



December 21, 2015

The Honorable Richard Cordray
Director
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, DC 20552

Dear Director Cordray:

We appreciate the tremendous work the CFPB has undertaken developing, implementing and clarifying the KBYO/TRID regulations. However, lingering misperceptions and technical ambiguities in the regulations have resulted in significant market disruptions in certain channels over the last month. We fear this disruption could develop into significant liquidity issues in the mortgage market without additional clarity conveyed to market participants by the Bureau as soon as possible, ideally this week. In addition we seek a commitment from CFPB to substantively re-engage with industry after the holidays to provide a process for ongoing written regulatory clarifications during the “diagnostic period” to address a range of KBYO interpretation questions that persist amongst lenders. Below, we establish the rationale for why we believe these steps are needed, with a focus on our proposed interim solution we ask you to implement as quickly as possible.

The Problem Today

Many MBA members are reporting that some investors have put in place strict KBYO compliance standards that are resulting in very high fail rates on closed loans delivered for sale. Moody’s recently reported that approximately 90 percent of one sample of loans did not fully comply with KBYO requirements. MBA is currently surveying our members to get a better sense of the number of errors and the standards being used by private investors and correspondent aggregators and the overall extent to which they are refusing to purchase, or demanding repurchase, of closed loans.

Today, the jumbo loan secondary market appears to be experiencing the most acute disruption, specifically for whole-loan trading¹ (WLT) and private-label securitizations (PLS). The reason is simple. Third party due diligence firms that are assigned by either ratings agencies or the investors themselves to perform quality assurance reviews on loans delivered into WLT, PLS and credit risk transfer (CRT) pools are failing loan deliveries in large quantities. These firms have taken an extremely conservative interpretation of several aspects of the KBYO rule and the physical disclosure display requirements. In addition, because a growing percentage of GSE loans sales are involved in CRTs² that require third party

¹ Whole loan trading is the bulk purchase of a pool of closed loans by an investor from a large aggregator of loans, in this case Jumbo loans.

² Credit risk transfers are a key strategic goals for FHFA that involves having private investors take expected losses on Agency MBS while the GSEs retain catastrophic, unexpected losses on the pool.

due diligence reviews, the impact of high TRID fail rates is also being felt in the conforming (non-jumbo) market.

Many of the errors being identified are minor or technical in nature – issues with the alignment or shading of forms, rounding errors, time stamps with the wrong time zone, or check boxes that are improperly completed on the LE. Compounding these minor errors is investor uncertainty regarding whether, and under what conditions, a Closing Disclosure (CD) can cure or correct the Loan Estimate (LE) for those data fields that are not subject to either tolerances or re-disclosures enumerated under the TRID rules.

Implications for the Market

The potential impact on the markets and consumers is troubling. Problems are most acute in the correspondent lending channel where several hundred smaller lenders sell loans to larger aggregators and investors. The correspondent channel currently accounts for about 35% of the single-family mortgage market. Each time a loan is rejected for purchase, an independent mortgage banker has a loan it cannot sell or must sell at a deep discount in a “scratch and dent” market for “TRID-failed” loans that has not yet developed. Similarly, community banks and credit unions that rely on secondary market sales for their mortgage operations have only limited balance sheet capacity for long-term fixed-rate loans that their aggregators have rejected.

If these conditions persist, many lenders will experience liquidity issues as unsold or repurchased loans clog warehouse lines and balance sheets. Importantly, IMBs, community banks and credit unions together account for more than 50% of loans used for home purchases. Although some lenders may have multiple investor options, these investors often have different standards in place for KBYO compliance. As a result, originators will not always be able to deliver loans to the investor with the best price (and hence the best rate for the consumer), and instead must deliver based on investors’ KBYO interpretations. For consumers, these dynamics will increase both the costs of origination and the interest rates they pay.

It is not clear that the impact will be limited to the jumbo market, or to the correspondent channel alone. The risk of broader disruptions cannot be discounted. Rising inventories of unsold loans on IMB warehouse lines and bank balance sheets could impact in fairly short order the entire mortgage operations, not just the lenders’ jumbo or correspondent channels. Some lenders could see their warehouse credit lines reduced because of concerns over rising inventories of unsold loans. Skittish warehouse credit line providers could initiate a general pullback from the market out of fear that the sector has become too uncertain and too risky. Further tightening of liquidity would further raise the cost of the mortgage credit in an already rising rate environment.

Finally, it is unknown how the GSEs and HUD will view KBYO compliance. For now the GSEs and HUD are honoring the grace periods but soon they will begin applying their own interpretations of KBYO to their own post-close quality control, repurchase (GSE), and claims review (HUD) processes. Moreover, compliance with TRID appears to be a “life of loan” warranty for the GSEs. Should the GSEs and HUD choose to make interpretations as conservative as the third party due diligence firms and demand repurchase or indemnification, a very significant market “event” cannot be ruled out.

Proposed Interim Solution

While the problem we are facing is potentially serious, we do believe there is an interim solution that would mitigate the specific events described above. This solution would give investors enhanced certainty, buy time to continue accumulating data on KBYO problems, and serve as a bridge until we can have a more robust dialog on additional clarifications after the holidays.

As an interim solution, we've attached for your consideration a draft written clarification (compliance bulletin, supervisory memo, or blog post) issued by the CFPB that would educate investors, due diligence companies and lenders on critical methods lenders can undertake to cure KBYO errors during the diagnostic period. The draft is in keeping with your statement that enforcement of the Know Before You Owe ("KBYO") rule enforcement will be "diagnostic and corrective, and not punitive" during the good faith implementation period. The document would emphasize the following:

- Errors on the LE may be corrected by providing a Closing Disclosure that conforms in good faith to the KBYO rule's requirements. For example, if a creditor failed to display the Total Interest Paid ("TIP") percentage due to a rounding error on the LE, but properly displayed the value on the CD, the CD would correct the error from the LE and the creditor is not required to take any further action to correct the error. This does not relieve the lender of the obligation to provide refunds to borrowers whenever there are tolerance violations.
- Lenders may correct numeric errors in the final CD by providing a corrected CD and, if there is an error that affects the APR, finance charge or total closing costs, ensure that the consumer does not pay more than as disclosed.
- Lenders may also continue to use their authority under the KBYO rule to correct non numeric clerical errors and must make post-consummation corrections to charges.
- Lenders may also continue to correct errors and unintentional violations as permitted by the Truth-in-Lending Act.

Simply put, we feel this interim solution would provide investors and due diligence firms the clarity they require in the near term to cure KBYO errors on both existing loans and newly originated ones. It would help get the Jumbo WLT, PLS and upfront CRT markets back on their feet, and stave off any spread to the broader market for now.

Need for Ongoing Guidance

We commit to vigorously continuing to accumulate data regarding where we see other risks emerging in the system resulting from KBYO implementation. We would ask the Bureau, in turn, commit to having your team engage with us in a robust dialogue about where additional written clarifications may be needed during the break-in compliance period to ensure more consistent interpretations of the rule by all market participants. We will assist in any way we can to disseminate interpretations to the industry.

KBYO Implementation Concerns

December 21, 2015

Page 4 of 4

Conclusion

It is our sincere hope that you will consider the interim solution we've proposed to be a modest, reasonable request, addressing a genuine market problem, which would have significant market benefits that vastly outweigh any risk of harm to consumers. We appreciate our ongoing tradition of an open and collaborative dialog. We look forward to following up immediately on this pressing matter so that we may all enjoy the holidays knowing that our mortgage markets are operating in a safe and sound fashion for consumers.

Sincerely,

A handwritten signature in black ink, appearing to read "David Stevens". The signature is stylized and cursive.

David Stevens, CMB

President and Chief Executive Officer

CC: Patricia McClung, Assistant Director, Mortgage Markets