

COMMENTS

to the

Consumer Financial Protection Bureau

12 CFR Parts 1024 & 1026

[Docket No. CFPB-2013-0010]

RIN 3170-AA37

**Amendments to the 2013 Mortgage
Rules Under the Real Estate
Settlement Procedures Act (Regulation
X) and the Truth in Lending Act
(Regulation Z)**

by the

**National Consumer Law Center
(on behalf of its low income clients)**

and the

National Association of Consumer Advocates

May 31, 2013

The **National Consumer Law Center**,¹ on behalf of its low-income clients, and the **National Association of Consumer Advocates**² appreciate the opportunity to submit comments on the Bureau's proposed revisions to its recently-issued servicing and ability to repay rules.

In Section I of these comments, we support the Bureau's proposal to clarify the effect of its RESPA rule on state law and suggest several clarifications, including inserting language relating to servicing as well as settlement practices and providing an example in the Commentary.

In Section II, we comment on the small servicer exemption. We are concerned that the exemption fails to ensure that small servicers will have the proper incentives to optimize loss mitigation and home-ownership outcomes. So long as there is an exemption for small servicers, we urge the Bureau to craft the exemption to include only those servicers who are servicing loans for which there are adequate incentives to encourage the servicers to avoid default. Thus, the emphasis in the small servicer exemption should be on the characteristics of the loans being serviced that will provide those consumer protection incentives. We also urge the Bureau to require all the servicing requirements to apply to FHA loans and reverse mortgages, even if they are being serviced by a servicer who is otherwise qualified for the small servicer exemption.

Finally, in Section III, we comment on several aspects of the income and debt definitions in Appendix Q to the ability to repay rule. We support the Bureau's proposed change to allow rental income in single family homes notwithstanding the relationship of the renter or boarder. The change regarding documentation of Social Security benefits, however, should not be adopted due to the potential for abuse; we instead suggest that the documentation requirements should be retained and augmented to require creditors to rely upon both a benefits letter and either tax returns or bank account or similar statements showing deposits of the benefits. We also propose some further clarification of the requirement to gross up public benefits to ensure the process supports rather than undermines affordability. Additionally, we propose a modification to the definition of projected obligations, which currently sets a trigger based on whether the debt will come due within 12 months. The Bureau should require creditors to look beyond the 12 month window for loans with clear payment amounts and start dates, and little flexibility in repayment terms, such as private student loans and student loans for parents.

¹ 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 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 Carolyn Carter, Alys Cohen, and Margot Saunders.

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.

I. The Effect of RESPA’s Provisions on State Law Should Be Clarified.

The Bureau proposes to make several changes to its rule regarding RESPA’s effect on state law. **We support these changes, although we suggest several clarifications.**

A. The Rule Regarding The Effect on State Law Should Be Moved to the General Provisions Section of the RESPA Regulations.

The RESPA regulation regarding the effect of RESPA on state law is currently numbered 12 C.F.R. § 1024.13 and found in a subpart of the RESPA regulations titled “Mortgage Settlement and Escrow Accounts.” The placement of the regulation in this subpart could imply that it does not apply to other subparts of RESPA, including new Subpart C, which deals with mortgage servicing. The Bureau therefore proposes to move this regulation to Subpart A, “General Provisions,” and to renumber it as 12 C.F.R. § 1024.5.

This change will be beneficial. It will place the rule in a more logical location and reduce the possibility of confusion and misinterpretation. It will also be consistent with the preemption provision of the RESPA statute, 12 U.S.C. § 2616, which similarly provides that it does not preempt state laws except to the extent that they are inconsistent with RESPA, and then only to the extent of the inconsistency. This statutory provision is applicable to all of RESPA.³

However, as noted in the next section of these comments, simply relocating the rule is not enough. The language of the rule should also be revised so that it does not refer only to settlement practices, but instead refers to all of the practices regulated by RESPA.

B. The Preemption Rule Should Refer to All of the Practices RESPA Regulates, Not Just Settlement Practices.

RESPA regulates both mortgage settlement practices and mortgage servicing practices. The second sentence of the rule regarding the effect on state law, however, refers only to settlement practices: “However, RESPA and these regulations do not annul, alter, affect, or exempt any person subject to their provisions from complying with the laws of any State *with respect to settlement practices*, except to the extent of the inconsistency.”⁴

It is clear from the Bureau’s proposed Commentary provision that it intends conflict preemption rather than field preemption to be the rule for all of RESPA, not just

³ 12 U.S.C. § 2616 (“this chapter” does not preempt state law except to the extent of any inconsistency; “The Bureau may not determine that *any* State law is inconsistent with *any* provision of this chapter if the Bureau determines that such law gives greater protection to the consumer” (emphasis added)).

⁴ 12 C.F.R. § 1024.13 as currently numbered (emphasis added).

the settlement practices provisions.⁵ This is also clear from the Bureau’s Section-by-Section analysis of the proposed rule.⁶ The second sentence of proposed 12 C.F.R. § 1024.5 should therefore be rewritten to replace “settlement practices” with “practices regulated by RESPA and these rules.”

C. The Bureau Should Adopt the Proposed Commentary Section Regarding Preemption, But With a Revision.

The Bureau also proposes to add a provision to the Commentary regarding the effect of RESPA on state law. We applaud the Bureau for this needed clarification.

The Bureau’s proposed commentary would accomplish several important purposes. First, it would add a statement that the RESPA rules do not preempt the field of regulation of the covered practices. We strongly support this proposal. The statute, 12 U.S.C. § 2616, could hardly be clearer that preemption under RESPA is limited to conflict preemption. Yet, if the Bureau is receiving inquiries about whether the RESPA rules preempt the field, it is wise to make it clear that it does not. Lack of clarity about whether state law applies has led to a great deal of litigation that should have been unnecessary.

Second, the proposed commentary would add a statement that state laws are not inconsistent with RESPA and are not preempted if they provide greater protection to consumers. We strongly support this provision as well, which is, like the rejection of field preemption, consistent with the statute.

The use of federal preemption to tie the hands of states trying to protect their residents from irresponsible lending allowed unsustainable mortgage lending to balloon, leading to the mortgage meltdown. When the mortgage crisis hit, states attempted to enforce their existing servicing protections and enact new ones, only to be met by claims that federal banking law preempted these statutes.⁷ One of the key drivers of the Dodd-Frank Act, which created the Bureau, was to allow states once again to protect their residents. Mortgage servicing, pre-foreclosure steps, and foreclosure are all areas that have traditionally been regulated by state law; indeed, in the absence of state law mortgage holders would have no means of foreclosing upon their mortgages. The Bureau’s approach of limited conflict preemption is the only approach that is consistent with the statute and with sound policy.

⁵ Proposed Official Bureau Interpretation 1024.5(c)-1.

⁶ 78 Fed. Reg. 25638, 25641 (May 2, 2013) (quoting previous Fed. Reg. notice that the servicing rules “generally do not have the effect of prohibiting State law from affording homeowners broader consumer protection relating to mortgage servicing...”; noting that proposed Commentary would clarify that RESPA and Regulation X “do not effectuate field preemption of States’ regulation of mortgage servicers or mortgage servicing”).

⁷ National Consumer Law Center, Foreclosures § 11.10.3 (4th ed. 2012).

D. The Bureau Should Provide an Example in the Commentary.

The inquiries that the Bureau reports about whether the RESPA regulations preempt the field evidence a high level of misunderstanding of the effect of RESPA on state law. In light of this high level of confusion, we recommend that the Bureau amend the proposed Commentary to include an example. We suggest the following example, which is adapted from the Bureau's Federal Register notice when it announced the servicing rule:

Example. 12 C.F.R. § 1024.41(c) requires mortgage servicers to evaluate loss mitigation requests received more than 37 days before the foreclosure sale. A state law that requires mortgage servicers also to evaluate loss mitigation requests received fewer than 37 days before the sale is not in conflict with the RESPA rule and is not preempted.

The Bureau has already made a statement to this effect in the section-by-section analysis for § 1024.41.⁸ Providing such an example will greatly assist servicers and others with implementation of the new loss mitigation rules.

II. The Standards for the Small Servicer Exemption Should be Tightened.

Small servicers are exempted from several important consumer protection requirements in the Bureau's servicing rules. Despite the beneficial nature of the consumer protections, the exemptions are provided to save the small servicers from the costs associated with development of systems necessary to meet the new standards.

⁸ 78 Fed. Reg. 10696, 10821-10822 (Feb. 13, 2013). As the Bureau noted:

In order to reduce burden to servicers and costs to borrowers, the Bureau has sought to maintain consistency among § 1024.41, the National Mortgage Settlement, FHFA's servicing alignment initiative, Federal regulatory agency consent orders, and State law mortgage servicing statutory requirements. In certain instances, each of these other sources of servicing requirements *may be more restrictive or prescriptive* than § 1024.41. That is intentional. Section 1024.41 establishes standard consumer protections and provides flexibility for Federal regulatory agency requirements, State law, or investor and guarantor requirements to impose obligations that *may be more restrictive on servicers*.

Servicers should comply with the most restrictive requirements to which they are subject. For example, § 1024.41 imposes requirements with respect to complete loss mitigation applications received more than 37 days before a foreclosure sale. This is consistent with the National Mortgage Settlement and GSE requirements. Notably, the National Mortgage Settlement and GSE requirements impose obligations to conduct an expedited loss mitigation evaluation for servicers with respect to loss mitigation applications received 37 days or less before a foreclosure sale (although in certain circumstances the servicer is not necessarily required to complete the review before foreclosure). Nothing in § 1024.41 prohibits or impedes a servicer from complying with these requirements and servicers may be required to comply with requirements that are more prescriptive than the regulations implemented by the Bureau.

Id. (Emphasis added; footnotes omitted).

Part of the rationale for the small servicer exemption is the view that these servicers have not been the cause of many of the problems homeowners have experienced with servicers in the past. The fact that there have been fewer complaints about small servicers--as compared to horrendous performance by the nation's largest and most powerful financial institutions--is not itself a reason to excuse small servicers from complying with these important new protections. The bar for compliance has been very low.

Rather, a better rationale for exempting some servicers from the rule would be the existence of other, market incentives that ensure efficiency and fairness, including access to loss mitigation. We suggest that the existence and breadth of the exemption should rest only on the presence of incentives for servicers to provide the same or equivalent consumer protections.

To assure that these incentives exist for exempt small servicers, we suggest several changes to the exemption requirements:

- a. Small servicers should only be permitted to be exempt from the servicing requirements if they both originated *and* currently own the mortgage loans.**
- b. No loans insured by FHA should be exempt from servicing protections.**
- c. Reverse mortgages should not be eligible for exemption from the servicing rules.**
- d. If the Bureau does not adopt our recommendation to require that both reverse mortgages and FHA mortgages always be provided with the full panoply of servicing protections, both types of mortgages should be counted toward the small servicer cap, regardless of the fact that the servicer may have originated and continue to own the mortgages.**

A. Origination *and* Ownership of Mortgage Loans Should Be Required.

Servicers who originate, service and keep in portfolio mortgage loans are involved from the inception of the loan to the final payoff. As originators who will continue to interact with the homeowners through the servicing, and will continue to own the loan, they have an incentive to ensure that the loan is affordable and fair and will not result in a foreclosure.

Servicers who own the loans they service avoid the conflict of interest issues that often arise between investors and large institutional servicers. Servicers of loans held in portfolio have significant financial and reputational interests in avoiding the losses that flow from foreclosure. If the losses can be avoided by engaging in loss mitigation efforts,

these servicers have built-in incentives for reaching out to homeowners, providing loan modifications and other solutions. While it would be preferable for the CFPB's mandates regarding servicing to apply to all servicers handling consumer mortgages, exemptions for servicers with a financial stake in loan performance are a more reasonable measure than a purely numerical threshold.

The best combination to ensure the presence of incentives is to craft an exemption applicable only to small servicers that both originated *and* continue to own the mortgage loans they service. These servicers are clearly involved with the homeowners; they probably have – or are developing – ongoing business relationships with them. These servicers are more likely to be cognizant of the stigma and cost to their business in the community if they engage in unfair or inappropriate behaviors towards homeowners.

This dynamic is far less likely to be the case for servicers who did not originate the loans, even if they currently own them. These servicers did not have an original relationship with the borrowers. The borrowers did not choose to do business with these servicers. While servicers who own the loans do have incentives to avoid losses, the risks of business reputational losses from avoidable foreclosures are not nearly as significant as for those who originated and still own the loans.

In applying the exemption we propose, the Bureau should take the position that servicing as trustee for a security that holds the loans being serviced is not ownership of the loans and does not qualify the servicer for the small-servicer exemption. Being trustee for a security which owns thousands of loans is very different from actually owning the loan. There are substantial protections against loss for the investors in the trust--including insurance and over-collateralization--which do not include ensuring consumer protections to the homeowners whose homes are secured by mortgage loans owned by the trust.

B. The Servicing of FHA Loans Should Not Be Exempt From Full Compliance With All Servicing Regulations; FHA Loans Should Count Toward the Small Servicer Exemption Cap.

As is obvious from the numerous news stories about record-breaking losses to HUD from FHA loans, both originators and servicers of FHA loans have been unsuccessful in avoiding foreclosures. The huge, unprecedented losses incurred from failed FHA mortgages⁹ is an indication that servicers of FHA loans--even those who service loans that they have originated--have failed to stop avoidable foreclosures. These losses illustrate the necessity of retaining all available consumer protections on these loans. Lenders and servicers of FHA insured mortgages know all too well that they will not bear the loss from a loan that has gone bad--a dynamic that has resulted in unprecedented losses to the FHA fund in the last few years.

⁹ See Vicki Needham, "Federal Housing Administration facing \$16.3 billion Loss," The Hill, November 16, 2012. Available at <http://thehill.com/blogs/on-the-money/1091-housing/268443-federal-housing-administration-facing-163-billion-in-losses-taxpayer-bailout#ixzz2UjWoQ17Q>.

Servicers who are servicing FHA loans--even if they originated and own these mortgages--should not be permitted to avoid any of the CFPB's servicing rules for these loans. While FHA servicing rules, and compliance with them, may be augmented in the future, at present FHA loans are consistently lacking in foreclosure avoidance.

If the Bureau declines to require small servicers to apply all applicable servicing rules to FHA loans, it should at least count all FHA loans--regardless of who originated and owns them--toward the small servicer exemption cap. Servicers who service significant numbers of FHA loans should be subject to the various baseline requirements established by the Bureau to ensure that sensible servicing and loss mitigation procedures are implemented. Compliance with such procedures and related beneficial outcomes have long been lacking in the FHA space.

C. Reverse Mortgages Should Not Be Eligible for Exemption From the Servicing Rules; Reverse Mortgages Should Be Counted Toward the Small Servicer Exemption Cap.

All reverse mortgages should be subject to the Bureau's servicing rules. The numbers of foreclosures of reverse mortgages, often caused by the homeowners' inability to pay off taxes and insurance, have been rising steeply in recent years.¹⁰ As the CFPB itself pointed out, one out of every ten homeowners with a reverse mortgage is currently in foreclosure.¹¹ To assist in avoiding unnecessary foreclosures, these homeowners need the periodic billing statements and loss mitigation tools that small servicers will not otherwise be required to provide. For these reasons, as with FHA loans, the small servicer exemption should not apply to any servicer that is servicing reverse mortgages.

If the Bureau allows the small servicer exemption to include those servicing reverse mortgages, it should at least count reverse mortgages toward the cap (contrary to the Bureau's proposal). Servicers who administer a significant number of reverse mortgages should not be eligible for the exemption due to the heightened need for loss mitigation and high-touch servicing for these loans.

III. Income and Debt Definitions: The Rental Income Definition Should Be Broader, Social Security Documentation Should Be Enhanced, Not Narrowed, and the 12-month Projected Obligations Trigger Should Include Exceptions.

The Bureau proposes clarifications in the definitions of income and debt for purposes of the Ability to Repay rule and the Qualified Mortgage rule. The Bureau states that, while it adopted HUD's FHA definitions, some additional changes are needed. Proposed changes include:

¹⁰ Ben Hallman, "Reverse Mortgage Foreclosures On The Rise, Seniors Targeted For Scams," Huffington Post, June 27, 2012, available at http://www.huffingtonpost.com/2012/06/27/reverse-mortgage-foreclosures_n_1631626.html.

¹¹ *Id.*

- a. Removing the requirement in Appendix Q that boarders/roommates in single family homes paying rental income must be related by blood, marriage, or law. **This change should be adopted.**
- b. Removing the option of using Federal tax returns for verifying Social Security benefits and instead requiring use only of a benefit verification letter issued by the Social Security Administration. **Documentation, in the form of tax returns or banking statements that demonstrate regular deposits, should be required in addition to the benefit verification letter.**

In addition, the Bureau has asked for input regarding Appendix Q. In the final rule, Appendix Q requires that debt payments do not have to be classified as projected obligations if the consumer provides written evidence that the debt will be deferred to later than 12 months after loan closing. **The 12-month maximum for defining projected obligations in Appendix Q should be extended at least for private student loans and student loan repayment by parents, where repayment terms and timelines are known in advance and repayment terms are not flexible.**

A. Rental Income on Single Family Homes Should Be Included Whether or Not Provided By a Party Related by Blood, Marriage or Law.

The Bureau should adopt the proposed removal of requirements on rental income for a single family home where the rent is paid by a roommate/boarder, rather than a tenant in a separate unit, so that income may be counted, whether or not provided by a party related by blood, marriage or law. This change is a significant improvement. Many homeowners need the additional income provided by roommate-provided income and plan on such arrangements upon purchase of the property. Moreover, some homeowners may want to take on renters but do not have the financial means to construct a rental unit. This expansion is a sensible adjustment that will provide greater access to affordable loans for homeowners sharing their single-family homes with roommates.

B. Documentation for Social Security Benefits Should Include Tax Returns or Bank Statements in Addition to the Verification Letter; Grossing Up Should Be Based on the Appropriate Tax Bracket.

The Bureau proposes changes to section I.B.11 of Appendix Q on how to account for Social Security income. The Bureau proposes to require creditors to obtain a benefit verification letter issued by the Social Security Administration as the sole form of documentation. The rule in its current form requires use of either Federal tax returns or verification from the Social Security Administration through an awards letter. So long as the documentation requirements for Social Security benefits require that the benefit verification letter come directly from the Social Security Administration, this documentation is sufficient. However, if the verification letter is delivered to the lender through a broker, or even an originator working for the lender, this is not sufficient

verification. Benefit verification letters – like other short verification documents – provide easy vehicles for the falsification of income.

The current rule should be revised to require creditors to use either tax returns or bank statements showing the deposit of the benefits into the bank account, in addition to requiring a verification letter (where the verification letter cannot be obtained directly from the government payor). This additional information will provide more substantial verification in a form that is still readily available to applicants. Tax returns, on their own, however, would be an incomplete additional means of documentation because many low income homeowners are not required to file tax returns. The additional option of using bank statements will allow a homeowner to demonstrate receipt of benefits through regular bank deposits. For those homeowners who receive their benefits on a debit card, statements documenting such transactions can be requested by the homeowner and provided to the creditor in lieu of a banking statement. This approach will ensure that homeowners have easy access to needed income documentation for obtaining a loan without providing a means for public benefits documentation to be used to inflate income on a loan.

Moreover, the Bureau should specify in Appendix Q, 1.B.11.ii that grossing up of Social Security benefits should be done based on a tax bracket that is appropriate for the income received. The general language currently in Appendix Q will lead to (and support the existing practice of) grossing up that allows, rather than prevents, many unaffordable loans. Many homeowners who receive SSA benefits have their income grossed up into the top tax bracket, with the result that the underwriting process assumes that they have more income available to them than is truly available. The Bureau should clearly allow creditors only to gross up Social Security benefits based on the actual tax bracket applicable to the amount of income received.

C. Projected Obligations Should Include Certain Student Loans That Come Due Beyond 12 Months

The Bureau also asked for input on Appendix Q. The 12-month maximum for defining projected obligations should be extended for loans with predictable repayment requirements and inflexible repayment terms—that is, at least for private student loans and student loan repayment by parents.

Dodd-Frank requires an analysis of ability to repay for a minimum of five years (based on the maximum payment) for Qualified Mortgages, and for seven years for non-QM loans. While many future obligations may be difficult to quantify substantially in advance, and may allow significant flexibility as to when they come due and how they are repaid, two types of student loans stand out as quantifiable and generally inflexible in terms of repayment options.

First are private student loans. While federal student loans are subject to income based repayment for borrowers who seek this assistance (and thus repayment terms are not necessarily knowable upon origination), private student loans have little room for

changing repayment terms. As the CFPB itself has noted, borrowers with private student loans are provided with little flexibility for repayment options.¹² Second, Parent PLUS loans, loans taken out by parents of students, also are not subject to income-based repayment and thus have predictable, and often substantial, monthly payments. Where future obligations will be subject to known monthly payments and have little flexibility in cases of hardship or limited income, student loans should be included in the projected obligations analysis under the Ability to Repay rule, even if payments begin after the first 12 months of the new loan. Student loan payments that come due in more than one year may substantially affect a borrower's ability to repay the mortgage.¹³ Ignoring such debt where the creditor is required to determine ability to repay for a horizon of five or seven years builds blind spots into a system intended to meaningfully assess affordability.

¹² Consumer Financial Protection Bureau, *Private Student Loans* 12-13 (Aug. 29, 2012), available at http://files.consumerfinance.gov/f/201207_cfpb_Reports_Private-Student-Loans.pdf.

¹³ *Id.* at 53-54 (based on a longitudinal study of borrowers who started school in 2003/2004, 20.4% of borrowers of monthly student loan payments owed payments of more than 10% of their monthly income).