NATIONAL ASSOCIATION of REALTORS®
REALTOR®

500 New Jersey Avenue, N.W.

Washington, DC 20001-2020



# 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.

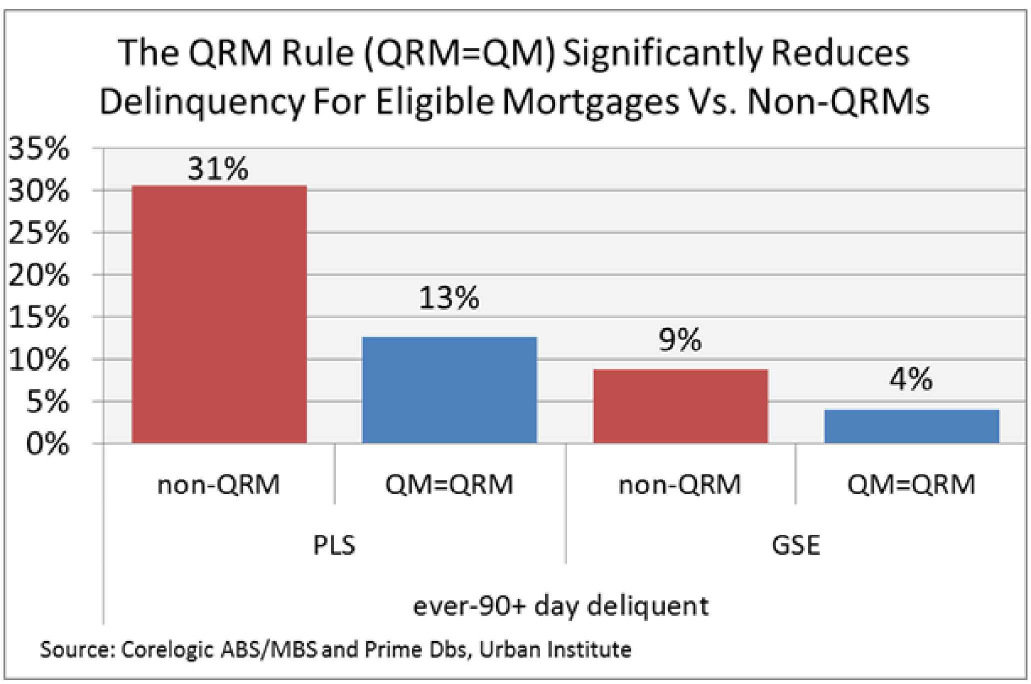
Therefore, we urge the CFPB to be flexible with the DTI standard should jumbo mortgage credit tighten or become unreasonably costly.

## 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

---

[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.

## <u>CONCLUSION</u>

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/).