July 22, 2011

Jennifer J. Johnson
Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Ave. NW
Washington, DC 20551
regs.comments@federalreserve.gov

**Re: Proposed Rule, Request for Public Comment (Docket No. R-1417 RIN No. 7100-AD75)**

Dear Ms. Johnson:

The Mortgage Bankers Association[1] (MBA) welcomes this opportunity to comment on these important amendments to Regulation Z [2] (proposal) and the accompanying Staff Commentary (commentary) proposed by the Board of Governors of the Federal Reserve (Board). The proposal would implement amendments to the Truth in Lending Act (TILA) under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) to establish the Ability to Repay/Qualified Mortgage (QM) requirements.

MBA appreciates the Board's fine work in developing this extensive proposal and looks forward to working with the Bureau of Consumer Financial Protection (CFPB) on a final rule.[3]

MBA believes this proposal and the Credit Risk Retention/Qualified Residential Mortgage (QRM) rule, to which we are responding in a separate comment letter, are the two most significant mortgage-related rules required by Dodd-Frank concerning mortgage lending. How these rules are finalized will determine who has access to affordable mortgage financing for generations to come.

---

[1]The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

[2] 12 CFR Part 226.

[3] General rulemaking authority under TILA was transferred to the CFPB on July 21, 2011 and the proposal indicates that it will become a proposal of the CFPB.

MBA recognizes that mortgage lenders need to take responsibility for their share of excesses during the recent housing boom. We are well aware that changes are needed to ensure such excesses will not be repeated in the future. But any responses to the mortgage crisis must promote recovery and the availability and affordability of mortgage credit to consumers.

Dodd-Frank and this proposal prohibit lenders from making a mortgage loan unless the originator makes a reasonable determination, in good faith, based on verified and documented information at the time the loan is consummated that the consumer has a reasonable ability to repay the loan, including all applicable taxes, insurance and assessments.

MBA has long supported establishment of an ability to repay requirement for mortgage loans. However, since the requirement will apply broadly and bring considerable liability to lenders and assignees for any violations, it is essential that the rule's QM requirements include unambiguous definitions and means of compliance. Clear "bright line" requirements will ensure the provision of sustainable mortgage credit to the widest array of qualified borrowers at affordable costs.

If these requirements are implemented incorrectly, however, we are deeply concerned that far too many borrowers will be excluded from affordable mortgage credit and/or will be subject to unreasonably increased financing costs, in turn harming the very people Dodd-Frank was intended to protect and undermining the nation's economic recovery.

Notably this rule is being proposed and will likely be finalized against a background where:

- The market itself has largely cleared out toxic mortgage products, credit is tight and several factors have limited the availability of mortgage credit to highly qualified borrowers;

- Even the most qualified borrowers today find qualifying for a mortgage far more difficult than ever. Existing regulations and market imperatives today already demand more documentation and verification than in previous years;

- The sheer quantity of rules is placing great stress on lenders, particularly smaller lenders who serve communities across the country;

- The prospect of far reaching legal liability that presents potential risks of up to $100,000 per loan for failing to meet the ability to repay requirement will lead to overly conservative lending behavior;

- There is considerable concern that private capital is not returning to the mortgage market and the government's involvement is expected to shrink;

- There is concern that tighter credit standards will disadvantage communities of color, and low- and moderate-income families the most as well as raise fair lending concerns in the future; and

- The economy is sputtering and undue restrictions on mortgage credit will worsen the housing market and the nation's economic recovery.

These and other factors demand the greatest care in developing and implementing a final rule.

In addition to implementing the ability to repay requirements the proposal offers two alternatives to define the QM. Both include several specific product limitations and underwriting requirements.

Alternative1 would establish a “legal safe harbor” to satisfy the ability to repay requirement if its requirements are met. Alternative 2 would establish a “rebuttable presumption of compliance” to satisfy the requirement. Both alternatives include a three percent limit on points and fees for “smaller loans” under $75,000 on a sliding scale with up to five percent for loans under $20,000.

For the reasons explained in this letter, MBA strongly believes that any final rule must:

(1) Structure the QM as a legal safe harbor with specific product features, documentation and underwriting requirements that may be more extensive than the requirements proposed in order to ensure the availability of sustainable, affordable mortgage credit to the widest array of qualified mortgage borrowers;

(2) Significantly adjust the limit on total points and fees in the QM alternatives proposed to ensure the availability of credit and address several other major concerns; and

(3) Provide a well-defined QM safe harbor that will serve as an alternative to the proposed QRM. The right QM definition will incentivize the origination of sustainable mortgages and, thus, serve the interests of investors as well as borrowers and invite private capital back to the market.

Our comment letter explains these three major concerns and addresses other key issues, including prepayment penalties, coverage, fraud, non-standard to standard refinances, and loan terms.

The outline of MBA’s comments is as follows:

I. General Background

    A. Overview of Proposal

    B. Background

II. Summary of MBA’s Major Comments

    A. The QM Should be Established as a Bright Line Safe Harbor Not a Rebuttable Presumption of Compliance.

    B. The Limit on Points And Fees in the QM Proposals Requires Significant Adjustment by the CFPB to Avoid Unduly Lessening the Availability of Credit and/or Removing Beneficial Options from the Market.

    C. A Sound QM Definition Structured as a Safe Harbor Should Serve as a Basis for the QRM Definition.

III. Discussion of Major Comments

## I. General Background

### A. Overview of Proposal

As indicated Section 1411 of Dodd-Frank prohibits a creditor from making a mortgage loan unless the originator makes a reasonable determination, in good faith, based on verified and documented information at the time the loan is consummated that the consumer will have a reasonable ability to repay the loan, including any mortgage related obligations.

Dodd-Frank Section 1412 also provides that if the loan meets the QM definition, it is presumed to meet the ability to repay requirements. The Board, and after July 21, 2011 the CFPB, is charged with prescribing rules to implement Section 1412.

The proposal offers options for creditors to comply with the ability to repay requirements including: (1) originating a mortgage loan after considering and verifying eight factors; (2)

refinancing a "non-standard mortgage" into a "standard mortgage;"[4] (3) originating a QM, which would be subject to either a safe harbor or rebuttable presumption of compliance; or (4) a small creditor operating predominantly in a rural or underserved area originating a "balloon payment QM."[5]

The eight factors proposed to satisfy the general ability to repay requirements include considering and verifying: (1) the consumer's current or reasonably expected income or assets, other than the value of dwelling that secures the loan; (2) if creditor relies on income from the consumer's employment in determining repayment ability, the consumer's current employment status; (3) the monthly payment on the mortgage loan calculated based on fully indexed rate and monthly fully amortizing payments that are substantially equal; (4) the consumer's monthly payment on any simultaneous loan the creditor knows or has reason to know will be made, including the payment under a loan or Home Equity Line of Credit (HELOC) that will be secured by the same dwelling and made to the same consumer at or before consummation of the covered transaction based on the payment required under the plan and amount of credit drawn at consummation of the transaction; (5) the consumer's monthly payment for mortgage-related obligations; (6) the consumer's current debt obligations; (7) the consumer's monthly debt-to-income ratio (DTI), or residual income; and (8) the consumer's credit history.

Under the general ability to repay standards, there are no numerical limits on the loan's features, term, or points and fees, but the creditor must follow certain underwriting requirements and payment calculations. The proposal permits the creditor to consider and evaluate a consumer's repayment ability using widely accepted governmental or non-governmental underwriting standards. [6]

As indicated, the Board offered two alternative approaches to the QM for comment that include different degrees of protection from liability to satisfy the ability to repay requirements.[7]

Alternative 1 would establish a legal safe harbor that the ability to repay requirement has been met for mortgage loans that: (1) do not include negative amortization, interest-only payments, or balloon payments (except as permitted pursuant to a narrow exception) or have a loan term exceeding 30 years; (2) have total points and fees not exceeding three percent of the total loan amount (with higher thresholds proposed for smaller loans); and (3) where underwriting: (a) is

[4] Proposed §226.43(d)(2)(i) substitutes the term "non-standard mortgage" for the statutory term "hybrid loan" and defines this term to mean any "covered transaction" that is: an adjustable rate mortgage, with an introductory fixed interest rate for a period of one year or longer; an interest-only loan; or a negative amortization loan. Proposed §226.43(d)(2)(ii) substitutes the term "standard mortgage" for the statutory term "standard loan" and defines the term to mean a covered transaction that: 1) may not provide for negative amortization payments, payments of interest only or of only a portion of the principal required to pay off the loan amount over the loan term, or a balloon payment; 2) total points and fees payable in connection with the transaction may not exceed three percent of the total loan amount, with exceptions for smaller loans specified in § 226.43(e)(3); 3) the loan term may not exceed 40 years; 4) the interest rate must be fixed for the first five years after consummation; 5) the proceeds from the loan may be used solely to pay (1) the outstanding principal balance on the non-standard mortgage; and 2) closing or settlement charges required to be disclosed under RESPA.

[5] A small creditor eligible to offer a balloon payment QM and the balloon payment mortgage would need to meet requirements in the proposal, including all requirements for qualified mortgage (except for the balloon payment restriction), including limits on points and fees; plus loan term of five years or more, and payment calculation based on scheduled periodic payments, excluding the balloon payment.

[6] Paragraph 43(c) Repayment ability, 76 Fed. Reg. 27492 (May 11, 2011).

[7] The proposal makes clear that only one is to be adopted in the final rule.

based on the maximum interest rate in the first five years; (b) uses a payment schedule that fully amortizes the loan during the loan term; and (c) takes into account any mortgage-related obligations. The income or assets of the borrower must also be considered and verified.

Alternative 2 would establish a rebuttable presumption of compliance that the ability to repay requirement has been met for loans meeting the requirements listed in Alternative 1 as well as certain additional underwriting requirements including considering and verifying: (1) the consumer's employment status, if the creditor relies on income from the consumer's employment; (2) the monthly payment for any simultaneous mortgage; (3) the consumer's current debt obligations; (4) the monthly DTI ratio or residual income; and (5) the consumer's credit history.

Both alternatives establish a three percent limit on points and fees that includes: (1) direct and indirect payments by a consumer to a creditor and mortgage broker as well as their originator employees; (2) bona fide third party fees received by a creditor, mortgage originator or affiliate; (3) mortgage insurance premiums in excess of the amount payable under the Federal Housing Administration (FHA) program; and (4) the prepayment penalty on the covered transaction or on an existing loan if it is refinanced by the same creditor.

Under Section129C of TILA, which was added by Dodd-Frank,[8] the Board may prescribe regulations that revise, add to, or subtract from the criteria that define a QM upon a finding that such regulations are necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of the provisions in the statute, necessary and appropriate to effectuate those purposes, to prevent circumvention or evasion thereof, or to facilitate compliance with such purposes.

## B. Background

### 1. Liability

Lenders accept that inherent in their business is a degree of risk and part of that risk includes liability. However, if threats and potential damages of lawsuits begin to outweigh the financial benefits, lenders will begin to reconsider whether the risk of remaining in the business of originating loans is worth the investment of capital.

Under Dodd-Frank, a mortgage creditor who fails to comply with the ability to repay requirements may be liable for: (1) actual damages; (2) all fees paid by the consumer and up to three years of finance charges paid by the consumer and (3) court costs and reasonable attorney's fees associated with the enforcement action.

Under preexisting TILA provisions, the ability to recover damages as well as attorney's fees has led to numerous putative class action lawsuits against lenders. As a result of Dodd-Frank changes to TILA, the incentive for lawsuits is increased dramatically. As noted above, Dodd-Frank makes violations of the repayment ability requirements subject to the expanded HOEPA loan damages of the fees and finance charges paid by the consumer, whether or not the loan is a HOEPA loan. Additionally, Dodd-Frank expanded the statute of limitations from one to three years for certain TILA violations, including violations of the repayment ability requirements, which permits a claim for damages that include up to three years of interest.

---

[8] TILA Section 129C(b)(3)(B)(i).

Most significantly, Dodd-Frank amends TILA to specifically provide that a consumer who is faced with a judicial or nonjudicial foreclosure action may raise a violation of the ability to repay standard as an offset to any claim in foreclosure action or another action to collect the mortgage debt by the creditor or an assignee, regardless of when the violation is raised.

The allegation literally could be made in the 29th year of a 30 year mortgage. This relief is in addition to the TILA damages enumerated above. Admittedly, if such a claim is made after many years of the consumer making payments on the loan it may be difficult for the consumer to succeed in the claim. However, if these claims are presented in the early years of a loan as part of a foreclosure proceeding they can result in considerable costs.

The additional cost to the creditor or assignee addressing such claims should not be underestimated. It is reasonable to conclude that a rebuttable presumption will encourage more claims than a safe harbor.

To illustrate the effects of these requirements, MBA has prepared the following chart showing potential damages for a violation of ability to repay claim on a moderately priced home loan of $212,000. The chart is based on the assumption that these rules were applied to a claim against a lender at the time of foreclosure after more than three years of mortgage payments with a 30 year conventional mortgage of moderate amount ($201,400) at today's historically low interest rate of 4.5 percent or at a rate of eight percent, which borrowers could face in coming years. As recently as 2000, 30-year fixed mortgage rates averaged 8.06 percent. Given the pressures on the federal budget, it is clearly possible that rates could reach similar levels again.

| | **Illustration of Costs Associated with Proposed Penalties Under QM Rule** | **Mortgage A** | **Mortgage B** |
|---|---|---|---|
| 1 | Initial Home Value | $212,000 | $212,000 |
| 2 | Initial Mortgage Balance | $201,400 | $201,400 |
| 3 | Mortgage Rate | 4.5% | 8% |
| | | | |
| 4 | Lender Fees (1% of mortgage balance) | $2,014 | $2,014 |
| 5 | Mortgage Payment (P+I on 30-year loan) | $1,020 | $1,478 |
| 6 | Mortgage Interest Paid Over First 3 Years | $26,535 | $47,723 |
| 7 | Down Payment | $10,600 | $10,600 |
| 8 | Attorney Fees under Safe Harbor ($300/hour, 100 hours) | $30,000 | $30,000 |
| 9 | Attorney Fees under Presumption ($300/hour, 167 hours) | $50,000 | $50,000 |
| | | | |
| 9 | **Potential Costs for Violation of ATR* Standard under Safe Harbor (4+6+7+8)** | **$69,149** | **$90,337** |
| 10 | **Potential Damages for Violation of ATR* Standard under Presumption (4+6+7)** | **$89,149** | **$110,337** |
| | | | |
| 11 | Average Production Profit per Loan in 2010 per MBA Performance Report | $1,054 | $1,054 |

**Ability to Repay (ATR)*

This chart under Mortgage A with a sample rate of 4.5 percent, assumes three years of finance charges[9] and under Mortgage B depicts a loan with an eight percent rate and similar charges.

As the chart shows, at the 4.5 percent rate MBA estimates that, on average, a lender would be subject to a potential $58,549 in finance charges and damages for a violation involving Mortgage A assuming three years of interest and a safe harbor construct. Note, actual damages could include the borrower's equity and much more depending on how courts interpret these provisions. MBA estimates the potential costs could rise to $79,737 for an eight percent loan.

With the same assumptions, but with a rebuttable presumption of compliance, MBA estimates that on average, a lender would be subject to $78,549 of costs for a violation at 4.5 percent or as high as $99,737 for an eight percent loan.

---

[9] Note, there is legal basis under Dodd-Frank to cap the finance charges at three years. It is unclear whether the courts will ultimately cap the amount at three years.

The difference in charges for a rebuttable presumption and a safe harbor depicted for both loans is based on a rough estimate of 40 percent greater attorneys' fees of $20,000 per loan for more extensive rebuttable presumption litigation. But this figure reflects only a small part of the cost difference to industry and borrowers of adopting a rebuttable presumption as opposed to a safe harbor.

A presumption of compliance coupled with attorneys' fees can be expected to invite more litigation particularly at the time of foreclosure. It also can be expected to result in far greater aggregate costs for numerous items, including loan sale due diligence, repurchase demands, document and staffing costs and reserves, to name a few.

Lenders today already make relatively little profit on each loan they originate (an average of $1,054 per loan according to MBA's 2010 Performance Report). Considering the potential costs that would result from the establishment of a rebuttable presumption and the relatively small return for origination, MBA believes there is good reason to fear that some lenders will act very conservatively and others will not participate in mortgage lending at all, considering the difficult value proposition that would be presented by legal uncertainty.

Accordingly, to reduce borrower and lender costs and avoid a lack of credit and/or increased costs to many borrowers, the adoption of a dispositive safe harbor with clear and unambiguous standards is essential.

**2. Economic Environment**

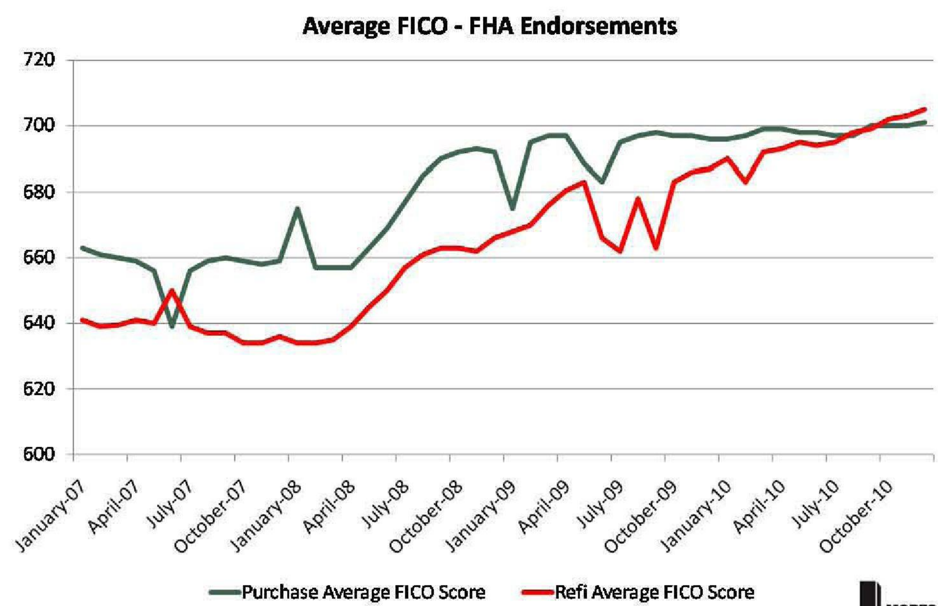
While MBA strongly supports the purposes of this proposal, it is critical that the fragility of the current housing market be carefully considered as the rule is finalized. Any undue constraint on the availability and affordability of credit would have a deleterious effect on housing demand, further depress the price of homes, and threaten the nation's economic recovery.

Today the nation faces a disproportionately large inventory of homes with additional "shadow inventory" to come on line soon, in the face of weak market demand. As of June, there were roughly 3.9 million new and existing homes for sale representing a combined total of nine months' supply. The shadow inventory comprises properties with owners who are significantly behind on their mortgages. These properties will likely come on the market in the upcoming months as distressed sales, short sales, foreclosure auctions, or as bank-owned properties. MBA estimates that this shadow inventory, composed of loans that are three or more months delinquent or already in the foreclosure process, totals approximately four million homes across the country.

MBA expects a continued slow purchase market through the end of the year with total loan originations decreasing to around $1 trillion. Beyond that, MBA projects that originations will continue to decrease to around $960 billion in 2012. Despite low volume, MBA forecasts that home prices at a national level may be able to begin to stabilize by the end of this year and show small increases in 2012. However, there is substantial risk that these ability to repay regulations as well as the credit risk retention regulations could further cut off the supply of mortgage credit decreasing the possibility of recovery.

At the same time, credit is tightening considerably in both the government and conventional mortgage markets. The following figures illustrate how average FICO scores for FHA loans and Fannie Mae loans have increased markedly.

## FHA Standards Tightening




Source: FHA

## Credit Tightening

### Fannie Mae's Acquisition Profile:

| | 2007 | 2010 |
|---|---|---|
| Average LTV | 75.5 | 66.3 |
| Average FICO | 716 | 760 |
| % with FICO > 740 | 40.1% | 73.7% |
| % Interest Only | 15.2% | 1.7% |
| % Alt-A | 16.7% | 1.1% |

These data and our modeling militate against establishing standards, including uncertain presumptions of liability, which will lessen the availability and affordability of sustainable mortgage credit and the demand for housing.

## II. Summary of MBA's Major Comments

Considering the legal liability attendant to Dodd-Frank and the profound need to facilitate the housing market and the nation's economic recovery, the following are MBA's major comments:

### A. The QM Should be Established as a Bright Line Safe Harbor Not a Rebuttable Presumption of Compliance

Having carefully considered the alternatives proposed, MBA strongly believes the QM test should be established as a bright line safe harbor to provide the strongest incentive for lenders to operate within its requirements and, at the same time, allow them to provide sustainable mortgage credit to the widest array of qualified borrowers. Such an approach will best achieve Dodd-Frank's intended purpose of ensuring safer, well-documented, well-underwritten mortgages. While MBA supports the original proposal, it would accept more requirements as long as they are part of a clear, unambiguous safe harbor.

Lenders who seek to best serve their borrowers and follow the rules should not be dogged by seemingly endless and costly litigation. The continued presence of smaller lenders serving consumers and communities should not be jeopardized by undue risk**.** A presumption of compliance, because of its relative uncertainty, will increase liability and borrower costs while lessening the availability of credit. Like the QRM, the presumption alternative would ultimately be more harmful to minorities, people with lower incomes, and first-time homebuyers. A safe harbor does not preclude a borrower from seeking relief; it simply focuses the claim on whether the requirements have been met. Considering the costs and public policy concerns attendant to the establishment of a presumption, MBA can find no purpose for choosing that alternative.

### B. The Limit on Points And Fees in the QM Proposals Requires Significant Adjustment by the CFPB to Avoid Unduly Lessening the Availability of Credit and/or Removing Beneficial Options from the Market.

First, MBA believes the points and fees limits should be established along the lines of restrictions established by the Government Sponsored Entities (GSEs) that are already in place. Second, the definition of smaller loans, where the three percent limit increases, should be revised upward to $150,000. Third, whether the customer chooses to use an affiliated provider of the lender or not for third party services, reasonable bona fide third party charges should be excluded from the calculation; the largest of these fees for title services are frequently "filed fees" over which the lender has no control and are not subject to manipulation by the affiliate. Fourth, compensation to employees of creditors and brokerages, including individual loan originator employees, should not be included in the points and fees calculation. "Double counting" of employee compensation, along with compensation to creditor and brokerage companies, is already included in points and fees and would be simply unfair. Fifth, MBA supports further exclusions in Dodd-Frank, including but not limited to certain up-front mortgage insurance premiums and up to two bona fide discount points depending on the extent of the rate reduction.

### C. A Sound QM Definition Structured as a Safe Harbor Should Serve as a Basis for the QRM Definition.

A sound safe harbor definition would serve the interests of investors as well as borrowers and invite private capital back into the market. Since the QRM and QM constructs were intended to achieve the same purpose of ensuring better, more sustainable lending, both constructs should be essentially the same. The QM proposal would increase the availability and affordability of credit for the largest number of qualified borrowers without establishing hardwired numerical limits. Considering that the QRM restrictions would exclude too many borrowers from the most affordable, sustainable loans, MBA believes the QM proposal is a much better starting point for both sets of rules.

## III. Discussion of Major Comments

A major aspect of the proposal that has received substantial attention, we believe deservedly, is whether the QM test should be established as a legal safe harbor or a rebuttable presumption of compliance with the ability to repay standard. The following section provides an overview of MBA's position, relevant background and key concerns in support of its view that a safe harbor should be provided in any final rule. MBA's view is that if a QM definition is well structured as a safe harbor, it will be the chosen means for lenders to comply and, therefore, the best way to incent the sound underwriting that Dodd-Frank seeks to ensure.

### A. Overview of Safe Harbor

Having considered the proposal carefully, MBA urges that adoption of a safe harbor with objective bright line standards as the best construct for the QM. Such an approach in MBA's view:

(1) Is clearly within power of the CFPB under TILA as amended by Dodd-Frank;

(2) Will provide the strongest incentive for lenders to operate within its requirements and at the same time offer sustainable mortgage credit to the widest array of qualified consumers;

(3) Will allow efficient and less costly litigation to determine that the safe harbor requirements have been met;

(4) Will prevent lenders who conscientiously meet the requirements of clear standards and serve borrowers from being dogged by endless and costly litigation including meritless claims that would be encouraged by anything less than a safe harbor;

(5) Will avoid saddling qualified borrowers with the costs of legal uncertainty in the form of higher interest rates and fees (which is the only way the industry will be able to support the litigation costs); and

(6) Will help maintain competition in the marketplace by reducing the burden on smaller lenders.

The rebuttable presumption of compliance, in contrast, we believe would:

(1) Lessen the use of QM as a standard and instead cause lenders to act more conservatively within the standards in many cases using QRM standards;

(2) Result in the denial of credit at a higher rate and/or or increase costs to many borrowers;

(3) Have the most serious effects on the availability and costs to credit for minority, low- to moderate-income and first-time borrowers who, though qualified, may present greater credit risks;

(4) Invite far more extensive litigation than necessary that will result in far greater costs being borne by all borrowers;

(5) Eliminate competition from the marketplace by creating a level of risk that does not support the returns from mortgage lending, and make compliance too costly for smaller lenders; and

(6) Diminish the possibility of recovery of the housing market and the nation's economy.

### 1. Background

While the proposal points out that Dodd-Frank provides special protection for creditors who make QMs, the proposal notes and says that it is "unclear" whether the protection is intended to be a safe harbor or a rebuttable presumption of compliance.[10]

The proposal notes that the law states that a creditor or assignee "may presume" that a loan has met the repayment ability requirement if the loan is a QM. The proposal also notes that this language might suggest that origination of a QM only provides a presumption of compliance which the consumer can rebut by providing evidence that the creditor did not in fact make a good faith determination of the consumer's ability to repay the loan. However, the proposal also indicates that the law does not require that a QM comply with all the underwriting criteria of the general ability to repay standard.

[10] A "safe harbor" is ordinarily defined as a provision of a statute or regulation that reduces or eliminates a party's liability under the law, on the condition that the party performs its actions in good faith in compliance with defined standards. In the context of the QM test, this would mean that if the lender complies with the requirements for a QM loan, then the lender would be protected from liability. Black's Law Dictionary 1363 (8th ed. 2004);
A "rebuttable presumption of compliance" is a provision of a statute or regulation that permits an assumption in court that a party has performed its actions in compliance with defined standards unless a party comes forward to contest it and prove otherwise. The proposal sets out certain requirements for the rebuttable presumption alternative. If all of these requirements are met, the creditor would have a presumption that the ability to repay test was met, but the consumer could still rebut this presumption. Black's Law Dictionary 1363 (8th ed. 2004);
Federal Rule of Evidence 301 defines a presumption as "impos[ing] on the party against whom it is directed the burden of going forward with evidence to rebut or meet the presumption." The proposal sets out certain requirements for the rebuttable presumption alternative. If all of these requirements are met, the creditor would have a presumption that the ability to repay test was met, but the consumer could still rebut this presumption. Fed. R. Evid. 301.

Beyond providing a statutory review, the proposal observes there "are sound policy reasons" for interpreting a QM as providing either a safe harbor or a presumption of compliance. Interpreting QM as a safe harbor

> "would provide creditors with an incentive to make qualified mortgages. That is, in exchange for limiting loan fees and features, the creditor's regulatory burden and exposure to liability would be reduced. Consumers may benefit by being provided with mortgage loans that do not have certain risky features or high costs."[11]

The proposal indicates that the only drawback of the safe harbor approach is that a creditor could not be challenged for failing to underwrite a loan based on the consumer's employment status, simultaneous loans, current debt obligations, or credit history, or for generally not making a reasonable and good faith determination of the consumer's ability to repay the loan.

However, we note that the reason these requirements need not be addressed is they are not present in the Board's safe harbor proposal itself. MBA would accept additional requirements as part of a clear and unambiguous safe harbor.

**2. CFPB Has Authority to Establish Safe Harbor and Revise the Safe Harbor Criteria**

MBA asked the law firm of Goodwin Procter to provide a legal opinion. MBA asked whether the Board's (or its successor, the CFPB's) has the requisite authority under Sections 1411, 1412 and 1414 of Dodd-Frank, to adopt a rule giving a creditor a safe harbor instead of a rebuttable presumption, particularly in light of the ambiguities in the statute and the legislative history of the requirements.

The legal opinion provided by Goodwin Procter is attached to these comments as an exhibit along with a memorandum also attached as an exhibit from Thomas Hefferon, a partner in the firm and an experienced consumer credit litigator with substantial experience in mortgage cases.

The Goodwin Procter opinion concludes that the Board, pursuant to its authority under Section 105(a) of TILA,[12] has the authority to adopt the safe harbor alternative in the final rule. It also says that the Board may, consistent with the provisions of TILA Section 129C(b)(3)(B), make a finding that a safe harbor is an appropriate mechanism to ensure continued availability of responsible mortgage loans.

The Board apparently reached a similar conclusion that it was authorized to propose a safe harbor. It identified its legal authority under TILA, Section 105(a), which directs the Board to carry out the law's purposes. In addition, the Board noted that Section 105(a), specifically authorizes the Board to issue regulations that may contain additional requirements or provide adjustments that in the Board's judgment are necessary to effectuate the purposes of TILA, facilitate compliance with the law, or prevent circumvention or evasion. This language gives the Board broad authority under the law and thus, pursuant to this authority, the Board may adopt the safe harbor alternative in the final rule.

---

[11] 76 Fed. Reg. 27390, 27396 (May 11, 2011).
[12] 15 U.S.C. §§ 1601 *et seq.* ("TILA").

As the Goodwin Procter opinion notes, Section 129C(b)(3)(B) of TILA also provides the Board specific authority to revise the criteria that define a qualified mortgage. This section grants the Board the power to "prescribe regulations that revise, add to, or subtract from the criteria that define a qualified mortgage upon a finding that such regulations are necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers."

Therefore, the Board has both the general authority under TILA Section 105(a) and specific authority under Section 129C(b)(3)(B) to ensure the continued availability of responsible mortgage credit and thus it is within their discretion to adopt a safe harbor versus a rebuttable presumption to ensure compliance under the law.

**3. QM should be established as a Bright Line Safe Harbor Rather than a Rebuttable Presumption as a Legal Matter.**

Based on the memorandum from Mr. Hefferon of Goodwin Procter and his colleagues, Lynne B. Barr and Sallie F. Pullman, and its understanding of the proposal, MBA believes the differences between a safe harbor and a rebuttable presumption strongly militate in favor of the CFPB establishing a safe harbor with bright lines to best ensure that the definition achieves its intended purposes. The memorandum states in part:

> "Generally speaking, safe harbors are different from rebuttable presumptions in how each is applied and in how courts judge compliance with either. A safe harbor is "a provision (as in a statute or regulation) that affords protection from liability or penalty."[13] Safe harbors typically describe a single standard or a multi-factor test which, if complied with, provide some sort of exemption from liability or conclusion of statutory compliance. If a transaction fits within the four corners of a safe harbor, the regulated entity enjoys that protection. As such, safe harbors provide a certain level of predictability.
>
> In a litigation context, the advantages of a safe harbor are magnified because the stated standard or factors are, by definition, the only standard or factors that a court can consider in judging its application. This means that a litigant seeking to establish that a safe harbor applies, or seeking to establish that it does not, can be certain that no standards or factors other than those stated are relevant. While there will be litigation over whether the standard or factors are met, the nature of safe harbors limits the scope of litigation and so can help preserve judicial and party resources and lead to a relatively early resolution of litigation.
>
> A test for liability or an exemption that is governed by a presumption that is rebuttable operates differently than a safe harbor, though many presumptions share the feature safe harbors have of being based on a single standard or multi-factor test. The

---

[13] Black's Law Dictionary 1363 (8th ed. 2004); *see also Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V.*, Nos. 09–5122–bk (L), 09–5142–bk (Con), 2011 WL 2536101, at *7 (2d Cir. June 28, 2011) (noting that a proposed reading of a securities regulation implementing a statutory safe harbor "would make application of the safe harbor in every case depend on a factual determination regarding the commonness of a given transaction" and that "[t]his reading of the statute would result in commercial uncertainty and unpredictability at odds with the safe harbor's purpose and in an area of law where certainty and predictability are at a premium."); *Williams v. OSI Educational Services, Inc.*, 505 F.3d 675, 680 (7th Cir. 2007) (noting that judicially-created safe harbor "was offered in an attempt both to bring predictability to this area and to conserve judicial resources").

difference is that, unlike a safe harbor, a rebuttable presumption typically allows for the introduction of evidence and argument about standards or factors that are not listed in the statute or regulation. So, while a regulated entity could establish that under the stated test its conduct meets the presumption, and so complies with law or triggers an exemption, another party such as a regulator or court could attempt to show that the presumption should be overridden by reference to some other set of facts, additional evidence, relevant policy considerations, or the like (depending on the statutory context). This leads to a certain level of unpredictability, particularly where the elements of the presumption are not exhaustive of the possible facts or circumstances that possibly are relevant.

In litigation, rebuttable presumptions are just that – rebuttable. Under evidence principles, proof that the presumption applies "imposes on the party against whom it is directed the burden of going forward with evidence to rebut or meet the presumption." Fed. R. Evid. 301. [14] Once that party rebuts or meets the presumption, the fact there was initial proof the presumption applied is not supposed to have any effect on the burden of persuasion as to ultimate liability. Fed. R. Evid. 301, advisory committee's notes. Moreover, in the case of a classic rebuttable presumption, there often are no specific limitations about what sort of factual issues or evidence can be used to rebut the presumption. Thus, by definition, the scope of inquiry for a rebuttable presumption is more open-ended and unpredictable than that for a safe harbor."

**4. A Safe Harbor Offers a More Efficient Means of Resolving Claims**

MBA requested that counsel consider the efficiency of safe harbor litigation as compared to litigation regarding a rebuttable presumption.

To evaluate how a safe harbor or rebuttable presumption might work here in practice, Mr. Hefferon's memorandum reviewed safe harbor and rebuttable presumption cases arising under two existing TILA provisions as examples. It found courts ruling on the application of a strict safe harbor provision have been able to resolve matters at early stages of litigation, for either party, often through a motion to dismiss, rather than after lengthy and costly discovery periods. Out of 24 decisions, reported and unreported, concerning TILA Section 130(f) following *Milhollin*, the safe harbor issue was resolved in 17 cases at the motion to dismiss or preliminary injunction state, while six cases went on to summary judgment, and only one case went to trial.

On the other hand, in reviewing 59 decisions, reported and unreported during the last five years, applying the presumption in TILA Section 125(c) for compliance with the requirement of providing the borrower a Notice to Cancel, only seven cases were resolved at the motion to dismiss stage (and five of those cases were resolved on other grounds), while 17 cases went on to be resolved at summary judgment, and the remaining 35 cases went on to be set for trial.

[14] Wright & Miller describes Rule 301 by saying that "[p]resumptions governed by this rule are given the effect of placing upon the opposing party the burden of establishing the nonexistence of the presumed fact, once the party invoking the presumption establishes the basic facts giving rise to it." 21B Charles Alan Wright & Arthur R. Miller et al., Fed. Practice and Proc. at Evid. R. 301 (interim ed. 2011). It goes on to state that "[a] presumption is a deduction which the law expressly directs to be made from particular facts." *Id.* at § 5124 (quoting N.Y. Comm'rs on Practice and Procedure, Code of Civ. P. § 1776 (1850)); *see also ITC, Ltd. v. Punchgini*, 482 F.3d 135, 147 (2d Cir. 2007) ("A presumption is an assumption of fact resulting from a rule of law which requires such fact to be assumed from another fact or group of facts found or otherwise established in the action.").

Their research suggested that litigation involving a rebuttable presumption can present two challenges that did not regularly appear in litigation involving a safe harbor. First, there has been uncertainty in the former types of cases as to which facts or evidence might be sufficient to rebut the presumption. Second, the interplay of the presumption and the additional facts appears to lead more often to litigation that does not terminate prior to or at the time of summary judgment.

As a general matter, litigation that is resolved at the motion to dismiss stage, without taking into account any appeal process, is less expensive for both parties than litigation that proceeds to summary judgment or trial. In order to proceed to summary judgment or trial, the parties must conduct fact-finding discovery, including but not limited to, exchanging document requests and interrogatories and conducting depositions.

There are many courts that have determined that a borrower's assertion of noncompliance alone creates a question of fact to be resolved at trial under a rebuttable presumption standard. *See*, *e.g. Stutzka v. McCarville*, 420 F.3d 757, 762 (8th Cir. 2005) ("Because [plaintiff]'s affidavit, at the very least, would have rebutted the presumption of delivery, the district court also erred in granting summary judgment on the TILA claims.").[15] But, illustrative of the general uncertainty created by a rebuttable presumption, some courts have determined that a borrower's assertion of noncompliance alone is insufficient to resolve the presumption in the borrower's favor. *See e.g.*, *McCarthy v. Option One Mortg. Corp.*, 362 F.3d 1008, 1011 (7th Cir. 2004) (affirming summary judgment in the creditor's favor because mere assertion of non-receipt is insufficient to rebut written evidence that disclosures were provided).[16]

Notably, none of these cases cited above concerning the necessary proof to rebut a presumption were resolved until the summary judgment stage or trial. Litigation that is resolved at the motion to dismiss stage, without taking into account any appeal process, is less expensive for both parties than litigation that proceeds to summary judgment or trial. In order to proceed to summary judgment or trial, the parties must conduct fact-finding discovery, including but not limited to, exchanging document requests and interrogatories and conducting depositions. Moreover, trial preparation can also be costly and time-consuming. The additional issues involved in proceeding to summary judgment or trial are likely to result in greater expense and attorneys fees for both parties regardless of the outcome of the litigation, than litigation that is resolved at the motion to dismiss stage.

[15] *See also Rodrigues v. Newport Lending Corp.*, No. 10-00029 HG-LEK, 2010 WL 4960065, at *6 (D. Haw. Nov. 29, 2010) (denying summary judgment based on plaintiff's denial of receipt of disclosures); *Briggs v. Provident Bank*, 349 F. Supp. 2d 1124, 1129 (N.D. Ill. 2004) (denying summary judgment based on claimant's deposition testimony concerning receipt of disclosures); *Macheda v. Household Fin. Realty Corp.*, 631 F. Supp. 2d 181, 191 (N.D.N.Y. 2008) (denying cross-summary judgment motions based on borrower's offer of proof to rebut presumption of delivery); *Jobe v. Argent Mortg. Co., LLC*, No. 3:cv-06-0697, 2008 WL 450432, at *4-5 (M.D. Pa. Feb. 15, 2008) (denying summary judgment based on plaintiffs' sworn statements that they were not each given two copies of the required notice); *Cooper v. First Gov't Mortg. & Investors Corp.*, 238 F. Supp. 2d 50, 64-65 (D.D.C. 2002) (same); *Hanlin v. Ohio Builders & Remodelers, Inc.*, 212 F. Supp. 2d 752, 762 (S.D. Ohio 2002) (same).

[16] *See also Williams v. GM Mortg. Corp.*, No. 03-cv-74788-DT, 2004 WL 3704081, at *8 (E.D. Mich. Aug. 18, 2004) (resolving summary judgment in the creditor's favor because "a Plaintiff's bare bones, self-serving denial is not sufficient to rebut § 1635(c)'s statutory presumption"); *Parker v. Long Beach Mortg. Co.*, 534 F. Supp. 2d 528, 536-37 (E.D. Pa. 2008) (finding plaintiffs failed to rebut presumption as part of post-trial Rule 52(c) judgment as a matter of law, when plaintiffs' only evidence offered to rebut presumption was testimony that they did not remember receiving disclosures).

Moreover, trial preparation can be costly and time-consuming. The additional issues involved in proceeding to summary judgment or trial are likely to result in greater expense and attorneys fees for both parties regardless of the outcome of the litigation, than litigation that is resolved at the motion to dismiss stage.

Based on the review of the application of both the safe harbor in TILA Section 130(f) and the rebuttable presumption in TILA Section 125(c), it appears reasonable to conclude that employing a safe harbor standard for a QM in the final rule is likely to lead to litigation that is more efficiently resolved than if a rebuttable presumption standard was adopted.

**5. A Safe Harbor Will Result in the Qualification of More Borrowers**

Lawmakers and regulators often include safe harbor provisions to incentivize the adoption of desirable practices. MBA agrees with the Board that a safe harbor would encourage the implementation of the QM requirements while providing loans to a broader range of qualified borrowers.

A clear safe harbor will allow lenders to qualify borrowers right up to the limits of a QM safe harbor. Conversely, as a result of the threat of litigation, some lenders will act more conservatively than is necessary to meet a presumption's standards, not extending credit to borrowers who might otherwise qualify.

There is real concern that some lenders may gravitate to only originating loans meeting QRM requirements because that subset of loans will be regarded as less risky and retain salability without risk retention.[17] Other lenders may choose to offer loans to borrowers who do not meet the QRM requirements at much higher costs.

**6. QM Should Be Established as a Safe Harbor Because of the Low Volumes of HOEPA and Higher Priced Loans**

If the QM is established in a manner that causes uncertain liability, MBA is concerned that many loans simply will not be available.

High cost loans bearing HOEPA liability have comprised only one-tenth of one percent of loans for the years 2004-2009.[18]

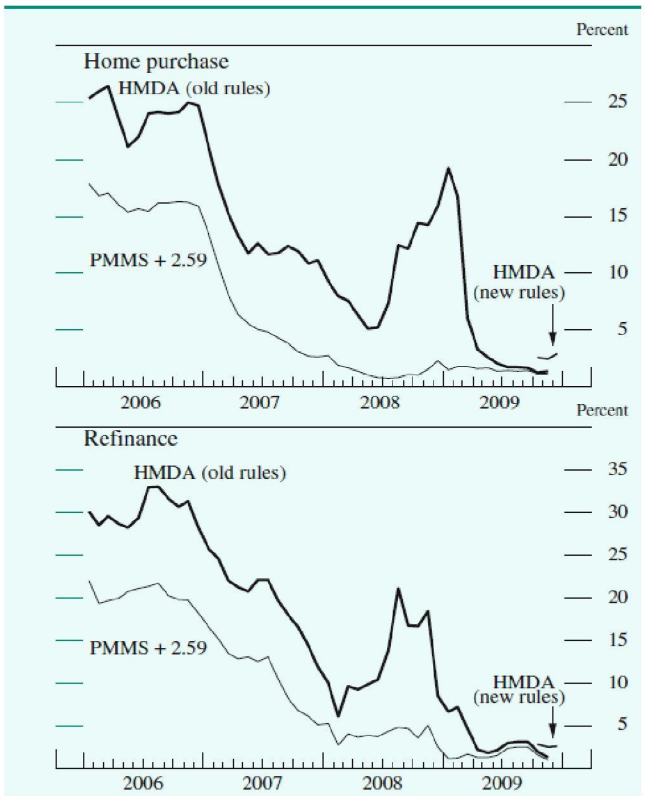
In July 2008, the Board issued new HOEPA rules[19] requiring lenders to assess a consumer's ability to repay and establishing restrictions on prepayment penalties for higher-priced mortgage loans (HPMLs) as distinguished from high cost loans. Notably, the final rule, which went into effect in October 2009, established a rebuttable presumption of compliance for verifying a consumer's ability to repay HPMLs.

The graph below shows a significant drop in HPML originations of both purchase and refinance HPMLs before the new rules went into effect.

---

[17] As noted under the current QRM proposal, loans purchased and securitized by the GSEs are not subject to risk retention while the GSEs are in conservatorship, however, this provision is not permanent.
[18] MBA Analysis of HMDA Data, 2011.
[19] 76, Fed. Reg. 27392 (May 11, 2011).

4. Higher-priced share of lending, by annual percentage rate threshold, 2006–09




NOTE: The data are monthly. Loans are first-lien mortgages for site-built properties and exclude business loans. Annual percentage rates are for conventional 30-year fixed-rate prime mortgages. For explanations of old and new pricing rules, see text.
PMMS Freddie Mac Primary Mortgage Market Survey.
HMDA Home Mortgage Disclosure Act.

New Home Mortgage Disclosure Act (HMDA) data on HPML lending should be available in September of this year. MBA urges the CFPB to consider this new data in conjunction with the establishment of a safe harbor.

### 7. Safe Harbor Should be Employed to Minimize Disparate Impact

The CFPB should adopt the safe harbor to lessen disparate impact on minorities and low- and moderate-income families. As indicated, it is quite possible that were a rebuttable presumption adopted some lenders will manage their risk by acting more conservatively and originating loans only to those borrowers with higher down payments, far lower DTIs and greater income or assets.

Borrowers who cannot afford higher down payments, have higher DTIs and less income and are likely to be disproportionately minority and moderate-income borrowers. A clear safe harbor would allow lenders, when necessary, to go to the boundaries of the QM construct in qualifying borrowers making more loans available to communities of color and low- and moderate-income borrowers.

### 8. Construction of Safe Harbor

MBA would support a safe harbor along the lines proposed by the Board, with certain adjustments to the points and fees calculation. In fact, MBA would support even more requirements as long as the standards were part of a clear safe harbor.

Such standards might include the standards proposed to satisfy the general ability to repay standard and the presumption of compliance in addition to proposed safe harbor requirements.

We note, however, how a safe harbor is constructed is as important as the establishment of a safe harbor itself. For a safe harbor to be effective, both to guide behavior and to efficiently resolve cases in court, it must be comprised of bright line standards, the performance of which can be evidenced by the four corners of mortgage and mortgage-related documents. A mortgage agreement, for example, could demonstrate that it does not include prohibited product features. A manual checklist and calculation sheet based on reliable third party standards or output from a recognized automated system(s) could demonstrate that underwriting standards have been followed.

The Memorandum from Mr. Hefferon summarizes:

> "Additionally, you have asked about our views concerning what types of standards could be included in a safe harbor such that it would likely maximize the advantages to such a structure. This is not a matter of legal judgment, but it seems that, based on the above discussion and in our experience, a safe harbor that contains definite, objective factors is more likely to serve the goals of certainty and predictability. In addition, a safe harbor that delineates the type of evidence that establishes the safe harbor may be even stronger. So, for example, if proof of a qualified mortgage safe harbor requires a demonstration that employment has been verified, the safe harbor would be stronger to the extent it specifically identified a conclusively-acceptable method of making such a verification."

An expanded safe harbor proposal could include the requirements in the proposal for the QM safe harbor and may include requirements from both the ability to repay requirements and the proposed presumption as long as they were in the form of clear and unambiguous objective standards. Notably, the proposal would require that the CFPB prescribe specific documentation requirements such as a written application signed by the borrower and evidence of written and/or automated records; creditor or assignee's worksheets; as well as evidence of use of a widely accepted standards such as FHA or GSE guides; and/or evidence of use of third-party automated systems, as appropriate, such as DU® or LP®.

Importantly, the acceptability of such a proposal turns on whether it is constructed with definite unambiguous factors such as consideration of two tax forms, a merged credit report, and records of assets. The safe harbor must also prescribe exactly which extrinsic guides or automated systems may be employed. MBA believes industry and stakeholders should work together with the CFPB on the specific requirements for the safe harbor to assure that they are practical, clear, and can be implemented.

### 9. Consumers Can Seek Relief Under a Safe Harbor

A common misconception is that a safe harbor prevents consumers from seeking relief. A safe harbor, in fact, allows focused litigation concerning whether the safe harbor requirements were met. If a consumer can show the requirements were not met, relief will be granted.

In MBA's request to Mr. Hefferon we asked whether having a safe harbor standard, in itself, will limit a borrower's ability to bring litigation challenging whether the standard was met.

The memorandum says,

> "Simply providing a regulatory safe harbor will not limit a borrower's ability to bring a lawsuit to dispute that the standard or the factors that trigger the standard were met by the creditor (within the constraints, of course, that such a dispute requires a good faith basis). While such a dispute might be resolved quickly, that does not necessarily mean that one party or the other would prevail."

The memorandum also pointed out that a safe harbor standard could be structured to put the burden on the creditor to demonstrate that its actions met the standard or the factors listed in the safe harbor. To the extent that is the case, the mere existence of the safe harbor does not disadvantage a borrower for the further reason that the borrower would not have to prove non-compliance with Section 129C to show the safe harbor was not available.

### 10. Adoption of a Safe Harbor Will Do Much to Return Private Investment to the Mortgage Market and a Rebuttable Presumption Will Do Little

A bright line safe harbor will do much to return private capital to the market. Conversely, investors are unlikely to invest in securities unless they can be assured that they are backed by loans that meet clear and unambiguous safe harbor requirements. MBA would urge that the return of private investment cannot be expected if standards are far less certain and left to courts to define.

## B. Points and Fees Limits in QM Proposal Requires Significant Revision

In general, the rule limits points and fees to three percent, but includes adjustments for loans below $75,000 and up to a five percent limit for loans below $20,000. The proposal offers alternative formulae for applying these adjustments. Alternative A would apply the limits based on tiers of loan amounts; for loans above $75,000 the limit is three percent ranging to five percent for loans under $20,000. Alternative B offers a precise mathematical formula for the points and fees limit based on loan amount.

The proposal also would revise the definition of "points and fees" in Regulation Z Section 226.32(b)(1) to conform to the amendments of the term under Dodd-Frank.[20] As amended, the term points and fees includes: (1) certain up-front mortgage insurance premiums in excess of the amount payable under FHA provisions; (2) all compensation paid directly or indirectly by a consumer or creditor to a loan originator including the compensation paid to employees of originators or creditors; and (3) the prepayment penalty on the covered transaction, or on the existing loan if it is refinanced by the same creditor.

[20] Section 1431 (c) (1) of Dodd Frank amended section 103(aa)(4) of TILA.

The proposal excepts from the calculation of points and fees: (1) any bona fide third party charge not retained by the creditor, loan originator or an affiliate of either; and (2) certain bona fide discount points. Points and fees also include compensation paid directly or indirectly by a consumer or creditor to a mortgage originator including lenders and mortgage brokers as well as originator employees.

MBA believes the CFPB should exercise its authority to adjust the requirements in the safe harbor limiting the points and fees for QM loans to avoid impairing the availability of credit to borrowers including those who require smaller loans. MBA believes there are several reasons why adjustment is warranted and several approaches to adjusting the limit.

**1. There are No Data that Further Restrictions on Closing Costs are Necessary**

MBA opposes excessive points and fees as unfair to borrowers and unnecessarily increasing loan costs. However, it knows of no data evidencing that points and fees have affected borrowers' ability to repay their loans. Notwithstanding, that points and fees are misplaced in the QM requirements, the limits proposed are far too narrow and risk lessening the availability of credit and depriving borrowers of reasonable closing cost options.

**2. The QM Safe Harbor Should Adopt Points and Fees Restrictions Along the Lines of Those Currently in Place**

For several years, the industry has functioned and borrowers have been protected under limits established by the GSEs, Fannie Mae and Freddie Mac, in their seller/servicer guides.[21] The Fannie Mae restrictions, which are substantially similar to the Freddie Mac restrictions, provide that "Fannie Mae will not purchase or securitize mortgages if the total points and fees charged to the borrower exceed the greater of five percent of the mortgage amount or $1,000 regardless of the party paying the fee."

Points and fees counted against the limitation include origination fees, underwriting fees, broker fees, finder's fees and other charges imposed by lenders as a condition of making the loan whether they are paid by the lender or a third party.

These limits explicitly exclude fees (essentially to third parties other than the lender) paid for actual services rendered in connection with origination of a mortgage such as attorneys' fees, notary's fees, and fees paid for property appraisals, credit reports, surveys, title examinations and extracts, flood and tax certifications, and home inspections, the costs of mortgage insurance, the costs of title hazard and flood insurance policies, state and local transfer taxes or fees, and escrow deposits for the future payment of taxes and insurance premiums.

The GSE standards are appropriately directed at lender charges and draw bright lines between such fees and third party charges and better accommodate smaller loan values. Considering that the GSE limits are an in-place market standard, MBA urges the Board to use its authority to adjust the safe harbor to align its restrictions with these existing standards instead of establishing a new three percent cap on points and fees for QM loans.

[21] Fannie Mae (B2-1.4-01 Fannie Mae Seller/Servicer Guide) and Freddie Mac (Freddie Mac Section 22.32 Seller/Servicer Guide).

While MBA supports use of the GSE standards, it notes that the current numerical limit of five percent may be unworkable. Under Dodd-Frank, the HOEPA points and fees limit is lowered to five percent of the loan amount. MBA supports implementing the GSE standards in rules, however, there must be a margin of error between any new limits and the HOEPA limits. We would suggest that the CFPB consider implementing a 4.5 percent limit applying the GSE standards. To make such a limit workable, it is important that affiliate fees and loan originator compensation be excluded.

3. **The Three Percent Limit Is Not a Realistic Approach and Risks Lessening the Availability of Credit**

The chart below includes data submitted by a large MBA member with an affiliated title company. It shows the potential effects of a three percent limit on loan amounts ranging from loans at $100,000 or under to $417,000 in each state.

These data show that if the limit were set at three percent of loan amount and affiliated title insurance, loan originator compensation and appraisal fees were included, with discount points excluded as the rule proposes, the great majority of loans up to $100,000 would not meet the points and fees requirements. Moreover, high proportions of loans in virtually every state from $100,001 to $150,000 would not meet the limits. If, however, the cap were raised to $150,000 less than ten percent of loans in nearly all of the states would fail to meet the limits.

## Comparison of QM Costs to a 3% Rule

**Title Included, Points Excluded, Compensation Included, Appraisal Included**

**Conventional Loans**

| | A | B | C | D | E | F | G | H | I | J | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | $100,000 and below | $100,001-$150,000 | $150,001-$200,000 | $200,001-$250,000 | $250,001 - $300,000 | $300,001-$350,000 | $350,001 - $417,000 | Greater than $417,000 | Total | |
| 1 | AK | 64.29% | 16.85% | 5.70% | 2.65% | 2.41% | 2.08% | 2.17% | 0.00% | 7.99% | 1 |
| 2 | AL | 81.83% | 25.96% | 6.35% | 1.89% | 2.34% | 1.52% | 0.00% | 0.00% | 27.04% | 2 |
| 3 | AR | 79.60% | 24.36% | 4.12% | 3.09% | 0.93% | 6.25% | 0.00% | | 30.31% | 3 |
| 4 | AZ | 86.41% | 43.25% | 9.23% | 1.84% | 3.07% | 1.15% | 0.29% | 0.00% | 24.65% | 4 |
| 5 | CA | 77.87% | 26.73% | 6.62% | 2.57% | 1.95% | 1.41% | 0.74% | 0.41% | 8.26% | 5 |
| 6 | CO | 91.58% | 39.19% | 4.98% | 1.68% | 0.00% | 0.00% | 0.87% | 0.00% | 13.51% | 6 |
| 7 | CT | 59.72% | 12.28% | 3.57% | 1.39% | 0.61% | 0.00% | 0.00% | 0.00% | 6.97% | 7 |
| 8 | DC | 72.73% | 12.50% | 8.00% | 1.16% | 0.00% | 0.00% | 0.00% | 0.00% | 3.15% | 8 |
| 9 | DE | 87.25% | 30.00% | 8.27% | 3.57% | 0.00% | 0.00% | 2.60% | 0.00% | 16.98% | 9 |
| 10 | FL | 84.46% | 31.10% | 5.34% | 2.69% | 1.39% | 1.13% | 0.00% | 0.00% | 24.38% | 10 |
| 11 | GA | 83.30% | 28.10% | 3.93% | 1.74% | 2.10% | 0.70% | 0.00% | 0.00% | 22.53% | 11 |
| 12 | HI | 70.00% | 30.77% | 5.68% | 0.82% | 2.88% | 0.89% | 1.69% | 0.72% | 6.12% | 12 |
| 13 | IA | 54.36% | 5.15% | 2.00% | 0.00% | 0.00% | 0.00% | 0.00% | | 16.94% | 13 |
| 14 | ID | 64.08% | 15.45% | 4.71% | 2.99% | 1.47% | 0.00% | 0.00% | 0.00% | 14.32% | 14 |
| 15 | IL | 74.51% | 20.19% | 1.79% | 0.65% | 0.51% | 0.00% | 0.00% | 0.00% | 16.74% | 15 |
| 16 | IN | 74.87% | 20.14% | 5.71% | 2.44% | 0.72% | 0.00% | 1.06% | 0.00% | 26.93% | 16 |
| 17 | KS | 76.40% | 23.79% | 3.61% | 1.27% | 0.00% | 0.00% | 0.00% | 0.00% | 26.97% | 17 |
| 18 | KY | 74.92% | 17.34% | 1.58% | 0.00% | 0.00% | 0.00% | 0.00% | | 21.96% | 18 |
| 19 | LA | 92.12% | 45.36% | 10.80% | 3.32% | 2.56% | 1.41% | 1.25% | 0.00% | 35.65% | 19 |
| 20 | MA | 75.09% | 20.39% | 5.26% | 2.68% | 1.00% | 1.04% | 0.15% | 0.00% | 8.12% | 20 |
| 21 | MD | 74.32% | 17.57% | 3.62% | 2.04% | 0.53% | 0.35% | 0.66% | 0.00% | 8.10% | 21 |
| 22 | ME | 70.55% | 19.45% | 6.79% | 0.62% | 0.00% | 0.00% | 0.00% | | 17.28% | 22 |
| 23 | MI | 72.39% | 17.11% | 2.74% | 1.04% | 0.57% | 0.31% | 0.26% | 0.00% | 17.11% | 23 |
| 24 | MN | 78.63% | 23.53% | 2.29% | 1.17% | 0.00% | 0.00% | 0.00% | 0.00% | 15.91% | 24 |
| 25 | MO | 63.78% | 13.01% | 4.43% | 1.90% | 0.64% | 1.37% | 0.00% | | 22.31% | 25 |
| 26 | MS | 81.27% | 27.93% | 4.51% | 3.76% | 3.08% | 3.23% | 0.00% | | 31.39% | 26 |
| 27 | MT | 93.00% | 52.27% | 9.31% | 5.41% | 2.38% | 0.00% | 0.00% | 0.00% | 27.79% | 27 |
| 28 | NC | 35.16% | 6.76% | 2.22% | 0.31% | 0.17% | 1.20% | 0.00% | 0.00% | 9.02% | 28 |
| 29 | ND | 59.70% | 14.29% | 7.32% | 4.76% | 0.00% | 0.00% | 16.67% | | 25.70% | 29 |
| 30 | NE | 74.59% | 22.81% | 6.02% | 0.00% | 0.00% | 5.56% | 5.56% | | 29.59% | 30 |
| 31 | NH | 75.00% | 20.96% | 8.37% | 2.07% | 1.10% | 0.00% | 0.00% | 0.00% | 12.75% | 31 |
| 32 | NJ | 62.86% | 7.42% | 1.51% | 0.41% | 0.21% | 0.22% | 0.09% | 0.00% | 5.13% | 32 |
| 33 | NM | 70.51% | 17.46% | 2.01% | 0.46% | 0.66% | 0.00% | 0.00% | | 15.68% | 33 |
| 34 | NV | 86.22% | 32.29% | 7.43% | 2.83% | 1.85% | 1.74% | 0.00% | 0.00% | 19.27% | 34 |
| 35 | NY | 85.70% | 31.80% | 5.59% | 3.18% | 1.64% | 2.10% | 0.79% | 1.02% | 17.46% | 35 |
| 36 | OH | 83.01% | 34.98% | 5.40% | 1.99% | 0.26% | 1.02% | 0.00% | 0.00% | 28.54% | 36 |
| 37 | OK | 65.48% | 16.90% | 1.46% | 1.19% | 2.38% | 0.00% | 2.13% | 0.00% | 24.37% | 37 |
| 38 | OR | 58.76% | 18.38% | 3.98% | 2.18% | 1.22% | 1.38% | 0.62% | 0.00% | 10.81% | 38 |
| 39 | PA | 88.18% | 41.95% | 9.92% | 3.03% | 2.42% | 3.06% | 0.57% | 0.00% | 26.50% | 39 |
| 40 | RI | 47.92% | 9.85% | 2.12% | 1.57% | 1.90% | 1.52% | 1.43% | 0.00% | 5.81% | 40 |
| 41 | SC | 83.83% | 29.87% | 6.70% | 2.39% | 0.80% | 1.26% | 3.14% | 0.00% | 24.42% | 41 |
| 42 | SD | 68.85% | 23.47% | 6.10% | 3.70% | 0.00% | 16.67% | 0.00% | | 23.30% | 42 |
| 43 | TN | 74.67% | 24.59% | 4.51% | 0.74% | 0.73% | 0.00% | 0.65% | 0.00% | 23.02% | 43 |
| 44 | TX | 57.88% | 23.24% | 5.41% | 2.34% | 0.72% | 0.94% | 0.38% | 0.00% | 20.81% | 44 |
| 45 | UT | 89.04% | 40.15% | 7.88% | 2.04% | 1.28% | 0.00% | 0.00% | 0.00% | 18.49% | 45 |
| 46 | VA | 78.57% | 25.88% | 6.74% | 2.24% | 0.96% | 0.55% | 0.40% | 0.00% | 11.43% | 46 |
| 47 | VT | 75.96% | 30.74% | 9.77% | 3.50% | 2.67% | 0.00% | 0.00% | 0.00% | 20.07% | 47 |
| 48 | WA | 67.07% | 16.23% | 5.25% | 1.90% | 1.75% | 0.78% | 0.40% | 0.00% | 9.13% | 48 |
| 49 | WI | 77.01% | 21.15% | 3.25% | 1.18% | 0.00% | 0.00% | 0.00% | 0.00% | 19.03% | 49 |
| 50 | WV | 82.09% | 35.23% | 9.09% | 3.42% | 1.67% | 2.63% | 0.00% | | 34.71% | 50 |
| 51 | WY | 74.42% | 21.15% | 6.72% | 4.35% | 0.00% | 0.00% | 0.00% | 0.00% | 18.71% | 51 |
| 52 | Total | 73.39% | 24.49% | 5.24% | 1.98% | 1.17% | 0.99% | 0.49% | 0.30% | 16.64% | 52 |

Data from another lender shows similar results using slightly different assumptions. This lender reviewed a sample of loans with fees charged for actual and necessary settlement services performed by affiliated providers during a recent one-month period. The collateral properties were located in one of three states. Of the 557 loans in the sample, forty-one percent could not comply with the cap imposed under Alternative 1 of the proposed rule. However, if the small loan limit is raised to $150,000, less than ten percent of these loans would exceed the cap. MBA would welcome an opportunity to share these data with the CFPB. They make clear that establishing a three percent limit with the ingredients proposed is far too narrow. Considering that these fees reflect real costs, MBA is concerned that establishing these limits will unduly restrict the availability of credit.

**4. The Small Loan Thresholds Should Be Reset**

As indicated, the above chart makes clear that the three percent limit is completely unworkable for most loans under $100,000 and for many between $100,000 and $150,000.

MBA data also shows that only 12 percent of purchase loans and ten percent of refinances are currently under $75,000.

***Distribution of Loan Sizes from MBA's Weekly Application Survey: First Half of 2011***

| purpose | LoanBalance | Share |
|---|---|---|
| Purchase | <=75K | 12.0% |
| Purchase | >75K and<=100k | 10.6% |
| Purchase | >100K and<=125k | 10.2% |
| Purchase | >125K and<=150k | 10.7% |
| Purchase | >150K and<=175k | 8.7% |
| Purchase | >175K and<=200k | 8.2% |
| Purchase | >200K and<=250k | 11.1% |
| Purchase | >250K and<=300k | 8.2% |
| Purchase | >300K and<=417k | 12.7% |
| Purchase | >417K | 7.7% |

| purpose | LoanBalance | Share |
|---|---|---|
| Refi | <=75K | 10.1% |
| Refi | >75K and<=100k | 11.9% |
| Refi | >100K and<=125k | 11.9% |
| Refi | >125K and<=150k | 11.5% |
| Refi | >150K and<=175k | 9.5% |
| Refi | >175K and<=200k | 8.2% |
| Refi | >200K and<=250k | 11.6% |
| Refi | >250K and<=300k | 8.2% |
| Refi | >300K and<=417k | 11.8% |
| Refi | >417K | 5.2% |

MBA believes that when combining these data and the severe limitations on points and fees proposed even with an adjustment to five percent limit for smaller loans, it is unlikely that many smaller loans will be made or that many will qualify as a QM and be affordable. MBA would suggest that this is an issue where discussions with stakeholders would be warranted to determine how best to incentivize smaller loans.

### 5. The Three Percent Limit Invites Litigation

As indicated, the Board's proposed limit on points and fees is not only narrower than the current industry standard but it includes more requirements. While MBA recognizes that the proposal seeks to implement amendments to Dodd-Frank that changed the points and fees definition,[22] it urges the CFPB to exercise its authority under Dodd-Frank to revise the criteria for the QM to come up with a far simpler formulation. The CFPB might also consider changes to the points and fees limit under HOEPA to simplify matters and assure that the QM limit does not bump up against that limit.

As the Board itself recognized in 2009, in its proposed rule to simplify the calculation of the Annual Percentage Rate (APR), the APR was so complicated that it invited compliance difficulties and litigation. The calculation of points and fees as proposed presents similar concerns.

Proposed § 226.32(b)(1)(i) would revise the current rules to include in points and fees: (1) all items considered to be a finance charge under § 226.4(a) and 226.4(b), except interest or the time-price differential; (2) any premium or charge for any guarantee or insurance protecting the creditor against the consumer's default or other credit loss to the extent that the premium or charge is assessed in connection with any Federal or state agency program; not in excess of the amount payable under policies in effect at the time of origination under Section 203(c)(2)(A) of the National Housing Act (12 U.S.C. 1709(c)(2)(A)); and (3) prepayment penalties.

Points and fees would also: (1) include third party fees but not fees of companies that are paid to creditors or their affiliates; and (2) include payments to creditors, brokerages and employee originators (including bonuses and other compensation); while excluding up to two bona fide discount points.

Merely keeping track of which fees are included, and which are not, will present very significant compliance burdens, greater litigation risk, lessen credit availability and ultimately increase consumer costs. Wholesale lenders and loan purchasers will also face difficulties in determining whether the third parties used by a broker or creditor were affiliates and what, if any, compensation to employees was included.

### 6. Affiliate Fees Should be Excluded from the Points and Fees Limit

As indicated, the rule would only exclude from the points and fees calculation bona fide third party charges that are not retained by the originator, creditor or an affiliate of the originator or creditor under both the proposed rebuttable presumption and the proposed safe harbor.[23] MBA opposes the exclusion of charges paid to affiliates for several reasons.

The Real Estate Settlement Procedures Act (RESPA), as amended by Congress in 1983, explicitly permits affiliated business arrangements and excepts them from RESPA's restrictions

[22] Dodd-Frank Section 1412 (adding TILA Section 129C(b)(2)(C).
[23] 76 Fed. Reg. 27396 (May 11, 2011).

under Section 8's prohibitions against kickbacks and referral fees so long as certain consumer protection and other requirements are satisfied.[24] These protections include a prohibition against requiring the use of an affiliated settlement service provider, a disclosure to the consumer at the time of any referral of the business relationship, and a limitation that the only thing of value received in the arrangement be a return on ownership interest.[25] These requirements help ensure that consumers have choices and are not simply referred to affiliates for compensation.

Moreover, third party fees are set by factors largely outside the creditors' control whether or not they are provided by an affiliate. Market forces determine the costs of most third party services ranging from flood surveys to pest inspections. Appraisal fees under Dodd-Frank must be "customary and reasonable."[26] Notably, the largest third party fee, for title insurance, and in some places some title services are "filed fees" or fees filed with the states over which the lender has no control. Such fees also are not subject to manipulation by the affiliate.

States require title insurers to file rates to be used by their direct operations and agents (i.e. title sources). Some states allow variations to these rate filings to provide for allowable discounts or special risks (commercial). Some states require "statutory" rate filings that make all rates uniform among all title insurers/agents. Regardless of whether the state is a statutory rate state (such as Texas, New York, Pennsylvania and Florida) or a filed rate state, there are so few insurers that we understand rates tend to be nearly identical among providers.

Today, a significant number of consumers opt for the use of affiliated settlement services providers. Advocates of these arrangements urge that they are good for consumers since cost efficiencies are passed through to them and that they provide more uniform and reliable results for lenders. Independent providers argue that their competition keeps costs lower.

In MBA's view consumers should continue to have the option of both business models: "one stop shopping" or the use of independent settlement service providers. Including affiliate fees in the three percent may stem the use of affiliates depriving consumers of choice.

For all of these reasons, the CFPB should exercise its authority under TILA as amended by Dodd-Frank to revise the safe harbor criteria defining a QM to exclude bona fide third party fees from the points and fees calculation whether or not they are retained by an affiliate of the creditor.

7. **Employee Compensation Should Not Be Included in the Points and Fees Calculation**

As indicated, the proposal would amend the requirements for closed-end mortgage loans so that the points and fees calculation includes all compensation paid directly or indirectly by a consumer or creditor to a loan originator as defined in Section 226.36(a)(1) of Regulation Z.[27]

---

[24] 12. U.S.C.§2601-2617.

[25] 12. U.S.C. §2607.
[26] Dodd-Frank Act, Title XIV: Subtitle F §1471-1476.
[27] a) Loan originator and mortgage broker defined. (1) *Loan originator*. For purposes of this section, the term ''loan originator'' means with respect to a particular transaction, a person who for compensation or other monetary gain, or in expectation of compensation or other monetary gain, arranges, negotiates, or otherwise obtains an extension of consumer credit for another person. The term ''loan originator'' includes

As such, the rule requires inclusion of compensation to employees in the calculation as well as compensation to the creditor and originator firm (mortgage brokerage).

MBA believes that the CFPB should exclude all compensation to individual employees who may or may not be loan originators from the points and fees calculation in light of the recent loan originator compensation rule that dealt with compensation concerns.

MBA notes with concern that the commentary indicates at Paragraph 32 (b)(ii) that loan originator compensation includes bonuses, commissions, yield spread premiums, awards of merchandise, services, trips or similar prizes, or hourly pay. All of these items would be counted in points and fees. MBA must point out that all but hourly pay is unlikely to be known with certainty at closing rendering this provision a compliance impossibility. Should the CFPB consider including some components of employee compensation in points and fees, MBA would be willing to explain in greater detail how the approach set forth in the proposal of determining future bonus compensation at the time of closing is infeasible.

MBA notes with favor, however, that the proposed revised commentary to the rule at Paragraph 32 (b)(ii)1 seems to indicate that loan originator fees already included in the points and fees calculation need not be counted again.

Considering the tight points and fees limits that already include compensation to creditors and brokerages firms, also including compensation to their employees is a form of double counting that would be unfair. For this reason and the obvious compliance difficulties, MBA urges that any final rule make clear that compensation to individual employees is excluded from the points and fees calculation.

### C. QM Should Guide QRM

As indicated, MBA is providing a separate detailed comment in response to the credit risk retention rule proposed by six federal agencies which contains the definition of QRM. Nevertheless, having carefully considered that rulemaking, MBA believes that this rulemaking, if constructed correctly, offers a better model for the QRM going forward.

Under Dodd-Frank, asset-backed securities may not be issued without retention of a portion of credit risk by the securitizer unless the loan is a QRM. While estimates vary, the clear result of any risk retention rule will be that loans that are not QRMs will be costlier or not available at all to some borrowers.

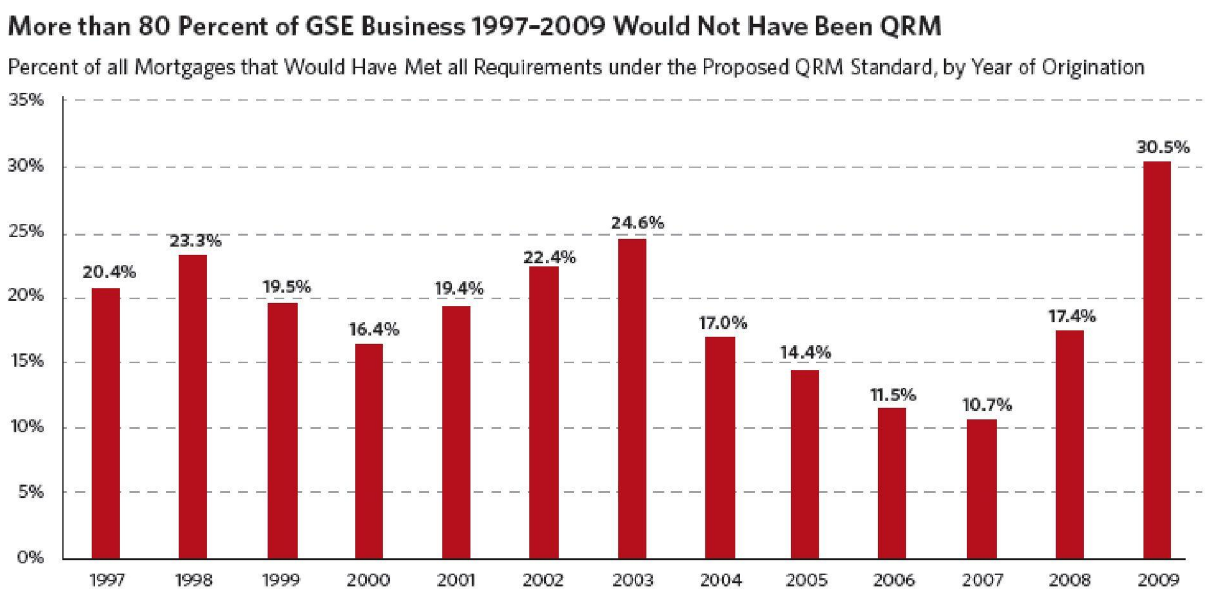
Regrettably, the regulators have proposed a QRM definition that includes a high down payment[28] and uncommonly low loan-to-value (LTV)[29] and DTI ratios[30] that would make most loans subject to risk retention, and therefore costlier and in some cases unavailable.

---

an employee of the creditor if the employee meets this definition. The term "loan originator" includes the creditor only if the creditor does not provide the funds for the transaction at consummation out of the creditor's own resources, including drawing on a bona fide warehouse line of credit, or out of deposits held by the creditor.
(2) *Mortgage broker*. For purposes of this section, a mortgage broker with respect to a particular transaction is any loan originator that is not an employee of the creditor.
[28]The proposed QRM would establish minimum down payment for purchase transaction of at least 20 percent of lesser of purchase price or property value plus closing costs.

Like Congress, we do not believe risk retention is necessary where loans are determined to be QRM. Moreover, we believe the proposal for a narrow QRM is inconsistent with what Congress intended and would drastically limit affordable mortgage financing options to moderate income families, first-time borrowers, minorities, and many others.

The government's own data show that the proposed regulations would hurt consumers by limiting access to credit for well-qualified borrowers.[31] As the next graph indicates, were the proposed QRM requirements in effect, more than 80 percent of GSE business between 1997-2009, including several years when underwriting standards were particularly rigorous, would not have qualified for QRM securitization without risk retention.




*Source:* FHFA. "Mortgage Market Note 11-02: Qualified Residential Mortgages." April 11, 2011.

Even high quality loans would not meet the proposed QRM requirements. For example, even though 2009 was a year of highly conservative underwriting standards, only 30 percent of loans purchased by Fannie Mae and Freddie Mac would have met the proposed requirements. In effect, the QRM would tighten credit in an already constricted lending environment.

Data in the chart below also show it could take moderate income borrowers, depending on where they live, up to 18 years to save for a 20 percent down payment for a moderately priced home.[32]

---

[29] Specific maximum LTV requirements for QRM of not more than 80 percent for purchase loans, 75 percent CLTV for rate and term refinancings (includes first lien and any other closed end or open end credit on property) and 70 percent of CLTV for cash out refinances.
[30] Would establish maximum front-end and back-end DTI ratio of 28 and 36 to qualify.
[31] FHFA. Mortgage Market Note 11-02: Qualified Residential Mortgages. April 11, 2011.See Chart above.
[32] MBA analysis of Census Bureau, Bureau of Labor Statistics, and National Association of Realtors data.

## Downpayment Calculations — Median Household

| | Birmingham | Philadelphia | Chicago | Seattle | San Francisco | Los Angeles | Phoenix | Houston |
|---|---|---|---|---|---|---|---|---|
| Median Annual Household Income | $31,704 | $36,669 | $46,781 | $58,990 | $70,040 | $54,828 | $48,881 | $42,797 |
| Monthly Income | $2,642 | $3,056 | $3,898 | $4,916 | $5,837 | $4,569 | $4,073 | $3,566 |
| After-tax Income | $2,246 | $2,597 | $3,314 | $4,178 | $4,961 | $3,884 | $3,462 | $3,031 |
| Monthly Savings (After-tax income-monthly expenditures) | $202 | $234 | $298 | $376 | $447 | $350 | $312 | $273 |
| Median Gross Rent | $758 | $912 | $900 | $1,015 | $1,303 | $1,197 | $912 | $848 |
| Median Home Price | $140,450 | $208,120 | $166,900 | $292,860 | $494,730 | $304,420 | $130,405 | $153,683 |
| Required Downpayment (20%) | $28,090 | $41,624 | $33,380 | $58,572 | $98,946 | $60,884 | $26,081 | $30,737 |
| Required Downpayment (10%) | $14,045 | $20,812 | $16,690 | $29,286 | $49,473 | $30,442 | $13,040 | $15,368 |
| Required Downpayment (5%) | $7,023 | $10,406 | $8,345 | $14,643 | $24,737 | $15,221 | $6,520 | $7,684 |
| Years to save for 20% downpayment | 12 | 15 | 9 | 13 | 18 | 15 | 7 | 9 |
| Years to save for 10% downpayment | 6 | 7 | 5 | 6 | 9 | 7 | 3 | 5 |
| Years to save for 5% downpayment | 3 | 4 | 2 | 3 | 5 | 4 | 2 | 2 |

*Sources:* MBA analysis of Census Bureau, Bureau of Labor Statistics, and National Association of Realtors data.

The proposed "alternative" of ten percent down payment is not significantly better. It will still take moderate income borrowers a long time to save for a ten percent down payment. Borrowers also must pay closing costs, which typically add another $5,000 to the amount a borrower must save.

At the same time, borrowers who have faithfully made their mortgage payments but have little equity and may live in areas where home prices have significantly declined will find it difficult if not impossible to refinance into a QRM loan because of the proposal's 75 percent LTV requirement for refinance loans.

MBA has made it a top priority, and is working in harmony with a very wide coalition of consumer advocates, civil rights groups and other industry associations, to educate policy makers and legislators concerning this rule. We have concluded that better mortgages for investors and homeowners alike could be accomplished if the final rule simply defined a QRM to exclude loans with risky product features and required documentation and verification as part of loan underwriting.

While MBA supports reasonable credit risk retention requirements, specific down payment, LTV and DTI requirements are unnecessary and not worth the societal costs of excluding far too many qualified borrowers from the most affordable mortgage loans to achieve homeownership.

The obvious difference between the QRM and QM proposals is that the QRM would hard wire high numerical down payment and low LTV and DTI requirements into its requirements.

While the QM also requires loans to meet strict product restrictions and underwriting requirements, it appropriately does not impose specific numerical down payment, DTI or LTV requirements though it requires that lenders use accepted standards including those of the GSEs, FHA and others.

As indicated, MBA believes that if a strong safe harbor for QM loans is not established, many lenders ultimately will retreat to the QRM construct, so that the only conventional loans originated will have to adhere to whatever requirements are finally imposed by the risk retention rule.[33] To avoid a future retreat to QRM requirements only, MBA urges that regulators work towards a sound QM safe harbor to largely replace the QRM requirements.

Both the QRM and QM constructs were intended to achieve the same purpose of ensuring better, more sustainable lending; both constructs should be essentially the same. Considering that the QRM restrictions would exclude too many borrowers from the most affordable, sustainable loans, MBA believes the QM proposal is a much better starting point for both sets of rules.

MBA believes a bright line QM safe harbor will do much to return private capital to the market. Conversely, investors are unlikely to invest in securities unless they can be assured that they are backed by loans that meet clear and unambiguous safe harbor requirements. The return of private investment cannot be expected if standards are far less certain and left to courts to define.

## IV. Other Key Concerns

In addition to our major issues outlined above, MBA requests that the CFPB consider revisions and clarifications to the following provisions:

### A. Coverage

While MBA generally supports the coverage provisions in the proposed rule, we request the following be considered before the rule is finalized:

#### 1. Construction-to-Permanent Loans (C-to-P)

The CFPB should consider treating the permanent portion of C-to-P loans as QMs. C-to-P lending is designed for borrowers who want to obtain a first mortgage loan to construct or rehabilitate a primary residence or second home and also to obtain permanent financing.

Borrowers appreciate this option for several reasons. The loans usually involve; (1) a one-time closing where a borrower can pay for the lot (if applicable), pay for all relevant attorney fees and closing costs, lock in at current market rates, and set up a loan to fund their home construction; (2) qualification of the borrower for the loan in the beginning of the loan origination process, as if he/she was being underwritten for a permanent loan; (3) one set of loan documents that cover both the interim construction phase and the permanent loan phase; and (4) a Certificate of Occupancy when construction is complete, the loan converts into a permanent loan.

The construction period can vary in length, but can be six to twelve months and for some lenders up to twelve to eighteen months.

[33] As noted under the current QRM proposal, loans purchased and securitized by the GSEs are not subject to risk retention while the GSEs are in conservatorship, however, this provision is not permanent.

There are a few key features of C-to-P loans that would render them currently ineligible for QM status, unless the construction phase is exempt from the ability to repay:

(1) The borrower usually only makes interest only payments during the construction phase, although the option of paying down principal is available;
(2) Borrowers may be subject to a "non-conversion fee" if the construction loan does not convert to a permanent loan within the established timeframe. This fee may be inaccurately regarded as a prepayment penalty (see below);
(3) The term of the construction phase frequently will be less than 12 months and under the current proposal, "temporary loans with terms of 12 months or less" are excluded; on the other hand, for some lenders who convert the construction loan into a 30 year permanent loan, the total loan term will exceed the 20 year limitation for QM; and
(4) The combined fees for both phases will exceed three percent, unless fees associated with the construction phase are excluded from the points and fees test.

Accordingly, MBA recommends that the rule be clarified so that the construction phase of a C-to-P loan and its attendant fees are excluded from the ability to repay and QM requirements. Only the permanent phase of a C-to-P should be subject to the ability to repay requirements.

MBA also believes that a mechanism needs to be developed for these permanent loans to qualify for QM status. Otherwise these loans will become less available.

**2. Vacation Homes**

Vacation homes are covered by the rule and subject to the ability to repay requirements and the QM. MBA members report, however, that there is considerable borrower fraud, in which borrowers represent the occupancy as primary residence, so that they qualify for lower rates. Considering this problem, while MBA does not object to the inclusion of vacation homes in the requirements, it urges that any fraud on the part of the borrower not exclude a lender from QM coverage where applicable. See C, below.

**B. Prepayment Fees**

Consistent with Dodd-Frank, the proposal would restrict prepayment fees.[34] Specifically a mortgage could not include a prepayment fee unless the transaction has: (1) an APR that cannot increase after consummation; (2) is otherwise a QM; and (3) is not a higher-priced mortgage loan. If a prepayment fee is permitted, it may not exceed three percent of the outstanding loan balance during the first year after consummation, two percent during the second year and one percent during the third year.[35] Also, a creditor offering a consumer a loan with a prepayment penalty must also offer a loan without a prepayment fee.

MBA has supported reasonable restrictions on prepayment fees and does not object to these provisions. However, MBA does not believe that certain arrangements should be regarded as prepayment fees subject to the rule.

---

[34] Section 1414 amends TILA.
[35] Section 1414 of the Dodd Frank Act creates new TILA section 129C which puts new limits on prepayment penalties; 76. Fed. Reg. 273939 (May 11, 2011).

The proposed rule defines a prepayment penalty as, "a charge imposed for paying all or part of a covered transaction's principal before the date on which the principal is due."[36] The proposed rule then provides examples.

1. **FHA's Accrual Amortization Method Should Not be Treated as a Prepayment Penalty Under this Proposal and in Any Final Rule**

MBA objects to the prepayment penalty example regarding the "interest accrual amortization method." Specifically, the proposal lists the following as a prepayment penalty:

> *Interest accrual amortization method. A prepayment penalty includes charges determined by treating the loan balance as outstanding for a period after prepayment in full and applying the interest rate to such balance, even if the charge results from the interest accrual amortization method used on the transaction. "Interest accrual amortization" refers to the method by which the amount of interest due for each period (e.g., month), in a transaction's term is determined. For example, "monthly interest accrual amortization" treats each payment as made on the scheduled, monthly due date even if it is actually paid early or late (until the expiration of a grace period).*[37]

The foregoing method is used by FHA to compute interest on its loans. The majority of FHA mortgages are securitized by Ginnie Mae. Under the Ginnie Mae program guidelines, when a loan is paid off, issuers must pay interest for the entire month to investors in the securities, regardless of when the loan is paid off. Advancement of interest is also the standard process for Fannie Mae, Freddie Mac, and private label mortgage backed securities.

This method has in the past been deemed acceptable by the Board in a letter to the Department of Housing and Urban Development (HUD), dated September 29, 2009. In the letter, the Board stated that lenders that use such an interest accrual method would not be required to treat the interest changed from the date of the prepayment until the next installment due date as a prepayment penalty for any purpose under Regulation Z. MBA does not understand why the Board's position changed and believes that this change will adversely impact the FHA program and its borrowers.

Under TILA as amended by Dodd-Frank, FHA may define the types of loans they insure as QMs and "revise, add to, or subtract from the criteria used to define" a QM upon a finding that such rules are consistent with the purposes of Section 129C of TILA but no such rules have yet been proposed.[38]

Were the proposed change here made under a final rule, absent action by FHA, Ginnie Mae would still require issuers to advance the interest due to investors whether or not the interest is paid by borrowers. The issuer would be responsible for advancing any gap in funds between the amount paid by the borrower and the amount due to the investor. Servicers, in turn, would be required to make the full interest payment for the investor but could not be expected to absorb this additional cost; it would be passed on to borrowers. Lenders would likely price approximately 15 days of lost interest into every mortgage transaction in order to offset their costs of passing through post-settlement interest to Ginnie Mae.

[36] 76, Fed. Reg. 27397(May 11, 2011).
[37] 76. Fed. Reg. 27415 (May 11, 2011).
[38] Sec. 1412 of Dodd-Frank.

Were this rule to apply to FHA loans, the fact that the interest can be charged after the third year of origination, would make these payments impermissible and thus the loan would not be in compliance with this rule. Moreover, the creditor would have to assume a prepayment penalty is charged in the first three years and include that amount in the points and fees calculation. Depending on the amount of other fees, this could cause a loan to exceed the maximum points and fees limitation rendering the loan a non-QM mortgage. Some lenders would not originate these loans, others would charge additional fees to address these additional risks.

In our view, it is within the CFPB's discretion, consistent with Dodd-Frank, to determine what is in fact a prepayment penalty. Also, in our view, FHA's accrual amortization method should not be so characterized. It is also within FHA's discretion to offer an alternative rule for its loans.

We understand FHA is currently conducting a cost-benefit analysis regarding this issue to determine if and how FHA should amend its policy. Considering these points, MBA strongly recommends that the CFPB not treat FHA's accrual amortization method as a prepayment penalty at this time. A far better approach would be for the CFPB to consult with FHA and Ginnie Mae on this matter going forward considering the CFPB's broader charge of protecting consumers and the prerogatives and powers which FHA also has under Dodd-Frank.

**2. C-to-P Loan Non-Conversion Fees Should Not be Treated as Prepayment Penalties**

Lenders originate one-time closing C-to-P loans with the expectation that they will hold the permanent loan following the construction phase of the loan, and such loans are priced accordingly. From the lender's perspective, the construction phase of the loan is the riskiest period. Borrower default during this phase is extremely costly and can result in the lender obtaining incomplete homes that are difficult to sell. Were the loan priced solely for the construction phase, the pricing would be far higher.

If a borrower chooses to convert their construction loan into a permanent loan with a different lender, the lender's costs of originating and carrying the construction loan are not recouped. For these reasons, as part of the loan agreement, borrowers are expected to complete the construction phase within the specified time noted in the mortgage documents and convert the loan into a permanent loan. When borrowers fail to do so, they may be subject to one-time, non-conversion fees.

These non-conversion fees reimburse the lender for costs incurred for carrying the loan beyond the agreed upon construction period and the increased risk of the loan during the construction phase. Based on the attributes of these fees, we believe they are simply compensation for actual loan costs and should not be regarded as prepayment penalties under any final rule. Any other result will make one-item closing C-to-P loans costlier and/or less available.

**3. Closing Cost Recapture should be Removed from the Definition of Prepayment Penalty**

Section 226.43 (b)(10)(i)(B), the definition of prepayment penalty, includes the following examples: "(B) A fee, such as a loan closing cost, that is waived unless the consumer prepays the covered transaction."

MBA is concerned that this definition might encompass lenders' closing cost reimbursements, which are common in many closed-end mortgages, as well as other products, such as HELOCs. Under these arrangements closing costs are advanced by the lender for and on behalf of the borrower, who is required to reimburse the lender pursuant to the loan documents; however, such a reimbursement requirement is waived if the borrower keeps the loan or line open for a certain specified time, typically three years. If the borrower pays off the loan before the end of three years, the reimbursement requirement remains and the borrower owes the lender the amount of closing costs the company advanced on the borrower's behalf. This arrangement is fully disclosed to the consumer.

MBA believes that these arrangements are beneficial to borrowers because they reduce up-front closing costs and differ from prepayment penalties.[39] These arrangements require reimbursement dollar-for-dollar, and are not based on a percentage of the amount prepaid as is the case with a traditional prepayment penalty. MBA is not aware of any state or federal law which treats closing cost reimbursement as prepayment penalties. In fact, the Maryland legislature recognized the ability of a lender to collect closing costs at any time and differentiates these costs from prepayment penalties which are prohibited by applicable Maryland law. For all of these reasons, these arrangements should not be considered prepayment penalties.

**C. Borrower Fraud**

Despite lenders' best efforts, borrower fraud far too often faces the mortgage lending industry. The Financial Crimes Enforcement Network (FinCEN) estimates losses for 2010 at more than $1.5 billion, a total that they characterize as grossly under reported. [40]

While Section 1417 of Dodd-Frank adds subsection (k) to section 130 of TILA to exempt a creditor or assignee from liability if a consumer has been convicted of obtaining his or her mortgage loan by fraud, we do not believe this is sufficient to protect lenders from the extensive liability risks in the context of these rules that would implement the ability to repay requirements.

Whether or not a criminal conviction is obtained, lenders should not be held accountable for determining a borrower's ability to repay when the lender can show it relied on falsified information of the borrower that the lender was unaware of, and should not reasonably have known, when it determined the borrower was qualified.

MBA therefore recommends that a provision be added to the rule to provide that when a lender can substantiate that borrower fraud affected its determination that the loan should be made, the lender should not lose its QM safe harbor. A lender should not be defrauded and then be open to significant damages as well.

MBA would also support a requirement, similar to the requirement in the QRM proposed rule, that a borrower sign its loan application and be forewarned in the signature block that fraud can result in criminal prosecution. Such warning may provide a degree of deterrence.

**D. Non-Standard to Standard Mortgages and Streamline Refinances**

---

[39] Some lenders may include a true prepayment penalty *in addition to a* closing cost recapture fee, and MBA agrees that such an additional fee would constitute a prepayment penalty.

[40] Mortgage Asset Research Institute Thirteenth Periodic Mortgage Fraud Case Report May 11, 2011.

**1. Non-Standard to Standard Mortgage Streamlined Refinance**

The proposal offers an exception to the ability to repay requirement for financing a non-standard mortgage into a standard mortgage. A non-standard mortgage includes a loan that is: (1) adjustable-rate with an introductory fixed interest rate for a period of at least one year; (2) an interest-only loan; and (3) a negative amortization loan. A standard mortgage cannot contain negative amortization, interest-only payments, or balloon payments; and is, among other requirements, subject to the QM limits on points and fees. A non-standard mortgage can be refinanced into a standard mortgage without the creditor having to verify the borrower's income or assets with written documentation, as long as the creditor for the existing mortgage and new mortgage are the same; the borrower has a positive payment history on the existing mortgage; and payment on the new mortgage is materially lower than the payment that will be required on the existing mortgage after it recasts.

MBA notes that the way the proposal works, it does not appear that the standard loan resulting from these refinances will necessarily qualify as QMs. MBA urges the CFPB to revisit these criteria so more borrowers qualify for streamline products and such products are treated as QMs. Specifically, MBA is concerned that the streamline refinance exemption to the income and assets sections of the Repayment Ability is not coordinated with the QM requirements. For example, if Alternative 2 of Section 226.43(e)(2)(v) is selected, it is unclear whether a streamline refinance must comply with requirements to consider the borrower's debt obligations, debt to income ratio, and employment to achieve QM status despite being exempt from verifying income. A requirement to consider these items (regardless of whether the streamline refinance is a non-standard to standard mortgage refinance or a traditional rate and term refinance (see below)) would seem to conflict with the very premise of the non-standard refinance concept and will eliminate borrowers from favorable and less costly refinance opportunities. The CFPB should review other QM standards to ensure there is clear guidance on how a streamline loan operates within the QM construct.

With regard to other provisions for non-standard mortgage refinances, the proposed regulation would bar a consumer from availing itself of the streamline refinance exemption if the mortgage has "recast", despite the fact that the standard mortgage having a lower payment. We urge the CFPB to expressly permit the streamline exemption if the borrower refinances to a lower payment after recast. We also believe the requirement that the payment on the standard mortgage be "materially lower" than the monthly payment on the non-standard mortgage at recast will deny access to desired credit for many consumers. The Commentary provides a presumption of compliance with the "materially lower payment" standard if the payment is reduced by ten percent. Ultimately, the ten percent safe harbor will become the rule. We recommend that the CFPB consider a different formulation to qualify more consumers.

Finally, we recommend removing 226.43(d)(3)(i)(B) as a condition of obtaining the streamline refinance safe harbor since a creditor would have to underwrite the borrower's income and assets to determine whether a borrower would "likely default," thus defeating in part the purpose of not reviewing income and assets. Moreover, the "likelihood of default" requirement is extremely vague and places lenders in a position of being second guessed and subject to liability for waiving the ability to repay requirements. As a result, few, if any lenders, will use this streamline refinance option which, in turn, will negatively impact borrowers.

**2. Traditional Rate and Term Streamline Refinances**

MBA believes that consumers seeking a traditional rate and term refinance (not insured or guaranteed by the federal government or a "non-standard mortgage") also should be afforded a streamlined option that allows waiver of the Repayment Ability standards mentioned above and qualifies for QM status. We, therefore, urge the CFPB to create a streamline refinance exemption for traditional rate and term refinances. Specifically, we recommend that the CFPB adopt similar standards established in Dodd-Frank (amending TILA Section 129C(a)(5)) for government loans. This would include the requirement that the borrower not be 30 or more days delinquent. We respectfully urge that the CFPB not mandate a "good payment history" in these cases as the consumer is already obligated to pay the debt, albeit at less favorable terms, and the note holder in many cases already bears the credit risk.[41] Because a traditional rate and term refinance will offer a better rate (except in the case of adjustable rate mortgages), we see no reason to deny the creditor the ability to improve its credit risk and to offer the borrower better financing.

In sum, we believe the CFPB should consider other means of ensuring that borrowers can avail themselves of streamlined products and remove impediments including income, debt, and asset requirements that may prevent the borrower from enjoying a more favorable loan.

### E. Loan Term

The proposed rule states that loan terms exceeding 30 years cannot qualify for the ability to repay or QM requirements except in high cost areas. The proposal asks for comment on whether 40 year loans should be permitted. MBA supports allowing 40 year mortgages under both the QM and ability to repay requirements. Providing the option of a longer term loan gives borrowers' in regions of the country where housing prices are especially high a sound financing alternative. Moreover, 40 year loan terms have also proven to be a sound option for borrowers having payment difficulties.

### F. Qualified Balloon Mortgage

The proposal would permit Balloon Payment QMs. These products would only be available to small creditors who operate in rural or underserved areas, and meet covered transaction, asset size, and holding requirements. Dodd-Frank gives the Board authority to interpret the details of these parameters. The Board interpreted "creditor operating in predominantly rural or underserved areas" to apply to creditors who extend more than 50 percent of total transactions that provide for balloon payments in one or more counties designated as "rural" or "underserved." The Board solicits comment on the holding requirement for balloon mortgages, but in general requires that loans are held in portfolio. The Board also solicits comment on the annual covered transactions threshold. The asset size threshold is set for $2 billion for calendar year 2011.

Given the extent of the portfolio, transaction, and asset requirements, MBA believes the CFPB should broaden the definition of creditors operating in predominantly rural or underserved areas to the greatest extent possible. The narrow requirements as proposed will significantly reduce the availability of these products.

---

[41] We recognize that loans in MBS may require additional underwriting of the borrower as the loan will be removed from one pool and delivered to a new pool with new investors. Our recommendation would benefit borrowers whose loans are held in the creditor's portfolio and would not harm loans in MBS as investors will most likely demand additional evidence of creditworthiness.

**V. Other Matters**

**A. Considering the Implications of this Proposal, the CFPB Should Utilize a Process to Obtain Further Input From Stakeholders**

While MBA appreciates the opportunity to comment on this extensive proposal, it is very clear that addressing our comments will necessitate further consultation with the industry and other stakeholders for several matters not least of all the development of a true safe harbor.

Considering the importance of the proposal, MBA urges the CFPB to do so before finalizing any rule to assure that ill-advised provisions are not adopted. We would also urge that if the CFPB intends to deviate from this proposal or determines to adopt a construct other than a QM safe harbor, that it repropose this rule for comment.

**B. The Drafting Paradigm Incorporating the Proposal into Regulation Z is Unnecessarily Difficult to Navigate**

As the CFPB takes over TILA regulation, it would be wise for it to reevaluate the form of TILA regulations. In MBA's comments on the 2009 and 2010 proposals to reform the TILA regulations, we urged that the Board establish separate regulations under TILA applicable to closed-end and open-end mortgage transactions rather than melding the modifications made by the Proposal into Regulation Z rules for other closed-end credit transactions. Submerging the changes made by the Proposal along with countless cross references in the regulation is confusing and far less effective in presenting requirements to consumers and practitioners. Effective compliance is greatly facilitated by clear and concise rules. The creation of separate parts in Regulation Z that contain all rules governing open-end and closed-end mortgage lending is long overdue.

**C. These Extensive Changes Will Require Considerable Guidance, Implementation Time and Costs**

Implementation of these new requirements if done correctly will necessitate numerous systems, operational and documentation changes. MBA would urge that, considering the breadth and scope of the proposed changes, at minimum the mandatory implementation period for the proposal should be at least 18 months. Sufficient implementation time is key to ensuring that the ability to repay requirements are put into practice correctly and effectively.

We respectfully urge that regulators fully recognize that these important changes are not the only changes taking place in the financial services industry. This vital initiative is being undertaken along with countless proposed and final regulations that require fundamental changes to the mortgage business model and a generation of systems that support it.

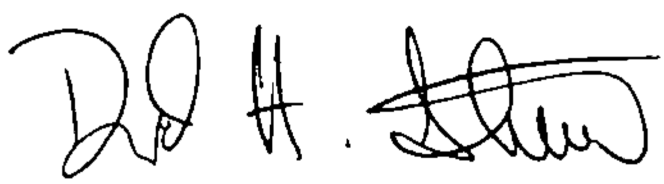
Major changes under TILA, including HOEPA revisions, and the new loan officer compensation rules, along with the forthcoming RESPA and TILA disclosures, Fair Credit Reporting Act (FCRA) and Secure and Fair Enforcement for Mortgage Licensing Act (SAFE) requirements, and new appraisal standards, to name a few, have overextended the compliance capabilities of most institutions, and have stretched to the breaking point the capabilities of smaller institutions. And even more rules are forthcoming under Dodd-Frank. If regulators do not step back and look at the cumulative effect of these rules, we would urge that they may unwittingly limit competition and the availability of sound housing finance options.

**VI. Conclusion**

MBA again appreciates the Board's work to propose this rule and looks forward to working with the CFPB to finalize it. MBA strongly believes that if the ability to repay rule, including the QM, is implemented correctly it will regularize sound and sustainable mortgage financing for consumers and assist the return of investment capital to the mortgage market.

Again, we appreciate the opportunity to comment on these proposed amendments to Regulation Z. Should you have questions or wish to discuss any aspect of these comments further, please contact Ken Markison, Regulatory Counsel, at (202) 557-2930 or kmarkison@mortgagebankers.org or Tamara King, Associate Vice President for Loan Production at (202) 557-2758 or tking@mortgagebankers.org.

Sincerely,



David H. Stevens
President and Chief Executive Officer
Mortgage Bankers Association

**EXHIBITS**

*Attached as exhibits to this comment letter are (1) the Legal Opinion of Goodwin Procter in response to MBA on the Ability to Repay Proposed Rule (Docket No. Regulation Z; Docket No. R-1417, RIN No. 7100-AD 75); and (2) a Memorandum from Thomas Hefferon, a partner with Goodwin Procter, entitled "Qualified Mortgage Definition Proposals Involving a Safe Harbor or a Rebuttable Presumption."*

GOODWIN | PROCTER

Goodwin Procter LLP
Counsellors at Law
901 New York Avenue, N.W.
Washington, D.C. 20001

T: 202.346.4000
F: 202.346.4444
goodwinprocter.com

**PRIVILEGED & CONFIDENTIAL**

July 21, 2011

Mortgage Bankers Association
1717 Rhode Island Avenue, NW
Suite 400
Washington, DC 20036

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

Ladies and Gentlemen:

You have asked for the opinion of this firm regarding whether the Consumer Financial Protection Bureau (the "Bureau")[1] has the requisite authority, when promulgating the final rule implementing the ability-to-repay requirements under Sections 1411, 1412 and 1414 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, H.R. 4173 (the "Dodd-Frank Act") (the "Final Rule"), to adopt a rule giving a creditor a safe harbor instead of a rebuttable presumption, particularly in light of the ambiguities in the statute and the legislative history of the requirements.

As set forth in greater detail and subject to the limitations, assumptions and qualifications stated in Section IV herein, we are of the opinion that the Bureau, pursuant to its authority under Section 105(a) of Truth In Lending Act[2], has the authority to adopt the safe harbor alternative in the Final Rule. We also believe that the Bureau may, consistent with the provisions of Section 129C(b)(3)(B), make a finding that a safe harbor is an appropriate mechanism to ensure continued availability of responsible mortgage loans.

This letter provides background and describes the authority granted to the Bureau to modify Section 129C(a) and Section 129C(b)of TILA.

[1] The regulatory authority of the Board of Governors of the Federal Reserve System )the "Board") under the Truth in Lending Act passed to the Bureau on July 21, 2011. Pub. L. No. 111-203, Title X, Subtitle H, § 1100A(2), 124 Stat. 2107.

[2] 15 U.S.C. §§ 1601 *et seq.* ("TILA").

## I. Background

Section 129C, created by Sections 1411, 1412 and 1414 of the Dodd-Frank Wall Street Act, adds a new section to TILA titled "Minimum standards for residential mortgage loans."[3] The Dodd-Frank Act states that Section 129C arises out of a Congressional finding that:

> [E]conomic stabilization would be enhanced by the protection, limitation, and regulation of the terms of residential mortgage credit and the practices related to such credit, while ensuring that responsible affordable credit remains available to consumers.[4]

The Dodd-Frank Act goes on to state that the purpose of Section 129C of TILA is to "assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay their loans."[5]

The ability-to-repay requirements found in Section 129C(a) of TILA prohibit a creditor from making a 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 . . . ."[6] The remaining portions of Section 129C(a) detail the requirements that a creditor must consider to determine a borrower's ability to repay. Section 129C(b)(1) of TILA establishes a "presumption of compliance" with the statute's ability-to-repay requirements to a creditor making a qualified mortgage, and Section 129C(b)(2)(A) defines the terms qualified mortgage, as well as other terms used in the section. Additionally, Section 1413 of the Dodd-Frank Act amends TILA by adding a defense to foreclosure for a borrower if a creditor makes a loan that fails to meet these minimum requirements and Section 1416 amends the civil liability provision to include a civil remedy for a consumer if the creditor fails to comply with the ability to repay requirements.[7] While the civil remedy has a three-year statute of limitations, the foreclosure defense is "available as a matter of defense by recoupment or set off without regard for the time limits on private action for damages under subsection (e)."[8]

---

[3] Dodd-Frank Act Section 1411; TILA Section 129C; 15 U.S.C. § 1639c (2010).

[4] Dodd-Frank Act Section 1402; TILA Section 129B(a)(1); 15 U.S.C. § 1639b(a)(1) (2010).

[5] Dodd-Frank Act Section 1402; TILA Section 129B(a)(2); 15 U.S.C. § 1639b(a)(2) (2010).

[6] Dodd-Frank Act Section 1411; TILA Section 129C(a)(1); 15 U.S.C. § 1639c(a)(1).

[7] Dodd-Frank Act Section 1416, TILA Section 130(a), (k); 15 U.S.C. § 1640(a), (k).

[8] Dodd-Frank Act Section 1413,TILA Section 130(k); 15 U.S.C. § 1640(k).

On May 11, 2011, the Board issued a proposed rule and request for public comment, Docket No. R-1417 (the "Proposed Rule") regarding, among other things in Section 129C, the ability-to-repay requirements and the presumption of meeting those requirements afforded a qualified mortgage. As part of the Proposed Rule, the Board presented two alternatives that may become Paragraph (e)(1) of the regulation pertaining to "Minimum standards for transactions secured by a dwelling," to be set forth in 12 C.F.R. § 226.43(e)(1). The Board's Alternative 1 (the "safe harbor") proposed for Paragraph (e)(1) states:

> (1) *Safe harbor*. A creditor or assignee of a covered transaction complies with the repayment ability requirement of paragraph c(1) of this section if the covered transaction is a qualified mortgage as defined in paragraph (e)(2) of this section. [9]

In contrast, the Board's Alternative 2 (the "rebuttable presumption") for Paragraph (e)(1) states:

> (1) *Presumption of compliance*. A creditor or assignee of a covered transaction is presumed to have complied with the repayment ability requirements of paragraph c(1) of this section if the covered transaction is a qualified mortgage, as defined in paragraph (e)(2) of this section. [10]

## II. <u>Statement of Factual Assumptions</u>

We have reviewed such documents and made such examinations of law as we have deemed appropriate to give our opinion. This opinion depends on a number of factual assumptions, which are outlined below and elsewhere in this opinion. We take these assumptions as true for purposes of this opinion. For purposes of our opinion, we have assumed the following:

1. That the Final Rule implementing Section 129C will include one of the two alternatives for Paragraph (e)(1) of proposed 12 C.F.R. § 226.43, the safe harbor or the rebuttable presumption, in substantially the same form in which it appears in the Proposed Rule.

2. That the Final Rule will define a qualified mortgage in substantially one of the two proposed forms in which the definition appears in the Proposed Rule

3. That any additions made to the safe harbor criteria in the Final Rule will be clear and unambiguous requirements.

4. That the Final Rule will include the comment to the alternative adopted for Paragraph (e)(1) of proposed 12 C.F.R. § 226.43, the safe harbor or the rebuttable presumption, in substantially the same form in which the relevant comment appeared in the Proposed Rule.

5. Except where the context of this letter requires otherwise, (a) our reference to a "safe harbor" means a law or regulation that provides that if a creditor complies with its terms,

[9] 76 Fed. Reg. 27390, 27484 (May 11, 2011).

[10] 76 Fed. Reg. 27390, 27484 (May 11, 2011).

the creditor will be deemed to comply with the ability-to-repay requirements of Section 129C(a), and (b) our reference to a "rebuttable presumption" means a law or regulation that provides that if a creditor complies with its terms, the creditor will be presumed to comply with the ability-to-repay requirements of Section 129C(a) but that presumption can be overcome based on additional or different evidence.

## III. Opinion

### A. The Authority of the Board to Revise the Safe Harbor and Issue Alternatives in the Proposed Rule

In the Proposed Rule, in the section titled "Revising the Safe Harbor," the Board identified its legal authority, and the legal authority of the Bureau as its successor,[11] to prescribe regulations to carry out TILA's purposes, which authority is found in Section 105(a) of TILA.[12] In addition, it noted that Section 105(a), as amended by the Dodd-Frank Act, states:

> [The Board's] regulations may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of this subchapter, to prevent circumvention or evasion thereof, or to facilitate compliance therewith.[13]

Further, the Board referred to its authority under Section 129B(e) and 129C(b)(3) of TILA to prescribe regulations guaranteeing that the ability-to-repay requirements continue to ensure responsible, affordable credit remains available for consumers.[14]

We share the Board's opinion that the Board (and the Bureau as its successor), pursuant to its general authority under Section 105(a) of TILA, may adopt in the Final Rule the safe harbor alternative in the Proposed Rule.[15]

The Board has long been acknowledged to have special expertise and the authority to issue regulations concerning consumer lending. In *Ford Motor Credit Co. v. Milhollin*, the United States Supreme Court acknowledged the Board's authority and described the deference it should be afforded. 444 U.S. 555, 565-67 (1980). "[D]eference is especially appropriate in the process of interpreting the Truth in Lending Act and Regulation Z. Unless *demonstrably irrational*, Federal Reserve Board staff opinions construing the Act or Regulation should be

---

[11] As noted above, that power has passed to the Bureau. .

[12] 76 Fed. Reg. at 27394.

[13] Dodd-Frank Act Section 1100A; TILA Section 105(a); 15 U.S.C. § 1604(a).

[14] 76 Fed. Reg. at 27394.

[15] This opinion assumes that Section 129C does not provide a safe harbor as a matter of law; we express no opinion as to whether it does.

dispositive for several reasons." *Id.* (emphasis added). The Court supported this position by stating that Congress' amendment and expansion of the provision in Section 1640(f) that permits creditors to rely on Board staff opinions, constituted a signal "to treat administrative rulemaking and interpretation under TILA as authoritative." Id. at 567-68. The Supreme Court later confirmed the deference that should be afforded the Board's interpretations of TILA. *Anderson Bros. Ford v. Valencia*, 452 U.S. 205, 219 (1981) ("But as we so plainly recognized in [*Milhollin*], *absent some obvious repugnance to the statute*, the Board's regulation implementing this legislation should be accepted by the courts, as should the Board's interpretation of its own regulation.") (emphasis added); *see also Pridegon v. Gates Credit Union*, 683 F.2d 182 (7th Cir. 1982) (finding that the Board's interpretation of a section of TILA was "controlling as it is not irrational nor repugnant to the statute."); *Cetto v. LaSalle Bank Nat'l Ass'n*, 518 F.3d 263, 276 (4th Cir. 2008) (citing *Milhollin* and Section 1640(f) for the proposition that an attack on the validity of the Board's interpretation of Regulation Z is necessarily equivalent to arguing that either the regulation or the interpretation is an unreasonable construction).

In addition, Section 129C(b)(3)(B) of TILA, gives the Bureau the power to "prescribe regulations that revise, add to, or subtract from the criteria that define a qualified mortgage upon a finding that such regulations are necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of this section, necessary and appropriate to effectuate the purposes of this section and section 1639b of this title, to prevent circumvention or evasion thereof, or to facilitate compliance with such sections."[16] Further, under Section 129C(b)(3)(B), the Bureau could make a finding that a safe harbor would "ensure" the continued availability of responsible mortgage credit and facilitate compliance.

Taken together, both the general and the specific authority given to the Bureau support the conclusion that it is within the Bureau's discretion to adopt a safe harbor rather than a presumption.

### B. Section 129C(a), Section 129C(b) and the Proposed Rule

In the Proposed Rule, the Board addressed what it viewed as a lack of clarity in the statute with respect to a rebuttable presumption or a safe harbor. At your request, we examine below the legislative history of Section 129C and its predecessor bills, and the alternatives proposed by the Board in the Proposed Rule, which may form the basis for the Bureau's determination to promulgate a safe harbor in the Final Rule.

#### 1. <u>Legislative History</u>

As noted above, as part of the "Minimum standards for residential mortgage loans," Section 129C(a) and Section 129C(b) add to TILA the ability-to-repay requirements a creditor

---

[16] Dodd-Frank Act Section 1411; TILA Section 129C(b)(3); 15 U.S.C. § 1639c(b)(3).

must consider when making a mortgage loan and define a qualified mortgage, which is granted a presumption of compliance under Section 129C(b)(1).[17] Similar ability-to-repay legislation was first proposed during the 110th Congress as H.R. 3915, and subsequently in the 111th Congress as H.R. 1728, to address certain lending practice practices by amending TILA.

(a) *H.R. 3915*

As first proposed in H.R. 3915, the ability-to-repay requirements defined two types of mortgages that could give a creditor some assurance of compliance: the first, a qualified mortgage, would have given a creditor a safe harbor of compliance, while the second, a qualified safe harbor mortgage, would have given a creditor only a rebuttable presumption of compliance. Section 203 of H.R. 3915, titled "Safe harbor and rebuttable presumption" was intended to amend Section 129B of TILA and states:

> (1) IN GENERAL.—Any creditor with respect to any residential mortgage loan, and any assignee of such loan, may presume that the loan has met the requirements of subsections (a) and (b), if the loan is a qualified mortgage or a qualified safe harbor mortgage.
>
> (2) REBUTTABLE PRESUMPTION.—Any presumption established under paragraph (1) with respect to any residential mortgage loan shall be rebuttable only—(A) against the creditor of such loan; and (B) if such loan is a qualified safe harbor mortgage.

Section 203 went on to define the qualified mortgage and the qualified safe harbor mortgage as follows:

> (B) QUALIFIED MORTGAGE.--The term "qualified mortgage" means -- (i) any residential mortgage loan that constitutes a first lien on the dwelling or real property securing the loan and either--(ii) any residential mortgage loan that is not the first lien on the dwelling or real property securing the loan and either--(iii) a loan made or guaranteed by the Secretary of Veterans Affairs.
>
> (C) QUALIFIED SAFE HARBOR MORTGAGE.--The term "qualified safe harbor mortgage" means any residential mortgage loan--(i) for which the income and financial resources of the consumer are verified and documented; (ii) for which the residential mortgage loan underwriting process is based on the fully-indexed rate, and takes into account all applicable taxes, insurance, and assessments; (iii) which does not provide for a repayment schedule that results in negative amortization at any time; (iv) meets such other requirements as may be established by regulation; and (v) for which any of the following factors apply with respect to such loan: (I) The periodic payment amount for principal and

[17] Dodd-Frank Act Section 1411; TILA Section 129C; 15 U.S.C. § 1639c (2010).

> interest are fixed for a minimum of 5 years under the terms of the loan. (II) In the case of a variable rate loan, the annual percentage rate varies based on a margin that is less than 3 percent over a single generally accepted interest rate index that is the basis for determining the rate of interest for the mortgage. (III) The loan does not cause the consumer's total monthly debts, including amounts under the loan, to exceed a percent-age established by regulation of his or her monthly gross income or such other maximum percentage of such income as may be prescribed by regulation under paragraph (6).

The report on H.R. 3915 from the House Committee on Financial Services confirmed the distinction between the presumption provided to a creditor for each type of mortgage. The report stated:

> [Section 129C] provides that a presumption can be made that the minimum standards (reasonable ability to repay and net tangible benefit) are met for "qualified mortgages" and "qualified safe harbor mortgages." Qualified mortgages are presumed to meet the minimum standards and this presumption may not be rebutted. For qualified safe harbor loans, the presumption may be rebutted only against creditors. [18]

The report also contained dissenting views criticizing the safe harbor in its entirety. Dissenters also challenged the bill on the grounds that it "creates a presumption that qualified safe harbor loans (those that meet a number of restrictions) will have a 'reasonable ability to repay' and a 'net tangible benefit,' but that presumption is rebuttable." [19]

Following the Committee's report, Rep. Garrett offered an amendment to extend the safe harbor to all loans that met the requirements listed in section 203(c)(3)(C), rather than just qualified mortgages.[20] That amendment did not pass. The House record following the rejection of the amendment extending the safe harbor contained additional criticism about the presumption afforded the creditor under that provision. Rep. Roskam remarked that "[t]here is language that creates the purported safe harbor in the bill, but it is a safe harbor that does not end with a period at the end of the sentence, essentially. It is a safe harbor that has a comma at the end and is simply a rebuttable presumption. So safe harbors are mostly safe, but not entirely safe."[21]

---

[18] H.R. Rep. No. 110-441 (2007)

[19] *Id.*

[20] H.R. Rep. No. 110-450 (2007).

[21] 153 Cong. Rec. H13978, 13984 (daily ed. Nov. 15, 2007).

H.R. 3915 passed the House on November 15, 2007. It was referred to the Senate Committee on Banking, Housing and Urban Affairs on December 3, 2007. No further action was taken on the bill.

(b) *H.R. 1728*

H.R. 1728 was then introduced in 2009 as "The Mortgage Reform and Anti-Predatory Lending Act" with Section 203 titled "Safe harbor and rebuttable presumption." Section 203 in H.R. 1728 as referred to the Senate, in part, stated:

> (c) Presumption of Ability To Repay and Net Tangible Benefit.-
> (1) In general. Any creditor with respect to any residential mortgage loan, and any assignee or securitizer of such loan, may presume that the loan has met the requirements of subsections (a) and (b), if the loan is a qualified mortgage.
>
> (2) Definitions. For purposes of this subsection, the following definitions shall apply: (A) Qualified mortgage. The term "qualified mortgage" means any residential mortgage loan-(i) that does not allow a consumer to defer repayment of principal or interest, or is not otherwise deemed a 'non-traditional mortgage' under guidance, advisories, or regulations prescribed by the Federal Banking Agencies; (ii) that does not provide for a repayment schedule that results in negative amortization at any time; (iii) for which the terms are fully amortizing and which does not result in a balloon payment, where a "balloon payment" is a scheduled payment that is more than twice as large as the average of earlier scheduled payments; (iv) which has an annual percentage rate that does not exceed the average prime offer rate for a comparable transaction, as of the date the interest rate is set-(I) by 1.5 or more percentage points, in the case of a first lien residential mortgage loan having a original principal obligation amount that is equal to or less than the amount of the maximum limitation on the original principal obligation of mortgage in effect for a residence of the applicable size, as of the date of such interest rate set, pursuant to the sixth sentence of section 305(a)(2) the Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1454(a)(2)); (II) by 2.5 or more percentage points, in the case of a first lien residential mortgage loan having a original principal obligation amount that is more than the amount of the maximum limitation on the original principal obligation of mortgage in effect for a residence of the applicable size, as of the date of such interest rate set, pursuant to the sixth sentence of section 305(a)(2) the Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1454(a)(2)); and (III) by 3.5 or more percentage points, in the case of a subordinate lien residential mortgage loan; (v) for which the income and financial resources relied upon to qualify the obligors on the loan are verified and documented;(vi) in the case of a fixed rate loan, for which the underwriting process is based on a payment schedule that fully amortizes the loan over the loan term and takes into account all

> applicable taxes, insurance, and assessments; (vii) in the case of an adjustable rate loan, for which the underwriting is based on the maximum rate permitted under the loan during the first seven years, and a payment schedule that fully amortizes the loan over the loan term and takes into account all applicable taxes, insurance, and assessments; (viii) that does not cause the consumer's total monthly debts, including amounts under the loan, to exceed a percentage established by regulation of the consumer's monthly gross income or such other maximum percentage of such income as may be prescribed by regulation under paragraph (4), and such rules shall also take into consideration the consumer's income available to pay regular expenses after payment of all installment and revolving debt; (ix) for which the total points and fees payable in connection with the loan do not exceed 2 percent of the total loan amount, where "points and fees" means points and fees as defined by Section 103(aa)(4) of the Truth in Lending Act (15 U.S.C. 1602(aa)(4)); and (x) for which the term of the loan does not exceed 30 years, except as such term may be extended under paragraph (4).

H.R. 1728 contained no reference to the term "qualified safe harbor mortgage." As a result, the bill provided only a presumption to creditors of meeting the ability-to-repay requirements, and the proposed Section 203 in H.R. 1728 did not clearly state whether a creditor making a qualified mortgage would enjoy a safe harbor or only a rebuttable presumption.

The Report of the House Committee on Financial Services on H.R. 1728, however, referred to the presumption as rebuttable when a creditor makes a qualified mortgage.[22] The report stated:

> [C]ertain high-quality, low-cost loans (defined as Qualified Mortgages) will be presumed to meet these Federal standards. *This is a limited safe harbor for these loans because the presumption can be rebutted.*[23]

The report also emphasized the finding and purpose of the ability-to-repay requirements, which is "to assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deceptive or abusive."[24]

Following the Committee's report, Rep. Sessions criticized the limited reach of the safe harbor, stating that "H.R. 1728 makes all real safe harbor mortgages rebuttable, meaning that borrowers can sue any creditor for any mortgage. Under the terms of this bill, no mortgages are

---

[22] H.R. Rep. No. 111-94 (2009).

[23] *Id.* (emphasis added).

[24] *Id.*

protected by safe harbor laws and all lenders can be sued."[25] H.R. 1728 passed in the House on May 7, 2009.

The bill was introduced in the Senate on May 12, 2009 with no additional changes made to the safe harbor provision. When introduced, the bill was read twice then referred to the Senate Committee on Banking, Housing and Urban Affairs. No further action was taken on the bill.

(c) *H.R. 4173*

The exact language in Section 203 of H.R. 1728 concerning the ability-to-repay requirements in Section 203(a) and the presumption and definition of a qualified mortgage in Section 203(b) was then incorporated into the Dodd-Frank Act, H.R. 4173, as Sections 1411 and 1412, respectively. During Senate testimony, Sen. Dodd explicitly stated that the ability-to-repay provision "provides that lenders making loans according to these standards would enjoy *the rebuttable presumption of the safe harbor* for qualified mortgages established by this section."[26] Although some amendments were made to the definition of a "qualified mortgage," no changes or additional comments were made to Section 1412, containing the presumption, before the provision was incorporated in the Dodd-Frank Act.[27]

2. Overview of TILA's Section 129C(a), Section 129C(b)(1), Section 129C(b)(2)(A), and Section 129C(b)(3) as Enacted in the Dodd-Frank Act

The statutory structure of Section 129C suggests that a creditor is given an alternative to meeting the ability-to-repay requirements in Section 129C(a) by making a qualified mortgage under Section 129C(b). Section 129C(a) sets forth the ability-to-repay requirements: the creditor must consider certain underwriting factors when analyzing a mortgage loan application, including the applicant's current and expected income and employment status, the payment amount based on a fully-amortizing schedule and fully-indexed rate, payments of other liens, taxes, and assessments, and the consumer's obligations, debt-to-income ratio, and credit history.[28] The ability-to-repay requirements do not include any limitations on the terms, costs or features of a mortgage loan that may meet the requirements.

Section 129C(b)(1), titled "Presumption of ability to repay" provides creditors making a qualified mortgage special protection from liability. That section states:

> In general. Any creditor with respect to any residential mortgage loan, and any assignee of such loan subject to liability under this title, may presume that the

[25] 155 Cong. Rec. H5174-75 (daily ed. May 6, 2009).

[26] 156 Cong. Rec. S5902, 5928 (daily ed. July 15, 2010) (emphasis added).

[27] *See* H.R. Rep. No. 111-365 (2009).

[28] Dodd-Frank Act Section 1411; TILA Section 129C(a)(1)-(4), (6)-(9); 15 U.S.C. §1639c(a)(1)-(4), (6)-(9) (2010).

> loan has met the requirements of subsection (a), if the loan is a qualified mortgage.[29]

In addition, Section 129C(b)(2) defines the term "qualified mortgage," which, in contrast to the general ability-to-repay requirements, also includes requirements about a borrower's income and resources, payment ratios and restrictions on certain terms, features and costs of the loan.[30] The definition of a qualified mortgage in TILA is:

> Qualified mortgage. The term "qualified mortgage" means any residential mortgage loan – (i) for which the regular periodic payments for the loan may not – (I) result in an increase of the principal balance; or (II) except as provided in subparagraph (E), allow the consumer to defer repayment of the principal; (ii) except as provided in subparagraph (E), the terms of which do not result in a balloon payment, where a "balloon payment" is a scheduled payment that is more than twice as large as the average of earlier scheduled payments; (iii) for which the income and financial resources relied upon to qualify the obligors on the loan are verified and documented; (iv) in the case of a fixed rate loan, for which the underwriting process is based on a payment schedule that fully amortizes the loan over the loan term and takes into account all applicable taxes, insurance, and assessments; (v) in the case of an adjustable rate loan, for which the underwriting process is based on a payment schedule that fully amortizes the loan over the loan term and takes into account all applicable taxes, insurance, and assessments; (vi) that complies with any guidelines or regulations established by the Board relating to ratios of total monthly debt to monthly income or alternative measures of ability to pay regular expenses after payment of total monthly debt, taking into account the income levels of the borrower and such other factors as the Board may determine relevant and consistent with the purposes described in paragraph 3(B)(i); (vii) for which the total points and fees (as defined in subparagraph (C)) payable in connection with the loan do not exceed 3 percent of the total loan amount; (viii) for which the term of the loan does not exceed 30 years, except as such term may be extended under paragraph (3), such as in high-cost areas; and (ix) in the case of a reverse mortgage (except for the purposes of subsection (a) of this section, to the extent that such mortgages are exempt altogether from those requirements), a reverse mortgage which meets the standards for a qualified mortgage, as set by the Board in rules that are consistent with the purposes of this subsection.[31]

---

[29] Dodd-Frank Act Section 1411; TILA Section 129C(b)(1); 15 U.S.C. § 1639c(b)(1) (2010).

[30] Dodd-Frank Act Section 1411; TILA Section 129C(b)(2)(A); 15 U.S.C. § 1639c(b)(2)(A) (2010).

[31] *Id.*

While the definition of a qualified mortgage in TILA does include some of the underwriting factors set forth in the ability-to-repay requirements in Section 129C(a), it does not include all of the underwriting factors. For example, a qualified mortgage does not require a creditor to consider the consumer's employment status, the payment of any simultaneous liens, current obligations and credit history, and does impose limitations of the costs and such a loan.[32]

Furthermore, Section 129C(b)(3)(B) is titled "Revision to safe harbor criteria." It provides the Bureau, as the Board's successor, the following authority:

> The Board may prescribe regulations that revise, add to, or subtract from the criteria that define a qualified mortgage upon a finding that such regulations are necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of this section, necessary and appropriate to effectuate the purposes of this section and section 1639b of this title, to prevent circumvention or evasion thereof, or to facilitate compliance with such sections.[33]

Additionally, Section 129C(b)(3)(A) gives the Board authority to issue regulations and rules to "revise, add to, or subtract from the criteria used to define a qualified mortgage."[34]

3. The Proposed Rule and the Alternatives for Paragraph (e)(1) of Proposed 12 C.F.R. § 226.43

Despite the discrepancies in the statutory text of Sections 129C(b)(1) and 129C(b)(3) about whether Section 129C gives a qualified mortgage a rebuttable presumption or a safe harbor and the ambiguity in the legislative history on this point, it is evident that the Board has authority under Section 105(a) of TILA to issue regulations to effectuate the purpose of Section 129C. As noted above, the Board addressed the presumption in the Proposed Rule and presented the two alternatives for Paragraph (e)(1) of proposed 12 C.F.R § 226.43, quoted *supra* at p. 3, the first granting a creditor making a qualified mortgage the safe harbor and the second, the rebuttable presumption. As support for its proposals, the Board analyzed the statutory construction and policy implications of interpreting Section 129C(b)(1) as the safe harbor or the rebuttable presumption. Although the Board generally stated that it reviewed and relied on the legislative history of the provision and similar provisions in H.R. 3915 and H.R. 1728, it did not include an in-depth discussion of that legislative history. The Board stated its belief that the scope of the presumption is unclear and that the statutory construction and policy implications could support either of the proposed two alternatives.[35]

---

[32] 76 Fed. Reg. at 27452.

[33] Dodd-Frank Act Section 1411; TILA Section 129C(b)(3)(B); 15 U.S.C. § 1639c(b)(3)(B) (2010).

[34] Dodd-Frank Act Section 1411; TILA Section 129C(b)(3)(B); 15 U.S.C. § 1639c(b)(3)(A) (2010).

[35] 76 Fed. Reg. at 27452-53.

First, the Board noted that the statutory language stating that a creditor or assignee "may presume" compliance supports an interpretation that "originating a qualified mortgage provides a presumption of compliance, which the consumer can rebut by providing evidence that the creditor did not, in fact, make a good faith and reasonable determination of the consumer's ability to repay the loan."[36] The Board also proposed that a rebuttable presumption would "better ensure that creditors consider a consumer's ability to repay the loan."[37] Such an approach would "require the creditor to comply with all of the ability-to-repay standards, and preserve a consumer's ability to use these standards in a defense to foreclosure or other legal action."[38] The Board noted that a rebuttable presumption would also permit a consumer to claim that, despite being given a qualified mortgage, the creditor failed to make a good faith and reasonable determination about a borrower's ability to repay. This approach, the Board said, would give little benefit or legal certainty to creditors and likely would discourage creditors from making qualified mortgage loans.[39] In addition, under Section 129C(b)(2)(B), the Board is free to add additional criteria to the safe harbor provision and the qualified mortgage requirements.

The Board's proposed comment concerning the rebuttable presumption notes that a "reasonable and good faith determination at or before consummation" of the loan is required and stated:

> Under §226.43(e)(1), a creditor or assignee of a covered transactions is presumed to have complied with repayment ability requirements of § 226.43(c)(1) if the terms of the loan comply with § 226.43(e)(2)(i)-(ii) (or if applicable, § 226.43(f)); the points and fees do not exceed the limits set forth in § 226.43(e)(2)(iii), and the creditor has complied with the underwriting criteria described in § 226.43(e)(2)(iv)-(v) (or if applicable, § 226.43(f)).[40]

The proposed comment went on to state:

> However, even if the loan is a qualified mortgage, the consumer may rebut the presumption of compliance with evidence that the loan did not comply with § 226.43(c)(1). For example, evidence of a high debt-to-income ratio with no compensating factors, such as adequate residual income could be sufficient to rebut the presumption.[41]

---

[36] 76 Fed. Reg. at 27453.

[37] *Id.*

[38] *Id.*

[39] *Id.*

[40] 76 Fed. Reg. at 27501.

[41] 76 Fed. Reg. at 27501.

The Board then discussed the alternative of a safe harbor for the qualified mortgage.[42] The Board noted that Section 129C(b)(1) states that a creditor or assignee of a qualified mortgage may presume that the loan has "met the requirements of subsection (a), if the loan is a qualified mortgage." Based on this language, the Board suggested that because Section 129C(a) read in its entirety includes both the general ability-to-repay standard in subsection (a)(1) and underwriting requirements in the remaining subsections, Congress may have intended the presumption to extend to both the ability-to-repay standard and any underwriting criteria, which should give a qualified mortgage a safe harbor.[43] The Board found further support for the safe harbor in the fact that a qualified mortgage does not have to meet all of the underwriting criteria, suggesting that a qualified mortgage is an alternative to the general ability-to-repay standard. The Board determined that one drawback to the safe harbor is that it "is not necessarily consistent with ensuring the consumer's ability to repay the loan."[44] The Board also noted that a safe harbor would limit a consumer's ability to challenge a creditor's reasonable and good faith determination of the consumer's ability to repay the loan, but would likely give more legal certainty to creditors and encourage creditors to make qualified mortgage loans.

The Board's proposed comment concerning the safe harbor stated, in part, that:

> A creditor or assignee that satisfies the requirements of § 226.43(e)(2) or § 226.43(f), as applicable, is deemed to have complied with § 226.43(c)(1). That is, a creditor or assignee need not demonstrate compliance with § 226.43(c)(2)-(7) if the terms of the loan comply with § 226.43(e)(2)(i)-(ii) (or if applicable, § 226.43(f)); the loan's points and fees do not exceed the limits set forth § 226.43(e)(2)(iii); and the creditor has complied with the underwriting criteria described in § 226.43(e)(2)(iv)-(v) (or if applicable, § 226.43(f)). The consumer may show the loan is not a qualified mortgage with evidence that the terms, points and fees, or underwriting did not comply with § 226.43(e)(2)(i)-(v) (or § 226.43(f), if applicable).[45]

In addition, the Board proposed two alternative definitions of the term "qualified mortgage," depending on whether the safe harbor or the rebuttable presumption is adopted in the final rule.[46] Under Alternative 1, the safe harbor, a covered transaction would be a loan that, as the Board summarized, includes the following characteristics:

> (a) The loan does not contain negative amortization, interest-only payments, or balloon payments, or a loan term exceeding 30 years; (b) The total points and fees

[42] *Id.*

[43] *See* Dodd-Frank Act Section 1411; TILA Section 129C(a); 15 U.S.C. § 1639c(a); 76 Fed. Reg. at 27453.

[44] 76 Fed. Reg. at 27453.

[45] 76 Fed. Reg. at 27501.

[46] 76 Fed. Reg. at 27484-86.

> do not exceed 3% of the total loan amount; (c) The borrower's income or assets are verified and documented; and (d) The underwriting of the mortgage (1) is based on the maximum interest rate in the first five years, (2) uses a payment scheduled that fully amortizes the loan over the loan term, and (3) takes into account any mortgage-related obligations.[47]

Under Alternative 2, the rebuttable presumption, a covered transaction would be a loan that, as the Board summarized:

> [Would include] all of the criteria listed under Alternative 1 as well as the following additional underwriting requirements from the ability-to-repay standard: (1) the consumer's employment status, (2) the monthly payment for any simultaneous loan, (3) the consumer's current debt obligations, (4) the total debt-to income ratio or residual income, and (5) the consumer's credit history.[48]

The Board solicited comments concerning the two different approaches to the presumption and the definition of qualified mortgage that are set forth in the Proposed Rule.

As we state above, it is our opinion that the Bureau has the authority under Section 105(a) of TILA to choose to provide a qualified mortgage a safe harbor and to add additional requirements to both the safe harbor and the definition of a qualified mortgage under Section 129C(b)(3).

## IV. Limitations and Qualifications

This opinion letter and the opinions it contains shall be interpreted in accordance with the Legal Opinion Principles issued by the Committee on Legal Opinions of the American Bar Association's Business Law Section as published in 53 *Bus. Law.* 831 (May 1998). To the extent we express a view or statement that is not expressly labeled as an opinion of the firm, it shall not be construed as a legal opinion of the firm.

We have limited our analysis to the statutory language and legislative history of Section 129C(b) of TILA, codified as 15 U.S.C. § 1693C(b), including predecessor legislation, and the Proposed Rule concerning the ability to repay provision, as well as other statutes and regulations listed in Annex A.

We believe that the opinions expressed herein represent a reasonable application of the legislative history, statutes and regulations covered herein based on their language and existing case law of which we are aware. The Proposed Rule has not yet been finalized, and the issues addressed by this opinion will be decided by the Board.

---

[47] 76 Fed. Reg. at 27390-91; *see also id.* at 27454, 27484-85.

[48] 76 Fed. Reg. at 27391; *see also id.* at 27454-55, 27485-86.

This letter is being furnished to the Mortgage Bankers Association (the "MBA"), and may only be made available to its members and to third parties upon request except MBA may make it available to third parties in connection with consideration of the Proposed Rule. It may not be relied upon by any person other than the MBA without our express written permission.

Very truly yours,

Goodwin Procter LLP

Goodwin|Procter LLP

CIRCULAR 230 DISCLOSURE:
To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. tax advice contained in this communication is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

GOODWIN | PROCTER

Thomas M. Hefferon
202.346.4029
thefferon@
goodwinprocter.com

Goodwin Procter LLP
Counselors at Law
901 New York Avenue NW
Washington, DC 20001
T: 202.346.4000
F: 202.346.4444

# MEMORANDUM

| | |
|---|---|
| **To** | Kenneth Markison, Mortgage Bankers Association |
| **From** | Thomas M. Hefferon TMH<br>Lynne B. Barr<br>Sallie F. Pullman |
| **Re** | Qualified Mortgage Definition Proposals Involving A Safe Harbor Or A Rebuttable Presumption |
| **Date** | July 22, 2011 |

In light of proposed "qualified mortgage" regulations to implement Section 129C of Dodd-Frank, you have asked us for an analysis of several issues that bear specifically on whether the qualified mortgage test ought to be structured as a safe harbor or as a rebuttable presumption:

- What typically are the different requirements of judicial proof required to establish the application of a safe harbor or a rebuttable presumption?
- What is the likely effect on the path of litigation between having a safe harbor rather than a rebuttable presumption?
- Does either regulatory choice necessarily favor one party or the other in any litigation?
- If a safe harbor is chosen, how might a safe harbor be constructed in order to maximize predictability and efficiency?

## I. Introduction and Background

Section 129C was created by Sections 1411, 1412 and 1414 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, H.R. 4173, (the "Dodd-Frank Act"), as a new section to the Truth In Lending Act ("TILA") titled "Minimum standards for residential mortgage loans."[1] For purposes relevant here, Section 129C prohibits a creditor from making a 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

[1] Dodd-Frank Act Section 1411; TILA Section 129C; 15 U.S.C. § 1639c (2010).

consumer has a reasonable ability to repay the loan . . . ."[2] Section 129C(b)(1) provides certain protection from liability to any creditor making a "qualified mortgage," as defined in Section 129C(b)(2)(A).

On May 11, 2011, the Board of Governors of the Federal Reserve System (the "Board") issued a proposed rule and request for public comment, Docket No. R-1417 (the "Proposed Rule") regarding, among other things in Section 129C, the ability-to-repay requirements and the protections afforded to "qualified mortgages." As part of the Proposed Rule, the Board presented two alternatives for a "qualified mortgage" standard, ultimately to be contained in proposed 12 C.F.R.§ 226.43(e)(1). The Board's Alternative 1 (the "Safe Harbor") states:

> (1) *Safe harbor.* A creditor or assignee of a covered transaction complies with the repayment ability requirement of paragraph c(1) of this section if the covered transaction is a qualified mortgage as defined in paragraph (e)(2) of this section.[3]

In contrast, the Board's Alternative 2 (the "Rebuttable Presumption") states:

> (1) *Presumption of compliance.* A creditor or assignee of a covered transaction is presumed to have complied with the repayment ability requirements of paragraph c(1) of this section if the covered transaction is a qualified mortgage, as defined in paragraph (e)(2) of this section.[4]

In so doing, then, the Board has suggested that the regulation may treat the making of a "qualified mortgage" (consistent with the statutory definition) to be a safe harbor for purposes of judging compliance with Section 129C's ability-to-repay requirement or may treat the making of a "qualified mortgage" as only a rebuttable presumption that Section 129C has been met.

Given the Board's suggestion that it is considering alternative approaches, you have asked us to describe the likely impact on litigation depending on whether the proposed regulation is enacted as a safe harbor or as a rebuttable presumption.[5]

## II. Safe Harbors and Rebuttable Presumptions: General Observations

Generally speaking, safe harbors are different from rebuttable presumptions in how each is applied and in how courts judge compliance with either. A safe harbor is "a provision (as in a statute or regulation) that affords protection from liability or penalty."[6] Safe harbors typically

---

[2] Dodd-Frank Act Section 1411; TILA Section 129C(a)(1); 15 U.S.C. § 1639c(a)(1).

[3] 76 Fed. Reg. 27390, 27484 (May 11, 2011).

[4] 76 Fed. Reg. 27390, 27484 (May 11, 2011).

[5] The Proposed Rule has not yet been finalized, and the issues addressed in this memorandum do not address the Proposed Rule directly. This memorandum also is not intended to express any view as to how the Proposed Rule or any other regulation, to be enacted in the future, may apply to a particular set of facts.

[6] Black's Law Dictionary 1363 (8th ed. 2004); *see also Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V.*, Nos. 09–5122–bk (L), 09–5142–bk (Con), 2011 WL 2536101, at *7 (2d Cir.

describe a single standard or a multi-factor test which, if complied with, provide some sort of exemption from liability or conclusion of statutory compliance. If a transaction fits within the four corners of a safe harbor, the regulated entity enjoys that protection. As such, safe harbors provide a certain level of predictability.

In a litigation context, the advantages of a safe harbor are magnified because the stated standard or factors are, by definition, the only standard or factors that a court can consider in judging its application. This means that a litigant seeking to establish that a safe harbor applies, or seeking to establish that it does not, can be certain that no standards or factors other than those stated are relevant. While there will be litigation over whether the standard or factors are met, the nature of safe harbors limits the scope of litigation and so can help preserve judicial and party resources and lead to a relatively early resolution of litigation.

A test for liability or an exemption that is governed by a presumption that is rebuttable operates differently than a safe harbor, though many presumptions share the feature safe harbors have of being based on a single standard or multi-factor test. The difference is that, unlike a safe harbor, a rebuttable presumption typically allows for the introduction of evidence and argument about standards or factors that are not listed in the statute or regulation. So, while a regulated entity could establish that under the stated test its conduct meets the presumption, and so complies with law or triggers an exemption, another party such as a regulator or court could attempt to show that the presumption should be overridden by reference to some other set of facts, additional evidence, relevant policy considerations, or the like (depending on the statutory context). This leads to a certain level of unpredictability, particularly where the elements of the presumption are not exhaustive of the possible facts or circumstances that possibly are relevant.

In litigation, rebuttable presumptions are just that – rebuttable. Under evidence principles, proof that the presumption applies "imposes on the party against whom it is directed the burden of going forward with evidence to rebut or meet the presumption." Fed. R. Evid. 301.[7] Once

---

June 28, 2011) (noting that a proposed reading of a securities regulation implementing a statutory safe harbor "would make application of the safe harbor in every case depend on a factual determination regarding the commonness of a given transaction" and that "[t]his reading of the statute would result in commercial uncertainty and unpredictability at odds with the safe harbor's purpose and in an area of law where certainty and predictability are at a premium."); *Williams v. OSI Educational Services, Inc.*, 505 F.3d 675, 680 (7th Cir. 2007) (noting that judicially-created safe harbor "was offered in an attempt both to bring predictability to this area and to conserve judicial resources").

[7] Wright & Miller describes Rule 301 by saying that "[p]resumptions governed by this rule are given the effect of placing upon the opposing party the burden of establishing the nonexistence of the presumed fact, once the party invoking the presumption establishes the basic facts giving rise to it." 21B Charles Alan Wright & Arthur R. Miller et al., Fed. Practice and Proc. at Evid. R. 301 (interim ed. 2011). It goes on to state that "[a] presumption is a deduction which the law expressly directs to be made from particular facts." *Id.* at § 5124 (quoting N.Y. Comm'rs on Practice and Procedure, Code of Civ. P. § 1776 (1850)); *see also ITC, Ltd. v. Punchgini*, 482

that party rebuts or meets the presumption, the fact there was initial proof the presumption applied is not supposed to have any effect on the burden of persuasion as to ultimate liability. Fed. R. Evid. 301, advisory committee's notes. Moreover, in the case of a classic rebuttable presumption, there often are no specific limitations about what sort of factual issues or evidence can be used to rebut the presumption. Thus, by definition, the scope of inquiry for a rebuttable presumption is more open-ended and unpredictable than that for a safe harbor.

## III. Empirical Evidence Of The Effect of the Choice Between A Safe Harbor and A Rebuttable Presumption

You asked us to give some context to how these general characteristics of safe harbors and rebuttable presumptions play out in actual litigation, to help draw some conclusions as to what effect the choice between the two approaches might have on future litigation concerning whether Section 129C's ability-to-repay standards were met by the making of a "qualified mortgage." One difficulty with doing so is the large variety of statutory and regulatory safe harbors and presumptions, and the different litigation contexts in which they are relevant. However, we concluded that studying TILA litigation involving a safe harbor or a rebuttable presumption could inform a conclusion about the subject. Our thinking was that these would provide concrete examples of how each mechanism operates in practice, and those examples likely would be instructive because Section 129C is also part of TILA and because future Section 129C litigation likely would involve the same types of parties as the parties involved in other TILA cases.

In order to develop our views concerning the effect of the choice between the two regulatory alternatives, we considered reported cases that have arisen in TILA litigation over a statutory safe harbor (Section 130(f)) and over a rebuttable presumption (Section 125(c)). We have conducted a complete review of reported and unreported decisions since May 2005 on both of these sections and have created Table 1 and Table 2, attached hereto, collecting cases analyzing these sections.

Based on our review, and our assumption that the experience under the two provisions we considered are predictive, and for the reasons set forth below, if the safe harbor approach is adopted, litigation concerning compliance with Section 129C is likely to be more efficiently resolved, less complex and less costly to all parties than if the rebuttable presumption approach is adopted.[8]

---

F.3d 135, 147 (2d Cir. 2007) ("A presumption is an assumption of fact resulting from a rule of law which requires such fact to be assumed from another fact or group of facts found or otherwise established in the action.").

[8] Our review of litigation was limited to cases we could access under Section 130(f) and Section 125(c). It should not be read as commenting on how either section applies in future litigation, or as a judgment as to whether any case was correctly decided. We have not been asked to, nor have we, conducted a survey of the legislative history, statutes, regulations or case law

### A. Safe Harbor Under Section 130(f) of TILA

As an example of how litigation develops and is resolved when a TILA safe harbor is involved, we examined case law relating to the defense to liability provided in Section 130(f) for a creditor's good faith compliance with a rule, regulation or interpretation of the Board or Board staff. That section of TILA states:

> No provision of this section, section 1607(b) of this title, section 1607(c) of this title, section 1607(e) of this title, or section 1611 of this title imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or interpretation thereof by the Board or in conformity with any interpretation or approval by an official or employee of the Federal Reserve System duly authorized by the Board to issue such interpretations or approvals under such procedures as the Board may prescribe therefore, notwithstanding that after such act or omission has occurred, such rule, regulation, interpretation, or approval is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.[9]

In *Milhollin*, after reviewing the deference that should be afforded the Board's regulations and commentary, the Supreme Court examined the scope and purpose of the safe harbor in Section 130(f). 444 U.S. at 567. The Court stated:

> Congress has specifically designated the Federal Reserve Board and staff as the primary source for interpretation and application of truth-in-lending law. Because *creditors need sure guidance* through the "highly technical" Truth in Lending Act, S. Rep. No. 93-278, p. 13 (1973), legislators have twice acted to promote reliance upon Federal Reserve pronouncements. In 1974, TILA was amended to provide creditors with a defense from liability based upon good-faith compliance with a "rule, regulation, or interpretation" of the Federal Reserve Board itself. *The explicit purpose of the amendment was to relieve the creditor of the burden of choosing "between the Board's construction of the Act and the creditor's own assessment of how a court may interpret the Act."* The same rationale prompted a further change in the statute in 1976, authorizing a liability defense for "conformity with any interpretation or approval by an official or employee of the Federal Reserve System duly authorized by the Board to issue such interpretations or approvals . . . ."

*Id.* at 567 (emphasis added) (internal citation omitted). The Court held, applying these principles, that a creditor could properly rely on a Board interpretation (about how acceleration

---

concerning other provisions of TILA or a complete survey of all statutory provisions employing a safe harbor or rebuttable presumption standard.

[9] TILA Section 130(f); 15 U.S.C. § 1640(f).

terms were disclosed) and that the creditor was therefore entitled to dismissal of any challenges. *Id.*[10]

This broad safe harbor has been applied to many areas in which the Board and its staff have issued comments or guidance. Courts often have found that compliance with the Official Staff Commentary to Regulation Z (the "Commentary") "shields an issuer from civil liability pursuant to TILA's safe-harbor provision." *Katz v. Cal-Western Reconveyance Corp.*, No. 5:09-cv-04866-JF, 2010 WL 424453, at *3-4 (N.D. Cal. Jan. 27, 2010).

Courts ruling on the application of this safe harbor provision have been able to resolve matters at early stages of litigation, for either party, rather than after lengthy or costly discovery. *See, e.g.*, *Katz*, 2010 WL 424453; *Raeth v. Nat'l City Bank*, 755 F. Supp. 2d 899, 903-06 (W.D. Tenn. 2010) (dismissing multiple TILA claims with prejudice because creditor satisfied safe harbor provision); *Alicea*, 210 F. Supp. 2d 4. Our research revealed that out of 24 decisions, reported and unreported, concerning Section 130(f) following *Milhollin*, the safe harbor issue was resolved in 17 cases at the motion to dismiss or preliminary injunction stage, while 6 cases went on to summary judgment, and only 1 case went to trial. *See* Table 1 (attached hereto collecting cases). Furthermore, our research on this provision revealed only 24 decisions in total since the *Milhollin* decision in 1980, while, as discussed more fully below, our research regarding the rebuttable presumption in Section 125(c) revealed 59 decisions over the last five years alone.

### B. Rebuttable Presumption Under Section 125(c) of TILA

To identify any contrast with the experience of a TILA safe harbor, we examined experience with the rebuttable presumption in Section 125(c) of TILA, concerning the requirement for right of rescission disclosures in Section 125(a) of TILA. The relevant portion of Regulation Z specifies that in order to provide proper notice of the right to cancel, "a creditor shall deliver two copies of the notice of the right to rescind to each consumer entitled to rescind." 12 C.F.R. § 226.23(b)(1); *see also* 12 C.F.R. § 226.23(a). The typical form of notice contains a space for signed acknowledgement by the borrower of timely receipt of the notice. *See* Rescission Model Forms H-8 and H-9. However, Section 125(c) states:

> Notwithstanding any rule of evidence, written acknowledgment of receipt of any disclosures required under this subchapter by a person to whom information, forms, and a statement is required to be given pursuant to this section does no more than create a rebuttable presumption of delivery thereof.[11]

[10] *See also Pittman v. Money Mart, Inc.*, 636 F.2d 993, 995 (5th Cir. 1981) (applying the safe harbor to "hold that [the creditor's] delinquency-charge statement complies with the disclosure requirements of section 226.8(b)(4), Regulation Z, quoted above, and that, therefore, [it] cannot be held civilly liable by reason of any claimed inadequacy of disclosure with regard to the delinquency charge imposable for late payment").

[11] TILA Section 125(c); 15 U.S.C. § 1635(c).

There is no additional guidance in applying the presumption in either Regulation Z or the Commentary.

Taken together, the rebuttable presumption set forth in Section 125(c) and Federal Rule of Evidence 301 indicate that the resolution of cases involving the rebuttable presumption permit a fact-specific inquiry. This raises the possibility that such cases may not be ones that could be resolved on the face of the pleadings or through modest discovery. This possibility is proven in practice, as reflected in the case law revealed by our research. In reviewing 59 decisions, reported and unreported over the last five years, applying the presumption in Section 125(c), only 7 cases were resolved at the motion to dismiss stage (and 5 of those cases were resolved on other grounds), while 17 cases went on to be resolved at summary judgment, and the remaining 35 cases went on to be set for trial. *See* Table 2 (attached hereto collecting cases).

Our research into these cases, and our experience, suggests that litigation involving a rebuttable presumption can present two challenges that did not regularly appear in litigation involving a safe harbor. First, there often is uncertainty in the former types of cases as to which facts or evidence might be sufficient to rebut the presumption. Second, the interplay of the presumption and the additional facts appears to lead more often to litigation that does not terminate prior to or even at the time of summary judgment.

There are many courts that have determined that a borrower's assertion of noncompliance alone creates a question of fact to be resolved at trial under a rebuttable presumption standard. *See, e.g. Stutzka v. McCarville*, 420 F.3d 757, 762 (8th Cir. 2005) ("Because [plaintiff]'s affidavit, at the very least, would have rebutted the presumption of delivery, the district court also erred in granting summary judgment on the TILA claims.").[12] But, illustrative of the general uncertainty created by a rebuttable presumption, some courts have determined that a borrower's assertion of noncompliance alone is insufficient to resolve the presumption in the borrower's favor. *See e.g., McCarthy v. Option One Mortg. Corp.*, 362 F.3d 1008, 1011 (7th

[12] *See also Rodrigues v. Newport Lending Corp.*, No. 10-00029 HG-LEK, 2010 WL 4960065, at *6 (D. Haw. Nov. 29, 2010) (denying summary judgment based on plaintiff's denial of receipt of disclosures); *Briggs v. Provident Bank*, 349 F. Supp. 2d 1124, 1129 (N.D. Ill. 2004) (denying summary judgment based on claimant's deposition testimony concerning receipt of disclosures); *Macheda v. Household Fin. Realty Corp.*, 631 F. Supp. 2d 181, 191 (N.D.N.Y. 2008) (denying cross-summary judgment motions based on borrower's offer of proof to rebut presumption of delivery); *Jobe v. Argent Mortg. Co., LLC*, No. 3:cv-06-0697, 2008 WL 450432, at *4-5 (M.D. Pa. Feb. 15, 2008) (denying summary judgment based on plaintiffs' sworn statements that they were not each given two copies of the required notice); *Cooper v. First Gov't Mortg. & Investors Corp.*, 238 F. Supp. 2d 50, 64-65 (D.D.C. 2002) (same); *Hanlin v. Ohio Builders & Remodelers, Inc.*, 212 F. Supp. 2d 752, 762 (S.D. Ohio 2002) (same).

Cir. 2004) (affirming summary judgment in the creditor's favor because mere assertion of non-receipt is insufficient to rebut written evidence that disclosures were provided).[13]

Notably, none of these cases cited above concerning the necessary proof to rebut a presumption were resolved until the summary judgment stage or trial. In our experience, as a general matter, litigation that is resolved at the motion to dismiss stage, without taking into account any appeal process, is less expensive for both parties than litigation that proceeds to summary judgment or trial. In order to proceed to summary judgment or trial, the parties must conduct fact-finding discovery, including but not limited to, exchanging document requests and interrogatories and conducting depositions. Moreover, trial preparation can also be costly and time-consuming. The additional issues involved in proceeding to summary judgment or trial are likely to result in greater expense and attorneys fees for both parties regardless of the outcome of the litigation, than litigation that is resolved at the motion to dismiss stage.

### C. Conclusions.

Our review of the application of the safe harbor in TILA Section 130(f) and of the rebuttable presumption in TILA Section 125(c) provides strong and concrete support for the conclusion that any litigation over TILA Section 129C compliance is likely to be cheaper, quicker, and more efficiently resolved if there is a safe harbor standard for a "qualified mortgage" than if a rebuttable presumption standard is adopted. This experience also supports the conclusion that a safe harbor can be expected to lead to more predictable results and certain application than does a rebuttable presumption.[14]

## IV. Legal Challenges Under a Safe Harbor

You have asked whether having a safe harbor standard, in itself, will limit a borrower's ability to bring litigation challenging whether the standard was met.

---

[13] *See also Williams v. GM Mortg. Corp.*, No. 03-cv-74788-DT, 2004 WL 3704081, at *8 (E.D. Mich. Aug. 18, 2004) (resolving summary judgment in the creditor's favor because "a Plaintiff's bare bones, self-serving denial is not sufficient to rebut § 1635(c)'s statutory presumption"); *Parker v. Long Beach Mortg. Co.*, 534 F. Supp. 2d 528, 536-37 (E.D. Pa. 2008) (finding plaintiffs failed to rebut presumption as part of post-trial Rule 52(c) judgment as a matter of law, when plaintiffs' only evidence offered to rebut presumption was testimony that they did not remember receiving disclosures).

[14] These observations do not take into account the actual safe harbor or rebuttable presumption that might be adopted, or assess the Proposed Rule's alternatives or any other structures that might be suggested by commentators. The design of a safe harbor or a rebuttable presumption can limit, or even eliminate, various of the advantages and disadvantages discussed; for example, if the safe harbor is based on subjective factors or fact-intensive factors, some of the certainty in a safe harbor structure may be lost.

As noted above, and evidenced by the safe harbor cases identified in Table 1, simply providing a regulatory safe harbor will not limit a borrower's ability to bring a lawsuit to dispute that the standard or the factors that trigger the standard were met by the creditor (within the constraints, of course, that such a dispute requires a good faith basis). While such a dispute might be resolved quickly, that does not necessarily mean that one party or the other would prevail.

We also point out that a safe harbor standard could be structured so as to put the burden on the creditor to demonstrate that its actions met the standard or the factors listed in the safe harbor. To the extent that is the case, the mere existence of the safe harbor would not disadvantage a borrower for the further reason that the burden of proof as to compliance with Section 129C would not fall on the borrower.

## V. Considerations In Design of a Safe Harbor

Additionally, you have asked about our views concerning what types of standards could be included in a safe harbor such that it would likely maximize the advantages to such a structure. This is not a matter of legal judgment, but it seems that, based on the above discussion and in our experience, a safe harbor that contains definite, objective factors is more likely to serve the goals of certainty and predictability. In addition, a safe harbor that delineates the type of evidence that establishes the safe harbor may be even stronger. So, for example, if proof of a qualified mortgage safe harbor requires a demonstration that employment has been verified, the safe harbor would be stronger to the extent it specifically identified a conclusively-acceptable method of making such a verification.

GOODWIN | PROCTER

# TABLE 1

**Safe Harbor (TILA Section 130, 15 U.S.C. § 1640):**

MTD = Motion to Dismiss; MSJ = Motion for Summary Judgment
Unless not otherwise noted, motions was brought by creditor

| | Case | Resolution of Safe Harbor Question |
|---|---|---|
| 1. | *Raeth v. Nat'l City Bank*, 755 F. Supp. 2d 899 (W.D. Tenn. 2010) | MTD, safe harbor applies |
| 2. | *Palmer v. Ameribanq Mortg. Grp.*, LLC, No. 05-2023, 2010 WL 3933273 (E.D. Pa. Oct. 6, 2010) | After bench trial (primarily on other issues), safe harbor applies |
| 3. | *Poulin v. Balise Auto Sales, Inc.*, No. 3:08-cv-01618 (CSH), 2010 WL 1370862 (D. Conn. Apr. 5, 2010) | MTD, safe harbor applies |
| 4. | *Katz v. Cal-Western Reconveyance Corp.*, No. 5:09-cv-04866-JF (N.D. Cal. Jan. 27, 2010) | MTD, safe harbor applies |
| 5. | *Olivera v. American Home Mortg. Servicing, Inc.*, 689 F. Supp. 2d 1218 (N.D. Cal. 2010) | MTD, safe harbor applies |
| 6. | *Valdez v. America's Wholesale Lender*, No. C 09-02778 JF (RS), 2009 WL 5114305 (N.D. Cal. Dec. 18, 2009) | MTD, safe harbor applies |
| 7. | *Jordan v. Paul Financial, LLC*, 644 F. Supp. 2d 1156 (N.D. Cal. 2009) | MSJ, safe harbor does not apply |
| 8. | *Kelly v. Performance Credit Corp.*, No. 08-40159-FDS, 2009 WL 3300030 (D. Mass. Apr. 14, 2009) | MTD, safe harbor applies |
| 9. | *Bonney v. Wash. Mut. Bank*, 596 F.Supp.2d 173 (D. Mass 2009) | MTD, safe harbor applies |
| 10. | *Mandrigues v. World Savings, Inc.*, No. C 07-4497 JF, 2009 WL 160213 (N.D. Cal. Jan. 20, 2009) | Motion for Preliminary Injunction, safe harbor applies |
| 11. | *Omar v. Wash. Mut. Bank*, No. 08-40044-FDS, 2008 WL 5650851 (D. Mass. Dec. 30, 2008) | MTD, safe harbor applies |
| 12. | *Quiles v. Wash. Mut. Bank*, No. 08-40039-FDS, 2008 WL 5650852 (D. Mass. Dec. 30, 2008) | MTD, safe harbor applies |

| | | |
|---|---|---|
| 13. | *Amparan v. Plaza Home Mortg., Inc.*, 678 F.Supp.2d 961 (N.D. Cal. 2008) | MTD, safe harbor does not completely apply |
| 14. | *Altamirano v. Copiague Funding Corp.*, No. 3:06cv1751 (PCD), 2008 WL 3845362 (D. Conn. Aug. 18, 2008) | MSJ (Plaintiff's), safe harbor does not apply |
| 15. | *Swanson v. Bank of America, N.A.*, 566 F. Supp. 2d 821 (N.D. Ill. 2008) | MTD, safe harbor applies |
| 16. | *Aubin v. Residential Funding Co.*, LLC, 565 F. Supp. 2d 392 (D. Conn. 2008) | MTD, safe harbor does not apply |
| 17. | *Megitt v. IndyMac Bank, F.S.B.*, 547 F. Supp. 2d 56 (D. Mass 2008) | MTD, safe harbor applies |
| 18. | *Cazares v. Pac. Shore Funding*, No. CV04-2548DSF(SSX), 2006 WL 149106 (C.D. Cal. Jan 3, 2006) | MTD, safe harbor does not apply |
| 19. | *Jeanty v. Wash. Mut. Bank, F.A.*, 305 F. Supp. 2d 962 (E.D. Wis. 2004) | MTD, safe harbor does not apply |
| 20. | *Fabricant v. Sears Roebuck*, No. 98-1281-CIV, 2002 WL 34477592 (S.D. Fla. Mar. 5, 2002) | MSJ, safe harbor does not apply |
| 21. | *London v. Chase Manhattan Bank USA*, N.A., 150 F. Supp. 2d 1314 (S.D. Fla. 2001) | MSJ (plaintiff's), safe harbor does not apply |
| 22. | *Greisz v. Household Bank*, 8 F. Supp. 2d 1031 (N.D. Ill. 1998) | MSJ, safe harbor applies |
| 23. | *Ritter v. Durand Chevrolet, Inc.*, 945 F. Supp. 381 (D. Mass 1996) | MSJ, safe harbor applies |
| 24. | *Lindsey v. Ed Johnson Oldsmobile, Inc.*, No. 95 C 7306, 1996 WL 411336 (N.D. Ill. July 19, 1996) | MTD, safe harbor does not apply |

GOODWIN | PROCTER

# TABLE 2

**Presumption (TILA Section 125, 15 U.S.C. § 1635):**

MTD = Motion to Dismiss; MSJ = Motion for Summary Judgment
If not otherwise noted, motion was brought by creditor

| | **Case** | **Resolution of Presumption Question** |
|---|---|---|
| 1. | Solomon v. Falcone, No. 09–2210 (ABJ), 2011 WL 2342759 (D.D.C. June 15, 2011) | MTD, denied because issue of fact exists |
| 2. | Kuenzi v. EuroSport Cycles, Inc., No. 08–3906, 2011 WL 1883052 (E.D. Pa. May 17, 2011) | MSJ (2nd), presumption not rebutted |
| 3. | Moore v. ING Bank, Inc., No. C11–139Z, 2011 WL 1832797 (W.D. Wash. May 13, 2011) | MTD, denied because issue of fact exists |
| 4. | Patterson v. Bank of America, No. C11–155Z, 2011 WL 1832814 (W.D. Wash. May 13, 2011) | MTD, granted on other grounds, but rejects presumption because issue of fact exists |
| 5. | Tacheny v. M&I Marshall & Ilsley Bank, No. 10–CV–2067 (PJS/JJK), 2011 WL 1657877, (D. Minn., Apr. 29, 2011) | MTD, denied because "premature" and must be brought in MSJ |
| 6. | Cavaco v. MERS, No. 09–00586 SOM/BMK, 2011 WL 1565979 (D. Haw. Apr. 25, 2011) | MSJ, denied because issue of fact exists |
| 7. | Hegrenes v. MGC Mortg., Inc., No. 10-422-AA, 2011 WL 841172 (D. Or. Mar. 7, 2011) | MSJ, granted because plaintiff did not rebut |
| 8. | Bakker v. Wells Fargo Home Mortg., No. CV–10–82–HU, 2011 WL 1124041 (D. Or. Feb. 28, 2011) | MTD, denied because pleading adequate to state claim without considering notices at MTD stage |
| 9. | Marr v. John Does 1-5, No. 09-CV-228, 2011 WL 382133 (E.D. Wis. Feb. 3, 2011) | MSJ, granted because plaintiff did not rebut after depositions |

| | | |
|---|---|---|
| 10. | Stallman v. Countrywide Home Loans, Inc., No. 1:10 CV 1006, 2011 WL 400103 (N.D. Ohio Feb. 1, 2011) | MSJ, granted because plaintiff did not rebut |
| 11. | Farwell v. Story, No. DKC 10-1274, 2010 WL 4963008 (D. Md. Dec. 1, 2010) | MTD, denied because premature |
| 12. | Rodrigues v. Newport Lending Corp., No. 10-00029 HG-LEK, 2010 WL 4960065 (D. Haw. Nov. 29, 2010) | MSJ, denied because issue of fact exists |
| 13. | Palmer v. Ameribanq Mortg. Grp., LLC, No. 05-2023, 2010 WL 3933273 (E.D. Pa. Oct. 6, 2010) | After bench trial, granted because plaintiff did not rebut |
| 14. | Calhoun v. Homeowners Friend Mortg. Co., Inc., No. 09-4568, 2010 WL 3802704 (E.D. La. Sept. 20, 2010) | MSJ, denied because issue of fact exists |
| 15. | Chernick v. Bank of Am. Home Loans, No. 2:09-cv-02746 JAM-DAD, 2010 WL 3269797 (E.D. Cal. Aug. 18, 2010) | MTD, granted |
| 16. | Frese v. Empire Fin. Servs., 725 F.Supp.2d 130 (D.D.C. 2010) | MTD, denied |
| 17. | Iannuzzi v. Am. Mortg. Network, Inc., 727 F.Supp.2d 125 (E.D.N.Y. 2010) | MSJ, denied in relevant part |
| 18. | Pacheco v. Homecoming Fin. LLC, No. C 08-3002 JF (HRL), 2010 WL 2629887 (N.D. Cal. June 29, 2010) | MSJ, granted |
| 19. | Hendricksen v. Countrywide Home Loans, No. 3:09-CV-00082, 2010 WL 2553589 (W.D. Va. June 24, 2010) | MSJ, granted |
| 20. | Bonanno v. Sec. Atl. Mortg. Co., No. 07-CV-4071 (JG)(WDW), 2010 WL 2134155 (E.D.N.Y. 2010) | MSJ, granted |
| 21. | Sias v. Wash. Mut. Bank, No. 3:10-CV-43, 2010 WL 2103448 (E.D. Tenn. 2010) | MSJ, granted |
| 22. | Lee v. Countrywide Home Loans, Inc., No. 3:09 CV 766, 2010 WL 1487131 (N.D. Ohio Apr. 13, 2010) | MSJ, granted |
| 23. | Burch v. GMAC Mortg., LLC, No. C-09-4214 MMC, 2010 WL 934088 (N.D. Cal. Mar. 15, 2010) | MTD, denied in relevant part |
| 24. | Morris v. Bank of America, No. C 09-2849 SBA, 2010 WL 761318 (N.D. Cal. Mar. 3, 2010) | MTD, denied in relevant part |
| 25. | Deutsche Bank Nat'l Trust Co. v. LaCapria, No. 08-2174 (JAP), 2010 WL 715617 (D.N.J. Mar. 1, 2010) | MSJ, granted |

| | | |
|---|---|---|
| 26. | Pearce v. Bank of America Home Loans, No. C 09-3988 JF, 2010 WL 689798 (N.D. Cal. Feb. 23, 2010) | MTD, granted on other grounds |
| 27. | Am v. Nat'l City Mortg. Co., No. 09-00060 SOM/KSC, 2010 WL 571936 (D. Haw. Feb. 17, 2010) | MSJ, granted |
| 28. | Payan v. Greenpoint Mortg. Funding, Inc., 681 F. Supp. 2d 564 (D.N.J. 2010) | Motion for judgment on the pleadings, granted |
| 29. | Horton v. Country Mortg. Servs., Inc., No. 07 C 6530, 2010 WL 55902 (N.D. Ill. Jan 4, 2010) | MSJ, denied in relevant part |
| 30. | Valdez v. America's Wholesale Lender, No. C 09-02778 JF (RS), 2009 WL 5114305 (N.D. Cal. Dec. 18, 2009) | MTD, granted on other grounds |
| 31. | Gonzalez v. Wells Fargo Bank, No. C 09-03444 MHP, 2009 WL 3572118 (N.D. Cal. Oct. 30, 2009) | Preliminary Injunction, denied |
| 32. | Seagren v. Aurora Loan Servs., Inc., No. CV 09-5050 ODW (AGRx), 2009 WL 3534171 (D.D. Cal. Oct. 28, 2009) | MTD, granted |
| 33. | Anderson v. Countrywide Fin., No. 2:08-cv-01220-GEB-GGH, 2009 WL 3368444 (E.D. Cal. Oct. 16, 2009) | MSJ, granted |
| 34. | Dahn v. Fifth Third Bank, No. 3:09-cv-184-JPG-PMF, 2009 WL 2588875 (S.D. Ill. Aug. 20, 2009) | Motion for judgment on the pleadings, granted |
| 35. | Jobe v. Argent Mortg. Co., LLC, No. 3:CV-06-00697, 2009 WL 2461168 (M.D. Pa. Aug. 11, 2009) | MSJ, granted |
| 36. | Byron v. EMC Mortg. Corp., No. 3:09-CV-197-HEH, 2009 WL 2486816 (E.D. Va. Aug. 10, 2009) | MTD, granted on other grounds |
| 37. | Siffel v. NFM, Inc., No. 07-cv-05152-JF, 2009 WL 1783523 (E.D. Pa. June 23, 2009) | MSJ, granted |
| 38. | Knittel v. First Fin. Mortg. Corp., No. 08-44-JBC, 2009 WL 1702174 (E.D. Ky. June 1, 2009) | MSJ, granted |
| 39. | Garza v. Am. Home Mortg., No. CV F 08-1477 LJO GSA, 2009 WL 1139594 (E.D. Cal. Apr. 28, 2009) | MTD, granted |
| 40. | Hill v. Tribeca Lending Corp., No. 07-5300, 2009 WL 691977 (E.D. Pa. Mar. 17, 2009) | Judgment for Defendants |
| 41. | Haywood v. Fremont Investment & Loan, No. 08 Civ. 4961 (BMC), 2009 WL 796090 (E.D.N.Y. Mar. 16, 2009) | MTD, denied |

| | | |
|---|---|---|
| 42. | Glucksman v. First Franklin Fin. Corp., 601 F. Supp. 2d 511 (E.D.N.Y. 2009) | Declaratory Judgment to Rescind Mortgage, denied |
| 43. | Quintos v. Decision One Mortg. Co., LLC, No. 08-CV-1757 JM (POR), 2008 WL 5411636 (S.D. Cal. Dec. 29, 2008) | MTD, granted |
| 44. | Briscoe v. Deutsche Bank Nat'l Trust Co., No. 08 C 1279, 2008 WL 4852977 (N.D. Ill. Nov. 7, 2008) | MTD, denied |
| 45. | Gonzalez v. The CIT Grp./Consumer Fin., Inc., No. 07-4156, 2008 WL 4771856 (E.D. Pa. Oct. 29, 2008) | MSJ, granted in relevant part |
| 46. | Macheda v. Household Fin. Realty Corp. of N.Y., 631 F. Supp. 2d 181 (N.D.N.Y. 2008) | MSJ, denied in relevant part |
| 47. | Buick v. World Savings Bank, 631 F. Supp. 2d 765 (E.D. Cal. 2008) | MTD, denied in relevant part |
| 48. | Kajitani v. Downey Savings and Loan Ass'n, F.A., 647 F. Supp. 2d 1208 (D. Haw. 2008) | MSJ, denied in relevant part |
| 49. | Abbott v. Wash. Mut. Fin., Inc., No. 05-4497, 2008 WL 756069 (E.D. Pa. Mar. 20, 2008) | Trial order in favor of defendant |
| 50. | Chiles v. Ameriquest Mortg. Co., 551 F. Supp. 2d 393 (E.D. Penn. 2008) | MSJ, granted |
| 51. | White v. Homefield Fin., Inc., 545 F. Supp. 2d 1159 (W.D. Wash. 2008) | MSJ, denied in relevant part |
| 52. | Jobe v. Argent Mortg. Co., No. 3:CV-06-0697, 2008 WL 450432 (M.D. Pa. Feb. 15, 2008) | MSJ, denied in relevant part |
| 53. | Parker v. Long Beach Mortg. Co., 534 F.Supp.2d 528 (E.D. Pa. 2008) | Motion for Judgment as Matter of Law, granted |
| 54. | Davis v. Deutsche Bank Nat'l Trust Co., No. 05-CV-4061, 2007 WL 3342398 (E.D. Pa. Nov. 8, 2007) | MSJ, granted |
| 55. | Rimstad v. Wells Fargo Bank, N.A., No. 07-2582 (DWF/AJB), 2007 WL 1752724 (D. Minn. June 15, 2007) | Motion to Vacate Temporary Restraining Order, granted |
| 56. | Peterson v. Argent Mortg. Co., No. 06-3796 (PAM/JSM), 2007 WL 1725355 (D. Minn. June 14, 2007) | MTD, granted |
| 57. | Caliguiri v. Columbia River Bank Mortg. Grp., No. 07-3003-PA, 2007 WL 1560623 (D. Or. May 22, 2007) | MTD, granted on other grounds |

| | | |
|---|---|---|
| 58. | In re Ameriquest Mortg. Co., No. 05-CV-7097, 2006 WL 1525661 (N.D. Ill. May 30, 2006) | Plaintiffs' Motion for Temporary Injunctive Relief, granted over the presumption |
| 59. | Stutzka v. Walters, No. 8:02CV72, 2006 WL 861284 (D. Neb. Mar. 28, 2006) | Plaintiff's and Defendant's MSJs, presumption rebutted sufficient to require trial |