Consumer Federation of America

The Honorable Richard Shelby
Chairman
U.S. Senate Committee on Banking,
  Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Sherrod Brown
Ranking Member
U.S. Senate Committee on Banking,
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534 Dirksen Senate Office Building
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Dear Senators,

Thank you for the opportunity to comment on Chairman Shelby's draft "Regulatory Improvement Act of 2015." Consumer Federation of America (CFA) is a national organization representing approximately 300 organizations at the state, local and national level that conducts public education and policy analysis on behalf of consumers, with a particular focus on low- and moderate-income consumers. This letter focuses on three main issues that are included in Senator Shelby's draft bill: home ownership and financing, financial stability, and improved access to capital and tailored regulation in the financial markets. These areas do not represent all of the concerns that CFA has with this draft legislation.

While there may be important changes that could be considered in Dodd-Frank to lessen burdens on smaller, community institutions and to streamline regulatory oversight, the scope and breadth of the changes contained in this bill's provisions are overly broad and should not be supported without significant changes to restrict their coverage and narrow their effect. Some provisions should be dropped altogether.

The bill as drafted would eliminate crucially important consumer protections and reopen financial markets and consumers to the same risks that brought down the financial system in 2008. It would impose unreasonable and unproductive new requirements as part of the oversight of systemically important financial institutions, weaken critical Dodd-Frank Act provisions to contain systemic risk, and limit the accountability and prudence of such institutions.

Title VII of the draft bill could foster important and positive movement toward an eventual long-term restructuring of the mortgage finance system. However, we have serious concerns about the details of these provisions, which are outlined below.

Home Ownership and Financing

Section 106 – Safe Harbor for Certain Loans
We strongly oppose the provisions in Section 106 that would exempt loans held by creditors in portfolio from the basic consumer protections for mortgage borrowers established in Dodd-Frank. Congress established these requirements after widespread failure by *all types of lenders* to apply basic underwriting judgments in granting mortgage credit. Dodd-Frank requires *all* mortgage creditors to make the ability to repay (ATR) judgment. It included a Qualified Mortgage (QM) provision that provides a presumption of compliance with the ability to repay (ATR) rule to any lender if all of its requirements are met, in the form of a safe harbor for most loans and a rebuttable presumption of compliance for higher-priced loans. But QM designation does not absolve a lender of the obligation to meet the ATR test. In fact, it explicitly *requires* the test to be met.

The new proposed subsection (j) in the circulated draft would exempt certain loans from the basic requirements of 15 U.S. C. 1639(c)(a), which establishes a creditor's obligation to make a good faith effort to determine that the borrower can fulfill the terms of the loan as offered. That section further enumerates the important components of a borrower's income and credit history that should be taken into consideration when making this determination. The proposed amendment would strip these basic protections from consumers served by creditors intending to hold the loan in their portfolio.

For these loans, the provision also would eliminate the cap on points and fees that is required for a loan to be a Qualified Mortgage (QM) in existing law. When combined with the elimination of an ability to repay (ATR) test, this provision could easily subject consumers to exactly the kind of unreasonable and potentially predatory pricing that plagued consumers in the run up to the financial crisis.

This section would also, for these loans, sweep away the protections against abusive features in balloon loans contained in existing law. This could subject consumers to a new round of loans with unfavorable terms simply because the creditor intends to hold the loan in portfolio.

This sweeping extinguishment of consumer protections would be extended to *any* loan held in a creditor's portfolio, or by any creditor who purchases the loan for their own portfolio. While the section opens with an enumeration of regulated depository lenders, it does not restrict its provisions only to such institutions. Thus, a life insurance company holding whole mortgage loans in portfolio or a captive reinsurance affiliate of another lender would seem to qualify for this treatment as could a special purpose entity of a regulated or unregulated institution set up to hold loans in its portfolio. It could be construed to apply to any loans purchased by Fannie Mae and Freddie Mac through their cash windows and held on portfolio. This is a staggering assault on the most basic consumer protections included in Dodd-Frank.

This proposed section does retain specific protections against loans with unstable and disadvantageous features, such as interest only payment options and negative amortization. We are pleased these remain. But this does not change our very strong opposition to the proposed Section 106.

For these portfolio loans, this proposed bill also would eliminate the requirement for first time homebuyers to receive housing counseling on loans that do not meet the QM requirements (which these loans would not meet), as well as provisions governing appraisals. Once again, there is no evidence that the mere act of retaining a mortgage in portfolio in any way justifies that consumers, and especially first time homebuyers, should not be afforded this basic protection when the loan does not comply with the requirements of the QM standards.

Proponents of these changes argue that lenders who retain the full credit risk of a loan by holding it in portfolio will have strong enough incentives to carefully underwrite mortgage loans and avoid granting credit on terms they do not believe consumers can fulfill. While this might once have been a reasonable assumption, there were many instances in the run-up to the crisis of depository lenders and other financial entities holding on their balance sheets both whole loans and securities backed by loans with predatory features. These loans failed in great numbers, leading to significant financial stress for the lenders involved, in some cases causing them to fail or be forced to merge with stronger institutions. The basic ability to repay requirement was designed to establish a firm barrier to irresponsible lending. The hard lessons learned in the period of reckless lending that caused the mortgage crisis should not be discarded. The basic requirement to establish a borrower's ability to repay a mortgage loan protects both the consumer and the creditor and should not be abridged as this proposal would do.

These changes are not necessary to accommodate the needs of smaller community banks because these institutions already have significant accommodations in Dodd-Frank and in the final regulations. The proposed legislation would expand these to include *any* creditor holding mortgage loans on their balance sheets. There is no reasonable justification for this provision and we urge you to strongly oppose its adoption.

Section 108 – Manufactured Housing

This section is a significant elimination of basic consumer protections that would most directly affect borrowers with low and moderate incomes for whom manufactured homes are a valuable and viable source of affordable home ownership.

By raising the threshold for compliance with existing consumer protections against high cost lending to $75,000 and the margin on interest rates that trigger these protections to 10 percent from the existing levels of $50,000 and 8.5 percent the proposed section would exempt most manufactured homes from coverage. As documented recently in a series of articles published by the *Seattle Times*, lending for manufactured homes most often lies outside of traditional regulated creditors. Moreover, because the industry has evolved to feature affiliations and joint ownership between the home dealers and financing entities there is a rich potential for abuse. This proposed change also would increase the cap on points and fees to 5 percent or $3,000, significantly increasing potential costs for buyers of these homes when compared to buyers of more traditional, stick-built homes. Again, this strips important consumer protections only on the basis of the type of home being purchased. We strongly oppose this provision and urge you to do the same.

Title II- Financial Stability

Title II of this bill undermines the Federal Reserve's ability to effectively supervise some of the country's largest banks. It does so by imposing an onerous and unreasonably long process that financial regulators must undertake before the Federal Reserve can apply enhanced supervision and prudential standards to banks with assets between $50 billion and $500 billion. This new process requires, for example: an initial recommendation by the Federal Reserve; followed by an evaluation and two-thirds vote by the Financial Stability Oversight Council (FSOC); followed by a proposed determination, requiring another two-thirds vote by the FSOC; followed by a notice to the bank of the proposed determination and an opportunity for the bank to contest the determination and submit plans to modify its business structure to address the potential threat that the company poses; followed by a vote by the FSOC on a final determination that the bank is systemically important. There is also a mandatory and cumbersome reevaluation process every five years. Such a burdensome, impractical, and time-consuming process will inevitably delay and possibly obstruct the Federal Reserve's ability to prevent and mitigate risks from forming within banks and, by extension, the financial system.

This proposal constitutes a dangerous rollback of important provisions of the Dodd-Frank Act, which requires enhanced supervision and prudential standards for banks with assets greater than $50 billion. Importantly, the Dodd-Frank Act requires a tailored application of prudential standards based on the relative size and risk of a bank. Regulators have a great deal of discretion to vary the prudential standards that they apply to smaller and less systemically significant banks, which is appropriate and desirable. This means that the Federal Reserve already treats a bank with $100 billion in assets differently from a bank with $450 billion in assets, and a bank with $450 billion in assets differently from a bank with $2 trillion in assets. However, by effectively preventing regulators from providing greater supervision and prudential standards to some of the largest regional banks in the country, this bill makes it more likely a large regional bank will fail, with devastating consequences for our nation's financial security.

The dangers of this approach are amply illustrated by the actual experience of Washington Mutual, a large regional bank with approximately $300 billion in assets that failed in 2008 in part because it was inadequately supervised. To stem the loss in confidence in the banking system as a result of Washington Mutual's failure, the bank received a government bailout, followed by a government facilitated takeover. Returning to a model that makes that scenario more likely would be ill-conceived and perilous.

Title VII – Improved Access to Capital and Tailored Regulation in the Financial Markets

Title VII of the draft would adopt a series of requirements and restrictions on Fannie Mae and Freddie Mac while they are under their current conservatorship. These changes could foster important and positive movement toward an eventual long-term restructuring of the mortgage finance system. Directing the Federal Housing Finance Agency (FHFA) to develop a common securitization platform that can accommodate other issuers in the future would allow the platform to be used in a number of different market configurations after conservatorship. Similarly, fostering more experimentation with risk sharing on the front end of the governmentsponsored enterprises' (GSE) process could help answer some important questions that vexed those working on GSE reform last Congress.

While we welcome the draft's intention to move forward on specific and important pieces of broader secondary market reform, and support some of the proposals, we do not support some of them without significant changes to modify and narrow their impact.

Guarantee Fees
We support Section 702, which would prohibit the use of guarantee fees charged by Fannie Mae and Freddie Mac to offset other expenditures in the budget. These fees are paid for by consumers and should relate only to the revenue needed to back the guarantees issued by the companies on their mortgage backed securities and to operate their businesses in a safe and sound manner.

Preferred Stock
Section 703 would prohibit the selling or other disposition of the Senior Preferred Stock held by Treasury in return for its support of the companies without explicit congressional approval. We agree with this provision. Until Congress adopts comprehensive mortgage finance reform, significantly altering the government's senior interest in the companies would be a mistake. This provision would ensure congressional review of any move to dispose of or transfer the Treasury's interest in this senior preferred stock. We believe this is sensible and support the provision.

Advisory Committee
Section 704 would require the Federal Housing Finance Agency (FHFA) to establish a Secondary Market Advisory Committee to advise Fannie Mae and Freddie Mac on the development of the common securitization platform that the two companies are developing through a joint venture, under FHFA's direction and supervision. While we support the idea of such a committee, we cannot support it without amendments that would require representation of consumer interests, particularly individuals with experience in developing and operating programs to expand access to responsible mortgage credit and in working with secondary market participants to ensure a liquid market for such products. The entire purpose of the government's support of the mortgage finance system is to provide a steady supply of affordable and sustainable mortgage credit to consumers. Leaving out this perspective from the proposed advisory committee is unacceptable.

Securitization Platform
Section 704 would direct the FHFA to develop a common securitization platform that can be used by securitizers other than Fannie and Freddie, to move forward a timetable for implementing the platform for this use and to initiate the platform's use by other entities. It also would require the board of the joint venture to be expanded to include representatives outside of Fannie and Freddie.

We support the intention of this section to ensure that the common securitization platform built under FHFA's direction has the capacity to serve other customers in addition to the GSEs. Given the uncertain nature of long-term mortgage finance reform, we believe it would be a serious mistake to build the platform without ensuring that it could be adapted to a variety of potential long-term solutions. These could include Fannie and Freddie as currently structured; entirely new entities; some new "utility" formed by merging some or all of Fannie and Freddie's current functions, or some other outcome. As we have noted in past statements to the Committee, we believe that a federal guarantee of mortgage backed securities is an essential element in any future mortgage finance system. The availability of a platform and associated documentation and servicing standards will be an essential element of any such guarantee structure. Thus we agree that the current common platform work should anticipate and be designed to accommodate these varying outcomes.

However, given the uncertain nature of a future outcome, and the importance of upgrading the GSEs' current platform expeditiously, we do not support this section's requirement that FHFA move, in a short period of time, to facilitate the issuance of securities by others within any certain time frame as required in this section. We urge you to amend this section to retain the strong direction to FHFA to ensure that the platform is designed to accommodate a variety of issuers, whether Fannie and Freddie or others, and to incorporate whatever features are necessary to make the transition to a multi-issuer platform seamless and without unnecessary friction without requiring FHFA to implement such use.

This section also would require the current board of the joint venture to include a minority of directors not employed by or serving on the boards of Fannie or Freddie. We are concerned that requiring this change at this time, while mortgage finance reform is unresolved, will potentially complicate and delay the platform's progress. Doing so could easily raise significant issues of proprietary business knowledge and processes, restraint of trade and competitive concerns, and other concerns that would delay rather than facilitate the platform's progress. The Advisory Committee authorized by a separate section should provide the requisite insight and advice to FHFA, as the companies' regulator for the time being.

Risk Sharing

Section 706 directs FHFA to require the GSEs to increase their use of risk sharing techniques to include risk sharing on the "front end" of the mortgage transaction, and to do so at a pace that would be established by Congress in this section. We support the increased use of non-GSE capital to absorb risks ahead of their guarantee. But we do not believe directing such risk-sharing's use without much more information about its impacts on the availability and affordability of mortgage credit by consumers is justified. Rather, any provision that we could support would require FHFA to direct the GSEs to carry out a limited number of pilots that would significantly expand the use of front end risk sharing from other entities approved by FHFA, like mortgage insurers who meet the requirements of the recently finalized Private Mortgage Insurer Eligibility Requirements (PMIERs) standards.

These pilots should be designed to prevent distorted results through "creaming" of their business in ways that would distort the conclusions of such pilots for more widespread use or distorting pricing of such coverage through preferential and differential pricing by lender customer, rather than by the characteristics of the loans being covered, for instance. Since a key aspect of such pilots is the reduction of the GSEs front end risk, they should include significant reductions in the GSEs' own guarantee fees. We note parenthetically that the value of mortgage insurance required today on certain higher risk loans is not necessarily reflected in lower GSE guarantee fees, adding costs to consumers. Moreover, such pilots should require extensive and comprehensive reporting by risk sharing partners of loan-level details of the loans covered by them in the pilots, including information about income and race of the borrower, location of the mortgaged property, and other data as closely aligned with that required of the GSEs as possible. The section should require FHFA to closely evaluate these pilots and report to Congress on their conclusions before any congressional direction is added to require broader adoption of the concept.

In addition, we are concerned about section 125 of the draft bill, "Ensure a Comprehensive Regulatory Review" which seeks to include a large number of federal agencies within the scope of the Economic Growth and Regulatory Paperwork Reduction Act of 1996. Regulations are adopted after an extensive notice and comment period. Industry perspectives and the impact of new regulations on financial institutions are fully considered during this process. This section could significantly weaken numerous provisions of the Dodd Frank Act's important consumer protective provisions.

In summary, there are numerous provisions throughout the draft bill that we strongly oppose. CFA cannot support the draft bill as circulated and we urge you to oppose it unless significant changes are made to address the serious issues we have highlighted. We look forward to working with you and your staffs on this matter, and appreciate the opportunity to participate in this process.

Sincerely,

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Cc: Members of the U.S. Senate Banking, Housing and Urban Affairs Committee