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Ms. Kathy Kraninger
Director
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, DC 20552

Docket No.: CFPB-2019-0039
Submitted Via: http://www.regulations.gov/

Dear Director Kraninger:

On behalf of the nearly 1.4 million members of the National Association of REALTORS® (NAR), the following letter is in response to the Consumer Financial Protection Bureau's (CFPB) advanced notice of proposed rulemaking (ANPR) on *The Qualified Mortgage (QM) Definition under the Truth in Lending Act (Regulation Z)*. NAR has long advocated for a reassessment of the general QM rule and QM "patch" and appreciates the CFPB's efforts to clarify a market-wide rule that would allow for consumer protections and fairness for originators. REALTORS® remain concerned that a more limited definition than the current patch would not support a broad and consistent national market for homeownership. NAR recommends that the CFPB;

1) ensure that the existing patch remains after the January 10, 2021 deadline and until a robust replacement can be enacted,
2) thoroughly vet alternative proposals (e.g. compensating factors, a hard DTI, or APOR spread) for market and consumer impacts and share the data and results of these analysis with the public before advancing a final rule
3) that the replacement be as durable and supportive of the market as the current patch and expand that level of support to the non-patch market to ensure a cohesive national definition, and
4) mimic the holistic approach to underwriting currently employed under the patch.

The National Association of REALTORS® is America's largest trade association, including NAR's five commercial real estate institutes and its societies and councils. REALTORS® are involved in all aspects of the residential and commercial real estate industries and belong to one or more of some 1,200 local associations or boards, and 54 state and territory associations of REALTORS®. NAR represents a wide variety of housing industry professionals, including approximately 25,000 licensed and certified appraisers, committed to the development and preservation of the nation's housing stock and making it available to the widest range of potential homebuyers.

REALTORS® believe that homeownership is an integral part of the American Dream that the QM rule should be flexible enough to adopt to changing life patterns and not out of reach for individuals and families that lack traditional income documentation. Underwriting is the foundation that America's housing finance system is built upon. The CFPB's rules process should not be rushed as the re-evaluation of the patch and a market-wide QM requires a thorough vetting of alternatives and their impact on both competition and consumer access.

GSE Loan Eligibility as Qualified Mortgage Status

The final ability to repay (ATR)/QM rule requires creditors to make a reasonable, good faith determination of a consumer's ability to repay their mortgage. For mortgages qualifying for QM status, creditors receive certain protections from liability in connection with their ability-to-repay determinations. To qualify as a QM under the general definition, a mortgage must fulfill the general ATR requirements and (1) comply with prohibitions on certain risky features, (2) come within limits on points and fees, and (3) have a debt-to-income ratio no greater than 43 percent. Alternatively, the mortgage may qualify as QM if it is eligible for purchase or guarantee by Fannie Mae or Freddie Mac (the government sponsored enterprises, or GSEs) while under conservatorship. This provision (or 'patch') simplifying qualification of QM status sunsets when the conservatorship ends and no later than January 10, 2021

The CFPB created the patch exemption to ensure the ongoing availability of mortgage credit while originators transitioned their underwriting standards to meet the provisions in the final rule. By providing for most of the conventional market to continue to originate higher debt-to-income loans as QM loans, the CFPB has allowed the market to originate well-underwritten loans to responsible consumers.

NAR continues to support and encourage innovation and responsible lending and, ultimately, we believe it is important to avoid constriction of credit to otherwise qualified borrowers. Therefore, careful consideration of available data and thoughtful analysis of anticipated market response is imperative prior to a final rule making. Today just as before the original QM definition was finalized in 2013, there is a dearth of quality data and analysis on the benefits of alternative measures of income and QM definitions. The CFPB would benefit the industry's discourse on this topic by sharing data it gleans from this ANPR with industry to aid in a more thorough discussion of potential QM alternatives during the notice of proposed rule making (NPRM).

Direct Measures of a Consumer's Personal Finances

A number of economic studies find that the front-end debt-to-income ratio (DTI) by itself has historically been a weak measure of default. While weak, it is still an intuitive and statistically significant measure and more so for marginal borrowers. Using data from Lender Processing Services (LPS) including front-end DTI, Amromin and Paulson[1] found that, "the DTI for prime loans is not significantly correlated with defaults, except for loans originated in 2007, but it matters consistently for subprime loans." Foote et al[2] also found that the front-end DTI measured at origination was not a strong predictor of default, but that it was more important for sub-prime borrowers with low credit scores. Likewise, Demyanyk, Koijen, and Van Hemert[3] found that the back-end DTIs were insignificant in most cases.

More recent studies have found that, back-end DTI too is weak and provides mixed signals. FHFA economists found that back-end DTI ratios of 45 percent were positive indicator of delinquency, but insignificant.[4] Likewise, Goodman and Kraul founds that, "The DTI ratio is one of several factors affecting borrower creditworthiness and ability to repay. But it is not a good predictor of default because it is often poorly measured."[5]

In part, that weak statistical power of DTI has historically been due to lax documentation of income wherein only income sufficient to reach the minimum DTI threshold was utilized. Intuitively, this measure would be more robust for marginal borrowers as income is more closely documented to meet thresholds and DTI would become a more binding measure of their total income and debts. However, this issue raises the question of whether DTI or any single factor should be used to define the qualified mortgage.

NAR supports a QM standard that incorporates a reasonable DTI ratio in conjunction with other factors. Borrowers should have enough residual income after making their monthly mortgage payment, including taxes and insurance, to meet their needs

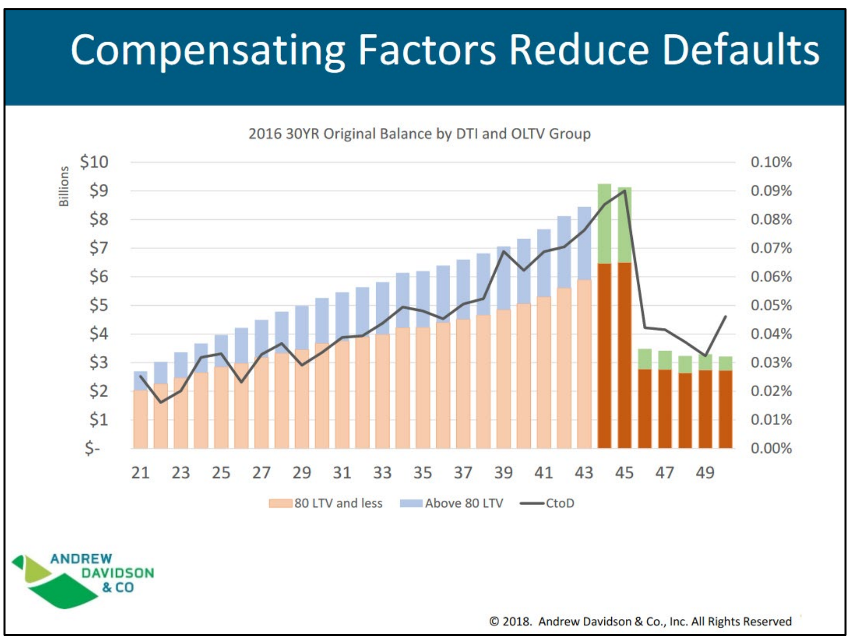
[1] Gene Amromin and Anna Paulson, "Comparing Patters of Default Among Prime and Subprime Mortgages."
[2] Christopher Foote, Kristopher Gerardi, Lorenz Goette, and Paul Willen. " Reducing Foreclosures: No Easy Answers"
[3] Demyanyk, Koijen, and Van Hemert, "Determinants and Consequences of Mortgage Default"
[4] Lam, Dunsky, and Kelley. "Impacts of Down Payment Underwriting Standards on Loan Performance – Evidence from the GSEs and FHA portfolios" FHFA Working Paper 13-3.
[5] Goodman and Kraul. "What, If Anything, Should Replace the QM GSE Patch?". Urban Institute. August 2018.

for food, utilities, clothing, transportation, work-related expenses, and other essentials. Requiring underwriting at a fully amortizing, fully indexed rate is meaningless if the originator uses such high debt-to-income ratios that the family does not have enough income remaining to pay for other necessities.

However, over-reliance on a particular debt-to-income ratio is problematic. As the CFPB pointed out in its ANPR, the choice to create the QM patch was in part a reliance on the underwriting of the GSE's systems and implicit recognition of the veracity of their methods. The GSEs do not condition acceptance based solely on a DTI. Rather DTI is used as a guidepost or signal and compensating factors are used at increasing levels of DTI. Thus, DTI is part of a more holistic view of a consumer credit risk profile.

Hard DTI limits can have large negative impacts for the broader market and public policy. As well documented by Corelogic[6] and the Urban Institute[7], borrowers with back end DTI ratios above 43 percent are a large part of the market and more likely to be lower income, older or younger, of color, rural, and have non-W2 income sources. There has been little detailed research into the composition of debt within back end DTIs beyond noting that they have increased over time, but the simultaneous increase in student debt and decline in public support for higher education suggests that rising DTIs may in part reflect this shift from public to individual balance sheets.

A limited view of a consumer's credit profile is neither prudent nor is ignoring a system of vetting loans that has served the majority of the market well for decades. However, non-agency players should be able to leverage these benefits in a way that expands participation and competition but does not weaken the foundation of safety and soundness. This could be accomplished by allowing originators to use an approved system of underwriting that incorporates compensating factors whether from a regulator-approved bank-developed algorithm or a system maintained by the GSEs, a regulator, or an independent third party (e.g. industry group or utility). Critical here is that the new QM system should build upon historically proven underwriting that evaluates a borrower's credit risk holistically rather than adopting a wholly new and untested strategy.



HUD economists have noted that compensating factors can improve mortgage outcomes and meet policy objectives and illustrate the use of compensating factors on front-end DTI.[8] More directly, economists at Andrew Davidson and Company have demonstrated that the use of compensating factors in GSE production reduces default rates above the 45 percent DTI

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[6] Carroll, P. "Expiration of the CFPB's Qualified Mortgage "GSE Patch" – Part 1" Corelogic. July 2019.
Pradhan, A. "Expiration of the CFPB's Qualified Mortgage "GSE Patch" – Part 2" Corelogic. July 2019.
Pradhan, A. "Expiration of the CFPB's Qualified Mortgage "GSE Patch" – Part 3" Corelogic. July 2019.
7 Goodman, L. "New Data Confirm the Urgency of Addressing the Expiration of the GSE Patch" Urban Institute. March 2019
8 Office of Policy Development and Research. "Research Report for Importance of Mortgage Downpayment as a Deterrent to Delinquency and Default as Observed in Black Knight (McDash) Servicing History" HUD. April, 2017. pp. 21

level (depicted above).[9] Andrew Davidson and Company[10] and the US Mortgage Insurance[11] trade association have each recommended plans that would incorporate compensating factors and a majority of members of the Structured Finance Association[12] support such a proposal. While NAR does not endorse a particular plan, it should be noted that the latter groups include both the issuers and investors in MBS who will bear the risk of manufacture and consumption. More thorough research into all of these options is needed before proceeding to a final rule.

DTI is a useful measure of a borrowers' cash flow relative to debts, but is prone to measurement issues. Furthermore, a single DTI rule alone does not provide a holistic measure of a borrower's credit worthiness. The patch currently allows for flexibility in underwriting that should be the centerpiece for its replacement.

Appendix Q and a Standard for Verification of Debt and Income

Appendix Q, while well intended, has proven static and has not evolved with the needs of the industry. Documenting the income of mainstream borrowers is relatively transparent, but the same chore is difficult for a growing number of borrowers in the gig economy and non-W2 earners. The majority of the 1.4 million members of the National Association of REALTORS® fall into this latter category.

Documenting and verifying income of borrowers proved to be part of the industry's Achilles heel in the last crisis as liar loans[13] and limited or no documentation proliferated. The ATR rule has faced limited legal challenges to clarify its bounds, mortgage fraud[14] will always remain an issue, and challenges in documenting income will evolve with the economy and trends in ownership. For instance, the Office of the Comptroller of the Currency recently issues guidance on the need to improve analysis and documentation of income sources on asset disposition loans, a trend that will likely rise with the increase in retired baby boomers buying homes.[15]

REALTORS® are agnostic on how Appendix Q is updated or whether an alternative such as FHA or GSE underwriting guides should be adopted, but believe that the market needs a more accurate and dynamic standard for measuring and documenting income. Furthermore, NAR believes that a standard for determining a borrower's ability to repay must be flexible to accommodate borrowers with unique income streams and life circumstances. It should be noted that the FHA and GSEs are both incented to update their guides to reflect both threats and innovation as they both bare the credit risk and political risk of weak guides.

Standards That Do Not Directly Measure a Consumer's Personal Finances

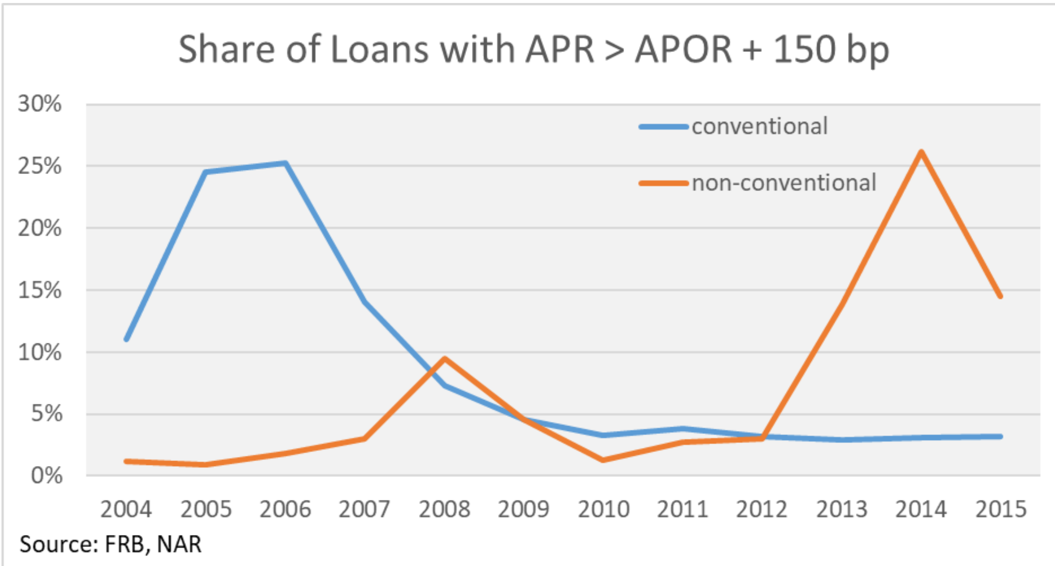
NAR's members appreciate the use of a broader spectrum of factors than income and DTI alone to measure one's ability to repay. However, REALTORS® are concerned that insufficient data and analysis exists on the performance of measures that do not require a direct measure of income as well as other alternative measures of risk. Further analysis is necessary to avoid unintended consequences to competition and credit access.

Pricing of risk provides for a more holistic view of a borrower than DTI alone. However, that view is relative and depends on the perspective of the entity performing the pricing. Not all pricing may be consistent between originators as one may gauge a

9 https://www.frbatlanta.org/-/media/documents/news/conferences/2019/0519-financial-markets-conference/presentations/davidson.pdf
10 https://www.ad-co.com/analytics_docs/QM-Patch.pdf
11 http://www.usmi.org/mi-industrys-observations-recommendations-for-replacing-cfpbs-qm-patch/
12Page 63. https://structuredfinance.org/wp-content/uploads/2019/09/Structured-Finance-Association-QM-Survey-Responses.pdf
13 Blackburn and Vermilyea. "The Prevalence and Impact of Misstated Incomes on Mortgage Loan Applications" Federal Reserve Bank of Philadelphia. 2010
14 https://www.corelogic.com/insights/mortgage-fraud-trends-report.aspx
15 Lalita Cozel. "Unconventional Mortgages Attract Warning From Regulator". Wall Street Journal. August 29, 2019

risk factor more significantly than another, based on fact or perception. Underpricing of risk can be used to gain market share. Furthermore, underpricing of credit risk was a systemic problem during the crisis.[16]

Setting QM based on pricing advantages certain business models over others. A system based on pricing would favor originators with a low cost of capital, weigh on competition, and likely access and cost for consumers. In addition, given the untested nature of the APOR-spread measure and potential litigation risk, primary market participants with the most robust analytical, pricing and legal resources are likely to dominate the market leading to de facto consolidation in pricing and products.



Pricing can change over time and the housing cycle as evidenced by the sharp increase in originator overlays following the great recession and decline in recent years. Federal Reserve data[17] depicted above shows swings in the share of fixed rate mortgages with pricing more than 150 basis points over average prime offer rate in both the conventional and non-conventional channel. The share of these high cost loans in the conventional channel surged prior to the crisis, before declining after. However, the share in the non-conventional channel was muted until surging after the crisis. The share in the non-conventional space rose sharply after implementation of the QM's safe harbor definition and the market reacted by curtailing volume. A QM definition based on pricing could expand the QM box late in the cycle and tighten during a recovery, exacerbating the housing cycle.

Furthermore, pricing could rise to reflect not just cyclical risk, but originator-specific concerns and a lack of rate shopping. An analysis by economists from the New York Federal Reserve of mortgage rates offered to borrowers found that, "substantial dispersion remains once we control finely for variation in different originators' pricing over time, across locations, or across loan programs. This implies that two observably identical borrowers may get quite different deals even from the exact same originator at the same time."[18] Furthermore, they found that locked rates', "dispersion is substantially larger for loan types and borrower characteristics that are associated with being more financially constrained and potentially less sophisticated." In a similar way, the average prime offer will fluctuate over time based on the market. *All of this evidence suggests that more testing of a patch alternative based on pricing is necessary and may require corrective measures or standardization.*

A concern for any replacement to the patch, whether through pricing or compensating factors, is that shifting the locus that defines the QM box to the primary market may have other unintended consequences. For instance, if the GSE's business model continues to be limited to QM eligible loans, the GSEs' ability to support a national market, underserved communities,

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[16] Wachter and Pavlov. "The Inevitability of Market Wide Underpricing of Mortgage Default Risk" University of Pennsylvania Scholarly Commons. 2006

[17] Bhutta and Ringo. "Residential Mortgage Lending from 2004 to 2015: Evidence from the Home Mortgage Disclosure Act Data" Federal Reserve Board. 2016

[18] Bhutta, Fuster, and Hizmo. "Paying Too Much? Price Dispersion in the US Mortgage Market" Federal Reserve Board. 2016

and countercyclical role, stipulations lain out in their charters, would depend in part on originators' risk preferences and other non-consumer related factors.

Relationship of Safe-harbor and Rebuttable-presumption QMs

REALTORS® believe that for the QM to induce strong underwriting behavior and support a liquid market, there needs to be a significant difference in the legal risks between QMs and non-QMs loans. The QM needs to provide originators with a robust tool to stop meritless ability-to-repay litigation as early as possible in the legal process, and to eliminate the "settlement value" of such litigation.

As a result, establishing the QM as a rebuttable presumption would be of very limited value to originators and investors in defending ability-to-pay litigation, even when making only qualified mortgages. Every borrower complaint filed – even a meritless one – has the potential to cost the originator or investor tens of thousands of dollars to defend or settle. If the QM provides a weak and ineffective tool for originators to dispense with non-meritorious cases early in the process, even originators who make only qualified mortgages will be faced with incurring major costs defending ability to pay litigation. We think this is precisely the result the "protections" of the QM were intended to avoid.

In addition, NAR believes the Bureau should only count points and fees paid directly by the consumer towards the calculation of points and fees under the 3 percent cap. The various structures under which originators are compensated reflect diversity and competition in the industry. Because compensation, reasonable profits, or cost of doing business under certain business models is more transparent than others should not lead to discrimination against those models.

NAR believes it is important that the CFPB consider consumers' sentiment in working with affiliated companies and the impact that the 3 percent cap has on consumers' ability to utilize such services. The National Association of REALTORS® commissioned surveys by Harris Poll in 2008, 2010, 2015, and 2019 on consumer preferences in real estate services. The surveys revealed that availability, interest, and usage in "one-stop shopping" (OSS) had increased significantly over the last decade. Nearly fifty percent of buyers used a single source to procure home-buying services in 2019 compared to 29 percent in 2008. One-stop shopping gained popularity with buyers and overall satisfaction levels were higher for those who used OSS (average of 8.4 on a scale of 0 to 10) than those who used multiple sources (8.0).[19]

Limiting competition by way of the current 3 percent cap on points and fees will only reduce service and access to credit while raising search and monetary costs for consumers.

To An Orderly Rulemaking Process and Transition

Following the finalization of the original QM rule in 2013, the CFPB provided a year for implementation. NAR Research surveyed a group of affiliated lending institutions and found that as of the 4th quarter of 2013, "16.7% of respondents indicated that they were already adapted, while an additional 44.4% indicated that it would take less than 3 months. Those that felt it would take three to six months were 27.8% of the sample and 11.2% of the sample indicated that it would take either six to nine months or nine months to a year."[20] This long lag in preparation suggests that the ability of the originators to adapt their systems and legal processes to such change take significant time. As such, REALTORS® believe any change to the QM patch should be implemented over a period of at least one year. However, this change will not occur in isolation. The administration is also seeking to make changes to the GSEs' capital standards and product availability. Thus, to the extent that these changes are advanced, additional time should be given to originators to adopt to the multiple challenges presented. However, a system with the least deviation from the current system, one that effectively adopts the holistic underwriting approach of the GSEs' system and expands it to the non-patch space would be the simplest and readily adopted by the broad market.

[19] https://narfocus.com/billdatabase/clientfiles/172/25/2950.pdf

[20] https://www.nar.realtor/mortgage-originators-survey/january-2014-mortgage-originators-survey

Conclusion

Underwriting is the foundation upon which the housing finance system rests. It is imperative that the CFPB and industry devote the time and resources to craft a clear, robust, and holistic alternative to the current patch that will extend the current robust market access under the patch to the entire market. NAR appreciates the opportunity to provide input and looks forward to continuing to work together on these important issues. If you have any questions, please contact me or NAR Senior Policy Representative, Ken Fears, at 202-383-1066 or KFears@REALTORS.org.

Sincerely,

John Smaby
2019 President, National Association of REALTORS®