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September 8, 2020

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

Re: Notice of Proposed Rulemaking Regarding Qualified Mortgage Definition Under the Truth in Lending Act (Regulation Z); Docket No. CFPB-2020-0020

Submitted Electronically Via: [*http://www.regulations.gov/*](http://www.regulations.gov/)

Dear Director Kraninger:

On behalf of the 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) notice of proposed rulemaking (NPRM) on the *Qualified Mortgage (QM) Definition under the Truth in Lending Act (Regulation Z): General QM Loan Definition*. NAR has long advocated for a reassessment of the general QM rule and QM "patch" for the Government Sponsored Enterprises (GSEs or Enterprises) and appreciates the CFPB's efforts to clarify a market-wide rule that brings a more wholistic approach rather than a limited, single debt-to-income (DTI) rule. However, REALTORS® remain concerned that the proposed rule has not addressed several weaknesses that could result in higher and inconsistent costs for consumers, discrimination, and a weakening of safety and soundness. The CFPB should at a minimum:

- Expand the proposed safe harbor in the pricing rule to 200 basis points over average prime offer;
- Create means to measure and minimize non-consumer and non-credit related factors from the APOR-spread used to qualify borrowers for the safe harbor; and,
- Transition over the long-term to a rule governed by an outcomes-based approach and either administered by the CFPB in conjunction with the Federal Housing Finance Agency or a private self-regulating organization (SSO).

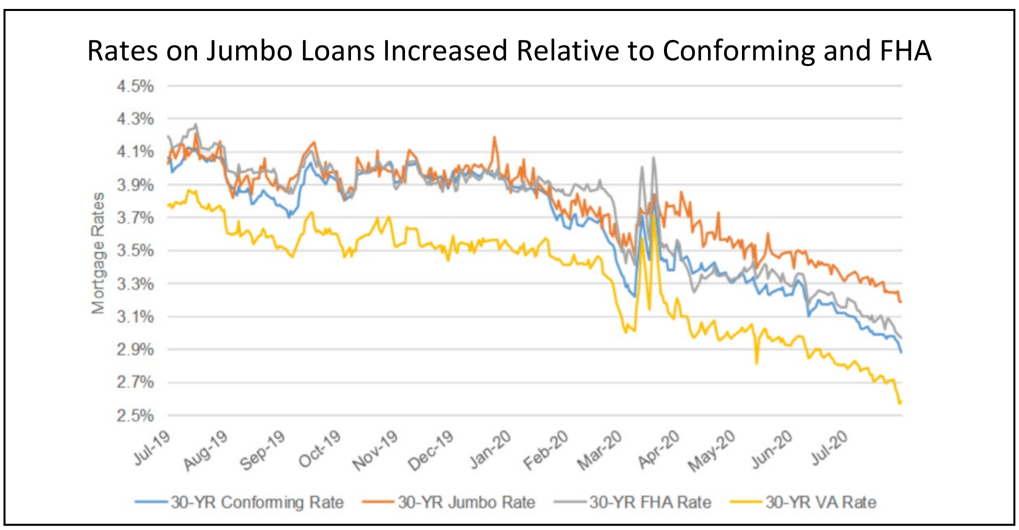
The National Association of REALTORS® is America's largest trade association, including NAR's five commercial real estate institutes and its societies and councils. REALTORS® are involved in all aspects of the residential and commercial real estate industries and belong to one or more of some 1,200 local 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.

Homeownership is an integral part of the American Dream and the QM rule should be flexible enough to adapt to changing life patterns, including for individuals and families with non-traditional income documentation. Underwriting is the foundation for America's housing finance system that supports this American Dream. Given what America is facing right now, with the financial strain and threat to housing security for many families across the country, the CFPB's rules process should not be rushed. A comprehensive re-evaluation of the patch and a market-wide QM requires a thorough vetting of all alternatives and their impact on both competition and consumer access under all economic conditions.

Proposal is a Notable Improvement

The proposed rule would adapt much of the current qualified mortgage rule with important modifications. Documentation and verification requirements for income, assets, employment, and other factors would remain in place as the ability to repay (ATR) rule is unchanged. Likewise, loans with pricing up to 150 basis points over the average prime offer rate (APOR) would retain legal safe harbor, but the CFPB has proposed a pricing cap of 200 basis points for a mortgage to retain a legal rebuttable presumption. Wisely, the CFPB has eliminated the invariant 43 percent back-end DTI ratio as a requirement for safe harbor status. Finally, the CFPB has proposed to allow originators to use facets of any underwriting guide deemed acceptable by the CFPB (e.g. Fannie Mae, Freddie Mac, FHA, VA, and Rural).

While the NPRM introduces a number of improvements, its reliance on a pricing approach would likely limit consumer participation and/or financing options in all economic environments, including at times where risk is normalized or when the market is stressed. Pricing in the non-GSE market spiked during the pandemic and remains elevated. As a result, under the proposed rule, a greater share of loans in the *non-GSE* segment could lose their safe harbor status under the proposed pricing structure or need to shift to the GSE market with a larger down payment (the orange line spikes above the blue and grey in the chart below). Likewise, production or consumer options within the GSEs segment could decline if their guarantee fees are raised relative to bank portfolio and PLS issuers. Broadening the price spread would help to ameliorate these issues.



The pricing approach as proposed, unnecessarily limits consumer options in other ways. The FHA maintains its own definition of QM, which adjusts for required FHA mortgage insurance in the safe harbor test. The FHA's safe harbor is APOR plus 115 bps plus the annual mortgage insurance premium (MIP). The U.S. Department of Housing and Urban Development (HUD) noted that the "MIP by itself should not be the factor that determines whether a loan is a higher-priced transaction" when it developed its policy.[1] Thus, the measure used by HUD provides safe harbor protections to a larger portion of the market than the market-wide definition proposed here. Yet, the CFPB deems those borrowers as receiving adequate legal protections and low risk. Expanding the APOR spread

[1] Housing and Urban Development Department. "Qualified Mortgage Definition for HUD Insured and Guaranteed Single Family Mortgages". 12/11/2013

for safe harbor protection in the proposed rule would help level the playing field for consumers using mortgage insurance, providing optionality without additional risk.

As the CFPB notes in the NPRM, mortgage originators have limited their production outside of the QM safe harbor legal protections. Thus, 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. Expanding the safe harbor to 200 basis points over APOR helps to achieve this certainty.

However, the proposal retains a number of issues which NAR previously conveyed to the CFPB in response to its advanced notice of proposed rulemaking on this topic.[2] Several of these concerns may be ameliorated as impediments to access by raising the proposed pricing spread to APOR, but the higher cost to consumers, weakened safety and soundness of the market, and other underlying concerns will likely remain. These concerns include:

- **Pricing Can Undermine Market Stability:**
    - Pricing of risk provides for a more holistic view of a borrower than DTI alone. However, this pricing is relative and dependent upon the perspective of the entity performing the pricing. Not all pricing may be consistent between originators as one may gauge a risk factor more significantly than another, based on fact or perception. Furthermore, underpricing of credit risk can be used to gain market share and was a systemic problem during the subprime crisis.
    - Furthermore, pricing can change over time and throughout the housing cycle, as evidenced by the sharp increase in originator overlays during the ongoing pandemic. A QM definition based on pricing could expand the QM box late in the cycle and tighten during a recovery, exacerbating the housing cycle.

- **Reduced Competition could cause Decreased Access to Credit:**
    - 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 could reduce access and raise costs for consumers. In addition, given the untested nature of the APOR-spread measure and potential litigation risk, primary market participants with a secondary market presence or 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 Models Treat Borrowers Inconsistently**
    - Pricing can incorporate risks or factors that are not specific to the borrower. An analysis of mortgage rates by economists from the New York Federal Reserve 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*."[3] 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.
    - Worse, a study by economists at the University of California at Berkeley found that, "that lenders charge otherwise-equivalent Latinx/African-American borrowers 7.9 (3.6) bps higher rates for purchase (refinance) mortgages, costing $765M yearly. FinTechs fail to eliminate impermissible discrimination, possibly because algorithms extract rents in weaker competitive environments and/or profile borrowers on low-shopping behavior."[4]

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[2] https://narfocus.com/billdatabase/clientfiles/172/3/3437.pdf
[3] Bhutta, Fuster, and Hizmo. "Paying Too Much? Price Dispersion in the US Mortgage Market" Federal Reserve Board. 2016
[4] Robert Bartlett, Adair Morse, Richard Stanton, and Nancy Wallace. "Consumer-Lending Discrimination in the FinTech Era". Haas School of Business UC Berkeley. November, 2019

- **A Pricing Approach Impacts Other Consumer Regulations**
    - A major 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, and countercyclical role - stipulations outlined out in their charters - would depend in large part on investor and originators' risk preferences, and other non-consumer related factors.

While the use of a broader spectrum of factors than income and DTI alone better measure one's ability to repay, the concerns outlined above reiterate that more sufficient data and analysis is needed to predict the performance of measures that lack a direct determination of income as well as other alternative measures of risk. Further analysis is critical to avoiding unintended consequences to competition, credit access, and consumers.

In the near term, the CFPB at a minimum, could ameliorate the effects a pricing model could have on access by expanding the maximum spread over APOR to 200 basis points for the legal safe harbor. However, the CFPB should also develop means for identifying factors that affect pricing, but which are not related to the consumers' ability to repay, and eliminate them from the proposed measure of pricing spread. Eventually, as discussed below, the CFPB will need to address the cost, fairness, and market stability issues raised by this approach.

Shift to a Dynamic Underwriting Guide
Appendix Q, while well intended, has proven static and not evolved with the needs of consumers and the industry. Documenting the income of mainstream borrowers is relatively transparent, but the same chore is difficult for the 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.

NAR advocates for the development of a comprehensive guide for verifying information used in determining a borrower's ability to repay that is also flexible and able 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 respective guides to reflect both threats and innovation as they both bare the credit risk and political risk of insubstantial guides. To this end, REALTORS® appreciate the proposed shift from reliance on appendix Q to allow originators to use aspects of multiple underwriting guides approved by the CFPB. Guides such as those used by Fannie Mae, Freddie Mac, the FHA, VA, and RHS, have long track records, are well vetted, and are regularly updated.

Need for an Orderly Rulemaking Process and Transition
The temporary GSE qualified mortgage rule supported access to credit for a broad swath of homebuyers in the wake of the crisis to the pandemic and in between. At the same time, GSE underwriting has been the standard for the market for several decades. As the CFPB points out in the NPRM, moving forward without an adequate replacement would harm a significant number of homebuyers. It will take time and investments by small and midsized lenders to adjust to and implement the requirements of the new rule. Larger originators with developed pricing abilities and the legal resources to defend them will have a head start, which could lead to a decline in competition. Originators with links to the secondary market and the ability to create a vertical structure from the primary to secondary market would have an even larger advantage.

In addition, in light of the recent Supreme Court decision in *Seila Law LLC v. the CFPB* changing the removal protections of the CFPB's leadership and the pending case of *Collins v. Mnuchin*, substantial reforms made in the months preceding a presidential election will be more susceptible to change should the Administration change hands. This could cost market participants significant invests as they prepare for the CFPB's proposed changes to the QM regime without the clarity that it will be sustained for the long-term. To this end, it would be best to provide a lengthy finalization and implementation period to avoid wasted time and expense, especially while the nations' mortgage market is simultaneously facing a looming instability crisis due to the end of unemployment insurance that will impact the mortgage and servicing industries.

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."[5] This long lag in preparation suggests that the ability of originators to adapt their systems and legal processes will take significant time. As such, any change to the QM patch should be implemented over a period of at least one year.

Finally, this change will not occur in isolation further complicating matters and potentially harming creditworthy borrowers and potentially destabilizing the market. The administration is also seeking to make changes to the Enterprises' capital standard. Analysts have estimated that the proposed capital rule will cause mortgage "rates [to] increase by an average of 15 to 20 basis points while the GSEs remain in conservatorship and 30 to 35 basis points if they were released from conservatorship." Since the average prime offer rate is based on conventional conforming loans in the primary mortgage market survey produced by Freddie Mac, that change will affect the average prime offer used in the proposed rule. Thus, to the extent that these changes are advanced on the current schedule, additional time should be given for the CFPB to study the impact of the FHFA's proposed capital rule on pricing, consumers, and the market, and to originators to adopt to the multiple challenges presented.

Need for Further Transformation

The CFPB created the patch exemption for the Enterprises 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 through the Enterprises, the CFPB has allowed the market to originate well-underwritten loans to responsible consumers. As the CFPB notes in the proposed rule, that rebuttable presumption space remains small as originators have limited production.

Similarly, mortgage investors have voiced concerns about the quality of loans in the non-government channel and their exposure to "assignee risk" under the qualified residential mortgage rule (QRM).[6] That is, under the QRM rule, investors who buy mortgages are liable for the underwriting of originators. Thus, investors have an interest in monitoring underwriting. In practice, though, monitoring underwriting to this level is difficult, if not impossible, and investors are at the mercy of originator practices. As a result, in the short-term, it may be difficult for MBS investors to venture beyond Enterprise-backed mortgages under the proposed rule in the same way that originators have shown little interest in producing rebuttable mortgages. This risk aversion is likely a remnant of the losses born by investors in the wake of the subprime crisis. Therefore, it is in investors' interest to purchase MBS with sound underwriting and pricing models, like the GSEs, which could undermine a leveling of the market around the QM rule and adoption of non-GSE innovations in underwriting.

Conversely, underpricing of risk or masking quality could become a concern over the long-term if the pessimism towards non-government backed or Enterprise securitization declines without commensurate improvements in non-GSE underwriting and oversight by investors of origination standards. While the proposed pricing rule may set a standard spread to the APOR, it does not create a consistent rule for pricing parameters relative to outcomes. For example, one originator could price a borrower with 680 credit score and 5 percent down payment near the safe harbor limit, while a second lender could price the loan well below it. It is not unreasonable to suggest that in the future, some lenders could underprice mortgages to gain the safe harbor, particularly if a path to securitization reopens. If in the future a willing securitization market for these loans develops, this proposal could recreate the originate-to-distribute model that allowed originators to avoid bearing the impact of the risk they syndicated in the subprime crisis, while putting investors at more risk than they anticipate. It is true that investors may vet mortgages more thoroughly today than in the past, but that could decline or new investors without the expertise may enter the market, resulting in an inability to separate quality in pools or push them back to issuers, jeopardizing the entire market.

To remedy variation in pricing parameters and lack of a cap on risk, both Andrew Davidson & Co. [7] and the U.S. Mortgage Insurance[8] trade association have each recommended the CFPB incorporate compensating factors based on historic GSE underwriting patterns, while others have proposed a QM replacement that sets a max default probability for each loan regardless of parameters. Furthermore, a majority of members of the Structured Finance Association,[9] which represents both the issuers and investors in MBS who will bear the risk of

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[5] https://www.nar.realtor/mortgage-originators-survey/january-2014-mortgage-originators-survey
[6] Libby Cantrill, Mike Cudzil, Daniel H. Hyman, Kent Smith. "Housing Finance Reform: First Things First" PIMCO. July 18, 2017
[7] https://www.ad-co.com/analytics_docs/QM-Patch.pdf
[8] http://www.usmi.org/mi-industrys-observations-recommendations-for-replacing-cfpbs-qm-patch/
[9] Page 63. https://structuredfinance.org/wp-content/uploads/2019/09/Structured-Finance-Association-QM-Survey-Responses.pdf

manufacture and underwriting, support such a proposal and nearly half support the creation of a private self-standard setting organization (SSO) to determine the QM standard. While NAR does not endorse a particular plan, at the minimum, any rule should protect consumers, while preserving safety and soundness and the steady flow of affordable mortgages. A long-term goal of the CFPB should be to transition the proposed pricing approach to one that looks at pricing in relation to consumer and market outcomes and which is vetted and accepted by both originators and investors.

Conclusion
Underwriting is the foundation upon which the housing finance system rests. It is imperative that the CFPB and industry continue to work toward a clear, robust, and holistic alternative to the current and proposed patch that will extend the current market access under the patch to the entire market. To this end, REALTORS® recommend that the CFPB first expand the proposed rule and develop means to eliminate non-consumer related factors in pricing. Over the long-term, the CFPB should transition to a framework that better protects both consumers and the 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@Nar.Realtor.

Sincerely

Vince Malta
2020 President, National Association of REALTORS®