HOW PROSPECTIVE AND CURRENT HOMEOWNERS WILL BE HARMED BY THE CFPB'S QUALIFIED MORTGAGE RULE

HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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HOW PROSPECTIVE AND CURRENT HOMEOWNERS WILL BE HARMED BY THE CFPB'S QUALIFIED MORTGAGE RULE

Tuesday, January 14, 2014

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:06 a.m., in room 2128, Rayburn House Office Building, Hon. Shelley Moore Capito [chairwoman of the subcommittee] presiding.

Members present: Representatives Capito, Duffy, Bachus, McHenry, Campbell, Pearce, Posey, Westmoreland, Luetkemeyer, Stutzman, Pittenger, Barr, Cotton, Rothfus; Meeks, Maloney, Hinojosa, Scott, Green, Ellison, Lynch, Capuano, Murphy, and Heck.

Ex officio present: Representatives Hensarling and Waters.

Also present: Representatives Fincher, Garrett, Huizenga; and Kildee.

Chairwoman CAPITO. The subcommittee will come to order.

Without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

I am now going to recognize myself for the purpose of making an opening statement. Last January, the Consumer Financial Protection Bureau (CFPB) issued a series of rules that will fundamentally change the mortgage market in the United States. Over the last year, we have had numerous hearings in the Financial Institutions and Consumer Credit Subcommittee to learn more about the effects these rules will have on the availability of credit.

Last November, I had the pleasure of joining Mr. Rothfus in Pittsburgh for a roundtable discussion with the community development organizations in the greater Pittsburgh area about the effect these rules will have on their ability to serve their consumers.

Two things emerged from these committee hearings: one, that the new mortgage rules impair the ability of lenders to work with borrowers on an individual basis; and two, that low- to moderate-income borrowers stand to lose the most if lenders cannot write loans outside the qualified mortgage (QM) definition.

This morning, we have a panel of witnesses who will further educate members of the subcommittee on how their constituents will be affected by this rule. We have three lenders who will discuss the difficulties in working with borrowers with credit profiles that fall outside the qualified mortgage definition.

In most cases, lenders will sit down with riskier borrowers—that is what we do in West Virginia—and craft a mortgage that is highly tailored to the borrower's needs and risk profile. This type of relation is especially crucial in the rural areas, such as my district in West Virginia. No two borrowers have the same credit profile, and I fear that the one-size-fits-all approach to the CFPB mortgage rule will severely hamper the ability of community lenders to tailor products to their borrowers.

I also fear that the very population that this rule seeks to protect, the low- to moderate-income borrower, is the population that will be most affected by these rules. This morning, we will learn about the difficulties that Habitat for Humanity will face in complying with this rule.

The ability of charitable programs like Habitat and other entities who provide mortgages to underserved populations is critical to helping these borrowers realize their dreams of homeownership. This is another example of the consequences of removing underwriting discretion from the hands of lenders and borrowers and placing it in the hands of the bureaucracies in Washington.

It is my hope that we can work together to find common-sense solutions, and to provide consumers with the transparency they deserve, without limiting the ability of lenders to work with borrowers on a case-by-case basis.

I now yield time to the ranking member of the subcommittee, Mr. Meeks, for the purpose of making an opening statement.

Mr. MEEKS. Thank you, Madam Chairwoman. And I certainly agree with you that today we hold a very important hearing, given that the QM rules were finally—became effective last Friday. I also think that we can all agree that this is one of the most important new financial reforms that have been passed in recent years. And I just wanted to also say thank you for being here today, this morning, knowing the serious issues that your constituents face in West Virginia dealing with their drinking water.

I am pleased that the discussion has progressed from possibly delaying the QM rule to finally discussing their implementation and impacts. But I think that we also need to issue some words of caution that the rules just became effective a few days ago. And although we are here to talk about their impacts, we really don't have the data yet to definitively argue what the effects of the new QM rules will be.

In fact, it may take a few years to have the conclusive data. But I think that it is important to have these discussions, and to have them now, because this is very important to me. I probably would not be sitting here today if it wasn't for the fact that my parents had the opportunity to own a home. We moved from public housing to buying a home, which was the American dream, at which time my parents were able to actually afford to provide me and my sisters with an education as a result of owning that home.

And so, this is significant, and it is somewhat personal for me. And I personally have no doubt that there are impacts, significant impacts on prospective home buyers. After all, it was our intent to have new rules that fundamentally changed the old practices of the mortgage industry. And what I have to try to weigh, and I think what we all have to try to weigh, is to make sure that we don't

eliminate the possibility of individuals like my parents owning a home, because that is how we move the American dream, and people have an opportunity to progress.

At the same time, we cannot have a short memory, because we know from January 2007 to December 2011, 4 million American households lost their homes through completed foreclosures, and another 4.2 million were appended. And by 2010, U.S. home values dropped by an average of 30 percent from their 2006 peak, more than the 26 percent drop that occurred between 1928 and 1933 during the Great Depression. And the fact that we lost a record 9 million jobs between 2008 and 2009, roughly 6 percent of the workforce.

This was devastating. And I look at a district like mine, still recovering, actually, from this devastation. They were the devastating consequences of an economic system that failed because of widespread predatory and fraudulent mortgage practices. And in the midst of all this, African Americans and Hispanics were disproportionately steered to these predatory loans.

Studies by The Wall Street Journal and Fannie Mae both concluded that about 50 percent of African Americans and Hispanics were steered to subprime loans, even though they could qualify for prime loans. These groups were targeted by subprime lenders and brokers who received incentives for jacking up the interest rates.

Wells Fargo, Bank of America, Citi, and Countrywide are among a list of large lenders that were sued for the lending practices that discriminated against minorities by steering them into high-interest subprime loans they eventually could not pay for. No other recent economic crisis better illustrates the saying that when America catches a cold, African Americans and Hispanics will get pneumonia. Today, the wealth gap between Blacks or Hispanics and Whites is the worst it has been since we started tracking these figures 3 decades ago.

So let me make it really clear. This is one of the most fundamental pieces of legislation that was long overdue in this country, and its effective implementation is an important milestone that we can be proud of. And I look forward to working in a bipartisan manner, because this affects all Americans. I talk specifically in regard to how it disproportionately affected African Americans and Hispanics, but it affects every American, every poor American.

In urban America, in rural America, this is something that we need to come together and work collectively on to resolve it, because, really, this is where the future of our country lies, and if we don't give individuals the opportunity to have a better life by investing in the American dream and owning a home, then shame on all of us.

I have been working very closely with my colleagues and the Chair, and I look forward to continuing to do so in a bipartisan manner so that we can make sure that we do the best things for America's people.

I yield back.

Chairwoman CAPITO. I thank the gentleman. I would like to, without objection, enter into the record the flyer many of the folks in the audience have been passing out in the hall today.

Without objection, it is so ordered.

[applause]

I would now like to recognize Mr. Duffy for 2 minutes for an opening statement.

Mr. DUFFY. Thank you, Madam Chairwoman.

And I appreciate you holding this very important hearing.

I understand the push, after the financial crisis, to have some form of a qualified mortgage rule when we are selling mortgages into the secondary market. That makes some sense.

My concern, though, with this rule, is the way it has been written. A lot of small banks in Wisconsin, and a lot of credit unions in Wisconsin, who may not have any interest in selling these loans into the secondary market—these actually are loans they want to keep on the books, but those loans don't fit within the qualified mortgage rule—aren't going to make these loans. And the people who are left behind by this rule are minorities, are low-income, or moderate-income individuals, people who might not have a traditional income stream of a 9:00 to 5:00 job. They may be a small business owner who may have a cyclical income with that small business.

It is these people who aren't going to be able to live the American dream, which is part of buying a home.

And so, I am interested in hearing from the panel today about how you are analyzing the QM rule, and how it is going to affect your lending practices. Because as I look back to my district—really work in our communities where our bankers are able to look at individuals in a number of different factors, and they take risk on them. And they give them loans. And oftentimes, those loans perform really well.

But now we see big government making rules, bureaucrats in Washington making rules that are going to prohibit that young individual, who is just coming out of college, just starting a family, from actually buying a home.

I would agree with Mr. Meeks that the pendulum was too far over before the 2008 crisis. But this rule swings the pendulum too far to the other side. We have to have a common-sense approach that is going to work for the American people no matter what kind of income stream you have. This just can't work for high-income Americans. And this rule is tailored toward high-income earners. We have to make sure we are looking out for all Americans.

I yield back.

Chairwoman CAPITO. Thank you. I would like to recognize Mrs. Maloney for 2 minutes for the purpose of an opening statement.

Mrs. MALONEY. I thank the chairlady and the ranking member for holding this important hearing. The qualified mortgage rule is one of the centerpieces that came out of the financial crisis. And it is supposed to ensure that borrowers are protected from the predatory lending practices that did so much damage to Americans.

We have to remember, this country lost $16 trillion. Thousands of people lost their homes, and their jobs. We are still recovering from the longest recession in my lifetime, which most economists attribute to the mortgage crisis, and the predatory, risky loans that were pushed out to consumers.

Now, what does this rule do?

It merely says that you cannot have risky features which can hurt consumers and the overall economy, such as saying interest-only payments, that is not a good thing to do. And it also says that negative amortization, where the total debt rises every month, that you can't do that. And it says that the payments should not exceed 43 percent of a borrower's monthly income. Most economists say it shouldn't be more than a third, and there are even exceptions to that. The rule came out on Friday, and the CFPB has already given a 2-year grace period to small lenders, community banks, and credit unions to see how they can monitor it, and see what the effect is.

They have also said—and I am very pleased to hear this—that based on their data, they are open to making adjustments and changes. I think we all agree that we don't want another financial crisis. And if we don't learn from the one we already went through, then we probably will have another financial crisis.

This rule is put in place to protect consumers, protect lenders, protect borrowers, protect banks, and protect our overall economy. And so, I look forward to monitoring it, seeing its impact, and making sure that it is fair to consumers and our overall economy.

I yield back.

Chairwoman CAPITO. Thank you.

I recognize Mr. Bachus for 2 minutes.

Mr. BACHUS. I thank the chairwoman.

I got my Kiplinger letter about 4 days ago, and it predicts 10 things for 2014. It was very similar to an article in The Economist that came out right after Christmas, and also in Bloomberg Business. They all predict the very same thing.

Here is what it says: You will pay a higher rate for a mortgage, and mortgages will be harder to obtain because of tighter lending restrictions from the Consumer Financial Protection Bureau (CFPB). It also says something else, as a result, slower growth for housing, and housing is about an eighth of our economy.

We are talking about home ownership, and Mr. Meeks told a story that really is an American story. I think the American dream is a job, not so much a home. Because if you don't have a job, it is hard to have home ownership. But that is what every person in this country aspires to do is get a job, and then for themselves or their family, find a home. And leading up to 2008, we may have gone too far because we wanted everyone to have a home, because we found that if you own your own home, communities are safer, children do better in school, people buy in to the community, and it benefits society as a whole.

I don't know of anything more beneficial to a community than high rates of home ownership. And, yes, we had very lax underwriting standards. No one wants a repeat of 2008.

But we don't want to overregulate. We don't want to go too far. We don't want to—as physicians say, first, do no harm. And this rule does harm. It is going to deny people like Mr. Meeks or myself—I can remember when we—

Chairwoman CAPITO. The gentleman's time has expired.

Mr. BACHUS. —moved into our first home. It was a great day. And I don't want to deny that to any American.

Thank you.

Chairwoman CAPITO. Thank you.

Mr. Green for 2 minutes.

Mr. GREEN. Thank you, Madam Chairwoman.

I would like to associate myself with the comments of the ranking member. And I would like to add a bit to it. Because, in Congress, I have a piece of legislation for alternative credit scoring.

I have a history of trying to make sure those persons who don't have opportunities, acquire opportunities. This piece of legislation would consider light bill, gas bill, water bill, utilities, and other forms of credit that are not traditionally scored. And this will help a lot of people.

I would also like to reflect for just a moment on what happened to cause us to get into this crisis. A lot of the people that we have been trying to help were given loans that were beyond what they qualified for. They qualified for a loan at 8 percent, with a yield spread premium, they got a loan of 10 percent, 12 percent. Or if they qualified for 5 percent, they got a loan for 10 percent.

And they didn't know. They did not know that they qualified for a 5 percent loan.

Because there was a system in place that allowed the person who was qualifying you to get a bonus, a kickback, if he could qualify you for a loan at a lower rate, and then push you into a higher-rate loan. That is dastardly. That is what this deal deals with.

We have to deal with the things that have caused African Americans to lose a generation of wealth. We don't want that.

Dr. King was right. He said life is an inescapable network of mutuality tied to a single garment of destiny. What impacts one directly impacts all indirectly.

That crisis that hit the African-American community, the minority communities, impacted the entire economy. It wasn't just some people who were taken advantage of in the final analyses.

So we have a duty to do all that we can to prevent this from happening again.

I want to see the balance. I support these community banks. But I don't want to see people taken advantage of. I yield back.

Chairwoman CAPITO. The gentleman's time has expired.

[applause]

If I could remind the audience, I am happy—and Mr. Green is hard to resist because he is very enthusiastic. But if I could ask you to respect the rules of the House, and refrain from expressing approval and disapproval, we will move the hearing on, I think quicker. And I thank you for your cooperation. Thank you.

I would like to recognize Mr. Pittenger for 1½ minutes, please.

Mr. PITTENGER. Thank you, Madam Chairwoman, for yielding me the time for this important issue.

As I travel throughout my 9th District in North Carolina, I meet with community bank leaders who tell me time and again of the struggles that they have with regulations pouring out of Washington, D.C., and their inability to address the real financial needs of their community.

Every so often, we have seen that the government has become its own worst enemy. We saw that clearly from what happened with the inception of this entire housing demise, where the government

forced institutions to do certain things and now the government is saying, well, now we are requiring you to do certain things.

The government seems to be the one who wants to dictate and micromanage to communities throughout the country.

While regulators here in D.C. say that there won't be a problem with this new rule, that is referred to as the qualified mortgage, we have found that may not be the case. We were also told that you can keep your health care if you would like to.

We are finding that the community banks back in our districts are not going to lend outside of the QM rule, because of fear of litigation by the Feds.

Diane Katz of the Heritage Foundation said that young adults and minorities will be the hardest hit by these rules. As first-time homeowners, they will be limited, with limited income and college debt, they will be pushing their debt-to-income ratio above qualified status.

So, Madam Chairwoman, I thank you. I believe that we need to give this important consideration.

Chairwoman CAPITO. Thank you.

Mr. Lynch, for 2 minutes, for the purpose of an opening statement.

Mr. LYNCH. Thank you, Madam Chairwoman.

Despite the controversy that seems to be percolating here, today's hearing deals with a very basic rule that is obviously necessary after the last crisis, and should be uncontroversial.

And that rule simply states that to stop the predatory lending that fed the housing bubble, the Wall Street reform law states very simply that before a lender offers a mortgage to a consumer, they should first come to a reasonable and good faith determination that consumer has the ability to pay the loan.

And that is it. That is what this hearing is about.

The law also authorizes the CFPB to define the contours of a qualified mortgage or one that bears the hallmark of safe, responsible lending practices.

Now, I understand there are some concerns from the banking and the mortgage lending industries about constricting access to credit. But the bottom line here is that the CFPB's rule is supported by a lot of groups who were hurt very badly by that last crisis, a lot you may have heard from already, especially in minority neighborhoods in my district.

Those people who had the most difficult time with the recent crisis are in support of this rule. And that includes the NAACP, the National Council of La Raza, the National Fair Housing Alliance, the Neighborhood Assistance Corporation of America (NACA), and the Center for Responsible Lending.

They are all here with us today. And these groups support this rule that was put in to protect the people that they represent.

The qualified mortgage definition may need some tweaking, no doubt about that, going forward. And if it does, I hope we can work in a way that the CFPB also supports.

But I think the folks on this committee would do well to tone down the doomsday talk and rhetoric about the rule that is going to do enormous good for home buyers and will allow a lot of people to own a home.

I yield back.

Chairwoman CAPITO. The gentleman yields back.

Mr. Huizenga for 1 minute.

Mr. HUIZENGA. Thank you, Madam Chairwoman. I appreciate you holding this hearing along with my good friend Mr. Meeks.

As someone who has worked in the housing industry as a REALTOR®, this is very important to me, and more importantly to all of our constituents.

We are here today to further discuss the impact of the qualified mortgage rule. Unfortunately, this is a flawed rule. I disagree with my colleague over there.

And I, along with my friend, Ranking Member Meeks, introduced bipartisan legislation which would clarify the rule to ensure access to affordable mortgage credit for low- and moderate-income families and first-time home buyers.

Today, I am especially pleased to introduce one of the witnesses who hails from the great State of Michigan, Mr. Bill Emerson. He is the CEO of Quicken Loans, based in Detroit.

You may be familiar with the work being done in the private sector by companies like Quicken, and people like Bill and Dan Gilbert, to revitalize Detroit. And we all applaud that.

Quicken Loans is the largest online and nonbanking mortgage lender in the Nation, employing 10,000 people. It has been voted one of the best companies to work for and has earned J.D. Power's customer satisfaction awards for 4 years in a row.

It is this kind of company and this kind of attitude that we need to help this—change this rule.

So thank you very much. I yield back.

Chairwoman CAPITO. Thank you.

And with the remaining 30 seconds, I yield to Mr. Pearce.

Mr. PEARCE. Thank you, Madam Chairwoman.

I represent the southern district of New Mexico, which is one of the poorest directs in America, and I can tell you we are hurt by the QM rule.

Fifty percent of the homes in my district are trailer houses, and QM automatically declares those high-cost loans and prohibits them, so that poor people have no access.

So while we are told this rule needs to be there to protect the poor, it is hurting the poor in my district. We must solve this problem. I appreciate your having the panel here today.

I yield back.

Chairwoman CAPITO. Thank you.

That concludes our opening statements.

We now welcome our panel of distinguished witnesses. Each of you will be recognized for 5 minutes to give an oral presentation of your written statement. And without objection, each of your written statements will be made a part of the record.

Our first witness, Mr. Jack Hartings, is the president and chief executive officer of The People's Bank of Ohio, and he is testifying today on behalf of the Independent Community Bankers of America.

Welcome.

STATEMENT OF JACK HARTINGS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, THE PEOPLES BANK CO., ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA (ICBA)

Mr. HARTINGS. Chairwoman Capito, Ranking Member Meeks, and members of the subcommittee, I am Jack Hartings, president and CEO of The People's Bank Company, and vice chairman of the Independent Community Bankers of America.

The People's Bank Company is a $400 million asset bank in Coldwater, Ohio. And I am also a member of the CFPB's Community Bank Advisory Council.

I am pleased to represent the ICBA and the nearly 7,000 community banks at this important hearing.

The CFPB's new qualified mortgage (QM) rule has the potential to drive many community banks with fewer resources out of the mortgage market, curtail access to mortgage credit, and hamper the housing recovery. The QM rule, by providing a safe harbor for harsh liability, including a private right of action under the ability-to-repay rule, effectively draws a tight box around the types of loans that will be made by community banks. Banks like mine simply will not incur the risk of making non-QM loans. I will note a few examples.

A start-up small business owner or farmer may have business-related debt on their credit report which will disqualify them under the QM's 43 percent debt-to-income (DTI) limitation. Business formation should be encouraged, not punished, by unrealistic DTI limitation. Minority borrowers are more likely to exceed the DTI limitation, according to the recent Fed study of 2010 lending. While many of these underserved borrowers use Federal loan programs, the QM status for these programs is only temporary.

The highly compensated individual may exceed the DTI limitation perhaps due to a second home or other types of debt and still have a high disposable income for mortgage payments. These individuals are critical to the housing market recovery.

As a small creditor under the CFPB's definition, my bank is not subject to DTI limitations. And I could serve these customers, but many other community banks do not have small creditor status. And I am very close to the 500 annual origination thresholds that would disqualify me as a small creditor.

We believe that loans sold in the secondary market should not apply to the threshold, and request this committee's support for that simple change. Even as a small creditor, I am significantly limited by QM here, and I may not be able to make some of the non-QM loans as a small creditor.

Low-dollar loans are common in many parts of the country for purchase or refinance, but the QM closing fee cap is often a challenge in making these loans. Balloon loans, which are used to manage interest rate risk on loans that can't be sold in the secondary market, are non-QM unless they are made by lenders in predominantly rural areas under the CFPB's very narrow definition of "rule" beginning in 2016.

Loans that exceed the price trigger may still be QM, but carry weaker liability protections even when those loans align with the lender's cost of funds, risk, and other factors. There are additional

examples of safe, legitimate loans that will fail the QM test even under the broader term available to small creditors.

ICBA's solution to the threat of QM, which is included in our Plan for Prosperity, is simple, easy to apply, and will preserve community bank lending. Safe harbor QM status should be granted to all community bank loans held in portfolio. A portfolio lender holds 100 percent of the credit risk and has every incentive to thoroughly assess the borrower's financial condition, ensure the loan is affordable, and work with troubled borrowers.

Withholding safe harbor status for loans held in portfolio and exposing the lender to excessive litigation risk will not make loans safer, nor will it make underwriting more conservative. It will merely deter community bank lending.

I would like to thank the members of this committee who have introduced bills that would provide QM status for community bank loans. These bills include the PATH Act, the CLEAR Relief Act, and the Portfolio Lending and Mortgage Access Act.

I want to thank you again for the opportunity to testify. Thank you.

[The prepared statement of Mr. Hartings can be found on page 85 of the appendix.]

Chairwoman CAPITO. Thank you.

Our next witness has been introduced by Mr. Huizenga. I would like to add my voice of support. I hear what is going on in Detroit, and I thank you for your company's active participation. Mr. Bill Emerson is the chief executive officer of Quicken Loans, Incorporated. And he is testifying today on behalf of the Mortgage Bankers Association. Welcome.

STATEMENT OF BILL EMERSON, CHIEF EXECUTIVE OFFICER, QUICKEN LOANS, INC., ON BEHALF OF THE MORTGAGE BANKERS ASSOCIATION (MBA)

Mr. EMERSON. Thank you, Chairwoman Capito, Ranking Member Meeks, and Chairman Hensarling. This hearing could not be more timely. While most people rang in the new year 2 weeks ago, for those of us in the mortgage industry, the new year began last Friday.

That is when a host of Dodd-Frank rules finally came online. None are more consequential, with the power to completely reshape the mortgage industry, than the ability-to-repay rule and its qualified mortgage standards. As the CEO of Quicken Loans, the Nation's largest online and non-bank mortgage lender, it has been my responsible to chart our company's course into the new regulatory regime.

The Mortgage Bankers Association, of which I am honored to serve as the vice chair, has devoted enormous resources over the past year to helping companies like ours come into compliance. A common question we have received, and one I want to answer at the outset, is whether we plan to write non-QM loans. I can tell you categorically that Quicken Loans, like the overwhelming majority of lenders, will not lend outside the boundaries of QM. In fact, even if we wanted to, we wouldn't be able to make non-QM loans because there is no discernible secondary market for them. The only place these loans can be kept is on a bank's balance sheet.

Beyond that, the liability for originating non-QM is simply too great. Claimants can sue for actual and statutory damages, as well as a refund of their finance charges and attorneys' fees, and there is no statute of limitations in foreclosure claims. By MBA's calculations, protracted litigation for an average loan can exceed the cost of the loan itself.

Given this uncertainty, at least for the foreseeable future, non-QM lending is likely to be limited to three narrow categories. First, there will be loans where there were unintended mistakes. That is, because of the complexity of the calculations, lenders will make loans they think to be QM only to find out they fail the test. MBA believes the CFPB should provide lenders with the ability to cure mistakes that cause a loan to fail to meet the QM test, just like exists under HOEPA.

A second group will be higher-balance and nontraditional loans to wealthier borrowers. Because of their income and assets, default rates on jumbo loans are relatively low and some lenders, particularly the large depository institutions, will have the resources to keep those loans in their portfolio.

And finally, a few lenders will be willing to make loans to riskier borrowers, but at significantly higher rates. Rate sheets we have seen suggest borrowers could pay an interest rate around 9 or 10 percent for non-QM loans. The bottom line is that non-QM will be very limited and very expensive for all but the wealthiest borrowers.

That is why it remains so important to continue to make adjustments to the QM rule. The CFPB deserves enormous credit for working with all stakeholders, lenders and consumer groups alike, in fashioning a rule we think is a substantial improvement over Dodd-Frank. We are also grateful that the Bureau is open to making additional revisions in the near future. Further amendments are essential to ensure that the QM rule promotes, rather than hinders, our tepid housing recovery.

The key eligibility for QM is the 3 percent cap on points and fees. A major problem with the 3 percent cap will be its impact on borrowers who take out smaller loans, particularly in the $100,000 to $150,000 range. Because so many origination costs are fixed, a lot of these loans will trip the 3 percent cap and fall outside of the QM definition.

That means consumers, particularly first-time homebuyers and families living in rural and underserved areas, will be priced out of the market. The Bureau has wide latitude to correct this problem and we urge it to do so.

Additionally, the final rule picks winners and losers between affiliated and unaffiliated settlement service providers, even though their fees are subject to identical regulation. Having been in this industry for more than 20 years, I can tell you that rules that pick winners and losers ultimately harm consumers.

At Quicken Loans, we have chosen to affiliate with title and other service providers to ensure our customers have the best loan experience and that there are no surprises at the closing table. As Congressman Huizenga noted, one of the reasons consumers awarded us the prestigious J.D. Power Award 4 years running is

because our affiliated arrangements have led to a smooth closing process.

MBA urges the House to promptly pass H.R. 3211, the Mortgage Choice Act of 2013. I want to thank Congressman Huizenga, Ranking Member Meeks and so many other members of this subcommittee from both sides of the aisle who have introduced and pushed this important legislation. I also want to thank Chairman Hensarling for including these changes in his more comprehensive regulatory relief package.

Madam Chairwoman, I think you will find that the MBA continues to be a willing partner in developing practical fixes to the QM rule. We truly want it to work for everyone: for lenders; for the consumers we serve; and for our economy.

Thank you again for holding this important hearing. I look forward to your questions.

[The prepared statement of Mr. Emerson can be found on page 74 of the appendix.]

Chairwoman CAPITO. I would like to recognize Mr. Fincher for the purpose of introducing our next witness.

Mr. FINCHER. Thank you, Madam Chairwoman.

I appreciate the opportunity to introduce Mr. Daniel J. Weickenand to the committee this morning. Since 2010, Mr. Weickenand has served as the president and chief executive officer of Orion Federal Credit Union in Memphis, Tennessee. Orion is the largest credit union in west Tennessee.

I was pleased to host Mr. Weickenand at a credit union roundtable discussion back in November, which included the qualified mortgage rule. Today, Mr. Weickenand is here representing the National Association of Federal Credit Unions, where he serves as a boardmember.

Madam Chairwoman, it is a pleasure to have Mr. Weickenand appear on this panel today, and I appreciate him taking the time to express his views about the qualified mortgage before the committee.

Thank you.

And I yield back.

Chairwoman CAPITO. Thank you.

Mr. Weickenand, you are recognized for 5 minutes.

STATEMENT OF DANIEL WEICKENAND, CHIEF EXECUTIVE OFFICER, ORION FEDERAL CREDIT UNION, ON BEHALF OF THE NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS (NAFCU)

Mr. WEICKENAND. Thank you.

Good morning, Chairwoman Capito, Ranking Member Meeks, and members of the subcommittee. My name is Daniel Weickenand, and I am testifying this morning on behalf of NAFCU. I serve as CEO of Orion Federal Credit Union headquartered in Memphis, Tennessee. NAFCU and the entire credit union community appreciate the opportunity to discuss the CFPB's ability-to-repay rule and the impact the qualified mortgage standard will have on credit union lending.

Credit unions did not cause the financial crisis and shouldn't be subject to the regulations aimed at those entities that did. Unfortu-

nately, that has not been the case thus far. As we are hearing from many of our credit union members, enough is enough when it comes to the tidal wave of new regulations.

NAFCU supports efforts to ensure that consumers are not placed into mortgages they cannot afford. This was a long-standing practice of credit unions before the financial crisis, and it continues to be the case post-crisis.

Credit unions have a history of making loans for their members who have the ability to repay. This was demonstrated by the quality of their loans during the financial crisis. While credit union loans generally do not have a problem meeting the ability-to-repay underwriting criteria, meeting the additional criteria to obtain a QM status and avoid the additional liability is not certain.

Under the rule, the least risk to credit unions is to originate only QM loans. Limiting loans to solely QMs would reduce a legal risk and help ensure the loans are eligible for sale in the secondary market. The ability to sell loans will help credit unions manage interest rate and concentration risk.

At Orion, we made a conscious decision at the onset of the financial crisis to double down on our efforts to return as much as possible to our members in the community in which we live. While some institutions may start charging a premium on their loans to account for the additional risk associated with non-QMs, we do not feel this is in the best interest of our credit union, our members, and our community. Consequently, due to the liability and liquidity concerns, we have decided to cease to offer non-QM loans at this time. I cannot tell you how difficult a decision this has been. Orion takes great care in placing our members with the right mortgage product, and the QM standard will inevitably force us to turn away many credit-worthy borrowers.

For example, in 2010 we started a special Orion Home Run Program that allows qualifying participants to rent an unsold foreclosed home for a set period of time. During that rental period, the participant is expected to make timely payments, keep the home in good condition, and have a positive impact on their neighborhood.

When the rental period lapses, the home can then be purchased outright for 70 percent of the tax value, with the previous rental payments applied as a downpayment, and guaranteed financing by us. Despite demonstrating the ability to repay, the program participants would not fit the QM standard, and therefore would not have the opportunity to become homeowners through Orion at this time.

I have talked with many of my fellow credit union CEOs about the issue. Some may be cautiously going forward with non-QM loans, but they have indicated that they will be more stringent in making them. For Orion, approximately 11 percent of all of our mortgage loans in the past few years have been classified as non-QM.

There are several changes to the QM standard that NAFCU is seeking. These areas are outlined in my written testimony, but include a fix to the points and fees issue, modifications to the small creditor exemption, consideration of 40-year loans to be QM, changes to the 43 percent debt-to-income ratio, and deeming all loans sold to the GSEs to be safe harbor loans.

NAFCU appreciates the CFPB looking for a good faith effort of compliance months after the rules take effect, however this will create ambiguity, and the CFPB must work closely with the NCUA to further clarify.

In conclusion, credit unions have historically put their members into affordable mortgages and continue to do so today. The unique relationship between credit unions and their members allows credit unions to provide flexibility to give their members products that work for them on an individual basis.

The restrictions of the new QM mortgage standards have eliminated this ability in many cases. Given the new liability and the additional costs that come with doing non-QM loans, many credit unions like mine have ceased or severely cut back on non-QM lending.

Congressional action to provide relief on some of the QM standards would help further more congressional action on regulatory leave would help ease the growing burdens associated with new compliance standards. I thank you for the opportunity to appear today, and I welcome any questions you may have.

[The prepared statement of Mr. Weickenand can be found on page 98 of the appendix.]

Chairwoman CAPITO. Thank you. Our next witness is Mr. Frank Spencer, the president and CEO of Habitat for Humanity in Charlotte, North Carolina.

Welcome, Mr. Spencer.

STATEMENT OF FRANK SPENCER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, HABITAT FOR HUMANITY OF CHARLOTTE, NC

Mr. SPENCER. Good morning, Madam Chairwoman, and Ranking Member Meeks.

I am Frank Spencer, president and CEO of Habitat for Humanity of Charlotte. I am here today in support of legislation to address several unintended consequences of mortgage regulation reform that threaten the continuing work of many habitat affiliates.

I have submitted my full written testimony for the record, and I appreciate the opportunity to share a brief overview of a few challenges being faced by our affiliate, and other habitat affiliates, in our collective efforts to comply with new mortgage regulations.

Habitat Charlotte builds new houses, rehabilitates vacant properties, repairs houses, operates a $4 million retail outlet, recycles 1,200 tons of steel per year, and currently services approximately 780 non-interest-bearing mortgages for its partner families. Habitat Charlotte has served 1,200 families in its 30 years, and is supported by 85 employees, and over 5,000 volunteers annually.

Habitat greatly appreciates the commitment Congress has made to stable and productive housing markets as the Nation continues to recover from the foreclosure crisis, and economic recession. The success of the Habitat ownership model is, in fact, predicated on market stability, and the long-term appreciation of real estate values.

Habitat understands and fully supports efforts to protect consumers and the American taxpayer from predatory lending schemes that undermine the stability of U.S. housing markets.

Habitat opposes neither the qualified mortgage standard specifically, nor the Dodd-Frank law more generally.

Habitat is seeking legislative relief only after having exhausted all other options.

The cost of compliance with the new mortgage regulations has been significant. As the largest affiliate in North Carolina, we are the only one to employ a licensed mortgage originator in the State. She has spent most of the last year becoming trained on the new standards, auditing our processes to ensure compliance, and organizing our staff to prepare for implementation this January.

Jill further works to guide other Habitat affiliates through seminars and meetings and has devoted well over 1,000 hours to this process. This is only on the origination side of the process. We have expended equal, if not greater, effort preparing for the requirements of the servicing component of these new regulations.

I can assure you that the compliance costs for most affiliates has been high, and every dollar spent on compliance is one that is not spent meeting local housing needs.

Habitat affiliates have worked hard to comply with the thousands of regulatory changes, but there are a few regulations that endanger an affiliate's capacity to serve partner families without providing our homeowners or the taxpayer any protection.

Habitat greatly appreciates Representative Meadows introducing legislation, H.R. 3529, the Protecting Habitat Homeownership Act, to provide relief from these regulations. These few provisions focus on monthly documentation of fees and interest, rarely relevant in a Habitat context, ability-to-repay requirements that fail to recognize the long history of success of the Habitat model, which provides home ownership opportunities to individuals who do not qualify for traditional mortgage products, and appraisal regulations that could threaten Habitat affiliates' ability to continue to accept donated appraisals.

With critical housing needs continuing to increase, Habitat resources can be better spent on serving families than on complying with regulations that ultimately provide protection neither to our partner families nor to the taxpayer.

I would like to say a few words about the ability-to-repay standards in particular. As drafted, these regulations have the unintended consequence of discouraging Habitat affiliates from working together to improve mortgage products. We in Charlotte used to service mortgages for other affiliates, but the loan limitation numbers prevent us from assuring compliance.

In conclusion, Habitat for Humanity of Charlotte is in compliance with the law. However, knowing the human and financial investment we have made, it is equally clear to me that many of our affiliates cannot adequately make the same investment. Over half of the housing built in North Carolina comes from small and rural affiliates. Habitat offers a hand up, not a handout. And we hope that we can eliminate any inadvertent impediments to that approach.

[The prepared statement of Mr. Spencer can be found on page 93 of the appendix.]

Chairwoman CAPITO. Thank you.

Our final witness is Mr. Michael D. Calhoun, president of the Center for Responsible Lending.

Welcome.

STATEMENT OF MICHAEL D. CALHOUN, PRESIDENT, CENTER FOR RESPONSIBLE LENDING

Mr. CALHOUN. Thank you, Chairwoman Capito, and Ranking Member Meeks. It is an honor to testify before this subcommittee, and an honor to be on this panel, particularly with Mr. Spencer from Habitat for Humanity.

I have served more than a decade as a member of the Finance Committee for my local Habitat in North Carolina. My brother is a 25-year veteran of Habitat and currently serves as a project director in Florida for the Habitat affiliate on the East Coast there.

It is also very appropriate that Habitat is here today, because it really brings us full circle. A lot of these mortgage provisions—as people know, North Carolina was the first State that adopted provisions to stop predatory mortgages. And Habitat played a key role in that.

In the late 1990s, our affiliate, Self-Help Credit Union, which has provided over $6 billion in financing for first-time home buyers, found that borrowers we had been putting into home loans were coming back to us on the brink of foreclosure. We looked at the loans that they were getting, and they had extraordinarily high interest rates and extraordinarily high fees, and we knew these borrowers' credit histories and they were far beyond that for which these borrowers qualified.

So, we undertook research to find out were they just targeting our borrowers? Was this a limited phenomenon?

We searched deeds in the record books across the State, and one of the things we found was that among the lenders being targeted by these predatory lenders were Habitat for Humanity borrowers. And indeed, 15 percent to 20 percent of Habitat borrowers had been refinanced out of their zero interest rate mortgages into subprime mortgages that were taking them—stripping their home equity with high fees and leading them to foreclosure.

As a response—and you will hear more of this perhaps in the question and answer—Habitat adopted a protection by putting on soft second mortgages that would protect that home equity from these people who were targeted. And this wasn't isolated. As a lender, we had companies offer to sell us target sheets of borrowers in our geographic area who were having financial difficulties, but had a lot of financial equity in their home.

So that is how we ended up these 15 years later, with a lot of pain in between, with a QM standard. And for those who doubt that predatory lending is still out there, this is an e-mail that came across my desk recently from a subprime lender today. The subject line reads, "This is the return of subprime lending." The text goes on to say, "This program is right there next to the old subprime of our memories." They promise to take the program nationwide by the end of last year.

So, subprime is back and ready there again.

A second reason we need the QM rule more broadly is that the mortgage market is inherently a boom-and-bust market. And I apologize for the small size of this, but if you look at the real price of homes over the years, it is not steady. It goes consistently up to

high peaks and bottoms, and the problem is that on those roads up to the peak, lending standards erode badly.

And if you are a lender, it is hard for you to say, I am not going to join in with the others, because you see all of your business go elsewhere. So, that is why a rule was needed. And to the CFPB's credit, they chose to adopt a rule that was broad, bright-lined, and limited liability at the bequest of industry, which we support, and they further have adopted important measures to make it a two-tier model with key protections for smaller lenders.

For example, they can charge an extra 2 full percentage points of rate, which we supported, and still be a qualified mortgage with a safe harbor.

To be clear, though, how broad this box is, any loan that qualifies for FHA, that is a 43 percent baseline debt to income. And remember that is before tax 43 percent. And with compensating factors, it can go up to 50 percent. You can have a loan that takes two-thirds of a borrowers' income and still meets the ablility-to-repay standard.

And we believe at this state in the market, that is the right approach.

On fees, the three-point limit does not include a lot of standard fees. The average fees charged on loans—according to Freddie Mac as of last week—was seven-tenths of one point for origination points and discount points. So, we are talking more than 3 times that.

We are glad you are holding this hearing. We look forward to your questions, and as many members have said, we look forward to places where this rule needs massaging, it should be. But this is a broad rule that comes really close to what we need.

[The prepared statement of Mr. Calhoun can be found on page 54 of the appendix.]

Chairwoman CAPITO. Thank you. I thank the witnesses.

And I will recognize myself for 5 minutes to begin the question-and-answer period.

I would like to say at the onset how I view this hearing in the context of where we are. I think the ranking member pointed out, as many others have, that the rules have only been in effect since Friday.

But I see this as being like when you go to the doctor and you get a baseline on your blood levels and your mammogram and other things that show you where to go, so that when we have this hearing in another 6 months, we will be able to see where our baseline was and to see what effect this rule is really having.

So I think this is a setting for the base to see from where the statistics can begin to grow.

That is where I am on that.

I would like to start with Mr. Emerson. At Quicken Loans, if you could just quickly tell me—and you and I have had this discussion. I don't think there is a full appreciation of how broad and large your business is. So how many mortgages would you say you write in a year and what does your average customer look like in your average loan?

Mr. EMERSON. Our average customer spans the scope of the country. We serve all 50 States. We serve every area. We serve

anybody out there who has the ability to qualify and the ablility to repay a mortgage.

Chairwoman CAPITO. Right.

Mr. EMERSON. In the calendar year of 2013, we originated $80 billion worth of loans. Call that roughly 400,000 clients that we served in the year 2013.

Chairwoman CAPITO. Have you quantified and looked at how many of those loans would fall beyond the QM standard? Have you looked at that yet in your portfolio from 2013?

Mr. EMERSON. Yes, we looked at it. We looked at it from 2010, 2011, and 2012, which arguably are some of the best performing loans ever written. And depending upon when we first looked at this and when the rules were initially put out, there was upwards of 30 percent to 40 percent of folks who wouldn't qualify. And, as the CFPB continued to work and tweak, we think ultimately somewhere around 90 percent to 93 percent of the market will be served with the current rule in place, absent of course the affiliate fee issue that we are dealing with a 3 percent cap.

But again, you have to realize that doesn't include the patches put in place for Fannie Mae and Freddie Mac and for loans that run through those GSEs, which exist for 7 years or until they come out of conservatorship. When that happens, or when that shifts, now you have a different market and fewer people will qualify at that point as well.

Chairwoman CAPITO. Right. Okay.

Mr. Hartings, in your community bank, you mentioned to me when we first met, that you have a lot of agriculture. Certainly, I think, the agriculture community has one of those boom-and-bust cycles that Mr. Duffy was talking about. Some years are better than others. How do you see the QM rule influencing your ability to lend to those agricultural households?

Mr. HARTINGS. It is obviously going to make it very difficult, Madam Chairwoman, especially in those bust years. When we look at our customers, they are long-term relationships. So we are looking at the last maybe 10, 15 years of their income often in the agriculture community, commodity prices or we have a disaster.

So those individuals will probably be shut out of our lending, because we do not plan to do non-QM loans. And the other thing about those individuals who are farmers, they are young people who come up through the farms. A lot of times they carry a lot of debt because they are trying to help the family farm. They live at home, and don't have much credit, but have shown the ability to save their downpayment on their own. We can look at their savings account. But in the secondary market, a lot of times they are looking for four trade lines. And they won't come up with those four trade lines. So their only choice is a portfolio loan, something we can offer them.

Chairwoman CAPITO. Thank you.

Mr. Weickenand, we have a bank in West Virginia that has a very similar program, or some similarities with your Orion Home Run Program. And this kind of bleeds into Habitat for Humanity. You are really serving a population that, were it not for either the special provisions that you have or that Habitat has or that our bank in West Virginia has a trust that was set up to help people

with downpayments who—and interest who would never, ever be able to have a home—they are not going to be able to—they don't feel comfortable with the way the QM is written that they are going to be able to fall into these QM with these charitable kind of programs to get home ownership to those who couldn't enjoy it.

So, will you be able to move forward with your program, or are you going to have to put a halt to it?

Mr. WEICKENAND. It has been put on halt anyway, just because of the market itself. Foreclosures slowed down. And my first responsibility is to sell the home out in the open market. If I can't, then the home rolls into this program.

But the non-QM loans, just from a point is a—it is more of a balance sheet kind of thing that we have to manage, because between the concentration risk, interest risk, my ALM, I can only hold so much—

Chairwoman CAPITO. Right.

Mr. WEICKENAND. —mortgage paper. So taking that ability to resell these non-QMs to a secondary market is really indirectly going to affect, obviously, 10 percent over the last several years of our membership.

Chairwoman CAPITO. All right.

Mr. Meeks?

Mr. MEEKS. Thank you, Madam Chairwoman.

In my estimation, there are a number of issues that are concerning to me.

First, we have gone from—historically from red lining, where African Americans, particularly, were denied loans, period, to the point where they were given loans that were no-doc loans or these adjustable rate loans, which was devastating in the financial crisis, because when I observed some, they were able to pay their mortgages for that first year. But after that first year, when the rates went up, they no longer could pay their mortgages.

And the fact that some who qualified for prime loans were steered away from them and into another loan that was much more expensive. What happens, unfortunately, in this society sometimes is that individuals who are the poorest and need that helping hand are the ones who are taken advantage of.

And it seems as though—not seems, it was a fact—that is what took place in the financial crisis from which we are recovering.

Now, on the other hand, we have individuals, as you heard me talk about earlier, like my parents, who struggled to own a home. It was their dream.

I don't know today—I couldn't tell you whether or not under these rules, they would have qualified for a loan. I know that they struggled. They had to take out extra money to make the downpayment. And it was something that was open with the banks, and the banks allowed it to happen.

And I also know that if it wasn't for a community bank that knew them and looked at their overall history to judge whether or not they would be able to pay that mortgage, they probably would have been turned down. But they looked at their entire history of how they paid their bills and what their income was.

And so, it wasn't a no-doc loan. They did the kind of investigation that was necessary to make sure that there was in fact in-

come, and looked at their history to see how they prioritized, how they spent their money.

So the question that presents itself now is whether or not we are creating, or have a system that can try to resolve, both of those issues, and that is why I think that this is difficult.

So I guess I will throw my first question out to Mr. Calhoun.

Because there are various reports which say that Blacks and Hispanics will have a harder time obtaining credit, or will mostly be given the higher-priced non-QM loans, now that the QM rules are effective, can you just clarify what would be the lending options or what lending options would still be available to low-income Americans who may not be able to meet the 43 percent debt-to-income limit?

Mr. CALHOUN. Thank you.

First of all, as noted, under the current rules that a loan can go beyond the 43 percent if it meets—any loan that would qualify for FHA insurance is per se a QM loan. And we urged, along with industry, that the CFPB allow for that extra capacity. We also, for smaller lenders, urged for exceptions. So, for example, your mortgage rates are about 4.5 percent today. For community banks, they can charge up to 8 percent interest today on loans. And that loan would still meet the qualified mortgage safe harbor level. That allows for a lot of extra features, risks to accommodate.

And we think the CFPB should do that and that it has made a good faith effort. There may be places where they need to tweak it.

For nonprofit programs, to be clear, the CFPB did set up a program, an exception for nonprofit programs. A concern has been whether these soft second mortgages count, because that could be a problem. I know the CFPB has talked with Habitat and tried to resolve that.

Mr. MEEKS. Mr. Spencer, would you respond to that? What is your—

Mr. SPENCER. Yes. We are already pushing up against that limit in terms of the number of mortgages that can be provided and have the exemption available to us.

So our interest here is certainly narrow, in that we are looking for the exemptions provided in H.R. 3529 so that they become statutory as opposed to interpretive by the regulatory agencies.

Our issue around this is that we are only doing qualified mortgages at Habitat Charlotte.

So, the rule may have become effective January 10th, but we have been working on this for a full year. And the reason we do that, like many other Habitats, is that there are—I don't want to use the term secondary market. We work with banks and other lending institutions to provide balanced sheet capital. We are concerned that they won't take those loans as collateral if they are not qualified.

And so, we now are only doing qualified mortgages, which potentially takes certain borrowers out of our pipeline.

Chairwoman CAPITO. The gentleman's time has expired.

Mr. Duffy?

Mr. DUFFY. Thank you, Madam Chairwoman.

There is no doubt that before the 2008 crisis, there were loans that were written which probably shouldn't have been written, and given to people who probably shouldn't have qualified, no doubt.

And I think today there are people who should qualify, after the QM rule, who now won't be able to get a loan. The pendulum has swung, I think, too far over.

We have heard a lot about predatory lending, and that did go on, no doubt.

But to Mr. Meeks' commentary and questions, you had a situation where his family—I don't know if they would qualify for the QM rule or not—were able to go to a community bank or a credit union and work with them in a way that treated them fairly, and they were able to actually buy a home.

And I am fearful that the way this rule is written, low-income and moderate-income minorities who had an opportunity previously to work with a community banker to get a mortgage to buy a house are the ones who are going to be left out.

And I think that is what happens when you have big government come in and say, "We are going to set the rules. We are going to set the standards. We know what is best in small town, rural America.

"You, the small town community banker and your clients can't figure out what is best for the both of you, even though you are going to hold that loan on your books."

I don't think this rule serves our community well. It doesn't serve low- and moderate-income individuals well, or minorities well.

I guess—and maybe to that point, would—and maybe to our three bankers, would you say that those mortgages you hold on your books, those loans you hold on your books, and focusing on those who are low- to moderate-income borrowers, there are more lower- and moderate-income borrowers who would not meet the QM rule? Is that fair to say?

Mr. Hartings?

Mr. HARTINGS. That would be a fair statement.

Mr. DUFFY. Mr. Emerson?

Mr. EMERSON. Yes, I think when you evaluate the 3 percent test, and when you take a look at lower loan amounts, again, specifically in the ranges of $100,000 to $150,000, fixed costs are part of the origination process. And there are going to be folks who fall into that bucket, who will fall outside of the 3 percent test, therefore falling outside of the QM rule.

Mr. DUFFY. Mr. Weickenand?

Mr. WEICKENAND. Being from Memphis, I serve a community that is over 60 percent African American. And a lot of loans, like you said, 11 percent, affects a major part of these individuals.

Now, my examiner procedures, based on this new rule, state prices on—our prices on QM mortgages adequately to address the additional risk, meaning, I don't want to—it is just not going to serve my community if I have to charge somebody for basically a mortgage I would have given them last year differently because now there is this rule in place.

Mr. DUFFY. And you are leading into my next question. So, if you find a lower-income borrower who doesn't meet the QM standard,

are you going to make the loan and hold it on your books? Are you going to charge them a higher interest rate and higher fees?

Mr. WEICKENAND. I would not charge them anything higher. The problem is on my balance sheet, I can only hold so much. So if I do say, "Okay, we are going to go full-bore into nonqualified mortgages," there is a limited time I can do this. So, there are only a limited amount of individuals I can serve due to me managing my balance sheet risk.

Mr. DUFFY. And I know it is a hard question, but you actually assess risk, right? And you have to charge for risk. And if you are not in a safe harbor, so you find someone who doesn't qualify for—under QM, that is a greater risk to the bank. So you are going to have to charge more for that risk, right? I know you don't want to say that, but I have to imagine you are going to charge more for the risk.

Mr. WEICKENAND. It would probably be the interest rate risk during today's interest rate environment, because of the interest rate you are going to provide them on the mortgage, knowing full well that within the next few years, rates are going to rise.

Mr. DUFFY. And so, previously we were able to have—there was predatory lending and we now frown upon that, right? It was wrong. It was inappropriate. It was abusive. But now, under the QM rule, in essence we are saying, "Listen, it is okay; we know you are going to charge minorities, low-income and moderate-income people more because they are not going to meet the QM standard." So, again, if you are wealthy, or you are middle-class, you are fine.

That is why I have a hard time seeing how people can support this rule when the people who can work with the community bank and afford a home—who can work together and afford a mortgage, are going to be charged more for it now with this new rule. Am I wrong on this, Mr. Hartings?

Mr. HARTINGS. No, I don't think you are wrong at all. Although our bank is making a decision not to make non-QM. If I made a non-QM, I would have to look at things like the litigation risk. I would have to look at risk to my bond insurance, because my bond insurance is out there to protect me against lawsuits. And that is going to probably go up.

I would look at things like my examinations. When examiners come in and look at my bank for safety and soundness, they are looking at loans that have lower credit scores. They are obviously going to look at non-QM loans, so I may be under higher scrutiny on the examination side of it.

So, there is a cost. There is a much higher cost to making non-QM loans going forward.

Mr. DUFFY. I appreciate everyone's testimony. I yield back.

Chairwoman CAPITO. Thank you. The gentleman's time has expired.

I would like to recognize the ranking member of the full Financial Services Committee, Ms. Waters, for 5 minutes.

Ms. WATERS. Thank you very much, Madam Chairwoman. I would like to thank you and our ranking member for holding this very important hearing.

This has been an issue that we have all spent a lot of time on for good reasons. We have experienced a subprime meltdown that

caused a recession in this country. And it has been very painful for a lot of our constituents. And of course, it goes without saying that we want our constituents to be able to get mortgages. We absolutely support that.

However, we don't like the fact that too many constituents were taken advantage of in too many ways. They were sold mortgages that they could not afford. They didn't know about the exotic products. Oftentimes, they didn't know what they were getting into. They didn't know what was going to happen when the devil came due on some of these loans. Mr. Meeks has referred to some of these exotic products, whether they are no-doc loans or no-interest loans, whatever.

And so now we are at the point where we have to figure out how to make sure that our constituents have access to credit, and the community banks that we are all working to give support to have the ability to make these loans without having too much interference, too much involvement, as you would term it, by government, that you are able to make loans that work.

So we want to help the community banks, but we certainly are going to protect our constituents and not allow our communities to be devastated again by foreclosures in the way that we have experienced. Now, having said that, we worked very hard with the CFPB in order to make sure that there was a difference between the community banks and the too-big-to-fail banks. And we had very special things that we did. I want to know why what we have done to differentiate between community banks and the too-big-to-fail banks is not enough.

And I think I will start by asking this question of Mr. Bill Emerson, chief executive officer of Quicken Loans, Incorporated, on behalf of the Mortgage Bankers Association. And before I get into the question, I would just like you to know I love your commercials. They are so cute.

[laughter]

Mr. EMERSON. Thank you very much.

Ms. WATERS. And before you answer, I want you to know I am going to ask you this question if it is not the right answer: Who do you think I am, Quicken Loans?

[laughter]

Mr. EMERSON. Quicken Loans is an independent mortgage bank, so we are not in the typical community bank lending scenario. And back to Representative Duffy's comments around the lending that goes along with that.

As an independent mortgage bank, we don't have a balance sheet. So at the end of the day, the loans that we are going to originate and the consumers that we are going to serve, we need to have a viable secondary market to be able to put that loan into. And without that viable secondary market for a non-QM loan, then independent mortgage bankers are not part of the process and therefore competition, frankly, falls a little bit by the wayside because you have lenders that can't participate.

So, I would have to defer on this one, Representative Waters, to the community bankers sitting at the table here to answer whether we should or shouldn't go further. I can tell you from the MBA's perspective, the way that we think about this, we clearly want to

make sure that we are helping as many people as we can. But we also don't know that we should be setting up necessarily separate rules because we want some consistency for the consumer to know exactly who they are working with and with whom they are dealing.

Ms. WATERS. We differentiated because we wanted to make sure that the community banks did not have the kind of regulations that you thought would be harmful to you. And what are you telling us? We didn't do enough?

Who are you saying that you want to answer the question?

Yes, go right ahead.

Mr. HARTINGS. I am a community banker. And I think what you realize under the QM rule is that we are trying to regulate the integrity of the product and not regulate the integrity of the institution. And I think the CFPB took a step in the right direction trying to create a tier. The issue is, I am a $400 million bank. And their tier is this: It says if you are less than $2 billion, and you originate less than 500 loans, you have the small creditor exception.

In 2012, I generated 493 loans. So, I would like to grow. I would like to continue to serve my customer, but I am right at the edge of losing my status. So, really, the issue is a much broader exception. I think tiered regulatory modeling makes a lot of sense. I like to say—I had this quote in The Wall Street the other day, "Community banks weren't the problem, but QM is the fix—it affects us anyhow, with everybody else, and we are kind of thrown under that blanket."

So it is really the amount of that exception that we see needs to be expanded to really be effective. Because at the end of the day, we want to see more consumers get loans, rather than less. And if this rule has the—actually contracts the lending instead of expanding it, then it is not doing its job.

Chairwoman CAPITO. The gentlelady's time has expired.

Ms. WATERS. Thank you.

Chairwoman CAPITO. Mr. Bachus?

Mr. BACHUS. Thank you.

Mr. Emerson, I am going to ask you this question. As you know, the current QM rule includes affiliated title insurance in the 3 percent points and fee trigger, but unaffiliated title insurance is not included. Since title insurance rates are filed by underwriters and have to be approved at the State level, or the State determines the title insurance rate for both types, is there any reason to differentiate between affiliated versus unaffiliated title insurance? And is there any benefit to the consumer if the title insurance is purchased by an unaffiliated title agent?

Mr. EMERSON. The simple answer to that question is no, there is no reason to differentiate between those two on that basic piece of information around title insurance. If you look at the rule, unaffiliated title companies, all charges for the title company are excluded from the 3 percent fees.

All of the fees for an affiliate are included. And what the industry has been looking at from an affiliated perspective is saying, take the title insurance, that one regulated piece which is the same as that filed by an underwriter at the State level—and a title agent must use that filed rate; they can't take it higher, they can't take

it lower—and exclude that from the 3 percent piece for affiliates, because by not doing so you are putting a different playing field together for an affiliated versus a non-affiliated title company.

And when you think about a non-affiliated title company, they are working with the same lenders and the same people every day. They are getting business on a regular basis from those folks. And so, there is an advantage for them doing that. From an affiliated perspective, actually with—now with the CFPB, and the fact that you have to manage your venders, you have very tight controls over that. And so, I think, putting that in place, it makes zero sense at all to differentiate on title insurance and the affiliated-unaffiliated piece.

Mr. BACHUS. Right, and of course, the rule does, which I agree doesn't make any sense.

Mr. Scott, back on May 21st said, "I mean to do so," in other words, putting affiliated under the fee trigger reduces competition in the choice of title servicers and insurance providers. So, it just reduces choices. And I don't see any reason why we ought to discriminate. I think that is one thing we ought to address.

What effect does putting affiliated title insurance under the 3 percent points and fee trigger how—what effect does that have on consumers? Particularly low-income consumers or—

Mr. EMERSON. Sure. I think it affects them in two ways. The reason that we got involved with an affiliated title provider was to provide service to our client, to provide a seamless end-to-end solution. It had nothing to do with the ability for us to make more money on the transaction. Frankly, when you think about it, our title company actually works with other lenders. So, our title company has proven that they are competitive and they do a great job.

The benefit to the consumer is an end-to-end seamless process. Where it hurts the consumer is that if you are working with a lender that has an affiliated title company and you include those fees into that, you are not going to qualify to deal with a lender that has an affiliated title company where you would qualify to deal with a lender that doesn't have an affiliated title company. And as a result of that—again and that bucket was particularly between $100,000 and $150,000, less competition and less opportunity for folks to be able to get mortgages, because they are working with a lender that has an affiliated title company.

Mr. BACHUS. I fail to see why they made that distinction.

Mr. Calhoun, I agree with you. The problem is that sometimes it is high fees and high interest rates. Those are the two big problems and this doesn't have any impact on that. In fact, it could lessen the fee. There are not a lot of HOEPA loans made, because of legal uncertainty.

So my next question to Mr. Emerson or any of you is, aren't we going to have the same problem with non-QM loans? There is no secondary market—no liquidity for HOEPA loans. We are going to find the same thing happening with these non-QM loans, and what impact will that have on low- and middle-income borrowers?

Mr. CALHOUN. If I may answer with that, there have been a number of articles recently that have quoted lenders saying that they intend to do non-QM loans, and that over time they expect the secondary market to develop. The liability on a HOEPA loan is or-

ders of magnitude higher than it is for a non-QM loan. The liability is actually very limited.

Mr. BACHUS. Do we know that? Because we are dealing with a blank slate. We don't know what people are going to rule. But, I can understand at some point you say it is clarified. It is only clarified after those loans are made. And they are going to charge higher interest rates if there is legal uncertainly.

Chairwoman CAPITO. The gentleman's time has expired. Mrs. Maloney?

Mrs. MALONEY. Thank you. I appreciate all of your testimony today.

And I understand your legitimate concerns of wanting to get borrowing and loans out to credit-worthy Americans.

But we have to start somewhere. And this CFPB rule is a beginning point. And I might add, I think it is a long time in coming. It came out last Friday, and it has been almost 5 years since the financial crisis. The purpose of this rule is to prevent another financial crisis from happening.

So I would like to ask every panelist for just a yes-or-no answer. Do you believe that the financial crisis merited serious reform of the mortgage industry, or should we have just left the industry just like it was with its no-doc loans?

Do you think it merited reform? Yes or no?

Starting with Mr. Hartings?

Mr. HARTINGS. It would be a qualified yes. I would like to expand on that a little bit.

Mrs. MALONEY. Okay, if you would like to put it in writing. Yes or no? Qualified, yes.

Mr. EMERSON. Yes, qualified.

Mr. WEICKENAND. Yes.

Mr. SPENCER. Yes.

Mrs. MALONEY. And we will accept your other answers in writing, but I want to get to a second question.

If this rule had been in place, flawed as it is, would it have prevented the financial crisis—in your opinion—from which we are still suffering?

Qualified yes or no? And put the long part in writing.

Mr. Hartings?

Mr. HARTINGS. I don't know. I can't answer that.

Mr. EMERSON. I can't do that either.

Mr. WEICKENAND. I am with them.

Mr. SPENCER. No.

Mrs. MALONEY. You don't believe it would?

Mr. CALHOUN. Absolutely. Let me give you one example.

Mrs. MALONEY. You will have to put it in writing—

Mr. CALHOUN. With ability to repay, Countrywide said 70 percent of their loans would not have qualified.

Mrs. MALONEY. Okay, but the answers, if they could come back in longer form to me, because I really want to get to this one.

I think that what we are seeing is that there is a very fine line between what we want to accomplish. We want to prevent a future financial crisis, but we want hardworking credit-worthy Americans to have access.

I know wealthy people will always be able to get a loan. They could be leveraged very highly with all their assets. But hard working people oftentimes cannot get loans, as my colleague from New York pointed out so beautifully in his opening statement.

I think that we share the same goal and principles, that we want to get this out, but we need to find this fine line. So what qualifications would you suggest to arrive at this careful balance, if you believe the balance that has come out from the CFPB is not the right balance?

We will be able to study it over the future with data and their research and monitor it, but I would like to ask each of the panelists if there were other qualifications or another way that you think would have had the fine line of protecting our overall economy from abuse, financial crisis, but getting that loan out to the qualified, hardworking, moderate-income American?

Mr. Hartings?

Mr. HARTINGS. Yes, I would like to speak about tiered regulatory modeling, because as a community banker—I know Congressman Meeks talked about adjusted rate mortgages, and there was some really predatory lending made on adjustment rate mortgages. But we recently had to redo our disclosures due to the new changes in the mortgage rules. And I went back and 17 years ago I used a different adjustable rate index, and I still have 20 of those loans on the books.

Now, if that was predatory, those people would probably have paid me off, but as a community banker, someone who keeps it on the portfolio, I can't allow that kind of product to be out there. So, a tiered regulatory model, when you try to be this prescriptive on what a qualified mortgage is, you can create something that is very safe and sound, but it is going to be very exclusive and you really will want to be more inclusive.

And I think the only way to do that is a tiered regulatory model for those in portfolio, or the smaller lenders, and I think that is the best solution.

Mr. EMERSON. I would give you four things that should be done.

Number one is, I think we should expand the QM safe harbor rule. Right now, it is rebuttable presumption, at 150 basis points over APOR. I think you should take it to between 200 and 250. I think you should increase the threshold for smaller loan amounts and have a sliding scale, and the MBA has attached a chart that would kind of define how that would work, and I think that would bring more folks into the program.

We have already testified, I think that we have to have the ability to make fixes to mistakes that take place and the care that exists and help it today. And then, one of the things—and I think the CFPB has tried to do a very good job of giving guidance. But, a lot of that guidance is oral. And the more written guidance we can get, the more clarity will be out there and the more certainty for people to understand the rules.

Chairwoman CAPITO. I think the gentlelady's time has expired.

I will let the next person go ahead and answer it while we get the clock reset.

Mr. WEICKENAND. We have been doing qualified mortgages since I entered the industry. That is all we do. We do not put people in

situations where they cannot be qualified now. What I can say is for a qualified mortgage or a qualified auto or anything like that, I know that market in Memphis, and I can make those decisions. The rules themselves, based on not being able to sell to the secondary market, will hinder our ability to make some of those decisions. And I think that is a real problem.

Chairwoman CAPITO. Thank you.

Unfortunately, the two timers that many Members use to gauge their questions have for some reason ceased working. So I guess I am going to have to say, trust me, I will give you your 5 minutes. How does that sound?

Our next questioner is Mr. McHenry.

Mr. MCHENRY. Thank you, Madam Chairwoman. If you don't mind, I will keep my own time.

[laughter]

Chairwoman CAPITO. I said, trust me, not you.

Mr. MCHENRY. Oh. That is a better choice. So, thanks.

Reclaiming my time, both seconds left.

In June of—let me start this way. Is the panel familiar with the disparate impact regulations put forward by HUD earlier this year?

Okay. Some of you are familiar with them.

Mr. Calhoun, are you supportive of the regulations as HUD has promulgated them?

Mr. CALHOUN. Yes.

Mr. MCHENRY. Okay, all right. But in June of this year, a group of industry trade organizations representing the mortgage industry sent a letter to Director Cordray of the CFPB and Treasury Secretary Donovan, highlighting the regulatory conflicts that would result if CFPB's QM regs, on one hand, and HUD's disparate impact rules promulgated earlier this year under the Fair Housing Act.

And the letter states, "These and other rules implementing Dodd-Frank, including those governing ability to repay and risk retention, will tighten credit standards through facially neutral requirements that may lead to disparate outcomes for some category of borrowers."

It goes on to claim that this lack of guidance will create uncertainty, resulting in higher prices to account for risk and less available credit for consumers. So, Mr. Calhoun, do you believe that this regulatory impact could have a negative impact on consumers? On the one hand, disparate impact standards, and on the other, QM, and perhaps restrict mortgage lending unnecessarily and result in lawsuits?

Mr. CALHOUN. No, for two reasons. Historically, lenders who chose not to do subprime lending, obviously that had a disparate impact since half of all African-American loans were subprime. There were no actions, private or public, brought against them for that decision.

And we have already had responses from the regulators saying that a lender's choice of just doing QM loans will not be used against them in a disparate impact situation for that analysis.

Mr. MCHENRY. Okay. Mr. Emerson, has your industry received assurances from the government that they are not going to pursue suits if you follow the box of QM, but disparate impact suits?

Mr. EMERSON. So, to get to that point, obviously I think our industry and the MBA strongly supports the Fair Housing Act. But what we have now come in context with is the CFPB and some regulators have come out and said what Mr. Calhoun indicated.

But what we haven't heard is we have not heard from HUD and we have not heard from the DOJ. And HUD is the group that promulgated that rule and the DOJ enforces it.

And I think when you are thinking about the industry and where there is a bend in the industry and what has taken place through repurchase processes, as well as HUD OIG and DOJ actions, I think there is a lot of nervousness around that by not hearing from those two groups.

So some guidance from those two groups would be tremendously helpful for the industry to know exactly where they stand on the disparate income issue.

Mr. MCHENRY. Mr. Calhoun, do you agree? I see you nodding.

Mr. CALHOUN. I agree that additional guidance would be helpful.

Mr. MCHENRY. Okay. Certainly.

And I certainly appreciate your organization, Mr. Calhoun's, support for dealing with the added pressure of litigation as a result of QM. Those that follow the strict QM standards, they will not be pursued. And I certainly appreciate that.

I know we have disagreements on the final construct and the impact it will have in the marketplace.

But, Mr. Hartings, in terms of the Community Reinvestment Act, do you think it is possible for financial institutions, if they are doing mortgages, to meet their CRA requirements if they are only doing QM mortgages, or does it make it much more difficult?

Mr. HARTINGS. It may be a wait-and-see. It certainly will make it more difficult—as you get to be a larger lender, you also have to have an investment test as well as a lending test.

If it reduces your mortgage volume, certainly there are some safe harbor percentages that if you are below that, you may have to have more documentation. So I believe it would make it somewhat more difficult to receive a satisfactory CRA rating.

Mr. MCHENRY. Okay. I certainly appreciate the witnesses' testimony today. We obviously do have deep concerns.

And this is really a deep concern not about the industry, but about your ability to provide products to my constituents who desperately need them. Especially those who are in moderately-priced homes where the question of points and fees in moderate-income areas, especially in my district, where because of the moderate income and the moderate price of the home, the points and fees have such a larger percentage, disproportionate to the cost of the loan. And we need to make sure we work through that.

And with that, thank you, Madam Chairwoman.

Chairwoman CAPITO. The gentleman's time has expired.

Mr. Hinojosa?

Mr. HINOJOSA. Thank you, Madam Chairwoman.

I am very interested in hearing from the panelists about the possible effect of this rule on the continued health of the housing market, and in particular the continued involvement of community banks and credit unions in the mortgage business.

Credit unions and community banks in my congressional district in deep south Texas are essential to the local economy.

My question to Mr. Calhoun: Not only do they provide competitively priced and fair mortgages, they contribute to local economic growth and community cohesion. So do you think that making banks and credit unions more attentive to underwriting nontraditional loans will help make the mortgage lending system healthier and safer?

Mr. CALHOUN. Yes. And to be clear, we are very strong advocates of the community banks. I think in addition to the mortgage lending they do, they do about half of all small business lending, and the mortgage lending is needed to both serve mortgage borrowers and also to support the institutions for all the other reasons you have there.

We have supported, as I say, the two-tier model with special provisions for community banks. There are places where we are on record and are still working to push further.

For example, we think some of those loan caps are too restrictive both for the community banks and for the nonprofits. We do have concerns, though, about a complete portfolio exception. There are some banks where we have reviewed programs which have had 30 percent and 40 percent foreclosure rates on portfolio loans under the old model of lending to people with lots of home equity. And we need to have some backstops for that.

But community banks need special treatment, and we fully support that under the QM rule and in general with the regulatory approach.

Mr. HINOJOSA. Under the QM rule, they tell me that many loans will not be made because they are below the 43 percent threshold that you spoke about that actually can go beyond 43 percent.

So how do we let both the lenders and the borrowers get that is possible, up to about, say, 50 percent? How do we do that?

Mr. CALHOUN. I think in two ways. First of all, there is the so-called patch that allows any loan that qualifies for GSE insurance, or FHA insurance does not have to be sold or insured by them. If it is eligible, even if it is kept on portfolio, that is, per se, a QM loan. It goes up to 50 percent.

We have urged, and we did with a joint comment with industry that covered most of the mortgage market, that the CFPB should use their data collection and develop specific broad criteria that would allow these so-called compensating factors for responsible lending above 43 percent, particularly by small lenders.

Mr. HINOJOSA. Okay.

Mr. Weickenand, many African-American and Hispanic home buyers are steered into subprime loans when in fact they qualify for a prime loan. So can you remind us of the prevalence of this practice during the subprime crisis? And how will these new rules change that practice?

Mr. WEICKENAND. I can't really speak to what others were doing. I just know that what we do is to provide quality products at low cost to sort of raise the water a little, if you will, of our entire community, which makes everybody's boat rise.

We are very, very sensitive to trying to improve the lives and the livelihoods of all of our members in our community at large.

So, we don't touch subprime. That is why we have a nonqualifying—the balance sheet limitations, plus the taste in my mouth of having to price these things differently, when last year I would not have to. So, I don't want to do that to my members.

Mr. HINOJOSA. Mr. Spencer, now that the QM rules are made effective, can you clarify for us what lending options are still available for low-income Americans who may not be able to meet the 43 percent debt-to-income (DTI) limit?

Mr. SPENCER. I can't really speak to the broad options available, but I can speak to what we are having to do. Our fear is the following: If you look at our borrowers, they would be subprime except for the fact that we are providing no-interest loans. And so, they become qualifying mortgages, but the borrowers themselves could not qualify for a commercial mortgage under the same terms.

And so, that is why we are asking for the relief in H.R. 3529 because we don't believe this rule is intended to address the ministry we are pursuing. And we hope that bipartisan support will allow that rule to be enacted.

Mr. HINOJOSA. My time has run out.

Chairwoman CAPITO. The gentleman's time has expired.

Mr. HINOJOSA. I yield back.

Chairwoman CAPITO. Thank you.

Mr. Westmoreland?

Mr. WESTMORELAND. Thank you, Madam Chairwoman.

I thank all of you all for being here today. I am a reformed homebuilder, I guess. And when you have somebody apply for a loan, if they are turned down for any reason or if the loan is not—typically, there are some explanations given for why the loan is turned down.

And Mr. Hartings and Daniel, if you were to turn down somebody's loan because it was not QM-compliant, what would you give as the explanation for having denied that loan?

Mr. HARTINGS. It is a little different when you don't have a product that is available to them. So what you would tell them is, we do not offer non-QM-qualified loans, so I can't help you out. You do not have to file an adverse action if it is not a product that you are offering.

But it is a shame. I offer what I call an HBA program, which is homebuyers assistance for those who have less than 20 percent down and I portfolio that loan. But I do it at a higher interest rate because I don't charge them PMI insurance. And I have already scaled it back. I used to allow 5 percent down. We have scaled it back to now only 10 percent, because we were running into the higher-priced mortgage issue.

That product may go away completely. I have been doing that for a little over 10 years and I have never had a foreclosure in that product because we use a lot of compensating factors. It is not just DTI.

Mr. WESTMORELAND. Thank you.

Daniel?

Mr. WEICKENAND. It would be the same response. We wouldn't offer that product to them at this time, and unfortunately couldn't serve their needs. And that is—

Mr. WESTMORELAND. Mr. Spencer, we hear from the other side of the aisle quite often that we need to pursue policies to have low-

and moderate-income people be able to obtain a loan. And I certainly agree with that. I was in the business, and I have seen what a difference owning a home makes in somebody's life, much as the ranking member shared about moving out of the housing project into a home. So, I very much want to do that.

Do you feel that the QM is going to hurt that goal?

Mr. SPENCER. We believe that not just QM, but that the specific issues that H.R. 3529 addresses gives us certainty in being able to pursue serving these customers, these clients, these partner families. And that certainty is important because we are dependent upon raising dollars to do that. But we also finance parts of our balance sheet by having loans that can be pledged as collateral.

Now, that is not the same as the secondary market that led to the housing crisis and the financial crisis. But it is an important aspect of how we assemble capital for affordable housing. And so, we have to have loans that are recognized and don't create a liability for us or for a potential financial partner who might want to partner with us, like the Self-Help Credit Union has in the past, or community or large banks.

Mr. WESTMORELAND. Could you describe for the committee who might be an individual who would be qualified or be somebody that you would make a loan available to who would now not be able to get that same loan?

Mr. SPENCER. Our target market is people who, as a household, are between 30 and 60 percent of median income. And I am now speaking for the Charlotte affiliate, but this is generally true of Habitat more broadly. And to qualify, our folks have to have income, but they might have a medical debt that would throw them out of the QM measure.

In the past, we have been able to work with them through financial counseling and, over time, help them pay that down. Whereas now, we are only doing QM loans to obtain the certainty that we need to be able to continue to move forward with our housing.

Mr. WESTMORELAND. Thank you.

And I yield back.

Chairwoman CAPITO. Mr. Scott?

Mr. SCOTT. Thank you, Madam Chairwoman.

First, let me go to you, Mr. Calhoun. We have a bill, H.R. 3211, with which you are familiar. It has significant bipartisan support because it is a compromise. It is a compromise that was made to address many of your concerns and the concerns of other consumer groups.

We have worked with Ranking Member Waters. We have worked with former Congressman Mel Watt for months. We have made noumerous worthwhile provisions. We have made changes. We have removed certain things that you objected to because we listened to you. We respect you. We know your work in the community.

So, we have this new bill that has your input and the input of others. And what it represents now is the bare minimum that is needed to do the most crucial thing, which is to level the playing field enough so consumers can choose one-stop shopping.

Are you happy with this bill now? Can we move forward? We appreciate your contributions to it. And are you supportive?

Mr. CALHOUN. Thank you for those comments and for your work with us. And I would like to say we have worked closely with Mr. Emerson in trying to hammer out something that would work for everything, not everyone's first choice.

We still have concerns on the title insurance for fears that this bill would actually create an unlevel playing field and it would harm consumers. And let me start with just one figure. The latest data on title insurance for 2012 is that over $11 billion of title insurance premiums were collected. During that same year, $765 million of claims were incurred, for a loss ratio of 6.8 percent. And that has been a typical loss ratio that they have had over the last 10 years.

Mr. SCOTT. Let us address that. That is a good concern, the title insurance.

So, Mr. Emerson, let me ask you, you are with Quicken Loans. You do a lot of work on this. You probably could have effectively answered some of this. In fact, what effect does discriminating against affiliate title companies that Mr. Calhoun is pointing out, have on competition?

Mr. EMERSON. Two things to that.

Number one, to Mr. Calhoun's point, we are not debating what the price of title insurance should or shouldn't be. The discussion has been, is there an opportunity to have a level playing field around an affiliated and a nonaffiliated? Because each one of them will have the same amount of title insurance. The fee will be the same. And that has been what we are talking about, because there is no harm to the consumer in that particular situation.

What it does for an institution like ours, in which client service is very important to us, is it takes us out of the game in a lot of cases, because we chose to affiliate with a title company to provide better client service, and there will be clients that we cannot help today, that we could have helped last Thursday.

Mr. SCOTT. Will discriminating against affiliate title reduce the cost of the insurance?

Mr. EMERSON. No, it won't reduce the cost of the insurance one bit.

Mr. SCOTT. Which consumers do you feel will be most affected by the reduced choices created by the 3 percent cap?

Mr. EMERSON. We believe it is the same consumers who will be affected by the 3 percent cap anyway, and that is going to be the lower loan amount folks, the folks between $100,000 and $150,000, the folks who will be first-time home buyers, the folks who will help this economy come back from a housing perspective and they are the ones, just add on top of that one more fee and title insurance.

Mr. SCOTT. And fine, let me go back to you, Mr. Calhoun.

Title insurance is regulated at the State level, not the Federal level. I think that is important for us to understand.

So if the title costs and regulations are done at the State level, shouldn't you be working on legislation and regulation in the States to address your concerns rather than at the Federal level?

Mr. CALHOUN. The regulation varies among the States. About 10 of them don't regulate the price. Others use very different procedures.

The concern is the difference between those two numbers I gave you goes for affiliated insurance largely to the lender, which gives them an advantage over other lenders because they are capturing that difference and the effect of that is to push title insurance rates going up.

Title insurance rates should be going down with automation. But title insurance has become more expensive over the last decade for borrowers. There has not been the adjustment in a functioning market that you would expect. And borrowers are paying—we are talking about a fee that could be several thousand dollars on the typical home loan.

This is real money to home buyers, and that is our big concern. As I said, we continue to work with Mr. Emerson and see if we can find something that works for lenders like him, but that don't fuel this increasing cost of title insurance, which is already too high for homeowners.

Chairwoman CAPITO. The gentleman's time has expired.

Mr. Luetkemeyer?

Mr. LUETKEMEYER. Thank you, Madam Chairwoman.

Recently, I met with a group of Missouri bankers who came to my office after they had been to visit some CFPB representatives over at their building. And my bankers were talking about the things that we are talking about this morning, the QM rule. And they were told by the CFPB representative that they were the 41st group to meet with them.

Basically, the gist of the conversation at the end of it was, "Thank you for coming. We know more about the effects of what is going to happen to the borrowers, the lenders, and the market than you do," which is very concerning.

So, as a result of that, myself and a number of my Missouri delegation members wrote to the Director and he responded back to us, and Madam Chairwoman, I would ask unanimous consent that those two letters be made a part of the record.

Chairwoman CAPITO. Without objection, it is so ordered.

Mr. LUETKEMEYER. And, in the letter, the Director indicates—he says, "The Bureau shares your concern that regulation should not place unnecessary burdens on community banks. We recognize that, with few exceptions, community banks and credit unions did not engage in the type of risky lending that led to the mortgage crisis."

We are glad to hear that the Director and see the Director believes where the problem was, and hopefully he will be willing to work with the committee and with the new legislation that comes out of this as a result of our hearings today, because it is pretty obvious that there are a lot of negative effects that are occurring here.

Along that line, I would like to talk with the lenders here for a moment and sort of get some things clear. Mr. Hartings, Mr. Weickenand, and Mr. Spencer, I think all three of you have mentioned this morning that you are not going to be doing non-QM loans. Is that correct?

Mr. HARTINGS. That is correct.

Mr. LUETKEMEYER. And Mr. Emerson, I didn't hear your—

Mr. EMERSON. Yes, that is correct.

Mr. LUETKEMEYER. You are not going to be doing that either, Mr. Weickenand and Mr. Spencer, is that correct?

Mr. WEICKENAND. Yes.

Mr. SPENCER. That is correct.

Mr. LUETKEMEYER. Okay. Why not? Give me a really quick answer, because I have this lady behind me who has a stop watch on me, and General Ronald Reagan once said, "Trust, but verify," but since she is a really nice lady, I am not going to verify. I am going to trust her. But I do need to get done quickly here.

Mr. HARTINGS. As a community banker, we like to keep things simple to be able to afford to do it in our setting. I don't do higher-priced mortgages today for the same reason, because of the extra regulatory burden, the real fear of litigation, and what that means long term.

I know we talked about this as marking it today and we will know 6 months from now or a year from now how it is really affected. But, my concern is those consumers who want to buy a house between the next 6 months or the next year, because they are going to be harmed if we are not right about this regulation. And I believe that it will restrict credit.

Mr. LUETKEMEYER. Mr. Emerson, please?

Mr. EMERSON. I agree with Mr. Hartings. And, I would add to that, by the very nature of QM and that is the loan that you should be making and there is a stigma that lending outside of QM is a loan that is not necessarily a good loan. You think about reputational risk, you think about re-purchase risk, you think about the liability associated with that and not to mention the fact, as I said in the testimony, that there isn't a secondary market for a non-QM loan.

So even if an independent mortgage bank wanted to originate that loan, which we don't want to, you couldn't because there is no place to effectively sell that loan.

Mr. WEICKENAND. I would agree with the gentleman previously that, for us, the idea of charging more for a loan that I wouldn't have charged differently from the previous year is just something I can't stomach. Plus the fact that balance in my balance sheet, with the ALM concerns and things of that nature not being able to offload loans like I am today. It will impact—and according to my records for the last 3 years if you just assume it is 11 percent, which may not seem a lot unless you are part of that 11 percent.

Mr. LUETKEMEYER. That is right.

Mr. Spencer?

Mr. SPENCER. We need certainty.

We need to know that we are within the bounds and I can say that I am sitting here representing 278 other affiliates who signed the letter in support of H.R. 3529, and we hope that we can get that certainty rather than trying to sort out uncertainty in the regulations as we have heard earlier.

Mr. LUETKEMEYER. Mr. Emerson, I think you hit on the point I was trying to get to here that is the heart of this matter. And that is, if it is a non-qualified loan, automatically there is a perception that there is a problem there or there is something that doesn't fit into the box. And while before these rules, the bank had the flexibility to price a loan and look at the customer and be able to figure

out what was best not only for the customer, but what would work best for the bank. Now that flexibility has been taken away from them, and if it doesn't fit in the box, it opens you up to this—the opposite of what can happen here is that if it doesn't fit in now, all of a sudden it is a negative.

There is an exposure—there is a risk there.

And my concern is, have any of you talked to your regulators about the problem that this could have when they come in and regulate you?

Is this the reason you stepped back? Because if a regulator comes in and sees you have a lot of non-QM loans, what are they going to do? They are going to assess that, I assume, against your capital or do you have an extra fund to sort of go back against for these funds or have you talked to them at all about this?

Mr. HARTINGS. I have reached out to my regulators. It is kind of a wait and see today. I would like to comment on something a little different, what Mr. Emerson said, and he talked about the secondary market and not being able to portfolio these loans.

That is the advantage of allowing community banks to portfolio these non-QM loans, and still have safe harbor. We would put these on our books if we had the safe harbor that went along with it. It is that litigation risk that is preventing us from continuing to make non-QM loans.

Chairwoman CAPITO. We can do quick answers, because the gentleman's time has expired.

Mr. EMERSON. I don't have anything to add to what we already added on my previous response.

Mr. LUETKEMEYER. Okay.

Mr. Weickenand, anything?

Mr. WEICKENAND. No.

Mr. LUETKEMEYER. Thank you, gentlemen.

Chairwoman CAPITO. Thank you.

Mr. Ellison?

Mr. ELLISON. Thank you, Madam Chairwoman, and thank you Ranking Member Meeks, and I would like to thank all of the panelists as well for your hard work and the information you bring to this process.

I would like to ask some questions of Mr. Emerson.

Mr. Emerson, obviously Quicken does a lot of loans. Could you tell me what percent of the loans that you guys issue, what percentage of borrowers choose not to use Title Source or other title insurance firms affiliated with Quicken?

Mr. EMERSON. I don't have that at my ready. I would give you a range probably 5 percent of the time, 5 percent to 10 percent of the time.

Mr. ELLISON. Thanks a lot.

I did look at your testimony, and I thank you for providing it. On page 6 and 7 of your testimony, you stated that, "The rationale for excluding title insurance paid to affiliates from the calculation of points and fees is unclear." I respectfully submit that I would disagree with that. Congress required the CFPB to exclude affiliated title insurance companies from the points and fees cap, explicitly. Why? To lower costs for borrowers and increase transparency in mortgage transactions.

Also, in your testimony you say that, "Studies have shown that when affiliates have been excluded from the market, title insurance charges have risen." That is not what my research shows. I would be happy to be better educated on the subject. Could you identify which studies you are referring to?

Mr. EMERSON. I am not sure exactly what you are referencing in the testimony. What I can tell you is from a title insurance perspective, I can appreciate the fact you disagree, but we just had the dialogue around and the regulation around title insurance. What we are not debating is any other title fees. We are not asking for closing fees or anything else associated with that. I think those are obviously—

Mr. ELLISON. Thank you, sir. I do appreciate your answer.

I was just hoping to look at those studies, because in your testimony you say, "Studies have shown that when affiliates have been excluded from the market, title insurance charges have risen."

I would like to read those studies, because if they are out there, I want to know more about the issue.

But, let me also say that there has been—this question has been looked at. And, I would submit that the studies you are referring to either don't say that or say something quite different and any way—

Mr. EMERSON. That is so—

Mr. ELLISON. Let me finish. I have also looked at a number of studies, including those by the Urban Institute, the GAO, and just last month the Consumer Federation of America, and the National Association of Independent Land Title Agents, calling for major reform in the title insurance industry.

I actually would like to submit for the record some of the testimony of Bob Hunter from the Consumer Federation of America before the New York State Department of Financial Services on December 10, 2013. And I would also like to submit for the record the testimony of the National Association of Independent Land Title Agents before the National Association of Insurance Commissioners on December 16, 2013.

Chairwoman CAPITO. Without objection, it is so ordered.

Mr. ELLISON. Yes.

And the CFA testimony asserts the title insurance system is highly concentrated, opaque, and results in reverse competition and raises cost to consumers. The one-stop shop system that has been praised in some quarters is in essence a noncompetitive and already overpriced marketplace, and for each title insurance payment a consumer makes, what I am curious to know is what percent of that fee from Title Source, or another affiliate, is provided back as commission on investment to Quicken?

Mr. EMERSON. There are two things I will address. Quicken Loans receives nothing back from Title Source. Title Source is a completely independent company. And so, there is nothing that will transact back from that. And testifying on behalf of the MBA, we will be happy to provide you the information and the studies we looked at to come to those conclusions.

Mr. ELLISON. I appreciate that, sir. So annually, I am curious to know how much Quicken Loans earn in revenue from—you said none from Title Source, so they should be a zero?

Mr. EMERSON. Yes, Title Source is an independent company.

Mr. ELLISON. And Quicken doesn't make any money from—

Mr. EMERSON. Correct.

Mr. ELLISON. Okay.

The Consumer Affairs Web site shows that there are issues going on about Quicken Loans and also about 88 percent of the filings give Quicken the lowest satisfaction rating.

For the record, I am troubled by the fact that the title insurance industry willingly allows referral sources to take pieces of title agencies as bounty for the referrals. I urge the chairwoman to invite land title agents to testify before this subcommittee.

And Mr. Emerson, I want to thank you for your candid answers. This should be a truth-seeking process. I don't have all of the answers. I don't claim to. And you guys have some of them. So I appreciate you responding back, and I look forward to you sharing the information you have with me.

Chairwoman CAPITO. The gentleman's time has expired.

Without objection, I would like to submit for the record statements from the following organizations: the Credit Union National Association, the National Association of REALTORS®, the American Bankers Association, the Manufactured Housing Institute, and the American Land Title Association.

Mr. Stutzman?

Mr. STUTZMAN. Thank you, Madam Chairwoman.

And thank you, gentlemen, for your testimony today and for your responses to a lot of good questions. I wanted to say thank you for what you intend to provide for constituents and for Americans across the country.

I just find it unfortunate that in today's economy, we are seeing Americans being squeezed harder and harder from every different direction, whether it is trying to get a home loan to buy either a new home or upgrade into another home or whether it is health care, whether it is their job seeing stagnant wages, this economy is not working for the American people.

And listening to the testimony from you all today, obviously we hear that your customers and consumers across the country are in for another surprise. I would like to drill down into DTI a little bit, if you could give us some of your thoughts.

I found it interesting that the CFPB sets the threshold for debt to income at 43 percent, but the Federal Reserve, as they were drafting ability-to-repay rules, did not require lenders to consider DTI.

Mr. Hartings, I would like you to comment on it, and then if we could just move down the line fairly quickly, because I have another follow-up question to that.

Mr. HARTINGS. Okay, I think there are two issues with DTI.

First, setting a hard DTI limit, because it is lifestyle that depends on what you can live on and not 43 percent or 36 percent. So that is going to exclude some borrowers just because they can afford it with their lifestyle and the kind of homes they live in. And, the other item with DTI—I can't remember what I was going to tell you right now, I will just pass on that one.

Mr. STUTZMAN. All right, thank you.

Mr. Emerson?

Mr. EMERSON. DTI is one calculation to look at. When you are evaluating the risk of a loan, you should be evaluating more than just the DTI. And I think as we evaluate DTI, we will see how that affects home buyers and first-time home buyers and how they are going to be able to qualify.

Mr. STUTZMAN. Okay, thank you. And, Mr. Weickenand, if you could also maybe include a metric that you would use as a strong performance measure?

Mr. WEICKENAND. We use DTI to determine what qualifies for us regardless of the type of loan. And I think it is very important to be used. However, again, what is being taken out of my hands is my personal knowledge of the person who is sitting in front of me applying for that mortgage loan.

Mr. STUTZMAN. What threshold might be too dangerous for you?

Mr. WEICKENAND. I can't really even go there, because there are always outliers to every circumstance. You want to give people an opportunity to succeed. The idea of us—we are in the lending business, and I am here to try to help people improve their lives. So what may work for somebody may not work for another.

Mr. STUTZMAN. Thank you. Mr. Spencer?

Mr. SPENCER. As borrowers have lower incomes, those ratios actually need to go down to be conservative.

And so, we actually work far below those standards. We try to stay at 30 percent, and so what is critical there is what else—how much absolute dollars is left to live on. So, we try to take a very conservative approach on that measure.

Mr. STUTZMAN. Sure. All right, thank you. Mr. Calhoun, would you like to comment?

Mr. CALHOUN. Yes, if I can add, the original rule did not have DTI. It had very general standards. It was at industry's request that a bright-line standard was put in place, because that is essential to have the certainty needed to get secondary market capital in, and if you didn't have the bright line, lenders were going to be very conservative, because they wouldn't know where the line was.

So I just want to make sure the record is clear. It was industry who asked for brighter-line standards including the MBA and that these are historically very high levels. These are FHA levels and I have not heard a clamor that FHA credit is too restrictive. I hear concerns people think it is too loose.

Mr. STUTZMAN. I would like to ask this very quickly of the bankers.

You said that none of you are going to be offering any non-QM loans. Have you heard of anybody in the industry that is going to be?

Mr. HARTINGS. Most—

Mr. WEICKENAND. Yes. Navy Federal will be.

Mr. STUTZMAN. Navy Federal will be offering non-QM?

Mr. WEICKENAND. Yes.

Mr. EMERSON. I think you will find lenders in the marketplace that will provide non-QM loans to their retail bank clients or folks who are in their high net worth brackets. Yes, those loans will take place.

Mr. HARTINGS. I don't know many other community bankers that will do non-QM loans.

Mr. STUTZMAN. Thank you. I yield back.

Mr. SPENCER. I think certain Habitat affiliates will do non-QM loans.

Mr. STUTZMAN. Okay.

Chairwoman CAPITO. The gentleman's time has expired.

Mr. Green?

Mr. GREEN. Thank you, Madam Chairwoman.

I thank the witnesses for appearing, and I regret that I won't be able to ask questions of all of the witnesses, but I do want to ask Mr. Hartings, you indicated that you have a $400 million institution, is that correct?

Mr. HARTINGS. That is correct.

Mr. GREEN. And how many first-lien loans per year?

Mr. HARTINGS. It does vary from year to year, but in 2012 we did approximately—we did right at 493. In 2013, we probably did closer to 400.

Mr. GREEN. And it is that 493 number that gives you some degree of consternation?

Mr. HARTINGS. Yes, because of the small creditor exemption.

Mr. GREEN. Which has a ceiling of 500?

Mr. HARTINGS. You have two thresholds. Either you are a $2 billion institution, which would be about 5 times as large as I am, or 500 first mortgage originations.

Mr. GREEN. I see. So what you would like to see is the $500 cap lifted. Is that correct?

Mr. HARTINGS. Yes. There are two ways to do that. Either raise the cap or currently it includes secondary market loans, which are already QM-qualified, and if we just looked at portfolio loans. In my last 2 years, approximately 20 to 30 percent of my loans are portfolio loans. The rest go to the secondary market, sold to either Freddie Mac or to the Federal Home Loan Bank.

Mr. GREEN. Thank you.

I am always interested in trying to find a way to help the smaller institutions.

Mr. HARTINGS. Thank you.

Mr. GREEN. Within your association, you indicated you have about 7,000 community banks. Is that right?

Mr. HARTINGS. Our association has approximately 5,000 members, and there are approximately 7,000 community banks around the United States.

Mr. GREEN. But you have about 5,000. How large is the largest in terms of assets?

Mr. HARTINGS. That is really not my expertise to tell you—to know that question. But I could get back with you, if you would like. I could check with our association.

Mr. GREEN. You are not aware of the size of your largest bank?

Mr. HARTINGS. I don't know that off the top of my head, sir, but I could find out for you.

Mr. GREEN. Would it be more or less than $50 billion?

Mr. HARTINGS. Probably less than $50 billion.

Mr. GREEN. More or less than $40 billion?

Mr. HARTINGS. It is $17 billion. I just got the answer for you.

[laughter]

Mr. GREEN. Okay. Thank you.

Mr. HARTINGS. That is what we like about community banking. It just cuts to the chase.

Mr. GREEN. That is what I like about persistence. It is amazing how these things happen.

$17 billion—can any size bank become an associate?

Mr. HARTINGS. Again, you are asking me something about which I don't know all the details. You certainly have to be a community bank.

Mr. GREEN. This is what I am getting to, is the term "community bank." We use it a lot, and I think that when I hear it, I may hear one thing. And when a colleague hears it, that colleague may hear an entirely different thing. So, just for assets alone—there may be other aspects of this—what is a community bank with reference to assets—the size?

Mr. HARTINGS. I think to answer that, it is a little bit like trying to answer what is a qualified mortgage. There are extenuating circumstances, so I don't know that I could answer it on assets—

Mr. GREEN. I understand. If I may just, because my time is limited, the reason I am asking is because we continually hear talk about community banks and we have had testimony connoting that a community bank can be as much as $30 billion to $50 billion. And when I want to help community banks, I am trying to get a sense of the size bank that I am talking about such that I can help you.

Mr. HARTINGS. I can tell you that our average member is approximately $250 million. Again, our largest member is $17 billion, but I don't have all the numbers in between there for you, sir.

Mr. GREEN. All right. Let me quickly move to Mr. Calhoun.

Mr. Calhoun, do you have some help that you can give me with reference to the size of a community bank?

Mr. CALHOUN. I think it is fair to say that over 90 percent of them are below your $2 billion threshold in the CFPB rule, and so would be covered by the existing small lender provision.

Mr. GREEN. So, $2 billion is your threshold?

Mr. CALHOUN. I don't think there is a precise definition, but that is the distribution the vast bulk of so-called community banks are below that. As you know, Dodd-Frank set the $10 billion—

Mr. GREEN. I understand. I have 9 seconds. Yes or no? Above $30 billion, is that a community bank?

Mr. CALHOUN. I don't consider that a community bank.

Mr. GREEN. If you consider more than $30 billion or a $30 billion level a community bank, raise your hand. Anyone?

Okay. I yield back. Thank you.

Chairwoman CAPITO. The gentleman yields back.

Mr. Rothfus?

Mr. ROTHFUS. Thank you, Madam Chairwoman.

Following up on your opening statement, Madam Chairwoman, with reference to the roundtable we had in Pittsburgh, I would like to ask unanimous consent to put into the record statements from participants in that roundtable.

Chairwoman CAPITO. Without objection, it is so ordered.

Mr. ROTHFUS. These individuals all expressed concern. This was November 12th we had the roundtable in Pittsburgh. They all expressed concern that as currently written, the QM rule will cause

harm to the housing market and make it much more difficult for working families in western Pennsylvania and around the Nation to buy homes.

Congressman Westmoreland had asked some questions about who was going to be impacted. But my question, and I am going to ask this to Mr. Hartings, is if you don't offer nonqualified mortgages, where might these working families turn for mortgage credit?

Mr. HARTINGS. Certainly to competition that may not be residents in our areas, that may not know our area as well. Certainly, probably a higher price cost of that mortgage could be the result of that. I can't tell you. I don't know exactly who that will be, but it will surely shrink their opportunities. And these are people who need all the opportunities to get themselves qualified.

Mr. ROTHFUS. Mr. Weickenand, do you have an opinion on where these individuals might turn for mortgage credit?

Mr. WEICKENAND. No. I am sure some entrepreneurial type of individuals who will charge a premium on these things in a lot of ways will go into that market just trying to make money.

Mr. ROTHFUS. In a speech on October 29, 2013, Senator Elizabeth Warren said that, "The potential liability associated with writing non-QM loans is relatively small. And in good times, lenders can compensate for those possible losses with higher rates or fees." She added that, "We need to consider strengthening or supplementing the QM rule so that it provides an adequate check on overly risky lending, even during housing booms."

I am going to ask Mr. Emerson this question. Do you agree with Senator Warren's assessment that the potential liability is relatively small?

Mr. EMERSON. No, we don't agree that the potential liability is small, unfortunately. We are going into new territory and I think ultimately time will tell what that is going to look like. But from a quantification perspective, in trying to understand the litigation risk associated with that, there is a distinct possibility that if you take that process all the way through, that the amount of costs associated with that loan is going to be greater than the principal balance of the loan that you lent.

Mr. ROTHFUS. There has been some press lately about the shrinking number of financial institutions. The Wall Street Journal had an article in the last month which mentioned, I think, that we are now under 7,000.

Mr. Hartings, in your testimony, you stated that community banks like yours simply do not have the legal resources to manage the risks that accompany nonqualified mortgages. How many QM-related lawsuits could a small community bank or credit union withstand before it is put out of business?

Mr. HARTINGS. It could be one. As a community banker, most of our directors are local businessmen and farmers, agricultural individuals who live in our area. The one thing they want is they want to serve the community, but they don't want a fear of litigation. So that fear of litigation to our reputation, one may be enough. That is a hard number to answer at this point in time.

Mr. ROTHFUS. Mr. Weickenand, do you have an opinion on how many QM-related lawsuits a typical credit union could handle before it would be put out of business?

Mr. WEICKENAND. I will give you an example of where we were part of a class action lawsuit on something we didn't do. It was a process and a payments, share drafts and things of that nature. We were accused of manipulating it to drive up fees. We didn't do that. It cost us between $50,000 and $100,000 to prove we were innocent.

And so, that is just a case where we actually were allowed to get out of a case. I can't imagine if we did a nonqualified mortgage and they had something to hold us to. That would be a very dangerous situation.

Mr. ROTHFUS. Mr. Spencer, you mentioned that you had engaged a consultant to walk through some of the qualified mortgage rules. I think her name was Jill, and you talked about 1,000 hours that she had done to date.

Mr. SPENCER. She is actually on staff.

Mr. ROTHFUS. She is on staff. Can you quantify in dollars what it is costing your organization to comply with this rule?

Mr. SPENCER. We estimate that we have invested both human and financial resources of $40,000 to $50,000 over the last 12 months. And to put that in perspective for our operation, we could let you sponsor a house for $70,000. So, that is one house we didn't build.

Mr. ROTHFUS. Thank you.

I yield back.

Chairwoman CAPITO. The gentleman's time has expired.

Mr. Murphy?

Mr. MURPHY. Thank you, Madam Chairwoman.

And thank you all for being here. Thanks for your time.

Mr. Spencer, I just first want to thank you for everything that you do and everything that your organization does for your community and really all of our communities.

I also want to take a second just to thank Mrs. Capito and Ms. Waters and Mr. Meadows for working together on a bipartisan bill to improve the legislation so you can continue to do what you do.

Obviously, no legislation out of this place is perfect, so we have a lot of work to do to improve it. And we will continue trying to do that.

I wanted you to just take a second to explain to everybody what makes organizations like yourself, Habitat, different from others, so provisions like DTI and servicing limits are not needed to protect consumers.

Mr. SPENCER. We were created, Habitat came into being with the mission of eliminating poverty housing worldwide. It was bold.

What we do in our individual communities is work with families. We provide financial counseling. We can't cover costs out of fees because we don't charge them. We can't cover expenses out of interest because we don't charge that either.

And so, what we do is we work with our local communities to assemble resources so that we can provide these deserving families with non-interest-bearing mortgages.

Because we believe strongly that these families need a hand up, not a handout, we don't give away houses. And so, we work very closely to make sure that our families have both the support and the capacity to repay the mortgages. And overwhelmingly, they do. We just don't want to be caught up inadvertently in a bill that was not aimed at this kind of housing ministry to begin with.

Mr. MURPHY. Okay, great. Thank you for that.

Mr. Hartings, Mr. Emerson, and Mr. Weickenand, the three of you, it sounds like the CFPB amendments are continuing to improve QM and it sounds like you all are happy with it.

But my question is timing. With some of the new clarifications as late as last fall, does that timing put you—do you feel like you need an extension to ensure that you get it right, or do you think that would just put you at a disadvantage?

Mr. HARTINGS. We are a small shop. I have 68 full-time equivalent employees, and I have 7 offices that we have to manage. We have kind of all hands on deck today from our mortgage lenders, our commercial lenders all trying to figure out everything we need to do with the new mortgage regulations.

More time would be very helpful, because we also have to see how our software vendors—although they may put in fixes, we want to make sure how that integrates into—we have multiple software vendors that certainly have to integrate into each other.

So all of those take a lot of time. And the massive amount of changes with this legislation has really put us—it is difficult doing anything else except trying to comply with QM and the mortgage regulations along with it.

Mr. MURPHY. Do you think that holds true for basically all community bankers?

Mr. HARTINGS. Yes, I believe it does.

Mr. MURPHY. Thank you.

Mr. WEICKENAND. I would agree.

With the confusion that is out there, trying to communicate and educate your employees on the changes and then trying to communicate to the members who come in the door, can lead to a lot of disruption and confusion.

Mr. MURPHY. Thank you.

Mr. EMERSON. The amendments are out, the rule is out there, so from that perspective, there is not much we can do from a time.

Obviously, there is a lot of work that goes into the technology build and everything associated with getting the systems right, not only internally but you are relying—a lot of lenders are relying on third-party vendors to make sure that they have it correct.

So I think the industry has done its level best to get to a place where they are trying to comply with the rule, with the QM rule.

We appreciate Director Cordray's statement that there is going to be some grace period, not—it is kind of not defined—of making sure that you are giving a good faith effort to comply and get it in there.

But I think in hindsight, time, certainly a little bit more time would have been helpful.

Mr. MURPHY. Thank you.

Last question for Mr. Calhoun: If a lender originates a loan and is willing to keep it on the portfolio, from a policy standpoint, why

is it not safe to assume that lender has already determined the ability to repay?

Mr. CALHOUN. So, the challenge is, we have a long history on this, that a lot of the past and even present subprime lenders were portfolio lenders, and they won one of two ways. If the loan paid, they collect the high fees and interest.

And these loans, 90 percent of subprime loans, were refinancing, not first-time home loans. So they would target people who had equity in the home that would cover the losses if they had to foreclose. And that is one of the challenges.

I think it raises the point—and let me be clear, we support the need for the clarity and the broader standards, a lot of which have been talked about today.

But, for example, FHA is in its problems today with finances in large part because a nonprofit housing program, seller-assisted downpayments, was operated through nonprofits and produced over $15 billion of losses at 3 to 4 times the rate of their normal rate of business.

So, we do need to draw these lines carefully. And I think the CFPB, with guidance from this committee, and the House and Congress can get us there.

Mr. MURPHY. Thank you.

Chairwoman CAPITO. The gentleman's time has expired.

Mr. CALHOUN. It does need to be done with a lot of care.

Chairwoman CAPITO. Mr. Barr?

Mr. BARR. I thank the chairwoman for the recognition and for holding this important hearing.

And I thank the witnesses for their testimony.

I think few would disagree that some kind of ability-to-repay analysis should obviously be part of the mortgage underwriting process.

But what I am hearing from most of the witnesses here today is that the QM rule is really a government, one-size-fits-all solution that deprives mortgage lenders of the flexibility to make individualized judgments about the creditworthiness of a particular borrower, and that it, at the same time, deprives creditworthy borrowers from a range of products that might not fit within the CFPB's bureaucratic credit box.

And so, my question—my first question would be directed to Mr. Hartings. And I appreciate your advocacy of a potential solution to provide additional flexibility, specifically a bill that I introduced, the Portfolio Lending and Mortgage Access Act.

And it kind of dovetails onto the comment from Mr. Calhoun that he didn't think that portfolio lending would really remedy the problem of what caused the financial crisis.

But it seems to me that one of the principal causes of the financial crisis was government policy that encouraged an originate-to-distribute model and that if you had an incentive through an amendment to the QM rule that would encourage lenders like community banks to retain the risk on their portfolio, that you would actually prevent some of the problems that caused the financial crisis, and at the same time provide that flexibility for creditworthy borrowers who, again, wouldn't necessarily fit into that bureaucratic credit box that is created by the CFPB.

So, if you could, Mr. Hartings, please elaborate on your support for this particular solution and maybe respond to Mr. Calhoun's objections.

Mr. HARTINGS. I can talk about my own experience. We went through the mortgage meltdown and we didn't have a lot of issues because we couldn't put our customers in a product, and I talked about adjustable rate mortgages before, that was going to put them in a subprime situation, actually create a foreclosure.

And when you have it on your books, you have 100 percent of the risk.

I look at it that I have always made qualified mortgages because everyone who comes into my institution, I try to qualify them.

There are certainly always outliers. And I can't prevent those.

But let's look at making the regulation; let's look at our regulators. We do have prudential regulators. We have—in my case, I have the FDIC and the State of Ohio.

If they find that I am doing something incorrectly, UDAP, is a great example, unfair and deceptive practices, can pull that in to take a look at those institutions.

So I think we have to look at those regulators to be able to be able to control that situation maybe going forward, versus trying to regulate it. Because when you try to regulate it, if I was to write a QM rule today, it would exclude people. I couldn't write it without excluding people.

And so, unless you tier that regulation and say portfolio lenders, we are going to give you a tier to allow you to make those and take those responsibilities, I think it is a great solution.

Mr. BARR. One other piece of legislation I have introduced that I would love the panel to comment on is H.R. 2672, the CFPB Rural Designation and Petition Correction Act.

And one of the concerns I have with the QM rule as currently constructed is the impact it will have, particularly in rural communities. And, as you may know, in rural communities, access to balloon loans, for example, can be particularly important in the agricultural context and other places.

These loans are going to away if they continue to be designated as non-QM, so what we want to make sure is that the CFPB's designation of "rural" is accurate. This is a very simple piece of legislation, bipartisan, that would allow a community to petition the CFPB for a correction to be designated as rural if it truly is a rural community so that those mortgage lenders could originate balloon loans and fit within the QM safe harbor.

My understanding is that Senator McConnell has introduced companion legislation in the Senate today, and I am appreciative of that.

Could you all comment on that as a potential solution as well in terms of modifying the QM and providing responsible mortgage credit?

Mr. HARTINGS. I know, our association, ICBA, does support your bill. I think any time you try to be that prescriptive on what a rural area is, it is difficult in the United States. So I like the idea of being able to petition to get into rural.

Mr. EMERSON. From the MBA's perspective, we haven't studied the rule yet. We are going to look at it, and we will get back to you and let you know what we think.

Mr. BARR. My time has expired. I yield back. Thank you very much.

Chairwoman CAPITO. Mr. Heck?

Mr. HECK. Thank you, Madam Chairwoman.

And I would like to add my expression of gratitude to each of you for spending your considerable amount of time here today.

I would like clarification on a couple of points or some provocative responses to questions beginning with Mr. Calhoun's assertion that there is a documented history, actually, of banks and credit unions making loans to people held in portfolio that did not go well.

Mr. Calhoun, I do want to amend one thing you said when you laid it off to nonprofits. Actually, the bulk of the red ink at FHA is attributable to reverse mortgage defaults, a problem that has been fixed thanks to Congress and the President's signature in August, in large part.

But, this question fascinates me. And let me preface this by saying, I think it is beyond the pale for us to assert that every hair on the head of every proposed rule is inherently virtuous and perfect. I don't think that is ever the case. And it is certainly not the case here.

But, having said that, there is a clear and fundamental difference of opinion between, perhaps, Mr. Hartings and Mr. Calhoun on this issue of mortgages held in portfolio.

Mr. Hartings, you asserted that we bear 100 percent of the risk. But frankly and with all due respect, that seems prima facie not to be true if there is substantial equity in a refinanced instrument, or if you are making this loan into a rapidly rising market and your fees and interest rates are sufficient that even in the eventual unfortunate headache circumstance of a foreclosure, your opportunity to re-coup is virtually assured.

So, while I have sympathy for this issue, any time you draw a fine, bright line in reduced flexibility, you are going to exclude somebody who otherwise, on the basis of merits, might be warranted an opportunity.

But sir, how do you counter the factual statement that you are not bearing 100 percent of the risk given market conditions and context?

Mr. HARTINGS. I am a lender. I have my lender certificate. As a bank president, I have to make that decision if we are going to foreclose. And I also have to work through the courts and the customer on those. And I can tell you, that is absolutely the last thing I want to do in any situation.

Mr. HECK. Excuse me. I take you at your word. And I believe you.

Then why did it happen so often?

Mr. HARTINGS. I think sometimes if you look at the types of products, they don't pass the smell test.

If it is an adjustable rate mortgage—again Congressman Meeks talked about the predatory lending in some of those situations. Interest-only loans can have a tendency to get a customer in trouble, because they are not paying back any equity. So, I don't know.

There are always going to be those players. But, I look at the same situation of if you look at the mortgage crisis, it was really everybody figured out how to game the system—or, I shouldn't say everybody, but the folks who got us in trouble—got them in trouble figured out that there is this no-doc loan out there. I know how to do that system.

So when you make hard and fast rules and you think that is going to fix something, what it ends up doing is just the outliers figure out how to game the system again. So, that is what concerns me is, I can see that if I hold it on portfolio I know how I would look at these loans. I know the risk I take. And I know how I look at my customers accordingly.

I don't design products that are going to put them in trouble. Do they get in trouble from time to time? Absolutely. That happens everywhere in the economy. But, I can't answer the outliers because I am not one of those.

Mr. HECK. So as one of the newbies here, let me just lay off some of my frustration on the panel.

I am frankly a little tired of finger pointing. It is all government which evidently has become a two syllable word. It is all on my side, predatory lenders or it is all borrowers made stupid decisions that they knew better than to make.

The truth of the matter, as we all know, is that there is plenty of culpability to spread around.

And I can either walk away from this kind of frustrated that we have amplified beyond measure the differences of opinion about how we might fix this proposed rule when in the wider scheme of the thing, we really are fixing a problem that was very, very material to our Nation's economy, and our family's well-being. And maybe I can walk away celebrating a little bit that the differences between us in the broader context, frankly, really aren't that big, so let's get to work and make it work.

Thank you, Madam Chairwoman. I yield back the rest of my time.

Chairwoman CAPITO. Mr. Kildee?

Mr. KILDEE. Thank you, Madam Chairwoman, for allowing me to participate in this hearing as a non-member of the subcommittee. I have a particular interest in this subject so I have found it to be as helpful as I expected it would be. So, I certainly appreciate your willingness to allow me to join.

And, in respect for time, I just have two subjects that I would like to quickly get some responses on. Many of the questions that I had planned to ask have been asked and I think answered quite adequately.

Before I do that, though, I want to make a comment on Mr. Emerson and his company. And while I don't represent Detroit, I represent Flint, which is—my district starts about 35 miles north of Detroit. I had a very good conversation with Mr. Gilbert last week. And I just want to say that while I suspect we agree on a lot of policy issues, even though we might not agree on all of them, I will say that Quicken, from the standpoint of corporate citizenship, is demonstrating what a company can do to not only do well in terms of your business plan and your business model and be a productive and profitable company, but to make sure that in doing

so, some of that profitability is actually shared in rebuilding the community that is the host to your company.

And I know that other folks here in this room appreciate that as well. But as a person involved in urban policy for a long, long time, I just want to say that to you and convey to your company and to other members of your company that appreciation.

Thank you.

Mr. EMERSON. Thank you. We appreciate it.

Mr. KILDEE. I wonder if perhaps Mr. Spencer—to be quick about this—could comment on some of the compensating factors that might actually open up home ownership, and lending possibilities, access to credit, particularly from the perspective of Habitat.

Can you just tell me about the experience with your clients, your customers, and what you do to prepare those individuals who otherwise might not succeed?

Setting aside the role of Habitat as a developer, but in preparing folks to be able to become homeowners through—particularly through home ownership counseling and how that has affected the success rate of your clients.

Mr. SPENCER. Absolutely. Every Habitat homeowner goes through financial training—and actually more than just financial. If you have never grown up living in a home, there are things you don't know about changing filters and fuse boxes, and we train everything from financial literacy through being a good neighbor and how to resolve disputes with your neighbor. So, we work on all of that.

And then, we stay involved with the families. The result is that our overall foreclosure rate, although it does happen, is extremely low. I think it would be a number that most of our for-profit brethren might envy. So we run below—depending on the affiliate—2 percent to 4 percent is about our failure rate, and so we try to avoid it. We are very successful at it. And overwhelmingly, more families have paid their loans in full by an order of magnitude than have ever been foreclosed on.

Mr. KILDEE. Thank you for that. And thank you for being a very qualified set-up man for the follow-up question, and that is—and I would certainly invite Mr. Calhoun to comment, as well, but particularly for the three lenders—what do you think can be learned from the experience of Habitat, particularly if, as a compensating factor, we were able to somehow integrate housing counseling into the homeownership process generally?

Given that experience, I don't think there is anything particular about your clients that is distinguishable from many other folks who go directly through a traditional lending experience. Do you think that there is value in thinking about counseling as an integrated part of the mortgage origination closing servicing process? If you could, any of the three of you?

Mr. WEICKENAND. Certainly, we do that already. But I think the example that Habitat shows is that giving people an opportunity, through your judgment and your processes, is not a bad thing, meaning that you are giving people an opportunity, to whom you normally would not give an opportunity, for homeownership and things of that nature.

Mr. CALHOUN. If I may add, we have proposed and supported that counseling could be one of those compensating factors to provide more room there. And I would say, just in general, one of the problems here is we are not writing the rule for the groups that you see here at this table today. These are the responsible lenders. The challenge is, how do you write a rule that protects both home borrowers and these responsible lenders from folks who drove the market in an unsustainable way, that caused our country so much harm?

Mr. KILDEE. I think my time has expired. I will follow up. I thank you for your indulgence in allowing me to participate.

Chairwoman CAPITO. Thank you. Mr. Lynch?

Mr. LYNCH. Thank you, Madam Chairwoman.

I do want to thank all of the panel members for your help today. I felt badly about coming back here and asking more questions, because I think you have probably suffered enough.

But I want to say that one of the—to your credit, for community banks and credit unions, and, God knows, Habitat for Humanity, the reason that your programs, especially with the credit unions and the community banks, outperformed the big banks during the crisis is because you know your customer. You know the people to whom you are lending. And so, you have the ability to look beyond even these criteria that are being laid out in the QM rule. You can look at someone—and I was there, when I bought my first house, I am sure that I was on the margins. As an ironworker, I probably didn't have the credit history that is being required here today in this rule, but thank God my banker knew I was a hard worker and so gave me a mortgage.

Our difficulty here is trying to craft a rule that fits everyone. And so the way this works, the way it is set up to work by the CFPB is that small banks will still be able to make that loan that is on the margins. You will still be able to make that loan, even though it will be a non-QM loan. And to be honest with you, it makes you, the people who are best able to judge that risk, liable, if you are going to hold it in portfolio.

The challenge for us is if we lower the bar in the rule, it will allow every bank to allow every customer who might have insufficient assets or insufficient income to get that loan. And we saw the consequences of that in the last housing crisis. So, that is the difficulty we have.

But one thing I keep coming back to is this threat of liability. And, when I look at the ability-to-repay standards here, it requires you to look at if a person is currently or reasonably expected to earn certain income or have certain assets. It requires you to look at their current employment status, the monthly payment on the covered transaction. It requires you to look at the monthly payment on any simultaneous loan, the monthly payment for mortgage-related obligations, current debt obligations, and alimony, and child support. Those are all factors that I think should be considered when you are going to give someone a loan, rather than just someone's credit history.

So I don't think that the requirements and the ability-to-repay rule is really unreasonable. And what I am hoping is that there are some instances that you have brought up where folks—we might

need to tweak the rule a little bit. But we are in a much better situation if you are making that decision on whether or not a person qualifies for a mortgage where you have the best information, and I don't see a lot of lawsuits coming from people if you do that due diligence. I don't get the threat of liability that comes with this rule. I don't. I don't see it. I don't think lawyers are lining up.

If you go through even a modicum of scrutiny to make sure a person has the ability to repay, I don't think you are going to have a long line of lawsuits. I don't see the litigation risk here that I think is being overstated in every single case.

Mr. Calhoun, I would like to have your thoughts on that.

Mr. CALHOUN. We have worked through 15 to 20 State laws where this was a major concern. And a lot of those, including North Carolina, have a lot more legal liability and a lot more signee liability than these do. Countrywide Mortgage initially said they wouldn't make any loans in North Carolina because of the North Carolina law. We only wish they did stay in the State through its harm.

But people found there have not been lawsuits, and this is tailored to make it extraordinarily difficult to bring a class-action lawsuit. And so that by itself is a major reduction.

But the rating agencies have been looking at this and coming to similar conclusions, that there is liability there, but practically these are not cases that lawyers can make money on, and that is what lawyers look for—

Mr. LYNCH. Exactly.

Mr. CALHOUN. —in whether they decide whether to take a case. It is a borrower in default who just wants to try and stay in their home. It is hard for—there is no big contingent fee for the lawyer in these cases.

Mr. LYNCH. Thank you.

Madam Chairwoman, I yield back.

Chairwoman CAPITO. The gentleman's time has expired.

And I would like to thank the witnesses. I think we have covered a lot of ground. We have a lot of common area. We have a lot of questions. And like I said, this sort of sets the bar. As we move forward, we will have another hearing—or at least more information as we move through this to see where we actually are. But I appreciate everyone's patience and your information.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

And without objection, this hearing is adjourned.

[Whereupon, at 12:48 p.m., the hearing was adjourned.]

A P P E N D I X

January 14, 2014

Testimony of Michael D. Calhoun
President, Center for Responsible Lending

Before the House Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

January 14, 2014

Good Morning Chairman Capito, Ranking Member Meeks, and Members of the Subcommittee. Thank you for inviting me to testify at today's hearing to discuss the mortgage reforms implemented by the Consumer Financial Protection Bureau that went into effect last week. These reforms will benefit borrowers by preventing future lending abuses, promoting stability in the mortgage market, and protecting access to credit.

I am President of the Center for Responsible Lending (CRL), a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, a nonprofit community development financial institution. For thirty years, Self-Help has focused on creating asset-building opportunities for low-income, rural, women-headed, and minority families, primarily through financing safe, affordable home loans and small business loans. In total, Self-Help has provided $6 billion in financing to 70,000 homebuyers, small businesses and nonprofit organizations and serves more than 80,000 mostly low-income families through 30 retail credit union branches in North Carolina, California, and Chicago.

New rules of the road are now in place for borrowers. In 2013, the Consumer Financial Protection Bureau (CFPB) released mortgage rules that address one of the core causes of the financial crisis: abusive lending practices where many lenders made high-risk, often deceptively packaged home loans without assessing if borrowers could repay them. These abuses stripped wealth from families and resulted in high foreclosure levels. The new rules – required by the Dodd-Frank Act of 2010 – went into effect on January 10, 2014.

Because of these reforms, lenders must now assess a mortgage borrower's ability to repay a loan. The rules also define a new category of loan called Qualified Mortgages, which are restricted from having negative amortization, interest-only payments, high fees or other harmful features. The CFPB's broad definition of what counts as a Qualified Mortgage will extend safe mortgages to families who in the past were too often steered into mortgages designed to fail. At the same time, the CFPB's rule provides lenders with

significant legal protection when they originate Qualified Mortgages, although they are not required to do so.

The CFPB's rules strike the right balance of providing borrower protections while also ensuring access to credit. Mark Zandi of Moody's Analytics estimates that the CFPB's Qualified Mortgage rule covers 95% of current originations.[1] This broad definition is key for borrowers, including borrowers of color who represent 70% of the net household growth through 2023.[2] The broad definition means that borrowers will not be boxed out of getting a home loan and will also benefit from the protections that come with a Qualified Mortgage.

Additionally, concerning non-QM lending, recent press articles have reported several lenders announcing that they will originate mortgages that do not meet Qualified Mortgage status.[3] I anticipate that these announcements will only grow over time.

The CFPB went through an extensive rulemaking process and actively sought feedback from lenders, realtors, other industry players, and consumer advocates and civil rights groups. No one side got everything they wanted in this rulemaking. But, I would agree with David Stevens, head of the Mortgage Bankers Association, who said "If you look at the overall final rule, we think the CFPB got a lot right."

In assessing the CFPB's Qualified Mortgage definition, my testimony will highlight the same "scorecard" of issues that CRL first highlighted in front of this subcommittee in July 2012 before the CFPB issued its final rules:

- **Qualified Mortgage definition is broadly defined:** The CFPB's rules adopt the widespread view – including from CRL – that Qualified Mortgages should be broadly defined to encompass the vast majority of the current mortgage market. As mentioned above, Mark Zandi of Moody's Analytics estimates that 95% of current originations will meet QM status. This broad coverage results from the CFPB establishing four different pathways for a mortgage to gain QM status. The first pathway uses a 43% back-end debt-to-income ratio. A second pathway is

[1] Prepared Remarks of Richard Cordray, Director of the Consumer Financial Protection Bureau, Mortgage Bankers Association Annual Convention, Washington, DC, October 28, 2013 (available at http://www.consumerfinance.gov/newsroom/director-cordray-remarks-at-the-mortgage-bankers-association-annual-convention/).
[2] Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing 2013*, at 3 (2013) (available at http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/son2013.pdf).
[3] *See* Erin Carlyle, *New Mortgage Rules Mean Paperwork for Borrowers, Not a Shutdown on Lending*, Forbes (January 10, 2014); Dakin Campbell and John Gittelson, *Wells Fargo Creates SWAT Team to Keep Loans In-House: Mortgages*, Bloomberg (January 8, 2013); Kate Berry, *Major Banks to Continue Making Interest-Only, Non-QM Loans*, American Banker (January 7, 2014).

based on eligibility for purchase by Fannie Mae and Freddie Mac. Another pathway is specifically crafted for small creditors holding loans in portfolio. Lastly, there is a pathway for balloon loans as well. This multi-faceted approach will maintain access to affordable credit for borrowers.

- **The CFPB used clear, bright lines in the Qualified Mortgage definition:** In addition, the CFPB used specific standards to define which mortgages will be eligible to obtain QM status. The CFPB's first prong for a Qualified Mortgage definition uses a back-end debt-to-income ratio cut-off of 43 percent, and another definition depends on whether the loan is eligible for purchase by Fannie Mae or Freddie Mac. This specificity will enable both lenders and borrowers to know upfront when a mortgage is originated whether it has QM status.

- **Qualified Mortgage definition protects borrowers with the riskiest loans:** On the issue of whether lenders should receive a safe harbor or a rebuttable presumption of compliance when originating a QM loan, the CFPB created a two-tier system. The vast majority of loans will have a safe harbor and others will have a rebuttable presumption. The threshold between the two depends on the loan's annual percentage rate (APR) relative to the average prime offer rate (APOR). Ideally, as consumer groups supported, the new rules would have allowed any borrower with a QM loan to challenge a lender who failed to evaluate if the borrower could afford the loan. However, the CFPB's rules do allow borrowers to hold lenders accountable on the riskiest types of mortgages, those in the subprime market where the problems that led to the housing crisis were concentrated.

As a whole, these rules continue the CFPB's approach of expanding access to credit while ensuring that loans are sustainable for the borrower, the lender and the overall economy.

I. Harmful Mortgage Features and Lending Practices Were Prevalent in the Pre-Crisis Mortgage Lending Market and Led to Massive Foreclosures.

In the fallout of the foreclosure crisis, the alphabet soup of harmful lending products and practices – such as YSPs, IOs and NINJA loans – is now well known. Many of these features and practices were at one time touted as innovations to serve borrowers. As the foreclosure crisis has made plain, such rhetoric has failed to match reality.

For more than ten years, CRL has produced research highlighting the increased foreclosure risk posed by abusive lending practices. In 2006, which pre-dated the worst of the foreclosure crisis, CRL released a report estimating that abusive and predatory lending would lead to approximately 2.2 million foreclosures among subprime mortgages.[4] At the time, our report was denounced by the mortgage industry as absurdly pessimistic. As we all now know, the system was loaded with much more risk than even CRL originally projected.

CRL released a follow-up report entitled *Lost Ground* in 2011 that builds on our pre-crisis research and confirms the link between risky mortgage features and foreclosure rates. For mortgages originated between 2004 and 2008, this research shows that loans originated by a mortgage broker, containing hybrid or option ARMs, having prepayment penalties, and featuring high interest rates (i.e., subprime loans) were all significantly more likely to be seriously delinquent or foreclosed upon than a 30-year fixed-rate mortgage without a prepayment penalty.[5]

CRL's research also demonstrates that African-American and Latino borrowers were much more likely to receive mortgages with these risky features. For example, African-American and Latino borrowers with FICO scores above 660 were **three times** as likely to have a higher interest rate mortgage than white borrowers in the same credit range.[6] Although the majority of foreclosures have affected white borrowers, *Lost Ground* confirms that African-American and Latino borrowers have faced a disproportionate number of foreclosures and delinquencies than white borrowers within every income range.

The foreclosure crisis could have been prevented, but it wasn't, and it bears revisiting the kind of harmful lending practices that fueled the crisis still affecting communities across the country.

- **2/28s and other ARMs:** Adjustable rate mortgages (ARMs) – including "2/28s" where starter rates reset after the first two years – were widespread in the years leading up to the foreclosure crisis. These 2/28s and other ARMs led to payment shocks for many households who were unprepared for higher

[4] *See* Ellen Schloemer, Wei Li, Keith Ernst, and Kathleen Keest, *Losing Ground: Foreclosures in the Subprime Market and Their Costs to Homeowners*, (December 2006), available at http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosure-paper-report-2-17.pdf.
[5] *See* Debbie Gruenstein Bocian, Wei Li, Roberto Quercia, *Lost Ground, 2011: Disparities in Mortgage Lending and Foreclosures*, (November 2011), available at http://www.responsiblelending.org/mortgage-lending/research-analysis/Lost-Ground-2011.pdf.
[6] *Id.*

monthly payments once the interest rates increased. As of 2009, subprime mortgages with short-term hybrid ARMs had serious delinquency rates of 48 percent compared to 21 percent for subprime fixed-rate mortgages and 36 percent for the total universe of active subprime mortgages.[7] In fact, were it not for the Federal Reserve lowering interest rates to historically low levels following the financial crisis, it's easy to imagine the payment shock from expiring teaser rates leading to an even higher number of foreclosures than has occurred so far.

A related product called interest-only (IO) ARMs let borrowers make interest only payments during an introductory period, which jeopardized any ability to build equity as well as leading to payment shock for borrowers once the loan started amortizing over a reduced loan life. Payment option ARMs (POARMs) allowed borrowers to make monthly payments where the amount paid could vary from month-to-month, including payment amounts that did not cover the full interest due. This resulted in negative amortization. Too many lenders structured these loans so that the payments would substantially increase in five years or less when borrowers hit their negative amortization cap, underwrote the loans only to the very low introductory teaser rate, and failed to document income.

The QM and Ability to Repay rules substantially reduce this risk by requiring underwriting to the maximum payment during the first five years of a loan for QM loans and to the fully indexed rate for all loans.

- **Prepayment penalties:** Many borrowers facing payment shock from increased interest rates once an introductory period ended also faced penalties when trying to exit into a new mortgage or to sell the property to avoid these built-in increases. These prepayment penalties are a feature associated with a higher likelihood of default[8] and were present in the great majority of subprime mortgages, and increasingly in Alt-A mortgages (which generally consisted of limited documentation mortgages to higher credit score borrowers), during the

[7] *See* GAO Nonprime Mortgages: Analysis of Loan Performance, Factors Associated with Defaults, and Data Sources, at 12-13 (August 2010) (available at http://www.gao.gov/assets/310/308845.pdf).
[8] *See, e.g.*, Lei Ding, Roberto G. Quercia, Wei Li, Janneke Ratcliffe, *Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Score Models*, at 49 (Working Paper: May 17, 2010) (stating "[w]e also found that subprime loans with adjustable rates have a significantly higher default rate than comparable CAP loans. And when the adjustable rate term is combined with the prepayment-penalty feature, the default risk of subprime loans becomes even higher.") (available at http://www.ccc.unc.edu/documents/Risky.Disaggreg.5.17.10.pdf).

mortgage boom.[9] To avoid default, the typical subprime borrower had to sell or refinance before the rate reset. This produced prepayment penalties, generally equal to six months' interest— typically 3.5 percent to 4 percent of the loan balance. Because the average borrower did not have the cash on hand sufficient to cover the prepayment penalties and refinancing fees, they had to pay them from the proceeds of the new loan. This produced ever-declining equity even when home prices were rising. Once home prices declined, foreclosure risk climbed catastrophically.

- **No-doc or low-doc loans:** The practice of failing to document a borrower's income and assets was also prevalent in the subprime and Alt-A market. For example, low-doc loans comprised 52 percent of Alt-A originations in April 2004 and rose to 78 percent at the end of 2006.[10] By 2006, no-doc or low-doc loans made up ***27% of all mortgages.***[11] These loans without proper documentation were frequently underwritten with inflated statements of the borrower's income.[12] Lawyers representing borrowers in predatory lending cases often found the borrower's tax returns included in the file of those who were nevertheless given "no doc" or "low doc" loans. Unbeknownst to these borrowers, they paid higher interests rate for the "privilege" of receiving a no-doc loan, even where they provided full documentation to the broker.

- **Yield Spread Premiums:** The proliferation of mortgages with these harmful features was driven in significant part by the use of yield spread premiums (YSPs) as a way to compensate mortgage brokers. Because YSPs paid mortgage brokers higher payments when a mortgage had a higher interest rate than the borrower qualified for, these YSPs gave mortgage brokers incentives to steer borrowers into loans that were more expensive and less stable than they qualified for. And, by 2006, mortgage brokers accounted for 45 percent of all

[9] *See Report to Congress on the Root Causes of the Foreclosure Crisis*, U.S. Department of Housing and Urban Development, Office of Policy Development and Research, at 23 (January 2010) (citing Demyanyk, Yuliya, and Otto Van Hemert. 2008. Understanding the Subprime Crisis. Working paper. St. Louis, MO: Federal Reserve Bank of St. Louis.) (available at http://www.huduser.org/Publications/PDF/Foreclosure_09.pdf).
[10] Rajdeep Sengupta, *Alt-A: The Forgotten Segment of the Mortgage Market*, Federal Reserve Bank of St. Louis Review, January/February 2010, 92(1), pp. 55-71 at 60 (available at http://research.stlouisfed.org/publications/review/10/01/Sengupta.pdf).
[11] *See* Financial Crisis Inquiry Commission, *Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States*, at 165 (Jan. 2011) [hereinafter FCIC Report], (available at http://fcicstatic.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf).
[12] Over ninety percent of a sample of stated income loans exaggerated income by 5 percent or more and almost 60 percent exaggerated income by over 50 percent. Mortgage Asset Research Institute, Inc, Eighth Periodic Mortgage Fraud Case Report to Mortgage Bankers Association at 12 (April 2006), (available at http://www.mortgagebankers.org/files/News/InternalResource/42175_Final-8thAnnualCaseReporttoMBA.pdf).

mortgage originations and 71 percent of all non-prime mortgage originations.[13] In fact, most borrowers who received subprime loans could have qualified for better, more sustainable loans. Many qualified for lower-cost prime loans;[14] those who did not often would have qualified for sustainable, 30-year fixed-rate subprime loans for at most 50-80 basis points above the introductory rate on the unsustainable "exploding" ARM loans they were given.[15] This 50-80 basis point increase is modest compared with the 350 to 400 basis point prepayment penalty (plus additional refinancing fees) that the borrower had to pay to refinance the typical 2/28 loan before the end of the second year.

- **No Escrows for Taxes and Insurance:** Subprime lenders commonly did not escrow for taxes and insurance, attracting borrowers with the deceptive lure of lower monthly payments. This practice increased the risk of default twice a year when the tax and insurance bills came due and produced further equity-stripping cash-out refinancings where the borrower had the equity to cover the bills and refinancing fees and penalties.

On top of these harmful loan features and lending practices, many lenders also failed to determine whether a borrower had an actual ability to repay their mortgage. Proper underwriting is particularly important for mortgages with resetting interest rates or negative amortization or interest-only payments (or all of the above) to ensure that borrowers can afford the larger monthly payments when they kick in down the road. However, for many mortgage lenders, this straightforward underwriting never happened. For example, at the time when Federal regulators proposed that lenders fully underwrite mortgages with ARMs, interest-only and negative amortization features at the fully indexed rate and payment, Countrywide estimated that 70% of their recent borrowers

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[13] Ren S. Essene & William Apgar, *Understanding Mortgage Market Behavior: Creating Good Mortgage Options for All Americans*, at 8 (Joint Center for Housing Studies, Harvard University Apr. 25, 2007) (citing Mortgage Bankers Association, MBA Research Data Notes: Residential Mortgage Origination Channels (2006) (available at http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/mm07-1_mortgage_market_behavior.pdf).

[14] For example, a Wall Street Journal study found that 61 percent of the subprime loans originated in 2006 that were packaged into securities and sold to investors "went to people with credit scores high enough to often qualify for conventional [i.e., prime] loans with far better terms." *See* Rick Brooks & Ruth Simon, *Subprime Debacle Traps Even Very Credit-Worthy As Housing Boomed, Industry Pushed Loans To a Broader Market*, Wall Street Journal at A1 (Dec 3, 2007). Freddie Mac estimated in 2005 that more than 20 percent of borrowers with subprime loans could have qualified for prime. *See* Mike Hudson & E. Scott Reckard, *More Homeowners With Good Credit Getting Stuck With Higher-Rate Loans*, Los Angeles Times (Oct. 25, 2005), available at http://articles.latimes.com/2005/oct/24/business/fi-subprime24.

[15] January 25, 2007 letter from the Coalition for Fair and Affordable Lending ("CFAL") to Ben S. Bernanke, Sheila C. Bair, John C. Dugan, John M. Reich, JoAnn Johnson, and Neil Milner, at 3. CFAL was an industry group representing subprime lenders.

would be unable to meet this standard.[16] This recklessness set borrowers up for failure and, as a result, caused a foreclosure crisis.

The CFPB's rules implementing the Ability to Repay and Qualified Mortgage reforms put in place a system of incentives that will make it difficult for this kind of risky lending to re-emerge in the mortgage market. These provisions benefit both lenders and borrowers. First, while lenders are not required to originate QM loans, they receive a legal presumption of meeting the separate obligation to reasonably determine that a borrower can afford the offered mortgage. Second, QM loans benefit borrowers, because these mortgages are restricted from having many of the risky product features that fueled the subprime lending crisis. The CFPB's Qualified Mortgage definition is explored in more detail below.

II. Overview of the CFPB's Rulemakings on the Qualified Mortgage Definition.

After an extensive rulemaking process that included the Federal Reserve proposing a rule in 2011 and the CFPB seeking additional notice and comment in 2012, the CFPB released rulemakings finalizing the Qualified Mortgage definition in 2013. The CFPB released its first rulemaking on January 10, 2013.[17] On the same day, the CFPB released a concurrent proposal to obtain additional comment on additional aspects of the definition. These remaining pieces of the definition were finalized in a rulemaking released on May 29, 2013.[18] As part of its implementation process and in response to stakeholder feedback, the CFPB issued additional clarifications to the Qualified Mortgage rulemaking pursuant to the notice and comment process.[19]

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[16] Countrywide Financial Corporation, "3Q 2007 Earnings Supplemental Presentation," Oct. 26, 2007.
[17] Consumer Financial Protection Bureau, Ability to Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 6408 (January 30, 2013) (rule was issued by the CFPB on January 10, 2013 and printed in the Federal Register on January 30, 2013) (hereinafter "January 2013 Final Qualified Mortgage Rule").
[18] Consumer Financial Protection Bureau, Ability to Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 34430 (June 12, 2013) (rule was issued by the CFPB on May 29, 2013 and printed in the Federal Register on June 12, 2013) (hereinafter "May 2013 Final Qualified Mortgage Rule").
[19] Consumer Financial Protection Bureau, Amendments to the 2013 Mortgage Rules Under the Real Estate Settlement Procedures Act (Regulation X) and the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 44686 (July 24, 2013) (rule was issued by the CFPB on July 10, 2013 and printed in the Federal Register on July 24, 2013); Consumer Financial Protection Bureau, Amendments to the 2013 Mortgage Rules Under the Equal Credit Opportunity Act (Regulation B), Real Estate Settlement Procedures Act (Regulation X), and the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 60382 (October 1, 2013) (rule was issued by the CFPB on September 12, 2013 and printed in the Federal Register on October 1, 2013).

Throughout the rulemaking process – including the implementation efforts – the CFPB has sought extensive feedback from various stakeholders and has incorporated that feedback into the final rules. Director Cordray has also explained that the CFPB "will be sensitive to the progress made by those lenders and servicers who have been squarely focused on making good-faith efforts to come into substantial compliance on time."[20]

The rules that went into effect last week will rein in many of the risky product features and lending practices that harmed borrowers during the subprime lending crisis while also prioritizing access to credit in many of the ways sought by lenders.

A. Overview of Qualified Mortgage Definition.

In order to create a rule that meets consumer protection goals while also providing flexibility, the CFPB has established four different pathways for loans to gain QM status. These pathways are addressed below.

Universal Product Feature Requirements

All four of the CFPB's Qualified Mortgage pathways require meeting basic product feature requirements:

- **Must be fully amortizing** (i.e., no interest-only or negatively amortizing loans)
- **Points and fees cannot exceed 3%** of the total loan amount (with adjusted thresholds for smaller loans)
- **Loan terms cannot exceed 30 years**
- **Adjustable-rate loans must be underwritten to the maximum rate** permitted during the first five years

4 Pathways

1. **General Definition:** The general definition requires that borrowers have a back-end debt-to-income ratio of 43% or below. Lenders must collect and verify a borrower's income, assets, debts and other obligations according to standards established in the regulation, which are found in Appendix Q of the regulation, in order to calculate the borrower's debt-to-income ratio. Additionally, loans under this category cannot be balloon loans.

2. **Compensating Factors:** The CFPB created a temporary definition that allows loans eligible for insurance or guarantee by Fannie Mae, Freddie Mac, the Rural Housing Service, and the Veterans Administration to gain Qualified Mortgage

[20] Prepared Remarks of Richard Cordray, Director of the Consumer Financial Protection Bureau, Mortgage Bankers Association Annual Convention, Washington, DC, October 28, 2013.

status. These agency guidelines use underwriting standards called "compensating factors" to approve some borrowers with a debt-to-income ratio above 43%. This temporary definition (available for a maximum of seven years) does not require that the GSEs or government agencies actually insure or guarantee loans under this category – only that loans would be eligible under the specified underwriting requirements for one of the agencies.

In addition, the Federal Housing Administration (FHA) has issued its own Qualified Mortgage definition, which outlines that loans insured by FHA have Qualified Mortgage status. FHA loans also incorporate compensating factors into their approved underwriting standards.

3. **Portfolio Loans Originated by Small Creditors Definition:** This definition is not required in the Dodd-Frank Act, but the CFPB created it using its regulatory authority with the goal of preserving access to credit. Under this definition, lenders need to meet two criteria to count as a small creditor: first, have assets of no more than $2 billion and second, originate no more than 500 first-lien mortgages per year. Additionally, loans must be held in portfolio for at least three years. The lender is "required to consider the consumer's debt-to-income ratio or residual income and to verify the underlying information." However, borrowers do not need to meet the 43% debt-to-income ratio threshold or use the debt-to-income ratio standards in Appendix Q.

4. **Balloon-Loan Definition:** The CFPB also created a Qualified Mortgage definition specific to balloon loans. The CFPB used its regulatory authority to establish a two-year transition period that allows all small creditors – regardless of whether they operate in rural or underserved areas – to obtain QM status for balloon loans that are held in portfolio. After the transition period, the balloon loan definition only applies to those lenders who operate in rural or underserved areas under a definition that the CFPB will continue to study. As in the small creditor definition, the lender must evaluate the borrowers debt-to-income ratio (or residual income), but is not required to adhere to the 43% ratio used in the general definition.

Safe Harbor vs. Rebuttable Presumption

When a loan gains status as a Qualified Mortgage, it carries with it a legal presumption of complying with the Ability to Repay requirements. The CFPB's final rule creates two different kinds of legal presumption: a safe harbor and a rebuttable presumption. Under a safe harbor, a borrower is unable to challenge whether the lender met its ability to repay obligations. Under a rebuttable presumption, the borrower has the ability to raise a legal

challenge but must overcome the legal presumption that the lender complied with this obligation.

Determining which legal category a loan falls into requires comparing the APR with a benchmark called the average prime offer rate (APOR). For loans meeting the CFPB's general and compensating factors definitions, first lien loans receive a safe harbor if the APR is no greater than 1.5% above the APOR benchmark. Loans exceeding 1.5% above APOR receive a rebuttable presumption. For loans meeting the CFPB's small creditor and balloon loan definitions, a safe harbor applies if the APR on a first lien is no greater than 3.5% above APOR.

Under FHA's Qualified Mortgage rule, loans receive a safe harbor if the APR does not exceed 115 basis points plus the on-going FHA mortgage insurance premium for that loan. Loans above this threshold receive a rebuttable presumption.

B. The Qualified Mortgage Points and Fees Threshold Prevents a Return to High Fee Lending While Also Facilitating Lender Compliance.

One borrower protection included across the four Qualified Mortgage definitions is a limit on the amount of points and fees the loan can have. Points are another name for upfront fees paid by the borrower, which encompass a number of items including yield spread premiums, origination fees and discount points. These costs are often expressed as a percentage of the borrower's loan amount where one point is equal to one percent of the loan amount. The points and fees component of the Qualified Mortgage definition ensures that higher fee loans – where lenders and originators would have less of an incentive to determine that a borrower has an ability to repay the loan over time because they receive so much compensation up-front – cannot benefit from the liability protections that come with QM status.

The statutory language in the Dodd-Frank Act states that the points and fees cannot exceed 3% of the loan balance, but there are other provisions in the statute and CFPB's rules that make this threshold larger than just 3% in practice. First, the Qualified Mortgage rules allow lenders to exclude up to two bona fide discount points that reduce the interest rate the borrower pays from the overall points and fees calculation. Second, fees paid by the borrower to independent third-parties are not included in the definition. Both of these exceptions allow for a substantial increase in the amount of fees a borrower can pay and still have the loan considered a QM. Third, the CFPB's rule also accommodates smaller loans by having higher points and fees thresholds for loans under

$100,000. Only loan amounts of $100,000 or more have a points and fees threshold of 3%, and the CFPB set the below thresholds for smaller mortgages:

- **3%:** loan balance is $100,000 and above (i.e., $6,000 for a $200,000 loan)
- **$3,000:** loan balance is greater than or equal to $60,000 and less than $100,000
- **5%:** loan balance is greater than or equal to $20,000 and less than $60,000
- **$1,000:** loan balance is greater than or equal to $12,500 and less than $20,000
- **8%:** loan balance is less than $12,500

Three parts of the points and fees definition – loan originator compensation (including yield spread premiums), settlement services paid to companies affiliated with the lender, and loan level price adjustments – are addressed in greater detail below.

1. Yield spread premiums are included the points and fees definition, but commissions to individual retail and mortgage broker loan officers are excluded.

The CFPB closely considered the issue of how to count loan originator compensation in the definition of points and fees, and the final regulations issued on May 29, 2013 address this issue in detail. In this final rule the CFPB requires including all yield spread premiums (YSPs) in the points and fees definition, plus any upfront payment that borrowers pay directly to lenders and mortgage brokers. YSPs are the payments that lenders make to mortgage brokers, which are indirectly funded by the borrower through an increased interest rate. In addition, the CFPB used its exception authority to exclude all commissions paid to individual mortgage broker and retail loan officers from the points and fees definition.

The inclusion of YSPs in the points and fees definition is a significant reform that will help prevent a return to the kind of abusive lending practices that dominated during the subprime lending boom. Prior to passage of the Dodd-Frank Act, YSPs were not included in the definition of points and fees used to calculate whether a loan counted as a high-cost HOEPA loan. The Dodd-Frank Act amended this definition to include YSPs, and the CFPB's regulations have implemented this reform. This is an appropriate change, because the underlying premise of a YSP is that it allows the borrower to pay a mortgage broker through an increased interest rate as a substitute for compensating the mortgage broker in cash up-front.[21]

[21] *See Nat'l Assoc. of Mortgage Brokers v. Fed. Reserve Bd.*, 773 F.Supp. 2d 151, 158 (D.D.C 2011).

Since YSPs and upfront payments are direct alternatives for one another, these payments must count equally in the points and fees definition. As a result, a loan with 1.75% paid by the borrower to the brokerage upfront will be treated the same as a loan with 1.75% paid by the lender to the brokerage.

If the CFPB had, instead, chosen to fully or partially exclude YSPs from the points and fees definition, this would have created an improper incentive for originators to use YSPs instead of upfront payments paid directly by the borrower. Such a structure would result in less transparent transactions that make it harder for consumers to comparison-shop and, and a result, often result in higher cost transactions.

While other reforms in the Dodd-Frank Act also aim to curb steering abuses, the points and fees limit is an essential reform to prevent a return to high fee lending. Because mortgage brokers are independent businesses (and not employees of the creditor), they can choose which lenders to do business with and can base this decision on who pays the highest YSP compensation. Lenders must compete for broker business, and they compete by bidding up payments to brokers, which inflates broker payments through reverse competition. Some brokers specialize in offering subprime loans that generated the greatest compensation. Prohibitions on loan term-based compensation would not prohibit such a result, as the DC District Court concluded in upholding the Federal Reserve's originator compensation rules.[22] Additionally, anti-steering rules do not require brokers to develop business relationships with lower cost lenders. Counting YSPs in points and fees is a necessary counterweight to this continued ability for brokers to steer borrowers into loans that benefit the brokers more than the borrowers.

The CFPB's May 29th rulemaking also provided that all commissions paid by mortgage brokers or retail lenders to their respective individual employee loan officers are excluded from the points and fees definition. The CFPB interpreted the statutory language as including these payments in the definition of points and fees, but the agency used its rulemaking authority to exclude them. The CFPB had proposed to exempt payments by mortgage broker companies to their employees because of concerns about double counting the compensation paid to the mortgage broker company by the borrower or the lender but had not proposed to exempt payments by retail lenders to their employee loan

[22] In upholding the Federal Reserve's 2010 loan originator compensation rule, the District Court noted that the prohibition on term-based compensation by itself did not eliminate all incentives for abuse by mortgage brokers: "Thus, proposed regulation § 226.36(d)(1), which prevents any compensation model based on the terms of the transaction, by itself, ensures that creditors' employees have no direct monetary incentive to direct consumers toward loans with higher rates of more adverse terms. ... The same is not true, however, for mortgage brokers. Although § 226.36(d)(1) prevents mortgage brokers from receiving compensation tied to the terms of a loan, it does not prevent them or their employees from creating incentives for a loan officer to guide consumers toward certain loans and or to certain lenders." *See Nat'l Ass'n of Mortgage Brokers*, 773 F.Supp.2d at 175.

officers. In the May 29, 2013 rule, however, the CFPB decided to treat employees of both types of entities the same because "there were significant operational challenges to calculating individual employee compensation accurately early in the loan origination process, and that those challenges would lead to anomalous results for consumers. In addition, the Bureau concluded that structural differences between the retail and wholesale channels lessened risks to consumers."[23] CRL supports this decision by the CFPB.

2. Settlement services provided by companies affiliated with the lender are included in the points and fees definition.

In conformance with the statutory language in place since HOEPA was first passed in 1994, the CFPB's rulemakings also established that settlement services provided by companies affiliated with the lender are included in the points and fees definition. Some settlement service providers – such as companies that provide title insurance – are affiliated with lenders, while others are independent and unaffiliated with any individual lender. It has been reported that 74% of the market uses unaffiliated providers. Because one of the underlying purposes of the QM points and fees definition is to include all compensation received by the lender, the QM points and fees definition differentiates between service providers that are affiliated with a lender and those that are not. Accordingly, if a title insurer is affiliated with the lender used by the borrower, then the fees paid by the borrower for that title insurance are included in the points and fees calculation.

Title insurance, which is one type of settlement service, is included in most mortgage transactions, but borrowers typically have limited control over the price charged for this service. A 2007 report by the U.S. Government Accountability Office found that "because consumers generally do not pick their title agent or insurer, title agents do not market to them but to the real estate and mortgage professionals who generally make the decision."[24] As a result, the GAO concluded that borrowers end up "in a potentially vulnerable situation where, to a great extent, they have little or no influence over the price of title insurance but have little choice but to purchase it."[25]

Given this market dynamic where borrowers overpay for title insurance because businesses are competing to drive up prices instead of driving them down, the points and fees definition provides needed pressure to reduce these costs for borrowers. Including

[23] May 2013 Final Qualified Mortgage Rule, at 35430.
[24] *Title Insurance: Actions Needed to Improve Oversight of the Title Insurance Industry and Better Protect Consumers*, United States Government Accountability Office, GAO-07-401 (April 2007).
[25] *Id.*

title insurance costs in the points and fees definition where the lender has an affiliation with the company supplying the title insurance reasonably targets the transactions with the most potential for up-charging.

III. Qualified Mortgage Definition and Future Mortgage Lending.

Taken as a whole, the CFPB's rules for the Qualified Mortgage definition are a reasonable approach to implement the reforms in the Dodd-Frank Act. In reaching this assessment, CRL looks to three different factors: 1) whether QM is defined broadly, 2) whether the definition uses clear, bright line standards, and 3) whether it provides borrowers with the ability to raise a challenge when a lender failed to reasonably determine whether the borrower could afford the offered mortgage.

A. Qualified Mortgage Definition is Broadly Defined.

The CFPB has drafted a QM rule that will cover the vast majority of the current mortgage market. This will prevent a dual mortgage market from developing, because a broad range of families capable of owning a home – including lower-income borrowers and borrowers of color – will be able to take advantage of mainstream Qualified Mortgages that are restricted from having risky product features instead of being pushed into more expensive loans with abusive features and high fees.

The breadth of the CFPB's rule is evident when considering that the Bureau adopted the four different ways described above that a loan can gain Qualified Mortgage status. Among these is the definition relying on whether a loan is eligible to be guaranteed or insured by Fannie Mae, Freddie Mac or a government agency program. This definition incorporates the compensating factors used by the GSEs or government agencies in order to lend to borrowers with debt-to-income ratios above 43%. The CFPB designed the rule in this way to "help ensure access to responsible, affordable credit is available for consumers with debt-to-income ratios above 43 percent and facilitate compliance by creditors by promoting the use of widely recognized, federally-related underwriting standards."[26]

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[26] *Id.*, at 6533.

In addition to covering current mortgage lending, the CFPB's rule also has the potential to bring additional private capital into the market. As described in the CFPB's rulemaking, "[t]he temporary exception has been carefully structured to cover loans that are eligible to be purchased, guaranteed, or insured by the GSEs (while in conservatorship) or Federal agencies regardless of whether the loans are actually so purchased, guaranteed, or insured; this will leave room for private investors to return to the market and secure the same legal protection as the GSEs and Federal agencies."[27] For example, if a private investor securitizes loans according to the standards in Desktop Underwriter – which adheres to Fannie Mae's underwriting guidelines – then these loans can obtain QM status even though they are not sold to the GSEs.

Lastly, the definition focused on smaller creditors holding loans in portfolio also provides flexibility for these lenders to exceed the 43% debt-to-income ratio cutoff that is the CFPB's general definition. In its rulemaking, the CFPB addressed the aligned incentives that small creditors holding loans in portfolio generally have to make affordable loans to borrowers:

> Small creditors also have particularly strong incentives to make careful assessments of a consumer's ability to repay because small creditors bear the risk of default associated with loans held in portfolio and because each loan represents a proportionally greater risk to a small creditor than to a larger one. In addition, small creditors operating in limited geographical areas may face significant risk of harm to their reputations within their communities if they make loans that consumers cannot repay.[28]

As a result of these aligned incentives and concerns that smaller lenders might restrict their lending if required to comply only with the general definition that has a 43% debt-to-income ratio threshold, the CFPB concluded that creating a separate definition tailored to these lenders was appropriate. The CFPB concluded that "[b]ecause there are thousands of small creditors as defined by § 1026.43(e)(5) in the United States, the Bureau believes that § 1026.43(e)(5) is likely to preserve access to affordable, responsible mortgage credit for hundreds of thousands of consumers annually."[29] These definitions, as a whole, demonstrate that the CFPB's rules not only cover the vast majority of the current market, but will also provide flexibility for mortgage lending moving forward.

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[27] *Id.*, at 6534.
[28] May 2013 Final Qualified Mortgage Rule, at 35485.
[29] *Id.*

Two additional points bear mentioning in terms of the breadth of the CFPB's definition. First, it's important to put CoreLogic's analysis of the Qualified Mortgage rule conducted earlier this year in proper context, because CoreLogic's conclusions are often taken out of context and the assumptions in their methodology are often not mentioned. CoreLogic's analysis found that when factoring in the definition relying on eligibility for guarantee or insurance by Fannie Mae, Freddie Mac, and the government agencies, "the near- and intermediate-term impacts of the rule are **very small**."[30] When assessing the part of the definition that uses a 43% debt-to-income ratio cutoff, the CoreLogic analysis reports that 52% of 2010 originations would be covered by this definition. However, CoreLogic made several assumptions resulting in an overly conservative analysis. First, it excludes all loans with credit scores below 640, although the Qualified Mortgage definition does not impose any credit score requirements. Second, it assumes that borrowers who received loan products with prohibited features would not be able to access QM-eligible loan products in the future – in fact, borrowers will be able to get safer mortgages instead. Unfortunately, this 52% figure is often taken out of context (i.e., the eligible for guarantee or insurance prong of the Qualified Mortgage definition is ignored) and the limiting assumptions are not mentioned.

Second, while there is limited data on the amount of points and fees charged to borrowers in recent years, it is clear that the vast majority of recent mortgages would not exceed the points and fees thresholds required under the QM definition. As described earlier, the statutory points and fees definition excludes a number of origination costs from being counted in points and fees, such as upfront mortgage insurance premiums, up to two bona fide discount points, third party closing costs, and commissions paid to individual loan officers employed by mortgage broker and retail companies.

Of the remaining charges eligible to be included in the points and fees definition, several sources confirm that the origination charges paid directly to lenders constitute a small percentage of overall loan balances. Freddie Mac provides weekly reports on the average fees charged to borrowers, and the figure for the week of January 9, 2014 was 0.7%, well under the 3% limit.[31] This figure is confirmed by an industry comment filed with the CFPB, which also finds that the origination charges paid by borrowers (up-front points and fees and more than two discount points) were – for all loan sizes – less than 1%.[32]

[30] Sam Khater, *The Mortgage Market Impact of Qualified Mortgage Definition*, CoreLogic, The MarketPulse, Volume 2, Issue 2 (February 12, 2013)(available at http://www.corelogic.com/downloadable-docs/MarketPulse_2013-February.pdf) (emphasis added).
[31] Freddie Mac, Weekly Primary Mortgage Market Survey (PMMS) (available at http://www.freddiemac.com/pmms/).
[32] AB Schnare Associates LLC, Ex Parte Comment on CFPB-2013-002, at 5 (April 5, 2013) (available at http://www.regulations.gov/#!documentDetail;D=CFPB-2013-0002-0933.).

This leaves considerable room in the points and fees calculation for other possible fees, such as mortgage broker compensation and settlement services paid to a company affiliated with the lender. The industry comment mentioned above determines that if **all** settlement services are provided by companies affiliated with the lender for every loan in the sample, then 5.6% of all loans would exceed the points and fees limit. However, not all lenders use affiliated settlement service providers; the Mortgage Bankers Association reports that there is 26% market share for affiliated settlement service providers.[33] As a result, it's appropriate to discount the comment's estimates by 74%, since loan level data on this sample is not available. This would result in 1.46% of all loans in the study sample exceeding the points and fees threshold when taking affiliate service providers into account, meaning that practically 99% of all loans in this sample would meet the QM points and fees limits. And, even this 99% figure is understated, because any of these remaining loans could meet the points and fees limit by using settlement service providers that are not affiliated with the lender, as most loans do, or by financing some of the fees into the interest rate.

B. The CFPB Used Clear, Bright Lines in the Qualified Mortgage Definition.

In addition to providing a broad QM definition, the CFPB also used clear, bright lines in establishing all four of the QM definitions. For example, the first prong of CFPB's definition for a QM loan includes a back-end debt-to-income ratio cut-off of 43% as one element of the definition. In establishing this threshold, the CFPB noted that that using a specific debt-to-income ratio cutoff "provides a well-established and well-understood rule that will provide certainty for creditors and help to minimize the potential for disputes and costly litigation over whether a mortgage is a qualified mortgage."[34] The CFPB also pointed to the fact that "[a] specific debt-to-income ratio threshold also provides additional certainty to assignees and investors in the secondary market, which should help reduce possible concerns regarding legal risk and potentially promote credit availability."[35] Additionally, the CFPB's definition relying on whether the loan is eligible for purchase or insurance by well-established programs also results in clear, bright line standards.

The CFPB's final rules provide substantial clarity on these definitions, which will enable both lenders and borrowers to know upfront when a mortgage is originated whether it has QM status. Furthermore, the CFPB is also working to refine and clarify these definitions

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[33] Mortgage Bankers Association, *Ensuring Housing Recovery: The Challenge of the Ability to Repay and Qualified Mortgage Rule to Credit Availability and Affordability for Homeowners*, at 18 (February 28, 2012) (available at http://www.fdic.gov/regulations/reform/MBA2-28-12.pdf).
[34] January 2013 Final Qualified Mortgage Rule, at 6505-06.
[35] *Id.*, at 6527.

through their implementation process. This includes publishing further guidance to clarify issues such as how requested put-backs on Fannie Mae, Freddie Mac and government agency mortgages will impact Qualified Mortgage status.

C. Qualified Mortgage Definition Protects Borrowers with the Riskiest Loans.

Leading up to the CFPB's final rule in 2013, there was considerable discussion from various stakeholders on whether QM status should provide lenders with a safe harbor or a rebuttable presumption of compliance with their obligation to reasonably determine whether a borrower can afford to repay a mortgage. CRL and other consumer groups supported a QM rule that provided a rebuttable presumption of compliance so all borrowers would have the ability to challenge whether a lender had appropriately fulfilled its Ability to Repay obligations. Lenders generally supported a rule that provided all QM loans with a safe harbor of compliance, meaning that no borrower receiving a QM loan could raise a legal challenge.

The CFPB's final rule establishes a two-tier system where the vast majority of loans will have a safe harbor and others will have a rebuttable presumption, and the threshold between the two depends on the loan's annual percentage rate (APR) relative to the average prime offer rate (APOR). A loan's APR is a figure that represents the overall cost of the loan, including both the interest rate as well as some specified fees. The APOR is a calculation that reflects the APR for a prime mortgage, and these figures are released on a weekly basis.

While this provision gives the vast majority of loans a safe harbor of compliance, the CFPB's rules do allow borrowers to hold lenders accountable on the riskiest types of mortgages. For the general definition using a 43% debt-to-income ratio threshold and the definition based on eligibility for purchase or insurance by Fannie Mae, Freddie Mac and government agencies, the dividing line between a safe harbor and a rebuttable presumption is 1.5% above APOR for a first-lien mortgage and 3.5% above APOR for a subordinate lien mortgage. Those loans above the thresholds have a rebuttable presumption of compliance whereas those loans below the thresholds have a safe harbor of compliance. The CFPB adjusted these figures upward for loans obtaining QM status under both the definition for small creditors holding loans in portfolio and for the definition for balloon loans, resulting in both first-lien and subordinate lien mortgages having a safe harbor up to 3.5% above APOR.

Conclusion

In summary, as stated at the outset, the CPFB's Qualified Mortgage definition has hit the right balance of protecting consumers, facilitating compliance with these rules, and protecting access to credit. The broad definition using clear, bright lines – in addition to providing borrowers in the riskiest mortgages with the opportunity to raise a legal challenge when necessary – will create incentives to avoid future subprime lending abuses and unnecessary foreclosures. At the same time, the four QM standards will also ensure that there is access to responsible credit and that lenders are able to comply with these standards.

Thank you for the opportunity to testify today, and I look forward to answering your questions.

Statement of Bill Emerson
Chief Executive Officer
Quicken Loans

On behalf of the
Mortgage Bankers Association

House Financial Services Committee
Subcommittee on Financial Institutions and Consumer Credit

"How Prospective and Current Homeowners Will Be Harmed by the CFPB's Qualified Mortgage Rule"

January 14, 2014

Chairman Capito, Ranking Member Meeks and members of the subcommittee, my name is William Emerson and I currently serve as Chief Executive Officer of Quicken Loans.

Quicken Loans is the largest on-line and non-bank mortgage lender in the nation. We employ 10,000 people nationally with 8,000 of our team members serving consumers from downtown Detroit. We are very proud of the fact that J.D. Power named Quicken Loans the Highest in Customer Satisfaction for Primary Mortgage Origination four years in a row – 2010, 2011, 2012, and 2013.

I appreciate the opportunity to testify before this subcommittee also as Vice Chair of the Mortgage Bankers Association[1]. MBA uniquely represents mortgage lenders of all sizes from the largest federally-chartered institutions to the smallest community lenders who serve the mortgage financing needs of families throughout the nation.

Background

Your decision to hold this hearing on the effects of residential mortgage lending standards under the Dodd-Frank Wall Street Reform and Consumer Protection Act is extremely timely. Just last Friday, an unprecedented number of rules issued by the Bureau of Consumer Financial Protection (CFPB or Bureau) became effective, notably including the Ability to Repay (ATR) Rule and its Qualified Mortgage (QM) definition.

Let me start by saying how much we appreciate the CFPB's work in crafting these regulations. They started with difficult and oftentimes ambiguous statutory provisions and, by listening to stakeholders and through their own hard work, created rules that are a substantial improvement over the Dodd-Frank framework.

Nevertheless, while the CFPB has done much to develop these rules – particularly ATR – we remain concerned that they are likely to unduly tighten mortgage credit for a significant number of creditworthy families who seek to buy or refinance a home. Unless there are changes along the lines we suggest in this testimony, these rules may impair credit access for many of the very consumers they are designed to protect.

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

Since the last hearing, the industry has spent several months reviewing, understanding and then operationalizing these rules, building new policies and procedures, re-engineering loan processes, reprogramming mortgage origination systems, and training our personnel. Considering the enormity of the tasks, we could have used more time to implement, but we have done our level best to comply.

In reviewing these rules, context remains important. Over the past several years, the housing market has been weak and a key concern has been the levels of uncertainty in the regulatory landscape.

Housing is making a recovery – though not as fast or as vigorously as we all hope. Housing starts are generally up. Sales prices have increased in many areas across the country, pulling many homeowners above water for the first time in years.

While the housing market is improving, data show that the improvement is predominantly at the higher end of the market, with increasing activity in higher priced homes while the lower end of the market is actually shrinking. Access to credit is clearly constrained with first-time and low- to moderate-income borrowers unable to qualify for a mortgage. The ATR rule could fuel this trend and further tighten credit to worthy borrowers.

Furthermore, over the past three months, applications to buy homes have weakened, and are now running about 20 percent behind their pace of one year ago. The increase in mortgage rates has certainly been a factor, but the complications of the new regulatory regime are likely having an impact as well. MBA has indicated that originations for 2014 are likely to be lower than had been forecast just a few months ago, reflecting this new, weaker data.

The Ability to Repay Rule

MBA has consistently supported reasonable ability to repay requirements that will prevent a reemergence of the competitive excesses of the housing bubble.

Even though the mortgage industry has implemented some of the most conservative underwriting standards in decades and riskier mortgage products are no longer available, we appreciate the value of embedding sound product and underwriting standards into law to ensure consumers are protected going forward.

Dodd-Frank requires that a residential mortgage loan cannot be originated unless the lender makes a reasonable and good faith determination based on verified and documented information that the consumer has a reasonable ability to repay the loan. The statute provides steep liability and penalties for ATR violations and significantly extends the period when claims can be brought. Claimants can seek actual and statutory damages, as well as return of their finance charges and attorney fees. By MBA's calculation, protracted litigation for an average loan can exceed the cost of the

loan itself.[2] The statute of limitations for claims is extended from one to three years. In a foreclosure, a claim of violation may be brought as a set off whenever foreclosure occurs. Claims may be made against any creditor, assignee or holder of the mortgage.

Considering the enormous potential liability for failure to adhere to this rule, Dodd-Frank established the Qualified Mortgage as a means to presume compliance with the ATR standards. To qualify as a QM, a loan must: exclude risky features, such as interest only, negative amortization and balloon payments; meet prescribed underwriting requirements including having a debt-to-income (DTI) ratio below 43 percent.

Under what has come to be known as the "temporary patch," for up to seven years[3], instead of satisfying the DTI requirement, a loan can qualify for Fannie Mae or Freddie Mac purchase or guarantee by a federal agency like the Federal Housing Administration, Veterans Administration, or Department of Agriculture.

Additionally, the points and fees paid for the loan must not exceed 3 percent of the loan amount for loans above $100,000 with adjustments for smaller loans.

To provide greater certainty to lenders, the Bureau also wisely created a compliance safe harbor for QMs with interest rates at or near the average interest rate for a comparable prime-market product, known as the Average Prime Offer Rate (APOR). Although MBA urged a safe harbor be established for all loans meeting QM requirements as the best means of extending beneficial QM lending beyond prime borrowers, under the final rule loans that are more than 150 basis points above the APOR only gained a "rebuttable presumption" of compliance.

The difference between a safe harbor and a rebuttable presumption of compliance is critically important. A safe harbor means that if a lender complies with the exact standards embedded in the rule that compliance will be presumed and any litigation will be confined to whether or not the loan is in fact a QM. Under a rebuttable presumption of compliance, however, the scope of the inquiry is potentially far more wide-ranging, with significant variations from one court to another on how the presumption is applied,

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[2] By way of example, a mortgage lender who fails to comply with the ability to repay requirement for a hypothetical $200,000 loan would face liability on the order of:

(1) Statutory damages of up to $4,000;

(2) All loan fees and up to three years of finance charges paid by the consumer, which on an average loan of $200,000 at 4.5 percent may be approximately $25,000;

(3) Actual damages, which could include, for example, the borrower's down payment (e.g., $20,000 if the down payment was 10%); and

(4) Court costs and reasonable attorney fees associated with the claim, which could be anywhere between $26,000 and $155,000 (depending on how protracted the court proceedings are).

[3] The patch applies until Fannie Mae and/or Freddie Mac leave conservatorship or the agencies issue their own rules (as HUD has done effective January 10, 2014) but in no later than 7 years.

including when and how extrinsic evidence may be considered beyond the standards. Such an inquiry is more open-ended, unpredictable and far more costly to defend.

Although MBA greatly appreciates that the Bureau created a safe harbor, MBA urges the CFPB to establish a safe harbor for all loans that meet QM standards. At a minimum, MBA recommends the Bureau increase the threshold from 150 basis points to 250 basis points so more borrowers with less than perfect credit would benefit from QM lending. MBA also urges greater clarity on the standards that lenders are to follow in determining a borrower's residual income.

Will Non-QM Loans Be Made?

MBA believes that at least initially the likelihood of widespread non-QM lending is very remote. The risks of liability and protracted litigation are greatest for these loans where there is no presumption of compliance and there is a strong possibility of inconsistent case law for several years. Non-QM lending will likely occur only in these limited circumstances: (a) where there has been a miscalculation of any of the standards that are embedded in the rule, including the points and fees limit; (b) to the most qualified borrowers with very high credit quality and ample other assets where the default risk is very low and where the loans can be kept in a lender's portfolio; and (c) to those who are able to afford significantly higher rates.

Unintentional Mistakes

The QM rules require several calculations including points and fees, the APR, and the APOR-to-APR comparison. Because of the complexity of these calculations, mistakes will be made.

MBA is concerned that because of the high penalties for violations, to avoid costly calculation mistakes, lenders will not lend to the edges and corners of the QM boundaries, but will instead choose to lend well within those boundaries. This risk is compounded by the fact that the rule does not provide a right to cure inadvertent errors.

MBA notes the new High-Cost Mortgage rules under the Home Ownership and Equity Protection Act (HOEPA) as amended by Dodd-Frank[4] explicitly allow a creditor or assignee to cure the "violation" by providing appropriate restitution and adjusting the transaction's terms. MBA urges that analogous cure provisions be established by the Bureau for the ATR rule to benefit borrowers and facilitate the availability of QM credit.

Jumbo loans

As a general matter, high balance loans do not qualify for agency purchase or guarantee and these borrowers' debt-to-income profiles frequently exceed 43 percent. Nonetheless, because of the income and assets of many jumbo borrowers, default rates

[4] Section 1026.32(h)

are relatively low. Consequently, MBA believes jumbo loans will be available in the non-QM market at competitive rates.

The availability of non-QM loans to wealthier borrowers may raise fair lending concerns. The solution is to broaden the availability of QM loans to low- and moderate-income borrowers. In addition, the CFPB should develop means for jumbo loans to be treated as QMs if, for example, they meet agency standards although they are not eligible for purchase.

Higher Default Risk Borrowers at Very High Rates

MBA believes, notwithstanding the views of the CFPB to the contrary, the greater risks of liability and protracted litigation will at least initially result in significantly higher costs for non-QM loans for all but the highest credit quality borrowers.

The rate sheets we have received indicate that non-QM loans other than those for low-default/high credit quality borrowers will cost significantly more. Very high downpayments or equity will be required, and rates will be 400 to 500 basis points over the typical QM loan.

The ATR requirements will apply to non-QM loans as well. Considering this and the high interest rates and low LTVs that are required for these loans, they are unlikely to be a viable financing option for most borrowers.

H.R. 3211, the Mortgage Choice Act

The QM definition generally excludes from the calculation of points and fees third party charges paid for title insurance and other settlement costs, unless those fees are paid to an affiliate of the lender. The rationale behind this decision is unclear and, based on the experience of our company, will end up raising prices, reducing quality customer service, and undermining consumer choice.

Some lenders including Quicken Loans have chosen to affiliate with title and other service providers to ensure that services are efficient, estimated fees and charges are accurate, and the consumer experience from loan application to closing is seamless, predictable and positive for our customers. Our experience, confirmed by national consumer surveys, demonstrates that homebuyers who take advantage of Quicken Loans' affiliated services report a highly satisfactory home loan experience.

Title and title related services are the largest third party settlement costs. Our affiliated providers and the affiliates of others offer services that are competitive in cost with those of unaffiliated providers. The fact that affiliated providers attract business from non-affiliated lenders supports this fact. As might be expected, studies have shown that when affiliates have been excluded from the market, title insurance charges have risen.

In all cases, consumers are free to make an informed choice of either an independent or an affiliated provider. Indeed, 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. There are clear penalties for forcing a consumer to use a particular affiliate or providing improper inducements to persuade a consumer to do so.

Concerns that lenders may augment their fees through the charges of affiliated companies are not valid. Title insurance premiums and, in many cases, fees for title services are regulated. Forty-four states and the District of Columbia require that title premiums be set by the state, approved by the state, or filed with the state (23 states also include title examinations and searches).

On a related subject, at present, the definition of "points and fees" in Dodd-Frank is ambiguous regarding whether amounts paid to lenders at closing and deposited into an escrow account for the payment of insurance and taxes also are included in the points and fees calculation. There is no policy reason for including them.

MBA thanks the many members of the Financial Services Committee who have introduced H.R. 3211, the Mortgage Choice Act, on a truly bipartisan basis. We are also grateful to Chairman Hensarling for including these important provisions in his broader housing finance bill, the PATH Act. We urge the House to pass H.R. 3211 so that consumers can continue to take advantage of the economies and efficiencies that may be available through affiliated providers.

Other Recommended Changes

The Credit Box is Too Small for QM Safe Harbor Loans

Only mortgages where the APR is less than 150 basis points over the benchmark APOR qualify for the QM safe harbor. However, as MBA testified six months ago, having analyzed the methodology underlying the determination of the APOR and the components of the points and fees test, an increase in the spread to 200-250 basis points is warranted. Such an approach would extend QM loans to a greater number of borrowers, satisfying their credit needs with sustainable and affordable loans.

The Threshold for Smaller Loans is Too Low

Low- and moderate-income borrowers tend to require lower balance loans. Because there are certain fixed costs in loan origination, lower balance loans are more likely to trigger the 3 percent fees and points cap. Moreover, increased regulatory compliance costs have resulted in an increase origination costs generally.

These factors make it more difficult for lower balance loans get under the 3-point cap. There is broad discretion, however, for the CFPB to adjust the 3 percent limit on points

and fees for smaller loans. The average loan size is $219,000. Yet the current rules only allow increases in the points and fees limit for loans under $100,000.

In MBA's testimony last June, we provided an example for a $150,000 loan, typical in many markets in the country. Applying a 3 percent limit to such a loan, only $4,500 would be available to cover fees reflecting the costs of the lender, compensation to a mortgage brokerage, some escrowed amounts and all third party fees to affiliates including title insurance and title services.

Based on this example, many loans that are smaller than the average loan amount but greater than $100,000 are likely to exceed the 3 percent limit and fail to qualify as QMs (even though they meet all other QM requirements) making QM loans unavailable to many low and moderate income borrowers. MBA urges the CFPB to increase the threshold for adjustment of the 3 percent limit to $200,000, as shown in the table below.

Current Rule		Recommended	
Loan Amount	Fees and Points Cap	Loan Amount	Fees and Points Cap
		$200,000 and up	3%
		$150,000 to $199,999	$6,000
$100,000 and up	3%	$100,000 to $149,999	4%
$60,000 to $99,999	$3,000	$80,000 to $99,999	$4,000
$20,000 to $59,999	5%	$20,000 to $79,999	5%
$12,500 to $19,999	$1,000	$12,500 to $19,999	$1,000
Less than $12,500	8%	Less than $12,500	8%

new tiers/caps

The Temporary Patch Needs Replacement

MBA strongly supported the establishment of the temporary patch that allows eligibility for GSE and agency programs as an alternative to the 43 DTI test. By including the patch, lenders could continue to use the underwriting systems that were effective when the rule was promulgated, as the housing market recovered. But the patch expires and the criteria used to qualify borrowers under these systems cannot be expected to be made available publicly.

If the 43 DTI test is not met, under the general QM standards, the loan simply does not qualify regardless of compensating factors such as the borrower's cash reserves, residual income or payment history. If government programs are the only alternative, then government and the taxpayers will be forced to assume inordinate risk and, at the same time, lessen the possibility that private capital will return to the market.

MBA urges the CFPB to begin work as soon as possible – in conjunction with stakeholders – to develop a transparent set of qualifications for QM that includes compensating factors that can become a permanent alternative to the DTI requirement.

Rebuttable Presumption QMs are Likely To Be Available, But at a Higher Cost Than the Bureau Suggests

Most lenders and mortgage investors, at least for the immediate future, will confine themselves to QM safe harbor loans. That is the choice Quicken Loans has made. While we and MBA appreciate the efforts of the Bureau to appropriately bound the basis for claims involving rebuttable presumption loans by focusing them on the ability to repay itself, such loans will still be more challenging and costlier because the risks are greater, and competition will be decreased.

MBA is submitting redacted rate sheets that it received very recently that indicate that the rates for QM rebuttable presumption loans are in excess of two points higher than the APOR and that high LTVs in excess of 30 percent will be necessary to obtain these higher priced loans.

While MBA notes that Fannie Mae and Freddie Mac have indicated that they will not price QM safe harbor loans differently than QM rebuttable presumption loans, MBA also notes that if claimants prevail in litigation concerning a rebuttable presumption QM, the GSEs can be expected to put the loan back to the lender, hence the lender will bear any resultant risk, not the GSEs.

MBA urges the CFPB to provide greater clarity on the standards that lenders should apply to determine lack of residual income and how lenders can defend a loan based on a sufficient payment history.

Better Guidance Is Essential

The lack of reliable, real-time guidance from the CFPB has proven to be a major concern during the implementation of the new rules, including ATR. The CFPB has taken the posture of only offering binding views through official commentary and rule amendments that have gone through the notice and comment process. At the same time, the Bureau offers guidance by telephone with the caveat that only commentary and rules can be relied upon.

This process has proven too slow given the deadlines for compliance. Oral advice has proven inconsistent, is not always disseminated widely, and is often distorted as it is re-told. In the vacuum created by the lack of firm guidance, aggregators, investors and even other agencies have offered varying interpretations.

As the industry and stakeholders move forward to implement these rules and those that follow, MBA regards it as essential that a middle ground for ensuring the availability of reliable written interpretative guidance needs to be found. While not all questions warrant written responses, there are numerous areas that do. We urge Congress to support MBA's call for a careful review of this problem culminating in a solution to provide real time written guidance on key issues with broad applicability.

Further CFPB Revisions

MBA is extremely pleased that consistent with public pronouncements, the CFPB's Regulatory Agenda announced that the CFPB plans, after the effective date of the new rules "to engage in a further rulemaking to consider certain additional refinements to these rules."

The industry welcomes this opportunity. While MBA appreciates the CFPB's work, as we have stated there remains much to do to avoid tightening credit. Attention should be directed to the credit box, the right to cure, affiliate fees and the other issues highlighted here and submitted on behalf of the industry.

QRM Should Be Synchronized with QM

Another key piece of providing sustainable financing opportunities for a maximum number of qualified families in MBA's view is aligning the QM and QRM definitions.

While the QM is the responsibility of the CFPB and the QRM is the joint responsibility of six financial regulators, both provisions have the same objective. One seeks to outline the design of a sustainable mortgage as a means of satisfying the ability to repay requirements and the other provides an exception to the requirement for risk retention. Notably, Section 941 of the Dodd Frank Act, which establishes the QRM exemption, also requires that the QRM definition be no broader than the definition of QM.

Considering these points, MBA shares the view of an array of stakeholders that the definitions should be the same. We were gratified that the recent reproposal of the Risk Retention rule offered synchronization of QRM and QM as the preferred approach.

Notably, however, the proposal also offered an alternative that would require a minimum 30 percent down payment for purchase loans and a maximum 70 LTV for refinances to qualify. While the preferred approach is supported by nearly every stakeholder in the consumer advocacy, lending and real estate communities, the alternative is strongly opposed vehemently by these same groups.

There is no justification for two disparate definitions of a sustainable loan. In fact, such a discrepancy will only increase costs and confusion in the industry and among consumers. Aligning the QRM and QM standards would ensure that strong incentives for safe and sound lending are in place, invite the return of private capital and result in lower mortgage rates to the widest array of qualified borrowers.

VA and the Other Agencies Designated In Dodd-Frank to Develop QM Regulations Should Move Forward to Maximize the Availability of Sustainable Credit

Since the last subcommittee hearing, HUD issued and finalized a QM Rule for FHA loans, which MBA supported.

FHA's upfront mortgage insurance premium (MIP) had been increased earlier this year and since the MIP is included in the APR and consumes a substantial amount of the 150 basis points, action was necessary to avoid excluding too many FHA loans from safe harbor treatment.

HUD's rule expanded the APR trigger for FHA loans to include the MIP. Without HUD's action, because of the MIP increase, a very large number of FHA loans indeed would have exceeded the APR threshold making them rebuttable presumption loans and potentially less available to qualified borrowers.

MBA urged HUD to take the position that all FHA loans that meet the program's requirements should be treated as QM loans. Unfortunately, the HUD rule still maintained a distinction between rebuttable presumption and safe harbor loans although the danger of over-classification of rebuttable presumption loans was lessened.

MBA urges the other agencies to move forward to ensure that agency loans are treated as QM loans. We would specifically urge that it is appropriate to treat all loans subject to government regulation as QM safe harbor loans to ensure the continued availability and affordability of agency loans.

CONCLUSION

We appreciate the efforts of the subcommittee to again examine these important regulations. As we said before, no matter how well intentioned these rules may be, we remain concerned that the ATR/QM rule will restrict unduly credit opportunities to qualified borrowers.

We urge your support for the changes we suggest and of H.R. 3211 to revise the points and fees provisions.

I look forward to your questions. We also look forward to continuing to work closely with this subcommittee as well as the CFPB to ensure a vibrant mortgage market for American consumers.

ICBA
INDEPENDENT COMMUNITY
BANKERS of AMERICA

Testimony of

Jack Hartings
President and CEO
Of
Peoples Bank Co.
Coldwater, OH

On behalf of the
Independent Community Bankers of America

Before the

United States House of Representatives
Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

Hearing on

"How Prospective and Current Homeowners Will Be Affected by the CFPBs Qualified Mortgage Rule"

January 14, 2014
Washington, D.C.

Chairman Capito, Ranking Member Meeks, members of the Subcommittee, I am Jack Hartings, President and CEO of The Peoples Bank Company and Vice Chairman of the Independent Community Bankers of America. I am also a member of the Consumer Financial Protection Bureau's Community Bank Advisory Council. I am pleased to represent ICBA and nearly 7,000 community banks across America at this important hearing on the Consumer Financial Protection Bureau's Ability-to-Repay/Qualified Mortgage Rule. We appreciate your raising the profile of this critical issue, which has the potential to drive many community banks with fewer resources out of the mortgage market, curtail access to mortgage credit and hamper the housing recovery.

Reform of QM is a key plank of ICBA's Plan for Prosperity: A Regulatory Relief Agenda to Empower Local Communities (the "PFP"). We appreciate the opportunity to discuss the PFP solution: Safe harbor QM status for all community bank loans held in portfolio. As explained below, this solution supports continued access to community bank credit without compromising consumer protection or safety and soundness.

The Peoples Bank Company is a $400 million asset bank in Coldwater, Ohio. We serve a community of about 5,000 and have been in business for 108 years. We survived the Great Depression and numerous recessions before and since – as have many other ICBA member banks – by practicing conservative, commonsense lending. We make sure loans are affordable for our customers and they have the ability to repay. Loans are underwritten based on sound practices using our personal knowledge of borrowers and their circumstances.

Mortgage lending has always had a significant place in the community bank business model that is focused on relationship lending. Community banks are locally owned, typically closely held institutions deeply rooted in their communities and funded primarily by local deposits. They have a vital stake in the success of their local economies because the fortunes of the local bank and the local economy are closely linked. Community banks thrive by cultivating long-term, cross-generational relationships with local families, farmers and small business owners and by serving the full spectrum of their financial needs. To sustain this business model and retain valuable customer relationships, community bankers must be able to meet the mortgage needs of their customers. Providing residential mortgages helps community bankers cement relationships with small business clients, for example, and opens up additional lending opportunities.

Mortgage lending by community banks represents approximately 20 percent of the national mortgage market.[1] However, in small towns and rural communities the local community bank is often the main source of mortgage credit. As the recent FDIC Community Banking Study

[1] The Federal Reserve's analysis of Home Mortgage Disclosure Act (HMDA) data indicates that banks with assets under $10 billion account for 18 percent of home loan originations. See "Community Banks and Mortgage Lending," Remarks by Federal Reserve Governor Elizabeth Duke, November 9, 2012. However, HMDA data does not capture institutions that operate exclusively outside of metropolitan areas. Therefore, we estimate that the community bank mortgage market share is slightly larger than 18 percent.

showed, in one out of every five counties in the United States, the only physical banking offices are those operated by community banks.[2] These markets are often neglected by larger national mortgage lenders that are driven by volume and margins, because the markets may not generate enough real estate lending activity. These communities will be hit the hardest by any policy changes that curtail community bank lending or even drive them out of the mortgage lending business.

What's more, the approximately 20 percent market share of community banks understates the significance of their mortgage lending. For example, community banks make a larger share of their home purchase loans to low- or moderate-income borrowers or borrowers in low- or moderate-income neighborhoods. Further, compared to larger banks, community banks make a larger share of home purchase loans than loans for other purposes such as refinancing or home improvement. For this reason, community bank mortgage lending plays a more significant role in the housing market than their percentage of market share would suggest.

The Qualified Mortgage Rule

There is no question that the new Qualified Mortgage (QM) rule will adversely impact my mortgage lending. This is true even though The Peoples Bank Company is currently a "small creditor" under the QM rule because we make fewer than 500 mortgage loans annually and have less than $2 billion in assets. As a small creditor, our QM loans are not subject to the 43 percent debt-to-income ratio and have a higher trigger for the "high cost" QM category, which has weaker liability protections. However, many community banks fail either the loan volume or the asset test. Even though my asset size is well below the $2 billion, in 2012 I made 493 mortgage loans, which is just at the annual loan threshold. We believe this threshold is far too low and is not consistent with the asset threshold. I will return to this point later in my testimony.

Even though The People's Bank is a small creditor, the QM rule poses a daunting challenge, will change the way that we lend, and reduce access to credit in our communities. Non-QM loans will be subject to significant legal risk under the Ability to Repay (ATR) rule. The liability for ATR violations is draconian, including enforcement actions by the CFPB and state attorneys general for up to three years following the violation, statutory damages and a private right of action potentially giving rise to class action suits. Non-compliance with ATR could also serve as a defense to foreclosure if the loan is deemed not to be a QM loan. While non-QM products may make sense for certain large lenders, community banks like mine simply do not have the legal resources to manage this degree of risk. As a result, certain loans we made in the past to accommodate customers will not be made in the future. Examples include:

[2] FDIC Community Banking Study, December 2012. Page 3-5. (http://www.fdic.gov/regulations/resources/cbi/study.html)

Low Dollar Amount Loans

Applying the QM standards to low dollar loans in particular often yields perverse results. Consider, for example, a $75,000 loan with an 80 percent loan-to-value ratio and a cash-out feature to a customer with a lower credit score. Low dollar loans with these characteristics are common in many parts of the country for purchase or refinance. This is a conforming loan that I could sell to Freddie Mac, and doing so would make it (by definition) QM. But selling this loan to Freddie Mac would cost the borrower over $4,100 in Freddie Mac fees alone and approximately $5,500 in total fees. No borrower wants to pay over 7.3 percent in closing fees. In the past I would accommodate this customer, who could be a good credit risk, by holding the loan in my portfolio, thereby avoiding the Freddie Mac fee. But my closing fee would still, of necessity, exceed $3,000, which is the ceiling on QM loans in this dollar range. With the QM rule in the effect, the only way I can serve this customer is by selling the loan and charging a significantly higher fee. Paradoxically, the fee cap will cause this customer to pay a higher fee for a Freddie Mac loan, or to lose access to credit altogether.

Balloon Payment Mortgages

Though not offered by my bank, balloon loans are a staple of community bank mortgage lending. Community banks make balloon loans to manage their interest rate risk on loans that are not eligible for sale into the secondary market, such as loans collateralized by unique properties without adequate comparables or loans to farmers or small business owners whose debt-to-income ratios fall outside of secondary market parameters, despite their personal net worth and means to repay the loan. These loans are made typically for 3 or 5 years, and repriced and renewed when they come due. However, balloon loans are explicitly excluded from QM status unless they are made in rural or underserved areas under unreasonably narrow definitions of "rural" and "underserved." Though the CFPB has suspended application of the rural definition for small creditors until 2016, this deferral does not provide community bankers with the certainty required for long-term business planning. A permanent statutory clarification is needed regarding the status of small creditor balloon loans.

"Higher priced mortgage loans"

Community bank loans often meet the regulatory definition of "higher priced mortgage loans." When a loan cannot be securitized, as many community bank loans cannot, it must be funded through retail deposits which include higher cost certificates of deposits, and this results in a higher interest rate. The regulatory definition is heavily weighted toward the pricing that Fannie Mae and Freddie Mac set based on their ability to access capital and funding markets that are not available to community banks. In addition, in today's historically-low interest rate environment, it is more likely that a reasonably-priced loan will meet the Federal Reserve's definition of "higher priced." Almost half of community bank survey respondents (44 percent) said that more

than 70 percent of their loans were "higher priced." "Higher priced" loans – even when that pricing is aligned with the lender's cost of funds, risk, and other factors – are excluded from the conclusive presumption of compliance (or "safe harbor") protections under QM and instead carry only a "rebuttable presumption of compliance," a much weaker protection which exposes the lender to unacceptable litigation risk for the life of the loan. A higher price trigger for the safe harbor applies for loans made by community banks that meet the definition of "small creditor" – 3.5 percent above average prime rate offer (APOR) – though we have recommended that the CFPB adopt an alternative rate threshold that takes into account a community bank's cost of funds.

While I cite three examples above, there are additional examples of safe, legitimate loans that will fail the definition of QM, even under the broader terms available to "small creditors," and therefore not be made by community banks.

QM Does Not Obviate Ability-to-Repay (ATR)

QM compliance, as outlined above, doesn't tell the full story of the impact of ATR. While we intend to limit our lending to QM loans, which are presumed compliant with ATR, we are still compelled to analyze each loan for ATR compliance. This analysis, which is costly and time consuming, is a necessary backstop. If a presumed QM loan is later determined not to be QM because, for example, the closing fees were not properly calculated and exceed three percent or the income verification was incomplete or faulty, we need assurances that the loan is at least ATR compliant. The liability for ATR violations, as noted above, is draconian. There is too much at stake to neglect ATR compliance.

In addition, we have every expectation that our prudential regulators will want to see clear, third-party documentation of the eight ATR underwriting factors. If such documentation is deemed insufficient, an asset may be downgraded and subject to higher capital. At this point, we simply don't know how the prudential regulators will approach ATR/QM, but there is a clear history of examiners applying rules that are not supposed to affect smaller institutions. In short, we cannot bear the risk making loans that are not ATR compliant. Even if a loan satisfies the QM criteria, we will not extend it if it fails the ATR criteria. We welcome QM as a safe harbor from ATR liability, but it does not provide any compliance relief.

The new ATR rules are very prescriptive on how we evaluate credit and calculate the debt-to-income ratio. Consider the difficulty of applying just one of the eight ATR factors, an applicant's credit history. Many first time homebuyers, the very people needed to spur a housing recovery, do not have sufficient credit history, sometimes because they've been living with their parents and have not had to make rent or utility payments. If such a borrower has saved for a 20 percent down payment and has sufficient income, we may consider him or her a good credit risk. What's more, the loan may even be a QM loan because QM does not require credit history. But the loan

would not be ATR compliant because the borrower has no credit history, and ATR must serve as a check on our QM lending.

Community banks need a solution that will provide for more clarity and simplicity in QM designations without tortuous analysis. This certainty will relieve us of the 6 factor QM analysis as well as the 8 factor ATR analysis. ICBA's recommended solution would set down a bright line: QM status for any community bank loan held in portfolio. I will elaborate on this solution later in the testimony.

QM/ATR analysis is particularly challenging for community banks. While large, conventional lenders typically take a "check list" approach to granting credit, community banks, by contrast, are committed to working with their customers to provide customized loans under exceptional circumstances. This is the source of our competitive advantage in an industry that is rapidly consolidating. However, QM/ATR, both the rules and their anticipated application by examiners, provide a strong disincentive to making exceptions and thereby erode the community bank advantage. I believe many community bankers will shift to using a correspondent lender for all residential mortgage loans, allowing someone else to assume the significant compliance burden.

Small Creditor Definition Should Be Expanded

The QM rule has two criteria for a "small creditor": assets of less than $2 billion and fewer than 500 first-lien, closed end mortgages originated in the last year. However, many banks that exceed either or both of these thresholds have all the attributes of authentic community banks, including deep roots in the community, local deposit funding, personalized service, and strong, conservative underwriting. What's more, the loan volume test is not consistent with the asset test. The Peoples Bank Company is well below the asset threshold with assets of approximately $400 million. Our loan volume varies considerably depending on demand. In 2012 we had total originated mortgages of 493, which is uncomfortably close to the threshold. While I don't have data comparing loan volume to asset size, I do not believe that my bank is atypical.

I would like to grow my bank's mortgage lending to serve more customers and small communities and meet growing demand as the housing market recovers. I'm confident that I can grow without changing the community-based character of my bank. But the prospect of crossing the loan volume threshold and losing "small creditor" status is a strong disincentive to growth and makes the alternative of selling to a larger lender more appealing.

Without "small creditor" status, my loans will be subject to a 43 percent debt-to-income limitation, a lower price trigger for "high cost" QM status which carries higher liability risk, and restrictions on balloon loans (which I do not currently offer but may in the future). Consider

some examples of safe, legitimate and commonly-offered loans that are denied QM status under the 43 percent DTI limitation:

- Young or start up small business owners or farmers are typically not incorporated so all of their business-related debt appears on their credit reports and must be included in the DTI calculation. These individuals often borrowed to purchase their businesses or farms and are highly leveraged as a result. Their entrepreneurial initiative, which spurs job creation and community development, should be encouraged. Forty-three percent is not a realistic or feasible DTI limitation for such individuals.
- Highly compensated individuals can incur high debt and still have a high disposable income for mortgage payments and other housing expenses. An individual earning $200,000 with a 48 percent DTI would still have $104,000 left over for living expenses. High earners often have second homes or other assets that justify their higher debt. Their purchasing helps drive economic growth. The 43 percent DTI limitation will reduce credit availability for high income individuals whose participation is needed to support the housing market recovery.

This committee should also take a very careful look at the QM rule's potential impact on minority and underserved communities. According to a recent Federal Reserve analysis of Home Mortgage Disclosure Act data, in 2010 roughly one third of loans made to African American and Hispanic borrowers would not meet the QM rule's DTI limitation.[3] In particular, ICBA is very concerned about the fate of these borrowers once QM status for federal loan programs, which many of these borrowers take advantage of, expires after 7 years or when Fannie Mae and Freddie Mac are restructured, whichever comes first.

ICBA urges this committee to support our request to the CFPB to raise the loan volume threshold. The problem could be easily addressed by disregarding loans sold into the secondary market in applying the threshold. This change would place my bank well below the threshold.

A Clean Legislative Fix is Needed

ICBA's Plan for Prosperity solution to the threat of QM is simple, straightforward, and will preserve the community bank lending model: Safe harbor QM status for community bank loans held in portfolio, including balloon loans in rural and non-rural areas and without regard to their pricing. When a community bank holds a loan in portfolio, it holds 100 percent of the credit risk and has every incentive to ensure it understands the borrower's financial condition and to work with the borrower to structure the loan properly and make sure it is affordable. Withholding safe harbor status for loans held in portfolio, and exposing the lender to litigation risk, will not make

[3] "Mortgage Market Conditions and Borrower Outcomes: Evidence from the 2012 HMDA Data and Matched HMDA-Credit Record Data." Neil Bhutta and Glenn B. Canner, Federal Reserve Division of Research and Statistics. November 2013.

the loans safer, nor will it make underwriting more conservative. It will merely deter community banks from making such loans in the many counties that do not meet the definition of rural.

Introduced Legislation

ICBA is very pleased that the solution discussed above has been included in four bills introduced by members of this committee:

- The Protecting American Taxpayers and Homeowners Act (H.R. 2767), introduced by Chairman Jeb Hensarling and Representative Scott Garrett, would delay implementation of the CFPB's ability-to-repay rules for one additional year and provide QM status to any mortgage originated and held in portfolio; among other mortgage reform provisions.
- The CLEAR Relief Act (H.R. 1750), introduced by Representative Blaine Luetkemeyer, a former community banker and bank examiner, would (i) accord QM status to mortgages originated and held in portfolio for at least three years by a lender with less than $10 billion in assets; among other mortgage reform provisions.
- The Portfolio Lending and Mortgage Access Act of 2013 (H.R. 2673), sponsored by Rep. Andy Barr (R-KY), would accord QM status to any residential mortgage loan held in the originator's portfolio.
- The CFPB Rural Designation Petition and Correction Act (H.R. 2672), also sponsored by Rep. Barr, would create a process in which individuals could petition the CFPB in order to have the rural status of a county reassessed. This process would help to more accurately identify rural counties and to ensure individuals in those communities have their mortgage needs met.

We are grateful to the sponsors of the above bills.

Thank you again for the opportunity to testify today. ICBA looks forward to working with this committee to reform the CFPB mortgage rules in order to preserve community bank mortgage lending.

Now More Than Ever
Help Build It!

Testimony

of

Frank Spencer
President and Chief Executive Officer
Habitat for Humanity of Charlotte, NC

before the

Subcommittee on Financial Institutions and Consumer Credit
Committee on Financial Services
United States House of Representatives

January 14, 2014

Madam Chair, Mr. Ranking Member, and members of the Subcommittee, thank you for the opportunity to testify regarding regulatory implications of the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203) for Habitat for Humanity's approximately 1500 U.S. affiliates and their partner homeowners in more than 2000 communities around the country. My name is Frank Spencer, and I am the President and CEO of Habitat for Humanity of Charlotte, North Carolina.

Habitat's vision and work in the United States

Habitat for Humanity's vision is a world where everyone has a decent place to live. Anchored by the conviction that housing provides a critical foundation for breaking the cycle of poverty, Habitat has helped more than 4 million people construct, rehabilitate or preserve homes since 1976. Habitat also advocates to improve access to decent and affordable shelter and supports a variety of funding approaches, including mortgage lending models, that enable families with limited resources to make needed improvements on their homes as their time and resources allow. As a nonprofit Christian housing organization, Habitat works in more than 70 countries and welcomes people of all races, religions and nationalities to partner in its mission.

My affiliate, Habitat of Charlotte, NC, builds new homes, rehabilitates foreclosed houses, repairs houses, runs a $4 million ReStore retail outlet, recycles 1,200 tons of steel per year, and currently services approximately 780 non-interest bearing mortgages for its partner families. Habitat Charlotte has served 1,200 families over its 30 years, and is supported by 85 employees and over five thousand volunteers.

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Habitat has a nearly 38 year track record in effectively and consistently addressing the needs of a key underserved sector of the U.S. mortgage market. The mortgages Habitat affiliates originate and service, by design, pose little risk either to our partner families or to the market, as has been demonstrated by Habitat's foreclosure rate that remained at about 2 percent throughout the housing crisis and recession, even outperforming the conventional mortgage market in many locations. The ongoing success of Habitat's self-help homeownership model—a unique approach to home building and mortgage lending that is thriving—merits federal support, not regulatory intervention that threatens its survival.

Habitat greatly appreciates the commitment Congress has made to stable and productive housing markets as the nation continues to recover from the foreclosure crisis and economic recession. The success of the Habitat homeownership model is, in fact, predicated on market stability and the long-term appreciation of real estate value. Habitat looks forward to continuing to work with members of this committee and the Consumer Financial Protection Bureau (CFPB) to protect the Habitat model as we all work to achieve a stable and resilient U.S. homeownership market.

Working toward Dodd-Frank compliance

While today I will testify in support of legislation to exempt Habitat affiliates from certain mortgage regulation reforms, Habitat understands and fully supports efforts to protect consumers and the American taxpayer from predatory lending schemes that undermine the stability of U.S. housing markets. Habitat opposes neither the Qualified Mortgage (QM) standard specifically nor the Dodd-Frank law more generally. Affiliates have worked diligently to meet the new standards, and we seek legislative relief only after having exhausted all other paths to compliance.

In our efforts to comply with these rules and regulations, Habitat has invested in trainings, materials, resources and guidance for affiliates developed in partnership both with industry experts and with law firms. Although Habitat was never the target of Dodd-Frank, compliance has required significant commitments of both human and financial resources that would otherwise be invested in meeting critical housing needs in the communities each of you represent.

Habitat Charlotte is the largest affiliate in North Carolina. We have a full-time employee who is the only Habitat employed licensed mortgage originator in the state. She has spent most of the last year becoming trained on the new standards, auditing our processes to insure compliance, and organizing our staff to prepare for implementation this January. Jill further works to guide other Habitat affiliates through seminars and meetings. She has devoted well over 1000 hours to this process. This is only on the origination side of the process. We have expended equal if not greater effort preparing for the requirements of the servicing component of these new regulations. Though I cannot speak to the specific costs incurred by each of Habitat's U.S. affiliates, as requirements and costs vary from state to state, I can assure you that the costs to nearly all affiliates have been very significant, indeed.

In seeking to avoid the need for legislative relief from Dodd-Frank, Habitat International has also worked closely and extensively with Director Cordray and his staff at the Consumer Financial Protection Bureau (CFPB) to ensure Habitat loans could not wrongly be viewed as "predatory" under the new guidelines and to protect Habitat affiliates from incurring liability simply by continuing to implement the Habitat model that has been highly successful for over 37 years. Habitat holds Mr. Cordray and his staff in the highest regard and appreciates their good-faith efforts, but as the regulations stand today, Habitat affiliates remain at significant risk of debilitating liability.

Protecting Habitat Homeownership Act of 2013 (HR 3529)

In spite of significant investments in compliance by Habitat affiliates and Habitat International's very constructive conversations with the CFPB, Habitat affiliates' state and local government partners and our critical financial partners continue to express concern regarding potential liability they could incur under the new mortgage regulatory framework by partnering with Habitat. Habitat greatly appreciates Rep. Meadows' introducing legislation that would exempt Habitat affiliates from three Dodd-Frank provisions that continue to threaten Habitat's future ability to serve low-income families. HR 3529 exempts affiliates from the following requirements.

(1) Periodic statement (15 U.S.C. 1638(f)): Costs associated with meeting Dodd-Frank periodic statement requirements unnecessarily divert Habitat affiliate funds from serving families to regulatory compliance.

Dodd-Frank includes very detailed requirements for monthly reporting by loan servicers. The primary purpose of the regulation is to ensure consumers are aware of the full costs of their mortgage interest and fees. Because Habitat homeowners are not typically charged interest or fees, the regulations do not serve a consumer protection purposes in the Habitat context, and the significant expense of acquiring the necessary technology platforms to meet the requirement will reduce the number of families affiliates can serve. This provision ensures that all Habitat affiliates will be protected from onerous requirements created for large banks with much greater staffing and resource capacity, even if they service Habitat loans owned or originated by other affiliates.

(2) Ability-to-repay (ATR) (15 U.S.C. 1639c(a)) : Although QM regulations provide limited protection to Habitat affiliates, regulatory exemptions do not apply to some affiliates, and regulatory uncertainty threatens affiliate relationships with government and financial partners across the board.

Because Habitat affiliates are required to serve families without access to traditional sources of mortgage financing, Habitat partner families' debt-to-income ratios will frequently, if not always, fail to meet industry and government ability-to-repay standards. That said, ensuring our families' actual ability to repay their Habitat loans is, obviously, central to the success of the model. Unlike conventional home loan programs, Habitat's partner families who typically earn no more than 60 percent of an area's median income, purchase their homes with affordable, no-profit mortgages provided by local Habitat affiliates. Habitat's no-profit/zero-percent interest loans are made affordable through the use of sweat equity (families must help build their homes), volunteer labor, and cash and in-kind donations. All home sales and mortgage financing transactions limit the monthly payments of a Habitat homeowner to no more than 30 percent of the household's gross income.

Additionally, all Habitat partner families receive extensive pre-purchase counseling through the affiliate, focusing on issues such as financial responsibility, budgeting, home repair, and being a good neighbor. The relationship between Habitat affiliates and their partner families is a true partnership, not simply a contractual relationship between a home builder and mortgagor and a purchaser. Habitat affiliates and partner families are financially and physically invested in one another and are dedicated to achieving successful homeownership.

Habitat affiliates understand that serving low-income households successfully means putting processes in place to assist partner families when life events result in their being unable to make their mortgage payments, and affiliates have long records of success in partnering with families to develop plans, sometimes including forbearances or loan modifications, to remedy any delinquencies. Partner families, by the same token, know that when they face hardships, their affiliates' family services coordinators are there to assist them in getting back on track.

In spite of the proven success of Habitat partner families in repaying their Habitat mortgages, Dodd-Frank ATR requirements seriously threaten affiliates' ability to meet local housing needs. While we are appreciative of CFPB's exempting affiliates extending credit no more than 200 times annually from the ATR guidelines, many affiliates will not qualify for the exemption, and for others, the exemption is insufficient to maintain longstanding partnerships with government and financial institutions. Government and financial partners are telling affiliates that the ATR exemption fails to protect against potential liability. As a result, tens, if not hundreds, of millions of dollars of investment in Habitat by government and financial institutions is at risk, as are the tens of thousands of families whose future housing needs will otherwise be met through these investments.

Even if the ATR exemption were completely effective, however, many affiliates would remain at serious risk. Although most affiliates extend credit far fewer than 200 times each year, ATR guidelines affect more than might be expected, because subordinate liens are counted against the limit. Most affiliates employ second and sometimes third "soft" mortgages to cover the difference between the appraised value of a home and the value of the first mortgage and to prevent partner families from "flipping" their Habitat home. Because these subordinate liens are typically forgiven over time or become payable only on sale of the property, there is not a monthly cost to the homeowner, meaning they never impact a homeowner's ability to repay a mortgage. New ATR regulations, therefore, threaten to significantly reduce Habitat's ability to serve families without providing any actual protection to the families or the broader housing market.

ATR regulations are also having the unintended consequence of discouraging Habitat affiliates from serving more families and growing their portfolios beyond 200 loans and from working together to improve their mortgage products and portfolios. We in Charlotte have provided mortgage servicing for smaller affiliates. This has both increased the quality of Habitat mortgage originations and servicing and improved the efficiency of affiliates.

In Charlotte, unfortunately, we have recently ended such arrangements, as we could not ensure compliance with the 200 loan limit. The potential liability of non-compliance serves as a disincentive to enter into such arrangements. As an alternative, some affiliates have moved to commercial servicers but retain the significant origination risk for which they are unlikely to have the resources to achieve immediate compliance. The proposed statutory exemption will enable more affiliates to join forces to standardize and improve the quality of their loan products and services, reducing costs and allowing more money to be committed to serving partner families.

(3) Appraisal: Appraisals donated to Habitat potentially violate independence and customary charges regulations (12 CFR §1026.42).

Dodd-Frank implementing regulations require property appraisals to be independent and appraisers to receive "customary and reasonable" fees. Because a large majority of Habitat's appraisals are donated, appraisers most frequently receive no fee at all, meaning affiliates could easily be judged to be in violation of the "customary and reasonable" requirement. Additionally, because the affiliate is receiving an appraisal without providing any value in return, the appraisal, itself, could be judged not to be independent.

Because Habitat's donated appraisals appear to violate the letter of Dodd-Frank's independence and customary fee requirements, and because there is no written clarification or regulatory exemption around this exception, Habitat affiliates remain at serious risk in spite of the CFPB's verbal interpretation declaring donated appraisals are acceptable in the Habitat context. The bill provides the necessary clarification by exempting Habitat's donated appraisals from these two regulations.

Habitat remains strongly committed to Dodd-Frank compliance, and the three exemptions provided in HF 3529 will enable affiliates both to meet the spirit of the law and to focus limited resources on providing responsible mortgage products to well-qualified families.

In conclusion, Habitat for Humanity of Charlotte believes it is in compliance with the law as it now stands. However, knowing the human and financial investment we have made, it is equally clear to me that many of our affiliates cannot adequately make the same investment. These affiliates are often the only option for affordable housing in their communities. Many are in rural areas. They know their borrowers as friends and neighbors. In North Carolina alone there are 85 affiliates. While we operate in the largest metropolitan area, we account for only about ten percent of the Habitat production in the state. Rural and small affiliates account for over half of the housing built.

Habitat offers a hand up, not a hand out. Our home owner partners purchase their homes from us at cost and can afford the mortgage only because it bears no interest. These folks are hard -working people with low-wage jobs. They are playing by the rules, pursuing the American Dream. We ask that you support HR 3529 so that other deserving, qualified families are not inadvertently thwarted in that pursuit.

Thank you, Madam Chair, for the opportunity to testify and for your many years of support of Habitat for Humanity. Thanks also to Representatives Meadows and Butterfield for their leadership on the bill and to all the bill's cosponsors for their support.

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NAFCU

National Association of Federal Credit Unions

Testimony of

Daniel Weickenand
CEO
Orion Federal Credit Union

On Behalf of

The National Association of Federal Credit Unions

"How Prospective and Current Homeowners Will Be Harmed by the CFPB's Qualified Mortgage Rule"

Before the
House Financial Services Subcommittee on Financial Institutions and Consumer Credit
United States House of Representatives

January 14, 2014

Introduction

Good morning, Chairman Capito, Ranking Member Meeks and Members of the Subcommittee. My name is Daniel Weickenand and I am testifying this afternoon on behalf of the National Association of Federal Credit Unions (NAFCU). I serve as the CEO of Orion Federal Credit Union headquartered in Memphis, Tennessee. Founded in 1957 as Memphis Area Teachers' Credit Union, Orion FCU has grown to become the largest credit union in western Tennessee, with over 50,000 members, and over $530 million in assets. To better serve our field of membership, in August 2012, Orion was granted low-income designation from the National Credit Union Administration (NCUA), as about one-third of Memphis residents live below the poverty line.

Prior to being named CEO of Orion FCU, I served as the Chief Financial Officer of FEDEX Employees Credit Association for over nine years after beginning my career as a financial institution auditor. I am proud of Orion's growth and our dedication to offering a full spectrum of financial services from checking and savings accounts, to auto loans and mortgages.

In 2013, I was elected as a Director-at-Large to NAFCU's Board of Directors. In this role, I help drive the trade association's agenda. As you know, NAFCU is the only national organization exclusively representing the interests of the nation's federally chartered credit unions. I also serve on NAFCU's Regulatory and National Share Insurance Committees. NAFCU member credit unions collectively account for approximately 68 percent of the assets of all federally chartered credit unions. NAFCU and the entire credit union community appreciate the opportunity to discuss the Consumer Financial Protection Bureau's (CFPB) 'ability-to-repay' rule and the impact the Qualified Mortgage (QM) standard will have on credit union lending and the 97 million credit union members across the country. As members of the subcommittee are aware, the QM standard is only one piece of a complicated set of mortgage rules that had a compliance deadline of last Friday.

Historically, credit unions have served a unique function in the delivery of essential financial services to American consumers. Established by an Act of Congress in 1934, the federal credit union system was created, and has been recognized, as a way to promote thrift and to make financial services available to all Americans, many of whom may otherwise have limited access to financial services. Congress established credit unions as an alternative to banks and to meet a precise public need – a niche that credit unions still fill today.

Every credit union is a cooperative institution organized "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes." (12 USC 1752(1)). While nearly 80 years have passed since the Federal Credit Union Act (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

- credit unions remain wholly committed to providing their members with efficient, low-cost, personal financial service; and,

- credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

Credit unions are not banks. The nation's approximately 6,600 federally insured credit unions serve a different purpose and have a fundamentally different structure than banks. Credit unions exist solely for the purpose of providing financial services to their members, while banks aim to make a profit for a limited number of shareholders. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union—"one member, one vote"—regardless of the dollar amount they have on account. Furthermore, unlike their counterparts at banks and thrifts, federal credit union directors generally serve without remuneration—a fact epitomizing the true "volunteer spirit" permeating the credit union community.

America's credit unions have always remained true to their original mission of "promoting thrift" and providing "a source of credit for provident or productive purposes." In fact, Congress acknowledged this point when it adopted the Credit Union Membership Access Act (CUMAA – P.L. 105-219). In the "findings" section of that law, Congress declared that, "The American credit union movement began as a cooperative effort to serve the productive and provident credit needs of individuals of modest means ... [and it] continue[s] to fulfill this public purpose."

Credit unions have always been some of the most highly regulated of all financial institutions, facing restrictions on who they can serve and their ability to raise capital. Furthermore, there are many consumer protections already built into the Federal Credit Union Act, such as the only federal usury ceiling on financial institutions and the prohibition on prepayment penalties that other institutions have often used to bait and trap consumers into high cost products.

Despite the fact that credit unions were not the cause of the financial crisis, they are still firmly within the regulatory reach of several provisions contained in the Dodd-Frank Act, including all rules promulgated by the Consumer Financial Protection Bureau (CFPB). The breadth and pace of CFPB rulemaking is troublesome as the unprecedented new compliance burden placed on credit unions has been immense. Many credit unions have had to add compliance staff and increase the workload on compliance officers just to keep up. Unfortunately, this takes away from resources that they could be dedicating to their members in services and loans. This is what NAFCU warned of during the financial reform debate and one of the reasons why we were the only trade association that opposed the CFPB having authority over credit unions.

The impact of this growing compliance burden is evident as the number of credit unions continues to decline, dropping by more than 900 institutions since 2009. While there are a number of reasons for this decline, a main one is the increasing cost and complexity of complying with the ever-increasing onslaught of regulations. Credit unions didn't cause the financial crisis and shouldn't be caught in the crosshairs of regulations aimed at those

entities that did. Unfortunately, that has not been the case thus far. As we are hearing from many of our credit union members, "enough is enough" when it comes to the tidal wave of new regulations.

As evidenced by today's hearing, the subcommittee has clear concerns about the breadth and pace of rulemaking stemming from the Dodd-Frank Act and what impact such rules will have on the mortgage origination process. Given the correlation between the health of the housing sector and the overall economy, we appreciate the subcommittee's well placed focus.

The CFPB's Ability-to-Repay / Qualified Mortgage Rule

NAFCU generally supports efforts to ensure that consumers are not placed into mortgages they cannot afford. This was the long-standing practice of credit unions before the financial crisis and continues to be the case post-crisis. Accordingly, NAFCU and its member credit unions have taken advantage of every possible avenue to educate the new Consumer Financial Protection Bureau about the unique nature of credit unions. While we have a positive relationship with the CFPB, and have weighed in on this issue repeatedly, we maintain concerns about the Qualified Mortgage (QM) standard that has been developed. We are concerned that this rule will potentially reduce access to credit and hamper the ability of credit unions to continue to meet their member's needs. As you know, the compliance deadline for the ability-to-repay rule outlining the QM standard just passed on Friday, January 10, 2014.

Under the new ability-to-pay rule, lenders must review eight key underwriting criteria and verify that borrowers have the income or assets that lead to a reasonable belief that the borrower can afford to repay the mortgage. Credit unions have long had strong underwriting standards, as was demonstrated by the quality of their loans during the financial crisis. Still, failure to follow the specific ability-to-repay rule can be costly for the lender as they may have to refund proceeds paid by the borrower and could lose the

ability to foreclose on the property if the loan goes into default. Loans that meet the QM standards are deemed to meet the ability-to-repay requirements.

In addition to underwriting criteria to verify a reasonable expectation of repayment, there are several basic criteria that most credit union loans must generally meet to be deemed a Qualified Mortgage:

- No negative amortization and interest-only payments;
- No balloon payments;
- Loan term of 30 years or less;
- Generally, a 3% cap on points and fees; and,
- the member's debt-to-income (DTI) must be 43% or less.

Credit unions must meet the ability-to-repay requirements for all closed-end consumer credit loans secured by a dwelling. The credit union's compliance with the eight underwriting criteria is necessary prior to originating a mortgage loan. However, meeting the additional criteria to obtain QM status is not required and credit unions may make a "non-QM" loan and accept the additional liability that comes along with it.

Unfortunately, a number of mortgage products sought by credit union members, and offered by credit unions, may disappear from the market as they are non-QM loans. For example, a forty-year mortgage loan cannot be a QM because it exceeds the maximum loan term for QMs. This has been a product sought by credit union members in high-cost areas as it can help lower the monthly mortgage payment. While credit unions can still originate forty-year mortgages, since the special legal protections for meeting the ability-to-repay requirements will not be extended, many may cease to do so. Similarly, because of a problematic definition, a number of credit unions make mortgage loans with points and fees greater than 3% because of their relationships with affiliates and because they can leverage those relationships to get the best deal for their members. Those mortgages will also not receive QM status, which could mean higher costs down the line for credit union members.

For non-qualified mortgages, a credit union will not receive any presumption of compliance with the ability-to-repay requirements. Under the rule, the least risk to credit

unions would be to originate only QM loans. Limiting loans to solely QMs would reduce the legal risk and help ensure their loans are eligible for sale on the secondary market (as the Federal Housing Finance Agency has stated it will not allow Fannie Mae and Freddie Mac to buy non-QM loans, with the exception of the debt-to-income ratio component of the QM definition). Additionally, the ability to sell the loans will help credit unions manage interest rate and concentration risks.

A recent NAFCU survey of its members revealed that a majority of credit unions will cease or greatly reduce their offerings of non-QMs. The credit unions that will offer non-QMs have indicated that only a very small portion of the mortgage offerings will consist of non-QMs.

At Orion FCU, the executive management team, in consultation with our board of directors, made a conscious decision at the onset of the financial crisis to double down on our efforts to return as much as possible to our members and the community they live in. We continue to follow this philosophy and oftentimes sacrifice earnings in order to achieve these important objectives. In today's lending environment, with interest rates at record lows, margins on non-QM loans will be very narrow. When you take into account the additional legal liability associated with non-QM loans, this margin will be even narrower. While some institutions may start charging a premium on their loans to account for the additional risk associated with non-QMs, we do not feel this is in the best interest of our credit union, our members and our community. Consequently, we have decided to cease to offer non-QM loans at this time.

I cannot tell you how difficult this decision has been. Orion takes great care in placing our members with the right mortgage product, and the QM standard will inevitably force us to turn many creditworthy borrowers away. For example, in November of 2010, we started a special "Orion Home Run Program" that allows qualifying participants to rent a home for a set period of time. During the rental period, the participant is expected to make timely payments, keep the home in good condition and have a positive impact on their neighborhood. When the rental period lapses, the home can then be purchased

outright at a reduced price with the previous rental payments applied as the down payment. Despite demonstrating an ability–to-repay, it is likely that many program participants would not fit the QM standard and therefore would not have the opportunity to become a homeowner through Orion FCU at this time.

As a NAFCU Board member, I have talked with many of my fellow credit union CEO's about this issue. I know that many of them share the same concerns that we have at Orion FCU and some have stopped their non-QM lending for the time being. Others may be cautiously going forward with non-QM loans, but many have indicated that they will be more stringent in making them and do them only on a limited basis. For Orion FCU, approximately 10% of all of our mortgage loans in the last few years would be classified as non-QM. Unfortunately, today these loans, and the people they would have helped, are no longer being offered by my credit union. In order to serve our members, we, and I am sure my fellow CEOs, will continue to look for other ways to help members get the affordable credit that they need. This could include future re-evaluation of our decisions on non-QM loans. However, at this time the uncertainty and the liability is just too great.

While the CFPB has sought input on the rules, the fact that the statute is so limiting means that significant changes to the ability-to-repay rule must be mandated by Congress. While credit unions understand the intention of the rule and importance of hindering unscrupulous mortgage lenders from entering the marketplace, this rule is unnecessarily restrictive for credit unions. There are several changes to the QM standard that would make it more amenable to the quality loans credit unions are already making. Congressional action in these areas would help open the spigot of mortgage lending that has been now shut off for a number of Americans.

Points and Fees

First and foremost, NAFCU strongly supports bipartisan pieces of legislation in the House (H.R. 1077/ H.R. 3211) introduced by Representative Bill Huizenga to alter the definition of "points and fees" prescribed by the QM standard. NAFCU supports exempting from the QM cap on points and fees: (1) affiliated title charges, (2) double

counting of loan officer compensation, (3) escrow charges for taxes and insurance, (4) lender-paid compensation to a correspondent bank, credit union or mortgage brokerage firm, and (5) loan level price adjustments which is an upfront fee that the Enterprises charge to offset loan-specific risk factors such as a borrower's credit score and the loan-to-value ratio.

Clearly, as constructed, the assumption being made by including affiliate fees in the calculation of points and fees stems from affiliate fees being higher than non-affiliate fees. However, in the case of credit unions and credit union services organizations, credit union members are often able to secure lower fees because of this relationship. Given the unique nature of credit unions compared to other loan originators, they look for the best interests of their member-owners in these relationships and seek to get them the best deal.

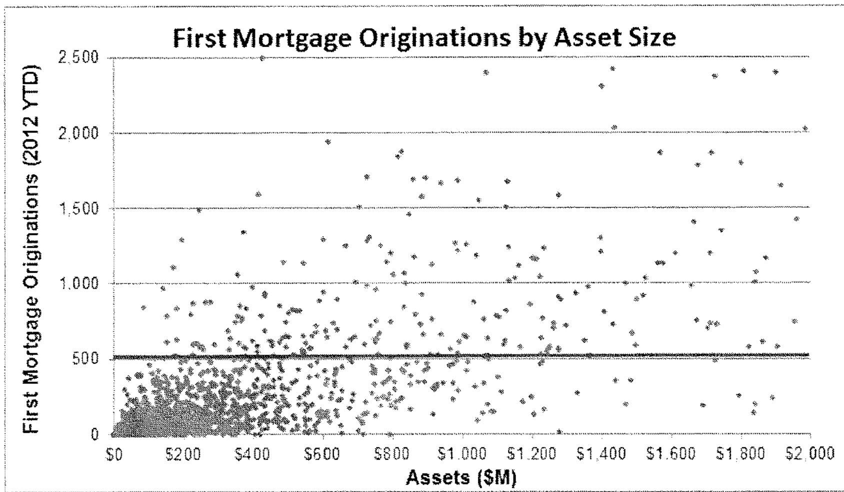
Making important exclusions from the cap on points and fees will go a long way toward ensuring many affiliated loans, particularly those made to low- and moderate-income borrowers, attain QM status and therefore are still made in the future.

"Small Credit" Exemption and Loans Held in Portfolio

NAFCU appreciates the CFPB's recognition that the ATR/QM rule presents significant challenges to small credit unions. To alleviate burdens on small creditors, the CFPB provided a "small creditor" exemption, under which credit unions with less than $2 billion in assets who conduct 500 or fewer mortgages in a year, and hold all of the mortgages in portfolio, are not subject to the rule.

While NAFCU acknowledges that this exemption is intended to provide relief for smaller institutions, there are several aspects that we believe need to be modified. First, we believe that both the asset-size and the 500 mortgages thresholds are too low. As the chart below indicates, there are many credit unions that are approaching one or both of the thresholds, which will effectively render the exempt moot for them.

Mortgages Extended by Credit Unions with $2 billion in Assets or Less



NAFCU also believes that *all* mortgages held in portfolio should be exempt from the QM rule. This exemption should not be limited to small credit unions. NAFCU supports exempting mortgage loans held in portfolio from the QM rule as the lender, via its balance sheet, already assumes risk associated with the borrower's ability-to-repay.

40-year Loan Product

Credit unions offer the 40 year product their members often demand. To ensure that consumers can access a variety of mortgage products, NAFCU supports mortgages of duration of 40 years or less being considered a QM.

Debt-to-Income Ratio

NAFCU supports Congress directing the CFPB to revise aspects of the 'ability-to-repay' rule that dictates a consumer have a total debt-to-income (DTI) ratio that is less than or equal to 43 percent in order for that loan to be considered a QM. This arbitrary threshold will prevent otherwise healthy borrowers from obtaining mortgage loans and will have a particularly serious impact in rural and underserved areas where consumers have a

limited number of options. The CFPB should either remove or increase the DTI requirement on QMs.

Loans Sold to the Government Sponsored Entities

NAFCU also believes that mortgages that are sellable to Fannie Mae and Freddie Mac should be deemed to meet the ATR standards and provided safe harbor protection. NAFCU believes that Fannie Mae and Freddie Mac have adequately stringent underwriting standards.

Given the current interest rate environment, it is also worth noting that credit unions are closely monitoring the extent to which a secondary mortgage market will develop for non-QM loans. This is a critical matter as credit unions need unrestricted access to liquidity to facilitate new lending. The likelihood of a viable secondary mortgage market for non-QM loans is questionable given that the Government Sponsored Enterprises will only purchase mortgages with QM features with the exception of the debt-to-income requirement. Accordingly, credit unions will make few if any loans with longer than 30-year terms or interest-only loans, which are in demand and appropriate for some borrowers.

Lastly, NAFCU appreciates that the CFPB is looking for "good faith effort" of compliance in the early months after the rule takes effect. However, this could create ambiguity and we are hopeful that the CFPB will work closely with the credit union prudential regulator, the National Credit Union Administration (NCUA) to ensure that (1) the NCUA has a clear understanding of what "good faith effort" means; and (2) the NCUA communicates with credit unions their exam expectations in regard the mortgage rules.

As mentioned at the beginning of my testimony, the ability-to-repay rule is just one piece of thousands of pages of new mortgage regulation and guidelines from the CFPB.

Covering everything from the scope of coverage under the Home Ownership and Equity Protection Act, comprehensive changes to mortgage origination and servicing, amended rules associated with the Truth in Lending Act and Financial Institutions Reform, Recovery, and Enforcement Act, changing requirements for escrow accounts and issuing rules under Dodd-Frank relative to what constitutes a QM -- the breadth and pace of new requirements are daunting. A timeframe of less than 12 months to implement the rules should have caused serious pause for lawmakers and regulators. Even if the mortgage proposals are well intended, they come with a significant burden particularly to smaller institutions that have trouble just keeping up to be sure that they stay compliant with all of the new rules. That is why NAFCU urged a delay in the implementation date of the new rules.

Areas Where Credit Unions Need Regulatory Relief

The new mortgage rules are just part of the growing regulatory onslaught being placed on credit unions. The time and money spent learning and complying with the new mortgage standards, along with complying with a number of other burdensome and outdated regulations, takes money and staff away from our mission of helping credit union members.

At the beginning of the 113th Congress NAFCU was the first credit union trade association to formally call on the new Congress to adopt a comprehensive set of ideas generated by credit unions that would lead to meaningful and lasting regulatory relief for our industry. As part of that effort, NAFCU sent a five-point plan for regulatory relief to Congress (**Attachment A**) to address some of the most pressing areas where credit unions need relief and assistance. The five-point plan includes administrative improvements for powers of the NCUA, capital reforms for credit unions, structural improvements for credit unions, operational improvements for credit unions, and as demonstrated by the Target Corporation data breach on December 19, 2013, much needed changes to data security standards for all entities handling sensitive consumer information. There are number of provisions in this plan that have been introduced as

part of the *Regulatory Relief for Credit Unions Act of 2013* (H.R. 2572), by Representative Gary Miller (R-CA).

Conclusion

In conclusion, NAFCU recognizes the efforts of the CFPB to help ensure consumers are not placed in mortgages that they cannot afford. Credit unions have been working to put their members into affordable mortgages before the financial crisis and continue to do so post-crisis. The unique nature of the relationship between credit unions and their members means that credit unions demonstrate flexibility to give their members products that work for them on an individual basis. The restrictions of the new QM mortgage standard have eliminated this ability in many cases. Given the new liability and the additional costs that come with doing non-QM loans, many credit unions like mine have ceased or severely cut back their non-QM lending.

Congressional action to provide relief on some of the QM standards would help alleviate some of the problems and allow the spigot of mortgage credit to continue to flow to many Americans. Furthermore, Congressional action on regulatory relief would help ease the growing burdens associated with new compliance standards.

I thank you for the opportunity to appear before you today and would welcome any comments you may have.

Attachment A: **NAFCU letter to Chairman Johnson, Chairman Hensarling, Ranking Member Crapo and Ranking Member Waters calling on Congress to provide credit union regulatory relief; February 12, 2013.**

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Fred R. Becker, Jr.
President/CEO

February 12, 2013

The Honorable Tim Johnson Chairman Senate Committee on Banking, Housing and Urban Affairs United States Senate Washington, D.C. 20510	The Honorable Michael Crapo Ranking Member Senate Committee on Banking, Housing and Urban Affairs United States Senate Washington, D.C. 20510
The Honorable Jeb Hensarling Chairman House Financial Services Committee United States House of Representatives Washington, D.C. 20515	The Honorable Maxine Waters Ranking Member House Financial Services Committee United States House of Representatives Washington, D.C. 20515

Re: NAFCU Calls on Congress to Provide Regulatory Relief for Credit Unions

Dear Chairman Johnson, Chairman Hensarling, Ranking Member Crapo and Ranking Member Waters:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents the interests of our nation's federal credit unions, I write today to call for Congressional action during this session of the 113th Congress to enact broad-based regulatory relief that is essential to the credit union industry's ability to serve its 95 million members.

Our nation's credit unions are struggling under an ever-increasing regulatory burden that must be immediately addressed. A survey of NAFCU members late last year found that 94% have seen their regulatory burden increase since the passage of the *Dodd-Frank Act* in July 2010. The regulatory onslaught continues to compound as credit unions now have over 5,000 pages of rules from the Consumer Financial Protection Bureau (CFPB) that they must understand, interpret, and ultimately comply with – despite the fact that Congress has widely acknowledged that credit unions were not the cause of the financial crisis. Credit unions, many of which have very small compliance departments, and in some cases only one compliance officer, must comply with the same rules and regulations as our nation's largest financial institutions that employ armies of lawyers. The impact of the ever-increasing regulatory burden is even more sobering, as the number of credit unions continues to decline. There are nearly 700 fewer credit unions today than there were before the passage of the *Dodd-Frank Act.*

It is with this regulatory onslaught in mind that we call on Congress to enact meaningful regulatory reforms and provide much needed assistance to our nation's credit unions. Over the past year, we have been actively conversing with our member credit unions to identify those areas where regulatory relief is requisite.

Our ongoing discussions with our members have led us to draft a five point plan for credit union regulatory relief:

I. Administrative Improvements for the Powers of the NCUA

We believe there are changes that must be made to strengthen and enhance the National Credit Union Administration (NCUA).

First, the NCUA should have authority to grant parity to a federal credit union on a broader state rule, if such a shift would allow them to better serve their members and continue to protect the National Credit Union Share Insurance Fund.

Second, the NCUA should have the authority to delay the implementation of a CFPB rule that applies to credit unions, if complying with the proposed timeline would create an undue hardship. Furthermore, given the unique nature of credit unions, the NCUA should have authority to modify a CFPB rule for credit unions, provided that the objectives of the CFPB rule continue to be met.

Third, the NCUA and the CFPB should be required to conduct a look-back cost-benefit analysis on all new rules after three years. The regulators should be required to revisit and modify any rules for which the cost of complying was underestimated by 20% or more from the original estimate at the time of issuance.

Fourth, new examination fairness provisions should be enacted to help ensure timeliness, clear guidance and an independent appeal process free of examiner retaliation.

Finally, the Central Liquidity Facility (CLF) should be modernized with changes such as: (1) removing the subscription requirement for membership, and (2) permanently removing the CLF borrowing cap so that it may meet the current needs of the industry.

II. Capital Reforms for Credit Unions

NAFCU believes that capital standards for credit unions should be modernized to reflect the realities of the 21st century financial marketplace.

First, the NCUA should, with input from the industry, study and report to Congress on the problems with the current prompt corrective action (PCA) system and recommended changes.

Second, a risk-based capital system for credit unions that more accurately reflects a credit union's risk profile should be authorized by Congress.

Third, the NCUA should be given the authority to allow supplemental capital accounts for credit unions that meet certain standards.

Finally, given that very few new credit unions have been chartered over the past decade, and in order to encourage the chartering of new credit unions, the NCUA should be authorized to further establish special capital requirements for newly chartered federal credit unions that recognize the unique nature and challenges of starting a new credit union.

III. Structural Improvements for Credit Unions

NAFCU believes there should be improvements to the *Federal Credit Union Act* to help enhance the federal credit union charter.

First, Congress should direct the NCUA, with input from the industry, to study and report back to Congress suggested changes to outdated corporate governance provisions in the *Federal Credit Union Act*. Congress should then act upon those recommendations.

Second, a series of improvements should be made to the field of membership (FOM) restrictions that credit unions face expanding the criteria for defining "urban" and "rural"; and allowing voluntary mergers involving multiple common bond credit unions and allowing credit unions that convert to community charters to retain their current select employee groups (SEGs).

Finally, all credit unions, regardless of charter type, should be allowed to add underserved areas to their field of membership.

IV. Operational Improvements for Credit Unions

Credit unions stand willing and ready to assist in our nation's economic recovery. Our industry's ability to do so, however, is severely inhibited by antiquated legislative restrictions.

First, Congress should show America that they are serious about creating jobs by modifying the arbitrary and outdated credit union member business lending (MBL) cap. This can be done by raising the current 12.25% limit to 27.5% for credit unions that meet certain criteria or by raising the outdated "definition" of a MBL from last century's $50,000 to a new 21st century standard of $250,000, with indexing for inflation to prevent future erosion. Furthermore, MBLs made to non-profit religious organizations, businesses in "underserved areas", or small businesses with fewer than 20 employees should be given special exemptions for the arbitrary cap.

Second, requirements to mail redundant and unnecessary privacy notices on an annual basis should be removed, provided that the credit union's policy has not changed and additional sharing of information with outside entities has not been undertaken since the distribution of the previous notice.

Third, credit unions should be given greater authority and flexibility in choosing their investments.

Fourth, the NCUA should be given greater flexibility in how it handles credit union lending, such as the ability to establish longer maturities for certain loans.

Finally, Congress should clarify that Interest on Lawyers Trust Accounts (IOLTAs) at credit unions are fully insured and also that the NCUA should have practical requirements on how credit unions provide notice of their federally-insured status in any advertising.

V. 21st Century Data Security Standards

Credit unions are being adversely impacted by ongoing cyber-attacks against the United States and continued data breaches at numerous merchants. The cost of dealing with these issues hinders the ability of credit unions to serve their members. Congress needs to enact new 21st century data security standards that include: the payment of costs associated with a data breach by those entities that were breached; establishing national standards for the safekeeping of all financial information; require merchants to disclose their data security policies to their customers; requiring the timely disclosure of entities that have suffered a data breach; establishing enforcement standards for provisions prohibiting merchants from retaining financial data; requiring the timely notification of the account servicer if an account has been compromised by a data breach; and, requiring breached entities to prove a "lack-of-fault" if they have suffered from a data breach.

We have outlined a number of proposals that are necessary to providing the regulatory relief and assistance that credit unions urgently require. The number of credit unions continues to decline on a monthly basis and the ever-increasing regulatory burden the industry is facing is accelerating that decline as compliance costs become even more onerous. It is with that in mind that we call on Congress to act on any and all of these proposals, whether as a comprehensive package, or individually. Our nation's credit unions and their 95 million members desperately need this relief and we call on Congress to enact it.

Thank you for your attention to this important matter.

If you have any questions or would like further information about any of these issues, please do not hesitate to contact me or NAFCU's Executive Vice President of Government Affairs Dan Berger by telephone at (703) 842-2203 or by e-mail at dberger@nafcu.org.

Sincerely,

Fred R. Becker, Jr.
President and CEO

cc: Members of the Senate Banking Committee
Members of the House Financial Services Committee

AMERICAN
LAND TITLE
ASSOCIATION

TM

Statement for the Record

U.S. House of Representatives
Committee on Financial Services

Subcommittee on Financial Institutions and Consumer Credit

Hearing entitled
"How Prospective and Current Homeowners Will Be Harmed by the CFPB's Qualified Mortgage Rule"

January 14, 2014

Introduction

The American Land Title Association (ALTA) appreciates the Subcommittee for holding this important hearing entitled, "How Prospective and Current Homeowners Will be Harmed by the CFPB's Qualified Mortgage Rule." ALTA's 4,700 members across the country support a robust and safe housing finance market.

Legislation before Congress would amend the Dodd-Frank Act's definition of a Qualified Mortgage (QM). Specifically, among other provisions, H.R. 3211, the Mortgage Choice Act, would remove fees paid to title companies owned by the lender from counting as compensation paid to the lender under the 3% cap on points and fees under the QM regulation. Under the Dodd-Frank Act, fees paid to a title company owned by the lender, called an affiliated title agency, are considered fees paid to the lender and are included in the 3% cap.

ALTA membership includes companies that are independent from the lender and companies that are affiliated with the lender. Since ALTA's members operate on both sides of the issue, ALTA is not advocating for or against the bill. However, ALTA will continue to serve as a resource to our members, regardless of their position on the bill, and to Congress.

In the past, certain groups opposed to H.R. 3211 have made a number of misstatements regarding title insurance. Regardless of your position on the legislation, ALTA wants to ensure you receive accurate information about title insurance. These statements about title insurance are misleading:

"Almost the entirety of a title insurance premium goes to commissions, not insurance coverage"

Fact: According to the national rating agency A.M. Best, expenses incurred as part of the title-search process typically make up 85 percent or more of the title premium, reflecting the loss-prevention nature of title insurance. Most of the title insurance premium goes to prevent a consumer from losing their home through a challenge to their title. In other words, title agents do work to protect consumers against claims caused by something that happened in the past, so they underwrite each individual consumer's homeownership based on legal documents unique to the title of each home. This type of underwriting work means that, over the long term, title insurers pay fewer claims than other insurers, but their operating expenses to underwrite the policy are much higher.

"Title insurance is overpriced"

Fact: Title insurance, including pricing, is stiffly regulated by state Insurance Commissioners. By statute title insurance prices can be neither excessive, inadequate nor unfairly discriminatory. The cost for title insurance is a one-time fee, as opposed to other lines of insurance that charge a monthly, quarterly or annual premium. When you consider the size of the asset protected by title insurance and amortize the payment for as long as the consumer owns their home, title insurance is among the best values of costs associated with a real estate closing.

"The price for this product is agreed upon between the lender and the title insurance company,"

Fact: The price for title insurance is set by state regulation or by local markets. These rates are based on an extensive set of actuarial data including, expenses experienced by title agents and insurers operating in that region, claims experience, and revenues. State laws are very clear that title insurance rates can be neither excessive, inadequate or unfairly discriminatory.

"Consumers cannot shop for this product,"

Fact: Consumers can shop for title insurance and consumers have the right to shop for title insurance. This consumer right is protected by federal statute in the Real Estate Settlement Procedures Act (RESPA). The title insurance industry supports and encourages consumer choice. To help consumers shop, the industry created *www.homeclosing101.org*, which is designed to help consumers navigate the homebuying process including identifying local title and settlement companies with whom they can shop.

"Title insurance prices are vastly inflated,"

Fact: According to a 2007 Government Accountability Office (GAO) report on the title insurance industry, title insurance comprised 4 percent of all closing costs. This was the same percent of closing costs spent on property and casualty insurance associated with a home purchase (including a home warranty). The real estate commission, lender fees and government taxes/fees accounted for 89 percent of all closing costs.

"States don't adequately regulate the market"

Fact: State departments of insurance regulate title insurance and coordinate through the National Association of Insurance Commissioners' (NAIC) Title Insurance Task Force. This national system of state-based regulation of title insurance includes oversight of title insurance including: company licensing, producer licensing, product regulation, financial regulation, market regulation, and consumer services. Title insurance is also governed by the Real Estate Settlement Procedures Act (RESPA) and regulated by the Consumer Financial Protection Bureau (CFPB) under the Dodd-Frank Act.

"There is minimal evaluation as to the appropriateness of fee increases."

Fact: State insurance departments require considerable information to approve title insurance premium rates. In fact, some states conduct public hearings to determine the appropriateness of rates. Title insurance premium rates are based on these considerations:

1. the cost of searching public records;
2. the cost of examining the status of title to the consumer's home;
3. the cost to resolve issues or clear defects to title;
4. the payment of claims;
5. depending on the state, the cost of closing; and,
6. the allowance for a reasonable profit.

Here are a few items to consider when comparing title insurance to other types of insurance such as casualty:

Casualty Insurance	vs.	Title Insurance
Risk Assumption	vs.	Risk Elimination
Recurring Premium	vs.	One-Time Premium
Dollars go to Claims	vs.	Dollars to go Operations
Prospective	vs.	Retrospective
Finite Coverage Period	vs.	Potentially Unlimited Coverage Period

When examining similar lines of insurance, it is important to note that according to A.M. Best, for the past ten years, title insurance average yearly expenses make up 91.8% of premiums compared to only 26.9% of property & casualty insurance premiums. Additionally, for the past ten years, title insurance saw an average yearly loss of 6.3% compared to 74.8% with property & casualty insurance.

Conclusion

As you consider various perspectives about how prospective and current homeowners will be harmed by the CFPB's Qualified Mortgage rule, we hope that these facts will help you and your staff better understand title insurance. Regardless of your position on H.R. 3211, if you have questions about title insurance, how the industry is structured or how it is regulated, please use ALTA as a resource.

CUNA
Credit Union National Association

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January 13, 2014

The Honorable Shelly Moore Capito
Chairman
Subcommittee on Financial Institutions
and Consumer Credit
United States House of Representatives
Washington, D.C. 20515

The Honorable Gregory Meeks
Ranking Member
Subcommittee on Financial Institutions
and Consumer Credit
United States House of Representatives
Washington, D.C. 20515

Dear Chairman Capito and Ranking Member Meeks:

On behalf of the Credit Union National Association (CUNA), I am writing to thank you for holding a hearing on the likely impact on Americans trying to buy homes from the Dodd-Frank Act's Ability to Repay/Qualified Mortgage Rule. CUNA is the largest credit union advocacy organization in the United States, representing America's 6,700 state and federally chartered credit unions and their 99 million members.

The Dodd Frank Act's ATR/QM Rule went into effect on January 10, 2014, so it is rather early to assess the impact it will have on the housing market other than to say that many of our members are concerned that it will have a negative impact on their mortgage lending and operations. As Congress considers the impact the regulation will have, we urge you to examine two key issues: (1) whether financial institutions need protection from lawsuits brought by private parties for a reasonable period of time after the effective date, and (2) whether credit unions ought to be subject to this regulation in the first place.

Congress Should Protect Lenders from Lawsuits Based on Early Noncompliance under the Rule

Eight mortgage related rules, including the ATR rule, become effective this month. Seven of these rules were finalized in October, and since then credit unions have been scrambling to come into compliance.

Finalization Dates for Mortgage Rules Effective January 2014			
Rule Name	**Date First Finalized**	**Date Last Amended**	**Number of Amendments/ Clarifications**
Ability to Repay/Qualified Mortgage	January 10, 2013	October 1, 2013	4
2013 HOEPA Rule	January 10, 2013	October 23, 2013	5
Loan Originator Compensation	January 20, 2013	October 1, 2013	2
ECOA Valuations	January 18, 2013	October 1, 2013	1
TILA HPML Appraisals	January 18, 2013	N/A	0
TILA HPML Escrows	January 18, 2013	October 1, 2013	3
Servicing TILA	January 17, 2013	October 23, 2013	3
Servicing RESPA	January 17, 2013	October 23, 2013	3

These new rules, and the commentary that accompanies them, weigh in at approximately 5,000 pages of new regulations. While we appreciate that the Consumer Financial Protection Bureau (CFPB) delayed finalization of many of these rules and included changes in an effort to be responsive to the concerns that we and others raised, the fact remains that a number of our members that make mortgage loans feel unduly burdened and that Congress, the CFPB and prudential regulators should not expect credit unions to be in compliance with these rules less than 100 days after final changes were adopted. As expected, many credit unions have indicated they would not be able to comply with the regulations on time, despite their best efforts.

The CFPB and the National Credit Union Administration (NCUA) have recently made statements that the agencies will provide some compliance flexibility to credit unions that are making good faith efforts to meet their responsibilities under the new mortgage rules. CUNA supports and appreciates these accommodations; however, credit unions that are not in compliance with these rules when they are effective are still vulnerable to lawsuits for up to several years because the *Truth in Lending Act*, under which the rules have been promulgated, carries a private right of action.

Only Congress can protect credit unions and other lenders from this threat, and we continue to urge you to take action on this matter as soon as possible.

Credit Unions' Structure and Performance Demonstrate that a Full Exemption Is Warranted

During the rulemaking process, the CFPB was receptive to and somewhat responsive to the concerns that credit unions raised. We appreciate the recent statements by the CFPB and the NCUA which emphasize to credit unions that not all mortgages need to be QMs. Nevertheless, we remain concerned about the long-term effect this rule will have on credit unions and their members, and we question why credit unions ought to be subject to the rule in the first place.

As we have noted in previous testimony before the Subcommittee, credit unions agree that it is always in the best interest of the credit union to assess a member's ability to repay when offering them a loan. That is what credit unions routinely did, even before the adoption of the rule.

Because credit unions are member-owned financial cooperatives and thus, the costs of compliance must be borne by all members, and in light of that fact that the rule was designed to address problems credit unions did not engage in, we believe there is a very strong statutory and public policy case to be made that credit unions ought to be fully exempt from the QM Rule. That case is also based on how credit unions are structured, which produces a set of operational incentives that is different from for-profit financial institutions, and also on the historical performance of credit union mortgage loan portfolios. Moreover, the CFPB has the legal authority to provide such an exemption, and Congress should assure the agency it has such power. A recent letter to Director Corday, with an attached memorandum discussing the agency's authority to exempt credit unions, is attached.

The not-for-profit, cooperative structure of credit unions presents incentives that are different from the incentives of for-profit, shareholder-owned financial institutions. Because credit unions have no outside shareholders, they have no incentive to maximize profits, so they tend to be more conservative lenders than their for-profit brethren. This important distinction engenders the

The Honorable Shelly Moore Capito
The Honorable Gregory Meeks
January 13, 2014
Page Three

tailoring of loan products to the needs of the borrower, as opposed to putting borrowers into a product that might not fit, but has a chance of having a positive impact on the institution's bottom line. Those who operate credit unions have no incentive to gamble on loans to members who do not have the ability to repay.

Credit unions have also historically been portfolio lenders, and continue to keep a significant percentage of mortgages on their books. If a credit union makes a bad loan to a member, it has an impact not just on the borrower but also on the other member-owners of the credit union, who may find credit less available and more expensive as a result of the loss.

The importance of these structural differences between credit unions and for-profit lenders is reflected in the historical performance of credit union mortgage portfolios. Prior to the financial crisis, annual net charge-off rates on residential mortgage loans at both banks and credit unions were negligible, less than 0.1%. However, as the recession took hold, losses mounted. At credit unions, the highest annual loss rate on residential mortgages was 0.4%. At commercial banks, the similarly calculated loss rate exceeded 1% of loans for three years, reaching as high as 1.58% in 2009.[1]

According to the CFPB, "the Ability-to-Repay rule is intended to prevent consumers from getting trapped in mortgages that they cannot afford, and to prevent lenders from making loans that consumers do not have the ability to repay."[2] Credit unions have implemented those goals since they were established in the United States over 100 years ago. They do not want their member-owners in mortgages they cannot afford. Credit unions are already doing what the CFPB and Congress want them to do. The overarching problem credit unions have with the Dodd-Frank ATR rule is that it makes it harder for them to achieve those goals for their members because the rule subjects credit unions to yet another layer of regulation that is appropriate for abusers of consumers. When regulators make it more difficult for credit unions to serve their members, consumers, communities and the economy lose.

We appreciate that the CFPB has allowed loans to be eligible for sale to FNMA or FHLMC to be considered QMs for 7 years or until the GSEs are dissolved, and included a small lender exemption in the final rule. However, as we have said to the CFPB and other policymakers, the exemption did not go far enough. Credit unions of all sizes should be exempt from the rule.

The rule currently exempts loans made by a financial institution with less than $2 billion in assets and that originates, together with affiliates, 500 or fewer first-lien mortgages in the prior year, and meets the following product features:

- Points and fees less than or equal to 3 percent of the loan amount (for loan amounts less than $100,000, higher percentage thresholds are allowed);
- No risky features such as negative amortization, interest-only, or balloon loans (balloon loans originated until January 10, 2016 that meet the other product features are QMs if originated and held in portfolio by small creditors);
- Underwriting information must be documented;
- The loan term does not exceed 30 years.

[1] Based on FDIC and NCUA data.
[2] http://www.consumerfinance.gov/f/201312_cfpb_mortgage-rules_fact-vs-fiction.pdf

The Honorable Shelly Moore Capito
The Honorable Gregory Meeks
January 13, 2014
Page Four

Furthermore, the lender must generally hold the loan in portfolio for at least three years and consider and verify a borrower's debt-to-income ratio (DTI), regardless if the DTI exceeds 43 percent or the loan is government sponsored enterprise/agency-eligible.

We do not believe that asset size and number of mortgages are what guides the underwriting of credit union mortgages; the structure of credit unions, their historic mission to serve the best interests of their members and their very low default and delinquency rates are the significant distinguishing factors that support an exemption for credit unions. We urge the Subcommittee to encourage the CFPB to provide all credit unions an exemption from the QM rule. Moreover, we believe other community based financial institutions should be considered for similar treatment under the QM rule.

Conclusion

As we have testified before, credit unions face an unprecedented regulatory burden. With the implementation of these rules, impact of the burden has become even more severe. We appreciate the subcommittee's continued oversight of the ever mounting regulatory responsibilities and liabilities facing community financial institutions, and we look forward to continuing to work with you on legislative solutions to relieve credit unions of regulatory burden and enhance their ability to serve their members.

On behalf of America's credit unions and their 99 million members, thank you for your consideration of our views.

Best regards,

Bill Cheney
President & CEO

Attachment

CUNA
Credit Union National Association

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January 10, 2014

The Honorable Richard Cordray
Director
Consumer Financial Protection Bureau
1801 L Street NW
Washington, D.C. 20036

Dear Director Cordray:

I trust you had an enjoyable holiday season, and want to wish you a very Happy New Year.

I was able to catch your appearance on "The Daily Show" Wednesday evening and was pleased with the comments you made regarding credit unions relative to the new mortgage rules. More specifically, you stated that the rules are "really taking mortgage lending back to what community banks and credit unions have done for decades, checking out the numbers to make sure people can actually succeed in the loan, not just giving it to them and not caring if they fail."

I could not agree more and as we have stated on numerous occasions, because of their pro-consumer lending practices that have resulted in very low default and delinquency rates, credit unions do not need new rules to force them to treat their borrowers fairly.

Your appearance with Jon Stewart came on the heels of comments you reportedly made to the National Association of Realtors this week in which you suggested that the exemption level under the Ability to Repay (ATR) Rule for community based institutions may be rethought at the CFPB.

Now that the initial task of developing the mortgage rules is behind the CFPB, CUNA urges the agency to revisit exemption issues as soon as possible. We do not think the agency's reconsideration should be limited to the ATR Rule but should include other mortgage rules and the international remittance transfer rule as well.

We feel strongly that the agency has solid statutory authority to exempt credit unions broadly, particularly from regulations designed to address abuses in which credit unions were not engaged. In that connection, I am resending to you a detailed legal analysis which demonstrates convincingly, we believe, that CFPB does indeed enjoy broad authority to exempt credit unions and other community financial institutions from its rules

or specific provisions in its rules. The memorandum was prepared by outside counsel with extensive experience at the Federal Reserve and at the CFPB itself.

We urge the CFPB to give this issue the consideration it deserves in light of the impact of the CFPB's major rules on credit unions.

I would welcome the opportunity for CUNA to meet with you on the exemption issues soon and will work with your office to try to set that up, depending on your availability.

In the meantime, CUNA and our members look forward to working constructively with you and your agency throughout this year and your tenure, as we have in the past.

Best regards,

Bill Cheney
President & CEO

Attachment

The Consumer Financial Protection Bureau's Statutory Authority to Provide Exemptions for Credit Unions

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You have asked us about the extent to which the Bureau of Consumer Financial Protection ("Bureau") has statutory authority to exempt credit unions from disclosure and other obligations imposed by certain consumer financial laws and regulations issued by the Bureau under those laws. Specifically, this memorandum addresses the Bureau's statutory authority to exempt credit unions from obligations imposed by: (1) Title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act[1] ("Dodd-Frank Act") and Bureau regulations issued under Title X; and (2) the "enumerated consumer laws" and Bureau regulations to implement those laws.

Executive Summary

As described in greater detail below, the Bureau has several sources of statutory authority that it could use to provide exemptions from the requirements of statutes or implementing regulations generally or the requirements of certain provisions specifically.[2] These statutory provisions individually and together grant broad authority to the Bureau and constitute a strong legal framework to support the agency's reasonable use of its exemption authority.

For example, Section 1022 of Title X of the Dodd-Frank Act permits the Bureau to exempt ***any* class of covered person from *any* provision of Title X or *any* rule issued by the Bureau under Title X** if such an exemption is consistent with relevant statutory considerations that the Bureau must take into account in issuing an exemption.

In addition to this general authority, of the eighteen enumerated consumer laws, eleven provide the Bureau with specific exemption authority. Specifically, of the eighteen enumerated consumer laws:

- Five permit the Bureau generally to provide exemptions for specific classes of transactions only;
- Five permit the Bureau to make exemptions from specific statutory provisions only; and
- One permits the Bureau to provide exemptions for specific classes of transactions and also permits the Bureau to make exemptions from specific statutory provisions.

As discussed below, however, the various statutes generally do not define the phrase "class of transaction" or otherwise clarify whether a "class of transaction" may apply to a specific type of institution. Nonetheless, the Bureau's exemption authority under specific provisions of certain laws may be broader than its more general "class of transaction" authority.

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[1] Public Law 111–203, 124 Stat. 1376 (2010).

[2] We note that, in large part, the Bureau's exemption authority is permissive and not mandatory. That is, where permitted, the Bureau may (but is not required to) provide exemptions.

Five of the eighteen enumerated consumer laws permit the Bureau to make exemptions for classes of transactions subject to substantially similar state laws.[3] This "substantially similar state law" exemption authority requires, among other things, that there be a state law that is substantially similar to the federal law and that there is adequate provision for enforcement of that state law.

Regardless of the source of exemption authority, our discussion below assumes that any Bureau use of its exemption authority would be consistent with the Administrative Procedure Act. Specifically, we assume that any Bureau use of its exemption authority by rule would not be "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[4] For example, if the Bureau were to make an exemption for credit unions and not for other types of institutions as well, the Bureau would need a sufficient basis for treating credit unions differently than other types of institutions.

Background on the Bureau

As you know, Title X of the Dodd-Frank Act created the Bureau as an independent agency within the Federal Reserve System. In general, the Bureau is charged with writing rules to implement a number of federal consumer financial laws, as well as supervision and enforcement of those laws. Certain consumer financial protection functions previously performed by the federal banking agencies and the National Credit Union Administration ("NCUA") were transferred from such agencies to the Bureau. In addition to inheriting supervisory and enforcement authority for certain institutions, the Bureau is generally authorized to issue regulations to implement various consumer financial protection laws. Separately, the Bureau is authorized to engage in rulemakings and to take certain actions regarding unfair, deceptive or abusive acts or practices in connection with consumer financial products and services.[5]

Broad Bureau Exemption Authority Under Section 1022 of Title X

Section 1022 of Title X of the Dodd-Frank Act authorizes the Bureau "to exercise its authorities under Federal consumer financial law to administer, enforce, and otherwise implement the provisions of Federal consumer financial law."[6] Section 1022 permits the Bureau to "prescribe rules and issue orders and guidance, as may be necessary or appropriate to enable the Bureau to administer and carry out the purposes and objectives of the Federal consumer financial laws, and to prevent evasions thereof."[7] The "Federal consumer financial laws" include Title X, the "enumerated consumer laws" and any Bureau rule prescribed under Title X or the enumerated consumer laws. As a result, in addition to any other rulewriting authority provided for under Title X or the enumerated consumer laws, Section 1022 separately authorizes the

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[3] Note that only one law, the Fair Debt Collection Practices Act, includes only the "substantially similar state law" exemption authority. That is, four of the five laws that include this type of exemption authority also include another type of exemption authority, such as the "class of transaction" authority discussed above.
[4] 5 U.S.C. § 706(2)(A).
[5] *See* 15 U.S.C. § 5531.
[6] 12 U.S.C. § 5512(a).
[7] 12 U.S.C. § 5512(b)(1).

Bureau to write rules as it deems appropriate to carry out the purposes and objectives of the Federal consumer financial laws.

Section 1022 also provides the Bureau with exemption authority with respect to Title X and the rules that the Bureau may prescribe to carry out the purposes and objectives of the Federal consumer financial laws (*i.e.*, Bureau rules issued under Title X). Specifically, Section 1022 provides that the Bureau "**may conditionally or unconditionally exempt any class of covered persons . . . from any provision of [Title X], or from any rule issued under [Title X]**, as the Bureau determines necessary or appropriate to carry out the purposes and objectives of" the Title.[8]

This exemption authority is far-reaching. Section 1022 authorizes the Bureau to provide an exemption from a Bureau rule issued under Title X that addresses conduct governed by an enumerated consumer law, even if that specific law does not provide the Bureau with independent exemption authority. That is, the Bureau's authority to provide an exemption from a rule issued under Title X is not contingent on statutory exemption set forth under the underlying enumerated consumer laws.

In order to exempt credit unions from a rule issued under Title X, the Bureau must determine that such an exemption is appropriate to carry out the purposes and objectives of Title X. The broadly stated "purpose" of Title X, as described in Section 1029A, is for the Bureau to implement and enforce the Federal consumer financial laws "consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive."[9] For example, if credit unions could no longer offer certain consumer financial products or services because of an inability to do so on a competitive cost basis, including because compliance costs outweigh revenue, the Bureau may find an exemption appropriate in order to ensure or expand consumer access to those products.

Moreover, the stated "objectives" of Title X, as described in Section 1029A, are that the Bureau's authority under the Federal consumer financial laws is "for the purposes of ensuring" that: (1) consumers are provided with timely and understandable information to make responsible decisions about financial transactions; (2) consumers are protected from unfair, deceptive, or abusive acts and practices and from discrimination; (3) outdated, unnecessary, or unduly burdensome regulations are regularly identified and addressed in order to reduce unwarranted regulatory burdens; (4) federal consumer financial law is enforced consistently, without regard to the status of a person as a depository institution, in order to promote fair competition; and (5) markets for consumer financial products and services operate transparently and efficiently to facilitate access and innovation.[10] For example, the Bureau may find it appropriate to rely on the "burden" objective (3) or the "markets" objective (5) to take the position that an exemption is appropriate where credit unions were not able to provide their members with access to certain financial products or services because of compliance burdens or cost challenges.

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[8] 12 U.S.C. § 5512(b)(3)(A) (emphasis added).
[9] 12 U.S.C. § 5511(a).
[10] 12 U.S.C. § 5511(b).

Finally, Section 1022 also includes three statutory considerations that the Bureau must take into account in issuing an exemption to a rule issued under Title X. Specifically, in issuing such an exemption, the Bureau must, as appropriate, consider three factors: (1) the total assets of the class of covered persons; (2) the volume of transactions involving consumer financial products or services in which the class of covered persons engages; and (3) existing provisions of law that are applicable to the consumer financial product or service and the extent to which such provisions provide consumers with adequate protections.[11] The statute is silent on how the Bureau should consider these factors. Nonetheless, based on the context, the Bureau might determine that an exemption is appropriate where, for example, a covered person has fewer total assets or engages in a volume of transactions that is less than the average covered person.

Bureau Exemption Authority Under the Enumerated Consumer Laws

As indicated above, the Dodd-Frank Act transferred certain existing rulewriting authority under the "enumerated consumer laws" from other agencies to the Bureau. Of the enumerated consumer laws, the following twelve provide the Bureau with some type of express exemption authority:

(1) the Consumer Leasing Act of 1976 ("CLA");
(2) the Electronic Fund Transfer Act ("EFTA"), except for Section 920 (debit interchange);
(3) the Equal Credit Opportunity Act ("ECOA");
(4) the Fair Credit Billing Act ("FCBA");
(5) the Fair Credit Reporting Act ("FCRA"), except for Section 615(e) (red flags) and Section 628 (disposal of credit report information);
(6) the Fair Debt Collection Practices Act ("FDCPA");
(7) Subsections (b) through (f) of Section 43 of the Federal Deposit Insurance Act ("FDIA");
(8) Sections 502 through 509 of the Gramm-Leach-Bliley Act ("GLBA"), except for Section 505 (enforcement) as it applies to Section 501(b) (information security);
(9) the Home Mortgage Disclosure Act of 1975 ("HMDA");
(10) the Home Ownership and Equity Protection Act of 1994 ("HOEPA");
(11) the Real Estate Settlement Procedures Act of 1974 ("RESPA"); and
(12) the Truth in Lending Act ("TILA").[12]

Each of these twelve enumerated consumer laws provides the Bureau with specific exemption authority, but such authority is not uniform. For ease of use, we have separated the

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[11] 12 U.S.C. § 5512(b)(3)(B).

[12] *See* 12 U.S.C. § 5481(12). Six of the enumerated consumer laws either do not provide the Bureau with specific rulewriting authority or do not provide the Bureau with express authority to make exceptions for credit unions. These six laws are: (1) the Truth in Savings Act; (2) the Alternative Mortgage Transaction Parity Act of 1982; (3) the Home Owners Protection Act of 1998; (4) the Interstate Land Sales Full Disclosure Act; (5) the S.A.F.E. Mortgage Licensing Act of 2008; and (6) Section 626 of the Omnibus Appropriations Act, 2009. If, however, the Bureau were to issue a rule under Title X relating to conduct also covered by these six laws, Section 1022 would appear to provide the Bureau with exemption authority for that rule, assuming that the rule was issued pursuant to Title X and not one of the six laws.

discussion of the Bureau's exemption authority into the following three sections based on the type of exemption authority:

- General authority to exempt specific classes of transactions;
- Authority to make exemptions from specific provisions of a statute; and
- Authority to exempt persons subject to substantially similar requirements under state law.

Class of Transaction Exemption Authority

A number of the enumerated consumer laws authorize the Bureau to make exceptions for classes of transactions that would otherwise be covered by these laws. Specifically, TILA, EFTA, ECOA, HMDA, RESPA and CLA each provide the Bureau with general authority to exempt classes of transactions. As discussed below, these statutes do not define the scope of this "class of transaction" exemption authority.

- Section 104 of TILA provides that the statute does not apply to any transaction for which the Bureau determines by rule that coverage under the statute is not necessary to carry out its purposes.[13]

- Section 105 of TILA provides that any Bureau regulation to carry out the purposes of TILA (except for the mortgage limitations of Section 129 (HOEPA)) "may provide for such . . . exceptions for all or any class of transactions, as in the judgment of the Bureau are necessary or proper to effectuate the purposes of [TILA], to prevent circumvention or evasion thereof, or to facilitate compliance therewith."[14]

- Section 105 of TILA also authorizes the Bureau to exempt by regulation from all or part of TILA "all or any class of transactions, other than transactions involving any mortgage described in section 103(aa), for which, in the determination of the Bureau, coverage under all or part of [TILA] does not provide a meaningful benefit to consumers in the form of useful information or protection."[15]

- Section 129H of TILA provides that the Bureau, the federal banking agencies, the NCUA and the Federal Housing Finance Agency may jointly exempt by rule "a class of loans" from the requirements of Sections 129H(a) and 129H(b) (relating to limitations on higher-risk mortgages without a written appraisal and the related appraisal requirements) if the agencies determine that the exemption is in the public interest and promotes the safety and soundness of creditors.[16]

- Section 904 of the EFTA provides that any Bureau regulation to carry out the purposes of the EFTA "may provide for such . . . exceptions" for any class of electronic fund

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[13] 15 U.S.C. § 1603(5).
[14] 15 U.S.C. § 1604(a).
[15] 15 U.S.C. § 1604(f)(1). In determining whether to exempt a class of transactions, the Bureau must consider five factors, including, for example, whether the goal of consumer protection would be undermined by the exemption. 15 U.S.C. § 1604(f)(2).
[16] 15 U.S.C. § 1639h(b)(4)(B).

transfers or remittance transfers, as the Bureau believes are necessary or proper to effectuate the purposes of the EFTA, to prevent circumvention or evasion thereof or to facilitate compliance with the EFTA.[17]

- Section 703 of the ECOA provides that any Bureau regulation to carry out the purposes of the ECOA "may provide for such . . . exceptions" for any class of transaction, as the Bureau believes are necessary or proper to effectuate the purposes of the ECOA, to prevent circumvention or evasion thereof or to facilitate compliance with the ECOA.[18]

- Section 703 of the ECOA also provides that the Bureau's regulations may exempt from the ECOA "any class of transactions that are not primarily for personal, family, or household purposes, or business or commercial loans made available by a financial institution, except that a particular type within a class of such transactions may be exempted if the Bureau determines, after making an express finding that the application of [the ECOA or any ECOA provision] of such transaction would not contribute substantially to effecting the purposes of" the ECOA.[19]

- HMDA provides that the Bureau's regulations to carry out the purposes of HMDA "may provide for such . . . exceptions" for any class of transaction that the Bureau believes are necessary or proper to effectuate the purposes of HMDA, to prevent circumvention or evasion thereof or to facilitate compliance with HMDA.[20]

- RESPA provides the Bureau with authority "to grant such reasonable exemptions for classes of transactions, as may be necessary to achieve the purposes of" the statute.[21]

- The CLA provides the Bureau with authority to "provide for . . . exceptions for any class of transactions, as the Bureau considers appropriate."[22]

To use these specific exemption authorities, the Bureau must classify or distinguish transactions that otherwise would be subject to the underlying statute. That is, the Bureau must determine what a "class of transactions" entails. Although the phrase "class of transaction" is not defined in the relevant statutory provisions, the plain language references transactions and not persons or specific types of persons, such as creditors. Nonetheless, the Bureau could take the position that one way to classify or distinguish transactions is to look to the type of institution that is engaging in the transaction, such as a credit union that is not for profit (as opposed to for-profit entities). For example, the Bureau could take the position that a credit card issued by a not-for-profit credit union (or similar entity) is a "class of transaction" for purposes of TILA.

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[17] 15 U.S.C. § 1693b(c).
[18] 15 U.S.C. § 1693b(a)(1).
[19] 15 U.S.C. § 1693b(b). Note that such an exemption may only be for a period of five (5) years and only may be extended if the Bureau determines that such exemption remains appropriate. 15 U.S.C. § 1693b(c).
[20] 12 U.S.C. § 2804(a).
[21] 12 U.S.C. § 2617(a).
[22] 15 U.S.C. § 1667f(a)(2).

Each of the provisions cited above (other than the CLA) provide that the exemption authority must be used as necessary or appropriate to fulfill the purposes of the underlying statute. Similar to the discussion above with respect to Section 1022, the need to determine that an exemption is appropriate to fulfill the purposes of the underlying statute would apply in the context of providing an exemption for credit unions; that is, where applicable, the Bureau would have to determine that an exemption for credit unions meets the underlying purpose of the statute. Depending on the specific exemption being considered, the Bureau may determine that an exemption for credit unions is consistent with a statute's purpose, such as if the Bureau were to find that such an exemption would ensure or expand consumer access to a particular financial product or service. For example, the Bureau is currently considering a remittance regulation under Regulation E. In this context, the Bureau may determine that an exemption for credit unions is consistent with the EFTA's purpose.

Although not exemption authority *per se*, we note that Section 904 of the EFTA directs the Bureau by regulation to modify the requirements of the EFTA "on small financial institutions if the Bureau determines that such modifications are necessary to alleviate any undue compliance burden on small financial institutions and such modifications are consistent with the purpose and objective of" the EFTA.[23] In addition to the Bureau's authority under the EFTA to provide for exceptions, including potentially for small financial institutions, the Bureau also would have the authority to modify (and presumably reduce the compliance burden associated with) specific requirements of the EFTA for small financial institutions.

Exemption Authority for Specific Statutory Provisions

A number of the enumerated consumer laws, specifically, TILA, FCBA, FCRA, GLBA, Section 43(d) of FDIA and HOEPA, include provisions that permit the Bureau to make exceptions from specific requirements of those laws (as opposed to exemptions from the laws generally). In some cases, such as, for example, TILA, this specific exemption authority is in addition to other exemption authority.

- Section 129D of TILA provides that the Bureau may exempt from the requirements of Section 129D(a) (relating to escrow or impound accounts) a creditor that: (1) operates predominantly in rural or underserved areas; (2) together with all affiliates, has total annual mortgage loan originations that do not exceed a limit set by the Bureau; (3) retains its mortgage loan originations in portfolio; and (4) meets any asset size threshold and any other criteria the Bureau may establish, consistent with the statutory purpose.[24]

- The FCBA provides that the Bureau may by rule provide "reasonable exceptions" to the statute's limitation on increases in the annual percentage rate for promotional rates for credit card accounts within the first six month such rate is effective.[25]

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[23] 15 U.S.C. § 1693b(c).
[24] 15 U.S.C. § 1639d(c). Note that the Federal Reserve Board issued a proposal in March 2011 to make such an exemption. *See* 76 Fed. Reg. 11,598 (Mar. 2, 2011).
[25] 15 U.S.C. § 1666i-2(b).

- Section 615(h) of the FCRA specifies that the Bureau's rules to implement the risk-based pricing requirements must address "exceptions to the [risk-based pricing] notice requirement . . . for classes of persons or transactions regarding which the agencies determine that notice would not significantly benefit consumers."[26]

- Section 504 of the GLBA provides that the Bureau's regulations to implement the GLBA privacy provisions may include exceptions to Section 502's opt-out requirements and limitations on reuse of information and sharing of account numbers for marketing purposes.[27]

- Section 43(d) of the FDIA provides that the Bureau may make exceptions to the Section 43(b) disclosure requirements applicable to depository institutions that do not have federal deposit insurance (*i.e.*, consumer oriented disclosures regarding the fact that an institution lacks federal deposit insurance) for any such institution that "does not receive initial deposits of less than an amount equal to the standard maximum deposit insurance amount from individuals who are citizens or residents of the United States, other than money received in connection with any draft or similar instrument issued to transmit money."[28]

- Section 129 of HOEPA provides that the Bureau may by rule exempt specific mortgage products or categories of mortgages from certain of Section 129's prohibitions, such as for prepayment penalties, balloon payments and negatively amortizing loans.[29]

To the extent that this exemption authority is not based on a specific type of transaction or product (like the HOEPA exemption authority), the Bureau would not have to address the scope of a "class of transaction" in order to use such authority, as discussed above. That is, the Bureau would not need to define a type of institution, such as a credit union, as a "class of transaction" in order to use this exemption authority. For example, to the extent a provision simply indicates that the Bureau has the authority to make exemptions without imposing conditions on such authority (*e.g.*, section 504 of the GLBA), the Bureau should have greater authority than under a provision that limits its exemption authority to certain types of transactions or products or under a provision that requires that the Bureau find that an exemption is appropriate to carry out the purposes or objectives a statute. As a result, the Bureau may have even greater flexibility to make exemptions for credit unions under these provisions than the "class of transactions" authority discussed above.

Substantially Similar State Law Exemption Authority

A number of the enumerated consumer laws authorize the Bureau to exempt from coverage under those laws classes of transactions that are subject to state laws that impose

[26] 15 U.S.C. § 1681m(h)(6)(B)(iii).
[27] 15 U.S.C. § 6804(b).
[28] 12 U.S.C. § 1831t(d).
[29] 15 U.S.C. § 1639(p)(1). Note that the Bureau must find that an exemption is in the interest of the borrowing public and will apply only to products that maintain and strengthen home ownership and equity protection. 15 U.S.C. §§ 1639(p)(1)(A) - (B).

substantially similar state requirements or provide for greater consumer protection and that make adequate provision for enforcement. Specifically, TILA, FCBA, HMDA, CLA and FDCPA include this type of exemption authority.

- Section 123 of TILA directs the Bureau by regulation to exempt from the requirements of Chapter 2 of TILA (relating to consumer credit cost disclosures) "any class of credit transactions within any State if it determines that under the law of that State that class of transactions is subject to requirements substantially similar to those imposed under [Chapter 2], and that there is adequate provision for enforcement."[30]

- The FCBA directs the Bureau to exempt from the requirement of the statute "any class of credit transactions within any State if it determines that under the law of that State that class of transactions is subject to requirements substantially similar to those imposed under [the Act] or that such law gives greater protection to the consumer, and that there is adequate provision for enforcement."[31]

- HMDA provides that the Bureau may by rule exempt from HMDA's requirements "any State-chartered depository institution within any State or subdivision thereof, if the [Bureau] determines that, under the law of such State or subdivision, that institution is subject to requirements that are substantially similar to those imposed under [HMDA], and that such law contains adequate provisions for enforcement."[32]

- The CLA directs the Bureau to write rules exempting from the requirements of the statute "any class of lease transactions within any State if it determines that under the law of that State that class of transactions is subject to requirements substantially similar to those imposed under [the Act] or that such law gives greater protection and benefit to the consumer, and that there is adequate provision for enforcement."[33]

- The Fair Debt Collection Practices Act ("FDCPA") directs the Bureau to exempt from the FDCPA's requirements "any class of debt collection practices within any State if the Bureau determines that under the law of that State that class of debt collection practices is subject to requirements substantially similar to those imposed by [the FCPA], and that there is adequate provision for enforcement."[34]

This type of exemption authority is more limited than the others discussed above. First, the Bureau must find that a class of transactions subject to the specific federal statute is also subject to a similar state law. This factor itself could limit the availability of the exemption to state-chartered credit unions in some instances. The Bureau also must find that the state law's requirements are "substantially similar" to those imposed by the federal statute. In addition, the Bureau must find that there is adequate provision for enforcement of the state laws. Also, this

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[30] 15 U.S.C. § 1633. Note that the Bureau has proscribed procedures for a state to apply for such an exemption. 12 C.F.R. pt. 1026, App. B.
[31] 15 U.S.C. § 1666j(b).
[32] 12 U.S.C. § 2805(b).
[33] 15 U.S.C. § 1667e(b).
[34] 15 U.S.C. § 1692o.

type of exemption authority is frequently limited to exempting classes of transactions. Since credit unions only would be exempt if they were also subject to substantially similar state laws, it is not clear whether this exemption authority would be as meaningful as the other exemption authorities discussed herein.

* * * *

As discussed above, Section 1022 of Title X of the Dodd-Frank Act and a number of the enumerated consumer laws provide the Bureau with express authority to provide exemptions from the requirements of statutes or implementing regulations generally or the requirements of certain provisions specifically. These various statutory provisions individually and together grant broad authority to the Bureau and constitute a strong legal framework to support the agency's reasonable use of its exemption authority.

We trust that this memorandum is responsive to your request. If we can provide further assistance on this matter, please let us know.

MHI
Manufactured Housing Institute

January 14, 2014

The Honorable Jeb Hensarling
Chairman
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

The Honorable Shelley Moore Capito
Chairman
Subcommittee on Financial Institutions and Consumer Credit
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

The Honorable Gregory W. Meeks
Ranking Member
Subcommittee on Financial Institutions and Consumer Credit
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Dear Chairmen Hensarling and Capito, and Reps. Waters and Meeks:

On behalf of the members of the Manufactured Housing Institute (MHI), thank you for the opportunity to submit a statement in response to the subcommittee's hearing on "How Prospective and Current Homeowners Will Be Harmed by the CFPB's Qualified Mortgage Rule."

MHI is the national trade and industry organization representing all segments of the factory-built housing industry. MHI members include home builders, lenders, home retailers, community owners, suppliers and others affiliated with the industry. MHI's membership includes 50 affiliated state organizations.

The manufactured housing industry has always been fully committed to protecting consumers throughout the home buying process. MHI recognizes the importance of responsible lending and improving the consumer experience. However, MHI and its members are deeply concerned that key mortgage rules issued by the Consumer Financial Protection Bureau (CFPB) that do not adequately take into account the unique financing challenges inherent to the manufactured housing market, would inadvertently curtail lenders' ability to make manufactured home loans.

The manufactured housing market is already experiencing a contraction of credit available to consumers seeking to purchase a manufactured home, particularly among low- and moderate-income families seeking to purchase affordable manufactured housing. As the full impact of High-Cost Mortgage (HCM) and Qualified Mortgage (QM) rulemakings is fully realized, the already credit-constrained manufactured housing market is likely to experience even greater retraction.

HOEPA HIGH-COST MORTGAGE AND QUALIFIED MORTGAGE RULES COULD TIGHTEN CREDIT AVAILABLE IN MANUFACTURED HOUSING MARKET

While those few lenders still serving the manufactured housing market will work diligently to conform and comply with the HOEPA HCM and QM and Ability-to-Repay (ATR) criteria outlined by the CFPB, the

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manufactured housing market is uniquely affected by the these standards in ways that adversely impact low- and moderate-income consumers.

CFPB rules and the Dodd-Frank Act expand the range of loan products that could now be classified as "high-cost" under the Home Ownership and Equity Protection Act (HOEPA). A loan is considered an HCM if the Annual Percentage Rate (APR) or points and fees exceed certain thresholds. Unfortunately, the limits outlined in the CFPB rules do not fully account for the economics of originating and servicing small balance manufactured home loans.

Due to increased liabilities and stigma associated with originating a HOEPA High-Cost Mortgage, it is likely that substantial numbers of these loans will be not made after this rule becomes effective.

According to data gathered by the Federal Reserve Board, roughly 75 percent of all loans originated for the purchase of a manufactured home were $75,000 or less. Given the prevalence of low-balance lending in the manufactured housing market, MHI has estimated that 20 percent of manufactured home loans would be impacted—a significant loss of credit in a market that saw only 66,000 manufactured home purchase loans originated in 2012 (*Source: 2012 HMDA data*).

In late-2013, key lenders in the manufactured housing market indicated they would no longer originate loans for manufactured homes of $20,000 or less. This is because lenders are unable to recoup the fixed costs associated with servicing and origination without violating one or both of the HOEPA High-Cost Mortgage triggers.

This announcement equated to an immediate loss of credit to the manufactured housing market of roughly five percent. American Housing Survey data indicates that potentially more than four million manufactured homes have a value/purchase price of $30,000 or less, which could lead to an even greater loss of credit to those seeking to purchase (or sell) a manufactured home over the coming months.

Legislation (H.R. 1779) introduced by Reps. Stephen Fincher, Bennie Thompson and Gary Miller, which has garnered more than 100 bipartisan co-sponsors, would establish HCM triggers that are better attuned to the unique pricing challenges attributed to manufactured home lending, without undermining consumer protection.

While MHI believes the CFPB's adjustment to points and fees limitations for smaller-sized loans (less than $100,000)—as outlined in its QM/Ability-to-Repay (ATR) rule—better allows manufactured home lenders to offset origination costs, limitations on borrower debt-to-income (DTI) ratios could force lenders into the uncomfortable and potentially legally perilous position of having to originate substantial numbers of non-QM loans.

Under QM limitations established by the CFPB, a borrower's total DTI ratio cannot exceed 43 percent. MHI appreciates that the CFPB wants to ensure consumers are not overextending their ability to repay a loan. However, MHI believes that this limitation serves as and unwarranted and powerful disincentive

to lenders seeking to provide loans to low- and moderate-income families seeking to purchase affordable manufactured housing.

Manufactured home lenders have long been subject to ability-to-repay requirements that precede those outlined by the Dodd-Frank Act (i.e., Reg. Z modifications outlined by the Federal Reserve Board in 2008) and have proven they can do so responsibly or to the detriment of consumers.

While manufactured home lender data varies, the DTI of the average manufactured home loan borrower hovers anywhere between 45 and 49 percent. At these levels, the delinquency levels of the most active manufactured home lenders is less than half that of those seen in the conforming loan market over recent years.

At this time, it is unclear as to the exact impact the QM DTI limitations will have on credit in the manufactured housing market. MHI believes that the number of manufactured homes loans that will potentially fall outside the QM definition, and that would therefore have to be originated absent the legal protections conveyed by the statute, is substantial. Lenders will need to determine on an individual basis their risk tolerances. However, it is clear that many manufactured lenders will view the potential legal and regulatory liability as a formidable disincentive to originating smaller-sized loans.

About Manufactured Housing

Manufactured housing is a key source of quality, affordable housing for more than 22 million Americans. During this critical time for our nation's housing markets, manufactured housing plays an important role in providing reliable, sustainable housing for current and prospective homeowners looking to meet a variety of housing and lifestyle needs.

Manufactured homes are built almost entirely in a controlled environment, transported to the building site, and completed at the home-site in accordance with federal building codes and enforcement regulations administered by the Department of Housing and Urban Development (HUD)—these governing rules are commonly referred to as the "HUD Code."

As the only federally-regulated residential building code, the HUD Code regulates home design and construction, installation requirements for strength and durability, resistance to natural hazards, fire safety, electrical systems, energy efficiency, and other aspects of the home. Homes are inspected by a HUD-approved third party during the construction process and our industry adheres to a robust quality assurance program which offers greater controls than others forms of housing in the home building industry.

Our greatest attribute is delivering quality and value to consumers. Through cost savings and technological advancements in the factory-building processes, the manufactured housing industry can produce homes for 10 to 35 percent less than the cost of comparable site-built construction.

Manufactured housing's affordability means it has long been the housing choice for many low- and moderate-income families, including retirees on fixed incomes and first-time homebuyers. When

compared to all homeowners, the median annual income of manufactured homeowners is nearly 50 percent less—$59,000 vs. $30,000 (*Source: 2011 American Housing Survey*).

Manufactured housing's importance as a sustainable source of affordable housing is reinforced by data (Source: U.S. Census Bureau) indicating that in 2012 it accounted for.:

- 73 percent of all new homes sold under $125,000;
- 54 percent of all new homes sold under $150,000; and
- 31 percent of all new homes sold under $200,000.

Manufactured homes serve many housing needs in a wide range of communities—from rural areas where housing alternatives (rental or purchase) are few and construction labor is scarce and/or costly (nearly two of three manufactured homes are located in rural areas), to higher-cost metropolitan areas as an in-fill application. Without land, the average purchase price of a new manufactured home is $61,900 versus nearly $223,085 for a new site-built home (*Source: U.S. Census Bureau*).

In addition to the valuable role it plays in providing reliable, efficient and affordable housing for nearly 8.5 million American families, the manufactured housing industry is an important economic engine. In 2012, the industry sold nearly 55,000 new homes, which were produced in more than 120 home building facilities, operated by 45 different companies, and generating nearly 60,000 full-time, good-paying American jobs.

When taken together, the HOEPA HCM triggers and the QM DTI limitations serve as a powerful disincentive for many lenders to serve a substantial number of low- and moderate-income manufactured home buyers.

We thank the Committee for the opportunity to provide feedback on this important issue and welcome the opportunity to answer questions or provide further feedback.

Sincerely,

Jason Boehlert
Senior Vice President, Government Affairs

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STATEMENT OF THE

NATIONAL ASSOCIATION OF REALTORS®

SUBMITTED FOR THE RECORD TO

THE UNITED STATES HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

HEARING REGARDING

HOW PROSPECTIVE AND CURRENT HOMEOWNERS WILL BE HARMED BY THE CFPB'S QUALIFIED MORTGAGE RULE

JANUARY 14, 2014

INTRODUCTION

On behalf of the 1 million members of the National Association of REALTORS® (NAR), who are involved in all types of real estate transactions, thank you for holding this very important hearing on "How Prospective and Current Homeowners Will Be Harmed by the CFPB's Qualified Mortgage Rule?"

The Dodd-Frank Wall Street Reform Act established the Qualified Mortgage (QM) as the primary means for mortgage lenders to satisfy its "ability to repay" requirements. NAR has been generally supportive of the Consumer Financial Protection Bureau's (CFPB or the Bureau) efforts to craft a QM rule that is not unduly restrictive and provides a safe harbor for lenders making QM loans. NAR has had policy supporting the idea that lenders measure a consumer's ability to repay a loan. For this reason NAR strongly supports the Ability to Repay (ATR) rule in general but has significant concerns with some elements of the QM portion of the rule, which include the 3 percent cap on points and fees as well as the 43 percent Debt-to-Income (DTI) limit. We also believe it is critical for policymakers to construct a QRM rule that mirrors the newly implemented QM rule.

3% CAP ON FEES & POINTS

Dodd-Frank provides that a Qualified Mortgage (QM) may not have points and fees in excess of 3 percent of the loan amount. As currently defined by Dodd Frank and the Consumer Financial Protection Agency's (CFPB) final regulation to implement the "ability to repay" requirements, "points and fees" include (among other charges): (i) fees paid to affiliated (but not unaffiliated) title companies, (ii) and amounts of homeowner's insurance held in escrow. They also include loan level price adjustments (LLPAs) and payments by lenders to correspondent banks and mortgage brokers in wholesale transactions.

As a result of this problematic definition, many loans made by affiliates, particularly those made to low- and moderate-income borrowers, will not qualify as QMs. Consequently, these loans would be unlikely to be made or would only be available at higher rates due to heightened liability risks. Consumers would lose the ability to choose to take advantage of the convenience and market efficiencies offered by one-stop shopping. H.R. 3211, "the Mortgage Choice Act" has been introduced to address the discrimination against affiliates. H.R. 3211 is bipartisan legislation introduced by Representatives Bill Huizenga (R-MI), David Scott (D-GA), Ed Royce (R-CA), Spencer Bachus (R-AL), Steve Stivers (R-OH), Gregory Meeks (D-NY), Gary Peters (D-MI), Patrick Murphy (D-FL), Mike Doyle (D-PA), and Betty McCollum (D-MN). The Senate companion is S. 1577 sponsored by Joe Manchin (D-WV), Mike Johanns (R-NE), Carl Levin (D-MI), Debbie Stabenow (D-MI), Mark Kirk (R-IL), and Pat Toomey (R-PA).

It has been argued that CFPB has the authority to fix this problem. However, as the CFPB noted in their final rule and intimated in 2013 testimony, they do not believe they have the authority to fix the issue of affiliate charges because the language of Dodd-Frank is specific. For this reason, NAR believes that only Congress can fully rectify the law's discrimination against affiliates, small and mid-size lenders, community banks, and credit unions in the calculation of fees and points.

H.R. 3211

The key components of H.R. 3211 include:

- The bill removes affiliate title insurance charges from the calculation of fees and points. The title industry is regulated at the state level and competitive. It does not make sense to discriminate against one type of provider, i.e. affiliates, on the basis of these regulated fees. To do so would only reduce competition and choice in title services and providers to the detriment of consumers. In a recent study of transactions by one real estate firm with affiliate mortgage and title operations, title and related charges were actually found to be $500 less than that of its unaffiliated competitors in the market.

Furthermore, owners of affiliated businesses can earn no more than a proportionate return on their investment under the Real Estate Settlement Procedures Act (RESPA). RESPA also prohibits referral fees or any compensation at all for the referral of settlement services. As a result, there is no steering incentive possible for individual settlement service providers such as mortgage brokers, loan officers or real estate professionals. Since the Bureau now enforces RESPA and has enhanced authority under the statute, the Bureau has all the power necessary to prosecute kickback situations and other violations of RESPA. Instead of applying a discriminatory double standard to affiliates via the 3 percent cap on fees and points, Congress should support the Bureau's use of its RESPA authority to ensure that both affiliated and unaffiliated companies of all sizes comply with the anti-steering and kickback provisions of existing law.

- The bill removes from the calculation of fees and points escrows held for insurance. Insurance escrows are held to pay homeowners insurance and can be large amounts. They are paid out when due to the insurer and any excess fees are not retained by an affiliate, and cannot be retained under RESPA, since RESPA requires excess escrows to be refunded. While the CFPB has stated that both taxes and insurance escrows are not to be counted, their guide to the Ability to Repay rule and the language defining fees and points both clearly state that insurance is to be counted when affiliates are involved with the transaction. While we appreciate the Bureau's efforts to try to address this, NAR believes the legislative fix is the most certain way to avoid future confusion and legal risk.

Ascribing additional charges to the affiliated lender is clearly unfair and may in fact lead to greater costs for consumers or at the very least, increased consumer dissatisfaction and decreased consumer choice. Studies show that consumers see a significant benefit to having their real estate agent and broker at the lead in the transaction and using their affiliated businesses for key services such as mortgage and title insurance. In a 2010 Harris Interactive study conducted after enactment of Dodd-Frank, buyers said that using affiliates saves them money (78 percent), makes the home buying process more manageable and efficient (75 percent), prevents things from "falling through the cracks" (73 percent), and is more convenient (73 percent) than using separate service providers. The survey also showed that buyers who used affiliates tended to be more satisfied than those who did not. Finally, more than 50 percent of home buyers who were aware that a firm offered a full

range of services reported that it positively impacted their decision to use a particular real estate agent and the firm (as opposed to no impact or a negative impact). Without H.R. 3211, many of these buyers would lose that option.

H.R. 3211 is a revised compromise version of the earlier bipartisan "Consumer Mortgage Choice Act" H.R. 1077. A couple of provisions were removed from H.R. 1077 in order to address some concerns of interest groups related to consumers:

- The provision regarding mortgage broker and creditor paid compensation has been removed. This provision while justified was nevertheless removed because of fears that some kind of "license" would be given to mortgage brokers to recreate the market of 2005-2007. Other provisions of Dodd-Frank and the ATR/QM rule prevent this- nevertheless the provision was removed.
- Also, the provision regarding the treatment of Fannie and Freddie Loan Level Price Adjustments (LLPAs) which was not in the Senate version (S. 949) has also been removed. Industry experts believe counting LLPAs toward fees and points needlessly drives consumers to more costly loans, particularly FHA loans with higher insurance premiums. Nevertheless, organizations purporting to represent consumers and the CFPB believe these charges are a measure of risk and are appropriately counted in fees and points. Therefore, the provision has been removed to satisfy their concerns.

After these compromises and others over the past three years, the remaining legislation represents the bare minimum of what Congress must do to restore a level playing field and consumer choice. Without this legislation, based on surveys of real estate and mortgage with affiliates, one-quarter to as much as one-half of loans originated in 2012-2013 would likely not be eligible for the QM safe harbor. Consequently, these loans will not be made by firms with affiliates, not made at all, or would be concentrated amongst the largest retail lenders whose business models are more protected by the rule from the fees and point definition discrimination. Therefore, Congress should pass H.R. 3211 without further delay to avoid further harm to consumers, the real estate market, and real estate service providers.

43% DEBT-TO-INCOME (DTI) LIMIT

Another area of concern with regard to the underwriting standards for QM will be jumbo loans with debt-to-income (DTI) in excess of 43 percent and other loans, particularly when the exception for GSE loans expires. For lower loan amounts, FHA and other government backed loans will be the only loans that will satisfy the QM safe harbor when DTI exceeds 43 percent. Even if the GSE exception is maintained, jumbo loans and non-GSE or non-government backed loans will be subject to the 43 percent DTI cap making them more costly or less likely to be made.

For jumbo loans in particular, the DTI cap could impose significant restrictions in high cost areas. High income borrowers are more likely to obtain jumbo financing. Because of their higher residual incomes in gross terms, they can afford to have a higher debt to income ratio. NAR fears that if the non-QM market does not emerge or is anemic, credit in high cost areas could be further restrained.

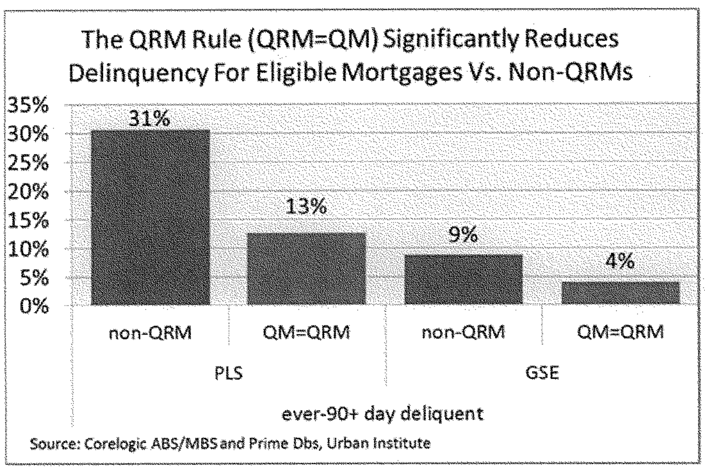
Therefore, we urge the CFPB to be flexible with the DTI standard should jumbo mortgage credit tighten or become unreasonably costly.

QUALIFIED MORTGAGE (QM) & QUALIFIED RESIDENTIAL MORTGAGE (QRM)

NAR believes that, assuming the concerns with fees and points are addressed, the QRM (which does not require risk retention by securitizers) should be constructed to match the QM. In August 2013, the six Federal Regulators published a revised proposed rule that would equate QRM with the newly implemented "ability-to-repay" Qualified Mortgage (QM) and underwriting standards issued by the CFPB. Moreover, Dodd-Frank establishes that the QRM can be no broader than the QM, but it does not say it cannot be substantially the same.

In synchronizing both definitions, the revised rule encourages safe and financially prudent mortgage financing while also ensuring creditworthy homebuyers have access to safe mortgage financing with lower risk of default. In addition, consistency between both standards reduces regulatory burden and gives mortgage professionals much-needed clarity and consistency in the application of the important mortgage standards required pursuant to Dodd-Frank.

By equating the QRM with the QM, regulators have provided clear rules that allow for robust markets that meet the needs of creditworthy borrowers in a safe and sound manner. The new proposed QRM will reduce the risk of default and delinquency as illustrated below.



An Urban Institute analysis[1] of mortgages in private label securities originated in or prior to 2013 found that the "over 90-day delinquency rate" (loans that have ever been 90 days or more delinquent) for all loans that did not meet the re-proposed QRM standard was 30.6 percent.

The delinquency rate for purchase and refinance loans that met the new QRM proposal was nearly two thirds lower at 12.6 percent.[2] Loans purchased by Freddie Mac and Fannie Mae that met the re-proposed QRM standard had default rates of 4.1 percent as compared to 8.7 percent for mortgages that did not qualify for QM status.

The study's authors point out that using an alternative measure of performance such as the 180-day delinquency rate or a measure of default would more accurately portray borrower behavior. The delinquency rates for private label security (PLS) and GSE mortgages originated over this same period that fell 180 days or more delinquent were 7.87 percent and 1.43 percent, respectively. Furthermore, as pointed out by researchers at the UNC Center for Community Capital, several recent studies of performance for QM and non-QM loans vary by time frame and mortgage features included, but all indicate that the QM standard significantly reduces risk, while providing broader access to credit than a QRM that includes a down payment requirement.[3]
The alignment of the QM definition with the QRM definition results in a construct that excludes risky product features and low or no-documentation lending that are closely correlated with increased probability of default. Appropriately, the definition of QM is not limited based on down payment. Although data shows that the risk of default increases somewhat as down payments decrease, this correlation is not significant enough to necessitate the inclusion of a downpayment requirement in QRM. Much like the private market operates today, investors can choose to package QRMs based on down payments if they choose to. Aligning QRM with QM allows market participants to assess and allocate risk within boundaries that will ensure stability to the market and a wide degree of credit access.

Recent market trends show that the QRM rule is unlikely to lead to a flood of zero down payment loans, as some critics of the proposed rule have suggested. Creditors currently are requiring borrowers to put significant amounts down in order to qualify for a loan before any risk retention rules are in effect. Both Fannie Mae and Freddie Mac recently raised their minimum down payments for most loans to five percent, and charge significant premiums and require mortgage

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[1] *See* Laurie Goodman and Ellen Seidman and Jun Zhu, "QRM, Alternative QRM: Loan default rates," The Urban Institute, MetroTrends Blog (October 17, 2013) (available at http://blog.metrotrends.org/2013/10/qrm-alternative-qrm-loan-default-rates/?utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%3A+MetrotrendsBlog+%28MetroTrends+Blog%29).

[2] To account for prepayment penalties, the authors of the Urban Institute's study filtered from their QM definition mortgages with prepayment penalties incurred more than three years after origination, but they were unable to screen those mortgages with penalties that exceeded the limit of 2 percent of the amount prepaid. Likewise, data limitations precluded their ability to screen hybrid ARM products for a maximum rate reset in the first 5 years. Mortgages with these features may have been screened from the QM definition for other reasons, but some were likely included and thus estimates for delinquency rates should be considered conservative.

[3] Reid, Carolina and Quertia, Roberto, "Risk, Access, and the QRM Reproposal." UNC Center for Community Capital, September 2013.

insurance for those with down payments below 20 percent. The inclusion of a down payment requirement in the QRM rule is therefore unnecessary. Nonetheless, if it were included it would set a rigid standard not amenable to adjustment by individual securitizers based on experience and market trends. Moreover, it would give the government's imprimatur to an underwriting factor. That was not Congress's intent and would exclude far too many borrowers from QRM loans.

As Laurie Goodman of the Urban Institute states, "The default rate for 95 to 97 percent LTV mortgages is only slightly higher than for 90 to 95 LTV mortgages, and the default rate for high FICO loans with 95 to 97 LTV ratios is *lower* than the default rate for low FICO loans with 90 to 95 percent LTV ratios. . . . For mortgages with an LTV ratio above 80 percent, credit scores are a better predictor of default rates than LTV ratios."[4]

For the reasons above, Congress should support, and regulators should establish, a QRM that substantially mirrors the QM.

CONCLUSION

NAR supports a broad QM rule that does not discriminate against affiliates, smaller lenders, community banks, or credit unions. Furthermore, NAR supports a QM rule that gives consumers maximum choice in service providers. Finally, NAR supports a QM and QRM rule that does not needlessly cause credit to be more costly or unobtainable.

We are already in a tight credit environment. The QM and other rules effectively ban the types of products and processes that led to the mortgage crisis. Congress and the CFPB should improve the QM rule to ensure that consumers who have the ability to repay their loans will have the access to affordable credit they deserve.
NAR thanks the Subcommittee members for their attention to these issues. We look forward to working with Congress and the Administration on efforts to address the challenges still facing the nation's housing markets.

[4] *See* Laurie Goodman and Taz George, "Fannie Mae reduces its max LTV to 95: Does the data support the move?," The Urban Institute, MetroTrends Blog (September 24, 2013) (available at http://blog.metrotrends.org/2013/09/fannie-mae-reduces-max-ltv-95-data-support-move/).

Consumer Federation of America

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Testimony of
J. Robert Hunter, Director of Insurance

Before the New York State Department of Financial Services

TITLE INSURANCE PUBLIC HEARING

December 10, 2013

Introduction

Mr. Superintendent, I appreciate the invitation to appear before you today to discuss current issues related to title insurance. I am J. Robert Hunter, Director of Insurance for the Consumer Federation of America (CFA).[1]

In 2012, consumers paid almost $11 billion in premiums for title insurance countrywide.[2] In 2012, consumers paid $819 million in premiums for title insurance in New York.[3]

Title insurance remains one of the most costly items at the closing of a real estate transaction, yet consumers poorly understand it. Title insurance assures the lender and buyer that the person selling a property actually has a clear title to transfer to the buyer. Unlike other forms of insurance that protect against future unexpected events, title insurance is essentially a guarantee that the title agent or title insurance company has diligently reviewed the relevant title information and identified any problems with the title prior to the sale.

There are two types of title insurance policies. The lender's policy – demanded by mortgage lenders – protects the lender for the loan amount. Although the lender requires the lender's title insurance policy, the lender never pays for it. Rather, the buyer pays for the lender's policy. An owner's policy protects the buyer up to the purchase price of the property. In addition to errors and omissions in the review of title records, title insurance also protects against unknown problems with the title. Title insurers guarantee that the title ownership is sound, defend the buyer against challenges to their title, and compensate the buyer and the lender if there is a problem with the clear ownership of the title.

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[1] CFA is a non-profit association of nearly 300 organizations that, since 1968, has sought to advance the consumer interest

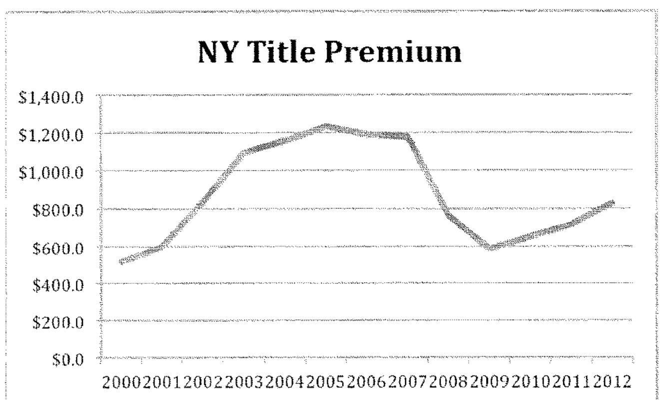
[2] Annual Statement for the year 2012 of the American Land Title Association – Industry.

[3] Ibid, Schedule T.

Title insurance facilitates homeownership by mitigating the risks related to the transfer of ownership for both the buyers and the lenders that finance their purchases. However, if there is a problem with the title, title insurance policies only reimburse the homeowner at the level of the purchase price, meaning that any market appreciation is lost.[4] Title insurance is important because some titles may have problems that are not clearly discernable in the public records due to errors or omissions that have not yet been uncovered, such as an earlier defective transfer due to fraud. However, the overwhelming majority of title problems are discoverable with a routine search of public records, including tax or mechanics' liens, possible heirs, errors or omissions in deeds or possible forgery.

The $11 billion in title insurance premiums paid by consumers in the USA in 2012 was roughly 32 percent less than the amount paid in 2000 but over twice the amount paid ($4.8 Billion) in 1995.[5] The ups and downs in title insurance premiums are driven by decreases and increases in the number of title insurance transactions – home sales and mortgage refinancings – and the increase in home values and mortgage amounts. Title insurance premiums are based on the amount of the sales price or mortgage loan. As home prices soared before 2008 in some parts of the country, title insurance premiums have jumped solely because of the increase in home prices rather than legitimate increases in the cost of providing services. As the financial crisis struck and sales of homes and home values declined, the premiums also fell back.

In New York, a similar pattern appears as the bubble in home sales was followed by the crash and, now, the recovery:



The title insurance industry is highly concentrated, with only four insurer groups controlling 86.7 percent of the market nationwide.[6] Nationally, the market concentration index HHI[7] places the

[4] Romano, Jay, "Title Insurance: Is a Rider Needed?" *New York Times*, March 26, 2006.
[5] Title Insurer Statutory Annual Statements, Schedule T, various years.
[6] 2012 Market Share by Family and State, ALTA
[7] "HHI" is the Herfindahl-Hirschman Index, is the sum of the squares of the seller market shares. The Federal Trade Commission and the Department of Justice have published guidelines for HHIs as part of their consideration of

title insurance market at a highly concentrated 2158. In New York, the top 4 companies have a market share of 90.6 percent, leaving New York with an even more concentrated HHI of 2250.[8]

The costs of the policy (a one-time premium) are usually based on the loan amount and can range from several hundred dollars to $2,000 on a median priced home, depending on the state. Theoretically, buyers have the ability to shop for title insurance and to choose the insurance company with the best rates and fees. In fact, this seldom occurs. Even when they do, rates among the title companies often remain essentially the same.

Numerous studies over the past thirty years have documented how inefficiencies in the title insurance market have harmed consumers through higher premium prices.[9] In 1977, the U.S. Department of Justice examined the impact of pricing and marketing of title insurance on consumers. In 1980, Peat Marwick performed a study for the U.S. Department of Housing and Urban Development of market competition based on price in title services. That study found that the structure of the title insurance market encouraged reverse competition (discussed below), which drove up prices. A 1986 Texas Department of Insurance report found widespread reverse competition as a result of real estate intermediaries driving the market for title insurance and homeowners exerting "no pressure on price at all."[10] These and other studies have documented the fundamental market problem with title insurance – reverse competition.

Reverse competition refers to a market structure in which the seller of a product markets the product to an intermediary instead of to the ultimate purchaser of the product. In the case of title insurance, title insurers market their products to real estate professionals – real estate agents, attorneys, mortgage lenders, mortgage brokers, homebuilders – who, because of their position in the real estate transaction, are able to steer the consumer who is actually paying for the product to a particular title agent or title insurer. The ultimate consumer has little or no market power in the title insurance transaction because title insurance is required for obtaining the loan or purchasing the property and because the consumer, who infrequently purchases real estate, has relatively little knowledge of title insurance. The entities with the market power in title insurance are those people who are able to steer consumers to particular title agents or title insurers. And the competition among title agents and title insurers for the business of the real estate professionals – title insurers identify real estate brokers, attorneys, mortgage lenders, mortgage brokers and homebuilders and not the consumers paying for the title insurance as their customers – causes title insurance premiums to increase as title agents and title insurers spend money and provide various considerations to the referrers of title insurance business. The provision of considerations to real estate professionals by title agents and title insurers takes both legal and illegal forms.

A HUD study concluded that "one of the most prominent criticisms of the title insurance industry is that costs are kept high by reverse competition, kickbacks, or inappropriate

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potential anti-competitive consequences of horizontal mergers. This is discussed in more detail later in this testimony.

[8] Ibid.

[9] *See* Birnbaum, Birny, Report to the California Insurance Commissioner, "An Analysis of Competition in the California Title Insurance and Escrow Industry," December 2005, at 28-37.

[10] Cited in Birnbaum at 35.

referrals...Most agree that reverse competition is inherent in the incentive structure facing settlement agents...(The Real Estate Settlement Procedures Act, or RESPA,) enacted in 1974, is intended to limit reverse competition by prohibiting kickbacks and referral fees and by outlining requirements for acceptable affiliated business arrangements between settlement agents and other parties in the settlement process. Reverse competition is still possible, however, through the negotiation of the premium retained by the settlement agent..." Referring to the "rating bureau" organization that developed rates and rating systems for title insurers, the study goes on to explain that this reverse competition was amplified by other anticompetitive aspects of the title insurance industry. Some have argued, the study explains, that a "rating bureau is essentially a cartel that keeps title insurance prices higher than they are in other states by restricting competition."[11]

Reverse competition makes low price competition useless. As the CEO of Title One, Inc. (a low cost title insurer) put it in Congressional testimony, "We would have to raise our fees to be competitive."[12] A new, lower cost title insurer, Entitle Direct Insurance, started business in 2008 with a 0.04 percent national market share. By 2012 it had grown only to a 0.11percent share of the market (flat at 0.11 percent since 2010). In New York, Entitle is doing a bit better, growing to a 0.60 percent share in 2012.[13] But the low cost should show stronger growth. Title One could not grow because, Mr. Miller testified, his rates were too low, not giving room for the kickbacks reverse competition requires.

I. The Title Insurance Market is Not Competitive

Title insurance remains one of the most expensive items at closing, yet consumers poorly understand it and they have little ability to shop around for this product. Title insurance costs are presented to homebuyers at the point of closing on real estate transactions along with many other closing costs. Purchasing a home is the largest and most complex financial transaction most households undertake. Many homebuyers, especially first time and financially unsophisticated buyers, are especially vulnerable during the closing process and are under the impression that the transaction terms and costs are fixed. If a consumer does question the title insurance charge, the threat of a delayed closing can be raised. Moreover, homebuyers assume that the transaction intermediaries (real estate agents, mortgage brokers and title agents) are acting in the buyers' interests, when in fact most intermediaries are acting in their own financial interests.

Under these circumstances, homebuyers are not positioned to be the most diligent consumers, but they are further hindered by the unique complexities of the title insurance marketplace.

Title insurance is not sold in a competitive marketplace. Consumers lack information about title insurance and are poorly situated to exert pressure on terms or prices. In practice, homebuyers are not even the consumers of title insurance; instead they are driven to title insurance policies through referrals by real estate intermediaries – the actual consumers who get all the marketing attention from title insurers.

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[11] "What Explains Variation in Title Charges," HUD, June 2012.
[12] Testimony of Douglas R. Miller, President and CEO of Title One, Inc., before the House Financial Services Committee, April 26, 2006
[13] Market Share by Family and State, ALTA, 2008-2012 editions.

Additionally, in most states, lenders require homebuyers to pay for both the lender's title insurance policy as well as their homeowner's title policy but do not help borrowers achieve similar savings that lenders receive on their policies through exerting economies of scale. Finally, the market for title insurance demonstrates marked price inelasticity, meaning that even large increases in title insurance prices will not cause consumers to stop buying title insurance. This result occurs because title insurance is a required part of the real estate transaction.

As mentioned above, title insurance is not marketed directly to the consumers who buy it, but instead is marketed to the intermediaries that service real estate transactions. As a result, there is almost no competition for individual consumers as there is with the marketing of auto and homeownership policies. Instead, title insurers compete to secure referrals from the real estate service providers who steer title insurance buyers to their businesses.[14]

Since consumers almost never solicit their own quotes for title insurance and there is very little consumer knowledge or understanding of the title insurance product, consumers can and often do pay more for insurance than necessary. Although consumers can legally purchase title insurance on the open market from any carrier, as a practical matter most homebuyers have title insurance chosen for them by their real estate agent or mortgage broker.

Since the title insurance companies are effectively marketing to the real estate or lender intermediaries, who do not have to pay for the product, the incentives to compete on the basis of cost are eliminated. Since the lenders requiring the insurance and the intermediaries placing it pass the cost on to the homebuyers, they are indifferent to the price. Indeed, lenders may have an incentive for higher prices if they are part of an affiliated business arrangement that profits from title insurance.

Consumers are unable to exert market pressure on title insurance prices because of their weak position in the real estate transaction and because the title insurance cost – while substantial – is a small portion of the total real estate transaction cost. The individual homeowner has an incentive to keep costs low and shop for the cheapest insurance, but because the overwhelming majority of homebuyers use their real estate or mortgage brokers, attorneys or, perhaps, their lenders to choose title insurance the homebuyer's incentive to seek low cost insurance is lost. Instead, the intermediary that is selecting the title insurance policy for the homebuyer has no incentive to hold down the cost of the policy. The real estate intermediaries have incentives to allow the title policies to become more expensive because higher cost policies generate higher rebates, referrals or other financial inducements from the title insurer, while the added costs are merely passed on to the buyers.[15]
Secondly, lenders use this product to protect themselves, yet require consumers to purchase the protection as a separate, stand-alone product. Competitive markets cannot function when the entity making the decision to purchase a product is not the same entity paying for the product.

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[14] Birnbaum at 26.
[15] Guttentag, Jack, "Title Insurance Fees Paid by Borrowers Include Referral Costs," March 21, 2005.

Lastly, there are a number of unique elements to title insurance that make it difficult for consumers to choose policies based on price, a condition known as price inelasticity. First, title insurance policies are never renewed and they do not have periodic premium payments. Title insurance is sold only when houses are purchased or refinanced. Homeowners and auto insurance policies are renewed annually, so consumers can renew with their underwriter or shop for cheaper policies when their coverage expires. Additionally, title insurance is a required precondition for lenders to be willing to write a mortgage. Since the focus is on the new home, not the insurance transaction and since conducting a price comparison for a product about which consumers have very little understanding might also require adjourning the closing of the home sale, few consumers are willing to do it even if they are aware of their right to do so. An inter-related factor is that title insurance premiums are a small portion of the entire real estate transaction. Even relatively higher title insurance premiums do not have a large impact on the aggregate purchase and closing price. While a thousand-plus dollar transaction would give consumers pause in most settings, given the unique context of purchasing a home, the high price of the policy is unlikely to deter consumers from a title insurance carrier presented to them.[16]

Because title insurance is essentially a derivative product dependent upon home sales, the number of title policies sold is unlikely to rise if the price of the policy declined. Because, that is, demand is very inelastic, title insurance underwriters have little incentive to lower prices to capture more of the market.[17]

Various studies have shown the impact of this lack of competition. For instance, there is much evidence that the title fee rises with loan amount, which "may be seen as evidence of market power exercised by title insurance underwriters and agents because the cost of examining titles and insuring their validity are unlikely to rise substantially with the size of the loan involved."[18] The study found that 25 percent of the title fee variation across the nation is because of the borrower's state of residence. "Much of this interstate variation in title fees remains unexplained. Even after controlling for loan amount and demographic characteristics of the borrowers."[19] This is particularly relevant to high cost states such as New York.

In a major review of title insurance, the GAO[20] confirmed these concerns about competition in the title insurance market: "Among the factors raising questions about the existence of price competition and the resulting prices paid by consumers within the title insurance industry are the following:

- Consumers find it difficult to shop for title insurance, therefore, they put little pressure on insurers and agents to compete based on price;
- Title agents do not market to consumers, who pay for title insurance, but to those in the position to refer consumers to particular title agents, thus creating potential conflicts of interest;

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[16] Boyer, M. Martin and Charles M. Nyce, "Banks as Insurance Referral Agents? The Convergence of Financial Services: Evidence from the Title Insurance Industry, "*Scientific Series*, Centre Interuniversitaire de Recherche en Analyse des Organisations, 2002s-78, September 2002, at 9.
[17] Birnbaum at 28.
[18] Woodward, Susan "A Study of Closing Costs for FHA Mortgages", HUD, 2008
[19] Ibid.
[20] Title Insurance: Actions Needed to Improve Oversight of the Title Insurance Industry and to Better Protect Consumers, GAO, April 2007.

- A number of recent investigations by HUD and state regulatory officials have identified instances of alleged illegal activities within the title industry that appear to reduce price competition and could indicate excessive prices;
- As property values or loan amounts increase, prices paid for title insurance by consumers appear to increase faster than insurers' and agents' costs; and in states where agents' search and examination services are not included in the premium paid by consumers, it is not clear that additional amounts paid to title agents are fully supported by underlying costs."

II. Product Costs are Excessive

The title insurance industry maintains that it incurs significant costs when offering title insurance policies, but the majority of the costs are not for losses or operating costs to generate the insurance policy. Instead, the majority of the premium is split with title agents who can receive as much as 90 percent (in New York approximately 85 percent) of the premium dollars. Title insurance industry costs include maintaining the title plant database, searching and examining property titles, clearing titles and the claims costs of any title defects.[21]

Title insurers can clear titles very easily and with nominal costs in most cases where modest problems arise.[22]

Examples illustrate the excessive price of title insurance.

1. Iowa has banned the sale of title insurance and, instead, has created the Iowa Title Guaranty, which is a state agency that provides title assurance and fixes the title in the event of a title problem. Iowa Title Guaranty charges a flat rate of $110 for a title guaranty. Combined with typical costs for an abstractor and attorney, the cost of title protection in Iowa is about $500 – less than half of what title insurance costs in other states.[23]
2. In 2005, a number of states took action against title insurers for a form of illegal rebating called captive reinsurance. Under this arrangement, a homebuilder, for example, would establish a captive reinsurer – a reinsurance company owned and controlled by the homebuilder. In exchange for the homebuilder referring homebuyers for title insurance, the title insurer reinsured the title insurance policy with the homebuilder's captive reinsurer and paid a premium to the captive reinsurer. In theory, the reinsurance premium should reflect the likelihood of losses on the policies reinsured. In the case of the title captive reinsurance, the title insurers paid almost half of the title premium as reinsurance premium, while the captive reinsurers paid little or nothing in claims. In essence, the captive reinsurance agreements were a kickback to the homebuilders of almost 50 percent of the premium. The size of the kickback is a further indication of how title premiums are

[21] DasGupta, Neil and Richard McCarthy, "Clouds on Horizon After Title Industry's Bright Year," A.M. Best Special Report, October 2005 at 7.
[22] Ibid.at 13.
[23] "Iowa's title alternative lifts its game," *The Title Report,* February 20, 2006 at www.thetitlereport.com. Confirmed rate on Iowa web site, visited November 30, 2013. Premium charge is $110 up to $500,000 (plus $1 per $1,000 over that). Owner's coverage is free up to $500,000.

excessive in relation to the costs of providing the product.[24] Captive reinsurance does not appear to be a problem in New York.

3. According to a major study done for HUD, indications that title insurance charges are greater than the competitive level include:
    - Positive correlation with property values although the costs of the search (the major cost involved) does not vary with price.
    - High total service profits.
    - High market concentration.
    - Borrowers in African-American neighborhoods pay on average an additional $120 for title services and those in Latino census tracts pay an additional $110, as compared to borrowers residing in neighborhoods with no minorities.
    - Differences in average title charges (taking loan and borrower characteristics into account) from the lowest-cost state—North Carolina—to the highest cost states—New York, Texas, California, and New Jersey—is more than $1,000. The type of title insurance regulation adopted by states explains only a small fraction of this variation.
    - Title charges are higher when fees paid to lenders, brokers, and real estate agents are also high, again controlling for all relevant loan and borrower characteristics. In other words, the same borrowers are being charged above-average fees for multiple components of their closing costs.[25]

Operating costs for title insurers include any direct title searching, examining and clearing of titles that are not performed by affiliated title agents as well as maintaining the title plant. Updating the plant requires constant and detailed attention, and the intellectual property of the title plants is carried on the books of title insurers as a non-depreciating asset. Operating the title plant is a small portion of the operating expense. Industry consultant Demotech reported that title plant updating and maintenance consumed less than 1 percent (0.67 percent) of annual industry revenue.[26] Title production services consumed about 5 percent (4.73 percent) of annual revenue.

The loss ratio for title insurance is among the very lowest in the insurance industry. This ratio measures the amount an insurer pays in claims relative to the amount it receives in premiums. Title insurance differs from other forms of insurance because it insures against risks in the past (such as incorrect deed recordings), not against future risks. As a consequence, title insurance companies' underwriting is not based on future actuarial risk balancing but on avoiding losses which can be greatly mitigated through due diligence by screening the pre-existing risks on the title.[27]

Title insurers pay out only a small percentage of premium in claims to policyholders, viz.:

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[24] "Insurance Commissioner John Garamendi Announces Major Settlement Agreements With Title Insurers—More Than $37 Million To Be Paid For Illegal Kickback Schemes," California Department of Insurance press release, July 20, 2005. See also charts prepared by Erin Toll, Colorado Department of Insurance for presentation at June, 2005 NAIC Title Insurance Working Group meeting. I do note that New York has not experienced use of captive reinsurance.

[25] Woodward, Susan "A Study of Closing Costs for FHA Mortgages", HUD, May 2008.

[26] Demotic, "Title Insurance Industry Information and Economic Data," 2005 at 65.

[27] Arrunada, Benito, "A Transaction-Cost View of Title Insurance and its Role in Different Legal Systems," *The Geneva Papers of Risk and Insurance*, Vol. 27, No. 4, October 2002.

Year	NEW YORK Direct Premiums Earned	Direct Losses Incurred	Loss and LAE Ratio	USA Direct Premiums Earned	Direct Losses Incurred	Loss and LAE Ratio
2005	$1,113,948	$50,175	4.5%	$16,443,263	$880,562	5.4%
2006	$1,168,670	$44,245	3.8%	$16,193,355	$803,532	5.0%
2007	$1,159,738	$52,870	4.6%	$13,846,817	$1,145,076	8.3%
2008	$755,690	$59,518	7.9%	$10,172,081	$1,231,841	12.1%
2009	$599,766	$31,672	5.3%	$9,470,620	$930,325	9.8%
2010	$661,812	$51,481	7.8%	$9,442,719	$1,018,291	10.8%
2011	$715,521	$47,349	6.6%	$9,365,645	$1,016,727	10.9%
2012	$818,921	$37,270	4.6%	$11,230,369	$765,167	6.8%
Total	$6,994,066	$374,580	5.4%	$96,164,869	$7,791,521	8.1%

Dollar figures in thousands
Source: Schedule T of the Annual Statements of the Industry from the American Land Title Ass'n

Title insurers paid only about 8 percent of premium dollars on claims nationally (5.4 percent in New York), compared to about 75 percent for auto and home insurers.[28] Part of this lower pay-out ratio in New York may be due to the ultra-high prices in the state. New York City was one of 6 cities studied by GAO.[29] It had the highest price for title insurance for a median priced home, viz.:

City	**Median home**	**Owner's Rate**
LA	$529,000	$1,587
NYC	$445,200	$2,190
Chicago	$264,200	$1,025
Denver	$247,100	$1,216
Dallas	$147.500	$ 871
Des Moines	$145,500	$ 700

Most title insurance is sold for title insurers through title agents. Title agents can be affiliated with the title insurer or non-affiliated independent title agents. The bulk of the title insurance premium – 70 to 90 percent, depending on the state (about 85 percent in New York) – goes to the title agent because the title agent is typically the one who does the search, examination and underwriting of the title insurance policy.

[28] Best's Aggregates and Averages Property/Casualty, 2013 Edition.
[29] Title Insurance: Actions Needed to Improve Oversight of the Title Insurance Industry and to Better Protect Consumers, GAO, April 2007.

The real costs to insurers are the amounts title insurance carriers and title agents pay to real estate intermediaries to capture homeowners' policy dollars. Title insurance companies pay commissions to title agents, not to real estate professionals. It is illegal to pay someone for a referral, which is why insurers either do it illegally or via affiliated business arrangements. The expenses of title insurers and title agents are often inflated because of considerations provided to the referrers, which may include money or a variety of free services, such as printing and distributing marketing materials for real estate agents. To secure these referrals, title insurers and title agents offer considerations to the real estate professionals (real estate brokers, attorneys, mortgage brokers, lenders and developers) and these considerations increase the cost of the insurance premium for the homebuyer.[30]

Some considerations are legal in some states, including paying for marketing costs, market analyses and mailing lists, while most forms of considerations and gifts are illegal kickbacks.[31]

The real costs of creating a title insurance policy are very low, a few hundred dollars for the title search and taxes and 5 percent of the premium price for losses, but consumers are being charged considerably more than the cost of the product plus a reasonable amount for profit. For a hypothetical $500,000 home with a $400,000 mortgage in Manhattan, title insurers are charging about $2,140 for the owner's policy.[32] Studies have shown, however, that the direct cost of the policy to the underwriter, may only a few hundred dollars to perform the associated administrative title services and 5 percent of the market premium, for a total of well under $1,000 – much less than the price being charged by title carriers[33]. The remainder may be the split the underwriter pays the real estate agent, mortgage broker or title agent. The title industry maintains that title insurance can't be compared to other insurance products because of much higher operating expenses (i.e., maintenance and records search expenses) than other lines of insurance, but the overwhelming majority of these costs are related to the commission split that is paid to the title agents.

III. Factors Contributing to Excessive Cost

Although consumers know little about it, title insurance is big business. Title insurance premiums written exceed most property and casualty lines including farmowners, mortgage guarantee, medical malpractice, earthquake, products liability, commercial auto physical damage and several other lines of property/casualty insurance.[34] Between 1995 and 2005, total operating revenue for the title insurance industry grew more than three-fold from $4.8 billion to $17.8 billion, according to data from the American Land Title Association (ALTA). After 2005, the recession impacted home values such that in 2012 the figure was $11.2 billion. Operating revenue includes premiums as well as escrow and other services. The revenue was used to pay claims, operating expenses and profits.

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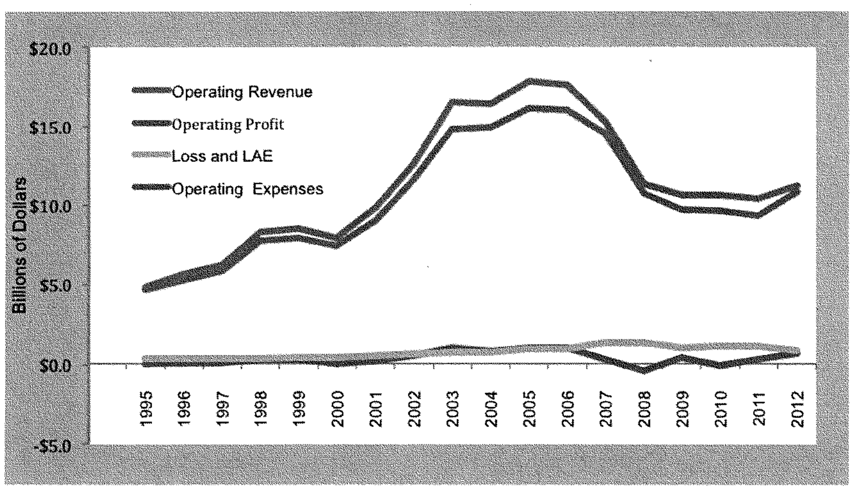
[30] Birnbaum at 27.
[31] Gandel, Stephen, "Congressman Calls for Title-Insurance Investigation," *Money*, February 24, 2006.
[32] Stewart Title Rate Calculator, visited on December 1, 2013.
(http://www.stewartstar.com/SRC/RateCalculator/Main.aspx)
[33] See, e.g., Consumers Union, "California Title Insurance Rates Remain High," April 3, 2003 and the industry magazine *The Title Report, 2003*
[34] Compared to Direct Written Premium in 2012, Best's Aggregates and Averages, Property/Casualty, 2013 Edition.

This broke down as follows over the past decade:

	Operating Revenue	Profit	Loss and LAE	Operating Expenses
1995	$4.8	$0.0	$0.3	$4.6
1996	$5.6	$0.1	$0.3	$5.2
1997	$6.2	$0.1	$0.3	$5.8
1998	$8.3	$0.3	$0.3	$7.7
1999	$8.5	$0.3	$0.4	$7.9
2000	$7.9	$0.0	$0.4	$7.4
2001	$9.8	$0.2	$0.5	$9.0
2002	$12.6	$0.5	$0.6	$11.6
2003	$16.5	$1.0	$0.7	$14.8
2004	$16.4	$0.8	$0.7	$14.9
2005	$17.8	$1.0	$0.9	$16.1
2006	$17.6	$1.0	$0.9	$16.0
2007	$15.3	$0.3	$1.3	$14.5
2008	$11.3	-$0.4	$1.3	$10.7
2009	$10.6	$0.4	$1.0	$9.7
2010	$10.6	-$0.1	$1.1	$9.6
2011	$10.4	$0.3	$1.1	$9.3
2012	$11.2	$0.7	$0.8	$10.8

Graphically, the data moved over time like this:



These data reveal that the huge jump in premium did not result in a similar jump in insurer profits and that the sharp drop in premium likewise did not impact profits significantly, likely because reverse competition forced insurers to pay ever greater amounts to referrers of business. Note that the operating expenses track the revenue but the profits to insurers do not.

Title insurance is a highly concentrated industry with the overwhelming majority of the market controlled by four firms, which control 87 percent of the national market and 91 percent of the New York market. Between 2009 and 2013, the number of title insurance firms declined from 88 to 44.[35]

Title Insurance Market Share Data

New York Data

	2006	2007	2008	2009	2010	2011	2012
Fidelity Family	52.6%	51.5%	50.6%	48.9%	36.7%	36.9%	34.3%
Stewart Family	14.3%	14.9%	16.4%	18.9%	21.4%	21.4%	21.4%
First American Family	24.6%	25.5%	24.3%	17.2%	18.5%	18.5%	17.5%
Old Republic Family	6.4%	6.3%	6.3%	9.0%	15.3%	15.3%	17.4%
Others	2.1%	1.8%	2.4%	6.0%	8.1%	7.9%	9.4%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Countrywide Data

	2006	2007	2008	2009	2010	2011	2012
Fidelity Family	46.5%	45.7%	45.0%	42.3%	34.7%	34.7%	33.9%
Stewart Family	11.9%	11.7%	12.6%	14.2%	13.7%	13.7%	13.0%
First American Family	28.9%	30.0%	28.9%	27.3%	26.8%	26.8%	26.3%
Old Republic Family	5.4%	5.5%	5.6%	7.9%	13.0%	13.0%	13.5%
Others	7.3%	7.1%	7.9%	8.3%	11.8%	11.8%	13.3%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Note: Fidelity Family added to LandAmerica Family prior to 2008.
Source ALTA Market Share by Family and State, various years as indicated.

[35] Performance of Title Insurance Companies, Demotech, 2009 In2 2013 Editions.

Title insurance markets are heavily concentrated, meaning that a few firms control most of the sales. As illustrated above, only four insurer groups are responsible for 87 percent of the sales on a countrywide basis and 91 percent in New York. In some states and in some counties, the concentration is even greater, with one or two title insurers controlling the entire market.

Another measure of concentration is the Herfindahl-Hirschman Index, which is the sum of the squares of the seller market shares. The Federal Trade Commission and the Department of Justice have published guidelines for HHIs as part of their consideration of potential anti-competitive consequences of horizontal mergers. According to the guidelines, a market with an HHI over 1,800 is highly concentrated.[36] The countrywide title insurance HHI is over 2,100. But even this high figure understates the concentration of title insurance. States or even counties within a state better define title insurance markets because title insurance regulation varies by state and because the raw material for title insurance comes from county courthouses. The HHI for New York is over 2,200. It cannot be ignored, then, that the insurance industry remains largely exempt from antitrust laws.

Three states – Florida, Texas and New Mexico – set rate caps while some other states, including New York, require the prior approval of rates before policies are offered. Other states have file-and-use (permitting state regulators to block the implementation of insurance rates within a short period after they were filed with the state), and some states have no rate regulation.

STATE	**Predominant Rating Law**	**STATE**	**Predominant Rating Law**
Alabama	F&U	Montana	F&U
Alaska	PA	Nebraska	PA
Arizona	F&U	Nevada	F&U
Arkansas	No File	New Hampshire	PA
California	F&U	New Jersey	PA
Colorado	F&U	New Mexico	Promulgate
Connecticut	PA	New York	PA
Delaware	F&U	North Carolina	F&U
Dist. Of Columbia	No File	North Dakota	PA
Florida	Promulgate	Ohio	PA
Georgia	No File	Oklahoma	No File
Hawaii	No File	Oregon	PA
Idaho	F&U	Pennsylvania	PA
Illinois	No File	Rhode Island	F&U
Indiana	No File	South Carolina	PA

[36] *See* U.S. Department of Justice, Antitrust Division Manual, Chapter 2: Statutory Provisions and Guidelines of the Antitrust Division, 1.5 Concentration and Market Shares; U.S. Department of Justice and Federal Trade Commission, "Commentary on the Horizontal Merger Guidelines," March 2006 at 15.

Iowa	State Monopoly	South Dakota	PA
Kansas	F&U	Tennessee	F&U
Kentucky	F&U	Texas	Promulgate
Louisiana	PA	Utah	F&U
Maine	PA	Vermont	F&U
Maryland	PA	Virginia	No File
Massachusetts	F&U	Washington	F&U
Michigan	F&U	West Virginia	No File
Minnesota	F&U	Wisconsin	F&U
Mississippi	No File	Wyoming	PA
Missouri	U&F		

F&U = File and Use
PA = Prior Approval
Source: Eaton and Eaton, 2007

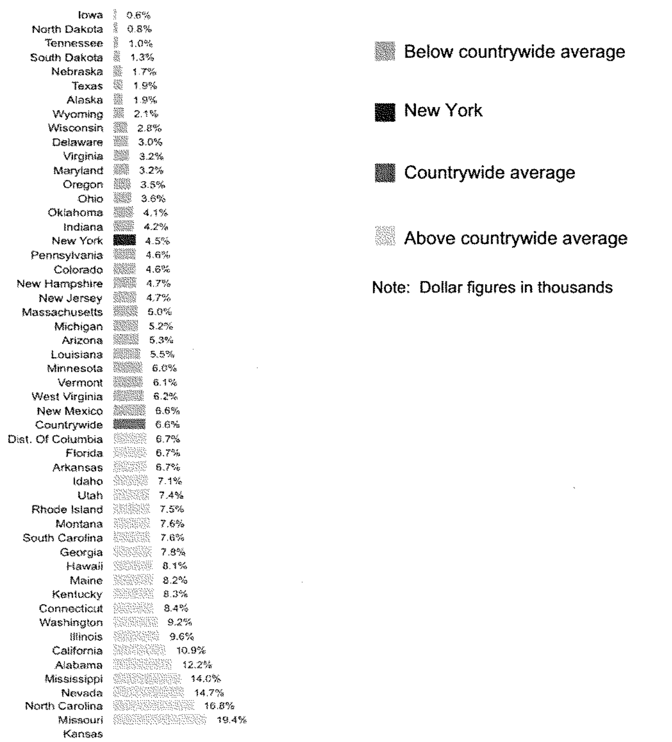
Further exacerbating the concentration problem in title insurance is the fact that the primary four Underwriters also control nearly all rating mechanisms within the title insurance industry, whether directly through their participation on rating bureaus or, indirectly, through their exertion of market dominance and corresponding rate filings in those states where file-and-use rules persist.

Weak price regulation in a reverse competition market is a prescription for excessively high prices for consumers. Reliance on market forces to protect consumers where reverse competition dominates does not work because the market is not responsive to consumers. Real and effective price regulation is required. Consumers don't have the market power to discipline title insurance prices and those that do have the power – referrers of business – have an incentive for higher prices that include funds to pay for considerations for the referral.

The loss ratio (the percentage of premium paid out in claims to home owners) for each state in 2012 are displayed in the following chart:[37]

[37] All states are included except Kansas, which had an unusually large loss ratio of over 90 percent in 2012 although in the 2008-2011 period, the overall Kansas loss ratio ran at just 4 percent. The Kansas Insurance Department is looking into these data and will tell CFA what they find prior to the hearing on December 10, 2013.

Figure 1: 2012 Title Insurance Loss Ratios



New York is 16th lowest in pay out to premium ratio, a sign that rates are too high in the state.

Proposals for Reform

The surest way to make competition work the way it is supposed to is to:

Make Lenders Pay for Title Insurance

To break the reverse competition strangle-hold on title insurance in New York, the lenders should be required to purchase the title insurance policies and include the cost of the title insurance in their APR. The APR is clearly subject to positive competitive forces.

This would help to limit or even eliminate the current lack of incentive to hold down the cost of title insurance premium, since there would no longer be an ability to indirectly pass the cost through to the home buyer. The direct pass-through as part of the APR will pressure the lenders to achieve low title insurance cost, squeezing out the excessive kickbacks from the title insurance product. Homeowners would be protected with lender purchased title insurance coverage for the borrower even after they pay off their mortgages. Title policies remain in force until the property is sold or the loan is repaid. When a consumer refinances, the old lender's policy expires and a new lender's policy is required. However, the owner's policy remains in force with a refinance.

The general approach would be to make those requiring the title insurance pay for it – the lender for lender's policies and the buyer for owner's policies. The lender would be prohibited from passing the cost of title insurance on as a separate charge, which would incentivize the lender to seek lower title insurance prices to keep the APR low. Since the lender would be a regular purchaser of many policies, the lender would be in a position to discipline title insurers on price in a more direct market transaction than currently exists. Indeed, if lenders have the title costs in the APR, they will likely look for innovative ways to lower costs of title insurance, including taking a serious look at Torrens and other more efficient systems in use in other states (i.e., Iowa) and other nations (e.g., Australia).

If Lenders are Not Required to Include Title Costs in the APR, then the Following Steps should be Considered to Reform the Title Insurance Market in New York

In a major research project released last month,[38] CFA conducted a review of the national auto insurance regulatory regimes and determined that the best practices included maximizing both competition and regulation for the benefit of consumers. It worked in California under Proposition 103 where tough regulation and removal of impediments to full competition such as the anti-trust exemption produced the lowest rate changes in the nation while keeping the state very competitive (California is the fifth most competitive state in the country for auto insurance) and delivered reasonable profits to the insurers.

CFA proposes that New York look at ways to both enhance competition and regulation in the clearly troubled title insurance market. Below is a discussion of proposals to enhance competition and , as a backstop to those proposals, ideas for to strengthening regulation. Both are needed.

<u>A) Enhancing Competition</u>

In its 2007 report, GAO called for improving consumers' ability to shop for title insurance, including publication of "complete title insurance cost information." This would be most useful if the market were made more competitive, changing it from a reverse competition market where competition drives prices up to a truly competitive market where competition drives prices down.

[38] What Works: A Review of Auto Insurance Rate Regulation in America and How Best Practices Save Billions of Dollars, Consumer Federation of America, November 2013

In order to set the stage for more competition, we suggest that the rating bureau be abolished and title insurers be required to file their own rates. In order for real competition to flourish, insurers and agents must compete on price. Rate bureaus (and Advisory Organizations) suffer from a fatal flaw, which is that they must produce a price (or an advisory loss cost) that is sufficient for their least efficient/least effective member insurance company to flourish. Thus, the tendency for the bureau is to use actuarial rating factors to jack up the price to the level needed to satisfy the entire membership. The New York department recently demonstrated knowledge of the rate bureau's overreaches, when the Department disapproved an excessive TIRSA filing.

In its 2007 report, the GAO suggested "that state insurance regulators, working through NAIC where appropriate, take two actions to improve the functioning of the title insurance market. Specifically, we are recommending that state regulators take action to (1) improve consumers' ability to shop for title insurance and (2) improve their oversight of title agents."[39]

In order to enhance consumer-shopping capabilities, New York should consider taking these steps:

- Require that the rate be as all-inclusive as possible so that shopping can be simplified.
- Develop an on-line, interactive and simple buyer's guide that includes all aspects of the price the consumer will be charged.
- Require that the buyer of a home be given a simple statement in bold print on a single sheet of paper when an offer is made and accepted on a home. This document will state, in plain language, that the Department develops, that personal shopping for title insurance will save the consumer hundreds of dollars and provide a link to the interactive guide to facilitate shopping.
    - Alternatively, title closers or someone else involved in every transaction could be required to provide homebuyer's with a premium quote sheet from all companies serving the market.

B) Improving Title Insurance Regulation

CFA's recent study of the nation's auto insurance systems showed that regulation and competition are not enemies but allies in ensuring that rates are the lowest possible that give a fair return to the insurers. Therefore, regulatory excellence must be enhanced in New York to achieve best practices for the title insurance system. Here are some regulatory steps CFA suggests:

Improper Expenses, Excessive Expenses and Expense Allocations

Ratemaking for expenses should protect consumers from improperly paying for expenses that should not be borne by them as ratepayers or for paying the cost for kickbacks, inefficiencies and other items that inappropriately inflate these costs.

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[39] Title Insurance: Actions Needed to Improve Oversight of the Title Insurance Industry and to Better Protect Consumers, GAO, April 2007.

States have not done a very good job in controlling insurer expense levels. One exception is California for auto insurance. There, as a result of voters enacting Proposition 103 in 1988, expenses are controlled through an efficiency standard and a prohibition on the pass through of expenses unrelated to the provision of insurance. States could adapt this concept to title insurance in several important ways, including:

- Requiring that expenses that are to be passed on to consumers must be (1) used (actually expended) and (2) useful (an expense that is required to deliver the insurance product to the consumer). Allowable expenses should be limited by rules so that excessive expenses are disallowed for use in setting ratepayer prices.
- Disallowing expenses that should not be passed through to consumers such as fines, bad faith lawsuit payments, political contributions, corporate sponsorships for sporting events such as golf tournaments, and so on. These could be termed improper expenses.
- Limiting the amount of salaries paid to executives that can be passed through to ratepayers (under the California rules, the salary itself is not capped, only the amount that can be passed through in rates. The Board of any insurer can decide to pay much higher salaries to executives if the company wants to pay for them outside of the rate structure).

CFA suggests that efficiency standards be adopted to control excessive expense levels in title insurance in New York. We do not suggest that the Department use the market averages to set these levels as California does, however. New York title insurance efficiency standards cannot be determined by a review of current title insurance costs since reverse competition has skewed costs upward and will always be an area ripe for hidden kickbacks that cannot be accounted for. The Department must set the efficient expense levels at both the insurer and agent level by audit and by study of the activities involved and by determining the reasonable cost of performing such activities. The efficiency standards should be set as overall efficiency standards for every expense line for title insurers and agents in New York.

Until the Department sets efficiency standards, it must protect consumers in the interim in three ways:

1. **Disallow Improper Expenses**: As an example of possible expenses that might be disallowed in title insurance in New York, the Department of Financial Services supplied data on the extent of improper expenses in the state. Improper expenses included such items as golf outings, sporting events, Madison Square Garden suites, tickets and promotions, entertainment, charitable contributions, gifts, dues, giveaways, etc.

The aggregate amount of improper expenses for the title insurance underwriters during the 2008 to 2012 period was a whopping $79,554,224.34, which represents 6.3 percent of the premiums ($1,259,100,651.14) collected by insurers during that time frame.

The aggregate amount of improper expenses for only some of the title insurance agents during three years for which data were collected (2009, 2011 and 2012) was $3805238.97which represents 4.8 percent of the premiums of $79,478,899.46 collected by the agents surveyed during those three years.

These are the sorts of expenses that should be disallowed. Title insurance prices in the future should be calculated excluding these expenses and the Department must regulate to see that this is done.

2. **Control Excessive Salaries:** The Department should also consider establishing regulations to control excessive salary levels from impacting the prices that consumers pay in New York for title insurance. As an example of what could be considered excessive salary levels, Chicago Title's top five executives were paid a combined salary of $33 million in 2012. Research on what would be fair for ratepayers to contribute to the pay of top executives should be undertaken.

3. **Study Allocation of Expenses to the State**: CFA's review of the TIRSA testimony in this matter indicates that TIRSA is unaware if allocations of national expenses to New York are valid. This is particularly alarming when the allocation of non-identifiable expenses to New York represented 21 percent of the national non-identifiable expense even though the New York title insurance premiums only represented 9 percent of the national data. The Department must obtain information on exactly how these allocations are made to see if New York is paying too much of the national expense costs and move to correct any over-allocations to the State.

CFA's comments on TIRSA's inadequate assistance to the Department in its role as the State of New York's Statistical Agent are attached as an Appendix entitled CFA Comments on TIRSA Testimony. The Department should replace TIRSA as the official state appointed title insurance statistical (stat) agent with an independent vendor of statistical services who will serve the state rather than the industry. CFA believes this is needed even if the rating bureau is disbanded because:

a. Small insurers will need data for ratemaking purposes;
b. Data from agents should be collected on an on-going basis; and
c. An independent stat agent would be able to assist the Department in research into title insurance markets to make further reforms in the future.

The independent vendor would be asked not only to collect and audit/validate the data, but to be pro-active in suggesting data calls and data stat plans to answer questions vital to making the system work better in New York. The Department would then authorize, amend or reject these proposed data collection tools. If approved by the Department, these tools would be used to collect title insurance data in the state. CFA proposes that this vendor be authorized to also collect data from the agents. As with TIRSA, the cost of data collection would be borne by the insurers and CFA suggests that agents should also bear part of the cost.

Regulate Agents' Costs

As noted above, GAO's second recommendation was to "improve oversight of title agents."[40]

In order to improve agent oversight, New York has much work to do. The typical agent/insurer split of the premium dollar is 85 percent/15 percent. Data collection and research is necessary to

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[40] Title Insurance: Actions Needed to Improve Oversight of the Title Insurance Industry and to Better Protect Consumers, GAO, April 2007.

determine exactly how much cost is borne by the agent and by the insurer to determine if the split is proper and if the overall level of the premium is justified. It is shocking that New York agents are not subject to any regulatory oversight, including routine data collection by the Department, given that they garner the lion's share of the costs of the system. This glaring regulatory loophole must be closed.

Only when competition is working properly, can regulators expect the market to be able to establish an appropriate agent/insurer split. Until then, the Department should establish standards based on its audits and expertise that ensure that agents' portions of title insurance premiums do not create excessive prices in the market for title insurance.

Conclusion

Mr. Superintendent, we appreciate your undertaking this important effort to help consumers who have, for too long, been burdened with excessive title insurance charges. New York should consider strong measures to overcome the extreme financial incentives for those in the title insurance business to engage in reverse competition.

APPENDIX

CFA COMMENTS ON TIRSA TESTIMONY

TIRSA essentially says that it collects only data that the Department approves for it to collect and that the data the Department seeks in this hearing are unavailable. TIRSA also admits that it has never audited the data since "TIRSA has never been requested to perform an auditing function." The limited data TIRSA produces to the Department as its statistical agent are therefore unnecessarily suspect.

As you will see in the responses of TIRSA to the Department's questions 1 through 4, excerpted below, the responses are totally inadequate. The apparent lack of interest of TIRSA in the important questions raised by the Department, including the lack of any initiative to suggest approaches to obtain the missing information, is troubling.

On specific questions of the Department:

Topic 1 – TIRSA "does not specifically advise underwriters what expense items to include in line 25" ("other expenses"), relying instead on NAIC instructions. "TIRSA has not obtained any breakdown of the 'Other' expense category..." nor have they ever audited "the reporting companies and the work papers that are the basis for their reported expenses, including the detail behind the 'Other' expense category."

Topic 2 – "TIRSA does not give the underwriters direct, specific guidance regarding what expense items should be considered non-identifiable expenses and, therefore, require allocation to New York." The allocation "basis is selected by the underwriter" from UFRP instructions. "The determination of which expenses are identifiable and which are non-identifiable is made individually by each underwriter."

Topic 3 – As to the categories of searches and services for which title insurers report expenses and income in the data they send to TIRSA, TRISA's "annual Data Call does not produce the specific information..."

Topic 4 – "The TIRSA Data Call does not produce the level of information that is being requested in this question...TIRSA does not see the individual data supplied by the agents to their underwriters in connection with the Data Call...Such data may be available to the Department directly, by subpoena or otherwise."

"Title Insurance agents are not subject to regulation by the Department or any other agency of the State of New York. Until legislation is enacted in New York that gives the Department regulatory authority over independent title agents, TIRSA will continue to face issues with obtaining more information regarding agents' expenses and charges."

Topic 5 – Should the TIRSA rate be all-inclusive? On this topic TIRSA ceases to merely defend itself and begins to advocate for the status quo, listing several reasons why all-inclusive rates cannot work:

- The Department has not said what they mean by all-inclusive.
- Questions if a rating bureau has the power to set such a rate under the law.
- Such rates might violate anti-trust law since joint activity in setting rates for things other than title insurance itself would present serious risks – outside the definition in law for title insurance.
- Proposing an all-inclusive rate might mean combining Zones 1 and 2, which is difficult since the Zone 1 (Upstate) rate does not include the cost of a search and the Zone 2 (NYC and downstate) rate does. Also, Zone 1 is characterized by the use of an abstract system, an abstract being maintained by the owner of the property and Zone 2 uses a courthouse search system.

TIRSA has failed to carry out at least one item requested by the Department almost four years ago:

"We acknowledge that the Department's 2006 Report on Examination of TIRSA (issued March 9, 2009) called for TIRSA 'to maintain actuarial data appropriate to the title insurance industry as directed by the Department' to support any zone differential. Although we further acknowledge that TIRSA has not effectuated this recommendation, neither has the Department provided any direction as to how or what it wants... It is clear then that the Insurance Law permits, in principle, different rates for different territories in the state. The standard is whether such an approach is unfairly discriminatory. For the reasons discussed at length above, TIRSA does not believe that the differential rates in TIRSA's Rate Manual for Zones 1 and Zones 2 are unfairly discriminatory."

Rather than offering to assist consumers in the difficult job of finding reasonably priced title insurance when consumers usually have little or no experience in making such a purchase, TIRSA instead offers what CFA believes is an inaccurate characterization of how the market is functioning:

> "Title insurance buyers and their attorneys are perfectly capable in choosing an underwriter or agent, of determining the likely charge for various services and searches and 'shopping' for the most reasonable deal. This does not appear to be a situation where the closing costs are too small or obscure for the consumer to care or to lack the ability to make an informed decision."

As the above testimony established, consumers often don't know that title insurance is not a fixed cost, and such costs are often obscure in the context of purchasing a home, which is the largest and most complex financial transaction most households undertake. In that context, regulation is necessary to ensure that homebuyers are informed and not overwhelmed by an unfamiliar landscape.

Fix the Title Insurance Industry: Prohibit Affiliated Business Arrangements

Submitted Written Testimony
of
Anthony L. Affatati
President, NAILTA

NAIC Meeting – Title Insurance Task Force
December 16, 2013
Washington, DC
Washington Marriott
Wardman Park

On behalf of the National Association of Independent Land Title Agents (NAILTA), I am privileged to address the NAIC and its member representatives. My name is Anthony Affatati. I am the President of Applied Title in Freehold, NJ and the current President of NAILTA. I am proud to call myself an independent real estate settlement services professional and I am here today to describe a problem that will prevent any meaningful regulatory reform from helping to improve the title insurance industry for the long haul: i.e., affiliated business arrangements. NAILTA's goal is to help NAIC and your respective states understand the basic problems associated with affiliated business arrangements (AfBAs) and why their promise of consumer benefit is nothing more than a myth.

The emergence of AfBAs has created an environment within the title insurance and real estate industries that threatens free market competition, increases closing costs for consumers while simultaneously reducing service levels, undermines the solvency of national and regional title underwriters, and erodes the accuracy of the land record system -- the lynchpin of the entire American economy.

Loss of Competition:

You may already understand the theory that goes hand-in-hand with the AfBA proposition: real estate transactions move faster and more efficiently when only one party (i.e. the realtor, lender, mortgage broker or homebuilder) is in control of the entire real estate process and that, in turn, is good for consumers and results in lower prices.

The one-stop shopping concept of purchasing real estate, mortgage and title insurance through affiliated companies may superficially seem like a good way to improve services to consumers and reduce costs, but it is not. Organizations such as RESPRO, NAR, MBA and the ALTA, directly and indirectly support a belief that such practices are actually preferred by consumers. This is just part of the ruse the referral source lobby has used to push pro-AfBA legislation across the United States.

You have no doubt heard testimony before today from proponents of the AfBA business model that attempts to, once again, revive the well-known myth that consumers "prefer" these settlement service providers, but this testimony is unsupported by credible data and is fraught with logical inconsistencies. The simple truth is that there is no reliable data that says consumers actually prefer AfBAs over independent title agencies. Likewise, there is no data that concludes that AfBAs reduce the cost of real estate settlements for consumers. There are three recent government studies that looked at the issue of costs in the title insurance industry and not one of them concluded that AfBAs help to reduce the costs for consumers. Not one.

Those studies are:

- "*What Explains Variation in Title Charges? A Study of Five Large Markets*" U.S. Housing and Urban Development (HUD), Office of Policy Development and Research, June 2012.

- *"Comparing Home Closing Costs: Title Charges Vary Widely in Five Metro Housing Markets."* The Urban Institute, Feinberg, Robert; Kuehn, Daniel, et al., September 2012.

- Woodward, Susan. *"A Study of Closing Costs for FHA Mortgages,"* U.S. Department of Housing and Urban Development, Office of Policy Development and Research, May 2008.

Upon a closer review of the AfBA practice, it is clear that there is **no direct benefit to consumers** who remain completely unaware that their settlement business is being traded as part of a *quid pro quo* to compensate unlicensed referral sources for steering their consumers to closely-held title insurance agencies. Much like many of you who have closed on the purchase of home or refinanced your home mortgage know, the real estate transaction is often times confusing, cumbersome and calculated to give advantage to those other than the consumer.

The root of this problem rests in the fact that the American real estate consumer does not truly "shop" for real estate settlement services. The consumer generally relies on the realtor, lender, mortgage broker or homebuilder to make the decisions as to where title insurance is purchased, and those decisions are based on the advantages for the realtor, lender, mortgage broker or homebuilder, not the consumer.

Once consumers are truly aware that their business has been referred to affiliated service providers based on the quantity of the referral fee as opposed to the expected quality of service they prefer independent providers by a healthy majority. Survey data aside, the question must be asked: In what other industry would consumers allow this type of business model to exist?

What if it was customary for personal physicians to refer patients to specialists based on his or her kickback as opposed to the quality of treatment that he or she would expect the patient to receive. Legislators would and, in fact have, passed laws to prevent this type of activity. While decisions on title insurance certainly are not life and death, it is this business model that persists in our industry and it is largely ignored.

As a result of the AfBA referral system and the highlighted problems of reverse competition in the title insurance industry, independent competition is effectively locked out from helping to lower consumer prices because real estate firms, lenders, mortgage companies and homebuilders "control" such a large percentage of business and their joint venture partners, which include many of the national and larger regional title insurance underwriters, continue to push the referral sources to isolate business away from true and healthy competition.

Increase in Costs:

While most title insurance premiums are set by laws which require licensed companies to file rates for use and/or approval, the non-title insurance premium fees, such as settlement fees, search fees, closing fees, and other ancillary costs related to closing continue to rise. Even in

those states where "soft-cost" fees are part of the title insurance risk premium, the upward trend of premiums illustrates that consumers are paying more for title insurance, not less.

Since the title agency typically rewards referral sources such as realtors, lenders, mortgage brokers and homebuilders anywhere from 25% to 50% of total revenue, agencies look to both increase revenue and decrease costs in order to maintain profitability. Once a title insurance business is in position to give away nearly half of its revenue to insure a flow of referrals, the argument for increasing title insurance premiums will grow ever louder.

In addition, there are certain fees that title agents have some latitude in charging. For example, in Pennsylvania, agents can only charge a settlement fee if the settlement is outside either the office or normal business hours. An agent that is giving away 50% of her premium will be much more likely to charge this fee to a consumer when given the opportunity to do so. In essence, AfBAs create upward pricing pressures, not downward pricing pressures that might actually help reduce settlement costs.

One has to ask if a title agent can afford to give up to 50% of their premium to a referral source that adds no value to the examination of the title or the issuance of the policy, whether risk premiums are too high already. Members of Congress are already considering such issues as part of the debate to reform the financial services sector. NAILTA has met with members of the House Financial Services Committee and CFPB to discuss these important policy issues and recommends that more study of costs be done to determine whether AfBAs truly do offer their consumers a benefit on price.

Due to the reverse competition in our market and the AfBA business model there is no downward pressure on pricing whatsoever. In a free market, sellers always want prices to be high in order to increase profits. Consumers balance that upward pressure with their ability to competitively shop for the best prices and quality of service. In the title insurance industry however, services are not marketed directly to consumers, they are marketed to the referral sources who also benefit from increased prices as they share in the revenue stream. It is telling that in 15 years of being a Title Insurance Agent I have never once marketed my services to any consumer or referral source based on having lower costs than my competition. Not once. This is not a healthy environment for the consumer.

Decrease in Service:

Similarly to the potential for increase in costs, paying referral fees of up to 50% of revenue forces agents to reduce costs beyond the normal improvements in efficiency that all business aim towards. Industry research shows that 29% of all title insurance sold in the United States is through an AfBA. 49% of the revenue in those transactions goes to the referral source who adds no value to the examination of title or the issuance of the policy. That equates to 14.21% of all revenue in the Title Insurance Industry. These numbers are all trending up. This reduced revenue in the industry, without any off-setting gain in productivity, can only cause harm to service.

Consider the typical AfBA business model. Unlike an independent service provider who actually pays money to market for business, the AfBA simply provides 50% of its profits to its

referral sources to secure a steady source of captive business. Incentives for service are not done at the service level; they are done at the management level. Thus, unlike an independent service provider who has the challenge of mixing service with marketing, the AfBA only has to make its operating account available to its referral sources to maintain business. Whether it performs its job on a service level is secondary to the referral itself. Actually, declaring that service is secondary is an over-statement, the fact is that it is almost irrelevant.

When service suffers, the consumer suffers. If a business has to give away half of its profits to maintain a captive referral base, it must compensate for that loss somewhere. Typically, the compensation comes from one of two sources. The title agent will overcharge consumers for non-premium related fees and other "soft" costs or they will strive to reduce costs in ways that are detrimental to performance. This includes hiring fewer and less knowledgeable professionals, leading to potentially catastrophic consequences for the industry and the fundamental stability of the economy.

Long Term Health of Underwriters is Diminished:

While national title insurance underwriters pursue their short term interests of increased market share by encouraging agents to participate in AfBAs, the long term health of those companies and the industry as a whole is in jeopardy. As agencies give away more and more revenue to referral sources they turn to the title underwriters and demand higher and higher premium splits to maintain profitability. The results are inadequate capital reserves for the underwriters, the effects of which are being fully realized in the current market. Claims and loss ratios are at historically high levels due to the combination of market forces and poor performance of agencies for the reasons listed above and underwriters continue to receive less and less of every premium dollar collected.

NAILTA is proud of its association with title insurance underwriters, both regional and national. In conjunction with those partners, NAILTA has researched and recommends the adoption of important objective criteria that regulators can use to broadly assist the title insurance marketplace avoid reserve shortcomings and, at the same time, maintain the solvency and stability of the title insurers. It is NAILTA's belief that these risks are related concepts. One such objective criterion is the "Premium-to-Surplus Rule," which is part of NAILTA's Blue Ribbon Title Insurance Underwriter Certification criteria.

The Premium-to-Surplus Rule is an objective measure of the health and solvency of a title insurance underwriter based upon a simple ratio of the insurer's annual gross title insurance premiums versus the insurer's policyholder surplus. Those title insurers with ratios greater than 5:1 are at a heightened and predicable risk of financial distress due to a material financial event, such as defalcations or high claims.

NAILTA has authored a White Paper on the subject of helping NAIC and its members to better regulate the title insurance industry concerning escrow fraud and the related solvency issues surrounding title insurance underwriters. A copy of our White Paper is available upon request.

Erosion of Accuracy in the Public Records:

Perhaps the most alarming aspect of this business practice is that Title Agents are supposed to be the guardians of the public land records, the underlying foundation of the entire economy of the United States. Poor performance by Agents and their less and less experienced staff, among other factors, is eroding the legitimacy of those records. If we do not clearly understand who owns what and the condition of the titles in question, the American economy may again be in jeopardy.

What Can You Do To Prevent Reverse Competition From Harming Your State?:

The problem of reverse competition is not a problem without a remedy. Instead, it is a problem that can be easily addressed with simple changes to administrative philosophies – for those states who already have anti-kickback legislation on their books – and with attention to the basic fundamentals of business economics – for those regulators with the foresight to see affiliated business arrangements for what they are (i.e. a kickback patronage system). In essence, when a business model is failing and cannot sustain revenues for itself, it should not be allowed to siphon off revenues from another business model in order to sustain itself. Corporate cannibalism is a threat to public policy and consumer protection. It is not a business model to be celebrated and protected through more pro-AfBA public action.

NAILTA recognizes that states have tools at their disposal to address these issues. In many cases, it is a question of developing the will to use those tools that will make the biggest impact on the problem. There is no single AfBA that would go out of business if AfBAs were forced to compete on price and service. Instead, those referral sources who were once paid for their referrals would likely continue sending their business to those service providers known to them for their service and their pricing. Proponents of AfBAs like to scare legislators and regulators with the false depiction that says a world without AfBAs would be a world we cannot live with.

In truth, if AfBAs were prohibited think of the potential consequences:

1. Lenders would be forced to find service providers who competed on price and service, not the value of their kickbacks and referral payments.

2. Consumers would be allowed to make service provider selections based upon the best performer in the price and service category. Any such referrals would be based upon what matters to a consumer – price and service – not whether the referring party would be paid to refer.

3. Market participants would have a downward pricing pressure to lower costs and improve service.

Currently, none of these advantages exist. Instead, proponents of AfBAs push unproven and unsupported myths that mask the truth – that AfBAs are nothing more than shell companies designed to disguise referral payments.

Conclusion:

In light of these problems, NAILTA recommends the following actions:

- Adopt laws that reinforce the fact that referral sources may not sell or solicit title insurance and may not get things of value, including stock dividends or ownership units, in exchange for the referral of settlement business.
- Promulgate laws that encourage market participation by local and regional title insurance underwriters.
- Seek input from their local independent land title association when considering the impacts of bills concerning market inducements, controlled business arrangements and their effects on small business.
- Create laws that protect consumers against substandard market practices by requiring minimum title search periods under Marketable Title Act or state customs (i.e. Ohio, 42 year title search; Louisiana, 30 year title search, etc.).
- Ensure that all title insurance agents maintain professional licenses and ethics training.
- Encourage the development of a separate escrow agent license program.

About NAILTA:

The National Association of Independent Land Title Agents (NAILTA) is a non-profit trade association that represents the interests of independent title insurance agents and independent real estate settlement professionals from across the United States. It was created by independent real estate settlement professionals to further the agenda of small business owners from within the title insurance, abstracting, surveying, and real estate community who lack representation at local, state and national levels.

To contact NAILTA, please visit our website at www.nailta.org.

Michael D. Calhoun, President
Center for Responsible Lending

Responses to Questions for the Record

Question 1: At the hearing, another witness said that the "rationale behind excluding points and fess paid to independents is unclear." My understanding is that Congress made a clear policy choice in the Dodd-Frank Wall Street Reform Act to discourage the ability for lenders to earn higher fees through opaque commissions in title insurance. Congress did not want to see more fees in the non-regulated side of the transaction. Congress has also expressed concern about a captive stream of commerce that often is unchallenged by price or service. What history can you provide as to why Congress wanted to rein in title insurance costs?

ANSWER 1:
For two decades, Congress has enacted mortgage reforms that provide clear borrower protections concerning the amount of points and fees charged in mortgage transactions. "Points and fees" encompass upfront fees paid by the borrower. These include a number of items such as yield spread premiums, real estate fees paid to companies affiliated with the lender, origination fees and discount points. These costs are often expressed as a percentage of the borrower's loan amount where one point is equal to one percent of the loan amount. Abusive lending often involves mortgages with high points and fees levels. The incentive to do so is clear, because it enables the mortgage originator to earn a larger gain upfront instead of over time as the borrower makes principal and interest payments on the loan. As a result, loans with higher fees can serve as a potential disincentive to fully underwriting loans based on a borrower's ability to repay the loan.

Points and Fees Overview
Two pieces of legislation have provided borrowers with points and fees protections: the Home Ownership Equity Protection Act of 1994 (HOEPA) and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Taken together, these laws provide incentives for lenders to originate mortgages with lower upfront points and fees but also provide enhanced borrower protections for loans with higher upfront costs. It is worth highlighting that these laws do not mandate that lenders adhere to any particular points and fees levels. Instead, Congress created this system of incentives and borrower protections.

Congress passed HOEPA in response to abusive lending practices that targeted existing homeowners with substantial home equity. These transactions flipped borrowers into refinanced loans with high fees, higher interest rates and other terms such prepayment penalties. As a result, many existing homeowners found themselves in unaffordable loans that led to multiple equity-stripping refinancings. Many homeowners also found themselves in default and, ultimately, foreclosure.

After holding hearings and introducing a previous version of the legislation, HOEPA became law in 1994. The HOEPA statute created a high-cost loan category, which requires giving borrowers additional disclosures and some consumer protections on loan terms. The law also put in place additional enforcement provisions for failure to comply with these requirements.

To qualify as a high-cost or HOEPA loan, Congress established two thresholds – an Annual Percentage Rate (APR) cutoff and a points and fees trigger. Loans with an APR or points and fee level in excess of the statutory thresholds designated the loan as a high-cost loan and became subject to the protections under HOEPA. Some loan costs – such as title insurance and appraisal fees – are excluded from the APR calculation. Therefore, in order to capture the cost of these upfront fees, a separate points and fees trigger is necessary. By including both thresholds, Congress ensured that borrowers receive HOEPA protections regardless of whether high loan costs are financed or paid upfront.

As part of the mortgage reforms responding to the subprime abuses of the late 1990's and 2000's, Congress also included points and fees reforms in the Dodd-Frank Act. In this legislation, Congress provided for a points and fees threshold for a new category of mortgages called Qualified Mortgages. As discussed at the hearing, these loans provide lenders with a presumption of complying with the Ability to Repay standard also included in the Dodd-Frank Act. Lenders are not obligated to originate Qualified Mortgages, but the presumption-of-compliance benefit gives lenders an incentive to do so. The Dodd-Frank Act also lowered the points and fees threshold for HOEPA loans from 8% to 5% of the total loan amount. And, while there are different thresholds set for each, Congress adopted the same definition for calculating the amount of points and fees for both HOEPA loans and Qualified Mortgages.

Congress Has a Long History of Including Affiliate Real Estate Fees – Such As Affiliated Title Insurance – in the Points and Fees Definition

One component of the points and fees definition established by Congress is that real estate fees – such as title insurance – are included in the calculation if they are paid to a company that is affiliated with the lender. Congress first adopted this definition with HOEPA's passage in 1994, and Congress reinforced the distinction between affiliate and non-affiliate fees in the Dodd-Frank Act.

Congress made an explicit decision in the HOEPA statute to include affiliated real estate fees in the points and fees definition. As originally introduced, HOEPA legislation in the Senate and the House included a points and fees trigger but did not provide a definition for this term.[1] At Congressional hearings, Members of Congress heard feedback on the HOEPA legislation, including recommendations to provide a points and fees definition. For example, the Federal Reserve Board Staff Comments raised "clarifying the phrase 'all points and fees'" in S. 924, and asked the question "[d]oes it apply to only points and

[1] S. 924, Home Ownership and Equity Protection Act of 1993, 103d Congress, 1st Session (introduced on May 7, 1993); H.R. 3153, Home Equity Protection Act of 1993, 103d Congress, 1st Session (introduced on September 28, 1993).

nonfinance charge fees such as appraisal fees, property surveys, title examinations and other closing costs, broker fees and voluntary credit life insurance premiums?"[2]

In adopting the distinction between affiliate and nonaffiliated fees in the enacted legislation, Congress rejected some of the recommendations made by other stakeholders concerning the point sand fees threshold. This included some industry stakeholders who advocated for only including discount points in the definition.[3] It also included some consumer advocates who argued for including all real estate fees in this definition, regardless of their affiliate status.[4]

In the final language for HOEPA, Congress made the decision to include those fees earned by affiliated entities as part of the points and fees definition. As a result, the definition established by Congress focuses on all fees benefiting the mortgage originator or entities affiliated with the mortgage originator.

The Dodd-Frank Act further underscored Congressional intent to include affiliate real estate fees and exclude unaffiliated ones in the points and fees definition. Not only did Congress specify that HOEPA loans and QM loans share the same definition, but the Dodd-Frank Act reinforces this distinction. In three separate places, Congress included language stating that the point and fees definition does not include "bona fide third party charges not retained by the mortgage originator, creditor, or an affiliate of the creditor or mortgage originator."[5]

Market Failures in the Title Insurance Industry

Congress specified that title insurance provided by affiliated companies is one of the affiliate fees included in the points and fees definition. This is an important consumer protection for borrowers, given market dynamics that increase title insurance costs for borrowers.

In addition to addressing affiliate title insurance costs in HOEPA and the Dodd-Frank Act, Congress has examined in other contexts how the market structure of the title insurance industry impacts borrowers. In February 2006, Congressman Michael Oxley (R-OH), then Chairman of the House Financial Services Committee, sent a letter to the U.S. Government Accountability Office (GAO) requesting that it investigate the title insurance industry.[6] Several months later, a subcommittee of the House Financial

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[2] Federal Reserve Board Staff Comments on S. 924, The Home Ownership Equity Protection Act of 1993, p. 42 (May 19, 1993).

[3] Statement of Diane M. Lopez on Behalf of the American Bankers Association and the Consumer Bankers Association, before the Senate Banking Committee, p.52 (May 19, 1993) (stating that "the definition should limit itself to points and exclude any reference to fees.").

[4] Written Testimony of Margot Saunders on behalf of the National Consumer Law Center, before the Senate Banking Committee, p. 56 (May 19, 1993) (stating that "it would be good if this language were clarified to ensure that it embraces *all* of the following...[t]he following fees, whether or not they are paid to a bona fide third party: (i) Fees for title examination, abstract of title, title insurance, property survey, and similar purposes...").

[5] See Pub. Law 111-203, §§ 1411, 1412, and 1431.

[6] Stephen Gandel, *Congressman calls for title-insurance investigation*, Money (February 24, 2006) (available at http://money.cnn.com/2006/02/23/real_estate/oxley_titleins/).

Services Committee held a hearing entitled "Title Insurance Cost and Competition." At this hearing, Chairman Oxley stated that

> [c]onsumers are paying home-purchase costs that are artificially high because of the lack of competition in real estate services...I don't believe that the lack of price competition in real estate services is something we can just enforce our way out of. HUD and State insurance departments simply do not have the resources to monitor every property transaction. This is a structural marketplace problem that at some point Congress will have to address."[7]

GAO also testified at this April 2006 hearing concerning the preliminary findings of the agency's title insurance investigation. The GAO's written testimony highlighted affiliated title insurance providers and stated that:

> [t]hese arrangements may benefit consumers to some extent, but also create potential conflicts of interest...Such arrangements, which may provide consumers with "one-stop shopping" and lower costs, can also be abused, presenting conflicts of interest when they are used as conduits for giving referral fees back to the referring entity or when the profits from the title agency are significant to the referring entity.[8]

Following this hearing, the GAO released its final title insurance report in April 2007, again highlighting concerns about the market dynamics of the title insurance industry. The GAO found that "because consumers generally do not pick their title agent or insurer, title agents do not market to them but to the real estate and mortgage professionals who generally make the decision."[9] As a result, the GAO concluded that borrowers end up "in a potentially vulnerable situation where, to a great extent, they have little or no influence over the price of title insurance but have little choice but to purchase it."[10] Furthermore, the GAO highlighted that 70% of title insurance premiums are "paid to or retained by agents" with only 5% of premiums going to cover losses.[11] The GAO also noted that this is a dramatically lower loss ratio compared to other insurance products.

Furthermore, state regulation of the title insurance industry continues to be uneven at best. A 2010 overview prepared by the National Association of Insurance Commissioners shows that as many as 8 states to not regulate title insurance rates and another 18 use

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[7] Opening Statement of Congressman Michael Oxley at House Financial Services Committee Hearing: Title Insurance Cost and Competition (April 27, 2006).

[8] Testimony of Orice M. Williams, U.S. Government Accountability Office, before the House Financial Services Committee, Subcommittee on Housing and Community Opportunity (April 26, 2006) (available at http://www.gao.gov/assets/120/113605.pdf).

[9] *Title Insurance: Actions Needed to Improve Oversight of the Title Insurance Industry and Better Protect Consumers*, United States Government Accountability Office, GAO-07-401 (April 2007).

[10] *Id.*

[11] *Id.*, at 41-42.

some version of a "file and use" or "use and file" regime, which provides very light or no price regulation in many instances. [12]

Given this market dynamic where borrowers overpay for title insurance because businesses are competing to drive up prices instead of driving them down, Congress's decision to include affiliated title insurance in the points and fees definition will provide needed pressure to reduce these costs for borrowers. After becoming law in 2010, the Dodd-Frank Act mortgage reforms went into effect on January 10, 2014. It is critical to maintain these reforms so they have an opportunity to lower prices for consumers on fees such as title insurance.

Question 2: Do you think the costs of referral source investment in affiliated service providers such as title insurance agencies are already included in title insurance premiums?

ANSWER 2:
Yes. Reverse competition and market dynamics continue to stifle true price competition in the title insurance industry. This reverse competition drives up prices as a result of referral and commission incentives, which end up constituting a substantial portion of premiums paid by borrowers. These commissions are included in the current title insurance premiums, and, indeed, make up the largest portion of the premiums.

One indication of this reverse competition is the low loss ratios in the title insurance industry. For example, according to data from the American Land Title Association, title insurance premiums paid by borrowers totaled $11.4 billion in 2012, whereas "[t]he industry paid $908 million in claims during 2012."[13] This equals a loss ratio of approximately 8 percent. As referenced by the GAO report, these loss ratios are consistently and substantially lower than the loss ratios of other insurance products.[14]

One new entrant to the title insurance industry highlights the business challenges of <u>not</u> providing referral and commission incentives. According to a 2013 article in the New York Times, this company offers lower rates as a result of "marketing directly to consumers and eliminating the use of title agents."[15] However, the company's market share remains low, and the article also notes that "[i]n Connecticut, where only lawyers

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[12] NAIC Title Insurance Task Force, Survey of State Insurance Laws Regarding Title Data and Title Matters, National Association of Insurance Commissioners (March 22, 2010) (available at http://www.naic.org/documents/committees_c_title_tf_survey_state_laws.pdf).

[13] American Land Title Association Reports 2012 Title Insurance Premium Volume Increases 21 Percent; Industry Paid $908 Million in Claims Last Year (April 18, 2013) (available at http://www.businesswire.com/news/home/20130418006510/en/American-Land-Title-Association-Reports-2012-Title).

[14] *Title Insurance: Actions Needed to Improve Oversight of the Title Insurance Industry and Better Protect Consumers*, United States Government Accountability Office, GAO-07-401, p.9 (April 2007).

[15] Lisa Prevost, *Saving on Title Insurance*, The New York Times (March 14, 2013) (available at http://www.nytimes.com/2013/03/17/realestate/saving-money-on-title-insurance.html).

can act as title insurance agents, 'very few attorneys will close with Entitle, or sell very hard against it, because they're not making the premium,' said Scott Penner, a lawyer in Milford. 'Or they will increase their attorney fee, and that offsets the savings.'"[16]

In a truly competitive market, referral and commission costs would not dominate premium costs. However, as the example above illustrates, the reverse competition in the title insurance industry favors inflated premiums driven by referral and commission incentives. By including points and fees reforms in the Dodd-Frank Act, the new mortgage rules that went into effect earlier this year provide an important counter-incentive to this reverse competition.

[16] *Id.*

Questions for the Record
Representative Keith Ellison
Hearing entitled "How Prospective and Current Homeowners Will Be Harmed by the CFPB's Qualified Mortgage Rule"
Tuesday, January 14, 2014 10:00 a.m. in 2128 Rayburn HOB
Financial Institutions and Consumer Credit Subcommittee

Questions for Mr. Emerson, Quicken Loans

- On page 6 of your testimony, you write, "As might be expected, studies have shown that when affiliates have been excluded from the market, title insurance charges have risen." Could you point to some studies that make this finding?

  The quoted sections from Mr. Emerson's testimony referred to above were extrapolated from two studies that are attached. The title descriptions of the referenced studies are as follows:

  Donald L. Martin PhD. & Richard E. Ludwick, Jr. PhD., CapAnalysis Group LLC, Affiliated Business Arrangements and Their Effects on Residential Real Estate Settlement Costs: an Economic Analysis (Oct. 10, 2006).

  Anton Economics, Inc., Economic Issues Relating to the Title Insurance Industry in Minnesota: Would Further Regulation be Helpful? (1992).

- Please list all the title insurance firms with which Quicken Loans has an affiliated business arrangement. Your website, http://www.quickenloans.com/about/partner-company, seems to indicate that Title Source is one of your partner firms.

  Quicken Loans is not affiliated with any title insurance firms or underwriters. Quicken Loans is affiliated with Title Source, which is an authorized title agent to several title insurance underwriters, including First American, Fidelity National Title, Chicago Title, Commonwealth, Old Republic Title, Williston Financial Group and Stewart Title.

- Of all the home mortgages that Quicken Loans was the agent for, what percentage had a title insurance agent that was not Title Source or a title insurance firm with which Quicken Loans had an affiliated business arrangement? Please provide this information for years 2008, 2009, 2010, 2011, 2012 and 2013.

  Quicken Loans is a residential mortgage lender, not a title agent. Title Source is not an exclusive title agent of Quicken Loans. Title Source provides title services to unaffiliated financial institutions and mortgage lenders as a title agent.

- I seek to better understand the financial arrangement – if any – between all parties in a real estate transaction.

    - Does Quicken Loans benefit financially in any way from its affiliation with Title Source or other affiliated title insurance firms?

      No.

    - For example, does Quicken Loans receive any form of remuneration from its parent company or any other affiliated company based directly or indirectly upon its capture rate of title business?

      No.

    - Do Quicken Loans' employees (at any level) benefit financially in any way, directly or indirectly from its capture rate of title business? If so, please describe. Examples: do managers, supervisors or executives at any level at Quicken Loans receive bonuses, commissions, promotions or any other sort of thing of value for achieving any sort of capture rate metrics?

      No.

    - Are Quicken Loans' employees' reviews or salary increase or decrease decisions based in any way based upon the capture rate of title business? If so, please describe.

      No.

    - Please provide any information on incentives paid by Quicken Loans or another firm to Quick Loan agents. Does Quicken Loan pay its agents any additional compensation when its borrowers use an affiliated Title Firm? Are there any capture rate commissions for using services provided by Quicken Loan's "sister companies."

      No.

    - Does Quicken Loans earn any compensation, profit, investment return from its affiliation with Rock Holdings LLC? If so, please describe. For example, if Quicken Loan's parent company is profitable, does that benefit Quicken Loans, any of its officers, managers or any other employees?

      No.

- Which firms profit directly or indirectly from the profitability of Title Source? Please describe the relationship and how they profit.

  Title Source, which is based in Detroit and employs approximately 1500 people, benefits from its own profitability.

- If Title Source finds a title problem, does the affiliation with Quicken Loans, the parent company, or any other affiliation, afford a more streamlined resolution to the title defect? In other words, does the affiliation improve the efficiency of resolving title defects or closing problems? If so, how?

  Title Source has the same strong commitment to customer service as Quicken Loans.

- In your testimony, you said, "In all cases, consumers are free to make an informed choice of either an independent or an affiliated provider. Indeed, 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. There are clear penalties for forcing a consumer to use a particular affiliate or providing improper inducements to persuade a consumer to do so." Please describe how Quicken Loans and any affiliates or partners provide borrowers with information on their options in buying title insurance.

  - At what point in time in the transaction does Quicken Loans provide to their customers the Affiliated Business Disclosure referred to above?

    As required by RESPA, Quicken Loans provides the affiliated business disclosure at the beginning of the loan process when the consumer applies for a loan. It is important to note that if a consumer chooses a lender that is not affiliated with a title agent, the lender orders title insurance from whichever title agent it chooses. Rarely is there a discussion between the lender and the borrower regarding selection of a title company and consumers do not shop settlement service providers.

  - At what point in time in the transaction does Quicken Loans provide to their customers a disclosure of the costs of their affiliates' services?

    As required by RESPA, Quicken Loans provides a Good Faith Estimate disclosure at the beginning of the process when the borrower applies for the loan.

  - Does Quicken Loans provide their customers with instructions on how to select their own title company or the costs of other title companies?

    All disclosures required by RESPA are provided to the consumer including information about settlement service providers.

Question for Mr. Hartings, The Peoples' Bank and Mr. Weickenand, Orian Federal Credit Union

- I seek to better understand the financial arrangement – if any – between all parties in a real estate transaction.
  - Does your firm benefit financially in any way from its affiliation with Title affiliated title insurance firms? Please name the title insurance firms in which you are affiliated.

    For example, does your firm receive any form of remuneration from its parent company or any other affiliated company based directly or indirectly upon its capture rate of title business?
  - Do your employees (at any level) benefit financially in any way, directly or indirectly from its capture rate of title business? If so, please describe. Examples; do managers, supervisors or executives at any level at your firm receive bonuses, commissions, promotions or any other sort of thing of value for achieving any sort of capture rate metrics?
  - Are your firm's employees' reviews or salary increase or decrease decisions based in any way based upon the capture rate of title business? If so, please describe.
- Would you say that your referral of settlement service business is dependent upon the best service and lowest cost option that you can find for your customer?
  - If not, what factors are the referral dependent upon?
- Banks, mortgage companies, real estate firms, homebuilders and developers known as "referral sources" all say their affiliated service providers are providing lower cost and more efficient service to real estate consumers than independent service providers. What is the added value that is being compensated for with the referral payment?
  - If affiliated business arrangements were prohibited altogether, would referral sources make the same or different decisions on where to refer clients?
  - Does the referral payment add to the overall cost of insurance or closing for American real estate consumers?
  - Does the expense of the referral increase, the overall cost of title insurance regardless of whether the fee is set by the state or not?

Response from Mr. Weickenand of Orion FCU to QFRs from Rep. Ellison:

(Please note the incorrect spelling of Orion FCU in the QFR).

At Orion FCU, we do not have an affiliated title insurance firm or settlement firm, and thus do not use one. Therefore, I cannot speak to the questions about affiliates.

I can say that at Orion FCU, we try to provide our members information if they request it about various options that our members have found to have the best service and pricing. We also make it clear that there is not affiliation and that they are able to choose whatever options work best for them.

Consumer Financial Protection Bureau
1700 G Street, N.W. Washington, DC 20552

December 20, 2013

The Honorable Blaine Luetkemeyer
U.S. House of Representatives
2440 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Ann Wagner
U.S. House of Representatives
435 Cannon House Office Building
Washington, D.C. 20515

The Honorable Jason Smith
U.S. House of Representatives
2230 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Sam Graves
U.S. House of Representatives
1415 Longworth House Office Building
Washington, D.C. 20515

The Honorable Vicky Hartzler
U.S. House of Representatives
1023 Longworth House Office Building
Washington, D.C. 20515

The Honorable Billy Long
U.S. House of Representatives
1541 Longworth House Office Building
Washington, D.C. 20515

Dear Representatives,

Thank you for your letter about the implementation of our mortgage rules. I appreciate the opportunity to address this issue with you all in more detail.

The Consumer Financial Protection Bureau's (Bureau) mortgage rules will be important in addressing some of the most serious problems that had undermined the mortgage market during the financial crisis. Congress established a specific deadline for the effective date of the rules it directed the Bureau to write, and the effective date reflects that deadline. The Ability-to-Repay rule, in particular, has been broadly expected since the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act in July 2010 and actually requires little more than the sound underwriting practices that have become standard in the years since the crisis. And the general contours of the mortgage servicing rules track the problems that have been identified in this industry for more than five years, most of which were squarely addressed in the standards set by the National Mortgage Servicing Settlement adopted in 2011.

The Bureau shares your concern that regulations should not place unnecessary burdens on community banks. We recognize that, with few exceptions, community banks and credit unions did not engage in the type of risky lending that led to the mortgage crisis. To that end, the Bureau took special care to ensure that our rules are balanced for community banks and credit unions and the consumers they serve. For instance, the Bureau has tailored the Ability-to-Repay rule and the standards for Qualified Mortgages to encourage

small creditors to continue providing certain credit products, while carefully balancing consumer protections

In addition, as we became aware of critical operational or interpretive issues with the rules, we have addressed them. The Bureau made a commitment to respond to substantial interpretive questions that significantly affect implementation decisions in writing through amendments to the official interpretations and, if need be, to the rules themselves. The Bureau issued various amendments over the course of the year with a single aim in mind: to ensure the effectiveness of our rules by making it easier for industry to comply. By addressing and clarifying industry questions, the Bureau has reduced the need for individual institutions to spend time reaching their own uncertain judgments on these matters.

The Bureau has also embarked on an implementation plan to prepare mortgage businesses for the rules that take effect next January. To that end, we published plain-language compliance guides that will be updated as necessary. We launched a series of videos explaining our rules. We worked closely with the other financial regulators to develop examination guidelines that reflect a common understanding of what the rules do and do not require, which were published well in advance of the effective date. We intend these efforts to be especially helpful to smaller institutions where regulatory burden weighs more heavily on fewer employees.

We understand this poses a challenge for industry, just as the writing of such a substantial set of mortgage rules by last January posed a significant challenge for our new agency. Had we failed to do so, many key statutory provisions that Congress had enacted, would have taken effect in their own right, which everyone recognizes would have been much harder for industry to comply with and much worse for the mortgage market.

Additionally, oversight of the new mortgage rules in the early months will be sensitive to the progress made by those lenders and servicers who have been squarely focused on making good-faith efforts to come into substantial compliance on time – a point that we have also been discussing with our fellow regulators.

It is critical that we move forward so these rules can deliver the new protections intended for consumers and provide certainty that the industry has been seeking. Thank you for your continuing interest in the Bureau's work.

Sincerely,

Richard Cordray

Richard Cordray
Director

Congress of the United States
Washington, DC 20515

December 10, 2013

The Honorable Richard Cordray
Director
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, D.C. 20552

Dear Director Cordray:

We are writing you to express concern about the implementation period for the mortgage rules that are scheduled to be effective in January 2014.

Pursuant to Title XIV of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Consumer Financial Protection Bureau (CFPB) has promulgated new regulations for mortgage products and services which go into effect in January. While we realize that these are final rules, we do believe that it is crucial to the stability of the mortgage market in our State and across the country that implementation be extended.

Banks and credit unions in our districts have expressed to us their serious concern that it will be impossible for them to assure that the necessary software updates and other compliance efforts are in place by the current deadline. Further, they have stated that banks and credit unions will not be able to lend unless they are certain they are in full compliance with these rules. Ultimately, we fear that consumers and borrowers could ultimately pay the price in limited credit and difficulty obtaining home mortgages.

Missouri is home to both rural and urban communities, and we have grave concerns about the impact that this implementation could have in those areas.

We urge you to extend implementation of these rules until January 1, 2015, in order to ensure adequate time for the transition so that financial institutions are able to be in full compliance with the rules.

We thank you in advance for your consideration of this important matter and look forward to your response by December 17, 2013.

Sincerely,

Blaine Luetkemeyer
Member of Congress

Ann Wagner
Member of Congress

Jason Smith
Member of Congress

Sam Graves
Member of Congress

Vicky Hartzler
Member of Congress

Billy Long
Member of Congress

November 12, 2013

Testimony of

James C. Gardill

On behalf of

WesBanco Bank, Inc.

before the

Roundtable on the Effects of the CFPB's Mortgage Rules on the Availability of Credit for Consumers

of the

Committee on Financial Services

United States House of Representatives

Introduction

Chairman Capito, Congressman Rothfus, my name is James Gardill, Chairman of the Board of Directors of WesBanco. I appreciate the opportunity to be here to present our perspective on the effect of the CFPB's Mortgage Rules on the availability of credit for consumers. I am greatly concerned about their impact, especially on low and moderate income borrowers and neighborhoods.

Comments

What did we not learn from the implementation of OBAMA Care? A highly complex law implemented through extensive, exhaustive and detailed regulations, fundamentally changing an industry, necessarily driven by computer programs and systems, rushed into effect based on assurances by regulatory agencies of its readiness, fell on its face and now has triggered the apologies of a President.

Here we are again. Director Cordray assured us on October 21 that systems, software, vendors, the financial services industry and consumers are ready for the new mortgage rules.

Warning signs are everywhere.

118 members of the U.S. House of Representatives signed a bipartisan letter this past month urging the CFPB and Director Cordray to delay the mortgage rules.

The investment banking firm, Keefe, Bruyette & Woods issued a report on October 29, 2013, indicating that mortgage banking income at most of the large mortgage originators fell, on average, 21% in the third quarter of this year from the second quarter, and 27% from a year earlier.

Approximately 4,000 pages of regulations on mortgage rules have been issued by the CFPB. These included so-called "final rules" issues in January of this year, but which have now been amended or clarified in hundreds of pages of commentary at least three times since then. We are now also receiving "unofficial" staff guidance on the new rules, I am just not sure how lenders can safely rely on such guidance.

The American Bankers Association has urged caution and requested a one year transition period. Banks have to overhaul systems, procedures, policies, processes, forms and train staff. Most rely on outside vendors for such systems. A recent ABA survey of nearly 200 banks indicated that 60% of banks reported that vendors have not provided information on when they will have the needed updates available.

The QM and ATR Rules are fundamental changes to the mortgage industry especially as they impact community banks. These changes include significant new risks which will impact non-QM loans under the new ATR Rules:

(a) Community banks have credit risk in non-QM loans

(b) Then we add a requirement that a bank assess the ability of the borrowers to pay their other obligations – not just their mortgage loan

(c) Then we layer in legal liability risks if they can't pay the loan

(d) Add in liability for the borrower's attorney's fees

(e) Then permit oral evidence to be introduced after the fact by borrowers' asserting information they claim they disclosed that the bank failed to consider under a facts and circumstances test on their ability to repay

(f) Then eliminate any statute of limitations so liability extends for 30 years plus 3 for a total of 33 years for a 30 year term loan

(g) Add statutory financial penalties even if the borrower sustains no consequential damages

(h) Add in state court jurisdiction to determine the facts and circumstances test as to whether the bank made a reasonable determination of the borrower's ability to repay

You have a recipe for a disaster of unintended consequences. We are essentially punishing the victim who has already sustained the credit loss on the loan.

The defensive response of community banks under ATR will be to:

(a) Eliminate loans to all but the most risk averse.

(b) Eliminate credit availability for marginal borrowers that do not fit into the QM square box.

(c) Reduce lending options and products to low and moderate income borrowers and neighborhoods.

Wouldn't the prudent step be to give them some thought – to test them – to consider the consequences, the impact and the benefit of the rules upon our communities before we subject them to these changes? Given our experience with Obama Care – we join the chorus of those requesting a year's delay to test the proposed rules, weigh their consequences and give us time to properly implement the inordinately complex rules when they are actually finalized.

HILL CDC

Hello, my name is Marimba Milliones, President & CEO of the Hill Community Development Corporation. The Hill CDC's focus is to catalyze, facilitate and stabilize development in the historic Hill District, an historically African American community that is centrally located in Pittsburgh PA. The Hill District faces both the threat and opportunity that a strategically located neighborhood often brings.

The opportunities include redeveloping an historic neighborhood that capitalizes on the commerce occurring in Pittsburgh's central business district, and the city's university district by linking residents to jobs, education and housing.

Just as the neighborhood's location is an opportunity -- it is a threat. As we know, gentrification can be both positive and negative. Positive gentrification is when diverse groups of people are brought together through opportunities created by a strengthening market, but also honoring the existing residents. Negative gentrification happens when a group of people become marginalized within their own neighborhood because regulatory policy and redevelopment efforts (such as urban renewal policies of the 50s and 60s) fail to consider the very citizens who endured a fledgling market, and who supported a transitioning market.

My concern is that the Qualified Mortgage and Qualified Residential Mortgage rule ushers in and accelerates negative gentrification. As a community looking to grow homeownership, build upon a strong cultural legacy and attract more people over the next 10 years, does this rule hinder our work, or will it foster our goal of creating a more stable base of homeowners. We need to help residents move from rental to homeownership. Does this trap our residents into long term rental housing? How will

we deal with the loss of mortgage products? Do we need to rethink our development plans? Does this undermine the Hill District's recently completed ten year plan?

I ask that there be flexibility regarding the implementation of these policies so that appropriate revisions that support the redevelopment of our neighborhood's housing stock can be applied moving forward.

Our work is tough enough already.

I respectfully submit these comments. Thank you.

Marimba Milliones

Gmail

Rick Swartz< bgcricks@gmail.com>

follow-up to today's hearing

1 message

Rick Swartz < ricks@bloomfield-garfield.org> Tue, Nov 12, 2013 at 2:48 PM
To: MMooney@fidelitybank-pa.com

Mike:

To summarize my comments today, I wanted to emphasize the following:

1) In states like Pennsylvania, where the tradition of community banks runs strong, and grass-roots organizations have been able to put the federal Community Reinvestment Act to work on their behalf, the new regulations coming from CFPB seem to be a solution in search of a problem. We are not hearing an outcry from people in the inner-city of Pittsburgh that more protections are needed from banks and mortgage companies seeking to help consumers achieve the goal of homeownership.

2) Our issues historically have been with the larger subprime lenders like Ameriquest, Countrywide, and Option One, to name but a few. Many of them have departed the scene with the 2008 financial collapse. They were the ones "churning" mortgage loans, generating the "no-doc" loans that caused havoc in the secondary mortgage market, using high debt-to-income ratios (over 45%) in qualifying borrowers, and falsifying, or encouraging others to falsify, information on loan applications or appraisals. These are some of the reasons why the CFPB was created in the first place. But we don't see these behaviors at work today in the banking community in southwestern Pennsylvania. So how will the new regulations make for stronger, working-class neighbohoods in places like Pittsburgh? Can someone at the CFPB give us the 5 ways this is likely to happen?

3) We need banks to be able to exercise some flexibility in applying all of the criteria used in making decisions on mortgage loan applications. Illness or dsiability, divorce, plant closings, and lack of employer-provided health insurance all can lead to negative credit histories for customers. We need lenders who are willing and able to sift through the tea leaves to ferret out the facts about the circumstances that put people in negative credit standing for periods of time in their lives. And lenders shouldn't be subject to attack through the court systems for extending themselves in certain situations, only to have to do a foreclosure in the end when the monthly payments have stopped for good.

4) The federal government truly needs to get better at finding ways for some percentage of those in the bottom third of society to be able to move out of poverty or near-poverty. One way is through a sound education and willingness to work. Another is through building wealth through vehicles like homeownership. If we cut away several huudred thousand homebuyers a year because of tightened lending regulations coming from Washington, then it will be the other two-thirds of society that will have to carry this segment for the balance of their lives, whether it's through entitlement programs like Social Secrity

disability, Social Security retirement, Temporary Assistance for Needy Families, or Medicaid. They will have no ballast in the ship's hull to carry them through the turbulent times that confront 90% of the population at one time or another.

Rick

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Rick Swartz
Executive Director
Bloomfield-Garfield Corporation
5149 Penn Avenue
Pittsburgh, PA 15224
(ph) 412-441-6950 x11
(fx) 412-441-6956
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Mooney, Michael

From: bgcaggie@gmail.com on behalf of Aggie Brose <aggie@bloomfield-garfield.org>
Sent: Tuesday, November 12, 2013 5:23 PM
To: Mooney, Michael
Subject: today's testimony

Mike:

The points I wanted to make today are that average class people like my family and myself were able to buy a home of our own, and thus achieve a measure of financial stability in our lives. Were it not for the innovative lending products that banks created in the wake of the CRA's passage in the late '70's, it's possible that none of us would have been able to buy the homes we now own. When we started the Bloomfield-Garfield Corp. in 1976, banks were only willing to make two types of mortgage loans: conventional ones, which usually meant 20% down payments, and FHA-insured ones, which allowed for smaller down payments. But what happened more often than not was that they only offered FHA-insured loans in neighborhoods like Garfield because they didn't want to take all of the risk themselves. Thus, "red-lining" happened in many city neighborhoods like Garfield, and it wasn't until we started the Pittsburgh Community Reinvestment Group in the late '80's, that things really began to change in the city. We have built 48 single-family, for-sale homes in Garfield in just the last 11 years, and if we had to live with these new regulations coming down from the CFPB, I doubt that even half of our buyers, most of whom were African-Americans earning less than $50,000 a year, would have been able to get a mortgage loan from a real bank. Someone needs to explain to all of us how the QM and QRM rules will keep the door to homeownership open for those of us who are not the rich and famous. From what I'm reading, I have serious concerns that this will be the case. We don't want to drive these families back into the arms of predatory lenders who operate under no scrutiny from the federal government whatsoever. But if we make it next to impossible for banks like WesBanco and PNC and Citizens and Fifth Third to make mortgage loans to working-class people, what good will really have been accomplished from these new regulations? We have a good system here in Pittsburgh that's taken us years to put in place, where banks and communities sit together at the table and find ways to make lending happen, and we don't want to lose it.

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Remarks for the November 12, 2013 meeting regarding the Dodd-Frank Act with Representative Capito and Representative Rothfus

Pittsburgh, PA

My name is Nancy Prager and I am the Director of Development for the City of Wheeling in West Virginia. The City of Wheeling is the lead agency of the Northern Panhandle HOME Consortium which receives HOME funds directly from the Department of Housing and Urban Development. We have been a consortium since 1997 providing downpayment and closing cost assistance to first time homebuyers that are low to moderate income. (less than 80% median) We provide up to $10,000 depending on the purchase price and terms of the loan.

In my research of the Dodd-Frank Act it has become apparent to me that many of our clients will not fall under the Qualified Mortgage framework of the law. If they do not meet the standards of a Qualified Mortgage then the mortgages that we assist would need to meet the Ability to Repay language in the law. The Ability to Repay language in this law makes it very clear that if a lender chooses to lend outside of the framework of a Qualified Mortgage, that lender faces significant risks of law suits related to the Ability to Repay or (ATR) requirement. With uncertainty associated with the potential litigation of the Ability Repay portion of the law, will lenders still be able to make loans that utilize our downpayment and closing cost assistance? Although the goal to drive out bad

products and bad lenders from the marketplace may have been the driving force behind this law it may do so with serious consequences to our clients.

Our program has been around since 1997. In that time we have assisted 830 families in the Northern Panhandle of West Virginia become homeowners. We have provided over $7,000,000 in HOME assistance and leveraged nearly $41,000,000 in mortgages. Our clients are hard working families that have been given a hand up not a hand out. They provide stabilization to neighborhoods where homes that are for sale may not have been purchased. They bring properties back in the tax rules of each county in which they reside. I am not a believer that all people should be homeowners but it has been my experience with the clients that we have served they were ready to become homeowners they just needed a little assistance to get them started. It would be a serious disservice to this income population not to be able to become homeowners simply because the Ability to Repay provision may be too burdensome for banks to undertake. We must get this right, for the sake of clients, our banks and the recovering housing market.

I appreciate the opportunity to speak with today and thank you for taking the time to listen to our concerns.

My name is Sonny Bringol and I want to thank Congresswoman Capito and Congressman Rothus for the honor of being included in this discussion on the impact of Qualified Mortgage (QM). I am the President of Victorian Finance, a regional Mortgage Bank with primary operations in Western Pennsylvania and West Virginia. Roughly, 50% of our clients live within your congressional districts. I am also the current President of the Mortgage Bankers Association of Southwestern PA.

Many aspects of Dodd Frank have had a positive impact. Primarily, lender residual liability and accountability has brought us back to Old Fashion Underwriting in which every borrower today endures a rigorous underwrite, sometimes referred to a Financial Colonoscopy, to ensure the borrower has the financial capability to afford the home they are purchasing or refinancing.

The new Qualified Mortgage is adding several complications to an existing rigorous client risk determination process.

The aspect with the most significant immediate impact to the real estate market will be the DTI limitation of 43% to meet QM/ATR standards. For each year from 2009 to present, approximately 20% of our loans exceeded the 43% DTI limit. This is 1 in 5 loans would not meet QM. At Victorian Finance, our default rates are below the national and local standards for our markets. Fannie Mae and Freddie

Mac have confirmed the 43% limit will be maintained. HUD's standard specifically did NOT include the 43% limit, however HUD has also not indicated what DTI limit they will enforce.

Second, QM has two standards, Safe Harbor and Rebuttable Presumption. To meet QM, the statute reads that a Creditor must make a reasonable & good faith determination, at or before consummation, that the consumer will have a reasonable ability to repay the loan according to its items. The statute has two references to the word REASONABLE in which the CFPB will not provide any further clarity. Attorneys love the lack of clarity in a law and this will create the incentive to sue. The Safe Harbor QM is supposed to be a presumption of innocence, however with the Vagueness of what does Reasonable mean, the Lender can still be challenged whether the Loan met QM ATR or not. Just the legal costs for this challenge are expected to be $25K per loan. The Rebuttable Presumption Loan has even less protections and the legal costs to defend this determination are estimated at $125K per loan. This level of legal expense risk is difficult for a small lender to absorb, however a large bank has teams of lawyers to handle this defense. The CFPB is hoping for the development of the Non-QM market, however this market will not develop with this level of uncertainly and liability risk.

Lastly, the 3% Cap in Fees rule as a part of the ATR requires the fees for any affiliated service providers be included in the 3% Cap in Fees. Especially for lower loan amounts, this is a disadvantage for consumers by a lack of choice of lower costs providers. House Bill 3211 provides a remedy for these 3% Cap issue and should be considered immediately.

In closing, all of us in the Industry want to comply with the new laws and rules. We want to be in compliance. At the 30,000 Foot view, our purpose is to put qualified borrows in homes they can afford. With the significant liability risks from lawsuits and a lack of clarity from the CFPB, I am afraid this will force the industry into tighter guidelines to ensure we are in compliance until a court case can provide a clear definition of Reasonable. Dodd Frank has doubled down on Too Big to Fail and has successfully created Too Small to Succeed.