Written Testimony of Richard Cordray
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Introduction

Thank you Chairman Johnson, Ranking Member Crapo, and members of the Committee for inviting me back today to testify about implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act. My colleagues and I at the Consumer Financial Protection Bureau are always happy to testify before the Congress, something we have done now 30 times.

Congress created the Bureau in the wake of the greatest financial crisis since the Great Depression. Our mission is to make consumer financial markets work for both consumers and responsible businesses.

Since the Bureau opened for business in 2011, our team has been hard at work. We are examining both banks and non-bank financial institutions for compliance with the law and we have addressed and resolved many issues through these efforts. In addition, for consumers who have been mistreated by credit card companies, we have worked in coordination with our fellow regulators to return roughly $425 million to their pockets. For those consumers who need information or help in understanding financial products and services, we have developed AskCFPB, a database of hundreds of answers to questions frequently asked by consumers. And our Consumer Response center has helped more than 100,000 consumers with their individual problems related to their credit cards, mortgages, student loans, and bank accounts.

We have also faithfully carried out the law that Congress enacted by writing rules designed to help consumers throughout their mortgage experience – from signing up for a loan to paying it off. In the Dodd-Frank Act, Congress gave the Bureau the responsibility to adopt specific mortgage rules with a legal deadline of January 21, 2013. If we had failed to do so, there were specific statutory provisions that would have automatically taken effect, which would have been problematic in various respects for consumers and the financial industry alike. We worked hard to meet our deadlines on those rules, which are the focus of my testimony today.

Ability-to-Repay

As we all know now, one of the reasons for the collapse of the housing market in 2007 and 2008 was the dramatic decline in underwriting standards in the mortgage market in the years leading up to the crisis. It became a race to the bottom, and in the end it was the American public and the American economy who were the losers in that unappetizing race. Many mortgage lenders made loans that borrowers had little realistic chance of being able to pay back. Some of those loans were high priced; many contained risky features. For example, lenders were selling "no-doc" (no documentation) and "low-doc" (little documentation) mortgages to consumers who were "qualifying" for loans beyond their means. Far too many borrowers found they had no problem getting so-called “NINJA” loans – even if you had no income, no job, and no assets, you still could get a loan.

The Dodd-Frank Act contains a provision to protect consumers from irresponsible mortgage lending by requiring lenders to make a reasonable, good faith determination based upon verified and documented information that prospective borrowers have the ability to repay their mortgages. Last month, the Bureau issued a rule to implement that requirement and provide further clarity as to what will be required of lenders.

In writing the Ability-to-Repay rule, we recognized that today’s consumers are faced with a very different problem than the one that consumers faced before the crisis. Access to credit has become so constrained that many consumers – even those with strong credit – cannot refinance or buy a house.

So our rule strikes a balance and addresses both problems by enabling safer lending and providing certainty to the market. It rests on two basic, common-sense precepts: Lenders will have to check on the numbers and make sure the numbers check out. It is the essence of responsible lending.

Under the rule, lenders will have to evaluate the borrower’s income, savings, other assets, and debts. No-doc loans are prohibited, and affordability cannot be evaluated based only on low introductory “teaser” interest rates. By rooting out reckless and unsustainable lending, while enabling safer lending, the rule protects consumers and strengthens the housing market.

In addition, Congress created a category of “Qualified Mortgages” that are presumed to meet the ability-to-repay requirements because they are subject to additional safeguards. Congress defined some of the criteria for these Qualified Mortgages, but recognized that it may be necessary for the Bureau to prescribe further specifics.

Our rule prohibits certain features that often have harmed consumers. Qualified mortgages cannot be negative-amortization loans – where the principal amount actually increases for some period because the borrower does not even pay the interest, and the unpaid interest gets added to the amount borrowed – or have interest-only periods. They cannot have upfront costs in points and fees above the level specified by Congress.

The rules also require that lenders carefully assess the burden that the loan places on the borrower. The consumer’s total monthly debts – including the mortgage payment and related housing expenses such as taxes and insurance – generally cannot add up to more than 43 percent of a consumer’s monthly gross income. The Bureau believes that this standard will help to draw a clear line that will provide a real measure of protection to borrowers and increased certainty to the mortgage market.

Loan Origination

The second rule I want to tell you about today has to do with mortgage loan originators.

Mortgage loan originators, which include mortgage brokers and retail loan officers, perform a variety of valuable services. They can assist consumers in obtaining or applying for mortgage loans, and they can offer or negotiate terms of those loans, whether the loans are for buying a home or refinancing an existing one. The financial reform law placed certain restrictions on a mortgage loan originator's qualifications and compensation. Building on rules issued earlier by the Federal Reserve, the Bureau applied what it heard from industry and consumers across the country to implement the new statutory restrictions.

The rules address critical conflicts of interest created by certain compensation practices in the run-up to the financial crisis, such as paying loan originators more money whenever they steered consumers into a more expensive loan and allowing them to take payments from both consumers and creditors in the same transaction. These practices gave loan originators strong incentives to steer borrowers toward risky and high-cost loans, and they created confusion among consumers about loan originators' loyalties. Restricting these practices will help ensure the mortgage market is more stable and sustainable.

Specifically, our mortgage loan origination rules help ensure that loan originator compensation may not be based on the terms of the mortgage transaction. At the same time, the rules spell out legitimate and permissible compensation practices, such as allowing certain profit-sharing plans. The rules say a broker or loan officer cannot get paid more by directing the consumer toward a loan with a higher interest rate, a prepayment penalty, or higher fees. The loan originator cannot get paid more for directing the consumer to buy an additional product like title insurance from the lender's affiliate. The rules also ban "dual compensation," whereby a broker gets paid by both the consumer and the creditor for the same transaction. Finally, our rules make existing requirements more consistent on matters such as screening, background checks, and training of loan originators, to provide more confidence to consumers.

Mortgage Servicing

For consumers who already have mortgage loans and are paying them back, the Bureau has adopted mortgage servicing rules to give them greater protections. The rules require common-sense policies and procedures for servicers' handling of consumer accounts.

By bearing responsibility for managing mortgage loans, mortgage servicers play a central role in homeowners' lives. They collect and apply payments to loans. They can work out modifications to loan terms. And they handle the difficult foreclosure process.

Even before the mortgage crisis unfolded, many servicers failed to provide a basic level of customer service. As the crisis unfolded, problems worsened. Servicers were unprepared to work with the number of borrowers who needed help. People did not get the help or support they needed, such as timely and accurate information about their options for saving their homes. Servicers failed to answer phone calls, lost paperwork, and mishandled accounts. Communication and coordination were poor, leading many homeowners to think they were on their way to a solution, only to find later that their homes had been foreclosed on and sold. In some cases, people arrived home to find they had been locked out unexpectedly.

To compound the frustrations, often the consumer's relationship with a mortgage servicer is not a matter of choice. After a borrower picks a lender and takes on a mortgage, the responsibility for managing that loan can be transferred to another provider without any approval from the borrower. So if consumers are dissatisfied with their customer service, they cannot protect themselves by switching to another servicer.

In this market, as in every other, consumers have the right to expect information that is clear, timely, and accurate. The Dodd-Frank Act added protections to consumers by establishing new servicer requirements. Last month, the Bureau issued rules to implement these provisions.

These provisions require that payments must be credited the day they are received. They require servicers to deal promptly with consumer complaints about errors. They require servicers to provide periodic statements to mortgage borrowers that break down payments by principal, interest, fees, and escrow. They require disclosure of the amount and due date of the next payment. (To help industry on this requirement, the Bureau is providing model forms that we developed and tested with consumers.)

Our servicing rules also implement Dodd-Frank Act requirements that mortgage servicers provide earlier advance notice the first time an interest rates adjusts for most adjustable-rate mortgages. The disclosure must provide an estimate of the new interest rate, the payment amount, and when that payment is due. It must also include information about alternatives and counseling services, which can provide valuable assistance for consumers in all circumstances, and particularly if the new payment turns out to be unaffordable.

All of these Dodd-Frank provisions address normal mortgage servicing. They protect everyday mortgage borrowers from costly surprises and runarounds by their servicers. But the Dodd-Frank Act did not speak specifically or comprehensively to the unique problems faced by borrowers who fall behind on their mortgages. Instead, Congress gave the Bureau general rulemaking authority to address these kinds of consumer protection problems.

Many American homeowners are struggling to stay on top of their mortgages. Our Office of Consumer Response has already fielded more than 47,000 complaints about mortgages. More than half were about problems people have when they are unable to make their payments, such as issues relating to loan modifications, collections, or foreclosure.

Accordingly, the Bureau's mortgage servicing rules put into place fairer and more effective processes for troubled borrowers. Beginning with the early stage of delinquency, we are providing new protections to help consumers save their homes.

Under our rules, servicers will be required to establish policies and procedures to ensure that their records are accurate and accessible. The idea is that servicers should be able to provide correct and timely information to borrowers, mortgage owners (including investors), and the courts. This provision will help prevent the egregious "robo-signing" practices that were found to be rampant in the marketplace. The rules also require servicers to have policies and procedures that assure a smooth transfer of information — including pending applications for foreclosure alternatives — when an account transfers from one servicer to another.

Our rules also require that servicers reach out to borrowers within the first 36 days after a payment is delinquent to determine whether the borrowers may need assistance. After 45 days, servicers must provide information about loss mitigation options and make staff available who will be responsible for helping borrowers apply for loan modifications or other foreclosure alternatives. The rules also carefully regulate the process for evaluating borrowers' loss mitigation applications and so-called "dual tracking," where a consumer is being evaluated for loss mitigation at the same time that the servicer is taking steps to foreclose on the property. The rules are designed to ensure that borrowers who submit a complete application by specified timelines are assessed for all available loss mitigation options and have an opportunity to appeal mistakes to their servicer.

The rules also require servicers to maintain policies and procedures that will ensure better coordination with loan owners to ensure that servicers offer all loss mitigation options that the owners permit, correctly apply the criteria for the loss mitigation options, and report back to the loan owners about how borrower applications are resolved. The goal is to avoid needless foreclosures – which is in the best interest of the borrower, the lender, and our entire economy.

In pursuing these rules, the Bureau struck a carefully calibrated balance. The rules mandate a fair process but do not require that a servicer, or an investor, offer any particular type of loss mitigation option or apply any particular criteria in considering such options. The rules likewise balance private and public enforcement.

Importantly, the rules apply to the entire market, not just to banks and other depository institutions. Many provisions are subject to private enforcement directly by consumers, and others will be monitored closely by the Bureau and other regulators. The rules also ensure better communications with loan owners, including investors, so that they too can be more effective in monitoring servicers' activities.

We will be vigilant about monitoring and enforcing these rules, and are coordinating on an ongoing basis with other federal agencies to address servicing issues. These rules mean a brand-new day for effective oversight of mortgage servicers by ensuring that no servicer can act in a manner that is indifferent to the plight of consumers.

Other Rules

The Bureau has also issued rules to implement a number of other provisions in the Dodd-Frank Act to strengthen consumer protections and address problematic practices that existed in the run-up to the financial crisis. For instance, the rules implement strict limitations on prepayment penalties that may have discouraged or disabled consumers from refinancing expensive or risky loans. The rules require creditors to maintain escrow accounts for borrowers who take out higher-priced mortgage loans for a longer period to help borrowers set aside money for taxes and property insurance. We also adopted new rules implementing the statutory requirement that mortgage lenders automatically provide applicants with free copies of all appraisals and other home-value estimates, as well as new and broader protections for high-cost "HOEPA" loans.

And in partnership with the Federal Reserve, Federal Deposit Insurance Corporation, Federal Housing Finance Agency, National Credit Union Administration, and Office of the Comptroller of the Currency, the Consumer Bureau adopted a new rule that implements Dodd-Frank's special requirements for appraisals of certain higher-priced mortgage loans. By requiring that creditors use a licensed or certified appraiser to prepare the written appraisal report based on a physical inspection of the property, the new rule creates an additional level of due diligence. The rule also requires creditors to disclose to applicants information about the purpose of the appraisal and provide consumers with a free copy of any appraisal report.

Smaller Institutions

As the Bureau worked through the requirements Congress imposed in the Dodd-Frank Act, we paid attention to the potential impacts on different types and sizes of creditors, servicers, and other financial service providers. To inform its work, the Bureau received input from banks, other lenders, mortgage brokers, service providers, trade associations, consumer groups, nonprofits, and other government stakeholders. We also convened small business review panels for input on various rules as prescribed by statute.

It is widely accepted that with few exceptions, community banks and credit unions did not engage in the kind of misdeeds that led to the mortgage crisis. Data available to the Bureau indicates that these institutions have lower severe delinquency rates and loss rates. At the same time, the Bureau knows these institutions may be more likely to retreat from the mortgage market if the regulations implementing the Dodd-Frank Act are too burdensome.

Accordingly, the Bureau created specific exceptions and tailored various rules to encourage small providers such as community banks and credit unions to continue providing credit and other services, while carefully balancing consumer protections. For example, we expanded earlier proposals to exempt certain small creditors operating predominantly in rural or underserved areas from the escrow rule requirements. We also issued a further proposal along with the Ability-to-Repay rule, which would treat various loans held by small creditors in portfolio as "Qualified Mortgages" subject to protections against any potential liability. We also finalized exceptions to substantial portions of our servicing rules for small companies such as community banks and credit unions that are servicing loans they originated or own.

We have carefully calibrated concerns about consumer protection and access to credit in making these distinctions. We know community banks and credit unions have strong practical reasons to provide responsible credit and have a long tradition of excellent customer service, both to protect their own balance sheets and because they care deeply about their reputations in their local communities. We know they provide vital financial services in rural areas, small towns, and underserved communities across this country. We believe the rules strike an appropriate balance to ensure consumers can continue to access this source of valuable and responsible credit.

Conclusion

As the Bureau has been working to finalize these mortgage rules by the statutory deadline, we have also been thinking hard about the process for implementing them. We know the new protections afforded by the Dodd-Frank Act and our rules will no doubt bring great change to the mortgage market, and we are committed to doing what we can to achieve effective, efficient, complete implementation by engaging with all stakeholders in the coming year. We know that it is in the best interests of the consumer for the industry to understand these rules – because if they cannot understand, they cannot properly implement.

To this end, we have announced an implementation support plan. We will publish plain-English summaries. We will publish readiness guides to help industry run through check-lists of things to do prior to the rules going into effect – like updating their policies and procedures and providing training for staff. We will work with other government agencies to prepare in a transparent manner for both our and their examinations. And we will publish clarifications of the rules as needed to respond to questions and inquiries.

Most importantly, we will continue to listen to consumers and businesses as we work to help the mortgage market – and American consumers – recover from the financial crisis.

I am very proud of the tremendous work our team has done on rulemaking and implementation efforts under the Dodd-Frank Act. And as I have said to you before, we always welcome your questions and your thoughts about our work.

Thank you.