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 undersigned associations, which represent diverse institutions in the real estate finance industry across the country, write to submit our views on potential changes to the Qualified Mortgage (QM) general definition under the Truth in Lending Act. Because of the significance of the QM standard in mortgage lending and investment decisions, any such changes could have a dramatic effect on consumer access to credit and the health of the national housing market.

We offer two recommendations to the Consumer Financial Protection Bureau (Bureau) that we believe are critical to protecting against major disruptions in the market:

- Remove the debt-to-income (DTI) ratio threshold as a standalone factor in the QM general definition; and
- If DTI ratios remain a factor in any form in the QM general definition, allow for industry-accepted, government-approved alternatives to the income and debt verification standards found in "Appendix Q".

Below, we provide further details on these recommendations, as well as the potential impact of a failure to reform the QM general definition ahead of the scheduled expiration of the "Government-Sponsored Enterprise (GSE) Patch."

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As is detailed in the Bureau's recent Advance Notice of Proposed Rulemaking (ANPR),[1] the GSE Patch ("the Patch") within the QM standard is scheduled to expire in January

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[1] 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.

2021.[2] Under the Patch, loans eligible to be purchased or guaranteed by Fannie Mae or Freddie Mac are provided with an exemption from the existing requirements of a maximum 43 percent DTI ratio, as well as the use of the outdated, inflexible terms of Appendix Q of the Ability to Repay/Qualified Mortgage Rule for calculating DTI ratios, in order to obtain QM status.

Conversely, if the Patch were to expire without reforms to the QM general definition, loans with DTI ratios above 43 percent could only obtain QM status if they were originated through programs operated by the Federal Housing Administration (FHA), the U.S. Department of Veterans Affairs (VA), or the U.S. Department of Agriculture (USDA). All loans outside the FHA/VA/USDA channels would also require use of the Appendix Q standards to document and verify borrower income and debt.[3]

There are certainly long-term benefits to the expiration of the Patch, if handled appropriately. The QM standard no longer would be reliant on the credit policies of the GSEs, which in turn should facilitate a more competitive market that better enables innovation from a variety of sources. Absent important QM reforms regarding DTI ratio thresholds and Appendix Q, however, the expiration of the Patch will likely cause significant harm in the short term.

According to one recent estimate, between $200 billion and $320 billion in single-family originations in 2018, representing 12 to 20 percent of the total single-family market, obtained QM status solely due to the Patch.[4] If the Patch were to expire without reforms to the QM general definition, much of this large portion of the market would be diverted into other channels, such as FHA/VA/USDA or the non-QM market. This outcome would likely raise costs while reducing choice for consumers. Further, some segment of loans that currently benefit from the Patch would not be originated at all, thereby restricting access to credit and harming consumers, other market participants, and the broader economy.

To ensure this disruption does not occur, the Bureau should make the necessary reforms to the QM standard to achieve the appropriate balance between the Bureau's dual statutory mandates, which require both consumer protection and promotion of the availability of affordable credit.[5] In doing so, it should directly address the two reasons

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[2] The Patch is scheduled to expire upon the earlier of: 1) the GSEs exiting conservatorship or receivership; or 2) January 10, 2021. Given the numerous impracticalities associated with the GSEs being released from conservatorship or receivership in this timeframe, we consider January 10, 2021 to be the expected sunset of the Patch, absent any further policy changes.

[3] Certain loans that are retained in portfolio by insured depository institutions or insured credit unions with less than $10 billion in total assets, as well as certain loans originated by small creditors operating in rural areas, are eligible for QM status even if they maintain DTI ratios above 43 percent or do not adhere to the Appendix Q standards.

[4] Carroll, Pete. "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.

[5] See 12 U.S.C. §5511(a).

that such a large volume of loans currently relies on the Patch—the 43 percent DTI ratio threshold and the requirements of Appendix Q.

Recommendation 1: Remove the DTI Ratio Threshold as a Standalone Factor

The use of DTI ratios in mortgage underwriting is common and well-accepted throughout the industry. A proper underwriting process, though, accounts for many relevant factors related to the borrower's financial position when determining whether the borrower has the ability to repay the loan. A particular DTI ratio does not, on its own, serve as sufficient evidence that a borrower can or cannot reasonably repay the loan.

The QM general definition, however, includes a strict 43 percent DTI ratio threshold. If a loan features a DTI ratio that exceeds this threshold, it cannot obtain QM status under the QM general definition. As such, the vast majority loans with DTI ratios greater than 43 percent have been originated through FHA/VA/USDA or under the terms of the Patch, so as to ensure QM status.

Reliance on a single underwriting factor as a determinant of QM status is inappropriate, and the reliance on DTI ratios is particularly troublesome, given the weak predictive capacity of DTI ratios in determining loan performance.

The Bureau therefore should remove the DTI ratio threshold from the QM general definition. Doing so would maintain the critical product feature limitations—for example, no negative amortization, no interest-only payments, no balloon payments, terms of 30 years or less—in the QM standard. If the Bureau feels that the QM standard requires further measure of a consumer's personal finances, it could explore other options, such as compensating factors regimes or residual income tests. If the Bureau were to include additional requirements along these dimensions, however, it should ensure that any necessary parameters or calculations are clear and simple to operationalize.

Absent this reform, hundreds of thousands of borrowers each year will see their cost of credit rise, or in some cases, their ability to access credit at all, severely impaired. We therefore strongly urge the Bureau to remove the DTI ratio threshold as a standalone factor in the QM standard.

Recommendation 2: If DTI Ratios Remain a Factor in any Form, Allow for Alternatives to the Appendix Q Standards

In addition to the options described above, the Bureau may also opt for reforms that maintain use of DTI ratios in the QM general definition—to be applicable to a smaller subset of loans or to be part of a more holistic approach that considers other factors. If DTI ratios remain in the QM general definition in any capacity, it is critical that the Bureau improve the standards by which they are calculated.

In order to ensure that creditors calculate DTI ratios in a uniform manner, the Bureau included a methodology for doing so in Appendix Q of the Ability to Repay/Qualified

Mortgage Rule. The Appendix Q standards for documenting, verifying, and calculating borrower income and debt were adapted from an earlier version of those standards in place at FHA.

Because they are codified in regulation, the Appendix Q standards are not able to be easily updated, making them static and inflexible. The rigid nature of these standards is particularly problematic for consumers with non-W-2 forms of income, such as rental income, retirement income, or income from self-employment. As the share of the workforce with some form of non-W-2 income grows, as it has in recent years and is projected to do so moving forward, it is critical that mortgage underwriting evolve to accurately evaluate potential borrowers' resources.

The Appendix Q standards, however, do a poor job of measuring cash flow and are often incompatible with innovations that rely on new technology to capture this information. As a result, many types of legitimate income may not qualify for consideration in mortgage underwriting. When this happens, consumers are often forced to obtain an FHA/VA/USDA loan or a non-QM loan, both of which typically come with higher costs, or these consumers may not be able to obtain a loan at all.

If the Patch expires without reforms to the QM general definition, a much larger segment of the market will need to satisfy the outdated requirements of Appendix Q. Rather than allow this overwhelmingly negative outcome, the Bureau should permit the use of standards that are dynamic and more accurately reflect widely-accepted industry practices.[6]

Simply updating the Appendix Q standards fails to address the most fundamental problem with Appendix Q—its static nature as a rule that cannot be easily updated or adjusted in response to changing demographics or market conditions. Instead, the Bureau should allow creditors to use existing standards subject to strong federal government oversight that are frequently monitored and updated for purposes of obtaining QM status. To do so, the Bureau should permit the use of income and debt verification standards in guides or handbooks maintained by FHA, VA, USDA, Fannie Mae, or Freddie Mac as alternatives to the Appendix Q standards.[7]

These existing standards are set or regulated by federal government agencies, are updated frequently, and are used by creditors of all types and sizes throughout the country. Such a reform by the Bureau would facilitate widespread industry adoption while maintaining proper oversight and accountability.

We therefore strongly urge the Bureau, if it includes DTI ratios in the scope of the QM standard moving forward, to adopt this critical reform to ensure that creditworthy borrowers across the spectrum of job types and income sources are well-served.

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

[7] Because Fannie Mae and Freddie Mac are privately-owned institutions, the use of the standards in their guides should be subject to approval by their regulator.

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The upcoming expiration of the Patch presents an important opportunity for the Bureau to improve the QM standard in a way that is not tied to the credit policies of the GSEs and is therefore more durable over time. This opportunity, however, also comes with significant risks. If the Bureau does not adequately address the existing problems with the QM parameters prior to the expiration of the Patch, it will likely cause large-scale barriers to access to mortgage credit throughout the nation.

As we have discussed, the Bureau should reform the two drivers of the reliance on the Patch in the current market: the 43 percent DTI ratio threshold and the Appendix Q standards. First, the Bureau should remove DTI ratios as a standalone factor in the QM general definition. Failing that, the Bureau should allow reasonable alternatives for verifying borrower income and debt. Such limited changes to the QM standard would minimize the disruptions that would occur upon the Patch's eventual expiration. We firmly believe this is a prudent and responsible approach to the future of the QM standard.

On behalf of our members, we thank the Bureau for its consideration of our views and for its efforts to improve the QM standard in a manner that protects consumers, strengthens the mortgage market, and promotes access to sustainable credit.

Sincerely,

Alaska Mortgage Bankers Association
Arizona Mortgage Lenders Association
Atlanta Mortgage Bankers Association
California Mortgage Bankers Association
Central New York Mortgage Bankers Association
Colorado Mortgage Lenders Association
Connecticut Mortgage Bankers Association
Gulf Coast Mortgage Bankers Association
Idaho Mortgage Lenders Association
Illinois Mortgage Bankers Association
Indiana Mortgage Bankers Association
Iowa Mortgage Association
Knoxville Mortgage Bankers Association
Maine Association of Mortgage Professionals
Maryland Mortgage Bankers and Brokers Association
Massachusetts Mortgage Bankers Association
Michigan Mortgage Lenders Association
Mid Hudson Valley Mortgage Bankers Association
Minnesota Mortgage Association
Montana Association of Mortgage Professionals
Mortgage Bankers and Brokers Association of New Hampshire

Mortgage Bankers Association of Alabama
Mortgage Bankers Association of Arkansas
Mortgage Bankers Association of Florida
Mortgage Bankers Association of Georgia
Mortgage Bankers Association of Greater Kansas City
Mortgage Bankers Association of Greater Philadelphia
Mortgage Bankers Association of Hawaii
Mortgage Bankers Association of Kentucky
Mortgage Bankers Association of Louisville
Mortgage Bankers Association of Memphis
Mortgage Bankers Association of Metropolitan Washington
Mortgage Bankers Association of Mississippi
Mortgage Bankers Association of Missouri
Mortgage Bankers Association of Northeastern New York
Mortgage Bankers Association of Southern Kentucky
Mortgage Bankers Association of the Bluegrass
Mortgage Bankers Association of the Carolinas
Mortgage Bankers Association of the Lower Cape Fear
Mortgage Bankers Association of Western North Carolina
Mortgage Lenders Association of Greater Charleston
Mortgage Lenders Association of Greater Columbia
Mortgage Lenders Association of Greater Hilton Head Island
Nebraska Mortgage Lenders Association
Nevada Mortgage Lenders Association
New Jersey Mortgage Bankers Association
New Mexico Mortgage Lenders Association
New York Mortgage Bankers Association
Northern Virginia Mortgage Lenders Association
Ohio Mortgage Bankers Association
Oklahoma Mortgage Bankers Association
Oregon Mortgage Bankers Association
Puget Sound Mortgage Lenders Association
Raleigh Mortgage Bankers Association
Rhode Island Mortgage Bankers Association
Richmond Mortgage Bankers Association
Spokane Mortgage Lenders Association
Tennessee Mortgage Bankers Association
Texas Mortgage Bankers Association
Triangle Mortgage Lenders Association
Vermont Mortgage Bankers Association
Virginia Mortgage Lenders Association
Washington Mortgage Bankers Association
Wisconsin Mortgage Bankers Association