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Qualified Mortgages & Government Reverse Redlining: How the CFPB's Qualified Mortgage Regulations Will Handicap the Availability of Credit to Minority Borrowers

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Qualified Mortgages & Government Reverse Redlining: How the CFPB's Qualified Mortgage Regulations Will Handicap the Availability of Credit to Minority Borrowers*

Patrick T. O'Keefe

Abstract

Imprudent underwriting and mortgage origination in the years leading up to the Global Financial Crisis of 2007 and 2008 was determined to be one of its predominant causes. As a result, partly in an effort to protect consumers and ensure that lending institutions did not relapse into poor mortgage origination practices, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act. This Note examines the qualified mortgage rule promulgated by the Consumer Financial Protection Bureau pursuant to the Dodd-Frank Act. This rule is intended to ensure that borrowers receive loans that are not unfair, deceptive, or abusive, and to ensure that lenders will be repaid by borrowers. However, despite public belief that the rule will afford protection to all borrowers, the rule may unintentionally have a negative impact on Black and Hispanic borrowers by increasing lending costs for a greater percentage of

minority borrowers.

This Note argues that there are strong justifications for modifying the qualified mortgage rule's requirement that a borrower have a 43% debt-to-income ratio. This Note will examine criticism of the rule as well as statistical data of historical mortgage originations to determine that the rule may negatively impact minority borrowers. The rule will force a larger percentage of Black and Hispanic borrowers to pay exorbitant prices for government guaranteed loans compared to similarly situated Asian and White borrowers. Black and Hispanic borrowers are, on average, more unlikely to meet the qualified mortgage rule's 43% debt-to-income requirement. This Note presents multiple solutions to this problem in the form of proposed amendments to the qualified mortgage rule.

*J.D. Candidate Fordham University School of Law, 2016; B.A., Politics and French, New York University, 2011. The author would like to thank Professor Susan Block-Lieb for her invaluable wisdom and guidance throughout the development of this Note. Any errors are my own. The author would also like to thank his parents, Tom and Gayle, and sister, Lauren, for their love and unwavering support.

All of these proposals will ensure that borrowers receive loans they are capable of repaying, while simultaneously removing the projected disparate impact upon Black and Hispanic borrowers.

KEYWORDS: Mortgage, Finance, Dodd-Frank, FPB

QUALIFIED MORTGAGES & GOVERNMENT REVERSE REDLINING: HOW THE CFPB'S QUALIFIED MORTGAGE REGULATIONS WILL HANDICAP THE AVAILABILITY OF CREDIT TO MINORITY BORROWERS

*By Patrick T. O'Keefe**

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Imprudent underwriting and mortgage origination in the years leading up to the Global Financial Crisis of 2007 and 2008 was determined to be one of its predominant causes. As a result, partly in an effort to protect consumers and ensure that lending institutions did not relapse into poor mortgage origination practices, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act. This Note examines the qualified mortgage rule promulgated by the Consumer Financial Protection Bureau pursuant to the Dodd-Frank Act. This rule is intended to ensure that borrowers receive loans that are not unfair, deceptive, or abusive, and to ensure that lenders will be repaid by borrowers. However, despite public belief that the rule will afford protection to all borrowers, the rule may unintentionally have a negative impact on Black and Hispanic borrowers by increasing lending costs for a greater percentage of minority borrowers.

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TABLE OF CONTENTS

INTRODUCTION	415
I. BACKGROUND	417
A. THE FINANCIAL CRISIS: CAUSES AND CONSEQUENCES	417
B. ADDRESSING THE CAUSES AND CONSEQUENCES	423
1. <i>Ability-to-Repay Rule</i>	423
2. <i>Qualified Mortgage as a Safe Harbor</i>	425
3. <i>Qualified Mortgage Requirements</i>	425
C. ALTERNATIVES TO QUALIFIED MORTGAGE RULE COMPLIANT LOANS.....	426
II. CONFLICTS	430
A. ARGUMENTS AGAINST QUALIFIED MORTGAGE RULE	430
1. <i>The Safe Harbor in the Qualified Mortgage Rule Will Discourage the Origination of Non-Qualified Mortgage Rule Loans</i>	430
2. <i>The 43% Debt-To-Income Threshold Will Unduly Preclude Creditworthy Borrowers From Obtaining Qualified Mortgages</i>	432
B. ANTICIPATED EFFECTS OF QUALIFIED MORTGAGE RULE: RACE AND AFFLUENCE CORRELATION	435
C. POTENTIAL SOURCES OF FUTURE LITIGATION: THE FAIR HOUSING ACT AND THE EQUAL CREDIT OPPORTUNITY ACT ...	438
III. RESOLUTION: PROPOSALS TO PROVIDE EQUAL ACCESS TO CREDIT FOR CREDITWORTHY MINORITY BORROWERS	441
A. ALLOW FOR THE CONSIDERATION OF COMPENSATING FACTORS	442
B. CREATION OF LOSS RESERVES BY LENDERS	443
C. INCREASE FOCUS ON THE CREATION OF AFFORDABLE HOUSING.....	445
CONCLUSION	447

INTRODUCTION

Title XIV of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), the Mortgage Reform and Anti-Predatory Lending Act, was intended to address irresponsible lending practices that occurred prior to the financial crisis, notably those relating to subprime mortgages.¹ Title XIV amends the Truth in Lending Act to require that consumers receive residential mortgage loans on terms that reasonably reflect their ability to repay and to receive a loan that is not “unfair, deceptive, or abusive.”² In implementing Title XIV, the Consumer Financial Protection Bureau (the “CFPB”) promulgated a definition of “qualified mortgage” that was intended to ensure that “residential borrowers only take loans that are suitable for them.”³ Clearly, the qualified mortgage rule was created to aid consumers.⁴ However, the final qualified mortgage rule has received backlash from consumer advocacy groups and industry constituents who argue that the rule will handicap consumers by unnecessarily limiting mortgage options and access to credit.⁵

1. Dodd-Frank Wall Street Reform & Consumer Protection Act, Pub. L. No. 111-203, § 1402, 124 Stat. 1376, 2138-39 (2010) (codified as amended at 15 U.S.C. §§ 1639a-1639b (2012)).

2. *Id.*

3. See Jay Weiser, *Dodd-Frank Qualified Mortgage Rules Will Create a New Bubble*, U.S. NEWS & WORLD REP. (Jan. 16, 2013, 10:45 AM), <http://www.usnews.com/opinion/blogs/economic-intelligence/2013/01/16/dodd-frank-qualified-mortgage-rules-will-create-a-new-bubble> [<http://perma.cc/UME2-VBCP>].

4. Ctr. for Responsible Lending et al., Comment Letter on Proposed Rule to Implement the Ability to Repay/Qualified Mortgage Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, at 1 (July 9, 2012), http://www.responsiblelending.org/mortgage-lending/policy-legislation/regulators/QM-Comment-Letter_Final_0709.pdf [<http://perma.cc/N7CS-JEUU>].

5. See *id.* at 5 (concluding that “a lower [debt-to-income] will also disproportionately exclude low and moderate income borrowers as well as communities of color.”); see also Ctr. For Responsible Lending et al., Discussion Draft on Ability-to-Repay (“ATR”) and Qualified Mortgage (“QM”) Determination, at 1 (Mar. 7, 2012), http://www.consumerfed.org/pdfs/QM_Term_Sheet_3-7-12.pdf [<http://perma.cc/M9CN-UE27>] (stating that “[i]f the QM [qualified mortgage] definition is construed narrowly, it will be more difficult for low-income and minority families to qualify for safer loans”); Greenlining Inst., Comment Letter on Proposed Rule to Implement the Ability to Repay/Qualified Mortgage Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, at 1 (July 9, 2012) (stating that “Greenlining is keenly aware of the potential negative impact the implementation of the proposed QRM

Part I of this Note provides background information on the financial crisis, the qualified mortgage rule, and lending alternatives to qualified mortgages. Part II examines the criticisms against the qualified mortgage rule, including an analysis of the anticipated disparate impact that some minority borrowers may face as a result of the rule, and a tension between the rule and the Fair Housing Act. Part III presents alternatives to the qualified mortgage rule that provide equal access to credit for creditworthy minority consumers. This Note concludes that the inflexible debt-to-income requirements and loan parameters of the qualified mortgage rule increase the likelihood that less affluent borrowers, and consequently more minority borrowers,⁶ will not be eligible for a qualified mortgage when Fannie Mae and Freddie Mac are removed from conservatorship.

[qualified residential mortgage] rules could have on low-income families and families of color”); Cmty. Depository Inst. Advisory Council, Comment Letter on Proposed Rule to Implement the Ability to Repay/Qualified Mortgage Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, at 1 (July 9, 2012) (stating that “[t]he CFPB’s proposed Qualified Mortgage (QM) Ability to Pay regulations, combined with the large number of additional restrictive mortgage lending regulations, have caused many community institutions to begin to curtail mortgage lending businesses or, alternatively, intentionally price themselves out of the mortgage loan market.”); Nat’l Cmty. Reinvestment Coal., Comment Letter on the Decision to Release a Final Rule on a Qualified Mortgage Safe Harbor or Rebuttable Presumption to the Consumer Financial Protection Bureau, at 2-3 (Nov. 20, 2012) (stating that “[p]ast experience suggests that racial minorities and borrowers from low and moderate-income neighborhoods are more likely to receive rebuttable presumption loans, both as the result of illegal steering and the unnecessarily restrictive criteria included in the compromise waterfall approach to defining qualified mortgages.”).

6. Hispanic and Black Americans are, on average, statistically less affluent than their Asian and White counterparts. In 2014, the real median household income by race was as follows: Asian: \$74,297; White: \$60,256; Hispanic: \$42,491; Black: \$35,398. See CARMEN DENAVAS-WALT & BERNADETTE D. PROCTOR, U.S. CENSUS BUREAU, INCOME AND POVERTY IN THE UNITED STATES: 2014, at 7 (2015), <http://www.census.gov/content/dam/Census/library/publications/2015/demo/p60-252.pdf> [<http://perma.cc/36C8-DLU8>]. Additionally, the median net worth of households by race in 2013 was as follows: White: \$141,900; Hispanic: \$13,700; Black: \$11,000. See Rakesh Kochhar & Richard Fry, *Wealth Inequality has Widened Along Racial, Ethnic Lines Since End of Great Recession*, PEW RES. CTR. (Dec. 12, 2014), <http://www.pewresearch.org/fact-tank/2014/12/12/racial-wealth-gaps-great-recession/> [<http://perma.cc/2SDB-6UFM>].

I. BACKGROUND

A. THE FINANCIAL CRISIS: CAUSES AND CONSEQUENCES

One of the pivotal causes of the global financial crisis and the underlying United States subprime mortgage crisis was the implosion of home value that began in 2007.⁷ Prior to this collapse, housing prices had experienced an extraordinary rise in value in the United States, with prices nationwide peaking in the second quarter of 2006.⁸ Between early 2002 and mid-2006, the average price of a home increased 71%.⁹ Because the value of American homes increased “more sharply and dramatically than the change in value of other assets,”¹⁰ the rise in home values was characterized as a bubble.¹¹ In fact, real estate prices grew faster than the increase in family income.¹²

Housing prices increased rapidly during this period for multiple reasons.¹³ First, the Federal Reserve “injected additional reserves” into the monetary supply,¹⁴ which caused interest rates to reach “near-historic lows” from 2002 to 2004, and made credit inexpensive and more accessible.¹⁵ Second, “irrational exuberance” caused a “heightened

7. Dean Baker, *The Housing Bubble and the Financial Crisis*, 46 REAL-WORLD ECO. REV. 73 (2008), <http://www.paecon.net/PAEReview/issue46/Baker46.pdf> [<http://perma.cc/7SLA-FPMY>].

8. STAN J. LIEBOWITZ, *Anatomy of a Train Wreck: Causes of the Mortgage Meltdown*, in HOUSING AMERICA: BUILDING OUT OF A CRISIS 287 (Randall G. Holcombe & Benjamin W. Powell eds., 2009).

9. N. GREGORY MANKIW & LAURENCE M. BALL, MACROECONOMICS AND THE FINANCIAL SYSTEM 389 (2011).

10. RICHARD SCOTT CARNELL ET AL., THE LAW OF FINANCIAL INSTITUTIONS 30 (5th ed. 2013).

11. Jeff Holt, *A Summary of the Primary Causes of the Housing Bubble and the Resulting Credit Crisis: A Non-Technical Paper*, 8 J. BUS. INQUIRY 120, 120-29 (2009), <http://www.uvu.edu/woodbury/docs/summaryofthepriamrycauseofthehousingbubble.pdf> [<http://perma.cc/Ry89-7PZR>].

12. *NAR Study: Majority of Metro Areas Experiencing Widening Inequality*, NAT'L ASS'N OF REALTORS (May 7, 2015), <http://www.realtor.org/news-releases/2015/05/nar-study-majority-of-metro-areas-experiencing-widening-inequality> [<http://perma.cc/YV9B-258J>].

13. See *infra* notes 14-25 and accompanying text.

14. JAMES GWARTNEY ET AL., SPECIAL TOPIC: CRASH OF 2008 10-11 (2011), http://commonsenseeconomics.com/wp-content/uploads/CrashOf2008_Aug10.pdf [<http://perma.cc/V6ZZ-MSQH>].

15. CARNELL ET AL., *supra* note 10, at 31.

state of speculative fervor” that home prices would continue to rise.¹⁶ The belief that home values would continue to increase was attributed to a variety of factors: (1) stable or increasing home values nationwide in any single year since the Great Depression,¹⁷ (2) anticipated increased demand in housing from the baby boom generation,¹⁸ (3) absence of “severe overbuilding,”¹⁹ and (4) healthy employment levels.²⁰ Confident that housing prices would continue to increase, lenders began to use the market value of homes as a proxy for security.²¹ Irrational exuberance resulted in banks willingly loaning larger amounts against homes because the homes served as collateral for the loan.²² Lenders presumed that even if a borrower were to become unable to repay their loan, a loss could be avoided by either having the borrower refinance the house for a larger loan based upon the appreciation in the value of the home from the time of the borrower’s initial purchase,²³ or foreclose on and resell the home in order to recoup the funds loaned to the borrower.²⁴ Thus, a cyclical “feedback effect” was created, where “[l]ow interest rates allowed people to borrow more, bidding up home prices,” and causing home prices to soar.²⁵

16. Holt, *supra* note 11, at 125.

17. *Housing Bubble -- or Bunk?*, BLOOMBERG BUS. (June 21, 2005), <http://www.bloomberg.com/bw/stories/2005-06-21/housing-bubble-or-bunk> [<http://perma.cc/4RNP-2FHA>].

18. JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., *THE STATE OF THE NATION’S HOUSING 3* (2006), http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/s_on2006_bw.pdf [<http://perma.cc/5Y7F-CVJ6>].

19. *Id.* at 2.

20. *Id.*

21. CARNELL ET AL., *supra* note 10, at 31.

22. *Id.*

23. See U.N.C. DEP’T OF STATISTICS & OPERATIONS RESEARCH, *SUBPRIME MORTGAGE CRISIS 6* (2008), <http://www.stat.unc.edu/faculty/cji/fys/2012/Subprime%20mortgage%20crisis.pdf> [<http://perma.cc/4M8N-2LAQ>]; see also CARNELL ET AL., *supra* note 10, at 31.

24. See Les Christie, *You Lost Your House - But You Still Have to Pay*, CNN MONEY (Feb. 3, 2010, 3:21 PM), http://money.cnn.com/2010/02/03/real_estate/foreclosure_deficiency_judgement/ [<https://perma.cc/6J78-UKH8>].

25. See Adam J. Levitin et al., *Securitization: Cause or Remedy of the Financial Crisis?* 9 (Georgetown Law & Econ., Research Paper No. 1462895; Univ. of Pa., Inst. for Law & Econ., Research Paper No. 09-31, 2009), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1462895 [<http://perma.cc/WUS2-W6J4>].

Moreover, residential mortgage origination “began to grossly deviate from prudent underwriting guidelines.”²⁶ Traditionally, mortgages have been originated with (1) “risk-based pricing,”²⁷ (2) “fixed-rate interest rates that were significantly higher than the then prevailing market levels or adjustable rate mortgages with comfortable margins over the index,”²⁸ and (3) mortgage insurance when “borrowers’ FICO scores were lower or [loan-to-value ratios] were higher than the underwriting norms.”²⁹ However, this conservatism was noticeably missing from mortgages originated in the mid-2000s and leading up to the global financial crisis.³⁰ Low-documentation and no-documentation mortgages,³¹ commonly known as “liar’s loans,”³² became prevalent as mortgage originators stopped requiring borrowers to provide extensive documentation of their assets and income.³³ Some originators even went so far as to collude with borrowers to overstate these items through the creation of counterfeit W-2 and 1099 forms.³⁴ Mortgages would routinely ignore the use of risk-based pricing.³⁵ Additionally, originators increasingly lowered down payments and, at times, required no down payment.³⁶ This created loans with loan-to-

26. JOSEPH C. HU, ASSET SECURITIZATION: THEORY AND PRACTICE 212-13 (2011); see also CARNELL ET AL., *supra* note 10, at 31.

27. See HU, *supra* note 26, at 212.

28. *Id.*

29. *Id.*

30. See *id.* at 213; see also CARNELL ET AL., *supra* note 10, at 31.

31. “No-doc” mortgages are a class of loans that permit borrowers to limit the income, employment, or asset information on mortgage applications. See KATHLEEN C. ENGEL & PATRICIA A MCCOY, THE SUBPRIME VIRUS, RECKLESS CREDIT, REGULATORY FAILURE, AND NEXT STEPS 36-37 (2011).

32. Liar’s loans refer to a category of low documentation loans, such as stated income/stated asset (“SISA”) loans and no income/no asset (“NINA”) loans, where lenders and/or borrowers would misrepresent the borrower’s income and/or assets to enable the borrower to qualify for a larger mortgage. See *id.* at 36; see also CARNELL ET AL., *supra* note 10, at 31.

33. John C. Coffee, Jr., *Ratings Reform: The Good, The Bad, and The Ugly*, 1 HARV. BUS. L. REV. 231, 245 (2011).

34. Binyamin Appelbaum, *How Mortgage Fraud Made the Financial Crisis Worse*, N.Y. TIMES, (Feb. 12, 2015), http://www.nytimes.com/2015/02/13/upshot/how-mortgage-fraud-made-the-financial-crisis-worse.html?_r=0 [<http://perma.cc/ML7F-CWQL>].

35. See HU, *supra* note 26, at 212.

36. CARNELL ET AL., *supra* note 10, at 31.

value ratios that exceeded the prudent level of 80%.³⁷ Loans with loan-to-value ratios exceeding 80% traditionally required private loan insurance; however, originators suspended this practice during this time.³⁸ Furthermore, originators manipulated maturity terms, amortization schedules, and teaser rates in adjustable rate mortgages in order to get mortgages approved, even when originators knew that borrowers lacked sufficient income to service the mortgage over the life of the loan.³⁹

Deviation from prudent underwriting guidelines resulted in the creation of the “originate-to-distribute” model of mortgage lending, in which mortgage originators quickly sell loans, often through a securitization transaction.⁴⁰ Originators, armed with the knowledge that they were immune from the risks of borrower default because originated loans were to be sold quickly, slacked in performing due diligence before loaning to borrowers with poor credit.⁴¹ As a result of the originate-to-distribute model, subprime mortgages, accounting for only 9% of the mortgage market in the 1990s, more than doubled to account for 20% of the mortgage market by 2006.⁴²

Securities backed by residential mortgages tie the success of the financial markets to home values.⁴³ In the lead up to the crisis, the financial world became increasingly exposed to the risk of these

37. See HU, *supra* note 26, at 212-13. The loan-to-value ratio is “the ratio . . . between the amount of a mortgage loan and the value of the property pledged as security for the mortgage.” *Loan-to-Value Ratio*, BLACK’S LAW DICTIONARY (10th ed. 2014).

38. HU, *supra* note 26, at 213.

39. See Tami Luhby, *Predatory-Lending Lawsuits on the Rise*, CNN MONEY (Oct. 9, 2009, 7:19 AM), http://money.cnn.com/2009/10/08/news/economy/Predatory_lending_lawsuits_increase [<http://perma.cc/HM8F-WH82>]; see also Dennis Hevesi, *New Curbs on Predatory Loans*, N.Y. TIMES (Nov. 10, 2002), <http://www.nytimes.com/2002/11/10/realestate/new-curbs-on-predatory-loans.html> [<http://perma.cc/MDS9-GXGU>].

40. CARNELL ET AL., *supra* note 10, at 31. For a more in-depth discussion of the originate-to-distribute model and its widespread effects, see Amiyatosh K. Purnanandam, *Originate-to-Distribute Model and the Subprime Mortgage Crisis*, 24 REV. FIN. STUD. 1881 (2011).

41. See Benjamin J. Keys et al., *Did Securitization Lead to Lax Screening? Evidence from Subprime Loans*, 125 Q. J. ECON. 307, 354 (2010).

42. Chris Arnold, *Economists Brace for Worsening Subprime Crisis*, NPR (Aug. 7, 2007, 12:42 PM), <http://www.npr.org/templates/story/story.php?storyId=12561184> [<http://perma.cc/ZC23-UMVB>].

43. CARNELL ET AL., *supra* note 10, at 31.

residential mortgage-backed securities.⁴⁴ This risk exposure was exacerbated by the prevalence of residential mortgage-backed securities that included subprime mortgages in the packaged pool of assets.⁴⁵ Due to the rise in popularity of residential mortgage-backed securities, the financial world was not exposed to a general risk of loan defaults, but rather to the increased risk caused by suspect lending practices during this period.⁴⁶ For example, declining home values caused borrowers to refinance their homes to obtain more money.⁴⁷ Simultaneously, adjustable rate mortgages that were originated at low teaser rates would increase to higher rates that many homeowners could not afford.⁴⁸

Declining home values, borrowers' inability to refinance, and the increase of interest rates in adjustable rate mortgages triggered a massive foreclosure crisis.⁴⁹ Between January 2007 and the end of 2009, an estimated 2.5 million foreclosures occurred.⁵⁰ In addition, it is projected that nearly 13 million homes will go through foreclosure before the effects of the crisis fully dissipate.⁵¹ Foreclosed homes tend to

44. *See id.* at 31-32.

45. Subprime loans are originated to borrowers who are not eligible to qualify for conventional mortgages due to poor credit scores. Subsequently, these borrowers receive higher interest rates to correspond with the heightened risk the borrowers create for lenders. *See* ENGEL & MCCOY, *supra* note 31, at 21, 25-32.

46. *See* CARNELL ET AL., *supra* note 10, at 31.

47. Katalina M. Bianco, *The Subprime Lending Crisis: Causes and Effects of the Mortgage Meltdown 9-10* (2008), <http://business.cch.com/images/banner/subprime.pdf> [<http://perma.cc/WF6P-HVC7>].

48. *See* ENGEL & MCCOY, *supra* note 31, at 29 (noting that as subprime lending became mainstream, “[b]ait-and-switch tactics persisted, with lenders surprising borrowers at loan closings with . . . new interest rates [that] were adjustable and could double or triple over time.”).

49. *See generally* U.S. DEP’T OF HOUS. & URBAN DEV., OFFICE OF POLICY DEV. & RESEARCH, REPORT TO CONGRESS ON THE ROOT CAUSES OF THE FORECLOSURE CRISIS (2010), www.huduser.org/portal/publications/foreclosure_09.pdf [<http://perma.cc/9LEK-ZS27>].

50. DEBBIE GRUENSTEIN BOCIAN ET AL., CTR. FOR RESPONSIBLE LENDING, FORECLOSURES BY RACE AND ETHNICITY: THE DEMOGRAPHICS OF A CRISIS 2 (2010), <http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosures-by-race-and-ethnicity.pdf> [<https://perma.cc/9PJV-HYV6>].

51. JAN HATZIUS & MICHAEL A. MARSCHOUN, GOLDMAN SACHS GLOB. ECON. RESEARCH, HOME PRICES AND CREDIT LOSSES: PROJECTIONS AND POLICY OPTIONS 16 (2009) (projecting 13 million foreclosures by 2014).

lack proper maintenance⁵² and are sold at discounted prices, which tend to erode the value of nearby homes.⁵³ This is because foreclosure sales are considered to be comparable sales when appraisers determine the value of homes in a neighborhood, even though foreclosed properties are sold for only a fraction of their original loan value.⁵⁴ Studies have found that foreclosures lower the price of nearby homes by at least 1%.⁵⁵ To make matters worse, empty homes are ravaged for copper plumbing and aluminum siding, and can also attract criminal drug activity.⁵⁶ Thus, foreclosed properties impair the value of neighboring properties, and harm neighboring homeowners who wish to sell or refinance their homes.⁵⁷ The effects of foreclosures are widespread, leading to “negative cycles of disinvestment” and the “decline [of] entire communities.”⁵⁸

In response to the subprime mortgage crisis, the federal government found it necessary to place Fannie Mae and Freddie Mac⁵⁹ into

52. See generally Irwin M. Stelzer, *Why They Call It the Dismal Science: Everything You Need To Know About the Mortgage Crisis in Three Economics Buzzwords*, WKLY. STANDARD, Nov. 26, 2007 (discussing externalities caused by the mortgage crisis).

53. See CTR. FOR RESPONSIBLE LENDING, 2013 UPDATE: THE SPILLOVER EFFECTS OF FORECLOSURES (2013), <http://www.responsiblelending.org/mortgage-lending/research-analysis/2013-crl-research-update-foreclosure-spillover-effects-final-aug-19-docx.pdf> [<http://perma.cc/FT76-UUJF>].

54. APPRAISAL INST., GUIDE NOTE 11: COMPARABLE SELECTION IN A DECLINING MARKET 3, <http://www.appraisalinstitute.org/assets/1/7/guide-note-11.pdf> [<http://perma.cc/MJQ8-WSEH>] (“Appraisers cannot categorically discount foreclosures and short sales as potential comps in the sales comparison approach.”).

55. *Id.*; see also Les Christie, *The Ugly Face of Foreclosure*, CNN MONEY (May 7, 2007, 6:54 PM) http://money.cnn.com/2007/05/02/real_estate/face_of_foreclosure/ [<http://perma.cc/ZW2B-B9AA>].

56. See Christie, *supra* note 55.

57. See *Calculated Risk Assessing Non-Traditional Mortgage Products: Hearing Before the Subcomm. on Housing & Transportation and the Subcomm. on Economic Policy of the S. Comm. on Banking, Housing, & Urban Affairs*, 109th Cong. (2006) (statement of William A. Simpson, Vice President, Mortgage Insurance Companies of America); see also Ian Urbina, *Foreclosures Prompt Cities to Make Plea for Aid*, N.Y. TIMES (Jan. 24, 2008), nytimes.com/2008/01/24/us/24mayors.html [<http://perma.cc/NZG9-EJ76>].

58. See John C. Dugan, Comptroller of the Currency, Remarks Before the National Foundation for Credit Counseling (April 4, 2007), <http://www.occ.treas.gov/news-issuances/speeches/2007/pub-speech-2007-44.pdf> [<http://perma.cc/SHU5-K95E>].

59. Fannie Mae and Freddie Mac are government-sponsored entities created to provide liquidity to the nation’s mortgage finance system by issuing mortgage-backed

conservatorship in September 2008.⁶⁰ In elaborating on the decision to place Fannie Mae and Freddie Mac into conservatorship, Treasury Secretary Henry Paulson opined that allowing them to fail “would affect the ability of Americans to get home loans . . . and other consumer credit and . . . would be harmful to economic growth and job creation.”⁶¹

B. ADDRESSING THE CAUSES AND CONSEQUENCES

Congress sought to address the subprime mortgage crisis by including key sections in the Dodd-Frank Act to target these issues.⁶² Title XIV of the Dodd-Frank Act, the Mortgage Reform and Anti-Predatory Lending Act, was intended to address irresponsible lending practices that occurred prior to the financial crisis, notably those relating to subprime mortgages.⁶³ Title XIV amends the Truth in Lending Act to require that consumers receive residential mortgage loans on terms that “reasonably reflect their ability to repay the loans on terms that are understandable and not unfair, deceptive or abusive.”⁶⁴

1. Ability-to-Repay Rule

Pursuant to the Dodd-Frank Act, “no creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information

securities. Fannie Mae and Freddie Mac lost a combined \$265 billion between January 2008 and March 2012 as a result of the U.S. subprime mortgage crisis. *See* John Griffith, *7 Things You Need to Know About Fannie Mae and Freddie Mac*, CTR. FOR AMERICAN PROGRESS (Sept. 6, 2012), <http://www.americanprogress.org/issues/housing/report/2012/09/06/36736/7-things-you-need-to-know-about-fannie-mae-and-freddie-mac/> [<http://perma.cc/B4YQ-AKBK>].

60. *FHFA as Conservator of Fannie Mae and Freddie Mac*, FED. HOUS. FIN. AGENCY, <http://www.fhfa.gov/Conservatorship/pages/history-of-fannie-mae—freddie-conservatorships.aspx> [<http://perma.cc/7BG4-7R33>].

61. Press Release, U.S. Dep’t of the Treasury, Statement by Secretary Henry M. Paulson, Jr. on Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers (Sept. 7, 2008), <http://www.treasury.gov/press-center/press-releases/Pages/hp1129.aspx> [<http://perma.cc/X5DU-TLVC>].

62. Dodd-Frank Wall Street Reform & Consumer Protection Act, Pub. L. No. 111-203, § 1402, 124 Stat. 1376, 2138-39 (2010) (codified as amended at 15 U.S.C. §§ 1639a-1639b (2012)).

63. *Id.* tit. XIV.

64. *Id.* § 1402.

that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance (including mortgage guarantee insurance), and assessments.”⁶⁵ To ensure that mortgage lenders readopted prudent underwriting guidelines, Congress also provided for a private right of action against lenders by amending the Truth in Lending Act.⁶⁶ As a result, any lender that fails to comply with this ability-to-repay rule may be held liable to the borrower for “actual damages, and the cost of any successful legal action together with reasonable attorney’s fees.”⁶⁷ Lenders that fail to comply with the ability-to-repay rule may also be held liable for any of the following:

(1) In an individual action, twice the amount of the finance charge involved.⁶⁸

(2) In an individual action relating to an open-end credit transaction that is not secured by real property or a dwelling, twice the amount of the finance charge involved, with a minimum of \$500 and a maximum of \$5000 or such higher amount as may be appropriate in the case of an established pattern or practice of such failure.⁶⁹

(3) In an individual action relating to a closed-end credit transaction secured by real property or a dwelling, not less than \$400 and not more than \$4000.⁷⁰

(4) In a class action, such amount as the court may allow (with no minimum recovery for each class member). The total amount of recovery in any class actions arising out of the same failure to comply by the same creditor, however, cannot be more than \$1 million or 1% of the lender’s net worth, whichever is less.⁷¹

Furthermore, the Truth in Lending Act also affords borrowers the right to assert a violation of its ability-to-repay standards “as a matter of defense by recoupment or setoff” against a foreclosure action.⁷² In general, the amount of recoupment or setoff shall be equal to the amount

65. *Id.* § 1411.

66. 15 U.S.C. § 1640.

67. *Id.*

68. *Id.* § 1640(a)(2)(A)(i).

69. *Id.* § 1640(a)(2)(A)(iii).

70. *Id.* § 1640(a)(2)(A)(iv).

71. *Id.* § 1640(a)(2)(B).

72. *Id.* § 1640(e).

that the borrower would be entitled to under 15 U.S.C. §1640(a) for a valid claim, plus the cost to the borrower of the action, including reasonable attorney's fees.⁷³

2. *Qualified Mortgage as a Safe Harbor*

To prevent lenders from having to defend against a vast number of suits for an alleged failure to comply with the ability-to-repay rule, Congress also provided lenders with a safe harbor.⁷⁴ The Dodd-Frank Act carves out a presumption that if a loan satisfies the requirements of a qualified mortgage, the borrower has the ability to repay the loan.⁷⁵ Any loan that is accepted by a government sponsored entity, such as Fannie Mae and Freddie Mac, will be considered a qualified mortgage even if its debt-to-income ratio is above 43%.⁷⁶ Additionally, lenders can achieve a rebuttable presumption of compliance with the Truth in Lending Act's ability-to-repay rule for "higher-priced" mortgage loans.⁷⁷

3. *Qualified Mortgage Requirements*

In implementing Title XIV, the CFPB promulgated a definition for a qualified mortgage, meant to ensure that "residential borrowers only take loans that are suitable for them."⁷⁸ In order to be considered a qualified mortgage, the covered transaction must meet the following requirements:

(1) The regular periodic payments for the loan are substantially equal;⁷⁹

73. *Id.* § 1640(k)(2)(A).

74. 12 C.F.R. § 1026.43(e)(1) (2015).

75. *Id.*

76. *See id.* § 1026.43(e)(2)(vi); *see also* Kate Berry, *Six Months Later, Does the QM Rule Still Matter?*, NAT'L MORTGAGE NEWS (June 17, 2014, 12:22 PM), <http://www.nationalmortgagenews.com/news/origination/six-months-later-does-the-qm-rule-still-matter-1041986-1.html> [<https://perma.cc/7CX6-JSPV>].

77. *See* 12 § 1026.43(e)(1)(ii); A "higher-priced" mortgage loan is defined as having an annual percentage rate that exceeds the average prime offer rate by 1.5 or more percentage points for first liens and 3.5 or more percentage points for second liens. *See id.* § 1026.35(a)(1).

78. *See* Weiser, *supra* note 3.

79. 12 C.F.R. § 1026.43(e)(2)(i).

(2) the loan does not have any negative amortization, interest-only, or balloon features;⁸⁰

(3) the loan term does not exceed thirty years;⁸¹

(4) the total points and fees do not exceed a specified percentage of the total loan amount, as listed in the regulation;⁸²

(5) the creditor underwrites the loan using the maximum interest rate that may apply during the first five years after the date on which the first regular periodic payment is due, and periodic payments of principal and interest that will repay either the outstanding principal balance over the remaining term of the loan as of the date the interest rate adjusts to the maximum or the loan amount over the loan;⁸³

(6) at or before consummation of the loan, the creditor considers and verifies the consumer's income and assets, including employment status if relied upon, and current debt obligations, mortgage-related obligations, alimony and child support;⁸⁴ and

(7) the total debt-to-income ratio does not exceed 43%.⁸⁵

C. ALTERNATIVES TO QUALIFIED MORTGAGE RULE COMPLIANT LOANS

For borrowers who are unable to satisfy the requirements of the CFPB's qualified mortgage rule,⁸⁶ a potential alternative option is to obtain a loan backed by the Department of Housing and Urban

80. *Id.* § 1026.43(e)(2)(i)(A)-(C).

81. *Id.* § 1026.43(e)(2)(ii).

82. *Id.* § 1026.43(e)(2)(iii). For a loan greater than or equal to \$100,000, the total points and fees cannot exceed 3% of the total loan amount. *Id.* § 1026.43(e)(3)(i)(A). For a loan greater than or equal to \$60,000 but less than \$100,000, the total points and fees cannot exceed \$3000. *Id.* § 1026.43(e)(3)(i)(B). For a loan greater than or equal to \$20,000 but less than \$60,000, the total points and fees cannot exceed 5% of the total loan amount. *Id.* § 1026.43(e)(3)(i)(C). For a loan greater than or equal to \$12,500 but less than \$20,000, the total points and fees cannot exceed \$1000. *Id.* § 1026.43(e)(3)(i)(D). For a loan less than \$12,500, the total points and fees cannot exceed 8% of the total loan amount. *Id.* § 1026.43(e)(3)(i)(E).

83. *Id.* § 1026.43(e)(2)(iv).

84. *Id.* § 1026.43(e)(2)(v).

85. *Id.* § 1026.43(e)(2)(vi).

86. At a minimum, 34% of Black borrowers and 32% of Hispanic borrowers are unable to satisfy the requirements of the CFPB's qualified mortgage rule. *See* Neil Bhutta & Glenn B. Canner, *Mortgage Market Conditions and Borrower Outcomes: Evidence from the 2012 HMDA Data and Matched HMDA-Credit Record Data*, FED. RES. BULL., Nov. 2013, at 37.

Development (the “HUD”).⁸⁷ In its qualified mortgage rule, the HUD chose not to adopt the CFPB’s 43% debt-to-income ratio in order to “remain consistent with [its] mission with respect to underserved borrowers.”⁸⁸ Instead, the HUD’s qualified mortgage rule allows borrowers with debt-to-income ratios above 43% to obtain a Federal Housing Administration (“FHA”) mortgage based upon “compensating factors.”⁸⁹ Compensating factors that may be used to justify the approval of mortgages originated to borrowers with debt-to-income ratios above 43% include:

- (1) verified and documented cash reserves;
- (2) minimal increase in housing payment;
- (3) no discretionary debt;
- (4) significant additional income not reflected in gross effective income; and
- (5) residual income.⁹⁰

87. 24 C.F.R. pts. 201, 203, 1005, 1007 (2015).

88. Qualified Mortgage Definition for HUD Insured and Guaranteed Single Family Mortgages, 78 Fed. Reg. 59,890, 59,897 (Sept. 30, 2013) (codified at 24 C.F.R. pts. 201, 203, 1005, & 1007). Research has shown that underwriting criteria, such as debt-to-income ratio, can limit minority access to homeownership. See ROBERTO G. QUERCIA, LEI DING & CAROLINA REID, CTR. FOR CMTY. CAPITAL ET AL., BALANCING RISK AND ACCESS: UNDERWRITING STANDARDS AND QUALIFIED RESIDENTIAL MORTGAGES 1, 10 (2012) (“setting low [debt-to-income] thresholds will serve to exclude primarily lower-income and minority borrowers”) (citing Zhu Xiao Di & X. Liu, Joint Ctr. for Hous. Studies, *The Importance of Wealth and Income in the Transition to Homeownership* (HUD Office of Policy Dev. & Research, Working Paper No. 05-6, 2005), <http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/w05-6.pdf> [<http://perma.cc/HQV6-T2XB>]); see also Stuart S. Rosenthal, *Eliminating Credit Barriers: How Far Can We Go?*, in LOW INCOME HOMEOWNERSHIP: EXAMINING THE UNEXAMINED GOAL 111-45 (Nicholas P. Retsinas & Eric S. Belsky eds., 2002); Roberto G. Quercia et al., *The Impacts of Affordable Lending Efforts on Homeownership Rates*, 12 J. HOUS. ECON. 29, 29-59 (2003); Raphael W. Bostic et al., *Hitting the Wall: Credit as an Impediment to Homeownership*, in BUILDING ASSETS, BUILDING CREDIT: CREATING WEALTH IN LOW-INCOME COMMUNITIES 155-172 (Nicholas P. Retsinas & Eric S. Belsky eds., 2005).

89. See generally U.S. DEP’T OF HOUS. & URBAN DEV., HUD MORTGAGEE LETTER 2014-02, MANUAL UNDERWRITING (2014), <http://portal.hud.gov/hudportal/documents/huddoc?id=14-02ml.pdf> [<http://perma.cc/YV3G-J2S3>].

90. *Id.* at 11-13.

Although FHA mortgages present an alternative source of financing to borrowers who cannot satisfy the CFPB's qualified mortgage rule, the requirements of the CFPB's qualified mortgage rule may result in a dual lending market that unintentionally discriminates against Black and Hispanic borrowers.⁹¹ Current data provides that 34% of Black mortgage borrowers and 32% of Hispanic mortgage borrowers cannot satisfy the CFPB's qualified mortgage rule based solely upon the 43% debt-to-income ratio cap.⁹² Thus, in order to obtain government-sponsored loans, which are accepted as qualified mortgage loans, these borrowers will be forced to obtain a FHA mortgage.⁹³ If mortgages that satisfy the CFPB's qualified mortgage rule and mortgages that satisfy the HUD's qualified mortgage rule came at the same cost to borrowers, the differences between the two types of mortgages would likely be negligible; however, FHA mortgages are costlier than conventional loans.⁹⁴ Additionally, Home Mortgage Disclosure Act data from 2012 analyzed by the Federal Reserve Board revealed that over 78% of Black and over 70% of Hispanic residential real estate purchasers used a nonconventional loan, such as a FHA mortgage, to finance their purchase.⁹⁵ As a result of being unable to meet the standards of the CFPB's qualified mortgage rule, a larger percentage of Black and Hispanic borrowers may be forced to pay more money to obtain government-sponsored loans than both Asian and White borrowers.⁹⁶

Admittedly, government-sponsored loans are not the only means available to borrowers to finance the purchase of residential real estate.⁹⁷

91. See Rachel Witkowski, *Blacks and Hispanics Likely to Be Hurt By 'Qualified Mortgage' Rule*, NAT'L MORTGAGE NEWS (Oct. 22, 2013, 3:48 PM), <http://www.nationalmortgagenews.com/dailybriefing/blacks-and-hispanics-likely-to-be-hurt-by-qualified-mortgage-rule-1039521-1.html?pg=1> [<http://perma.cc/AE8B-Z8E8>].

92. See Bhutta & Canner, *supra* note 86, at 37 tbl. 15.

93. See 12 C.F.R. § 1026.43(e)(2)(vi) (2015) (setting the maximum debt-to-income threshold for qualified mortgages at 43%).

94. See Kenneth R. Harney, *Fee Increases Are Making FHA Mortgages More Expensive*, L.A. TIMES (Feb. 10, 2013), <http://articles.latimes.com/2013/feb/10/business/la-fi-harney-20130210> [<http://perma.cc/LKV3-8LNV>]; Witkowski, *supra* note 91.

95. Bhutta & Canner, *supra* note 86, at 26.

96. *Id.* at 4 ("lower-income borrowers and black and Hispanic-white borrowers were more likely than other groups to have debt-to-income ratios above 43[%]").

97. See Brena Swanson, *Non-QM Lending: The New Normal For Mortgages?*, HOUSINGWIRE (Aug. 6, 2014, 12:05 PM), <http://www.housingwire.com/articles/30937-non-qm-lending-the-new-normal-for-mortgages> [<http://perma.cc/64H3-WWUV>] (non-

Borrowers may seek private mortgages that are not sponsored by the government.⁹⁸ However, the availability of private mortgages does not offer a solution to the difference in cost between mortgages that satisfy the CFPB's qualified mortgage rule and FHA mortgages.⁹⁹ Fannie Mae, Freddie Mac, and the HUD all have a preferable cost of capital to any private mortgage originator.¹⁰⁰ Therefore, borrower's can reasonably expect any private mortgage to cost more than a loan compliant with either of the qualified mortgage rules.¹⁰¹ As a result of being unable to meet the standards of the CFPB's qualified mortgage rule, a larger percentage of Black and Hispanic borrowers may be forced to pay more money to obtain mortgages, qualified or unqualified, than both Asian and White borrowers.¹⁰²

Consequently, two problems arise when borrowers are faced with these options. First, the creation of two different markets, one for Black and Hispanic borrowers, and the other for Asian and White borrowers is a problematic social policy.¹⁰³ Legal differentiation amongst borrowers that results in segregated pools of borrowers (supported by adherence to the CFPB's qualified mortgage rule) may easily enable more nefarious discrimination against Black and Hispanic borrowers.¹⁰⁴ Second, research indicates that the discretion held by mortgage originators has led to creditworthy Black and Hispanic borrowers paying more for mortgages than similarly situated Asian and White borrowers.¹⁰⁵ The

qualified mortgage lending constitutes roughly 10% of current mortgage originations, valued at approximately \$50 billion per year).

98. *Id.*

99. *See* Witkowski, *supra* note 91.

100. *Id.*

101. *Id.*

102. *See* Bhutta & Canner, *supra* note 86, at 4.

103. *See id.* at 25 ("concerns have been raised about the possibility that lenders steer borrowers in certain neighborhoods toward government-backed loans.").

104. *Id.*

105. *See* Charlie Savage, *Wells Fargo Will Settle Mortgage Bias Charges*, N.Y. TIMES (Jul. 12, 2012), http://www.nytimes.com/2012/07/13/business/wells-fargo-to-settle-mortgage-discrimination-charges.html?_r=0 [<http://perma.cc/MNR5-WZ85>] ("mortgage brokers . . . charged higher fees and rates to more than 30,000 minority borrowers across the country than they had to white borrowers who posed the same credit risk . . ."); Associated Press, *Study: Blacks, Latinos Pay More For Mortgages*, NBC NEWS (Jun. 6, 2006 3:43 PM), http://www.nbcnews.com/id/13081865/ns/business-real_estate/t/study-blacks-latinos-pay-more-mortgages/#.Vj6WsRCrQ6g [<http://perma>.

disparity in cost between CFPB's qualified mortgages and FHA mortgages¹⁰⁶ creates the possibility that mortgage originators may discriminate against minority borrowers in the cost of credit, under the guise of complying with the CFPB's qualified mortgage rule.¹⁰⁷ As a result, the new mortgage rules have had unintended implications.

II. CONFLICTS

A. ARGUMENTS AGAINST QUALIFIED MORTGAGE RULE

1. *The Safe Harbor in the Qualified Mortgage Rule Will Discourage the Origination of Non-Qualified Mortgage Rule Loans*

By providing lenders with a safe harbor, there is a disincentive for lenders to originate loans that do not meet the CFPB's qualified mortgage rule requirements.¹⁰⁸ In fact, the CFPB concedes that it is "concerned that creditors may initially be reluctant to make loans that are not qualified mortgages, even though they are responsibly underwritten."¹⁰⁹ For lenders that offer "higher-priced" mortgages, they

cc/N75D-E2QN] ("Black and Hispanic home buyers are more likely to pay high mortgage rates than white borrowers with similar credit ratings and income levels"); Sandra Fleishman, *Minorities Often Pay More for Mortgages*, WASH. POST (Sept. 14, 2005), <http://www.washingtonpost.com/wp-dyn/content/article/2005/09/13/AR2005091302070.html> [<http://perma.cc/ME8L-89WU>] (analysis of home-lending data found that "after adjusting for factors such as income level, loan size and property location that could raise the interest rate offered on a mortgage, blacks are still nearly twice as likely as whites to be given a high-cost loan.").

106. See Harney, *supra* note 94.

107. See Rachel Witkowski, *Lawmakers Voice Support for Disparate Impact*, NAT'L MORTGAGE NEWS (Nov. 20, 2013), <http://www.nationalmortgagenews.com/dailybriefing/Lawmakers-Voice-Support-for-Disparate-Impact-1039982-1.html> [<http://perma.cc/T2WJ-Q5SF>] (regarding disparate impact in lending, Rep. Emanuel Cleaver of Missouri said, "nobody is going to admit discrimination . . . [s]o if nobody admits it then they are either unintentionally committing it—committing discriminatory acts—or they are denying that what they're doing is in fact discriminatory.").

108. Diane Katz, *Dodd-Frank Mortgage Rules Unleash Predatory Regulators*, THE HERITAGE FOUND. (Dec. 16, 2003), http://www.heritage.org/research/reports/2013/12/doddfrank-mortgage-rules-unleash-predatory-regulators#_ftn27 [<http://perma.cc/4NGT-JM9X>] ("The relative safety of the QM means that lenders will be far less likely to offer loans that do not meet the QM criteria.").

109. CONSUMER FIN. PROT. BUREAU, SUMMARY OF THE ABILITY-TO-REPAY AND QUALIFIED MORTGAGE RULE AND THE CONCURRENT PROPOSAL 5 (2013), <http://files.co>

are only protected by a “rebuttable presumption” of compliance with the ability-to-repay rule, therefore they also face the risk of litigation.¹¹⁰ Conversely, each loan that is originated that conforms to the qualified mortgage rule provides the lender with the guarantee that the lender will not be subject to any suit for an alleged failure to comply with the ability-to-repay rule.¹¹¹ When juxtaposed, it becomes clear that lenders will opt to originate loans that satisfy the qualified mortgage rule requirements so as to be afforded the protection of the safe harbor.¹¹²

Moreover, the final qualified residential mortgage rule gave lenders further incentive to originate loans that conform to the qualified mortgage rule.¹¹³ The qualified residential mortgage rule lays out the requirements for mortgages to be pooled for securitization.¹¹⁴ The rule is an exemption to the Dodd-Frank Act’s risk retention rules that require lenders to retain 5% of the loans they sell into the secondary mortgage market.¹¹⁵ Although the initially proposed rules for a qualified mortgage and a qualified residential mortgage differed, the recently promulgated final qualified residential mortgage rule was designed to align with the qualified mortgage rule.¹¹⁶ This gives lenders further incentive to originate loans that conform to the qualified mortgage rule (and also the qualified residential mortgage rule), because these loans can be wholly

nsumerfinance.gov/f/201301_cfpb_ability-to-repay-summary.pdf [http://perma.cc/AKC7-L5UG].

110. SEAN M. HOSKINS, CONG. RESEARCH SERV., R43081, THE ABILITY-TO-REPAY RULE: POSSIBLE EFFECTS OF THE QUALIFIED MORTGAGE DEFINITION ON CREDIT AVAILABILITY AND OTHER SELECTED ISSUES 5 (2014), <http://www.fas.org/sgp/crs/misc/R43081.pdf> [http://perma.cc/7QA7-3M3L]; *Potential for Increased Litigation Risk Under the Ability to Repay Rule for Mortgage Lenders as a Result of the Affordable Care Act*, MD & DC CREDIT UNION ASS’N (Mar. 17, 2014), <http://www.mddccua.org/communications-exchange/press-room/6152> [http://perma.cc/947C-H9MN] (“Mortgage lenders will need to take a serious look at the litigation risk associated with offering higher-priced qualified mortgages.”).

111. 12 C.F.R. § 1026.43(e)(1)(i) (2015); *see also* Rachel Witkowski, ‘Safe Harbor’ for QM Loans May Not Protect Banks, NAT’L MORTGAGE NEWS (Sept. 6, 2013), <http://www.nationalmortgagenews.com/dailybriefing/Safe-Harbor-QM-Loans-May-Not-Protect-Banks-1038649-1.html> [http://perma.cc/XL65-KCEL].

112. *See* Katz, *supra* note 108 and accompanying text.

113. Kevin L. Petrasic, *Dodd-Frank Securitization Rule Is a Win for Banks*, LAW360 (Nov. 6, 2014, 1:32 PM), <http://www.law360.com/articles/593766/dodd-frank-securitization-rule-is-a-win-for-banks> [http://perma.cc/2PF8-NBCF].

114. 15 U.S.C. § 78o-11(c)(1) (2012).

115. *Id.* § 78o-11(c)(4)(B).

116. Credit Risk Retention, 79 Fed. Reg. 77,602, 77,686 (Dec. 24, 2014).

securitized in the secondary market.¹¹⁷ To the contrary, lenders are required to retain 5% of the credit risk for loans that are not eligible to be designated as a qualified mortgage (and are similarly incapable of the qualified residential mortgage designation).¹¹⁸ Thus, in order to avoid this requirement, lenders will originate mortgages that conform to the qualified residential mortgage rule, and by default, the qualified mortgage rule.

2. The 43% Debt-To-Income Threshold Will Unduly Preclude Creditworthy Borrowers From Obtaining Qualified Mortgages

By singularly emphasizing a borrower's debt-to-income ratio, the qualified mortgage rule fails to take into account other underwriting criteria that are salient to a borrower's ability to repay his loan.¹¹⁹ Although a borrower's debt-to-income ratio is usually one factor taken into account during the underwriting process,¹²⁰ multiple other borrower characteristics also factor into the underwriting process, including, but not limited to (1) loan-to-value ratio, (2) credit rating, (3) residual income, (4) liquid cash reserves, and (5) past payment history.¹²¹ Research has shown that a borrower's inability to satisfy the current debt-to-income ratio does not mean that the borrower will be incapable of repaying his or her mortgage.¹²² When loan-to-value ratio, total loan amount, and a borrower's credit score are all considered during the underwriting process, borrowers with a debt-to-income ratio between 43% and 45% were only slightly more likely to become delinquent on loan payments than borrowers with a debt-to-income ratio between 36% and 40%.¹²³ The CFPB itself has acknowledged that Federal Reserve Board research shows that "debt-to-income ratios may not have significant predictive power once the effects of credit history, loan type,

117. See 15 U.S.C. § 78o-11(c)(1)(C)(iii).

118. Credit Risk Retention, 79 Fed. Reg. at 77,603.

119. See Ctr. for Responsible Lending et al., *supra* note 4, at 11.

120. See generally FANNIE MAE, ELIGIBILITY MATRIX (2015), http://www.fanniemae.com/content/eligibility_information/eligibility-matrix.pdf [<http://perma.cc/7HSQ-8UNH>].

121. See Ctr. for Responsible Lending et al., *supra* note 4, at 1, 5-6, 24.

122. See *id.* at 1, 15.

123. *Id.* at 15.

and loan-to-value are considered.”¹²⁴ Moreover, not only have loan-to-value ratios and a borrower’s credit score been found to be more indicative of future loan performance than a borrower’s debt-to-income ratio,¹²⁵ but a borrower’s past payment history, residual income, and liquid cash reserves can also signal a borrowers’ ability to repay a mortgage, even at debt-to-income ratios between 43% and 50%.¹²⁶ By exclusively focusing upon a borrower’s debt-to-income ratio, the qualified mortgage rule unnecessarily denies potential creditworthy borrowers the opportunity to obtain a qualified mortgage.¹²⁷

Additionally, the qualified mortgage rule’s 43% debt-to-income threshold is too rigid.¹²⁸ When the Federal Reserve Board initially contemplated implementing a quantitative debt-to-income ratio as part of the rule,¹²⁹ the Board was concerned that “setting a specific debt-to-income ratio or residual income level could limit credit availability without providing adequate off-setting benefits.”¹³⁰ Currently, between

124. Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 6408 (Jan. 30, 2013); *see also* Yuliya Demyanyk & Otto Van Hemert, *Understanding the Subprime Mortgage Crisis*, 24 REV. FIN. STUD. 1848 (2011); James A. Berkovec et al., *Race, Redlining, and Residential Mortgage Loan Performance*, 9 J. REAL EST. FIN. & ECON. 263 (1994).

125. Mortgage Bankers Ass’n, Comment Letter on Proposed Rule to Implement the Ability to Repay/Qualified Mortgage Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, at 9 (July 9, 2012), <http://mba.informz.net/MBA/data/images/qmcommentletter070912.pdf> [<http://perma.cc/KY4Y-XL4Y>].

126. *See* Ctr. for Responsible Lending et al., *supra* note 4.

127. *See* Demyanyk & Van Hemert, *supra* note 124; Berkovec et al., *supra* note 124; Mortgage Bankers Ass’n, *supra* note 125; Ctr. for Responsible Lending et al., *supra* note 4.

128. *See* Ctr. for Responsible Lending et al., *supra* note 4, at 15 (stating that the organization found “no statistical difference in the likelihood of delinquency among loans with a [debt-to-income] of between 40 and 43[%] and those with a [debt-to-income] between 36 and 40[%]” and that “loans with a [debt-to-income] of between 43 and 45[%] were only marginally more likely to become delinquent than loans with a [debt-to-income] between 36 and 40[%].”).

129. On July 21, 2011, rulemaking responsibility was transferred from the Federal Reserve Board to the then newly established CFPB. *See Mortgage Origination: Hearing Before Subcomm. on Ins., Hous., & Cmty. Opportunity of the H. Comm. on Fin. Servs.*, 112th Cong. 12 (2011) (statement of Sandra F. Braunstein, Director, Division of Consumer & Community Affairs), <http://www.federalreserve.gov/newsevents/testimony/braunstein20110713a.htm> [<http://perma.cc/9T79-TZ6Z>].

130. Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 6408, 6525 (Jan. 30, 2013).

15% and 20% of the mortgage market is comprised of loans above the 43% debt-to-income ratio, and some of these loans perform well.¹³¹ Additionally, 23% of the loans acquired by Fannie Mae and Freddie Mac between 1997 and 2009 had debt-to-income ratios of 44% or more, while 19% of those loans had debt-to-income ratios equal to or exceeding 46%.¹³² Despite the CFPB's admission that no "magic" debt-to-income ratio exists that separates "affordable from unaffordable mortgages,"¹³³ they still opted to implement a fixed threshold based on a general "gradual increase in delinquency rates as debt-to-income ratios increase."¹³⁴ However, there is only a negligible difference between a debt-to-income ratio of 42% and 45%.¹³⁵ In fact, borrowers possessing debt-to-income ratios over 43% with ample residual income and liquid reserves have been shown to perform better than borrowers with debt-to-income ratios below 43% who did not meet these tests.¹³⁶ Additionally, even though loans underwritten with a debt-to-income ratio of over 46% are correlated with higher delinquency rates,¹³⁷ Fannie Mae continues to purchase loans originated to borrowers with debt-to-income ratios as high as 50%.¹³⁸ This is further evidence that undercuts the value of the current ratio. Therefore, by instituting an inflexible debt-to-income threshold in the qualified mortgage rule, the CFPB has placed too much importance on the correlation between delinquency rates and debt-to-

131. See Witkowski, *supra* note 91.

132. Katz, *supra* note 108.

133. Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z), 78 Fed. Reg. at 6527.

134. *Id.*; see also Truth in Lending (Regulation Z), 77 Fed. Reg. 33,120, 33,122 to 33,123 (June 5, 2012) (summarizing the HLP dataset by volume of loans and percentage that were ever sixty days or more delinquent, tabulated by the total debt-to-income on the loans and year of origination).

135. Katz, *supra* note 108.

136. See Ctr. for Responsible Lending et al., *supra* note 4, at 18.

137. *Id.* at 14.

138. Fannie Mae will purchase non-HARP loans underwritten by Desktop Underwriter that meet credit and collateral tests with compensating factors even if a borrower's debt-to-income is less than or equal to 50%. See FANNIE MAE, PRIVATE MORTGAGE INSURER ELIGIBILITY REQUIREMENTS 41 (2015), http://www.fanniemae.com/content/eligibility_information/private-mortgage-insurer-eligibility-requirements.pdf [<http://perma.cc/UQR3-B2PU>].

income ratios above 43%,¹³⁹ despite evidence that loans to borrowers with debt-to-income ratios above this threshold can be successful.¹⁴⁰

B. ANTICIPATED EFFECTS OF QUALIFIED MORTGAGE RULE: RACE AND
AFFLUENCE CORRELATION

Although the qualified mortgage rule is intended to ensure that borrowers receive loans that they are capable of repaying,¹⁴¹ the qualified mortgage rule may ultimately be shown to adversely affect minority borrowers.¹⁴² Mortgage lending has decreased after the rule became effective in January 2014.¹⁴³ Although some critics point to the implementation of the qualified mortgage rule as the cause of the decrease in mortgage lending, alternative explanations for the decrease in mortgage origination include (1) a sluggish economy, (2) student loan debt, (3) tepid income growth, (4) borrower obligations to underwater mortgages (meaning that the outstanding balance remaining on the loan exceeds the market value of the property), (5) fewer mortgage originators,¹⁴⁴ (6) the increased cost to originate a loan, and (7) the removal of unconventional loans from the marketplace.¹⁴⁵ Furthermore, it has been proffered that minority borrowers have not been impacted by the qualified mortgage rule¹⁴⁶ because there is also a seven-year exemption granted to loans accepted by the government-sponsored enterprises' automated underwriting engines (due to the fact that loans with a debt-to-income ratio above 43% can still be approved by the

139. See Ctr. for Responsible Lending et al., *supra* note 4, at 15.

140. See *id.*; Demyanyk & Van Hemert, *supra* note 124; Berkovec et al., *supra* note 124; Mortgage Bankers Ass'n, *supra* note 125.

141. See Dodd-Frank Wall Street Reform & Consumer Protection Act, Pub. L. No. 111-203, §§ 1411-1412, 124 Stat. 1376, 2142-48 (2010).

142. See Witkowski, *supra* note 91.

143. See Berry, *supra* note 76.

144. The qualified mortgage rule's requirement that total points and fees do not exceed 3% of the total loan amount is alleged to: (1) "disproportionately affect smaller loans" and the community banks that primarily originate them; and (2) be the cause of lowered profits for mortgage brokers, resulting in an estimated 30% fewer mortgage originators still operating by the end of 2015. See Berry, *supra* note 76.

145. See Berry, *supra* note 76.

146. *Id.*

automated underwriting engines of either Fannie Mae or Freddie Mac).¹⁴⁷

Despite various causes being attributed to the decrease in mortgage origination since the implementation of the qualified mortgage rule, the projected effects of the qualified mortgage are much more concentrated than an “across the board”¹⁴⁸ decrease in lending.¹⁴⁹ Although the qualified mortgage rule is neutral on its face, the rule will disproportionately impact less affluent borrowers, a significant portion of which tend to be minority borrowers.¹⁵⁰

To begin, a projected disproportionate impact upon less affluent borrowers correlates directly with a projected disproportionate impact upon minority borrowers.¹⁵¹ Real median household incomes for both Black and Hispanic households are lower than the real median household incomes of both Asian and White households.¹⁵² Even more striking is the gap between the median net worth of White households (\$141,900) compared to the median net worth of Hispanic households (\$13,700) and Black households (\$11,000) in 2013.¹⁵³ Furthermore, between 2010 and 2013, the median wealth of Black and Hispanic households fell, while the median wealth of White households increased.¹⁵⁴ As a result, a larger percentage of Black and Hispanic borrowers will be less affluent than the percentage of Asian and White borrowers who are less affluent.¹⁵⁵

147. CONSUMER FIN. PROT. BUREAU, EXAMINATION PROCEDURES: MORTGAGE ORIGINATION 6 (2014), http://files.consumerfinance.gov/f/201401_cfpb_mortgage-origination-exam-procedures.pdf [<http://perma.cc/WDE2-FWVM>].

148. See Berry, *supra* note 76.

149. See Witkowski, *supra* note 91.

150. *Id.*

151. See DENAVAS-WALT & PROCTOR, *supra* note 6; Kochhar & Fry, *supra* note 6.

152. In 2013, the real median household income by race was as follows: Asian: \$67,065; White: \$58,270; Hispanic: \$40,963; Black: \$34,598. See DENAVAS-WALT & PROCTOR, *supra* note 6, at 61 tbl. D-1.

153. See Kochhar & Fry, *supra* note 6.

154. Median wealth of White households increased by 2.4% from \$138,600 to \$141,900; median wealth of Black households fell 33.7%, from \$16,600 to \$11,000; median wealth of Hispanic households fell 14.3%, from \$16,000 to \$13,700. See Kochhar & Fry, *supra* note 6. Please note that the author *does not* mean to imply that the disparity in the growth rate of median household wealth by race is attributable to either the Dodd-Frank Act or the qualified mortgage rule. Rather, this is only meant to further illustrate the correlation between affluence and race.

155. See DENAVAS-WALT & PROCTOR, *supra* note 6; Kochhar & Fry, *supra* note 6.

Additionally, lower-income borrowers who applied for a loan in 2010 were more likely to exceed the 43% debt-to-income ratio limit.¹⁵⁶ Not only were mortgage denial rates “significantly higher” for Black and Hispanic mortgage applicants,¹⁵⁷ but those Black and Hispanic borrowers who were approved for a mortgage were more likely to have a higher priced mortgage compared to either Asian or White borrowers.¹⁵⁸ Not surprisingly, Home Mortgage Disclosure Act data from 2012 analyzed by the Federal Reserve Board revealed that Black and Hispanic mortgage borrowers also had lower credit scores and higher delinquency rates on mortgages than Asian and White borrowers in 2012.¹⁵⁹ Looking ahead, the Federal Reserve Board’s analysis also found that in 2010 34% of Black mortgage borrowers and 32% of Hispanic mortgage borrowers would be ineligible for a qualified mortgage based solely on their inability to satisfy the 43% debt-to-income requirement.¹⁶⁰

Despite these statistics, some claim that the qualified mortgage rule will not impact minority borrowers because any government-sponsored loan is considered to be a qualified mortgage.¹⁶¹ The Federal Reserve Board’s analysis of Home Mortgage Disclosure Act data noted that 70% of the 22% of residential mortgage borrowers who would not meet the qualified mortgage rule’s required debt-to-income ratio would still obtain government-sponsored loans,¹⁶² which are accepted as qualified mortgage loans during the seven-year exemption, or until Fannie Mae and Freddie Mac are removed from conservatorship, whichever comes first.¹⁶³ Although any government-sponsored loan is currently considered to be a qualified mortgage, there is no indication of what will happen to Black and Hispanic borrowers who cannot satisfy the 43%

156. See Bhutta & Canner, *supra* note 86, at 4.

157. *Id.* at 3

158. *Id.*

159. *Id.*; Notably, the delinquency rates of Black and Hispanic borrowers remain higher than the delinquency rates of Asian and White borrowers even after controlling for borrower credit score, geographic reductions in home value, and “higher-priced loan status.” See *id.*

160. *Id.* at 37.

161. See Berry, *supra* note 76; see also CONSUMER FIN. PROT. BUREAU, *supra* note 147, at 6.

162. See Bhutta & Canner, *supra* note 86, at 40. Included within this 22% are 33% of Black borrowers and 31% of Hispanic borrowers. *Id.* at 37.

163. CONSUMER FIN. PROT. BUREAU, *supra* note 147, at 6.

debt-to-income ratio when the seven-year exemption has ended or when Fannie Mae and Freddie Mac are removed from conservatorship.¹⁶⁴ Some hope that stronger economic conditions, such as healthy growth in salaries, employment, and the value of residential real estate, will result in a decreased percentage of borrowers who cannot satisfy the debt-to-income ratio.¹⁶⁵ Although the prospect of improved economic conditions may provide hope to some of the 34% of Black borrowers and 32% of Hispanic borrowers who currently cannot satisfy the debt-to-income ratio, these borrowers have neither a guarantee of stronger economic conditions in the future¹⁶⁶ nor a guarantee that their loans will remain qualified mortgages when the seven-year exemption has ended or Fannie Mae and Freddie Mac are removed from conservatorship.¹⁶⁷

C. POTENTIAL SOURCES OF FUTURE LITIGATION: THE FAIR HOUSING ACT AND THE EQUAL CREDIT OPPORTUNITY ACT

Mortgage lenders are fearful of being prosecuted for violations of the Fair Housing Act or the Equal Credit Opportunity Act.¹⁶⁸ The Fair Housing Act makes it illegal to “discriminate against any person in the terms, conditions, or privileges of sale . . . of a dwelling . . . because of race, color . . . or national origin.”¹⁶⁹ Notably, in *Texas Department of Housing and Community Affairs v. Inclusive Communities Project, Inc.*, the Supreme Court held that “[r]ecognition of disparate-impact claims is consistent with the [Fair Housing Act’s] central purpose,” noting that the Fair Housing Act “was enacted to eradicate discriminatory practices within a sector of our Nation’s economy.”¹⁷⁰ Similarly, the Equal Credit

164. See Witkowski, *supra* note 91.

165. *Id.*; see also Berry, *supra* note 76; Brad Finkelstein, *MBA Cuts Loan Forecast Again, Cites Lagging Home Purchases*, NAT’L MORTGAGE NEWS (May 19, 2014), <http://www.nationalmortgagenews.com/news/origination/mba-cuts-loan-forecast-again-cites-lagging-home-purchases-1041815-1.html> [<http://perma.cc/83KH-WMWQ>].

166. Improvement in borrower credit score customarily occurs only over a gradual period of time. See Bhutta & Canner, *supra* note 86, at 4. Although “financial assets, such as stocks,” have regained their value following the recession, they are “much more likely” to be owned by White borrowers than either Black or Hispanic borrowers. See Kochhar & Fry, *supra* note 6.

167. See Witkowski, *supra* note 91.

168. See Witkowski, *supra* note 107.

169. See 42 U.S.C. § 3604(b) (2012).

170. *Texas Dep’t of Hous. & Cmty. Affairs v. Inclusive Communities Project, Inc.*, 135 S. Ct. 2507, 2521 (2015) (citing 42 U.S.C. § 3601); see also H.R. REP. 100-711

Opportunity Act makes it unlawful for a lender to discriminate against an applicant on the basis of race, color, or national origin.¹⁷¹

Lenders may be apprehensive about the possibility of facing suits under either the Fair Housing Act or the Equal Credit Opportunity Act.¹⁷² In a potential lawsuit, lenders would face liability either for not offering qualified mortgages loans to a larger percentage of Black and Hispanic applicants due to their inability to meet the 43% debt-to-income requirement,¹⁷³ or for pricing loans to applicants with a debt-to-income ratio above 43% more expensively on account of the higher risk associated with the borrower.¹⁷⁴ These fears, however, are unfounded.¹⁷⁵ In *Texas Department of Housing and Community Affairs*, the Supreme Court explicitly held:

[A] disparate-impact claim that relies on a statistical disparity must fail if the plaintiff cannot point to a defendant's policy or policies causing that disparity. A robust causality requirement ensures that '[r]acial imbalance . . . does not, without more, establish a prima

(1988), as reprinted in 1988 U.S.C.C.A.N. 2173, 2176 (stating that the Fair Housing Act "provides a clear national policy against discrimination in housing").

171. See 15 U.S.C. § 1691 (2012). Although the Supreme Court's reasoning in *Texas Department of Housing & Community Affairs* regarding the Fair Housing Act may be applicable to the Equal Credit Opportunity Act, there are reasons to believe that the Supreme Court may not allow for disparate impact claims to be brought pursuant to the Equal Credit Opportunity Act. See *Special Alert: Disparate Impact Under The Equal Credit Opportunity Act After Inclusive Communities*, BUCKLEYSANDLER LLP (June 27, 2015), <http://buckleysandler.com/news-detail/special-alert-disparate-impact-under-the-equal-credit-opportunity-act-after-inclusive-communities> [<http://perma.cc/ZH9G-H5TG>].

172. See Witkowski, *supra* note 91; Witkowski, *supra* note 107; Evan Weinberger, *Feds Say QM Loans Won't Spur Fair Lending Suits*, LAW360 (Oct. 22, 2013, 6:37 PM), <http://www.law360.com/articles/482337/feds-say-qm-loans-won-t-spur-fair-lending-suits> [<http://perma.cc/94AV-3M7L>].

173. Evan Weinberger, *Banks Fear CFPB Rule Could Spur Fair Lending Fights*, LAW360 (Feb. 21, 2013, 7:47 PM), <http://www.law360.com/articles/417424> [<http://perma.cc/6VJY-Q5XV>].

174. See Marcus McCue, *It's Time to Get Serious About Non-QM Loans*, HOUSINGWIRE (Apr. 15, 2014), <http://www.housingwire.com/blogs/1-rewired/post/29675-its-time-to-get-serious-about-non-qm-loans> [<http://perma.cc/53U6-HZ2K>] ("With non-QM comes more risk"); *Understanding Mortgage Loan Underwriting*, HUD EXCHANGE, <http://www.hudexchange.info/resource/797/understanding-mortgage-loan-underwriting/> [<http://perma.cc/JRZ2-ACAH>] ("The key to profitable mortgage lending is pricing loans according to their risk of default.").

175. See Weinberger, *supra* note 172.

facie case of disparate impact' and thus protects defendants from being held liable for racial disparities they did not create.¹⁷⁶

A mortgage originator will not be held liable for a violation of the Fair Housing Act under a disparate impact theory because it is not the mortgage originator's policy that is causing the racial imbalance, but rather it is the mortgage originator's compliance with the CFPB's qualified mortgage rule that is the source of the racial imbalance.¹⁷⁷ Therefore, fears of being prosecuted for violations of the Fair Housing Act or the Equal Credit Opportunity Act for complying with the CFPB's qualified mortgage rule are both misguided and farfetched.¹⁷⁸

Further, Congress' inability to advance reforms regarding Fannie Mae and Freddie Mac has aroused concern that the seven-year exemption granted to the qualified mortgage rule will toll without a solution for the large number of mortgages backed by Fannie Mae and Freddie Mac. Under the current exemption, a loan with a debt-to-income ratio exceeding 43% may still receive an automated underwriting approval, despite the debt-to-income ratio exceeding the qualified mortgage rule limit.¹⁷⁹ This is significant because the Dodd-Frank Act creates a presumption that if a loan is a qualified mortgage then the borrower has the ability to repay the loan.¹⁸⁰ Lenders fear that at the expiration of the seven-year exemption, Fannie Mae and Freddie Mac will determine that automated underwriting approvals are insufficient to achieve qualified mortgage status on account of the debt-to-income ratio of a loan actually exceeding threshold limit.¹⁸¹ Under this scenario, not only would lenders be required to repurchase the mortgage from the government-sponsored enterprise,¹⁸² but the repurchased loan may also lose its presumption that the borrower had the ability to repay the loan at the time of origination.¹⁸³

176. Texas Dep't of Hous. & Cmty. Affairs v. Inclusive Communities Project, Inc., 135 S. Ct. 2507, 2523 (2015) (citing *Wards Cove Packing Co. v. Atonio*, 490 U.S. 642, 653 (1989)).

177. See Weinberger, *supra* note 172.

178. *Id.*

179. See Berry, *supra* note 76; see also CONSUMER FIN. PROT. BUREAU, *supra* note 147, at 6.

180. 12 C.F.R. § 1026.43(e)(1)(i) (2015).

181. See Berry, *supra* note 76.

182. See *id.*

183. See 12 C.F.R. § 1026.43(e)(2). Furthermore, it is worth noting that lenders may have a reliance interest in the qualified mortgage status of loans approved by

Although this situation is only supposition for the moment, it still highlights an important dilemma for mortgage originators. Lenders are currently relying upon the qualified mortgage status for loans approved by government-sponsored enterprises' automated underwriting engines to afford them a safe harbor.¹⁸⁴ To enable mortgage lenders to properly assess their exposure to litigation, the qualified mortgage rule should be amended to clarify what will happen to loans with a debt-to-income ratio exceeding 43% that receive an automated underwriting approval after the expiration of the seven-year exemption or when Fannie Mae and Freddie Mac are removed from conservatorship.¹⁸⁵ If these loans are to lose their qualified mortgage status, lenders should be put on notice, as this will afford them the opportunity to modify their loan origination practices.¹⁸⁶ This, in turn, will ensure that lenders are not exposed to ability-to-repay litigation for loans issued under the misconception that they would satisfy the qualified mortgage rule despite debt-to-income ratios exceeding 43%.¹⁸⁷

III. RESOLUTION: PROPOSALS TO PROVIDE EQUAL ACCESS TO CREDIT FOR CREDITWORTHY MINORITY BORROWERS

Having identified that (1) the qualified mortgage rule's creation of a safe harbor will discourage the origination of non-qualified mortgage rule loans,¹⁸⁸ (2) the 43% debt-to-income threshold will unduly preclude creditworthy borrowers from obtaining qualified mortgages,¹⁸⁹ and (3) the qualified mortgage rule is projected to disproportionately impact less

government-sponsored enterprises' automated underwriting engines. *See* *Omnia Commercial Co. v. United States*, 261 U.S. 502, 508 (1923) (holding that a contract interest represents "property" within the meaning of the Takings Clause). Thus, if Fannie Mae and/or Freddie Mac determine that the automated underwriting approval of a loan is invalid on account of the debt-to-income ratio of the loan exceeding the 43% qualified mortgage rule limit, the loss of the safe harbor protections that were previously afforded to the lender may be found to constitute a taking of property.

184. *See* Berry, *supra* note 76; Brian Collins, *Final QM Rule Will Keep the GSE Loan Market Going for Years*, NAT'L MORTGAGE NEWS (Jan. 10, 2013), <http://www.nationalmortgagenews.com/dailybriefing/final-qm-rule-favors-gses-1033807-1.html> [<http://perma.cc/69XZ-CR67>].

185. *See* Berry, *supra* note 76.

186. *See id.*

187. *Id.*; 12 C.F.R. § 1026.43(e)(1)(i).

188. *See supra* Part II.A.1.

189. *See supra* Part II.A.2.

affluent borrowers, and consequently more minority borrowers,¹⁹⁰ it is apparent that alternative options to the inflexible debt-to-income requirements of the qualified mortgage rule must be identified.¹⁹¹ In crafting alternative solutions, it is necessary to ensure that borrowers receive a loan that they are capable of repaying, fulfilling the intent of the qualified mortgage rule,¹⁹² while also making certain that low income consumers who are unable to comply with the 43% debt-to-income ratio, but who are otherwise creditworthy, are not improperly excluded from obtaining qualified mortgages.¹⁹³

A. ALLOW FOR THE CONSIDERATION OF COMPENSATING FACTORS

Although the CFPB settled on an unwavering 43% debt-to-income threshold in the qualified mortgage rule, the CFPB also points out “that there are many instances in which individual consumers can afford a debt-to-income ratio above 43[%] based on their particular circumstances,”¹⁹⁴ and that “the [CFPB] emphasizes that it does not believe that a 43[%] debt-to-income ratio represents the outer boundary of responsible lending.”¹⁹⁵ With this information in mind, the CFPB should heed its own advice and allow for the consideration of the compensating factors of individual borrowers in order to enable them to receive qualified mortgages.¹⁹⁶ Although a borrower’s debt-to-income ratio is usually one factor taken into account during the underwriting process,¹⁹⁷ multiple other borrower characteristics should factor into the underwriting process, including, but not limited to (1) loan to value ratio, (2) credit score, (3) residual income, (4) liquid cash reserves, and (5) past payment history.¹⁹⁸

190. See *supra* Part II.B.

191. See Ctr. for Responsible Lending, *supra* note 4; Cmty. Depository Inst. Advisory Council, *supra* note 5; Nat’l Cmty. Reinvestment Coal., *supra* note 5.

192. See CONSUMER FIN. PROT. BUREAU, *supra* note 109, at 1 (“The Consumer Financial Protection Bureau is issuing a final rule to implement laws requiring mortgage lenders to consider consumers’ ability to repay home loans before extending them credit.”).

193. See Witkowski, *supra* note 91.

194. See CONSUMER FIN. PROT. BUREAU, *supra* note 109, at 5.

195. Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 6408, 6527 (Jan. 30, 2013).

196. See Ctr. for Responsible Lending et al., *supra* note 4.

197. See FANNIE MAE, *supra* note 120.

198. See Ctr. for Responsible Lending et al., *supra* note 4.

State programs, such as the Connecticut Housing Finance Agency¹⁹⁹ and the Virginia Housing Development Authority,²⁰⁰ can serve as examples for the CFPB of how to reconcile these additional compensating factors with the debt-to-income threshold when determining whether a loan is entitled to the qualified mortgage classification. Under the Connecticut Housing Finance Agency regime, underwriting requirements demand the review of compensating factors such as a borrower's (1) capacity to afford a substantial down payment, (2) established capability to accrue savings, or (3) significant recorded cash reserves for consumers with debt-to-income ratios that surpass the Connecticut Housing Finance Agency's debt-to-income ratio limits.²⁰¹ Similarly, under the Virginia Housing Development Authority regime, underwriting protocols allow underwriters to approve loans to consumers whose debt-to-income ratios exceed the Virginia Housing Development Authority's debt-to-income ratio limits by up to 2% by taking into consideration factors such as a borrower's (1) employment and income, (2) credit history, (3) availability of liquid savings to complete a transaction, and (4) monthly housing expenditures.²⁰² By modifying its qualified mortgage requirements to be more similar to those of either the Connecticut Housing Finance Agency or the Virginia Housing Development Authority, the CFPB will cease to unnecessarily prohibit less affluent, and consequently more minority borrowers, who are otherwise creditworthy, from obtaining qualified mortgages simply due to an inability to satisfy the current debt-to-income ratio.²⁰³

B. CREATION OF LOSS RESERVES BY LENDERS

Moreover, in an effort to encourage lenders to originate mortgages to creditworthy borrowers with debt-to-income ratios above 43%, the CFPB should allow lenders to originate qualified mortgage loans to these borrowers if the lenders establish loss reserves to self-insure these

199. See CONN. HOUS. FIN. AGENCY, OPERATING MANUAL § 5 (2015), <http://www.chfa.org/content/CHFA%20Documents/Operating%20Manual%20%20Section%2005%20Underwriting%20Rev%209-24-15.pdf> [<http://perma.cc/SK76-GNRL>].

200. See VIRGINIA HOUS. DEV. AUTH., ORIGINATION GUIDE § 2.3 (2011), <http://www.vhda.com/BusinessPartners/Lenders/LoanInfoGuides/Loan%20Information%20and%20Guidelines/OriginationGuide.pdf> [<http://perma.cc/XM4G-28HX>].

201. See CONN. HOUS. FIN. AGENCY, *supra* note 199.

202. See VIRGINIA HOUS. DEV. AUTH., *supra* note 200.

203. See Ctr. for Responsible Lending et al., *supra* note 4.

loans.²⁰⁴ Under this scenario, the government, mortgage originators, and consumers all benefit. The government would benefit because the risk of default on these loans will not be shouldered by the government, as the originator-created loss reserves would be used to cover any losses that arise from defaults.²⁰⁵ The mortgage originators would benefit by obtaining the safe harbor from ability-to-repay litigation for qualified mortgages.²⁰⁶ These lenders would also benefit by having an expanded qualified mortgage market because this proposal would enable them to originate qualified mortgages to consumers with debt-to-income ratios greater than 43% *without* approval from a government-sponsored enterprise's automated underwriting engines.²⁰⁷ Furthermore, originators would bear no extra risk under this scenario because as long as the loans to borrowers with debt-to-income ratios greater than 43% are correctly underwritten and based upon the compensating factors, the funds in the loss reserves should rarely be lost.²⁰⁸ Less affluent, and consequently more minority borrowers, would benefit by now receiving qualified mortgages because lenders will seek out the untapped profits that would be available from a lending market that previously was not being

204. John R. Walter, Fed. Reserve Bank of Richmond, *Loan Loss Reserves*, ECON. REV., July/Aug. 1991, at 20, http://www.richmondfed.org/~media/richmondfedorg/publications/research/economic_review/1991/pdf/er770402.pdf [<http://perma.cc/XM5T-6LG9>] (describing how loan loss reserves have been used to absorb “loan losses both from loans the bank can currently identify as bad loans and from some apparently good loans that will later prove to be uncollectible.”).

205. Moral hazard results in the removal of market discipline by industry actors predicated on the expectation that the government will indemnify industry actors against the losses. Thus, if originators are self-indemnified, it follows that originators should engage in market discipline, removing moral hazard. Gary H. Stern, President, Fed. Reserve Bank of Minneapolis, Remarks at the University of Minnesota Economics Roundtable: Government Safety Nets and Banking System Stability (Mar. 11, 1998), <http://www.minneapolisfed.org/news-and-events/presidents-speeches/government-safety-nets-and-banking-system-stability> [<http://perma.cc/64MJ-LE8S>].

206. See 12 C.F.R. § 1026.43(e)(1)(i) (2015).

207. See *id.* § 1026.43(e)(2)(vi).

208. Christopher Palmer, Why Did So Many Subprime Borrowers Default During the Crisis: Loose Credit or Plummeting Prices?, 1, 8 (Nov. 15, 2013) (unpublished manuscript), http://web.mit.edu/cjpalmer/www/CPalmer_JMP.pdf [<http://perma.cc/L2GQ-Y2MB>]. Palmer states that “loose underwriting standards increase default rates.” *Id.* at 8. Therefore, it follows that stringent underwriting practices should decrease default rates, and thus the need for funds to be withdrawn from the loss reserves to cover the defaults.

addressed.²⁰⁹ This system would provide wider market access that is well underwritten because lenders will be incentivized to undergo proper due diligence when underwriting loans in order to not expend its funds that are tied up in the loss reserves.²¹⁰ The government, mortgage originators, and consumers would all benefit if the CFPB were to implement this proposal.

C. INCREASE FOCUS ON THE CREATION OF AFFORDABLE HOUSING

It may also be necessary to redirect some attention from modifying the CFPB's qualified mortgage rule to initiatives that can increase the development of affordable housing. Although the qualified mortgage rule has its shortcomings, the CFPB chose a 43% debt-to-income ratio because "[e]vidence from studies of mortgage loans suggest that borrowers with a higher debt-to-income ratio are more likely to run into trouble making monthly payments."²¹¹ Furthermore, the CFPB contends that the current ratio "protects consumer interests because debt-to-income ratios are a common and important tool for evaluating consumers' ability to repay their loans over time, and the [43%] threshold has been utilized by the . . . FHA . . . for many years as its general boundary for defining affordability."²¹²

The CFPB has admitted that "[a] consumer with a relatively low household income may not be able to afford a 43[%] debt-to-income ratio because the remaining income, in absolute dollar terms, is too small to enable the consumer to cover his or her living expenses."²¹³ As previously mentioned, the median net worth of Hispanic households and Black households in 2013 was \$13,700 and \$11,000, respectively, compared to \$141,900 for White households.²¹⁴ Meanwhile, the median

209. See Swanson, *supra* note 97 (valuing the non-qualified mortgage market at approximately fifty billion dollars per year).

210. See PHILIP F. BARTHOLOMEW, CONG. BUDGETING OFFICE, REFORMING FEDERAL DEPOSIT INSURANCE 104 (1990) (explaining that a self insurance system incentivizes actors to "contain moral hazard and minimize potential loss.").

211. *Ask CFPB: What Is a Debt-to-Income Ratio? Why Is the 43% Debt-to-Income Ratio Important?*, CONSUMER FIN. PROT. BUREAU (Feb. 8, 2016) [hereinafter *Ask CFPB*], <http://www.consumerfinance.gov/askcfpb/1791/what-debt-income-ratio-why-43-debt-income-ratio-important.html> [<http://perma.cc/7D22-7SBF>].

212. Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 6408 (Jan. 30, 2013).

213. *Id.*

214. See Kochhar & Fry, *supra* note 6.

household income of Hispanic households and Black households in 2014 was \$42,491 and \$35,398, respectively, in comparison to \$60,256 for White households and \$74,297 for Asian households.²¹⁵ Looking at these figures, it becomes apparent that the lower household incomes of Black and Hispanic households, when compared to the incomes of Asian and White households, may be correlated with the inability of more minority borrowers to comply with the 43% debt-to-income ratio.²¹⁶ Thus, if the 43% threshold protects consumer interests, but simultaneously excludes a portion of borrowers from obtaining qualified mortgages, the CFPB should work with other federal agencies on initiatives that can increase the development of affordable housing.²¹⁷

An example of a program the CFPB should strive to emulate is the Low-Income Housing Tax Credit, which is “the federal government’s primary program for encouraging the investment of private equity in the development of affordable rental housing for low-income households.”²¹⁸ Under the Low-Income Housing Tax Credit program, individual and corporate investors are allowed to claim tax credits on their federal income tax returns for investing “in the development, acquisition, and rehabilitation of affordable rental housing.”²¹⁹ Rather than provide tax credits for the rehabilitation or development of *rental* housing, the CFPB should work with other federal agencies to provide tax credits for the rehabilitation or development of affordable housing *for purchase*, as lower home prices would afford less affluent borrowers the opportunity to receive qualified mortgages.²²⁰

215. DENAVAS-WALT & PROCTOR, *supra* note 6, at 5.

216. *See* Witkowski, *supra* note 91.

217. Emily Badger, *The Housing Recovery Is Leaving Minorities Behind*, WASH. POST, (Mar. 17, 2014), <http://www.washingtonpost.com/news/wonk/wp/2014/03/17/the-housing-recovery-is-leaving-minorities-behind/> [<http://perma.cc/ZGK4-SUKA>] (noting that minorities are disproportionately excluded from the housing market during periods of constricted credit availability).

218. OFFICE OF THE COMPTROLLER OF THE CURRENCY, *LOW-INCOME HOUSING TAX CREDITS: AFFORDABLE HOUSING INVESTMENT OPPORTUNITIES FOR BANKS 1* (2014), <http://www.occ.gov/topics/community-affairs/publications/insights/insights-low-income-housing-tax-credits.pdf> [<http://perma.cc/6F2L-3FJW>].

219. *Id.* at 1-2.

220. *See Ask CFPB*, *supra* note 211. To calculate a debt-to-income ratio, the Consumer Financial Protection Bureau instructs to add all monthly debt payments and divide this number by gross monthly income. *Id.* It follows that smaller home prices will lead to smaller monthly debt payments, which will result in smaller debt-to-income ratios for borrowers.

CONCLUSION

Although the CFPB's qualified mortgage rule was designed with good intentions, it is anticipated that the implementation of the rule could have dire consequences. It is undisputed that the CFPB's qualified mortgage rule addresses the irresponsible, unfair, deceptive, and abusive lending practices that contributed to the subprime mortgage crisis. However, in doing so, the inflexible debt-to-income requirements of the CFPB's qualified mortgage rule increase the likelihood that less affluent borrowers will be ineligible to meet the requirements for a qualified mortgage. As a result, a larger percentage of Black and Hispanic borrowers are projected to have to pay higher prices than Asian and White borrowers to obtain government-sponsored loans, resulting in Black and Hispanic borrowers suffering a disparate impact. Moreover, lenders are currently unable to assess their exposure to ability-to-repay litigation, as it is unclear whether they will be able to rely upon the qualified mortgage status for loans approved by government-sponsored enterprises' automated underwriting engines after the expiration of the seven-year exemption or when Fannie Mae and Freddie Mac are removed from conservatorship.

Although there is no question that implementing measures to address irresponsible lending practices is no small task, the CFPB's qualified mortgage rule and its unyielding 43% debt-to-income ratio must be amended so as to not excessively constrain access to qualified mortgages for otherwise creditworthy borrowers, and to afford lenders the opportunity to modify their loan origination practices so as to not be unwillingly exposed to ability-to-repay litigation. Through the implementation of the consideration of compensating factors and the creation of loss reserves by lenders, lenders will have the opportunity to modify their loan origination practices, relieving the constraint on creditworthy minority borrowers.