

**Comments submitted by the
Center for American Progress¹
Center for Responsible Lending²
Consumer Federation of America³
National Council of La Raza⁴**

**to the Consumer Financial Protection Bureau
RE: Ability to Repay Standards under the Truth in Lending Act (Regulation Z)**

**Docket No. CFPB-2013-0002
RIN 3170-AA34**

February 25, 2013

Thank you for the opportunity to submit comments concerning the Consumer Financial Protection Bureau's (CFPB) proposed rulemaking released concurrently with a final regulation on the Ability to Repay standards under the Truth in Lending Act (Regulation Z).

The concurrent proposal addresses two issues that we believe are critical to the future of safe, sustainable, and affordable access to mortgage credit. First, it considers how to define compensation

¹ The Center for American Progress (CAP) is a progressive, nonpartisan think tank dedicated to improving the lives of Americans through ideas and action. CAP's housing team aims to preserve access to credit for all communities, prevent foreclosures, stabilize neighborhoods, and provide access to affordable, safe, and energy efficient rental housing. CAP also convenes the Mortgage Finance Working Group, which brings together experienced housing finance experts, affordable housing advocates, and leading academics to collaborate on policies related to the future of the U.S. mortgage finance system.

² The Center for Responsible Lending (CRL) is a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, one of the nation's largest nonprofit community development financial institutions. Self Help has provided \$6 billion in financing to 70,000 homebuyers, small businesses and nonprofits and serves more than 80,000 mostly low-income families through 30 retail credit union branches in North Carolina, California and Chicago.

³ The Consumer Federation of America (CFA) is a nonprofit association of some 300 national, state and local pro-consumer organizations created in 1968 to represent the consumer interest through research, advocacy, and education

⁴ The National Council of La Raza (NCLR) is the largest national Hispanic civil rights and advocacy organization in the United States and is a private, nonprofit, nonpartisan, tax exempt organization that works to improve opportunities for Hispanic Americans. NCLR serves all Hispanic subgroups in all regions of the country and has regional offices in Chicago, Los Angeles, New York, Phoenix, and San Antonio. Through its network of nearly 300 affiliated community-based organizations, NCLR reaches millions of Hispanics each year in 41 states, Puerto Rico, and the District of Columbia. To achieve its mission, NCLR conducts applied research, policy analysis, and advocacy, providing a Latino perspective in five key areas--assets/investments, civil rights/immigration, education, employment and economic status, and health. In addition, it provides capacity building assistance to its Affiliates who work at the state and local level to advance opportunities for individuals and families.

for the purpose of calculating the points and fees cap contained in the qualified mortgage definition. Second, it proposes a series of exemptions for specialized lending programs and financial institutions that play an important role in ensuring broad access to safe and affordable credit. We will comment on both of these aspects of the concurrent proposal in turn.

I. Defining Compensation for the Qualified Mortgage Points and Fees Cap

The CFPB's proposal on how to define "compensation" under the Qualified Mortgage (QM) and Home Ownership and Equity Protection Act (HOEPA) definitions has large consequences for the future of mortgage lending and consumer protections. Unfortunately, the CFPB's proposal includes options that would undermine the mortgage reforms in the Dodd-Frank Wall Street Reform and Consumer Protection Act and lead to unnecessary complexity. We encourage the CFPB to adopt the recommendations in this comment to ensure that the QM and HOEPA provisions protect consumers instead of creating incentives for lenders to make opaque transactions that double charge consumers.

The CFPB's concurrent proposal offers two alternate options for calculating loan originator compensation as part of the points and fees definition for QM and HOEPA loans. These options offer different methods for calculating the total points and fees in transactions where a creditor simultaneously obtains upfront payments from a borrower and also makes "back-end" payments to either the creditor's own loan officer or to a mortgage broker. The so-called "additive" approach would include both yield spread premium payments (YSPs) to mortgage brokers and commission payments to retail loan officers in the points and fees definition. The so-called "offsetting" approach would allow lenders to partially or fully exempt YSPs to brokers and commissions to retail loan officers.

We recommend that the CFPB adopt neither of these alternatives as drafted, because they do not differentiate between YSP compensation to brokers and commission payments to retail loan officers. Instead, we recommend the following:

- **Include YSPs in Points and Fees:** The CFPB should provide additional guidance stating that all YSPs paid to mortgage brokers are included as compensation in the points and fees calculation. In adopting the "additive" approach for YSPs, the CFPB should specify that YSPs are counted as points and fees in transactions where the borrower pays upfront costs to the creditor and the creditor also pays the mortgage broker a YSP.
- **Exclude Retail Loan Officer Commissions from Points and Fees:** Second, the CFPB should use its authority under TILA § 105(a) and exclude all compensation paid to individual employees of both mortgage brokers and retail lenders from the points and fees calculation. The CFPB already proposes to fully exempt compensation paid to individual mortgage broker employees, and this approach should also be extended to individual retail loan officers. As a result, the CFPB should reject both of the proposed alternatives as they apply to retail loan officer commissions. If the CFPB does not adopt this recommendation, we recommend the "offsetting" approach for retail

transactions to provide partial parity where payments to individual mortgage broker employees are exempted.

If the CFPB were to partially or fully exclude YSPs from points and fees, this would create a giant loophole in the definition for QM and HOEPA loans. In essence, it would allow too many loans to count as QM and too few loans to count as HOEPA. Furthermore, it would provide incentives for brokers to sell mortgages that combine upfront payments to creditors with YSPs rather than loans where borrowers simply pay brokerages upfront, and therefore affirmatively promote the origination of mortgages that are less transparent, more complex, and have been demonstrated to be more expensive. Because brokers get to choose who they do business with, they can choose to promote loans that have this complicated structure and choose to originate for lenders that provide the highest YSP compensation back to them, to the detriment to borrowers.

Because of differences between wholesale and retail channels, the same risks are not posed by exempting retail loan officer commissions from the points and fees definition, along with brokerage employee compensation. Instead, this exception would facilitate the ability of creditors to comply with the QM and HOEPA reforms included in the Dodd-Frank Act and put them on a more equal plane with the wholesale channel.

A. Background

The use of yield spread premiums to push borrowers into higher cost mortgages was a key part of the subprime crisis that stripped wealth from many lower-income borrowers and borrowers of color. Because transactions using YSPs are more complex and, therefore, less transparent, borrowers found themselves in loans where they essentially paid the broker twice – first through upfront fees and second through an increased interest rate that provided the funds for the lender to make a backend payment. Putting vulnerable borrowers in more expensive loans may have resulted in greater returns for mortgage brokers, but it left many homeowners with mortgages designed for failure.

This rulemaking is far from the first to address the regulatory treatment of YSPs. Before the Dodd-Frank Act and the creation of the CFPB, both HUD and the Federal Reserve Board underwent multiple YSP rulemakings seeking to better protect consumers. These rulemakings initially focused on YSP disclosures, until the Federal Reserve took rulemaking action to substantively regulate when brokers could earn YSPs. Now the CFPB is in the process of implementing final rulemaking action on how YSPs are treated under the Qualified Mortgage and HOEPA reforms put in place by the Dodd-Frank Act.

It is essential for the CFPB to get this rulemaking right and to include YSPs in the definition of points and fees, because this will prevent future incentives to steer borrowers into more expensive loans. To highlight the importance of this outcome, this section first details the complexity of YSPs and how they result in borrower confusion. Second, it explains why the anti-steering rules and prohibition on compensation that is based on loan terms will not eliminate incentives for brokers to steer borrowers

into more expensive loans. Third, it examines why mortgage brokers and the use of YSPs pose a unique steering risk that is different from transactions made through retail loan officers.

1. YSPs are complex and cause extreme consumer confusion about the real price of loan origination, particularly when paired with upfront payments.

Compensation for the loan originator is one of the costs associated with originating a loan. When a broker is involved, borrowers have three ways to pay the fee: (1) in cash directly to the broker; (2) by increasing the loan amount and paying the fee from loan proceeds; or (3) by agreeing to pay a higher interest rate on the loan, and the lender in turn pays the broker's fee from the expected stream of income generated by that increased interest rate. That form of broker's fee is known as a yield spread premium. The underlying premise of a YSP – and the resulting increased interest rate – is that the YSP serves as a substitute for the borrower paying the broker in cash upfront. In theory, mortgage brokers should receive the same amount of compensation when paid through a YSP as when they are paid upfront by the borrower, and should not care where they get their money from.

Borrowers attempting to evaluate the cost of a loan that includes a YSP face two distinct types of complexity, both of which are implicated in the CFPB's proposed rulemaking at issue here. First, YSPs, standing alone, are "complex and may be counter-intuitive even to well-informed consumers."⁵ The inclusion of a YSP in a mortgage transaction requires borrowers to evaluate complicated tradeoffs between paying a higher interest rate for the period of time they expect to be in a loan or more cash up front. However, studies have repeatedly shown and regulators have concluded that the vast majority of borrowers are unable to accurately evaluate the cost of a loan involving a YSP.

For example, after a years' long rulemaking process on YSPs that involved extensive consumer testing, the Federal Reserve Board concluded that the majority of consumers "did not understand yield spread premiums" and were therefore "not equipped to police the mortgage market to ensure that yield spread premiums are in fact applied to reduce their closing costs."⁶ Based on its consumer testing, the Board also concluded that the gaps in consumer comprehension were too extreme to be addressed by any type of disclosure.⁷ Disclosures simply did not work. This conclusion led to the Board's substantive reforms, which are discussed in the next subsection.

In a separate proposal, the CFPB has also acknowledged the difficulties borrowers have in understanding the tradeoffs involved in transactions with YSPs. In its efforts to create an Integrated Mortgage Disclosure, the CFPB stated that "the Bureau believes that consumers may not benefit from any additional disclosure of rate-based compensation when shopping for and considering the costs of a

⁵ Federal Reserve Loan Originator Compensation Rule, Truth In Lending (Regulation Z), 75 Fed. Reg. 58509, 58515 (Sept. 24, 2010) (hereinafter "Fed. Reserve 2010 Loan Originator Compensation Rule").

⁶ Fed. Reserve 2010 Loan Originator Compensation Rule, 75 Fed. Reg. at 58515-16.

⁷ *Id.* at 58515-16.

mortgage loan.”⁸ This led the CFPB to propose eliminating all YSP disclosures in the prototype Loan Estimate and Closing Disclosure,⁹ making it all the more important that YSPs be included in any calculation of points and fees.

Second, borrower confusion relating to YSPs is most extreme, and most detrimental to consumers, when a YSP is paired with a form of upfront payment from the borrower – whether upfront payments are to the broker or to the creditor.¹⁰ Research shows that homeowners end up paying far more when they must shop for multiple pricing variables – on both fees and rate – regardless of the quality of the disclosure.¹¹ Consumers are able to shop successfully for the cheapest loan only when the originator’s fee is either “all in” the rate, or “all out” of the rate, not when it is paid by a combination of the two. By contrast, borrowers who fund origination charges through a combination of a YSP and upfront cash pay as much as twice the origination costs, and in some cases nearly triple the costs, as borrowers who pay either through the interest rate or in cash, but not both.¹²

The higher costs for these “paying twice” transactions is significant here in light of the CFPB’s decision to use its exception authority to permit backend creditor payments to brokers, even when the borrower is also paying upfront creditor origination fees. While brokers remain prohibited from receiving a

⁸ Integrated Mortgage Disclosures Under the Real Estate Settlement Procedures Act (Regulation X) and the Truth in Lending Act (Regulation Z), Proposed Rule, 77 Fed. Reg. 51116, 51210 (Aug. 23, 2012).

⁹ *Id.*

¹⁰ See Fed. Reserve 2010 Loan Originator Compensation Rule, 75 Fed. Reg. at 58515 (“Consumers’ lack of comprehension of yield spread premiums is compounded where the originator also imposes a direct charge on the consumer.”); see also James M. Lacko & Janis K. Pappalardo, Fed. Trade Comm’n, *Improving Consumer Mortgage Disclosure: An Empirical Assessment of Current and Prototype Disclosure Forms* at 121-23 (2007) (summarizing failure of current mortgage cost disclosures to adequately convey actual key mortgage costs to consumers), available at <http://www.ftc.gov/os/2007/06/P025505MortgageDisclosureReport.pdf>;

¹¹ See Susan Woodward, *Diagnosing Consumer Confusion and Sub-Optimal Shopping Effort: Theory and Mortgage-Market Evidence*, 102 *The Am. Economic Review* 3249 at pp. 2, 23-27 (Dec. 2012), available at <http://www.stanford.edu/~rehall/DiagnosingConsumerConfusionJune2012> (hereinafter “Diagnosing Consumer Confusion”) (finding that borrowers who pay a higher interest rate to fund origination charges pay slightly less than borrowers who pay all origination charges in cash, but that both groups of borrowers “pay far less than borrowers who use both types of funding in roughly equal proportion”); *id.* at 29-31 (finding that borrowers who fund origination charges through a combination of a YSP and upfront cash end up paying more than twice the origination costs as borrowers who pay either through the interest rate or in cash, but not both); see also Susan Woodward, *Consumer Confusion in the Mortgage Market*, at 2 (2003) (finding that consumers who try to combine two or more price components in home mortgage shopping pay more for their mortgages than consumers who are shopping on a single price component), available at http://www.sandhillecon.com/pdf/consumer_confusion.pdf; Dep’t of Housing & Urban Dev., Office of Policy, Dev. & Research, RESPA: Regulatory Impact Analysis and Initial Regulatory Flexibility Analysis, FR-5180_F-02: Final Rule to Improve the Process of Obtaining Mortgages and Reduce Consumer Costs, at 2-24 -- 2-43 (2008), available at <http://www.hud.gov/offices/hsg/rmra/res/impactanalysis.pdf> (discussing research finding that borrowers end up paying the most in transactions where the loan originator receives payment from both the homeowner and the lender).

¹² See Woodward, *Diagnosing Consumer Confusion* at 27-31.

combination of upfront costs paid directly to the broker and a YSP from the creditor, transactions with YSPs and upfront costs paid to the creditor are permitted under the CFPB's rule. Transactions with a combination of YSPs and upfront costs to the creditor involve the same complexity for borrowers as when both costs are paid to the broker.¹³

While recent legislative and regulatory reforms have addressed steering abuses, these provisions leave open the possibility of future abuses akin to those that occurred during the recent subprime lending crisis, particularly for minority borrowers.¹⁴ As is detailed below, including YSPs in the points and fees definition for QM and HOEPA is necessary to provide mortgage brokers with incentives to avoid transactions where the consumer "pays twice" for origination costs.

2. Other reforms will not prevent the potential harm from failing to include YSPs in points and fees.

In addition to this rulemaking, regulators have finalized two other rules to correct incentives that encouraged mortgage originators to steer borrowers into more expensive loans than they qualified for. First, the CFPB recently finalized loan originator compensation rules that implement provisions of Dodd-Frank. Both the statute and the CFPB's final rule build on a multi-year rulemaking finalized by the Federal Reserve Board in 2010. Second, in the same 2010 rulemaking, the Federal Reserve Board put in place anti-steering provisions; this portion of the Federal Reserve's rule remains in effect.

Both of these rulemakings are improvements that will limit incentives for both brokers and retail loan officers to put borrowers into deceptive and more expensive mortgages, but they do not eliminate incentives for mortgage brokers to steer borrowers into expensive subprime mortgages in the future.

As a threshold matter, it is important to note that these two regulations imposed some restrictions on YSPs but did not ban them. During the subprime lending crisis, many mortgage brokers could earn higher YSP payments from creditors if the borrower was placed in a higher interest mortgage than the borrower qualified for.¹⁵ This put the broker in a position to pick a borrower's interest rate, and the higher YSP was a big incentive to go with a higher rate. Under the CFPB's recent rule, mortgage

¹³ See *id.* at 7; Woodward, *Consumer Confusion in the Mortgage Market* at 9-13; Fed. Reserve 2010 Loan Originator Compensation Rule, 75 Fed. Reg. at 58527 ("even when originator compensation is disclosed, consumers typically do not understand its complexities or how it relates to pricing").

¹⁴ See Antje Berndt, Burton Hollifield and Patrik Sandas, *The Role of Mortgage Brokers in the Subprime Crisis*, Tepper School of Business, Paper 573 at 4 (2010), available at https://fisher.osu.edu/blogs/efa2011/files/REF_1_3.pdf; *Challenges to Building Sustainable Homeownership in Latino Communities*, Testimony of Janis Bowdler before the U.S. Senate Committee on Banking, Housing and Urban Affairs (March 22, 2007), available at http://www.nclr.org/index.php/publications/challenges_to_building_sustainable_homeownership_in_latino_communities/

¹⁵ Kathleen C. Engel & Patricia A. McCoy, *The Subprime Virus: Reckless Credit, Regulatory Failure & Next Steps*, p. 32 (Oxford Univ. Press 2011).

originators are not able to earn any compensation that is based on a term of the loan. This prohibits increasing compensation as a result of, for example, increased interest rates or adding a prepayment penalty to a mortgage.

The CFPB's loan originator compensation rule implements a provision in the statute that allows paying an originator based on the size of the mortgage itself.¹⁶ As a result, the way YSPs will function under the new rules is that creditors could pay a mortgage broker a percentage of the loan's principal – such as 2 percent of a \$200,000 mortgage. Although borrowers would have the option of paying compensation to brokers upfront, it is also permissible to increase the borrower's interest rate a sufficient amount to fund the YSP from the creditor to the broker. In other words, the YSP can be funded through the interest rate, but the amount of the YSP cannot be based on the rate itself.

The CFPB's loan originator compensation rule also retains the Board's 2010 prohibition on dual compensation so that borrowers cannot pay brokerages upfront when the brokerage also receives a YSP payment from the creditor, although, contrary to the earlier Board rule, the new CFPB rule does allow individual broker employees to receive commission payments. In addition, the CFPB exercised its exemption authority to permit the kinds of transactions at issue in this rulemaking – where the borrower pays upfront fees directly to the creditor and either the creditor pays a YSP to a mortgage broker or pays a commission to its individual loan officer depending on how the mortgage was originated.

Further, the CFPB's loan originator compensation rule leaves in place the Federal Reserve's anti-steering requirements. These requirements prohibit loan originators from steering individuals toward a particular loan because it results in higher compensation for the originator. They also provide a safe harbor for brokers who seek out loan options from “a significant number of the creditors with which the originator regularly does business” and to then disclose three different loan options to the borrower (the loan with the lowest interest rate, the lowest interest rate loan that also does not have harmful loan features and the loan with the lowest amount of points, fees and discount points).¹⁷ A “significant number” is defined as three creditors, unless the broker does business with fewer than three.¹⁸ This standard, however, does not require brokers to begin working with new creditors that pay lower levels of compensation and offer less expensive loans to borrowers,¹⁹ nor to select among the creditors with whom brokers do business, those three who provide the cheapest mortgages.

In fact, brokers have continued to steer borrowers to costlier loans despite similar or even more stringent restrictions, as evidenced by states that have imposed some sort of fiduciary or other duty on

¹⁶ See Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 § 1403, Pub. L. No. 111-203, 124 Stat. 1376, 2139 (July 21, 2010) (amending Section 129B of the Truth in Lending Act, 15 U.S.C. § 1639b(c)(1)).

¹⁷ See 12 C.F.R. § 1026.36(e)(3)(i).

¹⁸ 12 C.F.R. § 1026.36, Supplement I to Part 1026 – Official Interpretations, Subpart E, Comment 36(e)(3)-1.

¹⁹ 12 C.F.R. § 1026.36, Supplement I to Part 1026 – Official Interpretations, Subpart E, Comment 36(e)(1)-2(i).

brokers. North Carolina, for example, required brokers to provide a loan that was “reasonably advantageous to the borrower” from lenders “with whom the broker regularly does business.”²⁰ Other states had still stronger provisions in the form of a fiduciary duty for mortgage brokers, which required them to act **only** in their clients’ best interest.²¹

The continued ability of mortgage brokers to seek out business relationships with creditors that pay larger YSPs is significant, because it would allow mortgage brokers to specialize in subprime lending and not run afoul of these rules. This steering risk is unique to lending through mortgage brokers, and is explored in more detail in the next subsection.

3. The different roles and consumer perceptions of mortgage brokers warrant different treatment under the rules.

Mortgage brokers and retail loan officers are different. They have different structures, different incentives, different levels of legally required transparency, different relationships with borrowers (at least in the eyes of borrowers), and different abilities to legally circumvent other regulations. Both HUD and the Federal Reserve recognized these critical differences in prior rulemaking actions and differentiated between the compensation received in mortgage broker and retail transactions. Courts have similarly rejected legal challenges alleging that the HUD and Federal Reserve rulemakings were arbitrary and capricious in their differential treatment of mortgage brokers and retail lenders, in large part because the record of these differences is so well-established.²²

Accordingly, any definition of compensation needs to acknowledge and account for the differences between mortgage brokers and retail lenders in order to be effective. Currently, the CFPB has proposed official interpretations treating YSPs paid to brokers and commissions paid to retail loan officers the same – either they are both added to points and fees or both offset by upfront costs paid to the creditor. This approach incorrectly treats different kinds of compensation as equals. Instead, the CFPB should adopt rules tailored for mortgages made through retail and wholesale channels.

The first and foundational difference is that, unlike individual retail loan officers, mortgage brokerages are independent business entities that contract with creditors and are not employees of the creditor. As a result, a mortgage broker has its own structure, business plan, and proprietary systems that are not controlled by the creditor, which differs from retail loan officers who are subject to the creditor’s

²⁰ See N.C. Gen. Stat. § 53-243.10 (2002) (repealed and replaced by the North Carolina Secure and Fair Enforcement (S.A.F.E.) Mortgage Licensing Act of 2009, N.C. Laws S.L. 2009-374); see also N.M. Stat. Ann. § 58-21B-20(A)(5); Me. Rev. State tit. 9-A, § 10-303-A(1)(F).

²¹ Cal. Civ. Code § 2923.1(a) (providing that mortgage broker is “fiduciary” of the borrower); Wash Rev. Code § 19.146.095 (imposing “fiduciary duty” on mortgage broker to borrower).

²² See *Nat’l Ass’n of Mortgage Brokers v. Board of Governors of the Federal Reserve System*, 773 F.Supp.2d 151, 169-75 (D.D.C. 2011); *Nat’l Ass’n of Mortgage Brokers, Inc. v. Donovan*, 641 F.Supp.2d 8, 13-15 (D.D.C. 2009).

compensation policies and use the creditor's technology and systems.²³ Additionally, because they are a separate entity, mortgage brokers can either receive their compensation directly from the borrower or from the creditor, whereas individual retail loan officers can only receive compensation from their employer (i.e., the creditor).

A second difference is that mortgage brokers are able to control which creditors they work with,²⁴ whereas retail loan officers can only offer the loans available through their single employer.²⁵ The ability to choose their own business partners provides mortgage brokers with a selection bias incentive in favor of the highest-paying creditors. For example, if a lender offers a YSP of two percent of the purchase price rather than one percent, even if the loan is more expensive, the broker may direct the business in that direction. It also places mortgage brokers in a position of leverage to drive up compensation levels if creditors are competing for the opportunity to originate mortgages via brokers and are able pay YSP compensation without impacting the QM or HOEPA status of those mortgages. Incentives for brokers to steer borrowers to loans that maximize the broker's compensation are so strong and have, to date, proven so resistant regulatory intervention, that in 2010, the Federal Reserve prohibited mortgage brokerages from paying their own employee-loan officers a commission if the borrower was also making an upfront payment, but left creditors free to use commissions.²⁶

The behavior of lenders competing for broker business by paying higher YSPs results in a market situation where the best interest of consumers are not always placed at the forefront. This market reality was noted in a recent speech by Director Cordray, who stated that “[w]hen a market's central

²³ “Information received by the Bureau suggests that creditors, mortgage brokers, title companies, investors, and other mortgage technology providers use systems with proprietary data formats. As a result, data must be translated between formats as it is transmitted from one point to another throughout the mortgage loan origination process.” Integrated Mortgage Disclosures Under the Real Estate Settlement Procedures Act (Regulation X) and the Truth in Lending Act (Regulation Z), Proposed Rule, 77 Fed. Reg. 51116, 51186 (Aug. 23, 2012).

²⁴ Office of the Comptroller of the Currency, *Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans*, Advisory Letter 2003-3, 2003 WL 21479359, at *7 (February 21, 2003) (stating that “[n]ational banks should have written agreements with third-party brokers and originators that specifically and clearly address the rights and responsibilities of each party”) see also *Nat’l Ass’n of Mortgage Brokers*, 773 F. Supp. 2d at 158 (noting that “[m]ortgage brokers are independent financial professionals who work with consumers and lenders to obtain mortgage loans”).

²⁵ One area where the lines between the retail and broker channels could become blurred is with respect to subprime affiliates of prime lenders. We strongly encourage the CFPB to ensure that an affiliate structure cannot be used by a financial institution to evade the intention of any distinction between the two channels or to undermine existing anti-steering rules. CFPB should also ensure that commission structure remains consistent among different divisions of the same entity.

²⁶ *Nat’l Ass’n of Mortgage Brokers*, 773 F. Supp. 2d at 173

focus is on the nature of the financial relationship between two businesses, consumers can become collateral damage to the dynamics that actually drive the economics of such markets.”²⁷

In several areas of the mortgage business, products are marketed and selected business-to-business, even though it is the consumer who is paying for the product. In the case of mortgage brokers, they encourage borrowers to rely on them to select or recommend loans. However, the broker, when determining which lenders to work with, has incentives to select the lenders they pay the largest broker YSPs. Lenders who pay these larger YSPs must have more expensive loans to cover the cost of the large YSPs. Borrowers working with a mortgage broker that seeks out the highest compensation for itself is likely to be unaware of the market forces at play and that they are being offered more expensive loans because the lender offers the broker a higher YSP than other lenders.

This same dynamic drives the selection and pricing of other products -- forced-placed property insurance, title insurance, and mortgage insurance. These products are also selected business-to-business, though the consumer pays for these products. The business selecting the product seeks the greatest return for it from the business providing the product. The business selecting the product and seeking the return -- like the mortgage broker -- is the servicer in the case of forced-placed insurance, the lender or settlement agent in the case of title insurance, and the lender in the case of mortgage insurance. The providers of these products -- like the lender -- compete for business by offering not the lowest prices to the borrower, but the highest commission or other benefit to the business that selects the product. The prices for these products are in turn inflated to provide the revenue to pay these commissions. The consumers, who are paying for these products, absorb the collateral damage in the inflated prices that they end up paying.

Third, a mortgage broker’s relationship with a borrower is very different from that of a retail lender. Most critically, it is different in ways that, absent appropriate regulation, can be exploited to the detriment of borrowers.²⁸ When a borrower obtains a loan from a retail loan officer, she is generally aware that she is negotiating with the lender and that the parties are on opposite sides of the bargaining table. However, borrowers often perceive brokers as trusted advisors who are essentially their representative, much like an attorney.²⁹ This perception is widespread, but is also wrong. With the

²⁷ See Prepared Remarks by Richard Cordray, Consumer Advisory Board Mtg (Feb. 20, 2013), available at <http://www.consumerfinance.gov/speeches/prepared-remarks-by-richard-cordray-at-a-consumer-advisory-board-meeting/>.

²⁸ Studies also show that for borrowers who are in the subprime market and who may have less financial expertise, brokered loans are significantly more expensive than retail loans. Keith Ernst, Debbie Bocian, and Wei Li, *Steered Wrong: Brokers, Borrowers, and Subprime Loans*, at 14-16, Center for Responsible Lending (2008), available at <http://www.responsiblelending.org/mortgage-lending/research-analysis/steered-wrong-brokers-borrowers-and-subprime-loans.pdf>.

²⁹ For example, a national study of older borrowers in 1999 and 2000 found that seventy percent of borrowers with broker-originated refinance loans “relied ‘a lot’ on their brokers to find the best mortgage for them,” compared to only half of borrowers with lender-originated loans. See Kellie K. Kim-Sung & Sharon Hermanson, *Experiences of Older Refinance Mortgage Loan Borrowers: Broker- and Lender-Originated Loans*, Data Digest No. 83, 3 (AARP Public Policy Inst., Jan. 2003), available at http://assets.aarp.org/rgcenter/post-import/dd83_loans.pdf. This point was also highlighted by the Mortgage Bankers Association, whose members

exception of a few states, mortgage brokers have no fiduciary duty toward borrowers; for the most part, a broker's goal is to make money for him or herself by selling the loans to borrowers for which they will get paid the most by the lenders.

The tendency of borrowers to perceive a broker as a trusted advisor was confirmed by extensive consumer testing that the Federal Reserve Board conducted in connection with its review and consideration of loan originator compensation between 2006 and 2010. The Board began examining the practice of using yield spread premiums to compensate brokers in 2006. After several rounds of public hearings, the Board initially proposed a rule in January 2008 that attempted to address the lack of transparency and potential unfairness to consumers associated with yield spread premiums.³⁰ Among other things, the 2008 proposed rule sought to address consumers' tendency to view brokers as their agents by mandating agreements between brokers and borrower that disclosed the broker's conflict of interest and "prohibited a creditor from paying a mortgage broker any compensation greater than the amount that the consumer had previously agreed to in writing."³¹

In order to test the effectiveness of these disclosures, the Board engaged a firm to test the model language, with the expectation that consumer testing would help the Board revise and refine the disclosures. Instead, results of the consumer testing demonstrated that the disclosures were at best ineffective and at worst, counterproductive.³² Despite multiple rounds of consumer testing, where each round sought to address comprehension failures in the previous round, consumers repeatedly failed to understand that they needed to shop among multiple brokers in order to find the best mortgage, in large part because the idea that a broker would not work in their best interest was so counterintuitive.³³ As a result, "the Board withdrew the proposed provisions relating to broker compensation."³⁴

include both retail lenders and mortgage brokers, in a 2008 publication stating that "[c]onsumers working with mortgage brokers generally rely on the broker, as an intermediary with access to multiple mortgage bankers' products, to identify the best loan product(s) for them. Consumers expect that mortgage brokers are comparison-shopping on their behalf. Mortgage brokers frequently perpetuate this expectation by promoting themselves as 'trusted advisors,' even though brokers in most cases have no legal obligation to act in borrowers' best interests." *See Mortgage Bankers and Mortgage Brokers: Distinct Businesses Warranting Distinct Regulation*, Mortgage Bankers Ass'n (2008), available at <http://www.mbak.org/pdf/2008/Mortgage%20Bankers%20and%20Mortgage%20Brokers%20May%202008.pdf>

³⁰ 73 Fed. Reg. 1672, 1698-1700 (Jan. 8, 2008).

³¹ Mem. in Opp'n to Pls' Applications for Temporary Restraining Order and Preliminary Injunction at 8, Nat'l Ass'n of Mortg. Brokers v. Board of Governors of Fed. Reserve Sys., 11-cv-489 (March 18, 2011) (Dkt. No. 14).

³² Fed. Reserve 2010 Loan Originator Compensation Rule, 75 Fed. Reg. at 58511.

³³ The Federal Reserve's consumer testing found that the belief that a broker would "provide the best loans available" was so strong that borrowers appeared to experience a form of "cognitive dissonance"; even the borrowers who understood the disclosures regarding brokers' conflict of interest "did not seem to retain or focus on this information" and ultimately "reverted to what they had assumed prior to the interview[,] ... that the broker would provide the best loans available." *See Macro Int'l Inc., Consumer Testing of Mortgage Broker Disclosures* (July 10, 2008) at 18, available at <http://www.federalreserve.gov/newsevents/press/bcreg/20080714regzconstest.pdf>. Those disclosures that successfully communicated brokers' potential conflict of interest were nevertheless ineffective; the idea that "brokers receive more compensation for providing loans with higher interest rates ... was extremely counter-

A fourth difference is that mortgage brokers can structure their business in a way that maximizes compensation while still complying with the prohibition on term-based compensation and anti-steering rules. Concerning the prohibition on term-based compensation, some creditors specializing in subprime mortgages could offer to pay a higher percentage of each loans' principal balance – for example 3 percent of a \$200,000 loan instead of 2 percent. Mortgage brokers working with these subprime creditors might earn higher compensation when compared with other creditors, but this compensation structure would not be explicitly based on the terms of those loans. As a result, it would not violate the prohibition on term-based compensation or steering. This difference in effectiveness was recognized by the District Court's decision upholding the Federal Reserve's 2010 rulemaking.³⁵

Additionally, if mortgage brokers specialized in working only with subprime creditors, they could comply with the letter of the anti-steering rules even if not the spirit. These rules prohibit originators from steering a borrower toward a loan based on compensation but they do not require mortgage brokers to build business relationships with less expensive creditors. Instead, mortgage brokers are required to evaluate possible loan offers from "a creditor with which the loan originator regularly does business...[the anti-steering rule] does not require a loan originator to establish a business relationship with any creditor with which the loan originator does not already do business."³⁶ Thus, if a mortgage broker works exclusively with creditors that pay the highest compensation levels, which results in a pool

intuitive to participants, most of whom had previously assumed that if they paid a commission to a broker he or she would work in their best interest. As a result, a significant number either did not believe or ignored the conflict of interest described in the agreement." *Id.* A recent study of a large sample of federally insured mortgages similarly concluded that enormous disparities in origination charges for loans involving brokers were attributable to borrower confusion regarding broker compensation and incentives, leading borrowers to conclude that shopping from multiple brokers is unnecessary. See Woodward, Diagnosing Consumer Confusion at 2, 23-27; *see also* Design and Testing of Truth-in-Lending Disclosures for Closed-end Mortgages, Federal Reserve Board (2009), available at <http://www.federalreserve.gov/boarddocs/meetings/2009/20090723/Full%20Macro%20CE%20Report.pdf> (finding that more than half of all borrowers did not shop at all for their mortgage, but instead consulted with only one broker or lender, primarily due to the borrowers' trust in the loan originator or because the borrower had been referred to a particular loan originator by a real estate agent or other party).

³⁴ Fed. Reserve 2010 Loan Originator Comp Rule, 75 Fed. Reg. at 58511.

³⁵In upholding the Federal Reserve's 2010 loan originator compensation rule, the District Court noted that the prohibition on term-based compensation by itself did not eliminate all incentives for abuse by mortgage brokers:

Thus, proposed regulation § 226.36(d)(1), which prevents any compensation model based on the terms of the transaction, by itself, ensures that creditors' employees have no direct monetary incentive to direct consumers toward loans with higher rates of more adverse terms. ... The same is not true, however, for mortgage brokers. Although § 226.36(d)(1) prevents mortgage brokers from receiving compensation tied to the terms of a loan, it does not prevent them or their employees from creating incentives for a loan officer to guide consumers toward certain loans and or to certain lenders.

See Nat'l Ass'n of Mortgage Brokers, 773 F.Supp.2d at 175.

³⁶ 12 C.F.R. § 1026.36, Supplement I to Part 1026 – Official Interpretations, Subpart E, Comment 36(e)(1)-2(ii).

of over-priced mortgages, the anti-steering rule will not prevent them from offering an expensive loan product. Further, in presenting options to borrowers, all the broker needs to do is select a “significant number” of the creditors they do business with, with three providing a safe harbor; nothing prevents the broker from only providing quotes from the three highest-cost creditors.

Fifth, it bears repeating that transaction complexity is another difference between mortgage broker loans with YSPs and upfront payments and retail loans with commissions paid to retail loan officers. As discussed earlier, borrowers must engage in an analysis of whether it is better to pay the mortgage broker upfront versus through an increased interest rate. This complexity, and the difficulty in disclosing this information, makes additional protections more important in the broker channel.

These misunderstandings and misaligned incentives apply both to home purchase loans, where the consumer may be seeking a loan after choosing a house to purchase, and therefore be particularly vulnerable to broker sales techniques in order not to lose the home for lack of a loan, and to refinancing. In the latter case, older and first time homeowners may be particularly vulnerable to broker sales tactics, which focus on the “value” that consumers can receive from refinancing their home. There is rich evidence that the subprime crisis was ignited by just this kind of predatory marketing, and that consumers were persuaded by skillful sales techniques to enter into transactions that enriched the brokers without commensurate value for themselves.

The CFPB should adopt a final rule that takes account of the differences described above, in addition to the complexity of the YSP itself.

B. The CFPB should adopt the additive approach for transactions involving YSPs paid to mortgage brokerages.

The CFPB should promulgate final rules stating that YSPs are included in the points and fees definition for QM and HOEPA, thereby adopting the so-called “additive” approach for those transactions involving YSPs. These rules should explicitly apply to transactions where a borrower pays upfront costs directly to the creditor and the creditor pays the broker a YSP, and it should allow no offsetting of the YSP with upfront charges paid to the creditor. Taking the contrary approach and adopting the “offsetting” option instead would result in a QM designation that is significantly broader than Congress intended and a HOEPA designation that is significantly narrower than Congress intended. It would also create incentives for originating loans that are more opaque for borrowers and that result in double charging borrowers for the cost of originating a mortgage.³⁷ Such a result would be contrary to the CFPB’s rulemaking authority under § 105(a), and these concerns are addressed in more detail below.

If the CFPB releases a final rule that discounts or exempts YSPs from the points and fees definition, this will gut the consumer protections in Title XIV of the Dodd-Frank Act, particularly for subprime loans. To put it simply, the offsetting approach would allow a loan to count as QM if a consumer paid 3 points up

³⁷ See *supra*, Section I.A.

front to the creditor along with an increased interest rate that funded a 3 point payment from the creditor to the mortgage broker. Instead of counting as a 6 point loan, and therefore exceeding the legislated requirement that QM loans have no more than 3 percent in points and fees, this loan would count as 3 percent in points and fees because upfront costs would “offset” the YSP.³⁸ Similarly, offsetting would also allow a loan to evade the HOEPA limits if a consumer paid 5 points up front to the creditor along with an increased interest rate that funded a 5 point payment from the creditor to the mortgage broker. Instead of counting as 10 percent in points and fees, offsetting would allow this loan to count as 5 points. This would result in the loan avoiding HOEPA status under the points and fees test, because only loans with points and fees in excess of 5 percent are required to meet HOEPA standards.³⁹ In both of these examples, an offsetting method of calculating points and fees would result in underreporting the true level of points and fees paid by the consumer. These examples demonstrate that offsetting YSPs with upfront costs would result in a greater number of abusive loans passing through the mortgage system in a way that cuts against Dodd-Frank and Congressional intent.

In addition to distorting the QM and HOEPA designations, allowing offsetting to discount or altogether exempt a YSP payment from points and fees would create an improper incentive for YSP compensation over upfront compensation. Why allow borrowers to pay the broker upfront and have a loan designated as non-QM when the transaction can use a YSP in order to a) earn more through a higher interest rate to fund the YSPs; b) still include maximum upfront fees paid to the creditor and c) get QM status as well because the two payments offset one another? This structure would result in brokers seeking out lenders that pay the highest YSP and then selling borrowers to that lender, and would cause lenders and brokers to choose this more opaque structure because more total compensation will be possible from the same borrower. As a result, lenders would get QM status but many borrowers would end up in loans that are more expensive than they are otherwise eligible for. For some borrowers, it would further increase the lending costs of subprime loans and possibly push homeownership for these families out of reach.

Promulgating a regulation with an incentive to make opaque transactions that result in double charging consumers would be a worse outcome for consumers than the status quo regulations that do not include Dodd-Frank’s QM and HOEPA reforms. While the CFPB used its authority to permit transactions where the borrower makes upfront creditor payments in combination with creditor payments to brokerages, it would not be appropriate – and, indeed, it would be harmful – to tilt the scales in favor of such transactions that have both upfront borrower payments to creditors and increased interest rates that fund creditor-paid YSPs to brokers. CFPB’s rules should not force responsible providers to move toward less transparent structures in order to compete.

³⁸ Under this offsetting hypothetical where the borrower is predictably double charged through upfront fees and an increased interest rate, there should be no consideration of whether the interest rate triggered a rebuttable presumption or safe harbor QM status. Because the offsetting approach would create incentives to double charge borrowers, it should not matter whether creditors get less litigation protection for loans that should not qualify for any kind of QM status in the first instance.

³⁹ 15 U.S.C. § 1602(bb)(1)(A)(ii).

Instead of favoring YSPs over upfront broker payments, there should be parity between transactions where the broker is paid upfront by the borrower and others where the broker is paid by the creditor through a YSP. Including YSPs in the points and fees definition will meet this parity objective, because a \$1,500 upfront broker payment would count the same as a \$1,500 YSP. Thus, a broker who charges the borrower upfront would not be at a competitive disadvantage to one that pushes their customer into a higher rate YSP structure.

In fact, the premise of offsetting YSPs with any upfront payments a borrower makes directly to a creditor is a solution begging for a problem. The theory used to justify allowing the offsetting approach is to state that because money is fungible, the creditor is merely redirecting upfront payments from the borrower to the broker – so counting both upfront and YSP payments would result in counting the same money twice (i.e., double counting). This theory overlooks the fact that YSPs are intended to be substitutes for upfront costs. If the borrower is paying costs upfront to the creditor that the creditor then funnels directly to the broker, the solution is for the borrower to pay that money upfront directly to the broker – not to the creditor.

Additionally, requiring that YSPs be included in the points and fees calculation provides much needed accountability to ensure that YSPs actually act as substitutes for upfront payments instead of as opportunities to double charge borrowers.⁴⁰ YSPs have long been touted as mere substitutes for upfront payments, but they have, instead, acted as a way to charge borrowers more. Including YSPs in the points and fees definition would equally impact QM and HOEPA status as compared to upfront broker payments, which would provide incentives for creditors to monitor broker compensation even if paying through a YSP.⁴¹ Concerns that broker transactions will be disfavored from gaining QM status are overstated, since we understand that broker fees generally do not exceed 1.75 points. Because the QM threshold is 3 points, with smaller loans having a higher threshold (and bona fide discount points being excluded), such a rule would still permit a thriving broker QM channel.

⁴⁰ “Industry representatives have long argued that yield spread premiums are not harmful to consumers because these payments are recouped through lower direct payments to mortgage brokers. However, our analysis suggests that this claim is baseless at least with respect to samples included in our database.” Howell E. Jackson and Laurie Burlingame, *Kickbacks or Compensation: The Case of Yield Spread Premiums*, 12 Stan. J.L. Bus. & Fin. 289, 295 (Spring 2007).

⁴¹ Because the CFPB has defined compensation for the purposes of § 1026.32(b)(1)(ii) as of the time the interest rate is set, we recommend that the CFPB provide additional guidance that total or maximum YSP compensation must be finalized as of this time. Since YSPs are a direct substitute for upfront borrower payments that are paid at closing, borrowers need to know what they can be. Nor should this be problematic for industry to implement, particularly since current practice is to fully pay the YSP at closing. However, it will also prevent any possible incentives to delay the calculation of broker YSP compensation until after the interest rate is set in order to avoid exceeding the QM or HOEPA points and fees limits. See *Nat’l Ass’n of Mortgage Brokers v. Donovan*, 641 F.Supp.2d at 14 (finding that YSPs are “known and definite at settlement”).

C. The CFPB should reject both the additive and the offsetting approach for individual retail loan officers and treat retail and broker employees the same.

The CFPB should use its authority under § 105(a) and exclude all individual loan officer compensation for mortgage brokers and retail loan officers from the points and fees definition.⁴² This recommendation is broader than the two options – additive and offsetting – presented in the CFPB’s Official Staff Interpretation alternatives, which address how to treat individual retail loan officer compensation in transactions where there are upfront costs paid directly to the creditor. However, our recommendation complements and supports the CFPB’s proposal in this rulemaking to exempt all compensation paid to individual mortgage broker employees. Adopting this recommendation is appropriate in order to provide parity in the treatment of broker and retail employees, to avoid double counting, and to facilitate compliance with the statute.

Exempting both mortgage broker and retail loan officer compensation from points and fees would address double counting concerns, because the funds used to compensate individual loan officers are already captured in the points and fees calculation when paid to the individual’s employer as origination charges. The CFPB proposes to exempt all compensation paid by a mortgage broker to its individual employees from points and fees. In explaining this rationale, the final rule’s preamble states “the Bureau does not believe the purposes of the statute would be served by counting some or all of the funds a second time, and is concerned that doing so could have negative impacts on the price and availability of credit.”⁴³ This same double counting concern exists for retail employee compensation in transactions where the borrower pays upfront costs directly to the creditor.⁴⁴ In this kind of transaction, the borrower’s upfront payment will always go to the creditor first and not the creditor’s individual employee, because individual retail loan officers do not have the option of receiving compensation directly from a borrower.⁴⁵

However, instead of fully exempting retail loan officer compensation, the CFPB proposes to address retail double counting concerns by offsetting individual retail loan officer commissions with upfront payments to the creditor. This offsetting approach is a complex undertaking, because it requires tracking

⁴² As one of the organizations submitting this comment letter, CRL notes that the current policy of its affiliate organization, Self Help, is to pay loan officers by salary and not by commission.

⁴³ Ability to Repay Standards Under the Truth in Lending Act (Regulation Z), Final Rule, 78 Fed. Reg. 6408, 6437 (Jan. 30, 2013).

⁴⁴ While there are situations where the individual retail loan officer’s compensation could be funded, in part, through the creditor’s profits earned on monthly payments or selling the mortgage entirely, the CFPB correctly acknowledges that “[b]ecause money is fungible, tracking how a creditor spends money it collects in up-front charges versus amounts collected through the rate to cover both loan originator compensation and its other overhead expenses would be extraordinarily complex and cumbersome.” Ability to Repay Standards Under the Truth in Lending Act (Regulation Z), Final Rule, 78 Fed. Reg. at 6437.

⁴⁵ *Nat’l Ass’n of Mortgage Brokers*, 773 F.Supp2d at 175 (noting that “a creditor’s employee never has the option of receiving direct compensation from a consumer”).

commission payments to individual employees as each loan is in the process of being originated.⁴⁶ The CFPB's final rule requires that commissions to retail loan officers be counted as part of points and fees as of the time the interest rate is set.⁴⁷ As the CFPB notes in its final rule, the exact amount of an employee's commission is often unclear at this time.⁴⁸ This uncertainty occurs for a number of reasons, including not knowing when the loan will close and the exact number of loans that the loan officer will close beforehand that month. This timing affects compensation levels, because most lenders have tiered commission policies where loan officers make more per loan after they have closed a set number of loans. Thus, lenders will need to track, for each loan officer and each loan when the interest rate is set (or reset), what tiered compensation plan the officer is on, how many loans the employee has closed by that point, and when the prospective loan is likely to close.

Because this new tracking requirement is such a complex undertaking, retail lenders would be at a disadvantage compared to brokerages, which would not need to engage in this employee and loan level tracking. Further, it would lead to arbitrary results. Whether a borrower's loan is a QM loan might depend on whether she uses a less rather than more productive loan officer who gets paid more, or her interest rate is set early as opposed to late in the month when loan officers receive more compensation per loan. Nor would tracking this payment capture all payments to loan officers. Since salary is exempt from the calculations, high salaries could be paid just as easily as high commissions.

These complexities and arbitrary conclusions are significant, and the better approach would be to entirely exempt compensation payments made to individual employees. Adopting this exemption is appropriate under the CFPB's § 105(a) rulemaking authority in order to facilitate compliance with the statute, because the alternative tracking requirement would be so extremely difficult to implement. The same compliance difficulty does not exist with tracking YSPs at the time a borrower's interest rate is set, because they are paid at closing and are currently disclosed on the HUD-1.

It is important to underscore that an exemption for retail loan officers would not raise concerns about evading or circumventing the consumer protection reforms included in Dodd-Frank. As noted by the DC District Court in a prior case, the loan originator compensation regulation, "which prevents any compensation model based on the terms of the transaction, by itself, ensures that creditors' employees have no direct monetary incentive to direct consumers toward loans with higher rates or more adverse terms."⁴⁹ This means that individual loan officers cannot increase their personal compensation by steering borrowers to the highest cost loan offered by their employer. In addition, the anti-steering rules adopted by the Federal Reserve also require disclosing different loan options to a consumer.

⁴⁶ In addition, the proposed rule asks whether to count hourly wages for the actual number of hours worked on particular transaction, and we also recommend that the CFPB not adopt this approach. Following our logic in this section, we believe that this would be too burdensome for lenders and would discourage originators from making loans to lower-income or thin-credit-file borrowers whose loans may be more time-consuming to originate.

⁴⁷ Final rule § 1026.32(b)(1)(ii).

⁴⁸ Ability to Repay Standards Under the Truth in Lending Act (Regulation Z), Final Rule, 78 Fed. Reg. at 6436.

⁴⁹ *Nat'l Ass'n of Mortgage Brokers*, 773 F.Supp.2d at 175.

Furthermore, unlike mortgage brokers, the individual retail loan officer is unable to engineer its own pool of loan options. These existing regulations would prevent individual retail loan officers from having incentives to evade QM and HOEPA standards, and, as a result, an exemption for individual loan officer compensation in this rulemaking would be appropriate under the CFPB's § 105(a) authority.

In making this recommendation, we recognize that the CFPB has addressed the possibility of such an exception and expressed an unwillingness to use its exception authority for this purpose. In the preamble to the final QM rule, the CFPB notes a concern that an exception for compensation paid to individual retail loan officers would "exacerbate the differential treatment between retail and wholesale channels concerning overhead costs." However, issuing regulations that recognize structural differences in how retail and mortgage broker originators can interact with consumers is not exacerbating differences; it is appropriately exercising the CFPB's rulemaking authority.

Indeed, there are significant differences between broker and retail channel originations, and courts have upheld prior regulations that differentiate between the two. The DC District Court case upheld the Federal Reserve Board's 2010 rulemaking, which justified not treating wholesale and retail compensation the same (the Federal Reserve rule had permitted commissions for retail lenders but not for brokerages) because of the unique risks the Board had documented concerning broker incentives to increase lending costs for borrowers. Similarly, a court upheld a HUD regulation requiring disclosure of YSPs but not of the gain on sale earned by creditors.⁵⁰

In this rulemaking, as is detailed throughout this comment, there is also an appropriate rationale for the CFPB to include YSPs in points and fees while excluding individual retail loan officer compensation. On the one hand, including YSPs in points and fees prevents evasion and avoids creating incentives for opaque transactions that result in the borrower paying twice for the same service. On the other hand, excluding individual compensation facilitates compliance and also does not create any incentives to evade the consumer protection purposes of the statute or creating incentives for opaque transactions. As a result of these differences, the CFPB should adopt the recommendations made in this comment.

If the CFPB is nevertheless unwilling to adopt our recommendation to exclude all employee compensation from points and fees, then the CFPB should adopt the offsetting approach taken in its second alternative for individual retail loan officer when the borrower pays the creditor upfront. This approach, however, would lack the benefit of facilitating compliance, because retail lenders would be required to track compensation such as commissions paid to individual loan officers and estimate the commissions as of the date the interest rate is set, and would create arbitrary results. However, this approach would address the retail double counting issue, which would arise if the additive approach were adopted.

⁵⁰ See *Nat'l Ass'n of Mortgage Brokers v. Donovan*, 641 F. Supp. 2d at 13-16.

II. The proposed exemptions for community-focused lenders, targeted rescue and refinance programs, and small entities will provide access to credit without unnecessarily adding risk to the system

A. The exemption for community-focused lending programs will support continued extension of credit to underserved communities without adding unnecessary risk.

Even as the U.S. housing market improves, thousands of low-income neighborhoods remain devastated by the foreclosure crisis. Mission-driven community lenders such as Housing Finance Agencies, Community Development Financial Institutions, Community Housing Development Organizations, Downpayment Assistance Providers, and other nonprofit creditors will play a critical role going forward to help these neighborhoods rebuild.

Unlike the predatory subprime lending that destroyed many low-income neighborhoods, affordable lending programs like the ones offered by these organizations typically offer low-cost mortgage products, require full documentation of income and demonstrated ability to pay, and often include extensive financial counseling with the borrower. Through their carefully tailored underwriting standards and other support for program participants, mission-driven community lenders have helped hundreds of thousands of lower-income borrowers become successful homeowners.

Yet, despite a proven track record of safe lending, some community lenders may find it difficult to operate without an exemption to the ability-to-repay requirements. These programs engage in intensive underwriting to ensure a borrower's ability to pay, but in an effort to reach underserved communities who may have limited credit histories or few assets to make a large down payment, they often consider other factors to evaluate creditworthiness and/or provide products that are designed for these populations. While they meet the ability-to-pay requirements of the CFPB's rule, they may not fit into the qualified mortgage definition, which could pose a problem for them.

For instance, the Massachusetts Housing Partnership operates a lending program called SoftSecond that has provided more than 15,000 homeowners with affordable home loans through subsidized second mortgages. Several aspects of this program's effective lending model might not fit within the qualified mortgage exemption, such as a debt-to-income ratio threshold that is higher than 43 percent and an interest rate subsidy that could potentially be viewed as a graduated payment schedule. Since the SoftSecond program relies upon the participation of multiple private lenders, uncertainty about whether or not its loans qualify for the type of protection offered to Qualified Mortgages could impact private participation and cause serious disruption to the program.⁵¹

Because of the unique configurations of many community lending programs, simply creating an "alternate" QM is not practical in this situation. Consequently, the full exemption from the ability-to-repay requirements is the best route to provide these organizations with the flexibility to continue their lending programs and the certainty their private lending partners seek.

⁵¹ See Massachusetts Housing Partnership's comments on the QM concurrent proposal.

<http://www.mhp.net/homeownership/>

However, because a full exemption from ability-to-repay provides borrowers with very little recourse, we recommend that the CFPB include additional conditions in the final rule to prevent fraud or abuse. First, we recommend that the CFPB set loan limits for these entities to prevent unscrupulous operators from fraudulently seeking and then abusing the designation. We recommend a limit of 250 loans per year for Community Housing Development Organizations, and we recommend that the CFPB work with the CDFI community to develop an appropriate loan limit for CDFIs. The CFPB also should work closely with the Departments of Treasury and Housing and Urban Development to ensure rigorous certification and oversight standards are in place for certifying entities as Community Development Financial Institutions and Community Housing Development Organizations.

Last, we recommend that the CFPB raise the upper lending limit for nonprofit creditors serving low-income borrowers from 100 loans per calendar year to 250 loans per calendar year. The proposed limit of 100 loans per calendar year may undermine lending programs. For example, Habitat for Humanity estimates that the 100 loan limit may only allow its affiliates to serve 50 families per year because they must also obtain equity protection, usually in the form of a subordinate mortgage for each mortgage they issue.⁵² A limit of 250 may be more appropriate while still sufficiently narrow to safeguard against abuse.

B. The Ability to Repay rule and qualified mortgage definition should specifically address the treatment of “soft” subordinate financing offered by community-focused lenders to ensure that this financing is not disfavored.

As noted above, many community-focused lenders offer subordinate financing that is designed to lower the overall costs of homeownership without adding a financial burden on qualifying households. Most often financed with public funds, these subordinate liens are made available to households meeting the low- and moderate-income and/or Census Tract targeting required by those programs. Often referred to as "Community Seconds," these liens typically are structured to require payment only on the sale of the property or the refinancing of the underlying primary loan. They may or may not accrue interest; where interest accrues it becomes payable on the occasion of these events. In some cases the Community Second is forgiven over time, and in all case the loans are repayable only to the degree that sale proceeds allow after extinguishment of the underlying first loan.

While the CFPB exempts these lenders themselves from the Ability to Repay rules, in many cases, this subordinate lien sits behind a mortgage financed by a traditional lender that will be subject to the rule. Were creditors to believe that the presence of such liens either undermined the borrower's ability to repay, or created a barrier to the loan's QM determination, it would work directly against the public purposes served by Community Seconds, i.e., to provide responsible and sustainable financing alternatives to low- and moderate-income borrowers and those living in distressed areas. For this reason, we believe it is important for the CFPB to clarify how these subordinate liens are treated under the Ability to Repay rule and the qualified mortgage exemption.

⁵² See Comment Letter from Habitat for Humanity to the Consumer Financial Protection Bureau, Feb. 13, 2013.

We strongly recommend that the CFPB strengthen its guidance to clarify that the presence of a Community Second loan does not adversely impact the ability-to-repay assessment for a first lien or impact the first lien's qualified mortgage status. The CFPB should include guidance about how lenders should assess such second liens in order to determine whether they fit the overall definition of a Community Second. Fannie Mae's lender guidance on this topic⁵³ provides a checklist that has been used successfully for many years to qualify such liens under Fannie Mae's underwriting guidelines and offers an example of the features that could be included in the CFPB's guidance.

C. Exempting creditors participating in EESA programs and government-backed refinance programs from Ability to Repay is appropriate because financial incentives are aligned with consumer interests.

In the wake of the crisis, the Treasury Department established foreclosure prevention programs using money from the Emergency Economic Stabilization Act (EESA). Programs such as the Home Affordable Modification Program and the Hardest Hit Fund program aim to keep homeowners in their homes as an alternative to foreclosure. The programs feature very specific, prescribed features and underwriting requirements aimed at improving the safety and sustainability of a homeowner's mortgage. The interests of the investors are aligned with those of the homeowner, as both benefit from the existence of the programs. Therefore, due to the complexity, standardization, and intent of these programs, as well as the alignment of incentives, it makes sense to exempt these programs from the ability-to-repay requirements of the Dodd-Frank Act.

Similarly, the CFPB should exempt the refinancing programs offered by Fannie Mae and Freddie Mac from ability-to-repay requirements. In this situation, because the loan will be owned by Fannie Mae or Freddie Mac both before and after the refinancing, improving the loan's rate and/or terms through a refinancing can benefit both the homeowner and the investor. However, we do not support limiting the rule to refinancings consummated before January 10, 2014, as there may be many interest rate movements over a seven-year period and it may well be in the homeowner's best interest to refinance more than once during that period.

Finally, we support the exemption for qualifying refinancing programs at the Federal Housing Administration, the Department of Veterans Affairs, and the Department of Agriculture until such time as those agencies promulgate their own rules as provided for by the statute.

D. The proposal addressing loans held in portfolio by small lenders is an appropriate means to support access to credit for communities served by such lenders.

We believe the CFPB's proposal to create a fourth category of qualified mortgages that includes certain loans originated by small creditors is appropriate as a means to ensure access to affordable credit, including the removal of the 43 DTI requirement and the change in the interest rate that triggers rebuttable presumption. As discussed in the CFPB's proposal, small creditors provide critical access to credit for many borrowers, particularly in underserved areas. Since eligibility is narrowly limited to loans

⁵³ Guidance can be found at https://www.fanniemae.com/content/fact_sheet/community-second-checklist.pdf

held in portfolio, the incentives of the creditor and the borrower are appropriately aligned. For that reason, we also support the proposal's specification that loans held in portfolio for less than three years should lose qualified mortgage status as a further safeguard against misaligned incentives that might harm consumers.