Statement of Bill Emerson
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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.

[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;
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> (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.