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DEPARTMENT OF VETERANS AFFAIRS

38 CFR Part 36

Loan Guaranty: Revisions to VA-Guaranteed or Insured Cash-out Home Loans

AGENCY: Department of Veterans Affairs.

ACTION: Advanced notice of rulemaking.

SUMMARY: The Department of Veterans Affairs (VA) is issuing this document in compliance with the Economic Growth, Regulatory Relief, and Consumer Protection Act (the Act). The Act requires VA to amend its regulation on VA-guaranteed or insured cash-out refinance loans and to publish the amended regulation within a shortened time frame. If VA determines that urgent or compelling circumstances make compliance with the advance public notice and comment requirements of the Administrative Procedure Act impracticable or contrary to public interest and publishes notice of that determination in the Federal Register, the Act permits VA to amend the regulation through an interim final rule or final rule. VA has determined that urgent and compelling circumstances do exist and is, therefore, issuing this Federal Register document announcing VA's intent to promulgate an interim final rule implementing the Act.

DATES: [insert date of publication in the Federal Register]

ADDRESSES: Loan Policy & Valuation, Loan Guaranty Service (26), Veterans Benefits Administration, Department of Veterans Affairs, 810 Vermont Avenue, NW., Washington, DC 20420.

FOR FURTHER INFORMATION CONTACT: Greg Nelms, Assistant Director for Loan Policy & Valuation, Loan Guaranty Service (26), Veterans Benefits Administration, Department of Veterans Affairs, 810 Vermont Avenue, NW., Washington, DC 20420, (202) 632-8862. (This is not a toll-free number.)

SUPPLEMENTARY INFORMATION: On May 24, 2018, the President signed into law the Economic Growth, Regulatory Relief, and Consumer Protection Act (the Act), Public Law 115-174, 132 Stat. 1296. Section 309 of the Act, codified at 38 U.S.C. 3709, provides new statutory criteria for determining when, in general, VA may guarantee a refinance loan. The Act also requires, among other things, VA to promulgate regulations, within 180 days after the date of the enactment of the Act, for cash-out refinance loans, specifically those where the principal of the new loan to be VA-guaranteed or insured is larger than the payoff amount of the loan being refinanced. Pub. L. 115-174, 132 Stat. 1296.

Section 309(a)(2) of the Act permits VA to waive the requirements of the Administrative Procedure Act (APA), 5 U.S.C. 551 through 559, if the Secretary determines that urgent or compelling circumstances make compliance with such requirements impracticable or contrary to public interest. Pub. L. 115-174, 132 Stat. 1348-1349.

VA believes there are several urgent and compelling circumstances that make advance notice and comment on this rule contrary to the public interest. First, VA is concerned about lenders who seem to continue to exploit legislative and regulatory gaps related to seasoning, recoupment, and net tangible benefit standards, despite anti-predatory lending actions that VA and Congress have

already taken. VA's regulatory impact analysis for this rule indicates that perhaps more than 50 percent of cash-out refinances remain vulnerable to predatory terms and conditions until this rule goes into effect. VA believes that VA must immediately seal these gaps to fulfill its obligation to veterans, prudent lenders, and those who invest in securities that include VA-guaranteed loans.

VA is also gravely concerned about constraints in the availability of program liquidity if VA does not act quickly to address early pre-payment speeds for VA-guaranteed cash-out refinance loans. In large part, cashflows derived from investors in mortgage-backed securities (MBS) furnished by the Government National Mortgage Association (Ginnie Mae) provide liquidity for lenders that originate VA-guaranteed refinance loans. When pricing MBS, investors rely on pre-payment models to estimate the level of pre-payments and any resultant potential losses of revenue expected to occur in a set period, given possible changes in interest rates. These pre-payment models tend to drive, at least in significant part, the valuation of Ginnie Mae MBS. Ginnie Mae, buyers of VA-guaranteed loans, and other industry stakeholders have expressed serious concerns that early pre-payments of VA-guaranteed loans are devaluing these investments. See "Slowing Down VA Refi Churn Proving More Difficult Than Expected", National Mortgage News (November 12, 2018), <https://www.nationalmortgagenews.com/news/slowing-down-va-refi-churn-proving-more-difficult-than-expected>. If such stakeholders view MBS investments that include VA-guaranteed refinance loans as less desirable, even

prudent lenders could be deprived of the cashflows, i.e. liquidity, necessary to make new VA-guaranteed loans to veterans.

In a hearing before the House Veterans' Affairs Committee's Subcommittee on Economic Opportunity, the Government National Mortgage Association (Ginnie Mae) issued warnings to Congress regarding the ripple effects that risky refinancing practices had on the valuing of VA-guaranteed loans, as well as Ginnie Mae pools at-large. See *Hearing on Home Loan Churning Practices and How Veteran Homebuyers are Being Affected Before the Subcomm. on Econ. Opportunity of the House Comm. on Veterans' Affairs*, 115 Cong. (2018). Thus, VA believes that, unless VA promulgates rules quickly, a loss of investor optimism in the VA product could further restrict veterans from being able to utilize their earned VA benefits.

Exacerbating the issue is the lending industry's varied interpretation of the Act, which has led to lender uncertainty in how to implement a responsible cash-out refinance program. VA believes this uncertainty has caused prudent lenders to employ a high degree of caution, (e.g. refraining from providing veterans with crucial refinance loans that are not predatory or risky). Absent swift implementation of clear regulatory standards, cautious lenders are less likely to make cash-out refinance loans, which means that veterans do not enjoy the widest range of competitive, responsible credit options that can, when used properly, result in placing the veteran in a better financial position than the veteran's current circumstances afford. Unfortunately, such caution has the potential to compound the risk of predatory lending, as irresponsible lenders

have more opportunity to prey upon veterans by stepping into areas where prudent lenders may have stopped competing.

At the same time, VA is concerned that certain lenders are exploiting cash-out refinancing as a loophole to the responsible refinancing Congress envisioned when enacting section 309 of the Act. VA recognizes there are certain advantages to a veteran who wants to obtain a cash-out refinance, and VA has no intention of unduly curtailing veterans' access to the equity they have earned in their homes. Nevertheless, some lenders are pressuring veterans to increase artificially their home loan amounts when refinancing, without regard to the long-term costs to the veteran and without adequately advising the veteran of the veteran's loss of home equity. In doing so, veterans are placed at a higher financial risk, and the lender avoids compliance with the more stringent requirements Congress mandated for less risky refinance loans. Essentially, the lender revives the period of subprime lending under a new name.

VA does not plan to dispense with the notice and comment requirements altogether. Section 309(a)(2)(A)(ii) and (iii) of the Act requires VA, 10 days before publication of the final rule, to submit a notice of the waiver to the House and Senate Committees on Veterans' Affairs and publish the notice in the Federal Register. Pub. L. 115-174, 132 Stat. 1296. VA is complying with these requirements. Section 309(a)(2)(B) further requires VA to seek public notice and comment on this regulation if the regulation will be in effect for a period exceeding one year. Pub. L. 115-174, 132 Stat. 1296. VA anticipates the regulation will be in effect past the one-year mark. Therefore, VA is seeking

public comment on the interim final rule once it is published in the Federal Register.

Signing Authority

The Secretary of Veterans Affairs approved this document and authorized the undersigned to sign and submit the document to the Office of the Federal Register for publication electronically as an official document of the Department of Veterans Affairs. Robert L. Wilkie, Secretary, Department of Veterans Affairs, approved this document on November 19, 2018, for publication.

Dated: November 19, 2018

Jeffrey M. Martin
Assistant Director
Office of Regulation Policy & Management
Office of the Secretary
Department of Veterans Affairs

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