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How CFPB Can Turn Restrictive Mortgage Rule into a Win for All

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Several recent reports in American Banker reflect widespread concern among both lenders and consumer advocates that the Qualified Mortgage rules being developed by the Consumer Financial Protection Bureau, while well intentioned, could significantly impact the availability and price of home mortgage credit.

The CFPB may want to consider supplementing the QM rule by promulgating an alternative Dynamic Disclosure process, described below, which could serve as a safety valve to relieve pressures on the market if the QM rule were to prove to be too restrictive.

In its recent rule-making initiatives, the CFPB has developed proposals to simplify disclosures called for under current law and is now in the process of defining the terms of Qualified Mortgages that would be deemed safe for consumers, imposing

increased economic risk for lenders and holders of loans that do not conform to the QM standard. This latter approach represents a significant departure from our historic reliance on markets to set transaction terms.

In the 1970's, I was present at the creation of the original consumer financial protection laws, serving as Republican Staff Director of the Senate Banking Committee for Senator Ed Brooke (R.-Mass) when the Committee Chairman, Senator William Proxmire (D.-Wis.), took the lead in passing the Truth in Lending Act, the Real Estate Settlement Procedures Act, the Fair Credit Reporting Act, the Equal Credit Opportunity Act and other statutes. I have since spent most of my professional career in private law practice dealing with these laws.

Having known Sen. Proxmire quite well, I expect that if he were in the Senate today, he and Sen. Brooke would be searching for ways to protect consumers from abuse while not unduly restricting availability of credit to those seeking to climb the economic ladder.

To its credit, the CFPB is engaged in a serious effort to recast some required consumer disclosures, in the process providing more understandable, user-friendly formats. However, using the power of advanced financial technology that is available now, it is possible to supplement standard static disclosures with dynamically presented empirical data and calculations based on a consumer's personal financial profile. If consumers

could access such information, their understanding of the risks and rewards associated with their borrowing decisions would be greatly enhanced.

Predictive models now form the basis on which lenders design, market, underwrite, price and service consumer credit products, including mortgages, credit cards and installment loans. What I am proposing is use of these data to educate consumers themselves. Let me offer an illustration.

When applying for a mortgage, the consumer would be provided access to a secure website developed by the CFPB in which she would enter the information provided on the loan application. The CFPB would then provide the consumer with the type of information that a lender receives through its underwriting engine, but organized in a way that is easily understood to the layperson. Among the data the consumer would receive would be a projection of the likelihood that the consumer will default on the type of loan applied for, based upon the history of defaults among consumers with similar credit profiles choosing the same type of mortgage. In this process, the CFPB would also share with the consumer information on how her credit profile and projected payment behavior will likely influence the price the consumer will pay for the loan. At the same time, the CFPB website would let the consumer know what changes in behavior would likely improve the terms on which the consumer could obtain credit.

While lenders regularly obtain this type of underwriting information or rely on a “black box” to provide it, having CFPB provide access to similar analysis to the consumer would not only promote transparency, but help to engage the consumer with the lender in the process of making the credit decision. Borrowers would essentially be invited to look “behind the underwriting curtain” and to play a more active role in the loan decision making process. They would be encouraged to share the underwriting analysis provided by the CFPB underwriting engine with their lenders and advisors and to engage in a discussion of options. Promoting a level information playing field reflects the understanding that both the lender and the borrower have an interest in avoiding default and assuring timely repayment of the loan.

The CFPB recently announced that it has finalized an agreement with the Federal Housing Finance Agency to build a national mortgage database. This database would include information spanning the life of a loan from origination through servicing and include loan-level data about the borrower’s financial and credit profile; the mortgage product and terms; the property purchased or refinanced; and the ongoing payment history of the loan. The agencies will build the database by matching a nationwide sampling of credit bureau files on borrowers’ mortgages and payment histories with informational files such as the Home Mortgage Disclosure Act database and property valuation models. It will include historical data back to 1998, and will be updated monthly.

This database will provide the information needed for the CFPB to provide the service to consumers that I am advocating.

The CFPB would have to do in-depth testing to determine what disclosure formats would best inform consumers, a process

that would draw on testing resources that CFPB is already very effectively employing. But by taking advantage of electronic analytics not available in the Proxmire era, the CFPB can make disclosures much more accessible, understandable and dynamic. Consumers would be empowered as they have never been before.

Assuming that some form of the QM structure is to be adopted, this Dynamic Disclosure process could be offered as an alternative to consumers and lenders when they want to enter into a mortgage contract that falls outside the strict limits imposed by the Qualified Mortgage definitions, without incurring the regulatory risks that would otherwise be imposed for straying from the prescribed terms.

Everyone recognizes that standards broke down in the mid-2000s, but it is important to acknowledge that mortgage originators and investors as well as consumers have learned a painful lesson. Given this, it may be counterproductive to impose strict QM rules on the housing market just when it is showing signs of recovery. Providing Dynamic Disclosures would provide a safety valve that consumers and lenders, properly informed, could use to arrive at terms make sense for all parties even if not in strict conformity with the QM rules.

For lenders, a great unknown in the Dodd Frank legislation is the so-called “UDAAP” provision that empowers the CFPB to take enforcement actions against lenders for “unfair, deceptive and abusive acts and practices.” This broad but vague mandate, if not clarified by regulatory guidance, could have the unfortunate, unintended, consequences. The overly aggressive use of UDAAP enforcement power by the CFPB in one or two cases could well cause responsible creditors to decide that the risks associated with consumer lending are too great and to exit or to limit their participation in the market

or raise rates to reflect the increased risk, thus restricting credit availability.

A solution to this regulatory uncertainty might be for the CFPB to provide a safe harbor from UDAAP liability, as it relates to loan origination, to lenders that provide documentary proof that their borrowers have entered their loan application into the CFPB underwriting engine and had an opportunity to discuss the results with the lender. The Dynamic Disclosure process could be used to avoid UDAAP liability whether or not the loan fits the QM definition. Using advanced credit analytics to provide transparency and equal access to information to both sides of the loan transaction seems an appropriate way to address concerns about “unfair, deceptive or abusive” practices in connection with a consumer’s choice of loans. To be clear: Sales practices designed to counteract these disclosures or mislead borrowers as to their meaning would fall outside any safe harbor.

For this proposal to be effectively implemented, it may be necessary for Congress to revisit the provisions in Dodd Frank related to Qualified Mortgages. The practical aspects of implementation of this concept will need a lot of work, and the idea may, after vetting, be found to have flaws.

But having worked in the Congress for eight years, I suspect that, confronted with consumers concerned about constricted credit opportunities and with lenders concerned about unmanageable regulatory risk, Congress may be open to a new approach.

This proposal is offered for discussion purposes – with the hope that Congress and the CFPB would consider giving the market another chance by putting faith in the power of properly informed consumers to make their own borrowing decisions.

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