AMERICANS FOR FINANCIAL REFORM
ACCOUNTABILITY ★ FAIRNESS ★ SECURITY

Americans for Financial Reform
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April 18, 2012

The Honorable Richard Cordray
Director
Consumer Financial Protection Bureau
1500 Pennsylvania Ave. NW
(Attn: 1801 L St.)
Washington DC 20220

Dear Director Cordray:

The Qualified Mortgage/Ability to Repay regulations pending before the CFPB are among the most important regulations that the Bureau will issue. They address a fundamental cause of the mortgage catastrophe that precipitated the greatest financial crisis in the last 80 years, a crisis which has cost millions of jobs, millions of foreclosures, and trillions of dollars in lost home equity and vanished retirement savings. This rule is aimed directly at the core deficiencies in the mortgage market that produced unsustainable loans, an inflated housing market, and resulting widespread economic hardship. And this rule will profoundly shape mortgage markets going forward.
In approaching implementation of the ATR/QM statute, AFR members share a number of key goals: broad access to credit on safe and fair terms; ending the dual mortgage market; and protecting borrowers, and the market, against abusive lending.

Many members of AFR have communicated with the CFPB in formal comments and follow up meetings and letters on this rule. The positions set out in these presentations reflect some differences on how best to accomplish these goals. However, the members of AFR are united and emphatic regarding the following basic principles, which we think are crucial:

- The rule must provide for a broad QM market that encompasses the vast bulk of lending, so that lenders are incentivized to provide sustainable, safe, and easy to compare loans. The financial crisis was marked and caused by lenders and brokers pushing loans that families could not understand or afford, and whose illusory performance depended on boom market increases in housing prices and repeated refinancings.
- There must be protections against abusive loan features, including the danger of deceptive artificially low starting monthly mortgage payments for ARMs that have the capacity to dramatically increase, leaving a family unable to afford the increased payments.
- There should be certainty as to the QM standards; and

- The rule must provide clear and reasonable procedures and standards for borrowers who receive unaffordable loans to raise violations of the rule.

In addition, we share the view that quality one-on-one counseling has a track record of safely expanding access to credit, and making homeownership sustainable, and that the rule should make use of this crucial tool.

1. QM Loans Should Be Widely Available and Should Encompass the Vast Bulk of the Mortgage Market.

QM loans have structural protections that address some of the core defects of the unsustainable loans that dominated the mortgage market leading up to the crisis. A fundamental goal of the provision is to encourage lenders to make loans with these protections, and to make them widely available.

Among the key protections are provisions that significantly reduce the risk of a return of deceptive lending based on starter payments. In the lead-up to the crisis, niche products -- some potentially appropriate as wealth management tools for a tiny portion of the market -- became dominant, used to make unaffordable loans seem affordable. Dodd-Frank does not ban these loan structures, such as interest-only, negatively amortizing, or balloons, that were key drivers of the mortgage crisis. Instead, it excludes them from QM loan status. Promulgating a rule with a narrow QM market would perpetuate a market where these risky products will be marketed broadly.

During the period leading to the mortgage and financial crisis, lenders and mortgage brokers engaged in a race to the bottom. Artificially low starting mortgage payments both fueled a housing bubble and put homeowners in unsustainable loans. As mortgage brokers and lenders know, and practiced all too well, the starting monthly mortgage payment sells loans. Mortgage loans are inherently complex and confusing for many borrowers, and this is exacerbated by the blizzard of paperwork that accompanies these transactions. While the CFPB is working to substantially improve the GFE/TILA disclosures, for many borrowers, as demonstrated by the CFPB's testing, the primary decision factors on loans will remain whether they can cover the closing costs through payment or financing, and whether they can make the initial monthly payment. This is especially true for the large number of households struggling to make ends meet month to month.

Good disclosures can help families better understand loans, but they cannot do the job absent substantive guidelines that provide basic ground rules for consumer protection and fair competition. Even the most sophisticated experts could not fathom, much less shop based on, the complicated provisions of the complex products that dominated the mortgage market leading up to the crisis. As a result, the QM requirement that loans have to be fully amortizing, not just have underwriting "based on" fully amortizing payments, is critical. And it is also critical to extend this protection broadly in the market.

A particular danger in the non-QM market results from the fact that the rules are extremely unlikely to set maximum DTI rates for non-QM loans. The risk is that the practice (common in the subprime market in the recent past) of using very high DTIs - sometimes over 55% - to qualify homeowners on starting teaser payments will continue, resulting in unnecessary foreclosures and loss of equity, particularly among vulnerable populations. The risk of future payment increases in ARM loans magnifies the dangers of lax underwriting. Artificially low initial payments, whether due to teaser rates or non-amortizing loan structures, leave borrowers very vulnerable to the offer of low monthly payments coupled with lender misrepresentations that any future problems with affordability can be cured with refinancings or modifications. Such promises by loan originators are both common and illusory.

Another important protection on QM loans is that they are limited to a lower point threshold of three points, compared to five points for non-QM loans that are below the HOEPA fee thresholds. The two-thirds greater point threshold for non-QM loans increases the incentive for lenders to focus on profitability through origination volume and fees, rather than successful loan performance and on-going interest payments. The lower origination points for QM loans, in contrast, realign incentives towards lenders building their business model on performing loans. The incentive structure for non-QM loans thus preserves the perverse incentive structure that directly led to the financial crisis. Economic stability mandates that the non-QM market must be kept minimal so that abusive lending does not again become the tail that wags the dog.

Finally, a broad QM market is mandated by the statutory language and legislative history of Dodd-Frank. The QM structure was from the start of the legislative process a part of the ability to repay provision, and was established to provide an incentive - a presumption of compliance with the ability to repay requirements - for sustainably structured loans. Amendments of the bill through the legislative process confirm that the legislative intent was for responsible loans to be able to meet the QM standard. For example, Congress removed interest rate limits on QM loans, so that higher rate loans could qualify, a clear message that QM status was not intended for just the least risky loans. In addition, the points and fees threshold was raised from two to three points, to allow more loans to meet the QM standard. Finally, Congress made it illegal for lenders to steer borrowers from QM loans to non-QM loans, reflecting a clear intent that QM loans are preferred for the bulk of the market.

2. <u>The Proposed Rule Needs To Be Strengthened to Provide Greater Protections against Abuses Including Payment Shock for ARMs.</u>

Most families do not have substantial room in their budgets for large increases in ongoing debt burdens and expenses.[1] The present rule, though, leaves room for mortgages -- both QM and

[1] For example, over a quarter of families in the United States lacked the available reserves to subsist even at poverty levels for three months in 2009 if they lost their income. See http://scorecard.assetsandopportunity.org/2012/measure/asset-poverty-rate.

non-QM -- to have large payment shocks and still meet the ability to repay standard through interest rate risk on ARM loans.

Looking first at QM loans, this risk arises from two factors. First, the QM statutory requirement that loans be underwritten based on the maximum payment in the first five years is an improvement over current practice, but it still permits unlimited increases after that five year period. Under the QM proposed rule, and unlike under the Qualified Residential Mortgage proposed rule, a loan could have unlimited monthly payment increases permitted at five years -- there are no "caps" or "collars" -- leaving borrowers with payments that could increase 50% or more in one step. In today's historically low interest rate environment, this is a very real risk, as index rates for mortgages are almost guaranteed to increase over current levels. The rule needs to be strengthened to address these concerns.

The second issue touches both QM and non-QM loans. The general ability-to-repay standard, applicable to QM and non-QM loans alike, as presently proposed, does not require any consideration of interest rate risk, only the "fully indexed" rate, which is based on current market interest rates, with no consideration of possible increases in those rates. Consequently, in order to provide reasonable protection regarding ARM loans, both the QM definition and the general ability to repay definition must be strengthened.

For both QM and non-QM loans, the lender should be required to underwrite to the greatest payment in the first six years <u>or</u> 200 basis points over the starting fully indexed rate, whichever is greater. In addition, there should be substantial caps (how much the loan's interest rate can increase over the life of the loan) and collars (the amount the loan can rise in any one adjustment) on loans. These provisions, combined, provide reasonable flexibility for ARM loans and additional protections for consumers. The six year period and the caps and collars are needed to encompass the risk of increases after the typical five year arm resets. The additional requirement of a minimum of 200 basis points above the starting rate is comparable to current GSE standards, and is needed to prevent both unaffordable payment shocks and the temptation to game any designated time period. Alternatively, the CFPB could require underwriting to the maximum payment permitted under the loan during its full term. Without these protections, five, or even six year, ARMs can operate as de facto balloon loans.

While the members of AFR are not of one mind on standards related to residual income as QM requirements, we share an interest in mechanisms to make loans safer, and agree that the CFPB should collect data in order to further study what residual income standards might be appropriate, along with the relationship of such standards to loan performance.

3. <u>There Should Be Certainty Regarding the QM Standards</u>.

Members of AFR have submitted several different options for language for the QM standard, but there is agreement on several key principles. First, the QM standards should be sufficiently clear and objective that lenders can reasonably determine with confidence that they have originated a

QM loan. This clarity promotes adherence to the QM standards and it also encourages broader access to lending, as uncertainty in the QM standards may lead lenders to unduly restrict credit to avoid the risk that their loans may not meet QM standards. Second, the standards should not sanction unaffordable lending. Third, the members also support enhanced use of housing counselors working for HUD-approved housing counseling agencies to verify nontraditional sources of income to meet the various alternative QM standards and to counsel borrowers when considering whether to extend the total debt to income ratio. Counselors, in well structured programs, increase the performance of loans and provide safeguards against unaffordable and unsuitable loans.[2] Independent, one-on-one counseling through a HUD approved agency is therefore well suited to help meet the goals of providing sufficient flexibility to allow households that can afford a quality loan to get that loan, sufficient clarity for lenders and investors, and sufficient rigor to prevent abusive loans from meeting QM

4. It Is Essential That Borrowers In Fact Be Able To Raise Claims That Their Loans Were Unaffordable.

The statute's goal is to encourage widespread sustainable lending on the front-end. A well-crafted regulation should primarily incentivize good lending, while still making available remedies for what should be rare unaffordable loans. Providing remedies to borrowers serves two purposes, deterrent and remedial, essential to further the statute's goal. The borrower enforcement provisions must provide a disincentive to making unaffordable loans, effective relief for borrowers who do receive unaffordable loans, and a backstop against lender noncompliance.

Experience shows that there are substantial legal and economic obstacles that make it very difficult for borrowers to raise claims that their loans are unaffordable. For the reasons discussed below, there have been very few of these individual types of mortgage claims brought, even with today's historically high foreclosure rates and in the aftermath of incredibly widespread abusive lending and illegal activity in the run up to the crisis. This makes it essential that the QM/Ability to Repay regulation not create further obstacles, and instead set out a clear and workable procedure.

First, the rule must implement the statutory language and Congressional intent that compliance with QM standards creates a rebuttable presumption of compliance, not a safe harbor from any claims. While those seeking a safe harbor point to language in some section headings, it is well

[2] See, for example, http://www.urban.org/uploadedpdf/412475-National-Foreclosure-Mitigation-Counseling-Program-Evaluation.pdf. Hirad, Abdighani, and Peter Zorn. 2002. A Little Knowledge is a Good Thing: Empirical Evidence of the Effectiveness of Pre-Purchase Homeownership Counseling. In Low-income Homeownership: Examining the Unexamined Goal, eds. Nicolas Retsinas, Eric Belsky, 146-174. Cambridge, Mass.; Washington, D.C.: Joint Center for Housing Studies; Brookings Institution Press. Counseling is required before a senior can obtain an FHA reverse mortgage; Section 255(d) of the National Housing Act and the implementing FHA regulations at 24 CFR § 206.41 state that all prospective HECM borrowers must receive reverse mortgage counseling prior to obtaining a HECM.

settled law that such language in headings cannot control the actual language in the substantive provisions themselves. As discussed in detail in several comments submitted to the Federal Reserve, including those of the National Consumer Law Center, the Center for Responsible Lending, and the Consumer Federation of America these headings were relics of a prior version of the provisions from a previous Congress - before the experience of the mortgage crisis - that expressly provided that secondary market purchasers of QM loans were immune from claims. That language was removed from the enacted statute and instead the present language sets out only a presumption. The enacted language reflects the lessons learned from the financial crisis: that unsustainable loans wreaked havoc on the housing market, homeowners, and the entire financial system and economy, and the new rules on mortgage lending should be structured and implemented so as to prevent a return to reckless practices.

The obstacles to borrowers' bringing ability to repay types of claims have been demonstrated in numerous contexts. First, the ability to repay standard is inherently difficult to prosecute in a class action, as claims usually depend on the individualized circumstances of each borrower. This means that the claims must be litigated on an individual basis, which tilts the economics against bringing these claims. In addition, the claims are complex, bringing in many areas of law including consumer law, contract law, real estate law and federal banking and preemption law. Very few attorneys have this expertise and are willing to consider taking these cases.

Few homeowners are able to finance the litigation of these claims. The claims are most typically raised when a borrower is facing foreclosure. Prior to that time, when a borrower is current with payments, it is very difficult for the borrower to assert that it was not possible to make the payments. When facing foreclosure, the borrower is in financial distress, without available cash to pay an attorney or pay for the expenses of the case. In addition to the ordinary expenses of litigation, and retention of counsel, these types of cases almost always require an expert witness to testify that the lender acted unreasonably and to rebut the likely lender expert. These experts easily cost $5,000 to $10,000 or more. Finally, the borrower typically wants to get their loan modified and avoid foreclosure, not litigate for years and risk being evicted in the meantime.   A resolution primarily involves a loan modification and is unlikely to provide for a recovery to pay legal fees. Even the statutory provision of attorney fees helps only a little, as the recovery of these fees is highly contingent, and in successful cases rarely provides as much as a regular hourly rate for the time spent, while providing nothing in unsuccessful cases.

The lender's unilateral drafting of form documents poses an additional hurdle to borrowers' seeking redress. Lenders typically insert in the mountain of documents clauses designed to insulate the lender and subsequent assignees from all legal liability. . Notwithstanding the CFPB's ongoing efforts to simplify and reduce the paperwork in the mortgage process, it remains, and likely will continue to be, a complex transaction . Borrowers have no realistic chance of affecting the preprinted terms of these documents. Lenders will continue to use boiler plate language, and typically complete the individualized data, of the mortgage documents. Loan originators, not borrowers, usually fill out loan applications and other borrower documents. This has some basis in necessity, as borrowers are typically unfamiliar with these forms. Originators, who remain eligible for volume bonuses, also want to increase the odds that the loan will be approved. These dynamics are hazardous for borrowers. Lenders insert boilerplate language into the documents they prepare and that the loan originator completes, including statements that the documents, again usually completed by the loan originator, contain all of the borrower's relevant information. These statements are given potent legal impact with the inclusion of so-called "integration clauses" that provide that the borrower may not claim or rely on anything outside of the lender drafted forms. The parole evidence rule then is used to prevent borrowers from offering any evidence to show that the forms did not accurately represent the information and promises that were the basis of the loan. If the CFPB fails to address these boilerplate clauses, they will effectively block virtually any borrower's 'ability to repay' claim.

Borrowers are also unlikely to know what criteria or information the lender used in underwriting the loan. Automated underwriting systems are typically "black boxes," and even manual underwriting often involves proprietary factors and weighting. In addition, the borrower will typically not know all of the information verified by the lender, or even information included in the credit reports obtained by the lender. The borrower should not be required to "know" and allege or even prove these matters when he or she cannot know them. <u>See</u> Ashcroft v. Iqbal, 556 US 662, 129 S.Ct. 1937 (2009) and related commentary on the burdens claimants face in having to plead facts that are known only to the other party. To deal with these challenges, the CFPB must set out clear and feasible standards and procedures for borrowers to raise and establish a claim that their loan was unaffordable, including through such means as demonstrating that they did not have sufficient residual income to make the payments.

Finally, as discussed above, the goal of the rule should be to incentivize lenders to provide QM loans, as they are structurally much safer for borrowers than non-QM loans. Accordingly, while QM loans receive a rebuttable presumption of compliance, for non-QM loans, the lender should have the burden of proving that the loan complies with the ability to repay provisions.

<u>Conclusion</u>

In conclusion, the many comments of the members of AFR reflect how important the Ability to Repay rule is to creating and maintaining a sustainable and accessible mortgage market. While the letters reflect some differences regarding mechanics of the rule, AFR members are united in the above core principles: a broad QM market with strong protections against abusive lending; greater protections against payment shocks for ARMs; clarity and certainty in the QM standards; and a clear and reasonable procedure for borrowers to raise and establish violations of the ability to repay requirements. We urge the CFPB to fully effectuate these principles in this critical rulemaking.

Sincerely,

Americans for Financial Reform

Following are the partners of Americans for Financial Reform.

All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.

- A New Way Forward
- AFL-CIO
- AFSCME
- Alliance For Justice
- Americans for Democratic Action, Inc
- American Income Life Insurance
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Greenlining Institute
- Good Business International

- HNMA Funding Company
- Home Actions
- Housing Counseling Services
- Information Press
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lake Research Partners
- Lawyers' Committee for Civil Rights Under Law
- Move On
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People's Action
- National Council of Women's Organizations
- Next Step
- OMB Watch
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO National Network
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club
- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS
- U.S. Public Interest Research Group

- UNITE HERE
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

List of State and Local Signers

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)

- Cooperative Fund of New England, Wilmington NC
- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- Neighborhood Economic Development Advocacy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network

- New Yorkers for Responsible Lending
- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

Small Businesses

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Pheonix AZ
- The Holographic Repatterning Institute at Austin
- UNET