January 21, 2020

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

Dear Director Kraninger:

The undersigned organizations are writing in response to the Consumer Financial Protection Bureau's (Bureau) rulemaking regarding the definition of a Qualified Mortgage (QM). Our organizations represent diverse housing finance stakeholders, including consumer groups, lenders, and mortgage insurers, and we appreciate the opportunity to provide our joint perspectives in addition to our individual comment letters that were submitted in response to the Bureau's Advance Notice of Proposed Rulemaking (ANPR). The Ability-to-Repay (ATR) rule in the Dodd-Frank Wall Street Reform and Consumer Protection Act is one of the most important consumer safeguards in the legislation, and the Bureau's regulations to promulgate and execute it will directly affect access to safe and affordable mortgage finance credit. We all agree that maintaining access to affordable and sustainable mortgage credit should be a key objective of the Bureau's revised rulemaking.

We appreciate the Bureau's thoughtful approach to assessing and implementing potential changes to the QM definition. This letter contains our joint recommendation that the Bureau implement a QM definition that relies on measurable underwriting thresholds and the use of compensating factors for higher risk mortgages rather than either a pricing-based QM definition that uses the spread between the annual percentage rate (APR) and the Average Prime Offer Rate (APOR) as a proxy for underwriting requirements (the "APOR approach") or a hard cut-off at either 43% or 45% DTI.

Specifically, this coalition strongly supports:

1. **The continued use of a modified debt-to-income (DTI) ratio in conjunction with certain compensating factors, which could be used in the underwriting process and would provide guidance to creditors on their use; and**
2. **Significant changes to Appendix Q to rely on more flexible and dynamic standards for calculating income and debt.**

<u>Compensating Factors Would Enable Prudent Underwriting and Affordable Access to Credit</u>

The Bureau should establish a set of transparent mitigating underwriting criteria – "compensating factors" – for mortgages with DTI ratios above 45% and up to 50%. While DTI is not the most predictive factor in assessing a borrower's ability to repay, it can, in concert with compensating factors, function as a bright line that mitigates undue risk in the conventional market while continuing to provide affordable access to mortgage finance for creditworthy borrowers. Moreover, DTI is a widely and commonly used metric when considering a borrower's ability to repay in mortgage loan underwriting and is the standard in the current rule issued in 2013. While a higher DTI may indicate increased stress for the borrower and a consequent strain on ability to repay, the presence of other positive credit characteristics – such as liquid reserves, limited payment shock, and/or a down payment from the borrower's own funds – can mitigate the heightened risk and limit the risk layering that drives loan non-performance. In fact, the automated underwriting systems (AUSs) used by Fannie Mae and Freddie Mac (the GSEs), as well as proprietary AUSs used by primary market lenders, have always used compensating factors to assess borrowers' ATR, and such a multifactor approach has long been the standard for manual underwriting throughout the industry.

The efficacy of using compensating factors for high-DTI mortgages is demonstrated by the track record of loans acquired by the GSEs. Rather than introducing undue risk to the housing finance system, these loans have performed well. In fact, high-DTI loans (with ratios between 45.1% and 50%) underwritten using compensating factors outperform loans with lower DTI ratios (between 35.01% and 45%). The lower delinquency rates on the higher DTI loans are almost certainly due to the presence of appropriate compensating factors in the GSEs' AUSs.[1]

The table below reflects one specific set of compensating factors we believe are appropriate for borrowers with DTIs above 45% and up to 50% that could be tailored for the revised rule. These recommendations are based on: (1) internal analysis and efforts to "back into" the compensating factors currently used by the GSEs to avoid a dramatic shift in the market; and (2) known factors that significantly impact borrowers' ATR. This is by no means an exhaustive list and we welcome further discussion about compensating factors and their respective predictiveness. The Bureau's final rule on the QM definition could authorize the GSEs, Federal Housing Finance Agency (FHFA), or an independent standard-setting entity to formulate a transparent list of compensating factors and should make the underlying data and analysis available to the public for ongoing review and assessment to ensure that dynamic compensating factors can be updated to reflect changes in the market and mortgage credit risk environment.

Factor	Rationale	Supporting Data
Liquid reserves of at least 3 months (similar to FHA, this would include checking and savings accounts, cash, stocks and bonds, and gifts).[2]	Borrowers with higher amounts of liquid reserves are less likely to become delinquent on their mortgages and are better prepared to weather a negative financial event.	A borrower with at least three months reserves in the bank is 5x less likely to default on his/her mortgage than a borrower who had insufficient funds to cover even 1 mortgage payment. While borrowers with less than 1 month's mortgage payment in savings comprised only 20% of mortgages, they accounted for 54% of the mortgages that went 90 or more days delinquent.[3]
Prior history of similar monthly payments and credit history that meets certain standards, including no 30-day late mortgage or rent payment and a maximum of one 30-day late non-real estate payment in the past 12 months.	Limited payment shock and demonstrated capacity to make similar monthly payments for housing—including rent payments where data is available—and other expenses is indicative of a borrower's ATR. A robust and established credit history has a positive impact on a borrower's credit profile and is reflected in his/her credit score.	Mortgages to borrowers with significant payment shocks are considerably more likely to be early payment default (EPD) loans.[4] Further, borrowers with adverse mortgage events (late payments, prior mortgage defaults, etc.) significantly underperform compared to borrowers with without adverse mortgage events.
Down payment of at least 5% from borrower's own funds (for purchase-money loans)	Borrowers with more equity are less likely to become delinquent on their mortgages.	Performance for borrowers with DTIs above 45% significantly improves with at least a 5% down payment. The ever-delinquent rate is 50% lower for loans with LTVs 90.01-95% versus loans with LTVs above 95%.[5]

[1] GSE Single Family Loan-Level Dataset.
[2] Documented cash reserves that are liquid or readily convertible to cash. Similar to FHA, this would include: borrower-held checking and savings accounts; cash held outside a financial institution; stocks and bonds; private savings clubs; and gifts (from relatives, close friend, charitable organization; or governmental agency). *See* HUD Single Family Housing Handbook at 4000.1.II.A.4.d, (Aug. 14, 2019), https://www.hud.gov/sites/dfiles/OCHCO/documents/4000.1hsgh.pdf.
[3] JPMorgan Chase Institute, *Trading Equity for Liquidity: Bank Data on the Relationship Between Liquidity and Mortgage Default* (June 2019), https://www.jpmorganchase.com/corporate/institute/report-trading-equity-for-liquidity.html.
[4] USMI member company data demonstrates that mortgage borrowers with a more than 50% payment shock form 2016-2019 were more likely to be EPD loans compared to borrowers whose payments remained similar or that had a less than 50% increase in their payments. This data is for all DTIs, and therefore additional analysis should be performed to understand specifically what percentage increase impacts borrowers with DTI ratios above 45% and up to 50%.
[5] GSE Single Family Loan-level Data.

Using an APOR-Only Approach Does Not Meet the Legislative Intent of the Statute and Does Not Appropriately Measure Ability to Repay

The APOR approach is premised on the faulty idea that pricing fully captures credit risk and that, in turn, credit risk is a reasonable marker for ability to repay. In the mortgage industry, a loan's pricing reflects a number of factors outside of an individual borrower's credit profile, including a lender's balance sheet capacity, prepayment speeds, the value of mortgage servicing rights, business goals, and broader economic considerations. With regard to risk, pricing does consider down payment and credit score, but often fails to capture risk-mitigating characteristics such as borrower reserves, DTI ratios, and payment shock.

Any QM definition that relies solely on the statutory ATR requirements or the price of a loan will be seriously flawed. ATR requirements are too broad and do not adequately reflect a borrower's ability to repay. On the other hand, a loan's price can be manipulated to gain QM safe-harbor status.

There are several important consumer protection concerns at issue. First, loans made within the QM safe harbor are not, practically speaking, subject to underwriting thresholds/requirements for determining ATR because if a loan meets the product feature requirements along with any other adopted QM standards, no adjudicative body or regulator can "look under the hood" and examine the fuller underwriting process.

Second, if the only underwriting protection is APOR, mortgages could be made to financially vulnerable borrowers at a price just below the safe harbor threshold even though the borrowers' financial/credit profiles might otherwise call for greater underwriting analysis consideration and ATR protections. This mispricing of risk helped set the 2008 financial crisis in motion.

Third, using this approach assumes creditors are able to uniformly and accurately price risk of repayment, an assumption that was disproven in the financial crisis and ignores market and economic pressures that can drive underpricing of risk.

Fourth, an APOR approach could increase risk within the mortgage finance system as APOR is a trailing indicator of risk and can be procyclical. Therefore, periods of sharply rising rates could cause temporary suspensions in lending that could impact prime loans with higher risk attributes. Additionally, during periods of low rates and loose credit, borrowers run the risk of being overextended.

An APOR Approach Could Make It Harder for Creditworthy Low Down Payment and Minority Borrowers to Obtain Mortgages

Moving from a DTI-based QM standard to an APOR approach could reduce the ability of low down payment and minority borrowers to obtain conventional mortgages. For example, based on 2018 Home Mortgage Disclosure Act (HMDA) data, $11-12 billion in GSE purchase origination volume had loan-to-value (LTV) ratios of >80% and APRs with spreads in excess of APOR + 150 basis points.[6] Further, based on the same dataset, African American and Hispanic borrowers were *twice* as likely as white borrowers to have mortgages with APRs in excess of the APOR + 150 basis points safe harbor spread.[7]

Many qualified borrowers who are not able to obtain mortgages that meet an APOR standard under a revised QM definition would be denied access to homeownership opportunities while other qualified borrowers in this category would see their loan options reduced. Some mortgages that would normally have been made in the conventional market would gravitate towards the 100% taxpayer-backed FHA, an outcome that is inconsistent with the Administration's housing finance reform principles and objectives as articulated in the September 2019 reports from the Department of the Treasury and the Department of Housing and Urban Development.

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[6] 2018 HMDA Data, GSE Purchase Origination Data, and Genworth MI.
[7] *Id*.

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Regardless of the solution chosen, we urge that the transition period from the existing GSE Patch to the new QM framework be sufficiently long to allow market participants adequate time to plan for, and adjust to, new rules and underwriting standards. Any transition to a new QM rule ought to be smooth and well thought-out. Otherwise it risks regulatory uncertainty that might cause mortgage originators to retreat from lending to creditworthy homebuying and refinancing borrowers.

Thank you again for the opportunity to share our collective perspectives on the Bureau's work regarding the QM definition. The expiration of the GSE Patch and what is developed to replace it will have significant implications for consumers' access to affordable and sustainable mortgage finance credit. We hope to have a continued constructive dialogue through a robust comment process to result in the best future standard and we welcome the opportunity to serve as resources as the Bureau works toward a proposed, and then final, rule.

Sincerely,

Consumer Federation of America
Community Home Lenders Association
The Community Mortgage Lenders of America
Independent Community Bankers of America
National Association of Federally-Insured Credit Unions
National Association of REALTORS®
National Community Stabilization Trust
National Consumer Law Center (on behalf of its low-income clients)
U.S. Mortgage Insurers

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