COMMENTS
to the
Consumer Financial Protection Bureau

regarding

12 CFR Part 1026
[Docket No. CFPB-2014-0009]
RIN 3170-AA43
79 Fed. Reg. 25,730 (May 5, 2014)

Truth in Lending Act – Regulation Z
Qualified Mortgage Rule

by the
National Consumer Law Center
on behalf of its low income clients

and the

National Association of Consumer Advocates

June 5, 2014

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The **National Consumer Law Center**[1] ("NCLC") submits the following comments, on behalf of its low-income clients, with the **National Association of Consumer Advocates**.[2]

I. Introduction

In this proposal the CFPB addresses aspects of the qualified-mortgage rule that affect how nonprofit housing-credit providers work. The majority of housing-credit providers are for-profit institutions and, therefore, most of them put the financial interests of their shareholders first. It was this drive to maximize "shareholder value" that led to the recent financial disaster. In contrast, bona fide nonprofit housing-credit providers are structured to promote borrower's interests.

The Bureau's proposal takes reasonable steps toward recognizing the need to adjust its regulations to address how nonprofits do business. Below we discuss this issue further and

[1] The **National Consumer Law Center**® (NCLC®) is a non-profit Massachusetts corporation specializing in low-income consumer issues, with an emphasis on consumer credit. Since 1969, 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 exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness. NCLC publishes a series of consumer law treatises including Mortgage Lending, Truth in Lending and Foreclosures. These comments are written by NCLC attorneys Alys Cohen and Andrew Pizor.
[2] The **National Association of Consumer Advocates** (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

recommend ways the Bureau should further tailor its regulations and commentary toward allowing nonprofits to achieve their goals without creating loopholes that permit abuse. These recommendations include:

- Add commentary to ensure that the nonprofit provisions of the small-servicer exception and silent-second mortgage exception are not abused.
- Adopt the modification proposed for associated nonprofits
- Adopt the silent-second mortgage exception.

Unfortunately, other aspects of this proposal are less praiseworthy. By proposing a right to cure,[3] as sought by the lending industry, the Bureau incentivizes sloppy lending without sufficiently looking behind the claim that such a change would enhance access to credit. As discussed below, the past history of efforts to prevent unfair credit practices shows that—when faced with strong regulations—creditors do not abandon creditworthy low- or moderate- income borrowers. Instead creditors adapt by making loans on better terms.

For these reasons, we recommend that the Bureau abandon the proposed right to cure.

But, if the Bureau declines to abandon the cure proposal, the proposed rule should only be adopted with significant modifications. We recommend the following minimum set of requirements:

- The cure must address all negative consequences to the borrower.
- Both origination of the loan as a qualified mortgage and the cure must be in good faith.
- Errors in legal judgment should not be curable.
- There must be a cap on the size of overcharges subject to cure.
- The right to cure must automatically terminate if:
    - The consumer exercises any right of rescission or asserts any other remedies involving the loan, including filing suit or complaining to regulators;
    - The consumer or a regulator notifies the creditor or assignee of the error; or
    - The consumer defaults on the loan.
- The regulation implementing the right to cure should have a "sunset clause" to take effect once the market adjusts to the new rules.
- The regulation should remain keyed to a fixed number of days after consummation and should not be subject to the discovery rule.
- The Bureau should require mortgage holders to regularly report the number of loans cured and the type of error in order to monitor the regulation for abuse. A high rate of post-consummation cure activity should be a red flag that triggers greater scrutiny. Aggregated information should be publically available.

[3] Proposed Reg. Z 1026.43(e)(3)(iii).

II. Adopt the Proposed Amendment for Associated Nonprofits and Silent Second Mortgages Originated by Nonprofits but Add Commentary to Prevent Abuse

The Bureau proposes two amendments to protect nonprofit housing-credit providers from unintended consequences of the qualified-mortgage rule. One proposal is to amend the definition of "small servicer" in Reg. Z § 1026.41 by adding a new provision for servicers having a tax exemption ruling or determination letter under IRC § 501(c)(3). This amendment would allow nonprofit servicers to service loans originated by associated nonprofits without losing their small-servicer exemption—so long as the servicer or associated nonprofit was the originating creditor. The other amendment would exclude certain "deferred or contingent, interest-free subordinate liens" (commonly known as "silent seconds") from being counted in the 200 loan limit for the nonprofit exemption in 1026.43(a)(3)(v)(D).[4] It is our understanding that these amendments are necessary to allow nonprofit providers of low-cost housing and the related mortgages to continue operations. We support this change because we believe these organizations provide a valuable service to low-income home buyers.

But while we support the proposed language of the regulation itself, we encourage the Bureau to adopt commentary that will prevent these provisions from being abused. The nonprofit aspect of these rules is based on the belief that nonprofit creditors and servicers, as well as the loans they (or their associates) originate, are beneficial to borrowers. The proposed rule, however, could be abused by dishonest operators of a 501(c)(3) entity.

Merely having a 501(c)(3) designation does not mean an entity is beyond reproach. As exemplified by problems in the debt relief services industry a decade ago, con artists sometimes setup or gain control of nonprofit organizations to take advantage of their credibility.[5] The IRS may revoke an entity's 501(c)(3) designation for failing to comply with IRS regulations. But, until the IRS formally does so, a noncompliant entity will still have a "tax exemption ruling or determination letter from the [IRS] under [IRC] section 501(c)(3)" as required to be eligible for the exemption proposed in Reg. Z § 1026.41. A strict interpretation of the proposed regulation would permit a rogue nonprofit to qualify for the exemption until the IRS revoked its designation. And the CFPB would be obliged to honor the exemption despite even blatant evidence that the entity was not a bona fide nonprofit. This problem, however, can be easily remedied by requiring the entity to be a *bona fide* nonprofit that operates in compliance with IRC § 501(c)(3). Adding commentary specifying that the rule is to be interpreted in this manner or amending the proposed rule to include such a requirement would preserve the intent of the rule without any impact on legitimate nonprofit entities.

We also recommend a clarification, in the commentary and supplementary information announcing the final rule, to prevent abuse of the "associated nonprofit" definition. As paragraph 4 of the proposed commentary currently states, the small servicer determination is made separately for each "associated nonprofit entity." This means each entity can service up to 5000 loans and maintain eligibility for the exemption. We encourage the Bureau to publicly state that it will monitor use of this exemption to ensure that sham associated nonprofits are not used to conceal a servicer's improper invocation of the exemption while servicing more than 5000 loans. Similarly, the Bureau should occasionally examine silent second mortgages made pursuant to the proposed rule to ensure that any associated charges are bona fide.

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[4] 79 Fed. Reg. at 25738.

[5] National Consumer Law Center, Federal Deception Law ch. 10 (2012 and Supp.).

III. Abandon the Cure Proposal Because it Does More Harm than Good.

A. Overview

The Bureau has also proposed a rule that would allow a creditor to maintain the qualified-mortgage status of a loan despite exceeding the points-and-fees cap. To do so, the rule would require the creditor to refund the overcharge within 120 days of the closing. We strongly urge the Bureau to abandon this proposal. This cure rule will do more harm to consumers than the harm it is proposed to remedy. It is also unnecessary, contrary to Congressional intent and has no evidentiary foundation.

The primary reason for this proposal, as explained in the Bureau's Federal Register notice, is concern that the failure to allow post-consummation corrections might lead some lenders and secondary market participants to establish a "buffer threshold" near the points-and-fees cap to avoid the risk of unintentionally making a non-QM loan. The possibility that lenders might impose such buffers, in turn, created concern at the Bureau that consumers who qualify for loans at the margins of the points-and-fees limits might have reduced access to QM credit or might be faced with more expensive credit.[6]

The likely benefit to creditors from this proposal are clear: it would reduce pre-closing compliance costs, because creditors could fix mistakes later;[7] and more loans would qualify for the QM safe harbor or rebuttable presumption, providing full insulation from liability for prime loans and substantial protection for other loans.

The Bureau admits that the chief benefit to consumers—the potential of slightly expanded access to credit—is speculative. In fact, not only is it unsupported by any evidence, but the fear of reduced access to credit is contrary to substantial evidence. Historically, claims that regulation would undermine access to credit have been unfounded. While the credit box is restricted now, that is the industry's response to the financial crisis—it was not caused by regulation. We further discuss the lack of evidence that regulations restrict access to credit below.

The harm to consumers from this proposal is clear. The existence of a right to cure weakens creditors' incentive to exercise diligence before closing. Why make an extra effort to catch errors before the closing when any overage that slip through can be cured later? For prime loans in particular, when creditors or assignees discover an overage and cure it (providing QM status), the borrower will be deprived of the right to use the creditor's shoddy underwriting practices as a defense to foreclosure—even though the overage is evidence that the creditor failed to process the loan correctly and may have failed to properly evaluate the borrower's ability-to-repay. For subprime loans, the right to cure will give the creditor or assignee an unjustified presumption of compliance despite evidence to the contrary. And, even with a refund, the right to cure will leave some consumers paying more than they would have if the creditor had complied with the points-and-fees-cap in the first place.

[6] 79 Fed. Reg. at 25,741.
[7] As explained below, creditors and secondary market participants will already be performing post-consummation reviews so this rule does not create any incentive to add a new review process.

Below, we further discuss how specific elements and gaps in the proposed rule will harm consumers.

B. Strong Consumer Protections Do Not Restrict Access to Credit

The chief premise underlying the perceived need for a right to cure is wrong. The QM rule will not reduce access to credit (or the cost of credit), even if the "buffer" assertion proves true. The lending industry has repeatedly argued that strong consumer protections hurt access to credit. Long experience and history tell us that these "Chicken Little" warnings from the industry are the key talking point for each and every consumer protection reform. Yet that argument has just as often been proven wrong.

Researchers have examined the impact of the FTC's Anti-Holder Rule,[8] the Credit Card Accountability Responsibility and Disclosure (CARD) Act,[9] state small-dollar-loan usury caps,[10] and state anti-predatory mortgage lending laws[11] and have found that these laws neither restricted access to credit nor had a significant impact on the cost of credit. Additionally, extensive experience in the field after HOEPA was passed revealed that creditors did not generally impose much of a buffer. Lenders often skated right along the 8% points and fees cap, charging 7.99%.

While today's credit box is tight, that predates Dodd-Frank's protections. The CFPB is a data-driven institution. And there is a strong history of data showing that consumer protection rules do not restrict access to credit. There is no data showing that requiring creditors to comply with the

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[8] *See* 40 Fed Reg. 53506, 53517-518 (Nov. 18, 1975) (describing industry warnings about impact of FTC Anti-Holder Rule). *See also* Federal Reserve Statistical Release G.19 (In 1970 total non-revolving credit in the U.S. was approximately $124 billion; growth continued steadily through the 1970s – with not even a blip in 1975 and 1976 when the FTC rule was announced. By December 1980, total non-revolving credit in the United States was approximately $297 billion.).

[9] Agarwal, Sumit and Chomsisengphet, Souphala and Mahoney, Neale and Stroebel, Johannes, Regulating Consumer Financial Products: Evidence from Credit Cards (April 2014), available at http://ssrn.com/abstract=2330942 (abstract stating "we find that regulatory limits on credit card fees reduced overall borrowing costs to consumers by an annualized 2.8% of average daily balances, with a decline of more than 10% for consumers with the lowest FICO scores"); Consumer Financial Protection Bureau, Card Act Report 60-61 (Oct. 1, 2013), available at http://files.consumerfinance.gov/f/201309_cfpb_card-act-report.pdf (finding that the tightening of credit supply in the credit card market was attributable to market cycles, not Credit CARD Act regulations); Frank, Joshua M., Credit Card Clarity: CARD Act Reform Works (February 16, 2011), available at: http://ssrn.com/abstract=2000416 (finding "the CARD Act has not caused prices to rise or credit to constrict.").

[10] Robert Mayer, Loan Sharks, Interest-Rate Caps, and Deregulation, 69 Wash. & Lee L. Rev. 807, 824-825 (2012) (arguing that regulation of small loans by imposing usury caps that were moderately higher than existing usury caps but well below market rates for salary loans did not lead to a restriction of the credit market and the rise of black market loan sharking as predicted by opponents of regulation); George J. Benston, An Analysis of Maine's 36-Month Limitation on Finance Company Small Loans, 33–41 (Dec. 1972), reprinted in the National Commission on Consumer Finance, Technical Studies, vol. II (Maine rate cap on refinanced loans resulted in many high-rate borrowers finding alternative and often lower-rate alter- natives and others viewed themselves as better off not having high rate credit); R. Peterson & G. Falls, Credit Research Center, Purdue Univ., Impact of a Ten Percent Usury Ceiling: Empirical Evidence (1981) (credit more available in Arkansas with 10% usury limit than in other states).

[11] Raphael W. Bostic et al., State and Local Anti-Predatory Lending Laws: The Effect of Legal Enforcement Mechanisms, 60 J. Econ. & Bus. 47 (2008); Giang Ho and Anthony Pennington-Cross, Predatory Lending Laws and the Cost of Credit, Fed. Res. Bank of St. Louis, Working Paper 2006-022A, available at http://research.stlouisfed.org/wp/2006/2006-022.pdf (finding state anti-predatory lending laws associated with "at most a modest increase in cost."); Wei Li and Keith Ernst, The Best Value in the Subprime Market: State Predatory Lending Re- form (Feb. 23, 2006), available at www.responsiblelending.org/ mortgage-lending/research-analysis/StateEffectsToolkit.pdf.

QM rule as written will restrict access to credit. Moreover, the Bureau has had a number of years to examine the market and determine whether the QM standards themselves should be adjusted. Clear guidelines are the best remedy for skittish creditors who have tightened credit; a cure for judgment errors will only promote abusive credit and greater non-compliance. For these reasons, the CFPB should not adopt the proposed right to cure.

C. The Existing Qualified Mortgage Rule—Without a Right to Cure—is Compatible with Access to Credit

The single biggest driver of credit practices in the mortgage lending industry is the bottom line. The lending industry changes practices and products as it deems necessary to maximize profits and minimize expenses. While regulations play some role in this, that role ultimately is far smaller than other factors.

In the years leading up to the foreclosure crisis, lenders thought it was profitable to be liberal with credit. As a result, their underwriting standards relaxed and there was little effort to maintain quality assurance. After the crisis, underwriting standards and quality assurance efforts were reversed. The industry decided that the best way to stem losses and preserve assets was to adopt much stricter underwriting guidelines and rigorous quality assurance efforts. But during those time periods—both before and after the crisis—the relevant body of law governing the mortgage lending industry remained unchanged, until the effective dates for the Dodd-Frank Act and implementation of CFPB's new regulations.[12]

For the CFPB, one of the most important lessons the aftermath of the foreclosure crisis yields is this: lenders' business decisions regarding the size of the credit box have a far greater impact on access to credit than do the Bureau's regulations.[13] The QM rule has been in effect since January 2014 and access to credit (as measured by the size of the credit box) is already expanding as the industry sees the need to attract more customers. The mortgage industry restricts or expands access to credit as it sees fit based not on the impact of consumer protection rules but instead based on perceptions of credit risk and profitability.

To the extent that credit is tight due to the risk of repurchase demands from the secondary market, the industry has already taken steps to allay that concern. Fannie Mae and Freddie Mac recently announced a set of revised quality review policies and a right to fix documentation problems that will reduce lenders' exposure to repurchase demands.[14] These and other changes announced by FHFA director Mel Watt are said to "remove one of the largest overhangs holding back a housing recovery."[15] The FHA has also announced changes calculated to increase access to

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[12] While the Federal Reserve and other agencies began to scrutinize the mortgage industry more closely before the Dodd-Frank Act, the initial government response to the financial crisis was to attempt to stabilize the industry. Efforts to design regulations came later.

[13] *See* Jim Parrott and Mark Zandi, Moody's Analytics and the Urban Institute, Opening the Credit Box (Sept. 30, 2013), available at http://www.urban.org/UploadedPDF/412910-Opening-the-Credit-Box.pdf (describing causes of tight mortgage credit in 2013).

[14] Kate Berry, GSEs Offer 'Get Out of Putbacks Free' Card, Am. Bankr. at 2 (May 15, 2014) ("By easing up on mortgage buyback requests, [the GSEs] just went a long way toward encouraging lenders to make more loans to borrowers with lower credit scores.").

[15] Kate Berry, GSEs Offer 'Get Out of Putbacks Free' Card, Am. Bankr. at 2 (May 15, 2014).

credit.[16] These, like those announced by FHFA, will reduce creditors' need to impose credit overlays—and the buffer that the CFPB has been concerned about.

For all of these reasons, the CFPB's proposed right to cure is not needed.

D. The Proposed Rule May Weaken Market Discipline When It Is Needed Most.

Today, concerns are about access to credit. But, as the real estate market heats up, creditors will loosen their standards in order to increase their market share—just as they did before the foreclosure crisis. The Dodd-Frank Act was adopted to prevent the market from flying out of control again. Each exception or loophole the Bureau adds to the QM rule weakens the restraints the Dodd-Frank Act imposed.

The proposed right to cure creates a risk that creditors will one day switch to an "originate first, fix later" model. Loan originators and processors will face pressure to close loans. Lender personnel may be pressured to overlook problems before closing in the belief that they can be cured or corrected later, after closing. While the Bureau's right to cure is currently addressed only to the points-and-fees cap, the Bureau has proposed allowing other fixes (such as for debt-to-income overages).[17] Plus, the same pre-closing, quality assurance procedures that would reveal excess points and fees would also reveal other problems. If the Bureau reduces the incentive to discover some problems before closing, other problems will remain concealed. As we have already seen, when the market heats up and profits are at stake, quality assurance will be less valued. The Bureau should not adopt rules that weaken incentives to be careful before closing, when it matters most to the borrower.

For the same reasons, the Bureau should avoid measures that weaken the fundamental principle that TILA requires strict compliance. As one judge explained, requiring strict compliance "has largely been responsible for the TILA's success in achieving widespread compliance with its requirements."[18] Adopting a right to cure could be misperceived as contrary to the argument that Regulation Z must be strictly followed.

IV. If the Bureau Adopts the Proposed Right to Cure, Do So With Greater Consumer Protections

A. Overview

If the Bureau decides to adopt a right to cure, the rule must have provisions that guarantee that the right will be used fairly. These minimum provisions, discussed further below, are:

- The cure must address all negative consequences to the borrower.
- Both origination of the loan as a qualified mortgage and the cure must be in good faith.

[16] Press Release, Fed. Hous. Admin., FHA Takes Additional Steps To Provide Access To Credit for Underserved Borrowers (May 13, 2014), available at https://portal.hud.gov/hudportal/HUD?src=/press/press_releases_media_advisories/2014/HUDNo_14-048.
[17] *See* 79 Fed. Reg. at 25,743. We also oppose this proposal for similar reasons.
[18] *In re* Brown, 106 B.R. 852, 857 (Bankr. E.D. Pa. 1989). *See also* Balderas v. Countrywide Bank, 664 F.3d 787, 791 (9th Cir. 2011); Marr v. Bank of Am., 662 F.3d 963, 968 (7th Cir. 2011).

- Errors in legal judgment should not be curable.
- There must be a cap on the size of overcharges subject to cure.
- The right to cure must automatically terminate if:
    - The consumer exercises any right of rescission or asserts any other remedies involving the loan, including filing suit or complaining to regulators;
    - The consumer or a regulator notifies the creditor or assignee of the error; or
    - The consumer defaults on the loan.
- The regulation implementing the right to cure should have a "sunset clause" to take effect once the market adjusts to the new rules.
- The regulation should remain keyed to a fixed number of days after consummation and should not be subject to the discovery rule.
- The Bureau should require mortgage holders to regularly report the number of loans cured in order to monitor the regulation for abuse. A high rate of post-consummation cure activity should be a red flag that triggers greater scrutiny. Aggregated information should be publically available.

The Bureau's proposed right-to-cure regulation has some features that reduce the harm to consumers, such as limiting the time to cure to a short period after consummation and requiring good faith in originating the loan as a qualified mortgage. But these limitations on the right to cure are not enough to prevent abuse. Below we list the distinct elements needed to minimize the harm to consumers and incentivize compliance. If the Bureau adopts a cure, it should amend the proposal accordingly.

B. The Right to Cure Must Include Certain Key Elements.

1. The creditor and assignee must act in good faith.

As the Bureau recognizes, an important condition of being allowed to cure a loan must be that the loan was originated as a qualified mortgage in good faith. Absent a good-faith requirement, the right to cure would become a license for sloppy underwriting. We support the Bureau's good-faith requirement and recommend that the Bureau also require that the cure itself be made in good faith. Without a good-faith requirement for the cure, creditors and assignees could selectively cure loans only when they feared a challenge to the creditor's compliance with the ability-to-repay rule or when the creditor wants to sell a loan on the secondary market. The final rule should make clear that curing some loans selectively, or otherwise using the right to cure in order to cutoff a consumer's attempt to seek a remedy, indicates the mortgage holder is attempting to game the system rather than making a good-faith attempt to comply with the QM rule.

To reduce the potential difficulty of establishing when an overage has been cured, the Bureau should state that the cure is only effective when the consumer *receives* a signed and dated explanation from the creditor or assignee documenting the overage and implementation of the remedy. This documentation must also be included in the loan servicing file so that all transferees are on notice.

To the extent that the Bureau has stated that the cure provision is needed to preserve access to credit, the rule is, in part, intended to benefit consumers. Allowing anyone to exercise the right to cure without good faith would defeat this purpose of the rule.

2. The creditor or assignee must remedy all negative consequences of the overcharge.

The Bureau has proposed allowing overcharges to be cured with a cash refund to the consumer, but has decided against requiring any other actions to make the consumer whole after the creditor's error. This would be inadequate in most circumstances because it leaves the consumer with a residue of the harm caused by the creditor's error.

a. Excess fees charged and paid in cash.

When the overcharge was imposed for a settlement service (such as a credit report or appraisal) and was paid in cash at or before the closing, a cash refund will be adequate to cure the overcharge. But this is almost the only time a refund would be adequate to make the consumer whole and avoid providing a financial benefit to the creditor for its error.

b. Excess fees charged and financed.

As the Bureau notes, when the consumer finances all the closing costs, the consumer will continue to pay interest on the excess principal balance attributable to the overcharge even if the creditor issues a refund. This interest is a benefit to the creditor and a harm to the consumer. While the creditor (or the consumer) could apply the refund to the loan balance as a prepayment, the consumer's loan payments would have been calculated based on the original amount borrowed—which included the overcharge. There may have also been other charges imposed and tied to the original balance, such as mortgage insurance.

Fully curing these aspects of the overcharge to avoid providing a financial benefit to the erring creditor requires recalculating the consumer's monthly payments based on the new balance as well as all associated charges. The Bureau downplays the value of these corrections to the consumer and appears to view them as too burdensome for the creditor or assignee to justify the benefit to the consumer.[19] However, it is creditors who have the expertise and software to make these adjustments. And in doing so the Bureau overlooks the harm it imposes on consumers and the cumulative monetary value of these amounts to all parties as groups. It is unfair to impose any financial burden, however small, on the consumer when:

- The creditor is the one who made the error;
- The creditor and assignee will reap a much more valuable reward in preserving the QM status of the loan; and
- The creditor and assignee are much more financially capable of bearing the cost.

Rather than making assumptions that err on the side of protecting creditors (such as the concern that a present value refund might overcompensate the consumer) the Bureau should adhere

[19] *See* 79 Fed. Reg. at 25,742.

to Congressional intent and insist on strong rules that protect consumers. Otherwise, the creditor comes away with unjust enrichment while also insulating itself from further liability.

c. Excess discount points charged but not bona fide.

Another potential overcharge could arise when a creditor charges discount points but does not reduce the interest rate as promised. In that case, the discount points would not qualify as "bona fide discount points" and would need to be counted toward the points-and-fees cap. Simply mandating a refund of the overcharge overlooks the fact that the homeowner paid the discount points to lower the interest rate on the loan, and that the homeowner has not obtained the benefit of that bargain. Thus, even with a refund of the points, the homeowner is paying additional interest for the life of the loan and will have a higher monthly payment.

Rather than merely requiring the creditor to refund the overcharge, the Bureau should give homeowners their choice among: a refund of the present value of the non-bona fide discount points (in cash or credited to the loan balance), a decrease in the interest rate (without a change in the payment amount), or reamortization of the loan at the lower rate. The default option, if the consumer does not respond, should be reamortizing the loan at the lower rate.

In the Federal Register the Bureau describes a scenario in which a consumer pays discount points that are later determined to not qualify as bona fide discount points.[20] The Bureau then states that "a refund of the discount points, without additional changes to the loan, may result in a net benefit to the consumer." The Bureau does not explain how the consumer could derive a net benefit from being charged non-bona fide discount points that are later refunded. The most likely reason discount points would not be qualified as bona fide is that they did not result in a rate discount. While the creditor clearly benefits from obtaining QM status for the loan, as well as the financial benefit of additional interest, that does not directly benefit the homeowner. A homeowner may benefit to some degree from having the points refunded, but is still likely paying more than she expected, since she expected a discount on her rate. Moreover, the choice as to how to remedy the error should be the homeowner's and not the creditor's. The creditor is the one that made the mistake, and the creditor will obtain a significant benefit in reduced liability under the CFPB's proposal. While some homeowners may plan to hold their loans for a short period and may decide that a refund of the points (present-valued) may be most beneficial to them, many homeowners will hold their loans long-term and will benefit the most from the interest rate reduction.[21]

A loan should only regain QM status when the consumer can be made whole. If that is not possible, the loan should not gain QM status. In the alternative, it may be easier for creditors and regulators—and safer for consumers—for the Bureau to issue a bright-line rule declaring that the right to cure may not be used for any provision involving the terms of the promissory note. Such a rule would, in effect, limit cures to overcharges for settlement services that have not been financed.

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[20] 79 Fed. Reg. at 25,742 n.20.

[21] Although a consumer who obtains the present value of the refunded points rather than a simple refund and later refinances the loan before the end of the term will benefit financially from such a decision. However, it is unfair to penalize all consumers by allowing a simple refund and to the extent a benefit is conferred on consumers that is because the creditor erred in the first place. To confer a financial benefit on an erring creditor compounds the harm to the consumer and could have the unintended result of incenting creditors to err pre-closing and then refund after the closing.

3. Errors in legal judgment should not be curable.

The Bureau appears to suggest (in the Federal Register notice announcing this proposal) that the complexity of the law is a valid reason to tolerate errors in the points-and-fees calculation.[22] We urge the Bureau to clearly state in the regulation or commentary that errors in legal judgment are not curable. While "[t]he calculation of points and fees is complex and can involve the exercise of judgment that may lead to inadvertent errors," the same can be said for HOEPA and many other aspects of TILA. The examples the Bureau mentioned are not good faith or harmless errors. Mischaracterizations of discount points, insurance premiums, or loan originator compensation should not be curable, except as already permitted under §1640(b).

An error in legal judgment is not a defense under §1640(b) or (c), nor is it a defense under the Fair Debt Collection Practices Act.[23] In fact, we are not aware of any federal consumer protection statute that tolerates errors in legal judgment. Mistakes in legal judgment should not be curable for creditors.

4. Cap the size of overcharges subject to cure.

The proposed rule already specifies that the error is only eligible for cure if "[t]he creditor originated the loan in good faith as a qualified mortgage."[24] The good-faith requirement is vital and we strongly support it. The magnitude of the error is relevant to determining whether the loan was originated in good faith as a qualified mortgage. The larger the amount by which the loan exceeds the cap, the less likely it is that the loan was originated in good faith as a QM loan. But without a bright line, this factor will be endlessly debated and subject to litigation.

To resolve this ambiguity, the Bureau should set a clear limit, above which making a refund would not restore QM status. The creditor or assignee would still be allowed to correct the error if its dollar value exceeded the limit—something honest businesses would do anyway—but exceeding the limit would preclude QM status. Congress has already implicitly supported this concept by adding "tolerances" to TILA's remedies.[25] In 1995, Congress said creditors and assignees should not be liable for violations below a certain dollar value. If a right to cure is adopted, creditors and assignees should only escape the consequences of exceeding the points-and-fees cap if the excess was small.

Because larger errors are less likely to be the product of a good-faith mistake, the Bureau should adopt a very low dollar limit, such as $50. The limit should be a fixed dollar value, and not a percentage of the loan amount because creditors should use the same quality assurance procedures regardless of the size of the loan. A percentage-based limit would imply that bigger loans justify bigger mistakes.

Adding a cap, while essential, may tempt some creditors to routinely exceed the points and fees cap, while keeping the amount below the cure cap. The Bureau should clearly state that such an

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[22] 79 Fed. Reg. at 25,740 ("The calculation of points and fees is complex and can involve the exercise of judgment that may lead to inadvertent errors with respect to charges imposed at or before consummation.").
[23] National Consumer Law Center, Fair Debt Collection § 7.2.2 (7th ed. 2011 and Supp.).
[24] Proposed Reg. Z § 1026.43(e)(3)(iii)(A).
[25] *See* 15 U.S.C. §§ 1605(f), 1635.

approach would be evidence of bad faith and disqualify such transactions from eligibility for a cure, or make such a creditor eligible for further supervisory action. Requiring creditors to report data on their cures, as explained below, will reduce this risk.

5. The right to cure must automatically terminate if the consumer acts prior to expiration of the cure period.

The Bureau should specify that the right to cure terminates immediately if the consumer notifies the creditor or assignee of the overcharge, rescinds the loan, or otherwise asserts misconduct in regards to the loan prior to the end of the cure period.[26] This concept is recognized by the terms of 15 U.S.C. § 1640(b).

If the creditor or assignee does not discover the overcharge or attempt to cure it until the consumer draws attention to the loan, the creditor or assignee should not get the benefit of the cure rule, which essentially insulates the creditor from liability in connection with the loan. A creditor that cures only after consumers alert it may be hoping that it will not be caught, and may correct the problem only for consumers who complain prior to expiration of the cure period, instead of acting in good faith. Furthermore, if the consumer discovers the problem first, it is likely that the creditor or assignee's quality assurance procedures are inadequate.

The Bureau justifies the decision to omit such a requirement in part by noting that the short window of time during which a cure is permitted (120 days after consummation) means "it is unlikely that the consumer would provide such notice or institute such action during that period."[27] While many homeowners may not discover the problem post-consummation, a rule should not penalize consumers who promptly review their loan documents and contact their creditors as soon as they identify an error. Further, if a loan is patently unaffordable and exceeds the points-and-fees cap, that homeowner should not have her rights diminished simply because her problem is egregious and she has acted quickly to obtain relief by contacting the creditor. She may be still making payments on the loan and not in default but rather at imminent risk and thus still in need of a remedy. As with a homeowner in default, the cure should not cut off the right to seek redress.

The Bureau's other justification is that terminating the right to cure early "might undercut the purposes of the cure provision . . . ." Here, the Bureau puts the speculative benefit of increased access to credit and the more likely benefit to creditors who exceed the points-and-fees cap ahead of the harm to those consumers who discover a reason to assert their rights. The most likely result of this balancing act is to harm consumers who are the victims of predatory lending. It is exactly the threat of losing the right to cure that will motivate creditors to improve post-consummation compliance reviews.

The right to rescind, in particular, should not be affected by the proposed right to cure. The same points-and-fees overcharge that affects QM status could also be tied to a finance charge error that entitles the consumer to rescind the mortgage under 15 U.S.C. §1635. Congress has already provided limited defenses to liability in §1640. Similarly, the proposed right to cure should not be allowed to alter whether a loan is subject to HOEPA. Congress has already adopted a right to

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[26] Such as by filing suit or a compliant with a regulator.
[27] 79 Fed. Reg. at 25,742.

correct HOEPA violations in § 1639(v). The Bureau would be exceeding its authority under TILA and HOEPA by providing creditors with any additional defenses.

6. The right to cure must automatically terminate if the consumer defaults.

The Bureau inquired whether a creditor or assignee should be able to cure a loan if the consumer is in default for non-payment. We urge the Bureau to say "no." If a consumer goes into default within 120 days after the closing, that is strong evidence that the creditor did not properly underwrite the loan. A default is a red flag showing the borrower presently cannot afford the loan. The creditor or assignee should not be entitled to the safe-harbor built into the QM rule for prime loans—or even the rebuttable presumption—where the consumer has defaulted and the creditor exceeded the points-and-fees cap. Even if the consumer has cured the default by the time the creditor or assignee wants to cure the overcharge, an early default should eliminate the creditor's or assignee's right to cure. Such a loan should not be entitled to QM status even if the creditor could have cured it before the default.

7. Add a sunset clause to the right to cure.

The Bureau states that it "expects that, over time, creditors will develop greater familiarity with, and capabilities for, originating loans that are not qualified mortgages. . . as well as greater confidence in general compliance systems" leading creditors to eventually "relax internal buffers regarding points and fees . . . ." Whether or not any buffer is established by lenders, the justification for the right-to-cure will fade as lenders work more in both the QM and non-QM spaces. In addition, as lenders gain experience with the rules, errors will be less likely to be the product of a good faith mistake. For these reasons, the Bureau should add an expiration date to any cure provision it adopts. Given that the QM rule will already have been in effect for approximately a year by the time a rule could become effective, the right to cure should sunset no later than one year after it takes effect.

8. Keep the deadline linked to origination. Do not adopt a discovery rule.

In developing the cure proposal, the Bureau rightly keyed termination of that window to a fixed number of days after consummation. Although the ability to cure errors may allow lenders to become sloppy, using a fixed deadline tied to consummation prevents the drawn-out uncertainly that section 1640(b)'s discovery rule causes. The question of when something was discovered is difficult to determine and promotes litigation. Allowing cure for 120 days after discovery would also make it harder for a homeowner to exercise her rights under the Dodd-Frank Act because some creditors would inevitably claim the violation had been discovered recently and that the right to cure is still available. While the points-and-fees test for qualified mortgages does not need a cure to work as intended, any cure should be cut off shortly after consummation.

9. Require creditors and assignees to report the number of loans they cure.

Because good faith is an important component of the basis for this rule, the Bureau should require creditors and assignees to track and report the number of loans they cure as well as the nature of the error cured and the remedy provided. Without such data, it will be significantly harder for regulators to determine whether this rule is being abused. Aggregate data on these subjects should be made available to the public.

Conclusion

The Bureau's proposed modification to the small-servicer exemption for nonprofit organizations and the new exemption for silent second mortgages originated by nonprofits are both useful changes that will protect consumers. With the minor modifications we recommend, these changes will be appropriate and well tailored to achieve their goals.

The proposed right-to-cure, however, is unnecessary and rife with loopholes. In numerous ways the proposal puts the interests of the lending industry ahead of consumers' best interests. The underlying rationale for the right to cure—to preserve access to credit—is entirely unsupported by any evidence. Instead, the weight of empirical evidence disproves the industry's assertion that the qualified-mortgage rule will reduce access to credit. While the Bureau states that creditors and assignees must have strong quality control programs in order to invoke the right to cure, the reality is that the proposal weakens pre-consummation quality control. We urge the Bureau to abandon this proposal entirely or, if not, to implement the minimum standards we discuss above. Thank you for the opportunity to comment on this proposal.