July 22, 2011

VIA ELECTRONIC MAIL (reg.comments@federalreserve.gov)

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW.
Washington, DC 20551
Attn: Jennifer J. Johnson, Secretary

Re: **Regulation Z; Truth in Lending; Docket No. R-1417; RIN No. 7100-AD75**

Ladies and Gentlemen:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to respond to the request for comment by the Federal Reserve Board (the "Board") on the Board's Docket No. R-1417, Regulation Z, Truth in Lending, Proposed Rule (the "Proposing Release") relating to amendments to Regulation Z (Truth in Lending) that would implement changes to the Truth in Lending Act ("TILA") made by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").

SIFMA's comments on the Proposing Release were developed by its diverse membership, which includes financial institutions that act as residential mortgage originators, securitization sponsors, broker-dealers that act as underwriters and placement agents, and asset managers that include some of the largest, most experienced investors in residential mortgage-backed securities ("RMBS") and other structured finance products. The comments reflect SIFMA's goal of restoring capital flow to the residential mortgage securitization markets and increasing the availability of credit to American consumers. We expect that the definition of a qualified mortgage ("QM") will broadly define the parameters of the vast majority of mortgage lending in the U.S. for the foreseeable future. Therefore this rulemaking is of utmost importance. Our

[1] The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit www.sifma.org.

focus in this letter is on the application of the QM to secondary markets; in other words, we discuss a number of issues that will be critical to ensuring that investment capital continues to flow from financial markets to mortgage borrowers. We note that QM will need to work seamlessly with its related construct, that of a qualified residential mortgage ("QRM") [2]. This will require a high degree of coordination among the various regulatory agencies to ensure that standards are interpreted and applied consistently, and we propose a mechanism to ensure that the mortgage standards are always aligned.

SIFMA wishes to extend its thanks to the Board for the obvious care and extraordinary effort involved in producing a proposed rulemaking as comprehensive as the Proposing Release. We appreciate and support many of the proposed rules, and while we believe that modification of some of the proposals is necessary, we are convinced that these modifications will greatly benefit borrowers because they will create more objective standards and the legal certainty that is necessary to attract significant private capital to the mortgage markets.

Summary of Comments

In this letter we present our recommendations on key aspects of the Proposing Release. A summary of SIFMA's views on the Proposing Release is as follows:

- *Safe Harbor*. The final rule should adopt proposed Alternative I which provides lenders with a safe harbor for mortgages that meet the definition of a Qualified Mortgage.

- *Objective Standards.* The final rule must include standards for compliance that are easily verifiable with certainty upon the closing of the mortgage loan and at the time of securitization.

- *Points and Fee*s. The final rule should define points and fees clearly and narrowly such that the exact amount of points and fees charged to a borrower can be verified at or prior to the origination of the loan. In addition, the final rule for the QM safe harbor should provide a cure mechanism for lenders and secondary market purchasers who discover that the points and fees limit in the QM safe harbor was exceeded.

- *Coordination of Rulemaking for QM and QRM*. It is critically important for the Bureau in drafting the final rules for a QM to coordinate with the several agencies preparing the final rules for the risk retention exemption for a QRM to ensure that those two definitions are not at odds with one another and are not later interpreted inconsistently by any of the agencies. Moreover, we believe the most efficient way to encourage origination of QMs and to improve the efficiency of the secondary mortgage market is to provide that any mortgage satisfying the definition of QRM shall also automatically satisfy the definition of QM.

[2] 76 Fed. Reg. 24090 (Apr. 29, 2011).

- *Second Round of Public Comment.* To the extent the Bureau contemplates significant deviations from the Proposing Release the revised rules should be published in draft form for a second round of public comment.

Detailed Comments

SIFMA supports many of the Board's proposals. We have studied each aspect of the Proposing Release and request that the Consumer Financial Protection Bureau (the "Bureau") take the following recommendations into consideration when drafting the final rule.

I. The Final Rule Should Adopt a True Safe Harbor

One of the most important goals of the drafters of the Dodd-Frank Act was to promote sound underwriting of mortgage loans. We believe that the general ability-to-repay standard will further that goal. The drafters of the Dodd-Frank Act also included the concept of a QM to provide further incentive for the origination of a defined class of mortgage loans where the borrower's ability to repay has been examined by the lender. The underlying rationale appears to be an expectation that lenders will originate as many QMs as possible, relative to non-QMs, and that consumers would benefit from obtaining QMs which restrict points and fees and risky features.

Critical to the success of this approach is the attractiveness of QM loans to secondary market purchasers. Mortgage lenders and assignees, including purchasers of whole loan pools and RMBS investors, face substantial potential liability for noncompliance with the ability to repay standards of the Dodd-Frank Act. The current proposal outlines two approaches to comforting originators and secondary market participants that loans are compliant with the provisions: a rebuttable presumption and a safe harbor. We examine each below.

a. The Rebuttable Presumption Approach is Inadequate to Provide Needed Certainty to Lenders and Secondary Mortgage Markets

SIFMA believes that the rebuttable presumption approach will be inadequate to provide assurance to lenders and secondary market participants that their potential liability is minimized. Unlike the safe harbor alternative, the burden on lenders is high and the benefit (in terms of potentially reduced exposure) is uncertain, and limited at best. Under the rebuttable presumption approach, the requirements that must be met to gain the presumption of compliance are essentially the same as those that must be met under the ability-to-repay test. To comply with these requirements, lenders will need to perform individualized, fact-intensive tests for each consumer. Such a fact-intensive approach will create uncertainty for lenders and adversely impact market efficiency, pricing and credit availability. Without a clear safe harbor, lenders are likely to be very conservative, and will likely limit extension of credit to marginal borrowers who actually would be able to repay the loans, due to concerns regarding the significant consequences of a mistake.

This situation will arise because a lender's underwriting conclusions will always be subject to challenge after the fact. In other words, it will be impossible to know, at the time of origination or secondary market purchase, whether or not the loan may be subject to the liability and penalties that come with noncompliance with the ability-to-repay standards. SIFMA notes that historical evidence shows that loans with significant or uncertain assignee liability are generally not made: see for example HOEPA high cost loan volumes[3], the impact of various state high-cost loan statutes on origination of covered loans and the experience in Georgia in 2002 when it briefly implemented significant assignee liability provisions.[4] The bottom line is that secondary market participants are not interested in taking chances on uncertain risk from legal liability; the credit, interest rate and prepayment risks of the mortgages or mortgage-backed securities they purchase are all the risk secondary markets desire. If a purchaser cannot easily assess whether a loan is a QM, the interest of secondary market purchasers in acquiring such loans will decline resulting in higher rates for consumers.

Under the rebuttable presumption approach, the uncertainty and potential liability faced by lenders and assignees will result in increased costs for consumers because consumers will be forced to bear some of the cost associated with the lenders' risk, in part because lenders may simply raise rates to compensate, and also because secondary market pricing on such loans will worsen. Additionally, lenders might restrict the availability of mortgages due to their risk of liability and the corresponding decreased demand in the secondary mortgage market.

b. A Safe Harbor Will Provide Certainty to Lenders and Secondary Market Participants

As discussed above, without the QM providing a true safe harbor SIFMA is concerned that that lenders and secondary markets will be less willing to fund mortgage lending, and the intent behind the creation of the QM will be thwarted. Furthermore, without a clear safe harbor, secondary markets will be less willing to purchase mortgage loans.

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[3] According to GAO analysis of Home Mortgage Disclosure Act data, in 2009 only 6500 loans considered HOEPA "high cost loans" were reported. This is less than 0.1% of all originations. See *"Mortgage Reform: Potential Impacts of Provisions in the Dodd-Frank Act on Homebuyers and the Mortgage Market"*, Government Accountability Office, July 19, 2011 (Available here: http://www.gao.gov/new.items/d11656.pdf).

[4] The late 2002 Georgia Fair Lending Act (Ga. Stat. Ann. Section 7-GA-1) provides a clear illustration of the impact of poorly crafted assignee liability provisions. This Georgia Fair Lending Act imposed unquantifiable liability on assignees of loans. After it was enacted, many lenders stopped originating loans in Georgia, and the three major credit rating agencies issued statements that they would not provide ratings for securitizations that contained Georgia loans that fell under the purview of this statute (which was a significant share of loans to Georgia residents). As a result of this, in March 2003 the Georgia Legislature amended this law and eliminated the most onerous liability provisions. The experience of Georgia in 2003 illustrates the mortgage secondary market's strong aversion to uncertain assignee liability, regardless of any good intentions. Other states, including New Jersey and Rhode Island, have experienced similar problems in their mortgage markets due to laws with oppressive assignee liability provisions. As a general manner, laws with subjective or excessive application of assignee liability provisions operate to obstruct the supply of secondary market financing for affected mortgage loans.

SIFMA believes that a clear legal safe harbor for QMs will be critical to protect and promote the liquidity of mortgage loans and mortgage-backed securities. With a safe harbor, lenders and assignees will have needed certainty that if they comply with the safe harbor requirements for a QM, they will not face substantial liability or litigation with an uncertain outcome. Assignees will likewise have security because, after verifying that mortgages meet the definition of a QM, they will not need to worry that purchasing such mortgages (or securities backed by payments on such mortgages) will extend a risk of liability to them. As noted above, experience with assignee liability shows that secondary markets are extremely reluctant to bear such risk. Therefore a safe harbor will provide lenders a significant incentive to originate QMs. As a result, more consumers will receive mortgages that they can reasonably afford and there will be better liquidity in the secondary mortgage market.

To summarize, we believe the rebuttable presumption approach is defective and will reduce the availability of credit to mortgage borrowers. With the limited, and ultimately uncertain, legal benefit of the rebuttable presumption, lenders would assume their costs will be higher, secondary markets would assign a lower value to the loans, and ultimately these costs would be borne by all borrowers. In addition, we believe that if faced with a greater threat of litigation, lenders will naturally act more conservatively than is necessary to meet the QM presumption standards, i.e., not making loans that would otherwise be made under a QM safe harbor.

II. QM Safe Harbor Standards Must Be Objective

In order to ensure the effectiveness of the QM safe harbor, we believe the final safe harbor rules need to be built upon clear bright-line standards which can be objectively measured by the relevant parties, including the lenders, assignees and mortgage due diligence providers, at the time of origination and securitization**.** The Alternative I safe harbor is currently based upon more objective bright-line standards and limits the ability of the borrower to challenge the status of the loan's conformity to the specific QM safe harbor standards (as opposed to opening up the loan to challenge on the basis of the full general ability-to-repay standards). The Alternative I safe harbor as a result provides for more legal certainty in terms of initial compliance and in assessing litigation risk. We request that the Bureau adopt the Alternative I safe harbor legal structure and include in the QM definition only objective standards that can be easily and decisively verified by examining the mortgage, note and the other documents in the loan file. To that end, it would be beneficial to have interpretive guidance included in the final rules that would serve as a roadmap for lenders and subsequent purchasers to confirm that a particular loan satisfies the QM safe harbor.

The Alternative II presumption and the general ability-to-repay standards, however, require more individual and subjective determinations to be made. The Alternative II presumption would therefore make it easier for borrowers to challenge the QM and introduce legal uncertainty as to the loan's legal status. We believe this is further reason to implement an objective safe harbor for QM.

We are particularly concerned that the final QM safe harbor not include subjective standards such as “net tangible benefit” or “suitability” tests being required at origination. While we appreciate the intent behind the tests, we believe such subjective standards will make it far less likely or impossible for a creditor or secondary market purchaser to confirm *with certainty* that a particular loan complies with the standard. If such determinations cannot be made, lenders will be less likely to make loans, and secondary markets will be reluctant to fund them at anything approaching an economical cost from the perspective of the borrower.

The secondary market for mortgage loans and the securitization markets will require verification of the QM status before a pool of loans is purchased or securitized. As discussed above, objective standards will also promote the legal certainty that is essential for lenders and their assignees to be able to effectively price the mortgage loans. Because we expect that the mortgage market, for the foreseeable future, will consist primarily (if not exclusively) of QM loans, it is especially important that the standards be written so that the lenders and secondary market purchasers can demonstrate compliance with the QM safe harbor based on the loan files as well as automated compliance tools.

III. Points and Fees: Definition and Cure Mechanism

We are requesting that the Bureau define points and fees in a manner that furthers the policy goals outlined above. If the points and fees element of the QM safe harbor is drafted too broadly or in a vague manner, the value of the QM safe harbor will be reduced. An overly broad definition will make compliance difficult, which will undermine the purpose of QM. Lenders and secondary market participants must be able to accurately and objectively verify the points and fees element of the QM safe harbor at or prior to the loan closing. We believe it is therefore appropriate to exclude from the definition of points and fees compensation to loan officers or mortgage brokers that are otherwise currently permitted under applicable law.

In addition, the final rule for the QM safe harbor should provide a cure mechanism for lenders and secondary market purchasers who discover that the points and fees limit in the QM safe harbor was exceeded. If the excess is discovered at any time by the borrower, lender or any subsequent purchaser, the holder of the mortgage should have the right within sixty (60) days of discovery of the error to refund to the borrower the amount of such excess plus interest on such excess amount. This would put the borrower in the position as if the overcharging had not occurred. Upon the refund of the excess amount plus interest, the loan should be deemed to be fully cured and the QM status of the loan should not be subject to challenge by the consumer due to that error. This simple cure mechanism would introduce an additional layer of legal certainty into the mortgage origination and secondary markets. This cure right would also further encourage the origination of loans under the QM safe harbor. Given the high level of pre-closing scrutiny and further due diligence conducted on loan pools, we do not expect that many loans will suffer from points and fees violations. Nevertheless, the cure right would be an important means of increasing legal certainty and reducing the overall costs to consumers for the origination of QM compliant loans.

IV. Regulatory and Interpretive Coordination in Preparing Final Rules for QM and QRM

The market will view QM and QRM as inextricably linked because both were intended to serve the same purpose of ensuring a more stable lending market and because falling outside of either definition will result in significant legal and/or economic consequences. We therefore respectfully urge the Bureau in drafting the final rules for a QM to coordinate with the several agencies preparing the final rules for the risk retention exemption for a QRM to ensure that those two definitions are not add odds with one another and are not later interpreted inconsistently by any of the agencies. For example, if a maximum level of points and fees is an element of the final QM and QRM rules, then we ask that the definition of points and fees be drafted and interpreted consistently (recognizing of course that the exact points and fees percentage limit could be set higher in the QM definition). Having a single consistently applied definition of points and fees will greatly reduce transaction costs for lenders and the secondary mortgage market, shorten due diligence review time and further increase the legal certainty as to the QM and QRM status of a particular loan.

By law, the definition of a QRM can be no broader than that of a QM. For the reasons set forth above, we urge the Bureau to adopt the broadest possible definition of QM that satisfies the legislative intent of the Dodd-Frank Act related to ensuring ability to repay. Moreover, we believe the most efficient way to encourage origination of QMs and to improve the efficiency of the secondary mortgage market is to provide that any mortgage satisfying the definition of QRM shall also automatically satisfy the definition of QM.

Finally, we ask that the final rules on QM and QRM be published simultaneously to allow the market to adjust origination practices to the new rules as efficiently as possible.

V. Public Comment on Significant Deviations from Proposal

We note that it is somewhat unusual for rules to be proposed by one regulator but finalized and implemented by another. To the extent the Bureau contemplates significant deviations from the rules proposed by the Board, the revised rules should be published in revised draft form for a second round of public comment for a period of at least 60 days. As noted above, the QM rules will be critically important to the future of mortgage finance.

Conclusion

SIFMA appreciates the opportunity to comment on the Board's proposed rules and commends the Board for its detailed and thorough Proposing Release. Although we generally support the proposed rules, we encourage the Bureau to carefully consider the observations and recommendations set forth in this letter to ensure that the final rules do not impede the growth of a robust secondary mortgage market.

We would be pleased to have the opportunity to discuss these matters further with the Bureau and its staff. If you have any comments or questions, please feel free to contact Richard

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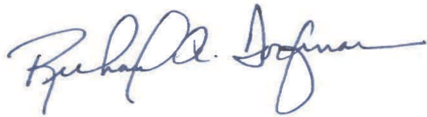
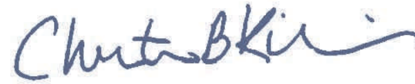
Sincerely,





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