NATIONAL ASSOCIATION of REALTORS®

Ron Phipps
ABR, CRS, GRI, GREEN, e-PRO, SFR
2011 President

Dale A. Stinton
Chief Executive Officer

GOVERNMENT AFFAIRS DIVISION
Jerry Giovaniello, Senior Vice President
Gary Weaver, Vice President
Joe Ventrone, Vice President
Jamie Gregory, Deputy Chief Lobbyist

500 New Jersey Ave., NW
Washington, DC 20001-2020
Ph. 202-383-1194 Fax 202-3837580
www.REALTOR.org

July 22, 2011

Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
Washington, DC 20551

Re: Ability-to-Repay Proposed Rule, Docket No. R-1417 and
RIN No. 7100-AD75

Transmitted electronically to: regs.comments@federalreserve.gov. The Board will transfer the comments to the Consumer Financial Protection Bureau (CFPB), which assumed TILA rulemaking responsibility on July 21, 2011, and will issue the final rule.

Dear Chairman Bernanke:

I am writing on behalf of the 1.1 million members of the National Association of REALTORS® (NAR) on the Ability-to-Repay proposed rule to implement amendments to the Truth in Lending Act (TILA) made by Title XIV of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The National Association of REALTORS® is America's largest trade association, including NAR's five commercial real estate institutes and its societies and councils. REALTORS® are involved in all aspects of the residential and commercial real estate industries and belong to one or more of some 1,400 local associations or boards, and 54 state and territory associations of REALTORS®.

OVERVIEW

Under section 129C of TILA, added by section 1411 of the Dodd-Frank Act, no creditor may make a mortgage loan without making a reasonable and good faith determination that the borrower has the ability to repay the loan.

The ability-to-repay requirement applies to most mortgages, including investor loans, but excluding open-end credit, timeshares, reverse mortgages, and temporary (for example, construction) loans.

The proposed rule gives creditors four ways to comply with the ability-to-repay standard:

1. Determining general ability to repay.
2. Originating a Qualified Mortgage.
3. Refinancing a non-standard mortgage into a standard mortgage.
4. Originating a balloon payment loan as a Qualified Mortgage in a rural or underserved area.

1. General Ability-to-Repay

One compliance option is for the creditor to make a reasonable and good faith determination that the borrower has a reasonable ability to repay the loan and related obligations, based on verified and documented information related to these eight factors.

i. Current or reasonably expected income or assets (from employment or other sources, but excluding the value of the home that secures the loan).

ii. Current employment status (if the creditor relies on income from the consumer's employment).

iii. Monthly payment on the mortgage (based on the fully indexed rate).

iv. Monthly payment on any simultaneous loans (any other loans that are secured by that same dwelling to be made at the same consumer, including HELOCs).

v. Monthly payment on any mortgage related obligations (such as taxes, insurance, homeowner association, condominium and cooperative fees, and assessments).

vi. Current debt obligations (such as student loans, automobile loans, credit cards, alimony or child support payments, and any existing mortgages).

vii. The monthly debt-to-income ratio, or residual income (the ratio of total debt obligations to income or the income the consumer will have left after paying his or her debt obligations).

viii. Credit history (traditional credit reports are acceptable, and creditors may also consider nontraditional references, such as rental payment history or public utility payments).

2. Originating a Qualified Mortgage

The creditor is presumed to have complied with the general ability-to-repay standard if the creditor originates a QM. The proposed rule offers two alternative definitions of a QM, but only one will be included in the final rule.

Safe Harbor—Alternative 1. The Safe Harbor defines a QM as a mortgage meeting all of the following criteria:

- No negative amortization, balloon, or interest-only payments, or a term of more than 30 years.
- Total point and fees cannot exceed 3% of the total loan amount.
- The borrower's income or assets relied upon in making the ability-to-repay determination are considered and verified.
- The underwriting of the mortgage (1) is based on the maximum interest rate in the first 5 years, (2) uses a fully amortizing payment schedule, and (3) takes into account any mortgage-related obligations.

Rebuttable Presumption—Alternative 2. The rebuttable presumption defines a QM as including all the criteria for the safe harbor plus additional underwriting from the ability-to-repay standard:

- Employment status.
- Monthly payment for any simultaneous loans.
- Current debt obligations.
- Total debt-to-income ratio or residual income.
- Credit history.

3. Refinancing a Non-Standard Mortgage into a Standard Mortgage

If the creditor is refinancing a consumer out of a risky, non-standard mortgage into a more stable standard mortgage that reduces the monthly mortgage payment, the creditor is not required to verify income or assets. A standard mortgage is a loan that, among other things, does not have negative amortization, interest-only payments, or balloon payments and does have limited points and fees.

4. Balloon Payment Exception for Rural and Underserved Areas

A creditor may originate a balloon payment QM as an exception to the general requirements of a QM if the creditor is operating in a predominantly rural or underserved area, if the loan term is 5 years or more, if the borrower can make all the scheduled payments from current or reasonably expected income or assets (other than the balloon payment), and if the loan otherwise qualifies as a QM.

NEED FOR A STRONG DEFINITION OF QUALIFIED MORTGAGE AS BASIS FOR THE DEFINITION OF A QUALIFIED RESIDENTIAL MORTGAGE

The regulation of the mortgage lending industry is becoming so complex that it threatens to weaken the system, instead of curing abuses. To minimize what many believe is becoming a chaotic situation, NAR's comment on the Risk Retention proposed rule will recommend that the regulators seriously consider defining a Qualified Residential Mortgage (QRM) as any mortgage that meets the QM ability-to-repay standard of Title XIV of the Dodd-Frank Act. A creditor is presumed to have met the ability-to-repay requirement if the loan is a QM. While the law requires that the definition of QRM not be broader than the definition of QM, there is no reason why it should not be the same. The QM standard will assure a safe and sound mortgage loan that does not include questionable loan features but does require verification and documentation of borrower income and assets and compliance with other sound underwriting criteria. A QM is a mortgage for which risk retention is not needed for investor security. Consistent with this recommendation, NAR urges that the final rule define QM to provide a high level of consumer protection in a safe harbor that minimizes litigation risk to creditors so a wide range of creditworthy consumers will be able to find mortgage financing. This balance is crucial to avoid inadvertently exposing consumers to risky mortgages or unduly restricting liquidity.

SELLER FINANCING

Ability-to-Repay Standard

Section 226.43(c) of the proposed rule states that no creditor may make a mortgage loan without making a reasonable and good faith determination, based on verified and documented information, that the consumer has the ability to repay the loan. A creditor is defined in the TILA regulations as a person who *regularly extends* consumer credit which is payable by agreement in more than four installments. A person who regularly extends consumer credit is one who extends such credit "more than 5 times for transactions secured by a dwelling in the preceding calendar year."[1] If a person did not meet the numerical standards in the preceding calendar year, the numerical standards are applied in the current year.

Under the definition of creditor, seller financing for the sale of a residence is not subject to the ability-to-repay requirements unless the person extending consumer credit does so more than 5 times in the pertinent calendar year. REALTORS® report to NAR that seller financing is a crucial source of mortgage lending in many markets, especially in times of economic stress. Sellers who provide financing for their own property are not routinely engaged in lending. These seller financers are typically homeowners and small investors who, from time to time or once in a lifetime, sell property they own. These sellers may own property that does not fit typical lender criteria or is located in an underserved or rural area or may be unable to find borrowers who qualify for traditional loans. Some are interested in providing the financing for the sale in order to establish a stream of income, such as income to support the seller in retirement.

NAR supports the current exemption from the definition of creditor for seller financing and other infrequent lenders. Without such an exemption from the ability-to-repay requirements, seller financing, as a practical matter, would not be provided. The final rule should retain at least the proposed exemption for seller financing under the definition of creditor. To minimize confusion, NAR recommends that the final ability-to-repay rule add an additional exemption for individuals providing seller financing who are exempt from licensing as a loan originator under the Secure and Fair Enforcement Mortgage Licensing Act of 2008 (SAFE Act). HUD's final rule[2] requires licensing

[1] 12 CFR § 226.2(a)(17)(v).

[2] 24 CFR Part 3400, 76 Fed. Reg. 38464 (June 30, 2011).

only of individuals engaged in the business of a loan originator because, in a commercial context and habitually or repeatedly, they (a) take a mortgage loan application and offer or negotiate loan terms for compensation or gain or (b) represent to the public they can perform such activities. State law is expected to govern what it means to act "habitually or repeatedly."

The exemption from the ability-to-repay requirement for those who are not covered by the definition of creditor and, even if they are, those who are exempt from loan originator licensing under the SAFE Act will protect the vital role seller financing plays in many markets.

Definition of Mortgage Originator

Section 1401 of the Dodd-Frank Act adds a new section 103(aa) to TILA, defining the term mortgage originator. The definition excludes persons who provide mortgage financing for the sale of no more than 3 properties in any 12 month period, if the financing meets certain criteria: (i) the seller did not construct the home, (ii) the loan is fully amortizing, (iii) the seller determines and documents that the buyer has a reasonable ability to repay the loan, (iv) the loan has a fixed rate or is adjustable after 5 or more years (subject to reasonable annual and lifetime caps), and (v) the loan meets any other criteria set by the Federal Reserve Board.

In the preamble to the final rule issued by the Federal Reserve Board promulgating the loan officer compensation requirements, including changes made by section 1403 of the Dodd-Frank Act, the Board states that "[t]he definition of 'loan originator' . . . is consistent with the Reform Act's definition of 'mortgage originators' [which] . . . . excludes certain persons and entities that originate loans but are also creditors that provide seller financing for properties that the originator owns." [3] The Board explained that, because persons providing seller financing are "'creditors' and are not loan originators using table funding, they are not covered by final rules that are applicable to loan originators." As noted above, these persons are exempt from the definition of creditor if they make five or fewer loans in a calendar year.

NAR requests that the CFPB confirm this conclusion since we receive many questions on this definition and the significance of the exclusion of seller financing from the definition of mortgage originator. Section 1402 adds a new section 129B(a) and (b) to TILA. Subsection (b) requires mortgage originators, when required, to be licensed under the SAFE Act. As noted, individuals providing seller financing are only required to be licensed if they engage in the business of a loan originator. This provision seems to add nothing substantive. Then section 1403 adds a new section 129B(c) entitled "Prohibition on Steering Incentives." Those provisions, as implemented by the Board in its loan originator compensation final rule published on September 24, 2010, and discussed above, do not appear to apply, by their terms, to seller financing. They restrict certain compensation paid to mortgage originators to prevent steering in the context of preventing abuses where some loan originators were paid more for arranging for loans that were disadvantageous to the consumer. Seller financing does not involve compensation paid by third parties. The loan originator compensation rule explicitly states "[t]he purpose of the final rule is to protect consumers in the mortgage market from unfair or abusive practices that can arise from certain loan originator compensation practices" and that "[t]his final rule *only* applies to parties who arrange, negotiate, or obtain an extension of mortgage credit for a consumer in return for *compensation or other monetary*

[3] 75 Fed. Reg. 58510 (September 24, 2010).

gain."[4] (emphasis added) NAR would welcome clarification that the requirements of section 129B(c) do not apply to those providing seller financing because they do not receive compensation and, therefore, it makes no sense to do so.

To the extent the CFPB determines that any provisions of section 129B do apply to seller financing, NAR urges that the exclusion in section 103(cc)(2)(E) for seller financing meeting the specified criteria be modified using the authority under TILA to make the exclusion practicable, consistent with what we believe is the intended purpose. Many REALTORS® report that seller financing typically includes a balloon payment. The purpose is to provide a loan for a period that allows the buyer to find alternative financing. We note that the proposed QM definition allows balloon payments in some circumstances, and the final rule should also allow them for the purpose of determining which seller financing is exempt from the definition of mortgage originator, as well, to the extent a substantive requirement is identified. The ability-to-repay determination, in section 103(cc)(2)(E)(iii), should also be streamlined to make it practical and avoid inadvertently driving seller financing out of the market, with the result that some markets will have extremely limited financing available, if it is available at all.

QUALIFIED MORTGAGE: FHA INSURED LOANS

NAR recommends that the final rule include all FHA insured mortgages in the definition of QM, based on the authority under section 129C(b)(3)(B) to "revise, add to, or subtract from the criteria that define a qualified mortgage." The commentary on proposed section 226.43(c), Repayment Ability, states that when evaluating a consumer's repayment ability, creditors may consider "widely accepted governmental or non-governmental underwriting standards, such as the Federal Housing Administration's handbook on Mortgage Credit Analysis for Mortgage Insurance on One- to Four-Unit Mortgage Loans."[5] FHA is cited as the standard for sound underwriting. It has always required strong underwriting and documentation of income and assets. Its loans have performed well, especially when factoring in the credit profile of its borrowers, and FHA has never received a government subsidy. Adding a layer of similar but overlapping criteria to the standard FHA criteria would result in discouraging lenders from making FHA insured loans, without adding more safety for consumers. The final rule should avoid imposing an additional layer of government regulation on FHA mortgages and define QM to include all FHA insured mortgages.

QUALIFIED MORTGAGE: SAFE HARBOR

Background

The proposed rule implements the Qualified Mortgage (QM) provision of section 129C(b) of TILA, added by section 1412 of the Dodd-Frank Act. The proposed rule establishes various compliance options for determining whether the creditor has met the ability-to-repay requirements. A creditor or assignee may presume that the loan has met the ability-to-repay requirements if the loan meets the definition of a QM. The Board explains in the preamble that it is not clear under TILA whether Congress intended to establish a safe harbor or a rebuttable presumption of compliance. The Board's analysis of the "statutory construction and policy implications demonstrate that there are

[4] 75 Fed. Reg. 58509, 58510 (September 24, 2010).

[5] 76 Fed. Reg. 27492 (May 11, 2011).

sound reasons for adopting either interpretation."[6] Due to statutory ambiguity and competing concerns, the Board has proposed two alternatives.

The proposed rule defines a QM as a mortgage that meets these requirements:

- The loan does not provide for negative amortization, interest-only payments, or a balloon payment, or have a loan term exceeding 30 years.
- The total points and fees do not exceed 3% of the total loan amount (with exceptions for smaller dollar amount loans).
- The income or assets relied upon in making the ability-to-repay determination are considered and verified.
- The underwriting of the mortgage (1) is based on the maximum interest rate that may apply in the first five years, (2) uses a payment scheduled that fully amortizes the loan amount over the loan term, or the outstanding principal balance over the remaining term as of the date the rate adjusts to the maximum, and (3) takes into account any mortgage-related obligations.
- Alternative 2 (rebuttable presumption) requires additional underwriting from the general ability-to-repay criteria: employment status, monthly payment for any simultaneous loans, current debt obligations, total debt-to-income ratio or residual income, and credit history.

The first alternative defines QM based on the criteria listed in the Act and would operate as a safe harbor and alternative to complying with the general ability-to-repay standard. Under this proposal, the safe harbor would limit the consumer's ability to challenge a creditor's determination of repayment ability based on the consumer's employment status, simultaneous loans, current debt obligations, or credit history, or for generally not making a reasonable and good faith determination of the consumer's ability to repay.

The second alternative defines a QM to include the requirements listed in TILA as well as the other underwriting requirements from the general ability-to-repay standard. This definition provides a presumption of compliance that could be rebutted by the consumer. The drawback of this approach is that it provides little legal certainty for the creditor, and thus, little incentive to make a QM, which benefits consumers by limiting loan fees and features. NAR has concerns that the second alternative may reduce credit liquidity if conservative lenders establish criteria stricter than the presumption's standards, to minimize litigation risk to the lenders.

NAR Recommendation for Strong Safe Harbor

NAR supports a QM definition that includes stronger consumer protections than proposed by the Board, promotes liquidity, incorporates important ability-to-repay standards, and offers lenders a safe harbor that reduces litigation exposure.

[6] 76 Fed. Reg 27452 (May 11, 2011).

REALTORS® are in exceptionally good positions to report on the challenges faced by consumers and creditors and, when necessary, to sound the alarm of problems in the mortgage market. In May 2005, we warned anyone who would listen (not many did) that consumers were being taken advantage of by intemperate, and often predatory, lending. NAR's 2005 policy includes the following statement:

> NAR supports strong underwriting standards that require all mortgage originators to verify the borrower's ability to repay the loan based on all its terms, including taxes and insurance, without having to refinance or sell the home. Lenders should consider all relevant facts, including the borrower's income, credit history, future income potential, and other life circumstances. Lenders should not makes loans to borrowers that make loss of the home through sale or foreclosure likely if the borrower is unable to refinance the mortgage or sell.

Earlier adoption of NAR's recommendations would have minimized the impact of abusive lending that flourished for too long. This May 2005 policy formed the basis for our comments on the 2006 and 2007 Interagency Supervisory Guidance on the risks of nontraditional mortgages and subprime mortgage abuses, as well as for our testimony before Congress.

Now REALTORS® are warning that the lending industry and the regulators have over-corrected in response to abuses in the middle of the previous decade. In November 2010, NAR called on the credit and lending communities and federal regulators to reassess the entire credit structure and look for ways to increase the availability of credit to <u>qualified</u> borrowers who are good credit risks.[7]

The purpose of recounting this history is to highlight the credibility we believe we have earned to recommend that the CFPB strengthen the definition of QM to give consumers protections and make it a safe harbor to give creditors a path for reducing litigation risk. The proposed QM definition should be strengthened by including the general ability-to-repay criteria.

The CFPB should assess the eight general criteria to make them as objective as possible. In this regard, we note the Board decided to not include the requirement to consider a consumer's debt-to-income or residual income in the safe harbor proposal. We think, however, that if a creditor considers and verifies this and the other general underwriting factors based on widely accepted underwriting standards such as the Federal Housing Administration's Handbook on Mortgage Credit Analysis for Mortgage Insurance on One-to-Four Unit Mortgage Loans, the creditor determinations should be sufficiently objective to make sense in the context of a safe harbor. We should note, however, that the final rule should give creditors the discretion to adapt debt-to-income or residual income requirements, based on changing markets, and not impose a rigid numerical standard. As we will describe in detail in our comment letter on the Risk Retention rule (due August 1, 2011), the impact of imposing low debt-to-income ratio requirements would be devastating to millions of potential creditworthy homebuyers.

In conclusion, NAR believes a QM safe harbor that limits product features and requires creditors to determine the ability of the consumer to repay the loan will benefit consumers by promoting mortgage liquidity and benefit creditors by minimizing litigation risk.

---

[7] http://www.realtor.org/government_affairs/gapublic/fincredissues.

POINTS AND FEES DEFINITIONS UNDER THE ABILITY-TO-REPAY STANDARD AND HOEPA

Discrimination against Affiliates

The ability-to-repay requirement of Title XIV provides, as one option for compliance, a safe harbor for mortgages that do not include risky product features, are well underwritten, and meet various other requirements. These other requirements include "fees and points" that are 3% or less than the mortgage amount. However, the definition of fees and points discriminates against lenders with affiliates for no obvious reason.

The Board notes in the proposed regulation that there was concern regarding the definition of fees and points in the legislation.[8] A legislative technical correction was included in House versions of these provisions dating back to 2007. The correction would have treated mortgage lenders with affiliates involved in the transaction almost the same as unaffiliated lenders as long as the affiliated relationship was in compliance with the Real Estate Settlement Procedures Act (RESPA). The Board also noted that Congress ultimately did not include a legislative technical correction for the definition that would have treated affiliated and unaffiliated providers more equally. While it is true that the legislative fix was removed in the final conference version of the legislation, its removal was largely the result of haste and not deliberate reflection as the Board implies. In fact, NAR has subsequently met with key Members of Congress who inserted the provision and those in a position to remove it, and none gave any indication or reason for its removal other than a possible staff error during the haste of the conference.

The RESPA affiliate exception should be reinstated, using the broad authority under TILA,[9] because it maximizes consumer access and choice in mortgage providers. RESPA prohibits kickbacks and unearned fees among settlement service providers. The affiliated business exception allows affiliates to profit for services rendered and for a parent owner or partner to receive a return on their ownership interest commensurate with their investment in the affiliated firm. It still prohibits unearned fees or returns and requires significant disclosure of affiliated relationships. For this reason alone, the fears that may have inspired the inclusion of affiliate charges, such as title insurance and escrow, are unwarranted.

What is most pernicious about the disparate treatment of affiliates is that the particular affiliate or other charges ascribed to lenders with affiliates in the transaction are not likely to differ whether there is an affiliate involved or not.

The item most likely to cause a lender to violate the points and fees cap is title charges. The title industry is heavily regulated, and the likelihood that consumers would pay a non-market rate to an affiliate title company, as opposed to an unaffiliated firm, is slim. In fact, in a December 2010 Harris Survey of recent and prospective buyers, respondents said that using affiliates saves them money (78%), makes the home buying process more manageable and efficient (75%), prevents things from "falling through the cracks" (73%), and is more convenient (73%) than using separate services. This response is consistent with data from similar surveys in 2008 and 2002.

---

[8] 76 Fed. Reg. 27404 (May 11, 2011).

[9] Sections 105 and 129C(b)(3)(B) of TILA.

Title and certain escrow charges (including homeowner's insurance) can be significant depending on location and would certainly contribute to either a firm exceeding the 3% cap or making a lender's interest rate uncompetitive if they must build in the true lender costs into the interest rate.[10] Of course, the other listed charges would also contribute to an affiliated firm exceeding the 3% cap while an unaffiliated lender would be free to charge the entire 3% for its own benefit. Therefore discrimination against affiliates could in fact increase costs since the consumer would still have to pay the other charges such as title and amounts in escrow (for example, insurance) to third parties.

Since discrimination against affiliates will reduce competition and perhaps even increase costs and given the repeated survey data showing consumer's preferences, NAR strongly urges the CFPB to either reinstate the RESPA affiliated business exemption or remove title and escrow charges from the calculation of fees and points, using its TILA adjustment authority.

Smaller Loans

The Dodd-Frank Act grants the regulator flexibility in altering the fees and points standard for smaller loans.[11] NAR strongly encourages granting latitude above 3% for smaller dollar amount loans. The fixed costs of providing mortgage credit are significant. Maintaining the narrow 3% cap for a smaller loan, for example, loans under $150,000, could lead to less competition, reduced access to credit, or a lack of availability of credit for lower dollar amount loans. A too narrow standard would therefore disadvantage low income and rural buyers and homeowners as lenders find it is not cost-effective to make low dollar amount mortgages. CFPB should therefore carefully balance both consumer access to credit and consumer protection on low dollar amount loans. NAR suggests that CFPB should start with a higher cap than the one included in the proposed rule and later readjust the cap as data on access to credit and costs accumulate.

MISCELLANEOUS COMMENTS

Expected, Seasonal, and Irregular Income. NAR recognizes the importance of allowing creditors to rely on expected, seasonal, and irregular income and urges that this flexibility be retained in the final rule. In this economy, many consumers rely on bonuses, seasonal, and commission income. Reasonable assumptions about counting these types of income provide crucial underwriting flexibility to avoid denying homeownership to the millions of consumers who do not receive a regular paycheck every two weeks.

Prepayment Penalties. NAR opposes all prepayment penalties and supports tight restrictions.

Safe Harbor for Balloon Mortgages for Rural and Underserved Areas. NAR supports the proposal to allow balloon mortgages in rural and underserved areas by qualified creditors.

Exclusion of Credit Transactions Secured by Vacant Land. NAR supports the proposal to limit coverage of the ability-to-repay requirements to dwellings and not vacant land. Purchasers of vacant land are not typical consumers requiring the protection of this rule.

---

[10] Building cost into the rate, an option discussed in the preamble, could be a risky option since the lender could face charges of discrimination and redlining.

[11] Section 129C(b)(2)(D) of TILA, added by section 1412 of the Dodd-Frank Act.

CONCLUSION

NAR's recommendations set forth in this letter are guided by our objective of achieving a reasonable balance among competing interests. We note that balance is critical if the impact of the final rule is to avoid denying or delaying credit to millions of creditworthy borrowers, especially first time and minority homebuyers who, especially in today's mortgage market, face the most daunting challenges to achieving the American dream of sustainable homeownership.

If you have any questions, please feel free to let me know or contact Jeff Lischer, NAR Managing Director for Regulatory Policy, 202.383.1117 or Jlischer@realtors.org.

Sincerely,

Ron Phipps, ABR, CRS, GRI, GREEN, e-PRO, SFR
2011 President, National Association of REALTORS®