MORTGAGE BANKERS ASSOCIATION

September 16, 2019

The Honorable Kathy Kraninger
Director
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, DC 20552

RE: Qualified Mortgage Definition Under the Truth in Lending Act (Regulation Z) [RIN: 3170-AA98]

Dear Director Kraninger:

The Mortgage Bankers Association (MBA)[1] greatly appreciates the opportunity to offer comments on the Consumer Financial Protection Bureau's (Bureau) Advanced Notice of Proposed Rulemaking (ANPR)[2] addressing the pending expiration of the Ability to Repay / Qualified Mortgage Rule's (ATR/QM Rule, or Rule) "Government-Sponsored Enterprise (GSE) Patch."[3]

The GSE Patch (or simply, "the Patch") has provided a crucial avenue for mortgage borrowers to obtain safe and sustainable loans unencumbered by the obsolete and burdensome requirements of Appendix Q. It has also allowed for creditworthy borrowers to receive more affordable credit through prudently underwritten loans that exceed the ATR/QM Rule's arbitrary 43 percent debt-to-income (DTI) ratio threshold. Expiration of the Patch without a defined plan to continue to serve these borrowers

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, DC, the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, credit unions, thrifts, REITs, Wall Street conduits, life insurance companies, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.

[2] 84 FR 37155, "Qualified Mortgage Definition Under the Truth in Lending Act (Regulation Z)," July 31, 2019. Available at: https://www.federalregister.gov/documents/2019/07/31/2019-16298/qualified-mortgage-definition-under-the-truth-in-lending-act-regulation-z.

[3] The "GSE Patch" is the common name for the ATR/QM Rule's temporary provision that provides QM status for loans eligible to be purchased or guaranteed by the Government-Sponsored Enterprises — Fannie Mae and Freddie Mac — under the conservatorship or receivership of the Federal Housing Finance Agency. See 12 C.F.R. §1026.43(e)(4)(ii)(A).

will have dramatic negative consequences for the housing market, resulting in more expensive or unavailable credit.

MBA offers the following comments to help guide the Bureau's work as it undertakes the process of determining how best to replace the Patch. The ANPR provided thought-provoking questions that raise a number of important issues. We present a detailed response below, but in sum we believe:

- Expiration of the Patch without necessary reforms to the existing QM general definition would cause significant disruption to the mortgage market.
- Expiration of the Patch may provide some benefits to the housing finance system by eliminating reliance on the GSEs' credit policies and allowing for a more diverse and stable market that encourages responsible innovation.
- The Bureau should make the following reforms to the QM standard before the expiration of the Patch to achieve the appropriate balance between the Bureau's dual statutory mandates, which require consumer protection and promotion of the availability of affordable credit.[4]
    - Eliminate the rigid 43 percent DTI ratio threshold and Appendix Q, or any reliance on it as a documentary standard.
    - If the Bureau retains a DTI ratio threshold despite it not being strongly predictive of repayment ability, allow for the use of other government-approved documentation and verification standards to determine DTI ratios in addition to Appendix Q.
- The reforms described above do not undermine the crucial product feature limitations embedded in the ATR/QM Rule or impact the safe harbor that allows lenders to understand the scope of their liability.
- Any changes to the ATR/QM Rule should be communicated clearly and provide sufficient implementation time to minimize market disruption and consumer confusion.

The comments that follow illustrate these points, as well as the importance of ensuring that broad, sustainable credit remains accessible within the QM standard following the expiration of the Patch.

[4] 12 U.S.C. §5511(a).

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Estimated Market Impact of the GSE Patch Expiration

Since its inception, the GSE Patch has served a crucial role in the mortgage market. By providing an exception to the strict 43 percent DTI ratio threshold and rigid income and debt verification requirements found in the QM general definition, the Patch has facilitated access to credit for the large segment of creditworthy borrowers whose DTI ratios exceed 43 percent or whose sources of income prevent qualification through Appendix Q.

In terms of loan volume, the impact of the Patch has been significant. Of the roughly 6.01 million closed-end first-lien residential mortgage loans originated in 2018, the Bureau's estimates suggest roughly one-sixth, or 957,000 loans representing a total of $260 billion in originations, benefited from the GSE Patch (see Figure 1).[5] A recent study by CoreLogic examining the composition of this segment — loans purchased by the GSEs that did not meet the requirements for origination under the QM general definition — found that nearly 80 percent had DTI ratios greater than 43 percent, while the remaining 20 percent were to borrowers with non-W-2 wage income (see Figure 2).[6]

The share of borrowers that depends on the GSE Patch will, according to the Bureau, "continue to comprise a significant proportion of mortgage originations through January 2021[.]" In fact, various trends suggest possible growth in the segment of borrowers currently served by the GSE Patch. For example, recent research conducted through the Internal Revenue Service's SOI Joint Statistical Research Program found the "share of the workforce with income from alternative, non-employee work arrangements has grown by 1.9 percentage points of the workforce from 2000 to 2016," with more than half of this growth attributable to the period from 2013 to 2016.[7] This segment of non-W-2 wage earners "now accounts for 11.8 percent of the workforce."[8] Such trends support the continued need to accommodate sustainable lending to this segment of borrowers after the expiration of the GSE Patch.

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[5] 84 FR 37159, "Qualified Mortgage Definition Under the Truth in Lending Act (Regulation Z)," July 31, 2019. Available at: https://www.federalregister.gov/documents/2019/07/31/2019-16298/qualified-mortgage-definition-under-the-truth-in-lending-act-regulation-z.

[6] Carroll, P., "Expiration of the CFPB's Qualified Mortgage "GSE Patch" – Part 1," CoreLogic Insights Blog, July 11, 2019. Available at: https://www.corelogic.com/blog/2019/07/expiration-of-the-cfpbs-qualified-mortgage-gse-patch-part-1.aspx. Note that the nearly 80 percent of loans with DTI ratios greater than 43 percent includes those to borrowers with only W-2 income and those to borrowers with non-W-2 sources of income.

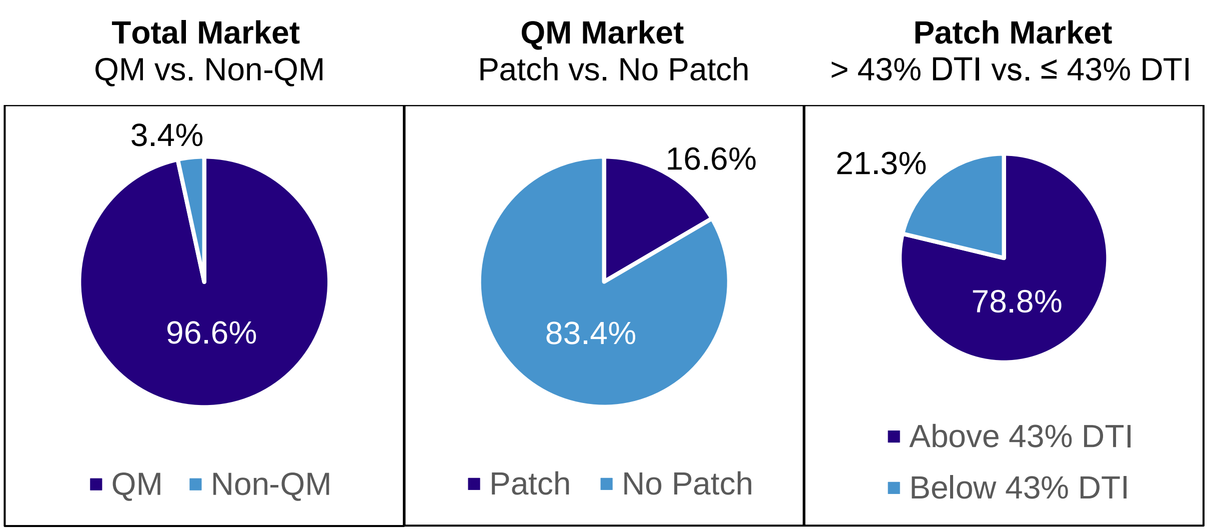
[7] Collins, B., Garin, A., Jackson, E., Koustas, D., and Payne, M., "Is Gig Work Replacing Traditional Employment? Evidence from Two Decades of Tax Returns," March 25, 2019 at pg. 1. Available at: https://www.irs.gov/pub/irs-soi/19rpgigworkreplacingtraditionalemployment.pdf.

[8] Id. at pg. 3.

Figure 1: Estimated Composition of 2018 Originations[9]

CATEGORY OF LOAN	% OF TOTAL MARKET
QM	**96.6**
Patch	***16.0***
Above 43% DTI Ratio	*12.6*
Safe Harbor	12.0
Rebuttable Presumption	0.6
Below 43% DTI Ratio	*3.4*
Safe Harbor	3.2
Rebuttable Presumption	0.2
No Patch	***80.6***
Above 43% DTI Ratio	*12.0*
Safe Harbor	11.4
Rebuttable Presumption	0.6
Below 43% DTI Ratio	*58.0*
Safe Harbor	55.3
Rebuttable Presumption	2.7
Small Creditor	*10.6*
Non-QM	**3.4**

Figure 2: Select Estimated Comparisons of 2018 Originations[10]



[9] Carroll, P., "Expiration of the CFPB's Qualified Mortgage "GSE Patch" – Part 1," CoreLogic Insights Blog, July 11, 2019. Available at: https://www.corelogic.com/blog/2019/07/expiration-of-the-cfpbs-qualified-mortgage-gse-patch-part-1.aspx.

[10] Id.; MBA calculations.

GSE Patch Expiration without Reforms: Four Problematic Options

Absent appropriate action to address the expiring GSE Patch, there are four potential outcomes for the market segment currently obtaining QM status by virtue of the Patch. Loans to these borrowers could be:

1. originated as non-QM loans, and either held in portfolio or sold to secondary market investors;
2. originated as QM loans under the Rule's Small Creditor Portfolio QM category;
3. originated as Federal Agency QMs under the Federal Housing Administration (FHA), Rural Housing Service (RHS), and Veterans Administration (VA) categories; or
4. not originated.

As the following discussion explains, these options are poor substitutes for the GSE Patch they would replace and demonstrate the necessity to reform the QM standard before the expiration of the Patch.

Non-QM Loans: Limited Capacity, Higher Costs

While loans currently originated as QMs under the Patch could be originated as non-QM loans, data on the extent of non-QM lending suggests such an outcome is unlikely at significant scale. Contrary to the Bureau's expectations, the Rule's features, particularly the GSE Patch, did not leave room for the development of a "'robust and sizable market' for non-QM loans beyond the 43 percent DTI ratio threshold."[11]

Several features of the non-QM market contribute to the overall low volume of non-QM lending, such as increased legal and regulatory risk, as well as the risk retention requirements of the Qualified Residential Mortgage standard. Absent the legal protection afforded QM loans, non-QM lenders or subsequent transferees are subject to heightened risk of possible borrower claims and, in a foreclosure action, defenses under the Rule's ability to repay provisions. In addition to legal risk, holders of non-QM loans may be subject to heightened capital requirements under various credit risk retention rules.

Legal uncertainty and less beneficial capital treatment partially explain the limited secondary market appetite for non-QM loans. While growing, volume for private

[11] Consumer Financial Protection Bureau, "Ability-to-Repay and Qualified Mortgage Rule Assessment Report," January 2019 at pg. 26. Available at: https://files.consumerfinance.gov/f/documents/cfpb_ability-to-repay-qualified-mortgage_assessment-report.pdf.

securitizations remains small, with estimates showing issuance of private-label residential mortgage-backed securities (RMBS) accounting for approximately 5 percent of the overall RMBS market.[12]

Estimates of the size of the non-QM market vary, but all such estimates show the non-QM market to represent a small fraction of the total single-family market. Research conducted by CoreLogic places non-QM volume in 2018 at approximately $55 billion, or 3.4 percent of mortgage origination volume.[13] This relatively low volume is consistent with the results of a lender survey conducted as part of the Bureau's recent *Ability-to-Repay and Qualified Mortgage Rule Assessment Report* (Assessment). Of the lenders surveyed, 30 percent did not originate non-QM loans. Of the lenders that did originate non-QM loans, "the majority indicated that the share of such loans among their originations was low, less than 5 percent."[14]

Absent sufficient private capital to fund a greater volume of non-QM loans, lenders have been reluctant to originate non-QM loans. Based on the CoreLogic estimate, the non-QM market would need to grow approximately sixfold to absorb the roughly $260 billion in originations currently dependent on the GSE Patch. While it would not be necessary for the non-QM market to fill the entire market void left by the expiration of the Patch, it is unlikely that the non-QM market could scale up so rapidly as to account for any significant share in the short term.

Given lenders' reluctance to originate non-QM loans in the years since the Rule became effective, it is unrealistic to view non-QM lending as a feasible substitute for the GSE Patch in the short term. Moreover, should the expiration of the GSE Patch prompt growth in the non-QM market, it would likely do so at the expense of borrower affordability. The Assessment found non-QM loans were priced at an estimated 119 basis points higher than similar safe harbor QM loans.[15] Such a result would be inconsistent with the Rule's underlying statutory purpose to ensure consumer access to affordable mortgage credit.

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[12] Urban Institute, "Housing Finance at a Glance: A Monthly Chartbook," August 2019. Available at: https://www.urban.org/sites/default/files/publication/100866/august_chartbook_2019_0.pdf.

[13] Carroll, P., "Expiration of the CFPB's Qualified Mortgage "GSE Patch" – Part 1," CoreLogic Insights Blog, July 11, 2019. Available at: https://www.corelogic.com/blog/2019/07/expiration-of-the-cfpbs-qualified-mortgage-gse-patch-part-1.aspx.

[14] Consumer Financial Protection Bureau, "Ability-to-Repay and Qualified Mortgage Rule Assessment Report," January 2019 at pg. 127. Available at: https://files.consumerfinance.gov/f/documents/cfpb_ability-to-repay-qualified-mortgage_assessment-report.pdf.

[15] Id. at 198.

Small Creditor Portfolio QM Loans: Limited Capacity, Un-level Playing Field

Another possibility is for loans currently originated as QMs under the Patch to be originated as QMs under the Rule's Small Creditor Portfolio QM standards. While this option would allow lenders to avoid the risks associated with non-QM lending, other drawbacks, including limits on capacity and market fairness concerns, make the Small Creditor Portfolio QM an unsuitable replacement for the GSE Patch.

The Rule's Small Creditor Portfolio QM standards provide an opportunity to originate QM loans that does not depend on borrower DTI ratios or Appendix Q. This QM category is only available to "small creditors," defined as lenders with less than $10 billion in assets. Further, Small Creditor Portfolio QM loans must be held in portfolio, generally permanently, although for lenders with assets under $2.167 billion, the retention requirement is a minimum of 3 years.[16]

Due to these creditor size and loan retention requirements, the number of lenders eligible to originate Small Creditor Portfolio QMs is limited. Further, as these loans must be held in portfolio and there is an asset cap on the size of the institutions that can originate these loans, the number of lenders eligible to originate Small Creditor Portfolio QMs would shrink over time if this product were widely utilized.

While it is difficult to determine the capacity of lenders who meet the Small Creditor Portfolio QM criteria, estimates indicate that in 2018, originations under the Small Creditor Portfolio QM category represented one-tenth of the mortgage market.[17] It is unlikely that these lenders could, in the near term, increase their capacity by more than 150 percent so as to absorb the volume potentially displaced by the expiration of the GSE Patch. If these lenders did expand their production to meet this void in the market, they could increase their interest rate risk through much larger holdings of fixed-rate loans.

Moreover, the vast majority of current origination volume is attributable to lenders with assets greater than $10 billion and/or to non-depository lenders (i.e., independent mortgage lenders with limited ability to hold loans). Disadvantaging

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[16] There are two categories of Small Creditor Portfolio QMs. Eligibility for the original Small Creditor Portfolio QM is limited to creditors with assets below $2.167 billion as of December 31, 2018 and annual volume of no more than 2,000 covered transactions. Under this category, loans must be held in portfolio for a minimum of 3 years. See 12 C.F.R. § 1026.43(e)(5). The second category, authorized by the Economic Growth, Regulatory Relief, and Consumer Protection Act, extends QM status to certain loans originated by a depository institutions with assets under $10 billion. These loans must be held in portfolio for the life of the loan. See 15 U.S.C. 1639c(b)(2).

[17] Carroll, P., "Expiration of the CFPB's Qualified Mortgage "GSE Patch" – Part 1," CoreLogic Insights Blog, July 11, 2019. Available at: https://www.corelogic.com/blog/2019/07/expiration-of-the-cfpbs-qualified-mortgage-gse-patch-part-1.aspx.

these lenders while they serve such a large market segment would adversely affect credit access and affordability, a result contrary to the Rule's purpose. In addition, relying on the Small Creditor Portfolio QM would provide an advantage to those lenders able to satisfy the category's asset size and loan retention requirements. Such an un-level playing field would be inconsistent with the Rule's goal to encourage a fair and competitive market for mortgage credit.

Federal Agency QM Loans: Greater Taxpayer Risk, Higher Costs

Loans ineligible to be originated under the QM general definition also could be originated as Federal Agency QMs. Under this QM category, loans guaranteed or insured by FHA, RHS, or VA receive either safe harbor or rebuttable presumption QM status. As with the options previously discussed, the drawbacks associated with the Federal Agency QM category make it a poor substitute for the GSE Patch.

Relying on the Federal Agency QM category to replace the Patch would have clear negative implications for borrower choice and credit affordability. Eligibility for loans insured by RHS or VA is restricted, limiting the ability of these programs to absorb the housing finance needs of borrowers currently benefiting from the Patch. This leaves FHA loans as the only widely available Federal Agency QM option. For most borrowers, a shift from GSE loans to FHA-insured loans would be costly. Unlike GSE credit policies, which only require mortgage insurance for loans with high loan-to-value ratios, all FHA borrowers are subject to life-of-loan mortgage insurance requirements. Other product differences, including pricing structures, make FHA-insured loans generally more expensive than comparable products offered by the GSEs. On average, these costs amount to an additional $100 per month.[18] Further, servicing requirements for FHA-insured loans are much more burdensome than the requirements for loans purchased by the GSEs. These differences are particularly impactful in the loss mitigation context, meaning an FHA borrower facing financial difficulties may face greater challenges in receiving a loan modification than a similarly situated GSE borrower.

Finally, driving more loans to FHA would do nothing to limit taxpayer exposure to mortgage credit risk since FHA loans benefit from government insurance. While FHA-insured loans are excellent products for many borrowers, FHA volumes should be based primarily on the needs of the borrowers that the program is designed to serve and the desire for a countercyclical market balance, particularly during periods of market stress. FHA volumes should not reflect regulatory uncertainties in the broader mortgage market.

[18] Kroll Bond Rating Agency, "Potential Effects of the GSE Patch Expiration," September 11, 2019 at pg. 4. Available at: https://www.krollbondratings.com/show_report/23589.

Loans Not Made: Harm to the Entire Market

Finally, it is possible that the options previously discussed prove too costly or are otherwise unavailable for some borrowers currently served by the GSE Patch. If lenders are unable to qualify for or originate QM loans under the Small Creditor Portfolio Rule, unwilling to originate or purchase non-QM loans, and/or unable to serve borrowers through an agency-insured or -guaranteed mortgage, it is very possible they simply will not originate the loan. Under this scenario, the expiration of the GSE Patch would remove a significant number of borrowers from the mortgage market. At roughly one-sixth of the overall mortgage market, eliminating even a portion of this segment would have harmful effects on access to credit generally and significant economic implications, extending well beyond the housing market. Given the Bureau's mandate to ensure access to financial opportunity, such an outcome should be avoided when considering how to change the QM standard to address the expiration of the Patch.

Market Segment Impacted by the GSE Patch Expiration

According to Bureau estimates, in 2018 the GSEs purchased approximately 957,000 loans — roughly $260 billion in originations — that, due to DTI ratio or income source, were ineligible for QM status under the general definition. Should the GSE Patch expire without an adequate replacement, these borrowers would be excluded from the credit affordability and choice the GSE Patch provides. Several studies attempt to estimate the demographic composition of this group by matching Home Mortgage Disclosure Act (HMDA) data to GSE loan application data. These studies indicate that low- and moderate-income and minority borrowers account for a disproportionate share of GSE loans with DTI ratios greater than 43 percent.[19] Based on this finding, we believe it is likely that these populations would be disproportionality harmed by the expiration of the GSE Patch.

Analysis of recently released 2018 HMDA data supports this conclusion, as it demonstrates that a greater share of low- and moderate-income borrowers relies on loans with higher DTI ratios than is the case for high-income borrowers (see Figure 3).

Though this is perhaps expected or obvious, it does suggest that expiration of the Patch could have a disproportionate impact on these borrowers — many of whom are aspiring first-time homebuyers. Similarly, analysis of this data by reported

[19] Carroll, P., Expiration of the CFPB's Qualified Mortgage "GSE Patch" – Part 3," CoreLogic Insights Blog, July 23, 2019. Available at: https://www.corelogic.com/blog/2019/07/expiration-of-the-cfpbs-qualified-mortgage-gse-patch-part-3.aspx#_ftnref3; Goodman, L., "New Data Confirm the Urgency of Addressing the Expiration of the GSE Patch," Urban Institute, March 25, 2019. Available at: https://www.urban.org/urban-wire/new-data-confirm-urgency-addressing-expiration-gse-patch.

race/ethnicity suggests that minority communities are more reliant on loans with higher DTI ratios and thus may be more dramatically harmed by the expiration of the Patch (see Figure 4).

Figure 3: DTI Ratio Distribution of Home-Purchase, Owner-Occupied 2018 Originations by Income Category

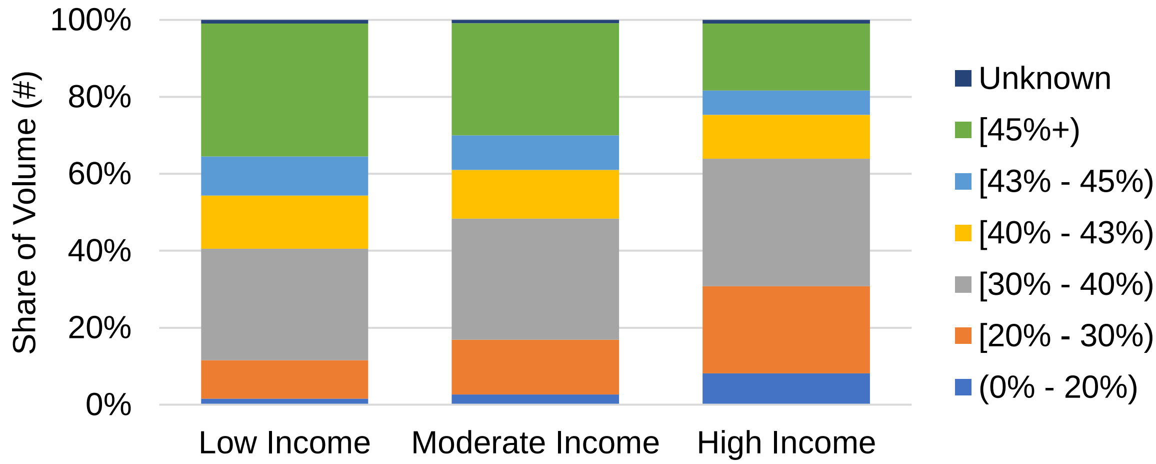
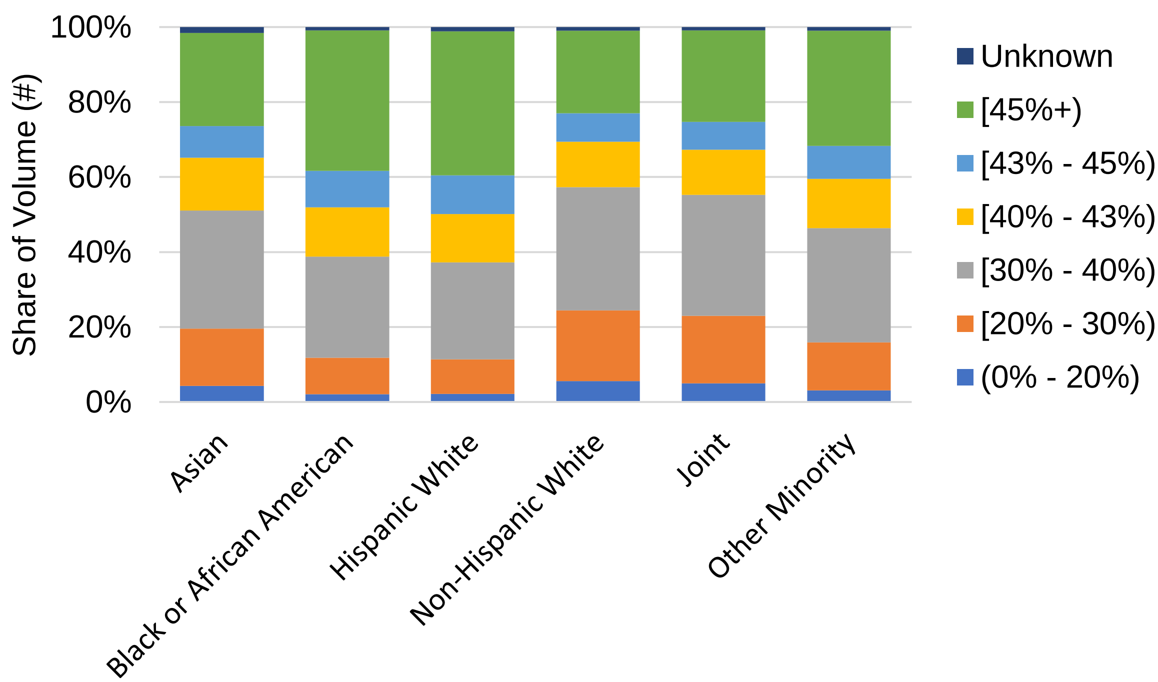


Figure 4: DTI Ratio Distribution of Home-Purchase, Owner-Occupied 2018 Originations by Race/Ethnicity Category



Long-Term Benefits of Replacing the GSE Patch

The Bureau proposed the Patch as a temporary measure to attempt to minimize the disruption to the mortgage market during a period of intense regulatory upheaval.[20] It was never intended to be a permanent feature of the QM standard, and its expiration — if carefully managed — will have long-term benefits. A thoughtful and appropriate revision of the ATR/QM Rule before the expiration of the Patch will allow the Bureau to ensure that the QM standard both acts as a clear bright line connoting ability to repay and allows for diverse capital sources to compete on a level playing field in the market.

Currently, the QM standard ties a large portion of the mortgage market to the credit policies of the GSEs and the ability to grant QM status to loans that obtain Fannie Mae or Freddie Mac automated underwriting system approval. This execution has provided two primary benefits to the industry by allowing loans to be made through widely dispersed underwriting technology and carefully calibrated underwriting standards. First, it has allowed lenders to determine DTI ratios through a more flexible and modern paradigm than the static requirements of Appendix Q.[21] Second, it has allowed for sustainable loans that exceed the Rule's 43 percent DTI ratio threshold to be made to creditworthy borrowers.[22]

While it has been undeniably beneficial, the Patch has created a strong linkage between the credit policies of the GSEs and QM compliance. Some investors believe that this has made it difficult for private capital sources to compete for similar loans. This execution advantage is compounded by the fact that any credit policy changes that the GSEs might institute would be immediately QM-compliant due to the presence of the Patch. Indeed, the Assessment identified how the growth in the GSEs' market share might be attributed to their dynamic underwriting standards. It is the fact that such innovation automatically received QM status that allowed the GSEs to benefit from this flexibility, in contrast to the rest of the market that remained in the

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[20] 78 FR 6408, 6534, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z)," January 30, 2013. ("The alternative definition of qualified mortgage recognizes the current market is especially fragile as a result of the recent mortgage crisis. It also recognizes the government's extraordinary efforts to address that crisis…The Bureau believes this temporary alternative definition will provide an orderly transition period, while preserving access to credit and effectuating the broader purposes of the ability-to-repay statute during the interim period.") Available at: https://www.federalregister.gov/documents/2013/01/30/2013-00736/ability-to-repay-and-qualified-mortgage-standards-under-the-truth-in-lending-act-regulation-z.

[21] The concerns with Appendix Q are discussed in detail below. See pages 15 to 18.

[22] The concerns with the 43 percent DTI ratio threshold are discussed in detail below. See pages 14 to 15.

static Appendix Q framework.[23] Private-label RMBS issuers and investors will have more incentive to compete if the QM standards are clear, flexible, and not linked explicitly to the credit policies of the GSEs.

The benefits of the Patch have always been conditional. The Patch is scheduled to expire either seven years from the QM implementation date or at the point at which the GSEs are no longer in conservatorship or receivership. Allowing the expiration of the Patch after a prudent revision of the ATR/QM Rule will increase long-term certainty in this market by separating the requirements of the Rule from the GSE reform process.

Concerns with the QM General Definition

Standalone DTI Ratio Threshold

Problems with the Pro-DTI Ratio Market Stability Argument

Housing market stability has occasionally been suggested as a justification for tying QM status to borrower DTI ratios. While the Rule is silent on this point, the argument is based on the idea that the DTI ratio threshold, currently at 43 percent, could be adjusted downward as a means to counter potential bubbles in the housing market. Though MBA strongly supports efforts to ensure housing market stability, altering the legal definition for what constitutes a QM loan is not an appropriate means to achieve this goal. It is an imprecise proxy for what it purportedly would be trying to achieve and instead would be an inappropriate assertion of the Bureau's statutory authority to attempt to regulate market forces.

Treating the QM definition in this way is inconsistent with the Rule's basic framework and the Bureau's statutory mandate as a consumer regulator. The Rule establishes a duty for the creditor to make a reasonable and good faith determination that the borrower has a reasonable ability to repay the loan. A creditor that originates a QM loan is presumed to have complied with the Rule's ability to repay requirement. The QM standard was created to provide necessary compliance certainty to creditors. This certainty, which depends on a clear and stable QM definition, is critical to the functioning of the mortgage market.

[23] Consumer Financial Protection Bureau, "Ability-to-Repay and Qualified Mortgage Rule Assessment Report," January 2019 at pg. 192-196. Available at: https://files.consumerfinance.gov/f/documents/cfpb_ability-to-repay-qualified-mortgage_assessment-report.pdf.

Problems with DTI Ratio as a Standalone Threshold

In crafting a framework to replace the expiring GSE Patch, it is important to remember what drove the Bureau's decision to create the Patch in the first place. As explained in the Rule, the Patch was created because the Bureau believed that the QM general definition, in particular its rigid 43 percent DTI ratio threshold, did not "[represent] the outer boundary of responsible lending[.]"[24] In other words, basing credit decisions solely on borrower DTI ratios would be under-inclusive, excluding far too many borrowers with a demonstrable ability to repay.

The Bureau recognized that the QM standard required greater flexibility to ensure consumer access to mortgage credit was not unreasonably restricted. To provide this flexibility, the Bureau created the Patch, which leverages the GSEs' underwriting expertise to extend QM lending to a broader segment of creditworthy consumers using a more comprehensive set of underwriting considerations. Along with promoting consumer access to mortgage credit, the decision to adopt widely-used GSE underwriting standards served the additional regulatory objectives of facilitating compliance and reducing implementation costs.[25]

These considerations remain crucial today. To avoid unnecessary disruption in the post-GSE Patch market, any replacement for the GSE Patch must allow for underwriting flexibility. A strict DTI ratio threshold, regardless of where the line is ultimately drawn, fails this requirement. Further, an approach that bases QM eligibility strictly on DTI ratios would be inconsistent with industry underwriting practices. Rather than relying on a single determinative factor, lenders' credit decisions depend on an increasingly broad array of underwriting factors, an approach that has proven effective in producing a more accurate borrower credit profile.

Along with restricting access to credit, a QM standard centered on DTI ratios is inappropriate for a more fundamental reason: DTI ratios are not a strong predictor of a borrower's ability to repay. More specifically, the relationship between borrower DTI ratios and ability to repay, as indicated by "early delinquency,"[26] is relatively weak.[27] An assessment of historical Fannie Mae loan performance data conducted by the

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[24] 78 FR 6408, 6527, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z)," January 30, 2013. Available at: https://www.federalregister.gov/documents/2013/01/30/2013-00736/ability-to-repay-and-qualified-mortgage-standards-under-the-truth-in-lending-act-regulation-z.

[25] Id. at 6533.

[26] Defined here as the percentage of loans becoming 60 or more days past due over the first two years following origination.

[27] Various industry studies have shown that factors such as cash reserves and residual income are significantly more predictive of future borrower default.

Urban Institute found that moving from the 40-45 percent DTI ratio range to the 45-50 percent range represented just a 7.7 percent increase in loan default risk when controlling for other relevant factors.[28] As the Center for Responsible Lending notes when discussing the practical import of this increase, "DTI is so weakly predictive for near-prime loans that for a thousand borrowers between 45% and 50% DTI, just two additional borrowers default, not nearly enough to warrant denying QM protections to the remaining borrowers."[29]

Recent research produced similar findings. A study on the effects of the Rule found that had the 43 percent DTI ratio threshold been in effect after 2004, "the policy would have reduced the five-year default rate by about 0.2 percentage points for loans originated in 2007 and 2008," a minor improvement considering "the 2007 cohort of loans experienced default rates as high as 24 percent after five years[.]"[30] This conclusion is consistent with research conducted by the JPMorgan Chase Institute that found that borrowers' financial buffers are significantly more indicative of their ability to repay than DTI ratios at origination.[31]

Appendix Q

In addition to affording QM status to non-government loans with DTI ratios above 43 percent, the other primary benefit of the Patch has been to obviate the need for creditors to follow the standards for determining consumer income and debt found in Appendix Q of the ATR/QM Rule.

Because the Rule includes a DTI ratio threshold for loans ineligible for government insurance/guarantees or the Patch, the Bureau needed to provide creditors with uniform standards to calculate such DTI ratios. In doing so, the Bureau relied on FHA manual underwriting guidelines in place at the time.

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[28] Golding, E., Goodman, L., and Zhu, J., "Fannie Mae Raises the DTI Limit: A Win for Expanding Access to Credit," Urban Institute, July 2017 at pg. 7. Available at: https://www.urban.org/sites/default/files/publication/91936/fannie_mae_raises_dti_limit.pdf.

[29] Stein, E. and Calhoun, M., "A Smarter Qualified Mortgage Can Benefit Borrowers, Taxpayers, and the Economy," Center for Responsible Lending, July 2019, at pg. 9. Available at: https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-a-smarter-qualified-mortgage-july2019.pdf.

[30] DeFusco, A., Johnson, S., and Mondragon, J., "Regulating Household Leverage," May 7, 2019 at pg. 7. Available at: https://ssrn.com/abstract=3046564 or https://cepr.org/sites/default/files/Johnson%2C%20Stephanie.pdf.

[31] Ferrell, D., Bhagat, K., and Zhao, C., "Falling Behind: Bank Data on the Role of Income and Savings in Mortgage Default," JPMorgan Chase & Co. Institute, October 2018 at pg. 14. Available at: https://www.jpmorganchase.com/corporate/institute/insight-income-shocks-mortgage-default.htm.

As an initial matter, the standards used in Appendix Q were widely understood to be in need of revision at the time of their adoption as the sole method for satisfying the income and debt verification requirements in the QM general definition. In any case, the use of static income and debt calculation standards that are codified in regulation quickly became problematic for the market. Reliable approaches to documenting income and debt have advanced dramatically in the years since the Rule was finalized, in large part because of developments responding to changing economic and demographic dynamics.

For example, creditors regularly utilize processes that leverage automation, algorithms, and optical character recognition to scan and understand consumer bank statements and related documents in order to verify income and debt more quickly and accurately. These processes reduce the need for consumers to provide duplicative or unnecessary documents, lessening the burden on both creditors and consumers while also reducing the incidence of fraud. When forced to comply with the outdated Appendix Q standards, creditors often must require and review such superfluous documents.

Similarly, the nature of income and debt has changed for many consumers in recent years. In particular, income derived from self-employment, part-time employment, and “gig economy” employment has grown as a share of overall income, with many consumers relying on such income to partially or fully cover their housing expenses. In response to these broader economic shifts, the mortgage industry has improved its ability to document and verify this income. For loans that require use of the Appendix Q standards, though, creditors are often unable to count such income as “qualifying” for the purposes of mortgage underwriting.

As a result of their static nature, the Appendix Q standards have become severely misaligned with established industry standards for calculating income and debt. For example, the Appendix Q standards provide a poor measurement of consumer cash flow, leading to a less accurate assessment of ability to repay monthly obligations. Many relevant add-backs to and subtractions from income are not considered in the Appendix Q standards. Inflexible guidelines regarding the timing and history of various sources of income also prevent legitimate consumer resources from being considered by the creditor.

A notable problem with the static nature of Appendix Q is that it prevents creditors from using updated documentation in response to changes in federal tax law. For example, the Tax Cuts and Jobs Act, which was enacted in late 2017, eliminated deductions for unreimbursed employee expenses for certain filers.[32] Appendix Q, however, requires creditors to deduct these expenses from the borrower’s income.

[32] H.R. 1, the *Tax Cuts and Jobs Act*, Section 1312. Enacted into law on December 22, 2017.

Because the deduction cannot be taken by these filers, creditors cannot obtain or calculate the value of these expenses — making it impossible to know whether they are in full compliance with the Appendix Q standards.

In other situations, the Appendix Q standards impose rigid requirements that do not allow for the consideration of legitimate income. For example, it is common for borrowers to seek a purchase loan when they are moving to begin a new job. Under Appendix Q, these borrowers would need a non-revocable employment contract — something offered rarely by employers — in order for creditors to consider projected income from the new job. Another common example entails renovations on rental properties. If an owner of a rental property undertakes renovations on that property to boost his or her future rental income, the owner will typically incur a loss in that year. If the owner then attempts to obtain a mortgage (on his or her primary residence), no rental income can be considered because of the loss taken in the prior year.

These shortfalls in Appendix Q have a disproportionate impact on consumers with non-W-2 sources of income, including rental income, retirement income, or income from self-employment. They also more frequently fail to properly account for consumers, frequently older borrowers without employment income, who rely on proceeds from asset sales, or consumers with W-2 income that is heavily weighted toward bonuses or other “non-traditional” salary structures.

In contrast, other industry-accepted standards are updated frequently, making them far more dynamic and responsive to the needs of the market. Since the ATR/QM Rule took effect in January 2014, Fannie Mae, Freddie Mac, FHA, RHS, and VA have each issued dozens of updates, bulletins, mortgagee letters, and other amendments to their underwriting guides and handbooks. While these changes do not all relate to documentation and verification standards, they do illustrate the need for mortgage finance programs and underwriting standards to be regularly adjusted and fine-tuned to keep pace with an industry that continues to innovate.

Modernization of the Appendix Q standards through the rulemaking process may alleviate some of these concerns, but the revised standards would surely become outdated once again shortly after they were implemented. As the industry and the economy continue to evolve, mortgage underwriting needs to keep pace to adequately serve a broad spectrum of consumers in a responsible manner. This flexibility is simply not possible when a requirement such as Appendix Q is only reviewed and updated every few years. The mortgage industry is dynamic, and it requires regulations and guidelines that are equally dynamic.

These various concerns with the Appendix Q standards have served to further dissuade creditors from offering or producing loans that achieve QM status outside of government insurance/guarantees or the Patch, as discussed above. This outcome disproportionately affects borrowers with very low, low, or moderate incomes and lower loan amounts. The lack of broad industry adoption has resulted in the lack of an established compliance framework for the Appendix Q standards. Creditors therefore experience uncertainty in interpreting many Appendix Q provisions, leading to inconsistent credit decisions for similarly situated consumers. This confusion is also evident in the differing interpretations of the Appendix Q standards put forth by third-party due diligence providers that review non-agency loans.

Taken together, the problems with the Appendix Q standards are likely to produce significant market disruptions if not addressed before the expiration of the Patch. Many consumers who access responsible mortgage credit today would be unable to obtain a loan with QM status, which could raise their borrowing costs or impede their access to credit entirely. Consumers who are self-employed or depend on non-W-2 sources of income — who represent a large and growing share of the workforce and the population — would be harmed disproportionately. These problems would only compound as the static Appendix Q standards grow more and more incompatible with the realities of the market and the economy.

Reforms to the QM General Definition

<u>DTI Ratio Threshold</u>

To better calibrate the QM standard with a reasonable reflection of a borrower’s ability to repay the loan, the Bureau should remove the 43 percent DTI ratio threshold as a standalone factor in the QM general definition. In doing so, the Bureau should prioritize options that provide clear standards for compliance and are simple for creditors to operationalize. The more complex the approach taken by the Bureau, the more market participants will pull back from serving the full spectrum of consumers due to legal uncertainty. This problem is evident today in the complexity associated with calculating DTI ratios under the Appendix Q standards — and the resistance of market participants to embrace the use of Appendix Q.

The use of DTI ratios as one factor among many in the mortgage underwriting process is a well-established and widely-accepted practice. DTI ratios have shown some limited predictive capacity with respect to loan performance, and they do represent an example of a direct measure of a consumer’s personal finances.

As is detailed above, however, DTI ratios are far less appropriate as a *standalone* threshold to determine whether a consumer has a reasonable ability to repay a loan at the time of consummation. DTI ratios are not dispositive of a consumer’s ability to repay; for example, there are high-risk loans with DTI ratios of 25 percent and low-risk loans with DTI ratios of 50 percent.

The use of DTI ratios in the QM general definition serves as a single-factor requirement for QM status. If the Patch were to expire without reforms, most non-government loans would have no path to achieving QM status if they feature DTI ratios above 43 percent.[33] This strict threshold places unwarranted emphasis on DTI ratios and their role in the underwriting process.

Below, we identify various options for removing and/or replacing the DTI ratio threshold. While each of these options has advantages and drawbacks, we firmly believe that each would represent an improvement over the current QM general definition.

Each of these options should be considered in light of the Bureau's dual statutory mandate to ensure both "that markets for consumer financial products and services are fair, transparent, and competitive" and "that all consumers have access to markets for consumer financial products and services."[34] The ideal approach will ensure that consumers are protected as contemplated by the ATR/QM Rule without restricting access to sustainable credit.

Remove the DTI Ratio Threshold

The simplest reform that the Bureau could undertake would be to remove the DTI ratio threshold. This approach would effectively set the parameters of the QM general definition as the various product feature requirements currently in place.[35]

Consumers would continue to have confidence that their ability to repay their loans was being considered appropriately in the design of their loan products. For example, the product feature requirements ensure that QM status is not granted to the types of loans that were associated with many abuses that took place during the financial crisis. Further, the differentiation between safe harbor and rebuttable presumption QMs would encourage loans to be made close to the average prime offer rate (APOR). While pricing is not a direct measure of a consumer's ability to repay, it is comprised of elements that holistically assess credit risk that make it a useful proxy. Together, the presence of product feature limitations and pricing thresholds for safe

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[33] Some loans held on portfolio by small creditors would obtain QM status due to the statutory exemption created in 2017.

[34] 12 U.S.C. §5511(a).

[35] Under the Truth in Lending Act, 15 U.S.C. §1639C(b), a QM is a residential mortgage loan which: does not have negative-amortization, interest-only, or balloon-payment features, a term that exceeds 30 years, or points and fees that exceed 3 percent of the loan amount; the consumer's income or assets are verified and documented; and the underwriting is based on the maximum interest rate during the first five years of the loan, uses a payment schedule that fully amortizes the loan over the loan term, and takes into account all mortgage-related obligations. See 15 U.S.C. §1639C(b).

harbor would govern creditor behavior and provide reliable guardrails to ensure sound origination practices.

This approach would also facilitate compliance by market participants, as these product feature requirements are generally well understood and include clear thresholds. Similarly, the need to calculate DTI ratios using the problematic Appendix Q standards would no longer present obstacles to loans qualifying for QM status.[36]

Such a construct would encourage lenders serving a wide population of consumers to follow the QM product parameters by eliminating the friction caused by varying sources of income. It would ensure that a broad set of consumers stood to benefit from the core QM product features that are an essential part of the ATR framework.

Institute a Compensating Factors Regime

The problems with a standalone DTI ratio threshold could be explicitly addressed by including other common underwriting factors in the QM general definition. While there are many variants of compensating factors, the basic premise is that QM status would be determined through a more holistic view of the consumer's personal finances and the features of the loan. This approach ensures that a DTI ratio is not the sole reason that a loan fails to achieve QM status.

For a compensating factors approach to be operationally feasible, it must include relatively simple features that are: 1) subject to "bright-line" thresholds that can be calculated with precision and 2) dynamic enough to accommodate market developments. Absent this design, creditors will face challenges similar to those they face with respect to the Appendix Q standards today. As discussed, this outcome would likely restrict access to credit for a broad range of consumers and could result in lender-by-lender inconsistencies.

To promote compliance certainty for creditors, the Bureau should use common data and decision standards, such as those used by the Mortgage Industry Standards Maintenance Organization (MISMO), to express its regulatory language. For example, expressing new requirements through the OMG® Decision Model and Notation® standard adopted by MISMO would reduce ambiguity, simplify implementation, and facilitate compliance across the industry.

[36] Appendix Q represents standards that offer a defined compliance route with regard to the requirements of 12 C.F.R. §1026.43(e)(2)(v). The numerous problems with Appendix Q remain in any context it is used, but to avoid inadvertently creating compliance uncertainty in removing the DTI ratio threshold and also Appendix Q, we recommend the Bureau replace references to Appendix Q outside the context of a regulatory DTI ratio determination (e.g., see 12 C.F.R. §1026.43(e)(2)(v)) with language directing the creditor to verify ability to repay using current federal agency or GSE underwriting guides.

Limit the DTI Ratio Threshold to a Subset of Loans

The Bureau may also determine that while a DTI ratio threshold is inappropriate for lower-risk prime or near-prime loans, there may be subsets of loans for which it prefers to include a direct measure of a consumer's personal finances. For example, loans with an annual percentage rate (APR) above a certain level relative to APOR may be viewed as "riskier," and a DTI ratio threshold would serve as a "check" on such loans, mitigating the effects of risk layering.

Again, the use of a DTI ratio threshold presents problems for both consumers and creditors, even if only applicable for certain loans. The extent to which this approach mitigates market disruptions will depend on the parameters set by the Bureau. The smaller the subset of loans to which the DTI ratio threshold applies, the smaller the expected market disruption.

Raise the DTI Ratio Threshold

Because a significant volume of non-government loans currently exceeds a 43 percent DTI ratio, the Bureau could mitigate a market disruption caused by the expiration of the Patch by raising the DTI ratio threshold to a higher level. This approach could better link the DTI ratio threshold to actual loan performance data, as the 43 percent threshold has not proven to be close to an inflection point with respect to delinquencies.[37]

As is noted above, though, the use of a standalone DTI ratio places too much weight on its utility in underwriting. All non-government loans would still be required to meet a DTI ratio threshold that serves as a gating mechanism for QM status.[38] This approach also does nothing to address the problems associated with the methodology for calculating DTI ratios. In addition, it sets another rigid requirement via Bureau rulemaking that is cumbersome to change and does not align with the dynamic nature of innovation within the industry.

As such, this approach does not provide for thorough reform of the QM general definition. Instead, it alleviates some portion of the expected market disruption that would occur if the Patch were to expire without any reforms. Much like the option to limit the DTI ratio threshold to a subset of loans, the level at which this disruption is mitigated would depend on the level at which the DTI ratio threshold is set and the

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[37] Kaul, K. and Goodman, L., "What, If Anything, Should Replace the QM GSE Patch?" Urban Institute, August 2018. Available at:
https://www.urban.org/sites/default/files/publication/98949/qualified_mortgage_rule_0.pdf.

[38] Some loans held on portfolio by small creditors would obtain QM status irrespective of DTI ratios due to the statutory exemption created in 2017.

extent of the necessary reforms to the calculation standard. It is also likely that such a solution would need to be updated periodically in the future, which is an inefficient method of addressing this problem.

Institute a Residual Income Test

If the Bureau feels it is necessary for the QM general definition to include a direct measure of a consumer's personal finances, it could explore alternatives to DTI ratios. A prominent example that is used in an existing federal guaranty program is a residual income test.

Residual income tests feature similar advantages and drawbacks as compensating factors regimes. In this approach, the gating mechanism — a consumer's remaining income in excess of that used for debt payments — may serve as a more accurate measure of ability to repay than the consumer's DTI ratio. The Bureau should conduct further analysis to better understand the relationship between residual income and DTI ratios, including the predictive capacity of each with respect to loan performance.

Like the compensating factors regime, the feasibility of a residual income test is dependent on the clarity of the required calculations. Without a simple framework that can be implemented by all creditors, this approach will likely result in curtailed access to credit for consumers.

Other Considerations Related to DTI Ratios

As will be discussed in greater detail below, any approach that maintains a DTI ratio threshold in the QM general definition — for all loans or only a subset of loans — must address the problems associated with the Appendix Q standards.[39]

Amendments to the DTI ratio threshold in the ATR/QM Rule should also ensure that certain types of creditors are not favored over other types of creditors. Reforms should be agnostic to the size or business model of the creditor, and should be

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[39] As is noted above, Appendix Q represents standards that offer a defined compliance route with regard to the requirements of 12 C.F.R. §1026.43(e)(2)(v). The numerous problems with Appendix Q remain in any context it is used, but to avoid inadvertently creating compliance uncertainty in removing the DTI ratio threshold and also Appendix Q, we recommend the Bureau replace references to Appendix Q outside the context of a regulatory DTI ratio determination (e.g., see 12 C.F.R. §1026.43(e)(2)(v)) with language directing the creditor to verify ability to repay using current agency or GSE underwriting guides. For bipartisan legislative proposals advocating a similar approach to address Appendix Q, see S. 540, the *Self-Employed Mortgage Access Act of 2019*, introduced by Senators Warner (D-VA), Rounds (R-SD), and Booker (D-NJ) on February 25, 2019, and H.R. 2445, the *Self-Employed Mortgage Access Act of 2019*, introduced by Representatives Emmer (R-MN) and Foster (D-IL) on May 1, 2019.

feasible for loans that are held in portfolio and seasoned as well as those that are sold into the secondary market shortly upon consummation.

Finally, once again, while there are advantages and drawbacks to these various approaches, all of the options discussed would be preferable to a scenario in which the Patch is allowed to expire without reforms.

Appendix Q

The continual evolution and technological innovation of mortgage underwriting allows for advances that improve consumer access to credit in a safe, responsible manner. It is clear that a static set of income and debt verification standards, codified in regulation and therefore difficult to update, cannot adequately support the market over time. Reforms that rely on simply updating Appendix Q via a rulemaking while not addressing this foundational problem are therefore insufficient.

To provide the market with the dynamic guidelines that are needed, the Bureau has two options:

- develop and maintain its own income and debt verification standards, or
- allow the use of existing income and debt verification standards maintained by other entities to calculate a DTI ratio subject to a threshold prescribed by the Bureau.

The first option would entail a significant undertaking for the Bureau. It would need to devote considerable staff resources to the initial development of a guide, as well as the regular maintenance of this guide. As was noted above with respect to the guides of other government agencies and GSEs, frequent updates are widely recognized as necessary to respond to a changing market. The Bureau would also need to devote dedicated staff to ongoing communication with creditors, as inevitable compliance questions arise.

In addition to the demands that would be placed on the Bureau, this option would create burdens for creditors and other market participants. Significant costs would be incurred to facilitate compliance, as this approach entails the creation of another set of partial underwriting standards, which would require resources on the part of creditors and other market participants to learn and understand.

Both of these problems would be well addressed by the second option described above, which would allow creditors to use certain existing income and debt verification standards for purposes of qualifying loans for QM status. To ensure that appropriate practices are followed and that the federal government maintains a role in setting and monitoring these standards, the Bureau should allow creditors to use standards set by federal government agencies or by GSEs overseen by federal government agencies to calculate a DTI ratio pursuant to the Bureau's statutory authority to determine a threshold for this ratio.[40]

Specifically, the Bureau should amend the QM general definition to allow alternatives to the Appendix Q standards.[41] These alternatives should be the standards set forth in guides or handbooks maintained by FHA, RHS, VA, Fannie Mae, or Freddie Mac.[42] Because Fannie Mae and Freddie Mac are privately-owned institutions, the use of their standards should be subject to approval by their regulator — the Federal Housing Finance Agency (FHFA).[43]

Such amendments to the ATR/QM Rule would provide many benefits to the market. Because the government and GSE standards are widely used and accepted, this option should result in quick industry adoption. Creditors would be able to leverage systems that are already in place, which would require little in terms of new infrastructure, processes, or training. In turn, this construct would facilitate a level playing field among creditors of varying sizes and business models while keeping new costs minimal. It would also result in the use of standards that are well understood by investors, thereby ensuring smooth implementation in the secondary market.

This approach also provides numerous safeguards against disruption to the market or deterioration of underwriting standards. Any creditor that wishes to use Appendix Q could continue to do so, as the government and GSE standards would serve as alternatives to, not replacements for, the Appendix Q standards. Each of these alternative standards also relies on approval and oversight by federal government agencies, which should alleviate concerns about private entities setting the terms of the QM general definition. For example, if a GSE were to promulgate standards that FHFA found to be inappropriate, FHFA could withhold or revoke approval for purposes of the QM general definition, in addition to any other supervisory actions that it would likely take.

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[40] 15 U.S.C. §1639c(b)(2)(vi).

[41] Such amendments should occur to both paragraph (e)(2)(v) and paragraph (e)(2)(vi) of 12 C.F.R. §1026.43.

[42] This approach is substantively identical to that of two bipartisan proposals recently introduced in the U.S. Congress. See S. 540, the *Self-Employed Mortgage Access Act of 2019*, introduced by Senators Warner (D-VA), Rounds (R-SD), and Booker (D-NJ) on February 25, 2019. See H.R. 2445, the *Self-Employed Mortgage Access Act of 2019*, introduced by Representatives Emmer (R-MN) and Foster (D-IL) on May 1, 2019.

[43] Amendments to the ATR/QM Rule should also ensure that the income and debt verification standards allowed for purposes of the QM general definition include those maintained by any additional guarantors that may be chartered by FHFA to compete with Fannie Mae and Freddie Mac, subject to approval by FHFA.

The Bureau has previously expressed some concern that an approach relying on alternative standards developed by outside parties could potentially be an impermissible delegation of authority. Courts have, however, recognized various ways in which federal agencies can rely on outside parties in carrying out regulatory responsibilities. In one case involving the Federal Energy Regulatory Commission (FERC), the Federal Power Act delegated authority to FERC to regulate all aspects of bandwidth calculation. FERC reviewed and accepted a “bandwidth formula” that incorporated state agencies’ depreciation rates.[44] The Louisiana Public Service Commission argued that the incorporation of depreciation rates approved by outside state agencies was an impermissible subdelegation of authority.[45] The Fifth Circuit disagreed, finding no unlawful subdelegation had occurred primarily “because FERC exercised its role when it initially reviewed and accepted the bandwidth formula incorporating the state agencies’ depreciation rates,” and further noting FERC’s determination that the rates were a “just and reasonable element of the bandwidth formula methodology.”[46]

In another case involving the Fish and Wildlife Service (FWS) within the Department of the Interior, Congress had delegated authority to the Secretary of the Interior to determine when controlling populations of migratory birds was permissible. FWS adopted a rule that authorized state fish and wildlife agencies, federally recognized tribes, and state directors of wildlife services programs to control populations of a certain type of migratory bird.[47] The Second Circuit rejected a challenge to the rule as an unlawful delegation of authority to outside parties, finding that the discretion granted to the third parties was limited to a certain type of bird and subject to oversight by the FWS, and thus did not constitute an impermissible delegation.[48]

Here, the Consumer Financial Protection Act granted broad authority to the Bureau to establish guidelines and regulations regarding ability to repay, including the definition of a “qualified mortgage.”[49] Allowing industry-accepted, government-approved

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[44] *Louisiana Public Service Comm’n v. F.E.R.C.*, 761 F.3d 540, 551 (5th Cir. 2014).

[45] Id.

[46] Id. at 552.

[47] *Fund for Animals v. Kempthorne*, 538 F.3d 124 (2d Cir. 2015).

[48] Id. at 132.

[49] See, e.g., 15 U.S.C. § 1639c(b)(2)(A) (defining “Qualified Mortgage” as, among things, a mortgage “that complies with any guidelines or regulations established by the Bureau relating to ratios of total monthly debt to monthly income or alternative measures of ability to pay regular expenses after payment of total monthly debt, taking into account the income levels of the borrower and such other factors as the Bureau may determine relevant and consistent with the purposes described in paragraph (3)(B)(i)”) (emphasis added); 15 U.S.C. § 1639c(a)(1) (“In accordance with regulations prescribed by the Bureau, no creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the

standards to serve as alternatives to Appendix Q is well within this authority and does not constitute an improper delegation of authority for several reasons. The proposed approach concerns only alternatives to Appendix Q and would not constitute the sole definition of a qualified mortgage. Appendix Q would remain as a standard promulgated by the Bureau for lenders to follow. The Bureau also has a reasonable basis for the proposed approach. It can review the current government-approved standards and has an established record of prior standards on which to base its decision. As also noted with respect to the GSE standards, a government agency (FHFA) oversees the activities and practices of the GSEs.

To the extent that the Bureau nonetheless continues to harbor reservations about delegation of authority issues, practical measures exist to further alleviate the concern. The Bureau could consider setting forth clear, bright line parameters that alternative standards would need to satisfy, at a minimum, to be considered acceptable for purposes of the QM general definition. For example, parameters concerning DTI ratios or residual income could be set that would still preserve the flexibility needed for the alternative standards to make the proposed approach effective. This approach would also be consistent with 15 U.S.C. § 1639c(b)(2)(A), which references Bureau guidelines or regulations "relating to ratios of total monthly debt to monthly income or alternative measures of ability to pay regular expenses after payment of total monthly debt" without going into more specificity about ability to repay analysis. The Bureau could also consider conducting a periodic review of the alternative standards to assess consistency with the purposes of the ability to pay statute and the appropriateness of continuing to use those standards. The timing and frequency of the reviews would need to take into account the market's need for stability, and could perhaps be set to occur every five years or some other period of sufficient length to provide adequate certainty to the market.

In order to incorporate dynamic income and debt verification standards into the QM general definition, the Bureau therefore should amend the ATR/QM Rule to allow industry-accepted, government-approved standards to serve as alternatives to the standards found in Appendix Q. These reforms will better ensure sustainable access to credit and clear guidelines for appropriate creditor consideration of consumer income and debt.

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time the loan is consummated, the consumer has a reasonable ability to repay the loan….") (emphasis added); 15 U.S.C. § 1639c(b)(3)(B)(i) ("The Bureau may prescribe regulations that revise, add to, or subtract from the criteria that define a qualified mortgage upon a finding that such regulations are necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of this section, necessary and appropriate to effectuate the purposes of this section and section 1639b of this title, to prevent circumvention or evasion thereof, or to facilitate compliance with such sections.") (emphasis added).

Other Reforms to the QM Standard

In addition to adopting an effective replacement for the expiring GSE Patch, MBA urges the Bureau to consider reforms to the Rule's "points and fees" requirements. Targeted amendments to the "small loan" threshold, the treatment of fees paid to lender-affiliated settlement service providers, and the creditor's right to cure will help lenders better serve the low- to moderate-income borrowers and borrowers in lower-cost housing markets that depend on smaller loans. Similarly, the Bureau should re-examine the QM safe harbor threshold in light of differences in the regulatory treatment of varying creditors and loan executions.

Small Loan Threshold

Under the Rule's points and fees provisions, loans under the "small loan" threshold are permitted to have points and fees in excess of 3 percent. When presented with an application exceeding the points and fees limit, creditors must choose between denying the loan, absorbing a loss, or making a non-QM loan that is subject to a less liquid secondary market and that, as noted above, also presents substantial litigation risk if the borrower defaults. These options discourage creditors from making small loans, which can have a disproportionate impact on low- to moderate-income borrowers and borrowers in lower-cost housing markets seeking these loans.

For loans originated in 2019, the small loan threshold is $107,747, whereas the average loan size for loans originated in 2018 was $263,140.[50] Given this large disparity and the increasing fixed costs of loan production, we believe the small loan threshold is artificially low. While the Bureau has raised the threshold, these adjustments have been insufficient to keep pace with rising home costs.[51] Accordingly, the loan size threshold for exceptions to the 3 percent points and fees threshold should be increased to a more reasonable level, such as $200,000, with future adjustments for inflation and a sliding scale that permits progressively higher points and fees thresholds for progressively smaller loans.

Affiliated Settlement Service Provider Fees

Under the Rule's points and fees definition, amounts paid for certain settlement services are included in the points and fees total if these services are provided by

[50] Average loan size calculated by MBA using 2018 HMDA data.

[51] Calculating adjustments based on the annual percentage change in the Consumer Price Index has resulted in an increase of just 5 percent since 2013, with the threshold rising from an initial level of $100,000 to $105,158 for loans made in 2018. During the same period, the average HMDA loan size grew by more than 15 percent, from $227,771 in 2014 to $263,349 for 2018. While the comparison is imperfect, it does demonstrate the small loan threshold's increasing disconnect with market realities.

affiliates of the creditor.[52] If paid to a non-affiliated settlement service provider, those same fees can be excluded. This treatment unfairly penalizes affiliated settlement service providers in favor of non-affiliates. The Bureau should use its discretion to treat fees equally regardless of whether they are paid to affiliates or non-affiliates. Such an approach is entirely consistent with the purposes of the Truth in Lending Act.[53] Equal treatment of affiliated and non-affiliated settlement service providers would create a more level playing field, benefiting consumers by facilitating greater market competition.

Right to Cure

The Bureau appropriately granted creditors the right to obtain QM status by curing inadvertent overages in points and fees.[54] Creditors' ability to cure, which must be exercised within 210 days of loan consummation, results in refunds for consumers but does not otherwise affect the terms of the loan. Such a cure provision also increases liquidity in the market, as it provides a buffer of protection for those who purchase loans soon after origination.

Like the GSE Patch, the right to cure points and fees overages expires on January 10, 2021.[55] Given that cures improve the consumer's position through refunded points or fees without impacting the loan's terms or the future indebtedness of the consumer, they should be encouraged by the Rule. MBA therefore recommends that the Bureau remove the sunset provision and allow such cures to continue.

Safe Harbor

As has been discussed, creditors have shown a strong preference for originating loans that meet the requirements to achieve safe harbor QM status. The ANPR also recognizes this reality of the market, as well as the likelihood that both creditors and investors will continue to favor loans with safe harbor QM status.[56] As a result, the pricing threshold that divides QM loans between safe harbor and rebuttable presumption status will likely continue to have a significant impact on market outcomes. In determining whether to adjust the existing safe harbor threshold, by which the APR cannot exceed APOR by 150 or more basis points, the Bureau should

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[52] 15 U.S.C. §1602(bb)(4)(C)(iii).

[53] 12 U.S.C. §5511(b).

[54] 12 C.F.R. §1026.43(e)(3)(iii)-(iv).

[55] Id.

[56] 84 FR 37159, "Qualified Mortgage Definition Under the Truth in Lending Act (Regulation Z)," July 31, 2019. Available at: https://www.federalregister.gov/documents/2019/07/31/2019-16298/qualified-mortgage-definition-under-the-truth-in-lending-act-regulation-z.

consider structural differences between the various QM categories, as well as forthcoming regulatory changes that could impact loan pricing.

An important difference between the general definition of QM and the Federal Agency QM status afforded by FHA is the threshold dividing safe harbor and rebuttable presumption loans. The maximum safe harbor pricing above APOR in the FHA context already considers the mortgage insurance premiums charged in connection with the FHA insurance. That is, if FHA mortgage insurance premiums rise or fall, the loan is no more or less likely to exceed the safe harbor threshold.

In contrast, the maximum safe harbor pricing above APOR in the general definition of QM is a static figure, which means variations in private mortgage insurance premiums or GSE price adjustors could impact whether or not the loan exceeds the safe harbor threshold. This dynamic may provide a structural advantage for FHA-insured loans relative to loans originated through other channels. More importantly, such an advantage could favor government-supported lending over lending backed by private financing, which would only increase taxpayer exposure to mortgage credit risk.

As the Bureau advances in the rulemaking process, it should analyze this issue and ensure that the safe harbor threshold is not set at a level, or calculated in a manner, that could direct origination activity away from private financing sources.

Similarly, the forthcoming implementation of the Current Expected Credit Loss (CECL) accounting standard could also impact loan pricing in certain segments of the market. Because the CECL standard requires banks to record expected life-of-loan losses at the time of origination, there may be situations in which loan pricing increases, potentially causing some loans to exceed the safe harbor threshold. The Bureau should therefore analyze the existing safe harbor threshold in the context of CECL to determine whether changes are necessary to ensure no disruption to safe harbor QM lending by banks.

In contemplating these factors, as well as other factors that could affect loan pricing, the Bureau should take a data-driven approach that focuses on removing regulatory barriers to a level playing field across lending institutions and loan executions.

Timing and Next Steps

MBA welcomes the Bureau’s work to begin the process of amending the ATR/QM Rule, particularly in light of the scheduled expiration of the Patch in approximately 16 months. The ANPR is an important first step in this process, though it would greatly benefit the market if the Bureau were to provide updates regarding its expected timeline as it considers further actions.

Once the public comment period for the ANPR closes, the Bureau will need to review and consider what will likely be a significant volume of responses. The Bureau will then use this input to develop a notice of proposed rulemaking (NPR) that includes specific amendments to the ATR/QM Rule. The publication of the NPR will be followed by another public comment period and Bureau review and consideration of these comments. After these steps, the Bureau will then be in a position to publish a final rule.

We believe the process described above could be very challenging for the Bureau to complete much before the scheduled expiration of the Patch. This timeline would present difficulty in many rulemakings, but we expect the widespread interest in the future of the QM standard will generate large volumes of comments for the Bureau to consider.

Further, it is critical that the Bureau not ignore or underestimate the necessary implementation period for market participants once a final rule is published. Creditors, servicers, investors, the GSEs, and other market participants will need to update operating systems and business processes to account for the revised QM standard. Credit policies will also need to be reassessed throughout the industry, given the reticence of many institutions to engage in transactions other than those that qualify for the QM safe harbor. An inadequate implementation timeframe would make it particularly difficult for lenders to offer products such as new construction loans, which can involve a lengthy period between loan application and loan closing.

In light of these realities of the rulemaking process and the marketplace, the Bureau should be prepared to include a short-term extension of the Patch in the final rule. In doing so, the Bureau can and should communicate clearly that the extension is being pursued purely to facilitate a smooth and orderly transition — an objective stated in the ANPR — rather than to delay a decision on the future of the QM standard.

To provide clarity and minimize disruption to the market, the Bureau should announce this short-term extension as soon as is practicable. The timing of the extension could be linked to the eventual promulgation of the final rule. For example, the Bureau could announce that it intends to extend the Patch until a date that is 12 months after the publication of the final rule. This announcement would give market participants comfort that they can feasibly implement any changes to the QM standard that are instituted. This announcement would also make clear that the Patch will expire in the near term and will not be allowed to continue indefinitely.

Finally, by linking an extension to the eventual publication of the final rule, the Bureau need not wait until the later stages of the rulemaking process to make this announcement. An earlier announcement will only further help the Bureau achieve the twin goals of removing the Patch from the QM standard while also minimizing market disruption. As such, MBA supports the immediate announcement of an extension of the Patch to the date that is 12 months following the date on which the final rule is promulgated.

Conclusion

As discussed above, expiration of the Patch without necessary reforms to the existing QM general definition would cause significant short- to medium-term disruption to the mortgage market. To avoid these disruptions, the Bureau should reform the QM standard by eliminating the rigid 43 percent DTI ratio threshold and any reliance on Appendix Q as a documentary standard. Neither of these reforms undermines the crucial product feature limitations embedded in the ATR/QM Rule nor impacts the critically important safe harbor that allows lenders the ability to understand the scope of their liability.

We will continue to work with our members to analyze market data that can further inform the Bureau's progress as it considers reforms to the QM standard. Such data will include historical loan performance across DTI ratios and rate spreads, which will provide the Bureau with a better ability to make evidence-based decisions with respect to the QM general definition, as well as the safe harbor threshold. We look forward to continued engagement on this front.

Thank you in advance for your consideration of these comments. Should you have questions or wish to discuss further, please contact Pete Mills, Senior Vice President of Residential Policy and Member Engagement, at (202) 557-2878 and pmills@mba.org.

Sincerely,

Robert D. Broeksmit, CMB
President and Chief Executive Officer
Mortgage Bankers Association