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SOS: Saving the Secondary Mortgage Market from the Consumer Financial Protection Bureau's Ability-to-Repay Rule, 49 J. Marshall L. Rev. 857 (2016)

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SOS: SAVING THE SECONDARY MORTGAGE MARKET FROM THE CONSUMER FINANCIAL PROTECTION BUREAU’S ABILITY-TO-REPAY RULE

LAQUENTA RUDISON*

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“The collateral damage of this crisis has been real people and real communities. The impacts of this crisis are likely to be felt for a generation.”¹

1. Fin. Crisis Inquiry Comm’n, *THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES* xvi (2011), <http://fcic.law.stanford.edu/report/>.

I. INTRODUCTION: THE RISKY BUSINESS OF MORTGAGE-BACKED SECURITIES²

The securitization³ of residential mortgages⁴ was supposed to be a way to make more money available to lenders to lend to creditworthy⁵ borrowers for home purchases.⁶ It was supposed to be the vehicle through which investors would help “finance the

2. Mortgage-backed securities comprise the secondary mortgage market. See Roy T. Black & Joseph S. Rabianski, Georgia Real Estate InfoBase pt. 10 ch. 45 para. 1-2 (Adrienne Black & Judith Weisman eds., 2009), www.grec.state.ga.us/infobase/table%20of%20contents%20pdf/Chapter%2045.pdf. The primary mortgage market consists of the lending transactions that occur between lenders and borrowers. *Id.* These transactions are the underlying transactions in mortgage-backed securities. *Id.*

3. Mortgage securitization is “the act of pooling mortgages and issuing a security backed by these mortgages.” *Trust for Investment in Mortgages Proposal and Tax Treatment of Secondary Mortgage Market: Hearing on S.1822 Before the S. Comm. on Finance*, 98th Cong. 169 (1983) [hereinafter “*Mortgages Proposal Hearing*”] (statement of Lewis S. Ranieri, Managing Director, Salomon Brothers, Inc.). Once mortgages are securitized, they are tradable on the secondary market. See Tim Plaehn, *What is Mortgage Securitization?*, DEMAND MEDIA (last visited Apr. 25, 2016), <http://homeguides.sfgate.com/mortgage-securitization-2645.html>. The proceeds of the monthly payments on the underlying mortgages are then distributed to the investors. See *Quick Guide to Pooling and Servicing Agreements in Foreclosure Cases* [hereinafter “*Quick Guide*”], The Legal Aid Society of Cleveland (last visited Apr. 25, 2016), <http://lasclv.org/wp-content/uploads/2010/11/Quick-Guide-to-Pooling-and-Servicing-Agreements-in-Foreclosure-Cases.pdf> (citing the case of *Wells Fargo v. Jordan* No. 91675, 2009 Ohio App. LEXIS 881 (Ohio Ct. App. 2009) where the investors who purchased the securities received payments on the underlying securitized mortgages).

4. A mortgage is a document that encumbers the real estate and provides the lender’s security for loan repayment. See STEVEN H. GIFIS, LAW DICTIONARY 347 (Barron’s Educational Series, Inc., 6th ed. 2010). The terms of the loan are evidenced by a promissory note. See American Securitization Forum, *Transfer and Assignment of Residential Mortgage Loans in the Secondary MORTGAGE MARKET* 7 (Nov. 16, 2010) www.americansecuritization.com/uploadedFiles/ASF_White_Paper_11_16_10.pdf.

5. A creditworthy borrower is someone to whom it is justified to extend credit. MERRIAM-WEBSTER, www.merriam-webster.com/dictionary/creditworthy (last visited Apr. 25, 2016) (determining whether someone is creditworthy is made based on past ability to repay debts. However, loan originators in the mid-to-late 2000’s made that determination based off of factors not related to the borrower’s ability to repay. A discussion of those factors is beyond the scope of this comment).

6. See generally *Mortgages Proposal Hearing*, *supra* note 3, at 168-176, (arguing that the entry of private investors into the field of mortgage-backed securities would allow lenders to tap into more funding to be able to lend to borrowers; Ranieri’s statement to the Senate makes no mention of the effect that inviting private investors to participate in mortgage-backed securities would have on lending guidelines, but hindsight is 20/20).

[American] dream of homeownership for generations to come.”⁷ However, the packaging of residential mortgages into mortgage-backed securities (hereinafter “MBS”) for trading on the secondary mortgage market was one of the contributing factors to the recent downturn in the economy.⁸ From 1990 to 2007, the volume of MBS traded on the secondary market exploded from \$380 billion to a \$2.2 trillion bubble.⁹ During that same time period, mortgage originations¹⁰ jumped from \$459 billion to \$2.3 trillion.¹¹ This activity, among other factors, contributed to a bubble in which lenders made mortgage debt easily accessible to individuals who were eager to consume the debt.¹² Once the bubble burst, it left a great recession and a high rate of foreclosures in its wake.¹³

7. *Id.* at 170. See also Black & Rabianski, *supra* note 2, at pt. 10 ch. 45 para. 2 (stating that “In the very simplest terms, the secondary mortgage market is a provider or source of funds to the primary mortgage market.”).

8. *Compare* Bank of New York v. Raftogianis, 13 A.3d 435, 441 (N.J. Super. Ct. Ch. Div. 2010) (stating that because securitizations became increasingly complex and widespread, they contributed to the “crisis in the financial markets”), with Elizabeth Renuart, *Uneasy Intersections: The Right to Foreclose and the U.C.C.*, 48 WAKE FOREST L. REV 1205, 1209 (2013) (setting forth that rather than securitization itself, human investors encouraged increased loan originations and mishandled documents that were supposed to be transferred specifically according to the terms of the securitization deal), and Shawn Tully, *Lewie Ranieri Wants to Fix the Mortgage Mess*, FORTUNE (Dec. 9, 2009 8:24 AM) http://archive.fortune.com/2009/12/08/real_estate/lewie_ranieri_mortgages.fortune/index.htm (blaming Wall Street for using securitization to create the eventually “onerous” mortgage products that contributed to the crisis). Because of the importance of the secondary mortgage market to the primary mortgage market, it is important to distinguish the transaction of securitization from the underlying practices that occurred in securitizing residential mortgage loans.

9. U.S. Census Bureau, *The Statistical Abstract of the United States*, § 25 at 745tbl.1199(2012), www.census.gov/prod/2011pubs/12statatab/banking.pdf.

10. A mortgage origination is “[t]he creation of a new mortgage.” INVESTOR WORDS, www.investorwords.com/7169/mortgage_origination.html (last visited Apr. 25, 2016).

11. U.S. Census Bureau, *supra* note 9, at 743 tbl.1194.

12. See Scott P. Kennedy, *The Good Faith Approach to Foreclosure Mediation: An Assessment of Washington’s Foreclosure Mediation Program* 5-6 (Aug. 2012) http://works.bepress.com/cgi/viewcontent.cgi?article=1000&context=scott_kennedy (explaining how subprime mortgages contributed to the housing bubble); see generally A. Mechele Dickerson, *Over-Indebtedness, the Subprime Mortgage Crisis, and the Effect on U.S. Cities*, 36 FORDHAM URB. L.J. 395 (Apr. 2009) (asserting that consumers’ hearty consumption of debt combined with the deregulation of the consumer credit market contributed to the housing bubble).

13. See R.A., *Grasping at an Understanding of the Crisis*, THE ECONOMIST (Jan. 8, 2011 8:10 PM), www.economist.com/blogs/freeexchange/2011/01/greatrecession (“The government’s efforts to [expand credit] helped produce the housing bubble, which led directly to crisis and recession.”).

By the end of 2007, the foreclosure rate reached its highest at 2.04% of all loans outstanding nationwide.¹⁴ By the end of 2009, the foreclosure rate more than doubled to 4.58%.¹⁵ Securitizing residential mortgages provided the capital which facilitated homeownership, but Wall Street's rush to capitalize on investment opportunities,¹⁶ the natural ebb and flow of home values, and the commission incentives provided to loan originators¹⁷ inflated the housing bubble to its capacity and led to the inevitable decline of the market.

In the aftermath of the housing bubble bust, Congress created an administrative agency named the Consumer Financial Protection Bureau ("CFPB").¹⁸ The CFPB is charged with regulating the residential lending industry.¹⁹ In furtherance of its regulatory responsibility,²⁰ the CFPB implemented the Ability-to-Repay rule (hereinafter "ATR").²¹ The ATR provides either a safe harbor²² or rebuttable presumption of compliance²³ for certain

14. *Delinquencies and Foreclosures Increase in Latest MBA National Delinquency Survey*, Mortgage Bankers Ass'n para. 2, 4 (Mar. 6, 2008), www.mortgagebankers.org/NewsandMedia/PressCenter/60619.htm; The Joint Economic Committee, *Subprime Mortgage Market Crisis Timeline*, 6 (July 2008), www.jec.senate.gov/public/_cache/files/4cdd7384-dbf6-40e6-adbc-789f69131903/subprimetimelineupdate0710080000000.pdf.

15. *Delinquencies, Foreclosure Starts Fall in Latest MBA National Delinquency Survey*, MORTGAGE BANKERS ASS'N para. 1 (Feb. 19, 2010), www.mortgagebankers.org/NewsandMedia/PressCenter.71891.htm.

16. MICHAEL W. HUDSON, *THE MONSTER: HOW A GANG OF PREDATORY LENDERS AND WALL STREET BANKERS FLEECED AMERICA – AND SPAWNED A GLOBAL CRISIS* 218 (2010) ("With so much money to be made . . . on Wall Street [off of] securities deals, it made sense for . . . investment banks to . . . buy directly into the mortgage-origination business.") It is important to note that while securitization funds purchases of homes, it also creates an income stream for investors. This income stream provides the incentive for the investor to invest!

17. *See, e.g.*, BETHANY MCLEAN & JOE NOCERA, *ALL THE DEVILS ARE HERE: THE HIDDEN HISTORY OF THE FINANCIAL CRISIS* 213 (2010) (recanting the story of a mortgage broker in which the broker worked with "an originator that made \$31,000 on one loan").

18. Dodd-Frank Wall Street Reform and Consumer Protection Act [hereinafter "Dodd-Frank"], 12 U.S.C. §§ 5301-5641, 5491 (2016).

19. Dodd-Frank § 5511(b) (all of the CFPB's authorities are to be exercised "with respect to consumer financial products and services"; residential mortgage lending is one of those types of services).

20. *See generally* Eric J. Mogilnicki & Melissa S. Malpass, *The First Year of the Consumer Financial Protection Bureau: An Overview*, 68 BUS. LAW 557 (Feb. 2013) (providing further insight into the CFPB's regulatory responsibility).

21. CFPB Ability to Repay Rule [hereinafter "ATR"], 12 C.F.R. § 1026.43 (2016).

22. The safe harbor "provides the lender with a **conclusive** presumption that it has complied with the [ATR]", thereby disallowing the borrower from showing otherwise. Ryan Bubb & Prasad Krishnamurthy, *Regulating Against Bubbles: How Mortgage Regulation Can Keep Main Street and Wall Street*

residential mortgage products.²⁴ Residential mortgage products²⁵ that contain payment-shock features²⁶ (hereinafter “non-traditional mortgage products”)²⁷ are not afforded a safe harbor or presumption of compliance.²⁸ This Comment proposes that non-traditional mortgage products should not be excluded from the protection of a rebuttable presumption²⁹ of compliance. If non-traditional mortgage products are excluded, the exclusion will deter the controlled rebirth of the secondary mortgage market and, contrary to the CFPB’s initial objective,³⁰ restrict consumers’ access to non-traditional mortgage products.³¹

Safe-From Themselves, 163 U. PA. L. REV. 1539, fn. 209 (May 2015) (emphasis added).

23. The rebuttable presumption allows for the borrower to make a showing that “at the time the loan was originated, the borrower lacked sufficient income to make required debt payments and to make living expenses.” *Id.* citing ATR § 1026.43(e)(1)(ii)(B).

24. ATR § 1026.43(e)(1)(i)(ii).

25. The phrase “residential mortgage product” refers to the terms under which the borrower can obtain a loan. For example, loan products vary based on the type of financing as dictated by the promissory note (such as a fixed or adjustable interest rate) or the amount required for a down payment. *See, e.g.*, MB Financial Bank, www.mbfinancial.com/personal/borrowing/mortgage/mortgage-loan-products/index.aspx (last visited Apr. 25, 2016) (listing the types of mortgage products and their respective terms).

26. *See* Lew Sichelman, *Mortgage Lenders try to Avoid ARM Payment Shock’ for Buyers*, CHI. TRIB., (Aug. 20, 1988), http://articles.chicagotribune.com/1988-08-20/news/8801240742_1_maximum-second-year-rate-payment-shock-mortgages (explaining how a payment shock feature works with an adjustable-rate loan).

27. Non-traditional products provide for a sudden increase in the monthly payment over the monthly payments required to be paid in the beginning of the loan term. Allen J. Fishbein & Patricia Woodall, *Exotic or Toxic? An Examination of the Non-Traditional Mortgage Market for Consumers and Lenders*, CONSUMER FEDERATION OF AMERICA, 1 (May 2006), www.consumerfed.org/pdfs/Exotic_Toxic_Mortgage_Report0506.pdf.

28. ATR C.F.R. § 1026.43(e)(2)(i)(A)-(C)(2016).

29. A rebuttable presumption is:

an ordinary presumption which must, as a matter of law, be made once certain facts have been proved, and which is thus said to establish a prima facie conclusion[. The presumption] may be . . . overcome through the introduction of contrary evidence, but if it is not, it becomes conclusive. . . . After rebutting evidence is introduced . . . the competing facts are weighed on their own merits, without further reference to the presumption.

GIFIS, *supra* note 4, at 412.

30. *See* Mogilnicki & Malpass, *supra* note 20, at 561 (stating that the CFPB’s goal was to strike “an appropriate balance between ensuring that consumers are not sold mortgages they cannot afford and making mortgages accessible”).

31. The only residential mortgage products that the ATR rule affords a safe harbor or a rebuttable presumption of compliance are those products that

Part II of this Comment examines the residential mortgage lending landscape before and after the decline of the housing market. Part III analyzes the justifications for excluding non-traditional mortgage products from the protection of a rebuttable presumption of compliance. Next, Part III evaluates the differences in ATR requirements between non-traditional mortgage products and traditional mortgage products (focusing on the 43% maximum debt-to-income ratio (hereinafter “DTI”)³² and the “reasonable and good faith determination”).³³ Finally, Part III evaluates the effect the exclusion will have on the secondary mortgage market and consumers’ access to non-traditional mortgage products. Part IV proposes that the framework the ATR mandates for traditional mortgage products should apply to non-traditional mortgage products because there is no substantial difference in ATR requirements between the two mortgage products. Part V concludes that non-traditional mortgage products should be afforded a rebuttable presumption of compliance.

fit the ATR’s definition of qualified mortgages [hereinafter “QMs”]. ATR § 1026.43(e)(1)(i)-(ii). Non-traditional products are not QMs. ATR § 1026.43(e)(2)(i)(A)-(C). The ATR rule draws its definition of QMs from Dodd-Frank. *See* Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z) [hereinafter “ATR Rule and QM Standards”], 78 Fed. Reg. 6408, 6408 (Jan. 30, 2013) (codified at 12 C.F.R. 1026.43) (stating that Dodd-Frank “established . . . a certain category of mortgages, called ‘qualified mortgages’” and the ATR rule is an implementation of that statutory construct). Therefore, this comment ultimately proposes that Dodd-Frank should be amended to include non-traditional products in its definition of QMs and that the distinction between QMs and non-QMs should be obliterated. However, since Dodd-Frank vested regulatory authority in the CFPB to finalize the rule regarding QMs, *Id.* at 6408. The ATR rule is the subject of this comment.

32. “A debt-to-income ratio is one way lenders measure . . . ability to manage the payments [a borrower] make[s] every month to repay the [borrowed money].” Consumer Financial Protection Bureau, *What is a Debt-to-Income Ratio? Why is the 43% Debt-to-Income Ratio Important?*, (Dec. 30, 2013), www.consumerfinance.gov/askcfpb/1791/what-debt-income-ratio-why-43-debt-income-ratio-important.html; *see also* Assured Guar. Mun. Corp. v. Flagstar Bank, FSB 2013 U.S. Dist. LEXIS 16682 at *13 (S.D.N.Y. 2013) (stating that the DTI measures “a borrower’s capacity to repay a loan.”).

33. The ATR rule requires that a lender make a “reasonable and good faith determination . . . that the [borrower] will have a reasonable ability to repay the loan.” ATR § 1026.43(c)(1). The ATR rule sets forth that a presumption of compliance is rebutted by a showing that the lender “did not make a reasonable and good faith determination of the [borrower’s] repayment ability.” ATR § 1026.43(e)(1)(ii)(B).

II. BACKGROUND: EXPANSION AND CONTRACTION ON THE SECONDARY MORTGAGE MARKET AND THE CONGRESSIONAL RESPONSE³⁴

In the years before private investor activity saturated the secondary mortgage market, residential mortgage products were generally offered with a one-size-fits-all approach; there was little to no customization to fit borrowers' unique circumstances.³⁵ Once private investors entered the secondary mortgage market,³⁶ lenders began offering non-traditional mortgage products in order to entice private investors. Also, lenders relaxed underwriting guidelines,³⁷ which resulted in more types of borrowers being able to qualify for residential mortgage loans.³⁸ Private investors bought residential mortgage loans from the lenders that consummated the loans, thereby transferring the risk of the loans out of lender portfolios and onto the secondary mortgage market. The transferred risk made lenders comfortable in offering non-

34. Comprised of mortgage-backed securities, the secondary mortgage market funds the primary mortgage market by attracting funds from investors who invest in mortgage-backed securities. See BLACK & RABIANSKI, *supra* note 2, at pt. 10 ch. 45 para. 2. When investors purchase mortgage-backed securities, the funds from the purchase are directed "to the lenders in the primary mortgage market." *Id.* "As a result, the secondary mortgage market directly affects the amount and cost of funds in the primary market." *Id.*

35. See Fishbein & Woodall, *supra* note 27, at 1 (stating that the majority of mortgage products offered were either those with fixed interest rates or adjustable interest rates); See also Fed. Deposit Ins. Corp., *Interagency Guidance on Non-Traditional Mortgage Product Risks*, para. 2 (Apr. 20, 2014), www.fdic.gov/regulations/laws/rules/5000-5150.html [hereinafter "FDIC"] ("While some institutions have offered nontraditional mortgages for many years with appropriate risk management and sound portfolio performance, the market for these products and the number of institutions offering them has expanded rapidly.").

36. This was not the first time that private investors have participated in mortgage-backed securities. MBSs date back to at least the 19th century. Michael Simkovic, *Competition and Crisis in Mortgage Securitization*, 88 IND. L.J. 213, 214 (2013).

37. Mortgage underwriting is the process of evaluating against guidelines established by a lender the collateral underlying a loan as well as a borrower's income, assets, and credit. Mortgage underwriting guidelines control risk by requiring the collection of documentation to support a borrower's ability to repay the loan and setting limitations on various factors relevant to a borrower's risk of default. *Flagstar Bank*, 2013 U.S. Dist. LEXIS 16682, at *11-12.

38. See Allan N. Krinsman, *Subprime Mortgage Meltdown: How Did it Happen and How Will it End?*, 13 J. STRUCTURED FIN. 13, 14 (2007) (stating that "the continued demand for subprime [mortgage-backed securities] may have contributed to loosened underwriting standards, which in turn resulted in the approval of borrowers who otherwise may not have qualified for mortgage loans").

traditional mortgage products because lenders did not have to keep the associated risk in their portfolios.³⁹

The activity on the secondary mortgage market was partially to blame for the disaster of the housing market in 2007.⁴⁰ In response to the disaster, Congress created the CFPB.⁴¹ The CFPB implemented the ATR pursuant to its rulemaking authority, and in an effort to prevent the types of lending practices that occurred during the housing boom.⁴² The following sections of Part II of this comment give a brief overview of the residential mortgage lending landscape before and during the expansion of the housing bubble. Part II ends with an overview of the current lending landscape and Congress' response to the housing crisis.

A. Residential Mortgage Lending Before the Housing Bubble

Before private investors entered the secondary mortgage market, lenders obtained funding to lend money by borrowing against depositor accounts or by issuing bonds.⁴³ Utilizing depositor accounts or bonds as funding mechanisms limited lenders' capacity to offer residential mortgages because the "demand for [loans] increased more rapidly" than that of lender-issued bonds or depository accounts.⁴⁴

After loans were closed and funded, borrowers began making monthly payments and lenders retained the loans in their portfolios. Loan retention meant that the risk associated with extending financing to borrowers was absorbed by lenders' portfolios. For example, on fixed-rate mortgages, lenders' portfolios absorbed any loss that occurred if market interest rates adjusted upward.⁴⁵ The absorption of loss is exactly what happened in the

39. See *Examining the Securitization of Mortgages and Other Assets: Hearing Before the Subcomm. on Sec., Ins., and Inv.*, 111th Cong. (Oct. 7, 2009) [hereinafter "*Securitization Hearing*"] (statement of Patricia A. McCoy, Professor of Law, Univ. of Conn. Sch. of Law), www.gpo.gov/fdsys/pkg/CHRG-111shrg397/html/CHRG-111shrg397.htm (stating that loan origination models during the housing bubble encouraged lenders to "pass the trash").

40. See *Bank of New York v. Raftogianis*, 13 A.3d 435, 441 (N.J. Super. Ct. Ch. Div. 2010) (stating that because securitizations became increasingly complex and widespread, they contributed to the "crisis in the financial markets").

41. Dodd-Frank, 12 U.S.C. § 5491 (2016).

42. Dodd-Frank § 5512.

43. Comptroller of the Currency, Administrator of National Banks, *Asset Securitization: Comptroller's Handbook 2* (Nov. 1997), www.occ.gov/publications/publications-by-type/comptrollers-handbook/assetsec.pdf.

44. *Mortgages Proposal Hearing*, *supra* note 3, at 228 (statement of Lewis Ranieri).

45. See *id.* at 232 (statement of Lewis Ranieri) (explaining that inviting private investors to participate in the secondary mortgage market would

early 1980s when interest rates significantly increased above that of the interest rates on the portfolios of fixed-rate mortgages.⁴⁶ As a result of the increase in interest rates, the Federal National Mortgage Association⁴⁷ lost millions of dollars in 1981 and 1982.

On the other hand, the practice of retaining mortgage loans in lenders' portfolios incentivized lenders to underwrite loans based on what risk the lenders were willing to absorb.⁴⁸ Financing was extended based upon several factors regarding borrowers' ability to repay the banks.⁴⁹ Lenders required borrowers to provide documentation to support their income and debts.⁵⁰ Some lenders would only lend exclusively to borrowers who had a previous depository relationship with the financial institution,⁵¹ which made lenders with relationship banking programs more

alleviate some of the interest rate risk to thrifts associated with the "traditional attitude of 'originate and hold.'")

46. *Id.* at 207 (statement of David O. Maxwell, Chairman and Chief Exec. Officer, Fed. Nat'l Mortg. Ass'n).

47. Federal National Mortgage Association [hereinafter "Fannie Mae" is a government-sponsored enterprise created in response to the crisis of the Great Depression. Federal Housing Finance Agency, Office of the Inspector General, *History of the Government-Sponsored Enterprises*, <http://fhfaog.gov/LearnMore/History> (last visited Apr. 25, 2016). Generally, Fannie Mae is responsible for "creating liquidity in the mortgage market." *Id.*

48. See *Securitization Hearing*, *supra* note 39 (statement of Patricia A. McCoy) (stating that once private investors entered the secondary mortgage market "[l]enders cared less about underwriting because they knew investors would bear the brunt if the loans went belly up.').

49. See e.g., *Know What Lenders Look For: Improve Your Chances of Getting a Loan by Learning what Lenders Look for* [hereinafter "*Know What Lenders Look For*"], WELLS FARGO, www.wellsfargo.com/financial-education/credit-management/five-c/ (last visited Apr. 25, 2016) (reciting the "5 C's" of credit that lenders use to assess the credit risk of an individual borrower); see also Dickerson, *supra* note 2, at 397-99 (Apr. 2009) (explaining that mortgage lending "[u]ntil the late 1970s" most often required documentation of borrowers' "income and assets").

50. See Jeff Holt, *A Summary of the Primary Causes of the Housing Bubble and the Resulting Crisis: A Non-Technical Paper*, 8 J. of Bus. Inquiry 120, 124 (2009) www.uvu.edu/woodbury/docs/summaryofthepriarycauseofthehousingbubble.pdf ("[B]orrowers . . . had to prove that their income was sufficient to ensure that the monthly mortgage payments would be manageable."); see also Chris Isidore, *Liar Loans: Mortgage Woes Beyond Subprime*, CNN (Mar. 19, 2007), http://money.cnn.com/2007/03/19/news/economy/next_subprime/index.htm (predicting that reduced documentation loans that became prevalent in 2004 and 2005 would contribute to a housing bubble bust).

51. Relationship lending is the practice of using a borrower's financial habits across different financial products with the same bank to assess whether that bank should extend financing. See generally Sreedhar Bharath et al., *So what do I get? The Bank's View of Lending Relationships*, 85 J. FIN. ECON. 368-419 (2007) www18.georgetown.edu/data/people/sd/publication-7506.pdf (discussing the impacts of relationship banking on lenders and borrowers).

comfortable with extending financing to those borrowers who had established relationships with the bank.⁵²

B. Expansion: Residential Mortgage Lending During the Housing Bubble

After 2003, private investor activity in the secondary mortgage market more than tripled from 12% to 38% of residential mortgage originations.⁵³ By 2005, private investor activity in the secondary mortgage market accounted for approximately half “of all new securitizations.”⁵⁴ With this increase in capital from private investors, the secondary mortgage market provided an effective means to fund home purchases.⁵⁵ Rather than relying on borrowing against depositor accounts and issuing bonds, lending institutions relied upon the proceeds earned from the sale of pools of mortgage loans to fund mortgage lending.⁵⁶ Purchasers of pools of mortgage loans included a wide variety and amount of investors, which eased the restriction on available capital for residential mortgage loan originations.⁵⁷ In a securitization the pooled mortgage loans are sold to investors,⁵⁸ thereby transferring the

52. See Elyas Elyasiani & Lawrence G. Goldberg, *Relationship Lending: A Survey of the Literature* 56 J. ECON. & BUS. 315-330, 315-316 (Mar. 2004) (stating that the amount of information that a lender gathers throughout the financial relationship with the borrower is “valuable” to the lender’s decision on whether to extend financing).

53. Viral Acharya et al., *Guaranteed to Fail: Fannie Mae, Freddie Mac, and the Debacle of Mortgage Finance* 33, <http://research.stlouisfed.org/conferences/gse/White.pdf>.

54. Ronel Elul, *Securitization and Mortgage Default* 3 (Research Dep’t, Fed. Reserve Bank of Phila., Working Paper No. 09-21/R, 2011), www.philadelphiafed.org/research-and-data/publications/working-papers/2009/wp09-21R.pdf.

55. *Sec. Indus. and Fin. Markets Ass’n, Investor’s Guide: Mortgage-Backed Securities (MBS) and Collateralized Mortgage Obligations (CMOs)* 1 (2010) [hereinafter “*Investor’s Guide*”], www.fidelity.com/static/dcle/learning-center/documents/MBS-CMOs.pdf.

56. See David Luttrell, Harvey Rosenblum, & Jackson Thies, *Understanding the Risks Inherent in Shadow Banking: A Primer and Practical Lessons Learned* 24 (Fed. Reserve Bank of Dallas, No. 18 Nov. 2012) (stating that the “demand for [mortgage-backed] securities . . . generates more mortgage lending to supply mortgage pools”).

57. See *id.* at 9 (explaining the process of shadow banking).

58. In a securitization:

[t]o obtain funds to make more loans, mortgage lenders pool groups of loans with similar characteristics to create securities or sell the loans to issuers of mortgage securities. As the borrowers whose loans are in the pool make their mortgage payments, the money is collected and distributed on a pro rata basis to the holders of the securities.

Quick Guide, *supra* note 3, at 4.

risk associated with those loans from the lender's portfolio onto the investor's portfolio.⁵⁹

Once lenders were able to use securitization as a means to escape the risks of residential lending,⁶⁰ lenders' goals changed from extending financing to a creditworthy borrower to extending financing that would be a suitable investment risk for a third party investor.⁶¹ Underwriting standards loosened while lenders aggressively closed more loans.⁶² For example, instead of relying upon documents that would evidence a borrower's income and debt, a lender would rely upon the figures the borrower stated on the loan application.⁶³

In addition to relaxing underwriting methods, lenders began to offer non-traditional mortgage products to borrowers who were traditionally deemed unqualified for these products.⁶⁴ The next three sub-sections briefly outline the features of three non-traditional mortgage products: negative amortization loans, interest-only loans, and balloon loans.

1. Negative Amortization

A negative amortization loan offers extremely low minimum payments at the beginning of the loan's term.⁶⁵ The loan payments consist of only payments that cover a fraction of the accruing interest on the loan.⁶⁶ Sophisticated borrowers tend to take

59. See *id.* at 1 (explaining that this is a simplified description of what occurs when mortgage loans are securitized. While the investor takes on the risk through her investment, the risk, on paper, lies with a trust created for the special purpose of securitization.).

60. See Adam J. Levitin, *The Paper Chase: Securitization, Foreclosure, and the Uncertainty of Mortgage Title*, 63 Duke L.J. 637, 649 (Dec. 2013) (highlighting the shift of risk from the financial institution that created the trust to the trust's investors).

61. See McLean & Nocera, *supra* note 17, at 134 (stating that investors' funneling of money into securitizations was "dictating what kind of mortgages they would buy and at what price").

62. U.S. Dep't of Hous. and Urban Dev., REPORT TO CONGRESS ON THE ROOT CAUSES OF THE FORECLOSURE CRISIS vii (Jan. 2010), www.huduser.gov/portal/publications/Foreclosure_09.pdf.

63. *Cyprus Credit Union v. Dehlin*, No. 09-20955, 2011 WL 1261623, (March 31, 2011), at *2 (Bankr. Utah) (explaining that the residential mortgage loan the debtors received was based upon a statement of the debtors' income rather than documented verification of the income).

64. See Fishbein & Woodall, *supra* note 27, at 1 (stating that non-traditional products were traditionally reserved for "wealthier" or more "sophisticated" borrowers).

65. See Fed. Deposit Ins. Corp., *Interest-Only Mortgage Payments and Payment Option-ARMs: Are they for you?*, FDIC (Oct. 31, 2006), www.fdic.gov/consumers/consumer/interest-only/ (stating that the payments on a negative amortization loan "may not cover all of the interest owed").

66. *Id.*

advantage of these low payments to participate in other investment activities.⁶⁷ However, during the period of low monthly payments, the interest that the borrower is not paying accrues on top of the principal balance,⁶⁸ which yields a principal balance that is more than what was originally borrowed.⁶⁹ When the period of low monthly payments is over, the payments significantly increase to cover the outstanding principal balance and the interest that has accrued on the principal balance.⁷⁰ The new payments are amortized over the period of time specified in the mortgage loan documents.⁷¹

For example, in *Wells Fargo Bank v. Kristall*,⁷² the note that was associated with the mortgage upon which Wells Fargo was foreclosing had a negative amortization provision.⁷³ Although the principal sum of the note was \$568,000, the principal sum had the potential to increase to \$710,000 because of negative amortization.⁷⁴ As explained in the previous paragraph, the negative amortization in Kristall's case stood to increase the principal by 125% of the original amount borrowed.⁷⁵

2. Balloon Loans

A balloon loan requires monthly payments that may be reasonably affordable at the beginning of the loan term.⁷⁶ However, by the end of the loan term the loan calls for one large "lump-sum" payment to pay the loan in full.⁷⁷ Like negative amortization loans, balloon loans offer an incentive to

67. See Fishbein & Woodall, *supra* note 27, at 1.

68. See Great Lakes Higher Education Corporation & Affiliates, *Top Six Ways to Reduce What You Owe*, GREAT LAKES, www.mygreatlakes.org/educate/knowledge-center/reduce-what-you-owe.html (last visited Apr. 25, 2016) (explaining capitalization in terms of interest on student loans where the student borrower ends up paying interest on interest).

69. *Id.*

70. See Fed. Deposit Ins. Corp., *supra* note 35 (explaining how negative amortization works for an \$180,000 mortgage loan).

71. *Id.*

72. *Wells Fargo Bank v. Kristall*, No. 27927-11 2014 LEXIS 4063 (N.Y. App. Div. Sept. 8, 2014).

73. *Id.* at *1.

74. *Id.*

75. *Id.*; see also Second Amended Complaint at 12-13, *California v. Countrywide Fin. Corp.*, No. LC081846, 2008 WL 4615941 (Cal. App. Dep't Super. Ct. filed June 25, 2008) (explaining how the principal balance on a particular negative amortization loan could increase from \$460,000 to \$523,792 and the monthly payments could increase from \$1,480 to \$3,748).

76. See generally Consumer Financial Protection Bureau, *What is a Balloon Loan? When Is one Allowed?*, (Dec. 30, 2013), www.consumerfinance.gov/askcfpb/104/what-is-a-balloon-loan.html (explaining the payment features of a balloon loan).

77. *Id.*

sophisticated borrowers who want to free up capital for other investment activities.⁷⁸

For example, in the bankruptcy of Terra Hooper Smith,⁷⁹ Smith's \$51,200 balloon loan required equal payments of \$542.07 for a term of 12 years at 12.39% interest, and one large payment at the end of the term to pay the loan in full.⁸⁰ The initial payments of \$542.07 were not enough to pay the loan in full.⁸¹ This resulted in the bank's claim that the borrowers owed \$50,583 at the end of the term.⁸² Unlike the negative amortization loan in *Kristall*, the principal balance of Smith's loan never increased above the original amount borrowed.

3. Interest-Only Loans

An interest-only loan allows the borrower to make payments consisting of only the interest due on the loan.⁸³ The interest-only payments continue for an amount of time specified in the mortgage loan documents, usually five or ten years.⁸⁴ After the interest-only period, the monthly payments increase to reflect the amount due to repay the principal and interest in full by the end of the loan term.⁸⁵

C. Contraction: Residential Mortgage Lending After the Housing Bubble

Once the housing bubble burst, private investors retreated from the secondary mortgage market.⁸⁶ This retreat left the

78. See Fishbein & Woodall, *supra* note 27, at 1 (stating that low payments are attractive to sophisticated borrowers so that the borrowers may "capitalize on other investment opportunities").

79. In re Smith, No. 12-07447-8-SWH, 2013 LEXIS 3443 (Bankr. E.D. N.C. 2013).

80. *Id.* at *1.

81. In order to pay the loan in full at the end of the term, Smith's monthly payments should have been \$684.61 per month. See *Mortgage Calculator*, BANKRATE.COM www.bankrate.com/calculators/mortgages/mortgage-calculator.aspx (input the loan characteristics into the calculator in order to obtain the resulting monthly payment).

82. *Smith*, 2013 LEXIS 3443, at *1.

83. Fishbein & Woodall, *supra* note 27, at 3.

84. *Id.*

85. *Id.*

86. John Griffith, *The Federal Housing Administration Saved the Housing Market*, CENTER FOR AMERICAN PROGRESS (Oct. 11, 2012), www.americanprogress.org/issues/housing/report/2012/10/11/40824/the-federal-housing-administration-saved-the-housing-market/ ("As private investors retreated from the mortgage business in the wake of the worst housing crisis since the Great Depression, the Federal Housing Administration increased its

alternate investors – government-sponsored enterprises (hereinafter “GSEs”) – as the primary participants in the secondary mortgage market.⁸⁷ “In the first half of 2010, the GSEs accounted for a whopping 64% of all single-family mortgage securities.”⁸⁸

Congress responded to the depressed housing market with the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank”).⁸⁹ Dodd-Frank’s purpose was to provide “financial regulatory reform” and to protect “investors and consumers” from the aggressive lending practices that occurred during the bubble.⁹⁰

Additionally, Dodd-Frank created the Consumer Financial Protection Bureau (hereinafter “CFPB”) for the purpose of “enforc[ing] Federal consumer financial law consistently [to ensure] that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive.”⁹¹ One of the CFPB’s functions is to “issu[e] rules, orders, and guidance implementing Federal consumer financial law.”⁹² When issuing rules under federal consumer financial laws, the CFPB must consider the impact of the rule on consumers and “the potential reduction of access by consumers to consumer Financial products.”⁹³ Pursuant to its rulemaking authority, the CFPB implemented the Ability-to-Repay rule (hereinafter “ATR”).⁹⁴

D. Congressional Response: Defining a Qualified Mortgage Under the ATR

The scope of the ATR is limited to closed-end consumer credit transactions that are secured by a dwelling (hereinafter “covered transactions”).⁹⁵ Covered transactions are divided into two groups: qualified mortgages and non-qualified mortgages.⁹⁶ The main distinction between qualified mortgages and non-qualified mortgages is that qualified mortgages are afforded the protection of either a safe harbor or rebuttable presumption of compliance.

insurance activity to keep money flowing into the market.”).

87. Acharya, *supra* note 53, at 56.

88. *Id.*

89. Dodd-Frank 12 U.S.C. §§ 5301-5641 (2016).

90. H.R. Rep. No. 111-517, at 1 (2010) (Conf. Rep.).

91. Dodd-Frank § 5511(a).

92. Dodd-Frank § 5511(c)(5).

93. Dodd-Frank § 5512(b)(2)(A)(i).

94. ATR 12 C.F.R. § 1026.43 (2016).

95. ATR § 1026.43(a).

96. *See* ATR § 1026.43 (e) (carving out special rules for qualified mortgages).

Non-qualified mortgages are ineligible for these protections.⁹⁷ The main similarity is that both types of loans require the lender to extend financing to the borrower on the basis of the borrower's reasonable ability to repay the loan.⁹⁸

1. *Qualified Mortgages*⁹⁹

Generally, the ATR defines a qualified mortgage as one that is a traditional mortgage product that has a term that "does not exceed 30 years."¹⁰⁰ Qualified mortgages cannot have excessive "points and fees [that are] payable in connection with the loan."¹⁰¹ The ATR goes further to designate a conservative underwriting methodology for the borrower's "mortgage-related obligations," and other "current debt obligations."¹⁰² Finally, the ATR proscribes a maximum debt-to-income ratio of 43% for qualified mortgages,¹⁰³ which must be substantiated by documenting and verifying the borrower's income and obligations.¹⁰⁴

Qualified mortgages are afforded the protection of a safe harbor, or a rebuttable presumption of compliance in the case of a higher priced transaction.¹⁰⁵ The presumption of compliance can be rebutted by a showing that the lender "did not make a reasonable and good faith determination of the [borrower's] repayment ability at the time of consummation" and that the lender knew that extending financing to the borrower "would leave the [borrower] with insufficient residual income or assets."¹⁰⁶

2. *Non-qualified Mortgages*¹⁰⁷

Under the ATR, non-traditional mortgage products are non-qualified mortgages.¹⁰⁸ The general requirements for non-qualified mortgages mandate that non-qualified mortgages be consummated based on the same standards as qualified mortgages that are afforded a rebuttable presumption of compliance.¹⁰⁹ Both the non-

97. ATR § 1026.43(e)(1).

98. ATR § 1026.43(e)(2), (e)(1)(ii).

99. Throughout this comment, the term "qualified mortgages" is used interchangeably with the term "traditional mortgage products."

100. See ATR § 1026.43(e)(2)(i)-(ii) (excluding mortgage loans that have features of non-traditional mortgage products).

101. ATR § 1026.43(e)(2)(iii).

102. ATR § 1026.43(e)(2)(iv).

103. ATR § 1026.43(e)(2)(vi).

104. ATR § 1026.43(e)(2)(v).

105. ATR § 1026.43(e)(1).

106. ATR § 1026.43(e)(1)(ii)(B).

107. Throughout this comment, the term "non-qualified mortgages" is used interchangeably with "non-traditional mortgage products."

108. ATR § 1026.43(e) (2013).

109. ATR § 1026.43(c)(1), (e)(1)(ii)(B).

qualified mortgage and the qualified mortgage that is afforded a rebuttable presumption of compliance must be consummated based on a “reasonable and good faith determination [that the borrower] will have a reasonable ability to repay the loan according to its terms.”¹¹⁰ As set forth in the Parts III and IV of this comment, this glaring similarity is the ultimate reason why non-qualified mortgages should receive the protection of a rebuttable presumption of compliance.

III. ANALYSIS: RESTRICTING BORROWER ACCESS TO NON-TRADITIONAL MORTGAGE PRODUCTS WITHOUT SUFFICIENT JUSTIFICATION

Excluding non-traditional mortgage products from the protection of a rebuttable presumption of compliance will deter lenders from offering non-traditional mortgage products.¹¹¹ Without the legal protection of a rebuttable presumption of compliance, mortgage originations will primarily consist of traditional mortgage products,¹¹² which will restrict the availability of non-traditional mortgage products.¹¹³

The fixed rate, interest only loan [which is a non-traditional mortgage product because of its interest-only feature], for example, . . . is a useful product for many consumers. The product offers low monthly payments, tax advantages, and a reset with a long window before refinance . . . providing a great deal of flexibility to consumers.¹¹⁴

Furthermore, the absence of non-traditional mortgage products in the primary market will remove the variety that

110. ATR § 1026.43(c)(1), (e)(1)(ii)(B).

111. Ronald L. Rubin, *The Essentials: the CFPB's Final Ability-to-Repay/Qualified Mortgage Rules*, CHI. BAR ASS'N (Jan. 22, 2013), www.lexology.com/library/detail.aspx?g=bbb84425-c0c1-44ec-b5a6-7dbaac9954c3 (concluding that the ATR rule will lead to “reduced credit availability” and the unavailability of some types of loans).

112. ATR Rule and QM Standards, *supra* note 31, at 6515 (“[I]ndustry commenters argued that the qualified mortgage criteria should not exclude specific loan products because the result will be that such products will be unavailable in the market.”).

113. Ronald L. Rubin, *The Essentials: the CFPB's Final Ability-to-Repay/Qualified Mortgage Rules*, HUNTON & WILLIAMS (Jan. 2013), <http://documents.lexology.com/b8e35bef-49f1-4894-97ef-b005817b2d6a.pdf> (concluding that the ATR rule will lead to “reduced credit availability” and the unavailability of some types of loans).

114. Letter from Kenneth L. Miller, Deputy Gen. Counsel, Bank of America, to Jennifer J. Johnson, Sec’y, Bd. of Governors of the Fed. Reserve Sys., 10 (July 22, 2011), www.regulations.gov/#!documentDetail;D=CFPB-2011-0008-0902.

investors sought in MBS.¹¹⁵ MBS will consist of only traditional mortgage products, rather than containing a diverse pool of mortgages from which investors can choose to purchase. This will adversely impact the growth of the secondary mortgage market,¹¹⁶ which will, in turn, decrease the amount of much needed private capital¹¹⁷ to fund home purchases.¹¹⁸

The following analysis examines the ATR's exclusion of non-traditional mortgage products from the protection of a rebuttable presumption of compliance, and the justifications given for the exclusion. The analysis reveals that the justifications for exclusion do not address the risks that non-traditional mortgage products pose to unsophisticated borrowers.¹¹⁹ Also, the ATR does not substantially distinguish underwriting practices between traditional and non-traditional mortgages such that excluding non-traditional mortgage products is justified.

115. See Goldman Sachs Asset Management, *A Reference Guide to Mortgages, Bank Loans, and Structured Credit: The Nuts and Bolts of Fixed Income Management* 8 (2008), www.wallstreetoasis.com/files/Reference_Guide_to_Mortgages.pdf (stating that diversity in "instruments and products" is what makes MBS "unique" investments).

116. See Robert H. Ledig, Ralph R. Mazzeo & Thomas P. Vartanian, *Impact of Ability-to-Repay and Qualified Mortgage Rules on Residential Mortgage Loan Purchasers, RMBS Participants, and Mortgage Industry Investors*, DECHERT LLP, (Oct. 2013), <http://sites.edechert.com/10/1815/october-2013/impact-of-ability-to-repay-and-qualified-mortgage-rules-on-residential-mortgage-loan-purchasers-rmbs-participants-and-mortgage-industry-investors.asp?intEmailHistoryId=4094877&intExternalSystemId=1> (stating that creditors "will be reluctant to make non-QM loans" because of "inherent risks"). That reluctance will most likely be based upon the lack of a safe harbor or presumption of compliance as offered for QM loans. *Id.*

117. See *Investors Guide*, *supra* note 54 at 2 (stating that "[m]ortgage securities play a crucial role in the availability and cost of housing in the United States."); ATR Rule and QM Standards, *supra* note 31, at 6411 (stating that "private investors have withdrawn from the mortgage securitization market and there are no other effective secondary measures in place[.]"); *id.* at 6412 (stating that "[o]utside of the securitization available through the Government National Mortgage Association (Ginnie Mae) for loans primarily backed by FHA, there are very few alternatives in place today to assume the secondary market functions served by the [government-sponsored enterprises].").

118. The reduced amount of participants in the secondary mortgage market may be enough on its own to deter investors from investing. See *Investor's Guide*, *supra* note 55, at 22 (listing one "important consideration" when investing in MBSs as "the level of activity in the secondary market should [the investor] need to sell the security").

119. See Fishbein & Woodall, *supra* note 27, at 2 (stating that "unsophisticated financial consumers . . . are less likely" to appreciate the value in a non-traditional mortgage product).

*A. Justifications for Excluding Non-Traditional
Mortgage Products from the Rebuttable Presumption
of Compliance*

The recent decline of the housing market is most often attributed to “loose underwriting practices” and the “failure [of lenders] to verify” borrowers’ repayment ability.¹²⁰ However, in implementing the ATR the CFPB was addressing the concern that non-traditional mortgage products should not be qualified mortgages simply because of their inherent risk.¹²¹ Also, the CFPB aimed to provide “objective criteria which creditors can conclusively demonstrate were met at the time of origination.”¹²² Without much inquiry into the effect the exclusion would have on the secondary mortgage market and consumer access to non-traditional mortgage products, the CFPB excluded non-traditional mortgage products from the protection of a rebuttable presumption of compliance.¹²³ The CFPB appears to have based the decision to exclude on “idiosyncratic” priorities without fully inquiring into the effects of the decision.¹²⁴ Such an inquiry would have revealed that the purported benefits of the exclusion do not justify leaving non-traditional mortgage products without the protection of a rebuttable presumption of compliance.¹²⁵

120. Loose underwriting practices by some creditors – including failure to verify the consumer’s income or debts and qualifying consumers for mortgages based on ‘teaser’ interest rates that would cause monthly payments to jump to unaffordable levels after the first few years – contributed to a mortgage crisis that led to the nation’s most serious recession since the Great Depression. ATR Rule and QM Standards, *supra* note 31, at 6408.

121. See Todd Zywicki, *Striking the Right Balance: Investor and Consumer Protection in the New Financial Marketplace*, 81 GEO. WASH. L. REV. 856, 876 (Apr. 2013) (explaining that the CFPB’s decision to exclude non-traditional mortgage products is one effect of the Agency having a “narrowly defined, single focus on consumer protection.”).

122. ATR Rule and QM Standards, *supra* note 31, at 6515; see also, Letter from Ken Markison, Assoc. Vice President and Regulatory Counsel, Mortg. Bankers Ass’n, to Richard Cordray, Dir., Consumer Fin. Protection Bureau, (Sept. 14, 2012) www.regulations.gov/#!documentDetail;D=CFPB-2012-0022-0172 (stating that “[t]he product, documentation and underwriting requirements must be based on **objective, bright line standards**”) (emphasis in original).

123. See ATR 12 C.F.R. § 1026.43(e)(2)(A)-(C)(2016) (requiring monthly payments on QMs to be “substantially equal” and not result in negative amortization, deferred principal payments, or balloon payments).

124. Zywicki, *supra* note 121, at 876.

125. See Letter from Miller, *supra* note 114 (stating that “[p]roduct type is not representative of the ability to repay, and the Qualified Mortgage rule should not exclude specific loan products.”).

1. *The Inherent Risk Justification*

The argument that non-traditional mortgage products should not be subject to a rebuttable presumption of compliance because of their inherent risk overlooks the true cause of borrower defaults on these types of loans.¹²⁶ The cause of default is the initial underwriting of the loan which extends financing to a borrower who has not evidenced their repayment ability when the monthly payments are set to increase.¹²⁷ For example, in the case of negative amortization loans, lenders are in the position during loan underwriting to conservatively estimate changes in the monthly payment once full payments of principal and interest become due.¹²⁸ Another example is in the case of balloon loans where lenders are in the position during underwriting to assess the borrower's ability to repay once the lump sum is due.¹²⁹ These conservative approaches should be the approaches lenders take during underwriting to determine whether the borrower can sustain the changes in monthly payments on non-traditional mortgage products.¹³⁰

126. See, e.g., Letter from Anne C. Canfield, Executive Dir., Consumer Mortg. Coalition to Jennifer J. Johnson, Sec'y, Bd. of Governors of the Fed. Reserve Sys., 8 (July 22, 2011) www.regulations.gov/#!documentDetail;D=CFPB-2011-0008-1406 (suggesting that one cause was the lender's underwriting methodology rather than the loan product type).

127. See ATR Rule and QM Standards, *supra* note 31, at 6510 (stating that “[t]he statutory underwriting requirements for a [QM] – for example, the requirement that loans be underwritten on a fully amortized basis . . . and not a teaser rate . . . will help prevent a return to . . . lax lending.”); Letter from Americans for Financial Reform to Jennifer J. Johnson, Sec'y, Bd. of Governors of the Fed. Reserve Sys., 8 (July 22, 2011), www.regulations.gov/#!documentDetail;D=CFPB-2011-0008-1519 (stating that “the only sensible approach to protect consumers against payment shock” on a non-traditional mortgage loan is to conservatively underwrite the loan to account for changes in the payment throughout the life of the loan as specified by the note); and compare to Letter from Ctr. for Responsible Lending, et. al. to the CFPB and the Fed. Reserve Bd., 6 (July 22, 2011), www.regulations.gov/#!documentDetail;D=CFPB-2011-0008-1294 (stating that “[i]t is worth remembering that the subprime market was once dominated by fixed rate traditional loans [that had] no built-in payment shock. They were simply high cost loans, made to equity-rich, vulnerable customers who could not afford them.”).

128. See Fishbein & Woodall, *supra* note 27, at 29 (stating that lenders must consider “potential negative amortization” when making the determination of whether to extend financing on a non-traditional mortgage product).

129. See, e.g., Fannie Mae Single Family Feb. 23, 2016 Selling Guide, Part B3-6-04, www.fanniemae.com/content/guide/selling/b2/1.3/02.htm#ARM.20Payment.20Shock (specifying certain circumstances in which the lender must qualify the borrower based on a “qualifying rate” rather than the rate specified in the note).

130. See Peter J. Wallison, *The True Origins of this Financial Crisis*, The

Furthermore, the change in the borrower's monthly payment on a non-traditional mortgage product can hardly be seen as a shock.¹³¹ The terms of the change are outlined in the mortgage loan documents that the borrower signs at consummation.¹³² It is no surprise that after the period of low monthly payments expires, the increased payments of principal and interest will become due as specified in the mortgage loan documents.

The ATR takes a conservative approach in requiring specific payment calculations for non-traditional mortgage products.¹³³ Under the ATR, non-traditional mortgage products will be extended only to borrowers who have a documented ability to repay the loans.¹³⁴ Limiting the extension of non-traditional mortgage products in the manner the ATR specifies ensures that only borrowers who can afford all of the monthly payments will be eligible for these products. Therefore, the fear of payment shock on a non-traditional mortgage product is an unconvincing reason to exclude an entire class of mortgage products from the protection of a rebuttable presumption of compliance.¹³⁵

Non-traditional mortgage products should be extended to borrowers who have evidenced a reasonable ability to repay the loan.¹³⁶ The lender should determine repayment ability based on a

American Spectator, (Feb. 2009) (attributing the “bubble in housing prices” to loose underwriting standards, the increased “availability of credit for mortgages,” and “the speculation in housing”); *see also* STAN J. LIEBOWITZ, ANATOMY OF A TRAIN WRECK: CAUSES OF THE MORTGAGE MELTDOWN (Oct. 3, 2008), www.independent.org/pdf/policy_reports/2008-10-03-trainwreck.pdf (pointing to the “intentional weakening of the traditional mortgage-lending standards” as being the epicenter of the bubble).

131. *See generally* Fishbein & Woodall, *supra* note 27, at 1 (referring to the sudden increase in mortgage payments on non-traditional mortgage products as “payment shock”).

132. *See, e.g.*, Fannie Mae, *Fixed/Adjustable Rate Note*, www.fanniemae.com/content/legal_form/3522.pdf (last visited Apr. 25, 2016).

133. *See* VAL SRINIVAS & RYAN ZAGONE, FIRST LOOK: IMPLICATIONS OF THE ABILITY-TO-REPAY RULE AND THE QUALIFIED MORTGAGE DEFINITION, 7 (2013), www2.deloitte.com/za/en/pages/financial-services/articles/ability-to-repay.html (discussing the importance of applying “conservative underwriting, similar to what is anticipated for non-[qualified mortgages]” to loans that are not subject to the ATR rule).

134. *See* ATR 12 CFR § 1026.43(c)(4)(2016) (requiring “verification of income or assets”).

135. *See* Letter from Miller, *supra* note 114, at 10 (arguing against excluding non-traditional products from the definition of a qualified mortgage).

136. ATR § 1026.43(c)(4). Furthermore, borrowers most likely to be able to afford non-traditional mortgage products will be sophisticated borrowers. *See* Dickerson, *supra* note 12, at 413 (stating that it appears unsophisticated “borrowers . . . accepted exotic loans without understanding that [there were] less expensive lending options . . . available”); *but see* Zywicki, *supra* note 121, at 904 (stating that non-traditional “mortgage products were used disproportionately by sophisticated, high-income borrowers with prime scores

reasonable and good faith determination.¹³⁷ Requiring such a determination to be made for non-traditional mortgage products adequately addresses the inherent risk in non-traditional mortgage products. It also justifies affording the products the protection of a rebuttable presumption of compliance.

2. *The Objective Criteria Justification*

Another argument for excluding non-traditional mortgage products from the protection of a rebuttable presumption of compliance reasons that the exclusion will allow the CFPB to provide objective criteria for traditional mortgage products.¹³⁸ However, this view negates the purpose of the objective criteria and does not address the view that non-traditional mortgage products are inherently more of a risk than traditional mortgage loans.

However, the ATR currently provides objective criteria that reveal whether the lender made a reasonable and good faith determination of the borrower's repayment ability. These objective criteria consist of limiting the borrower's debt-to-income ratio to 43%,¹³⁹ and requiring documentation and verification of income or assets.¹⁴⁰ The ATR rule mandates the utilization of the debt-to-income ratio criterion for traditional mortgage loans,¹⁴¹ but not for non-traditional mortgage loans.¹⁴² The income or asset documentation criterion applies to both traditional and non-traditional mortgage loans.¹⁴³ As addressed in the proposal to this comment, the 43% debt-to-income ratio should apply to non-traditional mortgage products as well.

a. How the 43% Maximum DTI Serves as an Objective Criterion

The purpose of analyzing a borrower's debt-to-income ratio is to provide the lender with a general view of the borrower's capacity to afford the mortgage.¹⁴⁴ The debt-to-income ratio is not

who were 'more strategic [defaulters]'").

137. ATR § 1026.43(c)(1).

138. See Letter from Markison, *supra* note 122 (stating that a definition of qualified mortgages that includes "bright line standards . . . is the only sure means to serve the widest array of qualified borrowers").

139. ATR § 1026.43(e)(2)(vi).

140. ATR § 1026.43(e)(2)(v).

141. ATR § 1026.43(e)(2)(vi).

142. ATR § 1026.43 (e)(2)(vi).

143. ATR § 1026.43(c)(4),(e)(2)(v).

144. Even during the housing bubble lenders were cognizant of the importance of the debt-to-income ratio. See ATR Rule and QM Standards, *supra* note 31, at 6412 (citing statistics from CoreLogic's TrueStandings

enough on its own to determine whether the borrower has a reasonable ability to repay.¹⁴⁵ The debt-to-income ratio is used in conjunction with other characteristics in the borrower's credit profile that gives lenders a basis to deny or approve the extension of financing to the borrower.¹⁴⁶ Even with the picture that a DTI can paint about a borrower's credit profile, the DTI is only as reliable as the underlying methods used to calculate it.¹⁴⁷ However, the DTI serves as a mathematical indicator of the borrower's ability to afford the mortgage payments at the borrower's verified income level.

The ATR restricts the debt-to-income ratio to 43% for traditional mortgage products.¹⁴⁸ However, the ATR provides no restriction on a lender's internal debt-to-income ratio for non-traditional mortgage products.¹⁴⁹ The lack of direction on how high the debt-to-income ratio should be for non-traditional mortgage products will force lenders to set their own internal debt-to-income ratios for non-traditional mortgage products.¹⁵⁰ This is one reason why the objective criteria of the 43% maximum DTI should apply to both traditional and non-traditional mortgage products.

b. How Income and Asset Documentation Requirements
Serve as Objective Criteria

The absence or presence of a document is an objective method by which it is easily determined whether a particular requirement was met.¹⁵¹ The ATR requires income or asset documentation for

Servicing Database that show the weighted average DTI was 39.8% "in the peak of the housing bubble").

145. See *generally Know What Lenders Look For*, *supra* note 49 (finding that a variety of factors determines whether the borrower can qualify for a loan).

146. *Id.*

147. See Plaintiff's First Amended Complaint at 16, *Assured Guar. Mun. Corp. v. Flagstar Bank FSB*, 2011 U.S. Dist. LEXIS 102722 (S.D.N.Y. Sept. 8, 2011) ("As part of [an auditor's] ongoing investigation of . . . files for the loans [pooled in the securitizations], [the auditor] discovered numerous loans where misstatements related to income dramatically affected the borrower's DTI . . . For example, [the auditor found] a \$150,000 loan . . . made under a stated income documentation program. The borrower claimed a monthly income of \$9,350 [but the auditor's investigation revealed] that the borrower's monthly income was actually \$2,000 at the time the loan was originated. The DTI ratio . . . was [actually] 189% [an in excess of] the 45 percent maximum DTI permitted under the applicable underwriting guidelines.")

148. ATR 12 C.F.R. § 1026.43 (2016).

149. *Id.*

150. See Interagency Guidance on Nontraditional Mortgage Product Risks, 71 Fed. Reg. 58,609 at 58,613-58,614 (Oct. 4, 2006) (stating that the responsibility of setting "prudent and appropriate underwriting standards" is that of the lending institution).

151. See *generally* Letter from Markison, *supra* note 122 (stating that a

both traditional and non-traditional mortgage products.¹⁵² In prohibiting lenders from extending financing to borrowers without documenting and verifying income or assets,¹⁵³ the ATR establishes an objective standard: either the loan was properly documented with paystubs or tax returns, or it was not. Therefore, if the documentation is missing, the loan is not ATR compliant. Considering the ATR requires income or asset documentation for non-traditional mortgage products, these products should be afforded the protection of a rebuttable presumption of compliance.

B. No Substantial Distinction in Underwriting Practices Between Traditional and Non-Traditional Mortgage Products

In addressing the concerns of relaxed underwriting practices that occurred during the expansion of the housing bubble, the ATR restricts certain underwriting practices for traditional and non-traditional mortgage products.¹⁵⁴ Generally, the restrictions guide the lender to use conservative monthly payment calculations and income documentation methods when determining whether to extend financing.¹⁵⁵ The expectation is that traditional mortgage products would have to be underwritten more conservatively than non-traditional mortgage products, because traditional mortgage products are afforded the protection of either the safe harbor or rebuttable presumption of compliance.¹⁵⁶

However, rather than requiring more conservative underwriting methodologies for traditional mortgage products, the ATR gives lenders a guide to underwriting traditional mortgage products that does not restrict underwriting methodologies any more than what is required for non-traditional mortgage products.¹⁵⁷ The following examples of income calculations show the reasonable and unreasonable approaches to underwriting. The

definition of qualified mortgages that includes “bright line standards . . . is the only sure means to serve the widest array of qualified borrowers”).

152. ATR § 1026.43(c)(4), (e)(2)(v).

153. ATR § 1026.43(c)(4), (e)(2)(v).

154. See e.g., SRINIVAS & ZAGONE, *supra* note 133, at 2 (stating that the ATR prohibits a lender from judging repayment ability based on an “introductory . . . rate without regard for affordability after the interest rate resets, a practice frequently undertaken during the mortgage boom”).

155. *Id.*

156. See CONSUMER FINANCIAL PROTECTION BUREAU, SUMMARY OF THE ABILITY-TO-REPAY AND QUALIFIED MORTGAGE RULE AND THE CONCURRENT PROPOSAL 3 (2013), http://files.consumerfinance.gov/f/201301_cfpb_ability-to-repay-summary.pdf (stating, for example, that “higher-priced mortgage loans” are protected by a “rebuttable presumption of compliance if creditors follow [ATR] requirements.”).

157. ATR 12 C.F.R. pt. 26 app. Q (2016).

comparisons in these examples reveal that the underwriting standards the ATR mandates for traditional mortgage products are not substantially distinct from those standards mandated for non-traditional mortgage products.

1. *An Unreasonable Determination of Income*

The case of *Assured Guaranty Municipal Corporation v. Flagstar Bank, FSB* provides an example of an unreasonable method by which to calculate income.¹⁵⁸ There, some of the underlying loans in a securitization were underwritten to a stated income standard where the borrowers did not provide proof of the income stated on the loan application.¹⁵⁹ The underwriter compared the borrower's income as stated on the loan application against income levels listed on publicly available databases.¹⁶⁰ The underwriter's determination of whether the stated income was reasonable depended upon whether the stated income fell in a particular range as shown in the database.¹⁶¹

In determining whether an expert's testimony regarding a violation of representations and warranties was admissible¹⁶², the court found that evidence of misrepresentation of stated income is "inherently material" in determining whether there is a breach of representations and warranties between the parties in an MBS transaction.¹⁶³ The lesson there is that had the income been documented with paystubs or W-2 forms, the amount of misrepresentation that occurred in that case would have been significantly less than what the expert found.¹⁶⁴ For traditional and non-traditional mortgage products, the ATR requires verification and documentation of the borrower's income so that unreasonable determinations like that in *Assured Guaranty* do not occur.¹⁶⁵

2. *A Reasonable Determination of Income*

When a statute gave examples of the types of documents required to evidence income, the court in *Massey v. Casals*¹⁶⁶ used evidence of an individual's lifestyle and representations in other

158. *Assured Guar. Mun. Corp. v. Flagstar Bank FSB*, 2013 U.S. Dist. LEXIS 16682 (S.D.N.Y. Feb. 5, 2013).

159. *Id.* at *12-13

160. *Id.* at *14.

161. *Id.* at *14.

162. *Id.* at *1.

163. *Id.* at *101-102

164. *See Id.* at *32 (stating that the expert found evidence of fraud in approximately 34% of the securitized loans).

165. ATR 12 C.F.R. § 1026.43(c)(4), (e)(2)(v) (2016).

166. *Massey v. Casals*, 315 S.W.3d 788 (Tenn. Ct. App. 2009).

documents to calculate income for an award of child support.¹⁶⁷ In *Massey*, a father's representation of his income to a lender for a mortgage loan was significantly more than what he represented to the juvenile court in an action against him for child support payments.¹⁶⁸ The statute listed examples such as "tax returns for prior years [or] check stubs" as sufficient for deriving an income calculation.¹⁶⁹

For traditional mortgage products, the ATR mandates that income documentation such as tax returns and paystubs be provided in support of the borrower's income.¹⁷⁰ For non-traditional mortgage products, the ATR does not require the same form of income documentation that is required for traditional mortgage products.¹⁷¹ However, for non-traditional mortgage products the ATR requires that income be verified by reasonably reliable records which evidence the borrower's income.¹⁷² Like the court determined in *Massey*, in extending financing for a non-traditional mortgage product, a lender's reasonable determination of a borrower's income may rest upon a combination of tax returns, paystubs, or other documents that reveal his income. These are the same documents that the ATR requires the lender to obtain when extending financing for a traditional mortgage product.¹⁷³

IV. PROPOSAL: PROVIDING BORROWERS ACCESS TO NON-TRADITIONAL MORTGAGE PRODUCTS

The ATR provides the framework for lenders to restrain underwriting practices from turning into the loose practices that occurred during the expansion of the housing bubble.¹⁷⁴ The ATR should apply that same framework to non-traditional mortgage products and afford those products the protection of a rebuttable presumption of compliance. The following proposal outlines the similarities in the determinations the ATR requires for traditional mortgage products and non-traditional mortgage products. The similarities reveal that the determinations are so similar that no rulemaking is required to heighten the requirements for non-

167. *Id.* at 795 (finding that "the evidence of [the] Father's expenses and lifestyle" support a finding in favor against the father for a child support order).

168. *Flagstar Bank FSB*, 2013 U.S. Dist. LEXIS 16682 at *12.

169. *Id.* at *15.

170. ATR 12 C.F.R. pt. 1026 app. Q(D)(4)(a) (2016) (requiring "signed, dated individual tax returns" in order to document income for self-employed borrowers).

171. ATR § 1026.43.

172. ATR § 1026.43(c)(3).

173. ATR pt. 1026 app. Q.

174. *See generally* ATR § 1026.43 (providing detailed provisions for lenders in determining whether borrowers have reasonable repayment abilities).

traditional mortgage products so that they may be afforded a rebuttable presumption of compliance.¹⁷⁵ Next, the proposal highlights the major differences, revealing that where the ATR regulates underwriting practices for traditional mortgage products, non-traditional mortgage products can be regulated in the same manner. Finally, the comment proposes that the ATR should be amended to afford non-traditional mortgage products a rebuttable presumption of compliance, which would effectively eliminate the distinction between qualified mortgages and non-qualified mortgages.

A. Applying the Framework

For traditional mortgage products that are afforded a rebuttable presumption of compliance,¹⁷⁶ the ATR specifies detailed standards under which traditional mortgage products can be consummated.¹⁷⁷ The detailed standards for traditional mortgage products can be applied to non-traditional mortgage products as well.¹⁷⁸ In fact, the ATR's requirements between traditional mortgage products that are afforded a rebuttable presumption of compliance and non-traditional mortgage products are already quite similar.¹⁷⁹ The similarities show that not much administrative rulemaking would need to be done in order to afford non-traditional mortgage products the protection of a rebuttable presumption of compliance.

175. See Dodd-Frank 12 U.S.C. § 5512(b)(1) (2016) (establishing that the CFPB's general rulemaking authority is limited to "prescrib[ing] rules . . . orders . . . and guidance as may be **necessary** . . . to enable the [CFPB] to administer and carry out [its] purposes and objectives") (emphasis added).

176. ATR 12 C.F.R. § 1026.43(e)(1)(ii) (2016) (establishing the rebuttable presumption of compliance afforded to qualified mortgages that are "higher-priced covered transactions").

177. ATR § 1026.43(e)(2) (2016) (mandating specific payment calculations, a maximum debt-to-income ratio of 43%, the types of loan products that are qualified mortgages, the limit on "points and fees payable in connection with the loan," loan documentation standards, bright-line underwriting standards by way of reference to Appendix Q, and a maximum loan term of 30 years loan term of 30 years).

178. See Letter from Americans for Financial Reform, *supra* note 127, at 8 ("It seems, therefore, logical and desirable for the ability to repay calculation on non-QM mortgages using variable rates - which may include these other, unstable features — to be underwritten to the highest payment possible.")

179. See ATR § 1026.43(c)(2)-(7),(e)(2)(i)-(vi) (mandating the same reasonable and good faith determination to be made between the two types of loan products).

1. The Similarities

The most obvious similarity is the “reasonable and good faith determination”¹⁸⁰ that the lender must make when deciding whether to extend financing. The ATR explicitly requires lenders to make a reasonable and good faith determination for non-traditional mortgage products.¹⁸¹ The ATR implicitly requires the same determination for traditional mortgage products that are afforded a rebuttable presumption of compliance.¹⁸² Therefore, no rulemaking would be required to change or heighten the standard of underwriting determinations for non-traditional mortgage products.¹⁸³

The next similarity is extremely important in determining the type of borrower that should qualify for non-traditional mortgage products because it deals directly with the borrower’s ability to make the mortgage payments.¹⁸⁴ For non-traditional mortgage products, the ATR requires conservative payment calculations to determine whether the borrower can sustain the monthly mortgage payments.¹⁸⁵ For example, on a non-traditional mortgage product with a negative amortization feature, the monthly payment must be based on “the maximum loan amount over the term of the loan”, rather than the lower principal balance at consummation.¹⁸⁶ For traditional mortgage products, the ATR

180. ATR § 1026.43 (c)(1).

181. See ATR § 1026.43 (c)(1) (stating that “A [lender] shall not make a loan that is a covered transaction unless the creditor makes a reasonable and good faith determination at or before consummation that the [borrower] will have a reasonable ability to repay the loan.”).

182. See ATR § 1026.43(e)(1)(ii)(B) (providing that in order to rebut the presumption of compliance it must be shown, *inter alia*, that the lender “did not make a reasonable and good faith determination of the [borrower’s] repayment ability at the time of consummation”).

183. Dodd-Frank limits the CFPB’s rulemaking authority to only those rules or orders that are necessary. See 12 U.S.C. § 5512(b)(1) (2016) (establishing that the CFPB’s general rulemaking authority is limited to “prescrib[ing] rules . . . orders . . . and guidance as may be **necessary** . . . to enable the [CFPB] to administer and carry out [its] purposes and objectives”) (emphasis added).

184. See Poonkulali Thangavelu, *How Much House Can You Buy?*, BANKRATE.COM, www.bankrate.com/calculators/mortgages/new-house-calculator.aspx#MHHCYB (last visited Apr. 25, 2016) (suggesting that lenders are chiefly concerned with the borrower’s repayment ability and implying that the monthly payment on the mortgage loan for which the borrower is applying is of significant importance to that determination).

185. See ATR 12 C.F.R. § 1026.43(c)(5)(B)(ii)(C) (2016) (outlining the payment calculations required to be made on negative amortization loans).

186. See ATR § 1026.43 (c)(5)(B)(ii)(C) (outlining the payment calculations required to be made on negative amortization loans); see also *In re Smith*, No. 12-07447-8-SWH, 2013 LEXIS 3443 (Bankr. E.D. N.C.) (providing an example of a balloon-loan that had the ATR been applicable, the lender would have used the higher monthly payment of \$684.61 to assess Smith’s repayment

requires a conservative payment calculation which is based on monthly payments that will pay the loan in full over the loan term.¹⁸⁷ In the area of the borrower's reasonable ability to repay, the CFPB would not need to adjust the ATR's standards for non-traditional mortgage products.¹⁸⁸

Another similarity relates to the practice of lenders during the expansion of the housing bubble of utilizing unverified or undocumented income to extend financing to borrowers. The ATR explicitly requires income or assets used in the determination of the borrower's ability to repay any loan (qualified mortgage or non-qualified mortgage) to be verified and documented. In the area of documenting income, the rule does not need to be revised to provide a heightened standard for non-traditional mortgage products.

2. *The Differences*

The first difference is the 43% maximum debt-to-income ratio, which does not apply to non-traditional mortgage products. Considering non-traditional mortgage products have "higher risk elements",¹⁸⁹ steps should be taken to ensure that non-traditional mortgage products are extended only to those borrowers who can truly afford the payments.¹⁹⁰ In fact, regardless of whether non-traditional mortgage products are afforded the protection of a rebuttable presumption of compliance, the maximum 43% debt-to-income ratio should apply to the determination required for non-traditional mortgage products.

ability).

187. See ATR § 1026.43(e)(2)(i) (requiring the loan to feature monthly payments that are substantially equal); see also § 1026.43(e)(2)(iv) (mandating that the traditional mortgage loan product be underwritten based on monthly payments that will pay the loan in full by the end of the loan term).

188. See Arnold & Porter, LLP, *The Consumer Financial Protection Bureau's Ability-to-Repay and Qualified Mortgage Rule* (Feb. 2013), www.arnoldporter.com/resources/documents/ADV213TheCFPBsAbilityToRepayAndQualifiedMortgageRule.pdf (noting that the required payment calculations for both qualified mortgages and non-qualified mortgages are similar).

189. FDIC, *supra* note 35; see also Jason Thomas, *Fannie, Freddie, and the Crisis*, 17 NATIONAL AFFAIRS 36, (Fall 2013), www.nationalaffairs.com/doclib/20130920_Thomas.pdf (stating that non-traditional mortgage loans "defaulted in large numbers beginning in 2007").

190. Letter from Barry Zigas, Dir. of Hous. Policy, Consumer Fed'n of America, to Jennifer J. Johnson, Sec'y, Bd. of Governors of the Fed. Reserve Sys., 9 (July 22, 2011) www.regulations.gov#!documentDetail;D=CFPB-2011-0008-0859 (stating that the way to protect consumers from payment shock on a non-traditional step-rate mortgage is to underwrite the loan "using the highest rate that can occur during the life of the loan").

The second difference is in the amount of guidance the ATR provides for traditional mortgage products.¹⁹¹ The guidance does not substantially distinguish required underwriting practices between traditional and non-traditional mortgage products. However, it does provide bright-line standards for lenders to apply to their underwriting procedures.¹⁹² Like the 43% maximum debt-to-income requirement, these bright-line standards should be added to the determinations required for non-traditional mortgage products regardless of whether they are afforded a rebuttable presumption of compliance.

B. Affording Non-Traditional Mortgage Products a Rebuttable Presumption of Compliance

With standards in place to ensure that a non-traditional mortgage product is extended to a borrower for whom the lender has determined possesses reasonable repayment ability, the only thing left to do is to presume that the non-traditional mortgage product complies with the ATR rule.¹⁹³ In the event of litigation regarding the loan, the borrower would be faced with having to show that the lender did not make a reasonable and good faith determination of the borrower's repayment ability.¹⁹⁴

Non-traditional mortgage products fall under the umbrella of non-qualified mortgages,¹⁹⁵ while traditional mortgage loans fall under the umbrella of qualified mortgages.¹⁹⁶ The major distinction between qualified mortgages and non-qualified mortgages is the protection of a safe harbor or rebuttable presumption of compliance that the ATR rule provides to qualified mortgages. If the requirements of traditional mortgage products are imposed upon non-traditional mortgage products, then there is

191. See ATR 12 C.F.R. pt. 1026 app. Q (2016) (detailing the type of standards that “resolve the appropriate treatment of a specific kind of debt or income where the standards provide a discernible answer to the question of how to treat the debt or income.”).

192. ATR pt. 1026 app. Q.

193. See Christopher Palmer, *Why did so Many Subprime Borrowers Default During the Crisis: Loose Credit or Plummeting Prices?*, 8 (Nov. 15, 2013), http://web.mit.edu/cjpalmer/www/CPalmer_JMP.pdf (stating that “Underwriting Standards and market conditions . . . interact to generate defaults.”).

194. See Ledig, Mazzeo & Vartanian, *supra* note 116, (stating that rebuttable presumption defenses are not available for non-QM loans).

195. See ATR 12 C.F.R. § 1026.43(e)(2)(i)(A)-(C) (2016) (excluding negative amortization, interest-only, and certain balloon-payment loans from the definition of a qualified mortgage).

196. See ATR § 1026.43 (e)(2)(i)(A)-(C) (excluding negative amortization, interest-only, and certain balloon-payment loans from the definition of a qualified mortgage).

no reason for the distinction the ATR makes between qualified mortgages and non-qualified mortgages.

V. FUELING THE CONTROLLED REBIRTH OF THE SECONDARY MORTGAGE MARKET

With proper regulation in place,¹⁹⁷ the MBS market can invite participation from private investors without replicating the unbridled growth the market experienced during the most recent housing bubble.¹⁹⁸ At the first signs of a runaway mortgage market, the CFPB and other federal financial administrative agencies can exercise their rulemaking authority to restrain financial institutions from making unsound lending decisions.¹⁹⁹ However, deterring lenders from offering non-traditional mortgage products will stunt the growth of the secondary mortgage market.²⁰⁰

197. See Dickerson, *supra* note 12, at 398 (explaining how deregulation affected the consumer credit markets since the mid-1970s).

198. See Letter from Kurt Pfothauer, Senior Vice President, Mortg. Bankers Ass'n to the Office of the Comptroller of the Currency, 6 (Mar. 29, 2006), www.federalreserve.gov/SECRS/2006/June/20060627/OP-1246/OP-1246_28_1.pdf (stating “In developing qualification standards for nontraditional mortgage products, lenders should account for possible risks associated with the non- and/or negative amortizing features of a mortgage product.”).

199. See Dodd-Frank 12 U.S.C. § 5511(b)(5) (2016) (establishing one of the objectives of the CFPB to be that of ensuring “markets for consumer financial products and services operate transparently and efficiently to facilitate access and innovation”).

200. This deterrence will be similar to what happened in the student loan market, for example. See Dickerson, *supra* note 12, at 416 (explaining the retreat of student loan lenders from the marketplace when investors no longer wanted to participate in the secondary market for student loans).

