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BUREAU OF CONSUMER FINANCIAL PROTECTION

12 CFR Part 1026

Docket No. CFPB-2019-0039

RIN 3170-AA98

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

AGENCY: Bureau of Consumer Financial Protection.

ACTION: Advance notice of proposed rulemaking.

SUMMARY: With certain exceptions, Regulation Z requires creditors to make a reasonable, good faith determination of a consumer's ability to repay any residential mortgage loan, and loans that meet Regulation Z's requirements for "qualified mortgages" obtain certain protections from liability. One category of qualified mortgages (QMs) is loans that are eligible for purchase or guarantee by either the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac). Under Regulation Z, this category of QMs (Temporary GSE QM loans) is scheduled to expire no later than January 10, 2021. The Bureau currently plans to allow the Temporary GSE QM loan category to expire in January 2021 or after a short extension, if necessary, to facilitate a smooth and orderly transition away from the Temporary GSE QM loan category. The Bureau is considering whether to propose revisions to Regulation Z's general qualified mortgage definition in light of that planned expiration and is issuing this ANPR to request information about possible revisions.

DATES: Comments must be received on or before [**INSERT DATE 45 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER**].

ADDRESSES: You may submit comments, identified by Docket No. CFPB-2019-0039 or RIN

3170-AA98, by any of the following methods:

- *Federal eRulemaking Portal*: *http://www.regulations.gov.* Follow the instructions for submitting comments.
- *Email*: *2019-ANPR-ATRQM@cfpb.gov.* Include Docket No. CFPB-2019-0039 or RIN 3170-AA98 in the subject line of the email.
- *Mail*: Comment Intake – ATR/QM ANPR, Bureau of Consumer Financial Protection, 1700 G Street, NW, Washington, DC 20552.
- *Hand Delivery / Courier*: Comment Intake – ATR/QM ANPR, Bureau of Consumer Financial Protection, 1700 G Street, NW, Washington, DC 20552.

Instructions: The Bureau encourages the early submission of comments. All submissions should include the agency name and docket number or Regulatory Information Number (RIN) for this rulemaking. Because paper mail in the Washington, DC area and at the Bureau is subject to delay, commenters are encouraged to submit comments electronically. In general, all comments received will be posted without change to *http://www.regulations.gov.* In addition, comments will be available for public inspection and copying at 1700 G Street, NW, Washington, DC 20552, on official business days between the hours of 10:00 a.m. and 5:00 p.m. Eastern Time. You can make an appointment to inspect the documents by telephoning 202–435–7275.

All comments, including attachments and other supporting materials, will become part of the public record and subject to public disclosure. Proprietary or sensitive personal information, such as account numbers, Social Security numbers, or names of other individuals, should not be included. Comments will not be edited to remove any identifying or contact information.

FOR FURTHER INFORMATION CONTACT: Seth Caffrey, Joseph Devlin, or Courtney Jean, Senior Counsels, Office of Regulations, at 202–435–7700. If you require this document in an alternative electronic format, please contact *CFPB_accessibility@cfpb.gov*.

SUPPLEMENTARY INFORMATION:

The Bureau is issuing this ANPR to request information regarding Regulation Z's definition of qualified mortgage loans.[1] The Bureau invites comment on all aspects of this ANPR from all interested parties, including consumers, consumer advocacy groups, industry members and trade groups, and other members of the public.

I. Background

A. *Dodd-Frank Amendments to the Truth in Lending Act*

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) amended the Truth in Lending Act (TILA) to establish, among other things, ability-to-repay (ATR) requirements in connection with the origination of most residential mortgage loans.[2] The amendments were intended "to assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deceptive or abusive."[3] As amended, TILA prohibits a creditor from making a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that the consumer has a reasonable ability to repay the loan.[4]

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[1] *See* 12 CFR 1026.43.

[2] Public Law 111-203, sec. 1411-12, 1414, 124 Stat. 1376 (2010); 15 U.S.C. 1639c.

[3] 15 U.S.C. 1639b(a)(2).

[4] 15 U.S.C. 1639c(a)(1). TILA section 103 defines "residential mortgage loan" to mean, with some exceptions including open-end credit plans, "any consumer credit transaction that is secured by a mortgage, deed of trust, or other equivalent consensual security interest on a dwelling or on residential real property that includes a dwelling."

TILA identifies the factors a creditor must consider in making a reasonable and good faith assessment of a consumer's ability to repay. These factors are the consumer's credit history, current and expected income, current obligations, debt-to-income ratio or residual income after paying non-mortgage debt and mortgage-related obligations, employment status, and other financial resources other than equity in the dwelling or real property that secures repayment of the loan.[5] A creditor, however, may not be certain whether its ATR determination is reasonable in a particular case, and it risks liability if a court or a regulator, including the Bureau, later concludes that the determination was not reasonable.

TILA addresses this uncertainty by defining a category of loans—called qualified mortgages (QMs)—for which a creditor "may presume that the loan has met" the ATR requirements.[6] The statute generally defines qualified mortgage to mean any residential mortgage loan for which:

- There is no negative amortization, interest-only payments, or balloon payments;
- The loan term does not exceed 30 years;
- The total points and fees generally do not exceed 3 percent of the loan amount;
- The income and assets relied upon for repayment are verified and documented;
- The underwriting uses a monthly payment based on the maximum rate during the first five years, uses a payment schedule that fully amortizes the loan over the loan term, and takes into account all mortgage-related obligations; and

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15 U.S.C. 1602(dd)(5). TILA section 129C also exempts certain residential mortgage loans from the ability-to-repay requirements. *See*, *e.g.*, 15 U.S.C. 1639c(a)(8) (exempting reverse mortgages and temporary or bridge loans with a term of 12 months or less).

[5] 15 U.S.C. 1639c(a)(3).

[6] 15 U.S.C. 1639c(b)(1).

- The loan complies with any guidelines or regulations established by the Bureau relating to the ratio of total monthly debt to monthly income or alternative measures of ability to pay regular expenses after payment of total monthly debt.[7]

B. *The Ability-to-Repay/Qualified Mortgage Rule*

In January 2013, the Bureau issued a final rule amending Regulation Z to implement TILA's ATR requirements (January 2013 Final Rule).[8] The January 2013 Final Rule became effective on January 14, 2014, and the Bureau amended it several times through 2016.[9] This ANPR refers to the January 2013 Final Rule and later amendments to it collectively as the Ability-to-Repay/Qualified Mortgage Rule, the ATR/QM Rule, or the Rule.

The ATR/QM Rule implements the statutory ATR provisions discussed above and defines several categories of QM loans.[10] Under the Rule, a creditor that makes a QM loan is protected from liability presumptively or conclusively, depending on whether the loan is "higher priced."[11]

One category of QM loans defined by the Rule consists of "General QM loans." A loan is a General QM loan if:

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[7] 15 U.S.C. 1639c(b)(2)(A).

[8] 78 FR 6408 (Jan. 30, 2013).

[9] *See* 78 FR 35429 (June 12, 2013); 78 FR 44686 (July 24, 2013); 78 FR 60382 (Oct. 1, 2013); 79 FR 65300 (Nov. 3, 2014); 80 FR 59944 (Oct. 2, 2015); 81 FR 16074 (Mar. 25, 2016).

[10] 12 CFR 1026.43(c), (e).

[11] The Rule generally defines a "higher priced" loan to mean a first-lien mortgage with an annual percentage rate (APR) that exceeded the average prime offer rate (APOR) for a comparable transaction as of the date the interest rate was set by 1.5 or more percentage points; or a subordinate-lien mortgage with an APR that exceeded the APOR for a comparable transaction as of the date the interest rate was set by 3.5 or more percentage points. 12 CFR 1026.43(b)(4). A creditor that makes a QM loan that is not "higher priced" is entitled to a conclusive presumption that it has complied with the Rule—*i.e.*, the creditor receives a safe harbor. 12 CFR 1026.43(e)(1)(i). A creditor that makes a QM loan that is "higher priced" is entitled to a rebuttable presumption that it has complied with the Rule. 12 CFR 1026.43(e)(1)(ii).

- The loan does not have negative-amortization, interest-only, or balloon-payment features, a term that exceeds 30 years, or points and fees that exceed specified limits;[12]
- The creditor underwrites the loan based on a fully amortizing schedule using the maximum rate permitted during the first five years;[13]
- The creditor considers and verifies the consumer's income and debt obligations in accordance with Appendix Q of the Rule;[14] and
- The ratio of the consumer's total monthly debt to total monthly income (DTI ratio) is no more than 43 percent, determined in accordance with Appendix Q of the Rule.[15]

Appendix Q contains standards for calculating and verifying debt and income for purposes of determining whether a mortgage satisfies the 43 percent DTI limit for General QM loans. The standards in Appendix Q were adapted from guidelines maintained by the Department of Housing and Urban Development's Federal Housing Administration (FHA) when the January 2013 Final Rule was issued.[16] Appendix Q addresses how to determine a consumer's employment-related income (*e.g.*, income from wages, commissions, and retirement plans); non-employment related income (*e.g.*, income from alimony and child support payments, investments, and property rentals); and liabilities, including recurring and contingent liabilities and projected obligations.[17]

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[12] 12 CFR 1026.43(e)(2)(i)-(iii).

[13] 12 CFR 1026.43(e)(2)(iv).

[14] 12 CFR 1026.43(e)(v).

[15] 12 CFR 1026.43(e)(vi).

[16] 78 FR 6408, 6527-28 (Jan. 30, 2013) (noting that Appendix Q incorporates, with certain modifications, the definitions and standards in HUD Handbook 4155.1, Mortgage Credit Analysis for Mortgage Insurance on One-to-Four-Unit Mortgage Loans).

[17] 12 CFR 1026, Appendix Q.

A second, temporary category of QM loans defined by the Rule consists of mortgages that: (1) comply with the Rule's prohibitions on certain loan features, its underwriting requirements, and its limitations on points and fees;[18] and (2) are eligible to be purchased or guaranteed by either Fannie Mae or Freddie Mac (collectively, the GSEs) while under the conservatorship of the Federal Housing Finance Agency (FHFA) (Temporary GSE QM loans).[19] Unlike for General QM loans, Regulation Z does not prescribe a DTI limit for Temporary GSE QM loans. Thus, a loan can qualify as a Temporary GSE QM loan even if the DTI ratio exceeds 43 percent, as long as the DTI ratio meets the GSEs' DTI requirements and other underwriting criteria. In addition, income and debt for such loans, and DTI ratios, generally are verified and calculated using GSE standards, rather than Appendix Q. The Temporary GSE QM loan category—also known as the GSE Patch—is scheduled to expire when the GSEs exit conservatorship or on January 10, 2021, whichever comes first.[20]

In the January 2013 Final Rule, the Bureau explained why it created the Temporary GSE QM loan category. The Bureau observed that it did not believe that a 43 percent DTI ratio "represents the outer boundary of responsible lending" and acknowledged that historically, and even after the financial crisis, over 20 percent of mortgages exceeded that threshold.[21] The

[18] 12 CFR 1026.43(e)(2)(i)-(iii).

[19] 12 CFR 1026.43(e)(4).

[20] 12 CFR 1026.43(e)(4)(iii)(B). The ATR/QM Rule created several additional categories of QM loans. The first additional category consisted of mortgages eligible to be insured or guaranteed (as applicable) by the U.S. Department of Housing and Urban Development (FHA loans), the U.S. Department of Veterans Affairs (VA loans), the U.S. Department of Agriculture (USDA loans), and the Rural Housing Service (RHS loans). 12 CFR 1026.43(e)(4)(ii)(B)-(E). This temporary category of QM loans no longer exists because the relevant Federal agencies have since issued their own qualified mortgage rules. *See, e.g.*, 24 CFR 203.19 (HUD rule). Other categories of QM loans provide more flexible standards for certain loans originated by certain small creditors. 12 CFR 1026.43(e)(5), (f); *cf.* 12 CFR 1026.43(e)(6) (applicable only to covered transactions for which the application was received before April 1, 2016).

[21] 78 FR 6408, 6527 (Jan. 30, 2013).

Bureau believed, however, that, as DTI ratios increase, "the general ability-to-repay procedures, rather than the qualified mortgage framework, is better suited for consideration of all relevant factors that go to a consumer's ability to repay a mortgage loan" and that "[o]ver the long term . . . there will be a robust and sizable market for prudent loans beyond the 43 percent threshold even without the benefit of the presumption of compliance that applies to qualified mortgages."[22]

At the same time, the Bureau noted that the mortgage market was especially fragile following the mortgage crisis, and GSE-eligible loans and other federally insured or guaranteed loans made up a significant majority of the market.[23] In light of the FHFA's focus on ensuring affordability of GSE-eligible loans following the mortgage crisis, the Bureau believed that it was appropriate to consider for a period of time that GSE-eligible loans were originated with an appropriate assessment of the consumer's ability to repay and therefore warranted being treated as QMs.[24] The Bureau believed in 2013 that this temporary category of QM loans would, in the near term, help to ensure access to responsible, affordable credit for consumers with DTI ratios above 43 percent, as well as facilitate compliance by creditors by promoting the use of widely recognized, federally related underwriting standards.[25]

In making the Temporary GSE QM loan provision temporary, the Bureau sought to "provide an adequate period for economic, market, and regulatory conditions to stabilize" and "a reasonable transition period to the general qualified mortgage definition."[26] The Bureau believed

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[22] *Id.* at 6527-28.

[23] *Id.* at 6533-34.

[24] *Id.* at 6534.

[25] *Id.* at 6533.

[26] *Id.* at 6534.

that the Temporary GSE QM loan provision would benefit consumers by preserving access to credit while the mortgage industry adjusted to the ATR/QM Rule.[27] The Bureau also explained that it structured the Temporary GSE QM loan provision to cover loans eligible to be purchased or guaranteed by the GSEs—regardless of whether the loans are actually purchased or guaranteed—to leave room for private investors to return to the market and secure the same legal protections as the GSEs.[28] The Bureau believed that, as the market recovered, the GSEs and the Federal agencies would be able to reduce their market presence, the percentage of Temporary GSE QM loans would decrease, and the market would shift toward General QM loans and non-QM loans above a 43 percent DTI ratio.[29] The Bureau's view was that a shift towards non-QM loans could be supported by the private market—*i.e.*, by institutions holding such loans in portfolio, selling them in whole, or securitizing them in a rejuvenated private label securities (PLS) market. The Bureau noted that, pursuant to its statutory obligations under the Dodd-Frank Act, it would assess the impact of the ATR/QM Rule five years after the Rule's effective date, and the assessment would provide an opportunity to analyze the Temporary GSE QM loan provision.[30]

C. *The Bureau's Assessment of the Ability-to-Repay/Qualified Mortgage Rule*

Section 1022(d) of the Dodd-Frank Act requires the Bureau to assess each of its significant rules and orders and to publish a report of each assessment within five years of the effective date of the rule or order.[31] In June 2017, the Bureau published a request for

[27] *Id.* at 6536.

[28] *Id.* at 6534.

[29] *Id.*

[30] *Id.*

[31] 12 U.S.C. 5512(d).

information in connection with its assessment of the ATR/QM Rule (Assessment RFI).[32] In response to the Assessment RFI, the Bureau received approximately 480 comments from creditors, industry groups, consumer advocacy groups, and individuals.[33]

Summary of Select Assessment RFI Comments[34]

Commenters addressed a variety of topics, including the General QM loan definition and the 43 percent DTI limit. One industry group stated that, if there is no significant change in mortgage performance if the DTI ratio exceeds 43 percent, the DTI limit should be eliminated or alternative ways to satisfy the General QM loan definition should be considered. Several industry groups, creditors, and individual commenters advocated raising the DTI limit from 43 percent to 45 percent or higher.[35] Two individual commenters argued against increasing the DTI limit, while one individual commenter argued that investors should be permitted to establish their own DTI limits. Several industry groups, a creditor, and individual commenters stated that the DTI limit should be eliminated because it has disadvantaged consumers who have income that is difficult to document, and because other measurements, such as cash flow, better indicate a consumer's ability to repay a loan.

Many commenters discussed perceived problems with Appendix Q of Regulation Z. An industry group stated that Appendix Q was borrowed from static, vague, and outdated guidelines that do not reflect today's employment and income trends and documentation standards. Several industry groups and creditors stated that calculating and verifying debt and income in accordance

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[32] 82 FR 25246 (June 1, 2017).

[33] *See* Bureau of Consumer Fin. Prot., *Ability-to-Repay and Qualified Mortgage Rule Assessment Report*, at 243 (Jan. 2019), *https://www.consumerfinance.gov/documents/7165/cfpb_ability-to-repay-qualified-mortgage_assessment-report.pdf* (Assessment Report or Report).

[34] *See id.* at Appendix B (summarizing comments received in response to the Assessment RFI).

[35] The Bureau's analysis of GSE loan data suggests that the GSEs have used a DTI threshold of 45 percent on loans eligible for purchase or guarantee. *See id.* at 97-98.

with Appendix Q is particularly burdensome for applications from consumers who receive income from self- or part-time employment, have irregular income, or wish to use asset depletion as income. A coalition of consumer advocacy groups stated that the documentation standards for self-employment income can discourage creditors and borrowers from pursuing loans when such income is present.

Multiple industry groups and creditors advocated for specific changes to discrete elements of Appendix Q, such as the provisions addressing employment verification, work-history gaps, Social Security income, and the use of tax information. Two industry groups and two individual commenters stated that the Bureau should approve alternatives to Appendix Q, such as the standards used by the GSEs, FHA, the U.S. Department of Veterans Affairs, and the Rural Housing Service. Several industry groups, a creditor, and a consumer advocacy group stated that Appendix Q should be eliminated altogether.

Commenters also specifically addressed the Temporary GSE QM loan provision. While commenters generally agreed that the provision has been beneficial, they disagreed about how the Bureau should address its expiration. Regarding beneficial effects, multiple commenters stated that the Temporary GSE QM loan provision has prevented significant disruption in the mortgage market and has enabled creditors to lend efficiently and to more consumers. Several industry groups stated that the Temporary GSE QM loan provision has combined a regulatory bright line with flexibility, allowing creditors to reach deeper into the population of creditworthy consumers.

Commenters expressed a range of ideas for addressing the Temporary GSE QM loan provision's expiration, from making the provision permanent, to extending it for a period of time or to other products, to eliminating it. For example, two consumer advocacy groups and two industry groups stated that the Temporary GSE QM loan provision should be maintained, citing the negative effect that expiration could have on the availability of credit, the need to encourage responsible lending above a 43 percent DTI ratio, and the benefits of maintaining the flexibility that the GSE standards incorporate. Three industry groups, two creditors, and a consumer advocacy group also argued for making the Temporary GSE QM loan provision permanent. Three other industry groups and a consumer advocacy group suggested an indefinite extension until an alternative is in place, an individual commenter suggested extending the provision for seven years, and a creditor and two industry groups supported extending it to jumbo mortgages.[36] One industry group stated that, although it believes the Temporary GSE QM loan provision is essential for mortgage market support at present, the provision must eventually expire. Finally, two industry groups and an individual commenter argued that the Temporary GSE QM loan provision should be eliminated and the Bureau should rely only on TILA's statutory requirements to define a qualified mortgage.

The Bureau's 2018 Call for Evidence

Beginning in January 2018, the Bureau issued a general call for evidence seeking comment on its enforcement, supervision, rulemaking, market monitoring, and financial education activities.[37] As part of the call for evidence, the Bureau published requests for information relating to, among other things, the Bureau's rulemaking process,[38] the Bureau's

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[36] Jumbo mortgages are mortgages for amounts greater than the maximum conforming loan limits set by the FHFA. *See, e.g.*, Fed. Hous. Fin. Agency, *FHFA Announces Maximum Conforming Loan Limits for 2019* (Nov. 27, 2018), *https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-Maximum-Conforming-Loan-Limits-for-2019.aspx*.

[37] *See* Bureau of Consumer Fin. Prot., *Call for Evidence*, *https://www.consumerfinance.gov/policy-compliance/notice-opportunities-comment/archive-closed/call-for-evidence* (last updated Apr. 17, 2018).

[38] 83 FR 10437 (Mar. 9, 2018).

adopted regulations and new rulemaking authorities,[39] and the Bureau's inherited regulations and inherited rulemaking authorities.[40]

In response to the call for evidence and requests for information, the Bureau received comments on the ATR/QM Rule from stakeholders, including consumer advocacy groups and industry groups. Commenters addressed a variety of topics, including the General QM loan definition, Appendix Q, and the Temporary GSE QM loan provision. Commenters raised concerns about, among other things, the inflexibility of the General QM loan definition's 43 percent DTI limit, the difficulty of applying Appendix Q in certain circumstances, and the risks of allowing the Temporary GSE QM loan provision to expire without any changes to the General QM loan definition or Appendix Q. The concerns raised in these comments were similar to those raised in response to the Assessment RFI, discussed above.

Assessment Report Findings Regarding Temporary GSE QM Loans

In January 2019, the Bureau published its ATR/QM Rule Assessment Report.[41] The Report included a number of findings about the effects of the ATR/QM Rule on the mortgage market generally, as well as specific findings about Temporary GSE QM loan originations.

The Report found that loans with higher DTI levels are historically associated with higher levels of "early delinquency" (*i.e.*, delinquency within two years of origination), which can serve as a proxy for measuring whether a consumer had the ability to repay at the time the mortgage loan was consummated.[42] The Report also found that, for high-DTI borrowers—*i.e.*, borrowers

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[39] 83 FR 12286 (Mar. 21, 2018).

[40] 83 FR 12881 (Mar. 26, 2018).

[41] *See generally* Assessment Report, *supra* note 33.

[42] *See, e.g.*, *id.* at 83-84, 100-05.

with DTI ratios above 43 percent—who qualify for loans eligible for purchase or guarantee by the GSEs, the Rule has not decreased access to credit.[43] However, based on application-level data obtained from nine large lenders, the Report found that the Rule eliminated between 63 and 70 percent of non-GSE eligible, high-DTI home purchase loans.[44]

One main finding about Temporary GSE QM loans was that such loans represent a "large and persistent" share of originations in the conforming segment of the mortgage market.[45] As discussed, the GSEs' share of the conventional, conforming purchase-mortgage market was large before the ATR/QM Rule, and the assessment found a small increase in that share since the Rule's effective date, reaching 71 percent in 2017.[46] The Assessment Report noted that, at least for loans intended for sale in the secondary market, creditors generally offer a Temporary GSE QM loan even when a General QM loan could be originated.[47]

The continued prevalence of Temporary GSE QM loan originations is contrary to the Bureau's expectation at the time of the ATR/QM Rule.[48] The Assessment Report discussed several possible reasons for this outcome. The first is Appendix Q. The Report highlighted commenters' concerns with the perceived lack of clarity in Appendix Q and found that such concerns "may have contributed to investors'—and at least derivatively, creditors'—preference"

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[43] *See, e.g.*, *id.* at 10, 194-96.

[44] *See, e.g.*, *id.* at 10-11, 117, 131-47.

[45] *Id.* at 188. Because the Temporary GSE QM loan provision generally affects only loans that conform to the GSEs' guidelines, the Assessment Report's discussion of the Temporary GSE QM loan provision focused on the conforming segment of the market, not on non-conforming (*e.g.*, jumbo) loans.

[46] *Id.* at 191.

[47] *Id.* at 192.

[48] *Id.* at 13, 190, 238.

for Temporary GSE QM loans.[49] Appendix Q, unlike other standards for calculating and verifying debt and income, has not been revised since the January 2013 Final Rule.[50]

A second possible reason for the continued prevalence of Temporary GSE QM loans is that the GSEs were able to accommodate demand for mortgages above the General QM loan DTI limit of 43 percent as the DTI distribution in the market shifted upward. According to the Report, in the years since the ATR/QM Rule took effect, house prices have increased, and consumers hold more mortgage and other debt (including student loan debt), all of which have caused the DTI distribution to shift up.[51] Mortgages with DTI ratios greater than 43 percent recently have been an increasing share of Temporary GSE QM loan originations.[52]

The Assessment Report found that a third possible reason for the persistence of Temporary GSE QM loans is the structure of the secondary market. If lenders adhere to the GSEs' guidelines, they gain access to a robust, highly liquid secondary market.[53] In contrast, while private market securitizations have grown somewhat in recent years, their volume is still a fraction of their pre-crisis levels.[54] According to the Assessment Report, recently there appears to have been some momentum toward a long-term structure with a greater role for private market securitization.[55]

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[49] *Id.* at 193.

[50] *Id.* at 193-94.

[51] *Id.* at 194.

[52] *Id.* at 194-95.

[53] *Id.* at 196.

[54] *Id.*

[55] *Id.* at 198.

D. *Possible Market Impact of Expiration of Temporary GSE QM Loan Provision*

Based on National Mortgage Database (NMDB) data,[56] the Bureau estimates that there were approximately 6.01 million closed-end first-lien residential mortgage originations in the United States in 2018. Based on supplemental data provided by the FHFA, the Bureau estimates that the GSEs purchased or guaranteed 52 percent—roughly 3.12 million—of those loans. Of those 3.12 million loans, the Bureau estimates that 31 percent—approximately 957,000 loans—had DTI ratios greater than 43 percent.[57] Thus, the Bureau estimates that, as a result of the General QM loan definition's 43 percent DTI limit, approximately 957,000 loans—16 percent of all closed-end first-lien residential mortgage originations in 2018—fell within the Temporary GSE QM loan definition but not the General QM loan definition.[58] Throughout this ANPR, the Bureau refers to loans that fall within the Temporary GSE QM loan definition but not the General QM loan definition as High-DTI GSE loans. The Bureau expects that High-DTI GSE loans will continue to comprise a significant proportion of mortgage originations through January 2021, when the Temporary GSE QM loan definition is scheduled to expire.

[56] The NMDB, jointly developed by the FHFA and the Bureau, provides de-identified loan characteristics and performance information for a 5 percent sample of all mortgage originations from 1998 to the present, supplemented by de-identified loan and borrower characteristics from Federal administrative sources and credit reporting data. *See* Bureau of Consumer Fin. Prot., *Sources and Uses of Data at the Bureau of Consumer Financial Protection*, at 55-56 (Sept. 2018), *https://www.consumerfinance.gov/documents/6850/bcfp_sources-uses-of-data.pdf*. Differences in total market size estimates between NMDB data and Home Mortgage Disclosure Act (HMDA) data are attributable to differences in coverage and data construction methodology.

[57] The Bureau estimates that 616,000 of these loans were for home purchases, and 341,000 were refinance loans. In addition, the Bureau estimates that the share of these loans with DTI ratios over 45 percent has varied over time due to changes in market conditions and GSE underwriting standards, rising from 47 percent in 2016 to 56 percent in 2017, and further to 69 percent in 2018.

[58] This estimate only includes GSE-purchased Temporary GSE QM loans that do not fall within the General QM loan definition because they have a DTI ratio over 43 percent. An additional, smaller number of Temporary GSE QM loans purchased by the GSEs may not fall within the General QM loan definition because of documentation or other underwriting differences. The estimate also does not include Temporary GSE QM loans that were eligible for purchase by the GSEs but were not sold to the GSEs.

The Bureau has identified several ways that the market for loans that would have been High-DTI GSE loans may respond to the expiration of the Temporary GSE QM loan definition. The Bureau recognizes the inherent challenges of identifying possible market responses that may be contingent on future economic, legal, and policy developments; nevertheless, the Bureau believes that possible market responses need to be considered in determining the best possible response to the expiration of the Temporary GSE QM loan definition. In identifying these possible market responses, the Bureau makes several assumptions about the future behavior of market participants. The GSEs currently are not permitted to purchase non-QM loans, and the Bureau assumes no change in this policy. The Bureau also assumes that lenders' preference for making Temporary GSE QM loans, and investors' preference for purchasing such loans, is driven in part by the safe harbor provided to such loans, and that these preferences will continue at least for some lenders and investors.

Given these assumptions, it seems likely, first, that many borrowers who would have obtained High-DTI GSE loans will instead obtain FHA-guaranteed loans since FHA currently guarantees loans with DTI ratios up to 57 percent.[59] The number of loans that move to FHA would depend in the first instance on FHA's willingness and ability to guarantee such loans, whether FHA continues to treat all loans that it guarantees as QMs under its own QM rule, and on how many High-DTI GSE loans exceed FHA's loan-amount limit. For example, the Bureau estimates that, in 2018, 11 percent of High-DTI GSE loans exceeded FHA's loan-amount limit.[60] This creates an outer limit on the share of High-DTI GSE loans that could move to FHA.

[59] In fiscal year 2018, approximately 55 percent of FHA-insured purchase mortgages had a DTI ratio above 43 percent. U.S. Dep't of Hous. & Urban Dev., *Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund, Fiscal Year 2018*, at 30 (Nov. 15, 2018), *https://www.hud.gov/sites/dfiles/Housing/documents/2018fhaannualreportMMIFund.pdf*.

[60] In 2018, FHA's county-level maximum loan limits ranged from $271,050 to $721,050. *See* U.S. Dep't of Hous. & Urban Dev., *FHA Mortgage Limits*, *https://entp.hud.gov/idapp/html/hicostlook.cfm* (last visited July 24, 2019).

Second, it is possible that some borrowers who would have sought High-DTI GSE loans will be able to obtain loans in the private market. The number of loans would likely depend, in part, on whether actors in the private market are willing to assume the credit risk associated with funding High-DTI GSE loans as non-QM loans or small-creditor portfolio QM loans[61] and, if so, whether actors in the private market would offer more competitive pricing or terms. For example, the Bureau estimates that 55 percent of High-DTI GSE loans in 2018 had credit scores at or above 680 and loan-to-value (LTV) ratios at or below 80 percent—credit characteristics traditionally considered attractive to actors in the private market. The Bureau also notes that there are certain built-in costs to FHA loans—namely, mortgage insurance premiums—which could be a basis for competition, and that depository institutions in recent years have shied away from originating and servicing FHA loans due to the obligations and risks associated with such loans. At the same time, as the Assessment Report found, there recently has been some momentum toward a greater role for private market non-QM loans, but it is uncertain how great this role will be in the future.

Third, if FHA and actors in the private market together do not guarantee or make all of the High-DTI GSE loans, some borrowers who would have sought High-DTI GSE loans might not obtain loans at all. Other borrowers who would have sought High-DTI GSE loans may simply adapt to changing options and make different choices. For example, some consumers may respond to the expiration of the Temporary GSE QM loan definition by adjusting their borrowing to result in a lower DTI ratio.

[61] *See* 12 CFR 1026.43(e)(5) (extending QM status to certain portfolio loans originated by certain small creditors). In addition, Section 101 of the Economic Growth, Regulatory Relief, and Consumer Protection Act, Public Law 115-174, 101, 132 Stat. 1296 (2018), amended TILA to add a safe-harbor for small-creditor portfolio loans. *See* 15 U.S.C. 1639c(b)(2)(F).

II. Topics on Which the Bureau Seeks Comment

As discussed above, the Temporary GSE QM loan provision is scheduled to expire no later than January 10, 2021. The Bureau does not intend to make the Temporary GSE QM loan provision permanent. The Bureau continues to believe, as it did in issuing the ATR/QM Rule, that consumers would be disserved if "the qualified mortgage rule [were to] define the limit of credit availability."[62] The Bureau also is concerned about presuming indefinitely that loans eligible to be purchased or guaranteed by the GSEs—whether or not the GSEs are under conservatorship—have been originated with appropriate consideration of consumers' ability to repay. Indeed, one GSE loosened its underwriting standards in ways that proved unsustainable.[63] In addition, the Bureau is concerned that making the Temporary GSE QM loan provision permanent could stifle innovation and the development of competitive private-sector approaches to underwriting. The Bureau also is concerned that, as long as the Temporary GSE QM loan provision continues, the private market is less likely to rebound. Indeed, the existence of the Temporary GSE QM loan provision may be contributing to the continuing anemic state of the private mortgage-backed securities market. For all these reasons, the Bureau believes that making the Temporary GSE QM loan provision permanent appears to be inconsistent with the purposes of TILA's ATR provision, and with the Bureau's mandate. The Bureau therefore seeks comment on the topics and questions listed below in light of the Bureau's intent not to make the GSE Patch permanent.

[62] 78 FR 6408, 6528 (Jan. 30, 2013).

[63] Assessment Report, *supra* note 33, at 194-95.

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

The Bureau is considering whether to propose to revise Regulation Z's General QM Loan definition in light of the planned expiration of the Temporary GSE QM loan provision in January 2021. The Bureau is considering whether the definition should retain a direct measure of a consumer's personal finances, such as DTI ratio or residual income, and how that measure should be structured. The Bureau is also seeking comment on whether the definition should instead include an alternative method for assessing financial capacity or should be limited to the express statutory criteria.

To assist the Bureau in developing any such proposals, the Bureau requests public comment on the questions below. The Bureau requests that commenters provide data and analysis to support their views. Commenters need not resubmit data provided to the Bureau in connection with the Assessment RFI or the 2018 call for evidence initiative.

1. Direct Measures of a Consumer's Personal Finances

The Dodd-Frank Act amended TILA to authorize the Bureau to adopt a DTI limit as part of the General QM loan definition.[64] In the preamble to the January 2013 Final Rule, the Bureau provided several reasons for using DTI ratio and for setting the limit at 43 percent. First, the Bureau stated that the QM criteria should include a standard for evaluating whether consumers have the ability to repay their mortgage loans, in addition to the statute's product feature and general underwriting requirements.[65] Second, the Bureau noted that DTI ratios are a common and useful tool for evaluating a consumer's ability to repay a loan over time because, as the available data showed, DTI ratio correlates with loan performance as measured by delinquency

[64] 15 U.S.C. 1639c(b)(3); 15 U.S.C. 1639c(b)(2)(A)(vi).

[65] 78 FR 6408, 6526.

rate.[66] With respect to the particular threshold chosen, the Bureau noted that, for many years, FHA used a 43 percent DTI limit as its general boundary for defining affordability.[67] Third, the Bureau predicted that, in incorporating a well-understood bright-line threshold, the 43 percent DTI limit would provide certainty for creditors and help to minimize the potential for disputes and costly litigation over whether a mortgage is a QM.[68] Finally, the Bureau recognized that there would be many instances in which individual consumers could afford a higher DTI ratio based on their particular circumstances, but stated that the general ATR framework, rather than the QM framework, would be better suited for such cases.[69] The Bureau predicted that the 43 percent DTI limit over time would allow room for a robust and sizable market for non-QMs.[70] The Bureau also suggested that a higher DTI threshold might require a corresponding weakening of the strength of the presumption of compliance, which would largely defeat the point of adopting a higher DTI threshold.[71]

The Bureau's Assessment Report found that, both before and after the financial crisis, loans with higher DTI ratios are historically associated with higher levels of early delinquency, which, in turn, is indicative of the lack of ability to repay at origination.[72] The Report also found that, overall, inclusion of a DTI limit in the General QM loan definition appears to have reduced the number of loan originations with DTI ratios above 43 percent and increased the number with

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[66] *Id.* at 6505, 6526-27.

[67] *Id.* at 6505.

[68] *Id.* at 6505-06.

[69] *Id.* at 6527-28.

[70] *Id.* at 6506.

[71] *Id.* at 6528.

[72] Assessment Report, *supra* note 33, at 83-84, 100-05.

DTI ratios at or just below the limit.[73] In addition, the Report found that a robust market for non-QM loans above the 43 percent DTI limit has not materialized as the Bureau had predicted when it promulgated the Rule.[74] The Report also noted recent academic research indicating that DTI limits can have broader housing market effects, potentially decreasing house price fluctuations and the resulting borrower responses to pricing corrections.[75]

In adopting a DTI limit in the January 2013 Final Rule, the Bureau acknowledged arguments that residual income—generally defined as the monthly income that remains after a consumer pays all personal debts and obligations, including the prospective mortgage—may be a better measure of repayment ability in the long run. The Bureau concluded, however, that it lacked sufficient evidence to prescribe a bright-line rule based on residual income.[76] Some stakeholders have continued to suggest that residual income, rather than DTI ratio, should be used in the General QM loan definition. Other stakeholders have suggested combining a higher DTI ratio with a requirement that creditors also consider residual income.[77] The Bureau has

[73] *Id.* at 115-47.

[74] *Id.* at 198.

[75] *Id.* at 99-100. Respondents to the Bureau's Assessment RFI noted that high-DTI lending can lead to house price booms. Respondents also observed that the General QM loan DTI limit of 43 percent may help constrain such house price growth, but such effects likely have been diluted by the Temporary GSE QM loan provision's allowance of DTIs above 43 percent. *See* Lynn Fisher, Norbert Michel, Tobias Peter & Edward J. Pinto, *Analysis of the BCFP's (CFPB's) temporary Qualified Mortgage category announced in January 2013, commonly known as the "Patch"* (Mar. 1, 2019), *http://www.aei.org/publication/analysis-of-the-bcfps-cfpbs-temporary-qualified-mortgage-category-announced-in-january-2013-commonly-known-as-the-patch*.

[76] 78 FR 6408, 6528.

[77] *See* Eric Kaplan, Michael Stegman, Phillip Swagel & Theodore Tozer, Milken Institute, *A Blueprint for Administrative Reform of the Housing Finance System*, at 17 (Jan. 2019), *https://assets1b.milkeninstitute.org/assets/Publication/Viewpoint/PDF/Blueprint-Admin-Reform-HF-System-1.7.2019-v2.pdf* (suggesting that the Bureau both (1) expand the 43 percent DTI limit to 45 percent to move market share of higher-DTI loans from the GSEs and FHA to the non-agency market, and (2) establish a residual income test to protect against the risk of higher-DTI loans).

authority under TILA to prescribe regulations requiring creditors to consider such alternative measures of ability to repay as part of the General QM loan definition.[78]

a. Assuming without deciding that, in addition to the statutory factors, the Bureau retains as part of the General QM loan definition a criterion that directly measures a consumer's personal finances, should the Bureau continue to include only a DTI limit, or should the Bureau replace or supplement the DTI limit with another method (*e.g.*, residual income or another method)? If so, which method and why? The Bureau requests that commenters provide data and analysis to support their views about the use of DTI, residual income, or any suggested alternatives that directly measure a consumer's personal finances.

b. Assuming without deciding that the Bureau retains a DTI limit as part of the General QM loan definition, should the limit remain 43 percent? Should the Bureau increase or decrease the DTI limit to some other percentage? Should the Bureau grant QM status to loans with DTI ratios above a prescribed limit if certain compensating factors are present?[79] The Bureau requests that commenters provide data and analysis to support their views about the optimal DTI limit if the Bureau were to retain a DTI limit as part of the General QM loan definition.

c. Assuming without deciding that the Bureau retains a criterion that directly measures a consumer's personal finances—DTI ratio, residual income, or some other measure—the Bureau is considering what standards creditors should be permitted or required to use to calculate and verify debt and income. Currently, Appendix Q provides these standards. Appendix Q

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[78] 15 U.S.C. 1639c(b)(3); 15 U.S.C. 1639c(b)(2)(A)(vi).

[79] For example, typical required compensating factors for GSE loans with DTIs above 45 percent include twelve months of cash reserves for the borrower and a maximum LTV ratio of 80 percent. *See* Assessment Report, *supra* note 33, at 98 n.233. *See also* U.S. Dep't of the Treasury, *A Financial System that Creates Economic Opportunities: Banks and Credit Unions*, at 99 (June 2017), *https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf* (revised QM loan requirements should permit higher DTI loans with compensating factors).

incorporates FHA's guidelines as they existed when the January 2013 Final Rule was developed (*i.e.*, FHA's 2011 Guidelines). The Bureau intended for Appendix Q to provide creditors with certainty about whether they had calculated a loan's DTI ratio in a way that the Bureau or a court would accept, so that the loan's compliance with the General QM loan definition's DTI limit could be ensured. Based on extensive public feedback and its own experience, the Bureau recognizes that Appendix Q's methods for documenting debt and income can be rigid, that its provisions for determining what debt and income can be included in DTI calculations can be difficult to apply, and that it does not provide the level of compliance certainty that the Bureau anticipated. Stakeholders have reported that these documentation and determination concerns are particularly acute for self-employed consumers, consumers with part-time employment, and consumers with irregular or unusual income streams.

i. Assuming without deciding that the Bureau retains a criterion that directly measures a consumer's personal finances—DTI ratio, residual income, or some other measure—should creditors be required to continue using Appendix Q to calculate and verify debt and income? Should the Bureau replace Appendix Q? If the Bureau retains Appendix Q, how should it be changed or supplemented? The Bureau requests that commenters provide data and analysis to support their views about any suggested changes to Appendix Q.

ii. If the Bureau does not retain Appendix Q or permits use of an alternative, what standard should the Bureau require or permit creditors to use to calculate and verify debt and income? Should the Bureau specify in Regulation Z an existing version of a widely used method of calculating and verifying debt and income that creditors would be required to use? Or, to provide flexibility to creditors, should the Bureau combine a general requirement to use a "reasonable method" with the option to use, as a safe harbor, a specified, existing version of a widely used method for calculating and verifying debt and income? If the Bureau were to specify an existing version of a widely used method for calculating and verifying debt and income under either of the approaches described in this paragraph, which method (or methods) should be allowed? Should Appendix Q be one of them? The Bureau requests that commenters provide data and analysis to support their views about the appropriate approach to calculating and verifying debt and income.

2. Alternatives to Direct Measures of a Consumer's Personal Finances

The purpose of TILA's ATR requirement is to ensure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deceptive, or abusive.[80] The ATR/QM Rule sought to achieve this purpose, in part, by including a DTI limit in the General QM loan definition. Some stakeholders have suggested that the Bureau rely on the statutory QM loan restrictions only (*i.e.*, prohibitions on certain loan features, requirements for underwriting, and a limitation on points and fees) to define a General QM loan.[81] Others have argued that the General QM loan definition should incorporate counter-cyclical limits, such as LTV ratio, that become more restrictive as housing prices increase.[82]

Still other stakeholders have suggested that the Bureau rely on factors that do not directly measure a consumer's personal finances because such factors may be more predictive of default than DTI or other direct measurements. For example, one stakeholder has suggested that the Bureau eliminate the DTI criterion and provide a QM safe harbor to a loan if the difference

[80] 15 U.S.C. 1639b(a)(2).

[81] *See* Edward DeMarco, *Three Ways to Draw Private Capital Back into Mortgages*, Am. Banker (June 14, 2019), *https://www.americanbanker.com/opinion/three-ways-to-draw-private-capital-back-into-mortgages*.

[82] *See* Fisher et al., *supra* note 75, at 34.

between the loan's annual percentage rate (APR) and the average prime offer rate (APOR) for a comparable first-lien transaction—*i.e.*, the rate spread—is less than 150 basis points, as long as the loan also meets the statutory QM criteria.[83] This stakeholder states that mortgage rates reflect credit risk more holistically than DTI ratios and that a rate-spread approach would encourage innovation in the high-DTI loan market.

Similarly, another stakeholder has suggested eliminating the DTI criterion for certain loans, depending on their pricing.[84] Under such an approach, for example, a loan with a rate spread of: (1) less than 150 basis points over APOR would receive a QM safe harbor regardless of DTI ratio, as long as the loan met the statutory QM criteria; (2) between 150 and 300 basis points over APOR would receive a QM rebuttable presumption regardless of DTI ratio, as long as the loan met the statutory QM criteria;[85] and (3) 300 basis points or more over APOR would receive a QM rebuttable presumption only if the DTI ratio did not exceed 43 percent and the loan met the statutory QM criteria. This stakeholder suggests that near-prime loans with high DTI ratios can still perform well, rendering it unnecessary to impose a DTI limit on these loans. By contrast, according to this stakeholder, because higher-rate loans pose greater risks to consumers, it is critical to include a DTI threshold for such loans. Loans with improperly calculated DTI

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[83] *See* Karan Kaul & Laurie Goodman, Urban Inst. Hous. Fin. Pol'y Ctr., *Updated: What, If Anything, Should Replace the QM GSE Patch*, at 6-7 (Oct. 2018), *https://www.urban.org/research/publication/updated-what-if-anything-should-replace-qm-gse-patch*.

[84] *See generally* Eric Stein & Michael Calhoun, Ctr. for Responsible Lending, *A Smarter Qualified Mortgage Can Benefit Borrowers, Taxpayers, and the Economy* (July 2019), *https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-a-smarter-qualified-mortgage-july2019.pdf*.

[85] A slight variation would require a lender originating a loan in this category to use a validated underwriting model with statistically-predictive compensating factors, including DTI or residual income, in order for the loan to obtain QM status. *See id*. at 12.

ratios would lose their QM status, thus exposing lenders to liability; to minimize that risk, lenders would be careful when originating such loans.

Others have suggested that the Bureau amend the Rule so that any performing loan that has been on a financial institution's books for at least two years (or some slightly longer time frame) would automatically convert to a QM loan.[86] These stakeholders argue that, when a loan defaults after performing for two or three years, it is not reasonable to conclude that the default was caused by the creditor's failure to consider the consumer's ability to repay.

Another possibility would be to require creditors to consider other credit risk factors, such as credit score or LTV ratio, in lieu of DTI ratio. The rationale for such an approach would be similar to the rationale for the pricing-based approaches already discussed. That is, because credit risk factors such as credit score and LTV ratio are predictive of default, they arguably are more useful criteria than DTI for determining whether a loan will be repaid.[87]

a. The Bureau requests comment on whether standards that do not directly measure a consumer's personal finances are consistent with, and further TILA's purpose of, ensuring that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans. The Bureau requests that commenters provide data and analysis to support their views.

b. The Bureau requests comment on the advantages and disadvantages of such standards relative to standards that directly measure a consumer's personal finances, including DTI ratio

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[86] *See, e.g.*, Norbert Michel, *The Best Housing Finance Reform Options for the Trump Administration*, Forbes (July 15, 2019), *https://www.forbes.com/sites/norbertmichel/2019/07/15/the-best-housing-finance-reform-options-for-the-trump-administration/#4f5640de7d3f.*

[87] *See, e.g.*, Assessment Report, *supra* note 33, at 100 n.239.

and residual income. The Bureau requests that commenters provide data and analysis to support their views.

c. Assuming without deciding that the Bureau were to adopt standards that do not directly measure a consumer's personal finances, should the Bureau retain the current line separating safe-harbor and rebuttable-presumption QMs or modify it and, if so, how? The Bureau requests that commenters provide data and analysis to support their views.

d. The Rule currently provides that a consumer may rebut the presumption of compliance only by proving that, based on the information available to the creditor at the time of consummation, the consumer lacked sufficient residual income to meet living expenses, including any recurring and material non-debt obligations of which the creditor was aware.[88] Assuming without deciding that the Bureau were to adopt standards that do not directly measure a consumer's personal finances, should the Bureau further specify or clarify the grounds on which the presumption of compliance can be rebutted? The Bureau requests that commenters provide data and analysis to support their views.

B. *Other Temporary GSE QM Loan Issues*

1. The Temporary GSE QM loan provision will remain in effect until the earlier of January 10, 2021, or the date that the GSEs exit conservatorship.[89] To minimize disruption to the mortgage market when the Temporary GSE QM loan provision expires, should the Bureau consider any other changes to Regulation Z's ability-to-repay and qualified mortgage provisions (*i.e.*, other than changes discussed in response to prior questions)? The Bureau requests that commenters provide data and analysis to support their views.

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[88] 12 CFR 1026.43(e)(1)(ii)(B).

[89] 12 CFR 1026.43(e)(4)(iii)(B).

2. The Bureau recognizes that industry will need time to change its practices to respond to the expiration of the Temporary GSE QM loan provision and any changes the Bureau makes to the General QM loan definition. To conduct an orderly rulemaking process and to smooth the transition to any new General QM loan definition, the Bureau requests comment, with supporting data, on how much time industry would need to change its practices following the issuance of a final rule with such a new definition. If the answer depends on how the Bureau revises the definition, the Bureau requests answers based on alternative possible definitions.

[THIS SIGNATURE PAGE PERTAINS TO THE ADVANCE NOTICE OF PROPOSED RULEMAKING TITLED "QUALIFIED MORTGAGE DEFINITION UNDER THE TRUTH IN LENDING ACT (REGULATION Z)"]

Dated: July 25, 2019.

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