MORTGAGE BANKERS ASSOCIATION

February 15, 2019

Mr. Jeffrey F. London
Director
Loan Guaranty Service
Veterans Benefits Administration
U.S. Department of Veterans Affairs
810 Vermont Avenue, NW
Washington, DC 20420

RE: Loan Guaranty: Revisions to VA-Guaranteed or Insured Cash-Out Home Refinance Loans [RIN: 2900-AQ42][1]

Dear Mr. London:

The Mortgage Bankers Association (MBA)[2] thanks the Loan Guaranty Service of the U.S. Department of Veterans Affairs (VA) for the opportunity to comment on its interim final rule to implement new protections with respect to cash-out refinance loans. MBA previously submitted comments addressing the operational challenges associated with the new borrower disclosures required by the interim final rule. The comments that follow in this correspondence contain MBA's broader recommendations to improve the effectiveness of the interim final rule.

MBA appreciates VA's commitment to protecting servicemembers, veterans, and surviving spouses from the harmful effects of serial mortgage refinancing, or "churning." In recent years, there has been a very concerning increase in the prevalence of churning in the market for VA-guaranteed or -insured loans. Many borrowers have been persuaded—often as a result of misleading or deceptive

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[1] 83 FR 64459, "Loan Guaranty: Revisions to VA-Guaranteed or Insured Cash-Out Home Refinance Loans," December 17, 2018. Available at: https://www.federalregister.gov/documents/2018/12/17/2018-27263/loan-guaranty-revisions-to-va-guaranteed-or-insured-cash-out-home-refinance-loans.

[2] 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, DC, the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to 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 2,300 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, credit unions, thrifts, REITs, Wall Street conduits, life insurance companies, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.

advertising—to refinance their VA loans repeatedly, receiving small decreases in their monthly payments while excessive fees are added onto their loan balances. This process strips borrower equity with each successive transaction, and the additional fees can eventually push the borrower into an “underwater” position in which he or she owes more than the value of the home. In some cases, the borrower may not even realize he or she is in such a position until attempting to sell the home.

Beyond the harm done to individual VA borrowers, churning also leads to higher costs for all borrowers utilizing mortgage programs operated by VA, the Federal Housing Administration (FHA), and the Rural Housing Service (RHS). Because churning causes abnormally fast prepayments of existing mortgages that serve as collateral for securities guaranteed by Ginnie Mae, investors in these securities do not earn their expected yields. This dynamic reduces investor demand for Ginnie Mae securities and lowers the prices investors are willing to pay, which leads to higher required yields on the securities and, in turn, higher mortgage interest rates for VA, FHA, and RHS borrowers.

In developing our recommendations with respect to the interim final rule and the VA cash-out refinance market, MBA gave careful attention to the needs of three constituencies—borrowers, lenders, and investors/Ginnie Mae. Borrowers must be protected from churning to the greatest extent possible, while maintaining access to refinances that are in their financial interest. Lenders need any rules and requirements to be clearly defined and operationally feasible so that compliance can be assured as they continue to serve their customers. Investors need the prepayment rates of the collateral underlying their Ginnie Mae securities to be predictable and bound within an acceptable range.

Finally, MBA evaluated the interim final rule in the context of changing market conditions. Any requirements and consumer protections must be effective in all environments, including periods of rising and falling interest rates, as well as increasing and decreasing home prices.

The interim final rule represents an important step toward eliminating the practice of churning in the VA market. MBA believes the recommendations that follow will further enhance the effectiveness of the rule as it is finalized.

Summary of Recommendations

<u>Net Tangible Benefit</u>

- For the applicable criteria set forth in the interim final rule, provide specific thresholds that must be met in order to satisfy the net tangible benefit test

Loan Fees and LTV Ratio Limits

- Clarify that no fees of any kind may be financed into the principal balance of the loan if the resulting LTV ratio would be above 100 percent

Loan Seasoning

- Begin the seasoning period for Type II cash-out refinances on the note date of the existing loan rather than the date of the first payment made by the borrower
- Pursue legislative efforts to change the start date of the seasoning period for streamlined refinances and Type I cash-out refinances to the note date of the existing loan
- Increase the required seasoning period on Type II cash-out refinances from six months to twelve months

Borrower Disclosures

- Replace the line item regarding the total amount the borrower will have paid on the existing and new loans with a simple sum of the fees that the borrower is paying to engage in the refinance transaction
- Create standard language for lenders to use to meet the requirement that they explain how borrowing against home equity may affect the borrower
- Postpone compliance with any requirement that lenders disclose information that is not already included in a standard loan application until the interim final rule is made final

Misleading or Deceptive Solicitations

- Monitor the market for improper solicitations and engage in further efforts to raise awareness among consumers

Implementation Questions that Need to be Addressed

- Provide clarity on outstanding questions related to lender compliance

Detailed Recommendations

Net Tangible Benefit

The interim final rule specifies eight criteria by which the refinance can be shown to provide a net tangible benefit to the borrower. Satisfying any one of these criteria is sufficient to meet the requirement. MBA concurs with the VA assessment that simply disclosing whether or not a loan meets any of the criteria is insufficient; the loan in fact should be required to satisfy one (or more) of the criteria to be eligible for VA guaranty or insurance.

The eight criteria can be divided into two types: those for which the variable that is subject to the test is binary and those for which the variable that is subject to the test falls along a continuum. Four criteria apply to each of these two categories.

Those variables that are binary in nature are:

- the presence of mortgage insurance on the loan being refinanced;
- the refinancing of an interim loan to construct, alter, or repair the home;
- the maintenance of a loan-to-value (LTV) ratio below 90 percent; and
- the refinancing of an adjustable-rate loan into a fixed-rate loan.

Those variables that fall along a continuum are:

- the term of the new loan;
- the interest rate on the new loan;
- the monthly payment on the new loan; and
- the borrower's monthly residual income.

In the former category, there is no need to evaluate the degree to which the refinance satisfies the criteria. For example, if a refinance moves the borrower from an adjustable rate to a fixed rate, that binary change clearly represents a positive outcome for the borrower. In the latter category, though, the degree to which the refinance satisfies the criteria is important. For example, a refinance could lower the borrower's interest rate by 150 basis points or by 5 basis points, and these two outcomes would be very different in determining whether the loan is in the financial interest of the borrower.

Given this dynamic, as well as the propensity for those engaged in churning to seek loopholes in the rules, MBA recommends that VA place thresholds on the criteria related to the term, interest rate, and payment on the new loan, as well as the borrower's monthly residual income. The presence of clear, well-defined thresholds in the final rule would eliminate scenarios in which a loan could be in technical compliance with the net tangible benefit test but still fail to deliver a substantive benefit to the borrower (for example, through a 1-month reduction in term, a 1-basis point reduction in interest rate, or a $1 change in monthly payment or monthly residual income).

Thresholds should be set at levels that strike a balance between the need to deter churning and the need to ensure that refinances that are beneficial to the borrower are permitted. As currently constructed, however, the lack of thresholds in the interim final rule render it unlikely to deter churning sufficiently. MBA is committed to working with and assisting VA as it develops these thresholds during the finalization of the rule.

Loan Fees and LTV Ratio Limits

In the interim final rule, VA notes that the U.S. Congress increased the maximum LTV ratio for cash-out refinances subject to a VA guaranty from 90 percent to 100 percent a decade ago through the *Veterans' Benefits Improvement Act of 2008*.[3] Existing regulations, however, allow the VA funding fee to "be included in the loan and paid from the proceeds thereof."[4] As a result of rolling the funding fee into the loan amount, VA borrowers can effectively increase their LTV ratios above 100 percent. In practice, other fees associated with the refinance transaction are also frequently added to the principal balance of the loan, allowing borrowers the ability to save on out-of-pocket costs at closing, but increasing their monthly payments and pushing their LTV ratios further beyond 100 percent.

The most egregious instances of churning occur when repeated transactions result in fees that are continually added to the principal balance, thereby perpetually keeping the borrower in an underwater position—a fact many borrowers may not realize when undertaking these transactions. The interim final rule seeks to address this problem by specifying that, for cash-out refinances, the funding fee can only be included in the loan to the extent that the LTV ratio remains at or below 100 percent. This requirement is a positive step toward preventing borrowers from being caught in a cycle that leaves them owing more than the value of their home.

Because the interim final rule addresses only the funding fee, it is unclear if the prohibition on fees above the threshold of a 100 percent LTV ratio applies to all other fees associated with the refinance. To further strengthen the final rule, MBA recommends that VA clarify that no fees of any kind may be financed into the principal balance of the loan if the resulting LTV ratio would be above 100 percent. This requirement would add certainty for lenders implementing the rule while also ensuring that borrowers cannot be pushed underwater on their mortgages due to their refinancing.

Loan Seasoning

Seasoning Calculation

Much of the initial policy response to the problem of churning focused on steps to introduce loan seasoning requirements to slow down the pace of serial refinancing. Ginnie Mae issued All Participant Memoranda (APMs) that instituted six-month

[3] Public Law 110-389, Section 504(b).

[4] 38 U.S.C. § 3729(a)(2).

seasoning requirements on streamlined refinances (effective in February 2017)[5] and, eventually, expanded these requirements to include cash-out refinances (effective in April 2018).[6] The U.S. Congress then codified six-month seasoning requirements for certain VA refinances, as well as all VA refinances serving as collateral for Ginnie Mae securities, in May 2018 through the *Economic Growth, Regulatory Relief, and Consumer Protection Act* (EGRRCPA).[7]

Though similar in nature, the calculation of the seasoning period differs between the Ginnie Mae APMs and EGRRCPA in important ways. Most notably, the start date of the seasoning period in Ginnie Mae APM 17-06 was set as the *first payment due date* of the initial loan. In contrast, the required seasoning period as established in EGRRCPA begins on the *date on which the first monthly payment is made on the loan*. The EGRRCPA construction has proven highly problematic from an implementation perspective, as the lender offering the refinance may not be able to determine the date on which the first payment was made. This problem is particularly relevant when the lender offering the refinance did not originate or does not service the existing loan, which is often the case.

Despite these operational impediments, the seasoning requirements specified in the interim final rule are calculated using the EGRRCPA construction. VA likely chose this option in order to align the seasoning requirements across its various refinance products. While such alignment is often a worthwhile goal that reduces implementation burden, MBA does not believe that alignment produces those benefits in this case. Instead, the use of the EGRRCPA construction will simply perpetuate the existing implementation problems.

Lenders should be able to originate refinances with confidence that they are in compliance with the seasoning requirements. MBA therefore recommends that, for Type II cash-out refinances, VA change the start date of the seasoning period to the note date of the initial loan, which is more readily available and verifiable. While this construct would differ from that of EGRRCPA, which applies to streamlined refinances and Type I cash-out refinances, there is no requirement in EGRRCPA that VA use the same construct in its rules related to Type II cash-out refinances. The

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[5] Ginnie Mae, “APM 16-05: Pooling Eligibility for Streamlined Refinance Loans,” October 19, 2016. Available at: https://ginniemae.gov/issuers/program_guidelines/Pages/mbsguideapmslibdisppage.aspx?ParamID=74.

[6] Ginnie Mae, “APM 17-06: Pooling Eligibility for Refinance Loans and Monitoring of Prepay Activity,” December 7, 2017. Available at: https://ginniemae.gov/issuers/program_guidelines/Pages/mbsguideapmslibdisppage.aspx?ParamID=82.

[7] Public Law 115-174, Section 309.

legislation clearly gives VA latitude to define seasoning requirements for Type II cash-out refinances in the manner it feels to be most appropriate.

More simply, it is preferable to use clear, well-understood standards when possible, rather than create alignment with a problematic approach. To this end, MBA also supports legislative efforts to amend the start date of the EGRRCPA seasoning requirements. Alignment is best achieved by fixing the operational issues with the requirements for streamlined refinances and Type I cash-out refinances rather than by perpetuating these issues for Type II cash-out refinances.

Seasoning Length

Similarly, the length of the required seasoning period for Type II cash-out refinances need not align with that of streamlined refinances and Type I cash-out refinances if there is a compelling reason for a different standard. Given our concerns regarding the prevalence of churning, as well as our doubts regarding the appropriateness of frequent refinances which pull cash from the home equity, there is a strong argument for lengthening the seasoning requirements. Specifically, MBA recommends increasing the seasoning period for Type II cash-out refinances from six months to twelve months.

This change would immediately slow the prepayment speeds of Ginnie Mae securities, particularly in light of the fact that Type II cash-out refinances account for the vast majority of VA cash-out refinances. To the extent that churning activity has shifted from the streamlined refinance market to the cash-out refinance market in recent months, this strengthened requirement is even more warranted. Streamlined refinances and Type I cash-out refinances also benefit from further anti-churning protections, such as a maximum fee recoupment period and required interest rate reductions. Since these protections do not apply to Type II cash-out refinances, the use of a longer seasoning period is further justified.

Finally, a longer seasoning period for Type II cash-out refinances would effectively ensure compliance with the existing Ginnie Mae seasoning requirements. As noted earlier, because of the uncertainty regarding the start date of the Ginnie Mae seasoning requirements (as introduced by EGRRCPA), some lenders have encountered situations in which they were forced to buy loans out of Ginnie Mae pools because the first payment made by the borrower occurred at an unusually late date. In those situations, the six-month seasoning requirement was not satisfied, despite more than six months having passed since the first payment due date. If twelve months of seasoning were required for purposes of the VA guaranty, the Ginnie Mae six-month requirement would also be met.

Borrower Disclosures

As was stated in an earlier letter submitted to VA, MBA "strongly supports the requirement that borrowers be given a clear description of how the terms of their refinance loan will differ from those of their existing loan—including the costs associated with the refinance transaction."[8] In that same correspondence, we also identified serious operational issues that will make implementation of the borrower disclosures required by the interim final rule very challenging for lenders. These operational issues will also diminish the accuracy of information supplied to borrowers, thereby detracting from the value of the disclosures.

Failure to provide accurate disclosures to borrowers could lead to significant lender liability under the False Claims Act. This liability could arise in a manner that deviates from VA's enforcement intentions, such as through actions by the Department of Justice or *qui tam* litigation. If lenders are unable to reasonably ensure the accuracy of their disclosures, many may choose to cease offering VA cash-out refinances rather than incur the risk associated with False Claims Act enforcement.

As written, the interim final rule requires lenders to disclose "the total the borrower will have paid after making all payments of principal, interest, and mortgage or guaranty insurance (if applicable), as scheduled, for both the new loan *and the loan being refinanced* [emphasis added]."[9] It is highly unlikely that lenders that did not originate or do not currently service the existing loan will be able to provide an accurate amortization schedule or estimate of the total remaining payments on the existing loan. Because the lender will not have the original promissory note or other related materials, it will need to rely on information provided by the borrower. This information may not be complete or accurate, and it is not captured in a standard loan application. Specific examples include principal curtailments that would affect the duration of mortgage insurance payments or any forbearance that was offered in response to a natural disaster.

Rather than require the lender to make assumptions about the borrower's existing loan, which may or may not be accurate, VA should instead require simpler measures that better describe the costs of the refinance transaction. For example, it will be very difficult for lenders to provide information about the equity being extracted from the home at the time of application because the value would not be established at initial disclosure. In addition, the interim final rule does not provide a clear description of what constitutes the equity being removed (i.e., whether this figure

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[8] Broeksmit, Robert D. "RE: Loan Guaranty: Revisions to VA-Guaranteed or Insured Cash-Out Home Refinance Loans [RIN: 2900-AQ42]," Mortgage Bankers Association, January 24, 2019. Available at: https://www.mba.org/Documents/MBA_VA_Disclosures_January2019.pdf.

[9] 83 FR 64463.

accounts for fees paid by the borrower). MBA recommends that the interim final rule be amended such that the line item regarding the total amount the borrower will have paid be replaced with a simple sum of the fees that the borrower is paying to engage in the transaction. This figure would include both the VA funding fee and any fees paid to the lender or other parties associated with the transaction.

Ideally, this figure would be placed immediately next to the line item showing the way(s) in which the loan satisfies the net tangible benefit test. Such a construct would allow the borrower to see clearly how much he or she is paying in fees and what cash-out benefits he or she is receiving in exchange for those fees. The finalized rule should also clarify that these benefits cannot include refunds from the escrow account on the existing loan or "skipped payments" resulting from the refinance transaction. Including these items would improperly inflate the cash-out benefits, when in fact they are offset by prepaid interest and funding of the escrow account on the new loan.

Much of the churning that has taken place recently relies on borrowers failing to comprehend the magnitude of the fees being added to their principal balance relative to the cash being received. With this amendment to the borrower disclosures, the total amount of fees paid—whether upfront or over time—would be apparent to the borrower, further discouraging churning.

Separately, much as VA is creating a standard template for the borrower disclosures, it should also consider creating standard language for lenders to use to meet the requirement that they "explain how the removal of home equity may affect the Veteran."[10] There is no apparent reason that the explanation regarding the effects of taking equity out of the home should differ across lenders. In fact, borrowers would be better served by receiving identical explanations, regardless of their lender. From a lender perspective, it is clearly preferable to use standard, government-approved language rather than attempt to craft unique language that may or may not meet the objectives set forth by VA. As such, MBA recommends that VA publish standard language that can be included in the borrower disclosure template.

Finally, compliance with the borrower disclosures requires lenders' time and resources. If lenders are to provide accurate disclosures to borrowers within three business days of the loan application, they must be able to rely on automated processes. The 60-day implementation period simply does not allow for such processes to be developed, tested, and put into use. Further, these processes may require additional updates and changes if VA amends the interim final rule in response to public comments.

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[10] Veterans Benefits Administration, "Circular 26-18-30: Revisions to VA-Guaranteed Cash-Out Refinancing Home Loans (RIN 2900-AQ42)," December 19, 2018. Available at: https://www.benefits.va.gov/homeloans/documents/circulars/26_18_30.pdf.

Given these significant operational challenges, MBA reiterates our recommendation that VA not mandate immediate compliance with any requirement that lenders disclose information that is not already included in a standard loan application until the interim final rule is made final. VA should instead continue to work with lenders and industry vendors to further develop and revise its borrower disclosure template, while ensuring that the necessary changes to various loan origination systems are in place before requiring full compliance. Similarly, to provide greater certainty for lenders, VA should publish written guidance on a "best efforts" standard for borrower disclosures prior to implementation.

Misleading or Deceptive Solicitations

While not directly addressed by the interim final rule, another important component of the problem is the manner in which lenders engaging in churning solicit borrowers. Many servicemembers, veterans, and surviving spouses have received dozens upon dozens of solicitations to refinance their loans, in some cases with ten or more solicitations arriving per day. These solicitations often begin very shortly after the borrower closes on the existing loan.

While the volume of such solicitations is worrisome, the more troubling feature is the misleading or deceptive content that may be present. These practices serve no purpose other than to mislead or deceive borrowers into overestimating the benefits of a refinance transaction. MBA urges VA to continue to monitor the market for improper solicitations and to engage in further efforts to raise awareness among consumers. A November 2017 warning order[11] provided useful information to the public, and VA should build on this publication with additional alerts and educational materials. MBA remains ready and willing to assist in any such outreach and public awareness campaigns.

Implementation Questions that Need to be Addressed

In the course of reviewing and analyzing the interim final rule, MBA has identified areas in which we request further clarification or explanation:

- When determining whether a loan meets the net tangible benefit criterion of maintaining an LTV ratio below 90 percent, is the LTV ratio calculated using the base loan amount or the total loan amount (inclusive of fees)?

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[11] "VA and the Consumer Financial Protection Bureau Warn Against Home Loan Refinancing Offers That Sound Too Good To Be True," VAntage Point Blog, November 21, 2017. Available at: https://www.blogs.va.gov/VAntage/43234/va-and-the-consumer-financial-protection-bureau-warn-against-home-loan-refinancing-offers-that-sound-too-good-to-be-true/.

- Where LTV ratio calculations include the VA funding fee, do they also include other fees associated with the refinance transaction?
- The interim final rule specifies that the LTV ratio threshold of 100 percent includes the VA funding fee. For purposes of these loans, how is the VA guaranty applied? For example, would the VA guaranty cover 25 percent of the base loan amount, the total loan amount (including the entire VA funding fee), or the base loan amount plus only the portion of the VA funding fee that brings the total LTV ratio up to 100 percent?
- When disclosing the net tangible benefit criteria satisfied by the refinance transaction, must lenders indicate <u>all</u> criteria that apply, or is it sufficient to indicate any single criterion that applies? For example, if a refinance transaction satisfies five of the eight net tangible benefit criteria, must the lender disclose all five criteria to the borrower?
- The interim final rule specifies that the lender must disclose to the borrower "the total the borrower will have paid after making all payments" on the existing and new loans. Is this requirement meant to capture only the <u>remaining</u> payments on the existing loan, or all payments since the origination of that loan?
- If the refinance transaction replaces both a first lien and a second lien, how are lenders required to show that they have satisfied the net tangible benefit test? How does such a situation change the required borrower disclosures?
- In some cases, loans for which applications were taken prior to February 15, 2019 and approval was granted through an automated underwriting system (e.g., the automated underwriting systems of Fannie Mae and Freddie Mac) may require subsequent approval after February 15, 2019. In such situations, do those loans necessarily require manual underwriting despite their earlier approval? Is VA planning to offer relief for lenders in such situations, particularly for those with large pipelines of affected loans? What is VA's acceptable tolerance for determining whether a loan requires subsequent approval?
- Where in the file upload stacking order should the new borrower disclosures be placed?

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MBA stands fully committed to continuing our work with VA, as well as Ginnie Mae, the U.S. Congress, and all stakeholders, to bring churning to an end. As part of our mission, MBA maintains the objective of "promot[ing] fair and ethical lending practices." Churning represents the very antithesis of this objective. We believe the recommendations described above will improve VA's capacity to deter churning and thereby better protect servicemembers, veterans, and surviving spouses. We urge VA to adopt these changes to the interim final rule as quickly as possible.

Thank you in advance for your consideration of these recommendations. Should you have questions or wish to discuss further, please contact Dan Fichtler, Director of Housing Finance Policy, at (202) 557-2780 and dfichtler@mba.org.

Sincerely,

Robert D. Broeksmit, CMB
President and Chief Executive Officer
Mortgage Bankers Association