

July 11, 2012

Statement for the Record

On behalf of the

American Bankers Association

before the

Subcommittee on Financial Institutions and Consumer Credit

of the

Committee on Financial Services

United States House of Representatives



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Chairman Capito, Ranking Member Maloney, and members of the Subcommittee, ABA appreciates the opportunity to comment on the impact of Dodd-Frank's home mortgage reforms. ABA represents banks of all sizes and charters and is the voice of the nation's \$14 trillion banking industry and its two million employees.

We would like to focus our comments today on the ability to repay provision and the qualified mortgage (QM) definition. We believe that the rules developed to implement the QM are among the most important provisions of DFA's consumer protection provisions. For that reason, we are including with this statement both comment letters ABA has submitted to date on the proposed QM rule as well as all supporting documents. The changes contained in these rules when they are finalized are significant. If not correctly crafted, the final rule will lead to serious disruptions in the availability of mortgage credit and we believe it is important to provide the CFPB and the Congress with the most detailed analysis and information available. Our comments below will summarize our views which are expressed in greater detail in the attached submissions for the record.

These rules represent a game-changer for the mortgage market because of the impact that the rule will have on qualified borrowers' ability to access credit at a reasonable cost, the harsh consequences of non-compliance and the costs associated with that compliance. Lenders that violate repayment ability requirements will be subject to the same damages applicable to Home Ownership and Equity Protection Act (HOEPA) loans, recoupment by the consumer, new enforcement authorities by state attorneys general, the potential to face liability for violation of ability-to-repay for the life of the loan, and more. Because of these severe potential consequences, the QM definition, which is intended to provide assurances that a lender has met the ability-to-repay

requirements, will be vitally important. Our members have assured us that the QM will become the limit and extent of their lending under the new “ability to pay” regime. Quite simply, few loans are likely to be made outside of the QM definition.

The QM standard will become the stage on which most mortgage lending will take place. As such, the QM must be designed, not as a small subset of selected loans, but rather, as a platform upon which the great majority of the mortgage market will now operate.

Dodd-Frank’s ability-to-repay and QM proposals were crafted in reaction to a period of lax underwriting and other credit qualification failings across much of the industry. Those lapses have been addressed and corrected by the marketplace, even absent the implementation of new rules. While it is vital to ensure that such lapses do not occur again, it is equally important, both for economic recovery and for future availability of affordable credit, not to over-regulate and unnecessarily constrict the mortgage market. If the mortgage market is to rebound, it is critical that the Consumer Financial Protection Bureau (Bureau) provide lenders with clear, understandable rules that allow for the kind of safe lending that is happening today and a safe harbor to properly shield lenders from unreasonable litigation risks when they make safe, quality loans. A final rule that does not give lenders clarity and breadth in standards and a safe harbor will not prove sufficient to achieve the stated goal of the Congress: to promote a robust mortgage lending market for all borrowers and to satisfy our nation’s reasonable housing finance expectations.

We would like to make the following points today.

- **The QM standard should be broad enough to encompass the vast majority of loans being made today.** Since it will serve as the basis for the entire mortgage market, it should be established with as much flexibility as possible.
- **The QM must afford lenders the legal certainty of a safe harbor against liability**
This is the only way that banks will take on the incredible risks associated with the new mortgage lending platform.
- **The final rule must take into account all of the other changes that are being mandated by other Dodd/Frank requirements and other regulations.**

We discuss these items in detail below.

I. The QM standard should be broad enough to encompass the vast majority of loans being made today.

ABA, and most other industry representatives, along with many consumer groups all agree that the QM should be a broad category encompassing most loans being made today. The loans being made now are well underwritten without exotic or troublesome features, unlike some of the loans made prior to the economic crisis. If the QM does not include most of these loans, it will unnecessarily restrict credit, harming efforts toward recovery in the mortgage sector. Even HUD Secretary Shaun Donovan has argued that the QM should be broad enough to include most loans made today.

For this reason, we are concerned about proposals to use inflexible or inappropriate methods to determine whether a loan is a QM. In our attached comment letters we address in some detail our concerns over using a Debt-to-Income (DTI) ratio of 43 percent, as some groups have proposed as a “bright line” for the QM.

ABA understands and appreciates the usefulness and desirability of using "bright line" standards for determining whether a borrower has an ability to repay. Clear bright lines help to provide certainty against legal liability and expense. We note however, that all bright line standards have limitations and unintended consequences. One of those consequences is that borrowers who may be otherwise well qualified for a loan, but who fail a specific DTI cutoff, could be denied credit. Additionally, because neither mortgage loans nor mortgage borrowers are homogenous, a hard and fast DTI will have differing effects upon different mortgage lenders and different mortgage applicants. For example, community banks, and the communities they serve, could be adversely impacted by too low a DTI. Community banks tend to engage in more relationship lending, where a long-standing relationship with a borrower and knowledge of that borrower's credit history and history with the bank is a key aspect of the underwriting of any loan. Such an institution (and their borrowers) would be far more likely to be impacted by a median DTI than would a larger institution which relies primarily on anonymous data averages in a standard underwriting model or program.

A representative sample of ABA mortgage lenders found that on average 14.3 percent of mortgages originated between October 1, 2010 and April 1, 2012 had a DTI of 43 percent or more. About 10 percent of institutions reported 30 percent of mortgages with a DTI of 43 percent or more, including portfolio lenders with outstanding loan performance records. Given the high underwriting

standards currently being utilized, it can be reasonably inferred that setting a DTI of 43 percent or lower will negatively impact a significant portion of borrowers who would otherwise qualify for credit even under today's stringent underwriting standards. For some institutions (and borrowers) a 43 percent DTI will have a pronounced impact on ability to qualify for the QM designation. A DTI cutoff of 43 percent will have an even more pronounced impact on low income and minority borrowers, who tend to have higher DTI ratios.

This impact on low and moderate income borrowers triggers a number of concerns related to fair lending and the potential for unintended consequences of the QM on banks' efforts to ensure compliance with fair lending laws.

ABA believes that this is a crucial element that must be addressed in any final rule dealing with repayment ability. As ABA identified in its July 2011 comments, the very core of the Qualified Mortgage rulemaking is to codify sensible mortgage underwriting standards and to discourage creditors from making mortgage loans outside of those standards. By design, therefore, these ability-to-repay rules narrow the alternatives to "safer" categories of loans. Such a structure, when imbedded in law, will reduce the diversity of lending products and will diminish banks' abilities to tailor financial products to fit consumers' specific needs.

The Bureau cannot turn a blind eye to this very significant dilemma—the rigidity of these rules will mean that individuals and populations with damaged or undeveloped credit will likely be excluded from the QM portions of the market, and that will mean significantly more expensive credit, or worse, no credit at all. These distinctions will be made even within the Qualified Mortgage marketplace. All Qualified Mortgage loans will not have the same risk of default, and many banks will – justifiably – not wish to face a single lawsuit alleging that the bank made a loan that the consumer did not have the ability-to-repay.

In our initial comments to the Bureau on this rulemaking, ABA asked that "regulators be cognizant of this point and remain vigilant of the real world impact that these new provisions will have on communities all across America." After further consultation with members and legal experts, ABA now urges more than mere recognition and vigilance. For purposes of safety and soundness, in order to achieve appropriate and orderly oversight of lending practices, in order to guard the reputational risk of the entire industry, and in order to ensure adequate levels of funding to all populations, ABA requests that the Bureau adequately discuss and define the appropriate and feasible interplay between discriminatory lending and ability-to-repay requirements.

The Bureau must, for instance, carefully articulate its views on the statistical differences among borrowers (which could be portrayed as disparate impact) that could result from limiting lending to Qualified Mortgage segments only. The Bureau must address the legal analysis that will apply to premium pricing in instances where lenders dare to lend outside of the Qualified Mortgage boundaries. We urge that these crucial clarifications be part and parcel of any final rule issued by the Bureau. We are not pointing out mere probabilities or hypothetical scenarios—we are referring to obvious discrepancies that are absolutely certain to arise. Ignoring or overlooking the disparate effects of this regulation will exacerbate a very crucial issue of basic fairness and will only create more confusion and disharmony in an already unsettled and highly charged issue area.

II. The QM must afford lenders the legal certainty of a safe harbor against liability.

The Board proposed two possibilities to provide protections to lenders, a rebuttable presumption and a safe harbor. The rebuttable presumption is an assumption that is made in the law that will stand as a fact unless someone comes forward to challenge the factual basis of the assumption. The "presumption" is only good until it is contested and shown to be wrong to a judge or jury. Clearly, this opens the doors to extensive and expensive litigation. The safe harbor would still allow for a challenge based upon the ability to repay. However, unlike the rebuttable presumption, there are methods to dispose of the challenge at an earlier stage of any legal proceeding, so long as the elements of the safe harbor are proven. We would like to commend you, Chairman Capito, as well as Rep. Brad Sherman, for your efforts in organizing a letter signed by over seventy five of your colleagues to the CFPB urging the adoption of a safe harbor.

Because liability for an ability to repay challenge runs for the life of the loan, without a safe harbor, lenders will face potential costly lawsuits for the life of any loan they make. The potential costs for defending against such claims will increase the cost of loans (because costs will be priced into the loan) or drive lenders from the marketplace (because they will not want to take on the liability). Even groups like Habitat for Humanity have told CFPB that without the legal certainty of a safe harbor they would be unable to continue their mission, because a single legal challenge would require more resources than they could afford. The potential cost of litigation will be of particular concern for medium- and smaller-sized banks that do not have the kind of legal department or budget to be able to assume the potential costs that will result from a rule without a safe harbor.

ABA was pleased that the CFPB listened to our concerns about potential litigation costs associated with a choice between a rebuttable presumption and a safe harbor and chose to reopen the comment period to gather further input on this topic. In our attached comment letter of July 9th, 2012 we discuss these issues in detail, but provide a summary of our views for you here as well.

To respond to the CFPB's request for additional information regarding litigation costs, ABA undertook a survey of a representative sample of ABA members to more methodically analyze the scope of lender reactions to this rulemaking. In this survey (see Attachment 3), ABA reached out to bank legal counsel and mortgage business line professionals to gather their views on the litigation and legal risks that they believe will be posed under the alternative Qualified Mortgage definitions of "rebuttable presumption" versus "safe harbor," as set forth in the proposed rule. ABA also requested that legal counsel respondents estimate potential litigation costs associated with a rebuttable presumption standard versus a safe harbor.

Finally, the survey collected opinions from both legal counsel and chief real estate lending officers on the likely business decisions which may result from the alternatives presented in the proposed rule. The results of this survey, described below, decisively validate the concerns that ABA expressed in its July 2011 comments.

Costs: ABA's survey requested legal counsel to approximate historical costs of litigation of all types, on a per case basis, where the bank prevailed at the summary judgment stage. Respondents estimated the average cost to be \$25,000 per case, with a maximum estimate of \$75,000 per case. By comparison, the survey inquired about the historical cost of litigation on a per case basis where the bank prevailed and the case was fully litigated. In such instances, the estimates jumped to an average cost of \$100,000 per case, with a maximum estimate of \$400,000 per case. These figures illustrate why banks are very concerned about the potential for a high-volume of ability-to-repay litigation. For community banks, one legal challenge could cancel out years of mortgage-related profits.

Rebuttable Presumption: To collect information regarding the rule's impact on lending, ABA surveyed bank counsel and real estate lending officers on their forecast of the effect that a rebuttable presumption standard would have upon the use of risk-based pricing methodologies. The poll reflects the prediction that changes in fee structures would occur, with 52 percent of respondents stating that they expected "significant" changes in fee structure to offset litigation risk, and 46 percent expecting a "small change."

In terms of the effect that a rebuttable presumption standard would have on underwriting methodologies, respondents unanimously discarded the possibility that there would be no change from current lending standards. In fact, 71 percent believe their bank will adopt “significantly” more conservative underwriting standards, while 29 percent believe that they would adopt only “somewhat” more conservative underwriting.

Finally, 71 percent of respondents believe that a rebuttable presumption standard would lead to reductions in mortgage lending, with 45 percent asserting that the reduction would be “significant.” If there is a rebuttable presumption rather than a safe harbor in the definition of a Qualified Mortgage, 10 percent of respondents believe their bank may exit the mortgage origination business. The survey revealed that only 19 percent of respondents could assert that this choice would lead to “little change” in the bank’s commitment to mortgage lending.

Conclusions of Survey: These somber numerical results portend significant reductions in mortgage credit if the rule's legal standards are not clearly crafted as a safe harbor to properly shield lenders when they make safe and compliant loans. By rather wide margins, the banks’ business officers and legal counsel believe that the application of a rebuttable presumption standard will result in higher fees, stricter underwriting and less credit availability.

III. The final rule must take into account all of the other changes that are being mandated by Dodd/Frank and other regulations.

It is vital to remember that the implementation of ability-to-repay and QM requirements is not occurring in a vacuum, but instead is taking place in parallel with an unprecedented number of other regulatory changes. Among these, are RESPA/TILA integration (on which ABA testified before the Subcommittee on Housing and Insurance on June 20th 2012) and reform mandated by Dodd/Frank, new Mortgage Loan Originator Compensation rules, reforms to the appraisal process and the development of new servicing standards. Implementation of all of these rules must occur in an orderly and coordinated fashion to ensure that disruptions are not created for borrowers, and to provide lenders with adequate time to adjust forms, products and implement training and reprogramming.

ABA believes that this rulemaking will demand significant implementation efforts and will therefore require expanded time periods for compliance. ABA has asked the Bureau to set a compliance date of, at minimum, 18 months from the issuance of the final rule.

ABA advances this request by noting that this rulemaking concerns loan underwriting—the most fundamental element in lending and one that will cause ripple effects across bank functions involving origination, settlement and regulatory compliance. These ability-to-repay requirements will force banks to re-analyze their product lines, retrain staff, and reorganize the processing and administrative elements of their mortgage operations. Banks will be required to make very broad system adjustments at many levels. As ABA expressed in its comments to the Bureau, the technology systems that ensure proper compliance with regulations and that generate the proper disclosures for individualized transactions are integrated rather than isolated. A change in a bank's documentation requirements or qualifying considerations will force a change in the compliance software. These changes must be identified, incorporated into existing systems, and tested to ensure that they respond adequately to all product lines.

There is no question that these rules will force broad scale changes to lending guidelines—as we describe above, secondary market players and investors will have to ensure that none of the loans they purchase fall outside the standards set forth by this rulemaking. The administrative and quality assurance efforts that must be devoted to these investor guideline changes demand considerable implementation resources. Depending on the final shape of the regulations, the ability-to-repay changes will require a reconsideration of most product lines as well as their pricing. Finally, it is important to realize that the scope of the reformation undertaken here will require that regulators develop new enforcement procedures and interpretative guidelines, and examination staff will have to develop new examination procedures for all their visits.

Conclusion

The Dodd-Frank Act's ability-to-repay provisions contain the most consequential policy implications of any other mortgage-related regulation. As expressed above, this rule will effectively delineate the scope of residential mortgage lending across all market segments, making it imperative that these provisions be thoroughly weighed and accurately considered. We commend the subcommittee for holding this hearing and for your efforts to work with all interested parties as well as the CFPB to ensure that we achieve a workable, enforceable and efficacious final rule. Again, ABA appreciates this opportunity to submit these comments, as well as the attached comment letters to the CFPB, for the record.

Attachments

July 9, 2012 Comment letter

<http://www.aba.com/Issues/commentletters/Documents/ABACommentsonCFPBReopeningofProposedAmendmentsstoRegZJuly092012.pdf>

July 22, 2011 Comment letter

http://www.aba.com/Issues/commentletters/Documents/1e5985a2f3a040a18aecf51472687d8ecl_RegZ2011July.pdf