exceed the points and fees threshold by over a $1000. As these examples show, due to the higher third party settlement costs to close a transaction in high-fee states such as New York, the normal fees to close a transaction will exceed the threshold even on larger loan sizes. This will leave consumers with no option to cover the costs but higher rates, if lenders are only originating QMs. In addition, our analysis indicates that if the consumer is offered a higher interest rate to cover fees, and a rate adjuster is used to accommodate impacted consumers by offsetting the costs to a low loan size, consumers will ultimately pay thousands of dollars more over the life of the loan.

There are fixed costs associated with all mortgage transactions. Providing consumers with choices in how to pay for these costs is the greatest opportunity to achieve the consumer's goal of owning a home. And there is no single consumer profile. Some have strong savings patterns and considerable assets but a fixed income. Others have higher incomes and can afford a higher monthly payment, but the availability of assets is restricted and saved for use in the event of an emergency. Other consumers fall somewhere in between these two extremes. If a lender is required to adhere strictly to the proposed 3% points and fees threshold, consumers' options will be reduced or even eliminated. Leaving the test as proposed could result in a rate increase to cover lender costs as the only alternative. While an increased rate might be a viable option for some, we believe it does not serve many other consumers well. Excluding more fixed costs from the points and fees test will enable more consumers to meet the threshold without a forced increase in rate to cover costs. We therefore recommend a more balanced approach that recognizes the needs for lenders to be able to cover fixed costs without restricting the options available to meet the varying needs and preferences of consumers. In addition, we have determined that our average retail mortgage loan amount is $220,000. Given this average, and information noted above, we also request that the small loan size buckets be significantly expanded.

We are additionally concerned that, if adopted as proposed, a potential consequence of the points and fees thresholds may be a significant constriction of credit available to minority and low-to-moderate income applicants and first time homebuyers. We are aware of various third party studies that acknowledge blacks and Hispanics are more likely to live in low-to-moderate income neighborhoods. This, in turn, can translate to an increased likelihood that these same individuals will be part of the consumer segment seeking lower loan sizes, due to income levels and the value of the homes in the areas in which they live. In addition, our internal analysis of historical loan production shows that first time homebuyers will also be significantly impacted by the 3% threshold. Presuming that lenders will prefer the QM standard and the associated safe harbor, low-to-moderate income populations, first time homebuyers and certain protected classes of consumers might be more likely to fall into the non-QM category, thereby reducing access to credit for these consumers.

Finally, we want the Board to be aware that our internal analysis examined loans that closed during a favorable rate environment. As rates and fees increase, the ability to meet the QM definition under the proposed points and fees thresholds may be even less likely. While the immediate concern can be addressed by modifying the small loan alternatives, we urge the Board to take great care to set the threshold limits in a way that will not severely disrupt the future availability of credit for consumers who are more likely to seek low loan sizes, including groups such as first time homebuyers, minorities and low-to-moderate income consumers.

2. <u>Inclusion of Loan Originator Compensation</u>

The proposed rule requires that all loan originator compensation paid by the lender or the consumer must be included in the points and fees test, including all compensation paid to a loan originator who is also a lender in a table funded transaction. In reviewing the impact of including loan originator compensation as proposed, Wells Fargo has identified several issues.

a. *Issues Related to Differing Compensation Models.* Wells Fargo believes that, as proposed, the requirement to include loan originator compensation will lead to inconsistencies in compensation models and the potential for double counting of certain compensation. To illustrate the impacts and inconsistencies, consider the following scenarios:

> Scenario 1: Assume a lender has decided to originate only QMs, and charges a flat lender origination fee of a $1000 on a particular loan. Further assume a very simple loan originator compensation plan that pays the loan originator, after closing, a flat fee of $800 on each loan. Because no loan originator fee is assessed to the consumer, the proposed rule would require the lender to use the figure of $1800 to calculate the QM points and fees threshold. Therefore, while the impact/cost to the

consumer is $1000, and the impact on the mortgage loan transaction is also $1000, the impact to the consumer's access to this transaction is $1800.

Scenario 2: Contrast this with a transaction originated by a mortgage broker, where the mortgage broker is paid $1000 by the lender, and the mortgage broker in turn pays its loan originator $800. Since the $800 is paid by the mortgage broker (who is not the consumer or the lender) in the transaction, only $1000 needs to be included for the purpose of calculating the QM points and fees threshold.

This inconsistency defeats the purpose of setting a high standard for a QM, creates an unlevel playing field, and leaves retail lenders at a competitive disadvantage, as their QM threshold is in effect forced lower than that of a broker.

b. *Difficulties in Determining Loan Originator Compensation.* The proposed rule goes into great detail regarding what would be considered loan originator compensation, including items such as an allocation of time spent on an application, bonuses and other components. Wells Fargo believes that many of these items are very problematic when used in a test that is intended to result in a safe harbor, or even merely a presumption of compliance. Further, loan originator compensation, in itself, is already subject to regulation and restriction under TILA prohibiting compensation from being tied to the terms of the loan.

Lenders will gravitate to originating QMs because of the protection they provide. To ensure that a loan is a QM, the points and fees test will need to be applied at time of application, so that the loan pricing can be set accordingly (as discussed above, under *1.Impacts of Thresholds*, pricing is likely the best way a lender can continue to cover the costs to underwrite, process and close the transaction in light of the low thresholds of the QM points and fees test). If individual loan originator compensation must be included *in addition to* the origination charge, as discussed above under *a. Issues Related to Differing Compensation Models*, it will be very difficult to determine how to calculate the amount of loan originator compensation to be included, even in a retail transaction, at the time the loan pricing must be established.

For example, lenders' current compensation plans are often tiered based on the number of loans closed in a month, which is not known at time of an application. In addition, if the Board would require the inclusion of actual hours spent on a particular transaction, a lender could have difficulty determining at the time of application the number of hours the loan originator spent working with a consumer prior to application (e.g., clearing credit issues), the number of hours the loan originator will spend taking and processing the application, and how to allocate overtime. Requiring the allocation of actual time on a loan level basis, in addition to any commissions paid, could also increase consumer costs, as the bulk of the allowable points and fees under the QM threshold would be taken up by loan originator compensation. This would reduce the amount of allowable points and fees remaining for the fixed costs, and could lead a lender to compensate by increasing the price of the loan.

In short, the rule as proposed creates an element of uncertainty for compliance, because lenders could never be sure that they have fully accounted for all loan originator compensation that may be attributable to a given loan. It also may add a level of inequality among lenders. Specifically, because the practice of providing higher compensation to a skilled loan originator will mean the QM threshold is met more quickly, the rule may encourage some lenders to employ lower paid, less skilled loan originators.

Another area where we would encourage the Board to provide additional clarification is including loan originator compensation in a table funded transaction. In such a transaction, the broker is the named lender and, therefore, similar to the retail scenario, both the compensation paid by the funding lender to the table funding lender, and the compensation paid by the table funding lender to its loan originator, would need to be included in the transaction. While this may seem reasonable on paper, in most real world transactions the funding lender will have no way to know in a timely fashion what compensation the table funding lender will pay to its loan originator, and will not be able to accurately run the QM points and fees test. This will also lead to an inconsistency between a traditional brokered transaction and a table funded transaction.

c. *Conclusion*. For all of the reasons outlined above, in particular in light of all the implications to the consumer, Wells Fargo encourages the Board to reconsider how individual loan originator compensation should be included in the QM points and fees test. The inclusion of loan originator compensation, as proposed, would add complexity and create inequity in credit products offered. It would also increase the costs of credit and likely reduce the availability of credit. Double counting does not further the focus of the rule.

We would therefore recommend the proposed rule be revised to clearly include all loan originator compensation (i) paid directly by the consumer; and (ii) paid by the funding lender to the mortgage broker entity. In other words, for all the reasons stated above, the QM test should include the origination charge that is disclosed on block 1 of the GFE, but should specifically *exclude* loan originator compensation paid by the lender or broker to their individual loan originators.

3. Other Issues Related to Loan Originator Compensation

a. *Definition of Loan Originator*. The Board has also requested comment on whether the definition of "loan originator" should include "any person who represents to the public through advertising or other means of communicating or providing information (including the use of business cards, stationery, brochures, signs, rate lists or other promotional items) that such person can or will provide any of the activities" of a loan originator. We agree with the Board's position in the Supplementary Information that it is unnecessary to include such a person in the definition because such a person has not received compensation for that function, and accordingly there is no compensation to compute in calculating the points and fees for a particular transaction. In fact, simply holding one's self out to the public as being able to offer or negotiate terms does not constitute a transaction, and no transaction exists at the point of marketing or other communications described above. The Board's position is also consistent with proposed comment 32(b)(1)(ii)-2, which clarifies that in calculating "points and fees" loan originator compensation excludes compensation that cannot be attributed to a transaction at the time of origination.

b. *Inclusion of Real Estate Broker Commissions*. The proposed rule excludes real estate broker compensation from the QM points and fees test, unless the real estate broker is compensated by the lender or loan originator. There are few, if any, situations in which a lender compensates a broker for marketing a property *except* where the lender sells real estate owned property and finances the purchase. Including the real estate broker commission in the points and fees calculation in these circumstances could substantially reduce sales of real estate owned properties by lenders, as they are disadvantaged in selling their own property. This could in turn increase the number of vacant properties, thereby negatively affecting communities and their stabilization initiatives. We accordingly request the proposed rule be revised to omit from the points and fees calculation real estate brokers' compensation paid by a lender when the lender is the holder of the real estate owned property.

4. Affiliate Fees

The proposed rule seeks to include all creditor-retained real-estate related fees, and any such fees retained by an affiliate of a creditor, into the QM points and fees calculation, but would exclude all real-estate related fees that are retained by an unaffiliated third party provider. Wells Fargo believes this discrepancy will discourage the use of affiliated business arrangements, particularly in connection with small loan sizes where the loan amount would make the QM designation nearly impossible to attain. As a consequence, the rule will reduce the availability of settlement service providers and increase the cost of consumer credit. It will also deny many consumers access to the benefits that can only be derived from affiliated business arrangements, namely, increased accuracy and efficiency through the use of shared data and communication platforms, the convenience of ordering multiple services through a single point of contact, and increased leverage that can be applied to resolve customer service issues in a timely fashion.

Wells Fargo does not believe that the differences in treatment between affiliated and unaffiliated third party fees will ensure that consumers receive residential mortgage loans on terms that reasonably reflect their ability to repay their loans. Rather, such a distinction will encourage creditors to use unaffiliated third party providers in an effort to meet the QM designation.

Moreover, Wells Fargo believes that adequate safeguards are already in place to ensure that the real-estate related fees affiliated businesses charge consumers remain competitive and that consumers are not charged an excessive fee.

- First, under the rule, any real-estate related fee that does not constitute a "reasonable charge" will automatically fall into the QM points and fees calculation. If a third party provider charges an unreasonable fee to a consumer for a particular service, the fee must be included in the 3% calculation, regardless of whether the fee was charged by an affiliated or unaffiliated provider.
- Second, RESPA prohibits both affiliated and unaffiliated third party providers from collecting a fee in connection with the delivery of a settlement service unless the service is actual, necessary, and distinct. Any failure to meet this statutory requirement could subject a settlement service provider to a fine of up to $10,000 and imprisonment for up to one year.
- Third, and finally, certain fees, such as title costs, are already subject to regulation. State regulators currently set, approve, or examine title insurance rates in 44 states, and those regulators are well positioned to observe and to take action against any title insurance rates that do not constitute a reasonable charge.

For the reasons stated above, Wells Fargo urges the Board to exclude from the QM points and fees calculation real-estate related fees retained by creditor affiliates.

5. <u>Bona Fide Discount Points</u>

Wells Fargo supports the Board's efforts to design a points and fees test that allows for the exclusion of bona fide discount points. However, we are concerned that the proposed definition of "bona fide discount points," and the limitation on the number of excludable points, are unnecessarily complicated and restrictive.

a. *Definition of Bona Fide Discount Point.* Under the proposed rule a bona fide discount point must be based on a calculation that is: (a) consistent with established industry practices for determining the amount of reduction in the interest rate or time-price differential appropriate for the amount of discount points paid by the consumer; and (b) accounts for the amount of compensation that the creditor can reasonably expect to receive from secondary market investors in return for the mortgage loan.

This calculation is complicated and overly technical. There is significant risk that a creditor will not be able to calculate accurately which bona fide discount points are included and which are excluded from the points and fees threshold, thereby increasing the possibility of noncompliance and consequential liability. If the rule is not clear, some lenders may choose to include all discount points in the points and fees calculation, or not allow them at all, further exacerbating the rule's impact on the availability of credit.

We also believe that requiring the calculation be based on the pricing of secondary market investors is both vague and overly restrictive. There are significant and legitimate variances in the rate-reduction value of a point based on economic and business model factors. Therefore, the relationship of the rate reduction to the value of a transaction in the secondary market does not create a bright line test, or a meaningful benchmark for loans held in portfolio. As noted in Appendix A, we believe a QM safe harbor with bright line standards is critical to ensure the continued flow of credit across consumer market segments.

b. *Limit on the Number of Excludable Points.* In addition, the proposed rule would allow lenders to exclude from the QM points and fees test up to two bona fide discount points paid by the consumer so long as the interest rate prior to discount does not exceed the Average Prime Offer Rate (APOR) by more than 1% (or up to one point if the rate prior to discount does not exceed the APOR by more than 2%). We believe this limitation unnecessarily restricts consumer options.

Bona fide discount points are not imposed by a creditor. Instead, they are voluntarily chosen by consumers or paid on consumers' behalf by third parties, such as sellers, builders, or employers in a relocation context. Many consumers select a bona fide discount points option in order to achieve the lowest possible rate. In the current lower rate environment, consumers may not be as likely to elect to pay bona fide discount points. However, in a future higher rate environment, where consumers expect to stay in their homes for a longer period of time, they should be given the opportunity to pay bona fide discount points without restriction. Other consumers may have significant assets but do not have income that matches these assets. They may choose to use those assets to pay down their interest rate and obtain the lowest qualifying rate, and should also be allowed to do so, without restriction. Finally, in situations where bona fide discount points are paid by third parties for the benefit of consumers, these points can be as much as the third party negotiates with the consumer and should not be restricted to 2 points. In short, we are concerned that the complicated formula of the proposed rule may eliminate bona fide discount points as an option for consumers and the third parties who elect to pay them on consumers' behalf.

6. <u>Fees Paid After Closing</u>

The Board questions whether it should require that certain types of fees be included in the QM points and fees test only if they are payable at or before closing, and is concerned that in the absence of such a qualifier some fees paid after closing could be deemed to be included in the test. We echo the Board's concern, and again emphasize the importance of drafting the rule in such a way that a lender can determine if a loan will be a QM at time of origination. Fees paid after closing arise due to circumstances in servicing the loan. We would therefore suggest the rule clearly indicate that any fee paid after closing should only be included in the points and fees test if it is known that such fee will be charged at or before closing.

***Other QM Criteria***

As discussed in Appendix A, Wells Fargo strongly supports the QM safe harbor approach referenced in the Board's proposal under Alternative 1, modified and supplemented as suggested in this letter. We do see a need for greater clarity related to certain of these QM criteria, to ensure lenders are able to originate, with reasonable certainty, loans meeting the QM standards. Therefore, we note the following with regard to the QM definition under Alternative 1.

1. <u>Loan Term</u>

The Board proposes that the term of a QM cannot exceed 30 years. Wells Fargo believes that a 30-year term standard is appropriate; however, greater clarity is required with regard to this standard as applied to construction-to-permanent loans. Consumers often choose a construction-to-permanent loan product, rather than obtaining separate construction and permanent loans, because the combined product provides a more streamlined experience, and is potentially less expensive, for the consumer. The typical length of the construction phase is 12 to 18 months, and the permanent financing phase is often a traditional mortgage with a term of 30 years. We therefore suggest that the Board clarify the term of the construction phase of a loan not be considered in determining whether the permanent financing phase meets the 30 year term maximum. Absent such clarification, consumers obtaining construction-to-permanent loans may find the availability of 30-year permanent financing to be limited.

2. <u>Income and Asset Consideration and Verification</u>

The Board proposes that a lender originating a QM must consider and verify the consumer's current or reasonably expected income or assets to determine the consumer's repayment ability. Wells Fargo supports the Board's proposal, but seeks additional clarity regarding the verification of income and assets. In addition to the comments included in Appendix A regarding the assessment and confirmation of safe harbor compliance, we seek an acknowledgment that verified income may be reasonably calculated in differing ways, and a confirmation that income and assets verification be based on information available to the lender at the time of underwriting. We also request that the Board provide additional detail related to the reasonable use of assets to repay a loan.

a. *Verification of Income and Assets.* While determining and verifying the amount of income for a consumer with W-2 income from a single employer may be straight forward, the income and asset determination for other consumers can be much more complex. For example, alternative methods to calculate monthly income may exist for a self-employed consumer with income and/or assets verified using a complicated tax return. The Board itself touched on this issue in proposed comment 43(c)(2)(i)-4, regarding seasonal or irregular income. Therefore, Wells Fargo would request the Board add language to the proposed rule that provides income and assets should be verified and calculated using widely accepted governmental and non-governmental underwriting standards. However, as discussed in Appendix C, we would ask the Board to clarify that lenders are not required to show compliance with all underwriting criteria provided in any particular governmental or non-governmental handbook. Further, we believe the Official Staff Interpretation should contain an acknowledgment that alternative methods of verified income and/or asset calculations are possible and acceptable.

Wells Fargo also sees a need for further clarification regarding the ability of lenders to rely on third- party verification documentation received during the underwriting process. Consumers who fail to advise their lenders of changed circumstances (e.g. loss of income, employment, or assets) after underwriting but before loan closing, should not derive a benefit under the rule for such failure. Therefore, as noted in Appendix A, Wells Fargo suggests clarifying language that allows a lender to reasonably rely on third-party verification documentation received during underwriting, provided the lender in the exercise of reasonable diligence does not know of a change in the consumer's income, employment, or assets.

b. *Assets.* Wells Fargo values the detailed guidance the Board provided regarding the consideration and verification of income. However, we believe additional direction is required with respect to the use of assets as a source of repayment, particularly as governmental and non-governmental underwriting standards provide little guidance concerning acceptable asset dissipation assumptions. For example, the proposed rule and Official Staff Interpretation recognize that lenders may take into consideration assets such as 401k plans, but there is not an acknowledgement that such assets may be used as a primary source to make loan payments. We therefore believe additional direction from the Board is critical to ensuring credit is available to all qualified consumers, including retired consumers with significant liquid investments who wish to use such assets to repay their loans.

## Appendix C – ATR Minimum Standards

Wells Fargo supports in principle the Board's ATR minimum standards, but believes further guidance is warranted in certain areas. We have already outlined concerns regarding the requirement to consider and verify income and assets in Appendix B, regarding the QM definition. We would also request that the Board consider the following additional comments.

1. Widely Accepted Underwriting Standards

The proposed Official Staff Interpretations frequently instruct lenders to look to widely accepted governmental and non-governmental underwriting standards for direction in determining whether lenders are meeting the proposed ATR requirements. For example, the proposed rule does not provide for a specific standard with regard to a maximum debt-to-income (DTI) ratio. Rather, proposed comment 43(c)(7)-1 provides that, to determine the appropriate threshold for the monthly DTI ratio or monthly residual income, the creditor may look to widely accepted governmental and non-governmental underwriting standards. Wells Fargo supports the Board's efforts to maximize the availability of credit by avoiding numerical absolutes in connection with the proposed underwriting standards. We believe, however, the Board should clarify that lenders may make a reasonable and good faith determination of a consumer's ability to repay a loan without showing compliance with all underwriting criteria provided in any particular governmental or non-governmental handbook.

2. Simultaneous Loans - HELOCs

The ATR minimum standards require the lender to consider and verify a consumer's monthly payment on any simultaneous loan the creditor knows, or has reason to know, will be made. Under the proposal, when the simultaneous loan is a home equity line of credit (HELOC), the consumer's payment is to be determined by using the periodic payment required under the terms of the plan and the amount of the credit drawn at consummation of the covered transaction. The Board has specifically asked for comment on what amount of credit should be assumed as drawn by the consumer at consummation. For example, the Board asks whether the rule should require lenders to assume a full draw of the credit line, a 50% draw, or some other amount instead of the actual amount to be drawn by the consumer. While Wells Fargo shares the Board's concern that a final rule requiring the assumption of a full draw may negatively affect the accessibility of credit, we believe a full draw assumption is most appropriate. On balance, we consider the risks noted by the Board associated with assuming anything less than a full draw (e.g. circumvention of rule through delayed draws, delay of HELOC originations until after the first mortgage consummation date) to outweigh the potential for a negative impact on access to credit.

## Appendix D – Scope of Covered Transactions - Temporary Loans

Wells Fargo supports the applicability of ATR standards to a broad range of dwelling-secured covered transactions, but does have a concern regarding the limited scope of the proposed exemption for temporary loans. We also recommend that the Board ensure construction-to-permanent loans do not lose access to QM treatment.

The proposed definition of "covered transaction" excludes only temporary loans with terms of 12 months or less and therefore, as drafted, would impose ATR standards on construction or other temporary loans with initial terms greater than 12 months. Wells Fargo accordingly suggests that "temporary loans" be defined by their purpose, rather than their duration; construction loans, in particular, often exceed a 12 months term, and we believe are not susceptible to abuse to avoid the ATR requirements.

In addition, we recommend that, to the extent lenders originate construction-to-permanent loans as a convenience and cost-savings to their customers, the construction loan should be "severable" from the permanent loan for purposes of the QM or ATR analysis. In particular, as we discussed in Appendix B, the construction period should not be added to the loan term of the permanent loan, since doing so in many cases would result in a total loan term in excess of 30 years, eliminating the opportunity for the permanent loan to qualify as a QM. The rule should allow the permanent loan to qualify as a QM, or if a non-QM loan satisfy the general ATR minimum standards, without requiring the consumer to incur the additional expense of "refinancing out" of the construction loan or construction phase with the same or a different lender.

# Appendix E – Other Issues

***Prepayment Penalties***

Wells Fargo is generally supportive of the proposed restrictions on the use of prepayment penalties, especially those regarding the 3-2-1 drop-down provisions to lower and eliminate the prepayment penalty for the consumer after a three-year period. However, in defining "prepayment penalty," the Board proposes to include the assessment of interest on a loan transaction for a period after the loan balance has been paid in full, even if the charges result from the interest accrual amortization method used on the transaction. Consistent with our comments in response to the Board's September 24, 2010 proposal to revise Regulation Z, Wells Fargo does not support this part of the prepayment penalty definition, in particular given its impact on FHA insured loans.

Under the terms of the FHA note, if a consumer prepays an FHA loan in full in the middle of the month, the consumer must pay interest through the end of the month in which the prepayment is made. Under the current FHA notes and structure of GNMA securities, the economics of a transaction are based on this method of calculating interest. Changing this requirement may have negative impacts on the cost and availability of FHA insured credit.

Wells Fargo is very concerned about the Board's position on this issue, and requests that the Board work with the HUD to reconcile this requirement with the current FHA and GNMA requirements to resolve the contradiction between the agencies and to ensure that FHA loans remain widely available and affordable to consumers.

***Non-Standard to Standard Refinance***

As noted in the cover letter, Wells Fargo is not making detailed comment on this proposed streamlined refinance option.