Issue Brief

An Analysis of the Financial Regulatory Improvement Act of 2015
Implications for Mortgage Consumers

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The Center for Responsible Lending
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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, a nonprofit community development financial institution. For thirty years, Self-Help has focused on creating asset building opportunities for low-income, rural, women-headed, and minority families. In total, Self-Help has provided $6 billion in financing to 70,000 homebuyers, small businesses, and nonprofits and currently serves more than 80,000 mostly low-income families through 30 retail credit union branches in North Carolina, California, and Illinois.

An Analysis of the Financial Regulatory Improvement Act of 2015 and its Implications for Mortgage Consumers

On May 12, 2015, the Senate Committee on Banking, Housing, and Urban Affairs' Chairman, Senator Richard Shelby (R-AL), introduced a discussion draft of "The Financial Regulatory Improvement Act of 2015" ("Chairman's Draft").[1] The proposal comes at a time when offering community banks relief from recently created laws and regulations for the mortgage market is dominating some discussions about Congressional efforts to secure the future of housing finance and policy. [2]

Given the differences in business practices, business scale, and company resources, CRL supports a regulatory framework and oversight structure that appropriately recognizes and accommodates the unique nature of community banks and credit unions. The focus should be on what will help traditional community banks and credit unions, while protecting consumers, those institutions, and the nation's economy as a whole. Thankfully, the Consumer Financial Protection Bureau ("CFPB") has been mindful of the differences between larger institutions and smaller lenders and is working to tailor mortgage rules implementing the Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank") accordingly.

Most recently, the CFPB released a proposal to quadruple the 500 first-lien mortgage cap under QM's small-creditor definition to 2,000, include only first-lien mortgage originations of small lender and its affiliate assets towards the current $2 billion asset cap, and, to accommodate concerns that the definition of a "rural and underserved" area is too narrow, expand the definition of rural areas by including all non-urban census blocks as defined by the Census Bureau.[3] While we may not always agree on all specifications, CRL has and continues to support the CFPB's ongoing efforts to reasonably explore how mortgage rules can further accommodate small lenders and lending in designated rural and underserved areas.

Originally proposed as a Community Bank bill, Chairman Shelby's discussion draft raises red flags about Congress' commitment to ensuring that the mortgage market extends responsible loan products and affordable housing opportunities to consumers—especially those in traditionally underserved communities. If passed in its current state, the legislation could jeopardize a large portion of the protections in Dodd-Frank and the law's attempt to have the mortgage market make a meaningful commitment to sustainable, non-predatory homeownership. These rollbacks would harm consumers, the mortgage market, and the nation's economy overall.

Almost seven years have passed since the nation suffered the greatest housing finance collapse in modern times. That collapse was triggered, in large part, by a period of reckless and predatory mortgage lending. The Wall Street Reform and Consumer Protection Act of 2010 sought to rein in these practices by adopting a series of safeguards and consumer protections for the mortgage market.[4]

The Senate Banking Committee is currently slated to markup the discussion draft on Thursday, May 21, 2015.[5] Given our initial analysis, CRL has determined that the Financial Regulatory Improvement of 2015 goes well beyond enacting sensible regulatory relief for community banks. Instead, the bill would usher in sweeping rollbacks to the consumer protections that the Wall Street Reform and Consumer Protection Act of 2010, which was enacted to prevent another housing crisis. We, therefore, oppose the passage of this legislation.

Analysis Overview and Table of Contents

In this issue brief, the Center for Responsible Lending ("CRL") presents a charted analysis of the major mortgage issues addressed in the Chairman's Draft and its proposed changes in key mortgage areas. Each chart includes a brief overview of the current law, the changes created by the draft, and CRL's initial analysis of the changes.

Sec. 106 Portfolio Mortgage Loans	
The Current Law	
Under the existing rules governing the Ability-to-Repay standard, the CFPB created an exemption allowing small creditors to have portfolio mortgage loans be treated as qualified mortgages if both the creditor and the loans satisfy certain criteria. Specifically, the creditor must have less than $2 billion in assets and have securitized 500 or less mortgage loans in the preceding calendar year. The CFPB recently proposed to expand the securitized loan cap to 2,000 mortgages and to extend the definition of "rural area" to include any U.S. Census block not designated as urban by the United States Census Bureau.[6]	
What the Chairman's Draft Changes:	CRL's Analysis of the Change:
ELIMINATES ASSET SIZE AND SECURITIZATION ELIGIBILITY CAPS FOR PORTFOLIO EXEMPTION:	**THESE CHANGES RAISE SERIOUS CONCERNS**:
Sec. 106(a) undoes the CFPB's existing size limitations on the Qualified Mortgage Provision by stating that any "creditor shall not be subject to suit,"[7] if the remaining portfolio lending requirements contained in the bill are satisfied.	By eliminating the asset size and securitization caps, the discussion draft would allow larger institutions to use the portfolio exemption. History shows that these larger institutions, who rarely rely on a relationship-based lending model, have poorer performance in portfolio lending. In fact, both Washington Mutual and Wachovia, two mid-size regional banks that would be eligible under the proposed change to the law, failed in the aftermath of the financial crisis because of poor mortgage portfolio loans.[12] The asset size and securitization caps are necessary to ensure that institutions who qualify for the portfolio exemption are truly engaged in using the relationship-based lending model that justifies treating portfolio loans differently.
REDUCES THE QUALIFIED MORTGAGE CRITERIA APPLICABLE TO PORTFOLIO LOANS:	
Under current rules, a small creditors' portfolio loan, including balloon loans, can only be granted QM status if the loan meets certain underwriting criteria.[8] The discussion draft would substantially reduce those criteria by eliminating the cap on points and fees, debt-to-income ratio considerations and limitation for larger banks, and interest rate restrictions.	By eliminating the cap on points and fees, debt-to-income considerations, and interest rate restrictions, the proposed bill would usher the return to pre-crisis lending models where lenders had no obligation to seriously consider a consumer's ability to repay a mortgage loan or consider the safety and soundness of its mortgage activities. Each of these provisions represents a critical component of responsible mortgage underwriting. In fact, without them, 2/28 adjustable-rate mortgages—one of the most popular and problematic subprime products during the lead up

	to the housing crisis[13]—would be deemed Qualified Mortgages under the Chairman's draft.
ELIMINATES THREE-YEAR HOLDING PERIOD AND TRANSFER LIMITATIONS: Sec. 106(a) also eliminates the three-year holding period for portfolio loans to become eligible for Qualified Mortgage treatment and the limitation on allowing transfers to occur only between small creditors while retaining QM status.[9]	By eliminating the three-year period for holding portfolio loans prior to QM designation, the bill provides additional disincentives for banks to monitor the risk of their portfolio loans because the risk can immediately be transferred or sold to another institution of any size without losing legal protection.[14]
SHIFTS THE LEGAL BURDEN FOR PLEADING AND PROVING QUALIFIED MORTGAGE ELEMENTS FROM FINANCIAL INSTITUTIONS TO CONSUMERS: Under existing law, a portfolio loan by a small creditor that satisfies the CFPB criteria is presumed to be a qualified mortgage. In turn, a creditor that issues a qualified mortgage is only presumed to meet the Ability-to Repay standard under the safe-harbor standard enacted by the CFPB. In contrast, the discussion draft suggests that portfolio loans shall not be subject to suit under ability-to-repay criteria.	As a general matter, a safe harbor is considered an affirmative defense, meaning the defendant (in this case, the financial institution) has the burden of pleading and proof. In contrast, an immunity clause (which, the language "shall not be subject to suit" is routinely considered as creating) is deemed to be an element of the cause of action itself and, therefore, the plaintiff (in this case, the consumer) would bear the burden of pleading and initially proving that the loan did not satisfy the bill's established criteria. This switch in the burden of proof would make it very difficult for consumers to prevail, given that they rarely have the same kind of documentation available to financial institutions. It also means that Ability-to-Repay claims would more likely be resolved at the motion to dismiss stage, rather than the summary judgment stage--the latter offering both parties an opportunity for discovery.

EXPANDS SMALL CREDITOR EXEMPTION TO LARGE NONDEPOSITORY LENDERS: Under the Chairman's draft, non-depositories with up to $10 billion in assets would be permitted to benefit from the portfolio exemption. [10]	In the past, the absence of oversight by federal financial regulators, when combined with inconsistent or weaker state oversight, proved to be highly problematic and created an environment where non-depository lenders, in particular, had improper incentives to push consumers into mortgage loans with problematic features. Granting those lenders legal protection for mortgages underwritten to looser standards undermines the lessons learned from the housing crisis and the safeguards Dodd-Frank intended to erect.
EXPANDS THE ESCROW EXEMPTION: By eliminating the predominance requirement, the bill would also expand the number of institutions eligible for the exemption to the requirement to establish escrow accounts for higher-priced loans.[11]	Escrow accounts protect consumers by ensuring that they have funds for reoccurring homeownership-related expenses, such as property taxes and insurance premiums. By reducing the number of consumers that benefit from escrow protections, the discussion increases the likelihood that consumers of high-cost mortgages will not have the necessary funds to pay for ownership-related expenses.

Sec. 108
High-Cost Manufactured Housing Loans

The Current Law

Under the Wall Street and Consumer Protection Act, employees of manufactured home retailers must be licensed loan originators if they help buyers access or negotiate financing.[15] All chattel lenders are now expected to ensure that consumer loans satisfy the Ability-to-Repay standard and high-cost chattel loans are subject to consumer protections under the Home Ownership and Equity Protection Act (HOEPA). Currently, chattel loan borrowers receive HOEPA protections if the loans annual percentage rate is above the average prime offer rate by 8.5%. HOEPA protections are also triggered by points and fees exceeding the following caps: 1) The lesser of 8% of the loan amount or $1000 for loans under $20,000; or 2) 5% of the loan amount for loans starting at $20,000.[16]

What the Chairman's Draft Changes:	CRL's Analysis of the Changes:
LOAN ORIGINATOR DEFINITION CHANGED FOR COMPENSATION RULES: Sec. 108 changes the definition of "loan originator" to exclude employees of manufactured housing retailers. Under the proposed language, retail employees would not be considered loan originators unless they "receive compensation that is in excess of any compensation received in a comparable cash transaction."[17]	**THESE CHANGES RAISE SERIOUS CONCERNS:** The discussion draft removes important consumer protections and makes homeownership more costly for those who can least afford it. The Wall Street Reform and Consumer Protection Act put those protections in place to give manufactured homeowners the same protections as traditional homeowners. As documented recently in a series of articles published by the Seattle Times, [19] the manufactured housing industry is dominated by affiliate and joint ownership arrangements between manufactured home dealers and financing shops. The closeness of these relationships, when combined with minimal state oversight and the proposed changes to the loan originator compensation requirements, will once again make the industry ripe for consumer abuses.
HIGH-COST LENDING TRIGGERS RAISED: SEC. 108 Raises the threshold for compliance with existing consumer protections against high cost lending to a 10% interest cap above the average prime offer rate for loans less than $75,000. The proposal would also raise points and fees thresholds from the current standard to the greater number of 5% of the loan or $3,000 for all chattel loans under $75,000.[18]	The proposed changes that raise high-cost interest rate thresholds and the points and fees cap would impact the majority of manufactured loans, whose average cost is about $64,000.[20] That result would significantly increase the potential costs for manufactured homebuyers when compared to buyers of more traditional, site-built homes.

<table>
<tr><th colspan="2">Title VII
The Future of Government Sponsored Enterprises</th></tr>
<tr><th colspan="2">The Current Law</th></tr>
<tr><td colspan="2">Under current law, government-sponsored enterprises (“GSEs”) Fannie Mae and Freddie Mac have been placed into conservatorship by their regulator the Federal Housing Finance Agency (“FHFA”). To secure funding for their operations in the aftermath of the financial crisis, the enterprises executed senior preferred stock purchase agreements with the United States Treasury.[21] Those agreements currently govern Treasury’s authority to dispose of preferred stock in the entities and the current sweep of their profits to satisfy terms.[22]</td></tr>
<tr><th>What the Chairman’s Draft Changes:</th><th>CRL’s Analysis of the Change:</th></tr>
<tr><td>SEC 703 BLOCKS TREASURY FROM DISPOSING OF GSE PREFERRED STOCK WITHOUT CONGRESSIONAL APPROVAL:
The discussion draft contains a provision that would block the “sale, or other disposition, of preferred stock in Fannie Mae or Freddie Mac, by the U.S. Treasury” without first obtaining Congressional approval.

SEC. 705 DIRECTS THE FHFA TO TRANSFER THE COMMON SECURITIZATION PLATFORM TO A NONPROFIT ENTITY OPEN TO ALL APPROVED ISSUERS:
Sec. 705 would require the FHFA to annually report to Congress on the development of the common securitization platform and, within five years, convert the common securitization platform to a nonprofit entity that is available for all “approved issuers.”[23] The provision contains no criteria for approved issuers and grants the FHFA no authority to create criteria.[24]</td><td>THESE CHANGES RAISE SERIOUS CONCERNS:
The discussion draft appears to enact significant GSE reforms without consideration of the affordable housing, cost, and other policy considerations that are essential and related components to a successful GSE reform strategy.

The proposal also seeks to unnecessarily tie the hands of the FHFA and Treasury in effectively managing the enterprises conservatorship. Given the failure of the last Congress’s GSE reform efforts and its inability to agree on legislation, it seems doubtful that Congress could quickly respond to a need to modify or otherwise dispose of the stock managed under the agreements.

In addition, by directing the FHFA to open up the common securitization platform to “approved” issuers other than Fannie Mae and Freddie Mac, without establishing criteria for those issuers approval or giving the FHFA any authority to independently establish criteria, the bill appears to favor a piecemeal, incomplete, and likely highly ineffective approach to securing the future of the secondary mortgage market. In contrast, CRL favors a responsible, comprehensive approach to GSE reform, one that builds upon the successes of the existing model to ensure access for all qualified consumers.</td></tr>
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SEC. 702 BLOCKS INCREASES IN GUARANTEE FEES FROM BEING USED TO OFFSET FEDERAL BUDGET: The proposal would also ban the use of increases in Fannie Mae or Freddie Mac guarantee fees to offset federal budgetary outlays or reductions in revenues for any purposes other than "enterprise business functions or housing finance reform as passed by the Congress in the future."	CRL does not oppose provisions that would prohibit the use of increases in enterprise guarantee fees to offset federal budgetary outlays.

Sec. 107
Exclusion of Escrow Insurance Fees from Points and Fees Calculation

The Current Law

The CFPB's current Qualified Mortgage definition allows points and fees to run up to 3% of the amount of loans over $100,000, with higher points and fees caps for loans below $100,000. The cap includes items like lender and affiliate fees, as well as escrows for the future payment of insurance. Recent reports by Freddie Mac indicate average industry charges at 75 basis points; accordingly, the 3% cap (300 basis points) under the current QM rule is relatively generous.

What the Chairman's Draft Changes:	Initial Analysis of the Change:
ESCROWED INSURANCE EXEMPTED FROM THE CALCULATION OF POINTS AND FEES: Section 107 amends the Truth in Lending Act to exempt escrow insurance payments from the calculation of points and fees under the high-cost mortgage definition.[25] **COMPTROLLER GENERAL STUDY ON ACCESS TO CREDIT:** Section 107(c) also requires the Comptroller General of the U.S. to study the impact of Dodd-Frank mortgage rules on the availability of mortgage credit, including the impact on affiliated lenders and underserved communities.	**THESE CHANGES RAISE CONCERNS:** The discussion draft's escrow provision threatens to undermine current regulations designed to help consumers stay in their homes and avoid the likelihood of default—which happens all too often where escrow protections are weakened. By excluding affiliated insurance from the points and fees cap calculation, the proposal allows institutions to engage in marked-up pricing and encourages the addition of newly created insurance products that will be included in a consumer's loan as mandatory but not subjected to pricing constraints or additional protections for high-cost lending. In addition, the proposed study by Comptroller General on access to credit appears to duplicate many studies conducted by financial regulators over the past few years. As a result the study appears to be unnecessary.

<table>
<tr><th colspan="2">Sec. 103
The Designation of Rural Areas</th></tr>
<tr><th colspan="2">The Current Law</th></tr>
<tr><td colspan="2">Consumer Financial Protection Bureau regulations permit small creditors, institutions with less than $2 billion in assets (when including mortgage originating affiliates) that issue less than 500 securitized mortgage loans in the preceding calendar year and operate in predominantly rural areas, to receive exemptions to certain escrow requirements and the criteria for having balloon portfolio loans deemed as qualified mortgages.[26]

The CFPB determines the areas that are designated rural using definitions by the U.S. Office of Management and Budget, which apply Urban Influence Codes established by the Department of Agriculture's Economic Research Service.[27] The CFPB has also recently proposed adding a second prong to the definition of a rural area that would include adding all U.S. Census Bureau defined blocks that are not in urban areas.[28]</td></tr>
<tr><th>What the Chairman’s Draft Changes</th><th>CRL’s Analysis of the Change:</th></tr>
<tr><td>PREDOMINANCE REQUIREMENT REMOVED:
Section 103 of the Chairman’s Draft would strike the “predominantly” rural and underserved requirement from the small creditor exemption, allowing all institutions that meet the asset and securitization limits to become eligible for the applicable exemptions whenever any loan is made in a rural or underserved area. [29]

APPLICATION PROCESS CREATED:
Section 103(a)–(f) also requires the CFPB to start a process that lets persons or businesses apply to have an area treated as rural if they live or do business there. The CFPB must publish each application within 60 days, allow public comment for 90 days, and then publicly post the grant or denial of the application, along with an explanation of the Bureau’s rationale. Nothing stops an applicant from re-applying to have an area designated as rural after the initial application comment period and there is no language granting the CFPB power to reject applications for areas already considered without restarting the 120-day process.</td><td>THESE CHANGES RAISE SERIOUS CONCERNS:
By eliminating the requirement that a lender operate predominately in a rural area, this provision endangers the ability of small lenders to operate in their local rural communities without undue competition from larger institutions and non-rural lenders. The CFPB ‘s narrower rule recognizes that the underlying purpose of the portfolio provision is to accommodate the relationship-lending model, while acknowledging that larger institutions lack the community ties to successfully employ that model with borrowers in underserved areas.

The proposed application process would also create an expansive and drawn out procedure for designating a rural area under the Ability-to-Repay rule and other consumer protection provisions in the Wall Street Reform and Consumer Protection Act. As a result, individuals would be able to continuously delay, block, and circumvent critical mortgage provisions adopted under Dodd-Frank and put in place by the CFPB.

The CFPB has already provided special considerations for both rural and small lenders. It also continues to consider and propose amendments that ensure that all rural areas receive the proper designation. Accordingly, the proposed application process is unnecessary.</td></tr>
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Sec. 112 Mandatory Reporting Requirements for Suspected Appraisal Fraud
The Current Law
Under the Appraisal Independence Requirements created by the Wall Street Reform and Consumer Protection Act, mortgage Lenders, Originators, brokers, appraisal management companies, or any person involved in a real estate transaction involving an appraisal in connection with mortgage lending must refer any reasonable suspicion of appraiser misconduct to the appropriate state appraisal regulatory agency.[30]

What the Chairman's Draft Changes:	CRL's Analysis of the Change:
GOOD-FAITH EXEMPTION FROM CIVIL LIABILITY FOR REPORTERS: Sec. 112 (1) of the discussion draft would prevent any person making a disclosure under the law from being held civilly for the disclosure under federal, state, or local law whenever the disclosure was made in good faith.[31] **ELIMINATES ALL PENALTIES UNDER MANDATORY REPORTING REQUIREMENT:** Sec. 112(2) of the bill would eliminate ***any*** penalties for failure to comply with the mandatory reporting requirement. [32]	**THESE CHANGES RAISE CONCERNS:** In the lead up to the financial crisis, consumers suffered from intentional inflation of home appraisals. This practice, extremely harmful on its own, also proved to be a dangerous combination with declining incomes and toxic loan products. [33] By proposing to eliminate all penalties for the mandatory reporting requirement, the discussion draft eliminates any meaningful incentive for industry participants to report bad actors and provides regulators with no mechanism for ensuring that the mandatory reporting requirement for fraudulent appraisals is actually enforced.

[1] The Financial Regulatory Improvement Act of 2015, *available at* http://www.banking.senate.gov/public/index.cfm?FuseAction=Issues.View&Issue_id=d86ae09c-b158-a803-253f-443c303a8deb (hereafter referred to as "Discussion Draft" in citations).

[2] See Kevin Cirilli, Proposed Banking Overhaul Sets up High-Stakes Battle, The Hill, available at http://thehill.com/policy/finance/241761-shelby-proposes-sweeping-financial-overhaul.

[3]Consumer Financial Protection Bureau Proposal, *available at* http://www.consumerfinance.gov/newsroom/cfpb-issues-proposal-to-facilitate-access-to-credit-in-rural-and-underserved-areas.

[4] Pub.L. 111–203.

[5] See "Executive Session To Mark-Up Original Legislation Entitled 'The Financial Regulatory Improvement Act Of 2015'", available at http://www.banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=7ff3e88c-c05d-45ae-92b6-33b7cd69b16e .

[6] Consumer Financial Protection Bureau Proposal, *supra* note 3.

[7] Discussion Draft, Section 106(a) at 20.

[8] 12 CFR §1026.43(e)(5).

[9] *Id*.

[10] Discussion Draft, Section 106(a) at 20.

[11] 12 CFR §1026.35(b)(2)(iii)).

[12] Ben White and Eric Dash, Wachovia, Looking for Help, Turns to Citigroup, New York Times (September 26, 2008), *available at* http://www.nytimes.com/2008/09/27/business/27bank.html?_r=0.

[13] Nikola Kojucharov, Clyde F. Martin, Robert F. Martin, Lili Xu , "*The Subprime Mortgage Crisis: Irrational Exuberance or Rational Error?",* Federal Reserve Bank of San Francisco (July 2008).

[14] Current CFPB rules limit the small creditor portfolio exemption to transfers between small creditors. The discussion draft would allow transfers to take place between creditors of any size while retaining the QM designation, as long as the loan is not securitized.

[15] 12 CFR §1026.36(a)(1).

[16] 12 CFR §1026.32(a).

[17] Discussion Draft, *supra* note 1, Sec. 108(a)(2) at 26-27.

[18] *Id*., Section 108(b) at 27.

[19] A recent exposé by the Pulitzer Prize winning investigative journalism group the Center for Public Integrity in partnership with the Seattle Times illustrated the shocking abuses consumers face in this industry, *available at* http://www.seattletimes.com/business/real-estate/the-mobile-home-trap-how-a-warren-buffett-empire-preys-on-the-poor.

[20] Average Loan data generated through Consumer Financial Protection Bureau Home Mortgage Disclosure Act (HMDA) table, *available at* http://www.consumerfinance.gov/hmda/.

[21] To access these agreements, use the following link: http://www.fhfa.gov/Conservatorship/Pages/Senior-Preferred-Stock-Purchase-Agreements.aspx.

[22] See, e.g. Third Amendment to Amended and Restated Senior Preferred Stock Purchase Agreement between Fannie Mae and Treasury, *available at*

http://www.fhfa.gov/Conservatorship/Documents/Senior-Preferred-Stock-Agree/2012-8-17_SPSPA_FannieMae_Amendment3_508.pdf.

[23] Discussion Draft, Sec. 705 at 153-154. 157, 159.

[24] *Id*.

[25] Discussion Draft, Sec. 107(a)(2) at 23.

[26] Ability-to-Repay and Qualified Mortgage Standards under the Truth in Lending Act (Regulation Z), 78 FR 6407 (Jan. 30, 2013) (January 2013 ATR Final Rule).

[27] 12 CFR § 1026.35(b)(2)(iv)(A). See also UNITED STATES DEPARTMENT OF AGRICULTURE, WHAT IS RURAL?, *available at* http://ric.nal.usda.gov/what-is-rural.

[28] CFPB Proposal *available at* http://www.consumerfinance.gov/newsroom/cfpb-issues-proposal-to-facilitate-access-to-credit-in-rural-and-underserved-areas.

[29] Discussion Draft, Section 103(g) at 12.

[30] 15 U.S.C. 1639e(e).

[31] Discussion Draft, Sec. 112 at 33.

[32] Discussion Draft, Sec. 112 at 34.

[33] FINANCIAL CRISIS INQUIRY COMMISSION, THE FINANCIAL CRISIS INQUIRY REPORT 16, 43 (2011), *available at* http://fcic.law.stanford.edu/report.