Center for Responsible Lending

The Leadership Conference on Civil and Human Rights

NAACP

National Urban League

UnidosUS

Comments to the Consumer Financial Protection Bureau

Advance Notice of Proposed Rulemaking

Qualified Mortgage Definition under the Truth in Lending Act (Regulation Z)

12 CFR Part 1026

Docket No. CFPB-2019-0039

RIN 3170–AA98

September 16, 2019

Submitted electronically to https://www.regulations.gov
Comment Intake
Consumer Financial Protection Bureau
1700 G Street NW Washington, DC 20552

The **Center for Responsible Lending** (CRL) is a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, one of the nation's largest nonprofit community development financial institutions. Over 39 years, Self-Help has provided $8.5 billion in financing through 159,000 loans to homebuyers, small businesses, and nonprofits. It serves more than 150,000 mostly low-income members through 60 retail credit union locations in North Carolina, California, Illinois, South Carolina, Virginia, Wisconsin and Florida.

The **Leadership Conference on Civil and Human Rights** is a coalition charged by its diverse membership of more than 200 national organizations to promote and protect the civil and human rights of all persons in the United States. Through advocacy and outreach to targeted constituencies, The Leadership Conference works toward the goal of a more open and just society – an America as good as its ideals.

Founded in 1909, the **National Association for the Advancement of Colored People** (hereinafter **NAACP**) is our nation's oldest, largest and most widely known grassroots civil rights organization. The principal objectives of NAACP are to ensure the political, educational, social and economic equality of all citizens; to achieve equality of rights and eliminate racial prejudice among the citizens of the United States; to remove all barriers of racial discrimination through democratic processes; to seek enactment and enforcement of federal, state and local laws securing civil rights; to inform the public of the adverse effects of racial discrimination and to seek its elimination; to educate persons as to their constitutional rights and to take all lawful action to secure the exercise thereof.

The **National Urban League** is a historic civil rights and urban advocacy organization. Founded in 1910, the National Urban League works to secure economic self-reliance, parity, power, and civil rights in historically underserved urban communities. We have 90 affiliates in 36 states and the District of Columbia that provide direct services to more than 2 million people annually. The National Urban League also conducts public policy research and advocacy work from its Washington, D.C. bureau.

UnidosUS, previously known as NCLR (National Council of La Raza), is the nation's largest Hispanic civil rights and advocacy organization. Through its unique combination of expert research, advocacy, programs, and an Affiliate Network of nearly 300 community-based organizations across the United States and Puerto Rico, UnidosUS simultaneously challenges the social, economic, and political barriers at the national and local levels. For 50 years, UnidosUS has united communities and different groups seeking common ground through collaboration, and that share a desire to make our country stronger.

The Center for Responsible Lending (CRL), The Leadership Conference on Civil and Human Rights, NAACP, National Urban League, and UnidosUS appreciate the opportunity to respond to the Consumer Financial Protection Bureau's (CFPB or Bureau) Advance Notice of Proposed Rulemaking (ANPR) on the Qualified Mortgage (QM) definition under the Truth in Lending Act (TILA) and Ability to Repay / Qualified Mortgage regulation (ATR/QM). Our comment refers to a paper published by CRL entitled *A Smarter Qualified Mortgage Can Benefit Borrowers, Taxpayers, and the Economy* (July 2019).[1] Rather than repeat information presented in the paper, the comment references where the paper discusses a topic instead. In addition, please see Appendix 1 for QM Principles.

A. Assessing Ability to Repay under the General QM Loan Definition

1. <u>Direct Measures of a Consumer's Personal Finances</u>

a. If CFPB retains a direct measure of a consumer's personal finances, should it include only a debt-to-income (DTI) limit or should it replace or supplement the DTI limit with another method (e.g., residual income)?

When underwriting, as required by the statutory ability-to-repay (ATR) provision and consistent with prudent lending practices, lenders must continue to use DTI or residual income in determining which loans to approve in their holistic evaluation of the borrower's ability to repay a loan. Lenders and other takers of mortgage-related risk, including the Federal Housing Finance Agency and Fannie Mae and Freddie Mac, will appropriately establish their own DTI limits based on their own modeling and overall risk considerations (pp. 9, 12-13). Greater experience with lenders applying residual income analysis, including potential advances in machine learning and analysis of deposit account activity, can improve residual income as a lending criterion and potentially replace DTI in lenders' decision-making processes (p. 19).

In defining QM, CFPB should retain the current DTI limit for higher-rate loans (those equal to or greater than 250/300 basis points over the average prime offer rate (APOR)) in order to protect borrowers from inherently more dangerous loans (pp. 14-16).[2] The APOR measure must continue to include both internal and external credit enhancement costs. Including these costs provides parity for portfolio lenders that do not choose to purchase external credit support with lenders that sell their loans and obtain external credit support. In addition, and crucially, not including credit enhancement costs for either type of lender would nullify the APOR measure

[1] Available at https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-a-smarter-qualified-mortgage-july2019.pdf.

[2] Please see page 7 of this comment for an alternative proposal.

that provides the foundation for QM protections, including the delineation of the safe harbor and rebuttable presumption.

There is not enough data on residual income, or on any other direct measure, for CFPB to use in a rule. However, CFPB should continue to study the use of residual income by, for example, studying the Veteran's Administration's use of the criterion, in order to potentially be able to consider using it in the future. The potential of residual income to become useful provides another caution against relying just on DTI or any single measure to determine QM status for all loans.

b. *If CFPB retains a DTI limit, what percentage should it be? Should CFPB grant QM status to loans with DTI ratios above a prescribed limit if certain compensating factors are present?*

The DTI limit should be 43%, but only for higher-rate loans because CFPB should replace the current GSE Patch exception to the General QM limit with a new exception for fully-documented near-prime loans (less than 250/300 basis points over APOR) that meet the QM product restrictions (pp. 13-16).[3] As mentioned in the response to question 1.a. above, lenders must continue to use DTI or residual income in underwriting all borrowers' ability to repay their loans.

CFPB should not attempt to determine which compensating factors should permit loans above a prescribed DTI limit to be considered QM. Any such underwriting rules would need to be dynamic as models incorporate the impact of additional performance data and become more advanced. Given CFPB's inherent limitations as a government agency in such an endeavor, and lenders' inevitable improvements over how compensating factors are used in assessing ability to repay, CFPB should leave the definition of appropriate compensating factors to lenders to determine (p. 11).

c. *If CFPB uses a direct measure of a consumer's personal finances:*

i. *Should creditors be required to use Appendix Q to calculate and verify debt and income, and if so, how should it be changed or supplemented?*

CFPB should eliminate Appendix Q (p. 12).

[3] Ibid.

ii. If CFPB does not retain Appendix Q, what standard should CFPB require or permit creditors to use?

CFPB should modify its ATR guidance to permit lenders to use a "reasonable method" of defining income and debts (p. 12 and endnote 39).

As its guidance currently reads, CFPB should continue to refer to GSE (although including the GSEs outside of conservatorship) and government underwriting guidelines as examples of such a reasonable method. If CFPB chooses not to refer to particular guidelines, it should say that examples of a reasonable method would be widely accepted governmental and nongovernmental underwriting standards to define income and debts. If it chooses not to use these terms, it can simply refer to industry standard definitions.

We note that this issue is salient largely just for lenders making higher-rate loans under our proposal.[4] It is appropriate that lenders would need to potentially defend their choice of standards for higher-rate loans since the potential for consumer abuse is greatest in this loan segment.

2. *Alternatives to Direct Measures of a Consumer's Personal Finances*
   a. *Are standards that do not directly measure a consumer's personal finances consistent with, and further TILA's purpose of, demonstrating ATR?*

Yes. Fully documented near-prime mortgages that meet the QM product protections are generally associated with greater ability to repay, given the combination of product features that make it easier to repay a loan and pricing that indicates that the lender has found the borrower to present relatively low credit risk, which is in turn associated with a greater ability to repay (p. 9 and endnote 22, p. 14 and endnote 43). While other factors are also involved in determining the credit risk that is associated with the price of a borrower's mortgage, the borrower's ability to repay the loan is an important component (pp. 15-16).[5] It is also worth noting that there is significant statutory and regulatory precedent for applying greater restrictions on loans with higher pricing over APOR due to greater risks to borrowers, which is why the proposal includes the 43% DTI limit for higher-rate loans (p. 15).

---

[4] Ibid.

[5] This paragraph clarifies statements made on pages 5 and 15-16 of CRL's paper discussing the association of APR with credit risk and ability to repay. In addition, while higher interest rates generally reflect risk, they may also reflect impermissible discriminatory pricing; please see page 13 of this comment for discussion on fair lending.

b. *What are advantages and disadvantages of standards that do not directly measure a consumer's personal finances compared to a direct measure?*

Proposal to allow lenders to use compensating factors for near-prime loans and retain the DTI limit for higher-rate loans

Our proposal keeps the 43% DTI limit, except for fully documented near-prime loans that meet the QM product requirements, where lenders can holistically evaluate ability to repay and credit risk by considering factors beyond the DTI ratio.

A disadvantage of using a single direct metric such as DTI to determine a borrower's ability to repay is that it will inherently exclude borrowers that fall outside of the metric who have a high ability to repay and include borrowers that fall inside the metric that have a low ability to repay. There will be borrowers with a DTI over a given limit, for instance, who have proven they can handle their debts by regularly paying more than the mortgage in rent, by making comparable mortgage and total debt payments successfully for years, or by having a lot of reserves in the bank to cover emergencies. And there will likewise be borrowers with a low DTI who, in the lender's judgment, has a 70% chance of not repaying the loan (endnote 61).

Further disadvantages of applying a DTI ratio alone for near-prime loans to determine their QM status include denying creditworthy borrowers access to a loan at all or forcing them to pay higher interest rates for riskier products, and the fact that creditworthy low-wealth families, including families of color, would be more likely to be excluded from QM product protections. In addition, the denial of QM status to creditworthy borrowers would cause more potential homebuyers to rent, causing greater competition for units and leading to further rent increases. And since 53% of the total rental market is comprised of single-family homes (1 to 4-unit properties), this enhanced competition among renters could itself cause a rise in the property values of single-family houses.[6] Applying a DTI ratio alone would cause many households to continue to pay a high percentage of their income on rent while being denied the opportunity to build wealth through homeownership (pp. 7-8).

An advantage of our proposal for near-prime loans versus applying a direct measure such as DTI is that if a loan is fully documented, meets the QM safer product restrictions and has a near-prime price, there is greater confidence that the lender has reasonably determined the borrower has the ability to repay the loan than whether a single direct measure is met. This is because in integrating multiple factors relevant to a borrower's ability to pay, lenders under this proposal can provide a more holistic and accurate assessment of ability to repay. As a result, the proposal would fulfill Congress's purpose in establishing the qualified mortgage to "ensure that responsible, affordable mortgage credit remains available to consumers . . . ." (p. 6).

[6] Freddie Mac, *Spotlight on Underserved Markets, Single-Family Rental, An Evolving Market*, p. 2, available at https://mf.freddiemac.com/docs/single-family-rental-markets.pdf.

The disadvantages of a single DTI ratio described above outweigh the advantages because of the small reduction in risk caused by excluding near-prime loans through a DTI cutoff. In fact, for a thousand borrowers between 45% and 50% DTI, *just two additional borrowers* default due to the higher DTI compared to loans between 40% and 45% (pp. 9-10). Therefore, just as with the Patch and the community bank QM portfolio exemptions today, CFPB should not use the DTI ratio for near-prime loans to determine eligibility for QM status.

Alternative proposal for higher-rate loans

If CFPB is not inclined to adopt our proposal of retaining the 43% DTI ratio for higher-rate loans, we suggest an alternative proposal. Near-prime loans would continue not to have a DTI ratio determine QM status. Under this alternative, however, rather than applying a DTI ratio to higher-rate loans to determine QM, as a result of which loans with DTIs above this ratio would be non-QM, all loans above the higher-rate threshold would be considered non-QM, with no DTI limit applying. In order to provide QM product protections to a sufficiently broad segment of loans, the higher-rate threshold would increase from 250/300 basis points over APOR to 350 basis points over APOR. By the same token, the definition of near-prime loans would rise to less than 350 basis points over APOR, which is consistent with the safe harbor limit for the Small Creditor Portfolio QM exception (although under our alternative proposal the rebuttable presumption would apply at that level).[7]

An advantage of this alternative proposal is that Appendix Q would not be an issue for higher-rate loans, since higher-rate loans would not include a DTI limit. Further, loans priced above the newly-increased higher-rate limit would be available for lenders to offer, but the lenders would appropriately have a higher degree of accountability under the ability to repay provisions for originating them. A disadvantage of the proposal would be that there would not be an option for higher-rate loans meeting the product protections with lower DTIs to be considered QM.

Seasoning proposal

A standard that does not directly measure a consumer's finances discussed on page 27 of the ANPR – to provide QM status to loans that have remained on a lender's balance sheet for a period of time without delinquency – has too many fundamental disadvantages to be adopted to help determine QM.

Seasoning should not convert non-QM loans into QM loans. Lenders and investors need to know at origination whether a loan is QM, not after a period of seasoning. If a lender sells a loan, and there is a subsequent delinquency during the specified period of time, the loan would be put back to the originator. The possibility of material put backs creates significant liquidity and credit risk for lenders, particularly non-depository lenders important to fully serving the market. Excessive GSE put backs after the crisis severely burdened lenders of all types. A seasoning rule would return to an unsatisfactory system and prevent lenders from originating

[7] See 12 C.F.R. Section 1026.43(b)(4), (e)(1)(i) and (e)(5).

loans with certainty about who ultimately bears the credit and liquidity risk and what their litigation risk will eventually be. In addition, a subsequent economic event should not determine whether a particular loan is QM; a recession that causes early delinquencies to spike should not increase a lender's exposure to non-QM loans. It is also the case that a seasoning requirement could be met by borrowers placed in unaffordable loans who are able to scrape by initially, and could exclude borrowers who missed a payment because, for example, they were on vacation or had a mix up with their bank.

Under no circumstances should a seasoning requirement be used to convert loans that are non-QM because they lack the QM product protections or are adjustable-rate mortgages into QM loans. Non-QM loans can be interest-only or negatively amortizing. Such loans will have teaser payments for the first few years, with payment shock due to higher future payments built into the structure of the loan. As a result, non-QM loans could easily pass a seasoning test during the teaser payment stage but still be fundamentally unaffordable for the borrower at the time the loan is consummated. It was just such payment shock that the QM product protections were designed to prevent. Similarly, the fact that a borrower can repay their ARM during an initial teaser rate or low economic interest rate period does not mean that they have the ability to repay the loan when their interest rates rise.

In addition, QM rebuttable presumption loans, particularly ARMs, should not be converted to safe harbor status based on seasoning either.

A seasoning requirement is inconsistent with the ATR/QM statute. Given that Congress provided a three-year statute of limitations for borrowers to bring affirmative claims, Congress indicated that when borrowers can make an affirmative claim, namely on non-QM or rebuttable presumption loans, a seasoning period could not be less than three years. Further, and more importantly, loans with the possibility of claims – again, non-QM or rebuttable presumption loans – are subject to claims of recoupment in response to a foreclosure at any time during the life of a loan, not limited to three years.[8] Congress intended that these claims should not be cut off with any hard time limit and, therefore, seasoning should not determine QM status. As appropriately stated in the Official Commentary, the longer the period that a rebuttable presumption loan remains current, the less likely the borrower would be able to rebut the lender's presumption of compliance with the ability to repay requirement.[9] However, rebuttable presumption determinations should remain case-by-case because with a particular loan there could be reasons why it defaulted very quickly that do not indicate that the borrower lacked an

[8] 15 U.S.C. 1640(k).

[9] See Comment 43(e)(1)(ii)-1, 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.

ability to repay, or reasons why it remained current for a long period that do not indicate that the borrower could reasonably afford it.[10]

d. *Should CFPB further specify or clarify the grounds on which the presumption of compliance can be rebutted?*

We believe that current guidance is sufficient.

B. Other Temporary GSE QM Loan Issues

1. *Should CFPB Consider any Other Changes to ATR or QM?*

Ability to repay provisions

CFPB should clarify in its rules that lenders must perform a full ATR analysis for all loans, including QM loans and including QM safe harbor loans, and buttress such rules. While QM provides a presumption that the borrower fulfilled the ATR requirements, and a conclusive presumption for loans priced below 150 basis points over APOR, CFPB should clarify that lenders must still engage in a full ATR review of such loans. In addition, CFPB should clarify that the ATR requirements are subject to CFPB supervision and enforcement, including for QM safe harbor loans.

Qualified mortgage provisions

CFPB should adopt the requirement in QM that lenders consider and verify debts and income. This basic borrower protection is included in the two community bank portfolio exceptions to QM (please see Appendix 2 to this comment for excerpts). Under the Small Creditor Portfolio QM exemption from DTI limits and Appendix Q that CFPB created using its exemption authority, the lender (1) must "consider and verify income and debts", and (2) must "consider[] the [DTI] ratio or residual income and verif[y] the debt obligations and income used to determine that ratio". This exemption is available for lenders under $2 billion in assets that hold loans in portfolio for at least three years.[11] In addition, under the portfolio exemption created by Congress in the Economic Growth, Regulatory Relief, and Consumer Protection Act, lenders may receive a QM safe harbor for loans that are exempted from DTI limits and Appendix Q. However, in order to receive the safe harbor lenders must "consider[] and document[] the

[10] Examples of the former could be a divorce or emergence of a health problem shortly after origination, while an example of the latter could be taking out credit card debt and forgoing medicine and food to keep mortgage payments current for a longer period of time.
[11] 12 C.F.R. Section 1026.43(e)(5), available at https://www.consumerfinance.gov/policy-compliance/rulemaking/regulations/1026/43/#e-5.

debt, income, and financial resources of the consumer". This exemption is available for lenders under $10 billion in assets that hold the loans on portfolio permanently.[12]

When CFPB increased the size of the Small Creditor Portfolio QM exemption, it clarified that it created this exemption from DTI limits in the first place because of the unique role of small creditors in their communities and the safe characteristics of the loans that they originate:

> The Bureau adopted these special provisions and exemptions for small creditors because of the important role that small creditors play in providing mortgage credit to consumers. The Bureau believes that many small creditors use a lending model based on maintaining ongoing relationships with their customers and often limit their lending activities to a single community. They therefore may have a more comprehensive understanding of the financial circumstances of their customers and of the economic and other circumstances of that community.[13]

In practice, the baseline requirement that lenders using this exemption must consider and verify debts and income has not appeared to present problems for lender compliance. The CFPB *Ability-to-Repay and Qualified Mortgage Rule Assessment Report* (the Report) includes a chapter discussing the Small Creditor Portfolio QM exemption and does not mention any issues lenders faced with the requirement to consider and verify debts and income.[14] The Report includes indications that the exemption is working as intended:

> Overall, small creditors account for a large portion of mortgage lenders and a small but growing share of loans.
>
> ***
>
> The differences across small and non-small institutions show that portfolio originations are a much larger proportion of mortgage originations for small institutions compared to non-small institutions. As the Rule generally requires Small Creditor QMs to be held on portfolio for three years after consummation, this may suggest that small creditors are utilizing this category of QM.[15]

Once the Patch expires, not to include the requirement to consider and verify debts and income as part of QM would be contrary to clearly expressed, recent congressional intent. Congress selected a particularly low risk segment of the market to provide QM safe harbor status without imposing a DTI limit, and it required lenders making such loans to meet this basic requirement.

---

[12] Title I, Section 101, available at https://www.congress.gov/bill/115th-congress/senate-bill/2155/text#toc-id8A028BC2C0144A63B9E53F8D23F3659F.

[13] 80 Federal Register 59943, 59947 October 2, 2015 (footnote omitted), available at https://www.govinfo.gov/content/pkg/FR-2015-10-02/pdf/2015-24362.pdf.

[14] Published January 2019, available at https://files.consumerfinance.gov/f/documents/cfpb_ability-to-repay-qualified-mortgage_assessment-report.pdf, at pp. 207-228.

[15] Ibid. at pp. 210 and 219.

CFPB should provide at least the same degree of protection to additional segments of the market when it exempts near-prime loans that meet the product requirements from a DTI limit.

<u>Adjustable-rate mortgages</u>

CFPB should provide additional borrower protections for adjustable-rate mortgages (ARMs) because of their inherent complexity and borrower dangers. Although ARMs can offer financial advantages over fixed-rate mortgages (FRMs) in certain circumstances, they are more complex for borrowers. New data from the National Survey of Mortgage Originations (NSMO) indicates that, as mortgage terms become more complex, borrowers experience difficulty comprehending available options. Specifically, the NSMO asked recent homebuyers to rate how well they could explain various mortgage transactions to others: Very Well, Somewhat, or Not At All. The descriptive statistics indicate that 44% of homebuyers do not understand very well the differences between FRMs and ARMs. This same percentage of homebuyers report not understanding very well the consequences of missing required mortgage payments. In addition, over 80% of recent homebuyers could not explain very well the amortization of the loan, the differences between the interest rate and the annual percentage rate, and the difference between prime and subprime loans. As these results show, self-reported mortgage literacy is low even among those who recently purchased a home or refinanced their mortgage.

In fact, two NSMO studies show that borrowers are more knowledgeable about simple mortgage concepts than they are about complex concepts. Critchfield et al investigate rural/urban differences. While controlling for income and credit quality, their study shows that rural borrowers are less knowledgeable and less confident about mortgage details than urban borrowers. Rural borrowers also report less favorable mortgage terms and lower satisfaction with their mortgage.[16]

Analyzing a nationally representative sample of first-time homebuyers, Argento et al considers how homeownership counseling relates to mortgage literacy while adjusting for respondent's selectivity into counseling. The authors find strong, positive effects for homeownership counseling on literacy. Borrowers who received homeownership counseling scored nine-percentage points higher in their ability to explain the process of taking out a mortgage and seven-percentage points higher in their knowledge of the consequences of not making required mortgage payments. While these findings demonstrate positive effects for homeownership counseling, they also underscore a worrisome gap in mortgage literacy for the large majority of borrowers who do not receive counseling.[17]

---

[16] Critchfield, T., Dey,J., Mota, N., Patrabansh, S. (2019). *Mortgage Experiences of Rural Borrowers in the United States: Insights from the National Survey of Mortgage Originations*. Cityscape 21(2), pp. 9-31.

[17] Argento, R.B., Brown, L.M., Koulayev, S., Li, G., Myhre, M., Pafenberg, F., Patrabansh, S. (2019) *First-Time Homebuyer Counseling and the Mortgage Selection Experience in the United States: Evidence from the National Survey of Mortgage Originations*. Cityscape 21(2), pp. 51-74.

Such gaps in mortgage literacy can increase the likelihood of defaults when mortgage terms and the lending environment become more complex. The market share of ARMs (vs. FRMs) increases with rising interest rates, which can also trigger defaults in response to payment shocks, especially for riskier loans. With ARMs, borrowers face payment adjustment shocks that depend upon the interval at which the contract rate is adjusted to the market. In a traditional one-year ARM, a payment shock can occur as early as 12-months.

Compared to FRMs, ARMs have higher default rates as they expose borrowers to these payment adjustment shocks. One early study of ARM vs FRM terminations found that payment adjustments are positively related to defaults.[18] Higher caps to the interest rate adjustment and shorter adjustment periods are key factors as both increase the likelihood that ARMs will default.

Hybrid mortgages can help by providing a FRM for a predetermined number of years following origination, but these products are also ARMs that expose borrowers to interest-rate risk at a later time of reset. For example, the 3/27 product is a FRM for three years following origination that converts to a traditional one-year ARM for the remaining 27 years of amortization. Using mortgage data from the 1990's, Ambrose et al studied the 3/27 product and found that both defaults and prepayments are concentrated around the rate adjustment period.

These authors also provide a hypothetical demonstration of the impact of resets. Their exercise illustrates the capriciousness introduced by these three-year ARMs and hybrid mortgages:

> To put these rates into perspective, consider three hypothetical mortgages originated in January 1995, January 1996 and December 1996. At the first adjustment date (month 36), the January 1995 mortgage would have experienced a 5.6% payment reduction as the contract rate fell from 8.4% to 7.7%, while the January 1996 mortgage would have experienced a payment reduction of only 0.9% because the contract rates for this cohort only declined from 7.1% at origination to 7% in month 36. In contrast, the December 1996 mortgage would have experienced a payment increase of 14.4% at the first adjustment as the contract rate increased from 6.9% at origination to 8.3% in month 36. Then, at the second adjustment date (month 48), the January 1995 mortgage would have experienced another payment reduction of 6.4% as the contract rate declined from 7.7% in month 36 to 7% in month 48, while the January 1996 mortgage would have experienced a payment increase of 15.4% as the contract rate increased from 7% to 8.6%. The December 1996 mortgage would have experienced a 4% payment drop as the contract rate declined from 8.3% to 8.1%. As this simple exercise demonstrates, depending on when the

[18] Cunningham, D.F., Capone, C. (1990). *The relative termination experience of adjustable to fixed-rate mortgages*. Journal of Finance 45 (5), pp. 1687–1703.

hybrid mortgage was originated, the borrower faced significantly different payment shocks at the 36-month adjustment date.[19]

As a result of the inherent complexities of ARMs and the difficulty of borrowers understanding or negotiating for their terms, CFPB should establish basic standards for ARMs in order for loans to be considered QM. First, and most importantly, CFPB should require at least a five-year initial fixed period for QM status. The statute requires the loan to be underwritten at the highest possible rate for the first five years of the loan. However, under our proposal for near-prime mortgages, QM would not require a certain DTI limit for ARMs. As a result, the requirement to underwrite at the maximum rate as a QM protection would become less meaningful. To maintain the spirit of the QM maximum rate provision and to protect borrowers from payment shock in the loan's initial years, ARMs should therefore only receive QM status if they have an initial five years of fixed payments.

Second, to protect borrowers from unreasonable and non-standard adjustments to QM ARM loans, the contract interest rate and payment should provide baseline adjustment requirements. In particular, such loans should not:

- Adjust more frequently than annually;
- Increase by more than 200 basis points in any annual rate adjustment; or
- Increase by more than 500 basis points over the life of the loan.

<u>Fair lending</u>

CFPB should maintain its commitment to fair lending analysis of lender underwriting models under the Equal Credit Opportunity Act and the Fair Housing Act, including through the application of disparate impact analysis (p. 18 and endnote 57). As mentioned in footnote 5 of this comment, CFPB should continue to be vigilant to ensure that mortgage pricing is based on legitimate risk factors and protect against discriminatory pricing.

2. *<u>How Much Time Would Industry Need to Change its Practices?</u>*

To minimize market disruption, CFPB should maintain the Patch until it issues its final QM rule, and then extend the Patch to permit lender compliance for a reasonable period of time (p. 12).

[19] Ambrose, B.W., LaCour-Little, M., Huszar, Z.R (2005) *A Note on Hybrid Mortgages.* Real Estate Economics 33, 765–782, p. 770.

Appendix 1 – QM Principles

1. **The Bureau has a dual mandate regarding mortgage regulations.**

   - To promote access to responsible, affordable credit, including for communities of color and low-income communities where fair and sustainable access is far too limited; and

   - To ensure that mortgage loans are only offered on terms that reasonably reflect borrowers' ability to repay.

2. **Ability to repay must remain part of the Qualified Mortgage.** Any changes to the Bureau's Qualified Mortgage (QM) rules must advance these purposes and therefore must ensure that lenders assess a borrower's ability to repay before a loan can benefit from qualified mortgage status. (15 USC 1639c(b)(3)).

3. **Credit risk is distinct from the statutory requirement of consideration of ability to repay.** While ability to repay should be an important component of the credit risk assessment reflected in loan pricing, lenders must also be required to reasonably determine ability to repay, as required under the statute, and, at a minimum, consider verified debts and income in order to receive QM status. The Bureau must retain its ability to examine for ATR compliance on all loans.

4. **Product restrictions should not be altered.** The Bureau should retain and not change the statutory qualified mortgage product restrictions. Creditors wishing to offer higher risk products or features outside of the current rule's definitions should comply with the full ATR requirement.

5. **Seasoning is not an ATR measure.** That Congress included in its ATR rules the provision for recoupment in foreclosure at any point in the loan demonstrates that it did not view seasoning as a substitute for assessing the ability to repay. Moreover, seasoning does not offer a "bright line" at origination, is not an option for lenders without large balance sheets, and would hit independent mortgage bankers, who are an important source of credit to underserved communities, particularly hard.

6. **A single DTI threshold in the absence of the patch or other broader underwriting would undermine the statute and constrict access to credit.** Abandoning the patch, as the Bureau has said it intends to do, while leaving in place a hard DTI cut off would be a serious blow to both congressional intent and to practical access to home finance for millions of qualified borrowers, especially borrowers of color.

7. **The Bureau should not maintain Appendix Q.** Appendix Q's cumbersome and outdated approach creates barriers to QM lending, especially for borrowers with non-traditional W-2 income. An alternate approach should be adopted.

Appendix 2 – Portfolio Exemptions

To receive QM status under the Small Creditor Portfolio QM exemption from DTI limits and Appendix Q, the lender must consider the DTI ratio or residual income and verify debt and income (for lenders under $2 billion in assets holding loans in portfolio for at least three years):

> **(i)** Notwithstanding paragraph (e)(2) of this section, a qualified mortgage is a covered transaction:
>
> **(A)** That satisfies the requirements of paragraph (e)(2) of this section [product protections, requirements to consider and verify income and debts[20]] other than the requirements of paragraph (e)(2)(vi) [the 43% DTI requirement] and without regard to the standards in appendix Q to this part;
>
> **(B)** For which the creditor considers at or before consummation the consumer's monthly debt-to-income ratio or residual income and verifies the debt obligations and income used to determine that ratio in accordance with paragraph (c)(7) of this section [ATR requirements], except that the calculation of the payment on the covered transaction for purposes of determining the consumer's total monthly debt obligations in paragraph (c)(7)(i)(A) shall be determined in accordance with paragraph (e)(2)(iv) [must underwrite ARMs and maximum possible rate for first five years] of this section instead of paragraph (c)(5) of this section [fully indexed rate];[21]

To receive QM safe harbor status exempted from DTI limits and Appendix Q through recent amendments to the Dodd-Frank Act, the lender must consider and document the debt, income, and financial resources of the consumer (for lenders under $10 billion in assets holding loans on portfolio permanently):

> "(ii) SAFE HARBOR.—In this section—
>
> "(I) the term 'qualified mortgage' includes any residential mortgage loan—
>
> "(aa) that is originated and retained in portfolio by a covered institution;

[20] See "For which the creditor considers and verifies at or before consummation the following:
(A) The consumer's current or reasonably expected income or assets other than the value of the dwelling . . .; and
(B) The consumer's current debt obligations . . . ." 12 C.F.R. Section 1026.43(e)(2)(v), available at https://www.consumerfinance.gov/policy-compliance/rulemaking/regulations/1026/43/#e-2-v.

[21] 12 C.F.R. Section 1026.43(e)(5), available at https://www.consumerfinance.gov/policy-compliance/rulemaking/regulations/1026/43/#e-5.

“(bb) that is in compliance with the limitations with respect to prepayment penalties described in subsections (c)(1) and (c)(3);

“(cc) that is in compliance with the requirements of clause (vii) of subparagraph (A);

“(dd) that does not have negative amortization or interest-only features; and

“(ee) for which the covered institution considers and documents the debt, income, and financial resources of the consumer in accordance with clause (iv); and

. . . .

“(iv) CONSIDERATION AND DOCUMENTATION REQUIREMENTS.—The consideration and documentation requirements described in clause (ii)(I)(ee) shall—

“(I) not be construed to require compliance with, or documentation in accordance with, appendix Q to part 1026 of title 12, Code of Federal Regulations, or any successor regulation; and

“(II) be construed to permit multiple methods of documentation.”.[22]

---

[22] Economic Growth, Regulatory Relief, and Consumer Protection Act, Title I, Section 101, available at https://www.congress.gov/bill/115th-congress/senate-bill/2155/text#toc-id8A028BC2C0144A63B9E53F8D23F3659F.