MEMORANDUM

TO: File No. S7-14-11

FROM: Jay Knight
Special Counsel
Office of Structured Finance
Division of Corporation Finance
U.S. Securities and Exchange Commission

RE: Meeting with the Coalition for Sensible Housing Policy

DATE: March 15, 2012

On March 1, 2012, Katherine Hsu, Jay Knight, David Beaning, and Steven Gendron of the Division of Corporation Finance, and Emre Carr of the Division of Risk, Strategy, and Financial Innovation participated in a meeting with the following representatives of the Coalition for Sensible Housing Policy:

- Joe Ventrone, National Association of Realtors (“NAR”)
- Ken Trepeta, NAR
- Ken Fears, NAR
- Ethan Handelman, National Housing Conference
- Pete Mills, Community Mortgage Banking Project
- Duane Duncan, Genworth
- Joe Pigg, American Bankers Association

The participants discussed topics related to the Commission’s March 30, 2011 proposals regarding credit risk retention.

Attachments.

Ensuring Housing Recovery

The Challenge of the Ability to Repay and Qualified Mortgage Rule to Credit Availability and Affordability for Homeowners

AFSA
American Financial Services Association

American Bankers Association

Community Mortgage Banking Project

CBA Consumer Bankers Association

Consumer Mortgage Coalition

Housing Policy Council
The Financial Services Roundtable

ICBA
Independent Community Bankers of America

NAHB
National Association of Home Builders

REALTOR

RESPRO
Real Estate Services Providers Council, Inc.

Mortgage Bankers Association
Investing in communities

11265

Why Are We Here

The to Repay/Qualified Mortgage (ATR/QM) Rule is scheduled to be issued in final form in April.

- We would appreciate your support to ensure the rule includes bright lines and does not unduly tighten and increase the costs of credit.
- This requires:
  - Establishment of safe harbor or similar bright-line means to define the QM
  - Three percent limit in QM be revised appropriately

- Bureau of Consumer Financial Protection (CFPB) can establish these provisions by regulation.
- In event regulations do not address our concerns, we will need your support to revise the rule.
- Legislation:
  - Has been introduced requiring the establishment of QM safe harbor
  - Is pending to revise the three percent limit

Today's Presentation Covers

I. Difference between QM and Qualified Residential Mortgage (QRM)

II. New liability surrounding QM

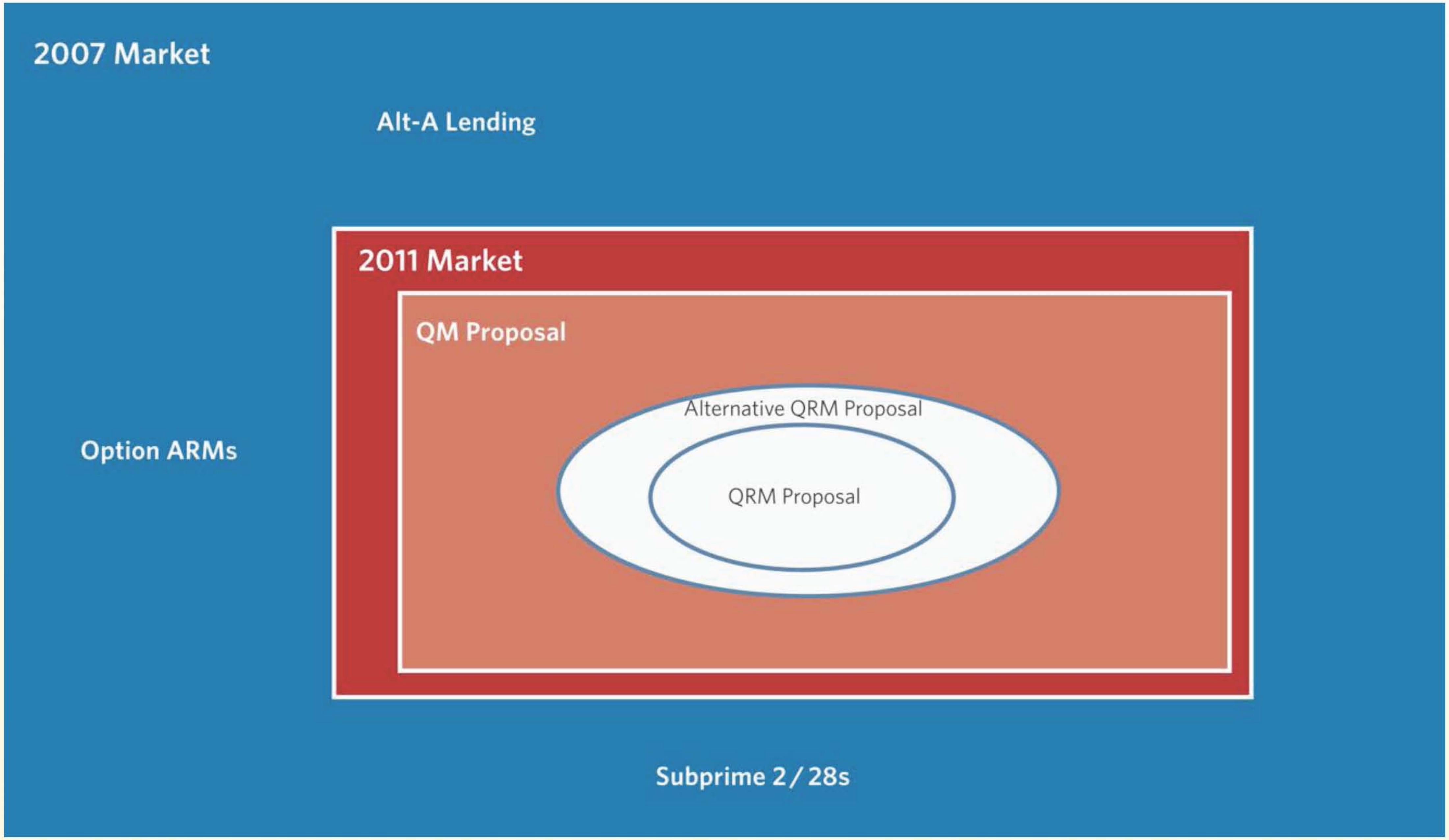
III. What Ability to Repay/QM Proposal is:

- Safe Harbor v. Rebuttable Presumption
  - Both provide judicial remedy
- Three percent points and fees limit

IV. Coalition's concerns about availability and affordability of credit under QM proposed rule

Today's Credit Market is Very Tight and New ATR/QM Rule Will Make It Tighter

Market Has Already Pulled Back to Safer Products



QM Is Not a QRM

QM

- Fed issued proposal, CFPB will finalize in April
- Means of complying with Ability to Repay requirement under Title XIV of Dodd-Frank
- Applies to loans beyond those that are securitized
- Includes product and underwriting standards to meet QM but not numerical requirements, for down payment, LTV, DTI
- If not carefully conceived will affect credit availability and affordability

QRM

- Proposal issued by six agencies, final rule likely after QM
- Exception to five percent risk retention requirement under Title IX of Dodd-Frank
- Applies to securitized loans
- Proposes hard-wired numerical 20 percent down payment, 80 percent LTV for purchase (75 and 70 for refis) and 28 and 36 DTI requirements
- As proposed, will unduly restrict credit availability and affordability

Four Ways to Comply with Ability to Repay, Including QM Proposal

1. **Originating mortgage loan after considering and verifying eight factors,** including consumer's:

   (a) current or reasonably expected income

   (b) employment status, if creditor relies on income from consumer's employment

   (c) monthly payment on mortgage based on fully indexed rate and amortizing payments that are substantially equal

   (d) monthly payment on any simultaneous loan creditor knows or has reason to know will be made

   (e) consumer's monthly payment for mortgage-related obligations

   (f) consumer's current debt obligations

   (g) consumer's monthly DTI ratio or residual income

   (h) consumer's credit history

Four Ways to Comply with Ability to Repay (Continued)

Safe Harbor Alternative

2. **Originating "Qualified Mortgage" (QM).** Proposes alternative definitions of QM with different degrees of protection from liability:

   ***Alternative A*: Legal safe harbor** — To qualify as QM a loan must not have certain product features including:

   (a) negative amortization, interest-only or balloon payments, or loan term exceeding 30 years

   (b) total points and fees exceeding three percent of loan amount (with alternative thresholds proposed for smaller loans) and

   (c) *must be* underwritten: based on maximum interest rate in first five years

   (d) *must be* underwritten: using payment schedule that fully amortizes loan over loan term

   (e) *must be* underwritten: taking into account any mortgage-related obligations

   (f) Also requires creditor *must*: consider and verify income or assets of consumer

Four Ways to Comply with Ability to Repay (Continued)

QM Rebuttable Presumption and Other Alternatives

2. **Originating "Qualified Mortgage" (QM).** Proposes alternative definitions of QM with different degrees of protection from liability:

   ***Alternative B*: Rebuttable presumption of compliance** — To qualify as QM *must* meet requirements in Alternative A and creditor *also must* consider and verify consumer's:

   (g) employment status

   (h) monthly payment for any simultaneous mortgage

   (i) current debt obligations

   (j) monthly debt-to-income ratio or residual income

   (k) credit history

3. **Originating "Balloon Payment" QM**

4. **Moving borrower from standard to non-standard product**

Significant Liability for Failing to Meet Ability to Repay

- **Sec. 1411 of Dodd-Frank** — Prohibits creditors from making mortgage loan without reasonable and good faith determination of consumer's ability to repay loan

- **Sec. 1412** — Allows creditor to presume loan meets ability to repay requirement if loan is QM

- **Sec. 1413** — Allows consumer to assert violation of ability to repay by creditor in foreclosure action by creditor, assignee or other mortgage holder

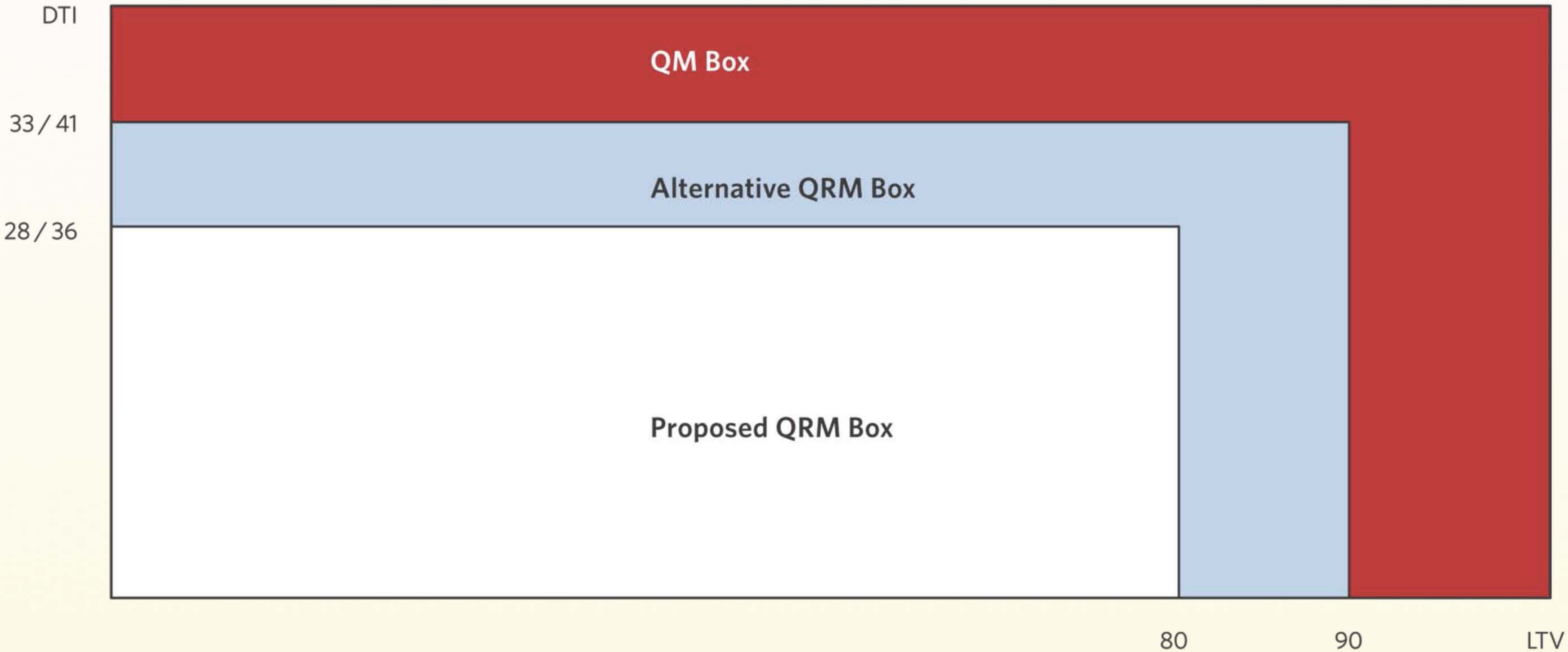
- **Also under TILA** — Mortgage creditor who fails to comply with the ability to repay requirements may be liable for (1) actual damages; (2) up to three years of finance charges; and (3) court costs and reasonable attorneys' fees

How QM Is Structured Is Key

- Main issue :
  - Safe harbor v. rebuttable presumption — both provide court remedy
  - Bright line v. subjective
- Consumers want access to credit at the lowest possible rate.
- Lenders need to meet needs of consumers and investors while complying with applicable statutes and earning reasonable rate of return.
- Investors want predictable performance with no hidden liability risks.
- The economy functions best when consumers, lenders and investors all can satisfy their needs.
- All of this requires QM rule that includes rigorous but clear bright-line standards to minimize uncertainty and legal risk for lenders as well as investors and assures legal remedy and maximum access to affordable credit for borrowers.
- Industry supports more rigorous standards for safe harbor than proposed.

Going Forward — How QM is Established Will Determine Credit Availability and Affordability for Families

Impacts on Market Liquidity



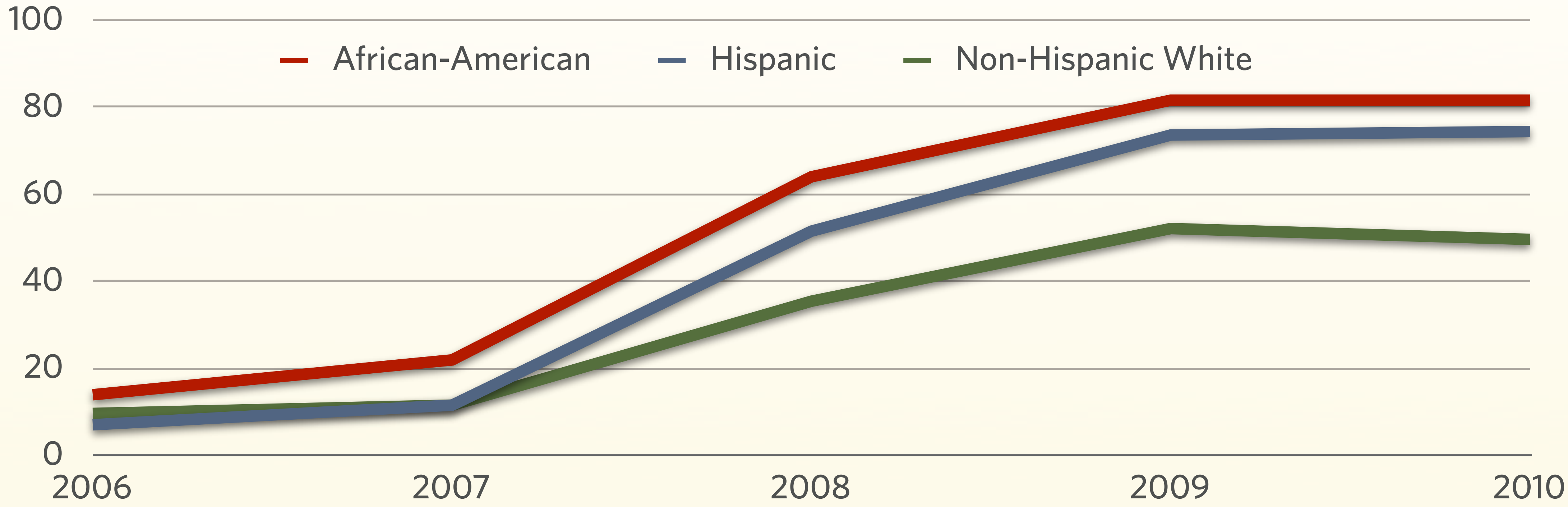
Note: Lenders typically will not lend outside the QM boundary.

Without bright-line safe harbor, lenders may retreat to the perceived safety of the QRM box.

Wrong QM Choice Would Further Stress Government Lending

Borrowers of Color Use Government Lending to a Greater Extent

Government[a] Share of Home Purchase Loans by Borrower Characteristic

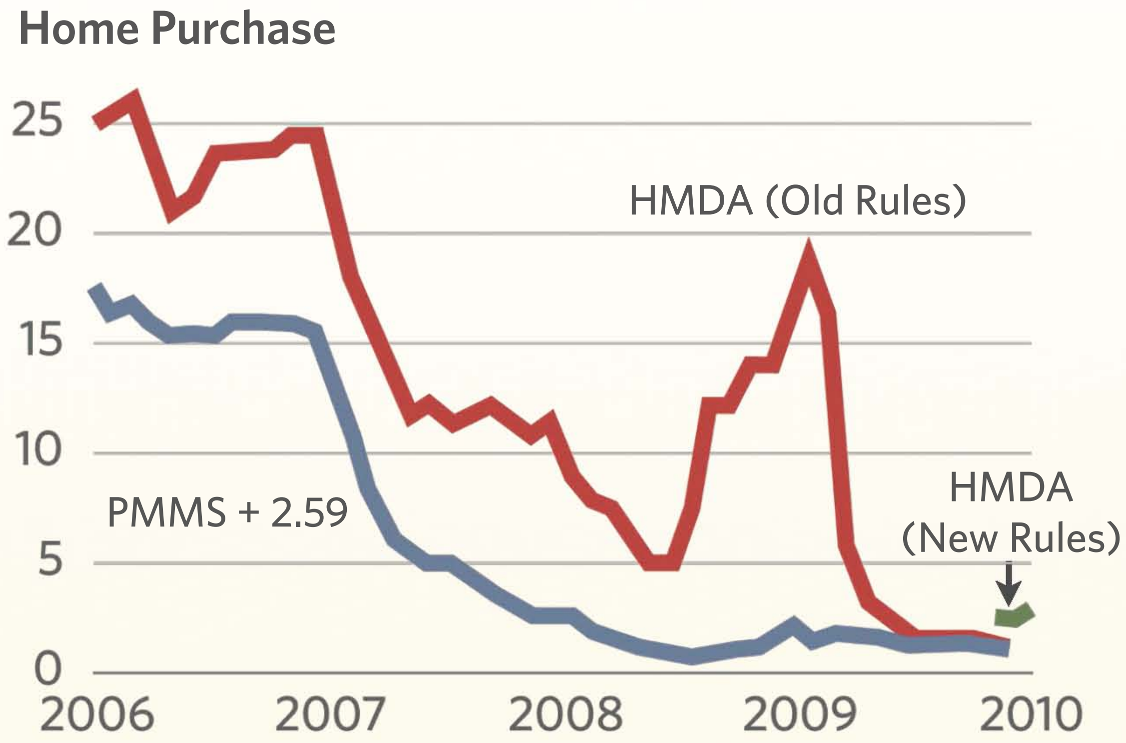


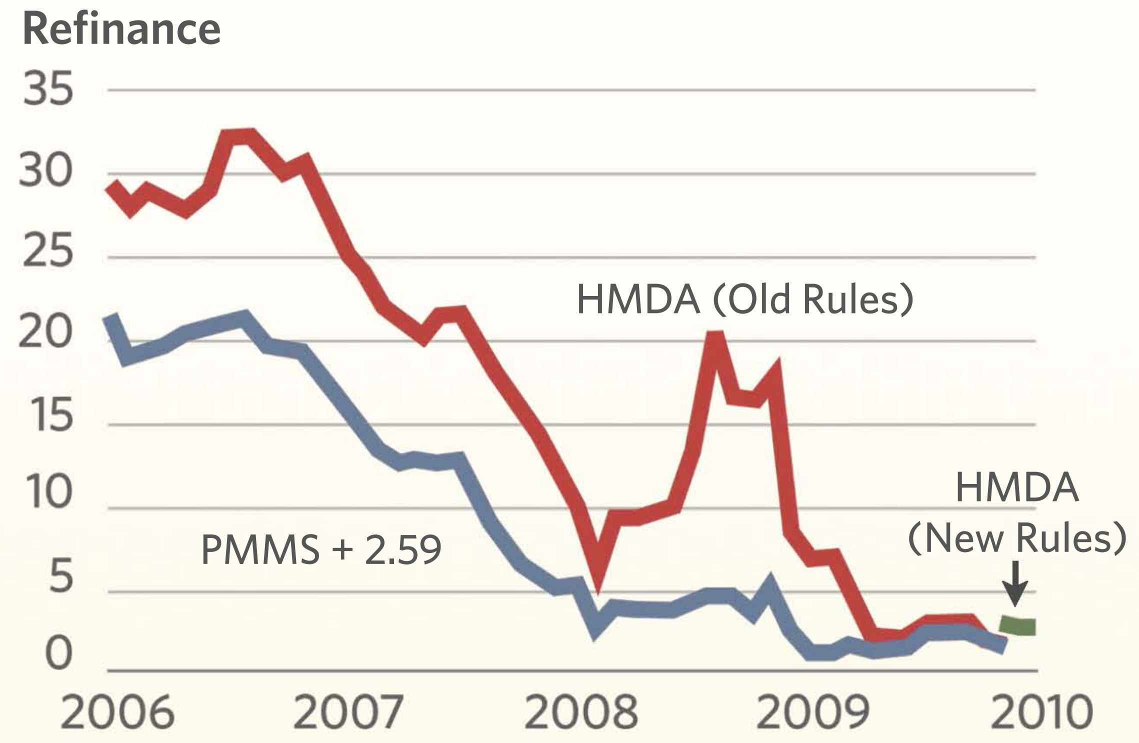
a. FHA, VA, USDA. *Source:* Federal Reserve Analysis of HMDA data.

- HMDA data show that borrowers of color have already heavily been using government housing programs such as FHA in recent years.
- For example, 81.6 percent of African-American borrowers used a government program to finance the purchase of a home in 2010.
- FHA and other government programs may establish their own QM standards but have not yet.
- Without workable QM standards under this or other rules, there will be even more pressure for FHA to fill the needs of underserved borrowers.

Higher-Priced Lending Has Been Limited Since New Rules

Higher-Priced Share of Lending, by Annual Percentage Rate Threshold, 2006-2009

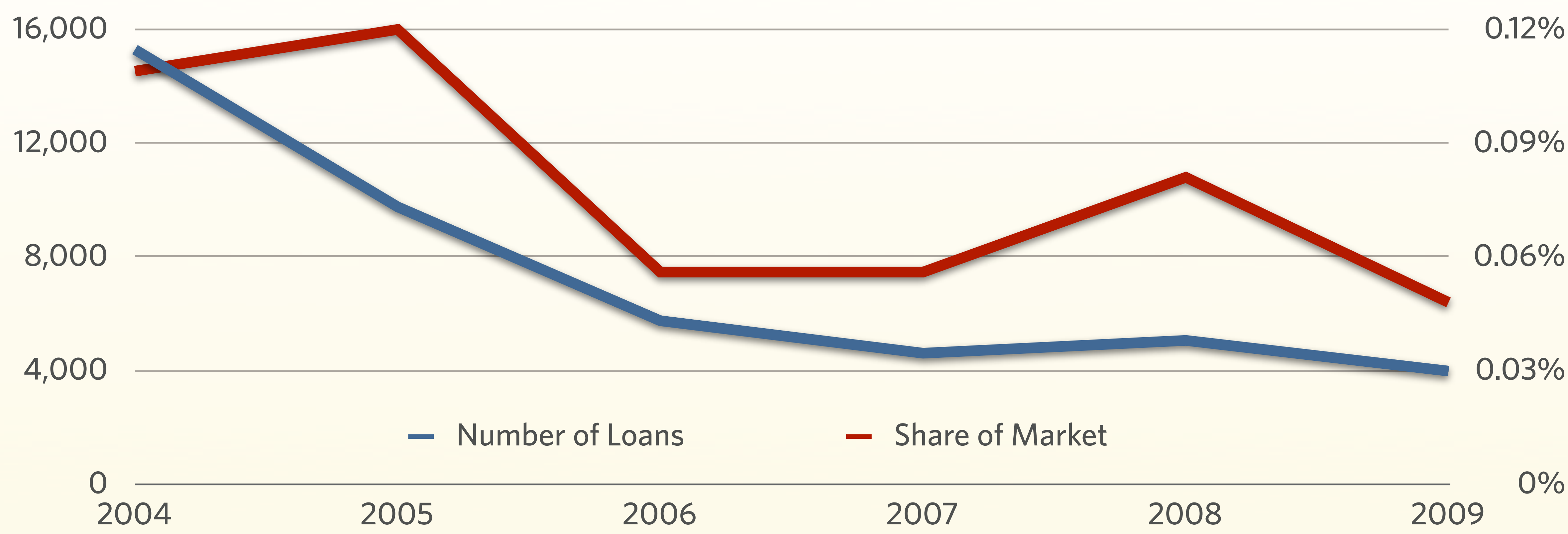




Note: The data are monthly. Loans are first-lien mortgages for site-built properties and exclude business loans. Annual percentage rates are for conventional 30-year fixed-rate prime mortgages. PMMS = Freddie Mac Primary Mortgage Market Survey. HMDA = Home Mortgage Disclosure Act.
Source: Avery et al, 2010, Federal Reserve Bulletin.

- The Federal Reserve has implemented new rules for "higher-priced lending" — for first mortgages, 150 bps over the Average Prime Offer Rate.
- These rules establish "rebuttable presumption" that ability to repay is satisfied for loans if certain requirements are met.
- Before the rules were issued, share of higher-priced lending peaked above 25 percent in 2006, but has since fallen to well below five percent.

High Cost or HOEPA Loans Barely Exist



- High-cost or HOEPA loans expose lenders and assignees to considerable legal and financial risks.
- These loans have generally accounted for less than 0.1 percent of the market.
- The severity of the ATR penalties would have a similar impact.
- Lenders will be unable to serve many borrowers unless there are bright-line protections such as in a bright-line safe harbor.

Safe Harbor v. Rebuttable Presumption

Safe harbor

- Provides borrower judicial remedy
- Demands establishment of clear standards
- Appropriately focuses litigation on whether requirements have been met and more efficiently resolves disputes
- Less costly for lenders and borrowers
- Better incents compliance
- Encourages secondary market investment

Rebuttable presumption

- Also provides borrower judicial remedy
- More protracted litigation, increasing risks and costs
- Takes pressure off of establishment of clear standards
- Boundaries to inquiry less defined
- Gives little certainty to investors
- Likely causes retreat to more conservative QRM standards

NOTE: A safe harbor loses its effectiveness if it is not well drafted or is subjective.

QM Includes Three-Percent Limit on Points and Fees

- **Limit:** QM's "points and fees" may not be in excess of three percent of the loan amount. As currently drafted, in addition to fees to lenders and mortgage brokers, points and fees may include:

  (1) charges to title companies affiliated with lenders and others

  (2) salaries paid to loan originators (LO)

  (3) amounts of insurance and taxes held in escrow

- **Smaller loans:** Proposal would also increase points and fees for smaller loans defined as those under $75,000 up to five percent on a sliding scale with five percent limit for loans under $15,000.

- **Comment:** There is no clear data that points and fees limits belong in QM requirements — points and fees, at least at these amounts, have no bearing on risk.

Inclusion of Affiliate Fees In Three Percent QM Limit Hurts Borrowers and Market

- Lenders and others have affiliated settlement service providers — 26 percent market share in 2006
- Affiliate arrangements add efficiencies to loan process, including by providing dependable service providers
- Consumers like one-stop shopping
- Under RESPA, affiliate relationships must be disclosed to consumer and use may not be required
- Lenders have little room to augment fees through affiliates
- Title insurance rates are filed or regulated at state level
- Based on experiences in the State of Kansas, title rates will climb if affiliates are excluded, and consumers will be harmed
- All third-party fees should be treated the same to avoid market interference

Inclusion of LO Comp and Escrows in Three Percent Limit: Unworkable and Unfair

- Fees to lenders and brokerage firms are included in three percent
- Includes compensation in the form of bonuses, which is impossible to ascertain at settlement
- Counting both fees to company and individual employee compensation involves double counting
- LO Compensation (LO Comp) was addressed in 2011 rule
- Limiting LO Comp unduly limits service to borrowers, especially the underserved
- LO inclusion also threatens to constrain virtually all transactions
- Escrows for insurance and taxes may also be included
- Homeowners insurance may be included, too
- Taxes and insurance are pass-throughs that do not go to lenders and should be excluded

Nearly Half of Loans are Under $150,000 and QM Three Percent Limit Should Be Adjusted Accordingly

Distribution of Loan Sizes from *MBA's Weekly Applications Survey*, First Half of 2011

Purpose	Loan Balance	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	Loan Balance	Share
Refinance	<=75K	10.1%
Refinance	>75K and<=100k	11.9%
Refinance	>100K and<=125k	11.9%
Refinance	>125K and<=150k	11.5%
Refinance	>150K and<=175k	9.5%
Refinance	>175K and<=200k	8.2%
Refinance	>200K and<=250k	11.6%
Refinance	>250K and<=300k	8.2%
Refinance	>300K and<=417k	11.8%
Refinance	>417K	5.2%

- More than 43 percent of purchase loans in the first half of 2011 had balances below $150K.
- Only 12 percent had balances below $75K.

- Under the proposed rule, loans of up to $200K could be adversely impacted by the three percent limit while only loans <$75K would gain any relief.

Comparison of QM Costs to 3 Percent Rule

	$75,000 and below	$75,000-100,000	$100,001-$125,000	$125,001-$150,000	$150,001-$200,000	$200,001-$250,000	$250,001-$300,000	$300,001-$350,000	$350,001-$417,000	> $417,000
All in	100%	95%	76%	49%	23%	10%	7%	5%	3%	1%
Title out	99%	89%	57%	35%	16%	7%	5%	4%	2%	1%
Title and LO Comp out	89%	43%	26%	16%	8%	4%	3%	2%	2%	1%

- Data from a major lender shows that most loans under $200,000 would exceed the three-percent limit if title and employee compensation are included ("all in"). This would make these loans unavailable, or in some cases, only available at increased rates.

- However, even if only affiliated title costs are included, a large portion of loans under $150,000 would exceed the limit and if these loans were available, their rates would increase.
- The decreased availability and increased costs of loans resulting from three-percent limit will fall on low- and moderate-income homebuyers who purchase lower-valued properties and have smaller loans.

What if Amounts in Excess of Three-Percent Limit Go Into Rate?

Prior to regulation, consumer received a loan as follows:

$150,000 loan

4.0% rate, 4% points and fees ($6,000)

Monthly P + I payment: $716

Total payments over life of loan: $257,804

But in order to qualify as a QM under new regulation, any fees in excess of three points would get pushed into the rate as follows:

$150,000 loan

4.25% rate, 3% points ($4,500) in costs

Monthly P + I payment: $738

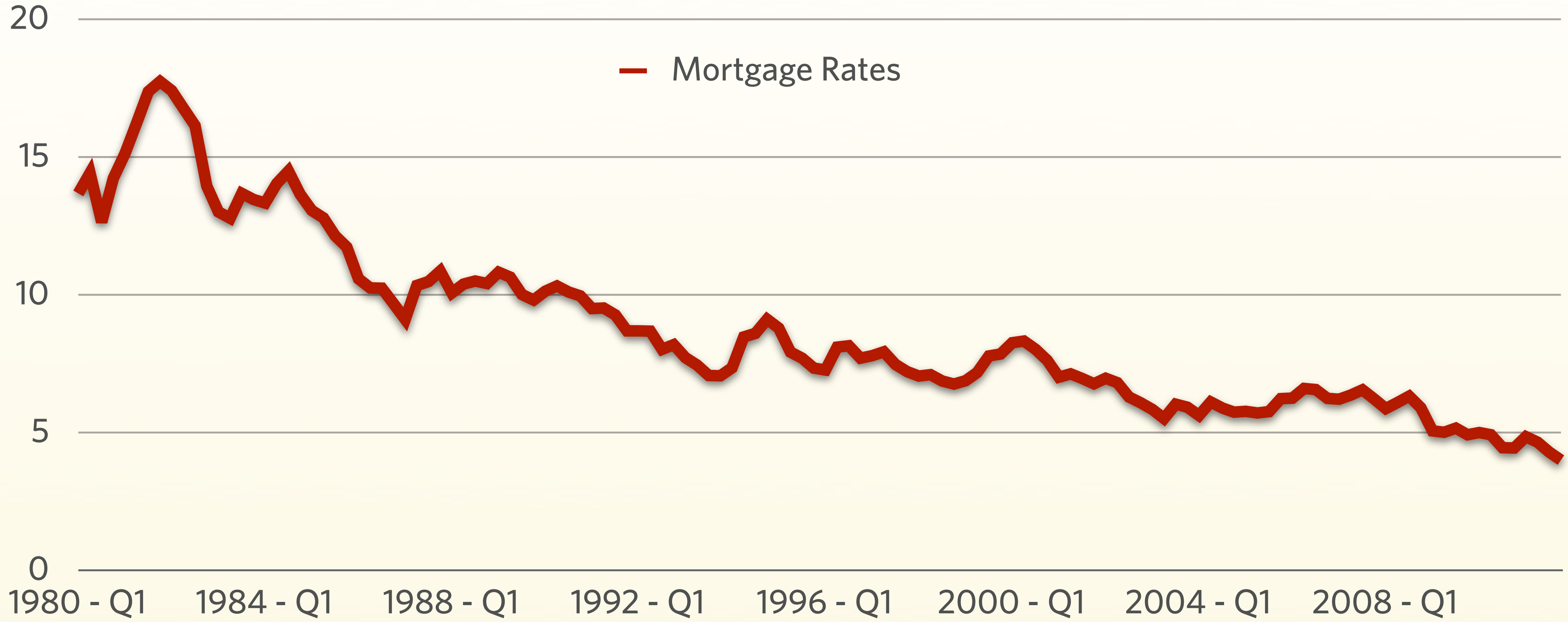
Total payments over life of loan: $265,648

- Before three percent limit, consumers who planned to stay in the property for a long time could rationally choose to pay all their points and fees up front to lower their payments over the life of the loan.
- With the three-percent limit, a borrower might only have the choice of a higher-rate loan with a higher monthly payment, making payments less affordable.
- Under this example, the new regulation would "save" the borrower $1,500 in up-front costs at closing, but actually cost the borrower $7,800 in higher payments.

NOTE: Significant increases in rate may trip higher-priced loan trigger.

These Rules Will Apply for a Generation

FHLMC: 30-Year Fixed-Rate Mortgages, U.S.



Source: Freddie Mac.

- Choices made today, when rates are at four percent, will be in place for a generation.
- When rates return to more typical levels, 6–7%, or even higher (if rates reach early 1980s levels), affordability and point/rate tradeoff will be much more challenging for consumers.

What a Final Rule Should Be

The proposed rule can and should be finalized in a way that:

- Is not harmful to consumers;
- Does not unnecessarily limit or restrict access to credit for qualified borrowers; and
- Provides bright-line standards to ensure compliance and protect consumers

For More Information Please Contact

Ken Markison
Regulatory Counsel
Mortgage Bankers Association
(202) 557-2930

Mike Fratantoni
Research and Economics
Mortgage Bankers Association
(202) 557-2935

MORTGAGE BANKERS ASSOCIATION®
Investing in communities

1717 Rhode Island Ave., NW, Suite 400
Washington, DC 20036
www.mortgagebankers.org

QRM and the Market:
Finding the Correct Balance

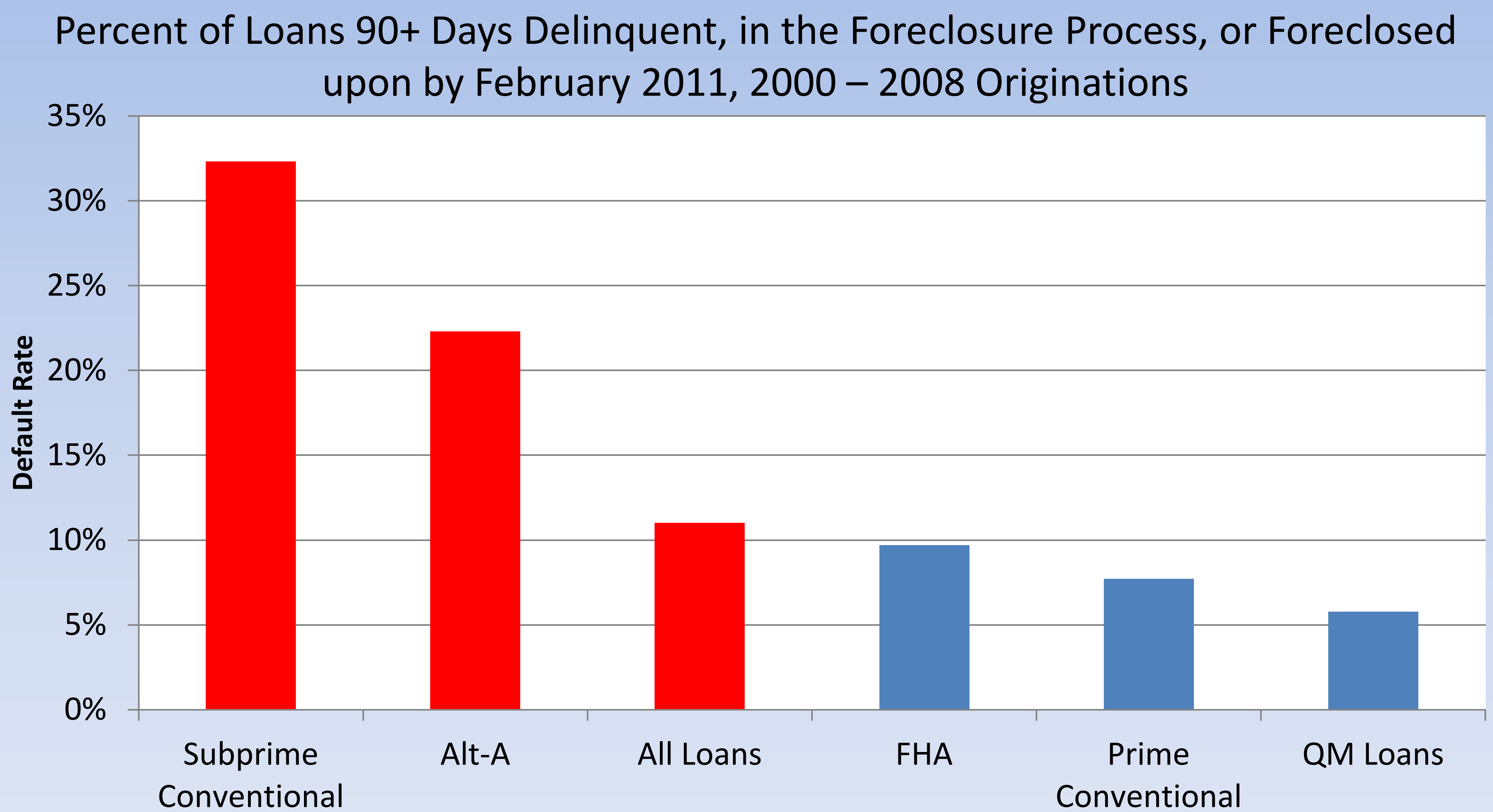
Protection for Investors

Impact on Consumers, Housing, and the Economy

Broad QRM is Essential to Maintaining Credit Availability

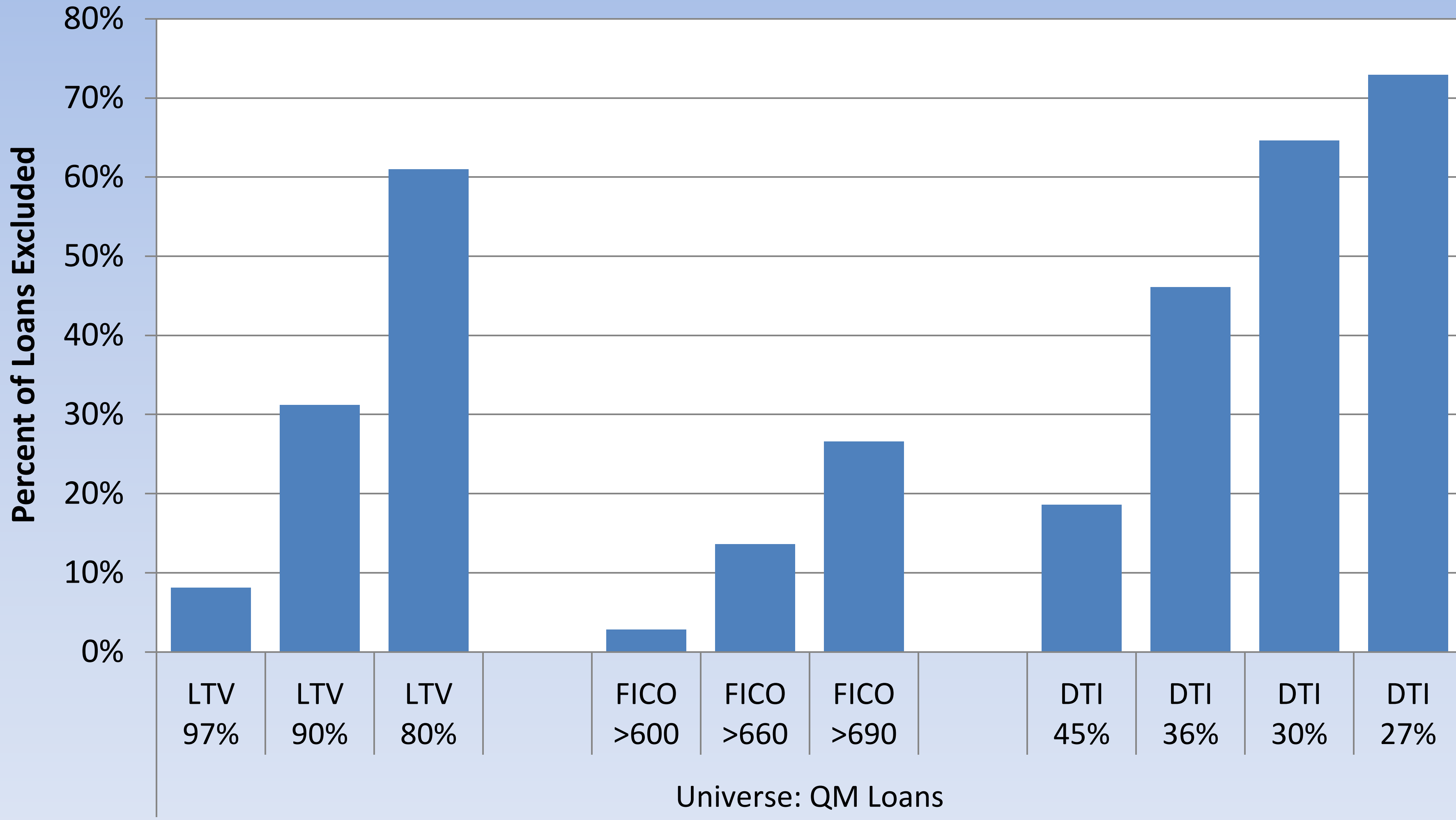
- A narrow QRM would needlessly tighten credit, making mortgages more expensive or unobtainable for large portions of eligible borrowers.
- A narrow QRM will have a disparate impact on African Americans, Latinos, those with low incomes, and first time buyers relative to other groups
- The QRM should track closely with the QM, which addresses important underwriting features and creates a significantly safer environment for both borrowers and investors where risks better understood by regulators and investors.

QM Restores Traditional Underwriting, Significantly Reducing Risk to Investors and the Economy



Citation: Roberto Quercia, Lei Ding, and Carolina Reid (2012). "Balancing Risk and Access: Underwriting Standards for Qualified Residential Mortgages," UNC Center for Community Capital Research Report, January 2012.

QRM Impacts More than 65% of Loans in the Safe, QM Market Space

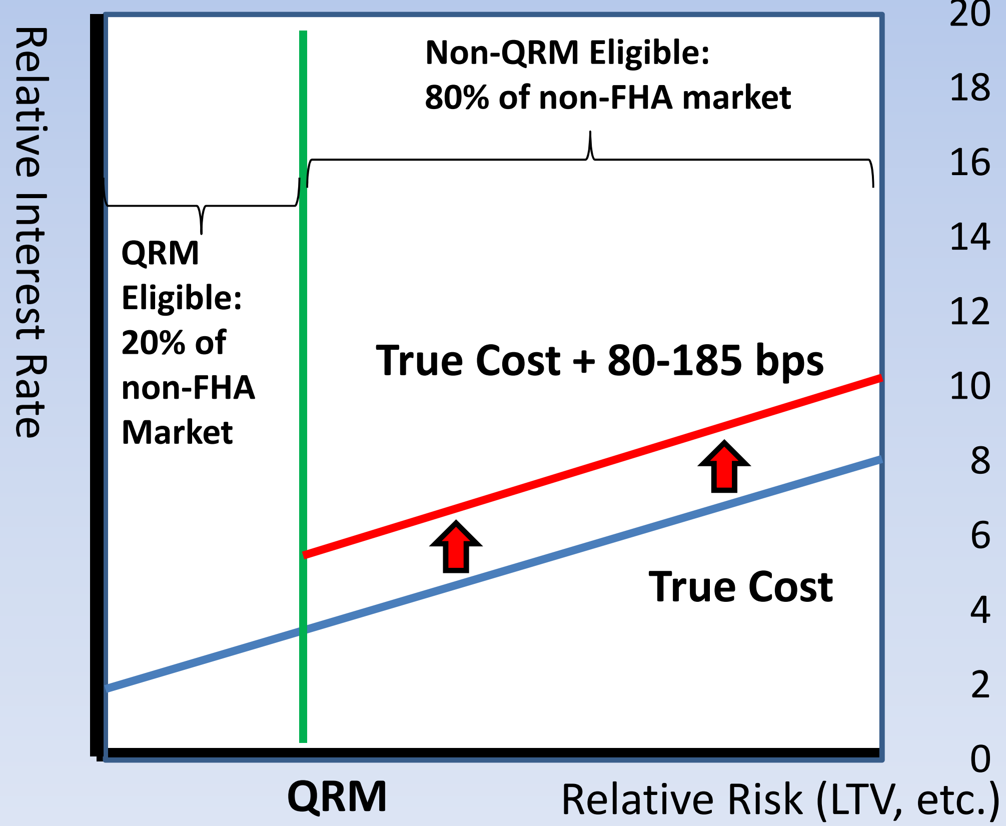


Citation: Roberto Quercia, Lei Ding, and Carolina Reid (2012). "Balancing Risk and Access: Underwriting Standards for Qualified Residential Mortgages," UNC Center for Community Capital Research Report, January 2012.

Cost of Retention Passed onto the Consumer

Non-QRM Rates Rise 80-185 bps Due to:

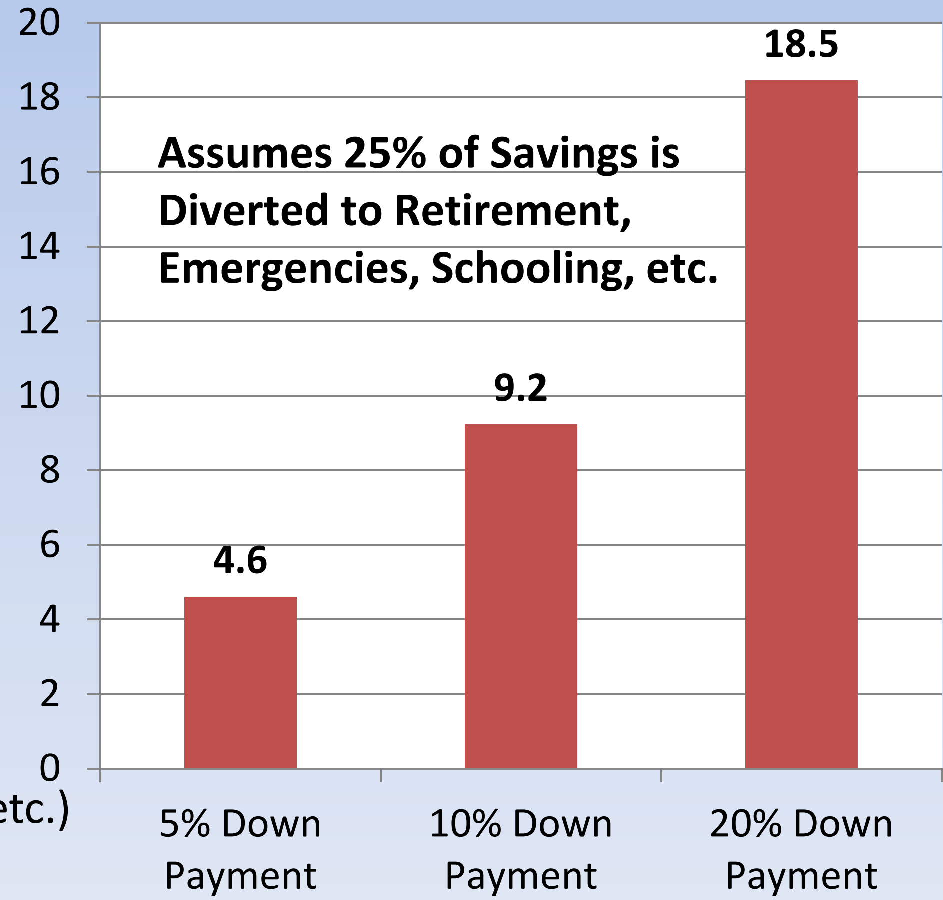
- Cost of capital
  - Premium Capture Reserve*
- Loss of liquidity
- Fewer Securitizers



* The cost from the premium capture reserve could rise based on interpretation

Longer to Reach Downpayment

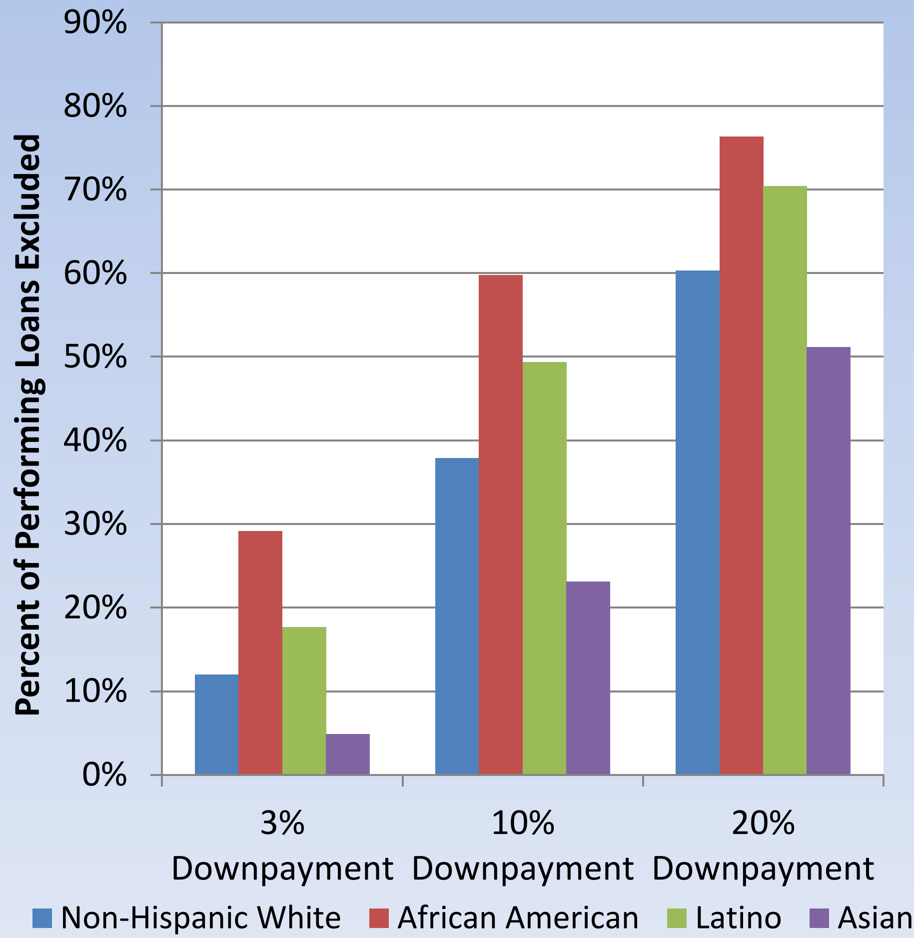
Years to Accrue Downpayment and 5% Closing Costs based on the 2011 Median National Home Price



Source: BEA, Census, NAR

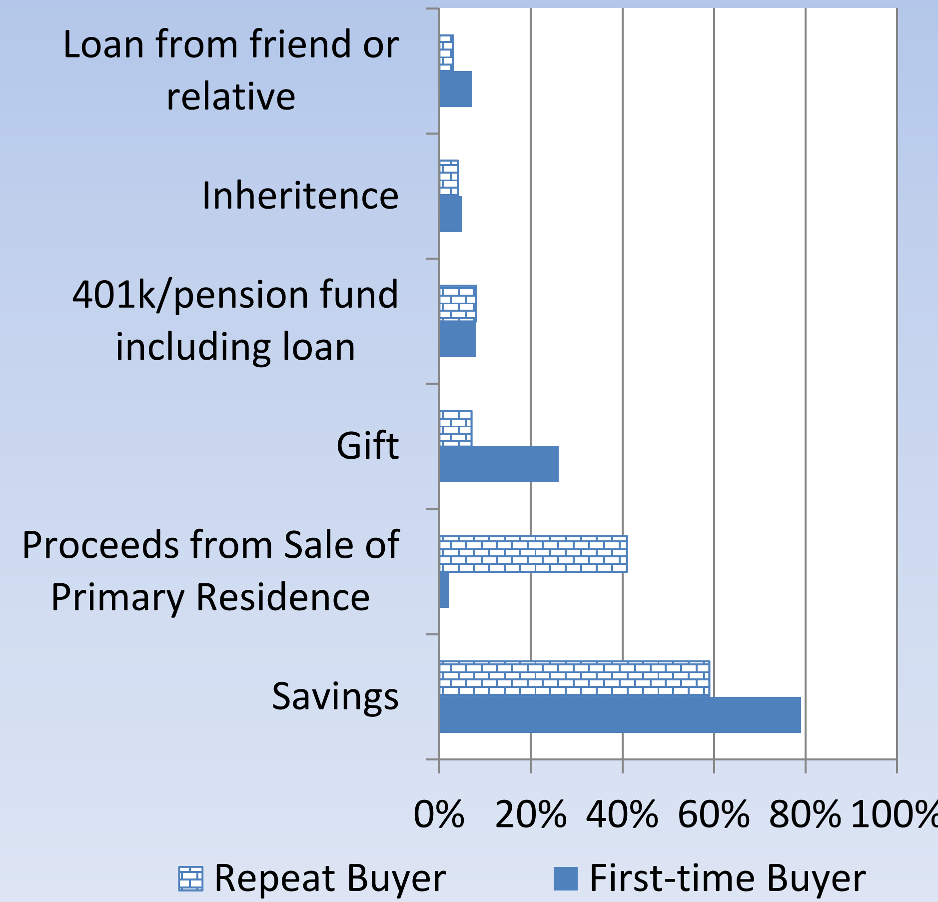
Social Implications from QRM

LTV Requirements More Restrictive for African Americans and Hispanics



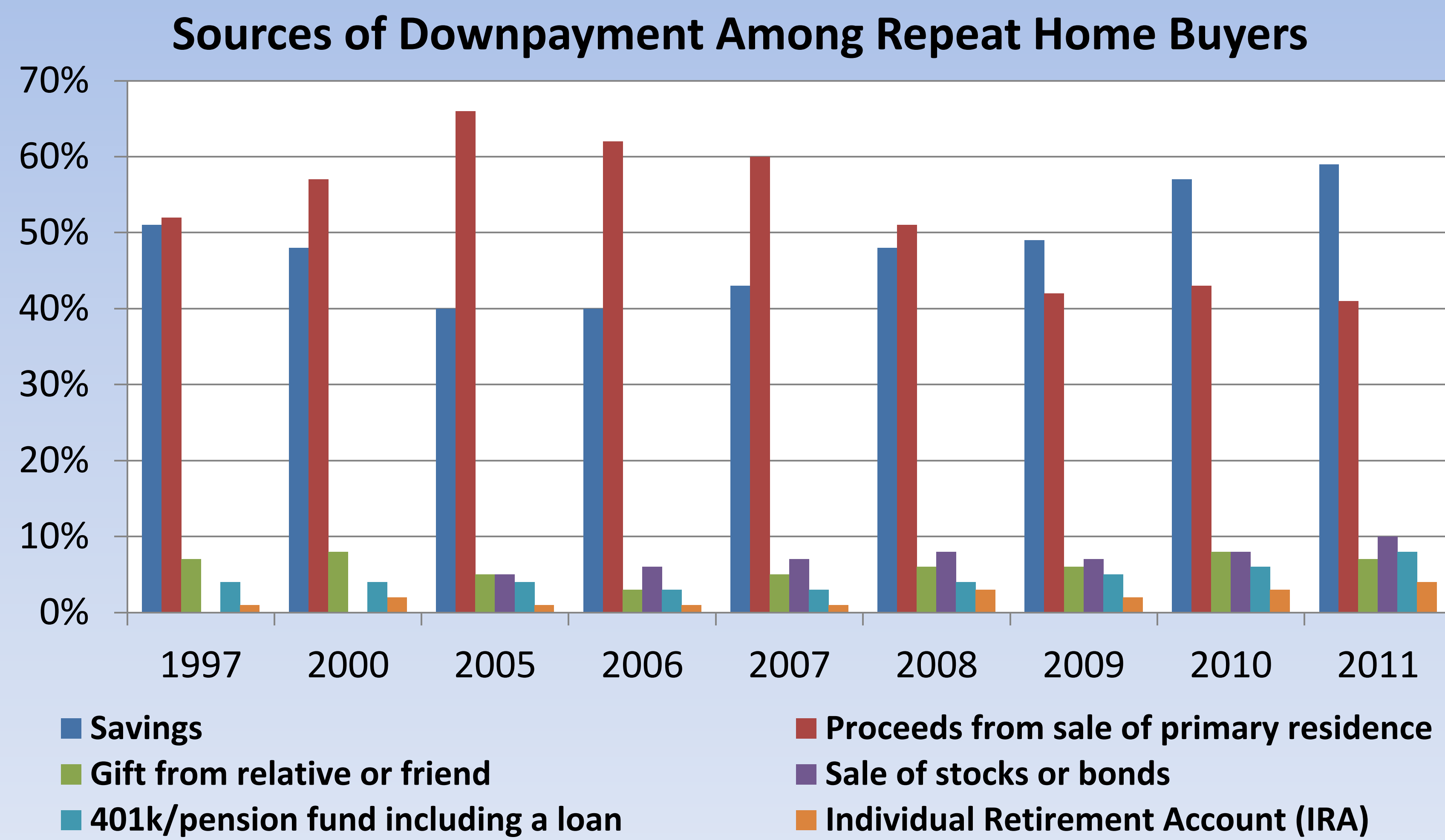
Source: UNC/CRL Study cited above

Longer Time to Save Hurts First-Time Borrowers, Who are More Dependent on Savings, Undermining Trade-up Sales



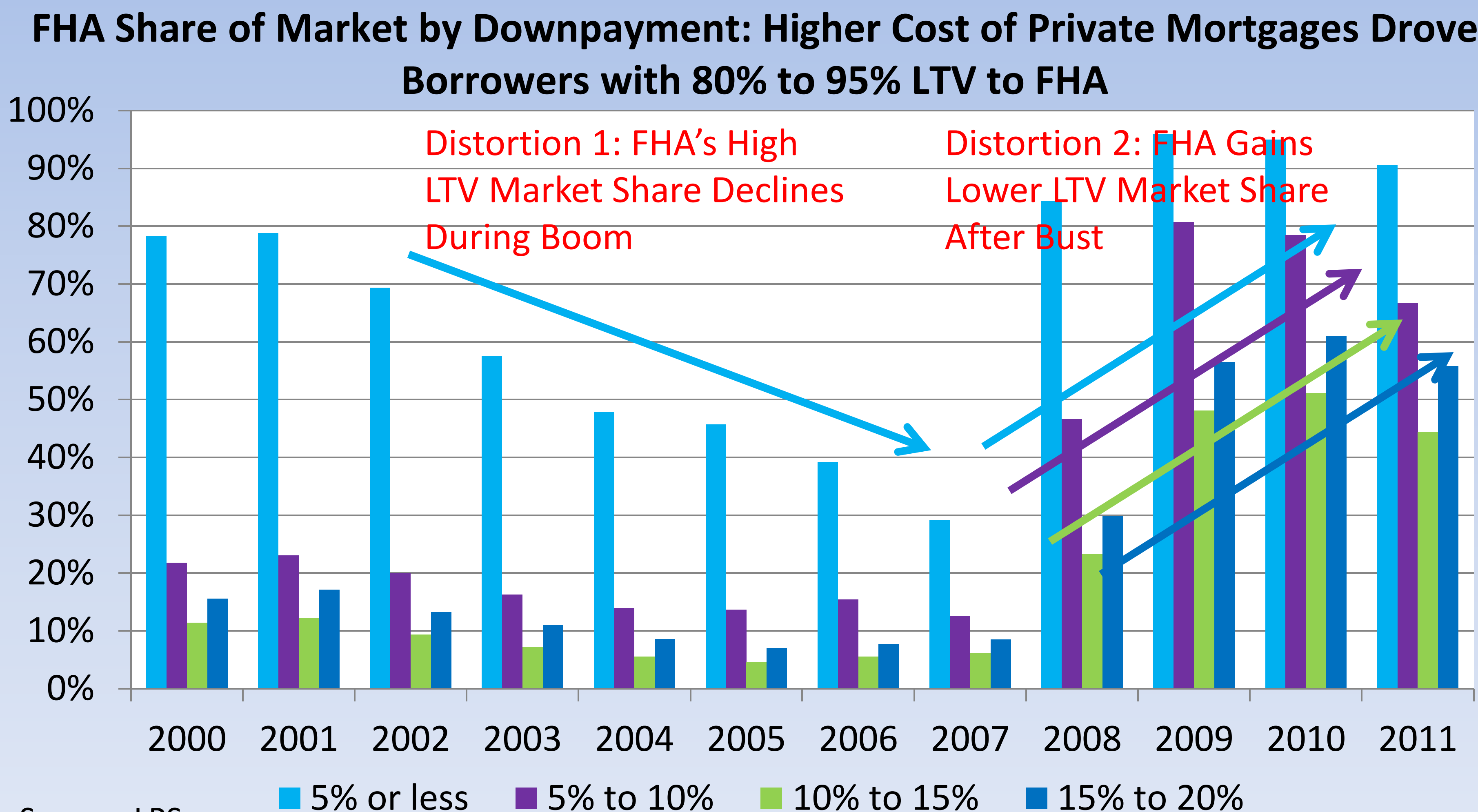
Source: NAR 2011

Flat and Falling Home Values Have Made Trade-Up Buyers More Dependent on Savings, Gifts, and Retirement Funds



Source: NAR

Higher Cost of QRM Will Drive Non-QRM Borrowers to the FHA



Source: LPS

Negative Impacts of the Proposed QRM

- Housing Impacts:
  - Sales decline 8% to 12%
  - Prices fall 6.5% to 13%
- Social Impact
  - Fewer Hispanic, African American, and first-time buyers
- Undermines reduction of government role in mortgage finance
- Economic Impacts:
  - Less spending on housing related products and services (historically, 15%-18% of GDP)
  - Drag from negative housing wealth effect
  - Limited refinancing weighs on spending and affordability for owners

THE ALTERNATIVE IS PROBLEMATIC

Looser LTV and DTI Requirements Exacerbate the Impact on Consumers

Regulators Offered an Alternative* That is Also Problematic

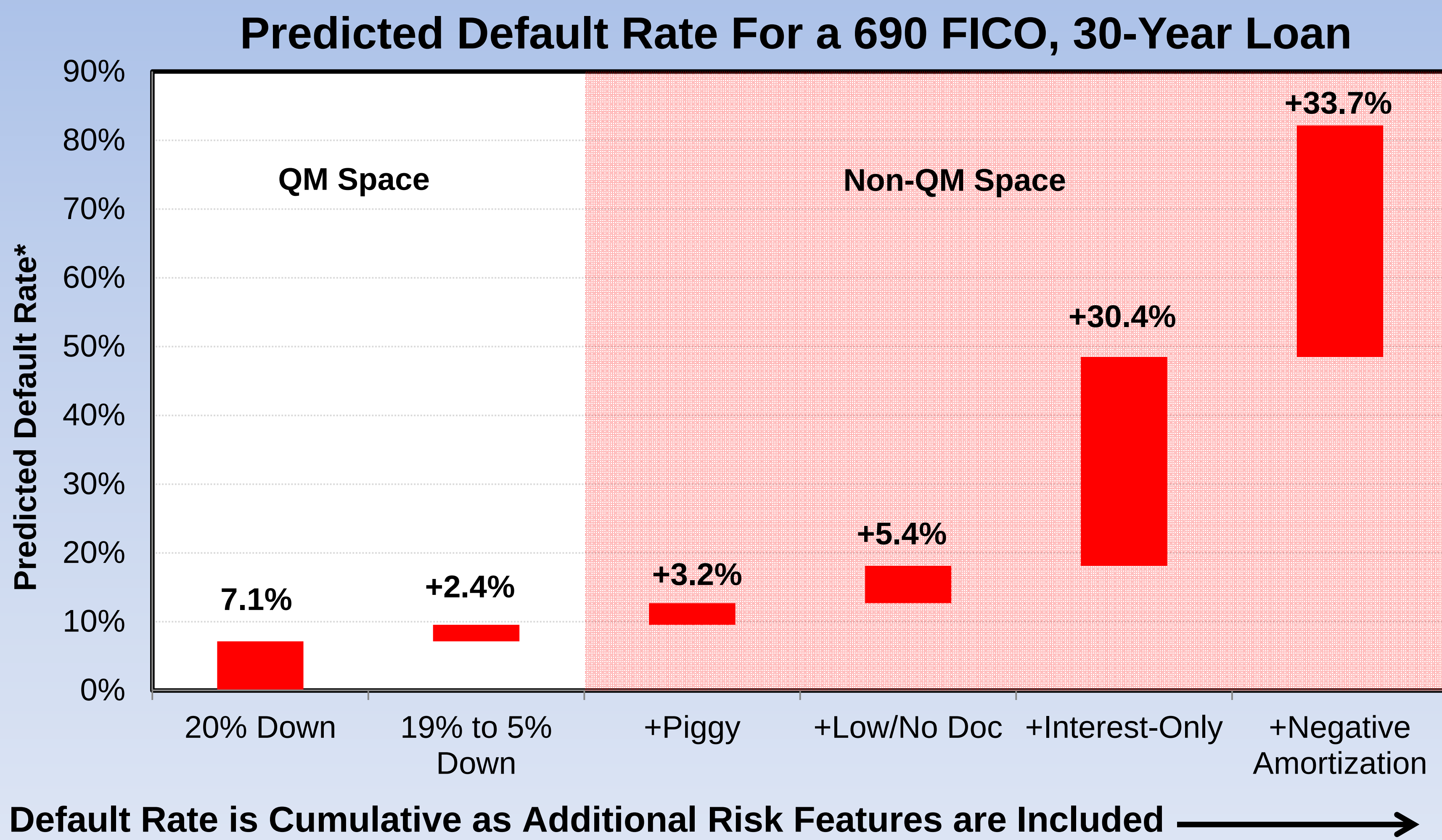
- Any narrow definition of QRM splits the private mortgage market, raising costs for both QRM and non-QRM loans
- Unnecessarily impacts a large number of consumers:
  - Roughly 10 performing mortgages that meet the QM would be excluded from the exemption to prevent 1 delinquency
- Higher mortgage rates for non-QRM loans will drive FHA-eligible borrowers to the FHA
- Disproportionately focuses higher rates and limited credit access on African-Americans, Latino, and first time homebuyers.

*Alternative: 90 LTV, 33%/41% DTI, credit standard, no exotics, etc.

STRIKING THE RIGHT BALANCE

Mortgage Investors, Consumers, and the Economy

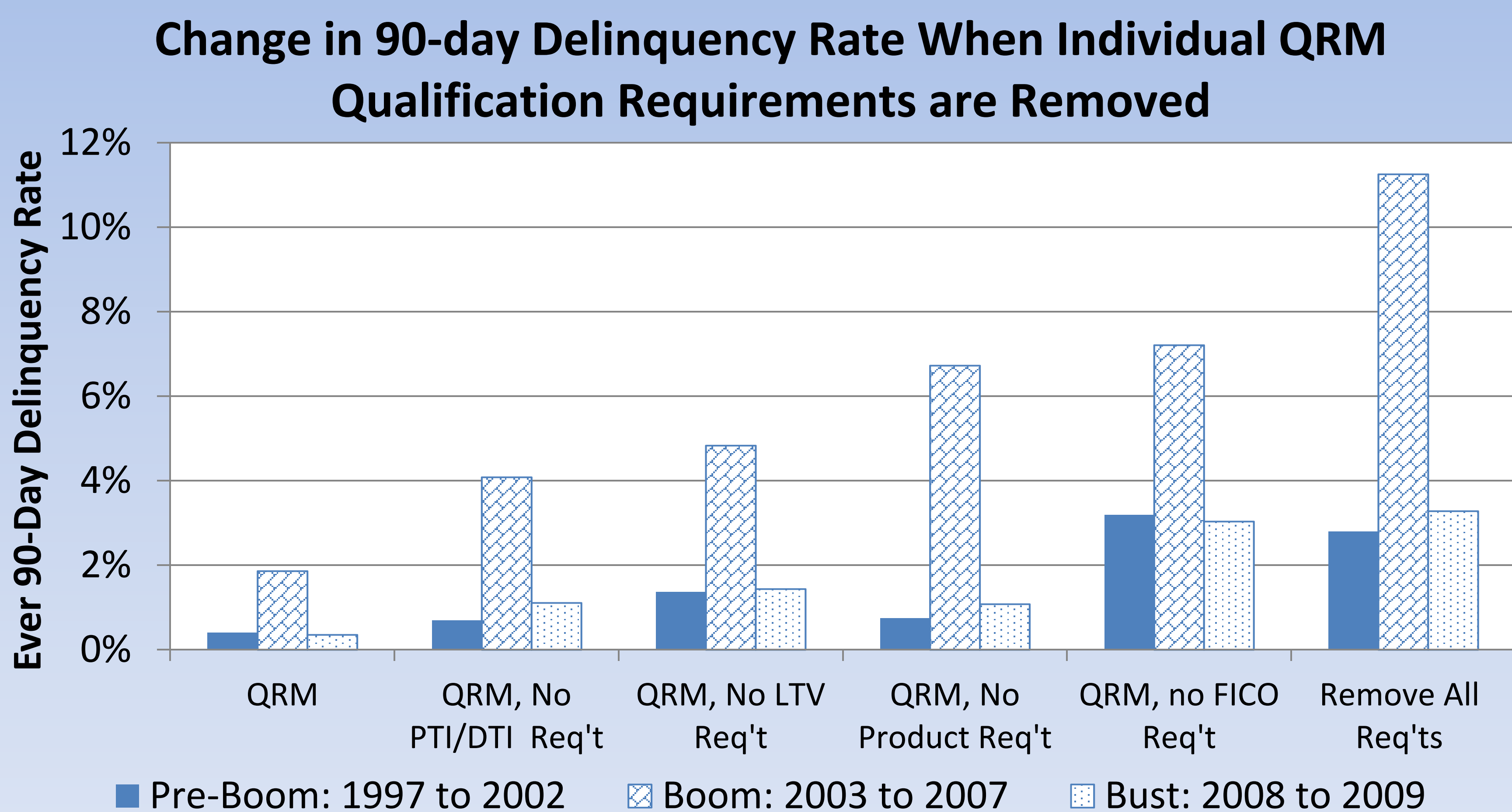
QM Eliminates Riskiest Loan Features, Letting Investors Weigh and Manage Quantifiable Risks



Based on a logistic regression of 2003-2008 loans in the CoreLogic Servicer Database

* Default = Foreclosed + 90+ Delinquent as of January 2012

LTV and DTI matter, but less so than Product Type and FICO

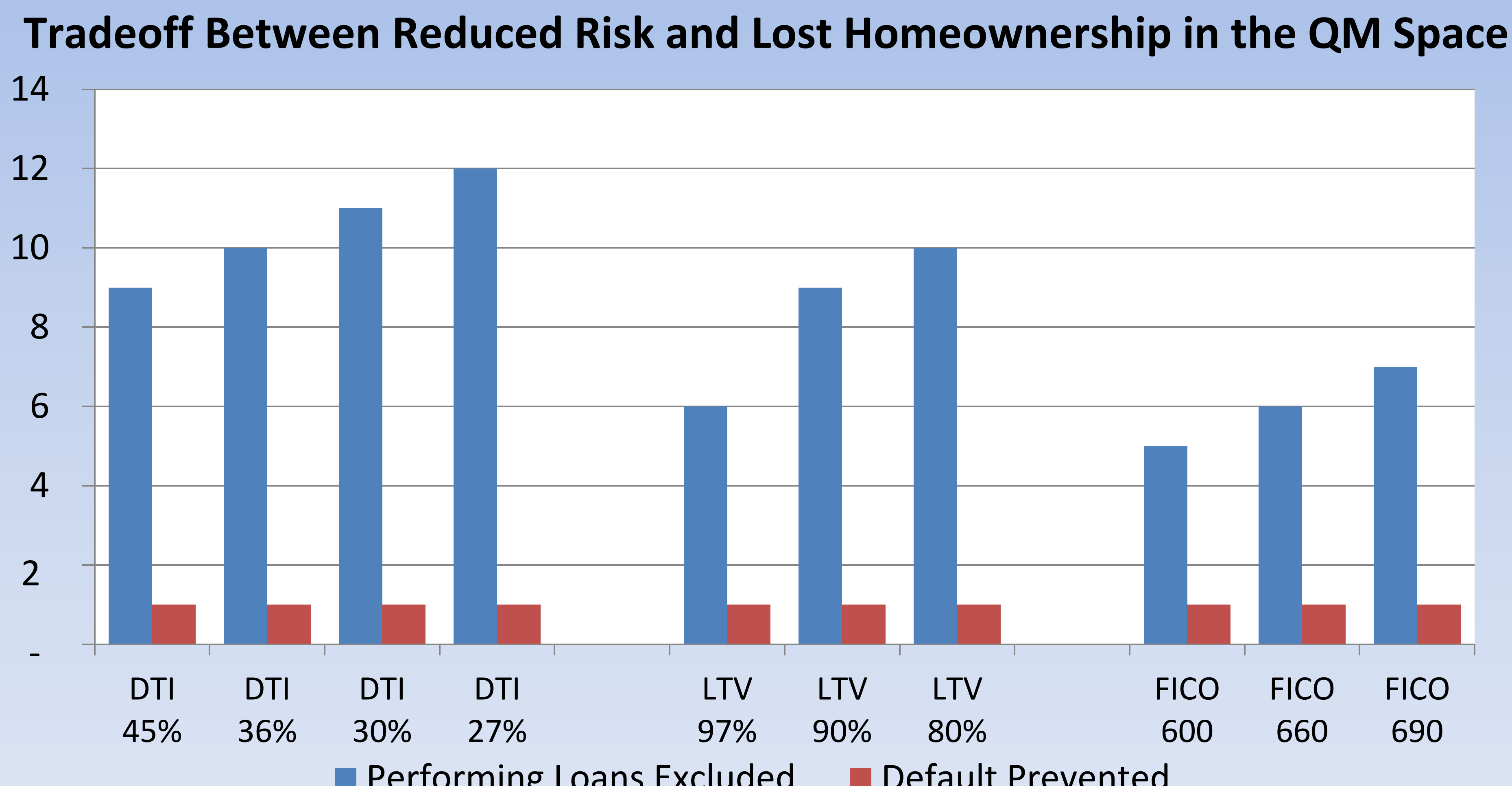


Source: FHFA Mortgage Market Note: 3/31/2011

QRM: PTI/DTI = 28%/36%, LTV < 80, Product-Type*, FICO>690

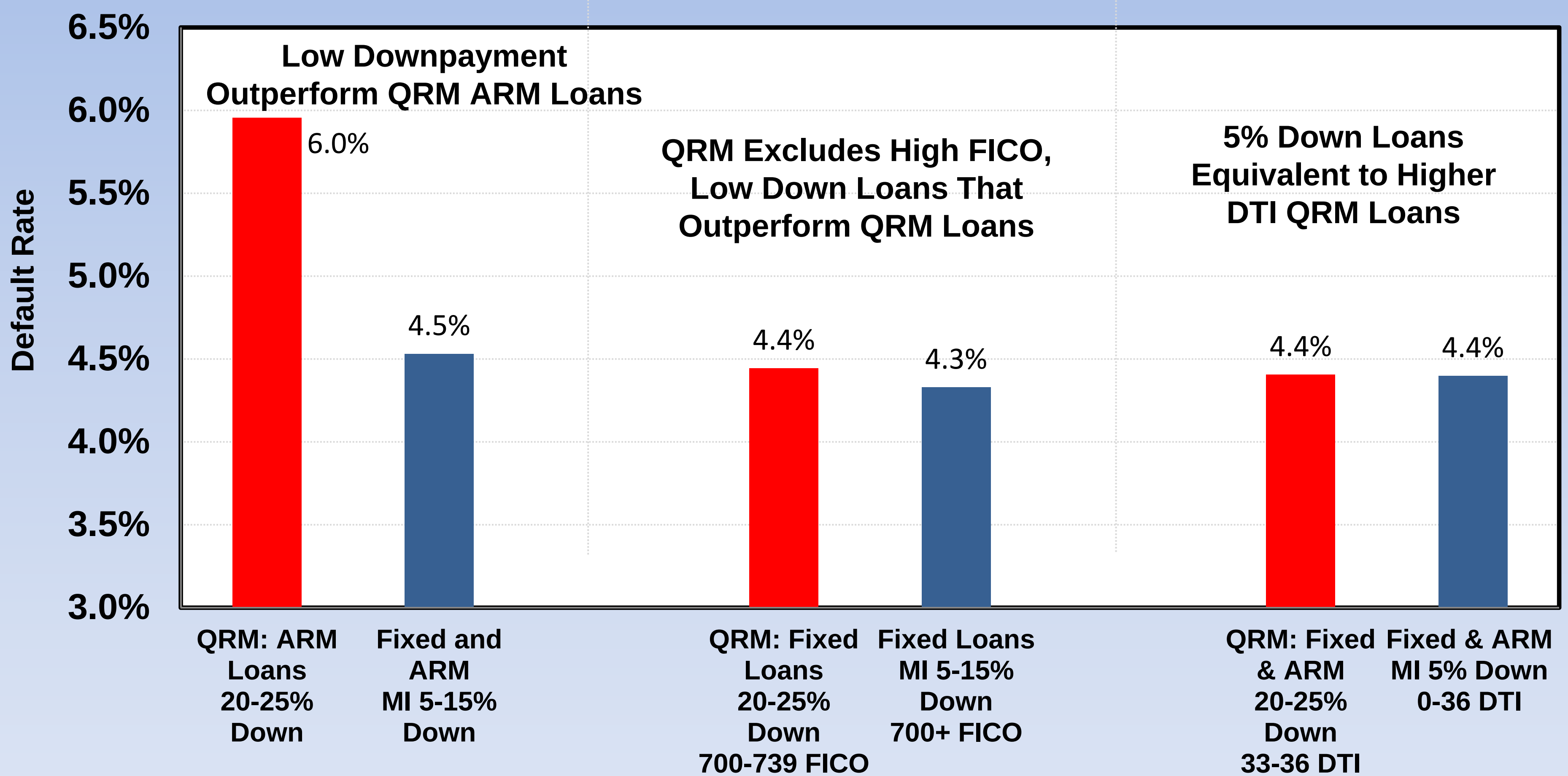
*fully documented, fully amortizing, no IO , ALT-A or maturity > 30 years, limitations on resets

LTV and DTI are the Least Efficient Means to Reduce Risk in the QM Space



Source: Prepared by NAR based on findings from Roberto Quercia, Lei Ding, and Carolina Reid (2012). "Balancing Risk and Access: Underwriting Standards for Qualified Residential Mortgages," UNC Center for Community Capital Research Report, January 2012.

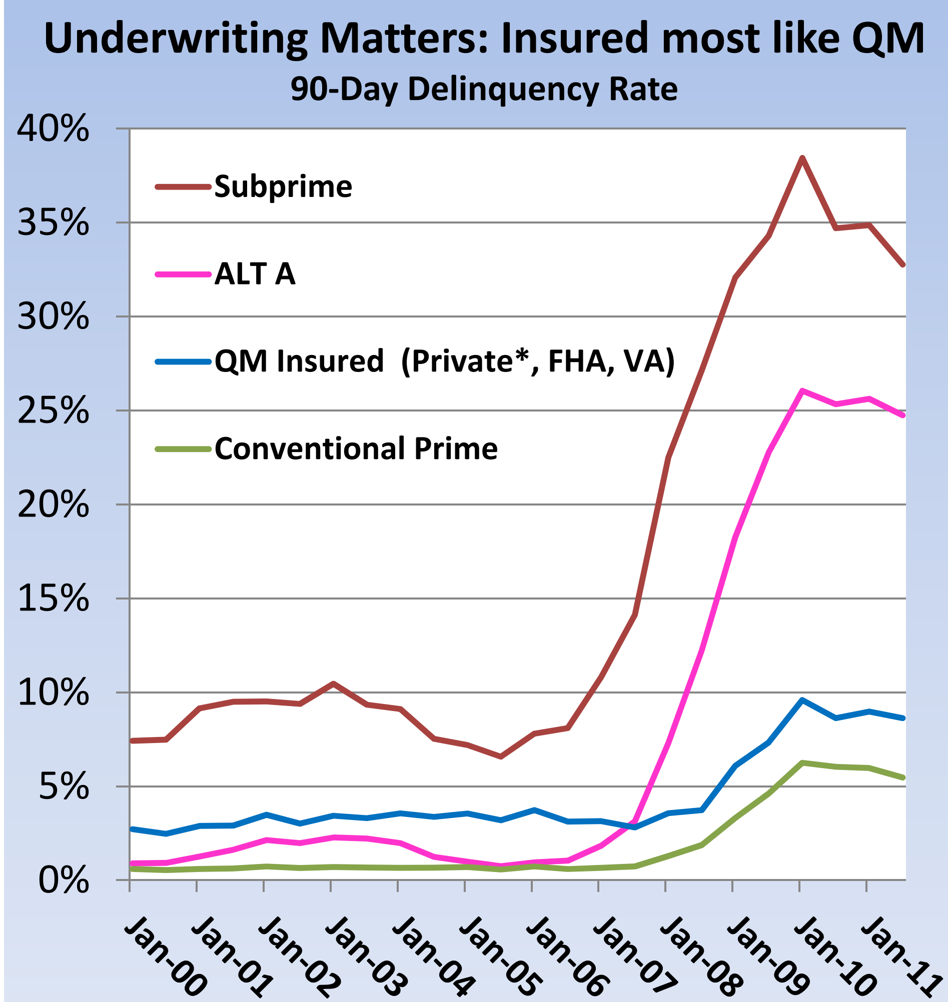
Narrow QRM Excludes High Quality, Low Downpayment Loans



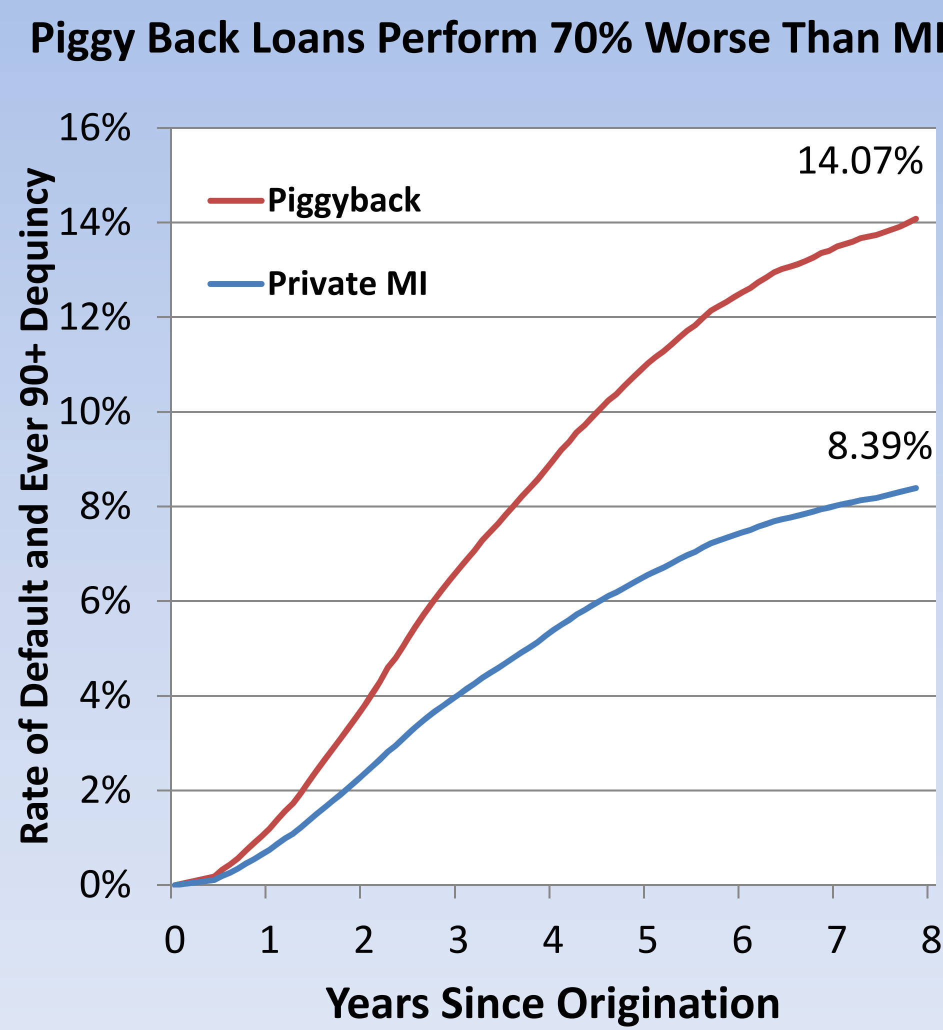
All Loans: 2000-2008, Full Doc, Fully Amortizing, No Interest-Only, No Piggyback

Source: Corelogic, Genworth Financial

Shore Up Traditional Lending: Underwriting and Mortgage Insurance



*Genworth Construct Based on UNC/CRL definition of QM
Source: Corelogic, Genworth Financial



Source: Promontory Financial Group: Corelogic 2003-2007

Improve the Proposed QRM Exemption

- Remove LTV and DTI requirements: allow underwriting to eliminate highest risk loans
- Reconsider rigid and misleading proposed credit standard to allow for compensating factors

Quick Summary: Ability to Repay, QM, Safe Harbor and Rebuttable Presumption

Ability to Repay Requirement

Dodd-Frank prohibits lenders from originating a mortgage unless the lender makes reasonable and good faith determination, based on verified and documented information, that the borrower has a reasonable ability to repay the loan and any mortgage-related obligations.

Violation of Requirement Brings Daunting Liability for Violation

Dodd-Frank allows a consumer to sue for violation of ability to repay requirement to recover special statutory damages including fees paid by the consumer and up to three years of finance charges. Damages may be in addition to actual damages, up to a prescribed threshold, and court costs and attorney fees available for violations of other Truth in Lending Act (TILA) provisions. The statute of limitations to bring a violation of the ability to repay provision was extended to three years from date of occurrence. Also, Section 1413 provides consumer may assert ability to repay violation as a defense to foreclosure by recoupment or set off without time limit against lender and assignee.

Under Proposal, Lenders Can Comply with Ability to Repay Requirement by:

1. **Originating mortgage loan after considering and verifying eight factors including:** (1) the consumer's current or reasonably expected income or assets, other than the value of dwelling that secures loan; (2) if the lender relies on income from a consumer's employment in determining repayment ability, the borrower's current employment status; (3) monthly payment on mortgage calculated based on fully indexed rate and monthly fully amortizing payments that are substantially equal; (4) the borrower's monthly payment on any simultaneous loan the lenders knows or has reason to know will be made, including HELOC payment using payment required under plan and amount of credit drawn at consummation of transaction; (5) the borrower's monthly payment for mortgage-related obligations; (6) the borrower's current debt obligations; (7) the borrower's monthly debt-to-income ratio or residual income; and (8) the borrower's credit history.
2. **Originating a Qualified Mortgage (QM).** The proposal offers two alternative approaches a "legal safe harbor" and a "rebuttable presumption" to the QM. Only one of these approaches will be adopted.
   - Legal safe harbor (Alternative A) would be available for mortgage meeting the following requirements: (1) does not include negative amortization, interest-only payments, or balloon payments, or have a loan term exceeding 30 years; (2) total points and fees, discussed below, do not exceed three percent of the total loan amount (with alternative thresholds proposed for smaller loans); (3) income or assets of borrower have been considered and verified; and (4) underwriting: (a) is based on the maximum interest rate in the first five years, (b) uses a payment

For more information, visit **www.mortgagebankers.org.**

schedule that fully amortizes the loan over the loan term, and (c) takes into account any mortgage-related obligations.

- Rebuttable presumption of compliance (Alternative B) would be available to a mortgage meeting the requirements listed for the safe harbor as well as the following additional requirements, which include considering and verifying: (i) the consumer's employment status, (ii) the monthly payment for any simultaneous mortgage, (iii) the consumer's current debt obligations, (iv) the monthly debt-to-income ratio or residual income, and (v) the consumer's credit history.

3. **Originating a "Balloon Payment QM" by Small Lender Operating Predominantly in Rural or Underserved Area.** The lender and the balloon mortgage would have to meet all requirements in proposal including limits on points and fees and repayment determination based on scheduled periodic payments (excluding balloon payment) and applicable taxes,insurance and assessments (and scheduled periodic payments must be based on an amortization period of no more than 30 years.)

4. **Refinancing a "Non-Standard Mortgage" into a "Standard Mortgage."** Intended to provide an exception to ability to repay requirements for certain streamlined refinancings, such as low-documentation loans, in order to quickly refinance a consumer from a non-standard to a standard product.

Safe Harbor Is Essential

- Both Safe Harbor and Rebuttable Presumption permit court review of whether ability to repay requirement was satisfied.
- Under safe harbor structure, litigation considers only whether the requirements of the safe harbor have been satisfied.
- Under a rebuttable presumption, evidence and arguments may be introduced in court about standards or factors that are beyond those identified in the presumption.
- If a regulated entity could establish that its conduct met the presumption, another party could overcome presumption by reference to some other set of facts or evidence.
- Limiting litigation to a consideration of the factors identified in the safe harbor ensures that the relevant standards are well conceived.
- At the same time, a safe harbor reduces the costs to all borrowers of freewheeling inquiries and lessens chance that competitors will flee the market.
- A presumption, on the other hand, markedly reduces the incentive for providing loans to all qualified borrowers; lenders must act conservatively to decrease risk. A presumption also increases the costs of litigation that are ultimately borne by all borrowers.

Quick Summary:
Three Percent Limit on Points and Fees

Dodd-Frank provides a Qualified Mortgage (QM) cannot have points and fees in excess of three percent of the loan amount. As currently defined, points and fees include: (i) charges to affiliated title companies, (ii) the salaries paid to loan originators, and (iii) amounts of insurance and taxes held in escrow. As a result of this definition, many loans, and especially those made to low- and moderate-income borrowers, will not qualify as QMs and therefore either may not be available or require higher rates and payments.

Points and Fees Definition Requires Revision

To ensure that consumers continue to be able to access affordable housing credit, the regulations must amend the definition of points and fees to:

- **Remove Affiliated Title Charges.** The definition as it stands includes title charges paid to an affiliate but excludes title charges paid to an unaffiliated title company. This result is both anti-competitive and anti-consumer. There is no evidence to support a finding that lenders are "hiding" fees in their affiliated title companies, which arguably was the reason affiliated title charges were originally included under the definition. The Real Estate Settlement Procedures Act (RESPA) requires a clear disclosure of affiliated relationships and their cost and does not permit a consumer to be required to use an affiliated entity. By establishing a definition of points and fees to exclude all title charges, provided they are bona fide and reasonable, the rules will: (i) maintain a competitive marketplace, (ii) prevent the withdrawal of affiliated companies from the marketplace where they have been found in the past to provide 26 percent of services and, (iii) preserve the ability of consumers to avail themselves where they choose of one-stop shopping to obtain title insurance from affiliated title companies.

- **Clarify Salary Exclusion.** An interpretation of the definition of points and fees as drafted is that it requires the inclusion of any salary or bonus paid by a creditor or mortgage broker to its employee loan originators. This result is simply unworkable. First, considering bonuses would be included, creditors will be unable to accurately predict the compensation to a loan officer that is attributable to a particular loan, making application of the rule impossible. Second, the creditor already includes in the calculation of points and fees any money paid directly or indirectly to the mortgage broker or creditor. Since this money also constitutes the basis for the salary of the employee, the inclusion of the salary can constitute "double counting" of the money paid related to any one loan.

For more information, visit **www.mortgagebankers.org.**

MORTGAGE BANKERS ASSOCIATION®
Investing in communities

- **Clarify "Escrow Charges."** At present, the definition of points and fees is ambiguous regarding whether the dollar values for amounts held for insurance and taxes within the escrow itself are included in the calculation. Historically, the industry has not included such amounts because the Homeowners Equity Protection Act (HOEPA) made clear that the amounts held for escrows were excluded. And, at present, there simply is no public policy reason to include these amounts. Amounts for insurance are not retained by the lender or its affiliates and amounts for taxes are paid to governmental entities. Additionally, amounts held in escrow that exceed a certain "cushion" are returned to the consumer.

Myths and Facts about the Impending Ability to Repay / Qualified Mortgage (QM) Rule

This publication is intended for educational purposes only and is not intended to provide legal or other professional advice.

MORTGAGE BANKERS ASSOCIATION®
Investing in communities

11277 February 28, 2012 10:31 PM

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) requires rulemaking to implement amendments to the Truth in Lending Act (TILA) to establish an ability to repay requirement for all mortgage loans; the rules are to include an exemption for a "Qualified Mortgage" (QM). This rulemaking is frequently confused with a separate rulemaking being undertaken to implement the credit risk retention requirements of Dodd-Frank that also includes an exemption for a similarly termed "Qualified Residential Mortgage" (QRM). Considering this and other points of confusion, this paper discusses common myths and facts surrounding the QM rule.

Myth:

The "Qualified Mortgage," or "QM," is the same as the "Qualified Residential Mortgage," or "QRM."

Fact:

These definitions are different, based on different sections of Dodd-Frank and are the subjects of separate proposed rules.

While both are intended to define a better, more sustainable mortgage, exempt from particular requirements, the QRM, unlike the QM specifies minimum numerical down payment and maximum LTV, DTI, credit-related and other requirements. The QM, on the other hand, specifies underwriting standards without dictating numerical requirements.

QM

Originating a QM is a means of complying with the requirement under Dodd-Frank[1] that no creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms, and all mortgage-related obligations, such as taxes, insurance (including mortgage guarantee insurance) and assessments.

Under Dodd-Frank, a creditor and an assignee of a QM may presume that if loan meets the definition of a QM,[2] it satisfies the ability to repay requirements. The law defines a QM as a residential mortgage: (1) that does not include negative amortization, interest-only payments, or balloon payments, or have a loan term exceeding 30 years; (2) where total points and fees, discussed below, generally do not exceed three percent of the total loan amount (with alternative thresholds proposed for smaller loans); (3) income or assets of borrower have been considered and verified; and (4) underwriting: (a) is based on the maximum interest rate in the first five years, (b) uses a payment schedule that fully amortizes the loan over the loan term, and (c) takes into account any mortgage-related obligations.

The Federal Reserve issued the ability to repay and QM proposed rule implementing Dodd-Frank, comments were received July 22, 2011, and the Consumer Financial Protection Bureau (CFPB) is expected to finalize the rule in the first half of 2012 (as soon as April). The proposed rule offers alternative approaches to the QM — as a safe harbor or a rebuttable presumption — along with additional requirements. Only one alternative will be adopted.

Alternative A proposes to define QM as a "safe harbor." A mortgage loan would qualify for the safe harbor as long as the loan (1) did not include negative amortization, interest-only payments, or balloon payments, or a loan term exceeding 30 years; (2) did not have total points and fees exceeding three percent of loan amount (with alternative thresholds proposed for smaller loans); (3) was underwritten: (a) based on the maximum interest rate in the first five years, (b) using a payment schedule that fully amortizes the loan over loan term, and (c) taking into account any mortgage-related obligations. Also requires creditor to consider and verify income or assets of borrower.

1. Sec. 1411 of Dodd-Frank
2. Sec. 1412

Alternative B proposes to define QM as a "rebuttable presumption of compliance." A mortgage loan would qualify for the presumption as long as the loan met the requirements in Alternative A and also met additional underwriting requirements that involve considering and verifying (1) the consumer's employment status, (2) monthly payment for any simultaneous mortgage, (3) consumer's current debt obligations, (4) monthly debt-to-income ratio or residual income, and (5) consumer's credit history.

QRM

The QRM is an exemption from another section of Dodd-Frank[3] that requires six agencies, including the federal banking agencies, the Securities and Exchange Commission (SEC), the Department of Housing and Urban Development (HUD) and the Federal Housing Finance Agency (FHFA) to jointly prescribe rules to: (1) require any securitizer to retain an economic interest in a portion of the credit risk for any residential mortgage asset that the securitizer, through the issuance of an asset-backed security, transfers, sells, or conveys to a third party; (2) exempt QRM loans from the risk retention requirements; and (3) define the term "Qualified Residential Mortgage," taking into consideration underwriting and product features that historical loan performance data indicate result in a lower risk of default.

The regulators issued their proposal and comments were received August 1, 2011. It is unclear when they plan to issue a final rule or whether, in light of the comments, they may repurpose the rule.

The proposed QRM definition requires a minimum down payment of 20 percent plus closing costs in cash, a maximum loan-to-value (LTV) of 80 percent for purchase loans and 75 percent for refinances, as well as 28 and 36 maximum front-and back-end debt-to-incomes (DTI), respectively.

Under the risk retention provisions of Dodd-Frank, the QRM may not be broader than the QM. In the interest of consistency and maintaining credit availability, many have urged that the QM and QRM definitions converge along the lines of a QM safe harbor.

3. Sec. 941

Myth:

The industry prefers the QM safe harbor proposal from the Federal Reserve because, as proposed, it contains fewer requirements than the rebuttable presumption of compliance.

Fact:

In response to the Federal Reserve's proposal, industry representatives commented that they supported QM standards for the safe harbor beyond those that were proposed including the standards proposed to satisfy the presumption of compliance.

Myth:

The QRM rule will have a greater impact on the mortgage market than the QM rule.

Fact:

The QM rule will have a greater impact.

The ability to repay / QM rule will apply to *all* residential mortgage loans and the QRM rule, while exceedingly important to assuring private market mortgage financing, will affect only residential mortgages which are, or may be, securitized. Notably, if a QM clear safe harbor is not established, many lenders will act more conservatively and retreat to the more stringent QRM construct, which will limit access to credit for many consumers. It is important that all safe harbor requirements be in the form of bright-line standards.

Myth:

The matter of whether the QM is defined as a rebuttable presumption or a safe harbor has little impact on consumers.

Fact:

To the contrary, structuring the QM as a presumption of compliance instead of a clear safe harbor will result in greater risk to lenders which, in turn, will increase costs and reduce the availability of credit to consumers.

- Any violation of the ability to repay will lead to very significant liability including supporting a claim at foreclosure that the requirements were not met.
- If a transaction fits within the four corners of the standards in a safe harbor, a regulated entity can be reasonably certain that it met the requirements. Consequently, establishing the QM as a safe harbor, because of the certainty it provides, will allow lenders to qualify consumers right up to the bounds of the QM definition.
- In contrast, structuring the QM as a rebuttable presumption of compliance will not give the lender confidence that it met the standards in the presumption. If the QM is established as a rebuttable presumption, it is likely that lenders will gravitate to originating only loans to these consumers meeting QRM requirements because only those loans will be regarded as less risky and will retain salability without risk retention. Other lenders may choose to offer loans to consumers who do not meet QRM requirements at much higher lending costs reflective of the additional risk. This new market could potentially become the "new subprime" lending space.

Myth:

A consumer will not have any remedy for a violation of the ability to repay requirement if a safe harbor is established for QM loans.

Fact:

A consumer will be able to make a claim and litigate in court whether the QM is structured as a safe harbor or a rebuttable presumption.

- Simply establishing a regulatory safe harbor will not limit a consumer's ability to bring a lawsuit to dispute that the standard or triggering factors were met by the creditor. A safe harbor allows more focused litigation concerning whether the safe harbor requirements were met. If a clear safe harbor is established the action can be resolved relatively efficiently. If a consumer can show the requirements were not met, the consumer will be granted relief. Conversely, for a lender to be deemed within the safe harbor, the lender must demonstrate that a loan satisfies the QM requirements.

Myth:

Legally, there is little difference between a safe harbor and a rebuttable presumption.

Fact:

While both provide the borrower an opportunity for a judicial review of a claim that a the ability to repay was not satisfied, there is a great difference between the two constructions. A safe harbor is a fairer and more efficient means of both implementing and assuring QM requirements are met.

- In a litigation context, the stated standard or factors of the safe harbor 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. Such an approach preserves judicial and party resources and leads to a fair and efficient resolution of litigation for consumers and lenders.
- Consideration of liability by a court under an exemption that is governed by a presumption that is rebuttable is far more burdensome than 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. Therefore, while a regulated entity could establish that under the stated test its conduct met the presumption, another party could attempt to show that the presumption should be overridden by reference to some other set of facts or evidence. This leads to a heightened level of unpredictability and will dramatically increase the risk of originating mortgage loans.
- Once a party rebuts or meets the presumption, the fact that there was initial proof that the presumption applied will not affect the burden of persuasion as to the ultimate liability. 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.

Myth:

As long as the QM definition is a safe harbor it does not matter what standards are included.

Fact:

How a safe harbor is constructed is as important as the establishment of a safe harbor itself.

- In order 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. A safe harbor should delineate the type of evidence that meets its standards. For example, if proof of a QM safe harbor requires a demonstration that employment has been verified, the safe harbor should identify a conclusively acceptable method of making such a verification.
- Such standards also could 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 certification or checklist of standards that have been met, a calculation sheet based on reliable third party standards or output from automated system(s) also could be specified and incorporated into a safe harbor.

Myth:

Dodd-Frank did not authorize the establishment of the QM as a safe harbor under the ability to repay requirements.

Fact:

Both a major law firm and the Federal Reserve concluded that there is legal authority under TILA[4] for the Federal Reserve and its successor, the CFPB, to establish the QM as a safe harbor.

- In preparing its comments on the ability to repay rule, MBA requested the law firm of Goodwin Procter to advise on this point. The resulting opinion, signed by the firm and available from MBA concludes that the Federal Reserve and the CFPB have the authority to adopt the safe harbor alternative. Similarly, the Federal Reserve concluded it was authorized to propose a safe harbor under TILA, Section 105(a).

4. Sections 105(a) and 129C(b)(3)(B)

Myth:

Dodd-Frank requires that all loans must be QM loans.

Fact:

Dodd-Frank requires that a lender determine that a consumer has a reasonable ability to repay a loan. Originating a QM loan will be the preferred means of complying simply because of liability concerns, but a lender may also comply by considering and verifying eight statutory factors.

- These factors include consumer's: (1) current or reasonably expected income; (2) employment status if creditor relies on income from consumer's; (3) monthly payment on mortgage based on fully indexed rate and amortizing payments that are substantially equal; (4) monthly payment on any simultaneous loan creditor knows or has reason to know will be made; (5) monthly payment for mortgage-related obligations; (6) consumer's current debt obligations; (7) monthly DTI ratio, or residual income; and (8) credit history.
- Lenders may also comply by refinancing a "non-standard mortgage" into a "standard mortgage." Small lenders operating in predominantly rural or underserved areas may also comply by originating a "balloon payment QM."

Myth:

If the QM safe harbor is not available, lenders will simply originate non-QM loans that meet the ability to repay requirements.

Fact:

Mainstream lenders are unlikely to originate non-QM loans because they bear great legal liability for lenders and investors.

Under Dodd-Frank, a lender who fails to comply with the ability to repay requirements may be liable for actual damages, all fees paid by the consumer, up to three years of finance charges paid by the consumer, court costs and reasonable attorney's fees associated with enforcement action. Significantly, Dodd-Frank expanded the statute of limitations from one to three years for certain TILA violations, including violations of ability to repay requirements. Dodd-Frank allows a claim at foreclosure grounded on a failure to determine ability to repay.

Myth:

Establishing the QM as a presumption of compliance will not increase the safety and soundness risks of lenders and the mortgage market at large.

Fact:

A presumption of compliance will result in much higher litigation costs and present unquantifiable risk to lenders. Based on experience with regulation of higher-cost lending, it can be expected to markedly lessen the number of lenders participating in the mortgage market.

For More Information Please Contact

Ken Markison
Regulatory Counsel
Mortgage Bankers Association
(202) 557-2930

Mike Fratantoni
Research and Economics
Mortgage Bankers Association
(202) 557-2935

MORTGAGE BANKERS ASSOCIATION®
Investing in communities

1717 Rhode Island Ave., NW, Suite 400
Washington, DC 20036
www.mortgagebankers.org