Memorandum

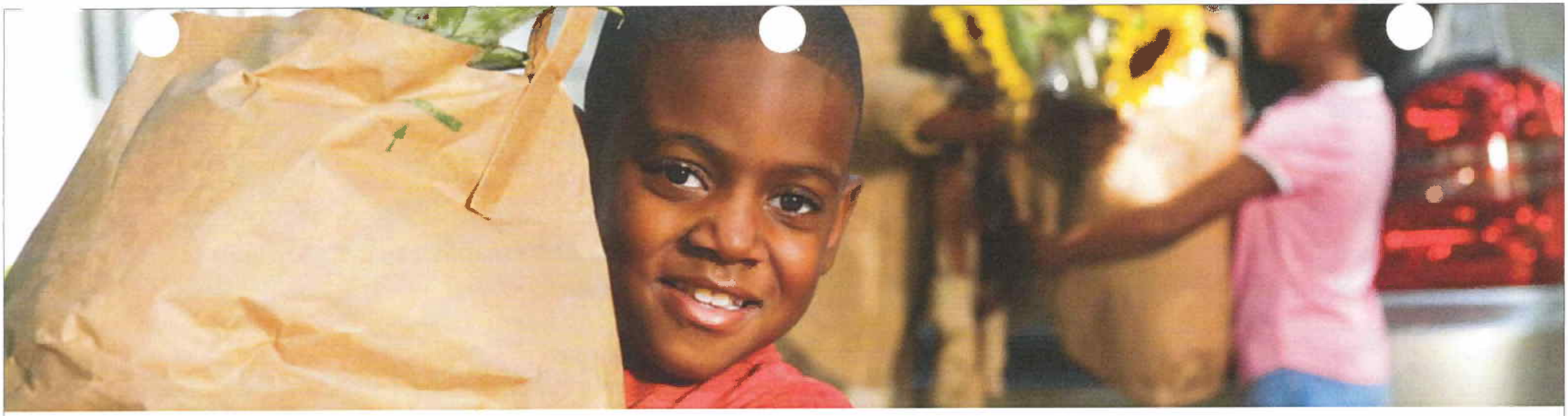
To: Public File – The Federal Reserve Board’s Notice of Proposed Rulemaking: Ability to Repay under Regulation Z and defining Qualified Mortgages (12 C.F.R. Part 226; RIN 7100-AD75).

From: FDIC Staff

Date: February 28, 2012

Subject: Meeting with Mortgage Bankers Association

On February 28, 2012, FDIC management (Jonathan Miller, Luke Brown, Kieth Ernst, and Karyen Chu) and staff (Janet Gordon, Richard Foley, Michael Briggs, Sandra Barker, and Kathleen Keest) participated in a meeting with representatives from the Mortgage Bankers Association (David H. Stevens, Tamara I King, Stephen A. O'Connor, Kevin Christopher Pezzani, Lisa I. Klika, Shawn M Krause, Michael C Fratantoni, Samuel B. Morelli, Sr., Philip F. DeFronzo, Michael Joseph McQuiggan, Joshua A Weinberg, Kyung H. Cho-Miller, Michael S. Malloy, Kenneth A Markison, Nathan J. Burch, Lawrence Daniel Moss, and Hollis Beckner). The Mortgage Bankers Association representatives presented their concerns about the Qualified Mortgage definition in the Ability to Repay Rule (Regulation Z) proposed for comment pursuant to the Dodd-Frank Act by the Federal Reserve Board on April 19, 2011. Rulemaking authority under the Truth in Lending Act transferred to the Consumer Financial Protection Bureau (CFPB) on July 21, 2011. The CFPB is required under the Dodd-Frank Act to consult with FDIC on this rulemaking.



Ensuring Housing Recovery

The Challenge of the Ability to Repay and Qualified Mortgage Rule to Credit Availability and Affordability for Homeowners

MORTGAGE BANKERS ASSOCIATION®
Investing in communities

Tuesday, February 28, 2012

Why Are We Here

The to Repay/Qualified Mortgage (ATR/QM) Rule is scheduled to be issued in final form in April.

- We would appreciate your support to ensure the rule includes bright lines and does not unduly tighten and increase the costs of credit.
- This requires:
  - + Establishment of safe harbor or similar bright-line means to define the QM
  - + Three percent limit in QM be revised appropriately
- Bureau of Consumer Financial Protection (CFPB) can establish these provisions by regulation.
- In event regulations do not address our concerns, we will need your support to revise the rule.
- Legislation:
  - + Has been introduced requiring the establishment of QM safe harbor.
  - + Is pending to revise the three percent limit.

Today's Presentation Covers

I. Difference between QM and Qualified Residential Mortgage (QRM)

II. New liability surrounding QM

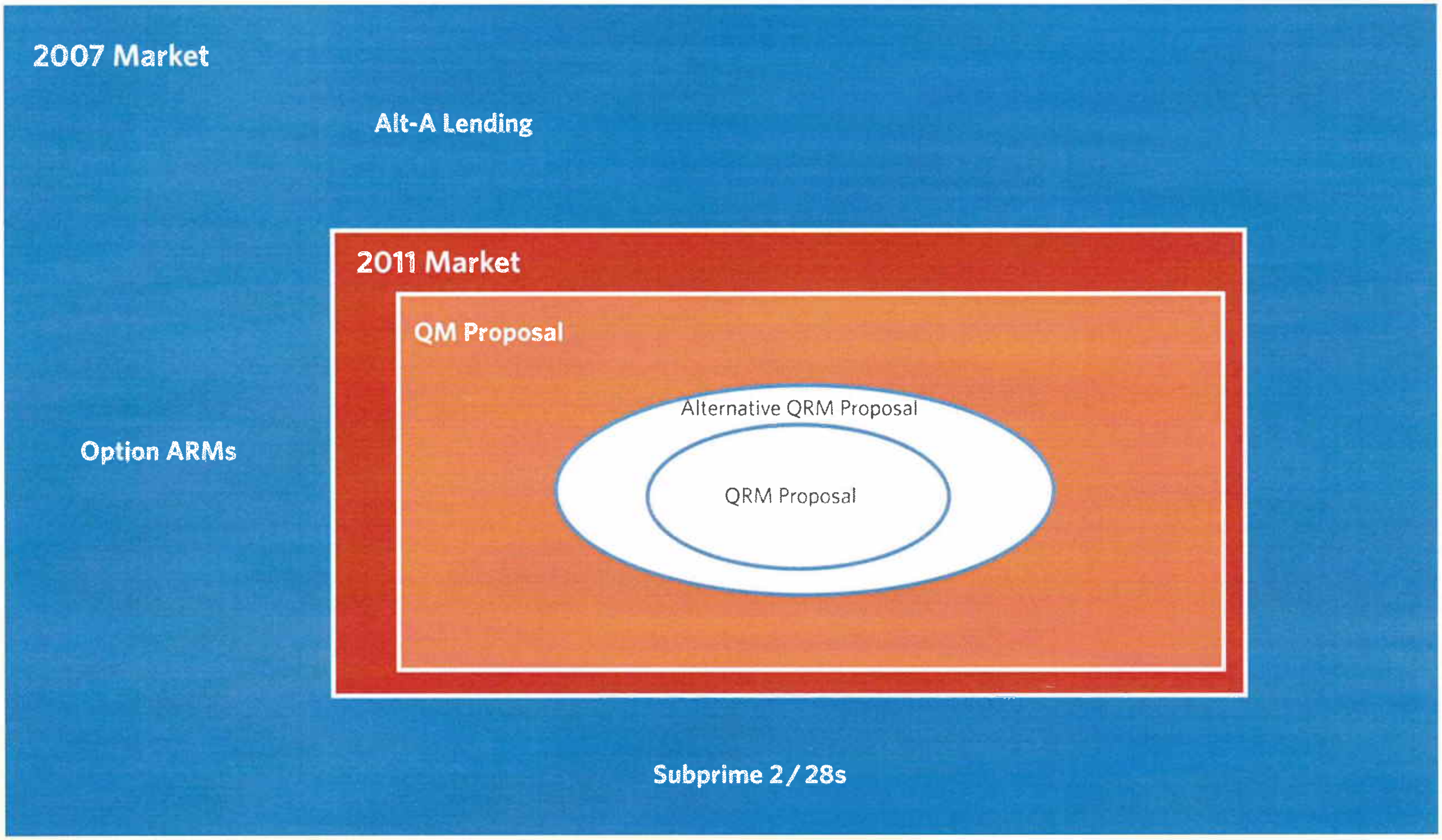
III. What Ability to Repay/QM Proposal is:

- Safe Harbor v. Rebuttable Presumption
    - + Both provide judicial remedy
- Three percent points and fees limit

IV. Coalition's concerns about availability and affordability of credit under QM proposed rule

Today's Credit Market is Very Tight and New ATR/QM Rule Will Make It Tighter

Market Has Already Pulled Back to Safer Products



Tuesday, February 28, 2012

QM Is Not a QRM

QM

- Fed issued proposal, CFPB will finalize in April
- Means of complying with Ability to Repay requirement under Title XIV of Dodd-Frank
- Applies to loans beyond those that are securitized
- Includes product and underwriting standards to meet QM but not numerical requirements, for down payment, LTV, DTI
- If not carefully conceived will affect credit availability and affordability

QRM Is Not a QM

QRM

- Proposal issued by six agencies, final rule likely after QM
- Exception to five percent risk retention requirement under Title IX of Dodd-Frank
- Applies to securitized loans
- Proposes hard-wired numerical 20 percent down payment, 80 percent LTV for purchase (75 and 70 for refis) and 28 and 36 DTI requirements
- As proposed, will unduly restrict credit availability and affordability

Four Ways to Comply with Ability to Repay, Including QM Proposal

1. **Originating mortgage loan after considering and verifying eight factors,** including consumer's:

   (a) current or reasonably expected income

   (b) employment status, if creditor relies on income from consumer's employment

   (c) monthly payment on mortgage based on fully indexed rate and amortizing payments that are substantially equal

   (d) monthly payment on any simultaneous loan creditor knows or has reason to know will be made

   (e) consumer's monthly payment for mortgage-related obligations

   (f) consumer's current debt obligations

   (g) consumer's monthly DTI ratio or residual income

   (h) consumer's credit history

Four Ways to Comply with Ability to Repay (Continued)

Safe Harbor Alternative

2. **Originating "Qualified Mortgage" (QM).** Proposes alternative definitions of QM with different degrees of protection from liability:

   ***Alternative A*: Legal safe harbor** — To qualify as QM a loan must not have certain product features including:

   (a) negative amortization, interest-only or balloon payments, or loan term exceeding 30 years

   (b) total points and fees exceeding three percent of loan amount (with alternative thresholds proposed for smaller loans) and

   (c) *must be* underwritten: based on maximum interest rate in first five years

   (d) *must be* underwritten: using payment schedule that fully amortizes loan over loan term

   (e) *must be* underwritten: taking into account any mortgage-related obligations

   (f) Also requires creditor *must*: consider and verify income or assets of consumer

Four Ways to Comply with Ability to Repay (Continued)

QM Rebuttable Presumption and Other Alternatives

2. **Originating "Qualified Mortgage" (QM).** Proposes alternative definitions of QM with different degrees of protection from liability:

   ***Alternative B*: Rebuttable presumption of compliance** — To qualify as QM *must* meet requirements in Alternative A and creditor *also must* consider and verify consumer's:

   (g) employment status

   (h) monthly payment for any simultaneous mortgage

   (i) current debt obligations

   (j) monthly debt-to-income ratio or residual income

   (k) credit history

3. **Originating "Balloon Payment" QM**

4. **Moving borrower from standard to non-standard product**

Significant Liability for Failing to Meet Ability to Repay

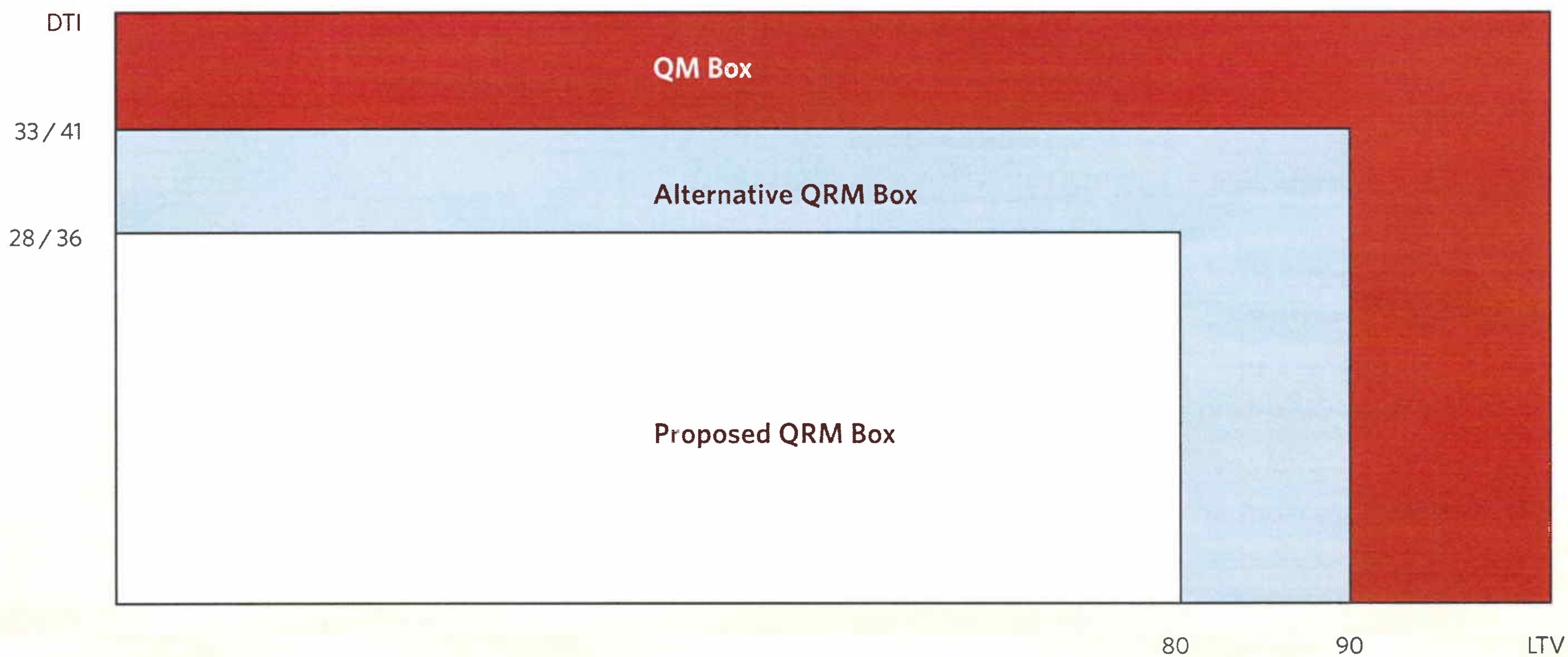
- **Sec. 1411 of Dodd-Frank** — Prohibits creditors from making mortgage loan without reasonable and good faith determination of consumer's ability to repay loan
- **Sec. 1412** — Allows creditor to presume loan meets ability to repay requirement if loan is QM
- **Sec. 1413** — Allows consumer to assert violation of ability to repay by creditor in foreclosure action by creditor, assignee or other mortgage holder
- **Also under TILA** — Mortgage creditor who fails to comply with the ability to repay requirements may be liable for (1) actual damages; (2) up to three years of finance charges; and (3) court costs and reasonable attorneys' fees

How QM Is Structured Is Key

- Main issue :
  - + Safe harbor v. rebuttable presumption — both provide court remedy
  - + Bright line v. subjective
- Consumers want access to credit at the lowest possible rate.
- Lenders need to meet needs of consumers and investors while complying with applicable statutes and earning reasonable rate of return.
- Investors want predictable performance with no hidden liability risks.
- The economy functions best when consumers, lenders and investors all can satisfy their needs.
- All of this requires QM rule that includes rigorous but clear bright-line standards to minimize uncertainty and legal risk for lenders as well as investors and assures legal remedy and maximum access to affordable credit for borrowers.
- Industry supports more rigorous standards for safe harbor than proposed.

Going Forward — How QM is Established Will Determine Credit Availability and Affordability for Families

Impacts on Market Liquidity



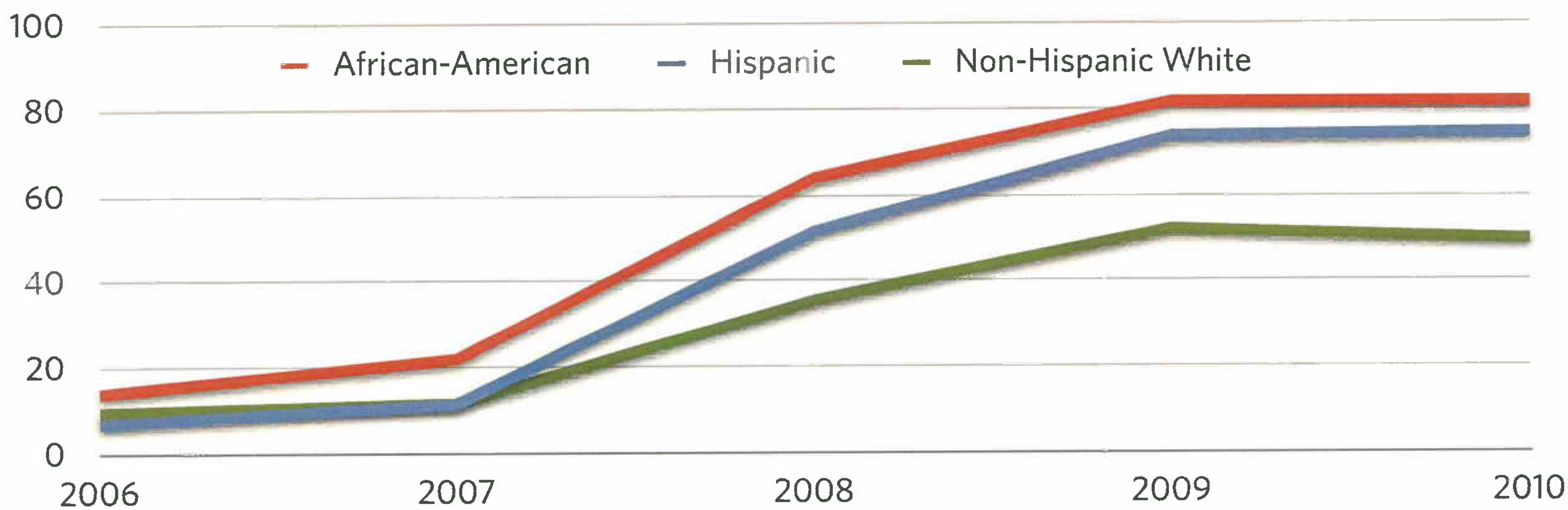
Note: Lenders typically will not lend outside the QM boundary.

Without bright-line safe harbor, lenders may retreat to the perceived safety of the QRM box.

Wrong QM Choice Would Further Stress Government Lending

Borrowers of Color Use Government Lending to a Greater Extent

Government[a] Share of Home Purchase Loans by Borrower Characteristic

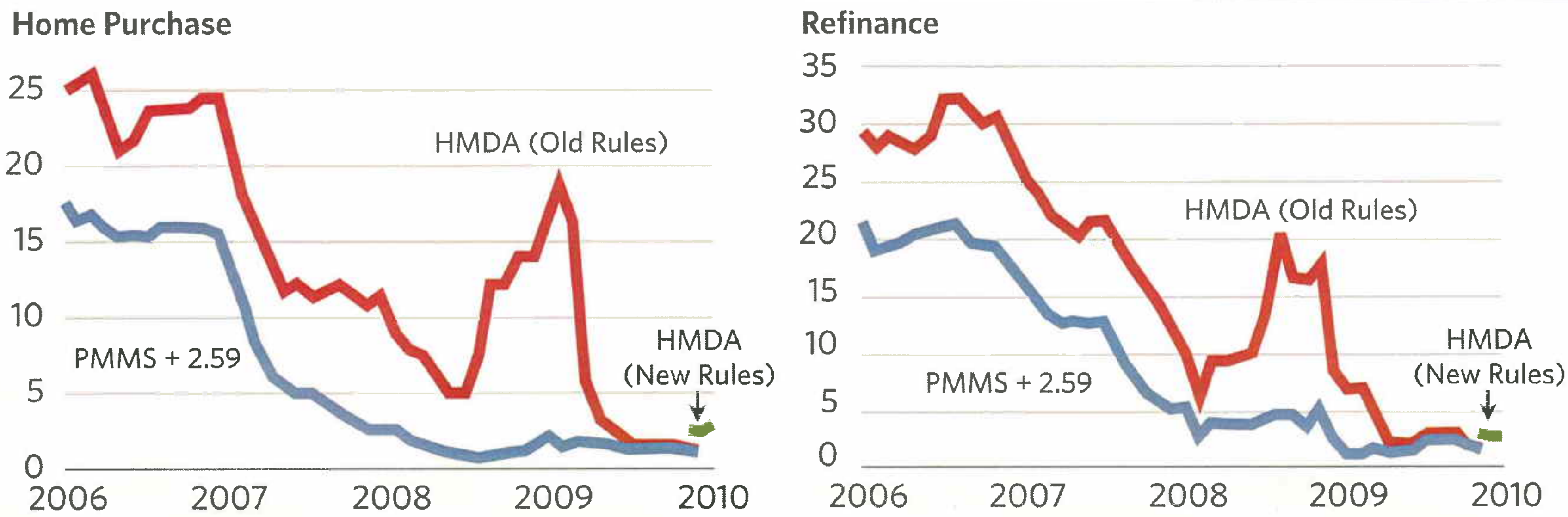


a. FHA, VA, USDA. *Source:* Federal Reserve Analysis of HMDA data.

- HMDA data show that borrowers of color have already heavily been using government housing programs such as FHA in recent years.
- For example, 81.6 percent of African-American borrowers used a government program to finance the purchase of a home in 2010.
- FHA and other government programs may establish their own QM standards but have not yet.
- Without workable QM standards under this or other rules, there will be even more pressure for FHA to fill the needs of underserved borrowers.

Higher-Priced Lending Has Been Limited Since New Rules

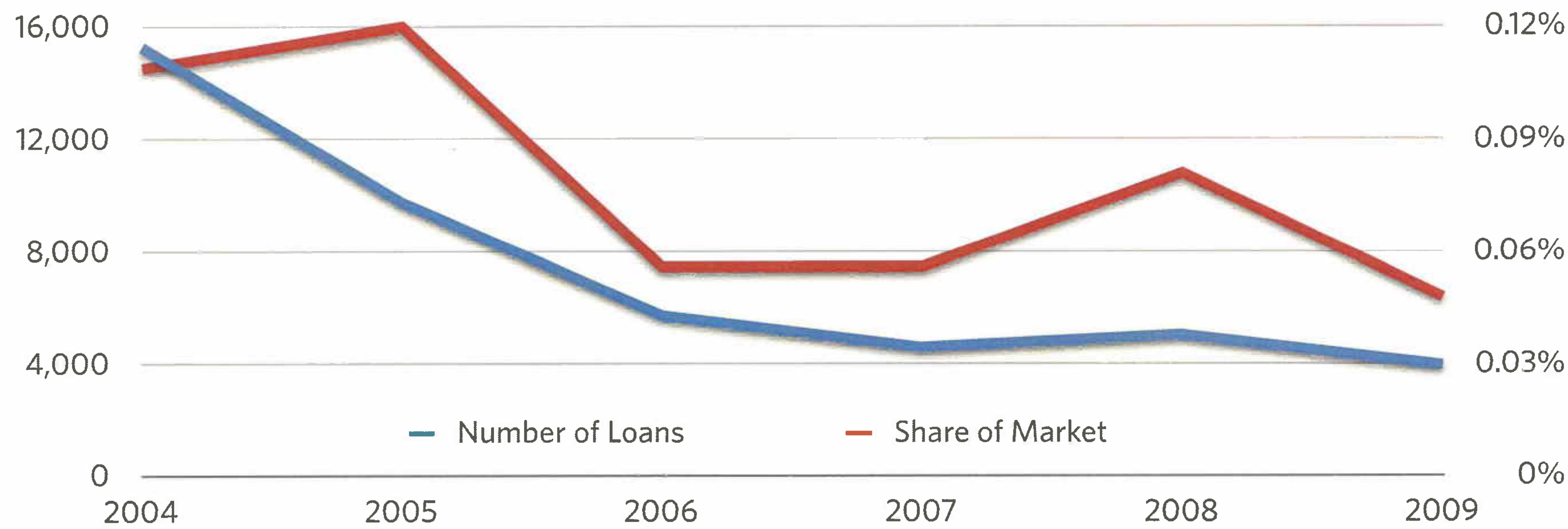
Higher-Priced Share of Lending, by Annual Percentage Rate Threshold, 2006-2009



Note: The data are monthly. Loans are first-lien mortgages for site-built properties and exclude business loans. Annual percentage rates are for conventional 30-year fixed-rate prime mortgages. PMMS = Freddie Mac Primary Mortgage Market Survey. HMDA = Home Mortgage Disclosure Act.
Source: Avery et al, 2010, Federal Reserve Bulletin.

- The Federal Reserve has implemented new rules for "higher-priced lending" — for first mortgages, 150 bps over the Average Prime Offer Rate.
- These rules establish "rebuttable presumption" that ability to repay is satisfied for loans if certain requirements are met.
- Before the rules were issued, share of higher-priced lending peaked above 25 percent in 2006, but has since fallen to well below five percent.

High Cost or HOEPA Loans Barely Exist



- High-cost or HOEPA loans expose lenders and assignees to considerable legal and financial risks.
- These loans have generally accounted for less than 0.1 percent of the market.
- The severity of the ATR penalties would have a similar impact.
- Lenders will be unable to serve many borrowers unless there are bright-line protections such as in a bright-line safe harbor.

Safe Harbor v. Rebuttable Presumption

Safe harbor

- Provides borrower judicial remedy
- Demands establishment of clear standards
- Appropriately focuses litigation on whether requirements have been met and more efficiently resolves disputes
- Less costly for lenders and borrowers
- Better incents compliance
- Encourages secondary market investment

Rebuttable presumption

- Also provides borrower judicial remedy
- More protracted litigation, increasing risks and costs
- Takes pressure off of establishment of clear standards
- Boundaries to inquiry less defined
- Gives little certainty to investors
- Likely causes retreat to more conservative QRM standards

NOTE: A safe harbor loses its effectiveness if it is not well drafted or is subjective.

QM Includes Three-Percent Limit on Points and Fees

- **Limit:** QM's "points and fees" may not be in excess of three percent of the loan amount. As currently drafted, in addition to fees to lenders and mortgage brokers, points and fees may include:

  (1) charges to title companies affiliated with lenders and others

  RESPA & TILA calc

  9

  (2) salaries paid to loan originators (LO)

  (3) amounts of insurance and taxes held in escrow

- **Smaller loans:** Proposal would also increase points and fees for smaller loans defined as those under $75,000 up to five percent on a sliding scale with five percent limit for loans under $15,000.

- **Comment:** There is no clear data that points and fees limits belong in QM requirements — points and fees, at least at these amounts, have no bearing on risk.

Inclusion of Affiliate . ees In Three Percent QM Limit Hurts Borrowers and Market

- Lenders and others have affiliated settlement service providers — 26 percent market share in 2006.
- Affiliate arrangements add efficiencies to loan process, including by providing dependable service providers.
- Consumers like one-stop shopping.
- Under RESPA, affiliate relationships must be disclosed to consumer and use may not be required.
- Lenders have little room to augment fees through affiliates.
- Title insurance rates are filed or regulated at state level.
- Based on experiences in the State of Kansas, title rates will climb if affiliates are excluded, and consumers will be harmed.
- All third-party fees should be treated the same to avoid market interference.

Inclusion of LO Comp and Escrows in Three Percent Limit: Unworkable and Unfair

- Fees to lenders and brokerage firms are included in three percent
- Includes compensation in the form of bonuses, which is impossible to ascertain at settlement
- Counting both fees to company and individual employee compensation involves double counting
- Loan Officer Compensation (LO Comp) was addressed in 2011 rule
- Limiting LO Comp unduly limits service to borrowers, especially the underserved
- LO inclusion also threatens to constrain virtually all transactions
- Escrows for insurance and taxes may also be included
- Homeowners insurance may be included, too
- All of these fees are pass-throughs that do not go to lenders and should be excluded

Nearly Half of Loans are under $150,000 and QM Three Percent Limit Should Be Adjusted Accordingly

Distribution of Loan Sizes from *MBA's Weekly Applications Survey,* First Half of 2011

Purpose	Loan Balance	Share
Purchase	<=75K	12.0%
Purchase	>75K and<=100k	10.6%
Purchase	>100K and<=125k	10.2%
Purchase	>125K and<=150k	10.7%
Purchase	>150K and<=175k	8.7%
Purchase	>175K and<=200k	8.2%
Purchase	>200K and<=250k	11.1%
Purchase	>250K and<=300k	8.2%
Purchase	>300K and<=417k	12.7%
Purchase	>417K	7.7%

Purpose	Loan Balance	Share
Refinance	<=75K	10.1%
Refinance	>75K and<=100k	11.9%
Refinance	>100K and<=125k	11.9%
Refinance	>125K and<=150k	11.5%
Refinance	>150K and<=175k	9.5%
Refinance	>175K and<=200k	8.2%
Refinance	>200K and<=250k	11.6%
Refinance	>250K and<=300k	8.2%
Refinance	>300K and<=417k	11.8%
Refinance	>417K	5.2%

- More than 43 percent of purchase loans in the first half of 2011 had balances below $150K.
- Only 12 percent had balances below $75K.
- Under the proposed rule, loans of up to $200K could be adversely impacted by the three percent limit while only loans <$75K would gain any relief.

Comparison of QM Costs to 3 Percent Rule

	$75,000 and below	$75,000-100,000	$100,001-$125,000	$125,001-$150,000	$150,001-$200,000	$200,001-$250,000	$250,001-$300,000	$300,001-$350,000	$350,001-$417,000	> $417,000
All in	100%	95%	76%	49%	23%	10%	7%	5%	3%	1%
Title out	99%	89%	57%	35%	16%	7%	5%	4%	2%	1%
Title and LO Comp out	89%	43%	26%	16%	8%	4%	3%	2%	2%	1%

- Data from a major lender shows that most loans under $200,000 would exceed the three-percent limit if title and employee compensation are included ("all in"). This would make these loans unavailable, or in some cases, only available at increased rates.
- However, even if only affiliated title costs are included, a large portion of loans under $150,000 would exceed the limit and if these loans were available, their rates would increase.
- The decreased availability and increased costs of loans resulting from three-percent limit will fall on low- and moderate-income homebuyers who purchase lower-valued properties and have smaller loans.

What if Amounts in Excess of Three-Percent Limit Go Into Rate?

Prior to regulation, consumer received a loan as follows:

$150,000 loan

4.0% rate, 4% points and fees ($6,000)

Monthly P + I payment: $716

Total payments over life of loan: $257,804

But in order to qualify as a QM under new regulation, any fees in excess of three points would get pushed into the rate as follows:

$150,000 loan

4.25% rate, 3% points ($4,500) in costs

Monthly P + I payment: $738

Total payments over life of loan: $265,648

- Be fore three percent limit, consumers who planned to stay in the property for a long time could rationally choose to pay all their points and fees upfront to lower their payments over the life of the loan.

- With the three-percent limit, a borrower might only have the choice of a higher-rate loan with a higher monthly payment, making payments less affordable.

- Under this example, the new regulation would "save" the borrower $1,500 in up-front costs at closing, but actually cost the borrower $7,800 in higher payments.

NOTE: Significant increases in rate may trip higher-priced loan trigger.

These Rules Will Apply for a Generations

FHLMC: 30-Year Fixed-Rate Mortgages, U.S.

Source: Freddie Mac.

- Choices made today, when rates are at four percent, will be in place for a generation.
- When rates return to more typical levels, 6-7%, or even higher (if rates reach early 1980s levels), affordability and point/rate tradeoff will be much more challenging for consumers.

What a Final Rule Should Be

The proposed rule can and should be finalized in a way that:

- Is not harmful to consumers;
- Does not unnecessarily limit or restrict access to credit for qualified borrowers; and
- Provides bright-line standards to ensure compliance and protect consumers

For More Information Please Contact

Ken Markison
Regulatory Counsel
Mortgage Bankers Association
(202) 557-2930

Mike Fratantoni
Research and Economics
Mortgage Bankers Association
(202) 557-2935

MORTGAGE BANKERS ASSOCIATION®
Investing in communities

1717 Rhode Island Ave., NW, Suite 400
Washington, DC 20036
www.mortgagebankers.org