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TESTIMONY OF

SCOTT LOUSER
2012 VICE PRESIDENT AND LIAISON TO GOVERNMENT AFFAIRS
NATIONAL ASSOCIATION OF REALTORS®

BEFORE THE

UNITED STATES HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

HEARING TITLED

THE IMPACT OF DODD-FRANK'S HOME MORTGAGE REFORMS: CONSUMER AND MARKET PERSPECTIVES

JULY 11, 2012

INTRODUCTION

On behalf of the 1.1 million members of the NATIONAL ASSOCIATION OF REALTORS® (NAR), who are involved in residential and commercial real estate as brokers, sales people, property managers, appraisers, counselors, and others engaged in all aspects of the real estate industry, thank you for holding this very important hearing on the impact of Dodd-Frank's home mortgage reforms.

My name is Scott Louser, and I am NAR's 2012 Vice President and Liaison to Government Affairs. I have been a REALTOR® for more than 14 years, and I am the broker \ owner of Preferred Minot Real Estate in Minot, N.D. I have served the REALTOR® community in many capacities from leadership of my local board to Vice-President of my Region to member of the National Associations' Board of Directors. Lastly, I am a current member of the North Dakota State Legislature, representing District 5.

Most economists and housing market analysts in government and in the private sector agree that today's underwriting standards are tight and are contributing to a slow housing recovery. NAR believes that an unnecessarily narrow definition of the Qualified Mortgage (QM) that covers only a modest proportion of loan products and underwriting standards and serves only a small proportion of borrowers would undermine prospects for a housing recovery and threaten the redevelopment of a sound mortgage market.

NAR urges Congress and the Administration to collaborate to construct a broadly-defined QM rule using clear standards. We believe that is the only way to help the economy and at the same time ensure that the largest number of credit worthy borrowers are able to access safe, quality loan products for all housing types, as Congress intended in enacting the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).

Congressional Intent Calls for Broadly Defined QM

Every version of the Ability to Repay provisions introduced in Congress, including the final version of Dodd-Frank that became law, paired the Ability to Repay Requirement with the QM. The reasoning was that pairing the prospect of liability with an exception for well underwritten, safer, more sustainable loans was the best means of ensuring sound lending for borrowers.

To add incentives for QM lending, the law also added liability for steering consumers from QM to non-QM loans. Further, the Consumer Financial Protection Bureau (CFPB) was given broad flexibility to define the QM in a manner that will "ensure that responsible, affordable mortgage credit remains available to consumers." All of these provisions demonstrate Congress's intent that all creditworthy borrowers – especially low- and moderate-income borrowers and families of color – should be extended the important protections of a QM.

The Reasonable Ability to Repay Standard

Under the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA or Dodd-Frank Act), no creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination, based on documented and verified information, that the consumer has a

reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance and assessments. This determination must be made as of the time the loan is consummated.

In making this determination, the creditor must consider and verify a number of factors, such as the borrower's credit history, current income, expected income reasonably assured of being received, current obligations, debt-to-income ratio, employment status, and financial resources other than the real property that secures the loan. The amount of income and assets must be verified by reviewing IRS transcripts of tax returns or another method that effectively verifies income documentation by a third party.

Failure to comply with the "ability to repay standard" subjects the creditor to civil liability that includes minimum statutory damages, and potential class action liability. The statutory damages include the consumer's attorney fees. Further, such failure can be raised at any time as a defense to foreclosure proceeding brought by the holder of the mortgage, whether the holder is the initial lender or an assignee.

Qualified Mortgage Safe Harbor and Rebuttable Presumption

Section 1412 of the DFA, entitled "Safe Harbor and Rebuttable Presumption," provides that the creditor may presume that the loan has met the "ability to repay" standard if the loan is a "qualified mortgage" (QM). The statute lists the minimum qualifications for a QM as:

- There is no negative amortization;
- No balloon payments (except in rural or underserved areas);
- No ability to defer payments of principal, e.g., no "interest only" payments;
- Income and financial resources of the borrower are verified and documented;
- The loan is underwritten based on payments reflecting full amortization and takes into consideration all mortgage-related obligations, such as taxes, property insurance and assessments;
- Variable rate loans are underwritten based on the maximum rate permitted in the first five years and a payment schedule that reflects full amortization;
- Complies with any regulatory guidelines on debt-to-income ratios;
- Total points and fees generally do not exceed 3 percent of total loan amount; and
- The term does not exceed 30 years, unless this limit is extended by regulations;
- In the case of a reverse mortgage, meets guidelines established by regulation.

Significance of QM for Housing Finance

The QM definition has a very large impact on the availability and cost of housing finance. First, as explained above, a lender making a loan meeting the definition of a qualified mortgage will enjoy at least a presumption of having satisfied the "ability to repay" standard. Anyone making a loan, or purchasing a loan, that is later found to have not met this standard will be subject to significant liability, including the risk that a borrower can raise this issue as a defense to a foreclosure at any time. Thus, even if an originator uses best efforts to comply with the "ability to repay" requirement when making a non-QM loan, the loan will create meaningful liability risks for the originator. Similarly, anyone purchasing a non-QM loan will also face the risk that the borrower can raise the "ability to repay" issue as a defense in any foreclosure action. As a result, both originators and

secondary market participants may be very reluctant to make or purchase non-QM mortgages, and if these mortgages are issued, the cost of the mortgage will increase to reflect this risk.

The definition of QM also is linked to the prohibition on "steering" found in section 1403 of the Dodd-Frank Act. This section prohibits mortgage originators from steering customers to a non-QM loan if the customer could obtain a QM loan. For example, even if a consumer specifically asks for a balloon loan, a mortgage originator cannot offer that product if the borrower would qualify for a QM loan that, by definition, cannot include a balloon payment. In order to avoid potential liability for "steering," it is likely that mortgage originators will only recommend QM loans unless very unusual circumstances exist.

The definition of a QM is also important because under the Dodd-Frank Act, it is directly linked to the imposition of a risk retention requirement. Under section 941 of the Dodd-Frank Act, a "securitizer" or a loan originator has to retain an economic interest in a portion of the credit risk transferred to investors through a mortgage-backed security. This requirement is likely to raise the cost of mortgage lending by making the securitization process more costly and cumbersome for loan originators and securitizers. In light of this concern, the statute exempts securitization transactions for "qualified residential mortgages" (QRM), as such term is to be defined in regulations issued by the federal banking agencies, HUD, FHFA and the SEC. However, the Dodd-Frank Act states that the definition of a qualified residential mortgage "can be no broader than the definition [of] a qualified mortgage." Therefore, the definition of a QM directly limits the definition of a QRM, and thereby controls the extent to which the banking agencies, HUD, FHFA and the SEC can expand the scope of mortgages that are not subject to risk retention. In other words, a narrowly defined QM eliminates the ability of the other agencies to have a more inclusive definition of QRM, even if these agencies determined that public policy dictates that risk retention should not apply broadly.

Finally, the definition of a QM loan is linked to the ability to include a prepayment penalty in a mortgage loan. Only a QM may include such a penalty, and in any case the penalty must be phased out over a 3-year period.

As a practical matter, faced with the adverse consequences of making a non-QM loan, explained above, very few non-QM mortgages will be made. Mortgage brokers will face liability for "steering" consumers obtaining non-QM loans, creditors will face liability for failing to comply with the "ability to repay test," and secondary market participants will face the possibility of having to defend against a charge that the loan did not meet the "ability to repay test" for the life of the loan. This alone is likely to make the development of a secondary market for these loans very problematic. This is compounded by the fact that non-QM loans will not qualify for the exemption from risk retention under the QRM test, and cannot contain a prepayment penalty. In light of these impediments, few non-QM loans are likely to be made.

Regulatory Discretion to Alter QM Requirements

The Dodd-Frank Act contains explicit authority for the Federal Reserve Board to revise the qualified mortgage definition. This authority was transferred to the Consumer Financial Protection Bureau (Bureau) on July 21, 2011. The statutory authority to modify the QM definition provides:

The [Bureau] may prescribe regulations that revise, add to, or subtract from the criteria that define a qualified mortgage upon a finding that such regulations are necessary or proper to ensure that

responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of this section, necessary and appropriate to effectuate the purposes of this section and section 129B, to prevent circumvention or evasion thereof, or to facilitate compliance with such sections.

This legislative language is ambiguous. The problem is created by the lack of semicolons in the statutory language, which are typically used to separate different alternatives. Without the semicolons, the language is not clear. It can be read as requiring the regulator to make one of three independent findings before issuing regulations, or it can be read as requiring the regulator to make one finding that covers several points.

A review of the legislative history indicates that the second interpretation better reflects Congressional intent. Congress was concerned with the possible adverse consequences of this legislation on mortgage availability, and, therefore, wanted the regulator to consider that factor when issuing regulations to change the criteria for a QM mortgage. Chairman Frank personally guaranteed that this would be included in the bill that passed the House.

Non-QMs Will Be Less Protective, Less Available and More Expensive

A narrowly defined QM would put many of today's loans and borrowers into the non-QM market, which means that lenders and investors will face a high risk of an ability to pay violation and even a steering violation. As a result of these increased risks, these loans are unlikely to be made. In the unlikely event they are made, they will be far costlier, burdening families least able to bear the expense. Beyond that, these higher-priced loans would not be required to include important protections against certain practices and the loan features that drove the highest failures in the mortgage boom – negative amortization, interest- only payments and the like— that are embedded in QM.

There is no question that some residential mortgage underwriting standards were too lax during the housing boom, and that strong regulatory standards are needed to make sure that those mistakes are not repeated. We support the establishment of such standards and we believe the establishment of the QM is central to that effort. Rather than narrowing the QM market, we believe the CFPB should work to ensure that the QM market becomes the market. Creating a broad QM, which includes sound underwriting requirements, excludes risky loan features, and gives lenders and investors reasonable protection against undue litigation risk, will help ensure the revival of the home lending market.

Clear Standards are Critical to Any QM Definition

Vague parameters for the QM also will add legal uncertainty, increase costs and limit access to credit. If the parameters of the QM are not clear, risks become unpredictable, forcing lenders to decrease their risk tolerance and operate well within the standards. Such an outcome will, lessen both the availability and affordability of credit for far too many borrowers. For these reasons, the CFPB should establish clearly defined standards in the QM definition that are objectively determinable at origination in any QM definition.

The impending Ability to Repay (ATR) Qualified Mortgage (QM) rule will shape access to mortgage credit for the foreseeable future. Even if the rule is done perfectly, it will tighten access to credit in

an already tight lending environment. It is critical therefore that Congress and the Administration strongly lean towards maximum consumer access to mortgage credit in the QM. The broadest possible QM with strong legal protections for lenders will ensure maximum access to credit and minimal market disruption.

3% Cap on Points and Fees Provision

The "Ability to Repay" provisions of Dodd-Frank include among other provisions, a provision that if a loan's fees and points do not exceed 3%, the loan will be considered a "Qualified Mortgage" (QM). NAR believes that the QM will define the universe of readily available mortgages for a long time to come and non-QM mortgages will be rarely made. The problem is that the calculation of fees and points under the 3% cap discriminates against real estate and mortgage firms with affiliates involved in the transaction. NAR strongly urges Congress to pass H.R. 4323, the 'Consumer Mortgage Choice Act", to correct this discrimination and level the playing field between affiliated and unaffiliated firms and also makes a technical correction that prevents the potential double-counting of compensation against the 3% cap.

The basic definition of fees and points covers what is often traditionally thought of as fees and points in the industry. However, when an affiliate is involved, additional items must also be included under the HOEPA definitions including title charges and money that is held in escrow to pay homeowners insurance and possibly even property taxes. In the case of title charges, this industry is heavily regulated at the state level with 44 states requiring rates to be filed or set by the state so the differences among providers are not likely to be significant. With regard to escrow, those charges are paid to third parties or the state. In both cases, it makes no sense to discriminate against the affiliated lender by making them count these charges toward fees and points when an unaffiliated lender would not.

If these provisions are not corrected, up to 26% of the market or more could be affected. The ultimate effect would be that consumers would be denied the choice of using in house services and there would be less competition in the lending and settlement services industry as well as likely reduced access to credit. The choice of affiliated services has achieved growing popularity over the years and in the most recent Harris Interactive Survey on the topic (December 2010), consumer satisfaction levels were a full 10 points higher for those who used affiliates than for those who did not. Consumers reported that using affiliated services saved them money (78%), made the process more manageable and efficient (75%), prevented things from falling through the cracks (73%), and was more convenient (73%).

Conclusion

REALTORS® believe that one of the biggest issues impacting the housing economy is uncertainty in the rules that govern housing finance. This uncertainty impacts all participants in housing finance: lenders, investors, and consumers. Until there is market certainty that encourages the return of private capital, FHA and the GSEs (Fannie Mae and Freddie Mac) will continue to dominate the housing finance system with the taxpayer on the hook.

We believe that a first step to creating certainty in the housing finance system is to broadly define QM so that it encompasses the vast majority of the high quality lending being done today. An effective ability to repay rule that provides strong incentives for lenders to focus on making well-

underwritten QMs affordable and abundantly available to all creditworthy borrowers will require both a legal safe harbor for lenders and investors, and a clear, objective definition of the QM that itself is not unduly restrictive. This action, along with correcting the 3% cap on Points and Fees, will ensure that credit and housing services are available and affordable to the consumer. If we are able to get this right, the market will continue its recovery and move toward stability.

NAR thanks you for this opportunity to share our thoughts on the impact of Dodd-Frank's mortgage reforms. As always, the National Association of REALTORS® is at the call of Congress, and our industry partners, to help continue the housing and national economic recovery.