

**Comments submitted by the  
Center for Responsible Lending, National Consumer Law Center (on behalf of its low-income  
clients), and the National Fair Housing Alliance**

**to the Consumer Financial Protection Bureau  
RE: 12 CFR Part 1026  
Amendments to Small Creditors and Rural or Underserved Areas under the Truth in Lending  
Act (Regulation Z)  
Qualified-Mortgage Rule**

Docket No. CFPB-2015-0004

RIN 3170-AA43

March 30, 2015

## **Introduction**

Thank you for the opportunity to submit comments on the Consumer Financial Protection Bureau's (CFPB) proposal to expand the qualifications for small-creditor status and the designation of areas as rural under the Ability-to-Repay rule and accompanying qualified-mortgage definition.

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.

Since 1969, the nonprofit National Consumer Law Center® (NCLC®) has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitative practices, help financially stressed families build and retain wealth, and advance economic fairness.

National Fair Housing Alliance ([www.nationalfairhousing.org](http://www.nationalfairhousing.org)) – Founded in 1988, the National Fair Housing Alliance (NFHA) is a consortium of more than 220 private, non-profit fair housing organizations, state and local civil rights groups, and individuals from 37 states and the District of Columbia. Headquartered in Washington, DC, NFHA, through comprehensive education, advocacy and enforcement programs, provides equal access to housing for millions of people.

The Dodd-Frank Act's sweeping changes included the centerpiece of Title XIV, a requirement that lender's reasonably evaluate a borrower's ability to repay a loan. This standard was written into law to place homeowners and the sustainability of their loans at the core of how mortgage loans are

made. The Qualified Mortgage standard, while providing a presumption of compliance for lenders, prioritizes features that generally result in more sustainable lending for borrowers.

Thus, any rulemaking in connection with these provisions must focus primarily on the homeowner's position and whether the loan standards ensure the borrower can afford the loan. This need for sustainable loans is universal. It is not limited to borrowers only receiving one type of loan or homeowners working with one type of lender. Dodd-Frank's mandate to reasonably evaluate the borrower's ability to repay a loan applies to all covered loans. Thus, any rulemaking that seeks to create or extend an exception to the overall rule must place at its center the question of whether it will promote responsible lending practices. The CFPB's efforts to maintain and promote access to credit must be grounded in this imperative for sustainable lending and any movement to create exceptions should be based on a demonstrable showing that it will benefit homeowners and communities.

Regulatory oversight of the mortgage activities of small depository institutions must also appropriately recognize and accommodate the fact that they are different from larger financial institutions. Small depository lenders provide important financial services using a different business model often in communities where larger financial institutions have little to no presence. As a result, small depository lenders play a critical role in providing borrowers from rural and other underserved markets greater access to credit. They participate much less in the capital market, have smaller transactions, and rely upon closer ties to the borrowers and communities that they serve. This tailored underwriting model often results in more successful lending. Yet, it is essential that regulations intended to promote the unique needs of borrowers doing business with smaller depository institutions, including those in rural and underserved areas, do not contain loopholes that open the door to abuses by either larger depository institutions primarily doing business outside the communities where they are based, or non-depository institutions.<sup>1</sup>

We applaud the Bureau's goal of seeking to ensure that small depository lenders—especially those operating in rural areas—can participate and compete in the mortgage market. The work of small

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<sup>1</sup> See, e.g., IN RE: COMMUNITY BANK OF NORTHERN VIRGINIA AND GUARANTY NATIONAL BANK OF TALLAHASSEE SECOND MORTGAGE LOAN LITIGATION (MDL 1674) (3<sup>rd</sup> Cir. Sept. 22, 2010)(discussing the predatory scheme involving a community bank and other actors including a non-depository), available at <http://www2.ca3.uscourts.gov/opinarch/083621p.pdf>.

community lending institutions is important and they must be able to continue successfully conduct business in communities across the country. The CFPB has consistently recognized the different needs of small lenders and has worked to tailor mortgage rules accordingly. In creating the existing Ability-to-Repay and QM regulations, the Bureau adopted numerous special provisions for small depository institutions to ensure their participation and competitiveness in the financial services market. Of particular significance are the small creditor designation and exceptions for rural lenders. Each of these provisions accounts for the fact that smaller institutions may have a harder time managing their business under the standard QM perimeters in the communities that they serve. They also accommodate a need expressed by smaller lenders for flexibility in loan terms due to the need for farm/home combined loans and other special circumstances.

The proposed rule suggests the following three changes to the CFPB's existing small lender exceptions:

- Including the mortgage assets of all small lender-affiliates in calculating whether a creditor is under the annually adjusted asset limit for small creditor status, which is currently set at \$2 billion;
- Raising the small creditor status loan annual origination limit from 500 to 2,000 first-lien mortgages, while excluding from the calculation all loans held in portfolio by the small creditor and its affiliates;
- Expanding the definition of "rural" to include census blocks that are not in an urban area as defined by the U.S. Census Bureau;

While homeowners borrowing from small creditors may often have unique needs, any expansion of existing exemptions should be based on documented need for further accommodation based on data supporting those borrower needs and data supporting the operational challenges faced by small, depository lenders operating in the communities where they are based.

In the wrong hands, certain aspects of the small creditor exemption could provide opportunities for abuse. For example, the small creditor exemption removes the debt-to-income (DTI) ratio cap on Qualified Mortgages while providing substantial legal insulation for lenders. Additionally, the three-year limit on the requirement to hold loans in portfolio can be used to structure loans that may fail after the three years has expired. Moreover, expansion of the rural designation must be limited to efforts that truly promote access to credit in the targeted areas, rather than providing opportunities for

evading Dodd-Frank’s mandate outside of rural areas. Thus, any increase in the loan cap for small creditors or the rural definition should both ensure that small creditors can continue to do business with underserved markets, and ensure that larger or non-rural entities will not have an opportunity to take undue advantage over a change in the rule. Moreover, revisions to existing rules should only be adopted when there is data to support the need for changes, consumer protections are not compromised, and the modified rule continues to prioritize the making of sustainable loans by all entities.

Therefore, we urge the CFPB to ensure that the final rulemaking on amendments relating to small creditors and rural or underserved areas under the Truth in Lending Act (Regulation Z):

- Maintains the \$2 billion small lender asset cap and adopts the inclusion of the first lien originated mortgage assets of affiliates, as proposed;
- Excludes non-depository institutions from small creditor exemptions generally or includes additional requirements for non-depository institutions to ensure they are providing responsible mortgage credit;
- Requires small creditors to hold portfolio loans for the life of the loan rather than three years.
- Keeps expansions of the definition of a “rural and underserved” area narrowly tailored to prevent non-rural lenders from taking undue advantage of the rule; and
- Excludes HOEPA loans from the Qualified Mortgage exemptions.

Any exemptions that are adopted should be narrowly tailored, based on data-driven assessments, and clearly delineated to promote compliance and limit abuse.

**1. Any further regulatory changes must be viewed in context with the existing framework the CFPB has already created to promote sustainable lending by small depository lenders.**

The Dodd–Frank Act creates a series of bright line rules to protect consumers from the abusive mortgage lending practices that led to the Great Recession. The CFPB’s implementing regulations of the Ability-to-Repay rule seek to strike a balance between protecting consumers and maintaining access to credit. The rules address a key cause of the mortgage meltdown and ensuing recession: Lenders making high-risk, often deceptively-packaged home loans, without assessing if borrowers

could repay them. Because of these reforms, lenders must now assess a mortgage borrower's ability to repay a loan.

When a loan gains QM status, it carries with it a legal presumption of complying with the Ability-to-Repay requirements.<sup>2</sup> Generally, a mortgage loan satisfies QM criteria if: 1) it is fully amortizing (i.e. no interest-only or negatively amortizing loans; 2) the points and fees do not exceed 3% of total loan amount, with larger percentages for small loans<sup>3</sup>; 3) the terms do not exceed 30 years; and, 4) the rate is fixed or, for adjustable-rate loans, has been underwritten to the maximum rate permitted during the first five years.

Mortgages originated by an eligible small creditor can obtain QM status if the loan meets the adjusted points and fees thresholds, is fully amortizing, does not include interest-only payments, and has a term of no more than 30 years. In addition, the lender is also "required to consider the consumer's DTI ratio or residual income and to verify the underlying information." However, these lenders do not need to meet the 43% DTI ratio threshold or use the DTI ratio standards. While these rules provide greater flexibility to smaller creditors, removal of the 43% DTI means that it is crucial that the CFPB monitor the market to ensure that this aspect of the small creditor exemption does not result in loans that are unsustainable. Moreover, the loans must be held in portfolio by a small creditor for three years to attain permanent QM status. While this requirement promotes the origination of performing loans, the termination at three years could incentivize some lenders to schedule loans to reset at or after that point. The ability of small creditors to sell a loan to another small creditor even before that three year mark may also diminish a creditor's incentive to make performing loans.

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<sup>2</sup> The rule creates two different kinds of legal presumptions: a 'safe harbor' and a 'rebuttable presumption.' Under a 'safe harbor,' a court will presume that a lender has complied with Ability-to-Repay if it finds that the mortgage is QM. Under a 'rebuttable presumption,' even where the loan satisfies the QM requirements and is presumed to comply with the Ability-to-Repay rule, the borrower has the ability to challenge this presumption and show that the lender did not reasonably assess the loan's affordability. Generally, the dividing line between a 'safe harbor' and a 'rebuttable presumption' is 1.5% above APOR for a first-lien mortgage and 3.5% above APOR for a subordinate lien mortgage.

<sup>3</sup> The QM points and fees threshold is adjusted for loans under \$100,000. Caps include: \$3,000 in fees when loan balance is between \$60,000 and \$100,000; 5% cap when loan balance is between \$20,000 and \$60,000; \$1,000 in fees when loan balance is between \$12,500 and \$20,000; and 8% cap when loan balance is less than \$12,500.

The CFPB also created a QM definition for small lenders specific to balloon loans. This designation is required by Dodd-Frank for small lenders operating predominantly in rural or underserved areas. The Bureau used its regulatory authority to establish a two-year transition period that allows all small creditors – regardless of whether they operate in rural or underserved areas – to obtain QM status for balloon loans that are held in portfolio. After the transition period, the balloon loan exception only applies to those lenders who operate in rural or underserved areas, although it already is not limited to loans in those areas but rather to any loan made by those lenders. The CFPB also created an exemption to the escrow holding requirement for small creditors operating predominately in rural and underserved areas.

Like the larger institutions, small and rural creditors also receive protections regarding the legal safeguards of QM loans. However, for small lenders, the CFPB adjusted the first-lien threshold for a safe harbor upward to match the second-lien threshold, resulting in a 3.5% threshold for both first and second-lien mortgages to receive the safe harbor, meaning small lenders have higher interest rate caps. The effect of this CFPB-created exception is a significant additional flexibility for smaller lenders.

Accordingly, the CFPB has already created for small lenders an existing regulatory framework to comply with the Ability-to-Repay rule that contains a series of substantial, narrowly tailored exemptions that recognize the unique business model of smaller depository lenders and the differing characteristics of the communities they often serve. It has been over a year since the Ability-to-Repay rule and QM designations were implemented, and early reports discussed below suggest that the rule has not negatively impacted mortgage lending, access to credit, or the profitability of community banks.

According to the latest report from the Federal Deposit Insurance Corporation (FDIC), community banks, which the FDIC defines as community-based depository lenders with less than \$2 billion in assets, fared even better than the industry as a whole. According to the FDIC, year-over-year community bank earnings for the fourth quarter of 2014 were up nearly 27.7 percent compared with net income at \$4.8 billion.<sup>4</sup> In other words, the community banking industry did substantially better after the mortgage rules took effect in January of 2014. Thus, the mortgage reforms of Dodd-Frank,

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<sup>4</sup> FEDERAL DEPOSIT INSURANCE CORPORATION, FDIC QUARTERLY, *available at* <http://www.fdic.gov/bank/analytical/quarterly>.

including existing small creditor exceptions under the Ability-to-Repay rule and QM, have not hurt mortgage lending or access to credit, as predicted.

The Federal Reserve's Senior Loan Officer Survey also supports that QM has not halted mortgage lending with the majority of respondent loan officers finding no impact from the QM rule on their lending activity.<sup>5</sup> The Urban Institute also notes that QM has not negatively impacted lending or access to credit.<sup>6</sup> Instead, the Urban Institute attributes a lack of improved access to overcorrections in the market post-crises that have constrained lending.

As a general matter, we urge the CFPB to continue adopting data-driven policy rules that are based on the market's actual response and consumer impact before deciding to alter the Ability-to-Repay provisions. Given the rule's relative newness and the market's generally positive response, further changes at this early juncture may be premature.

**2. The Bureau should adopt its proposal to include the first lien originated mortgage assets of affiliates. The CFPB should not increase the overall asset limit of \$2 billion in calculating whether the small creditor asset limit is satisfied.**

It is imperative that the exceptions granted by small-creditor status be limited to those institutions that are truly small creditors. Under the current CFPB rule, a creditor must not have more than \$2 billion in assets. The only assets counted are those of the lending or holding institution.<sup>7</sup> As a result, very large financial institutions—both deposit taking and non-deposit taking—can create unlimited smaller affiliates and have each of them qualify as a small creditor under the rule. During the subprime boom prior to the housing crisis, large financial institutions used the affiliate model in particular to house their subprime lending activities. As an example, First Union, once the sixth

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<sup>5</sup> BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, JANUARY 2015 SENIOR LOAN OFFICER OPINION SURVEY 37 (2015), available at <http://www.federalreserve.gov/boarddocs/snloansurvey/201502/fullreport.pdf>; SEE ALSO JIM PARROT ET. AL., DATA SHOW SURPRISINGLY LITTLE IMPACT OF NEW MORTGAGE RULES, URBAN INSTITUTE, (AUGUST 21, 2014) CITING BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, JULY 2014 SENIOR LOAN OFFICER OPINION SURVEY ON BANK LENDING PRACTICES (2014), available at <http://blog.metrotrends.org/2014/08/data-show-surprisingly-impact-mortgage-rules>.

<sup>6</sup> JIM PARROT AND MARK ZANDI, OPENING UP THE CREDIT BOX 5 (2013), available at <http://www.urban.org/UploadedPDF/412910-Opening-the-Credit-Box.pdf>.

<sup>7</sup> § 1026.35(B)(2)(III)(B).



largest bank in the United States, purchased affiliate Money Store for its highly problematic and predatory subprime mortgage operations.<sup>8</sup>

The Bureau’s asset limit test was created to “preclude a very large creditor with relatively modest mortgage operations from taking advantage of a provision designed for much smaller creditors with much different characteristics and incentives....”<sup>9</sup> The present exclusion of affiliated assets in calculating the small creditor cap is a significant loophole. It undermines the protections for consumers created by the Ability-to-Repay rule and the accompanying qualified mortgage designation. And it is also entirely unsupported by the justifications for allowing exemptions for small creditors in the first place, mainly the idea that small creditors are using an underwriting model based on closer ties to the borrowers and communities that they serve, are engaging in far fewer transactions than their larger counterparts, and have greater relative costs to comply with the general rule for responsible mortgage credit.

The CFPB’s proposed amendment would correct this loophole by including the mortgage assets of any mortgage-originating affiliates in calculating whether a creditor is under the current \$2 billion limit. We have previously advocated for this change and we support the CFPB’s proposed amendment. Larger financial institutions should not be able to bypass important protections for mortgage consumers by hiding the scale of their activities in related affiliates.

### **3. The Bureau’s proposal to increase the small creditor definition to 2,000 first-lien mortgages and exclude all portfolio loans appears overly broad.**

Under the proposal, the loan origination limit for small-creditor status would be raised from 500 to 2,000 first-lien mortgages. Yet, most small depository lenders and their affiliates make well below 2,000 loans annually. In fact, the American Bankers Association notes that institutions with up to \$750 million dollars in assets—an asset size that accounts for nearly 90% of all small depository lenders according to the FDIC—<sup>10</sup> “1000 loan originations per year is a common amount.”<sup>11</sup>

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<sup>8</sup> Mark Anderson, *Legacy of the Money Store*, Sacramento Business Journal (Feb. 11, 2001), available at <http://www.bizjournals.com/sacramento/stories/2001/02/12/focus2.html?page=all> (last accessed 03/30/2015).

<sup>9</sup> Proposed Rulemaking, at 29.

<sup>10</sup> FEDERAL DEPOSIT INSURANCE CORPORATION, 2013 SIZE DISTRIBUTIONS OF CHARTERS AND ASSETS, YEAR END 2013.

<sup>11</sup> AMERICAN BANKERS ASSOCIATION, COMMENT RE: DOCKET NO. CFPB-2014-0009; RIN 3170-AA43;

We are concerned that an increase to 2,000 non-portfolio loans could encourage non-depository institutions to scale their mortgage operations under the rule while they continue to operate in an environment that provides significantly less oversight of their business activities. 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 those lenders, in particular, had improper incentives to push consumers into mortgage loans with problematic features. Accordingly, if the CFPB retains the proposal to increase the cap to 2,000 loans, we encourage the CFPB to limit it to depository institutions exclusively.

In addition to lifting the loan limit, the proposal retains an automatic QM designation for all mortgage loans that a small creditor keeps in portfolio for three years. In some cases, portfolio loans charge larger fees and higher interest rates often with shorter loan terms. Therefore, these loans can be much riskier for borrowers and we are particularly concerned about abuses as it relates to portfolio loan holding. We believe that it is critical that the final rule not expand the small creditor and rural lender definition in a way that allows other financial actors to use the three-year portfolio requirement to harm consumers and strip consumer equity.

Portfolio exemptions must ensure that lenders have an actual incentive to avoid risky and unnecessarily expensive products. While some portfolio loans are safer because the lender is at financial risk, there are other scenarios where this is not the case. For example, many homeowners have very substantial equity in their homes and a significant number of those have no current home debt. Current information shows that the average loan-to-value for GSE loans is 75% with many loans having much lower levels. With these loans, the borrower's equity absorbs the risk of loss rather than the lender—and, therefore, the lender is protected even from very risky loan terms.

Similarly, the three-year portfolio exemption does not prohibit an institution from selling the loan before the three year-period without losing the QM designation. Instead, a small creditor who sells its loan at any time may keep the loan's QM designation as long as it is sold to another creditor that meets the criteria regarding the number of originations and asset size. Thus, an immediate selling of

the risk to another small creditor absolves the originator of any interest or credit risk associated with the loan, while allowing them to capture the initial origination fees. This is the exact reason that the Ability-to-Repay protections, along with the QM definition, was passed: to ensure that consumer protection remained a key consideration.

Moreover, the three-year limit on holding loans in portfolio could result in institutions creating loans that reset to unsustainable levels when that limit has expired. In light of the “exploding Adjustable Rate Mortgages” that helped drive the recent foreclosure crisis, this minimal rule may open the door for abuse. Recent experience demonstrates clearly that these products are harmful for many consumers and ill advised. Accordingly, we urge the CFPB to establish meaningful limitations on the scope of the rule allowing portfolio loans to gain automatic QM designation by limiting the exception to a depository's loans held in portfolio for the life of a loan absent exigent financial circumstances for the depository institution. At a minimum, the CFPB should seriously consider limiting any three-year portfolio loan exemption to depository institutions exclusively.

**4. We urge the CFPB to ensure that the expansion of the definition of rural be narrowly tailored to prevent non-rural lenders from taking advantage of the expansion.**

In addition to counties that are considered to be “rural” under the CFPB’s current mortgage rules, the proposal would expand the definition of “rural” to include census blocks that are not in an urban area as defined by the Census Bureau. The CFPB currently uses terms that are defined by the U.S. Office of Management and Budget, applied under currently applicable Urban Influence Codes (UICs), which are established by the United States Department of Agriculture's Economic Research Service (USDA-ERS).<sup>12</sup> We understand that this proposal is an attempt to accommodate rural pockets in urban areas or traditionally not rural classified areas. We also understand that the CFPB is responding to concerns that the current definition of a rural and underserved area is too restrictive. The CFPB is proposing to add a second prong to the definition of a rural area, which includes adding a second prong to the current rural definition as Census Bureau defined census blocks that are not in an urban area. Census blocks are generally the smallest geographic units that the Census Bureau recognizes in its geographic scheme. According to the 2010 Census Urban and Rural Classification

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<sup>12</sup> 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>.

and Urban Area Criteria, an urban area is defined as a territory encompassing at least 2,500 people, “at least 1,500 of which reside outside institutional group quarters.”<sup>13</sup>

We appreciate that the CFPB continues to consider how the rules can be further tailored to address access in rural and underserved areas. However, we are concerned that adding a second prong that includes census blocks that are simply “not urban” will improperly classify other areas that are neither urban nor rural as rural. For instance, areas that are suburban may be serviced by non-community banks that have the resources, staff, and means to originate QM loans without the rural exemptions and may be able to use a loophole in the second prong to improperly gain access to making higher cost and balloon loans, while obtaining QM legal protections. This possibility will provide non rural lenders with an exemption that they do not need, and more importantly, this does not help rural and underserved households gain access to mortgage lending. It is essential that non-rural lenders will not be able to take undue advantage of the rule proposal and that the rule be centered on how to increase homeownership opportunities in actual rural and unserved communities.

##### **5. The final rule on small creditor exemptions should only apply to depository institutions.**

While we support efforts to ensure that small lenders have as much ability as possible to originate QM loans to underserved and rural communities, there are dangers of expansion of the small and rural exemptions to the abusive actors that flourished in the lead up to the housing crisis and Great Recession of 2008. We are concerned that such actors, such as hard money lenders, foreclosure rescue scams<sup>14</sup>, property flipping schemes<sup>15</sup> and other small operations targeting homeowners for abusive products would be able to take harmful advantage of the QM exemptions, yet be able to

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<sup>13</sup> 2010 CENSUS URBAN AND RURAL CLASSIFICATION AND URBAN AREA CRITERIA, *available at* <https://www.census.gov/geo/reference/ua/urban-rural-2010.html>.

<sup>14</sup> FEDERAL TRADE COMMISSION, MORTGAGE RELIEF SCAMS, *available at* <https://www.ftc.gov/news-events/media-resources/consumer-finance/mortgage-relief-scams>.

<sup>15</sup> See *United States v. Sheneman*, 2012 WL 1831660 (N.D. Ind. May 18, 2012) (mortgage broker was both seller and broker, and used his employment as mortgage broker to complete false loan applications); *Hoffman v. Stamper*, 867 A.2d 276 (Md. 2005) (detailing a property flipping scam); see also *United States v. Bennett*, 621 F.3d 1131 (9th Cir. 2010) (describing property flipping scheme in which same individual acted as mortgage broker, appraiser, and escrow agent); *United States v. Sloan*, 505 F.3d 685 (7th Cir. 2007) (providing an overview on how straw buyers are used in an FHA flipping scheme); *Ingalls v. United States*, 2007 WL 119161 (D.N.J. Jan. 10, 2007) (real estate agent participated in property flipping and drug money laundering scheme, whereby unqualified buyers were put in substandard houses with HUD-insured mortgages); *McClelland v. Family Dwellings, L.L.C. (In re McClelland)*, 2008 WL 5157685 (Bankr. W.D. Mo. June 20, 2008) (describing property flipping scheme in Kansas City involving real estate broker, appraiser, mortgage broker, and seller); *Nationwide v. Echeverria*, 725 N.W.2d 659 (Iowa Ct. App. 2006) (title company did not pay off prior lien and closed transaction although seller lacked title to the property).

maintain QM legal protections, including a safe harbor for loans up to 350 bp over APOR, even if they are, in fact, unaffordable. For instance, borrowers have been plagued by false advertising promising mortgage payment relief via refinance or foreclosure prevention assistance for a high fee, only to lose that fees and receive no mortgage relief whatsoever.<sup>16</sup> With the increase of non-depository institutions, such as those performing servicing<sup>17</sup>, it is important that the CFPB considers ways it can tailor its rulemaking to ensure that these entities are appropriately regulated. Expanding exemptions to these entities will not serve the purpose of the rule because it will not promote sustainable lending for the target populations. It instead will provide legal insulation without adequate consumer protections. In particular, the removal of the 43% DTI ratio will open up significant opportunities for abuse among these entities. Consumers may be left with little to no legal recourse in the event that an abusive actor takes advantage of rule extensions such as these.

We urge the CFPB to use its separate exemption authority to apply this extension of the current rule to depositories only. In Dodd-Frank, the CFPB is granted broad exemption authority to provide exceptions, with such conditions as it determines are appropriate, from its rules. One of the explicit required considerations for exemptions is the presence of other safeguards in place for the exempted loans. Depositories are subject to better supervision, and have a much stronger history of responsible lending. Since the CFPB can attach any “conditions” to exemptions, it can apply the safeguard protections discussed in this comment, as conditions, in the exemptions. This approach better carries out the purposes of providing protection for consumers while providing additional flexibility for lenders with substantial supervision.<sup>18</sup>

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<sup>16</sup> LAUREN K. SAUNDERS ET. AL., DESPERATE HOMEOWNERS LOAN MOD SCAMMERS STEP IN WHEN LOAN SERVICERS REFUSE TO PROVIDE RELIEF 14-16 (2009), NATIONAL CONSUMER LAW CENTER, *available at* [http://www.nclc.org/images/pdf/foreclosure\\_mortgage/scam/loanmodscamsreport0709.pdf](http://www.nclc.org/images/pdf/foreclosure_mortgage/scam/loanmodscamsreport0709.pdf)

<sup>17</sup> Faith Swartz, Loan servicing: The Rise of the Non-Bank Servicer: Adapting to the Changing Marketplace, Corelogic, *available at* <http://www.corelogic.com/blog/authors/faith-schwartz/2015/03/loan-servicing-the-rise-of-the-non-bank-servicer.aspx#.VRm9pU10zcs>.

<sup>18</sup> Dodd-Frank provides in its objectives that: “Federal consumer protection law is enforced consistently, without regard to the status of a person as a depository institution, in order to promote fair completion.” Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub.L. 111–203 Sec. 1021(b)(4). However, the objective of enforcement without regard to depository status language does not compel that the rules ignore the distinctions between depository and non-depositories. Equal enforcement does not preclude the CFPB from promulgating rules that acknowledge distinctions.

**6. High-cost loans should not be eligible for the Qualified Mortgage presumption, nor should they be eligible for the small creditor or rural carve outs—even if they are part of the Qualified Mortgage.**

“High cost” loans, mortgage loans subject to the Home Ownership and Equity Protection Act (HOEPA), are the most expensive home loans in the market. Long before the recent housing crisis, Congress acted to enhance consumer protections when these loans are made. In 1994, Congress amended the Truth in Lending Act with the passage of HOEPA.<sup>19</sup> HOEPA was designed to protect vulnerable consumers from certain predatory lending practices by providing additional consumer protections for a class of relatively expensive home mortgage loans.

This high cost class of loans has continued to receive regulatory and legislative attention in light of the significant potential for abuse. In December 2001, the Federal Reserve Board significantly expanded HOEPA coverage and protections.<sup>20</sup> Major changes were also adopted in July 2008.<sup>21</sup> Congress again acted to increase these protections in 2010 as part of the Dodd-Frank Act<sup>22</sup> (and began formally referring to these loans as “high cost”).<sup>23</sup> HOEPA’s additional protections include three-day advance *Miranda*-like disclosures; prohibitions on certain abusive loan terms and creditor practices; increased statutory damages; and an extension of potential liability for assignees. Because of the enhanced potential for abuse with high cost loans, Congress went beyond directly regulating these loans by also limiting the Bureau’s ability to use its exemption authority in this area. While the Truth in Lending Act specifically allows the Bureau to exempt classes of transactions from regulations, high cost mortgages are explicitly carved out of this authority.<sup>24</sup>

While HOEPA was enacted well before the housing crisis that brought the global economy to its knees, it did not prevent abusive, expensive, and risky home mortgage lending. HOEPA does not regulate excessive interest rates or fees per se. Instead, it subjects expensive loans to some additional protections. Moreover, since HOEPA did not cover the entire market, excluding purchase money loans, open-end home equity loans, and reverse mortgages, abusive lending remained unchecked and even grew in many market segments. Thus, while HOEPA is an important component of limiting

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<sup>19</sup> Home Ownership and Equity Protection Act of 1994, Subtitle B of Title I of the Riegle Cmty. Development and Regulatory Improvement Act, Pub. L. No. 103-325, 108 Stat. 2190 (Sept. 23, 1994) (codified at 15 U.S.C. § 1639).

<sup>20</sup> 66 Fed. Reg. 65,604 (Dec. 20, 2001).

<sup>21</sup> 73 Fed. Reg. 44,522 (July 30, 2008).

<sup>22</sup> REG. Z § 1026.32(A) (EFFECTIVE JAN. 10, 2014).

<sup>23</sup> 15 U.S.C. § 1602(BB).

<sup>24</sup> 15 U.S.C. § 1604(F).

home loan abuse, its regime must remain connected with the newer protections initiated by Dodd-Frank.

The question of how much protection to provide for high cost loans is a pressing matter despite the general depletion of lending activity in underserved markets. High cost lending is alive and well and in fact is more able to thrive because of the general retraction from the market of more conventional lenders. In the wake of the housing crisis and limited access to conventional credit, particularly in historically underserved areas, there has been a resurgence of “hard money lending” (by individuals and small lenders working outside traditional securitization) at exorbitant interest rates.<sup>25</sup> Foreclosure rescue scams also are often covered by HOEPA,<sup>26</sup> although the loans generally do not comply with legal requirements because they are not formally arranged as loans.

Despite the long history of association between high cost loans and abusive loans, the CFPB has allowed lenders to be able to avail themselves of the Qualified Mortgage rebuttable presumption even for these high interest, high fee loans. Moreover, in the context of the small creditor exemptions, high cost loans also are included. As a result, a lender, if it qualifies for the small creditor exemption, can make a high cost loan without needing to meet any targeted debt-to-income ratio. That lender can shed itself of the loan in three years, or immediately if it sells it to another small creditor. Because most homeowners do not find representation to address cases of abusive lending, how the rules and exemptions are drawn serves as the main set of incentives for market behavior. Providing a legal presumption of affordability to high cost loans is itself questionable. Doing so while removing key affordability protections through the small creditor exemption raises even greater concerns.

Every time Congress has amended the HOEPA rules it has strengthened high cost protections. Congress has expressed a significant level of concern about the need to protect homeowners from such exorbitant lending. In fact, when focusing on the rulemaking to prevent lenders from evading HOEPA’s protections, the CFPB itself expressed concern about the importance of maintaining the

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<sup>25</sup> Press Release, “NYDFS Launches Investigation into Potential Predatory Practices by Hard Money Lenders,” New York Department of Financial Services, Sept. 16, 2014 (discussing subpoenas sent to nine companies), *available at* <http://www.dfs.ny.gov/about/press2014/pr1409161.htm>.

<sup>26</sup> *See, e.g., In re O’Brien*, 423 B.R. 477 (Bankr. D.N.J. Jan. 22, 2010) (no HOEPA disclosures provided), *aff’d*, *Cleveland v. O’Brien*, 2010 WL 4703781 (D.N.J. Nov. 12, 2010).

applicability of HOEPA's protections.<sup>27</sup> Congressional and regulatory activity to expand protections for borrowers receiving high cost loans are not consistent with the Bureau's application of the QM carve outs to these same loans, diminishing protections in the most vulnerable portion of the market.

High cost loans should not be eligible for the Qualified Mortgage presumptions due to their inherently risky nature. Further, they should not be eligible for the special exemptions available to small and rural creditors because the less stringent underwriting fails to protect the homeowner receiving such an expensive loan. The total lack of a DTI cap paired with the rebuttable presumption of compliance incentivizes loans that push the envelope on affordability. Moreover, the three-year limit on portfolio lending combined with the free pass for loans sold to another small entity prior to the three year deadline further opens up opportunities for abuse in what Congress has intended to be a highly regulated portion of the market.<sup>28</sup> The purpose of the small creditor and rural exemptions, as described by the Bureau, is to expand access to *sustainable* lending. Borrowers receiving high cost loans need loans with a stringent DTI analysis and require lenders to be invested in the performance of the loans. They should not be included in any carve out provided by the Bureau.

### **Conclusion**

Thank you for taking the time to consider our comments on the CFPB's proposed amendments relating to small creditors and rural or underserved areas. We strongly believe that a healthy national economy depends on a healthy housing sector and that small creditors play a critical role in ensuring that consumers have access to mortgage credit. We urge the CFPB to continue to carefully consider how expansions of the rule's exemptions may impact consumers, as well as small lenders. Rule exemptions must be based upon the appropriate data and should be narrowly tailored to address the specific issue without creating loopholes that hurt prospective and current homeowners. For further information about this comment, please contact Yana Miles at [Yana.Miles@Responsiblelending.org](mailto:Yana.Miles@Responsiblelending.org).

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<sup>27</sup> 77 Fed. Reg. 49089 (August 15, 2012).

<sup>28</sup> While the Bureau has created a separate exemption for high cost balloon loans, we do not address that here. That narrow exemption, however, is distinguishable from this much broader inclusion of high cost loans in the Qualified Mortgage standard, and the further step of allowing small creditors to retain Qualified Mortgage status for a loan even without meeting the entire QM standard.