Report to Congress on Document Disclosure and Consumer Education

Department of Veterans Affairs
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Department of Veterans Affairs (VA)

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P.L. 115-174 § 309

Introduction

Section 309(d) of the Economic Growth, Regulatory Relief and Consumer Protection Act (the Act), P.L. 115-174, directs the Secretary of Veterans Affairs to issue a publicly available report, not less frequently than once each year, that examines the following, with respect to loans provided to Veterans under chapter 37, title 38, United States Code:

- The refinancing of fixed-rate mortgage loans to adjustable-rate mortgage loans;
- Whether Veterans are informed of the risks and disclosures associated with that refinancing; and
- Whether advertising materials for that refinancing are clear and do not contain misleading statements or assertions.

The report must also include findings based on any relevant complaints VA received from Veterans and the Secretary's assessment of the refinancing market. This report covers the period April 1, 2021, through February 28, 2022.

Background

Initial Concerns over Serial Refinancing/Loan Churning

The mission of VA's Home Loan Guaranty Service is to maximize opportunities for Service members and Veterans (collectively "Veterans") to obtain, retain and adapt their homes by providing viable and fiscally responsible benefits in recognition of the Veterans' service to our Nation.

For many years, VA has partnered with other Government agencies, including the Consumer Financial Protection Bureau (CFPB) and the Office of the Comptroller of the Currency to address lender advertising materials that contain misleading statements or assertions. In November 2016, CFPB released a report detailing over 12,500 mortgage complaints from Veterans. The complaints ranged in topics such as misleading loan solicitations and lenders continuously communicating with Veterans even after a cease contact request.

A considerable volume of the complaints centered on lenders soliciting Veterans on refinance loan products. As a result, in November 2017, VA and CFPB issued the first joint Warning Order to Veterans who had a VA-guaranteed loan. Specifically, the Warning Order advised Veterans of the dangers associated with refinance loans that inaccurately purport items such as extremely low interest rates, the ability to skip loan payments or provide cash back.

Also, in 2017, stakeholder concerns relating to misleading advertising and serial refinancing[1] of VA-guaranteed loans prompted multiple Congressional inquiries and briefings. In October 2017, VA and the Government National Mortgage Association (GNMA) established a joint task force to examine the frequency of loan churning and predatory lending practices, which included an examination of the aggressive and misleading refinancing propositions outlined in CFPB's November 2016 report.[2] On December 7, 2017, the VA-GNMA Task Force issued a GNMA All Participant Memorandum, which imposed a 6-month seasoning requirement for streamline and cash-out refinance loans to be eligible for certain GNMA securities. This action strongly discouraged lenders from soliciting Veterans immediately after a VA-guaranteed loan closing because of the lengthened seasoning requirement for GNMA securities.

Shortly thereafter, in January 2018, VA announced its plans to issue a proposed rulemaking addressing churning practices and predatory lending in the refinance loan market.[3] While the proposed rule was under development, VA sought to mitigate predatory lending practices by issuing administrative policy guidance. On February 1, 2018, VA published Circular 26-18-1, Policy Guidance for VA Interest Rate Reduction Refinance Loans (IRRRL).[4] The Circular advised lenders that certain loan disclosures should be provided early in the application process, such that Veterans could make informed decisions and determine if an IRRRL is in their financial interest.

On May 24, 2018, the President signed the Act into law. Section 309 of the Act, codified in part at 38 U.S.C. § 3709, provided new statutory criteria for determining when VA may guarantee a refinance loan. The Act required VA to promulgate regulations for certain cash-out refinance loans within 180 days (i.e., refinance loans where the principal balance of the new refinance loan is larger than the payoff amount of the loan being refinanced).

On December 17, 2018, VA published an interim final rule (AQ42) setting forth standards applicable to VA-guaranteed cash-out refinance loans.[5] The rule became effective on February 15, 2019, and applies to all cash-out refinance loan applications taken on or after that date. VA notes that this rule did not address the impact of the Act on VA-guaranteed IRRRL loans. VA plans to propose additional rulemaking on IRRRLs in the near future.

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[1] "Serial refinancing" and "loan churning" are used interchangeably and reflect the practice of refinancing a mortgage multiple times within a short timeframe. Serial refinancing negatively impacts Veterans, often through increasing the principal balance, stripping equity from the home and increasing the loan-to-value ratio which potentially raises the risk of loan default.

[2] VA Press Release: VA, Ginnie Mae Create Task Force to Address Mortgage Refinancing Issues (Oct. 12, 2017) https://www.va.gov/opa/pressrel/pressrelease.cfm?id=2962.

[3] Loan Guaranty: Revisions to VA-Guaranteed Refinance Home Loans. RIN 2900-AQ25. VA withdrew this proposed rulemaking in June 2018, following enactment of the Act.

[4] IRRRLs are also referred to as streamlined refinances. The terms are interchangeable in VA's program. https://benefits.va.gov/HOMELOANS/documents/circulars/26_19_22.pdf.

[5] Loan Guaranty: Revisions to VA-Guaranteed or Insured Cash-Out Home Refinance Loans. RIN 2900-AQ42, 83 FR 64459 (Dec. 17, 2018). https://www.federalregister.gov/documents/2018/12/17/2018-27263/loan-guaranty-revisions-to-va-guaranteed-or-insured-cash-out-home-refinance-loans.

Assessment of the Refinance Market

According to Freddie Mac's Primary Market Mortgage Survey, the 30-year fixed rate mortgage rate averaged 2.9% in the first half of 2021, a decline of approximately 20 basis points from a year earlier. Also, according to the Survey, during the first half of 2021, house prices rose 19.2% as "homeowners continued to take advantage of the low mortgage rates and increased homeowner equity to refinance their properties, reducing their monthly payments and extracting equity through cash-out refinances."

The Survey also stated that "borrowers who refinanced their first lien mortgages in the first half of 2021 lowered their mortgage rate on average by more than 1.20 percentage points" and "saved over $2,800 in mortgage payments (principal and interest) annually." Additionally, borrowers are opting for shorter terms and fixed-rate products when refinancing. "Of borrowers who refinanced in the second quarter of 2021, 30% shortened their term...[and] almost 100% of borrowers chose a fixed-rate product." Although mortgage rates remained near record lows in the first quarter of fiscal year (FY) 2022, VA agrees with Freddie Mac's forecasts that refinance volumes will slow "given the expected increase in mortgage rates."[6]

Refinancing Loan Activity and VA Oversight

VA observes that while many of the public comments received in response to AQ42 predicted a contraction of the cash-out refinance loan market due to increased regulatory requirements, VA's data do not reflect such concerns. For cash-out and other non-IRRRL refinance loans, volume contracted from 160,051 in FY 2018 to 145,188 in FY 2019. However, this downward trend did not continue, as VA guaranteed 156,330 of such refinance loans during FY 2020 and 165,871 cash-out loans during FY 2021. Cash-out refinance volume has increased significantly during the first half of FY 2022, with 102,381 loans guaranteed through February 2022. This trend represents an increase of over 86% fiscal year-over-year. Table 1 below describes the trend in VA-Cash-Out and Other Non-IRRRL Refinance Loans since FY 2015.

Table 1. VA Cash-Out and Other Non-IRRRL Refinance Loans Guaranteed by Fiscal Year

	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
Cash-Out/Other Refinancing	114,222	136,911	169,038	160,051	145,188	156,330	165,871

While VA cash-out refinance activity has remained relatively steady, the VA-guaranteed IRRRL (also known as a streamlined refinance loan) volume increased dramatically through FY 2021. Since passage of the Act in 2018, IRRRL volume increased over

[6] Freddie Mac's Quarterly Economic Forecast: January 21, 2022, https://www.freddiemac.com/research/forecast/20220121-quarterly-economic-forecast.

1,000% and VA guaranteed 831,824 IRRRLs in FY 2021. The increase in IRRRL volume in FY 2021 is likely attributable to record-low interest rates. See Table 2 below.

Table 2. IRRRLs Guaranteed by Fiscal Year

	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
IRRRLs	194,805	215,561	190,914	67,347	94,861	662,065	831,824

Due to the increasing interest rate environment, IRRRL volume is expected to trend downward in FY 2022. Through February 2022, VA has guaranteed 114,675 IRRRLs, a decrease of over 73% fiscal year-over-year.

VA continues to systematically review IRRRLs guaranteed, to assess compliance with the Act's statutory requirements regarding loan seasoning, net tangible benefits (i.e., interest rate requirements) and recoupment. VA implemented preventive controls in its system of records, to mitigate the risk of lenders incorrectly entering data for new VA-guaranteed loans and requires lenders to self-report non-compliant loans discovered through internal reviews.

On August 3, 2021, a report, *AWOL: How Watchdogs Are Failing to Protect Servicemembers from Financial Scams,* was published, alleging predatory lending practices and outlining recommendations specific to VA-guaranteed cash-out refinancing loans.[7] In response, VA conducted focused oversight on each of the lenders identified therein and discussed its findings with GNMA and CFPB. Oversight activities did not reveal violations of regulatory or statutory requirements or indicate any predatory lending practices. VA encourages legislation to provide VA broad statutory authority to address predatory lending and servicing practices as they occur.

VA's Examination of Fixed-to-Adjustable-Rate Loan Transactions

Transactions where a fixed-rate loan is refinanced to an adjustable-rate loan represent a small percentage of VA's guaranteed loan portfolio. Since enactment of the Act, VA guaranteed 1,721,560 IRRRLs and 623,390 cash-out refinance loans. Of those loans, less than 1% (1,056 loans) refinanced a fixed-rate loan to an adjustable-rate loan. For the period covered in this report, VA guaranteed 410,608 IRRRLs and 198,529 cash-out refinance loans. Of those loans, 155 loans refinanced a fixed-rate loan to an adjustable-rate loan.

Understanding the Risks of Fixed-to-Adjustable-Rate Loan Transactions

Adjustable-rate loans are often higher risk loans. Despite fixed-to-adjustable-rate transactions representing a small percentage of VA's guaranteed loan portfolio, VA

[7] https://porter.house.gov/uploadedfiles/va_home_loans_final.pdf.

focuses special attention to lending practices that target Veterans for such refinances. Generally, borrowers obtain adjustable-rate loans to aid in affording a home for a short period (i.e., 3 to 5 years). However, adjustable-rate loans have a higher risk of payment shock. An increase in the dollar amount that a Veteran owes for a monthly loan payment increases the probability that the Veteran will refinance again or even default. This increases the risk of serial refinancing or a foreclosure. Fixed-rate loans, on the other hand, provide a stable interest rate over the life of the loan and may provide more certainty in the long term.

Decreasing Veteran Risk Through Disclosure

Because of the increased risk associated with fixed-to-adjustable-rate loan transactions, VA believes it is imperative that Veterans fully comprehend the financial risks and outcomes associated with such refinances. Ensuring that clear information is provided to Veterans during the loan process helps Veterans better understand the financial implications of the refinance loan. These details enable Veterans to make more informed decisions about whether to proceed with the loan.

Before the Act was signed into law, VA required lenders to provide a loan comparison statement to Veterans who obtained IRRRLs. In conforming VA's cash-out refinance loan regulation to the Act, VA incorporated a similar disclosure requirement applicable to cash-out refinances. For cash-out loans, lenders must provide both a comparison statement and an equity statement to Veterans not later than 3 business days from the date of the loan application, and again at loan closing.[8] Requiring lenders to provide Veterans this information on two separate occasions enables Veterans to better understand the cash-out refinance transaction, including fixed-to-adjustable-rate transactions.

The comparison statement provides Veterans with up-front information about the overall cost of the new loan. This statement compares loan data and costs associated with the existing loan to the data and costs associated with the proposed refinance loan. The equity statement informs the Veteran of the amount of home equity that would be removed from the property due to the refinance. The disclosure also explains that removal of such equity may affect the Veteran's ability to sell the home in the future. A Veteran must certify that he or she received these disclosures on both occasions. VA provided a sample disclosure to assist lenders in satisfying this regulatory requirement.

In addition to implementing and enforcing its own disclosure requirement, VA reviews lender compliance with CFPB-required disclosures (e.g., those specifically related to adjustable-rate loans).[9] VA's oversight process includes sampling loans for Full File Loan Reviews. This process helps ensure that Veterans are provided with the required disclosures prior to closing. If, during these reviews, VA does not see evidence of CFPB-required disclosures, VA can refer the case to CFPB for potential action.

[8] See 38 C.F.R. § 36.4306(a)(3).
[9] See 38 C.F.R. § 36.4312(d)(6) and 12 C.F.R. § 1026.20(c) and (d).

Decreasing Veteran Risk Through Oversight of Advertising Material

Lender advertisements or solicitations, regardless of form, concerning VA-guaranteed loans must not include any information falsely stating or implying that such advertisements or solicitations were issued by, or at the direction of, VA or any other department or agency of the United States.[10] Lenders also cannot use such materials to falsely state or imply that the lender has an exclusive right to make VA-guaranteed loans.

VA routinely conducts audits to ensure that lenders comply with relevant Federal statutes, VA regulations and VA policies, including those relating to loan advertising materials. When VA learns of lenders who violate VA's advertising standards, VA can act against such lenders (e.g., withdraw a lender's ability to automatically close VA-guaranteed loans).[11] For the period covered in this report, VA's Loan Guaranty Service has not withdrawn a participating lender's automatic authority.

Veteran Education and Industry Training

On December 8, 2021, VA testified before the House Committee on Veterans' Affairs, Subcommittee on Economic Opportunity on Removing Barriers to Veteran Home Ownership. VA noted that industry education and training is essential to breaking misconceptions about the VA home loan. To that end, VA routinely meets with lenders and real estate professionals to advocate for VA's Home Loan program. On March 16, 2022, VA partnered with the National Association of Realtors® to record a 2-part series on misperceptions and the advantages of VA-guaranteed loans. VA is committed to continuing these efforts in the coming year.

VA is similarly focused on Veteran education and financial literacy. On May 3, 2021, VA's Loan Guaranty Service was featured on the Borne the Battle podcast to explain VA-guaranteed refinancing loans. This episode specifically addressed IRRRLs and equipped Veterans with questions to ask their lenders and ways to avoid predatory lending practices. In addition, VA has incorporated advice, on avoiding predatory lending practices, into the VA Transition Assistance Program (VA TAP). Led by VA benefits advisors, VA TAP helps prepare Service members transitioning to civilian life. VA is dedicated to improving Veteran awareness of the VA home loan and continues to work with other agencies on financial literacy programs.

VA Findings on Complaints

As noted previously, VA and CFPB issued a Warning Order in November 2017 that advised Veterans of the dangers associated with misleading solicitations and provided information on what to consider when receiving refinance materials from lenders. Both agencies published the Warning Order and took steps to disseminate the document

[10] See 38 C.F.R. § 36.4370.
[11] See 38 C.F.R. § 36.4353.

(i.e., sharing it on official social media platforms and informing news organizations, Veteran advocacy groups and lending industry trade groups of its publication).

CFPB's publicly available database[12] reflects the receipt of 298 complaints relating to VA-guaranteed loan applications during calendar year (CY) 2021. See Table 3 below.

Table 3. CFPB Complaints Related to VA-Guaranteed Loan Applications by Calendar Year

	CY 2018	CY 2019	CY 2020	CY 2021
Complaints	99	137	287	298

This is a 4% increase from 287 complaints in CY 2020. Of the complaints submitted in CY 2020, 9% (28 complaints) referenced misleading advertising and/or solicitation. The most common complaints related to unsolicited advertisements promising Veterans extremely low interest rates, the ability to "skip" payments and no out-of-pocket costs to refinance their loan. Another common complaint involved certain companies sending out mail that falsely appears to be from or affiliated with VA. The solicitations claim an urgent matter and to contact the sender immediately to refinance to a lower rate. More recently, from January 2022 through February 2022, CFPB received 25 complaints related to VA-guaranteed loan applications. None of these complaints referenced misleading advertising and/or unwanted solicitations.

During the period covered by this report, VA continued working with CFPB to mitigate deceptive advertising practices. On July 23, 2021, VA and CFPB posted a consumer fraud alert to provide Veteran-borrowers tips for spotting and avoiding VA home loan scams. VA advised borrowers to be wary of fraudulent calls and mailers that claim to be affiliated with the Government, VA or their home loan servicer, and provided resources for Veterans to report deceptive practices and scams.

Conclusion

VA and CFPB continue to inform Veterans that they might receive misleading solicitations from unscrupulous lenders. Both agencies are also continuing to assist Veterans in understanding the costs and benefits of refinancing their existing loans. VA encourages Veterans, lenders and industry stakeholders to contact VA about questionable advertising materials that they may read or receive.

Veterans who have questions about refinancing or other home loan issues may contact VA through email or telephone to speak directly with a VA representative. VA representatives are readily available to provide information to lenders and Veterans. The availability of VA Loan Specialists to assist Veterans and lenders reflects VA's

[12] CFPB Consumer Complaint Database. https://www.consumerfinance.gov/data-research/consumer-complaints/.

commitment to provide the highest level of customer service. Congress enacted section 309 of the Act, in part, to assist Veterans in securing refinance loans that are in their best financial interest. VA appreciates the opportunity to implement Congress's objective, thereby improving the financial wellbeing for Veterans.

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