

Testimony of

James Gardill

On behalf of the

American Bankers Association

before the

Financial Institutions Subcommittee

of the

Financial Services Committee

United States House of Representatives



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Chairman Capito, Ranking Member Meeks, my name is James Gardill, Chairman of the Board of WesBanco. I appreciate the opportunity to be here to represent the American Bankers Association (ABA) to present the views of the ABA regarding the new Ability to Repay and Qualified Mortgage rules. ABA represents banks of all sizes and charters and is the voice for the nation's \$14 trillion banking industry and its two million employees.

Before I discuss the impact of the new rules on mortgage markets, let me describe a bit about my bank. We are a \$6.1 billion institution in Wheeling, West Virginia. We have 118 offices in West Virginia, Ohio and Pennsylvania. We are active mortgage lenders and currently hold \$1.3 billion in outstanding home mortgage loans.

The mortgage market comprises a substantial portion of the GDP in our economy and touches the lives of nearly every American household. The new Ability to Repay (ATR) and Qualified Mortgage (QM) rule represent a fundamental change in the housing-finance market. It is critical that these rules make sense and do not end up hurting creditworthy Americans that want to own a home.

Unfortunately, the Ability to Repay/QM rule, however well intentioned, will end up restricting mortgage credit making it more difficult to serve a diverse and creditworthy population. Under the ATR rule, underwriters must consider a borrower's ability to repay a mortgage loan, despite having no binding guidance on how to determine ability to repay. Qualified Mortgages are designed to offer a "safe harbor" within which loans are assumed to meet the ATR requirement. However, the definition of QM—which covers only a segment of loan products and underwriting standards and serves only a segment of well qualified and relatively easy to document borrowers—could undermine the housing recovery and threaten the redevelopment of a sound mortgage market.

The problem is three-fold: First, the general non-QM segment is very unclear and compliance is uncertain. More pointedly, the heightened penalties and liabilities applicable in the Ability to Repay rule are tremendously burdensome. Given the legal and reputational risks imposed by this regulation, banks are not likely to venture outside the bounds of the QM safe harbors.

Second, the new rules create a narrowly defined box that consumers must fit in to qualify for a QM-covered loan. Since banks will make few, if any, loans that do not meet QM standards, many American families across the country that are creditworthy but do not fit inside the QM “box,” will be denied access to credit. In practice, this also likely means that less affluent communities may not be given the support they need to thrive. These rules may leave many communities largely underserved in the mortgage space.

In particular, I am concerned that our bank will be unable to continue a charitable plan we administer designed to promote homeownership among families that would otherwise not be able to own a home. Loans made under our Laughlin plan, which I will discuss in greater detail below, would likely not qualify for QM status, and at least some of the loans made under the plan will not meet ATR requirements, meaning we would not be able to make them at all.

Third, even if banks choose to make loans only inside the QM framework, they will still face a number of risks and uncertainties that create disincentives to lend. Some loans that fit within the QM framework are only partially covered by the protections offered by QM. These loans, specifically higher interest rate loans, still carry both higher credit risk and now, under QM’s rebuttable presumption, liability risk, and as a result, banks will be hesitant to offer them. This means that banks will be limited to offering loans to only the best qualified borrowers. The end result of this will be limiting credit to credit-challenged communities or demographics. Thus, in practice, the QM box ironically may conflict with fair lending rules and goals of the Community Reinvestment Act.

The rulemaking has left banks little time to comply with the QM regulations despite the wide-reaching market implications and tremendous amount of work banks must undertake to comply with these rules. Currently, these rules are scheduled to go into effect in January of 2014. Between now and then banks must fully review all of the final rules; implement new systems, processes and forms; train staff; and test these changes for quality assurance before bringing them online. We must get this right, for the sake of our customers, our banks’ reputations, and to promote the nascent recovery of the housing market. For some institutions, stopping any mortgage lending is the answer

to this unreasonable deadline because the consequences are too great if the implementation is not done correctly.

These rules need to be revised so that they help the economy and at the same time ensure that the largest number of credit worthy borrowers are able to access safe, quality loan products. In order to do this, we need to extend the existing deadlines as well as address outstanding issues to ensure that all creditworthy borrowers have access to credit:

In my statement today, I would like to make three key points,

- The QM rule will limit mortgage lending because the QM guidelines narrow lending parameters and impose high risks on those lending outside of these parameters;
- Even within the QM framework, the ability to lend to a diverse group of consumers may be difficult and may lead to fair lending and Community Reinvestment Act concerns; and
- Because of the wide reaching implications for the mortgage business and credit availability, the implementation date should be delayed to assure that banks have the time to fully comply with the rule's requirements.

I. The QM rule will limit mortgage lending because the QM guidelines narrow lending parameters and impose high risks on those lending outside of these parameters

The Dodd/Frank Act requires that lenders show that a borrower has an ability to repay a loan, which is a practice that all good lenders, and certainly any that intend to remain in business for the long-term have always followed. Unlike many prior federal actions in this area, the new ATR requirement and the QM provisions do not merely impact disclosures or timing. The rules create a fundamentally new paradigm for residential mortgage lending by creating a narrow framework, outside which there are significantly higher risks to lenders.

ABA believes that the Ability to Repay standard in Dodd/Frank has the very commendable goal of driving out bad products and bad lenders from the marketplace. But the ATR/QM rule achieves that goal at a significant cost. It takes away some necessary flexibility for good lenders to make some loans because they simply will not meet Ability to Repay standards. The Consumer Financial Protection Bureau (CFPB) has recognized this, and tried to make accommodations for at least some of the instances where Ability to Repay can stifle good lending. On May 29, 2013 the CFPB exempted certain non-profit lenders serving specific populations from Ability to Repay

requirements. This was a step in the right direction, but much more is needed. Take for example a loan made by a community banker to a customer, who may not meet traditional underwriting requirements, but who is known and trusted by the banker from years of personal interaction. Under the Ability to Repay standard, that loan most likely will not be made. The regulatory, litigation and reputational risk will simply be too great. While it is true that loans like that are the exception and not the rule, they do matter, especially to the borrower in need of that type of loan.

In crafting the QM, the CFPB did manage to encompass the majority of loans being made today. A loan that is eligible for sale to Fannie Mae or Freddie Mac is a QM loan. With further refinements recently made by CFPB, many balloon loans made by an institution of \$2 billion in assets or less will be considered QM, so long as that institution holds the loan in portfolio and does not make more than 500 mortgage loans per year. But not all loans will be QM loans. A loan exceeding Fannie and Freddie conforming loan limits, even if it meets all other GSE eligibility standards, is not a QM loan. Many loans made by a portfolio lender with more than \$2 billion in assets, and otherwise equivalent to a QM loan made by a lender with less than \$2 billion in assets, will not be considered a QM loan unless the borrower's debt-to-income ratio is at 43 percent or lower. Similarly, a loan made by a portfolio lender under \$2 billion in assets who made 480 mortgage loans in the last year may qualify as a QM loan, but the same loan, made by a lender with \$1 billion in assets but who made 502 loans in the last year, would not qualify as a QM loan. As you can see, these are arbitrary standards and their complexity is likely to lead to some very strange outcomes.

The increased risks associated with making loans that fall outside of the QM framework mean that many banks, including mine, will not lend outside of QM and many borrowers will be unable to find lenders willing to make them loans. The QM rule establishes strict guidelines under which mortgage loans are granted protection from certain lawsuits. Banks that choose to lend outside of this framework face significantly increased risks of lawsuits related to ATR requirements. As a result of these increased risks, these loans are much less likely to be made, leaving many potential borrowers without access to credit. In the event that these non-QM loans are made, they will be far costlier, burdening the families least able to bear the expense. The limits on credit availability will be felt keenly by those borrowers who are unable to obtain a loan, but may also be felt by the broader economy. Cutting credit to this market now, just as it is showing signs of a recovery, could prove a sharp blow to an already struggling market. A further delay in the housing recovery would

be felt by all Americans, both through the value of their homes and the impact of housing on the broader economy.

Risks Posed to Lenders from ATR and QM

The ATR Requirement prohibits lenders from making a covered residential mortgage loan unless the lender has made a good faith determination that the consumer will have a reasonable ability to pay the loan according to its terms. Lenders must take the following eight factors into consideration when assessing a borrower's ATR:

- Current or reasonably expected income or assets;
- Employment status, if creditor is relying on employment for repayment;
- Monthly payment on covered loan;
- Monthly payment on a simultaneous loan secured by the same property;
- Monthly payment for mortgage-related obligations;
- Current debt obligations, alimony and child support;
- Monthly debt-to-income ratio ("DTI") or residual income;
- Credit history.

Although these eight factors afford much latitude, the concern is that every technical detail of the underwriting decision will have to be documented and demonstrably verified. As a consequence of this ATR Requirement, foreclosing on a delinquent borrower will likely become significantly more difficult because counsel for many delinquent borrowers will attempt to put the lender on trial, by arguing that the borrower is delinquent on the loan because the lender made a loan that it should have known the borrower would not be able to repay. A borrower who is able to mount a strong challenge in this regard effectively may be able to prevent a foreclosure or negotiate more favorable terms on a modified loan. While that is appropriate if in fact a lender did not appropriately consider a borrower's ability to repay, it should not be the outcome if ability to repay was properly determined, but the lender cannot, years later, prove that they met every element of the guidelines. Whether an ATR determination is reasonable and in good faith will depend not only on the creditor's underwriting standards, but on the facts and circumstances of a particular loan and how the creditor's standards were applied to those facts and circumstances. The authorization of the use of oral evidence and post-closing factors in judging such decisions opens lenders to new challenges that cannot be mitigated. This provides a borrower the opportunity to argue that a creditor's underwriting standards were too lax and that the creditor failed to appropriately apply its standards

to the specific circumstances of the borrower. It also puts a burden on the lender to demonstrate the appropriateness of its policies and the strength of its controls.

Some specific risks associated with making loans outside of QM are as follows:

Litigation Risk

There are many and varied ways to demonstrate an ability to repay a loan. There are also many and varied ways to challenge a showing of ability to repay. The statute recognizes that, and appropriately did not try to codify all underwriting decisions. But that also means that challenges based on Ability to Repay grounds will be litigated, and there is much uncertainty associated with potential litigation.

The CFPB did not adopt any binding regulations regarding the adequacy of an ATR determination. According to the regulations, the underwriting standards must be “reasonable.” Given the rule’s abstract guidance, this issue will ultimately be determined in court proceedings relating to individual loans. In those cases, the court will have to determine the nature and extent of discovery that it will permit, and then make individual substantive decisions as to whether the ATR requirement was satisfied in a particular case. Over time, it can be expected that courts will develop standards for both of these issues to which lenders will have to adjust. But in the near term, lenders will face a significant level of uncertainty when they are presented with borrower ATR claims. They are essentially on their own when it comes to implementing the rules and adopting policies and controls. That creates a significant responsibility on banks, their managements and boards of directors.

Statutory Liability for an ATR Requirement Violation

A lender that is found to have not complied with the ATR requirement is subject to general Truth in Lending Act damages and special ATR statutory damages that may be up to the sum of all finance charges and fees paid by the consumer. Furthermore, when a lender or an assignee initiates a foreclosure action, a consumer may assert an ATR violation as a basis for recoupment or setoff. Thus, from a practical perspective, an undeniably delinquent borrower may be able to prevent a foreclosure. Borrower’s counsel, in many instances, will use the prospect of an ATR challenge to seek to arrive at a resolution with a creditor that leaves the borrower in possession of the property on new loan terms. In short, in light of the potential for a proven violation, it is possible that the lender may find it more

advantageous to actually forgive a significant portion of the remaining indebtedness, thereby raising issues as to the value of a portfolio of loans with the same characteristics.

Safety and Soundness Concerns

A bank is subject to enforcement action if it violates laws or regulations or engages in unsafe and unsound practices. The question therefore arises—will non-QM loans be deemed “safe and sound”? Will such loans carry higher risk weights or be weighed as “inferior” to QM loans? In addition, banks that make non-QM loans may be subject to claims that certain loans do not meet the ATR requirement and, thus, violate the Truth in Lending Act and the CFPB’s ATR Rules. These claims may be made by borrowers as well as regulators. Widespread claims of this type could potentially be viewed as constituting an unsafe and unsound practice. Finally, to the extent that banks lend beyond the limits of a QM, any weakness in the portfolio of the bank may be attributed to unsafe and unsound lending practices. These and other issues related to the ATR Rules could form the basis for an enforcement action against a bank.

II. Even within the QM framework, many concerns remain that could limit credit availability to a diverse group of consumers

Even banks making loans exclusively within the QM framework face a number of risks and remaining questions that could limit the availability of credit to a diverse group of consumers. Banks cannot simply eliminate the risk introduced by the ATR requirement by exclusively making QM loans. Some loans made within the QM framework, specifically at higher interest rates, are only partially covered by QM’s protections

Potentially, it also means that my bank will face risks associated with NOT lending outside of the QM, including difficulties meeting our Community Reinvestment Act obligations, and potentially even fair housing and fair lending claims based upon “disparate impact” analysis. It is quite the “Catch-22” when a bank attempts to limit its regulatory, litigation and reputational risk by staying within government prescribed rules, only to be subject to possible regulatory, litigation and reputational risks for NOT straying outside those rules.

A bank’s compliance with the fair lending laws is an important concern. Since QM loans naturally will create tighter underwriting standards that may narrow the range of qualified

borrowers, how a bank approaches compliance with the ATR Rules could have an adverse impact on the bank's ability to respond to a governmental fair lending inquiry, or to a private party claim under the fair lending laws, i.e., the Equal Credit Opportunity Act and the Fair Housing Act.

Limiting loans to QM loans will also have a large impact on the communities we serve, limiting credit to families that may need it the most. If banks are only making loans within the QM structure, many lower-income borrowers may be unable to get the credit they need to purchase a home. At my bank in particular, we have a charitable program, the Laughlin Plan, designed to encourage the heads of large families to own their own homes. This is a charitable program created under the Will of George A. Laughlin, and administered by the bank, which provides financial aid to the heads of families residing in Ohio County, West Virginia. Under the terms of Mr. Laughlin's Will, applicants must be "sober, industrious, and have good general character." This aid is made available only to those who, without the aid of such assistance, would find it difficult, if not impossible, to acquire homes on their own. The Plan provides interest free loans and insurance to these families. The Plan has been in place since 1951 and has helped hundreds of families achieve home ownership in Ohio County, West Virginia. We currently have approximately 100 active loans under this program, providing homes to families who otherwise would not be able to afford one. We are concerned that, under the new rules, loans like these will not qualify for QM status, and as a result it will be very difficult to continue this program that has given so much back to the community. Of even greater concern is the fact that some borrowers served by this program would not meet the Ability to Repay standards and thus could not be helped by this, or any other bank program going forward.

III. Given the complexity of the risks and the new systems associated with QM, implementation deadlines must be extended.

Given the complete reshaping of the relationship between mortgage borrowers and lenders compelled by these new rules, there is much work to be done before banks can be ready to implement them. These ATR/QM rules do not come alone—there are currently 6 rules that are being finalized simultaneously, and these new rules are thousands of pages in length and establish a broad new regulatory framework for mortgage lending and servicing activities. These rules affect the entire mortgage-lending industry, including lenders, service providers, appraisers, escrow agents, and virtually anyone with a relationship to the mortgage lending process. The new rules will

significantly reshape the housing-finance market, which comprises a substantial proportion of our country's gross domestic product and touches the lives of nearly every American household. If we do not get this right it will have a negative impact on banks, our customers, and the nascent recovery of the housing market.

Our most urgent concern right now is ensuring we have sufficient time to fully review all of the final rules; implement new systems, processes and forms; train staff and test these changes for quality assurance before bringing them online. Although most of the changes mandated by the new rules call for a 12-month implementation period, the actual amount of time available to financial institutions to comply is in fact much shorter. In order to manage year-end regulatory and tax reporting requirements, many institutions have an information technology "freeze" between November and early January. Because it is not possible to test or revise the new mortgage compliance systems during the lock-down period, the compliance deadline will effectively be November, 2013.

Regulatory implementation is further complicated by the fact that many banks commonly rely on vendors for software updates and system upgrades. Many banks report their vendors are not yet ready to provide the necessary updates to the individual institutions and some vendors may not do so until late summer or early fall.

A vendor recently told its community bank client that it will not have the majority of its updates out until November 22nd. This means that the vendor's customers will have 7 weeks to customize, update, and train – with the Thanksgiving, Christmas, and New Year's holidays sandwiched in between, along with the year-end freezes for purposes of regulatory reporting.

In addition to these challenges, financial institutions face the difficult prospect of implementing the new mortgage rules with important provisions of the Ability to Repay/Qualified Mortgage rule still outstanding and many significant questions yet unanswered. Since the release of the final mortgage rules, ABA and a group of other trade associations have provided the CFPB with detailed requests for guidance on specific provisions of the rules which the industry finds unclear or confusing. These requests are not a complete list, and it is very likely other issues will emerge as financial institutions, and their third-party vendors, progress through their implementation plans. However, clarity on these issues is a necessary prerequisite for our members to fully implement the changes mandated by the new rules.

CFPB has, as recently as May 29th issued additional revisions to the mortgage rules and accompanying staff commentary, and other CFPB proposals are pending. We anticipate these clarifications will provide important information to help our members make strategic decisions regarding their business models and with regulatory implementation. Bankers are very concerned about the prospect of making such decisions while the mortgage rules and commentary are in the process of being revised and each revision issued requires further compliance efforts by our members, their vendors and others, all of which takes additional time.

For the reasons outlined above, we ask Congress to urge the CFPB for quick action on providing the industry with guidance and for more time than the allotted 12-month period to comply with the new mortgage rules. The requirements mandated by the new rules are overwhelming and the short implementation period, along with the lingering uncertainty surrounding the final rules, poses additional compliance challenges. While we welcome the CFPB's recent issuance of the Small Entity Compliance Guide for the Ability to Repay and Qualified Mortgage Rule, as well as recent final clarifying rules on points and fees and balloon loans, these do not obviate the need for a longer implementation period. The industry needs adequate time to review and implement the underlying final mortgage rules and their continuing modifications in order to be in full compliance.

We have suggested in the past, and we repeat this request now, for the CFPB to use its exemption authority to extend implementation of the mortgage rules by 12 months in order to facilitate an orderly compliance process. Without more time to comply, we are concerned certain lenders may choose to mitigate the resulting operational risks by reducing, or even eliminating, their mortgage lending activities in the short-term. This will be devastating to the industry and reduce mortgage loan options for consumers at a time when all agree there should be an increase in responsible mortgage lending. Lacking that action by CFPB, we urge Congress to statutorily extend the implementation date for the mortgage rules by one year, to January of 2015.

Conclusion

Despite the good intentions behind the QM rules, as currently designed, these rules will restrict, rather than facilitate, credit to mortgage borrowers, and most particularly, borrowers on the margins. The ATR and QM rules represent a fundamental change in housing finance. This is an important market, representing a substantial portion of GDP. As such, it is critical that we get these rules right. Although the QM rule provides a necessary "safe harbor," its relatively narrow scope will reduce availability of housing credit. The risks associated with lending outside of QM standards mean few

loans will be made outside of the QM designation. The result will be limited credit availability to many households across the country. Even if banks make loans exclusively within the QM framework, they face a number of risks that could discourage them from making loans. Moreover, the short timeline to comply with these rules will leave many banks scrambling to meet the new regulations, and may reduce the credit availability further unless timelines are extended.