Freddie Mac
We make home possible®

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By Electronic Mail: reg.comments@federalreserve.gov
Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, NW
Washington DC 20551
Attn: Jennifer J. Johnson, Secretary

Re: Comments on Proposed Rule, Docket No. R-1417
(Regulation Z; Truth in Lending)

Ladies and Gentlemen:

The Federal Home Loan Mortgage Corporation ("Freddie Mac") is pleased to submit these comments in response to the Notice of Proposed Rulemaking published by the Board of Governors of the Federal Reserve (the "Board"), on May 11, 2011 (the "Proposal") to amend Regulation Z (Truth in Lending, 12 CFR Part 226).[1] The Proposal implements the ability to repay requirements of Section 129C of the Truth-in-Lending Act ("Section 129C"), as added by Section 1411 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Section 129C generally prohibits a creditor from making a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance and assessments ("Ability to Repay Standard").

Freddie Mac was chartered by Congress in 1970 with a public mission to stabilize the nation's residential mortgage markets and expand opportunities for homeownership and affordable rental housing. Our statutory mission is to provide liquidity, stability and affordability to the U.S. housing market. Freddie Mac currently operates under the direction of the Federal Housing Finance Agency (FHFA) as our conservator.

[1] 76 Fed. Reg. 27390 (May 11, 2011).

Brief Summary of Comments

Freddie Mac's comments are organized as follows:

- Section I discusses the Board's proposal to address certain streamlined refinance transactions.
- Section II discusses the Board's proposal to address the treatment of loan level price adjustments.
- Section III discusses the Board's proposal to establish either a safe harbor or a presumption of compliance for Qualified Mortgages.
- Section IV offers suggested clarifications on certain terms pertaining to the Board's proposal on Ability-to-Repay requirements.

General Statement of Interest

Freddie Mac supports the Board's objective that sufficient safeguards should exist to reasonably ensure borrowers have the capacity to repay a mortgage loan; such safeguards should benefit borrowers and enhance the credit quality of loans including those purchased by Freddie Mac.

Freddie Mac constantly evaluates market conditions and the credit environment to ensure that our underwriting standards, policies and business practices serve our mission to provide liquidity and stability to the conforming, conventional mortgage market. The conclusion that a mortgage is acceptable must be based on a determination that the borrower is creditworthy (acceptable credit reputation and capacity) and the mortgaged premises (collateral) is adequate for the transaction. Credit reputation, capacity and collateral are often called the "three Cs" of underwriting. If one of these components is not acceptable or if there is excessive layering of risk across components, the mortgage is not acceptable for sale to Freddie Mac.

In addition, Freddie Mac requires income and assets verification and documentation, except for Relief Refinance Mortgages℠ – Same Servicer.[2] We believe that nationally applied income and asset documentation requirements are critical tools to help prevent a recurrence of the lending abuses and effects of those abuses we have seen over the past few years. We believe that documentation requirements – such as W-2 forms

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[2] Freddie Mac does not require documentation of income in connection with our Relief Refinance Mortgage because we already own the mortgage and have already assumed the borrower's credit risk.

covering the most recent tax year, recent paystubs and verification of employment – provide the underwriter a basis for evaluating the amount, consistency, recent history, and probability of continued receipt of the income upon which the borrower will be relying to make the mortgage payment. Asset documentation helps to confirm that the borrower has sufficient savings to make the down-payment and will have sufficient reserves to cover the mortgage payment. Income and assets are quite probative of a borrower's ability to repay a mortgage. However, that probative value is lost if the sources to verify income and assets are neither reasonable nor reliable.

Freddie Mac has been working throughout the crisis to build a strong foundation of responsible lending practices, which will result in better quality loans as these practices are implemented by our seller/servicers. Our goal is to create sustainable homeownership opportunities for America's families, ensure fewer unexpected costs for our seller/servicers, drive better loan performance, and reduce Freddie Mac's dependence on taxpayer dollars.

Since 2009, we have made some important strides. We have:

- Strengthened credit standards on new single-family loans: our average FICO score today is 752 and our original loan-to-value (LTV) ratio is currently 70%.
- Forged best practices with our lenders in loan underwriting and processing.
- Implemented other measures to drive quality and consistency throughout the mortgage process.
- Helped educate future homebuyers about the new rules of the road for getting a mortgage: good credit, stable income and a common-sense down payment.

While these changes involve costs for the lender – and in some cases, tighter credit requirements for borrowers – we believe these changes are essential to placing the housing finance system on a better foundation of responsible lending practices.

Freddie Mac believes its efforts are consistent with the broad themes underlying the Board's proposal; affordable housing, sustainable homeownership and a continuous flow of mortgage funding.

I. Streamlined Refinance Transactions Exemption

Streamlined refinance programs are an important resource for consumers, mortgage lenders and Freddie Mac. For consumers, a streamlined refinancing can result in lower monthly mortgage payments thereby helping to sustain homeownership. For the primary and secondary markets, a streamlined refinance program can be an important component of an overall credit risk management process. For Freddie Mac, in particular, a streamlined refinance program can help reduce the credit risk on the loans we already own.

Freddie Mac does not require documentation of income in connection with our Relief Refinance Mortgage℠ because we already own the mortgage and have already assumed the borrower's credit risk. The Relief Refinance Mortgage program provides mortgage lenders with flexibility that allows LTV ratios up to 125 percent, relief from standard mortgage insurance requirements and simplified appraisal and borrower eligibility requirements.

The Board, through its research and outreach, understands that streamlined refinances have been an important resource for consumers. With respect to these refinancing transactions, assuming certain, specific conditions are met, the creditor is not required to comply with the income and asset verification requirements of proposed section 226.43(c)(2)(i) and (c)(4). We generally agree with the approach the Board has taken with respect to its important focus on refinancing a "non-standard mortgage" (defined in proposed section 226.43(d)(2)(i)) into a "standard mortgage" (defined in proposed section 226.43(d)(2)(ii)), subject to certain conditions being met. We understand and agree with the Board's intent to preserve these consumers' access to streamlined refinancing transactions that lower their payments.

The Dodd-Frank Act requires a creditor making a residential mortgage loan to verify amounts of income or assets that such creditor relies on to determine repayment ability.[3] The statute further permits the Department of Housing and Urban Development, the Department of Veterans Affairs, the Department of Agriculture and the Rural Housing Service to exempt refinancing under a streamlined refinancing from this income verification requirement as long as certain conditions are met.[4] The Board also commented in the Proposal that "[f]inally, as noted, TILA Section 129C(a) includes

[3] 15 USCS § 1639c (a)(4); P.L. No. 111-203.
[4] 15 USCS § 1639c (a)(5); P.L. No. 111-203.

a provision that specifically addresses how the general ability-to-repay requirements apply to streamlined refinances under programs of government agencies such as the Federal Housing Administration and U.S. Department of Veterans' Affairs."[5]

Senator Dodd explained on the Senate floor that the exemption was not intended to apply only to non-conventional loans:

> However, certain refinance loans, such as VA-guaranteed mortgages refinanced under the VA Interest Rate Reduction Loan Program or the FHA streamlined refinance program, which are rate-term refinance loans and are not cash-out refinances, may be made without fully reunderwriting the borrower, subject to certain protections laid out in the legislation, while still remaining qualified mortgages.
>
> *It is the conferees' intent that the Federal Reserve Board and the CFPB use their rulemaking authority under the enumerated consumer statutes and this legislation to extend this same benefit for conventional streamlined refinance programs where the party making the new loan already owns the credit risk. This will enable current homeowners to take advantage of current low interest rates to refinance their mortgages.* [Emphasis added][6]

Freddie Mac's Relief Refinance Mortgage program, which supports the Obama Administration's Making Home Affordable program, is comparable to the Federal Housing Administration's (FHA) streamlined refinance program and, we believe, should be treated the same as FHA and the other federal agencies.

We submit to the Board that it is our experience that streamlined refinance programs are an important resource for consumers looking to refinance into a lower monthly payment mortgage even if the underlying mortgage is not a "non-standard mortgage." Therefore, we respectfully suggest that the Board consider modifying its exemption proposal to include conventional loans. We believe such an approach can help stabilize the housing market and is consistent with congressional intent.

Thus, we respectfully urge the Board and the Consumer Financial Protection Bureau to use their rulemaking authority to extend this same benefit for conventional streamlined

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[5] 76 Fed. Reg. at 27440.

[6] 156 Cong. Rec. S5928 (July 15, 2010).

refinance programs where the party making or purchasing the new loan already owns the credit risk. The final rule could clarify that TILA Sections 129C(a)(5) and/or (a)(6)(E) do not preclude borrowers with conventional loans held by Freddie Mac from benefiting from the streamlined refinance provisions.

II. Loan Level Price Adjustments

For purposes of establishing the scope of a qualified mortgage, the Dodd-Frank Act, limits the points and fees payable in connection with the mortgage loan to no more than three percent of the total loan amount.[7] Similarly, for certain streamlined refinances, the Dodd-Frank Act limits the total points and fees payable in connection with the refinancing to no more than three percent of the total new loan amount.[8] In addition, the Dodd-Frank Act excludes "bona fide third party charges not retained by the mortgage originator, creditor, or an affiliate of the creditor or mortgage originator" from the definition of points and fees.[9] The Board is likewise proposing to exclude "bona fide third party charges not retained by the mortgage originator, creditor, or an affiliate of the creditor or mortgage originator" from the definition of points and fees.[10]

The Board is requesting comment on whether and on what basis the final rule should exclude from points and fees for qualified mortgages points charged to meet risk-based price adjustment requirements of secondary market purchasers.[11] In addition, the Board is asking whether an exemption for loan level price adjustments (LLPAs) is consistent with congressional intent in limiting points and fees for qualified mortgages.[12]

In its proposal, the Board specifically recognizes that, "in setting the purchase price for specific loans, Fannie Mae and Freddie Mac make loan-level price adjustments (LLPAs) to compensate offset added risks, such as a high LTV or low credit score."[13] The Board further noted that during its outreach activities, some creditors argued that points charged as a result of LLPAs should not be counted in points and fees for qualified

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[7] 15 USCS § 1639c (b)(2)(A)(vii); P.L. No. 111-203.
[8] 15 USCS § 1639c (5)(C); P.L. No. 111-203.
[9] 15 USCS § 1639c (C)(i); P. L. No. 111-203.
[10] 76 Fed. Reg. at 27465.
[11] 76 Fed. Reg. at 27466.
[12] *Id.*
[13] *Id.*

mortgages under the exclusion for "bona fide third party charges not retained by the mortgage originator, creditor, or an affiliate of the creditor or mortgage originator".[14]

Freddie Mac charges LLPAs to mortgage originators to compensate for higher levels of risk in some mortgage products. Lenders must pay LLPA fees to Freddie Mac in cash at the time of loan delivery. We determine prices of our LLPA fees based on our assessment of credit risk and loss mitigation related to single-family loans. We vary our LLPA fee pricing for different mortgage products and mortgage or borrower underwriting characteristics. In 2009 and 2010, because of the uncertainty of the housing market, we implemented several increases in LLPA fees (delivery fees) applicable to mortgages with certain higher-risk loan characteristics. Additional delivery fee increases became effective March 1, 2011 (or later, as outstanding contracts permit) for loans with higher LTV ratios. To help ensure appropriate pricing of risk in the form of rate or price, we need to have an appropriate mechanism to manage these changes.

We think there is a reasonable basis to exclude from points and fees for qualified mortgages points charged to meet risk-based price adjustment requirements of secondary market purchasers. First, LLPA fees are not retained by the seller/servicer.[15] We believe this view is consistent with the Board's clarification of the meaning of "retained by" for purposes of this proposed rulemaking.[16] Second, we believe excluding loan level price adjustments from the definition of points and fees for qualified mortgages is consistent with Congress' underlying intent to encourage secondary mortgage market participants, like the GSEs, to use prudential risk management techniques in their purchase activities and to assess appropriately and price for the risks associated with certain mortgage products.

Moreover, we ask the Board to consider and assess the impact on the mortgage market if points and fees for qualified mortgages included points charged to meet risk-based price adjustment requirements of secondary market purchasers. Finally, points charged as a result of LLPAs should not be viewed the same as, or comparable to, discount points or bona fide discount points because LLPAs are not used by a consumer to buy down the interest rate.[17]

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[14] *Id.*

[15] We recognize, as does the Board, that a lender may, but is not required to, pass the costs to the consumer in the form of a fee charged at closing or through an increase in the interest rate.

[16] 76 Fed. Reg. at 27465.

[17] 76 Fed. Reg. at 27466.

In consideration of the foregoing, Freddie Mac respectfully requests that the Board clarify in its final rule that LLPAs charged by Freddie Mac or other secondary mortgage market participants are "bona fide third party charges not retained by the mortgage originator, creditor, or an affiliate of the creditor or mortgage originator" and thus are excluded from the definition of points and fees for qualified mortgages.

III. Consideration of Qualified Mortgages and the Presumption of Compliance

The Dodd-Frank Act provides legal protection for assignees that purchase qualified mortgages. Under the Dodd-Frank Act, an assignee may presume that a loan that meets the requirements to qualify as a "qualified mortgage" has met the requirements of TILA Section 129C(a). The Board writes that it is unclear whether the protection is intended to be a safe harbor or a presumption of compliance with the ability-to-repay requirements; concluding that an analysis of the statutory construction and policy implications demonstrate that there are sound reasons for adopting either interpretation. As a result of its analysis, the Board proposes two alternative definitions of a "qualified mortgage": One that operates as a safe harbor and one that operates as a presumption of compliance.[18] The Board then discusses the strengths of each alternative and the drawbacks to each alternative. We found the Board's discussion of strengths and drawbacks of each alternative informative.

As a secondary mortgage market participant -- an assignee or subsequent purchaser of mortgages -- there are actions taken by creditors or originators that Freddie Mac can neither detect nor control. This is true even in light of the pre- and post-purchase due diligence efforts that we perform. This is true even after we have made significant improvements in our underwriting requirements (and, of course, such enhancements are on-going, based on various factors, including market conditions).

In addition, as the Board knows, our seller/servicers are contractually obligated to deliver eligible loans to Freddie Mac in accord with the Freddie Mac Seller/Servicer Guide.[19] As part of determining loans eligible for delivery to Freddie Mac, we consider

[18] 76 Fed. Reg. at 27452.

[19] The rebuttable presumption approach could complicate any potential role of automated underwriting systems under the rule. Under the rebuttable presumption approach, the credit decision is subject to re-examination at any point during the life of the loan. If the loan were reviewed by an automated underwriting system, creditors would still have to separately underwrite the file. On the other hand, Freddie Mac believes that automated underwriting systems can play an affirmative role to help facilitate creditor compliance with the rule.

the potential for increased legal liability. As a result, we have issued policies that high-cost, high-fee loans or loans with unacceptable terms or conditions or resulting from unacceptable practices are ineligible for delivery to Freddie Mac. We concluded that such loans created legal uncertainty and additional legal risk.

We have concerns with a liability standard that would apply even in instances where an investor had exercised every reasonable step to confirm purchase of qualified mortgages but nonetheless inadvertently purchased a non-qualified mortgage. By imposing this type of liability on mortgage investors for the actions of all other parties in the chain of title, a secondary market investor essentially would have to review each loan prior to purchase to be certain that the loan was originated in accordance with the qualified mortgage requirements.

Given the volume of loans Freddie Mac purchases, it would be highly impractical for us to conduct business this way and would result in significant new borrower costs. Moreover, even a review of the loan file could not detect all of the actions of the creditor or originator that could be inconsistent with the qualified mortgage requirements. As a result, it is highly unlikely for a secondary market participant to be certain that loans would comply with the substantive provisions of the requirements.

Thus, we have concerns with any requirement that might subject Freddie Mac to increased legal liability, particularly for matters where assignees would have difficulty acting to defend themselves and where, even after the exercise of reasonable due diligence, may be held accountable for the actions of originators that could neither be detected nor controlled. We believe that an approach that presumes that a secondary mortgage market participant should effectively control and be accountable for the primary market lending practices involved in the origination of loans subject to these provisions provides significant challenges for Freddie Mac.

At the same time, we do not believe it is appropriate to create incentives or establish legal standards that could undermine robust underwriting on the part of originators, leading to lower quality loans. We believe that procedures and standards must ensure that the originator, which underwrites the loan, exercises its best judgment in its underwriting practices regarding a borrower's ability to repay. The statute provides "Any creditor ... and any assignee ... may presume that the loans has met the requirements ... if the loan is a qualified mortgage." TILA Section 129C(b)(1), as amended by the Dodd-Frank Act, sec. 1412. The strict reading of this language would appear to favor certainty for borrowers, creditors and assignees.

Furthermore, Freddie Mac recognizes the balancing of interests that the Board must consider with respect to an innocent borrower and a responsible assignee. Freddie Mac, however, believes those interests are aligned –both parties want to ensure sustainable homeownership opportunities. We believe those interests are realized through robust underwriting requirements. As discussed above, our focus is on building a strong foundation of responsible lending practices to produce better quality loans.

Freddie Mac believes that, whether the Board's final rule adopts Alternative 1 or Alternative 2 or even another approach, the Board must establish clear and objective criteria for the origination requirements for qualified mortgages as well as compliance processes in support of those requirements. Such criteria will help originators undertake their duties to see that borrowers have the ability to repay. Such criteria will help secondary mortgage market participants assess the scope of any potential mortgage purchase risk as determined by the scope of any potential liability associated with the mortgage purchase decision. Indeed, a robust regime for originator conduct to assure that the standards of the Dodd-Frank Act are met will provide value not only to borrowers and secondary market parties, but to the originator as well.

IV. Clarification of Certain Terms Pertaining to Ability-to-Repay Requirements

Certain terms and requirements would benefit from clarification and assist in implementation. Specifically, to improve clarity and maintain access to credit for consumers, the final rule could provide the clarifications, as more fully discussed below, regarding the following: (i) creditors may use automated underwriting systems to evaluate a borrower's ability to repay; (ii) rules for treatment of debt obligations expiring in 10 months or less, (iii) consideration of deferred obligations; and, (iv) treatment of undrawn amounts on home equity lines of credit (HELOCs).

A. "Widely Accepted Underwriting Standards" to Include Automated Forms

Freddie Mac agrees with the Board's proposed commentary to Section 226.43(c) that would allow creditors to look to "widely accepted governmental and non-governmental underwriting standards" to evaluate a consumer's ability to repay. By way of example, the Board references the Federal Housing Administration's (FHA) handbook. Of course, Freddie Mac's Single-Family Seller/Servicer Guide would be another example. In today's marketplace, many lenders also use automated underwriting systems like Freddie Mac's Loan Prospector® (LP) or FHA's TOTAL Mortgage Scorecard. The final commentary could be clarified so that a creditor may rely on written and automated versions of underwriting standards.

B. Underwriting Rules for "Current Debt Obligations" Including Simultaneous Loans

As proposed by the Board, a creditor must consider a consumer's current debt obligations to determine the consumer's ability to repay the loan.

The Board asked whether it should provide guidance on debts that will pay off in 10 months or less. We believe the Board should provide such guidance because not all types of obligations are equally predictive and not all widely accepted underwriting standards treat such obligations the same. Some debts, such as installment debts, separate maintenance payments and other obligations with a definitive end date of 10 months or less, may not have a discernible impact on a consumer's performance. Such obligations could be disregarded unless the consumer will have limited cash assets post-loan closing. Therefore, we recommend that the final rule clarify that obligations with a definitive end date or maturity date of 10 months or less be disregarded in determining a consumer's ability to repay where appropriate as not providing a material impact on the capacity to repay.

In addition, the Board solicited comment on whether obligations in forbearance or deferral should be taken into account for purposes of determining a consumer's current debt obligations. As a general matter, Freddie Mac requires that monthly payments on debts in forbearance or deferral be counted in the borrower's debt-to-income ratio. Freddie Mac has a limited exception to this general rule. For "Affordable Seconds" loans that do not require payments within the first 60 months, the monthly payments are not required to be counted in the housing- and debt-to-income ratios (DTI). Freddie Mac asks the Board to provide clarifying guidance regarding "Affordable Seconds" loans.

Also, the Board solicited comment on its proposal that would require creditors to consider only the portion of a HELOC that is drawn at loan closing, instead of the full amount of the HELOC. The Board's proposal is consistent with Freddie Mac's underwriting requirements as related to HELOCs.

V. Conclusion

Freddie Mac recognizes the Board's task is a difficult one. On the one hand, the Board has been directed to fortify the protections available to consumers who are obtaining home financing. On the other hand, for the Board to foster the recovery of the secondary mortgage market, and to provide a regulatory environment in which reasonably priced loans will be available to creditworthy borrowers, the "rules of the road" will need to be clearly articulated and applied. If there is a great deal of uncertainty about such rules, the return of private capital to the market will be delayed. A complex and delicate balance must therefore be reached. Freddie Mac believes that the best way to achieve such a balance would be for the Board to meet with industry and consumer groups to become as knowledgeable as possible about the probable effect of the Board's proposed actions, and to identify (and avoid) any potential unintended consequences, such as unreasonable increases in the cost of home loans, or the complete unavailability of such financing to certain deserving consumers. Freddie Mac believes that such meetings should occur prior to the adoption of an interim final rule or a final rule, and Freddie Mac would be happy to participate and perhaps facilitate such meetings.

Sincerely,

Wendell J. Chambliss

Wendell J. Chambliss