July 9, 2012

Monica Jackson
Office of the Executive Secretary
Bureau of Consumer Financial Protection
1700 G Street, NW
Washington, DC 20552

Re: Docket No. CFPB-2012-0022 or RIN 3170-AA17

Dear Ms. Jackson:

The Mortgage Bankers Association (MBA)[1] welcomes the decision of the Bureau of Consumer Financial Protection (CFPB or Bureau) to reopen the comment period for its proposed rule amending Regulation Z and the accompanying Staff Commentary (commentary) to implement the Ability to Repay/Qualified Mortgage (QM) provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. MBA uniquely represents mortgage lenders of all sizes, from federally-chartered institutions to the smallest community lenders, who serve the mortgage financing needs of families and neighborhoods throughout the nation.

MBA believes the Ability to Repay/QM rule (hereinafter QM rule) is the most significant rule required by Dodd-Frank affecting mortgage lending. How it is finalized — what it contains and how it is structured — will determine how many consumers have access to safe, affordable and sustainable mortgage credit for generations to come.

This letter responds to the particular questions raised. Nevertheless, we believe the Bureau has sufficient latitude under Dodd-Frank to create a rule that does allow risky loans and at the same time does not stem sound credit and unduly regulate underwriting. We are working an approach to Ability to Repay/QM rule that will not harm consumers and undermine the economic recovery. We look forward to sharing it with the Bureau.

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[1]The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

Notably, this rulemaking proceeds as lenders are continuing to tighten credit over the 2011 book of business, which was already tighter than we have seen in years. Access to credit is taking on some disturbing characteristics that will have long term impacts if not addressed. Without lending, the economy will not recover, especially for the middle and lower middle class who buy starter homes and lower sales price homes.

As Federal Reserve Chairman Ben Bernanke observed:

> "One reason for the very slow recovery in mortgage credit, despite monetary policy actions that have helped drive mortgage rates to historically low levels, is that many lending institutions have tightened underwriting conditions dramatically, relative to the pre-recession period. Given the lax standards during the credit boom, some tightening was doubtless appropriate to protect consumers and ensure lenders' safety and soundness. However, current lending practices appear to reflect, in part, obstacles that are limiting or preventing lending even to creditworthy households." [2]

Secretary of Housing and Urban Development Shaun Donovan has said he believes that in today's market 10-20 percent of potential home buyers who could adequately carry the debt were being "locked out" of the market because credit was either not available or was available only at a restrictive price. He observed:

> "We had risk-amnesia going into the crisis and I think now we've gone a bit too far in the other direction," he said.[3]

Even though the mortgage industry has implemented some of the most conservative underwriting standards in decades and toxic mortgage products are no longer available, we understand the value of embedding sound product and underwriting standards into the law to ensure consumers are protected going forward. But the standards must be established so they provide the right balance between consumer protection and access to credit. Establishing an ability to repay requirement, along with an unambiguous set of standards in the form of a clear QM rule, is the right way to accomplish this.

If this rule is not done correctly, the impact will be worse on the very borrowers we are trying to protect and hinder the availability of credit for far too many qualified borrowers. We may very well end up with a far more restrictive lending environment than we have today and, at the same time, harm the economy for years to come.

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[2] Speech before the National Association of Home Builders, Orlando, FL, 2/10/12

[3] As quoted in Reuters, 5/10/12

For this reason, we do not believe there can be too much deliberation on this rule. It is absolutely essential that it carries out its purpose without unwittingly undermining the availability and affordability of credit and the nation's economic recovery.

In reopening the comment period, the Bureau specifically seeks comment on: (1) data received by the CFPB from the Historical Loan Performance (HLP) dataset of the Federal Housing Finance Agency (FHFA) regarding loan performance by year and debt-to-income (DTI) range as well as data from other data sets relevant to loan performance; and (2) estimates of litigation costs and legal liability risks associated with claims alleging a violation of ability-to-repay requirements for a mortgage loan that is a “not qualified mortgage” versus a “qualified mortgage.”

In this letter, MBA supplements its July 22, 2011, comment letter as well as other comments provided to the Bureau and respectfully offers (1) a summary of key points in our responses to the questions raised by the Bureau; (2) our responses to the questions themselves and (3) the principles MBA supports to finalize the rule going forward.

I. Summary of Key Points in Responses - The responses provide significant detail. The following summarizes the key points.

A. Comments on FHFA and Related Data

- Our original July 21, 2011, comment letter suggested that the QM could require compliance and evidence of compliance with widely accepted underwriting standards such as Fannie Mae’s Desktop Underwriter® (DU) and Freddie Mac’s Loan Prospector ® (LP). However, a mechanism must also be established to approve current and future standards available from sources other than the Government Sponsored Enterprises. We still believe incorporating these standards including the use of automated underwriting systems, with clear, objective and specific standards regarding their use, offers a sound alternative that has the virtue of assuring that the standards for the QM are dynamic and responsive as understanding of mortgage performance and the ability to repay deepens.

- The other approach that has been offered would involve embedding objective, numerical standards in the definition such as a particular DTI and a “waterfall” of alternative criteria. In March 2012, some lenders and consumer groups met with the CFPB and proposed a maximum total-debt-to-income ratio (TDTI) of 43 percent that, if not met, could be satisfied through a waterfall.

- While we appreciate these efforts to establish clear standards for the safe harbor and bound the issues before the court, the 43 percent TDTI, which would ensure a loan is regarded as a QM, is a problem. Using the Federal Housing Finance Agency (FHFA) data, from 1997-2009, 23 percent of the loans acquired by the

Enterprises had DTIs of 44 percent or greater. Over the same time period, 19 percent of those loans had DTIs of 46 percent or greater.

- There is no real reason looking at the FHFA data to choose 43, 44 or even 46 as the default. Loan performance and ability to repay does not markedly change at any of these points and a DTI number included in a waterfall should be greater.

- Notably, the Colorado Housing Finance Agency permits DTIs up to 50 percent. North Carolina allows lenders to presume a loan meets an ability to repay standard at 50 percent and Fannie Mae caps eligibility for their loans in its waterfall at 50 percent.

- Beyond the issue of a 43 percent DTI, a fatal flaw in the proposal from our standpoint is that it includes its waterfall in a rebuttable presumption, as discussed later in this comment, and it does not confine the litigation to whether the QM standards are met. Any waterfall should be embedded in a safe harbor if this approach is adopted by the Bureau.

- MBA also does not believe that relying exclusively on DTI ratio is wise. What is most clear to us is that there are multiple factors that along with DTI have a significant impact on predicting mortgage performance and ability to repay.

- MBA believes the recent effort to improve the rule should be a starting point, not an end. In this letter to the Bureau, we indicate we are working on a more acceptable approach. We look forward to sharing it with the Bureau.

- The Bureau should not establish QM standards for the U.S. Department of Housing and Urban Development (HUD), Federal Housing Administration (FHA), Department of Veterans Affairs (VA), Department of Agriculture and Rural Housing Service (RHS) loans. Exercising their authority under Dodd-Frank, the agencies should put out simple rules that say that their loans meeting the product standards in Dodd-Frank, e.g., no negative amortization, etc., and meeting the respective programs' underwriting standards shall be QMs.

- Emphasis on documentation and verification of income, assets, and employment is likely to be beneficial for performance going forward. Fully documented purchase loans have traditionally shown much stronger performance than low documentation loans.

B. Liability and Litigation Risks

- MBA believes there will not be many lawsuits alleging an ability to repay violation regarding "non QMs." The simple reason is that MBA estimates that there will be few if any "non QMs" originated, assuming the QM is structured as broadly as it should be. MBA and a wide range of organizations representing consumers, civil rights organizations and other stakeholders have urged a broad safe harbor.[4] The liability risks are simply too great and flows to assignees and holders of mortgages as well as lenders.

- Establishing the QM as a rebuttable presumption will invite litigation, increase costs and cut off credit to too many qualified borrowers. We believe this to be the case because attorney fees are awarded under the Truth in Lending Act (TILA) as amended by Dodd-Frank for ability to repay claims, a simple rebuttable presumption offers ample opportunity to offer evidence beyond any QM standards, and the potential damages are large. Not only will the costs per suit in a rebuttable presumption be greater, but there will be a far greater number of suits. MBA received a memorandum from counsel at the law firm of Ballard Spahr that is relevant to these points. See Attachment A, Memorandum from Ballard Spahr, July 9, 2012.

- MBA believes the availability of the new claim at foreclosure, if a rebuttable presumption construct is employed, will ensure that an action regarding ability to repay will become nearly perfunctory for all foreclosures. MBA data indicates that 2.2 million borrowers were in foreclosure in the first quarter of this year.

- Considering the extent of potential claims, the costs of foreclosure will rise dramatically and require lenders to price that risk into loans for all consumers. Likewise, the risk to investors will increase, and if they purchase or securitize loans they will require higher interest rates on loans to compensate them for their increased risks.

- MBA's earlier estimates in its comment letter of the attorney fees for a safe harbor versus a rebuttable presumption were too conservative. The Ballard Spahr memorandum, Attachment A, estimates charges at various stages of litigation.

- The memorandum from Ballard Spahr, Attachment A, provides that the attorney fees to the lender will be approximately $26,000 in cases where the matter is disposed of at the motion to dismiss stage. The fees for the cost of trial can reach $155,000 dollars for the lender. An earlier memorandum from Thomas Hefferon at Goodwin Proctor (Attachment B) indicates that safe harbor claims are more likely to be dismissed at the motion to dismiss stage than the rebuttable presumption claims.

- MBA does not have specific information on the attorney fees of borrowers which lenders may bear although it believes they may be very significant, particularly if a matter goes to trial.

[4]See Attachment D, April 12, 2012 Joint Association Letter

The Truth in Lending Act (TILA) as amended by Dodd-Frank provides considerable damages for violations in addition to attorney fees.

- Even where the lender had acted properly, the lender would still have to pay estimated attorney fees that could reach $155,000 to defend a rebuttable presumption claim through trial.

- By contrast, a safe harbor claim where the lender acted properly would likely cost the lender around $26,000 to defend.

- Claims of the magnitude suggested here under a rebuttable presumption will force lenders large and small to exit the mortgage business. While large claims might be managed and priced in by some large lenders, even a single claim may be ruinous to a smaller lender.

- The costs of litigation claims and lessened competition will be built into increased loan charges for all borrowers. Moreover, if the rule is finalized to include a rebuttable presumption, because of the enormous costs of such claims, it is virtually certain that lenders will adopt more conservative lending standards than any lending standards established as part of a QM test to reduce their risk.

- The cost of this litigation will result in a reduction in the availability of credit, particularly to qualified borrowers at the margins who under a safe harbor construct would likely be approved. Considering that fewer loans will be available, the dollar costs of claims ironically may decrease as the societal costs of excluding otherwise qualified borrowers increase.

- Some assert that the volume of borrowers represented by counsel in foreclosure is small and that the threat of litigation around ability to repay is therefore unlikely. Ballard Spahr's memorandum, Attachment A, pages 7-8, states:

  > "…While we have not undertaken a review of the foreclosure laws of the states in connection with this analysis, we observe that the level of representation of borrowers in such programs, or in foreclosure in general, does not appear to be a relevant proxy for the ability of borrowers to obtain counsel to bring ability to repay claims. As noted above, the TILA attorneys' fee provision enables borrowers to obtain counsel to bring TILA claims. In our experience, foreclosure laws typically do not have TILA-like attorneys' fees provisions, nor do they typically provide for the level of damages that would apply to a violation of the ability to repay rule under TILA.[5] The reports regarding the New York and Philadelphia requirements

[5] New York law provides for an award of attorney fees to the prevailing party in connection with a foreclosure, which allows a borrower to obtain attorney fees by successfully contesting a foreclosure. N.Y. Real Property Law § 282(2)

that are cited by the CFPB also suggest a conclusion other than the inability of borrowers to obtain counsel for ability to repay claims."

- Similarly, it has been asserted that state laws (such as North Carolina's) which include ability to repay provisions have not engendered litigation and therefore, there won't be litigation under the Dodd-Frank requirements. Attachment A, the Ballard Spahr opinion, indicates these comments are irrelevant for several reasons described below. These include that North Carolina law also does not offer attorney fees and the damages are lower. Beyond that, the law includes presumptions of compliance if a borrower has a DTI of 50 and it does not encompass loans in excess of $300,000 – both factors that exclude most claimants.

- It is far more analogous to examine the effects of the Home Ownership and Equity Protection Act triggers that carried significant assignee liability and higher priced loan rules that offered a rebuttable presumption. Such provisions effectively eliminated those loans from the marketplace.

- While we understand efforts by some lenders and others to propose numerical standards in a rebuttable presumption structure to bound issues before a court in the event of a claim, the proposal offered does not adequately confine the litigation to whether the QM standards are met.

- MBA maintains that the enormous costs to consumers should drive the Bureau's decision to establish a safe harbor with clear and rigorous standards.

- The potential costs of put-back claims also militate strongly in favor of a QM constructed as a safe harbor rather than a rebuttable presumption.

- We have heard from some that a safe harbor might not address a particular case. If that is so, then the Bureau's energies should remain focused on ensuring the standards are properly constructed and then embedding them within a safe harbor to serve all. The interests of the vast majority of consumers should not be sacrificed to allow for an as yet unspecified and impossible to anticipate claim or claims by a tiny few.

II. Responses to Questions

A. FHFA Data and Bureau Questions

1. Background

(Consol. 2012). That is not the equivalent of a borrower being able to obtain significant damages plus attorney fees for a violation of the TILA ability to repay rule.

The Bureau states that the Federal Housing Finance Agency (FHFA) data are drawn from the FHFA's Historical Loan Performance (HLP) file. The data include a one percent random sample of all mortgage loans in the HLP dataset from 1997 through 2011; and tabulations of the HLP dataset by FHFA showing the number of loans and performance of those loans by year and debt-to-income (DTI) range. These data consist of all mortgage loans purchased or guaranteed by the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) (jointly with Fannie Mae, the "Enterprises"), but does not include loans backing private-label mortgage-backed securities (MBS) bought by the Enterprises.

The dataset contains loan-level information on characteristics and performance of all single-family mortgages purchased or guaranteed by the Enterprises. Among other elements, the dataset includes product type; payment-to-income and debt-to-income (PTI/DTI) ratios at origination; initial loan-to- value (LTV) ratios based on the purchase price or appraised property value and the first-lien balance; and credit score(s) for the borrower(s).

The Bureau states it proposes to use these data to tabulate volumes and performance of loans with varying characteristics and to perform other statistical analyses that may assist the Bureau in defining loans with characteristics that make it appropriate to presume that the lender complied with the ability-to-pay requirements or assist the Bureau in assessing the benefits and costs to consumers, including access to credit, and covered persons of, as well as the market share covered by, alternative definitions of a "qualified mortgage." For example, the Bureau is examining various measures of delinquency and their relationship to other variables such as a consumer's total DTI ratio.

The Bureau noted that organizations suggested that it adopt a specific DTI requirement in the QM. In fact, on March 7, 2012, the Clearinghouse, representing five large lenders, along with three consumer advocacy organizations requested that the Bureau adopt a 43 total DTI ratio requirement for qualified mortgages. These groups also suggested that if a borrower's total DTI ratio is above a specified threshold, the mortgage loan could satisfy the qualified mortgage requirements if other specified conditions are met, such as a certain amount of assets, money in a savings or similar account, or a certain amount of residual income. The Bureau notes, however, that available data does not provide information on certain non-collateral factors, such as liquid financial reserves, which would enable the Bureau to examine their relationship with measures of loan performance and a consumer's ability to repay.

B. Questions

Introductory Question - *The Bureau seeks data, if available, from commenters or interested parties on such factors (in addition to DTI ratios as discussed above) and their relationship to measures of delinquency or their impact on the number or percentage of mortgage loans that would be a "qualified mortgage."*

Answer - MBA has analyzed extensive data on the factors that influence mortgage performance. What is most clear from analyses in academic work, by the credit rating agencies, and in implementations of credit standards such as automated underwriting systems is that there are multiple factors that have an impact on predicting mortgage performance and ability to repay.
Most notably, measures of borrower credit and LTV are much more predictive of performance than DTI. Moreover, while these variables are highly predictive, ultimately performance is largely a result of the broader economic factors, in particular the paths of unemployment rates and home prices. This explains why the data presented shows only a marginal impact of DTI on performance, while there are orders of magnitude larger impacts across vintages. Simply put, while DTI certainly affects the ability to pay at some level, that impact is swamped by other factors and hence it makes little sense to hang the QM definition solely or largely on a DTI cutoff.

CFPB faces a fundamental problem when dealing with data points such as DTI and liquid reserves. Borrowers report only qualifying income, not necessarily their full income, as part of their mortgage application. Stronger borrowers may not need to report investment income, rental income, or income from second jobs because they have sufficient income from their primary employment to qualify for the loan. Similarly, they may not need to report retirement assets or other accounts so long as they can show sufficient liquid reserves to make several months of payments. While such income and assets may not be reported for the strongest borrowers, they are much more likely to be reported for more marginal borrowers. Hence, there is a persistent, pervasive and largely uncorrectable measurement error with these variables. It is going to be very difficult to be confident that true performance differentials are being accurately calculated.

Consequently, MBA also does not believe that relying exclusively on debt-to-income (DTI) ratio is wise.

The Bureau also asks the following:

Question 1 - *The Bureau seeks comment on the dataset received from FHFA and commercially available data on mortgages securitized into private label securities, including the data source, parameters, and whether other data or studies are available or more appropriate for the purposes indicated above.*

Answer - As noted above, the data set from FHFA indicates very little difference in mortgage performance at various DTI levels. Notably, while the Clearinghouse and consumer group proposal suggested a 43 total DTI as a standard, there is minimal difference among "ever 60" delinquency rates for loans with DTIs of <42, <44 and <46 or greater as depicted in the FHFA data. Fannie Mae currently uses 45 as a benchmark for DTI in their Seller Guide, with higher DTIs permitted with the presence of compensating factors. Moreover, using the FHFA data, from 1997-2009, 23 percent of the loans acquired by Fannie and Freddie had DTIs of 44percent or higher. Over this same time period, 19 percent of these loans had DTIs of 46 percent or higher.

While efforts to establish clear standards for the safe harbor and bound the issues before the court are understandable, the 43 percent TDTI standard is clearly problematic. There is no real reason looking at the FHFA data to choose 43, 44 or even 46 as a default standard. Loan performance and ability to repay does not markedly change at any of these points. For instance the Colorado Housing Finance Agency permits DTIs up to 50 percent, North Carolina allows lenders to presume a loan meets an ability to repay standard at 50 percent and Fannie Mae caps eligibility for their loans in its waterfall at 50 percent.

MBA does not believe that a one-dimensional test, relying exclusively on DTI, should be the basis of defining a QM. Our original comment letter suggested that the QM could require compliance and evidence of compliance with widely accepted underwriting standards including Fannie Mae's Desktop Underwriter® (DU) and Freddie Mac's Loan Prospector ® (LP). However, a mechanism must also be established to approve current and future standards available from sources other than the Enterprises.

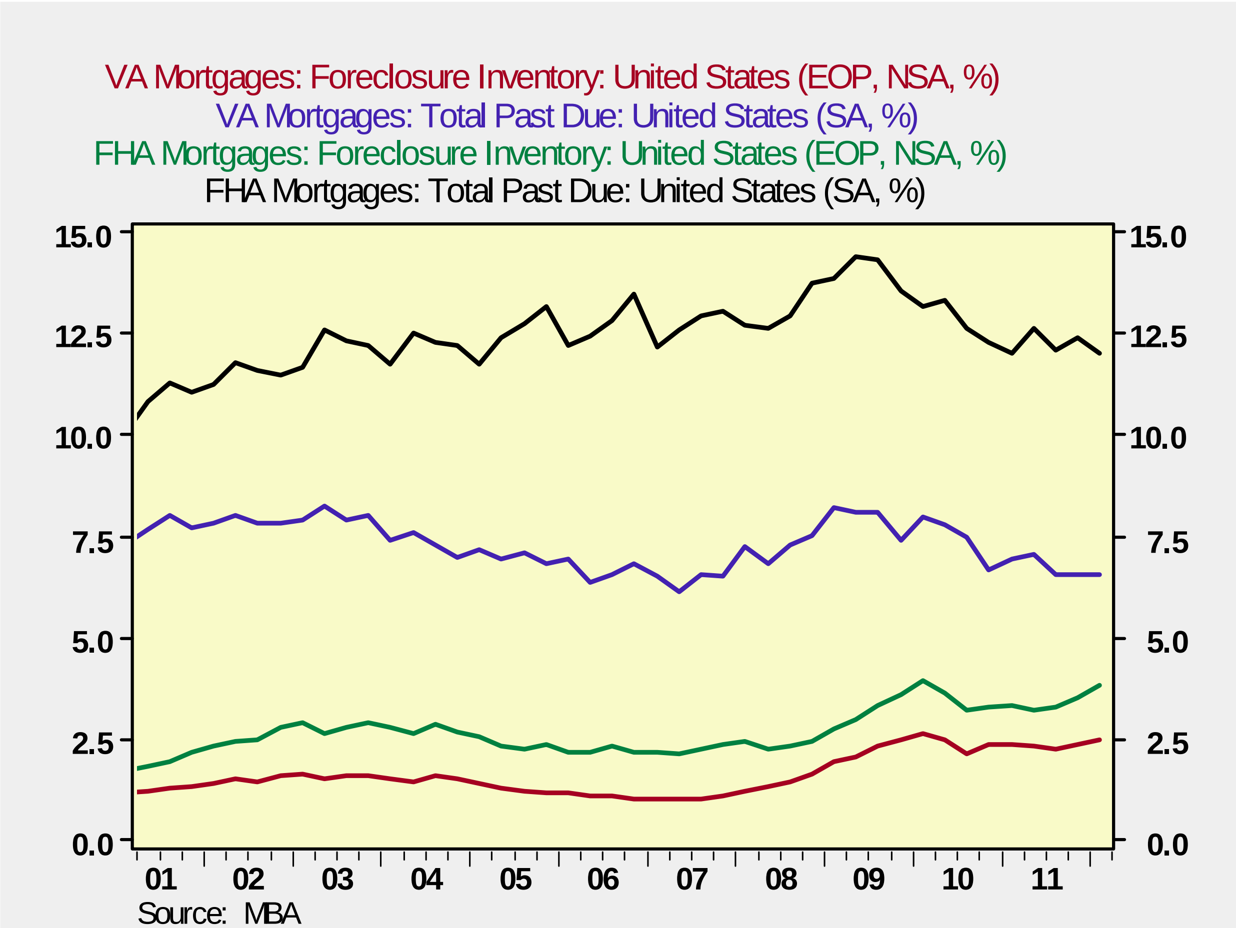
We still believe incorporating the use of automated underwriting, with clear, objective and specific standards regarding their use, offers a sound alternative that has the virtue of assuring that the requirements for the QM are dynamic and responsive as understanding of mortgage performance and the ability to repay deepens.

As existing standards develop, as they have so much over the last decades, such developments may be incorporated without changing the rule. We would also urge that if static numbers are included that the rule develops a mechanism for their periodic review and update.

Notably, any "incorporation" or "waterfall approach" should only be applied in the context of a broadly designed QM for as many qualified borrowers as possible, with clear, objective and specific standards, in a legal safe harbor.

Question 2 - *The Bureau requests data or tabulations for loans not covered in the FHFA data, including loans insured by the Federal Housing Administration (FHA loans), the Department of Veterans Affairs (VA loans), the Department of Agriculture and the Rural Housing Service (RHS loans); or loans held in portfolio or securitized outside of the Enterprises or a federal agency, which would be appropriate for the purposes indicated above.*

Answer - MBA is furnishing data on FHA and VA delinquency and foreclosure rates from MBA's National Delinquency Survey.



Nevertheless, we do not believe that it is necessary for the Bureau to develop a term sheet or other standards for FHA, VA, Agriculture and RHS loans. All of these programs have well-developed and well-tested underwriting requirements. Moreover, Dodd-Frank makes clear that FHA, VA, Department of Agriculture and RHS may establish their own requirements in consultation with the Bureau. MBA believes the best solution is for these agencies to put out simple rules that say that their loans meeting the statutory product standards in Dodd-Frank, e.g., no negative amortization, etc., as well as meeting the respective programs' underwriting standards will be QMs.

Question 3 - *The Bureau seeks comment and data on any measures of loan performance and their relationship to a consumer's DTI ratio.*

Answer - As mentioned above, MBA's analysis of performance factors along with our review of other analyses indicates that DTI is only of limited importance in terms of predicting delinquencies. One recent example that highlights this is the revisions to the ratings criteria for RMBS that the credit rating agencies have published. In S&P's publication, they highlight the impact on performance from credit scores, LTV, documentation, occupancy, and DTI.

S&P's analysis shows that loans to borrowers with poor credit and low down payments can default at rates 10-20 times that of the typical prime loan. "No-doc" loans can default at 6 times the rate of full documentation loans. By contrast, S&P estimates that loans with a 60 percent DTI only have 1.8 times the risk of a typical prime loan.

See "Request For Comment: U.S. RMBS Rating Methodology And Assumptions for Prime Jumbo, Alternative-A, and Subprime Loans", Standard & Poors, 2009.

Question 4 - *The Bureau seeks comment and data on any measures of residual income, the use of such measures in loan underwriting, the relationship of these measures to loan performance, and their relationship to measures of consumer expenditures.*

Answer - While the VA has had considerable experience with a residual income, it is not clear whether it could be widely employed as an underwriting approach. There is legitimate concern that this approach could have the potential, particularly in combination with a rebuttable presumption, for endless litigation regarding expenses that lenders "should have known" would impact loan performance. At a minimum, any residual income considerations would require a workable standard with clear, specific and objective criteria and be explicitly limited to specific expense items.

Question 5 - *The Bureau seeks comment and data regarding any measures of the amount of liquid financial reserves available to meet (i) mortgage-related obligations or (ii) current obligations, the use of such measures in loan underwriting, and the relationship of these measures to loan performance.*

Answer - As indicated above, data on liquid reserves is likely to be biased and misleading, as stronger borrowers likely under report their true reserves, while weaker borrowers likely make a more complete reporting. As a result, MBA believes this variable is of little value in terms of predicting performance.

Question 6 - *The Bureau seeks comment and data regarding any measures of stable income and timely housing payments, the use of such measures in loan underwriting, and the relationship of these measures to loan performance.*

Answer - The current marketplace and aspects of the proposed regulation put an emphasis on documentation and verification of income, assets, and employment. These efforts are likely to be beneficial for loan performance going forward. As noted, full-documentation purchase loans have traditionally shown much stronger performance than low documentation and no documentation loans.

B. Bureau Questions on Litigation Costs and Liability Risks

1. Background

In response to information received from commenters, including MBA, and ex parte communications, the Bureau seeks comments and data on estimates of litigation costs and liability risks associated with claims alleging a violation of ability-to-repay requirements for a mortgage loan that is not a QM in addition to costs and risks that might apply to a QM.

Dodd-Frank establishes great liability and stiff penalties and remedies for violations of the ability to repay provisions at TILA § 129C (a).[6] Specifically, under Dodd-Frank, a mortgage creditor who fails to comply with the ability to repay requirements in connection with, by way of example, a $200,000 loan may be liable to a consumer for:

- Actual damages, including for example, the borrower's down payment of 10 percent or more (i.e., $20,000 or more);
- Statutory damages of up to $4,000;
- All fees and up to three years of finance charges paid by the consumer which on an average loan of $200,000 at 4.5 percent may be approximately $25,000; and
- Court costs and reasonable attorney's fees associated with the action, depending on how the QM is structured.

In addition, a lender will have to pay considerable costs to defend any claim no matter how meritorious its actions may have been. According to the Ballard Spahr memorandum, Attachment A, page 4, these amounts will range from $26,000-$155,000 dollars depending on the stage of the proceeding when the claim is resolved notwithstanding whether the actions of the lender were appropriate.

Dodd-Frank also extends the statute of limitations for an action based on a violation from one year to three years from the date of the occurrence. Beyond this, Dodd-Frank also allows a consumer to assert a violation of the ability to repay provisions as a defense to foreclosure by recoupment or set off without regard to the three year time limit — at any time over the life of a mortgage.[7] Such a claim may be made against any creditor, assignee or other holder of a residential mortgage loan. This means that a consumer in a foreclosure proceeding late in a mortgage can claim a violation and seek to offset the foreclosure claim with a claim for actual and statutory damages, finance charges and attorney fees.

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[6] § 1416 of Dodd-Frank

[7] § 1413 of Dodd-Frank

TILA as amended by Dodd-Frank provides in Section 1412, entitled "Safe Harbor and Rebuttable Presumption," that a creditor may presume that a residential mortgage loan has met the ability-to-repay requirements if the loan is a "qualified mortgage." To implement these provisions, the Federal Reserve proposed two alternatives to construct the QM — a legal safe harbor or a rebuttable presumption.

As the Bureau notes, some commenters, notably including MBA and interested parties, presented estimates of the costs of litigation for alleged violations of the ability-to-repay requirements. Commenters and interested parties argued that these estimated costs should inform the Bureau's determination between a safe harbor or a rebuttable presumption as well as the scope of coverage of a "qualified mortgage." Other commenters said additional litigation costs should be considered, such as commercial litigation costs associated with "put-back" liabilities and risks for loans sold on the secondary market and extended foreclosure timelines because of ongoing ability-to-repay litigation.

Consumer groups said that due to the complexity of mortgage-related litigation, such as a violation of TILA, asserting an ability-to-repay violation would require access to a lawyer. These groups noted that appropriate proxies for the number of complaints filed would be the percentage of borrowers in foreclosure who are represented by a lawyer as well as the number of other types of TILA violation cases. The Bureau cited survey and other data that indicate that a majority of borrowers in default would not have legal representation.

2. Questions

Introductory Question *- The Bureau seeks comment or data on whether and if so, how the number of lawsuits alleging an ability-to-repay violation would vary under the following circumstances:*

> *(a) The mortgage loan is conceded not to be a "qualified mortgage."*
>
> *(b) The mortgage loan is claimed to be a "qualified mortgage."*

Answer - MBA appreciates the question but believes that responses should be provided for more than the choices of a QM and a non QM. As discussed below, considering the risks involved and assuming the QM is constructed broadly as we and so many others urge, it is likely there will be few loans that are non QM, and consequently few cases.

At the same time, there will be considerable variation in the number of cases depending on how the QM is constructed — from a rebuttable presumption to a safe harbor with possible variations in between.

Accordingly, we will provide comments on what we think would be the number of lawsuits if there were: (1) non QM; (2) QM rebuttable presumption of compliance; (3) QM in light of recent proposals for a presumption of compliance with numerical standards; and (4) QM safe harbor.

Non QM Loans

As indicated, we do not believe there will be many lawsuits alleging an ability to repay violation regarding non QMs. The simple reason is that MBA estimates that there will few if any non QMs originated if the QM is structured broadly. The liability risks are simply too great and flows to assignees and holders of mortgages as well as lenders.

While there is considerable skepticism in the minds of some as to whether non QMs will be available at all, MBA believes that the few loans that are made, assuming a broad QM, will go to wealthy customers whose loans banks may be able to hold in portfolio. We doubt any such loans will be made by lenders that sell their loans for securitization.

Considering the potential assignee liability for non QM loans, and the fact that the Bureau will soon finalize the Home Ownership and Equity Protection Act (HOEPA) rule lowering HOEPA's rate and points and fees triggers while adding an additional trigger for certain prepayment penalties as well as further liability, it is hard to imagine how a secondary market for “non QM” loans will exist.

QM Loans

As stated, MBA believes the number of lawsuits will vary considerably depending on how the QM is structured. If the QM is structured as a rebuttable presumption, there will be many more suits and considerably greater litigation costs per suit.

The number of suits will be curtailed at some level, however, by the fact that borrowers at the margins will not be offered loans.

If on the other hand, the QM is structured as a safe harbor, clear standards will discourage meritless litigation and, where suits are filed, lessen litigation costs. Borrowers will have the same access to the legal system no matter whether the QM is structured as a safe harbor or a rebuttable presumption.

Rebuttable Presumption

Establishing the QM as a rebuttable presumption will invite litigation, increase costs and cut off credit to qualified borrowers. Considering that attorney fees are awarded under Dodd-Frank for ability to repay claims, that a simple rebuttable presumption offers ample opportunity to offer evidence beyond any QM standards and the potential damages are large,[8] not only will the costs per suit in a rebuttable presumption be greater but there will be a far greater number of claims.

As indicated, MBA received a memorandum of counsel from the law firm of Ballard Spahr that confirms these conclusions. See Attachment A, Memorandum from Ballard Spahr, July 9, 2012.

The memorandum provides in part at page 5:

> "The ability of consumers to obtain attorneys' fees when bringing TILA claims must be considered when assessing a safe harbor approach or a rebuttable presumption approach to a qualified mortgage.
>
> Under TILA, if a borrower is successful in an action to enforce liability against the creditor under TILA section 130, the borrower is entitled to recover the costs of the action, together with a reasonable attorney's fee as determined by the court. TILA § 130(a)(3) (15 USC § 1640(a)(3).) That is, once a court finds a violation of TILA, the award of attorneys' fees to the consumer is mandatory. *See Stutzka v. McCarville*, 243 Fed. Appx. 195 (8th Cir. 2007); *Purtle v. Eldridge Auto Sales, Inc.*, 91 F.3d 797, 802 (6th Cir. 1996). In our experience, the ability of a borrower to recover attorneys' fees contributes to plaintiffs' attorneys agreeing to take cases against lenders involving TILA claims, and also contributes to plaintiffs' attorneys seeking out consumers to bring TILA claims, even when any harm to the consumer may be negligible.[9] It should be no surprise that counterclaims in foreclosure actions are often brought under TILA based on the ability of the borrower to obtain attorneys' fees."
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> * * * * *
>
> "Courts in a wide variety of contexts have found that the availability of counsel fees operates as an incentive for plaintiffs to bring claims. *See, e.g., Moore v. National Assoc*

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[8] See opinion of Buckley Sandler attached as Attachment C

[9]The LexisNexis Court Link Database reflects that on average 930 individual TILA actions have been filed in federal courts in each of the last three years, which represents approximately 98% of the TILA cases (the remaining 2% were class actions).

> *of Securities Dealers, Inc.*, 762 F.2d 1093, 1116 (D.C. Cir. 1985) ("The availability of an attorneys' fee encourages individuals injured by discrimination to seek judicial redress . . . [and] provides an incentive to competent lawyers to undertake" such cases).
>
> Consumers will be able to obtain legal representation to bring claims that lenders violated the ability to repay provisions of TILA. Thus, the threat of lenders facing significant litigation costs if a rebuttable presumption standard is adopted for qualified mortgages is real. In fact, it is likely that a cottage industry will develop with plaintiffs' lawyers aggressively pursuing consumers to bring claims, much in the way that plaintiff's lawyers currently solicit consumers who have taken certain prescription medication, used certain medical devices or implants or been exposed to certain substances."

MBA shares counsel's concerns and believes that the availability of attorney fees and lucrative awards will ensure a large caseload if a rebuttable presumption is established.

Recent Rebuttable Presumption Proposal

As indicated above, in March, 2012, some lenders and consumer groups suggested specific, numerical standards for QMs, including standards for underwriting, points and fees, and a maximum total-debt-to-income ratio (TDTI) that, if not met, could be satisfied through a "waterfall" of alternative bright-line qualifications. However, these efforts did not include a safe harbor.

While these efforts to establish clear standards for the safe harbor and bound the issues before the court are understandable, the proposal submitted did not confine the litigation to whether the QM standards are met. The proposal states:

> "However, even if the loan is a qualified mortgage, the lender has not necessarily complied with the ability-to-repay requirement in § 226.439 (c)(1). For example, (1) evidence of a high debt-to-income ratio with no compensating factors, such as adequate residual income, or (2) evidence that the lender did not reasonably consider information provided to it relevant to the borrower's ability to repay could be used by the borrower to establish that the creditor did not meet the ability-to-repay requirement. When a loan is a qualified mortgage, the consumer has the burden of proving that the

> creditor did not comply with the repayment ability requirement of § 226.43(c)(1)."[10]

Accordingly, as it stands, the proposal allows evidence beyond whether the QM requirements are met to be introduced to refute the lender's determination of the borrower's ability to repay. As such, the proposal at this point is functionally a rebuttable presumption with the similar litigation and social costs.

The fact that the borrower would bear the burden of proof still does not resolve any concern. Even if a lender initially defends a claim of non-compliance, because the borrower could raise various factual issues it is likely a lender would need to go to trial to prevail. As set forth in the memorandum from Ballard Spahr LLP, the average cost to a lender to defend a TILA lawsuit that goes to trial is approximately $155,000. Knowing that lenders would face such expenses, borrowers and their counsel will bring claims, meritorious or otherwise, as a strategy to obtain funds from the lender, either in an outright payment or a reduction in the amount owed, by way of a settlement.

Safe Harbor

A safe harbor is a well settled mechanism in law to establish legal standards and encourage compliance. Unfortunately, the concept of a legal "safe harbor" is open to misunderstanding based on the name. It is neither a pass for lenders nor does it deprive consumers of an opportunity for court review. Under either a "safe harbor" or a "rebuttable presumption," a borrower may opt to go to court and seek review of an alleged violation. A safe harbor does not in any way restrict access to the courts for consumers or prejudge their claims.

If a safe harbor is established, litigation is focused on whether the relevant standards were met. If a transaction fits within the four corners of the standards of a safe harbor, a regulated entity can be reasonably certain that it met the requirements. On the other hand, if the standards are not met, the borrower will be granted relief.

Consequently, establishing the QM as a safe harbor will result in lower costs because of the certainty it provides. Cases will not be brought unless performance under the standards is questionable. Those non-meritorious cases which are brought can likely be resolved based on pre-trial motion. Both of these

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[10] Center for Responsible Lending, the Clearing House Association, Consumer Federation of America, Leadership Conference on Civil and Human Rights. "Ability-to-Repay ("ATR") Analysis and Qualified-Mortgage ("QM") Determination DISCUSSION DRAFT," for a meeting with Consumer Financial Protection Bureau, March 7, 2012, at p. 7.

factors will lower costs and these savings will be passed to consumers in the form of lower rates and broader access to credit.

Most importantly, the standards of a safe harbor will allow lenders to serve consumers right up to the QM boundaries; ensuring qualified borrowers receive the credit they deserve.

Question 1 -The Bureau seeks comment on the likelihood of potential outcomes of litigation, such as dismissal, summary judgment, settlement, or judgment after trial, and the effect on costs under various scenarios including:

(a) The mortgage loan is conceded not to be a "qualified mortgage."
(b) The mortgage loan is claimed to be a "qualified mortgage."

Answer - MBA's July 22, 2011, comment letter pointed to a significant difference in outcomes of litigation for a rebuttable presumption and a safe harbor.

As part of our initial comment letter dated July 22, 2011, we included a memorandum from Thomas Hefferon of Goodwin Procter LLP addressing the use of a safe harbor or rebuttable presumption as the QM. The memorandum at page 3 includes the following comparison of a safe harbor versus a rebuttable presumption:

> "In a litigation context, the advantages of a safe harbor are magnified because the stated standard or factors are, by definition, the only standard or factors that a court can consider in judging its application. This means that a litigant seeking to establish that a safe harbor applies, or seeking to establish that it does not, can be certain that no standards or factors other than those stated are relevant. While there will be litigation over whether the standard or factors are met, the nature of safe harbors limits the scope of litigation and so can help preserve judicial and party resources and lead to a relatively early resolution of litigation.
>
> A test for liability or an exemption that is governed by a presumption that is rebuttable operates differently than a safe harbor, though many presumptions share the feature safe harbors have of being based on a single standard or multi-factor test. The difference is that, unlike a safe harbor, a rebuttable presumption typically allows for the introduction of evidence and argument about standards or factors that are not listed in the statute or regulation. So, while a regulated entity could establish that under the stated test its conduct meets the presumption, and so complies with law or

> triggers an exemption, another party such as a regulator or court could attempt to show that the presumption should be overridden by reference to some other set of facts, additional evidence, relevant policy considerations, or the like (depending on the statutory context). This leads to a certain level of unpredictability, particularly where the elements of the presumption are not exhaustive of the possible facts or circumstances that possibly are relevant.

The memorandum considered the implications of the difference between safe harbors and rebuttable presumptions by reviewing cases involving the safe harbor under TILA section 130(f) regarding any act done or omitted in good faith in conformity with any rule, regulation or interpretation of the Federal Reserve Board,[11] and the rebuttable presumption under TILA section 125(c) regarding a written acknowledgment of receipt of the notice of right to cancel.

Thomas Hefferon's memorandum provides at pages 6-7:

1. With regard to 24 cases analyzed that addressed the safe harbor under section 130(f), 17 were resolved at the motion to dismiss or preliminary injunction stage, six went on to summary judgment and one went on to trial.
2. With regard to 59 cases analyzed that addressed the rebuttable presumption under section 125(c), 7 were resolved at the motion to dismiss stage, 17 went on to summary judgment and 35 cases went on to be set for trial.

To provide additional information to respond to the more specific questions in the Bureau's notice, the attached memorandum from the law firm of Ballard Spahr, Attachment A to this letter, was developed at the request of MBA in part to provide information based on the firm's experience and information related to the costs of litigation that was resolved on motion to dismiss, at the summary judgment stage, settlement and at the trial stage.

Significantly, the analysis was based on lawsuits in which most of the time the lender prevailed (either by having a motion to dismiss or motion for summary judgment granted or winning at trial). This information supplements the materials provided with our original comment letter including memoranda from Thomas Hefferon of the law firm of Goodwin Proctor and Buckley Sandler as Attachments B and C respectively to this letter.

[11] In connection with the transfer of TILA to the CFPB by the Dodd-Frank Act, section 130(f) was amended to refer to any rule, regulation or interpretation thereof by the CFPB.

The Ballard Spahr memorandum reflects that MBA's projections of costs in its comment letter were too conservative.

Non QMs

As indicated above, we do not believe that there will be many non QM cases because there simply will not be many non QM loans assuming a broad QM. Nevertheless, we would anticipate that where a suit is brought for a non QM case, without the benefit of either a rebuttable presumption or a safe harbor, the likelihood of a matter being disposed of by motion is remote. For this reason, we estimate that the costs of simple ability to repay, i.e. non QM, claims will be at the high end as discussed below.

QMs

The attached Ballard Spahr memorandum states at page 4 as follows:

> "Because a safe harbor approach better provides for a resolution of litigation at an early stage than a rebuttable presumption approach, insight into the difference in litigation costs between the approaches can be gained by assessing the difference in litigation costs based on the stage at which a litigation matter is resolved. For purposes of our analysis we divided litigation matters into three important stages—the motion to dismiss stage, the summary judgment stage and the trial stage."
>
> We reviewed 78 cases filed since January 1, 2007, in order to determine the average litigation costs as of the conclusion of the matters. The cases were brought in federal and state courts and were all residential mortgage-related cases and most involved TILA claims. In most of the cases the lender was successful, in that the lender's motion to dismiss or summary judgment motion was granted or the lender prevailed at trial. The average cost to litigate the matter at resolution varied as follows based on whether the matter concluded at the motion to dismiss stage, the summary judgment stage or went to trial:
>
> | | |
> |---|---|
> | Motion to Dismiss: | $ 26,000 |
> | Summary Judgment: | $ 84,000 |
> | Trial: | $155,000 |
>
> The difference in litigation costs between the three stages is substantial, and is rendered more stark by the fact that in

> most of the cases the lender had to incur the costs to prevail. While having to address a number cases at the motion to dismiss stage would still be a material expense to lenders, the cost is dwarfed by litigation costs lenders would incur if forced to face a significant number of ability to repay challenges that cannot be resolved until the summary judgment or trial stage. Thus, if the approach adopted under the ability to repay rule does not provide in general for the resolution of claims at the motion to dismiss stage, a lender will face significant litigation costs to defend a claim. A significant level of claims should be anticipated because, as addressed below, borrowers will have little difficulty in obtaining counsel to pursue claims. Thus, a rebuttable presumption approach for a qualified mortgage would leave lenders exposed to substantial litigation costs, because there likely will be a substantial number of claims and the approach would in general not allow for an early resolution of the claims."

The memorandum makes clear that the costs of litigation which may be chargeable to lenders if a claim is successful will vary considerably based on whether the QM is constructed as a safe harbor or a rebuttable presumption notwithstanding that both may have identical standards.

MBA believes after having consulted counsel that safe harbor claims can be resolved at early stage of the proceedings at less costs, possibly at the $26,000 figure that Ballard Spahr suggests, with attorney fees for rebuttable presumptions generally ranging from $84,000 to $155,000 for the lender. See also Attachments B and C. (The Ballard Spahr opinion did not review the costs of consumers' attorneys fees but they may be assumed to be similar and are paid by the lender even in cases where the damages awarded to the borrower are limited.)

Notably these costs indicate that MBA's estimates of litigation costs submitted with our original comment letter were overly conservative.

Using our hypothetical $200,000 loan, a lender may be liable to a consumer for:

1. Actual damages, including for example, the borrower's down payment of 10 percent or more (i.e., $20,000 or more)
2. Statutory damages of up to $4,000
3. All fees and up to three years of finance charges paid by the consumer which on an average loan of $200,000 at 4.5 percent may be approximately $25,000; and;
4. Court costs and reasonable attorney's fees associated with the action.

Based on the memorandum provided by Ballard Spahr concerning the costs of claims, Attachment A:

- Even where the lender had acted properly, the lender would still have had to pay for the estimated attorney's fees that could reach $155,000 to defend a rebuttable presumption claim through trial.

- By contrast, a safe harbor claim where the lender acted properly would likely cost the lender around $26,000 to defend.

It is fair to estimate that the costs of a claim on the hypothetical loan sustained for the borrower using a rebuttable presumption process would cost the lender approximately $204,000 ((1) plus (2) plus (3) plus $155,000)) in addition to a court award to the borrower of their attorney fees which could be substantial.

Claims of the magnitude suggested here for a rebuttable presumption will force lenders large and small to exit the mortgage business. While large claims might be managed and priced in by some large lenders, even a single claim may be ruinous to a smaller lender.

MBA data indicates that there were approximately 2.2 million loans in foreclosure in the first quarter of this year. It is fair to assume considering the provisions of Dodd-Frank that such claims will become perfunctory for foreclosures and thus that the costs ultimately borne by consumers will be staggering.

These costs will be built into increased loan charges for all borrowers. At the same time, because of the costs of each claim, it is also likely that the existence of these risks will force lenders to adopt more conservative lending standards than any lending standards established as part of a QM test. This will result in fewer loans, particularly to borrowers at the margins who under a safe harbor construct would likely qualify. Considering that fewer loans will be available, the dollar costs ironically will decrease somewhat as the societal costs of excluding otherwise qualified borrowers sky rocket.

Question 2 - The Bureau seeks comment and data on assumptions about a loan, such as interest rate, purchase price, finance charges, and fees, required to calculate average amount of damages awarded in a TILA case involving a violation of the ability-to-repay requirements based on the scenarios listed above in paragraph 1.

Answer - A key component of damages, in addition to attorney fees, is up to three years of finance charges. The amount of finance charges depends on the loan amount as well as the interest rate. Today's interest rates are at historic lows. The chart in our original comment letter at page eight indicates that at these rates for an average $200,000 loan at 4.5 percent the finance charges will be in excess of $25,000 for three years. At eight percent the numbers will be closer to $40,000.

Loans in higher priced markets will have much greater loan amounts and much greater finance charges. A $417,000 loan, closer to average in key metropolitan areas would be approximately double the charges. When these amounts are coupled with attorney fees, statutory damages and actual damages, the potential per case liability is indeed staggering.

Question 3 - The Bureau seeks comment on the impact of other aspects of damages, such as a consumer's attorney's fees, and lender's litigation costs.

Answer - The prospective lenders' litigation cost is evident from the Ballard Spahr memorandum. From that memorandum, costs range from $26,000 for a safe harbor proceeding resolved on a motion to dismiss to $155,000 for litigation that is resolved at the trial stage.

While the litigation costs for a lender and the litigation costs for a borrower in any given matter may be very different, overall the range of lender litigation costs calculated by Ballard Spahr may be a reasonable approximation of the overall range of litigation costs for consumers. In any event, an award to a consumer can be expected to include an amount for attorney fees that is significant.

The award of attorney's fees is a significant provision under TILA as amended by Dodd-Frank and will likely lead to more litigation, particularly under a rebuttable presumption. The attached Ballard Spahr memo explores this point in detail and reviews lenders' fees, but to summarize, it is clear that an award of attorney's fees makes it far more likely that a borrower will be represented in court, perhaps to the point of incentivizing plaintiff's attorneys to seek out claimants.

Similarly, the memorandum explains that a lack of litigation under North Carolina's high cost loan law is not predictive of potential behavior for a Dodd-Frank ability-to-repay claim because that North Carolina statute includes significant exemptions discussed above that are not present in Dodd-Frank and lacks similar provisions for the award of attorney's fees.

Another vital issue that has not been discussed is the QM will require tighter underwriting standards in any event and as such lenders should be immunized from disparate impact claims. By necessity, the QM will result in tighter underwriting standards that will exclude some lower-income borrowers. Unfortunately, those borrowers often tend to be disproportionately members of a protected class.

The QM should provide a statutory exemption for any fair lending disparate impact claims against a lender for making only QM loans. Absent such an exemption, a lender would be in a double bind where they would be forced to either break one regulation in order to comply with another. Litigation costs will increase if lenders must face both disparate impact and ability to repay claims.

Additionally, compelled compliance could lead to quota systems and disparate treatment of consumers of different races, conduct that is contrary to the spirit of the Fair Housing Act and the idea of fair and universal access to credit.

Question 4 - The Bureau seeks comment on whether any additional factors should be considered in assessing the litigation-related costs associated with the ability-to-repay requirements.

Answer - As indicated, the costs of a QM will turn on how the QM is constructed.

If a QM is not established as a safe harbor, litigation will be increased and it will be more costly; the costs will become a tax on all borrowers.

Lenders will be forced to adopt more conservative underwriting standards and these "costs" will be borne by those borrowers who are excluded simply because the standard was established unwisely.

If the QM is not established as a safe harbor, the costs of claims will be withdrawal of some lenders from the mortgage market. While claims under a less than certain set of standards might be managed by larger lenders, they can be ruinous to smaller lenders. Consumers will lose the cost and service advantages of a competitive market.

Question 5 - The Bureau seeks comment and data on any other potential costs of ability-to-repay litigation, including:

(a) Costs associated with risks that loans are "put back" to originators by secondary market participants due to a potential ability-to-repay claim or proven violation. Factors that may determine the total cost of put backs may include: (i) number and type of representation and warranty provisions in purchase and sale agreements going forward; (ii) number of loans that could potentially be put back; (iii) frequency of put backs being realized; and (iv) cost to lender net of any recovery through foreclosure or sale.
(*b) Costs associated with extended foreclosure timelines due to ability-to-repay litigation.*

Answer -The potential costs of put back claims also militate strongly in favor of a QM constructed as a safe harbor rather than a rebuttable presumption.

The number of repurchase claims have never been higher than they are today with securitizers and other purchasers making claims based on underwriting over the last several years. Uncertainty over standards and how they were met fuels these claims.

While it might seem that the ability to repay standards alone would regularize the market and pare back repurchase claims in the future, the likely outcome is that the secondary market will only purchase QM loans.

MBA anticipates that representation and warranty provisions in purchase and sale agreements going forward would require that sellers of mortgages represent and warrant that loans are QM and possibly provide additional evidence through an underwriting form or otherwise demonstrate that the QM requirements have been met. How a QM is structured also may affect its accounting treatment, a subject that deserves further exploration.

In any event, as indicated, we do not anticipate any secondary market interest for non QM loans.

If the QM is established as a safe harbor, we expect a more active secondary market with clearer standards, less buyback claims and far lower resultant pricing for consumers

If the QM is established as rebuttable presumption, we expect continuation of uncertain standards, claims and counterclaims and thus increased costs. It is also likely that both investors and lenders will impose additional underwriting standards both to limit their risks as sellers and purchasers. The costs ultimately will be borne by consumers, society and the economic recovery.

IV. MBA's Principles

Considering the overarching significance of this rule to the availability and affordability of credit for consumers, there has been intense discussion since it was first proposed nearly fifteen months ago. Having considered this and the earlier comment request, MBA urges that the finalization of this rule be guided by the following principles:

1. **First, in order to reach as many borrowers as possible with safe, affordable and sustainable financing, the QM needs to be broadly defined.** As provided in the statute, the QM will embody a sound well-underwritten loan without risky features. Such loans should be available to virtually all qualified borrowers.

2. **Second, the rule must include clear, specific and objective standards.** Government programs will likely require separate rules and standards.

3. **Most importantly, the QM should be established as a safe harbor.** Unusually high penalties for violations coupled with extended claims periods and awards of attorney's fees invite high levels of litigation as well as potential damages. While

a safe harbor, like other constructs, permits borrowers judicial review, it focuses the litigation on whether the standards have been met. If a safe harbor is established, lenders will be able to confidently operate with clear standards qualifying as many borrowers as possible. Consumers with legitimate claims will have access to the court and consumer will not bear the many costs of unbounded litigation.

4. **Finally, the requirements of the QM need to be crafted to avoid unintended consequences.** The three percent limit on points and fees requires revision under the CFPB's exemption authority to exclude affiliate fees, compensation to individual employees and payments for escrow accounts and to allow adjustment to serve borrowers with low and moderate income properties and smaller loans.

V. Conclusion

MBA again appreciates the Bureau's care in reopening this proposal and its judicious work to finalize this exceedingly important rule. This rule is of paramount importance to mortgage lending. We maintain that if the QM rule is implemented correctly it will regularize sound and sustainable mortgage financing for consumers and assist the return of investment capital to the mortgage market. We are also profoundly concerned that if the rule is not finalized correctly it will tighten credit further, harm consumers and endanger the nation's economic recovery.

Should you have questions or wish to discuss any aspect of these comments further, please contact Ken Markison, Regulatory Counsel, on (202) 557-2930 or kmarkison@mortgagebankers.org, Tamara King, Associate Vice President for Loan Production on (202) 557-2758 or tking@mortgagebankers.org or Justin Wiseman, Assistant Regulatory Counsel on (202) 557-2854 or jwiseman@mortgagebankers.org

Sincerely,

David H. Stevens
President and CEO

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MEMORANDUM

TO	Kenneth Markison, Mortgage Bankers Association
FROM	Richard J. Andreano, Jr. Martin C. Bryce, Jr.
DATE	July 9, 2012
RE	Litigation Costs Associated With Safe Harbor or Rebuttable Presumption Approach Under the Ability to Repay Rule

The Consumer Financial Protection Bureau (CFPB) reopened the comment period on the proposed rule that will implement the ability to repay provisions of the federal Truth in Lending Act (TILA) that were added by The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The CFPB seeks comment on loan data received from the Federal Housing Finance Agency, and regarding litigation risks and costs. This memorandum responds to your request that we address:

1. The difference in litigation costs for lenders to successfully defend claims of violation of the ability to repay rule under a safe harbor approach and under a rebuttable presumption approach;
2. The ability of consumers to obtain legal representation to bring such claims;
3. Whether a rebuttable presumption approach can sufficiently limit litigation costs;
4. Whether the level of legal representation of borrowers in foreclosure is a relevant proxy for the ability of borrowers to obtain legal representation to bring ability to repay claims under TILA; and
5. Whether the absence of a severe constriction of mortgage lending in North Carolina following the adoption of the North Carolina high-cost home loan law (N.C. Gen. Stat. § 24-2.1E) can be used to predict the potential result if a rebuttable presumption approach is adopted under the ability to repay rule.

Background

With regard to litigation risks and costs, items on which the CFPB requests comment include:

1. The likelihood of potential outcomes of litigation, such as dismissal, summary judgment, settlement or judgment after trial, and the effect on costs under various scenarios including:
    a. The mortgage loan is conceded not to be a "qualified mortgage."

    b. The mortgage loan is claimed to be a "qualified mortgage."
2. The affect of aspects of damages other than loan costs, such as consumer's attorney's fees and lender's litigation costs.

As part of its initial comment letter on the ability to repay rule proposed by the Federal Reserve Board in May 2011, the Mortgage Bankers Association (MBA) addressed litigation and litigation costs, and included a memorandum prepared by Goodwin Procter addressing the use of a safe harbor or rebuttable presumption as the qualified mortgage standard. The memorandum provides that (1) a safe harbor is different from a rebuttable presumption in that a safe harbor typically describes a single standard or multi-factor test which, if complied with, provide some sort of exemption from liability or conclusion of statutory compliance and (2) a rebuttable presumption is just that—rebuttable, and that there often are no specific limitations about what sort of factual issues or evidence can be used to rebut the presumption. The memorandum includes the following comparison of a safe harbor versus a rebuttable presumption:

> In a litigation context, the advantages of a safe harbor are magnified because the stated standard or factors are, by definition, the only standard or factors that a court can consider in judging its application. This means that a litigant seeking to establish that a safe harbor applies, or seeking to establish that it does not, can be certain that no standards or factors other than those stated are relevant. While there will be litigation over whether the standard or factors are met, the nature of safe harbors limits the scope of litigation and so can help preserve judicial and party resources and lead to a relatively early resolution of litigation.
>
> A test for liability or an exemption that is governed by a presumption that is rebuttable operates differently than a safe harbor, though many presumptions share the feature safe harbors have of being based on a single standard or multi-factor test. The difference is that, unlike a safe harbor, a rebuttable presumption typically allows for the introduction of evidence and argument about standards or factors that are not listed in the statute or regulation. So, while a regulated entity could establish that under the stated test its conduct meets the presumption, and so complies with law or triggers an exemption, another party such as a regulator or court could attempt to show that the presumption should be overridden by reference to some other set of facts, additional evidence, relevant policy considerations, or the like (depending on the statutory context). This leads to a certain level of unpredictability, particularly where the elements of the presumption are not exhaustive of the possible facts or circumstances that possibly are relevant.

The memorandum addresses the safe harbor under TILA section 130(f) regarding any act done or omitted in good faith in conformity with any rule, regulation or interpretation of the Federal Reserve Board,[1] and the rebuttable presumption under TILA section 125(c) regarding a written acknowledgment of receipt of the notice of right to cancel. The memorandum provides that:

1. With regard to 24 cases analyzed that addressed the safe harbor under section 130(f), 17 were resolved at the motion to dismiss or preliminary injunction stage, 6 went on to summary judgment and 1 went on to trial.

[1] In connection with the transfer of TILA to the CFPB by the Dodd-Frank Act, section 130(f) was amended to refer to any rule, regulation or interpretation thereof by the CFPB.

2. With regard to 59 cases analyzed that addressed the rebuttable presumption under section 125(c), 7 were resolved at the motion to dismiss stage, 17 went on to summary judgment and 35 cases went on to be set for trial.

The memorandum demonstrates the significant difference in being able to efficiently resolve litigation in the context of a safe harbor and the limited usefulness of a rebuttable presumption in being able to efficiently resolve litigation.

Based on a preliminary assessment of litigation costs, in its comment letter the MBA provided an illustration that reflected a $20,000 difference in attorney's fees paid by a lender between the use of a safe harbor ($30,000) and a rebuttable presumption ($50,000) for qualified mortgages. You asked that we conduct a further analysis of litigation costs to better assess the difference between the adoption of a safe harbor approach versus a rebuttable presumption approach.

Litigation Costs

An important factor contributing to litigation costs is whether a matter can be resolved at an early stage, principally the motion to dismiss stage, or whether the matter cannot be resolved until a later stage, principally the summary judgment or trial stage. As addressed in the Goodwin Proctor memorandum, in general a safe harbor approach limits the factors that can be at issue when there is a claim of non-compliance with a law, while a rebuttable presumption approach leaves open the factors that can be at issue and, as a result, the scope of the inquiry for a rebuttable presumption is more open-ended and unpredictable than that for a safe harbor. The comparison in the Goodwin Proctor memorandum of cases involving the TILA safe harbor under section 130(f) and the TILA rebuttable presumption under section 125(c) reflects that the safe harbor approach better allows for an earlier resolution of litigation at the motion to dismiss stage than a rebuttable presumption approach, which is more likely to result in a trial.

That result should not be surprising, given that a rebuttable presumption typically does not sufficiently limit the factors that a plaintiff may raise to claim non-compliance with a law. *See, e.g.*, *Marr v. Bank of America*, 662 F.3d 963, 968 (7th Cir. 2011); *Cappuccio v. Prime Capital Funding LLC*, 649 F.3d 180, 189 (3rd Cir. 2011) (in both cases the courts determined that the borrower's testimony that he or she did not receive copies of the notice of right to cancel in accordance with TILA requirements was sufficient to rebut the presumption created by a signed acknowledgment of receipt; the *Marr* court stated "uncorroborated , self-servicing testimony, if based on personal knowledge or firsthand experience, may prevent summary judgment" and the *Cappuccio* court stated the quantum of evidence necessary to rebut a presumption is "minimal, given that the presumption's only effect is to require the party contesting it to produce enough evidence substantiating the presumed fact's absence"). Litigation costs can be limited if the factors that may be placed at issue are limited to specific, clear and objective criteria, and a safe harbor approach is much more likely to achieve that goal than a rebuttable presumption approach.

In short, by better defining the issues that can be raised to the specific issues outlined in the safe harbor, a safe harbor approach is better suited to provide for an efficient resolution of claims at an early stage, particularly the motion to dismiss stage. In contrast, by opening the door to a realm of factors, a rebuttable presumption approach does not provide for the efficient resolution of claims, as resolution likely cannot be obtained until the trial stage. If, however, a rebuttable presumption were narrowly constructed to limit the issues that may be raised, and thus operate more in the nature of a safe harbor, the rebuttable presumption would enable a more efficient resolution of claims than a typical rebuttable presumption.

Because a safe harbor approach better provides for a resolution of litigation at an early stage than a rebuttable presumption approach, insight into the difference in litigation costs between the approaches can be gained by assessing the difference in litigation costs based on the stage at which a litigation matter is resolved. For purposes of our analysis we divided litigation matters into three important stages—the motion to dismiss stage, the summary judgment stage and the trial stage.

We reviewed 78 cases in which we were involved that were filed since January 1, 2007 in order to determine the average litigation costs as of the conclusion of the matters. The cases were brought in federal and state courts and were all residential mortgage-related cases and most involved TILA claims. In most of the cases the lender was successful, in that the lender's motion to dismiss or summary judgment motion was granted or the lender prevailed at trial. Based on our experiences in the cases we calculated the average cost of litigation to the lender. We determined that the average cost to litigate the matter at resolution varied as follows based on whether the matter concluded at the motion to dismiss stage, the summary judgment stage or went to trial:

Motion to Dismiss:	$ 26,000
Summary Judgment	$ 84,000
Trial	$155,000

The difference in litigation costs between the three stages is substantial, and is rendered more stark by the fact that in most of the cases the lender had to incur substantial costs to prevail. Thus, even though the lenders acted properly, they still faced significant litigation costs. While having to address a number cases at the motion to dismiss stage would still be a material expense to lenders that have acted properly, the cost is dwarfed by litigation costs such lenders would incur if forced to face a significant number of ability to repay challenges that cannot be resolved until the summary judgment or trial stage. Thus, if the approach adopted under the ability to repay rule does not provide in general for the resolution of claims at the motion to dismiss stage, a lender that acted properly will face significant litigation costs to defend a claim. And a significant level of claims should be anticipated because, as addressed below, borrowers will have little difficultly in obtaining counsel to pursue claims. Thus, a rebuttable presumption approach for a qualified mortgage would leave lenders that acted properly exposed to substantial litigation costs, because there likely will be a substantial number of claims and the approach would in general not allow for an early resolution of the claims.

For a loan that is not a qualified mortgage, compliance with ability to repay rule will be determined under the general ability to repay requirements. Based on the proposed rule, there likely will be numerous factors that can be placed at issue when there is a claim of noncompliance with the general ability to repay requirements[2] and, as a result, it is likely that, in general, litigation involving such

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[2] For example, the proposed rule provides that to evaluate a consumer's repayment ability under the general ability to repay determination requirement creditors may look to widely accepted governmental or nongovernmental underwriting standards, such as the Federal Housing Administration's handbook on Mortgage Credit Analysis for Mortgage Insurance on One- to Four-United Mortgage Loans. Thus, the general ability to repay requirement does not limit the factors at issue to specific, clear and objective criteria.

claims will not be resolved at an early stage. The costs, in general, would likely equal or exceed the litigation costs when a loan is a qualified mortgage if a rebuttable presumption approach is adopted for such mortgages.

TILA and Attorneys' Fees

The ability of consumers to obtain attorneys' fees when bringing TILA claims must be considered when assessing a safe harbor approach or a rebuttable presumption approach to a qualified mortgage.

Under TILA, if a borrower is successful in an action to enforce liability against the creditor under TILA section 130, the borrower is entitled to recover the costs of the action, together with a reasonable attorney's fee as determined by the court. TILA § 130(a)(3) (15 USC § 1640(a)(3).) That is, once a court finds a violation of TILA, the award of attorneys' fees to the consumer is mandatory. *See Stutzka v. McCarville*, 243 Fed. Appx. 195 (8th Cir. 2007); *Purtle v. Eldridge Auto Sales, Inc.*, 91 F.3d 797, 802 (6th Cir. 1996). In our experience, the ability of a borrower to recover attorneys' fees contributes to plaintiffs' attorneys agreeing to take cases against lenders involving TILA claims, and also contributes to plaintiffs' attorneys seeking out consumers to bring TILA claims, even when any harm to the consumer may be negligible.[3] It should be no surprise that counterclaims in foreclosure actions are often brought under TILA based on the abililty of the borrower to obtain attorneys' fees.

In the context of enforcing class action waivers, the courts have repeatedly found that the ability to obtain counsel fees, particularly under TILA, acts as an incentive to borrowers and their counsel to bring small dollar claims. *See, e.g.*, *Johnson v. West Suburban Bank*, 225 F.3d 366, 374 (3rd Cir. 2000), *cert. denied*, 531 U.S. 1145 (2001) ("Nor will arbitration necessarily choke off the supply of lawyers willing to pursue claims on behalf of debtors. Attorneys' fees are recoverable under the TILA"); *Jenkins v. First American Cash Advance of Ga., Inc.*, 400 F.3d 868, 879 (11th Cir. 2005), *cert. denied*, 126 S. Ct. 1457 (2006) ("when the opportunity to recover attorneys' fees is available, lawyers will be willing to represent such debtors"); *Snowden v. CheckPoint Check Cashing*, 290 F.3d 631, 638 (4th Cir. 2002) (rejecting argument that plaintiff would "be unable to maintain her legal representation given the small amount of her individual damages . . . [as] unfounded in light of . . . the fact that attorney's fees are recoverable by a prevailing plaintiff in a TILA action").[4]

Courts in a wide variety of contexts have found that the availability of counsel fees operates as an incentive for plaintiffs to bring claims. *See, e.g., Moore v. National Assoc of Securities Dealers, Inc.*, 762 F.2d 1093, 1116 (D.C. Cir. 1985) ("The availability of an attorneys' fee encourages individuals

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3 The LexisNexis Court Link Database reflects that on average 930 individual TILA actions have been filed in federal courts in each of the last three years, which represents approximately 98% of the TILA cases (the remaining 2% were class actions).

4 We note, courts have refused to certify classes finding a class action not superior to an individual lawsuit precisely because a class member could bring an individual claim and had the incentive and ability to do so because of a counsel fees provision. *Andrews v. American Tel. & Tel. Co.*, 95 F.3d 1014, 1025 (11th Cir. 1996) (relatively small individual claims under RICO "can be feasible given the possibility of the award of treble damages and attorneys' fees to successful plaintiffs."); *Castano v. American Tobacco Co.*, 84 F.3d 734, 748 (5th Cir. 1996) (availability of attorneys' fees is a common basis for a finding of non-superiority of class action).

injured by discrimination to seek judicial redress . . . [and] provides an incentive to competent lawyers to undertake" such cases).

Consumers will be able to obtain legal representation to bring claims that lenders violated the ability to repay provisions of TILA. Thus, the threat of lenders who acted properly facing significant litigation costs if a rebuttable presumption standard is adopted for qualified mortgages is real. In fact, it is likely that a cottage industry will develop with plaintiffs' lawyers aggressively pursuing consumers to bring claims, much in the way that plaintiff's lawyers currently solicit consumers who have taken certain prescription medication, used certain medical devices or implants or been exposed to certain substances.

Specifying Standards

Because borrowers will be able to readily obtain legal counsel to bring claims that lenders violated the ability to repay rule, if the rule is structured in such a manner that lenders that acted properly cannot defeat such claims without generally proceeding to summary judgment or trial, the litigation costs facing the mortgage lending industry will be staggering. Lenders that acted properly may be forced to settle claims simply to limit litigation costs and avoid potentially adverse decisions. To avoid subjecting lenders who have acted properly to such risk, the rule must carefully limit challenges solely to discrete issues, such as limiting challenges to whether the loan satisfied clear, specific and objective criteria that made the loan a qualified mortgage loan and not allowing challenges based on any other factors.

If an approach to the rule leaves the door open for borrowers to assert that there are other factors not included in the clear, specific and objective criteria set forth in the rule that are relevant to the determination of whether a particular loan is a qualified mortgage loan, or that even if a loan is a qualified mortgage loan, there are factors demonstrating that the borrower could not repay the loan, the rule will not successfully protect lenders who have acted properly from significant litigation costs.

For example, if an approach provided for clear and objective criteria for establishing that a loan was a qualified mortgage loan, but also allowed the borrower to introduce other factors to assert that, even though the loan was a qualified mortgage loan, the lender did not appropriately determine the ability of the borrower to repay the loan, a lender that had acted properly likely could not defeat the challenge until the summary judgment or trial stage. An example of an approach that raises such a concern is a joint approach put forth by consumer groups and The Clearinghouse Association.

The proposal sets forth a waterfall approach of determining whether a loan is a qualified mortgage loan. A borrower could claim that a lender did not comply with the ability to repay rule by asserting that the loan did not in fact meet any of the criteria to be a qualified mortgage loan. If the factors regarding whether a loan is a qualified mortgage loan are limited to clear, specific, objective criteria, and the borrower cannot refute information provided to the lender upon which the lender made the ability to repay determination, then a lender generally could successfully defeat a claim of noncompliance without incurring significant litigation costs. However, even if a loan is a qualified mortgage loan, the proposal also permits a borrower to claim that a lender did not comply with the ability to repay rule "by demonstrating that the lender failed to take into account information provided to it that, if properly considered, would have prevented a reasonable and good faith finding of a reasonable ability to repay." Specific language offered regarding the proposal reflects that the information would need to be provided "reasonably prior to closing" but does not define the applicable timeframe.

Under the proposal, even if a mortgage loan is a qualified mortgage loan, a borrower still could assert that the lender was provided with information in any form (i.e., in an oral, written or electronic format), and at any point in time that was reasonably prior to closing, that should have led the lender to the conclusion that the borrower could not reasonably repay the loan. Thus a borrower could raise factual issues that there was information—any type of information—that should have led to a conclusion that the borrower could not reasonably repay the loan, and that such information was provided to the lender—in any form and at a time that met a reasonably prior to closing standard (which standard would need to be defined). The existence of the numerous factual issues would essentially rule out a claim being decided at the motion to dismiss stage and very unlikely at the summary judgment stage—meaning that lenders in most cases would be facing a trial, even though they acted properly. *See, e.g., R.B. Ventures, Ltd. v. Shane*, 112 F.3d 54, 60 (2nd Cir. 1997) ("Absent some special limitation imposed by the relevant substantive law, the oral testimony of the plaintiff is a permissible and sufficient means of establishing that a genuine issue of material fact exists requiring a trial").

Even if a qualified mortgage is defined by clear, specific and objective criteria, any approach that allows the borrower to raise factual issues beyond whether the clear, specific and objective criteria were met would not avoid significant litigation costs for a lender that has acted properly when a borrower asserts a violation of the ability to repay rule.

Borrower Representation in Foreclosure

You asked whether the level of representation of borrowers in foreclosures is a relevant proxy for the ability of borrowers to obtain representation to bring ability to repay claims under TILA. The CFPB request for comment provides that consumer groups note that the percentage of borrowers represented by counsel in foreclosure is a proxy for the number of ability to repay TILA complaints that would be filed by borrowers. The CFPB states "survey and other data indicate that a majority of borrowers in default would not have legal representation." The CFPB cites a report regarding the New York State mandated settlement conference law which provides that up to 90% of the borrowers sued in a foreclosure action failed to appear and received default judgments. The CFPB also cites a report providing that only 4.5% of borrowers were represented by counsel in connection with the Philadelphia foreclosure diversion program. Finally, the CFPB also cites a survey by the Department of Housing and Urban Development regarding foreclosure mediation programs nationwide that noted legal resources for homeowners in mediation programs generally are "quite limited". 77 Fed. Reg. 33124-33125 (2012).

The CFPB does not address whether the foreclosure mediation programs in general provide for an award of attorneys' fees to borrower or the ability of a borrower to obtain the damages at the level that would apply to a violation of the ability to repay rule. Violations of the ability to repay rule will subject a lender to actual damages, statutory damages of up to $4,000 plus an amount equal to the sum of all finance charges and fees paid by the consumer, and costs and attorneys' fees. While we have not undertaken a review of the foreclosure laws of the states in connection with this analysis, we observe that the level of representation of borrowers in such programs, or in foreclosure in general, does not appear to be a relevant proxy for the ability of borrowers to obtain counsel to bring ability to repay claims. As noted above, the TILA attorneys' fee provision enables borrowers to obtain counsel to bring TILA claims. In our experience, foreclosure laws typically do not have

TILA-like attorneys' fees provisions, nor do they typically provide for the level of damages that would apply to a violation of the ability to repay rule under TILA.[5] The reports regarding the New York and Philadelphia requirements that are cited by the CFPB also suggest a conclusion other than the inability of borrowers to obtain counsel for ability to repay claims.

The report regarding the New York mandatory settlement conference law notes that the before the law the rate of borrowers failing to appear in a foreclosure action was by some estimates up to 90%, but that in 2010 (when the law was in effect) only 20% of homeowners failed to appear for their scheduled settlement conferences. 2010 Report of the Chief Administrator of the Courts—*Pursuant to Chapter 507 of The Laws of 2009*, page 8.[6] The report also notes that 37% of borrowers were represented by counsel in the settlement conferences. *Id.*, page 11. The report further notes that borrowers facing foreclosure would be apprised of available free counseling and legal services. Id., page 2 (referencing model conference notification letter attached to the report).

The report regarding the Philadelphia foreclosure diversion program that is cited by the CFPB notes that "Homeowners are able to freely access housing counseling services as well as legal assistance from Community Legal Services, Inc., Philadelphia Legal Assistance or Philadelphia VIP (Volunteers for the Indigent Program). Once in Court, when the collective efforts of the homeowner (and her counselor or attorney) and the plaintiff do not progress, they can access one of the Judges Pro Term (JPT) to facilitate the process. JPTs are attorneys who perform this function on a pro bono basis." Philadelphia Residential Mortgage Foreclosure Diversion Program: Initial Report of Findings, page 4.[7] With regard to the level of borrowers with legal assistance, the report also notes that the "data evidencing the extent of counseling or representational assistance is, at the moment, incomplete" and, with respect to the 4.5% level of representation, the report provides "We know this to be an underestimation of the percent of homeowners that received legal assistance because another significant (but unknown) number of homeowners received legal assistance that was limited in nature." *Id.*, page 10. Thus the report concedes the cited 4.5% level of legal representation is understated. We also note that, based on our experience, because the conciliation conference generally takes place 30 to 45 days after the filing of the complaint, borrowers often have not had the opportunity to retain legal counsel for the conference and, if the foreclosure is not resolved as a result of the conciliation, it is not unusual for the borrower then to obtain legal counsel.

While the New York report suggests that the ability to obtain free legal counsel for a mandatory settlement conference may have increased the level of borrowers seeking legal counsel, both the New York and Philadelphia reports suggest that many borrowers do not seek legal counsel, even though free legal counsel is available. This suggests that something other than cost is a factor.
If a borrower is in default on his or her mortgage and does not have a claim against the lender that enables the borrower to seek damages similar to the substantial damages under the ability to repay

[5] New York law provides for an award of attorney fees to the prevailing party in connection with a foreclosure, which allows a borrower to obtain attorneys' fees by successfully contesting a foreclosure. N.Y. Real Property Law § 282(2) (Consol. 2012). That is not the equivalent of a borrower being able to obtain significant damages plus attorneys' fees for a violation of the TILA ability to repay rule.

[6] http://www.courts.state.ny.us/publications/pdfs/foreclosurereportnov2010.pdf.

[7] http://www.trfund.com/resource/downloads/policypubs/Foreclosure_Diversion_Initial_Report.pdf

rule plus obtain attorneys' fees, the borrower often has little incentive to seek legal counsel, or even challenge the foreclosure. The reports on the New York and Philadelphia programs can be read to support this conclusion rather than being reflective of the wherewithal of borrowers to bring ability to repay rule claims under TILA or obtain legal counsel to do so.

We also note that the New York law provides "A party to a foreclosure action may not charge, impose, or otherwise require payment from the other party for any cost, including but not limited to attorneys' fees, for appearance at or participation in the settlement conference." N.Y. C.P.L.R. 3408(h) (Consol. 2012). Thus, the law is far from a situation in which a borrower can obtain significant damages plus attorneys' fees for a violation of the TILA ability to repay rule.

North Carolina High-Cost Loan Law

You asked whether the absence of a severe constriction of mortgage lending in North Carolina based on the North Carolina high-cost home loan law (High-Cost Loan Law), N.C. Gen. Stat. § 24-1.1E, can be used to predict the potential result if a rebuttable presumption is adopted as the standard for qualified mortgages under the TILA ability to repay requirements. In our view, a few important aspects of the High-Cost Loan Law make the law largely irrelevant to the assessment of the affect on lending nationwide if a rebuttable presumption standard is adopted for qualified mortgages.

The High-Cost Loan Law applies to home loans that meet one or more of the following triggers:

1. The annual percentage rate that triggers the application of the high-cost loan provisions of TILA.[8]

2. The total points and fees exceed 4% of the total loan amount, or the lesser of 8% of the total loan amount or $1,000 if the total loan amount is less than $20,000.[9]

3. The loan documents permit the lender to charge prepayment fees or penalties more than 30 months after the loan closing, or that exceed in the aggregate more than 2% of the amount prepaid. (For an open-end loan that provides for conversion to a loan with a fixed rate and

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[8] The annual percentage rate trigger under the TILA high-cost loan provisions is an annual percentage rate that at consummation will exceed by more than 8 percentage points for first-lien loans, or by more than 10 percentage points for subordinate-lien loans, the yield on Treasury securities having comparable periods of maturity to the loan maturity as of the fifteenth day of the month immediately preceding the month in which the application for the extension of credit is received by the creditor. 12 CFR § 1026.32(a)(i). The Dodd-Frank Act provides for a change in the trigger to a rate that exceeds by 6.5 percentage points for first lien loans, or by 8.5 percentage points for subordinate lien mortgage loans, the average prime offer rate for a comparable transaction. Pub. Law No. 111-203, § 1431(a) (amending TILA § 103(aa) (15 USC § 1602(aa)).

[9] The High-Cost Law uses a definition of points and fees that is modified from the points and fees definition under existing TILA regulations, and more similar to the revised definition of points and fees provided for in the Dodd-Frank Act. *See* Pub. Law No. 111-203, § 1431(c) (Dodd-Frank Act. amending TILA § 103(aa)(4) (15 USC § 1602(aa)(4)); 12 CFR § 1026.32(b)(1) (existing TILA regulations); N.C. Gen. Stat. §§ 24-1.1E(a)(3), (5), (6) (High-Cost Loan Law).

fixed term, the High-Cost Loan Law would be triggered if prepayment fees or penalties could be imposed more than 30 months after the conversion.)

Excluded from the High-Cost Loan Law are loans with an original principal amount that exceeds the lower of (1) the Fannie Mae conforming loan size limit for a single-family dwelling or (2) $300,000. The TILA ability to repay provisions do not contain such an exception, which means much more loans will be subject to the TILA provisions.

Ability to Repay Requirement. Under the High-Cost Loan Law, a lender may not make a high-cost home loan unless the lender reasonably believes, at the time of consummation, that one or more of the obligors (which include the borrower, co-borrower, cosigner or guarantor), when considered individually or collectively, will be able to make the scheduled payments based on a consideration of current and expected income, current obligations, employment status and other available financial resources (other than equity). The High-Cost Loan Law provides that: "An obligor **shall be presumed** to be able to make the scheduled payments to repay the obligation if, at the time the loan is consummated, the obligor's total monthly debts, including amounts owed under the loan, do not exceed 50% of the obligor's monthly gross income as verified by the credit application, the obligor's financial statement, a credit report, financial information provided to the lender by or on behalf of the obligor, or any other reasonable means; provided, **no presumption of inability** to make the scheduled payments to repay the obligation **shall arise solely** from the fact that, at the time the loan is consummated, the obligor's total monthly debts (including amounts owed under the loan) exceed 50% of the obligor's monthly gross income." N.C. Gen. Stat. § 24-1.1E(c)(2) (emphasis added).

On the face of the statute a creditor is entitled to a defense that is more in the nature of a safe harbor than a rebuttable presumption if the debt-to-income ratio is 50% or less, and there is no presumption of an inability to repay based solely on the fact that the debt-to-income ratio exceeds 50%. Under the High-Cost Loan Law whether the creditor is entitled to the defense is limited to the issue of whether the debt-to-income ratio is 50% or less, and other factors, such as residual income or non-debt expenses, are not relevant. A creditor still has risk, because a borrower could present factors regarding his or her debt-to-income ratio at the time of consummation, but the risk is limited to the debt-to-income ratio. The risk would be far greater if the defense were more in the nature of a rebuttable presumption that allowed the borrower to present other factors, such as residual income or non-debt expenses. *See, e.g., Cappuccio v. Prime Capital Funding LLC*, 649 F.3d 180, 189 (3rd Cir. 2011) (quantum of evidence necessary to rebut a presumption is "minimal, given that the presumption's only effect is to require the party contesting it to produce enough evidence substantiating the presumed fact's absence.")

Attorneys' fees. As addressed above, under TILA once a court finds a violation, the award of attorneys' fees to the consumer is mandatory. The High-Cost Loan Law does not provide for the recovery of attorneys' fees by a borrower for a successful suit against the lender.[10] We note, the High-Cost Loan Law is contained in the North Carolina usury statute, and the statute provides for penalties for making or collecting a usurious loan, including court costs. However, the court costs section provides that "costs" are not recoverable by either party in an action to recover upon a usurious contract, and the law does not otherwise provide for attorneys' fees. *See* N.C. Gen. Stat. § 6-25. Thus, the High-Cost Loan Law, and the usury statute in which the law is contained, do not have an attorneys' fee provision in the nature of the attorneys' fee provision under TILA.

[10] Under the High-Cost Loan Law a lender may recover attorneys' fees for which it contracted.

The High-Cost Loan Law provides that a violation of the law is an unfair and deceptive trade practice in violation of section 75-1.1 of the North Carolina unfair and deceptive trade practice law (UDAP Law). A borrower may elect to bring a challenge regarding a violation of the High-Cost Loan Law under the UDAP Law. (The Attorney General, the Commissioner of Banks, or any party to a high-cost loan may enforce the provisions of the High-Cost Loan Law.) Any person seeking damages or penalties under the High-Cost Loan Law may recover damages under either Chapter 24 (usury law, which contains the High-Cost Loan Law) or Chapter 75 (UDAP Law), but not both. N.C. Gen. Stat. § 24-1.1E(d).

In any suit instituted by a person who alleges that the defendant violated section 75-1.1 of the UDAP Law, the presiding judge may, in his or her discretion, allow a reasonable attorney's fee to the prevailing party. The fee can be imposed as taxes that are part of the court costs and payable by the losing party, upon a finding by the presiding judge that (1) the party charged with the violation willfully engaged in the act or practice that was the basis for the violation, and there was an unwarranted refusal by such party to fully resolve the matter that constituted the basis of the suit, or (2) that the party instituting the action knew, or should have known, the action was frivolous or malicious. N.C. Gen. Stat. § 75-16.1. Thus, the attorneys' fees provision of the UDAP Law differs substantially from the TILA attorney's fee provision. Under the former, if the applicable standard is met, attorneys' fees may be assessed in the discretion of the judge against the losing party, be it the creditor or borrower, and attorneys' fees may be assessed against the creditor only upon a finding that there was a willful violation by the creditor and an unwarranted refusal by the creditor to resolve the matter. Thus, the UDAP Law does not have an attorneys' fee provision in the nature of the attorney's fee provision under TILA.

The incentive for plaintiffs' attorneys to take cases against lenders involving TILA claims, and even to seek out consumers to bring TILA claims, that is prompted by the TILA attorneys' fee provision simply does not exist with respect to the High-Cost Loan Law. Based on the lack of a TILA-like attorneys' fee provision for violations of the High-Cost Loan Law, and the "shall be presumed" standard of the law, the absence of a severe constriction of mortgage lending in North Carolina because of the High-Cost Loan Law simply is not relevant to the assessment of affect on lending nationwide of adopting a rebuttable presumption standard for a qualified mortgage under the TILA ability to repay provisions.

RJA/

EXHIBITS

Attached as exhibits to this comment letter are (1) the Legal Opinion of Goodwin Procter in response to MBA on the Ability to Repay Proposed Rule (Docket No. Regulation Z; Docket No. R-1417, RIN No. 7100-AD 75); and (2) a Memorandum from Thomas Hefferon, a partner with Goodwin Procter, entitled "Qualified Mortgage Definition Proposals Involving a Safe Harbor or a Rebuttable Presumption."

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M E M O R A N D U M

To Kenneth Markison, Mortgage Bankers Association

From Thomas M. Hefferorv-T M
Lynne B. Barr \'
Sallie F. Pullman

Re Qualified Mortgage Definition Proposals Involving A Safe Harbor Or A Rebuttable Presumption

Date July 22, 2011

In light of proposed "qualified mortgage" regulations to implement Section 129C of Dodd-Frank, you have asked us for an analysis of several issues that bear specifically on whether the qualified mortgage test ought to be structured as a safe harbor or as a rebuttable presumption:

- What typica lly are the different requirements of judicial proof required to establish the application of a safe harbor or a rebuttable presumption?

- What is the likely effect on the path of litigation between having a safe harbor rather than a rebuttable presumption?

- Does either regulatory choice necessatily favor one party or the other in any litigation?

- If a safe harbor is chosen, how might a safe harbor be constructed in order to maximize predictability and efficiency?

I. Introduction and Background

Section 129C was created by Sections 1411, 1412 and 1414 ofthe Dodd-Frank Wall Street Refonn and Consumer Protection Act, Pub. L. No. 111-203, H.R. 4173, (the "Dodd-Frank Act"), as a new section to the Truth In Lending Act ("TILA") titled "Minimum standards for residential mortgage loans."[1] For purposes relevant here, Section 129C prohibits a creditor from making a mortgage loan "unless the creditor makes a reasonable anc good faith determination based on verified and documented infonnation that, at the time the loan is consummated, the

[1] Dodd-Frank Act Section 1411; TILA Section 129C; 15 U.S.C. § 1639c (201 0).

consumer has a reasonable ability to repay the loan . . . ."[2] Section 129C(b)(1) provides certain protection from liability to any creditor making a "qualified mortgage," as defined in Section 129C(b)(2)(A).

On May 11, 2011, the Board of Governors of the Federal Reserve System (the "Board") issued a proposed rule and request for public comment, Docket No. R-1417 (the "Proposed Rule") regarding, among other things in Section 129C, the ability-to-ref ay requirements and the protections afforded to "q ualified mortgages." As part of the Propo!;ed Rule, the Board presented two alternatives for a "q ualified mortgage" standard, ultimately to be contained in proposed 12 C.F.R.§ 226.43(e)(1). The Board's Alternative **1** (the "Safe Harbor") states:

> (1) *Safe harbor*. A creditor or assignee of a covered transaction complies with the repayment ability requirement of paragraph c(l) of this section if the covered transaction is a qualified mortgage as defined in paragraph (e)(2) of this section. [3]

In contrast, the Board's Altemati ve 2 (the "Rebuttable Presumption") states:

> (1) *Presumption of compliance*. A creditor or assignee of a covered transaction is presumed to have complied with the repayment ability requirements of paragraph c(l) of this section if the covered transaction is a qualified mortgage, as defined in paragraph (e)(2) of this section. [4]

In so doing, then, the Board has suggested that the regulation may treat the making of a "qualified mortgage" (consistent with the statutory definition) to be a safe harbor for purposes of judging compliance with Section 129C's ability-to-repay requirement or may treat the making of a "qualified mortgage" as only a rebuttable presumption that Section 129C has been met.

Given the Board's suggestion that it is considering alternative approaches, you have asked us to describe the likely impact on litigation depending on whether the proposed regulation is enacted as a safe harbor or as a rebuttable presumption.[5]

11. Safe Harbors and Rebuttable Presumptions: General Observations

Generally speaking, safe harbors are different from rebuttable presumptions in how each is applied and in how courts judge compliance with either. A safe harbor is "a provision (as in a statute or regulation) that affords protection from liability or penalty."[6] Safe harbors typically

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[2] Dodd-Frank Act Section 1411; TILA Section 129C(a)(l); 15 U.S.C. § 1639c(a)(l).

[3] 76 Fed. Reg. 27390, 27484 (May 11, 2011).

[4] 76 Fed. Reg. 27390, 27484 (May 11, 2011).

[5] The Proposed Rule has not yet been finalized, and the issues addressed in this memorandum do not address the Proposed Rule directly. This memorandum also is not intended to express any view as to how the Proposed Rule or any other regulation, to be enacted in the future, may apply to a particular set of facts.

[6] Black's Law Dictionary 1363 (8th cd. 2004); *see also Enron Creditors Recovery Corp. v. A/fa, S.A.B. de C.V.,* Nos. 09–5122–bk (L), 09–5142–bk (Con), 2011 WL 2536101, at *7 (2d Cir.

describe a single standard or a multi-factor test which, if complied with, provide some sort of exemption from liability or conclusion of statutory compliance. If a transaction fits within the four comers of a safe harbor, the regulated entity enjoys that protection. As such, safe harbors provide a certain level of predictability.

In a litigation context, the advantages of a safe harbor are magnified because the stated standard or factors are, by definition, the only standard or factors that a .;ourt can consider in judging its application. This means that a litigant seeking to establish that a safe harbor applies, or seeking to establish that it docs not, can be cc11ain that no standards or factors other than those stated are relevant. While there will be litigation over whether the standard or factors are met, the nature of safe harbors limits the scope of litigation and so can help preserve judicial and pa1ly resources and lead to a relatively early resolution of litigation.

A test for liability or an exemption that is governed by a presumption that is rebuttable operates differently than a safe harbor, though many presumptions share the feature safe harbors have of being based on a single standard or multi-factor test. The difference is that, unlike a safe harbor, a rebuttable presumption typically allows for the introduction of evidence and argument about standards or factors that are not listed in the statute or regulation. So, while a regulated entity could establish that under the stated test its conduct meets the presumption, and so complies with law or triggers an exemption, another party such as a regulator or court could attempt to show that the presumption should be overridden by reference to some other set of facts, additional evidence, relevant policy considerations, or the like (depending on the statutory context). This leads to a ce11ain level of unpredictability, particularly where the clements of the presumption are not exhaustive of the possible facts or circumstances that possibly are relevant.

In litigation, rebuttable presumptions are just that – rebuttable. Under evidence principles, proof that the presumption applies "imposes on the party against whom 1t is directed the burden of going fotward with evidence to rebut or meet the presumption." Fed. R. Evid. 301.[7] Once

June 28, 2011) (noting that a proposed reading of a securities regulation implementing a statutory safe harbor "would make application of the safe harbor in every case depend on a factual determination regarding the commonness of a given transaction" and that "[t]his reading of the statute would result in commercial uncertainty and unpredictability at odds with the safe harbor's purpose and in an area of law where certainty and predictability are at a premium."); *Williams v. OS! Educational Services, Inc.*, 505 F.3d 675, 680 (7th Cir. 2007) (noting that judicially-created safe harbor "was offered in an attempt both to bring predictability to this area and to conserve judicial resources").

[7] Wright & Miller describes Rule 301 by saying that "[p]rcsumptions governed by this rule are given the effect of placing upon the opposing party the buTden of establishing the nonexistence of the presumed fact, once the party invoking the presumption establishes the basic facts giving rise to it." 21B Charles Alan Wright & Arthur R. Miller et al., Fed. Practice and Proc. at Evid. R. 301 (interim ed. 2011). It goes on to state that "[a] presumption is a deduction which the law expressly directs to be made from particular facts." *Id.* at § 5124 (quoting N.Y. Comm'rs on Practice and Procedure, Code of Civ. P. § 1776 (1850)); *see also fTC, Ltd. v. Punchgini*, 482

that party rebuts or meets the presumption, the fact there was initial proof the presumption applied is not supposed to have any effect on the burden of persuasion as to ultimate liability. Fed. R. Evid. 301, advisory committee's notes. Moreover, in the case of a classic rebuttable presumption, there often are no specific limitations about what sort of factual issues or evidence can be used to rebut the presumption. Thus, by definition, the scope of inquiry for a rebuttable presumption is more open-ended and unpredictable than that for a safe harbor.

III. Empirical Evidence Of The Effect of the Choice Between A Safe Harbor and A Rebuttable Presumption

You asked us to give some context to how these general characteristics of safe harbors and rebuttable presumptions play out in actual litigation, to help draw some conclusions as to what effect the choice between the two approaches might have on future litigation concerning whether Section 129C's ability-to-repay standards were met by the making of a "qualified mortgage." One difficulty with doing so is the large variety of statutory and regulatory safe harbors and presumptions, and the different litigation contexts in which they arc relevant. However, we concluded that studying TILA litigation involving a safe harbor or a rebuttable presumption could inform a conclusion about the subject. Our thinking was that these would provide concrete examples of how each mechanism operates in practice, and those examples likely would be instructive because Section 129C is also part ofTILA and because future Section 129C litigation likely would involve the same types of parties as the parties involved in other TILA cases.

In order to develop our views concerning the effect of the choice between the two regulatory alternatives, we considered reported cases that have arisen in TILA litigation over a statutory safe harbor (Section 130(f)) and over a rebuttable presumption (Section 125(c)). We have conducted a complete review of reported and unreported decisions since May 2005 on both of these sections and have created Table 1 and Table 2, attached hereto, collecting cases analyzing these sections.

Based on our review, and our assumption that the experience under the two provisions we considered are predictive, and for the reasons set forth below, if the safe harbor approach is adopted, litigation concerning compliance with Section 129C is likely to be more efficiently resolved, less complex and less costly to all parties than if the rebuttable presumption approach is adopted.[8]

F.3d 135, 147 (2d Cir. 2007) ("A presumption is an assumption of tact resulting from a rule of law which requires such fact to be assumed from another fact or group of facts found or otherwise established in the action.").

[8] Our review of litigation was limited to cases we could access under Section 130(f) and Section 125(c). It should not be read as commenting on how either section applies in future litigation, or as a judgment as to whether any case was correctly decided. We have not been asked to, nor have we, conducted a survey of the legislative history, statutes, regulations or case law

A. Safe Harbor Under Section 130(f) of TILA

As an example of how litigation develops and is resolved when a TILA safe harbor is involved, we examined case law relating to the defense to liability provided in Section 130(f) for a creditor's good faith compliance with a rule, regulation or interpretatit-n of the Board or Board staff. That section of TILA states:

> No provision ofthis section, section 1607(b) ofthis title, section 1607(c) of this title, section 1607(e) ofthis title, or section 1611 ofthis title imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or interpretation thereof by the Board or in conformity with any interpretation or approval by an official or employee of the Federal Reserve System duly authorized by the Board to issue such interpretations or approvals under such procedures as the Board may prescribe therefore, notwithstanding that after such act or omission has occmTed, such rule, regulation, interpretation, or approval is amended, rescinded, or detennined by judicial or other authority to be invalid for any reason.[9]

In *Milhollin,* after reviewing the deference that should be afforded the Board's regulations and commentary, the Supreme Court examined the scope and purpose of the safe harbor in Section 130(£). 444 U.S. at 567. The Court stated:

> Congress has specifically designated the Federal Reserve Board and staff as the primary source for interpretation and application of truth-in-lending law. Because *creditors need sure guidance* tlU'ough the "highly technical" Truth in Lending Act, S. Rep. No. 93-278, p. 13 (1973), legislators have twice acted to promote reliance upon Federal Reserve pronouncements. In 1974, TILA was amended to provide creditors with a defense from liability based upon good-faith compliance with a "rule, regulation, or interpretation" of the Federal Reserve Board itself. *The explicit purpose of the amendment was to relieve the creditor of the burden of choosing "between the Board's construction ofthe Act and the creditor's own assessment of how a court may interpret the Act.*" The same rationale prompted a further change in the statute in 1976, authorizing a liability defense for "conformity with any interpretation or approval by an official or employee of the Federal Reserve System duly authorized by the Board to issue such interpretations or approvals . . . ."

Id. at 567 (emphasis added) (internal citation omitted). The Court held, applying these principles, that a creditor could properly rely on a Board interpretation (about how acceleration

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concerning other provisions ofTILA or a complete survey of all statutory provisions employing a safe harbor or rebuttable presumption standard.

[9] TILA Section l30(f); 15 U.S.C. § 1640(f).

terms were disclosed) and that the creditor was therefore entitled to dismissal of any challenges. *Jd.IO*

This broad safe harbor has been applied to many areas in which the Board and its staff have issued comments or guidance. Courts often have found that compliance with the Official Staff Commentary to Regulation Z (the "Commentary") "shields an issuer from civil liability pursuant to TILA's safe-harbor provision." *Katz v. Cal-Western Reconveyance Corp.*, No. 5:09-cv-04866-JF, 2010 WL 424453, at *3-4 (N.D. Cal. Jan. 27, 2010).

Courts ruling on the application of this safe harbor provision have been able to resolve matters at early stages of litigation, for either party, rather than after lengthy or costly discovery. *See, e.g.,.Katz,* 2010 WL 424453; *Raeth v. Nat'! City Bank,* 755 F. Supp. 2d 899, 903-06 (W.D. Tenn. 2010) (dismissing multiple TILA claims with prejudice because creditor satisfied safe harbor provision); *Alicea* , 210 F. Supp. 2d 4. Our research revealed that out of 24 decisions, reported and unreported, concerning Section 130(f) following *Mi/hollin*, the safe harbor issue was resolved in 17 cases at the motion to dismiss or preliminary injunction stage, while 6 cases went on to summary judgment, and only 1 case went to triaL *See* Table 1 (attached hereto collecting cases). Furthermore, our research on this provision revealed only 24 decisions in total since the *Milhollin* decision in 1980, while, as discussed more fully below, our research regarding the rebuttable presumption in Section 125(c) revealed 59 decisions over the last five years alone.

B. Rebuttable Presumption Under Section 12S(c) of TILA

To identify any contrast with the experience of a TILA safe harbor, we examined experience with the rebuttable presumption in Section 125(c) of TILA, concerning the requirement for right of rescission disclosures in Section 125(a) ofTILA. The relevant portion of Regulation Z specifies that in order to provide proper notice of the right to cancel, "a creditor shall deliver two copies of the notice of the right to rescind to each consumer entitled to rescind." 12 C.F.R. § 226.23(b)(I); *see also* 12 C.F.R. § 226.23(a). The typical form of notice contains a space for signed acknowledgement by the borrower of timely receipt of the notice. *See* Rescission Model Fonns H-8 and H-9. However, Section 125(c) states:

> Notwithstanding any rule of evidence, written acknowledgment of receipt of any disclosures required under this subchapter by a person to whom information, fonns, and a statement is required to be given pursuant to this section does no more than create a rebuttable presumption of delivery thereof. [11]

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[10] *See also Pittman v. Money Mart, Inc.*, 636 F.2d 993, 995 (5th Cir. 1981) (applying the safe harbor to "hold that [the creditor's] delinquency-charge statement complies with the disclosure requirements of section 226.8(b)(4), Regulation Z, quoted above, and that, therefore, [it] cannot be held civilly liable by reason of any claimed inadequacy of disclosure with regard to the delinquency charge imposablc for late payment").

[11] TILA Section 125(c); 15 U.S.C. § 1635(c).

There is no additional guidance in applying the presumption in either Regulation Z or the Commentary.

Taken together, the rebuttable presumption set forth in Section 125(c) and Federal Rule of Evidence 301 indicate that the resolution of cases involving the rebuttable presumption permit a fact-specific inquiry. This raises the possibility that such cases may not be ones that could be resolved on the face of the pleadings or through modest discovery. This possibility is proven in practice, as reflected in the case law revealed by our research. In reviewing 59 decisions, reported and unreported over the last five years, applying the presumption in Section 125(c), only 7 cases were resolved at the motion to dismiss stage (and 5 of those cases were resolved on other grounds), while 17 cases went on to be resolved at summary judgment, and the remaining 35 cases went on to be set for trial. *See* Table 2 (attached hereto collecting cases).

Our research into these cases, and our experience, suggests that litigation involving a rebuttable presumption can present two challenges that did not regularly appear in litigation involving a safe harbor. First, there often is uncertainty in the former types of cases as to which facts or evidence might be sufficient to rebut the presumption. Second, the interplay of the presumption and the additional facts appears to lead more often to litigation that does not terminate prior to or even at the time of summary judgment.

There are many courts that have determined that a borrower's assertion of noncompliance alone creates a question of fact to be resolved at trial under a rebuttable presumption standard. *See, e.g. Stutzka v. McCarville*, 420 F.3d 757, 762 (8th Cir. 2005) ("Because [plaintiff]'s affidavit, at the very least, would have rebutted the presumption of delivery, the district court also erred in granting summary judgment on the TILA claims.").[12] But, illustrative of the general uncertainty created by a rebuttable presumption, some courts have determined that a borrower's assertion of noncompliance alone is insufficient to resolve the presumption in the borrower's favor. *See e.g., McCarthy v. Option One Mortg. Corp.*, 362 F.3d 1008, 1011 (7th

[12] *See also Rodrigues v. Newport Lending Corp.*, No. 10-00029 HG-LEJ(, 2010 WL 4960065, at *6 (D. Haw. Nov. 29, 2010) (denying summary judgment based on plaintiff's denial of receipt of disclosures); *Briggs v. Provident Bank*, 349 F. Supp. 2d 1124, 1129 (N.D. Ill. 2004) (denyin g summary judgment based on claimant's deposition testimony concerning receipt of disclosures); *Macheda v. Household Fin. Realty Corp.*, 631 F. Supp. 2d 181, 191 (N.D.N.Y. 2008) (denying cross-summary judgment motions based on botTower's offer ofproofto rebut presumption of delivery); *lobe v. Argent Mortg. Co., LLC*, No. 3:cv-06-0697, 2008 WL 450432, at *4-5 (M.D. Pa. Feb. 15, 2008) (denying summary judgment based on plaintiffs' sworn statements that they were not each given two copies ofthe required notice); *Cooper v. First Gov't Mortg. &Investors Corp.*, 238 F. Supp. 2d 50, 64-65 (D.D.C. 2002) (same); *Hanlin v. Ohio Builders & Remodelers, Inc.*, 212 F. Supp. 2d 752, 762 (S.D. Ohio 2002) (same).

Cir. 2004) (affinning summary judgment in the creditor's favor because mere assertion of non-receipt is insufficient to rebut written evidence that disclosures were provided). [13]

Notably, none of these cases cited above concerning the necessary proof to rebut a presumption were resolved until the summary judgment stage or trial. L1 our experience, as a general matter, litigation that is resolved at the motion to dismiss stage, without taking into account any appeal process, is less expensive for both parties than litigation that proceeds to summary judgment or trial. In order to proceed to summary judgment or trial, the parties must conduct fact-finding discovery, including but not limited to, exchanging document requests and interrogatories and conducting depositions. Moreover, trial preparation can also be costly and time-consuming. The additional issues involved in proceeding to summary judgment or trial are likely to result in greater expense and attomeys fees for both parties regardless of the outcome of the litigation, than litigation that is resolved at the motion to dismiss stage.

C. Conclusions.

Our review of the application of the safe harbor in TILA Section 130(f) and of the rebuttable presumption in TILA Section 125(c) provides strong and concrete support for the conclusion that any litigation over TILA Section 129C compliance is likely to be cheaper, quicker, and more efficiently resolved ifthcre is a safe harbor standard for a ''qualified mortgage" than if a rebuttable presumption standard is adopted. This experience also suppmis the conclusion that a safe harbor can be expected to lead to more predictable results and certain application than does a rebuttable presumption. [14]

IV. Legal Challenges Under a Safe Harbor

You have asked whether having a safe harbor standard, in itself, will limit a borrower's ability to bring litigation challenging whether the standard was met.

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[13] *See also Williams v. GM Mortg. Corp.*, No. 03-cv-74788-DT, 2004 WL 3704081, at *8 (E.D. Mich. Aug. 18, 2004) (resolving summary judgment in the creditor's favor because "a Plaintiffs bare bones, self-serving denial is not sufficient to rebut § 1635(c)'s statutory presumption''); *Parker v. Long Beach Mortg. Co.*, 534 F. Supp. 2d 528, 536-37 (E.D. Pa. 2008) (finding plaintiffs failed to rebut presumption as pa1i of post-trial Rule 52(c) judgment as a matter of law, when plaintiffs' only evidence offered to rebut presumption was testimony that they did not remember receiving disclosures).

[14] These observations do not take into account the actual safe harbor or rebuttable presumption that might be adopted, or assess the Proposed Rule's alternatives or any other structures that might be suggested by commentators. The design of a safe harbor or a rebuttable presumption can limit, or even eliminate, various of the advantages and disadvantages discussed; for example, if the safe harbor is based on subjective factors or fact-intensive factors, some of the certainty in a safe harbor structure may be lost.

As noted above, and evidenced by the safe harbor cases identified in Table 1, simply providing a regulatory safe harbor will not limit a boiTower's ability to bring a lawsuit to dispute that the standard or the factors that trigger the standard were met by the creditor (within the constraints, of course, that such a dispute requires a good faith basis). While such a dispute might be resolved quickly, that does not necessarily mean that one party or the other would prevail.

We also point out that a safe harbor standard could be structured so as to put the burden on the creditor to demonstrate that its actions met the standard or the factors listed in the safe harbor. To the extent that is the case, the mere existence of the safe harbor would not disadvantage a borrower for the further reason that the burden of proof as to compliance with Section 129C would not fall on the bon·ower.

V. Considerations In Design of a Safe Harbor

Additionally, you have asked about our views concerning what types of standards could be included in a safe harbor such that it would likely maximize the advantages to such a structure. This is not a matter of legal judgment, but it seems that, based on the above discussion and in our experience, a safe harbor that contains definite, objective factors is more likely to serve the goals of certainty and predictability. In addition, a safe harbor that delineates the type of evidence that establishes the safe harbor may be even stronger. So, for example, if proof of a qualified mortgage safe harbor requires a demonstration that employment has been verified, the safe harbor would be stronger to the extent it specifically identified a conclusively-acceptable method of making such a verification.

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TABLE 1

Safe Harbor (TILA Section 130, 15 U.S.C. § 1640):

MTD = Motion to Dismiss; MSJ = Motion for Summary Judgment
Unless not otherwise noted, motions was brought by creditor

	Case	Resolution of Safe Harbor Question
1.	*Raeth v. Nat'l City Bank*, 755 F. Supp. 2d 899 (W.D. Tenn. 2010)	MTD, safe harbor applies
2.	*Palmer v. Ameribanq Mortg. Grp.*, LLC, No. 05-2023, 2010 WL 3933273 (E.D. Pa. Oct. 6, 2010)	Aftr bench trial (primarily on other i sues), safe harbor applies
3.	*Poulin v. BaLise Auto Sales, inc.*, No. 3:08-cv-01618 (CSH), 2010 WL 1370862 (D. Conn. Apr. 5, 2010)	MTD, safe harbor applies
4.	*Katz v. Cal-Western Reconveyance Corp.*, No. 5:09-cv-04866-JF (N.D. Cal. Jan. 27, 2010)	MTD, safe harbor applies
5.	*Olivera v. American Home Mortg. Servicing, Inc.*, 689 F. Supp. 2d 1218 (N.D. Cal. 2010)	MTD, safe harbor applies
6.	*Valdez v. A1neriCCL's Wholesale Lender*, No. C 09-02778 JF (RS), 2009 WL 5114305 (N.D. Cal. Dec. 18, 2009)	MTD, safe harbor applies
7.	*Jordan v. Paul Financial, LLC*, 644 F. Supp. 2d 1156 (N.D. Cal. 2009)	MSJ, safe harbor does not apply
8.	*Kelly v. Performance Credit Corp.*, No. 08-40159-FDS, 2009 WL 3300030 (D. Mass. Apr. 14, 2009)	MTD, safe harbor applies
9.	*Bonney v. Wash. Mut. Bank*, 596 F.Supp.2d 173 (D. Mass 2009)	MTD, safe harbor applies
10.	*Mandrigues v. World Savings, Inc.*, No. C 07-4497 JF, 2009 WL 160213 (N.D. Cal. Jan. 20, 2009)	Motion for Preliminary Injunction, safe harbor applies
11.	*Omar v. Wash. Mut. Bank*, No. 08-40044-FDS, 2008 WL 5650851 (D. Mass. Dec. 30, 2008)	MTD, safe harbor applies
12.	*Quiles v. Wash. Mut. Bank*, No. 08-40039-FDS, 2008 WL 5650852 (D. Mass. Dec. 30, 2008)	MTD, safe harbor applies

13.	*Amparan v. Plaza Home Mortg., Inc.*, 678 F.Supp.2d 961 (N.D. Cal. 2008)	MTD, safe harbor does not completely apply
14.	*Altamirano v. Copiague Funding Corp.*, No. 3:06cv1751 (PCD), 2008 WL 3845362 (D. Conn. Aug. 18, 2008)	MSJ (Plaintiff's), safe harbor does not apply
15.	*Swanson v. Bank of America, NA.*, 566 F. Supp. 2d 821 (N.D. Ill. 2008)	MTD, safe harbor applies
16.	*Aubin v. Residential Funding Co.*, LLC, 565 F. Supp. 2d 392 (D. Conn. 2008)	MTD, safe harbor does not apply
17.	*Megill v. lndyMac Bank, F.S.B.*, 547 F. Supp. 2d 56 (D. Mass 2008)	MTD, safe harbor applies
18.	*Cazares v. Pac. Shore Funding*, No. CY04-2548DSF(SSX), 2006 WL 149106 (C.D. Cal. Jan 3, 2006)	MTD, safe harbor does not apply
19.	*Jeanty v. Wash. Mut. Bank, F.A.*, 305 F. Supp. 2d 962 (E.D. Wis. 2004)	MTD, safe harbor does not apply
20.	*Fabricant v. Sears Roebuck*, No. 98-1281-CIV, 2002 WL 34477592 (S.D. Fla. Mar. 5, 2002)	MSJ, safe harbor does not apply
21.	*London v. Chase Manhattan Bank USA*, N.A., 150 F. Supp. 2d 1314 (S.D. Fla. 2001)	MSJ (plaintiff's), safe harbor does not apply
22.	*Greisz v. Household Bank*, 8 F. Supp. 2d 1031 (N.D. Ill. 1998)	MSJ, safe harbor applies
23.	*Ritter v. Durand Chevrolet, Inc.*, 945 F. Supp. 381 (D. Mass 1996)	MSJ, safe harbor applies
24.	*Lindsey v. Ed Johnson Oldsmobile, Inc.*, No. 95 C 7306, 1996 WL 411336 (N.D. Ill. July 19, 1996)	MTD, safe harbor does not apply

TABLE2

Presumption (TILA Section 125, 15 U.S.C. § 1635):

MTD = Motion to Dismiss; MSJ = Motion for Summary Judgment
If not otherwise noted, motion was brought by creditor

	Case	Resolution of Presumption Question
1.	Solomon v. Falcone, No. 09–2210 (ABJ), 2011 WL 2342759 (D.D.C. June 15, 2011)	MTD, denied because issue of fact exists
2.	Kuenzi v. EuroSport Cycles, Inc., No. 08–3906, 2011 WL 1883052 (E.D. Pa. May 17, 2011)	MSJ (2nd), presumption not rebutted
3.	Moore v. ING Bank, Inc., No. Cll–1392, 2011 WL 1832797 (W.O. Wash. May 13, 2011)	MTD, denied because issue of fact exists
4.	Patterson v. Bank of America, No. C11–155Z, 2011 WL 1832814 (W.D. Wash. May 13, 2011)	MTD, granted on other grounds, but rejects presumption because issue of fact exists
5.	Tacheny v. M&I Marshall & llsley Bank, No. 10–CV–2067 (PJS/JJK), 2011 WL 1657877, (D. Minn., Apr. 29, 2011)	MTD, denied because "premature" and must be brought in MSJ
6.	Cavaco v. MERS, No. 09–00586 SOM/BMK, 2011 WL 1565979 (D. Haw. Apr. 25, 2011)	MSJ, denied because issue of fact exists
7.	Hegrenes v. MGC Mortg., lnc., No. 10-422-AA, 2011 WL 841172 (D. Or. Mar. 7, 2011)	MSJ, granted because plaintiff did not rebut
8.	Bakker v. Wells Fargo Home Mortg., No. CV–10–82–HU, 2011 WL 1124041 (D. Or. Feb. 28, 2011)	MTD, denied because pleading adequate to state claim without considering notices at MTD stage
9.	Marr v. John Docs 1-5, No. 09-CV-228, 2011 WL 382133 (E.D. Wis. Feb. 3, 2011)	MSJ, granted because plaintiff did not rebut after depositions

10.	Stallman v. Countrywide Home Loans, Inc., No.1:10CV 1006,2011 WL400103 (N.D. Ohio Feb. 1, 2011)	MSJ, granted because plaintiff did not rebut
11.	Farwell v. Story, No. DKC 10-1274,2010 WL 4963008 (D. Md. Dec. 1, 2010)	MTD, denied because premature
12.	Rod1igues v. Newport Lending Corp., No. 10-00029 HG-LEK, 2010 WL 4960065 (D. Haw. Nov. 29, 2010)	MSJ, denied because issue of fact exists
13.	Palmer v. Amexibanq Mortg. Grp., LLC, No. 05-2023, 2010 WL 3933273 (E.D. Pa. Oct. 6, 2010)	After bench trial, granted because plaintiff did not rebut
14.	Calhoun v. Homeowners Friend Mortg. Co., Inc., No. 09-4568, 2010 WL 3802704 (E.D. La. Sept. 20, 2010)	MSJ, denied because issue of fact exists
15.	Chemick v. Bank of Am. Home Loans, No. 2:09-cv-02746 JAM-DAD, 2010 WL 3269797 (E.D. Cal. Aug. 18, 2010)	MTD, granted
16.	Frese v. Empire Fin. Servs., 725 F.Supp.2d 130 (D.D.C. 2010)	MTD, denied
17.	Iannuzzi v. Am. M01tg. Network, Inc., 727 F.Supp.2d 125 (E.D.N.Y. 2010)	MSJ, denied in 1::levant part
18.	Pacheco v. Homecoming Fin. LLC, No. C 08-3002 JF (HRL), 2010 WL 2629887 (N.D. Cal. June 29, 2010)	MSJ, granted
19.	Hendricksen v. Countrywide Home Loans, No. 3:09-CV-00082, 2010 WL 2553589 (W.D. Va. June 24, 2010)	MSJ, granted
20.	Bonanno v. Sec. Atl. M01tg. Co., No. 07-CV-4071 (JG)(WDW), 2010 WL 2134155 (E.D.N.Y. 2010)	MSJ, granted
21.	Sias v. Wash. Mut. Bank, No. 3:10-CV-43, 2010 WL 2103448 (E.D. Tenn. 2010)	MSJ, granted
22.	Lee v. Countrywide Home Loans, Inc., No. 3:09 CV 766,2010 WL 1487131 (N.D. Ohio Apr. 13, 2010)	MSJ, granted
23.	Burch v. GMAC Mortg., LLC, No. C-09-4214 MMC, 2010 WL 934088 (N.D. Cal. Mar. 15, 2010)	MTD, denied in relevant part
24.	Morris v. Bank of America, No. C 09-2849 SBA, 2010 WL 761318 (N.D. Cal. Mar. 3, 2010)	MTD, denied in relevant part
25.	Deutsche Bank Nat'! Trust Co. v. LaCapria, No. 08-2174 (JAP), 2010 WL 715617 (D.N.J. Mar. 1, 2010)	MSJ, granted

26.	Pearce v. Bank of America Home Loans, No. C 09-3988 JF, 2010 WL 689798 (N.D. Cal. Feb. 23, 2010)	MTD, granted on other grounds
27.	Am v. Nat'l City Mortg. Co., No. 09-00060 SOM/KSC, 2010 WL 571936 (D. Haw. Feb. 17, 2010)	MSJ, granted
28.	Payan v. Greenpoint Mortg. Funding, Inc., 681 F. Supp. 2d 564 (D.N.J. 2010)	Motion for judgment on the pleadings, granted
29.	Horton v. Country Mortg. Servs., Inc., No. 07 C 6530, 2010 WL 55902 (N.D. Ill. Jan 4, 2010)	MSJ, denied in relevant part
30.	Valdez v. America's Wholesale Lender, No. C 09-02778 JF (RS), 2009 WL 5114305 (N.D. Cal. Dec. 18, 2009)	MTD, granted on other grounds
31.	Gonzalez v. Wells Fargo Bank, No. C 09-03444 MHP, 2009 WL 3572118 (N.D. Cal. Oct. 30, 2009)	Preliminary Injunction, denied
32.	Seagren v. Aurora Loan Servs., Inc., No. CV 09-5050 ODW (AGRx), 2009 WL 3534171 (D.D. Cal. Oct. 28, 2009)	MTD, granted
33.	Anderson v. Countrywide Fin., No. 2:08-cv-01220-GEB-GGH, 2009 WL 3368444 (E.D. Cal. Oct. 16, 2009)	MSJ, granted
34.	Dahn v. Fifth Third Bank, No. 3:09-cv-184-JPG-PMF, 2009 WL 2588875 (S.D. Ill. Aug. 20, 2009)	Motion for judgment on the pleadings, granted
35.	Jobe v. Argent Mortg. Co., LLC, No. 3:CV-06-00697,2009 WL 2461168 (M.D. Pa. Aug. 11, 2009)	MSJ, granted
36.	Byron v. EMC Mortg. Corp., No. 3:09-CV-197-HEH, 2009 WL 2486816 (E.D. Va. Aug. 10, 2009)	MTD, granted on other grounds
37.	Siffel v. NFM, Inc., No. 07-cv-05152-JF, 2009 WL 1783523 (E.D. Pa. June 23, 2009)	MSJ, granted
38.	Knittel v. First Fin. Mortg. Corp., No. 08-44-JBC, 2009 WL 1702174 (E.D. Ky. June 1, 2009)	MSJ, granted
39.	Garza v. Am. Home Mortg., No. CV F 08-1477 LJO GSA, 2009 WL 1139594 (E.D. Cal. Apr. 28, 2009)	MTD, granted
40.	Hill v. Tribcca Lending Corp., No. 07-5300, 2009 WL 691977 (E.D. Pa. Mar. 17, 2009)	Judgmcnt for Defendants
41.	Haywood v. Fremont Investment & Loan, No. 08 Civ. 4961 (BMC), 2009 WL 796090 (E.D.N.Y. Mar. 16, 2009)	MTD, denied

42.	Glucksman v. First Franklin Fin. Corp., 601 F. Supp. 2d 511 (E.D.N.Y. 2009)	Declaratory Judgment to Rescind Mortgage, denied
43.	Quintos v. Decision One Mortg. Co., LLC, No. 08-CV-1757 JM (POR), 2008 WL 5411636 (S.D. Cal. Dec. 29, 2008)	MTD, granted
44.	Briscoe v. Deutsche Bank Nat'!Trust Co., No. 08 C 1279, 2008 WL 4852977 (N.D. Ill. Nov. 7, 2008)	MTD, denied
45.	Gonzalez v. The CIT Grp./Consumer Fin., Inc., No. 07-4156, 2008 WL 4771856 (E.D. Pa. Oct. 29, 2008)	MSJ, granted in relevant part
46.	Macheda v. Household Fin. Realty Corp. of N.Y., 631 F. Supp. 2d 181 (N.O.N.Y. 2008)	MSJ, denied in relevant part
47.	Buick v. World Savings Bank, 631 F. Supp. 2d 765 (B.D. Cal. 2008)	MTD, denied in relevant part
48.	Kajitani v. Downey Savings and Loan Ass'n, F.A., 647 F. Supp. 2d 1208 (D. Haw. 2008)	MSJ, denied in relevant part
49.	Abbott v. Wash. Mut. Fin., Inc., No. 05-4497, 2008 WL 756069 (E.D. Pa. Mar. 20, 2008)	Trial order in favor of defendant
50.	Chiles v. Ameriqucst Mortg. Co., 551 F. SupiJ. 2d 393 (E.D. Pe1m. 2008)	MSJ, granted
51.	White v. Homefield Fin., Inc., 545 F. Supp. 2d 1159 (W.D. Wash. 2008)	MSJ, denied in relevant part
52.	Jobe v. Argent Mortg. Co., No. 3:CV-06-0697, 2008 WL 450432 (M.D. Pa. Feb. 15, 2008)	MSJ, denied in relevant part
53.	Parker v. Long Beach Mortg. Co., 534 F.Supp.2d 528 (E.D. Pa. 2008)	Motion for Judgment as Matter of Law, granted
54.	Davis v. Deutsche Bank Nat'l Trust Co., No. 05-CV-4061, 2007 WL 3342398 (E.D. Pa. Nov. 8, 2007)	MSJ, granted
55.	Rimstad v. Wells Fargo Bank, N.A., No. 07-2582 (DWF/AJB), 2007 WL 1752724 (D. Minn. June 15, 2007)	Motion to Vacat Temporary Restraining Order, granted
56.	Peterson v. Argent Mortg. Co., No. 06-3796 (PAM/JSM), 2007 WL 1725355 (D. Minn. June 14, 2007)	MTD, granted
57.	Caliguiri v. Columbia River Bank Mortg. Grp., No. 07-3003-PA, 2007 WL 1560623 (D. Or. May_22, 2007)	MTD, granted on other grounds

58.	In re Ameriquest Mortg. Co., No. 05-CV-7097, 2006 WL 1525661 (N.D. Ill. May 30, 2006)	Plaintiffs' Motion for Temporary Injunctive Relief granted over the presumption
59.	Stutzka v. Walters, No. 8:02CV72, 2006 WL 861284 (D. Neb. Mar. 28, 2006)	Plaintiffs and Defendant's MSJs, presumption rebutted sufficient to require trial

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Rebuttable Presumption vs. Safe Harbor: What Practical Difference Does It Make?

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INTRODUCTION

Section 1411 of the Dodd-Frank Act[1] amends the Truth in Lending Act ("TILA") to require any closed-end residential mortgage lender to consider a borrower's ability to repay. In particular, Section 1411 prohibits such a lender from making a residential mortgage loan unless the lender "makes a reasonable and good faith determination … [that] the consumer has a reasonable ability to repay the loan."[2] In the next section of Dodd-Frank, Congress created a "safe harbor and rebuttable presumption," which provides that a "qualified mortgage" will meet this ability-to-repay standard.[3] Taken together, these TILA provisions contemplate minimum underwriting standards, but grant lenders some degree of protection if they meet those standards.

The Consumer Financial Protection Bureau ("CFPB") is now in the process of crafting regulations to implement the ability-to-repay provisions. Consequently, mortgage industry participants, financial regulators, and the public are negotiating the contours of the qualified mortgage exemption. Among other things, these parties must determine whether the qualified mortgage exemption should (a) provide a safe harbor or (b) give rise to a rebuttable presumption.

This issue is not merely a matter of semantics. TILA will allow borrowers to assert purported violations of the ability-to-pay requirement in suits for damages and as a defense to a foreclosure proceeding.[4] The ultimate choice between a safe harbor and a presumption will significantly affect the timeframes (and perhaps outcomes) of this expensive TILA litigation. Moreover, the scope of the exemption could directly affect the availability and affordability of credit to borrowers.

This white paper focuses on the consequences for expected litigation, describing litigation paths for ability-to-repay litigation in federal courts under two scenarios: (1) a

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1 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 (2010), 124 Stat. 1376 ("Dodd-Frank").

2 15 U.S.C. § 1639C(a).

3 *See id.* § 1639C(b).

4 *Id.* § 1640.

scenario in which the qualified mortgage provision creates only a rebuttable presumption of compliance, and (2) a scenario in which the qualified mortgage provision provides a safe harbor to the lender. **As explained below, a rebuttable presumption would be largely useless to lenders at the pleadings stage and provide only a limited defense at the summary judgment stage (or even at trial). In contrast, a "safe harbor" could allow for early disposition of non-meritorious cases at the summary judgment stage and—perhaps—at the motion to dismiss stage.**

I. THE CONTEXT: THREE TYPES OF ABILITY-TO-REPAY CHALLENGES

Even though Section 1411 creates a new right under TILA, we can easily foresee essentially three types of ability-to-repay challenges that a borrower might make.[5] In the first type of challenge, a borrower might take issue with either (a) the entire actual standard used by the lender to determine a borrower's ability to repay or (b) one or more specific aspects of that standard. In the latter two types, a borrower could assert that the lender violated Section 1411, notwithstanding the lender's use of the correct ability-to-repay standard. Each of these challenges is considered in turn.

A. Challenges to Ability-to-Repay Standards Themselves

In the first type of challenge, a borrower might allege that the standard used by the lender to determine his ability to repay was inappropriate, even if the borrower met the standard. Imagine, for example, a lender who used a debt-to-income ratio ("DTI") limit of 55% to determine a borrower's ability to repay. If a borrower fell below that limit (perhaps with a DTI of 53%), then the borrower might challenge the limit as inappropriately high. The borrower could then ask that the court or jury to determine that the borrower did *not* have ability to repay, notwithstanding the fact that he or she met the lender's underwriting standards.

The regulators could address this category of challenges by providing guidance in the regulation or staff commentary. For instance, if the CFPB were to indicate that a certain DTI would definitively be viewed as meeting the ability-to-repay standard, this type of challenge would fail. If, however, the guidance is less definitive (*e.g.*, a certain DTI is only *presumed* to be appropriate)—or no such guidance is provided—lenders will not be able to select (at least with any confidence) any underwriting guidelines sufficient to defeat an ability-to-repay challenge. Consider again the issue of DTI. Would a lender be "safe" using the DTI standards set forth by the Department of Veterans Affairs for the loans it guarantees? Should the lender instead use the DTI standards set forth by the Federal Housing Administration for the loans it insures? Perhaps the lender should apply the standards set by the government-sponsored enterprises for the loans that they purchase and securitize? Or should the lender instead use the DTI standards set by the Department of the Treasury for a HAMP modification?

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[5] Borrowers will conceive and attempt other types of challenges; this paper simply discusses three expected forms of such challenges.

B. Challenges to the Application and Use of Ability-to-Repay Standards

In a second type of challenge, a borrower might allege that—even if the lender's standard was appropriate for determining that the borrower had an ability to repay the loan—the borrower did not meet that standard. For example, a borrower might claim that he or she did not actually meet the lender's unchallenged DTI standard because the lender did not properly calculate the borrower's income. This kind of calculation challenge (*e.g.*, "the lender should have discounted my overtime income even using its own guidelines") would be available even if the CFPB creates a safe harbor for a certain DTI level. In the instance of a safe harbor, this type of challenge would simply allege that the loan was not actually within the safe harbor.

In a third type of foreseeable challenge, a borrower might allege that—even if the lender's standard was appropriate for determining that the borrower had an ability to repay the loan—there was other extrinsic evidence that the lender should have used to determine the borrower could not repay the loan. Here, a borrower might claim that she had informed an employee of the lender (or even a loan broker) that she had (or her co-borrower had) an unstable job, or that the bonus or overtime income was inconsistent, or that self-employment income prospects were weakening. Alternatively, the borrower could claim that a certain DTI was inappropriate for her in light of her prior loan history, even if that DTI might be appropriate for borrowers generally. For instance, the borrower might have shown in a past loan that she was unable to meet her obligations at a similar or lower DTI.[6] Fortunately, a safe harbor would generally foreclose this type of challenge, as the lender would be able to document that the borrower met a set DTI guideline that is within the safe harbor.

II. THE REBUTTABLE PRESUMPTION: A LIMITED EVIDENTIARY TOOL

Some parties suggest that the qualified mortgage provision should give rise to only a rebuttable presumption, rather than a safe harbor. The consequences of such an approach depend on two principal concepts: (1) how a presumption is defined and (2) how courts treat such presumptions at various stages of litigation.

A. What Is A Rebuttable Presumption?

Neither the Federal Rules of Evidence nor the Federal Rules of Civil Procedure specifically define the term "presumption."[7] Generally, however, the term refers to "an

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[6] For instance, the borrower might have defaulted and needed a loan modification to take her from 38% to 28% DTI. The borrower could then contend that she had shown she could not make payments at a 38% DTI and the lender should have known this.

[7] This white paper focuses on the standards and principles applicable in federal court. State courts often apply similar standards, but there are state-by-state variances that cannot be fully addressed here. *See* Joel S. Hjelmaas, *Stepping Back from the Thicket: A Proposal for the Treatment of*

assumption of fact resulting from a rule of law which requires such fact to be assumed from another fact or group of facts found or otherwise established in the action."[8] In one sense, a presumption provides the party it benefits with an evidentiary head start: it can be thought of as a tool to give a party "the luxury of not having to produce specific evidence to establish the point at issue."[9]

Although a definition is useful, the "[t]he difficulty lies not so much in deciding what a presumption is, but in determining what a presumption does."[10] Federal Rule of Evidence 301 explains how presumptions operate in federal civil cases. Specifically, "the party against whom a presumption is directed has the burden of producing evidence to rebut the presumption," while the actual burden of persuasion remains the same. Several courts have described this rule as embodying a "bursting-bubble" theory of presumptions.[11] Under that theory, a presumption disappears from the case once the party opposing it summons sufficient evidence:

> Rebuttable presumptions are rules of law attaching to proven evidentiary facts certain procedural consequences as to the opponent's duty to come forward with other evidence. … As Dean Wigmore has explained, the peculiar effect of a presumption of law (that is, the real presumption) is merely to invoke a rule of law compelling the trier of fact to reach a conclusion in the absence of evidence to the contrary from the opponent. If the opponent does offer evidence to the

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Rebuttable Presumptions and Inferences, 42 Drake L. Rev. 427, 450-51 (1993) ("Treatment of rebuttable presumptions in the states has been far from uniform[.]"). Even in state courts, however, the court would be interpreting a presumption created by federal law.

8 *ITC Ltd. v. Punchgini, Inc.*, 482 F.3d 135, 148 (2d Cir. 2007); *see also* Hjelmaas, *supra* note 7, at 430-31 (1993) ("A rebuttable presumption is a legal fiction that allows the finder of fact to determine the existence of one fact (the presumed fact), for which there may be no direct evidence, upon presentation of proof of other facts (the basic facts). Once the basic facts supporting the rebuttable presumption are established, the existence of the presumed fact will be assumed until the opposing party meets a specific burden to challenge the existence of the presumed fact. A rebuttable presumption is "coercive: once the basic facts are established, the trier of fact is compelled to find the ultimate fact unless evidence of the nonexistence of the ultimate fact has been introduced." (internal marks and footnotes omitted)).

9 *Routen v. West*, 142 F.3d 1434, 1440 (Fed. Cir. 1998).

10 D. Craig Lewis, *Should the Bubble Always Burst? The Need for Different Treatment of Presumptions Under IRE 301*, 32 Idaho L. Rev. 5, 5 (1995) (quoting Jack B. Weinstein, et al., *Weinstein's Evidence* § 300-1 (1982)).

11 *See, e.g.*, *City of Arlington v. FCC*, 668 F.3d 229, 256 (5th Cir. 2012); *McCann v. Newman Irrevocable Tr.*, 458 F.3d 281, 287-88 (3d Cir. 2006); *Nunley v. City of Los Angeles*, 52 F.3d 792, 796 (9th Cir. 1995); *A.C. Aukerman Co. v. R.L. Chaides Const. Co.*, 960 F.2d 1020, 1037 (Fed. Cir. 1992). The bursting bubble theory is to be contrasted with the Morgan theory, which provides that presumptions shift both the burden of proof and persuasion to the opposing party; the resisting party must provide evidence establishing his fact is *more probable* than the presumed fact. *See, e.g.*, *Pennzoil Co. v. FERC*, 789 F.2d 1128, 1138 (5th Cir. 1986).

> contrary (sufficient to satisfy the judge's requirement of some evidence), the presumption disappears as a rule of law, and the case is in the factfinder's hands free from any rule. As more poetically the explanation has been put, presumptions may be looked on as the bats of the law, flitting in the twilight, but disappearing in the sunshine of actual facts.[12]

Put more directly, a presumption exists to fill "factual vacuum," but drops out of a case once the party opposing it produces some amount of contrary evidence.[13] This is not to suggest that the evidence giving rise to the presumption actually drops out of the case. Although the presumption might disappear, that evidence can still be used in the case to support the presumed fact.[14]

B. How Do Rebuttable Presumptions Operate in Federal Litigation?

A rebuttable presumption might be relevant to three key stages of litigation: (1) on a motion to dismiss for failure to state a claim (*i.e.*, the pleadings stage), (2) on a motion for summary judgment, or (3) at trial.[15] To understand how the presumption operates at each stage, one must first understand the basic standards applicable at each step.

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12 *Legille v. Dann*, 544 F.2d 1, 6 (D.C. Cir. 1976) (footnotes and internal marks omitted).

13 *See, e.g.*, *Combo Mar., Inc. v. U.S. United Bulk Terminal, LLC*, 615 F.3d 599, 605 (5th Cir. 2010); *City of Chicago v. M/V Morgan*, 375 F.3d 563, 572 (7th Cir. 2004); *see also A.C. Aukerman Co.*, 960 F.2d at 1038 ("In other words, the evidence must be sufficient to put the existence of a presumed fact into genuine dispute. The presumption compels the production of this minimum quantum of evidence from the party against whom it operates, nothing more").

14 *McCann v. Newman Irrevocable Trust*, 458 F.3d 281, 288 n.5 (3d Cir. 2006); *Am. Online v. AT&T Corp.*, 243 F.3d 812, 818 (4th Cir. 2001) ("Although evidence rebutting the presumption may neutralize the presumption itself—i.e., that the burden of proof on the fact giving rise to the presumption has been met without rebutting evidence—it does not eliminate from the case the evidence itself that gave rise to the presumption.").

15 Theoretically, a defendant might also attempt to use the qualified mortgage provision in bringing a motion for judgment on the pleadings. *See* Fed. R. Civ. P. 12(c). But the Rule 12(c) motion has few—if any—advantages over motions to dismiss or motions for summary judgment and would not present significantly different issues. 5C Charles Alan Wright, et al., *Federal Practice and Procedure* § 1369 (3d ed. 2011 supp.) ("At this point in time the Rule 12(c) motion is little more than a relic of the common law and code eras."). Accordingly, this white paper does not consider the Rule 12(c) motion.

1. Motion to Dismiss for Failure to State a Claim.

The purpose of a motion to dismiss for failure to state a claim is to test the sufficiency of the complaint,[16] not to determine whether the plaintiff will ultimately prevail on his claim.[17] Thus, "[t]o survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to state a claim to relief that is plausible on its face."[18] Even under this plausibility standard, however, a court is not free to engage in broad factual inquiry beyond the complaint. Factual allegations (as opposed to legal conclusions) must be taken as true,[19] and matters outside the pleadings generally cannot be considered—at least without converting the motion to a motion for summary judgment.[20]

Because the motion to dismiss stage does not allow the weighing of *evidence*, "courts have [usually] refused to consider presumptions in favor of the defendant on a motion to dismiss."[21] Courts seem to refuse for three basic reasons. *First*, many courts reject the use of presumptions at the pleading stage out-of-hand, "since presumptions are evidentiary standards that are inappropriate for evaluation at the pleadings stage."[22] The U.S. Court of Appeals for

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16 *See, e.g.*, *Herebian v. Berv*, 644 F.3d 122, 130 (2d Cir. 2011); *Godin v. Schnecks*, 629 F.3d 79, 89 (1st Cir. 2010); *Riverview Health Inst. LLC v. Med. Mut. of Ohio*, 601 F.3d 505, 512 (6th Cir. 2010); *Presley v. City of Charlottesville*, 464 F.3d 480, 483 (4th Cir. 2006).

17 *See Skinner v. Switzer*, 131 S. Ct. 1289, 1296 (2011).

18 *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949 (2009) (quotation marks and citation omitted).

19 *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555-56 (2007); *Cal. Motor Transp. Co. v. Trucking Unlimited*, 404 U.S. 508, 515 (1972).

20 Fed. R. Civ. P. 12(d). Of course, there are certain limited circumstances where a court may consider "extrinsic" matters. For instance, the court may consider any document the plaintiff attaches to his complaint. Likewise, if a document is central to the plaintiff's claim or otherwise relied upon by him, it may be considered (even if it is not attached), as long as the document's authenticity is not in dispute. And the court can consider facts of which it can take judicial notice. *See, e.g.*, *Schatz v. Republican State Leadership Comm.*, 669 F.3d 50, 52 (1st Cir. 2012); *Braun v. Maynard*, 652 F.3d 557, 559 n.1 (4th Cir. 2011); *Kerber v. Qwest Group Life Ins. Plan*, 647 F.3d 950, 959 (10th Cir. 2011); *DiFolco v. MSNBC Cable LLC*, 622 F.3d 104, 111 (2d Cir. 2010).

21 *See* 5B Charles Alan Wright, et al., *Federal Practice and Procedure* § 1357 (3d ed. 2011 supp.).

22 *Id.*; *see also, e.g.*, *Ibrahim v. MortgageIT, Inc.*, No. 11–0802 SBA, 2011 WL 2560233, at *6 (N.D. Cal. June 28, 2011) ("By definition, a rebuttal presumption involves consideration of *evidence* to determine whether the presumption has been rebutted."); *Boltz-McCarthy v. Boltz*, No. 1:10-cv-00215-jgm, 2011 WL 1361913, at *2 (D. Vt. Apr. 11, 2011); *In re Regions Morgan Keegan ERISA Litig.*, 6692 F. Supp. 2d 944, 953-54 (W.D. Tenn. 2010); *United States v. Town of Lake Park, Fla.*, No. 09-80507-CV, 2009 WL 3667071, at *4 (S.D. Fla. Oct. 23, 2009) ("The appropriate method to challenge the rebuttable presumption of the evidentiary validity of the 2000 Census data is through a presentation of competent evidence to the contrary, either at the summary judgment or trial stage of the litigation." (internal marks and citations omitted)); *Haywood v. Fremont Inv. & Loan*, No. 08 Civ. 4961, 2009 WL 706090, at *1 (E.D.N.Y. Mar. 16, 2009) ("[R]ebuttable presumptions will rarely

the Ninth Circuit took this approach in a recent TILA case concerning a required notice of the right to rescind a mortgage loan.[23] There, the Ninth Circuit rejected the defendant's effort to invoke a presumption on a motion to dismiss stemming from the borrower's signed acknowledgment of receiving the notice. In the Ninth Circuit's view, presumptions "are rebutted by evidence" and "the time for presenting evidence ha[d] not yet arrived."[24] *Second*, courts have concluded that rebuttable presumptions are premised upon extrinsic documents that cannot be considered on a motion to dismiss.[25] *Third*, and lastly, courts have sometimes found that a plaintiff's contrary allegations in his complaint are enough to defeat the presumption because those allegations must be taken as true.[26] The U.S. District Court for the District of Maryland applied this logic in *DeCosta v. U.S. Bancorp*.[27] In that case, a lender again presented an acknowledgment that gave rise to a rebuttable presumption that the borrower had received certain required notices of right to rescind. Nevertheless, the court observed that the plaintiffs' complaint "allege[d] that they received only one copy of the notice … instead of the requisite two" and concluded that "that factual allegation [wa]s enough" to defeat a motion to dismiss.[28]

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have any effect on a Rule 12(b) (6) motion; by definition, they involve a weighing of the evidence and thus play no role on a motion directed to the pleadings."); *Glucksman v. First Franklin Fin. Corp.*, 601 F. Supp. 2d 511, 514 (E.D.N.Y. 2009); *In re Hopkins*, 372 B.R. 734, 749 (Bankr. E.D. Pa. 2007); *In re Excel Energy, Inc. Sec., Derivatives, & "ERISA" Litig.*, 312 F. Supp. 2d 1165, 1180 (D. Minn. 2004).

23 *Balderas v. Countrywide Bank, N.A.*, 664 F.3d 787 (9th Cir. 2011). Regulation Z requires lenders to give borrowers notice of their right to rescind certain mortgages; when this notice is given in written form, the borrower must get two copies. 12 C.F.R. § 226.23(b)(1). If the borrower signs a written acknowledgment that he received the notices, that acknowledgment creates "a rebuttable presumption of delivery thereof." 15 U.S.C. § 1635(c).

24 *Id.* at 790.

25 *See, e.g.*, *Geraghty v. BAC Home Loans Servicing LP*, No. 11–336 (JNE/TNL), 2011 WL 3920248, at *6 (D. Minn. Sept. 7, 2011) (calling a motion to dismiss premised on a signed borrower acknowledgment "premature" partly because the court could not "consider matters outside the pleadings"); *Ibrahim*, 2011 WL 2560233, at *6; *Solomon v. Falcone*, No. 09-2210, 791 F. Supp. 2d 184, 190 (D.D.C. 2011); *Morris v. Bank of Am.*, No. 09-2849, 2010 WL 761318, at *4 (N.D. Cal. Mar. 3, 2010).

26 *See, e.g.*, *In re Kauffman Mut. Fund Actions*, 479 F.2d 257, 263 n.4 (1st Cir. 1973) ("The presumption[,] … whatever may be its effect at a trial, could not be used to contradict the complaint, if plaintiff is correct that the court so employed it."); *Smith v. United Residential Servs. & Real Estate, Inc.*, No. 10 C 5440, 2011 WL 3047492, at *3 (N.D. Ill. July 25, 2011); *Veera v. Ambac Plan Admin. Comm.*, 769 F. Supp. 2d 223, 230 (S.D.N.Y. 2011) (holding that plaintiffs' specific allegations were enough to rebut so-called *Moench* presumption on a motion to dismiss); *Briscoe v. Deutsche Bank Nat'l Trust Co.*, No. 08 C 1279, 2008 WL 4852977, at *3 (N.D. Ill. Nov. 7, 2008).

27 No. DKC 10-0301, 2010 WL 3824224 (D. Md. Sept. 27, 2010).

28 *Id.* at *4; *cf. Upshaw v. United States*, 669 F. Supp. 2d 32, 41 (D.D.C. 2009) (explaining that, to rebut rebuttable presumption that federal employee was acting within scope of his employment

As the cases described above reflect, courts have been especially likely to reject the use of presumptions at the motion to dismiss stage in the TILA context. There is nothing to suggest that a rebuttable presumption in an ability-to-repay case would be treated any differently. Although there have been occasional instances where courts have relied on rebuttable presumptions to dismiss a TILA complaint, those cases appear to be decidedly in the minority.[29]

Thus, if qualified mortgage status does no more than create a rebuttable presumption of lender compliance, that presumption will be of limited use at the motion to dismiss stage. Perhaps, in exceptional cases, lenders might attempt to argue that a plaintiff's claims of inability to repay are facially implausible. Yet that approach would require two circumstances unlikely to arise in a single case: (1) a plaintiff who included sufficient facts in his complaint to allow the defendant to make such a claim based on the complaint alone;[30] and (2) a court willing to take an especially aggressive approach to motions to dismiss. Such cases are likely to be rare and, in any event, would not be substantially aided by the presumption.

2. Motion for Summary Judgment.

The proposed rebuttable presumption might also be relevant at the summary judgment stage. "Summary judgment is appropriate where there is no genuine issue as to any material fact and the moving party is entitled to a judgment as a matter of law."[31] Put differently, "[w]here the record taken as a whole could not lead a rational trier of fact to find for the nonmoving party, there is no genuine issue for trial."[32] Where there is some genuine dispute over facts, the facts must of course be construed in the light most favorable to the nonmoving party, but a "metaphysical doubt" is not enough to create a genuine dispute.[33] And "[w]hen opposing parties tell two different stories, one of which is blatantly contradicted by the record, so that no reasonable jury could believe it, a court should not adopt that version of the facts for purposes of ruling on a motion for summary judgment."[34]

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created by government's certification that he was, plaintiff needed to allege specific "facts that, if true, would establish that the defendants were acting outside the scope of their employment").

29 *See Basham v. Fin. Am. Corp.*, 583 F.2d 918 (7th Cir. 1978) (affirming district court's dismissal of notice of rescission claim where lender presented written acknowledgment and borrower "failed to rebut this presumption by filing an affidavit or otherwise pleading further"); *Garcia v. Fannie Mae*, 794 F. Supp. 2d 1155, 1167 (D. Or. 2011) (listing cases wherein courts relied on TILA rebuttable presumption to dismiss complaint).

30 In other words, a plaintiff would need to "plead himself out" of federal court. *See, e.g.*, *Indep. Trust Corp. v. Stewart Info. Servs. Corp.*, 665 F.3d 930, 941-42 (7th Cir. 2012).

31 *Alabama v. North Carolina*, 130 S. Ct. 2295, 2308 (2010) (internal marks omitted).

32 *Ricci v. Destefano*, 129 S. Ct. 2658, 2677 (2009) (internal marks omitted).

33 *Scott v. Harris*, 550 U.S. 372, 380 (2007) (internal marks omitted).

34 *Id.*

If a rebuttable presumption could be used at the summary judgment stage, it might soften the blow of not being able to use the presumption at the motion to dismiss stage. Under amendments made to the Federal Rules of Civil Procedure in 2009 and 2010, a party may move for summary judgment at *any* time,[35] even at the "commencement of an action."[36] Thus, a lender could theoretically make an early motion for summary judgment, which would require the borrower to either (a) summon his contrary evidence to rebut the presumption or (b) file an affidavit (or declaration) specifically detailing the particular discovery he needs.[37]

Unfortunately, though, courts have struggled with how to handle rebuttable presumptions on motions for summary judgment.[38] Specifically, courts seem to require varying levels of evidence to rebut a presumption. Sometimes, a plaintiff's sworn statement is enough to rebut the presumption. Other times, some evidence beyond a borrower affidavit is required—but it often is not considerable evidence.[39] These different approaches render a summary judgment motion premised on any rebuttable presumption an unpredictable exercise to say the least.

The struggle probably stems from two competing interests. On the one hand, the bubble bursting approach to evidentiary presumptions seems to contemplate only a "minimal" burden for the rebutting party, as anything more would effectively shift the burden of persuasion.[40] On the other hand, judges have long been hostile to conclusory, self-serving affidavits on summary

35 Fed. R. Civ. P. 56(b).

36 Fed. R. Civ. P. 56(b) advisory committee's note.

37 Fed. R. Civ. P. 56(d); *see also Pennsylvania v. Sebelius*, No. 10-4584, 2012 WL 8590263, at *15-16 (3d Cir. 2012).

38 One scholar suggests that presumptions have no role in the summary judgment inquiry, as presumptions were intended to be weighed by the jury. *See generally* Steven D. Smith, *The Effect of Presumptions on Motions for Summary Judgment in Federal Court*, 31 UCLA L. Rev. 1101 (1984).

39 In *Ehlis v. Shire Richwood, Inc.*, 233 F. Supp. 2d 1189, 1198-99 (D.N.D. 2002), for example, the court denied summary judgment "based on [a] rebuttable presumption" because the plaintiffs had produced "some" evidence contrary to that presumption. *See also Stutzka v. McCarville*, 420 F.3d 757, 762-63 (8th Cir. 2005) (reversing grant of summary judgment in TILA notice of right to rescind case, where plaintiff proffered contrary affidavits of borrower and borrower's guardian).

40 *See Cappuccio v. Prime Capital Funding LLC*, 649 F.3d 180, 189 (3d Cir. 2011) ("[T]he quantum of evidence needed to burst the presumption's bubble under Rule 301 is also minimal, given that the presumption's only effect is to require the party contesting it to produce enough evidence substantiating the presumed fact's absence to withstand a motion for summary judgment or judgment as a matter of law on the issue." (internal marks omitted); *see also St. Mary's Honor Ctr. v. Hicks*, 509 U.S. 502, 510-11 (1993) (explaining that a presumption's only role is to force the opposing party "to come forward with some response," after which it simply "drops out of the picture").

judgment.[41] Allowing a plaintiff to resist a presumption with only the weakest of sworn statements seems to run counter this basic notion while giving the presumption little respect. Indeed, the Rules Advisory Committee originally *rejected* the "bubble bursting" approach to presumptions precisely for this reason.[42]

But regardless of the broader debate over presumptions, many courts have held in TILA cases that a plaintiff's sworn assertion of a contrary fact was enough to defeat the defendant's rebuttable presumption.[43] In *Hammox v. Heartland Home Fin., Inc.*,[44] for example, the U.S. District Court for the Eastern District of Tennessee refused to grant summary judgment to the defendant in another TILA notice-of-right-to-rescind case. This refusal came even though the defendant produced signed acknowledgments from the borrowers that they had received the required notices. In denying summary judgment, the court noted that plaintiffs swore that (a)

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41 *See, e.g.*, *Angle v. Miller*, No. 10-16707, 2012 WL 833901, at *8 n.6 (9th Cir. Mar. 14, 2012) (listing cases); *Broaddus v. Shields*, 665 F.3d 846, 856 (7th Cir. 2011) ("We have repeatedly held that self-serving affidavits without factual support in the record will not defeat a motion for summary judgment."); *Frevert v. Ford Motor Co.*, 614 F.3d 466, 473 (8th Cir. 2010) ("A properly supported motion for summary judgment is not defeated by self-serving affidavits." (internal marks omitted)); *Skrzypczak v. Roman Catholic Diocese of Tulsa*, 611 F.3d 1238, 1244 (10th Cir. 2010) (same); *Kirleis v. Dickie, McCamey & Chilcote, P.C.*, 560 F.3d 156, 161 (3d Cir. 2009).

42 *See* Fed. R. Evid. 301, advisory committee's note on proposed rule ("The so-called 'bursting bubble' theory … is rejected as according presumptions too 'slight and evanescent' an effect." (citations omitted)).

43 *See Rodrigues v. Newport Lending Corp.*, No. 10-00029 HG-LEK, 2010 WL 4960065, at *6 (D. Hawaii Nov. 29, 2010); *Ianuzzi v. Am. Mortg. Network, Inc.*, 727 F. Supp. 2d 125, 135-36 (E.D.N.Y. 2010) (citing cases and observing that "[n]umerous courts applying the rebuttable presumption of 15 U.S.C. § 1635(c) have held that sworn statements by the borrowers asserting that they did not receive the requisite copies of their notice of right to rescind, despite signed acknowledgments to the contrary, are sufficient to preclude summary judgment."); *cf. United States ex rel. Westmoreland v. Amgen, Inc.*, 812 F. Supp. 2d 39, 79 (D. Mass. 2011) (explaining that recipient's sworn statement that he did not receive mail does not defeat presumption created by mailbox rule, but does create triable issue of fact); *but see, e.g.*, *Williams v. G.M. Mortg. Corp.*, No. 03-CV-74788-DT, 2004 WL 3704081, at *8 (E.D. Mich. Aug. 18, 2004) ("Because Plaintiff signed the Notice of Right to Cancel acknowledging receipt of two copies of it, she bears the burden of rebutting the statutory presumption of delivery. All that Plaintiff here offered is her bald denial of receipt. The Court is finds that a plaintiff's bare bones, self-serving denial is not sufficient to rebut § 1635(c)'s statutory presumption, particularly where, as here, Plaintiff admitted that she knew that she had to wait until three days after consummating the loan transaction (i.e., the statutory cancellation period) before the loan proceeds would be disbursed to her."); *Deutsche Bank Nat'l Trust Co. v. Lacapria*, No. 08-2174, 2010 WL 715617, at *4 (D.N.J. Mar. 1, 2010) (holding that TILA presumption was not rebutted by borrower's testimony that he did not remember receiving required notices).

44 No. 4:04-CV-113, 2005 WL 1130347 (E.D. Tenn. May 13, 2005).

they had not removed any documents from the original "packet" they received at closing and (b) the required notices were not in that packet.[45] These spare averments were enough.

The lone federal appellate court to address the TILA rebuttable presumption on summary judgment has also imposed a low standard of proof for the borrower. In *Marr v. Bank of America, N.A.*,[46] the U.S. Court of Appeals for the Seventh Circuit faced a case quite like the one presented in *Hammox*: a borrower who claimed that (a) his "folder" of loan documents was undisturbed since closing; and (b) his folder did not contain the requisite notices. Just like *Hammox*, the lender produced a signed borrower acknowledgment that the notices had been given at closing. But unlike *Hammox*, there was some suggestion that the folder had *not* been perfectly preserved, as it contained several documents post-dating the loan closing.[47] Even with this new wrinkle, the Seventh Circuit still concluded that summary judgment was inappropriate. The borrower's sworn assertions—combined with his statement that his closing did not follow the lender's standard closing procedures—was enough to foreclose summary judgment for the lender. At least in the Seventh Circuit's view, this "evidence [wa]s enough to permit a reasonable jury to find in [the plaintiff's] favor."[48]

In short, a "qualified mortgage rebuttable presumption" might be—at best—a limited and unpredictable tool at the summary judgment stage. Lenders will be unable to determine with certainty what *standard* of proof will apply and what *type* of rebutting proof the borrower will offer.[49] And, perhaps most importantly, prior TILA-specific cases suggest the presumption is easily defeated.

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45 *Id.* at *2-3

46 662 F.3d 963, 967-68 (7th Cir. 2011). *Contrast with Jackson v. New Century Mortg. Corp.*, 320 F. Supp. 2d 608, 612 (E.D. Mich. 2004) (holding that the so-called "envelope theory"—that all documents received at closing were in sealed envelope—was insufficient to rebut presumption of notice).

47 *Marr*, 662 F.3d at 968.

48 *Id.*

49 Some courts have seemed willing to dispense with presumptions based on considerations of "fairness," rending presumptions even more unpredictable. *See, e.g.*, *Panduit Corp. v. All States Plastic Mfg. Co., Inc.*, 744 F.2d 156, 1581 (Fed. Cir. 1984), *overruled on other grounds by Richardson-Merrell, Inc. v. Koller*, 472 U.S. 424 (1985) ("Presumptions of fact have been created to assist in certain circumstances where direct proof of a matter is for one reason or another rendered difficult. They arise out of considerations of fairness, public policy, and probability, and are useful devices for allocating the burden of production of evidence between the parties. However, derived as they are from considerations of fairness and policy, they must not be given mechanical application. … We must not give undue dignity to a procedural tool and fail to recognize the realities of the particular situation at hand.")

3. Trial.

Much like summary judgment, the effect of a presumption at trial is somewhat difficult to predict.[50] But also like summary judgment, prior TILA cases suggest the presumption provides the lender with only limited comfort, as borrowers can sometimes (and perhaps oftentimes) defeat the presumption with testimony alone. A decision by the U.S. Court of Appeals for the Third Circuit, *Cappuccio v. Prime Capital Funding LLC,*[51] provides one example. There, the borrower testified at trial that she did not receive any notice of her right to rescind her mortgage loan on the night she closed her loan.[52] The Third Circuit determined that this testimony alone was enough to burst the presumption bubble despite its concededly self-serving nature. The jury, the Third Circuit concluded, was free to credit the testimony of either the borrower or the lender in such circumstances—without resort to any presumption.

Of course, a court *in a particular case* may ultimately determine that a borrower's testimony is not sufficient to defeat the presumption. Such was the case in *In re Giza*,[53] a TILA notice-of-rescission case wherein the court found the borrowers' "inconsistent, unpersuasive and confused" testimony was not enough to rebut the presumption of delivery. But by the time a court or a jury makes such a decision at the trial stage, a lender has been forced to incur significant litigation costs. What's more, the now well-understood unpredictability of trial outcomes[54] suggest defendants will be compelled to pay settlement sums to a TILA plaintiff long before the matter would ever be resolved. In other words, the distant possibility of a win at trial hardly makes the "rebuttable presumption" battle worth it. Without any means to deal with non-meritorious cases early, lenders who make *only* qualified mortgages could still be forced to make significant time and money investments in ability-to-repay TILA litigation.

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50 At least one case, *Hammox*, 2005 WL 1130347, at *3, seems to believe that presumptions are handled differently on summary judgment and at trial.

51 649 F.3d 189-90.

52 *Id.* at 184; *see also, e.g.*, *In re Sousa*, No. 06-11398-JMD, 2011 WL 917583, at *6-7 (Bankr. D.N.H. Mar. 14, 2011) (observing that "[c]ourts are split over whether a borrower's testimony of non-receipt is enough to rebut the presumption of delivery in TILA," but ultimately concluding that the plaintiffs' "credible" and "unequivocal" testimony was enough to rebut the presumption at trial).

53 458 B.R. 16, 28 (Bankr. D. Mass. 2011); *see also Williams v. First Gov't Mortg. & Invs. Corp.*, 225 F.3d 738, 751 (D.C. Cir. 2000) (affirming judgment in TILA notice-of-right-to-cancel case, where trial court found plaintiff's testimony was not credible).

54 This unpredictability would likely be exacerbated in ability-to-repay litigation, where a broad spectrum of proof could potentially be relevant to the ultimate decision. For example, a borrower might conceivably seek to introduce such things as his entire credit history, his employment history, his income information, or his general spending habits. This broad spectrum of potential rebuttal proof will render it harder for lenders to assess the merits of their cases while opening the door for greater jury prejudice via "emotional evidence" (such as significant evidence of financial hardship).

III. THE SAFE HARBOR: A CLEARER FRAMEWORK

TILA's qualified mortgage provision could also be treated as a "safe harbor." Here again, to fully comprehend the consequences of characterizing the provision as a safe harbor, one must understand two things: (1) the nature of statutory safe harbors generally and (2) their use and effect in litigation.

A. What Is A Safe Harbor?

Generally, a safe harbor provision is one that affords the beneficiary with "protection from liability or penalty."[55] Different types of safe harbors work in different ways; some are more akin to affirmative defenses, while others seem to operate as something else entirely.[56] But they all generally share a common characteristic: once the standards set for invoking the safe harbor are met, liability is foreclosed.

More likely than not, TILA's safe harbor provision would operate in the manner of an affirmative defense. "An affirmative defense is defined as a defendant's assertion raising new facts and arguments that, if true, will defeat the plaintiff's or prosecution's claim, even if all allegations in the complaint are true."[57] Such would be the case in the instance of the qualified mortgage provision: a defendant could concede all of the *facts* alleged in an inability-to repay complaint and still defeat the claim on a showing that the mortgage was a qualified mortgage. Moreover, Congress did not include any indication in the qualified mortgage provision that it meant the provision to be something other than an affirmative defense. That absence is telling. For instance, in the Private Securities Litigation Reform Act ("PSLRA"), Congress included an explicit statutory provision indicating that courts should consider the safe harbor on a motion to

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55 *Black's Law Dictionary* (9th ed. 2009); *see also* Qian Tao, *The Knowledge Standard for the Internet Intermediary Liability in China*, 20 Int'l J.L. & Info. Tech. 1, 9 n.33 (2012) ("The term 'Safe harbor' is referred to as provision that reduces renders immune a party from liability on the condition that the party performed its actions in good faith or in compliance with defined standards.").

56 *Compare Pfeil v. State Street Bank & Trust Co.*, No. 10-2302, 2012 WL 555481, at *11 (6th Cir. Feb. 22, 2012) (explaining that safe harbor provision in Employee Retirement Income Security Act is an affirmative defense), *EEOC v. Minn. Dep't of Corr.*, 648 F.3d 910, 913 (8th Cir. 2011) (safe harbor in Age Discrimination in Employment Act is affirmative defense), *United States v. Mintmire*, 507 F.3d 1273, 1293-94 (11th Cir.2007) (explaining statutory safe harbor prohibiting liability for obstruction of justice in certain circumstances was an affirmative defense), *and 303 West 42nd St. Enters., Inc. v. IRS*, 181 F.3d 272, 278 (2d Cir. 1999) (finding safe harbor from tax liability is affirmative defense), *with Southland Sec. Corp. v. INSpire Ins. Solutions, Inc.*, 365 F.3d 353, 371 (5th Cir. 2004) (requiring plaintiffs to plead facts to avoid safe harbor in Private Securities Litigation Reform Act).

57 *Saks v. Franklin Covey Co.*, 316 F.3d 337, 350 (2d Cir. 2003) (internal marks omitted); *see also Riemer v. Chase Bank USA, N.A.*, 274 F.R.D. 637, 639 (N.D. Ill. 2011) ("An affirmative defense is one that admits the allegations in the complaint, but avoids liability, in whole or in part, by new allegations of excuse, justification or other negating matters.").

dismiss.[58] Because (as explained below) courts typically do not consider affirmative defenses on a motion to dismiss, the PSLRA's safe harbor is usually assumed to operate as something different. There is no similar "hint" in TILA.

B. How Do Safe Harbors Operate in Federal Litigation?

Were the TILA safe harbor provision to function as an affirmative defense, it would be of some limited use on a motion to dismiss. To be sure, "[c]omplaints can't be dismissed just because they ignore potential defenses; the time to deal with an affirmative defense is [ordinarily] after it has been raised [through an answer]."[59] Consequently, courts routinely decline to consider affirmative defenses on a motion to dismiss,[60] even when those defenses are premised upon safe harbors.[61] But affirmative defenses *may* be asserted on a motion to dismiss when they appear on the face of the complaint.[62] Therefore, a lender might mount a successful defense if the borrower anticipates the qualified mortgage safe harbor or otherwise provides the facts necessary to mount the defense in the complaint.[63]

More importantly, however, a safe harbor would be especially useful on summary judgment. . A lender could move for summary judgment early on—indeed, just after the complaint is filed—and the borrower's *only* argument could be that the loan did not in fact meet

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58 *See* 15 U.S.C. § 78u-5(e); *see also* Rachel Schneller Ziegler, *Safe But Not Sound: Limiting Safe Harbor Immunity for Health and Disability Insurers and Self-Insured Employers Under the Americans with Disabilities Act*, 101 Mich. L. Rev. 840, 873-74 (2002) (looking to legislative history to determine whether "safe harbor" in Americans with Disabilities Act is affirmative defense).

59 *Edgenet, Inc. v. Home Depot U.S.A., Inc.*, 658 F.3d 662, 664 (7th Cir. 2011).

60 *See, e.g.*, *In re Tower Air, Inc.*, 416 F.3d 229, 416 F.3d 229, 238 (3d Cir. 2005).

61 *See, e.g.*, *Pfeil*, 2012 WL 555481, at *12; *Feder v. Frost*, 220 F.3d 29, 35 (2d Cir. 2000); *Teoba v. Trugreen Landcare LLC*, 769 F.Supp.2d 175, 186-87 (W.D.N.Y. 2011); *Crocker v. KV Pharm. Co.*, 782 F. Supp. 2d 760, 784 (E.D. Mo. 2010); *In re Enron Creditors Recovery Corp.*, No. 01-16034, 2009 WL 3349471, at *5 (S.D.N.Y. Oct. 16, 2009); *Martin v. Caterpillar, Inc.*, No. 07-cv-1009, 2008 WL 5082981, at *5 (C.D. Ill. Sept. 25, 2008); *Ill. Bell Tel. Co. v. Village of Itasca, Ill.*, 503 F. Supp. 2d 928, 946 (N.D.Ill. 2007).

62 *Bingham v. Thomas*, 654 F.3d 1171, 1175 (11th Cir. 2011) ("A complaint may be dismissed if an affirmative defense ... appears on the face of the complaint."); *accord Iowa Pub. Emps. Ret. Sys. v. MF Global, Ltd.*, 620 F.3d 137, 145 (2d Cir. 2010); *Riverview Health Inst.*, 601 F.3d at 512; *LeFrere v. Quezada*, 582 F.3d 1260, 1263 (11th Cir. 2009); *Santana-Castro v. Toledo-Davila*, 579 F.3d 109, 113-14 (1st Cir. 2009); *Pressley v. Tupperware Long Term Disability Plan*, 553 F.3d 334, 336 (4th Cir. 2009); *Noble Sys. Corp. v. Alorica Cent., LLC*, 543 F.3d 978, 983 (8th Cir. 2008).

63 *See, e.g.*, *Hecker v. Deere & Co.*, 556 F.3d 575, 588 (7th Cir. 2009) (affirming dismissal of complaint where plaintiff anticipated safe harbor defense and provided basis for defendant to raise it); *Raeth v. Nat'l City Bank*, 755 F. Supp. 2d 899, 904-05 (W.D. Tenn. 2010) (dismissing TILA claim based on safe harbor, where borrower alleged lender violated statute by failing to consider information that did not need to be considered under safe harbor).

the definition of "qualified mortgage." Assuming the lender properly documented a loan's qualified mortgage status, that argument would be a difficult (if not an impossible) path for the borrower to take. Non-meritorious cases could be resolved early and finally. Quite simply, a safe harbor affords the predictability in standards and proof that a rebuttable presumption does not.

CONCLUSION

Safe harbors and rebuttable presumptions provide significantly different degrees of protection for their beneficiaries. Rebuttable presumptions are burdened by unavailability at the early stages of litigation and unpredictability at all stages of litigation. In contrast, safe harbors afford some degree of predictability and expedient resolution. In the qualified mortgage context, these differences are critical. If lenders are forced to wrestle with presumptions, adverse consequences are likely to follow. Lenders will likely attempt to calculate the costs of this greater unpredictability and—by necessity—pass them on to borrowers. And given the questionable usefulness of a presumption, lenders may determine that they have insufficient incentive to focus on qualified mortgages at all. That would hardly serve the interests of lenders, regulators, or consumers.

ATTACHMENT D

April 12, 2012
The Honorable Richard Cordray Director
Bureau of Consumer Financial Protection
1700 G St. NW
Washington, DC 20552

Dear Director Cordray:

The undersigned organizations representing a very broad spectrum of lenders, investors, housing professionals, consumer advocates and civil rights groups write to you today to strongly urge that a broadly-defined Qualified Mortgage (QM) be central to the forthcoming Ability to Repay regulation.

Most economists and housing market analysts in government and in the private sector agree that today's underwriting standards are tight and are contributing to a slow housing recovery. Our organizations believe that an unnecessarily narrow definition of QM that covers only a modest proportion of loan products and underwriting standards and serves only a small proportion of borrowers would undermine prospects for a housing recovery and threaten the redevelopment of a sound mortgage market.

Admittedly, the undersigned hold different views about whether the QM should be designed as a safe harbor or a rebuttable presumption (both options were included in the proposed rule). Nevertheless, we stand united in urging the Bureau of Consumer Financial Protection (CFPB) to construct a broadly-defined QM using clear standards. We believe that is the only way to 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 for all housing types, as Congress intended in enacting the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).

<u>Congressional Intent Calls for Broadly Defined QM</u>

Every version of the Ability to Repay provisions introduced in Congress, including the final version of Dodd-Frank that became law, paired the Ability to Repay Requirement with the QM. The reasoning was that pairing the prospect of liability with an exception for well underwritten, safer, more sustainable loans was the best means of ensuring sound lending for borrowers.

To add incentives for QM lending, the law also added liability for steering consumers from QM to non-QM loans. Further, the Bureau was given broad flexibility to define the QM in a manner that will "ensure that responsible, affordable mortgage credit remains available to consumers." All of these provisions demonstrate Congress's intent that all creditworthy borrowers – especially low- and moderate-income borrowers and families of color – should be extended the important protections of a QM.

Non-QMs Will Be Less Protective, Less Available and More Expensive

A narrowly defined QM would put many of today's loans and borrowers into the *non*-QM market, which means that lenders and investors will face a high risk of an ability to pay violation and even a steering violation. As a result of these increased risks, these loans are unlikely to be made. In the unlikely event they are made, they will be far costlier, burdening families least able to bear the expense. Beyond that, these higher-priced loans would not be required to include important protections against certain practices and loan features that drove the highest failures in the mortgage boom that are embedded in QM.

There is no question that some residential mortgage underwriting standards were too lax during the housing boom, and that strong regulatory standards are needed to make sure that those mistakes are not repeated. We support the establishment of such standards and we believe the establishment of the QM is central to that effort. Rather than narrowing the QM market, we believe the CFPB should work to ensure that the QM market becomes the market. Creating a broad QM, which includes sound underwriting requirements, excludes risky loan features, and gives lenders and investors reasonable protection against undue litigation risk, will help ensure revival of the home lending market.

Clear Standards are Critical to Any QM Definition

Vague parameters for the QM also will add legal uncertainty, increase costs and limit access to credit. If the parameters of the QM are not clear, risks become unpredictable, forcing lenders to decrease their risk tolerance and operate well within the standards. Such an outcome will lessen both the availability and affordability of credit for far too many borrowers. For these reasons, the CFPB should establish clearly defined standards in the QM definition that are objectively determinable at origination.

All of us would appreciate the opportunity to meet with Bureau staff at your earliest convenience to discuss all of these concerns and to share our data. We are convinced that the choices around this important rule, including in large measure the breadth of the QM standard, will affect sustainable homeownership for generations to come.

Sincerely,

American Bankers Association
American Escrow Association
American Financial Services Association
American Land Title Association
American Securitization Forum
Asian Real Estate Association of America
Center for NYC Neighborhoods
Columbus Housing Partnership
Community Associations Institute

Community Mortgage Banking Project
Community Mortgage Lenders of America
Consumer Bankers Association
Consumer Mortgage Coalition
Financial Services Roundtable
Habitat for Humanity International
Housing Policy Council
Independent Community Bankers of America
Leading Builders of America
Mortgage Bankers Association
Mortgage Insurance Companies of America
National Association of Hispanic Real Estate Professionals
National Association of Home Builders
National Association of Mortgage Brokers
National Association of Neighborhoods
National Association of Real Estate Brokers
National Association of Realtors®
National Community Reinvestment Coalition
National Council of State Housing Agencies
National Housing Conference
Real Estate Services Providers Council, Inc. (RESPRO®)
Real Estate Valuation Advocacy Association
The Appraisal Institute
The Realty Alliance

ATTACHMENT E

April 27, 2012

Honorable Richard Cordray
Director, Bureau of Consumer Financial Protection
1700 G Street, NW
Washington, DC

Dear Director Cordray:

The undersigned trade associations representing the financial services, home building and real estate industries as well as other concerned organizations write to you today regarding the Qualified Mortgage (QM) under the Ability to Repay rule to be issued by the Bureau of Consumer Financial Protection (CFPB). Our purpose is to reiterate our very strongly held view that the QM should be structured as a legal safe harbor with clear, well-defined standards. The standards must embody requirements for sound mortgages for consumers and specify the grounds on which there can be litigation or enforcement action as to whether those requirements have been met.

Safe Harbor versus Rebuttable Presumption

Structuring the QM as a safe harbor and focusing litigation and enforcement activity on whether the standards are met is the only means of ensuring that the largest number of borrowers possible will enjoy the safest and most affordable options for sustainable credit available through the QM. In contrast, establishing the QM as a rebuttable presumption of compliance—even with clear substantive standards but lacking clarity or limitations regarding the scope of litigation—will markedly lessen the availability and affordability of sustainable mortgages to consumers.

Effects of Rebuttable Presumption

A QM rule with a rebuttable presumption can be overridden by facts or evidence beyond, and completely unrelated to, the requirements of the QM. This unpredictability, in a setting where the potential liability for each claim can be extensive, will force lenders to retreat to far more conservative lending standards.

Smaller lenders will have great difficulty managing this degree of risk and the resultant litigation costs. A presumption can be expected to result in the exit of lenders—large and small—from the market and a reduction in credit from those remaining. This will harm consumers by depriving them of robust competition and lower costs.

Benefits of Safe Harbor

The undersigned believe the establishment of clear standards and defined proceedings, in the form of a safe harbor, is the only practicable approach. While a consumer is just as entitled to judicial review of an alleged failure to determine ability to repay through litigation involving a safe harbor, any such review would be appropriately focused only on whether the QM's standards or factors have been met. Such an approach will require the CFPB to develop the right standards rather than simply leaving the matter to the courts.

Carefully defining the standards for litigation in the form of a safe harbor also will have the advantage of reducing the number of groundless claims, whose costs are ultimately borne by all. It will allow lenders of all sizes to compete. Most importantly, it will allow lenders to comfortably operate within the boundaries of the standards prescribed, allowing the maximum number of families to qualify for traditional, affordable and sustainable loans.

Conclusion

We firmly believe the way the QM is finally structured is the most critical mortgage lending issue facing the CFPB today and will have ramifications for consumers for years to come. We urge the CFPB to carefully evaluate the potential impacts of a safe harbor versus a rebuttable presumption on consumers, financial services providers and the economy as a whole before issuing the final rule. The final rule should increase the availability and affordability of sustainable mortgage credit to consumers as Congress intended, not unduly reduce its availability or increase its costs.

We appreciate your attention to this matter. We also would welcome an opportunity to meet with you at your earliest convenience.

Sincerely,

American Bankers Association
American Escrow Association
American Financial Services Association American Land Title Association Community
Mortgage Banking Project Consumer Mortgage Coalition
Community Mortgage Lenders of America
Consumer Bankers Association Financial Services Roundtable Habitat for Humanity
Housing Policy Council
Independent Community Bankers of America
Leading Builders of America
Mortgage Bankers Association
Mortgage Insurance Companies of America National Association of Federal Credit
Unions National Association of Hispanic Real Estate Professionals
National Association of Home Builders
National Association of Realtors®
The Realty Alliance
Real Estate Services Providers Council, Inc. (RESPRO®)
Securities Industry and Financial Markets Association
The U.S. Chamber of Commerce