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 March 1, 2022, through February 28, 2023.

Background

Initial Concerns over Serial Refinancing/Loan Churning

The mission of VA's 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, VA began developing a proposed rulemaking to address churning practices and predatory lending in the refinance loan market. While the proposed rule was under agency 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).[3] 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.[4] The rule became effective on February 15, 2019, and applies to all cash-out refinance loan applications taken on or after that date.

VA previously indicated its intention to undertake rulemaking activities on VA's streamlined refinance loan or IRRRL. On November 1, 2022, VA published a proposed rule[5] to address the impact of the Act on VA-guaranteed IRRRL loans. VA is currently completing an analysis of the public comments.

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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] https://www.benefits.va.gov/HOMELOANS/documents/circulars/26_18_1.pdf. IRRRLs are also referred to as streamlined refinances. The terms are interchangeable in VA's program.
[4] 83 FR 64459 (Dec. 17, 2018).
[5] 87 FR 65700 (Nov. 1, 2022).

Assessment of the Refinance Market

According to Freddie Mac's Primary Market Mortgage Survey, mortgage rates in 2022 increased "at the fastest rate since the early 1980s," which resulted in a rapid deceleration of origination activity as markets absorbed the impact of higher mortgage rates.[6] The report notes that although rates are not as high as they were in the 1980s, mortgage rates have nearly doubled in the past year. In the first half of 2021, the 30-year fixed rate mortgage rate averaged 2.9%, whereas rates averaged 6.94% in the week of October 20, 2022, and 7.08% in the week of November 10, 2022. Rates remained above 6% for the duration of the period covered by this report. Also, according to the survey, although house prices rose approximately 40% since 2020, the accelerated increase in interest rates has led to a market correction and, more recently, a modest decrease in housing prices.

Due to the rising mortgage rate environment, VA previously indicated an expected contraction of refinance volume starting in the second half of fiscal year (FY) 2022. This forecast was realized, and VA is experiencing a 99% fiscal year-over-year decrease in IRRRLs and a 63% fiscal year-over-year decrease in cash-out refinance loans (from October 2021 to March 2022 vs. October 2022 to March 2023). VA agrees with Freddie Mac's forecasts that refinance volumes will continue to remain low in 2023.[7]

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, although volume contracted from 160,051 in FY 2018 to 145,188 in FY 2019, volume quickly rebounded, and VA guaranteed 156,330 of such refinance loans during FY 2020 and 165,871 during FY 2021. In FY 2022, due to increasing property values spurred by competitive market conditions and the historically low interest rates in the first half of the fiscal year, VA non-IRRRL refinances surged, and VA guaranteed 207,777 of such loans.

Although the volume of refinances has decreased during the first half of FY 2023, the primary cause has been the rising interest rate environment. VA guaranteed only 33,739 refinances through end of month February 2023. This trend represents a decrease of 63% as compared to the same period in FY 2022. Table 1 on the next page describes the trend in VA-Cash-Out and Other Non-IRRRL Refinance Loans since FY 2015.

[6] Freddie Mac, *Quarterly Forecast: Rapidly Rising Rates & Declining Demand Driving a Housing Market Slowdown* (Oct. 2022), https://www.freddiemac.com/research/pdf/2022Q4-Forecast-04.pdf.
[7] Freddie Mac, *Mortgage Rates Continue Their Upward Trajectory* (Mar. 9, 2023), https://freddiemac.gcs-web.com/news-releases/news-release-details/mortgage-rates-continue-their-upward-trajectory.

Table 1. VA Cash-Out and Other Non-IRRRLs Guaranteed by Fiscal Year

	FY 2015	FY 2016	FY 2017	FY 2018
Cash-Out/Other Refinancing	114,222	136,911	169,038	160,051
	FY 2019	**FY 2020**	**FY 2021**	**FY 2022**
	145,188	156,330	165,871	207,777

Attributable to record low-interest rates, VA-guaranteed IRRRL (also known as a streamline refinance loan) volume increased dramatically throughout FY 2021. However, with the sharp increase in interest rates in FY 2022, IRRRL volume plummeted nearly 85% fiscal year-over-year. VA guaranteed 127,949 IRRRLs in FY 2022. Table 2 below describes the trend in VA IRRRLs since FY 2015.

Table 2. IRRRLs Guaranteed by Fiscal Year

	FY 2015	FY 2016	FY 2017	FY 2018
IRRRLs	194,805	215,561	190,914	67,347
	FY 2019	**FY 2020**	**FY 2021**	**FY 2022**
	94,861	662,065	831,824	127,949

Due to the high interest rate environment, IRRRL volume is expected to remain low in FY 2023. As with VA's non-IRRRL refinances, IRRRL volume decreased significantly during the first half of FY 2023, with only 588 loans guaranteed through February 2023. This trend represents a decrease of over 99% as compared to the same period in FY 2022.

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.

<u>VA's Examination of Fixed-to-Adjustable-Rate Loan Transactions</u>

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 has guaranteed 1,722,426 IRRRLs and 756,350 cash-out refinance loans (through end of month February 2022). Of those loans, less than 1% (1,472 loans) refinanced a fixed-rate loan to an adjustable-rate loan. For the period covered in this report, VA guaranteed 13,864 IRRRLs and 139,116 cash-out refinance loans. Of those loans, 416 loans refinanced a fixed-rate loan to an adjustable-rate loan. The rising rate environment has led to an increase in adjustable-rate mortgage loans. VA continues to monitor trends related to fixed-to-adjustable-rate transactions for predatory activity, but notes that rate reduction requirements imposed on refinancing loans, by the Act and AQ42, provide significant barriers for unscrupulous lenders.

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 focuses special attention on 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, Veterans who obtain 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 refinance, VA believes it is imperative that Veterans fully comprehend the associated financial risks and outcomes. 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 had already begun requiring 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. VA

[8] *See* 38 C.F.R. § 36.4306(a)(3).

requires lenders to obtain the Veteran's certification that the Veteran received these disclosures on both occasions.[9] VA provided a sample disclosure to assist lenders in satisfying this regulatory requirement.

In addition to implementing and enforcing its own disclosure requirement, VA requires lender compliance with certain CFPB-required disclosures (e.g., those specifically related to adjustable-rate loans).[10] 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.

<u>Decreasing Veteran Risk Through Oversight of Advertising Material</u>

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.[11] 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).[12] For the period covered in this report, VA's Loan Guaranty Service has not withdrawn a participating lender's automatic authority.

<u>Veteran Education and Industry Training</u>

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, industry groups and real estate professionals to advocate for VA's Home Loan program.

VA is similarly focused on Veteran education and financial literacy. In April 2022, VA published *The VA Home Loan Guaranty Buyer's Guide,*[13] a comprehensive guide for Veteran borrowers with advice on avoiding predatory lending practices. This guide has been incorporated into the Transition Assistance Program (TAP),[14] a program coordinated with the Department of Defense, Department of Labor and VA. TAP provides information, resources and tools to Service members and their loved ones to

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[9] *Id*.
[10] *See* 38 C.F.R. § 36.4312(d)(6); *see also* 12 C.F.R. § 1026.20(c) and (d).
[11] *See* 38 C.F.R. § 36.4370.
[12] *See* 38 C.F.R. § 36.4353.
[13] VA, The VA Home Loan Guaranty Buyer's Guide, https://www.benefits.va.gov/HOMELOANS/documents/docs/VA_Buyers_Guide.pdf (last visited May 4, 2023).
[14] TAP, https://www.benefits.va.gov/transition/tap.asp (last visited May 4, 2023).

help prepare for the move from military to civilian life. Service members begin TAP 1 year prior to separation, or 2 years prior to retiring. 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 (i.e., sharing it on official social media platforms and informing news organizations, Veteran advocacy groups and lending industry trade groups of its publication).

VA and CFPB posted a follow-up consumer fraud alert on July 23, 2021,[15] to provide Veteran-borrowers tips for spotting and avoiding VA home loan scams. VA advised borrowers to be wary of fraudulent calls and mailers who claim to be affiliated with the Government, VA or their home loan servicer and provided resources for Veterans to report deceptive practices and scams.

CFPB's publicly-available database[16] reflects the receipt of 322 complaints relating to VA-guaranteed loan applications during calendar year (CY) 2022.

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

	CY 2018	CY 2019	CY 2020	CY 2021	CY 2022
Complaints	99	137	287	293*	322

*The 2022 report incorrectly reported the CY 2021 number as 298. Table 3 is updated to correctly reflect the CY 2021 CFPB complaints related to VA-Guaranteed Loan Applications.

This is a 10% increase from 293 complaints in CY 2021 (see Table 3 above). Of the complaints submitted in CY 2022, only 3% (11 complaints) referenced misleading advertising and/or solicitation, which is a decrease from 11% in CY 2021. The most common complaints related to unsolicited advertisements that promise Veterans unrealistically low interest rates, extreme reductions in monthly mortgage payments and "thousands of dollars" in cash-back to refinance their loan. Another common complaint involved solicitation letters that read "Report of Available Funds." The letter shows the approximate unpaid principal balance remaining on the loan and estimates the amount of equity a Veteran could "cash-out" of their home. Although these letters appear official, they are advertisements. This may be an effective solicitation strategy if property values

[15] VA, *Consumer fraud alert: Tips for avoiding VA home loan scams*, https://news.va.gov/92256/consumer-fraud-alert-tips-for-avoiding-va-home-loan-scams/ (last visited May 4, 2023).
[16] CFPB, *Consumer Complaint Database*, https://www.consumerfinance.gov/data-research/consumer-complaints/ (last visited May 4, 2023).

have appreciated, and the available funds number stated on the letter is high. As with previous years, some advertisements 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 2023 through March 2023, CFPB received 49 complaints related to VA-guaranteed loan applications, two of which referenced misleading advertising and/or unwanted solicitations.

As a result of continued deceptive mortgage advertising practices and unauthorized use of VA seals and Federal Housing Administration logos, in violation of a 2015 order, CFPB fined and made a recommendation to permanently ban a lender for continuing "to lie to military families by falsely implying government endorsement of its home loans."[17] VA will continue to work with CFPB and the VA Office of Inspector General, as appropriate, to address the aforementioned concerns.

Conclusion

VA and CFPB continue to inform Veterans 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 they may read or receive.

Veterans who have questions about refinancing or other home loan issues may contact VA through e-mail 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 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' objective, thereby improving the financial wellbeing for Veterans.

Department of Veterans Affairs
May 2023

[17] CFPB, *CFPB Shuts Down Mortgage Loan Business of RMK Financial for repeat Offenses Against Military Families* (Feb. 27, 2023), https://www.consumerfinance.gov/about-us/newsroom/cfpb-shuts-down-mortgage-loan-business-of-rmk-financial-for-repeat-offenses-against-military-families/.